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Europe in Hard Times: Driving Institutional Change during the Eurozone Crisis

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Abstract

The goal of this research is to provide a mid-range rationalist explanation of the dynamics of institutional change occurred in the European Union during the sovereign debt crisis. My starting hypothesis is that the crisis may represent a driving force for the emergence of major institutional changes. Moreover, I claim that the policy outcomes adopted are not a pure reflection of actors' bargaining powers, but they are decidedly mediated by the existent institutional rules, and the decision making process behind their adoption, i.e. intergovernmental or supranational, can be determinant for their successfulness. Taking stock of the institutional changes occurred between 2010 and 2014, the research aims at understanding whether the Eurozone crisis triggered a deepening of the European integration, reflected by any eventual upload of authority from the national to the supranational level. In order to assess these issues, I analyze three different economic policies, namely the progressive strengthening of the rules of fiscal discipline, the creation of the financial instruments to support member States in need and the progressive setup of a banking union in the EU. For each issue area, I search empirical validation of my starting hypotheses and I apply an original index to measure the "rate of supranationalism" of different aspects of the policy. By comparing the institutional setup before and after the crisis, I am able to provide an assessment of the eventual supranationalization of each single policy, then of the EU as a whole.

My findings offer a substantive empirical validation of the leading hypotheses. Namely, I demonstrate that the timing of adoption of major policy outcomes is strongly related to the most acute phases of the crisis in terms of financial markets' pressure. Moreover, I show that intergovernmental policy making tends to create only incremental outcomes and even institutional deadlocks, while supranational decision making produces more effective outcomes. Finally, the application of the original index suggests that over the last years the European integration undertook a deepening process, resulting in a widening of the scope of supranational policies, an intensification of EU institutions' powers as well as different forms of authority delegation to supranational bodies. These patterns of supranationalization were mainly driven by the pressure of financial markets and by the necessity of overcoming the institutional deadlocks engendered by intergovernmental negotiations, demonstrating that the Eurozone crisis has represented a political momentum for transformative institutional changes in the EU.

Chapter 1
Introduction

1.1. Main goals and research questions

"Europe will be forged in crises, and will be the sum of the solutions adopted for those crises", Jean Monnet wrote almost forty years ago (1978:417), showing an enviable foresight. That Europe is in crisis is abundantly clear. Since September, 15th, 2008, the day on which the failure of Lehman Brothers catapulted the world economy into disorder, and even more since the onset of the sovereign bond crisis in the Eurozone in early 2010, European countries have been confronted with social, economic and political obstacles that put severely into question the bases of their economies and social structures. The challenges the Eurozone has faced have been defined as an existential crisis for Europe (Giddens 2014). Even scholars reluctant to use crisis rhetoric assess that the current situation is without any doubt a major crisis for the Eurozone (Parsons and Matthijs 2015). This reveals the historical importance of the phase we are currently living for the future of the European integration – as well as for the life of around 500 millions of European citizens.

What is slightly more debatable, in Monnet's prediction, is the assessment of whether Europe is heading towards closer union thanks to the solutions envisaged to overcome the crisis. The governance of the Eurozone, and of the European Union more generally, has witnessed impressive changes in the last few years, but the institutional framework that has resulted is profoundly complex. So much so, that at on the face of it, the long-term implications of these changes are difficult to assess – even more so, considering that the development of this framework is still in progress. On the one hand, the economic crisis may have boosted a sort of policy re-nationalization or a retrenchment into the national sphere. Such a response is often posited as a natural defensive move by States in times of economic crisis, as witnessed in the 1930s when hitherto integrated national economies threw up barriers to trade (James 2002). Thus, the Eurozone crisis could well trigger a dis-integration of the single market and of the European polity more broadly. On the other hand, circumstances may have triggered a sort of "supranational leap"; that is, the crisis may have made it necessary for EU member States to further deepen some aspects of the integration process in order to overcome the crisis, captured in the idea of moving "forward-through-crisis" (Gross 2011; Lefkofridi and Schmitter 2015). The truth – as the proverbial saying goes – is probably somewhere in the middle. For sure, the chain of events and the political development of these years are far from self-evident. Rather, the crisis has involved a series of back-and-forth, a mix of contradicting figures, which can lead the observer toward one of the two directions illustrated or, paradoxically, toward both at the same time.

The main aim of this research is therefore to solve this dilemma, by offering an in-depth understanding of the institutional impact of economic crises in Europe, and of the Eurozone crisis in particular, by recognizing which dynamics of change are fostered by major economic distress on the process of European integration. To be more precise, my research objectives are situated on two levels – a policy level, and a systemic level.

Concerning the policy level, the research focuses on the institutional change that occurred in some specific European policies due to the economic crisis. The premise of the research is that, as the consolidated scholarship in political science suggests, "institutions matter." Institutions, understood principally as institutional rules, are scrutinized in two different ways. On the one hand, the dissertation aims to determine how the economic crisis impacted – and eventually transformed – institutional structures in Europe. On the other hand, it will analyze how already existent rules were determinant in orienting that institutional change. For instance, how did the unanimity rule within the European Council influence the decision making at moments of crisis? But also, what kind of change in terms of different interpretation and application did any given rule undergo because of the changed environmental circumstances due to the crisis?

In this light, the research sits squarely within the neo-institutionalist framework (Hall and Taylor 1996). In particular, it shares the main assumptions of rationalist explanations of European integration – especially, distributional rational choice institutionalism (Héritier 2007) – about the rationality and purposiveness of the actors involved. Stemming from the empirical observation of the creation of policy outcomes in different policy areas, and adopting the analytical framework provided by the strategic choice approach (Lake and Powell 1997), the research will provide an interpretation of the policy change that occurred by looking at the interplay of actors and their environment, accounting for the role played by the crisis on institutional structures.[1]

On a broader level, which I define in systemic terms, the goal of the research is to understand the *overall* impact of crises on the European polity. Here, the emphasis is on understanding how much, and in which direction, the balance of power between national and supranational actors has shifted during the crisis. In other words, taken together, which are the comprehensive effects of the different institutional changes witnessed in the last few years? While remaining somewhat agnostic within the debate between the two so-called grand theories of European integration – liberal intergovernamentalism (Moravcsik 1998) and neo-functionalism (Haas 1958, 1970; Schmitter 1970) – the research intends to provide a sort of mid-range explanation to assess if, in the end, a major economic crisis boosts or limits the supranational sphere *vis-à-vis* the national one. Such assessment is made possible by the construction of an original "index of supranationalism", which includes policy-specific indicators and is applied to each policy under scrutiny.

Formally, the central research questions concerning the dissertation are: what is the institutional impact of economic crises on the process of European integration? How did the crisis effectively translate into policy outcomes? And how did these changes impact on the balance of power between national and supranational level?

These apparently simple questions actually open up space for potentially infinite discussions, given the complexity of the issue, which

[1] For the accurate presentation of the theoretical and methodological framework, refer to chapter 2.

forces a necessary scope limitation in the observation. The last few years, indeed, have represented for the European Union, and for the Eurozone in particular, a sort of institutional "big bang", with several radical changes and infinite minor evolutions, which have affected many policy areas. Without even looking beyond domain of economic and monetary affairs, a non-exhaustive list of policy changes and major transformations would include changes across a swathe of sectors – financial supervision, the banking system, fiscal discipline, capital taxation and control, financial aid programs, and public debt management. And of course one could add the inevitable effects that the crisis has triggered on other sensitive policy areas such as external relations, international trade, neighborhood policy, social policies, migration policy, and so on. A related point is that for every single policy area observed, a plurality of actors are involved (not least, all 28 member states and the European institutions), which makes the analysis inexorably complex.

For this reason, the dissertations tries to tackle the issue of the institutional impact of economic crises by focusing attention over a few and circumscribed aspects. Analysis centers on three distinct but important policy areas, all related with economic and monetary aspects in the management of the common currency: (1) the evolution of the rules of fiscal discipline; (2) the provision of financial support to member States, and; (3) the creation of a banking union. For each of the three policies, the research aims to monitor the policy outcomes that have occurred, explaining in which measure the crisis was functional to their adoption or to their effective implementation. The final step assesses whether those outcomes can be seen as a deepening or a restriction of the supranational sphere *vis-à-vis* the national one, thus combining the analysis of the policy level institutional change with the macro-level of general evolution of the integration toward – or away from – supranationalism.

1.2. Europe and crisis: An ongoing debate

The historical period in which we are living lends itself to research on the impact of economic crisis. Indeed, according to Charles Kindelberger (2005:7), “The production of books on financial crises is countercyclical”. In other words, the interest of academics in economic and financial troubles rises – quite understandably – during an economic backlash, and rapidly disappears when the crisis fades. Scholars are inevitably intrigued by economic crises while they are experiencing them. It is natural to attempt to understand their causes, explain their development and foresee any sort of future implications. After all, despite the diffuse impoverishment and social unrest they usually engender, crises are fascinating because they represent *moments of fracture*. Crises give the impression of history in the making, of the end of “normal politics”, and of imminent epochal transformation as history prepares to move in fundamentally new directions. For good reason, then, scholarship in political science, particularly historical institutionalist approaches[2], see crises as “critical junctures” that trigger fundamental institutional changes and forge new institutional pathways (Pierson 2004). Crises constitute the exogenous shock *par excellence* – inflection points that shift the course of history.

What *is* a crisis, then? According to the Oxford English Dictionary, a crisis is “a vitally important or decisive stage in the progress of anything”, and it especially applies to “times of difficulty, insecurity, and suspense in politics or commerce”. Such suspense is largely given by a sentiment of the unknown, of something which is *in fieri* but still out of our control. According to Antonio Gramsci, “Crisis consists precisely in the fact that the old is dying and the new cannot be born; in this interregnum a great variety of morbid symptoms appear” (1971: 276). Focusing the attention more on the interconnection among causal elements and outputs during a crisis, Maier claims that “applied to a society or a regime, [crisis] refers to a situation in which institutional arrangements no longer deliver the results expected from them – whether public order, economic transfers and social justice, or economic growth – and where normal corrective actions seem only to make the

[2] Political economists make similar claims (e.g. Acemoglu and Robinson 2012).

situation worse", adding that "crises do not always destroy regimes or economic systems, but they do significantly recast institutions" (2010: 25-26). As a result, there is a strict causal link between crisis and change, be it social, political or economic.

For our purpose, crisis is defined as a protracted period of instability which gives rise to political and institutional change, challenging existent structures and contributing to the casting of new ones. It follows that a crisis can be economic, political or institutional, when the instability concerns respectively financial markets and markets in general, the political system, and the institutional setting. According to this basic definition, the Eurozone crisis is at the same time an economic, a political and an institutional crisis, since it originated in a diffuse crisis of confidence in financial markets. This triggered major repercussions on the sustainability of national public debts, and thus soon became the source of political tension among member states. It also brought immense pressure to bear on institutional setting of the Monetary Union, which proved largely inadequate for the challenge.

In line with Kindleberger's claim, studies on economic crises are prominent in the literature, starting from the main historical reference in the field, the Great Depression (Galbraith 1954, Kindleberger and Aiber 2005). In assessing the institutional consequences of economic crisis, scholars have sought to understand how they can radically change the political space. Studies have focused on the effects on political and social structures (Gourevitch 1986), and on the economic system (Cassis 2011). Concerning European studies, since one of the dominant narratives has seen crisis as the engine of European integration, scholarship on this subject is abundant, both in the historical (Olivi and Giacone 2007) and in the political perspective (Schmitter 1970)[3], even without considering the literature on the current crisis.

[3] As a matter of fact, all the neo-functionalist scholarship considers economic crises as main elements triggering functional spillover toward deeper integration, hence the attention devoted to the concept by neo-functionalist scholars.

It goes without saying that the Eurozone crisis confirms this trend in the scholarship. The Eurocrisis has attracted the attention of scholars since its inception, with coverage spanning the perspectives of economists (Lapavitsas 2012, Heise 2013, Pisani-Ferry 2014, Daianu et al. 2014, Sinn 2014), through to political philosophers (Habermas 2012, Beck 2012, Morin 2014), to cite but a few examples. Political scientists have devoted their efforts in multiple directions, trying to give an account of the role played by single actors, such as Germany (Schild 2013; Bulmer and Paterson 2013; Newman 2015), the European Commission (Bauer and Becker 2014), or the European Central Bank (Irwin 2013; Torres 2013). Others have looked at the development of internal and external policies (Rodriguez and Xiarchogiannopolou 2014), or the setup of new Treaties (De Witte 2011; Gocaj and Meunier 2013). Specific events involving specific countries have been the focus of yet more studies, with Greece featuring first and foremost (Featherstone 2011, Pelagidis and Mitsopoulos 2011, Pappas 2014).

When it comes to the link between the Eurozone crisis and European integration, scholars' increasing attention to the issue has accompanied the writing of this dissertation. Indeed, while my research was in progress, numerous articles and books on the issue were published, signaling the centrality of the issue at the present time. A number of special issues of academic journals dealt with the subject[4], accompanied by a vast array of very recent contributions (among them: Fabbrini 2013; Hooghe and Marks 2014; Schimmelfennig 2014; Lefkofridi and Schmitter 2015; Ioannou et al. 2015; Matthijs and Blyth 2015). All make the consequences of the crisis on the development of the integration process and its institutional logics their subject. The purpose of this research, then, is to contribute to this lively debate by providing as accurate an account as possible, bearing in mind that a complete understanding of the subject comes only through the juxtaposition of different theoretical perspectives.

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[4] Among them, the Journal of European Integration in 2013 (Special issue: "Redefining European economic governance") and in 2014 (Special issue: "Coping with crisis: Europe's strategies and challenges") and the Journal of European Public Policy in 2015 (Special issue: "European integration in times of crisis: Theoretical perspectives").

1.3. Outline of the chapters

Following this introductory section, chapter 2 lays out of the main theoretical and methodological issues underlying the research, and presents in detail an explanatory model to be applied to the different case studies. In this chapter the leading research hypotheses are outlined, as well as the main methodological aspects underpinning the dissertation. Subsequent chapters are devoted to the empirical analysis of the institutional changes that have occurred during the Eurozone crisis in different policy areas. Chapter 3 provides a bird's eye view on the major developments in the Eurozone crisis as it unfolded. Here, the course of the crisis is reconstructed, by offering a functional chronology of events to aid the empirical assessment of the leading hypotheses. Chapter 4 deals with the first case study – the redefinition of fiscal obligations for member states after the outbreak of the crisis. Chapter 5 tackles the case of the policy of financial assistance to distressed countries, by looking at those instruments implemented to offer financial aid to troubled States in the Eurozone. The last case study, the progressive setup of a banking union in the European Union, is discussed in chapter 6. The concluding chapter offers a discussion on the findings of the research, with a redefinition of the explanatory model in light of the empirical findings resulted by the analysis. It discusses the theoretical innovations that have emerged from the analysis, suggesting at the same time some broader implications for the process of European integration as well as for further research on the issue.

Chapter 2
EU and the crisis: A Theoretical Framework

2.1. Introduction

As a brief reminder, this dissertation addresses the following question: what is the institutional impact of the economic crisis on the process of European integration? The answer will be provided on two levels: a single-policy level, and on a macro level. At the policy level, the dissertation scrutinizes the role of economic pressure on institutional change occurring during the crisis, and the dynamics that characterize this change. This can be considered as the core of the dissertation, which takes into account key variables such as the environment created by the crisis, actors' strategic behavior, and the fundamental role played by existing institutional rules. By aggregating different single policy analyses, then, the dissertation tries to understand, at a systemic level, the consequences of the Eurozone crisis for the process of European integration. Namely, whether crisis triggers a limitation or an expansion of policy supranationalization.

The combination of the policy level and of the systemic approach constitutes a sort of logic and temporal sequence underlying the analysis, which is also reflected in the leading hypotheses. That is, the research faces the issue of the institutional change during the crisis, trying to understand (I) the causes of the institutional change – more specifically with respect to the role played by economic distress and markets' pressure towards change; (II) the dynamics of change – namely the pattern of change engendered in supranational or intergovernmental policy processes; and finally (III) the consequences of the institutional change, with special reference to institutional structures of the EU and their supranational nature.

In order to assess the research questions outlined in the introduction, it is necessary to define the theoretical framework and the methodological aspects guiding the research. This first chapter is devoted to the definition of the main theoretical aspects, such as the general framework in which it is located, the main perspective it adopts, as well as the hypotheses leading the research. By adopting a strategic choice approach, the dissertation aims at investigate the main institutional shifts witnessed in the European Union in these recent years of deep and challenging economic crisis. To this end, along with three main hypotheses, it develops an explanatory model which constitutes an interpretation of the main EU main institutional shifts, which is then applied to three different policy areas, each representing a case study. In this first chapters these theoretical and methodological aspects are discussed and defined, in order to set the stage for the analysis.

The chapter proceeds as follows. In a first section, the main theoretical aspects of the dissertation are outlined. At the outset, a survey of the principal theoretical arguments regarding institutional change in the neo-institutionalist scholarship is presented. In particular, the issues of institutional creation, stability and transformation, as well as the main interpretations of the elements triggering institutional change are covered. Then I will discuss the strategic choice approach adopted to carry out the analysis, along with the main variables used in the core of the analysis – actors, environment, and institutional rules. Finally, I will outline the explanatory model and formulate the associated hypotheses leading the analysis. The second section, for its part, is devoted to some methodological aspects, such as the presentation of the case studies, some problematic issues concerning case selection and comparison, the instruments adopted to assess variation of the variables used, as well as the modalities of data collection.

2.2. Theoretical framework

2.2.1. Institutions and institutionalism(s)

Institutions are key concepts to the understanding of social and political reality (March and Olsen 1989), because they facilitate and constrain social interaction (North 1990). Throughout, I conceive institutions principally as *institutional rules*. This definition is central, for two main reasons. The first is that institutions define the modes of governance and of policy making required in a specific policy area and orient it along a certain path, both restricting and enabling actors' behavior. In short, actors do not act in an institutional *vacuum*; their behavior is always shaped by the institutional rules surrounding them, which for the most part are prior to their action. In this sense, it is crucial to understand the role of existing institutions in shaping any process of policy development and more specifically of institutional change. Secondly, when trying to assess changes that occurred in Europe during the crisis institutional rules become themselves the object of analysis. In other words, a policy outcome – understood as the result of a process of change – is nothing more than a formal (or sometimes even informal) change in terms of institutional rules, which creates a new institutional framework in which actors keep moving.

To be sure, institutional change may occur even without the intervention of an external crisis, but for our purpose the presence of an external shock is fundamental. Institutions, then, are both an *independent* variable of the analysis – albeit not the only one – capable of producing effects on outcomes, and a *dependent* variable, because change is appreciated through the nature of institutional change at stake. That is why a preliminary presentation of major issues about institutions and institutional change is necessary to set the stage of the theoretical framework of the research. More importantly, the underlying conception of the terms "institution" and "institutional change" clearly shape the theoretical perspective leading the analysis, and must be clearly specified. In the following paragraphs I will discuss the various conceptions of institutions and institutional change among the different interpretations given by the predominant neo-institutionalist approaches to political studies: historical institutionalism, rational choice institutionalism and sociological institutionalism (for a comprehensive overview, see Hall and Taylor 1996).

Taking institutions as fundamental aspects of social and political reality and focusing on their role in structuring behavior, the three neo-institutionalisms present different sensibilities and stress particular elements of institutions over others, though amalgams and overlaps of concepts among them are far from the exception (Katznelson and Weingast 2007). Historical institutionalism tends to view institutional development by emphasizing path dependence and unintended consequences, relying on the importance that history and "path" have in shaping such development (for a thorough discussion see Steinmo 2008). Rational choice institutionalism sees institutions as solutions to collective action problems. Assuming actors are rational – thus having determined sets of preferences and acting strategically in order to maximize their goals – rational choice institutionalism considers institutions as creations which are designed to facilitate cooperation among actors (for a discussion over origins and internal differentiations of rational choice institutionalism see Shepsle 2005). Against the claims of actors' instrumental rationality and the idea of rules as outcomes of strategic interaction, sociological institutionalism considers institutions predominantly as structures of cultural practice, which are not necessarily linked to any form of efficiency-seeking, but as products of social reproduction among actors (DiMaggio and Powell 1991).

2.2.2. Institutions and institutional change: Definition and theoretical perspectives

The definition of a concept reveals a lot of the conception behind it, and this applies also to the concept of institution. According to the definition presented by North (1990), institutions are conceived as actor-created rules of behavior, thus institutional rules, that restrict and enable actors' behavior. Such definition is closer to the sensibility of rational choice institutionalism, rather than the two other strands. Thus, following the differentiation in the institutions' dimensions operated by Greif (2006), institutions are not intended as organizations (such as the European institutions)[5] nor – as sociological institutionalists would

[5] Of course, when talking of the European institutions (European Parliament, European Commission, European Central Bank and so on) the term "institution" will be used, but in the analysis these will be considered as actors (see following paragraph).

have it – as social norms, i.e. standards of behavior internalized by members of a society influencing behavior, nor finally as shared beliefs, i.e. internalized beliefs about the state of the world.

The concept of institutions as institutional norms highlights the fact that they are created by actors, and not socially, though standing outside the choice of individual actors; they provide informations that somehow coordinate behavior, and they finally induce behavior by offering rewards or threatening sanctions (ibid.). Moreover, it is important to notice that institutional rules may have distributional implications, that is, each institutional configuration is more or less beneficial for individual actors (Knight 1992). Finally, institutional rules, though primarily formal and written down such as laws, treaties and constitutions, may also be informal (Stinchcombe 1968), and in this case they are not subject to formal sanctioning.

A second important aspect concerning institutions is the differentiation between institutional stability and institutional change. On the one hand, indeed, parts of the institutionalist literature have highlighted the character of institutional persistence over time, while others have focused on how and why institutions change. In particular, historical institutionalism is more prone to stress institutional continuity over change, explaining the persistence of some institutions over long periods of time (Mahoney 2000; Pierson 2004), mainly relying on the concept of path dependence, which creates a sort of lock-in situation preventing institutions from radical change, or at least allowing for gradual change over time. Another model that privileges institutional continuity is punctuated equilibrium (Aminzade 1992; Abbott 2001). Here, institutions are characterized by general stability but subject to more or less radical changes, from time to time, due to external shocks, considered as ruptures, or critical junctures (Capoccia and Kelemen, 2007), at either the social or cultural level – according to sociological institutionalism – or at historical one – according to historical institutionalism.

Unlike these conceptions, scholars have also showed how once created, institutions can change over time, more or less gradually, but anyway significantly. Considering endogenous change not merely as possible, but also as differentiated in its forms, in a transformative and gradual way, Streeck and Thelen (2005) have identified five different ways in which institutions may incrementally vary over time: layering, drift, displacement, conversion and exhaustion. Layering occurs when new institutional elements are added to existent ones; drift when institutions are challenged by external elements; displacement happens when some elements of an institutions become more important over time; conversion comes when institutions are redirected to new functions; exhaustion finally happens when an institution gradually loses its functions. For any of these peculiar changes, anyway, the elements triggering change may be various, both exogenous and endogenous.

Most of the literature on institutional change stresses the importance of external elements to explain change: change in beliefs, new interpretative frames, external events and so on may all trigger change. Exogenous elements are generally considered essential to variation because institutions are seen as stable constructions, internally coherent, which cannot easily vary without an external shock or shift. Among the theorizations of institutional change given by endogenous elements we find one by Greif and Laitin (2004) which relies on the differentiation between parameters and quasi-parameters as well as on the concept of self-enforcement of rules, admitting that institutional rules may endogenously vary over time. Another theorization of endogenous institutional change is the one of interstitial institutional development elaborated by Farrell and Héritier (2005, 2007), according to whom institutional change occurs when ambiguities in higher-order rules – because of their nature of incomplete contracts – lead to the negotiation of informal rules endogenously determining institutional change. Other scholars for their part try to combine exogenous and endogenous elements in a new model of institutional change (Mahoney and Thelen 2010). According to them, institutional change is given not only to the characteristics of the political context and of actors' nature (exogenous elements), but also to the features of the institutions themselves, in particular to their degree of ambiguity and possibility of open interpretation of their provisions (endogenous element). Taken together, the two elements may account for institutional change.

2.2.3. Rationalist explanations of institutional change

Each one of the three neo-institutionalisms, then, account for institutional change in different ways. If sociological and historical institutionalism, though stressing the element of stability, admit that institutional change is possible, yet essentially triggered by external elements – being social evolution or critical junctures according to the approach – rational choice has different interpretations of institutional change (Héritier 2007). Among them, one can identify a functional-rationalist explanation and a distributional one. According to the *functional rationalist* explanation, institutional change occurs when at least one actor has an incentive to reconsider the existing institutional rule and propose an altered rule that is more advantageous for her than the existing one. Thus, institutional change is triggered by the will of an actor of reconsidering the existent equilibrium. On the other hand, *distributional* rational choice institutionalism emphasizes the distributional implications of institutions as outcomes of a power-oriented bargaining process, emphasizing political conflict and strategic bargaining among actors, whose results are well explained by asymmetries in resource ownership. In this perspective, institutional change could result from a breaking apart of the dominant change-resisting coalition, or from a change in the bargaining power of the actors due to a change in their resources or fallback positions, possibly caused by a change in the environment. Such change, for the purpose of the research, is exactly what happens during major economic crises with reference to those distributional policies which will be examined.

If then, as a general rule, each one of the theories listed can account more accurately for some specific situations rather than others, for the purpose of this study a rationalist perspective, and more precisely a distributional rational choice explanation of institutional change (a power-based explanation, essentially) will be adopted, supposing that such a perspective is the one that can best explain the issue at stake in the dissertation.

2.2.4. A mid-range rationalist explanation of EU integration

European affairs, much like other aspects of international relations, can be seen through the lenses of a variety of theoretical approaches, each of them adding a particular, if partial, contribution to the whole understanding of facts and events. The use of a single approach may fit better one situation rather than another, or might better explain part of a story, and there are claims about the necessity of integrating different approaches, in line with a particular necessity of "going empirical" when studying Europe (Jupille, Caporaso and Checkel 2003). As a general claim, given the complexity of reality, of course, no theory can account for institutional change under any and all circumstances (Héritier 2007: 228). That is, every approach presents its own potentialities as well as its limits: if on the one hand a certain perspective may help in better explaining a social fact, on the other it may overshadow other characteristics, that would probably benefit from another approach. In this sense, any choice about the perspective used in a research brings about the recognition of stressing some aspects rather than others.

Embracing pragmatism, this dissertation will not erect barriers among different perspectives, i.e. no theory will be unequivocally followed excluding any other competitive explanation. Rather, it will primarily adopt a strategic choice approach (Lake and Powell 1997), thus not a rigid theory with straightforward assumptions, but an approach combining instruments and assumptions of different rationalist traditions, in order to get the most accurate analysis of the events under scrutiny. Within the analytical framework of the strategic choice approach, insights from bargaining theory will be functional to better understand actors' behavior, focusing on devices adopted during negotiations, such as their credibility, the credibility of their threats, the enforcement possibilities and the social context affecting their choices. As a result, the research is a study of European Union under an institutionalist perspective, which has become a prominent way of studying internal dynamics and evolutions of the integration process (Dowding 2000).

The dissertation, in line with other rationalist explanations, does not aim to present a new general theory of the European integration[6], but its aim is to offer a deeper understanding of some underlying dynamics of specific evolution of the integration, thus a mid-range explanation of the events occurring in Europe while it is confronted with those complex phenomena that are economic crises. In this light, the rationalist approach seems to be more promising than the perspective given by a grand theory. Indeed, while a grand theory helps designing the larger frame of European integration and its underlying long-term processes, rationalist explanations can account for the day-by-day negotiations, the role of single rules in the smaller processes of institutional change and the minor – though fundamental – changes which are proper of a mid-range explanation. Nonetheless, some insights from the classical grand theories of European integration will be recalled (for instance, the concept of functional spillover from neo-functionalism or the stress on collective action problems from the liberal-intergovernamentalist perspective) but their use will be functional to an ex-post appreciation of the observed dynamics at stake, rather than used as *a priori* categories of analysis.

2.3. The analytical framework: A strategic choice approach

Providing analytical tools, the strategic choice approach considers two crucial units of analysis of international relations: strategic problems and interactions. This approach fits particularly well the aim of the research, namely the interest in investigating the reasons and mechanisms triggering institutional change, with a special focus on actors' behavior and the environment in which they operate. Indeed, actors and the environment are taken as the fundamental independent variables in the system, and they are assumed to be analytically separated (ibid: 8), unlike other constructivist and more sociological

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[6] The term general theory, or grand theory, refers to those explanations trying to theorize the whole process of European integration. The two competitive grand theories of European integration are liberal intergovernamentalism and neo-functionalism. For an overview on the different theories of European integration see Wiener and Diaz (2009).

perspectives. As this definition suggests, the strategic choice approach considers that actors operate strategically, i.e. their ability to reach their goals depends on other actors' actions, more importantly because actors' preferences are divergent, and some sort of interest reconciliation is needed. In brief, "in any given setting, an actor prefers some outcomes to others and pursues a strategy to achieve its most preferred possible outcome" (Frieden 1997: 41).

2.3.1. Main assumptions on the units of analysis

The strategic choice approach involves some assumptions on the characteristics of the units of analysis considered, as well as a scale of simplification of the reality, which is nonetheless a useful tool to better understand the complex interaction among actors. As stated, the actors and the environment are considered to be the independent variables of the system. This is particularly functional to the aim of the research, because it helps defining the causal role played both by actors and the environment, by taking them duly separated (Frieden 1997: 39). More specifically, by treating the features of the environment as an independent variable it will be possible to assess the particular role played by the crisis in determining outcomes, with reference to its variation, taking constant actors' preferences over time. Moreover, as actors form strategies based on the possibilities presented by the environment (ibid: 46), it will be possible to assess the effective role played by the crisis – thus, a variation in the environment – in affecting strategic interaction, then outcomes in the end.

In the strategic choice approach, actors are composed of their preferences and of their beliefs, thus their preferences over other actors' preferences. The content of states' preferences is given, but different for any actor and for every policy outcome, and more importantly preferences of different actors over outcomes are divergent. Thus, strategic choice refuses the realist assumption of indistinct state preferences of power maximization (Morgenthau 1948) or the neorealist one of security and survive (Waltz 1979). National preferences, then, are different and divergent for states. Moreover, they are somehow policy-specific, i.e. for every different policy, states formulate differentiated preferences. As a branch of rational choice institutionalism and of bargaining literature, the approach considers actors as rational and instrumental, thus they can rationally rank their preferences over a specific goal and they can, given the environment, act strategically in order to reach those goals. It should be noted that the definition of actors' rationality here considered is rather minimalist (Lake and Powell 1997:7), and it does not involve full information but only normal cognitive abilities.

For its part, the environment is composed of the actions that are available to actors as well as the information structure, that is what actors know – or what they can possibly infer from other actors' behavior. In this light, the environment represents the space in which actors operate and interplay with others in order to reach their goals, or more specifically, the external conditions enabling or facilitating actors' behavior. As an independent variable, the environment has direct impact on actors' strategic behavior, i.e. a variation in the environment implies different strategic behavior, than different outcomes in the end, taking actors' preferences constant and divergent. For the purpose of the research, the economic crisis is a fundamental component of the environment, because it has significant influence on actors' strategic behavior. Indeed, crises are peculiar moments in which actors have to radically change their strategies because of a changing environment. In particular, a crisis can influence strategic interaction by restricting the available actions of actors, or they can put pressure on policy makers, thus influencing the timing of the policy making.

In order to clarify the role that crises can have on actors' behavior it may be useful to borrow the concept of "pressing functional demand" from Lindseth (2010), which he considers as one of the three main historical components fostering institutional change, along with the political and the cultural dimension. Pressing functional demand is defined as the dimension "in which existing institutional structures and legal categories come under pressure and are even transformed as a consequence of objective social and economic demands" (ibid: 13). I claim that economic crises can be regarded as exerting pressing functional demand on European institutional structures, thus generating a sort of environmental change constraining actors' behavior. This idea is also shared by neo-functionalist explanations of

European integration, which see into crises a driving force toward further integrative steps (Schmitter 1970). For its part, the information structure within the environment for a great part is conveyed by institutional rules, which make actors' behavior more foreseeable (see §2.2.6).

To sum up, the strategic setting is composed of actors' preferences and beliefs, and by the set of available actions and the information structure: these four elements are capable of explaining variation of the dependent variable, that is the policy outcome (fig. 1). A direct consequence of the strategic setting is that in the strategic choice perspective, there are no untheorized preference shifts, that is, the variation in a single policy outcome is not explained by an actor's changing preference over time (Lake and Powell 1997:19). Instead, actors' preferences are considered divergent, given and constant over time. The variation of outcomes is thus dependent on the strategic interaction.

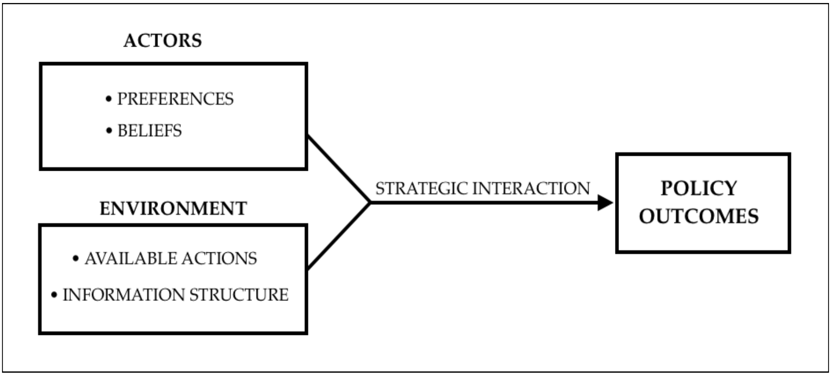

Figure 1. Strategic setting defining policy outcomes.

2.3.2. Definition of actors and their features

For our purpose, some further specification is needed to construct the strategic setting, both concerning actors and the environment, the main independent variables of the model. Concerning actors, it is first of all necessary to define them, stating as well their main characteristics. It is difficult, and probably impossible, to take into account every single actor – individual or collective – which has played any role in the development of the crisis. They would include domestic actors, i.e. single personalities, leaders, organizations, collectivities, organized groups such as parties and unions, interest groups – multiplied for every single member of the EU – as well as international actors such as states, EU members and otherwise, international organizations, large corporations and so on. That would probably provide a more accurate analysis of the events, but it would involve an unwieldy level of complexity. For the sake of the analysis, for a necessary parsimony in the model that I propose, and for the consolidated tradition of the discipline of international relations, the dissertation considers as main actors states and European institutions. In the former the member states of the EU are included, while the latter consist mainly in the main European institutions (European Commission, European Parliament, European Central Bank)[7], as well as in some external institutions, such as the International Monetary Fund, which has been playing a non negligible role.

States and institutions are considered as unitary, rational and purposive. I deliberately overlook the process of national interest formation, then conflicting sub-national interests and their composition (Moravcsik 1993, 1998). In other words, the process of national interests' formation is not under scrutiny: national preferences are taken as given, whatever complex the process leading to them might have been. Thus, actors are considered to have precise and fixed preferences over an issue, as well as the capacity to rationally rank them and, most of all, of strategically operating in order to reach those goals depending on others' actions and preferences. Thus, the dissertation assumes that a state has fixed preferences over time about a specific issue, and that notwithstanding a normal political and cultural evolution – elections involving a government shift, the development among citizens of a certain sensibility over an issue, the transformation of lobbies' behavior and so on – those preferences do not sensibly change over time. In this

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[7] The European Council and the Council of EU are not considered because, as essentially intergovernmental arenas, their preferences are the composition of single members preferences, which are considered individually.

way, as already stated, variation in the observed outcomes cannot be reconnected to preferences' shifts.

Even considering only state actors, thus neglecting the sub-state level, the fact of dealing with 28 member states and other main international organizations, might lead the analysis toward excessive complexity. That is why EU member states are organized in homogenous groups along their preferences. For sure, such division might overview some specific positions of a single state over an issue, but considering the dynamics at stake within the European Council, it can appear as a simplification, but not a radical misrepresentation of the confrontation among member states. Indeed, by carefully looking at the history of the integration process, the same groups of states often appear to be opposed along the same line, when it comes to economic and monetary affairs.[8] A familiar, though sometimes stereotyped, division is the one opposing Northern Europe countries and Mediterranean ones, which is somehow overlapping to the cleavage between creditor/surplus and debtor/deficit countries – but also anti-inflationary vs inflationary countries.[9]

The division between creditor and debtor countries is not a real oversimplification of the dynamics inside the European Council. Though leaving apart some states that do not stand overtly as debtor or creditor – namely those outside the Eurozone – it crystallizes very well some recurrent fractures toward the main policies concerning the common currency and economic integration in general. Indeed, today's creditors are usually yesterday's so-called "economicists" as opposed to

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[8] While examining every single policy case, a more accurate definition of the position and preferences of each group will be obviously analyzed, and eventual policy-specific actors will be presented.

[9] In any case, the cleavage at stake is not the one rich vs poor countries, that seems to have minor significance for the political economy of European integration (Schelkle 2012).

the “monetarist” countries[10] (Lucarelli 2013). That demonstrates that states’ preferences toward financial and monetary aspects of the integration are not so swinging even in the medium and long term. The former group – northern/creditor countries – is headed by Germany, and includes the Netherlands, Finland and Austria, but also to a certain extent Slovakia. These countries gained competitiveness since the creation of the Euro, shifting most of their resources in the export sector, they have historically low inflation, a surplus position with regard to public debt and generally obey to fiscal rules. The latter – southern/ debtor countries – includes France, Italy, Spain, Portugal, Greece. The contingencies of the crisis have led some other states to “join the south”, as in the case of Ireland. These countries are traditionally more inflation prone, which determined a consistent competitiveness loss in the last decade, they generally present a deficit position in the management of public debt, and their interpretation of fiscal discipline turns generally out to be quite flexible.[11] The two groups of states are considered as unitary actors, with determined preferences, which will be preliminarily presumed for every single policy observed.

In such configuration, it is a bit more difficult to include within the two groups those states that are out of the Eurozone – UK above all – because their preferences over monetary issues might be more ambiguous. It is also true that their effective role in influencing policies linked to the common currency has been limited. Nonetheless, all along

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[10] In view of creating a monetary union, a division opposed countries on the timing of the creation of the common currency and the achievement of a convergence of economic indicators. The so-called “economicist” countries were those that considered fundamental a process of solid economic convergence before the creation of a common currency, fearing that eventual divergences in the economic fundamentals would undermine the cohesion of the monetary union. On the other hand, the “monetarist” countries – whose vision prevailed in the end – were those countries considering that the monetary integration would naturally lead toward an economic convergence.

[11] These features, for sure, do not apply for each one of the members of the two groups. For instance, one can note that at the onset of the crisis Spain presented a very good fiscal position, or that Netherlands and Finland – though being part of the German-led coalition – over the last years lost their status of creditor countries.

the scrutiny of the different case studies, a preliminary presentation of the actors at stake – as well as of eventual policy-specificities – will be made, and specific positions of any states not included in one of the two groups will be duly assessed.

When it comes to European institutions, for sure, their number is limited, including only the European Parliament, the European Commission and the European Central Bank – taking apart the European Council and the Council of Ministers representing eminently states' preferences. In this respect, however, a differentiation among institutions has to be made, since not all of them have formal powers in the decision making. For instance, the European Central Bank does not formally intervenes in the policy making, though it has a *de facto* political weight in the institutional confrontations. That is why, when discussing the individual case studies, a slight differentiation will be made between the preferences and behavior of institutions with formal powers in the decision making (European Commission and European Parliament) and other actors without such powers (ECB), which will be considered as influential allies of other actors.

Unlike actors' preferences, the environmental conditions are not taken as stable, but they change over time. Namely, the observation of crisis periods subsumes that crises are fundamental in determining outcomes, thus part of the variation in the outcome can be related to the variation in the independent variable which is the environment. In particular, as specified in the methodological section (see §1.3.3), variation will be assessed through a distinction between periods of crisis and those of non-crisis, but even an internal distinction within crisis' years, with reference to peaks and bottoms of the crisis itself.

2.3.3. Institutions: Mediating effects and independent role

In the logic of the research, institutions are considered in a double aspect, both in the process of change and in their role of affecting such change. Indeed, existent institutions in a given strategic set may influence the process of institutional change, leading the pattern toward certain outcomes rather than others (Snidal 1996). Observed outcomes, then, are not a pure reflection of states' bargaining power, but institutions have a mediating effect, which will be duly taken into account in the research. Also, they provide information to actors on other actors' likely behavior (Greif 2006), making it possible to coordinate behavior. Such coordination is made possible by the fact that institutional rules allow to involved actors to incorporate the expectations on other actors' behavior on the bases of existent rules, thus constituting an important source of information on others' presumed behavior. In other words, strategic interaction does not occur in an institutional *vacuum*. For instance, the institutional rule of the unanimity within a certain organization may mediate a decision making process toward certain outcomes rather than a majority rule. In this light, institutions are considered to influence the process of strategic interaction among actors, representing a fundamental element of the environment in a twofold direction: on the one hand they orient the nature of policy outcomes; on the other they shape the information structure which is analytically part of the environment in which actors behave.

A clear example of how an institutional rule may orient, and even decidedly influence, the negotiation outcome is the decision making process.[12] We may say that decision making processes are a set of institutionalized formal rules which apply to specific cases in a policy making process, which have peculiar impact on bargaining structures, because of their ability to convey information and shape likely behavior among participants. In the field of European policies and EU decision making, a clear-cutting differentiation is made between so-called intergovernmental and supranational decision making, each applied in specific policy contexts. Intergovernmental decision making implies the requirement of the unanimity among member states in order to get a

[12] For sure, institutional rules concerning the decision making are not the only possible way in which institutions may exogenously affect outcomes. Davis (2004), for instance, shows that the institutionalization of cross-sector issue linkages, i.e. the combination of different sectors in a single negotiation process – differing from separate negotiations for single issues – has tangible consequences in the negotiation process, and over outcomes in the end. Héritier and Schoeller (2015) also consider the issues of delaying strategies, linking-arenas strategy and urgency of decision making as other elements that can affect outcomes.

decision. In these cases European institutions generally do play little role in the decision making process. The conduct of a European foreign policy is an example of intergovernmental policy. Supranational policies, or the ones conducted according to the community method, are the set of policies whose decision making process within the Council of Ministers is lead by the majority vote criterion, and where European institutions play a greater role: the European Commission has the traditional monopoly of legislative initiative and the European Parliament and the European Council are involved in the co-decision procedure.

The consequences of each decision making process are patent, and a decision taken by unanimity differs from one taken by majority – and even by qualified majority. In the former decision making process, indeed, the outcome will realistically represent a sort of least common denominator among the actors at stake, because the risk of veto playing – which is up to every single participant – will prevent any risk taking. And such dynamic is directly functional to the number of participant in the negotiation process: the higher the number of participants, the higher the possible veto players, the least the possibility of having transformative policy outcomes. Instead, a majority vote regime leaves more room to negotiation, because the outcome shall not make every single participant satisfied.

The consideration of the role played by institutional rules results in a slightly more complex illustration of the strategic interaction, because at this stage the environment is affected by institutional rules and policy outcomes are not a pure reflection of the combination of actors behavior, but they are mediated by the presence of existent institutions which affect their nature (figure 2). Institutions, then, boldly affect the nature of the policy outcomes. In this view, the mediating role of institutions is crucial to determine the nature of the policy outcomes in terms of their failure or success. More precisely, it is probable that a heavier decision making process which requires a unanimity compromise among several actors has a more incremental – and possibly engendering deadlocks – outputs than one in which agreement among actors is taken by majority. That is why a causal relation – to be proven – is addressed between modes of governance in a single policy domain, and the relative successful nature of its outcome.

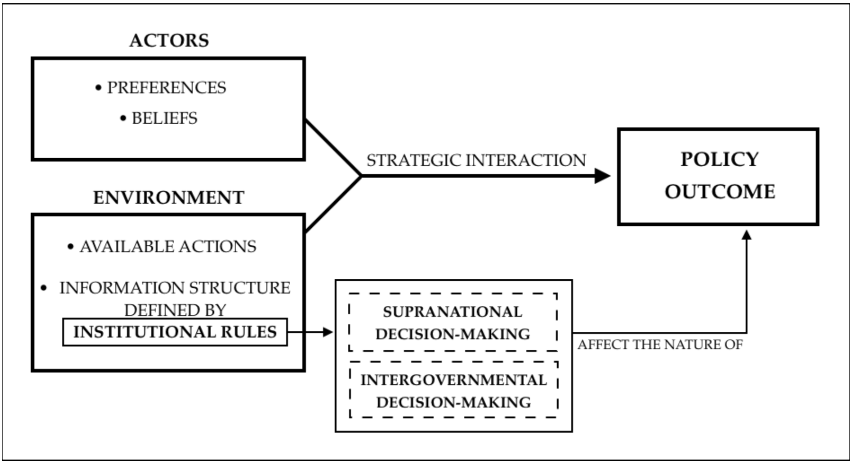

Figure 2. Strategic setting defining policy outcomes in presence of mediating institutional rules.

2.4. Hypotheses formulation and associated variables

Three main hypotheses are formulated, which are to be tested for each of the case studies considered. In particular, the first one refers to the general link existing between economic crisis and institutional development of EU structures, while the second and the third one are more related to the mechanism leading to the policy outcomes observed with explicit reference to the dichotomy intergovernmental/ supranational decision making. The three hypotheses reflect a sort of temporal and logic sequence in the development of the institutional change during economic crises, each of them representing a theoretical step linking economic crises to their general consequences for the integration process. They investigate three subsequent aspects of the institutional change in the EU: the causes (the "why" question), the modality of development ("how" question) and the consequences ("then what?" question). Indeed, the first one refers to the role of economic crises in shaping institutional change, the second one focuses on the type of institutional change according to the modes of governance used, while the third and last one addresses the consequences of economic crises on the institutional structure of EU.

2.4.1. Hypothesis n. 1

The first hypothesis formulated is that, given the existent conditions in the EU, (H1) an economic crisis is fundamental in the determination of major institutional changes, in terms of their quantity and quality, because it exercises a functional pressure toward change over policy makers and institutional structures. Such functional pressure exercised by financial markets has been particularly strong since the Eurozone crisis has been an economic crisis resulted from a financial crisis; this particular type of crisis makes it more necessary for policy makers regaining market credibility, much more than in other kinds of economic crises, such as those resulted from supply-side shocks.

To be more specific, according to the first hypothesis, (H1a) the less the pressure on policy makers, the more they are prone to postpone the adoption of major and transformative policy outcomes; conversely (H1b), the more the pressure on policy makers, the more they are forced to adopt those policy outcomes. According to the strategic choice approach, the main independent variables at stake for H1 are environment and actors, with the preferences of the latter taken as given and constant. Evidently, H1 takes as the dependent variable the presence of institutional change in terms of quality and quantity of policy outcomes adopted.

To summarize, for H1 we have:

> *H1*: An economic crisis is a fundamental driver of major institutional changes, both in terms of their quantity and quality;

Independent variables:

- Pressure on policy makers given by economic crisis;
- Actors' preferences (fixed);
- Institutional rules with mediating effects on policymaking (fixed)

Dependent variable:

- Policy outcome

2.4.2. Hypothesis n.2

The second hypothesis refers to the link existing between the institutional setting defining policy making procedures and the nature of resulted outcomes. In particular, the second hypothesis focuses on successful or unsuccessful nature of policy outcomes, according to the idea that institutional rules do have tangible effects in the determination of final outcomes. In particular, it can be explored how the dichotomy between intergovernmental and supranational decision making reflects of the effectiveness of policy outcomes.

According to H2, intergovernmental policy making tends to have incremental and ineffective policy outputs and to create institutional deadlocks; conversely, supranational policy making tends to have successful and more effective outputs. The independent variable at stake is the modes of governance used in the crisis management, addressed in the dichotomy supranational/intergovernmental decision making. For its part, the independent variable in this second hypothesis is the character of the policy implemented in terms of its success or failure to target the initial goal.

Then, resuming, for H2 we have:

> H2: Intergovernmental policy making tends to have incremental and ineffective policy outputs and to create institutional deadlocks; conversely, supranational policy making tends to have successful and more effective outputs;

Independent variable:

- Kind of decision making process (supranational/intergovernmental)

Dependent variable:

- Policy success/Policy failure

2.4.3. Hypothesis n.3

In light of H2, the third hypothesis (H3) claims that the failure of intergovernmental solutions leads to a process of delegation to the supranational level, determining an empowerment of supranational institutions *vis-à-vis* member states. H3 draws from rationales of delegation and principal-agent theory (Pollack 2003), according to which delegation enhances policy credibility through the use of neutral actors as arbiter among conflicting interests and improves outcomes thanks to technical expertise of the delegated. Then, in case of conflicts engendered by dead-locked intergovernmental policy making (independent variable) we may find the presence of authority delegation from the national to the supranational level (dependent variable), that is, an upload of competencies to supranational institutional creating a *de facto* supranationalization in the policy area considered.

Formalizing it, we have that:

> H3: In the case of policy failure due to irreconcilable conflicting interests or institutional deadlocks, a process of delegation to a neutral – i.e. supranational – actor occurs, resulting in an empowerment of supranational institutions *vis-à-vis* member states.

Independent variable:

- Presence/absence of policy failure;

Dependent variable:

- Presence/absence of supranationalization through authority delegation to supranational institutions.

2.4.4. An explanatory model

Taken together, the hypotheses represent a challenging interpretation of the role of the economic crisis on the institutional structures of the EU, and of the Eurozone in particular, because they could potentially reveal a crucial paradox, if proved to be true. Namely, the fact that, notwithstanding a quintessential intergovernmental setup of the EMU, as well as the predominance of the intergovernmental management of the crisis, economic crises do increase the level of supranationalism of EU, thus a step toward the *ever closer union* prefigured in the treaties, in a sort of neo-functionalist perspective, against liberal-intergovernmental claims. That is not to say that one of the two grand theories is completely discharged and the other one is considered to perfectly fit all the evolution of the European integration. Rather, if confirmed, the hypotheses might suggest that a neo-functional perspective is more adapt to explain the institutional evolution of the integration process in those peculiar and temporarily limited phases which are major economic crises, giving then the big frame of the different dynamics to be uncovered through rationalist explanations.

The interaction among the three hypotheses results in the explanatory model underlying the research (fig. 3), which for its part tries on the one hand to reveal the temporal and logical sequence among the hypotheses, an on the other hand to link the set of independent and dependent variables as to offer – if the hypotheses prove to be true – a mid-range explanation of the dynamics occurring in Europe during major economic crises.

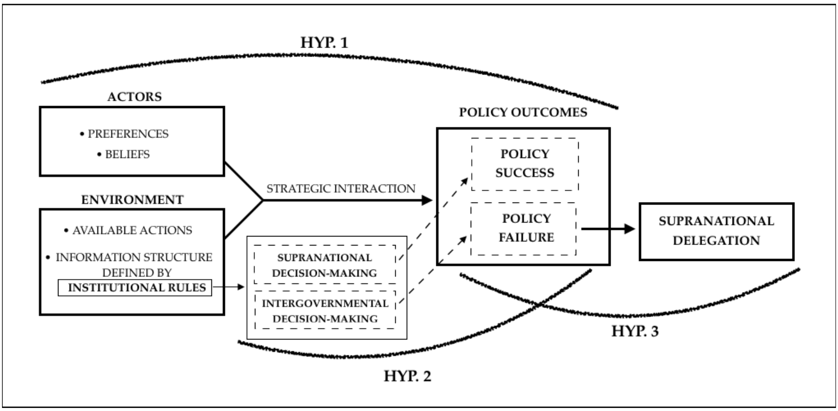

Figure 3. Explanatory model of the dissertation.

2.5. Methodological aspects

The dissertation stems from the idea that in order to assess some characteristics of the EU one has to take into account the set of policy domains it is composed of. Thus, it has not too much sense to discuss in abstract of the institutional nature of the European Union, unless one accurately looks at the different single policies (Wallace et al. 1977). In this view, in order to understand the consequences of the economic crisis on the institutional structures of EU, I will adopt an empirical approach, that is, the reflection will be mostly guided by the focused observation of different policy domains. By doing this, it will be possible to uncover general trends in the integration and to give a plausible interpretation of the institutional patterns taken by EU when confronted with major economic crises. In practice, I will test the leading hypotheses of the research for three different policy domains, which represent three case studies under scrutiny. In this section I deal with the main methodological aspects underlying the choice of the case studies and their practical observation.

2.5.1. Choice of case studies

The three case studies all refer to the institutional change that occurred during the Eurozone crisis, thus to the events destabilizing European economy since 2009 onwards. Methodologically, the case studies represent different variations in the independent variables, thus, they are different cases in which a certain outcome is observed (policy outputs in consequence of crisis, supranational delegation) as the result of a variation of the independent variable (crisis/no crisis). By consequence, it will be possible to assess whether similar variation in the independent variables do correspond to similar variation in the dependent variable, which might give raise to recurrent observable patterns of institutional change.

The three policy domains, referred to the Eurozone crisis, are all related to monetary and economic aspects of European integration. Namely, they are: (1) the evolution of the rules of fiscal discipline; (2) the provision of financial support to member states and (3) the setup of a banking union. Before looking more closely to them, it is necessary to make it explicit the logic underlying their choice. The first, evident, reason why the three cases all concern economic aspects of the integration is that in this peculiar domains it could be easier to find, if any, direct correlation with the surrounding economic crisis. That is not to say that other policy domains of the EU were not affected by the economic crises[13], rather, that it is intriguing to find direct links between economic crisis and the development of economic policies.

The second reason is that, for their nature, the three policy areas all involve similar dynamics among the actors involved. Indeed, they all represent policy areas whose outcomes imply some distributional effects. For instance, a reformulation of the rules of fiscal discipline – or the setup of financial support for member states – implies a substantive redistribution of resources among member states, unlike other policy domains in which such distributional effects are less evident (e.g. enlargement policy; research and innovation policy). Such distributional effects directly affect the interaction among actors, making the element of strategy at the core of their relations, and making at the same time the three case studies a comfortable field of application of distributional rationalist explanations of institutional change discussed above.

Finally, a third reason underlying the choice of the case studies is that the three policy areas were highly interdependent and interconnected both in provoking the Eurozone crisis and in determining its evolution (Drudi, Durré and Mongelli 2012). Indeed, there is a strong interdependence among fiscal stability (addressed by the strengthening of fiscal discipline), financial stability (addressed by the programs of financial assistance) and price stability (mainly concerning the role of banks, thus linked with the creation of a banking union). In a monetary union, all the three elements are strictly connected, and a genuine one should provide firewalls in order to prevent spillover effects from one country to another. Following McNamara (2015), an "Embedded

[13] Some studies highlight that other policy domains, not strictly related to economic affairs, were actually affected by the economic crisis. See for example Rodriguez and Xiarchogiannopolou (2014) for what concern social policy, or Chetail and Bauloz (2011) for the asylum policy.

Currency Area"[14] needs four elements: a credible lender of last resort – which is the issue addressed by the policy of financial support; a mechanism of fiscal redistribution – related to the field of fiscal discipline; a regulation of financial risks – assessed by the setup of the banking union; and finally political solidarity – which for its part should have characterized all the three domains. Nonetheless, in lack of these elements – the "three forgotten unions" at the base of the unfinished institutional design of the Eurozone (Matthijs and Blyth 2015) – the Eurozone lived contagion effects determining the systemic crisis of last years, which spread from an economic field to another.

The first policy domain considered is then the progressive transformation of the rules of fiscal discipline for the members of the Eurozone. Indeed, this domain saw major changes since the incept of the crisis in 2008-2009: while before the crisis it was regulated by the sole Stability and Growth Pact of 1997 – with its notorious provisions of the limit of 3% between annual deficit and GDP and the other of 60% between national debt and GDP – the pact saw progressive modifications, in line with the economic troubles of the Eurozone crisis. Indeed, changes were adopted for what concerns the application of sanctions, the reinforcement of its provisions as well as of their enforcement and the related sanctioning system, through a rich transformation both at the level of treaties (e.g. the Fiscal Compact) and of secondary legislation (e.g. the Six Pack and the Two Pack).

The second case study refers to the provision of financial support to member states. In particular, it will be analyzed how the financial aid programs and the financial facilities were created, the underlying conflicts among member states and the clash among their visions. Despite the explicit no-bailout clause inserted in the treaties, EU institutions and member states have provided financial support to some of the peripheral states severely hit by the crisis. In particular,

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[14] Drawing from Polanyi (1944), McNamara suggests that even a monetary union, in order to be effective and legitimate, should be "embedded" within larger social institutions. To this end, they should present the four elements here recalled, which rather than an optimum, do constitute a minimum foundation for monetary union (2015:26).

bilateral loans amounting to €80 billion were provided to Greece in March 2010, then financial support was given to Ireland (€85 billion in November, 2010), Portugal (€78 billion in May 2011) and again Greece for a second financial aid in March 2012 (€130 billion).[15] Moreover, a certain amount of money flew towards Spain and Cyprus for the recapitalization of their banking sectors, as well as to other non-members of the Monetary Union. This case study then analyzes how this financial aid where provided, through which means and which were their consequences. In particular, an analysis will be carried out of the progressive creation of new instruments used to support peripheral states, which were an absolute novelty in the EU institutional environment, namely the EFSM (European Financial Stabilization Mechanism), the ESFS (European Financial Stability Facility), the ESM (European Stability Mechanism) and the the two programs implemented by the ECB, namely the SMP (Securities Markets Programme) and the OMT (Outright Monetary Transactions).

The third and final area is represented by the creation of a banking union in the EU, which is a *ex novo* policy creation, after that such creation has been envisaged for decades (Enria 2013). As a response to the financial turmoil in the banking sector endangered by the crisis and to the often opaque and ambiguous relation between member states and their major banks, the so-called banking union consists in the creation of a Europe-wide supervision of banking institutions – which are put under the common supervision of the ECB – through the Single Supervisory Mechanism, and the provision of a Single Resolution Mechanism, in order to ensure an orderly resolution of failing banks with minor costs for taxpayers. The empirical observation reconstructs the progressive steps toward the setup of a banking union – which is still in progress given that a major component, the Single Resolution Fund, will be effective only in the next years – from a situation on very loose coordination among member states, up to the creation of a stronger one through the banking authorities and finally the setup of the main pillars of the banking union in 2013 and 2014.

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15 The third financial plan accorded to Greece in July 2015 is out of the chronological scope of the dissertation, which considers the span of time 2009-2014.

For each of the case studies the three hypotheses will be tested, in order to understand what the real role of the financial disorder in the creation of the instruments was, in which way the intergovernmental negotiations affected their nature and potential performances, and whether or not, in the end, the institutional framework created in this field represents a sort of supranationalization of the Eurozone structures, because of any upload of competencies to the supranational level.

2.5.2. Measuring outcomes and variations: Methodological aspects

The test of hypotheses passes through the empirical check of events in search of eventual confirmations of the propositions made. For the purpose of the research, the hypotheses are confirmed if respectively: a direct and causal link is found between the economic crisis and the adoption of major and transformative policy outcomes (H1); there is a relation between modes of decision making and success of policy outcomes, and more specifically if intergovernmental decision making creates only incremental outcomes and/or institutional deadlocks – and if, conversely, supranational decision making leads to successful policy outcomes (H2); if finally an institutional deadlock created by the failure of intergovernmental decision making leads to a delegation to supranational institutions in order to solve the original problem (H3).

As a general rule for the dissertation, quantitative methods are barely helpful for the analysis. A number can hardly indicate whether an outcome is more or less supranational than another, more or less successful or how much intergovernmental is a decision making process. That is why the research mostly relies on qualitative indicators, plus an original index of supranationalism, which is functional to interpret the patterns of institutional change, giving sense of the final findings of the research.

Concerning the first hypothesis, the first variation to measure is the presence of any pressure on policy makers given by the context of economic crisis. In this regard, a preliminary specification is to be made: the dissertation only takes into account case studies coming from a period of crisis – namely the development of the Eurozone crisis between 2009 and 2014 – without any explicit comparison with periods of non crisis. Thus, a diachronic comparison for a single policy will be taken somehow implicit. The reference to assess eventual variations will be their development in the pre-crisis years, thus the span of time since the creation of the common currency up to 2008. In this respect, a diachronic comparison is not always linear and evident. Indeed, if it is relatively easy to assess the variation in the management of the rules of fiscal discipline because some rules within the same policy area were already there (the Stability and Growth Pact since 1997) it might be difficult to assess a presumed variation in the field of financial aid to peripheral states, since they were never provided before 2010. The case of the banking union is somehow in between the two cases. Indeed, if the effective design and implementation of a system of banking union and banking supervision at European level occurred only during the Eurozone crisis, a certain coordination was already present for certain aspects. Long-term variations, then, will be assessed between policy-specific terms of references: namely, the pre-existent institutional setup before the onset of the crisis is the main term if reference for the rules of fiscal discipline and the banking union, while the variation concerning the policy of financial support will be assessed with reference to the very first phases of the crisis.

For the aims of the research, it is necessary to assess variation in the independent variable not only in the medium term, that is, in relation to a broad distinction between periods without crisis and periods of crisis (i.e. respectively, the first decade since the creation of the Euro, and the years following 2009). Rather, it is essential to understand the intensity of market pressure even within a protracted period of crisis, by identifying even shorter periods of intense pressure, which can be considered as peaks of a crisis. These acute phases are not always perfectly reflected by macroeconomic indicators. Indeed, the unemployment rate is not an immediate indicator for the day-by-day attitude of financial markets, and GDP is measured only quarterly, thus it can hardly indicate the shortest periods of intense crisis and market pressure. In this respect, a good indicator may be the trend of the spreads among sovereign bonds in Europe[16], as well as the course of credit default swaps (CDS) on the same sovereign bonds.[17] Indeed, since 2010, they represented a daily indicator of economic situation all around Europe.

The graphic (see appendix: fig. a1) shows the yields of 10-years government bonds of seven European countries over twenty years, since 1992 up to 2012, with the indications of the launch of Euro in 1999 and the onset of the international financial crisis in late 2008. The figures suggest two main issues: firstly, the decade prior to the Eurozone crisis can be correctly judged as one without great economic pressure. Indeed, it seems that the creation of the common currency contributed to a substantial convergence in the cost of debt serving for Eurozone members. Secondly, within the Eurozone crisis' years, spreads' trend shows a series of up and down and an increasing divergence among member states, signaling that pressure on policy makers has been far from homogenous all along the crisis, and it is quite differentiated for every country. Such a sclerotic attitude of financial markets is also witnessed by the trend of CDS on national bonds, that as a highly volatile financial product immediately reflects any variation in markets expectations (see appendix: fig. a2).

In the next chapter I identify the most problematic phases of the Eurozone crisis – i.e. a variation of the independent variable – in order to check if in those occasions peculiar policy outcomes have been adopted. To this end, the most immediate indicator of market pressure is the trend of co-movements of CDS premiums on the sovereigns bonds, that is, the aggregate dimension of their value, a very good synthetic indicator which gives an accurate representation of the "economic climate" all over the crisis (see appendix: fig. a3). An

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[16] The spread between sovereign bonds represents the difference between their yields, and it is a measure of how much a bond is considered to be riskier than another. Indeed, the spread represents the risk premium that investors demand to hold the risky asset. During the Eurozone crisis, peripheral states' bonds spread skyrocketed with reference to the German ones, which are considered to be one of the most secure assets in the world.

[17] CDS are a sort of investors' insurance against the risk of bankrupt of a state; the higher their value, the more likely it is supposed the state to go bankrupt.

increase in the indicator suggests an increase in the joint default risk, thus a period of more intense pressure of markets towards policy makers. Starting from 2010, six peaks of the crisis can be identified: two in 2010, the very onset of the crisis in Greece in May and the first contagion in Ireland in October-November; two again in 2011, with the contagion to Spain and Italy during the summer and a new dramatic phase of October-November due to the fears of a referendum-induced "Grexit"; a very big one in mid-2012 because of a new menace of a Greek exit following general elections in May and June; and then a last one in March due to the banking crisis in Cyprus. I claim that in those phases policy makers were incredibly urged to act, in order to calm down markets.

When it comes to the second hypothesis ("Intergovernmental policy making tends to have incremental and ineffective policy outputs and to create institutional deadlocks; conversely, supranational policy making tends to have successful and more effective outputs"), it has to be assessed the variation in the modes of decision making, as well as in the degree of success or failure of the policy outcomes. Concerning the dichotomy between supranational and intergovernmental decision making, references are present in the theoretical section.[18] Supranational decision making, or community method, is the one in which the European Commission has the monopoly of legislative initiative – on the main policy lines dictated by the European Council – and then the Council and the Parliament vote in the so-called ordinary legislative procedure (art. 294 TFEU). In this system, decisions within the Council are taken by qualified majority. On the opposite, intergovernmental decision making resides in the monopoly of the process in the hands of member states. Namely, the European Council defines broad strategies, while the Council implements and develops

[18] See §2.3.2

concrete measures. Decisions are taken by unanimity, and the role of other institutions is limited to advise governments.[19]

What is to be specified is that the dichotomy doesn't catch a fundamental passage of the integration process, namely supranational delegation, which for its part represents the dependent variable of the third hypothesis. It is defined as "the delegation of political authority from representative organs to non-majoritarian institutions, which are neither elected by the people nor directly managed by elected politicians" (Tallberg 2002). In this sense, supranational delegation is not to be confused with the formal shift of a policy from intergovernmental management toward community method, generally sanctioned by a formal treaty (e.g. the "communitarization" of the environmental policy occurred through the Single Act). Rather, it is qualitatively more than a simple "communitarization" of policies, representing a further integrative step, thus the complete abandon by member states of a once national competence in the hands of a supranational body, generally non representative (i.e. European Commission, European Central Bank). Such delegation can be informal or – more often – formally sanctioned, and it applies to specific aspects of a single policy, e.g. the monitoring of fiscal obligations of member states. If occurring, then, supranational delegation means that a single aspect of a policy is completely left in the hands of supranational institutions, contributing to the general supranationalization of the entire policy.

When it comes to policy outcomes, an assessment on their failure or success is clearly case specific. For example, the signature of a new treaty containing new rules of fiscal discipline can be seen as successful if it helps in relaxing the financial environments (e.g. by reducing the spreads); on the contrary, if the decisions taken in a summit contribute to the deterioration of the climate, it obviously results that such

[19] A third type of decision making residing somehow in the middle is the one of Open Method of Coordination, often used in the area of social policies, whose elements are soft coordination among member states, benchmarking and share of best practices and decisions taken by consensus (Radaelli 2003).

outcome is far from optimal.[20] When discussing each case study, the criteria to assess the successful/unsuccessful nature of a certain outcome will be presented.

2.5.3. The "supranationalization rate" index

It is necessary to find a way to validate or disconfirm the underlying conjecture of the research, i.e. that the economic crisis is functional to an increase of the supranationalism in the European polity. That is, a major economic crisis can be a driving force for a substantial enlargement of competencies and authority at the supranational level. According to the empirical approach of the research, such assessment derives from the direct observation of single policies. That is why it is necessary to evaluate how much an individual policy outcome is more or less supranational than another, or better said, if a single policy outcome contributes to make the policy more or less supranational than before.

To this end, it can be helpful to borrow the concept of a continuum between intergovernmental and supranational politics proposed by Stone Sweet and Sandholtz (1997) (figure 4). The aim of the two authors was to build a new theory of European integration[21], and to this end they created an index to evaluate the level of supranationalism/ intergovernamentalism in European politics, which was assessed along three main dimensions (rules, organizations, society). From their theorization I borrow the idea – common to much research on

[20] A great example of failing outcome from the Eurozone crisis is the so-called "collective action clause" taken in the Deauville agreement between Merkel and Sarkozy in October 2010 and then welcomed by the European Council – and opposed by the head of ECB, Jean-Claude Trichet – which determined weeks of panic among international investors (Bastasin 2012:239).

[21] In the line of the neo-functionalist tradition, Stone Sweet and Sandholtz proposed a theory of the integration relying on three causal factors: transnational exchanges, supranational organizations and EU rule making. Their idea is that growing transnational exchanges require more and more supranational regulation, provided by supranational institutions in a process which results in their rising institutionalization and, in the end, further integration.

European integration – of the continuum, which has as its poles a completely intergovernmental or a fully supranational character. Like the two authors, I consider that within the complex framework of the EU, certain policies can be situated in a specific site of the continuum, while others can be situated elsewhere.

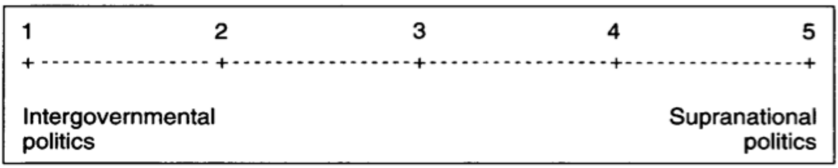

Figure 4: The continuum of supranationalization of a policy.

To better specify the different sites of the continuum, I operationalize the indicators by using the five-point scale proposed by Borzel (2005) to assess the level of authority of supranational institutions over policy processes. In particular, the pole at the extreme left (=1 point) corresponds to a situation in which competencies lye exclusively at the national level, and policy coordination at EU level is absent. On the contrary, the pole at the extreme right (=5 points) represents an institutional setting were the authority over a policy is completely in the hands of supranational institutions, thus there is a complete centralization of authority. The intermediate sites do represent different shades of the concept. Level 2 means that competencies are shared very lightly, prefiguring a sort of intergovernmental cooperation on the issue. At level 3 there is a balanced distribution of authority between the national and supranational level, in what can be defined as a joint decision making. At point 4 of the continuum we find the configuration of the community method, which is not yet a full centralization of authority at the supranational level, but largely involves European institutions.

In order to assess the degree of supranationalism of a policy, and not of a political regime in general, I adopt three different categories of indicators, which taken together can give precise indications on how to situate a single policy along the continuum. The index of supranationalism is then composed by the following dimensions, each including policy-specific indicators: (1) width of supranational management of policy cycle; (2) power of supranational institutions in the policy; and (3) presence of any supranational instrument, mechanism or procedure.

The width of supranational management of the policy consists in the assessment of how much of a policy resides "in Bruxelles", that is, which is the balance between responsibility of governments or supranational institutions in the different phases of the policy cycle: agenda-setting, elaboration, implementation and evaluation of the policy. At a level 1 we would find a pure "intergovernmental" policy, in which the elaboration, the decision making and the implementation are all in the hands of governments, and where there is no room for supranational authority. At the opposite pole, instead, we would find a policy whose management is fully in the hands of supranational institutions – such as, for example, the monetary policy for the member states of the Eurozone. Being every single indicator of this first dimension situated more or less close to one of the two poles, from the average of the different aspects one can determine how much the management of the whole policy cycle is relied to the supranational sphere – and how much eventually this value shifted over the crisis years.

The second dimension, i.e. the power of supranational institutions, refers to the effective role of European bodies within the policy: are institutions effectively responsible in the policy field, or their role is one of subsidiarity to governments? How much freedom do member states enjoy in implementing the policy? Again, to situate a single policy in the continuum it is necessary to look at the different phases of the policy making. If supranational institutions have effective powers in the design, the decision making and in the implementation, the policy resides on the right pole. Otherwise, if governments lead the whole process, then the policy stands on the left pole. For sure, the presence of any recognition of supranational delegation as defined above, signals an evident move towards the right pole in the policy eventually concerned by the act of delegation.

The final dimension refers to the presence of any supranational instrument, mechanism or procedure, whose creation is functional to the management of the policy at supranational level. Indeed, common mechanisms or instruments are often created as a way to upload to supranational level a certain competence without a complete abandon of authority by the states. Both the Single Resolution Mechanism and the European Stability Mechanism are examples. With regard to these instruments, states have a certain role, but they suggest that the policy area is undertaking a process of supranationalization. Beside, certain policies present peculiar procedures which can be more or less intergovernmentally-oriented, such as the Excessive Deficit Procedure under the SGP. In this perspective, the presence of any particular procedure, and its nature, helps in better defining the rate of supranationalization of the policy.

Taken together, the three dimensions – which will hardly situate on opposite poles for every single policy – help identify how much a policy can be considered supranational or intergovernmental, and how much it became more or less supranational than before the crisis. In this way, by confronting all the case studies at stake and appreciating eventual variations, one can have an accurate framework to understand whether or not economic crisis contributed to the further integration of Europe.

2.5.4. Sources and data collection

Concerning data collection, the quality of the sources is fundamental for the validity of the dissertation. While not a strictly historical work, major mistakes on the reliability of sources and an inaccurate reconstruction of events can undermine the overall validity of the research, or at least decrease its explanatory power (Lieshout, Segers and van der Vleuten 2004). That is particularly the case for this research, because it heavily relies on empirical analysis. Reliability of sources is even more important because on the basis of sources, actors' preferences have to be realistically presumed. This is far more difficult than simply *describing* their actions, since unlike behavior, preferences and motivations are not observed (Frieden 1997: 40).

Concerning data collection about the Eurozone crisis, reliable material already exists, notwithstanding the obvious absence of the historical perspective that is only possible after several decades. Nevertheless, accurate reconstructions of the Eurocrisis' events have been made by several authors (Bastasin 2012, Irwin 2013, Peet and La Guardia 2014), and they provide a solid base for the analysis. At the same time, I rely on official documents of both national and European institutional bodies, member states' officials, media coverage, newspapers, official reports and all kinds of documents which are easily available today, and whose number is already quite impressive. For what concerns newspapers' sources, many of the most important newspapers in the world have their special eyes on Brussels, represented by journalists and observers very close to their sources, well inside the *coulisses* in Bruxelles, and thus reliable in their analyses and reconstructions. The best examples are the blog of Peter Spiegel for the "Financial Times"[22], the one by Jean Quatremer for the French press "Libération"[23], or the "Charlemagne" blog in "The Economist".[24] Their contribution in the reconstruction of the events, as well as in the reconstruction of strategic behavior of actors – which is sometimes difficult to uncover through official documents – will be of major importance.

[22] "Brussels blog" can be found at: http://blogs.ft.com/brusselsblog/

[23] The blog is named "Coulisses de Bruxelles" and it can be found at: http://bruxelles.blogs.liberation.fr/coulisses. The author of the blog published two very interesting reconstructions of two different phases of European integration, namely the construction of the monetary union (Quatremer and Klau 1999) and the years around 2000, including the negotiations behind the Nice Treaty and the French referendum on the European Constitution (Quatremer and Clarisse 2005).

[24] The column "Charlemagne" can be found at: http://www.economist.com/blogs/charlemagne.

Chapter 3
The Eurozone Crisis: An Overview

"Crisis appears to be the new normal state of affairs in the European Union", according to Copsey and Haughton (2012:1). Indeed, since the eruption of the international financial crisis in 2007-2008, Europe has witnessed the deepest and longest crisis in its 60-year history, which severely put into question the economic bases of the integration process. Moreover, the exemplar of European integration, the common currency, and indeed the entire political and institutional framework of the European Union are in doubt. "If the Euro fails, Europe fails," has been a mantra (Spiegel 2014a). Over the last few years, crisis has become a sort of normal state of affairs because the end game has always been unclear, and because year after year new developments have only served to exacerbate the crisis. New problems and threats came about, making it very difficult to formulate any sort of prevision even with regards to the near future. Although at the time of writing the debt crisis' acute phase seems to be over, the weak economic outlook, the danger of deflation and some unresolved issues about public debt in some countries make it impossible to affirm that the crisis is completely behind us. The main aim of this chapter is to offer a brief overview of the events that happened in Europe since May 2010, which can be considered as the beginning of the Eurozone crisis, up to the latest developments in late 2014, which – considering the ambiguity of the future – is the temporal limit of the analysis carried out in this dissertation.

3.1. The global financial crisis and the Eurozone

The Eurocrisis is a complex matter, a multidimensional series of events related to a growth crisis, a banking crisis and a government debt crisis

(Schambaugh 2012) that, being highly interdependent, erupted into a serious political crisis among the member states of the European Union, and the Eurozone in particular. In temporal terms, it can be considered as the dramatic appendix of the global financial crisis, the third and final phase of a transformative crisis that passed through an initial phase of market turmoil (August 2007- September 2008), followed by a systemic global financial crisis (September 2008-May 2010), and finally the Eurozone sovereign debt crisis (May 2010-onwards) (Drudi, Durré and Mongelli 2012: 881).

The Eurocrisis is the debt crisis that involved some of the peripheral member states of the Eurozone – the so-called PIIGS: Portugal, Ireland, Italy, Greece, and Spain – which at different levels found themselves in trouble while refinancing public debt. Though primarily concerning those peripheral states, the debt crisis had serious repercussions for the European economy as a whole with most of the Eurozone members living a double dip recession. The unemployment rate, particularly youth unemployment, raised to unprecedented levels, the indicators of public finance deteriorated and industrial production began to stagnate. The figures are striking, and show how the debt crisis turned into a social crisis: Greece lost 25% of its GDP in a few years; Portugal lost 15% of its work force, and in Spain, one person out of four is currently unemployed – for young people the rate is one in two.

How was this possible? A simplistic narrative reduced Europe's chaos to just one fundamental reason: profligacy of member states. That is, the idea that fiscal troubles in peripheral states, at the origins of uncertainty among investors and of the rapid escalation of the costs of debt serving, were essentially due to public overspending of the PIIGS countries. Such a vision, often taken as the official version by European officials and politicians (Schäuble 2011; Fernholz 2013), relied on academic works (Reinhardt and Rogoff, 2010) whose findings later emerged as partially wrong (Krugman 2013). The merits of austerity – seen by many as necessary to counteract the crisis – shaped the debate over the last years. Nevertheless a seemingly straightforward explanation is just one part of the story, and things are far more complicated. Excessive public spending was not the core reason of the Eurozone crisis – or, at least, it was not the only one.

Several elements contributed to the transformation of the international financial crisis into a Euro-specific crisis. Most of the problems date back to the creation of the Monetary Union, when policy makers committed some original sins, leaving the common currency infrastructure incomplete and unable to face eventual major crises (Nordvig 2014). Namely, errors included the absence of a centralized fiscal policy – in other words, a bold EU budget – to counterbalance natural economic divergence among member states[25]; the lack of any European control of national budgets, which were largely left to the discretion of national governments; and the one-size-fits-all monetary policy that cannot help save an individual economy during periods of economic stress, especially if the central bank cannot print money and has the sole objective of price stability defense. A second element concerns European banks that, apart from transmitting the financial crisis to the real economy through the so-called credit crunch in 2008-2009, since the creation of the Euro progressively became "too big to bail"[26] in absence of a central bank that can act as a lender of last resort (Blyth 2013: 74). Having adopted hazardous operations such as incredibly high leverages, and large bond holdings – often strongly biased in favor of their own sovereign debt (Peet and La Guardia 2014: 36) – banks risked to go burst when large investors began to leave peripheral states' bonds determining a fall of their value. Governments were then forced to provide financial support to save the banking system from collapse, generating enormous public deficits, and engendering, *de facto*, the most immediate mechanism for the transformation of banks' debt into state debt (Blyth 2013: 46).

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[25] Divergence showed up in two main dimensions. The first is the inflation gap among member states: countries with higher inflation (Greece, Ireland, Spain) experienced rising labour costs, and non-inflationary countries (Germany and its "close periphery") took advantage of a relative improvement in competitiveness. The other element of divergence is the current account, which was largely in deficit for some countries (e.g. Greece) and in surplus for others (again, Germany). This determined a destabilizing flow of foreign capital towards the periphery, making PIIGS far more exposed to eventual financial crises. On the economics and politics of the Eurozone crisis, see Hall (2012).

[26] Just to offer a figure, in 2008 Deutsche Bank alone had assets for over 80 per cent of German GDP (Kirchfeld, Logutenkova and Comfort 2012).

In this situation of systemic weaknesses, some national experiences triggered the Eurocrisis. Within the fragile and incomplete institutional framework of the Eurozone, national experiences worked as successive catalysts for the explosion of the situation and for its progressive deterioration. Greece is the best, though inglorious, example.[27] The case of Greece is one of a state that took too much advantage of the low borrowing costs engendered by the common currency[28], and that run expansionary policies progressively widening its current accounts and enlarging public deficits and debt. Along with a progressively lower productivity, a very weak system of tax collection and an uncoordinated system of public spending, Greece became the sick man of the Eurozone, in spite of the apparent economic growth since its access to the monetary union. The tragedy erupted in 2009, and the very bad coordination of European governments deteriorated the situation of the Hellenic state, which – at the time of writing – is still uncertain.

Nevertheless, PIIGS are hardly homogenous. Where the Greek case can be duly considered as one of bad management of public finances, the others cannot, and successive waves of the crisis were triggered by different reasons. For instance, the Irish and Spanish crises were underpinned by a housing bubble.[29] In particular, since their access to the common currency, both countries witnessed a striking flow of cheap money which was mainly directed towards the housing sector, determining a soar in real-estate pricing. To cover increased domestic lending, Irish banks funded themselves in the United States at impressive levels of leverage, and when the banking system collapsed in the US – due to the Lehman Brothers affair – Ireland almost went

[27] For a thorough discussion of the Greek case: Featherstone (2011), Pelagidis and Mitsopoulos (2011).

[28] After its access to the Eurozone, Greece profited more or less of the same interest rates on sovereigns as Germany, though being the two economies completely different and progressively divergent: a clear signal that financial markets were dysfunctional and unable to correctly discriminate economic situations (De Grauwe and Ji, 2012).

[29] For the evolution of the crisis in Ireland see Donovan and Murphy (2013); for the Spanish case see Pascual-Ramsay (2014) and Ferreiro and Serrano (2012).

bankrupt. The Irish state, guaranteeing the entire banking system's liabilities, created an enormous public deficit. A similar housing bubble burst in Spain, which represents seven times the Irish economy, and thrust Spain into the PIIGS club. Given that the housing sector employed 14 per cent of the working population before the crisis, the sudden burst of the bubble generated unprecedented levels of unemployment, very high levels of private debts, a major decrease in tax revenues and an increase in social spending, which contributed to the general deterioration of public finances.

Portugal and Italy, for their part, experienced neither a housing bubble nor a completely reckless public finance management.[30] Instead, the problem is low competitiveness and productivity, and low rates of GDP growth, combined with persistently high levels of public debt. While were not a real problem before the financial turmoil – even Portugal and Italy enjoyed very low borrowing costs – they set the stage for a domino effect once borrowing costs rose. Indeed, with a heightened perception of risk after 2008-2009, all of a sudden the two countries emerged on the frontier of the debt crisis, though the objective underlying risk was relatively limited. It was as if investors overnight discovered that Italy holds one of the largest public debt stocks in the world, and that the long-term prospects for economic growth remain weak. This contributed to the general deterioration of the already fragile conditions of European economic system.

3.2. The main evolution of the crisis

The main feature of the Eurocrisis was that it didn't proceed linearly, but events developed, month after month, through a striking series of more and more dramatic waves, that repeatedly put the common currency – as well as the economic system in Europe, and not only – on the brink of the abyss. And whenever policy makers seemed to set the

[30] For an account of the evolution of the crisis in Italy, with interesting insights on the national political interplays, see Barbera and Feltri (2014); for a historical perspective on Italian social and political situation engendering crisis, see Amato and Graziosi (2013).

stage to restore confidence, a new drama erupted. With the help of hindsight, since the beginning of the Greek tragedy, up to 2014, one can identify six different waves of the Euro crisis, each representing an acute phase of the crisis and engendering specific policy outcomes.[31] To be sure, even before 2009 Europe had experienced significant financial turmoil due to the subprime crisis in the US[32], warning that the climate was already tense. Indeed, the bankruptcy of Lehman Brothers in September 2008, engendered a series of unfortunate events, up to the definite begin of the Eurozone sovereign debt crisis in early 2010.

3.2.1. Greece and the first wave of the crisis

Between end of 2009 and spring 2010, the first wave of the crisis is represented by the Greek drama. National elections in October sanctioned the victory of the PASOK headed by George Papandreou, which unveiled the previously hidden, enormous, deficit left by the precedent government (14 per cent of GDP, more than three times above the target). At that point, investors almost completely abandoned Greek government bonds, rating agencies downgraded the Hellenic debt, the borrowing costs soared, and Greek GDP consequentially fell sharply. That was the beginning of the Eurozone crisis as we know it. After the formal request from Papandreou, among tense negotiations, a rescue plan was granted to Greece (110€ billion) in the form of bilateral loans by European peers and the IMF, at a "non concessional rate" and under strong conditionality, namely the set up of a harsh austerity plan in order to reassure the markets and contain fiscal deficit and national

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[31] As argued in the methodological section (§2.5.2), the main peaks of the crisis are identified through the observation of the course of CDS on sovereign bonds, a synthetic though accurate indicator of markets' pressure on policy makers (see fig. a3).

[32] In July 2007 the German IKB was bailed out; a month later the French bank BNP Paribas froze two funds heavily exposed to subprime credit; then, in February 2008 there was a run on a British bank, Northern Rock, which was later nationalized. For a reconstruction of the events occurred in the financial sector – and the relative role of central bankers since 2007, see Irwin (2013). For an American perspective on the subprime crisis and the consequent international financial crisis: Blinder (2013).

debt. Its supervision was left to a new established technical body – the Troika – composed by the staff of the European Commission, the ECB and the IMF. For its part, the ECB started an unprecedented operation of bond purchase on the secondary market[33], the SMP (Securities Markets Programme) in order to relax the pressure in the market of sovereigns. Beside, two different instruments were created to provide financial aid to Eurozone members: the EFSM (European Financial Stabilization Mechanism) and the ESFS (European Financial Stability Facility). The former is an emergency funding program guaranteed by the European Commission able to raise up to €60 billion; the latter was a temporary rescue mechanism with a lending capacity of €500 billion, which would act as a firewall against speculation and uncertainty among investors.

3.2.2. The second wave: From Greece to Ireland

That wasn't enough. A second wave of crisis was to come in the last months of 2010, when Ireland came under the attack of financial markets. After that spread on its 10-years bonds soared to the explosive rate of 9%, the once Celtic tiger asked for a financial support (€85 billion delivered in November). That was the first real contagion of the Eurocrisis, that from Greece had moved to Ireland, and would attack other peripheral states. A few weeks before, a hardly visionary agreement between the Chancellor Merkel and the French president Sarkozy – the "Merkozy" duo progressively became a sort of directorate of the Eurozone – panicked financial markets. In a comprehensive agreement on the management of the crisis, in Deauville the couple agreed that future bail outs would require "an adequate participation of private investors", a formula known as PSI – private sector involvement. The official approval by the European Council opened up the space for the "Merkel crash" in the financial markets, in a time when the European Commission was striving to

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[33] European Treaties prevents ECB to directly purchase national bonds (art. 123 TFE). In any case, the official motivation behind SMP was not to help troubled States, but to "hampering the monetary policy transmission mechanism" (Pee and La Guardia 2014: 48).

calm down markets through the presentation of the so-called "Six pack", a set of directives to strengthen fiscal discipline in the Eurozone – which was finally voted after one year. The end of 2010 then saw a new rush of the crisis, requiring a certain activism of European governments, which agreed to raise the capacity of the EFSF, to create a stable mechanism of financial support (the European Stability Mechanism, ESM) and to sign a new treaty for the fiscal consolidation, known as the Euro Plus Pact.

3.2.3. Summer 2011: The crisis hits Eurozone's core

After a period of relative calm in the first months of 2011, markets turned to Lisbon. In May, after an official request by the Portuguese government, a bailout was provided to the country (€78 billion). The rescue was not a real shock for the markets *per se* – they were quite confident that bailout funds would effectively help smaller peripheral economies – but it was traumatic because the fall of Portugal brought about contagion to some of the most important economies in the Eurozone, the ones "too big to save": Spain and Italy. Collectively, the instruments implemented would be insufficient to bail out the two countries. Summer 2011 represented, then, the third wave of the Eurocrisis, the one in which a crack was approaching the core of Europe. The bad situation of Spanish banks, weakened by the housing bubble, and the gargantuan Italian debt began to frighten investors, pushing up the spreads of the two countries. At a time where Italian government headed by Berlusconi seemed unable to counteract to markets' attack, a massive purchase of Italian and Spanish bonds by the ECB, under the SMP, helped to temporarily calm down markets, but the worst was yet to come.

3.2.4. The fourth wave: the Eurozone on the brink

The last months of the year represented, more than a further wave of the crisis, "the point where clearly the Eurozone as we know it could have exploded: it was the feeling [that with] the contagion, at this point, you were on the brink of explosion", according to a French official

(Spiegel 2014b). Along with uncertainties over Italy, in view of a new austerity plan, the Greek government called for a referendum over its membership to the Eurozone. That was the first open and official reference to a possible "Grexit", which precipitated markets' trust, opening up a political tug-of-war in the core of Europe. In a few dramatic weeks, through a European Council and a G20 meeting in Cannes, Italian and Greek governments were substituted by two technocratic cabinets; a haircut of the Greek debt was decided; the Greek referendum was cancelled and a second bailout was offered to Greece (€130 billion), while the European Commission strengthened the fiscal policy framework through the Two pack's proposal – came into force in 2013. Problems seemed to be over when in December European governments agreed on a new Fiscal Compact for a further tightening of fiscal obligations, on a new version of the ESM with more funds, and when finally the newly elected president of the ECB, Mario Draghi, announced two rounds of LTROs (Long Term Refinancing Operations) in favor of European banks.

3.3.5. Greece, again

But again, the situation deteriorated a few months later, and Athens was again the catalyst of a new wave of the crisis. At a time when Hollande was elected as the new French President in May 2012, Greek voters failed to elect a stable majority in the Greek parliament, making necessary a new ballot in June. Though the conservative – and to a certain extent, pro-European – Samaras won in the end, the danger of having a Euro-skeptic government headed by the leftist Syriza's leader Alexis Tsipras[34] again precipitated a Europe-wide panic. The fear of a dissolution of the common currency was still alive, and two bailouts programs and two rounds of debt restructuring seemed not to be enough to revive the Greek economy. Contagion, again, passed towards Italy and Spain, whose spreads approached the psychological threshold

[34] Alexis Tsipras would later become Prime Minister, in January 2015, overly challenging the Troika in order to obtain some sort of renegotiation of Greek debt. New early elections in September 2015 confirmed Tsipras at the head of the Greek cabinet.

of 7%. At a time when the new ESM was still not fully implemented, the intervention of the ECB was providential: in July Mario Draghi announced that the ECB was ready to do "whatever it takes" to save the Euro, and a few months later – against the resistance of German member of the Governing Council, but backed by Angela Merkel – ECB launched the Outright Monetary Transactions (OMT), the nuclear bomb against speculation coming from Frankfurt. OMT are a program of unlimited purchase of sovereigns bonds, to be implemented under formal request of a state and attached to formal conditionality.[35] In the meantime, a loan of €100 billion was provided to Spain for the recapitalization of its banks, and a fundamental rule by the German Constitutional Court legitimated the ESM, which finally became operative in October, eight months after the governmental agreement on its new version.

3.3.6. The final wave: Cyprus' affair

Beginning in 2013, the Fiscal Compact too entered into force, and the combination of the new instruments implemented concurred to a certain optimism. Such optimism was punctually deceived a few months later, when a final – for the moment[36] – wave of the crisis came from Cyprus. The consequences of the international financial crisis and the high exposure of Cypriot banks to Greece sinked the over-sized financial sector of the island, making it necessary an external bailout. Dangerously intertwining Russian political interests – Cypriot banks are full of oligarchs' money – a final compromise was finally found,

[35] Conditionality and formal request by a state are the two fundamental aspects in which OMT differ from SMP, which being limited and without conditionality were effective in the short-run, but hardly successful in the long time (Eser and Schwab 2013).

[36] While writing the dissertation, the expectation that the crisis in Cyprus was the last one was proven wrong. Indeed, in the summer 2015, the Greek crisis erupted again with the distinct possibility that the country could exit the Eurozone, following a non reimbursement to the IMF. The further crisis led to the delivery of a new financial aid program to Greece, the third one, amounting at €86 billion.

under the form of a €10 billion loan and a haircut of banking deposits, with major consequences for the European scenario (Hall 2013; Jones 2013). If the Greek economy is relatively small, Cyprus' can be seen of very relative importance if compared to the Eurozone. Yet, the little island's troubles were big enough to put into question – again – the whole common currency, which after that seemed to very weakly recover. Moreover, it became even more necessary for European policymakers to focus their attention on the creation of a banking union, since the Cypriot crisis was first and foremost a banking crisis.

3.3. General remarks on the Eurozone crisis

Before moving to the test of the leading hypotheses for the three case studies, it is worth providing some general considerations about the origin and the development of the Eurozone crisis, in order to offer a broad comprehension of the events, whose complexity was only partially deconstructed in this short discussion.

Indeed, the interplay among actors was actually complex, given their number and the stakes. The crisis saw the interaction of the immaterial – though highly influential – financial markets, of conflicting governments and different European institutions. In this framework, a convincing narrative of the events is the one proposed by Bastasin (2012) which sees the crisis as a tug-of-war between European governments, retrenched in their national interests and unable to offer a Europe-wide solution to the crisis, and European institutions – ECB, more specifically – forced to become primary actors, often beyond their formal powers according to the treaties. If on the one hand, states cannot be held the sole responsible for triggering of the crisis, on the other much of the fault for its deterioration is in their hands. If sclerotic financial markets and inadequate framework of the common currency decidedly contributed to the explosion of the crisis, the strategic disputes within the European Council and the Ecofin were key to the dramatic exacerbation of the crisis.

As a general result, by no doubt, the Eurocrisis contributed to enlarge economic and political divergences among member states, with a core of countries opposed to peripheral ones. A sort of hierarchy among creditor and debtor countries has been constructed, and it will probably continue to influence EU political life: the formal equality among member states has progressively disappeared in the concrete development of events – more than ever happened over the integration process, actually. Germany, thanks to its undoubtedly good economic performance, acted as a clear veto player in many policy aspects, and yet failed to act as a true hegemonic leader capable of steering a path to resolution (Bulmer and Paterson 2013; Newman 2015). As the ringmaster of the crisis management, Germany tried to impose a simple equation to peripheral states: solidarity – that is, financial aid – must come only after the respect of harsher fiscal rules. The following analysis will highlight how much the overwhelming bargaining power of Germany reflected on policy outcomes. Indeed, thanks to its better bargaining resources and, over all, thanks to a better fallback position in case of negotiations' failure, Germany became the most important actor of the strategic setting of the Eurozone.

Finally, the reconstruction deliberately overviewed the fundamental issue of the relation between democracy and democratic accountability, market expectations and political decision making. The appointment of technocratic governments in Italy and Greece in 2011, the empowerment of non elected body such as the Troika in the elaboration of economic policies, as well as the direct role played by the ECB in exhorting – or even blackmailing – national governments in undertaking austerity-driven reforms[37] were all of primary importance in this perspective. The crisis showed that the timing and the priorities of financial markets do greatly differ from those of democratically elected governments, and of bruxelloise negotiations even more. Moreover, it showed that states were found completely unprepared to

[37] In August, 2011, the ECB sent two letters to Italy and Spain – at high risk of financial contagion – in which it explicitly dictated the instruments of economic policy to be implemented in a short time. The counterpart of these reforms would be the maintaining of purchase of Italian BTPs and Spanish *bonos* through the SMP. The letter to the Italian government was immediately leaked (Corriere della Sera 2011), while the contents of the one to Spain were known only two years later.

face such challenges, transforming a financial turmoil into a historical economic defeat.

Chapter 4
The evolution of the rules of fiscal discipline

The first case study under scrutiny is represented by the transformation over the last years of the rules of fiscal discipline for the members of the Eurozone, in a complex process of revision and strengthening of the provisions of the Stability and Growth Pact (SGP) agreed in 1997. The aim of the chapter is to provide the first empirical examination of the process of institutional change that occurred during the crisis, testing the three leading hypotheses in the narrower context of the evolution of a specific policy.

A preliminary caution is in order. It can be difficult to completely isolate the events surrounding a specific policy area from those that occurred in other sectors, given the high level of interdependence of different levels of the crisis. For instance, negotiations over the reform of the SGP largely overlapped with those on financial assistance programs, and policy outcomes were sometimes the result of cross-sector negotiations. In fact, while the former represents the "stick," the latter is the "carrot" offered to distressed states.[38] That said, events, preferences and issues of every specific policy will be isolated analytically as much as possible from others. A second caution concerns the policy-specific objects of analysis. When not specified, rules of fiscal discipline are observed in processes of rule creation and adoption, with a focus on the policy process leading to outputs and the strategic interaction among actors underlying their creation, rather than their effective implementation over time, which would require a closer observation of their impact on the long-time. This is problematic given the time proximity and would, in any case, represent a different research focus. For the purpose of the

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38 Methodologically, this means that the three case studies are not causally independent, but certain elements of the strategic setting of one could well be be relevant for others, an unavoidable feature while dealing with such a level of policy interdependence.

dissertation, for instance, it is not of fundamental importance whether a state does or does not comply to a Commission's recommendation in view of adopting a national budget, but it is important that the Commission has acquired over time the power of issuing such recommendation *before* the budget is written – or before it is voted in national parliament.

Fiscal rules are a fundamental element of the EMU's framework – EU treaties make explicit reference to the necessity of fiscal policy coordination among member states (art. 119 to 126 TFEU) – because they force member states to maintain their fiscal dynamics under more or less controlled paths, prudently binding their behavior in public spending. The rationale behind this sovereignty limitation is linear: in a monetary union unsustainable fiscal dynamics in one country may trigger dangerous externalities, forcing other states to bear the costs produced by non prudent behavior, namely inflationary debt monetization and the eventual necessity of fiscal transfers towards "undisciplined" countries (Buti and Carnot 2012: 900). A transfer union is precisely what Germany and some other countries wanted to avoid while constructing the EMU – and still today, apparently (The Economist 2010). Nevertheless, the rules agreed before the onset of the crisis proved insufficient to constrain states' behavior and to prevent contagion of the crisis among member states. Thus, events triggered the necessity of further constraining member states' fiscal discipline, the end result of which was the adoption of new treaties (the Euro Plus pact[39] and the Fiscal Compact) and of brand new secondary legislation (the sets of directives in the Six Pack and in the Two Pack) that, taken together, represent a comprehensive and substantive reform of the SGP.

The aim of the chapter is to observe the progressive reform of the SGP throughout the crisis years and then use collected data to test the three leading research hypotheses, as well as the underlying conjecture according to which economic crises do foster an effective

[39] The contents of the Euro Plus Pact will not be closely scrutinized, as the agreement focuses much more on instruments to foster European countries' competitiveness. It also includes provisions on fiscal discipline, namely the engagement to translate budget rules into national legislation, which were later confirmed and formalized in the Fiscal Compact.

supranationalization of EU policies. Each of the three hypotheses will be tested by linking specific independent and dependent policy specific variables (table 1).

	TYPE OF VARIABLE	POLICY-SPECIFIC VARIABLE	POLICY-SPECIFIC INDICATOR
H1	**INDEPENDENT VARIABLE**	Pressure on policy makers	- Course of yields' spreads and CDS (2010-2014)
	DEPENDENT VARIABLE	Policy outcome	- Amendment of existing fiscal rules - Adoption of new rules in the field of fiscal discipline
H2	**INDEPENDENT VARIABLE**	Modes of decision making: intergov./ supranational	- Presence of international agreements - Presence of intergov. negotiations - Presence of unanimity regime (or, conversely) - Adoption of outcomes via community method - Adoption of new instruments by supranational institutions
	DEPENDENT VARIABLE	Policy success	- Possibility of easy enforcement of the rules - Low level of politicization of rules' enforcement - Low flexibility in rules interpretation
H3	**INDEPENDENT VARIABLE**	Policy failure	- Politicization of the enforcement phase preventing the effective implementation of rules - High flexibility of rules' interpretation - Lack of effective enforcement of rules
	DEPENDENT VARIABLE	Supranational delegation	- Formal act of delegation to supranational institutions (e.g. Treaty change) - Upload of competencies for policy management (e.g. implementation or monitoring phase) - Creation of new legislative procedures empowering supranational institutions

Table 1: Reform of the SGP: Relevant variables and indicators of the case study.

As discussed in the theoretical section (§2.4), the three main hypotheses of the dissertation are the following ones:

> H1: An economic crisis is a fundamental driver of major institutional changes, both in terms of their quantity and quality;
>
> H2: Intergovernmental policy making tends to have incremental and ineffective policy outputs and to create institutional deadlocks; conversely, supranational policy making tends to have successful and more effective outputs;
>
> H3: In the case of policy failure due to irreconcilable conflicting interests or institutional deadlocks, a process of delegation to a neutral – i.e. supranational – actor occurs, resulting in an empowerment of supranational institutions *vis-à-vis* member states.

The chapter is structured as follows. First of all, a brief outline of the functioning of the SGP is provided in order to better appreciate the institutional change that occurred over time, namely before/after the crisis. I'll then provide an analysis of the comprehensive reform of SGP adopted in the last years. After defining the relevant actors and assessing their assumed positions over outcomes, the strategic interaction behind the adoption of each output will be analyzed. Finally, the leading hypotheses of the dissertation will be tested, drawing on the empirical date. Some concluding remarks and an assessment on the overall significance of the policy in the broader context of European integration will complete the analysis.

4.1. Fiscal discipline before the crisis: The Stability and Growth Pact

After creating the EMU and setting up the rules to access it, states realized that no provision was there to discipline behavior once a state joined the common currency. For this reason, Eurozone members agreed in 1997 to sign the Stability and Growth Pact (Council of the European Union 1997a, 1997b) to enforce the monitoring and coordination of fiscal policies in order to assure sound public finances. Formally, the pact is composed by two regulations, whose dispositions are recalled in the protocol n. 12 attached to the treaties.

The SGP is composed of two main pillars: a preventive arm and a corrective one.[40] The preventive arm set up targets of fiscal discipline for member states, namely fiscal positions close to balance or in surplus, so that in bad times the annual deficit should not exceed 3% of GDP. In order to achieve this, member states set an annual Medium-Term Objective (MTO) for maintaining a safety margin and guaranteeing a progress toward a sustainable budget position. The European Commission (EC), in case of any deviation from the MTO's objectives, triggers a warning, and even sanctions in case of significant gap – up to 0.5% of GDP in case of repeated failure. The corrective arm, for its part, copying nominal convergence criteria from the Maastricht Treaty (public deficit under 3% of GDP and public debt under 60% of GDP), illustrated the reduction steps to be undertaken in case of acknowledged excessive deficit or debt. Failure to respect these targets may engender an Excessive Deficit Procedure (EDP) by the EC. In both cases, sanctions were preceded by early warnings by the Commission, then by an examination of the Ecofin, and only after a vote by qualified majority – on the bases of a recommendation of the Commission – could the Council impose sanctions to undisciplined member states. As a result of this set of institutional rules, and mainly due to the possibility given to the Council of opposing a sort of veto on penalties, no sanctions were ever imposed to member states. In 2003, at a time when France and Germany came under the EDP, Ecofin refused to deliver sanctions against the two countries, revealing the main deficiencies of the SGP's enforcement framework, i.e. non automatic sanctions and political interplays within the Council capable of interfering with the rules. In the event, more powerful countries proved able to ignore the procedure at will, seriously undermining the overall sense of collective discipline.

Moreover, a reform to the SGP in 2005 introduced the concept of a "structural balanced budget," which is an accommodating measure that "purges" the nominal government balance from the effects of an eventual recession, thus taking into account difficulties presented by

[40] For a technical presentation of the SGP, see Geeroms et al. (2014: 245-255); for a thorough discussion on the political rationale of SGP and its enforcement over years, see Heipertz and Verdun (2010).

the economic cycle. An explicit reference to "individual national circumstances" was added, which has the effect of justifying eventual infractions to the pact (e.g. the high level of private savings of Italian households). Then, further flexibility was put into the pact, relaxing the timing for correcting excessive deficits, which resulted in a *de facto* watering down of the pact's provisions. In particular, the ambiguity inherent in vague concepts such as "consideration of individual national circumstances" and "exceptional circumstances," as well as the unclear delineation of precisely what would constitute a structural balanced budget represented a set of *ad hoc* escape clauses included by member states in order to decrease the possibility of having penalties imposed on them for errant behavior.

In retrospect, the pact was never actually enforced strictly, especially considering the favorable economic conditions of the decade, leading observers to speak of "wasted good times" (Schuknecht et al. 2011). An overly flexible interpretation of rules (in practice, the threshold of 3% represented a target rather than a hard-limit), the lack of strong incentives to comply, the absence of automatic sanctions, and political argy-bargy among member states undermined the economic rationale of the rules of fiscal discipline embedded in the pact, opening up the stage for the outburst of the crisis, and the urgent necessity for their reform.

4.2. Fiscal discipline after the crisis: A step-by-step reform of SGP

Beginning in 2010, when the international financial crisis had already affected the European economy, the newly elected president of the European Council Herman Van Rompuy was given a mandate by the EU member states to establish a task force, along with the European Commission and the ECB, to design a renewed framework for economic surveillance. The "Van Rompuy Task Force", a clear sign of the progressive intergovernmentalization of the crisis management[41], issued its proposals in October (Van Rompuy Task Force 2010), anticipated by those of the ECB (2010). Concerning the fiscal policy framework, both documents pledged to enhance fiscal surveillance in order to avoid negative spillovers among member states. Some of their suggestions were progressively implemented over the crisis' years through different legislative instruments, but the modalities of such reform remained contested. The different actors at stake, indeed, given their divergent preferences over outcomes, determined a strategic interaction leading to the measures adopted, resulting in a series of fundamental institutional changes.

4.2.1. Assessing actors and their preferences over new fiscal rules

Though conscious that the SGP had failed to prevent the spillover of fiscal troubles among member states, member states and European institutions could not agree on the design of the new rules of fiscal discipline. Indeed, the issue raised a tug-of-war among different groups of actors, each supporting a different vision of the transformation of the legal framework. The great debate was the one opposing discipline to solidarity (Geeroms et al. 2014: 244): at different degrees, actors can be situated in the continuum spanning from the pole of those demanding harsh measures of fiscal discipline and a rules-based and automatic sanctioning system and the other of those claiming for much more flexibility in the system, the recognition of country-specific situations and formalized instruments of solidarity towards members in financial troubles.

The main representatives of the first group of states are northern creditor countries, i.e. Germany, Netherlands, Austria, Finland and

[41] It is to be noticed the coincidence between the beginning of the crisis and its management with the implementation of the Lisbon Treaty (Dinan 2011), that came into force in very late 2009, and whose provisions contributed to give further visibility and responsibilities to the European Council (Puetter 2012, Fabbrini 2013).

Slovakia.[42] They saw the tightening of fiscal discipline rules as a necessary, and preliminary, step before any provision of financial aid to presumed profligate states. Common guarantees backed by creditors may come only after a process of structural convergence, with tighter rules as the main element, in a sort of "Germanization" of Europe (Bastasin 2012: 308). Their rationale was both economic and moral. In economic terms, the definition of clear-cutting rules and their effective enforcement was considered as a necessary firewall against negative externalities in the Eurozone and a precaution against fiscal transfers toward peripheral states. The Eurozone crisis, however, contributed to transform normal political interplays into a morality play (Hewitt 2013:107): for Germany, "deficit sinners" were to be punished, and rules to be obeyed. According to Germany and to its close periphery, to the extent that one can realistically presume from officials' declarations, such rules would imply automatic sanctions for non-compliant countries, up to the suspension of voting rights in the Council as well as the suspension of development and agricultural funds (Spiegel 2010). Moreover, according to German finance minister Schäuble, the European Commission shall have a formal veto right over national budgets, so as to preventively block any possibility of unsound policies through the independent figure of a commissioner for economic and monetary affairs (Pisani-Ferry 2014: 111). German chancellor Angela Merkel went as far to propose the exclusion of rule-breakers from the Eurozone (Euractiv 2010). All in all, a tougher SGP resided as one of the key pillars strongly supported by creditor countries all along the crisis, together with the respect of the no-bailout clause and the independence of the ECB.

[42] On the definition of "creditor" – that is, a country showing a surplus in the balance of payments, thus able to finance foreign net investments – it has to be noticed that if it was true at the beginning of the crisis for all the countries here recalled, over the last years a few of them (e.g. Finland and Netherlands) lost this status, remaining however member of the northern/surplus coalition. In this sense, it holds the observation made at §2.3.2 (footnote n. 10) on the application of these generalizations to each member of the two groups of states identified.

On the other side, peripheral debtor countries strove to have as much flexibility as possible in the renewed SGP. Headed by France, the group was composed of Greece, Spain, Portugal, Italy and in general by those states in fiscal troubles. According to their diagnosis, states under markets attack are not fiscal sinners, but victims of financial speculation (Hewitt 2013: 107). Hence, tighter rules are necessary, but their preferences are for a flexible system, in which governments may retain their possibility to impose sanctions on their peers (Bastasin 2012: 225), in a process that remains highly politicized. Moreover, debtor countries fought to inverse the temporal sequence between financial support and rules: these may come later, once financial assistance is provided to weak states, so as to prevent contagion first of all. To this, a further divergence was in the form in which these rules may come: according to Germany, a treaty reform was necessary to make commitments more credible (ibid: 209; Hewitt 2014: 214), literally "legally unchallengeable" (Peel 2010), while other states opposed this solution, aiming at a simple amendment of EU legislation.

The Franco-German couple, then, emerged as quite a strange creature. If indeed they led together much of the crisis management, the couple – with no significant differences between the presidency of Sarkozy up to 2012 and the one of Hollande onward – was internally divided even on the great orientations. Indeed, each one of the two countries was the champion of a different vision of the crisis management. Interestingly, Hewitt (2014: 98) argues of "opposite twins". Between the two poles, and paradoxically enough, the UK's position was that of pushing forward European integration, by tightening fiscal rules. While reaffirming British opt-outs concerning fiscal policies, however. More and more biting rules, then, but just for Eurozone members. Indeed, all over the crisis' years, the UK position was one of guaranteeing that Eurozone troubles would not spread towards London, striving to maintain at the same time the privileges that the UK had achieved over time, namely concerning financial supervision. According to observers, such attitude turned out to make Great Britain largely irrelevant and isolated in the negotiations, and even more during those for the writing of the Fiscal Compact (Hewitt 2014: 215-234; Peet and La Guardia 2014: 115-120).

Beside states, European institutions were on the front line for the enhancement of the SGP. Indeed, being the process represented not only by a new treaty creation but also by the renovation of secondary legislation, supranational institutions were fully involved in the process. The Commission, first of all. Realistically, the executive's initial preferences were twofold: on the one hand, it wanted to secure the fact that the process of SGP's reform would walk along the community method – in a time when the creation of the Van Rompuy task force prefigured an "intergovernmentalization" of the crisis–management. In other words, the Commission presumably aimed at confirming its role of agenda-setting over the claims of European Council. And it is not a case that there was a competition between the two bodies to lead the debate, by issuing its own proposals before the other (Chang 2013a: 162).[43] As well as it is not by coincidence that the Franco-German duo interfered with the Commission's work through formal and informal messages (ibid.). On the other hand, the Commission aimed at reinforcing its own position, to the detriment of member states, by enhancing its control over budget rules, with the aim of introducing automatic sanctions in order to sideline Ecofin in the EDP, or at least impede that a simple majority vote of the Council may override a Commission's decision over fines.

The European Parliament, in line with the Commission's preferences, aimed at securing the community method first of all, because a policy "re-intergovernmentalization" would completely marginalize the EP itself. Notwithstanding the political and national cleavages within the parliament, an official document shows the EP's preferences over fiscal rules at the beginning of negotiations (European Parliament 2011): automatic sanctions for rule-breakers, a clear definition of states' engagements to re-enter within fiscal limits, and more transparency of the whole process – i.e. more involvement of the EP and open–door decisions on fiscal issues within the Council.

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43 Interestingly, borrowing from principal-agent theorizations, Chang (2013a, 2013b) suggests that the "Van Rompuy Task Force" was created by the European Council (principal – or better, multiple principals) as a "police patrol" in order to take under control the Commission (agent) and defend principal's interests while rewriting SGP.

The ECB's attitude toward the tightening of fiscal rules, laid down in a clear-cutting list of eleven priorities for the reform of the governance of the common currency (ECB 2010a), was the one of determining a "quantum leap" toward a more integrated Europe. Concerning fiscal discipline, the ECB proposed an independent fiscal agency under the European Commission, in order to depoliticize the enforcement of fiscal rules (Bastasin 2012: 222). In this sense, the ECB was very sympathetic with the Commission on the modalities of reforming the SGP, calling for an empowerment of supranational institutions in order to enhance credibility and offer concrete enforcement to rules.[44] Deprived of formal decision making powers, the ECB did not intervene in the reform of SGP, but it enjoyed a *de facto* political weight since it was a fundamental player in the realm of financial assistance to member states. And since it operated according to the underlying idea to intervene in sustaining member states only after obtaining their serious commitment to fiscal discipline[45], its vision has been taken into great account. The list of possible reforms envisaged by the Frankfurt-based institution includes greater "automaticity" and stricter deadlines in the sanction procedure, so as to eliminate escape clauses, increased reporting obligations for non-compliant member states as well as possibility of review mission by the European Commission – and the ECB, of course. In addition, ECB praised for more ambitious and legally binding benchmarks for establishing the existence of a public deficits and for improved quality of national data and statistics.

In the complex renegotiation process of the SGP, coalitions of interests and preferences were then differentiated and radically divided over different cleavages. On the one hand, those seeking hard and binding rules – creditor countries plus supranational institutions – were opposed to those more disposed to to fiscal flexibility and solidarity. Nonetheless, a typical cleavage among states and institutions was

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[44] In this sense, the ECB can be methodologically considered as an external ally (without formal decision making powers) of a coalition of actors empowered with formal powers.

[45] See for example the declaration by Mario Draghi (2011) on the necessity of a binding fiscal compact.

equally at stake, the former, both creditor and debtor countries, aiming at leading the process in an intergovernmental way – through treaty reform and eventually parallel intergovernmental agreements – and the latter pledging for a global reform within EU legal framework.

During the negotiation process leading to new fiscal rules, outcomes were variously determined by different elements, such as the institutional framework surrounding the decision making process and the capacity of actors in advocating their preferences over others', as well as their relative weight. Indeed, not all the actors faced negotiations at the same level. On the contrary, structural conditions heavily influenced the process: countries in fiscal troubles, needless to say, were in a very weak position while negotiating, because their fiscal profligacy, presumed or not, made them barely credible in defending the possibility of a very soft tightening of rules. On the other hand, creditor countries were in the strong position to impose their point of view. In addition, they were highly motivated in tightening rules because eventual fiscal transfers would weigh for the most part on their shoulders. Such asymmetry among actors in resource ownership if on the one hand decidedly influenced the path of negotiations toward a progressive tightening of fiscal rules, on the other highlights the nature of distributive policy of the reform of those rules, making distributional rational choice the most accurate explanation for the institutional change at stake. Fiscal discipline rules, indeed, are not financially neutral, as they involve fiscal consolidation, supply-side policies' reconfiguration and eventual fiscal transfers.

4.2.2. The European Semester

The first recommendation of the Van Rompuy Task Force to be implemented was the so-called European Semester, aimed at reinforcing the *ex ante* dimension of fiscal policy coordination, considered to be too fragmented. In a communication the European Commission (2010a) proposed to synchronize the budget drafting procedures in the member states, so as to guarantee a coordinated and consistent guidance to all the European countries. This process, the European Semester, became effective in January 2011.

It consists in a cycle of economic policy coordination which starts in January and lasts for about six months – hence its name – and has to be repeated every year. At the beginning of the year the Commission presents an Annual Growth Survey, where it sets out the main priorities to be fulfilled by member states. After discussions within the Council and the European Parliament, the document is endorsed in spring, when the European Council invites member states to take into account those priorities in the drafting of the annual budget. Alongside this, the European Commission elaborates country-specific recommendations, policy guidance documents which are to be followed by member states. On the bases of policy guidances, each state has to present to its peers a Stability or Convergence Programme (SCP) in April, then *before* the discussion in their respective Parliaments, which gave rise to some doubts about the democratic legitimacy of the measures (Hallerberg et al. 2011). The semester cycle ends with the Council's elaboration of country-specific policy recommendations based on the SCP, which then feeds in to the final drafting of the budget in the last part of the year. The Commission subsequently analyzes budget outcomes in the Annual Growth Survey at the beginning of the following year.

The European Semester is designed explicitly as a six-months timetable to be followed by member states and the Commission in order to align the timing of budget elaboration, but also the coordination of fiscal policy among member states. The intention here is to establish synchronic and consistent policy guidance issued from a common document at the beginning of the year and, most importantly, an aligned system of budget monitoring.

The Commission's proposal for the adoption of the European Semester came in May 2010, at a time when the crisis in Greece begun to severely concern financial markets; it was also present in the VRTF's proposals and an agreement was found before the end of the year, in order to begin to implement the instrument in 2011. Being a sort of code of conduct, rather than a rigid set of binding rules, and basically residing in the area of policy coordination, the adoption of the European Semester did not find any major obstacle in the process of adoption. Preferences, indeed, were not so divergent so as to shape a considerable strategic interaction among actors. Still, the fact that the same procedure was envisaged both in the Commission's proposal and in VRTF's document[46] – respectively advocating supranational and intergovernmental principles – and that the negotiation process was very quick, demonstrates that the measures proposed were already a good compromise for actors at stake. On the one hand those pledging for tighter fiscal rules, were glad to insert some sort of Europe-wide coordination in the writing of national budgets, and on the other member states were all satisfied with the relative freedom they still maintain in the practical elaboration of their budgets, which would be undermined only with provisions of the Six Pack to be approved in the following year. What is to be noticed, however, is that such relative consensus over rules was a direct consequence of the climate of economic incertitude, which begun to be felt in 2010 after the the unfolding of the Greek drama, making member states aware that some sort of fiscal coordination was necessary at least to prevent any further crisis. In any case, the institutional change triggered by the European Semester, thus the provision of an *ex ante* coordination in the writing of national budgets, does not contemplates any formal obligation or binding clause, as the measures to come would.

4.2.3. The Six Pack's provisions

While the European Semester provides a timetable for enhancing fiscal policy coordination, the set of directives known as Six Pack[47] offers a

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[46] The VRTF's press release explicitly refers to the Commission's proposal of a European Semester, and the proposal was officially incorporated in the VRTF works in June 2010 (Chang 2013b: 260). For a closer analysis on vote behavior at the European Parliament, see Schwarzer 2013.

[47] The Six Pack draws its name by the composition of the legislative package: five regulations and a directive (three regulations and the directive on fiscal policy and two regulations on macroeconomic imbalances). More specifically, the regulations are the n. 1173/2011 on the effective enforcement of budgetary surveillance in the Euro area,1174/2011 on enforcement action to correct excessive macroeconomic imbalances in the Euro area, 1175/2011 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, 1176/2011 on the prevention and correction of macroeconomic imbalances, 1177/2011 on speeding up and clarifying the implementation of the excessive deficit procedure and the directive 2011/85/EU on requirements for budgetary frameworks of the member states (to be implemented before the end of 2013).

comprehensive – though incomplete, given the further measures to come – reform of the SGP. Agreed in September 2011 according to the community method, it entered into force in December, and represents a formal amendment of the preventive and corrective arms of the SGP along with some further dispositions for member states.[48]

Concerning budgetary discipline, the Six Pack formalizes the introduction of the European Semester into the EU legislation; it maintains all the provisions of the SGP concerning early warnings in case of significant deviation from the medium-term target and the EDP, though accelerating the timing and reinforcing the amount of sanctions to undisciplined countries (namely, sanctions are gradually delivered at an early stage of the EDP and not in the end); it provides new technical tools to measure growth of public expenditures in order to have more accurate data and limit the possibilities of public deficits (i.e. a benchmark is introduced to target public expenditure growth at a rate equal or lower than GDP's expected growth); it includes further fines for countries misreporting their national data and the possibility for the Commission to enhance the surveillance over public finances through review missions of its staff in European countries, with the eventual presence of ECB's staff in case of Eurozone member states. Moreover, unlike previous provisions focusing almost exclusively on national deficits, greater attention is devoted to countries with high levels of public debt. A progressive path towards debt reduction is foreseen in

[48] For a comprehensive assessment of the novelties introduced in the secondary legislation see the economic governance review of the European Commission (2014a).

the legislative package through an operationalization of debt criteria, so as to enhance the sustainability of their public finances.[49]

More importantly, a proposed amendment in the voting system for the EDP represented a significant change in institutional rules. Before the reform, members of the Council voted to deliver sanctions by approving the Commission's proposals and recommendations by simple majority, which in 2003 made it possible to stop the sanctions proposed by the Commission against France and Germany. According to the "reversed qualified majority" (RQM) method established after the reforms, a majority vote is needed to block Commission proposals, rather than to confirm them.[50] As a result, the process of imposing sanctions, while not being completely automatic, is substantially more routine today than before the crisis.

Official proposals for a Six Pack were issued by the European Commission in September 2010, during the second wave of the crisis, and were largely tailored on the VRTF's report, which represented a sort of non-formal delimitation of the Commission's freedom in the agenda-setting phase. On the base of the VRTF report, indeed, the Commission acknowledged what European governments were ready to accept in terms of fiscal rules' reform, then it avoided to present a too ambitious reform package, knowing that this would obtain a firm opposition by member States. In this sense, the institutional setting was functional in determining actors' strategic behavior and in shaping the

[49] Beyond the object of the case study but equally worth to be mentioned, two regulations of the Six Pack create a brand-new Macroeconomic Imbalance Procedure in the framework of a stricter surveillance of macroeconomic imbalances among member states, by taking into account macroeconomic elements such as external imbalances, competitiveness, asset prices, and internal and external debt (Geeroms et al. 2014: 258-263). The aim of these measures is to alert states, and eventually sanction them, about major macroeconomic imbalances that can mine financial stability and engender negative spillover effects among members, but they've not yet found concrete implementation.

[50] More precisely, if the Council does not vote nor approve a recommendation, the Commission can – after a month – present the same recommendation and have it automatically adopted unless a majority vote of the Council refuses it within ten days.

information structure. The strategic interaction behind the adoption of the legislative package partially overcame the boundaries of fiscal policy, overlapping the one of financial support to troubled states. Indeed, initial preferences of actors made it very difficult to find an agreement with respect to the "automaticity" of sanctions in case of non compliance to the SGP's provisions, on their timing and amount, as well as on the balance of power among European institutions and states, and on their degree of flexibility in the elaboration of national budgets.

The tug-of-war over the Six Pack pitted the Commission, the European Parliament and creditor countries plus the UK and the ECB against debtor countries. Even before the delivery of the Commission's proposals in July the German minister of finance sent a paper to his peers to claim the inclusion in the future revision of treaties of a clause for politically sanctioning rule breakers through the suspension of voting rights within the Council. That was probably an attempt to show how far Germany would go in order to affirm the necessity of fiscal discipline. A first comprehensive solution came in the agreement taken by France and Germany in the Deauville meeting[51], one of the milestones of the Eurozone crisis. In October, when the Irish banking system was on the brink of collapse, Chancellor Merkel renounced to automatic sanctions in exchange of a treaty revision which would suspend non-compliant states' voting rights within the Council (Euractiv 2010).[52] Of course, German concession was made in view of a future renegotiation of treaties, which with hindsight never occurred in

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[51] The same meeting in which Angela Merkel agreed to create a non temporary rescue mechanism in exchange of the involvement of private sector in the eventual default of Greece, which for its part demonstrates the high interdependence among the issues at stake (see §5.3.3).

[52] Interestingly, Franco-German compromise of October 18th was reached between Sarkozy and Merkel in Deauville while the Ecofin was discussing SGP's reform in Brussels. Hence, while the German-led coalition was fighting for automatic sanctions in Brussels, German delegation discarded its own proposal in view of a more comprehensive agreement on the crisis management, with great surprise of Swedish, Finnish and Dutch negotiators, and great disappointment of ECB's President Trichet (Chaffin and Spiegel 2010).

the way prospected in Deauville, and any voting limitation was never included in the EU legislation. However, though dropping claims for automatic penalties, the agreement opened up the space for the creation of the RQM voting system, thus the necessity to get a qualified majority within the Council to overrule Commission's sanctions, which is nevertheless ad advancement in the direction of automaticity with respect to SGP's initial provisions. Moreover, it is a concrete enhancement of the Commission's power to detriment of member states, which lose part of the power to limit the behavior of their agent. The greater "automaticity" of sanctions can even be seen as a delegation to supranational institutions of control over the concrete enforcement of legislative provisions. Such delegation can enhance the credibility of states' engagement (Pollack 2003), limiting *de facto* the possibility for member states to indulge reflexively in sub-optimal conduct.

The agreement in Deauville was the main framework of the would-be Six Pack. For its part the European Parliament, enjoying the co-decision legislative procedure providing a sort of veto on the package[53], boldly intervened in the negotiations through more than two thousands amendments to the Commission's text, with the aim of providing automatic sanctions (Chaffin 2011) in line with EBC and creditor countries. In the end, the RQM voting system was agreed by the parliament, that for its part obtained an earlier delivery of penalties for non-compliant states as well as sanctions for countries falsifying national statistics and greater transparency of the process. Moreover, the Commission obtained from the Council the possibility of getting broader informations from member states in order to closely monitor national fiscal evolutions.

[53] More precisely, the EP enjoyed of the co-decision procedure only for four legislative provisions out of six, but it managed to obtain a *de facto* veto power through the so-called strategy of cross-arena linkage, that is, dealing with all the legislative issues as a package under the menace of blocking the whole legislative process (Héritier and and Schoeller, 2015).

4.2.4. The Fiscal Compact

The "Treaty on Stability, Coordination and Governance", better known as the Fiscal Compact[54] is the intergovernmental agreement taken in late 2011 and then signed the following March by 25 out of 27 members of the European Union (i.e. before Croatia's accession). The UK and the Czech Republic, both non-Eurozone countries, elected not to participate. The Fiscal Compact, which entered into force in January 2013, formally resides outside the legislative architecture of the EU, being an international treaty voluntarily signed by contracting countries to circumvent the longest – and politically fatiguing – process of the EU-treaty reform.[55] The result is a somewhat unusual legal creature, which runs separate and parallel to EU legal provisions, but at the same time draws upon EU structures and institutions in its enforcement phase.

In general terms, the Fiscal Compact does not provide any new measure of fiscal surveillance beyond those inserted in the Six Pack. Rather, its objective is to give them "more teeth at national level" (Buti and Carnot 2012: 907). In other words, the agreement tries to confer more visibility and credibility to national engagements in terms of fiscal consolidation. Needless to say, the treaty was forcefully advocated by Germany, under the equation that more solidarity needs more discipline (Baratta 2012). Indeed, the agreement came in the middle of one of the worst phases of the Eurozone crisis[56], at a time when European governments were struggling to restore market confidence

[54] The provisions on fiscal rules are just one part of the TSCG (Title III), but being the most relevant section of the agreement it turned out to give its name.

[55] However, contracting parties pledge for the integration of the Fiscal Compact in the EU legislation within five years (art. 16). Such a "repatriation clause" was demanded and obtained by the European Parliament, which did not participate to the negotiations but succeeded in putting forward another strategy of "linked arena" strategy thanks to the chronological coincidence of Fiscal Compact negotiations and those over the Two Pack (Héritier and Schoeller, 2015). For the reasons underlying the use of international law instead of EU legal framework, see *infra*.

[56] According to the chronology proposed, the Fiscal Compact was adopted during the fourth wave of the crisis (October - November 2011).

after a dramatic summer in which the core of the Eurozone was attacked by speculation and just after the fears of a "Grexit" following the Greek referendum on membership of the Eurozone.

The Fiscal Compact largely reproduces provisions of the Six Pack such as the statement of debt and deficit levels to be pursued, the system of reversed qualified majority and the respect of country-specific Medium Term Objectives. The supposed enhanced credibility – on which observers however have doubts (Feldstein 2012) which reality seems to confirm (Godin 2014) – comes from the obligation for contracting parties of inserting in national Constitutions the set of budget rules, to give them "binding force and permanent character, preferably constitutional". The rules at stake, namely, are the limit of 0.5% of GDP every year of the structural deficit, and the progressive reduction of debt stock of 1/20 of the amount exceeding 60% of GDP every year so as to converge towards the threshold of a sustainable debt. At the same time, the treaty imposes a sort of automatic corrective measures in case of non respect of its obligations, such as the block of national expenses. Another novelty, which is also a naiveté of the treaty, comes from the provision of empowering the EU Court of Justice (ECJ) to impose sanctions to those countries that do not respect treaty discipline, in a sort of external delegation of provision enforcement. Further, the treaty formalizes the Eurosummit meetings, which are to be held at least twice a year.

The rationale of the agreement, then, more than including new provisions in terms of fiscal discipline, is one of trying to enhance the possibilities of having them correctly implemented and enforced by member states, which all through the crisis often promised to undertake costly structural reforms without following through effectively. The insertion at constitutional level of those provisions, as well as the empowerment of the ECJ in the monitoring phase, was thought as necessary by Germany in order to fight against moral hazard. All in all, according to Jean Quatremer (2012), the fiscal compact is just "a treaty aiming at reassuring markets".

Negotiations for the treaty started at the European Council of December 2011[57], as a sort of fiscal tightening counterpart for the anticipation of the establishment of the ESM (Council of the European Union 2011), and two main issues were at stake: the first concerning the form to be taken by the agreement – formal EU treaty revision or parallel intergovernmental agreement; the second concerning provisions of the central part of the agreement, the one about the enforcement of rules. Positions on the new treaty, as usual, were quite diversified (Quatremer 2011): needless to say, the treaty was strongly advocated by Angela Merkel, who desired an official treaty revision in order to calm down internal opposition (Hewitt 2013:214), avoid antagonizing the German Constitutional Court (Bastasin 2012:209) and restore markets' trust. Even though it was backed by most of EU peers, according to one diplomat, "no one else but Germany wanted it" (ibid: 233). The sole explicit opposition came from UK Prime Minister David Cameron, who, miscalculating the German desire to revise treaties and threatening a formal veto on them, proposed a formal protocol to prevent the City from even stricter financial regulation in the future. Moreover, the UK argued for a return to the unanimity principle within the Council for issues related to the single market. That was too much for European partners, who agreed to conclude an intergovernmental agreement outside the EU framework to circumvent the British veto, which concretely isolated the UK. Neither Britain nor the Czech Republic signed the treaty.[58] All in all, such choice helped states avoid a longer process of formal treaty modification, and all the associated political challenges.

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[57] An apocalyptic climate characterized the meeting. During the preparation of the meeting, aimed at demonstrating to markets that a concrete plan for Italy and Spain existed, leaders did not hide the stakes: according to Juppé, French foreign minister, "Peace in Europe was at stake"; Barroso argued that "We must do anything to save the Euro", and Polish foreign minister warned that a break up of the Euro would be apocalyptic (Hewitt 2013: 219).

[58] For an authoritative reconstruction of the British *affair* on the Fiscal Compact, see Hewitt (2013: 215-234). Beside, it is worth to observe that the choice of using international law instead of EU legal framework may not be a premeditated strategy for the "re-intergovernmentalization" of Europe, but rather a consequence of contingencies of the crisis (De Witte 2013).

On the issues tackled by the fiscal compact, Germany proposed an effective "Germanization" of Europe (Bastasin 2012: 308), through the constitutional inclusion of the golden rule into national legislations and an automatic procedure to let ECJ enforce eventual infractions. As the new treaties passed through six different drafts, such dispositions were discussed and renegotiated, leading to a partial tightening and a partial watering down (Krillinger 2012). To start with, the first two drafts contemplated the transpositions of the treaty's dispositions into "provisions of a constitutional or equivalent nature", while the final draft states that such transposition shall happen through "provisions of binding force and permanent character, preferably constitutional", thus letting Ireland use an extra-constitutional transposition to avoid holding a referendum. Nevertheless, the Irish victory came at the price of strict conditionality linking future assistance by ESM to the ratification of the treaty that, for its part, is a clear result for German negotiators. A partial watering-down with respect to the provisions of the Six Pack came with the elimination of the reverse qualified majority principle when it comes to decisions about debt criterion, a measure fiercely sustained by highly indebted countries, headed by Italy.

Concerning the role of ECJ, a first draft permitted any country to bring a case before the court when in its view another state had failed to comply with the its treaty obligations. A further tightening came when it was decided to allow the Commission to bring case before the court of its own volition. However, the final draft (art. 8) states that the Commission can only issue a report, and when confirming the incorrect application of norms, only states may bring a case before the Court, which represents an element of flexibility and politicization in the system. That is, the depoliticized process of external delegation to a supranational institution in the enforcement phase comes only after a politicized step, i.e. the decision by a member state to bring the case before ECJ.

All in all, a general assessment on the new treaty has two consider two contradicting aspects. On the one hand, the presence of an external enforcement mechanism – in the form of the ECJ – is a clear success for creditor countries and for those institutions seeking binding fiscal rules. On the other hand, a certain ambiguity resides in the definition of public finance objectives[59], and the eternal presence of justifying "exceptional circumstances" makes the fiscal compact a binding agreement, but with substantive escape clauses for member states. Again, ambiguous definitions and the possibility of open interpretation bring about low possibilities of straightforward enforcement of rules, to the detriment of the quality of institutional change. Acknowledging these features, financial markets quickly discarded the agreement, which in hindsight turned out to be minimally effective treaty.

4.2.5. The Two Pack

While the Eurozone approached the edge of the abyss in late 2011 and states struggled over the creation of the Fiscal Compact, the European Commission issued two proposals for a further enhancement of the Six Pack, given the shortcomings that emerged in those months, namely the scarce level of compliance of member states of the measures suggested by the European executive. The set of two new regulations[60], widely known as the "Two Pack" came into force in May 2013, after a process of negotiation which took place under the terms of the community method.

The two regulations provide extra coordination and monitoring of member states' fiscal policy, building on and complementing the previous measures of the Six Pack (European Commission 2013a, 2014b), and they apply exclusively to Eurozone members and to those states under (or having just exited) programs of financial assistance, including precautionary assistance. Completing the annual timeline initiated by the European Semester, the Two Pack assures that states present to the Commission on October 15th a preliminary draft of their annual budget, which is then discussed within the Ecofin, and then an opinion is issued by the Commission by the end of November. In case of severe non-compliance with the obligations under the Stability and

[59] The Fiscal Compact does not solve the recurrent ambiguity given by the lack of a clear-cutting definition of "structural balanced budget", a concept largely residing in subjective and contingent appreciations.

[60] The Two Pack is composed by the regulations n. 472/2013 and n. 473/2013.

Growth Pact, the Commission can ask the member state concerned to submit a revised plan, before the final approval in the national parliament by the end of the year.[61] If coordination takes place in spring, then, autumn brings about an enhanced surveillance over national budgets.

Moreover, specific measures are designed for member states under EDP – who are obliged to submit a detailed plan of structural reforms envisaged to reduce deficits in a lasting way – as well as those under precautionary assistance, and the ESM's financial assistance program, including those having just exited such a program. For these states, this enhanced surveillance involves regular review missions from the Commission and the submission of full macroeconomic adjustment programs. In the initial proposal of the Commission, which attempted to coordinate EU legislation with the provisions in the Fiscal Compact, a requirement to include the "golden rule" of a balanced budget within national legislation was presented, although this was excluded in the final text.

As one might expect, the Commission's proposal, as had been the case with the Six Pack, sought to enhance as much as possible its role *vis-à-vis* member states, through an unaccountable system of budget revision which gave to the Commission a sort of veto on national budget laws, which was naturally opposed by the member states. They forwarded counter-proposals to engender some balance and flexibility in the system, i.e. a heavier role for the Ecofin and the European Council in the assessment of the validity of national budget rules. Despite these disagreements, a preliminary agreement within the Council was reached relatively easily, and a common position was issued three months after the Commission's proposals, in February 2012.

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[61] In view of the ultimate vote of national Parliaments over budget, according to the European Commission (2013), "the Two Pack does not give the Commission the right to change draft national budgets, nor does it create the obligation for Member states to strictly follow the Commission's opinion". Concretely, though, the Commission has a sort of near-veto on national budgets, especially towards those states weakened by fiscal troubles.

Being the Two Pack voted by the co-decision procedure, the preferences of the European Parliament over the final outcome of the negotiations was fundamental.[62] In this respect, position of the EP was consistent the one taken during the negotiations for the Six Pack, when it sought a greater degree of democratic control and accountability from the Commission, along with measures to "ring fence" social policies against indiscriminate budget cuts and peculiar attention toward economic growth (i.e. less emphasis on extreme austerity) (European Parliament 2012a). The EP's amendments to the Commission's proposals included a roadmap toward the creation of Eurobonds, the establishment of a European Debt Redemption Fund to mutualize ratios of national debt exceeding 60% of GDP, and a program of significant infrastructure investment. In order to counter-balance the empowerment of the Commission on the monitoring of national budgets, the EP proposed a strict collaboration between the European executive and national parliaments, so as to create a collaborative and democratic dialogue among institutions at stake, including the EP (Kovacheva 2012). Lastly, the EP defended the presence of the RQM within the Council in all those aspects related to the budgetary process.

As a result of these contrasting positions, the negotiation process was difficult. It took one year and a half years, and seven trialogues among European institutions to strike the final deal in February 2013, which opened the way for the final approval of the regulations in May.

The final compromise concerned two main issues: the level of sovereignty erosion in budgetary surveillance measures, and the proposed countermeasures to the austerity-focused legislative package. On the first issue, a degree of flexibility was built in to the legislation. No formal obligation for states to comply with measures suggested by the Commission in the budget drafting is included, and if a state chooses to ignore Commission advice and "play hard" with markets, it is free to do so. Moreover, states that do not break fiscal rules are

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[62] For sure, the position here recalled is not the one of the whole Parliament, but that sorted out within the two committees charged of the analysis of the texts (The Ferreira and Gauzès committees, from the names of the rapporteurs). Indeed, the intra-EP discussions were quite politicized on the cleavage over austerity. For a closer analysis of MEPs voting behavior, see Schwarzer 2014.

completely free to choose how to allocate national resources. In the end, an individual state's room to manoeuvre is directly proportioned to its fiscal health: the worse the state's financial situation, the more intrusive the Commission's surveillance (De la Parra 2013). Indeed, given the Two Pack is particularly focused on troubled states, they remain in a very difficult position, and non-compliance triggers systems of closer and closer surveillance restricting countries' leeways (ibid.). The Commission can decide to put non-compliant states under enhanced surveillance, up to suspending all financial assistance in case of severe non-compliance under financial assistance programs.

On the other hand, a compromise was finally reached in the balance between attention to fiscal discipline and growth stimulus and debt mutualisation, strongly claimed by the EP. In this respect, the final compromise was found on the basis of a Commission's commitment to elaborate an official feasibility study on a European Redemption Fund – which in turn is strongly opposed by some member states (Chaffin 2013). Concretely, the Commission won the resistances of the parliament by committing itself in initiating a process of debt mutualisation that will hardly be implemented in the next future. All in all, then, austerity-led measures and fiscal consolidation won – at least on the short-time – over financial solidarity. Anyway, the parliament obtained some concrete results on transparency (De la Parra 2013): the "economic dialogue" among institutions is confirmed and the Commission has to provide explicit reasons behind its decisions on national budget processes. Moreover, some claims coming from left-wing MEPs were accepted, such as the defense of healthcare and education in the processes of national fiscal consolidation.

4.3. Empirical assessment of hypotheses: The case of fiscal rules

The case study on fiscal rules is particularly significant for the empirical assessment of the leading hypotheses, given its specific features. Indeed, among the three case studies, it is the only policy which was duly structured even before the outbreak of the Eurozone crisis. In this sense, the empirical observation of events makes it easier to assess eventual variations on outcomes while confronting the two periods. As a result, the three hypotheses will be tested with reference to the variations that occurred between the pre-crisis period (1999-2008)[63] and the crisis period (2009-2014), so as to confirm or disprove them.

4.3.1. Hypothesis n.1

The first hypothesis asserts that "an economic crisis is fundamental in the determination of major institutional changes, in terms of their quantity and quality", that is to say that policy making is multiplied during economic downturns in order to cope with emerging problems.

Before the beginning of the crisis, fiscal obligations were dictated by the SGP, created in 1997. Scholars agree that following reforms to the pact in 2005 its controls were diminished, through the introduction of the concepts of structural balance and "national individual circumstances". In the period 1999-2008, then, there was no real pressure on policy makers to strictly observe fiscal rules. On the contrary, if a political challenge presented itself, the rules were relaxed, rather than reinforced. Moreover, in practice rules were not enforced, since sanctions on rule breakers were never imposed, because of opposition from within the Council.

By way of contrast, between 2009-2014, a multiplication of legislative outputs was deliberately agreed in order to manage the crisis and prevent the outburst of new ones. In fact, more change has been initiated since 2009 than in the entire decade previous. The Six Pack and Two Pack which both contained several measures of secondary legislation – and Euro Plus Pact and Fiscal Compact intergovernmental agreements, which also determined the inclusion of fiscal rules into national legislation, were significant. In general terms, the Eurozone crisis shaped the environment by "obliging" European actors to take action against the crisis itself. In that sense, it restricted actors' available actions while confronting them with fiscal rules: if *before* the crisis they were divided over the possibility of reinforcing or relaxing fiscal obligations, *during* the crisis the only available action appeared to be

[63] The SGP was agreed in 1997, but its concrete implementation started in 1999 with the creation of the Monetary Union.

tightening. Cleavages among actors certainly existed in the post-crisis period, but only in so far as the *degree* and *modalities* of tightening were concerned.

Moreover, the crisis exercised a tangible pressure on policy makers, and even chronologically speaking, one can find a close connection between the crisis pressure and the outputs adopted. Indeed, major outputs were adopted when the crisis hit the hardest, that is, during "peak" moments of the crisis. Clearly, for those outputs adopted via the community method, one has to consider the date of their initial proposal, rather than the one of of final agreement, since the legislative procedure is time-consuming. In this perspective, the Commission's proposal for a European Semester came in May 2010 (European Commission 2010), during the first wave of the crisis; it was approved just a few months later and immediately implemented at beginning 2011. During the second wave of the crisis (last quarterly of 2010) proposals for the Six Pack were issued. When it comes to the Two Pack, the proposal originated in the dramatic phase of October-November 2011 (European Commission 2011a) considered as a the necessary amendment of the existing fiscal framework.

Concerning the Fiscal Compact, again, its necessity began to be felt during the same phase of late 2011, and its negotiations were unprecedentedly quick. Observers agree that the new treaty's vocation was twofold: internally, it was meant to "constitutionalize" rules of fiscal discipline, and externally it aimed at reassuring markets that EU would not produce another Greece (Quatremer, 2012). Even the formal veto of the UK was not an insurmountable obstacle to the agreement, which was finally settled just three months later.

Seen this way, and considering the complex path leading to the new fiscal rules in 2009-2014, the first hypothesis of the research is proved true. Market pressure on decision makers, unprecedentedly high in the history of the common currency, shaped policy options, making it necessary for leaders to create and implement new rules of fiscal discipline, according to the dominant idea that fiscal rigidity would help calm down markets, re-establishing a normal course for the European economy. Indeed, major outputs occurred when the crisis hit the most, showing that crisis exercised a pressing functional demand for a concrete policy change (see appendix, fig. a4).[64] Crisis, then, shaped the environment in two different ways: on the one hand, it restricted actors' available actions, making it somehow necessary to tighten fiscal rules, and obliging states to negotiate *how* to change rules, rather than *whether* to do so. On the other hand the crisis, through the fundamental role played by financial markets and perfectly illustrated by the course of spreads among sovereigns and of CDS' co-variation, exercised concrete pressure on policy makers even in terms of timing, dictating the timing of reforms, which for a great part were elaborated during the phases of major instability and undertook a quick decision making process.

Finally, the comparison among the pre- and post-crisis period shows how much, taking actors' preferences as fixed, a change in the environment produced decidedly different outcomes, confirming the hypothesis that such independent variable plays a fundamental role in determining, at least, the quantity of outcomes. Moreover, confirming an assumption drawn by distributional rational choice institutionalism, institutional change occurs when an external shock determines a redistribution of power and resources in the system. Indeed, distributional implications were behind the renegotiation of fiscal rules discipline: namely, the crisis increased the fear of guaranteeing fiscal transfers to distressed states, making it necessary to rewrite institutional rules, and during the process asymmetries of resources were functional to the definition of final outcomes.

4.3.2. Hypothesis n.2

The second hypothesis of the dissertation inquires on the eventual role existing between decision making processes and successful/unsuccessful nature of outcomes. In particular, the hypothesis claims that intergovernmental decision making would bring about just

[64] In particular, when considering the outputs adopted by community method (e.g. European Semester, Six Pack and Two Pack), the European Commission initiated the process during a crisis "peak"; while the negotiations for the Fiscal Compact, adopted by intergovernmental decision making, were substantially initiated during a phase of major market pressure.

incremental and ineffective policy outcomes, including the possibility of institutional deadlocks, while supranational decision making, on the contrary, would produce successful outcomes and solve eventual institutional deadlocks. That is to say that the outcomes of negotiation processes are not a pure reflection of actors' bargaining powers, but they are mediated by the existing institutional setting. Institutions, then, coordinate actors' behavior toward certain outcomes and shape the information structure.

In order to prove or confirm the causal link between decision making procedures and the quality of outcomes, a first preliminary step to assess the effective/ineffective nature of the outcomes observed. As it is out of the scope of the dissertation to provide a comprehensive assessment of the long-term impact of new fiscal rules adopted – which, however, would be very partial given the short distance of time passed since their effective implementation – their effectiveness can be appreciated in light of the possibility of their concrete enforcement. That is, though overlooking whether states complied or not to fiscal provisions, a certain policy outcome will be considered as effective if it presents an easy possibility of enforcement. In this sense, in line with what already stated, the former rules of SGP of 1997 were hardly effective. Concrete application of sanctions never occurred.[65] On the other hand, at least in theory, the concrete enforcement of the Six Pack and the Two Pack, given the quasi-automatic sanctions and restricted flexibility of rules, appears to be easier than before. Moreover, one can say that the gradual transformation of fiscal rules was incrementally successful: if the European Semester alone was insufficient, and the Six Pack still showed some shortcomings, the application of the Two Pack seems to complete a coherent framework of fiscal surveillance that has more possibilities to correctly orient states' fiscal conduct in the whole budget cycle.

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[65] The fact of not having penalties delivered can be seen as a sign of the effectiveness of the policy, whose rules would arguably prevent undesirable fiscal behavior. Anyway, we know that sanctions were proposed by European Commission, but the Council expressed negative advice to such recommendations, neutralizing *de facto* the power of rules.

When it comes to decision making processes, it has to be noticed that the SGP was the result of a pure intergovernmental agreement occurring at the level of the European Council on the initiative of the German finance minister Theo Waigel in 1995, which resulted in a preliminary agreement at the European Council in Madrid in 1995, then confirmed in December 1996 in Dublin and finally agreed in the two regulations of the Council in July 1997 (Clergerie et al. 2008: 470-471), and integrated as a protocol to the EU treaties. Concretely, then, states themselves elaborated rules that would bind their hands in fiscal matters, which for sure resulted in a poorly successful agreement. There is a subtle paradox behind the creation of the SGP. The pact, indeed, was created in view of the launch of the common currency because some states were genuinely worried about the fiscal performances of already indebted states – it is not a case that the proposal for a fiscal pact came from Germany. Nonetheless, the necessity of obtaining the unanimity within the Council, as well as the exclusion of supranational institutions from the elaboration of the policy, determined a broadly ineffective policy outcome, and actually the pact could not prevent the outburst of a fiscal crisis in Europe a decade later.

If unanimity regime had been required even for the process of SGP revision, the result would have been probably the same. Instead, what we have seen is that the Parliament, the Commission and the ECB strongly supported a real tightening of rules, and they boldly intervened in the reform of the pact, thanks to the adoption of the community method. As a consequence, the voting system required within the Council was not the unanimity, but the "simple" qualified majority. In this sense, even if a compromise was certainly necessary to recompose inner cleavages within the Council – flexibility vs discipline – it was more difficult to completely water-down fiscal provisions. By consequence, then, the fact of having the SGP's reform under the community method was effectively functional to more concrete possibilities of rule enforcement.

To be more precise, it has to be noticed that in the broad framework of the community method, which involves the agreement of both governments and of supranational institutions for the adoption of a policy outcome, EU institutions pushed for a real tightening of rules, while European governments' intervention was more functional to a watering down of rules. Indeed, the agreement in Deauville between Germany and France eliminated the possibility of automatic sanctions, pledged by European institutions, instead; Italy forcefully obtained the elimination of the RQM in case of assessments on debt criteria. Ireland, for its part, strongly claimed for the consideration of the "quasi-constitutional level" when it comes to the transposition of the rule of balanced budget into national legislation. Given that fiscal policy represents a state's primary means to implement national welfare and redistribution objectives, governments understandably remain quite protective of their fiscal freedom, and quite reticent to surrender their sovereignty to supranational institutions.

To return to the point, it is possible to find a certain link between the procedures of decision making and the effectiveness of outcomes, when it comes to the adoption of fiscal rules. Namely, while a pure intergovernmental decision making process underpinned the ineffectiveness of the original SGP, the community method informing the 2005 reform seems to have provided more possibilities to improve rule design. However, as the analysis has shown, the reform does not guarantee a perfect enforcement of rules, mainly due to ambiguity and a degree of flexibility possible in their application. That is, the set of new institutional rules is not unequivocally designed for a purely effective fiscal framework, but they sketch out an ambiguous system. All in all, then, we can argue for a quasi-successful outcome, which was incrementally ameliorated through the successive amendment of rules, that is, through the passage from the European Semester, to the SixPack and finally the TwoPack. This pattern suggests the necessity of a partial refinement of the hypothesis, i.e. supranational decision making does not immediately provide successful outcomes, but they may undertake an amendment process to get better.

Moreover, according to the reconstruction, the margins of flexibility were largely due to member states' intervention, aimed at protecting their freedom in fiscal matters and budgeting processes. In this sense, the intergovernmental components of the community method, i.e. the vote within the Council, was functional to a certain watering down of rules, while the supranational component, i.e. the Commission's proposal and the EP intervention, was more prone to an effective tightening of rules.

In the light of empirical observation, then, the second hypothesis is partially confirmed: if it is true that intergovernmental decision making prevents the adoption of effective outcomes[66], a supranational decision making process is not sufficient to obtain such effectiveness, as a necessary recomposition of interests in the community method opens up the space for ambiguous measures. Such ambiguity, considered as a quasi-successful outcome, may result in an amendment process, i.e. the adoption of successive outcomes to ameliorate those already adopted.

The hypothesis, however, can be completed by an observation. That is, if it doesn't result a perfect linearity between decision making processes and quality of outcomes, the successful nature of policy outcomes seems to reside in other institutional features. Namely, in the set of institutional rules governing the management of the policy, rather than its creation. That is, fiscal rules appear to be more effective if supranational actors boldly intervene in the application phase. Otherwise, if states are left free to carry out the whole policy management, they operate in the sense of letting fiscal rules be less binding and almost unenforceable. In this perspective, supranational decision making is not *sufficient* in order to get effective outcomes, but it is *necessary* to have also a supranational management of the policy in order to improve the margin of its effectiveness.

All in all, then, institutional rules are fundamental components in mediating the quality of policy outcomes in different ways, and for the case at stake they not only intervene in the decision making procedures, but also in the phase of their effective enforcement. Concerning the case of fiscal rules, then, the second hypothesis can be restated as follows: Intergovernmental policy making tends to have incremental and ineffective policy outputs and to create institutional deadlocks;

[66] A confirmation of this aspect comes from the elaboration process of the Fiscal Compact, which saw the formal veto of UK, which was able to potentially create an institutional deadlock. Indeed, while Germany aimed at formally reforming EU Treaties, the necessity of having unanimity prevented such reform, which resulted in a simple intergovernmental agreement.

conversely, supranational policy making tends to have more successful and more effective outputs, *which might be eventually completed and ameliorated through policy amendment, but additional supranational management of the policy is necessary in order to improve the effectiveness of policy outcomes.*

4.3.3. Hypothesis n.3

The empirical observation of the transformation of fiscal rules offers material to test the third hypothesis, according to which, "In the case of policy failure due to irreconcilable conflicting interests or institutional deadlocks, a process of delegation to a neutral – i.e. supranational – actor occurs, resulting in an empowerment of supranational institutions vis-à-vis member states.". In the case of fiscal discipline, the policy failure at stake is the complete inadequacy of the SGP to prevent a fiscal crisis and a contagion throughout the Eurozone. Indeed, provisions agreed in 1997 and then reformed in 2005, proved to be insufficient to firmly bind states' behavior. Namely, the presence of a number of escape clauses, of a substantial veto of the Council against Commission recommendations, and the fact of relying for the most part on a non-binding system of intergovernmental coordination on fiscal discipline, instead of having binding rules, made the SGP a barely effective instrument of fiscal discipline. The Eurozone crisis, anyway, came to partially subvert such non optimal equilibrium.

The progressive reform of the SGP followed a clear trajectory. As a general rule, there was no real new provision in terms of the fiscal macro–prudential limits on set (the threshold of 3% in the ratio of deficit and GDP and the one of 60% for debt remain untouched. However, there is significantly more emphasis on the instruments of fiscal policy coordination, on monitoring and fiscal surveillance, as well as on the respect of the effective implementation of rules into national boundaries and on the enforcement of the sanctions' framework, through a different vote system within the Council and the involvement of institutions such as the ECJ. As a result, the "new" Stability Pact is more stringent for members of the Eurozone, and the enforcement tools are less discretionary and less politicized. Even if there is still some flexibility in the Pact, the underlying *fil rouge* of its reform was precisely one of de-politicizing the rules' enforcement phase, making it less discretionary and less politically involved. To this aim, the rule of RQM was crafted, and two technical bodies were empowered, i.e. the Commission and the ECJ.

If it is true that, at least concerning fiscal rules, the Commission lost part of its power of agenda setting through the creation of an intergovernmental task force for the reform of the SGP and for the active role of member states in orienting the elaboration of Commission's proposals, the European executive saw during the crisis a substantial increase of its competencies in the area of fiscal surveillance (Bauer and Becker 2014). In particular, the Commission has today the power of managing the *ex ante* phase of budget coordination in line with the dispositions of the European Semester. Furthermore, it has greater role in the delivering of sanctions against non-compliant member states, which kicks in at an earlier stage. Moreover, it achieved a sort of near-veto on national budgeting processes, which is even increased in case of countries in fiscal troubles. Lastly, members of the Commission can now hold review missions on member states, which for their part have the obligation of reporting more and more precise data and statistics. Alongside all this, it has to be noticed that staff of the European Commission remains part of the so-called Troika, which has been accused of undermining national sovereignty and challenging democratic legitimacy when operating in those states under financial aid programs.

Such empowerment came through the creation of new rules (e.g. review missions of Commission staff; creation of *ex ante* coordination of budget drafting), or through the slight transformation of new ones (e.g. the passage from a qualified majority within the Council required for the approval of sanctions to a qualified majority for opposing penalties delivery; anticipation of the phase of sanction delivery), showing that even small changes in institutional rules can have major impact on overall policies.

Moreover, the Commission was not the only technical and supranational body that was empowered. For the first time, indeed, an intergovernmental agreement felt the necessity of involving the ECJ in the monitoring of contracting parties' compliance to the provisions of the agreement. In line with the Fiscal Compact, indeed, the Court in Luxembourg monitors whether or not states transpose the obligation of a balanced budget in the national legislation, though this passage can only be requested by member states and not autonomously by the European Commission.

The rationale behind the empowerment of these institutions, in line with principal-agent theories, is to provide credibility to policies, especially when it comes to the effective implementation of rules agreed, as strongly claimed by the coalition of creditor countries and European institutions. Indeed, their essentially technocratic nature allowed these bodies to be viewed as impartial by member states, and technically capable of conducting sensitive assessments in a depoliticized process of budget surveillance. In this sense, the policy is internally more credible, that is, the commitment of states is perceived to be more stringent in front of their peers. This is understood to apply now to all states, weak and strong. The highly politicized betrayal of the spirit of collective discipline by France and Germany in 2003 shows how sorely such a stringent process was needed. Moreover, given the main reason underlying the reform of the SGP was to restore confidence to financial markets, delegation of compliance to supranational institutions – rather than trust on peer pressure and non-binding objectives – decidedly helped in enhancing the credibility of states' commitments towards even external actors worried about the credibility of states' commitments.

All in all, then, the progressive reform of the pact, consisting in several and different institutional changes, confirms the third hypothesis, i.e. in front of a policy failure, states accept delegation of the management of policy (in this case the entire phase of compliance surveillance) to supranational institutions, in order to make the policy more credible, both internally and externally. As discussed below, this can seen as a substantive advancement of the integration process.

4.4. A more supranational policy? An assessment

A final assessment to be made with regard to the progressive change of fiscal policy concerns the comparison of the overall level of supranationalization of the policy *before* and *after* the Eurozone crisis, by applying the index elaborated in the methodological section, so as to confirm or disprove the overall conjecture of the dissertation that major economic crises trigger a process of supranationalization of the European polity.

In order to do this, it is necessary to appreciate and situate some indicators along the continuum spanning from a completely intergovernmental policy up to a completely supranational one. The dimensions at stake are (1) the width of the supranational management of the policy; (2) the power of supranational institutions in the policy and (3) the presence of supranational instruments or mechanism. Each one of them is composed by different indicators, whose value can span from a very low level of supranationalization (n. 1 in the scale 1 to 5), up to a very high one (level 5 in the scale), or an intermediate level (level 2 representing a low-to-medium level; 3 as a medium level; 4 as medium-to-high level of supranationalization). Thanks to a comprehensive analysis of the indicators, the single policy can be situated more or less close to one of the poles of the continuum, and by comparing the situation in the two periods (before/after the crisis) one can appreciate any eventual variation.

Concerning the rules of fiscal discipline, the three dimensions are declined into different policy specific indicators. Concerning the width of supranational management of the crisis, I will assess the level of supranationalization of the policy with respect to the phases of agenda-setting, policy formulation, implementation and evaluation, in line with the heuristic policy cycle approach proposed by scholarship (Jones 1970; Anderson 1975). With respect to the power of supranational institutions, I will situate on the scale the intensity of delegation of competencies, the politicization of the policy and the overall room for manoeuvre left to member states. Finally, I will evaluate the supranational character of any supranational institutional setting, mechanism or peculiar procedure of the policy. Being absent for the policy at stake an *ad hoc* mechanism (such as the ESM for financial assistance or the Single Supervisory Mechanism for the banking union), I will consider the eventual supranationalization of a peculiar procedure which is the one of excessive deficit (EDP), with regard to its evolution before and after the crisis.

The table (table n.2) restates the values of the different indicators identified, including the overall level of each of the three categories of indicators in the two periods considered. As it can be easily recognized, though not becoming completely supranational, the fiscal policy undertook a process of non negligible supranationalization, for each one of the three dimensions analyzed. The overall management of the policy cycle underwent a sclerotic transformation: on the one hand, a certain intergovernamentalism persisted for what concern the phase of agenda-setting – in which the European Council maintained a certain relevance and set up an intergovernmental task force to detriment of the Commission – and in the one of policy formulation – intergovernmental agreements intervened in the process, member states led some phases of the policy formulation through formal and informal intervention, and the overall bargaining process was highly sensitive to inner cleavages among member states.

Nevertheless, the progressive transformation occurred did increase the rate of supranationalism of the policy in the two other key aspects here considered. Namely the implementation phase and the evaluation one. Concerning the former, a new implementation phase was created, the one of the *ex ante* coordination through the European Semester; and the aspects of compliance and enforcement were strongly revised in a supranational perspective, by empowering the European Commission – which saw a counterbalance of its loss of agenda-setting powers (Bauer and Becker 2014). Concerning the evaluation phase, even if the Ecofin can still evaluate countries' fiscal performance, the Commission again obtained indisputably more powers in the overall assessment of states' behavior, that resulted in an increase of the rate of supranationalism.

	BEFORE THE CRISIS	AFTER THE CRISIS
- Agenda-setting	2	2
- Policy formulation	2	3
- Implementation	2	4
- Evaluation	2	4
= (1) SUPRANATIONAL MANAGEMENT OF THE POLICY	**2**	**3.25**
- Delegation of competencies	2	4
- Policy politicization*	3	4
- states' room for manouevre*	3	4
= (2) POWER OF SUPRANATIONAL INSTITUTIONS	**2.6**	**4**
- Excessive Deficit Procedure	2	4
= (3) SUPRANATIONAL MECHANISM/PROCEDURE	2	**4**

* The value of supranationalization is to be considered as the inverse of the hypothetic value of the indicator (e.g. a low level of politicization corresponds to a high level of supranationalization).

Table 2. Policy of fiscal discipline: Index of supranationalization .

Secondly, the power of supranational institutions rose from a medium-to-low level (2.2) up to a medium-to-high (4). That is, they passed from a setting in which they were scarcely involved and with very low powers, to one in which they are much more relevant and powerful. Such increase was determined by new institutional arrangements, such as the RQM, which considerably restricted member states' room for manoeuvre and the overall flexibility of the system, which was at the basis of the precedent policy failure of the SGP. In particular, a double delegation of competencies toward the Commission and the ECJ in the phase of enforcement of rules and compliance monitoring, a depoliticization of the policy through semi-automatic sanctions and a reduced, though still present[67], flexibility determined a higher level of supranationalization of this peculiar policy aspects.

Finally, the overall above-mentioned transformation occurred with respect to the Excessive Deficit Procedure, which can be rightly considered as a unique instrument created in order to make fiscal rules effective, resulting in a significant increase of its rate of supranationalism. For sure, as the sanctions are not yet completely automatic and with quite a degree of flexibility remaining in the system, it cannot be considered as *completely* supranational, but it is certainly less intergovernmentally-oriented than before.

All in all, the policy of fiscal discipline undertook a diffuse increase of its supranational rate, measured according to the index created. By combining the different values of the three dimensions, the overall level of supranationalism of the policy[68] passed from a low-to-medium level (2.2) up to a medium-to-high one (3.75) (fig. 5).

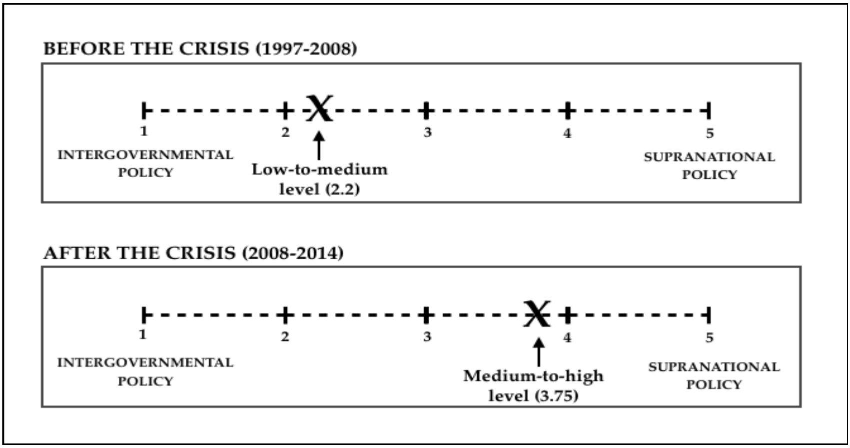

Figure 5. Evolution of the supranationalization rate of the policy of fiscal rules.

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67 A completely automatic sanctioning system would translate in a "5" in the supranationalization rate.

68 The overall level of supranationalism is given by the average of the three components, each assumed to have the same weight.

Reflecting the intensity scale borrowed by Borzel (2005), the values obtained mean that there was a significant shift in the rate of supranationalization of the policy. In particular, the index suggests that before the crisis the policy was mainly in the hands of governments, with a very low involvement of supranational institutions. All in all, the policy was more intergovernmental than supranational. On the contrary, after the comprehensive reform of the SGP, the policy witnessed the enlargement both in scope and intensity of its supranational dimension. Supranational institutions do have more power, and this power is exercised in broader areas of the policy. In other words, if the set of outcomes adopted did not yet make the fiscal policy a completely supranational one, it provoked a shift from low intergovernmental coordination up to a genuine joint decision making, providing a first confirmation of the underlying conjecture of the analysis, which has still to face the empirical confirmation of the two other case studies.

Chapter 5
The policy of financial support to states in need

The second case study of the dissertation consists in the analysis of the different instruments of financial support adopted and implemented in the Eurozone since the outset of the sovereign debt crisis in 2010, up to late 2014.[69] Indeed, the outbreak of the sovereign crisis made it necessary for member states and EU institutions to set up brand new mechanisms aimed at helping those countries unable to refinance their public debt, because of the exacerbation of credit conditions demanded by financial markets in response to economic and political interplays. Taking together all the evolutions occurred in the field, Eurozone governments appear to have progressively set up a new policy sector, that is, the one of financial support to member states in need.

Some elements make this case study different from the previous one on fiscal rules. First of all, the fact that any real policy of financial support toward member states did not exist before 2010. Indeed, European treaties formally forbid any assistance to troubled states, according to the "no-bailout clause" of article 125 of the TFEU.[70] In this sense, we are

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[69] The conclusion of the narrative at the end of 2014 is admittedly arbitrary. It is nevertheless necessary because of the ongoing nature of the Eurozone crisis, which continues to offer the prospect of new developments. The end of the analysis thus predates the beginning of Quantitative Easing by the ECB which nevertheless at first sight, appears to confirm the policy trends identified in this chapter.

[70] Article 125 TFEU states: "The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project".

in front of a process of progressive policy *creation*, rather then incremental policy *change*, as member states played a sort of quasi-constituent role in the *vacuum* of the pre-crisis institutional panorama (Dehousse 2012).

As a consequence, the chapter will not provide an explicit comparison of the effectiveness of policy implementation in two different periods (before/after the crisis), as in the first case study. Rather, it offers an analysis of the progressive creation and evolution of the policy from the beginning of the crisis, by looking at the different steps undertaken by European countries since that time. Secondly, the analysis will be mostly detached from a simple chronicle of events concerning bailouts, save a brief overview in the first paragraph. Indeed, it would be difficult to reconstruct the complex array of events related to the different bailouts, such as external pressures, domestic resistance, political confrontations, and so on. The focus of the chapter, then, is not on domestic events, but on the creation of financial assistance instruments and on the institutional change behind them.

Moreover, the analysis will leave aside the great debate over the conditions attached to the provision of funds: the debate on the necessity/opportunity of austerity within the EU during the crisis, though interesting and fundamental in the perspective of the European polity, constitutes a different research project. In this sense, both the effective implementation of the instruments over the years, and the elements of conditionality attached will be only briefly addressed, and closer attention will be paid on the process of their creation and the strategic interaction behind them. Here, how actors' preferences oriented the decision making, how that process was determined by the existing institutional setting, and the role played by the financial environment, as well as the overall significance of the new instruments for the institutional setting in the European polity will be the significant foci of analysis.

In spite of the absence of any formalized instrument of financial assistance to member states before 2010, the crisis' years witnessed an impressive effervescence of European policy making, through the creation of at least four different instruments or programs of financial support: the EFSF in 2010, the ESM in 2011, the SMP in 2010 and the

OMT in 2013. While the first two instruments are the product of intergovernmental negotiations, and thus a creation of member states, the two other programs are ECB-led operations, thus the product of a supranational institution. In this respect, it has to be specified that the ECB obviously did not intervene to directly bail out troubled countries, but it managed to help peripheral States in quite an indirect instrument, that is, the purchase of sovereign bonds in order to calm down markets' pressure on those States. Alongside these instruments, bilateral loans were initially provided to Greece in early May 2010, and an additional temporary facility, the European Financial Stabilization Mechanism, was created by the European Commission. Several other instruments were proposed, but never actually established – such as Eurobonds, but also a European Monetary Fund and a European Debt Agency. For the sake of the analysis, the chapter will only deal with the most significant of them, namely the EFSF, the ESM, and the two programs by the ECB – SMP and OMT.[71]

The aim of this chapter is to present empirical data in the specific policy area of financial assistance and then use them to test the three main hypotheses of the dissertation, as well as the underlying conjecture that economic crises foster an effective supranationalization of EU policies. As discussed in the theoretical section (§2.4), the three main hypotheses of the dissertation are as follows:

> H1: An economic crisis is a fundamental driver of major institutional changes, both in terms of their quantity and quality;
>
> H2: Intergovernmental policy making tends to have incremental and ineffective policy outputs and to create institutional deadlocks;

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[71] The EFSM, though being important as the first supranational facility – funded with the EU budget and managed by the European Commission – to grant financial assistance during the crisis, actually has a limited endowment (€60 billion). For an overview of this instrument, see Bianco (2012). For a discussion on the possibility of creating a European Monetary Fund, see the special issue of Intereconomics (2010); for the proposition of a European Debt Agency, see Leterme (2010); for a discussion on Eurobonds see Intereconomics (2009). As observed above, there is no mention of the Quantitative Easing by the ECB, which has been implemented since January 2015, and thus falls out of the chronological scope of the dissertation.

	TYPE OF VARIABLE	POLICY-SPECIFIC VARIABLE	POLICY-SPECIFIC INDICATOR
H1	**INDEPENDENT VARIABLE**	Pressure on policy makers	- Course of yields' spreads and Credit Default Swap (2010-2014)
	DEPENDENT VARIABLE	Policy outcome	- Creation of new instrument or program of financial support
H2	**INDEPENDENT VARIABLE**	Modes of decision making: intergovernmental/ supranational	- Presence of int.al agreements - Presence of intergov. negotiations - Presence of unanimity regime (or, conversely) - Adoption of community method - Adoption of new instruments by supranational institutions
	DEPENDENT VARIABLE	Policy success	- Capacity of the outcome of decreasing market pressure
H3	**INDEPENDENT VARIABLE**	Policy failure	- Incapacity of the outcome of relenting market pressure or solving the original problem - Insurgence of new wave of crisis - Contagion of the crisis in a new country
	DEPENDENT VARIABLE	Supranational delegation	- Formal act of delegation to supranational institutions (e.g. Treaty change) - Upload of competencies for policy makin (e.g. legislative power) - Informal act of delegation (e.g. via open interpretation of rules)

Table 3: Instruments of financial support: Relevant variables and indicators of the case study.

conversely, supranational policy making tends to have successful and more effective outputs;

H3: In the case of policy failure due to irreconcilable conflicting interests or institutional deadlocks, a process of delegation to a neutral – i.e. supranational – actor occurs, resulting in an empowerment of supranational institutions *vis-à-vis* member states.

Each of the three hypotheses will be tested by linking specific independent and dependent policy-specific variables (table 3). Among the policy-specific indicators in the last column, there are also some of those used to create the original index of supranationalization of the policy.

The chapter is structured as follows. After a brief overview of the key events related to the bailouts of states in need and the main political considerations underlying those operations, the chapter will turn to the different instruments created to provide financial assistance to member states: after a presentation of the presumed divergent preferences of actors over outcomes, an analysis of those policy outcomes and the strategic interaction behind their creation will be carried out. This analysis guides the testing of the leading hypotheses of the dissertation, and it is at the base of a final assessment of the degree of supranationalization in respect of the policy.

5.1. To help or not to help? The politics of bailouts

As a necessary *addendum* to the commitment to sound fiscal policies, while building up the European Monetary Union, member states agreed to insert a "no-bailout clause" into the treaties (art. 125 TFEU). This clause, formally prohibits member states and European institutions from providing any sort of financial assistance to member states in financial difficulty. The rationale was straightforward, if seen from the perspective of incentives and rational behavior: an eventual provision of any form of rescue funds would reduce states' incentives to exert fiscal discipline, rendering fiscal rues pointless (Pisani-Ferry 2014:80). Fears of this "moral hazard," has been a recurrent element throughout the crisis: a state aware that an external agent will agree to bear a significant proportion of the costs associated with financial troubles has little interest in undertaking costly and painful reforms to avoid difficulty. Moreover, in Maastricht states were confident that measures of crisis prevention would be sufficient to avoid the setup of any crisis management instrument, whose existence itself would feed states' moral hazard (ibid: 81). Nevertheless, the events triggered by the crisis came to substantially subvert the pre-crisis institutional equilibrium on the issue.

Notwithstanding an initial formal prohibition financial assistance was provided to Greece (two bailouts in 2010 and 2012)72, Ireland (late 2010), Portugal (in 2011), Spain (for recapitalization of its banking sector in 2012) and Cyprus (in 2013), as well as the financial support provided to non-Eurozone members such as Romania, Hungary and Latvia.[73] Focusing only on Eurozone member states, it is quite impressive to notice how much, and how quickly, a solid framework of financial assistance was established. At the beginning of Greek drama in 2010, states could only agree on provision of discrete bilateral loans to Greece, without any support from the ECB. By 2013, had established a permanent rescue facility, and the ECB has become actively involved in helping member states through three different programs, for a total amount of many hundreds of billions of euros.

The politics of bailouts was focused around two main questions: should member states be bailed out? And secondly, who should pay? (Pisani-Ferry 2014). The first issue focused on the perceived urgency of supporting distressed states, essentially ignoring article 125. The answer to the question, of course, presented a classic dilemma: on the one hand, helping a fellow government in need may feed moral hazard, encouraging profligate behavior. On the other hand, a refusal to help exacerbates the magnitude of the problem through the risk of contagion (Zahariadis 2012). Member states faced then a difficult alternative, since financial assistance would surely undermine the efforts for fiscal consolidation, but a lack of financial support would probably trigger worse systemic consequences.

The second question is related to who should pay, raising the underlying issue of the creation of a transfer union in the Eurozone, and affecting quite understandably domestic considerations. States in

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[72] A third program of financial assistance was granted to Greece in summer 2015.

[73] For a complete overview of all the programs of financial assistance provided during the crisis, please refer to the European Commission's website: http://ec.europa.EU/economy_finance/assistance_eu_ms/

need invoked the principle of solidarity, arguing that treaty rules ought to be read flexibly to enable either richer countries or a supranational institution – i.e., the ECB – to offer financial support. Creditor countries, for their part, envisaged an international organization such as the IMF stepping in, as if troubled states were not part of a monetary union.

The battle over the two issues shaped the process of policy response, rendering it highly fragmented and unable to offer a definitive and credible solution to the crisis. Indeed, at least until mid-2012, the response by member states was a set of poorly coordinated policy attempts, that made the situation even worse. According to Jones (2015) "The early European response to the financial crisis was piecemeal and tactical rather than structural or strategic", since "strategic action need time and deliberation […] and both elements were in short supply as the crisis unfolded". The preferences of actors have been so divergent to make it very difficult and time consuming to find a compromise on a policy response to the crisis. At the same time financial markets remained highly demanding in terms of the long-term sustainability of policy outcomes, but their expectations were barely met (Smeets and Zimmermann 2013). Indeed, as a consequence of states' hesitation throughout the crisis, economic and financial instability progressively increased, making it necessary for the ECB to step more actively into the political *vacuum* created by governments' conflicting interests, if not by directly offer financial sustain, at least by creating non standard measures to meet markets expectations. As a result, the policy has been shaped by two main elements: governments hesitation and difficult intergovernmental negotiations on the one hand, and resolute intervention of the ECB on the other. In this sense, as the analysis will demonstrate, the increased role of the central bank can be seen as an unintended consequence of failed intergovernamentalism (Sacchi 2014a).

5.2. Definition of actors and their preferences over outcomes

The progressive evolution of the policy of financial help to member states reflected the interplay of a number of actors. In line with the methodological assumptions of the dissertation,[74] it is necessary to preliminarily determine the key actors formulating the policy, as well as their initial preferences over outcomes.

Likewise the previous case study, in which actors were divided over a principle issue, i.e. the automaticity of sanctions for rules-breakers, a major cleavage divided member states in the policy sector of this second case study: the attitude towards the bailout of states in trouble. On the one hand, creditor countries, the main representatives being Germany, Finland, and the Netherlands, were generally against any form of financial assistance, fearing that such operation would endanger the efforts of fiscal consolidation in weaker states and feed moral hazard. Quite understandably, another group of states, mostly those that had entered financial assistance programs, as well as other debtor countries such as Italy and France, were more disposed to to financial solidarity within EU members. The key priority for these states was avoiding any risk of contagion among member states. Patterns of state preferences in this respect partially mapped on to the different positions in relation to SGP reform, especially where attitudes towards fiscal rectitude and financial worries were concerned. Nevertheless, states' positions also reflected national economic traditions and the domestic considerations of member states.

The coalition of surplus countries was not in favor of any bailout in whatever form, whether it be financial assistance from EU peers, or an active role for the ECB, with its potential to finance national deficits by increasing the monetary base in the Eurozone and by mutualizing national debt. This "no-bailout attitude" was primarily rooted in economic considerations, particularly the recognition that the costs of any financial assistance program would fall most heavily on them. In this sense, ultimately, the issue was about the aversion of progressively transforming the EU – or the Eurozone, at least – into a transfer union (The Economist 2010), where creditor states would finance debtor states, as already happens *within* every European country, including, most notably, Germany itself. Quite understandably, northern leaders

[74] For a discussion on the definition of actors and their features see § 2.3.2

desired to keep the costs of the Eurocrisis low for taxpayers[75] (Mayer 2012: 171), so as to avoid that external events could interfere with electoral dynamics.[76] At the same time, scholars have highlighted that the fiscal interests of taxpayers were not the only domestic source shaping creditors' preferences. Other societal interests were relevant, among them, trade interests of the export-oriented sectors and financial interests of the banking industry (Steimberg and Vermeiren 2015). These considerations were reinforced by the strong belief that indebted countries needed bold fiscal consolidation, and that assistance would inevitably reduce incentives to undertake needed structural reform. In this sense, the German idea has been to offer help only as an *ultima ratio*, i.e. only when all other solutions had been tried. Additionally, the Germans felt that bailouts would never solve all states' problems in any cases, leaving states vulnerable to market pressure (Bastasin 2012: 159). Financial support, then, should not come neither too early, in order to increase the pressure for reforms in distressed states, nor too late, so as to avoid a complete lost of confidence of financial markets in troubled countries, resulting in a careful evaluation of the "timing of politics" (Jacoby 2015). Being very difficult to discriminate the appropriate timing of intervention, such tactical attitude has been labelled as the "policy of uncertainty" (Bastasin 2012:310).

Nevertheless, these realistic and practical considerations went along with other more ideationally, sociologically and historically lead ones. First, public opinion in northern countries, particularly in Germany, is overwhelmingly against any rescue of (supposedly) profligate states (Barysch 2010). Indeed, the view is that the Eurozone crisis is itself a direct consequence of southern states' misbehavior and of their unsound fiscal policies, so they are responsible for solving their own

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[75] Reducing costs for taxpayers does not only means to avoid any rescue plan, but also – in case of their effective implementation – the involvement of the IMF and of private investors, as to relieve member States' burden.

[76] In this respect, it has to be noticed that all along the crisis EU decisions were often postponed as to avoid the interference with domestic elections – or they were decidedly influenced by electoral considerations. For instance, the first Greek bailout was postponed in view of local elections in North Rhein-Westphalia, which probably contributed to exacerbate Greek fiscal situation.

problems. This demonstrates the extent to which the economic crisis turned into a morality play for Eurozone members. According to François Baroin, former French finance minister, "the [German] problem with Greece was not economic or strategic, but moral" (Hewitt 2013: 67). And Mario Monti, former Italian prime minister, once suggested to Barack Obama that when discussing economic issues with Angela Merkel to always bear in mind that for Germans economics is a branch of moral philosophy (Barbera and Feltri 2014: 88).

Additionally, in Germany the idea of protecting the independence of the central bank has deep roots, given how the monetization of debt caused catastrophic hyperinflation in Germany in the early '20s. Thus the independence of the central bank, which Germany demanded in order to reach agreement on establishing the EMU, is not only a pillar of the monetary union (Issing 2010), but also a strong element in German economic culture. In the end, then, creditor countries staunchly opposed any active role of the ECB in supporting states in financial difficulties through the monetization of debt at European level.

Creditor countries thus saw resolution of the crisis in terms of "no bailouts" and no shared debts, leaving open the possibility of a "orderly default" within the Eurozone, a position sometimes suggested by the German government (Davies 2011). However, a second-best option for Germany and for creditor countries emerged during the crisis (Spiegel 2014a). Such second-best option has three aspects: first, financial support could be provided, only as *ultima ratio*, and only in presence of a centralized and capillary control, thus of harsh measures of conditionality; second, money should not be provided by the ECB, but in a shared way by member states, private investors and IMF as well, so as to limit as much as possible the burden on creditor countries' taxpayers; third, every step towards a formalization of financial assistance should come as a counterpart of a credible commitment of peripheral states to sound fiscal policies.

By contrast, southern debtor states, headed by France, sought more solidarity among Eurozone members (so as to prevent contagion), flexibility in the interpretation of treaties' rules on bailouts, and an active role for the ECB in the provision of financial support. The view of the PIIGS was that creditor countries should actively support fellow states, given it was in their interest also to contain the risks of contagion. They demanded the creation of instruments at the supranational level to contain the crisis and prevent any future sovereign risk. For example, the preferences of Italy and France were oriented toward the creation of "Eurobonds", a Eurozone-wide bond to collectivize member states' debt, so as to avoid high yields for weaker states (Kulish and Eddy 2012). At the same time, they sought an active role for the ECB, which they argued should act much as the Federal Reserve does in the US ("the Fed") – notwithstanding their different mandate and the underlying institutional rules. The French government's preferences in particular were oriented toward non-standard measures by the ECB, which in its view, should commit to purchase national bonds to relieve the pressure on spreads (Spiegel 2014c), which of course ran against German positions.[77] Sarkozy often urged the ECB to follow the example of the Fed, which demonstrates scarce respect of central bank independence. Nonetheless, representatives of the Portuguese, Italian and Spanish governments consistently backed Sarkozy's request, demonstrating how much their preferences were oriented toward a crisis management approach that politicized the ECB's role, and a strong commitment of the institution in the rescue of countries in need.

As had been the case with fiscal rules, the UK remained largely aside from negotiations. The UK's position was that whatever Eurozone members decided, Britain would not contribute to any bailout fund (Charlemagne 2010). Even though the City remained highly exposed to troubled states, the conservative government of David Cameron decided to stand aloof from any supranational instrument of financial support, following domestic public opinion, in the conviction that Britain would be in a position to offer workable alternatives even in

[77] In different phases of the crisis, as will be highlighted, debtor countries' preferences for a proactive role of the ECB were declined in different technical devices, which were not limited to the possibility of a direct bond-purchase by the ECB, but they'd include the possibility for the EFSF of borrowing money from the ECB, let the ECB finance resources of ESM, let the ECB indirectly buy national bonds through private banks and other technical devices.

case of a Euro break-up (ibid.).[78] Nonetheless, while standing apart from rescuing Greece and other Eurozone countries, the UK agreed to contribute almost €3.4 billion to the €85 billion Irish bailout in 2010, in the form of bilateral loans, since the British and Irish financial and banking sectors are highly interconnected (The Guardian 2010). As a general consequence of Britain distancing itself from European crisis management, the Eurogroup obtained significant visibility and responsibility to the detriment of the European Council, enhancing at the same time the role of Germany, as the best placed nation to lead the negotiations (Bastasin 2012: 248).

The European institutions constitute the third key set of actors. Given that the Commission, Parliament and Central Bank had each played a distinct and decisive role in shaping the development of new fiscal rules, it was necessary to assess the specific position of each in that analysis (see Chapter 4). The evolution of financial support, however, followed a different path. Indeed, as an *ex novo* creation, the policy was largely managed at the intergovernmental level, and the community method was not considered at all either in the provision of the first financial assistance, or in the setup of new instruments. The European Parliament, in particular, was largely sidelined in the crisis management process (Sacchi 2014b; Schmidt 2015). The Commission, for its part, played a limited, mostly technical, role in the setup of new instruments. Its main preferences, in line with its institutional position, concerned the possibility of triggering a supranationalization of the policy. This process could result from the setup of two different instruments: the creation of a brand new instrument of crisis management with EU resources (the EFSM); and the so-called "Stability Bonds". In this respect, the Commission elaborated an official proposition for the creation of the "Stability Bonds" (European Commission 2011b) through three different options, which had the merit of opening the debate on a issue highly opposed by Germany

[78] The attitude of UK, however, was not shared by all members outside the Eurozone. For instance, Poland and Sweden offered their contribution for supporting European States fallen into the debt crisis, under the consideration that they'd enjoy of financial stability in the continent.

(Spiegel 2011). On their creation, however, there is not yet agreement among governments.

The most significant institution in this policy sector has been the ECB. Though deprived on any formal power in the traditional decision making process, i.e. the community method, the ECB undoubtedly enjoyed a *de facto* political weight, that southern countries were adamant to win over to their side. The Frankfurt-based institution indeed actively stepped into the policy making through at least three different non-conventional programs aimed at limiting the stress on financial markets due to the sovereign crisis (SMP, OMT and the QE), plus the two rounds of Long-Term Refinancing Operations (LTRO) for the support of the banking sector. Since the beginning of the crisis, the ECB's preferences have been very well defined and openly stated, both in relation to its independence and to the eventual role it might play in the crisis, which were the two main issues under debate among member states. The ECB position, both under the presidency of Jean-Claude Trichet and that of Mario Draghi since November 2011 was very clear: states must act first. While the central bank has never completely excluded the possibility of intervening in favor of distressed states, the ECB has expected member states to clearly commit in credible and sustainable measures of fiscal restructuring – mainly through fiscal austerity. Its reasoning has been to avoid moral hazard and not undermine states' efforts in fiscal consolidation, as well as to defend its independence and to respect its mandate, Moreover, unlike creditor countries, the ECB has always claimed that any default, even an orderly one, within the Eurozone should be avoided given the disastrous consequences it may have for financial stability in Europe and worldwide, and for the credibility of the monetary union itself (Bastasin 2012: 149).

The ECB was cautious in two main directions concerning taking on a more active role: the respect of its mandate as dictated by the treaties, and the defense of its independence. Any potential action would need to be embedded in the rigid framework of institutional rules shaping the ECB mandate. Both Trichet and Draghi were concerned to respect the letter of the treaties, which explicitly prohibit direct ECB financing of national debt. Even in his famous "whatever it takes" speech in July

2012, Draghi was at pains to mention that "the ECB is ready to do whatever it takes to save the Euro", but *"within our mandate"* (Draghi 2012), a qualified commitment revealing the great concern for the respect of institutional rules even in emergency conditions dictated by the Eurozone crisis.

A second aspect concerned the defense of ECB's independence, despite the formal and informal requests by member states to boldly intervene in favor of weak states. In Sarkozy's aforementioned 2010 meeting with Trichet, the French President proposed a "wall of money" to avoid contagion, to which the head of the ECB angrily responded that the ECB was not taking orders from anybody. Were members to continue applying pressure, he said, the "ECB Council would react negatively with disastrous consequences" (Bastasin 2012: 208), a very clear declaration in defense of ECB independence.

A final actor whose role in crisis management was important, if understated, was the United States.[79] While the US played no role in the debate over reform of fiscal rules in the Eurozone, the question of potential sovereign default was clearly a sensitive issue outside of Europe. The US, while avoiding open statements which could be seen as an intrusion in European affairs, often showed its disappointment for the poor coordination of European national responses to the crisis, concerned that Eurozone troubles might spill over across the Atlantic (Barber 2010). The influence of the United States was in fact decisive in certain phases of the crisis, at least in persuading European governments – especially Germany – of the need for decisive action The US declined to advocate any particular policy response of others, but rather sought to impress upon European governments the need to act in whatever direction necessary to save the common currency and guarantee financial stability worldwide. The US role will be carefully examined, in order to understand how crisis exigencies made it possible for an external actor to intervene in European public affairs.

[79] As for the case of the ECB, US are obviously not an actor empowered of any role in the European decision making. Methodologically, it can be considered as a powerful ally with a *de facto* political weight of one of the two coalition of States (debtor countries, namely).

5.3. Instruments of financial help implemented during the crisis

A key features of the policy of financial assistance in the Eurozone is its *progressive* character. Member states and institutions systematically built up an increasingly complex institutional framework over time, moving from the very first solutions adopted to counteract the possibility of a Greek default, up to the more complex programs of financial help aimed at addressing potential default in a large economy, such as Italy or Spain. In this sense, the evolution of the policy maps closely on to the evolution of the crisis. Not only did the increasing magnitude of the crisis make it necessary to develop new instruments with new features, the crisis itself was fed by the weaknesses in each successive policy innovation. The chronological and political nexus between key peaks of the crisis identified in chapter 2 (i.e. the break-up of the Greek crisis in early 2010; the Irish crisis in late 2010; the dramatic summer of 2011; the troubles of autumn 2011; the second Greek crisis in mid-2012) and the evolution of financial assistance programs' framework are striking.

5.3.1. The first Greek bailout through bilateral loans

The necessity of providing financial support to Greece was the direct consequence of the Greek fiscal crisis, which erupted in early 2010. In spite of the efforts of Prime Minister Papandreou in January to reassure fellow member states and the markets (The Guardian 2010), international investors progressively abandoned Greece, resulting in an unprecedented rise in the spreads on Greek bonds, making it more and more difficult for the country access the markets.[80] The situation worsened between late January and the beginning of February, when markets began to bet on a Greek default and break up of the Euro Nonetheless, the European Council could not break a deal in the meeting of February 11th. In that occasion, French President Sarkozy was in favor of "putting some billion immediately on the table" and

[80] The day when Moody's warned on the bad outlook of Greece, in January 2010, CDS on Greek debt saw the most impressive one-day rise ever, soaring from 49 to 328 basis points (Bastasin 2012: 148).

decide later the details, but Chancellor Merkel was doubtful over the feasibility of such operation (Bastasin 2012: 167).

A key element of disagreement was whether to involve the IMF in the rescue plan, and what form the action should take – bilateral loans, or a supranational program. France and Germany – representing the core/creditor vs periphery/debtor cleavage – could not reconcile their positions. France was opposed to IMF involvement[81] and was inclined to a political management of the crisis while Germany, fearing the partiality of the Commission, sought the inclusion of the IMF and a more rational and technical approach to the rescue action. In the end, the final statement of the European Council (European Council 2010) asserted that "Euro area member states will take determined and coordinated action, if needed, to safeguard financial stability in the Euro area as a whole". The statement was vague enough to reassure member states that fellow members were supportive, while avoiding any specific or detailed commitments, for the time being.

That decision came in late March, at a time when markets continued to put pressure on Greek bonds, when a EU summit stated that Euro-area members were "ready to contribute to coordinated bilateral loans" (Eurosummit 2010), thus not through a common pool of resources. Moreover, contributions would be "decided by unanimity and subject to strong conditionality", involving the IMF as a complementary financing body. For sure, no automatic rescue fund was to be provided. A week later, the financial situation in Greece took a turn, because of several related events: a bank run, the downgrade of Greek debt, the increase of the spread among German and Greek bonds and the soar of CDS's on Greek debt, which taken together created a dramatic spiral of distrust in the markets. On April 8th an Ecofin meeting was called to discuss the technicalities of the rescue

[81] The French were hostile towards the involvement of the for two reasons. First, Sarkozy feared that the United States, through the IMF, would interfere with European affairs. Secondly, at that time the IMF was headed by Dominique Strauss-Kahn, who was expected to be the Socialist Party candidate against Sarkozy in the 2012 election, before a sex scandal in 2011 compromised his path toward the Elysée.

mechanism, which were finally set up a few days later. The joint IMF/ EU support package, to be activated following an official request by Greek government, began to take shape (Ecofin 2010). A collaboration between the IMF and the EU was to start in order to sketch out their respective roles and contribution after which assistance would be provided in exchange of harsh austerity measures. A newly established technocratic body, the Troika, obtained the role of monitoring its implementation. Finally, assistance was provided at "non-concessional interest rates", so as to demonstrate that Greece was not being subsidized. On April 23, Papandreou officially requested the activation of the mechanism, whose final features were set up in early May. The Troika (i.e. the EU, the IMF, and the ECB) elaborated the austerity measures demanded for Greece, while member states agreed on figures. The final amount of the rescue plan was set at €110 billion, of which €80 billion was to come from loans by member states, and €30 billion from the IMF, at rate 3% above the Euribor rate, increasing to 4% after three years.

The package was the first program of financial aid for a member of the Eurozone, and it was the result of a dramatic strategic interaction among actors at stake. Indeed, the provision of bilateral loans was a compromise between those seeking a more comprehensive supranational mechanism, and those less inclined to provide financial aid. Germany and creditor countries were quite reticent about the bailout, fearing moral hazard above all. Nonetheless, with the financial climate rapidly deteriorating, Germany agreed in the end to a bailout as a *ultima ratio*, as specified in the Eurosummit statement (Eurosummit 2010), according to the German idea that a troubled state should feel the pressure of financial investors up to the limit, in order to prevent moral hazard. Moreover, the provision of robust conditionality in the form of demands for harsh austerity measures, and prohibitive interest rates were presented as non-negotiable by Germany. On the other hand, France and other southern countries favored a more political intervention, i.e. the creation of a bold supranational mechanism that would stop speculators and avoid contagion. Bilateral loans ended up being the point of common agreement across actors with such varying preferences.

In all likelihood, the package would have not seen the light of day, without the external intervention of the US government, which according to some authoritative reconstructions intervened behind the scenes in negotiations (Barbier 2010). At a dinner held on April 22 at the Canadian embassy in Washington, the US treasury secretary lobbied his European counterparts to take action in order to avoid a global contagion. Moreover, the US government, as had the IMF, offered crucial expertise concerning financial rescues, so as to save Greece, and warned that the amount of the first aid package envisioned in late March[82] would be insufficient to calm financial markets. Actually, the final package was substantially larger than the one that was previously foreseen, and the IMF was actively involved in the assistance program. According to Barbier, this demonstrates that the meeting in Washington was fundamental in determining the necessity for collective action.

Institutional rules clearly played a significant role in structuring the final outcome. The "no-bailout clause" was a major obstacle for the creation of a new instrument. In considering aid to Greece, member states had proposed the creation of a European Monetary Fund (Gocaj and Meunier 2013) a "European IMF", in order to support weak states and give to the Eurozone an instrument of crisis management. The idea,proposed by scholars (Mayer 2009) and initially backed by German finance minister Schäuble (2010), was however shelved by Angela Merkel because of its huge legal implications (Ludlow 2010). Because an EMF would require a treaty change to circumvent article 125, and would require the unanimity of member states – a difficult and time-consuming task – it was not seen as a viable alternative under the circumstances.

The final package, agreed in May 2, however, was scarcely effective in containing a possible contagion of the crisis to other European countries, as market dynamics during the following week showed.

[82] In a first version of the package, the one presented on March 24-25, the amount of financial support was €45 billion, one third from the IMF and two third from bilateral loans.

5.3.2. EFSF – The European Financial Stability Facility

That the €110 billion package for Greece was insufficient to forestall contagion became clear very quickly. Only a few days after the agreement on the first bailout, interest rates on 10-years Greek bonds soared to 12%, with Portugal's rising above 6% at the same time[83] (Djankov 2014). Interbank lending froze and the money market returned to a situation not seen since just before the Lehman crisis (Ludlow 2010). It was a clear sign that financial markets did not trust the way in which the Greek rescue had unfolded, in particular the reticence of member states to act quickly and decisively to help Greece. Investors took the view that the European response had been "too little, too late." On May 7th the European Council held an emergency meeting in which another instrument of financial assistance was established: the European Financial Stability Facility (EFSF). This time, EU leaders sought a structural mechanism, rather than relying on uncoordinated bilateral loans. An Ecofin meeting on May 9th was called to define the details of the program, which was voted on that same day.[84]

The EFSF is a temporary, limited facility, financed by European members and the IMF, amounting to around €750 billion.[85] It became effective in August 2010, and it was intended to expire in July 2013. The legal basis of the EFSF is rather ambiguous, being an original mix of EU law and private financial law (Bianco 2012). Technically, the EFSF is a limited liability company, established in Luxembourg. It is a special

[83] During the sovereign debt crisis in Europe, the threshold of 7% on 10-years bonds has become a psychological one, meaning that above that rate national debt becomes unsustainable to finance on markets.

[84] The final communiqué is the "Decision of the Representatives of the Governments of the Euro Area Member States Meeting within the Council of the European Union", Brussels, May 9.

[85] €440 billion of guarantees backed by Eurozone members – with Germany being the biggest contributor, followed by France and Italy – €250 billion from the IMF and €60 billion from the European Commission through the ESFM. The total amount was imagined to eventually cover a joint crisis in Greece, Portugal and Ireland, but the funds available were completely insufficient were the crisis to spread to Spain or Italy.

purpose vehicle (SPV), i.e. a company that raises money by issuing bonds backed by member states' guarantees. As a consequence the EFSF is not strictly a fund into which member states transfer money to concerned countries, although it is financed only by Eurozone members its benefits are restricted to Eurozone members. Instead, funds are raised on market, with states simply providing guarantees, up to the amount envisaged in the agreement. In sum, the EFSF is an intergovernmental agreement[86], decided by the governments of the Eurozone, but relying on the European Commission for technical aspects. The Commission can manage the funds raised by the EFSF and it negotiates the memorandum of understanding in which are attached the conditions of financial aid, but the whole process is closely supervised by Eurozone governments.[87]

The strategic interaction behind the adoption of the EFSF perfectly reflected the cleavages among actors involved, as well as the necessity of striking a deal in the dramatic aftermath of the Greek bailout in early May 2010, and in particular before the opening of financial markets on Monday, May 10, which was imagined to bring about a massive attack on the common currency, according to the US government (Bastasin 2012: 206), and which was very much feared by European policy makers. On the one hand, the position of the ECB was in line with its vision of crisis management, according to which member states should act first. States, for their part, were divided over the issue: creditor countries defended the ECB's independence and were reluctant to create a EU-wide structural instrument of crisis management, while debtor ones were more inclined to solicit bold steps into crisis management from the ECB.

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[86] An evocative image of the complexity of the legal framework behind the creation of the EFSF is given by De Witte (2011), according to whom the EFSF was adopted by the representatives of the governments of the Euro area member states, "wearing their intergovernmental hats", but meeting within the Council of the European Union.

[87] For a thorough discussion on the legal aspects of the EFSF, please refer to Bianco (2012) and De Witte (2011).

Mediterranean countries, headed by France, were quite understandably in favor of an operation to stop the possibility of contagion throughout Europe, as next in line were Portugal, thenSpain and Italy, and – inevitably – France. This latter, in particular, was also worried because of the high exposure of its banks to Greece.[88] Debtor countries' suggested creating a supranational system of crisis management, through the European Commission and the ECB (Ludlow 2010: 30-32). The Commission would mobilize a great amount of funds, while the ECB would intervene to release pressure on troubled countries purchasing their bonds. Sarkozy also went so far as to propose the creation of Eurobonds (Hewitt 2013: 77). In this regard, southern countries found in the Commission a precious ally, given that the supranational executive was interested in creating a structural fund under its control. According to the Wall Street Journal (Walker, Forelle and Blackstone 2010), on May 9, the Commission signed off on a draft pact foreseeing a rescue facility where majority vote by Euro members would suffice to make money available. The Commission would raise all of the funds by selling collective EU bonds, and the mechanism would have no temporal limits, and would not involve the IMF.

Germany, however, disagreed, and Chancellor Merkel headed a group of states opposed to the French plan. Germany, the Netherlands, Luxembourg, Finland, as well as Slovakia were reluctant to concede dramatic assistance to "profligate" states. Their vision, moreover, was in line with the defense of central bank independence, whose necessity was taken far more into account than in the southern countries. To be sure, at a time when it became clear that some sort of financial support was an imperative, they were not against the creation of any rescue facility, but their vision was quite the opposite of the French one: the ECB should not be politically involved in this phase of the decision making, but the IMF on the contrary was very welcome and over all,

[88] To be sure, even German banks were highly exposed to Greece, and in general towards any weak European country's debt, because of the consolidated financial surplus of the country and for the proportions of its banking sector. This element probably played some role on the German decision to assure a rescue to fellow States, whose modalities however were fundamentally shaped by German general preferences over outcomes.

the instrument should be in line with treaty's provisions, an element which seemed to be overlooked by debtor countries.

The German government's fears, in particular, were focused on a possible rejection of the instrument by its Federal Constitutional Court, which is particularly attentive to defend the prerogatives of German Parliament in any step toward further European supranational integration.[89] Moreover, Chancellor Merkel was concerned about the legitimacy of the EFSF in view of the no-bailout clause in the Lisbon Treaty. This explains the final decision to pursue the intergovernmental procedure for the creation of the instrument, instead of a process fully within EU law (De Witte 2012). In addition, creditor countries wanted to avoid the creation of an open-ended fund where countries would transfer funds, because it would represent a first step toward a form of transfer union, or it could set up a precedent for a common public debt. The choice of a SPV and not of direct funds, was the compromise solution suggested by the director of foreign relations at the Dutch finance minister Maarten Vervey (Bastasin 2012: 213), and it was the one on which countries finally agreed on.

Another key issue of the negotiations was the mechanism of activation of the fund (ibid: 212). According to debtor countries it should be an automatic mechanism, or at least one triggered by a majority vote, while Germany was in favor of a unanimity to activate the rescue funds, so as to highlight the intergovernmental character of the instrument. This was, in the end, the solution found.[90] Two final features of the EFSF were in line with the preferences of northern countries. The EFSF was given a time limit, which was decided in order to rule out the possibility of an eventual creation of a transfer union among member states, and non-concessional interest rates on funding

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[89] The Constitutional Court in particular has focused its critiques towards two aspects of the crisis management: first, Germany's financial participation in any bailout must be determinate and not open-ended; and second, national legislature must be given an effective voice in approving the extent of Germany's financial participation. For further details on the role of Karlsruhe Court in the crisis management, please refer to Lindseth (2012).

[90] For an overview on the activation process and the effective functioning of the EFSF, see Gocaj and Meunier (2013: 245-47).

was agreed, in order to rule out the impression that the EFSF was providing subsidies to weaker states.[91]

As with the Greek bailout, US intervention in the European negotiations signaled the urgency of situation and the risks of delay. Again, Washington did not interfere openly, but actively "persuaded" European governments to act to reassure markets. President Obama called Chancellor Merkel at least twice during the negotiations to remind her what was at stake (Hewitt 2013: 79), and other US representatives made repeated calls to European finance ministers during the Ecofin (Barber 2010). While the US intervention played no role in the technical aspects of the agreement, American pressure was nevertheless a key aspect overall.

5.3.3. ESM – The European Stability Mechanism

The immediate reaction of financial markets to the creation of the EFSF was positive, but only temporarily. The amount of funds mobilized was warmly welcomed by investors, who nonetheless soon recognized the weaknesses of the project. Four limits, in particular, emerged upon closer inspection. First, EFSF lending capacity was clearly insufficient to cover an eventual rescue of a core state, such as Spain or Italy (Atkins 2010). Additionally, given its nature as an SPV, the fund was not endowed with real money, but member states simply guarantee funds that in the end may not be actually provided.[92] Third, the EFSF's activation process was heavy, and it relied on the unanimity of its contributors (Bastasin 2012: 216). Finally, it was subject to time limit,

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[91] The interest rate was the market rate plus a charge of 300 basis points for maturities of up to three years and an additional 100 basis points for longer maturities; in addition, a service fee of 50 basis points would be added to cover operational costs (Gocaj and Meunier 2013).

[92] Moreover, the credibility of the EFSF lied on its AAA credit rank, given by the presence of "triple A creditors" among its contributors. However, the downgrade of France, Austria lead to a downgrade of the fund, with severe implications for its capacity of collecting money through States' guarantees (Chorafas 2013: 78). Indeed, in 2011, EFSF auctions on markets to collect money were very weak (Pisani 2011).

and investors could see that the fund was not a structural or systemic framework for the future of the common currency, but merely an instrument of crisis management created by Eurozone members to buy themselves some time, as Angela Merkel later admitted (Euractiv 2011).

Taking stock of these shortcomings, investors rapidly returned to a position of anxiety regarding a possible Eurozone break-up[93], and the EFSF couldn't forestall contagion reaching Ireland, which just a few months later, in autumn 2010, became the second Eurozone country to succumb, spreading panic among European decision makers, again. Finally, European governments realized that a systemic response would be needed, through a correction to the EFSF's shortcomings, which would lead to its transformation into the European Stability Mechanism (ESM). The road to the new rescue facility, however, was difficult, as the different actors had different preferences over the final outcome.

The debate over the transformation of the EFSF, indeed, turned around four main issues. The first and most understandable, was the necessity of increasing its lending capacity. Realizing that the fund was not large enough to save Spain or Italy, and given that it was already operative for Greece and Ireland[94] – and would also be used for Portugal in early 2011 – voices raised on the necessity of increasing the amount of money. In particular, the ECB, the European Commission and peripheral countries praised for an increase of EFSF financial backing, but the issue was not welcomed by Germany, Netherlands and Austria (Castle 2011; Spiegel and Pignal, 2011). The second issue was the provision of any formal conditionality – or, alternatively, of some flexibility – for the rescue fund. According to northern countries, it was necessary to establish some kind of formal conditionality for those countries accessing the EFSF, so as to limit the possibility of moral hazard. For their part the ECB, the European Commission and member states that accessed financial aid programs called for a re-discussion of lending conditions, i.e. lower interest rates and more flexibility – so as to avoid

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93 Less than a week after the creation of the EFSF, the Euro fell to its lowest level against the dollar since November 2008 (Bowley 2010).

94 Irish government official requested the access to EFSF on November 22, and it was agreed by the Ecofin a few days later, for a total amount of €85 billion.

austerity measures imposed by creditors strangling any possibility of economic recovery (Spiegel and Peel 2011). A third element was represented by the involvement of private creditors into an eventual default of a country. This was one of the main arguments of German government, and it was functional to present German government's role in the bailouts to domestic electorate; and the decision was taken in the famous Deauville meeting between Chancellor Merkel and President Sarkozy in October, 2010. The main point of the agreement was an exchange between the two parties: on the one hand, Germany renounced to have automatic sanctions in the new framework of fiscal rules[95], on the other, France accepted the so-called "collective action clause" in the future bailout, strongly opposed by ECB President Trichet (Bastasin 2012: 232). According to the Deauville agreement, any eventual "grand bargain" on a future revision of the EFSF should pass through the provision of the private sector involvement. The final, and more technical, yet politically relevant, issue about an eventual transformation of the EFSF was the possibility for the facility to operate to directly purchase sovereign bonds. This possibility, highly welcomed by the ECB – which was adamant to decrease the central bank's involvement into direct bond purchase[96] – and by debtor countries, was opposed by Germany, which saw in the measure the possibility of directly financing national debt, against treaty's provisions (ibid: 262-263).

The long negotiations for a structural rescue fund in the Eurozone, then, passed through the debates over these issues, and the long creation process of the ESM somehow reflected the difficulties of composing the different positions of actors at stake. A first, though vague, reference to a future ESM was made in the Deauville meeting by Angela Merkel, and then included a few days later in the Van Rompuy

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[95] As noticed in §3.2.2, the agreement in Deauville demonstrates how much the policies under scrutiny have been interrelated during the crisis. From a methodological point of view, it shows that every single policy is not fully causally independent, but its development may be subject to some events related to another case-study. Nonetheless, it is an unavoidable consequences while dealing with the Eurozone crisis, because of its multifaceted character.

[96] In May 2010 the ECB had started the SMP (see *infra*).

Task Force report (2010), which stated that "in the medium term there is a need to establish a credible crisis resolution framework". The turning point came with the Irish crisis in November 2010[97], when states realized that it was time to act, and the same day of the approval of a line of credit for Ireland, the European Council invited Ecofin to approve the creation of the ESM (Djankov 2014: 131). The plan included the "collective action clause", but only starting from 2013, so as to reassure investors in the present. It took some months of negotiations but the fear that contagion could spread to Portugal assisted agreement among member states.[98] In the Euro-area summit of March, 11 the lending capacity of the EFSF was increased up to €440 billion, and the ESM was designed to have one of €500 billion. France was inclined to put on the table €1 trillion as maximum lending capacity of the ESM, but Germany and Finland opposed this decision (ibid). In the same meeting, Merkel conceded that the ESM could directly buy bonds on the primary market, but that purchase on the secondary market was blocked (Bastasin 2012: 263). The idea of issuing Eurobonds, which was newly advanced by France and southern rim countries, and backed by the European Commission, was also blocked (Djankov 2014: 131-132).

Nonetheless, the effective creation of the ESM was not possible until the European Council by unanimity decided to operate a treaty change, which they agreed during their summit on March, 25 (European Council 2011). On that day, they agreed in adding a paragraph to article 136 TFEU, which states: "The Member States whose currency is the Euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the Euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality". The treaty change, obtained through the simplified revision procedure introduced in the Lisbon

[97] The contagion to Ireland of the sovereign debt crisis represents the second wave of the Eurozone crisis, according to the chronology proposed in §3.2.

[98] Indeed, the decision of creating the ESM was taken on the same day in which Portuguese government resigned, which opened the way to the financial rescue of the country.

Treaty[99], was a necessary step required by Germany in order to circumvent any eventual objections by the Federal Constitutional Court. The treaty for the establishment of the ESM was finally signed in July, 2011, and then slightly revised in February 2012 in order to increase its lending capacity. After the conclusion of the ratification process, it became operational in October of the same year, one year before the expected expiration of the EFSF.

Legally speaking, the ESM is an international financial organization under international law, based on an international agreement between the seventeen member states of the Eurozone (Bianco 2012). The treaty establishing the ESM, then, is a pure intergovernmental creation, which nonetheless has direct implications for the framework of the European Union and the Eurozone in particular (ibid.). It has a permanent character, enjoying a total subscribed capital of nearly €705 billion. This includes €80 billion in the form of paid-in capital provided by the Euro area member states and €625 billion of committed callable capital, that is, money that member states can be called to pay to absorb eventual losses (Munchau 2011). In order to collect money, as the EFSF, the ESM can issue bills, bonds and other funding instruments, but being an independent organization, it is less vulnerable to eventual downgrades of its members, which was a major shortcoming of the EFSF.[100]

The purpose of the ESM is to provide financial support to countries which are experiencing, or are threatened by, severe financing problems. However, unlike the EFSF, the ESM foresees clear measures of conditionality. The most important of these is that a country, in order to be eligible to receive ESM funds, must have signed and ratified the Fiscal Compact. In this sense, the rescue fund has incorporated a major

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[99] For a discussion on the legal implications of the Treaty change and of the creation of the ESM, including the role of the Parliament in the Treaty revision process, see De Witte (2011).

[100] The problem of a possible "can't pay, won't pay" problem in case of major difficulties of a ESM contracting party, however, it is not fully overcome. Namely, major problems may come in case a weak State without a AAA credit rating, i.e. Italy, is called to increase its capital in the ESM in order to help another country, and such endowment might possibly deteriorate Italian finances (Manasse 2011).

negotiation point of Germany. Chancellor Merkel moreover obtained agreement that any major decision, i.e. whether to come and rescue a member state, must be taken by unanimity of Eurozone members (Manasse 2011). All in all, then, Germany succeeded in obtaining the maximum value from its economic and political weight during the negotiations. As the major contributor, although in principle against any form of rescue mechanism that might trigger moral hazard, Germany managed to design a permanent rescue mechanism almost fully reflecting its preferences over the final outcome, including private sector involvement, conditionality with the ratification of the Fiscal compact, up to the prohibition for the ESM to operate on the secondary market, so as to avoid its transformation into a fiscal instrument.

5.3.4. The intervention of the ECB: The Securities Markets Programme

Even if supranational institutions did play some minor role in shaping the creation of the different instruments of financial assistance to member states as mentioned above, the programs were largely conducted by governments under a preeminent intergovernmental umbrella. On their effectiveness, however, investors were doubtful: as had happened for initial bilateral loans to Greece and for the EFSF, financial markets soon discounted the ESM too. Its major shortcomings were, again, the insufficient lending capacity– "too little, too late"– and its complex voting mechanism preventing any emergency provision of funds, and finally its funding system, still too much subject to the "can't pay, won't pay" dilemma (Manasse 2011; Munchau 2011).

Actually, the creation of the ESM, even though its concrete implementation started only in late 2012, did not prevent the contagion of the Eurocrisis to the core of Europe, i.e. Italy and Spain, in the dramatic summer of 2011 and the even more dramatic autumn of the same year[101], "the point where clearly the Eurozone as we know it could have exploded", according to a French official (Spiegel 2014b). The main limits of the instruments adopted were a direct consequence of the deliberative method in the EU (Copsey and Haughton 2012).

101 These are identified as the third and fourth waves of the crisis, see §3.2

The the presence of too many actors and of their diverging preferences involves too many veto-players, bringing about two major problems. The first is timing. European actors seemed to react to events, rather than shaping them (ibid.). The second is effectiveness. The necessity of accommodating divergent interests brings about policy outcomes that, being a compromise, fail to effectively address the underlying problem. That is why the intergovernmental momentum opened up a political vacuum during the crisis, and in particular in this specific policy sector, in which the ECB could step in.

The ECB's stance favored persuading member states to collectively act in order to address the crisis. The main reason of this attitude lies in the ECB mandate. According to article 127 of the TFEU, the ECB has the sole goal of maintaining price stability in the Eurozone, defined as a year-on-year increase in the index of prices for the Euro area of below 2%. It is commonly known that, unlike the US Federal Reserve, the ECB can sustain economic growth and full employment only without prejudice to the objective of price stability. Moreover, according to article 123 of the TFEU, the ECB cannot directly finance member states debt through money creation. In other words, it cannot act as the lender of last resort of the Eurozone[102] (Hu 2014), which represents a major "unsolved political problem" of the monetary union (Matthijs and Blyth 2015).

The bank since 2008 has struggled to maintain a fragile balance between treaty requirements and the compelling necessity of facing the crisis, even more so in the case of policy failures or deficient policy making by member states. In this sense, the ECB's attitude evolved, passing from the defense of monetary orthodoxy up to the implementation of so-called "non-standard measures", in the same logic followed by other central banks across the world. Indeed, at first President Trichet strongly defended the institution's independence and excluded any possible bailout of Greece by the ECB (Trichet 2010). Later, however, the central bank elaborated three different programs of bond-purchase, indicating a more and more active interventionism in

[102] For a discussion on the issue of ECB as lender of last resort in the Eurozone, see De Grauwe (2011).

this policy area, through a progressive stretching of its mandate.[103] In 2010 the Securities Markets Programme was implemented, in 2012 Outright Monetary Transactions were created, and finally in early 2015 the ECB started its program of Quantitative Easing.[104]

SMP is a program of bond purchase implemented by the ECB between 2010 and 2012[105] (ECB 2010b). Notwithstanding the formal prohibition for the ECB to directly finance states' debt, it can operate on the secondary market – that is, purchasing sovereign bonds already issued in the open market – as a normal investor, an option taken up by the bank in due course. In this way the ECB succeeded in sustaining European countries under market pressure, with the result of temporarily relaxing Europe's over stressed peripheral states (Eser and Schwaab 2013). The ECB enacted two different rounds of SMP: the first was decided in May 2010, and a second round was set up in 2011 when crisis spread to Spain and Italy. The total amount of money released in the two SMP rounds is around €220 billion, massively directed towards Italian (around €100 billion), Irish, Portuguese, and Spanish bonds. Despite the boost represented by the SMP, its potential is not infinite:

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103 For sure, the role of ECB during the crisis is not limited to this interventions, but spans from the support of banking institutions through different rounds of Long-Term Refinancing Operation; the participation in the Troika for monitoring the respect of conditionality in the rescue programs, up to the re-orientation of the classic instruments of monetary policy. As to help Greece at the onset of the crisis, the ECB also decided to accept Greek debt as a collateral even in case of credit rate downgrade. For a discussion on the ECB role during the crisis, Barbier (2012), Irwin (2013) and Torres (2013).

104 The analysis will not closely consider QE, as it resides out of the temporal scope of the analysis (2009-2014). Nonetheless, it is worth noticing that it can be seen – for the moment – as the apex of the open and non-standard intervention of the central bank into this specific policy area, thus a sort of prosecution in the line of SMP and OMT, which confirms the trends highlighted in this chapter.

105 In line with the methodological assumptions of the dissertation, the ECB is considered to be a unitary actor, even though it is commonly known that these interventions provoked an internal division within the Governing Council, namely because of the opposition of German members. Indeed, Jurgen Stark and Axel Weber resigned after the adoption of non-standard measures, both in disagreement with the operations of bond-purchase implemented by the ECB.

the idea underlying SMP, indeed, is not to finance states without limits of money and time, but rather to buy time for governments in order to have the reforms voted and implemented, as confirmed by Italian member of ECB Governing Council Lorenzo Bini Smaghi (Spiegel 2014b).

The timing and climate in which the SMP were adopted was the one of the first Greek bailout, in early May 2010, when the confrontation between those defending ECB independence and others claiming for a bold intervention was at unprecedented levels (Bastasin 2012: 202). While openly Trichet was lobbying member states to act, with the threat the ECB would not come to rescue Greece, in a meeting in Lisbon the Governing Council of the ECB – with the opposition of German and Dutch representatives – decided to start the SMP, but to keep that a secret from the finance ministers and heads of state until they'd reached their own deal on the Greek rescue (Irwin 2013: 261). A few hours after the announcement of the creation of the EFSF, President Trichet launched the first round of SMP. In order to remain within the legal framework of the treaties, the operation was justified as necessary to "reestablish the proper monetary transmission mechanism" in "those market segments that are dysfunctional". In this sense, the spirit of Maastricht Treaty would be violated, while keeping to the letter of the law (ibid: 253). Moreover, so as to avoid a rise in the inflation rate, the program included a mechanism of "sterilization" – such that the SMP would not be allowed to result in an increase in the Eurozone money supply overall.

At first, the program worked. Spreads of PIIGS bonds sharply decreased after the launch of the SMP, but the program had the effect of reducing not only the pressure of financial markets, but pressure on southern countries to undertake structural reforms. The ECB, indeed, decided to suspend the program in March, and it was reopened only when the crisis reached the core of the Eurozone. In this sense, given that a round of bond purchase may decrease borrowing costs for almost 100 basis points for troubled states, the SMP emerged as a means to punish or reward the actions of governments (ibid: 365). In this climate, in August 2011 the ECB sent the notorious letters to the prime ministers of Italy and Spain spelling out what they needed to do to regain the confidence of markets (Corriere della Sera 2011), with the none-too-subtle implication that if they did not agree to the plan described, the central bank would cease buying bonds to ease the market pressure on them (Irwin 2013: 363).

5.3.5. The final step: Outright Monetary Transactions

As time passed, the effectiveness of SMP decrease. As a program of limited purchases, financial investors found ways to keep yields at high levels. In the turbulent political phase of late 2011[106], Mario Draghi became the new president of the central bank, and he soon launched two unprecedented operations of liquidity for the European banking system, the LTROs (Wyplosz 2012). The underlying idea was to let the banks fund themselves at very cheap costs – the total amount of LTRO two rounds was around €1 trillion – so as to have them purchase sovereigns and ease the ECB's burden of purchase programs.

In the next summer, nevertheless, a fifth wave of the crisis approached, this time related to the fear of Grexit due to the Greek general elections. At that time, the Spanish bank Bankia went burst, companies began prepare for a Euro break up, and Italian and Spanish yields soared yet again. The Eurozone, again, seemed on the brink, when in London, on July 26, President Draghi declared that the central bank was ready to do “whatever it takes to save the Euro”. Indeed, two months later, he was to announce the suspension of the SMP and the creation of a second program of non-standard measures, under the name of Outright Monetary Transactions. OMT are programs of unlimited purchase of sovereigns made by the ECB under strict conditionality, which are implemented when a state clearly shows its intention to apply. It goes as follows: when a state needs a credit line, it asks for the intervention of the ESM, then accepts some terms of conditionality. In this scenario, ECB guarantees unlimited support to finance the ESM. Being

[106] In a few days panic spread again Europe in October-November: after calling for a referendum in order to have austerity measures approved in Greece, Papandreou resigned; in the meantime, Berlusconi left Italian government after some turbulent weeks in the domestic and international stage. For an account, see Spiegel 2014a.

apparently a limitless support to member states, its strength is its real power of deterrence (ECB 2012). Speculation is foreclosed because no investor would bet against a central bank showing clear intentions of full commitment, even for bond markets as large as Spain or Italy.

OMT makes up for the two main deficiencies of the SMP: OMT are programs of *unlimited* purchase, and they present *explicit* conditionality. What is similar to SMP, is the underlying technical rationale: according to Mario Draghi, OMT are not an intervention in the fiscal policy of member states, but a monetary policy to "remove tail risks related to unfounded fears regarding the Euro, [that] was essential to fight fragmentation of the Euro area markets" (Barber and Steen 2012). The fact that, up to now, OMT have not still being implemented, suggests that they could be the definitive arm against speculation on sovereigns. As the course of spreads and CDS show, indeed, market pressure seems to have declined markedly after the launch of OMT (see appendix, fig. a5).

As one can easily guess, the underlying negotiations behind OMT creation was not easy.[107] Once again, the turbulent process of policy creation reflected the recurrent cleavage among member states on the solutions to be found to sustain weak countries. The project of establishing a credible, unlimited program of bond purchase was opposed by Germany at every level, both at governmental level and within the Governing Council[108]. On the contrary, it was welcomed by Italian PM Mario Monti and all debtor countries, as well as by United States. Spiegel (2014a) reports that Professor Monti in a G20 meeting in Los Cabos, on June, succeeded in creating an axis with President Obama in order to convince Chancellor Merkel to agree on a ECB–

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[107] As an ECB program OMT should have been independently decided by the central bank, but being a very sensitive instrument, president Mario Draghi tried to negotiate its creation in order to obtain a large consensus on the measure among all the European actors involved.

[108] Jens Weidmann voted against OMT, and its view was known. During the conference press for the presentation of OMT, asked if the decision to enact the program was unanimous, Draghi told reporters, "There was one dissenting view… It is up to you to guess."

backed firewall, that is, on the possibility for the ECB to buy sovereign bonds in strict liaison with the ESM. A few days later, Monti is reported to have opposed its veto to a German proposition in the European Council, in order to force Angela Merkel to back a sort of "anti-spread shield" (Barberi and Feltri 2014: 89-92). These harsh negotiations effectively broke up the northern creditor coalition and let the ECB operate without the explicit opposition of its biggest contributor, Germany.

Mario Draghi's strategy, indeed, was to try to obtain the agreement of Angela Merkel for its bond-purchase program, because without German participation the program would be considerably less credible. Such agreement was reached through the introduction of the major feature of OMT, i.e. its explicit conditionality. In this way, Draghi managed to convince Merkel on the merits of the program, lessening the feared risk of moral hazard, and opening up the space for what has been considered the "coup de grace" of the Euro crisis (Spiegel 2014a).

5.4. Hypotheses validation: The case of financial support instruments

Unlike the previous case study on fiscal rules, this one does not offer the possibility of tracing a policy change with respect to the pre-crisis period, as the policy of financial support to countries in need was absent, due to the no-bailout clause. Nonetheless, the policy saw an incremental transformation since the beginning of the sovereign crisis, when it was implemented mainly through bilateral loans, up to the late developments, when supranational and EU-wide programs and instruments were set up. That is why the attention in this section will be put on the institutional transformations occurring within the crisis period, i.e. between early 2010 and late 2014, and the three leading hypotheses will be tested for this span of time.

5.4.1. Hypothesis n.1

The first hypothesis claims that "An economic crisis is a fundamental driver of major institutional changes, both in terms of their quantity and quality", that is to say that policy making is multiplied during economic downturns in response to the challenges coming from external market pressure.

The discussion on the creation of the different instruments of financial support to peripheral states showed that - unlike in the pre-crisis period, when the formal establishment of a rescue mechanism was peremptorily excluded by member states as to avoid moral hazard – Eurozone members progressively set up a framework of financial assistance, including a stable rescue facility, the ESM. One of the main aspects of this policy sector is that EU governments always seemed to react to external pressures, setting up what was perceived as necessary by financial investors, and trying to follow the timing required by financial markets. This climate of urging pressure is witnessed by the reconstructions made by the same actors: finance minister of Bulgaria, Simeon Djankov, recalls that during the negotiations on whatever instrument of crisis management "markets reactions to Ecofin decisions became a bigger part of our considerations […]; there was an explicit discussion in Ecofin of how much information would be sufficient to placate markets on any one issue" (Djankov 2014: 71); Christine Lagarde, during tense EFSF negotiations, was reported to be particularly fearful of the opening bell of financial markets in Tokyo, and to call out the names of markets as they opened (Hewitt 2014: 80). That demonstrates how much external pressure – extraordinary well represented by the image of the opening of Asian markets, normally on Monday – was functional to the decisions that were progressively taken in the crisis years.

To be more specific, one can find some correlation between the indicator used to signal the raise of market pressure, i.e. the course of spreads and CDS on sovereign bonds, and the adoption of policy outcomes (see appendix, fig. a6). Indeed, the policy outcomes analyzed were all adopted when the crisis hit the most, according to the different peaks identified in the overview of the crisis. The first wave of the crisis, the one due to the outbreak of the Greek crisis in early 2010, brought about the adoption of the first bailout package and the creation of the EFSF.[109] Moreover, in the same week the ECB set up its first

[109] And of the EFSM as well, which has not been tackled in the chapter.

program of bond purchase, the SMP. What is peculiar is that these three instruments were progressively set up because financial markets seemed not to welcome what had been done before: the EFSF became necessary as markets judged as insufficient bilateral loans, and the ECB decided to intervene fearing that states would not find an agreement on Greece, which would be disastrous for financial stability in the old continent.

When it comes to the ESM, the process of its creation perfectly reflects the course of the crisis. It began to be felt as necessary when the contagion spread to Ireland, as the shortcomings of the EFSF emerged. Indeed, on the same day of the approval of a line of credit for Ireland, the European Council invited Ecofin to approve the creation of the ESM (Djankov 2014: 131). Then, the treaty reform for its creation was agreed when Portugal was under market pressure, and the final signature of the treaty establishing the ESM was in July 2011, in the middle of the financial storm which menaced Italy and Spain, during the third wave of the crisis.

Finally, concerning the intervention of the ECB in the policy sector, we've seen how much SMP creation was due to market instability. For sure, even the set up of the other programs was highly influenced by the behavior of financial markets. The two LTROs in support of the banking sector were decided during the fourth wave of the crisis – in autumn 2011, probably the most dramatic phase of the Eurozone crisis. The OMT, for their part, were the concrete realization of the "whatever it takes" discourse by Mario Draghi, in July 2012, in the middle of the fifth wave of the crisis, due to the re-emergence of Greek troubles. Indeed, it was after some weeks of tense negotiations to buy the agreement of Germany that the ECB launched the Outright Monetary Transactions, which decidedly contributed to calm down markets nerves.

It appears quite clear, then, that the first hypothesis is confirmed by empirical data concerning the case study on financial assistance to states in need. There is, indeed, a significant causal link between the pressure exercised by financial markets on policy makers, and the adoption of policy outcomes.

5.4.2. Hypothesis n.2

The second hypothesis of the dissertation inquires on the relationship between decision making processes and whether outcomes were successful or not. In particular, the hypothesis claims that intergovernmental decision making result only in incremental and ineffective policy outcomes, including the possibility of institutional deadlocks, while supranational decision making, on the contrary, will produce successful outcomes and solve eventual institutional deadlocks. In other words, the outcomes of negotiation processes are not a pure reflection on states' and institutions' bargaining powers, but they are mediated by the existing institutional setting. Institutions, then, coordinate actors' behavior toward certain outcomes and shape the information structure.

To start with, it is necessary to assess how the effectiveness of a policy outcome can be assessed. Given that the policy at stake is set up to relieve weak states from the pressure of financial markets, a good indicator to assess the successful character of a policy outcome is its effectiveness in meeting markets' expectations. That is to say, a certain policy outcome is not considered to be effective only if it succeeds in rescuing a country[110], but if in doing this it offers a credible solution to the crisis, which can be measured through the observation of markets' reactions to the outcome, i.e. through the change in spreads and CDS on sovereign bonds. In other words, if market conditions deteriorate after the adoption of a policy outcome, it has to be considered as unsuccessful, while if markets' nerves are calmed, represented by a decrease of CDS and spreads, it can be considered as effective.

In this sense, in line with the empirical data reported above, one can assess that pure intergovernmental instruments – bilateral loans, EFSF and ESM – were far less effective than supranational programs adopted by the ECB. Or, to be more precise, bilateral loans and the EFSF were very weak in meeting markets expectations, while the ESM was slightly

[110] According to this perspective, indeed, ECB's programs would be ineffective as they've never formally contributed to a bailout, and even the first Greek bailout through bilateral loans,which was very poorly welcomed by markets, would be considered as effective.

more convincing, but it presented nonetheless serious shortcomings undermining its credibility.

It has been noticed that the first bilateral loans for the first Greek rescue in early 2010 were very poorly received by financial investors, so badly that European governments were forced to create a further facility just a few days later. Indeed, less than a week after the agreement on the first bailout, interests on Greek bonds soared at impressive rate. Those of other peripheral countries also increased (Djankov 2014), interbank lending froze and the market returned to pre-Lehman levels of panic (Ludlow 2010). The reason is that governments agreed on a program that was at the same time too little and it came too late, and it was unable to stop any risks of contagion. Seemingly, markets reactions to the EFSF were positive only for a few days, until they realized its major shortcomings. Namely, that the amount of the facility was insufficient, that the SVP mechanism did not provide real money, that there was a heavy activation process and that the facility was temporally limited. Again, the outcome was too little with regard to the necessities imposed by the situation. Such market reactions demonstrate that, though the two instruments were able to offer financial assistance in the short term, they were not able to represent sustainable solutions to the crisis in the middle and long term.

On the contrary, scholars have highlighted the positive impact of the SMP, the program launched by the ECB in those same days of May 2010, in terms of influence on spreads and CDS (Eser and Schwaab 2012). In particular, the different rounds of bond purchase by the ECB corresponded to a sharp decrease of yields among sovereign bonds. Moreover, the suspension of the program decided in March 2011 had as a consequence an expansion of the crisis, which spread to Italy and Spain, until the ECB did not decide to launch another round of SMP to relieve the two countries (Savelin and Darvas 2012). Actually, the SMP seems to be "very significant" in positively influencing spreads of the country whose bonds are purchased (ibid.).

When it comes to the ESM, its main shortcoming is due to the very long process of decision making behind its adoption. It took two years, indeed, from the first references to an eventual transformation of the EFSF into a permanent mechanism, discussed in Deauville, in October

2010, for the first time, up to its definitive activation in October 2012. Indeed, the process involved a treaty change, the signature of an international agreement, and finally a process of ratification, being the ESM a pure intergovernmental creature. In the meantime, events made it necessary to bailout Ireland, Portugal, Greece again, and the Spanish banking sector. All in all, then, even if the ESM can be better placed as an instrument of crisis management in the long-term – due to its permanent character and its bolder financial endowment – the intergovernmental negotiation process behind its creation provoked an institutional deadlock which exacerbated the crisis, as markets realized that EU governments were not ready to quickly respond to crisis with comprehensive, credible and long-sighted measures.

As a last instrument here analyzed, OMT were set up in mid-2012 by the ECB, and they were presented as the "bazooka" used by the central bank to save the Euro (Steen et al. 2012). The program, which was never implemented, resulted then as a successful deterrence instrument (ECB 2012). Indeed, a formal inclusion of conditionality, as well as a promise to unlimited bond purchase in case of activation make the OMT a credible commitment of the ECB to save the common currency. By consequence, the launch of the program in 2012, together with its anticipation in the "whatever it takes" pledge by Mario Draghi in July, resulted in a considerable, and lasting, decreases in bond yields and CDS for European weaker states. All in all, if the crisis is not yet over – the crisis in Cyprus occurred after the launch of OMT, and at the time of writing a new Greek crisis has re-emerged – OMT represented a credible instrument of crisis prevention, one that markets waited for since 2010, and in response to which they considerably relented their pressure on the Eurozone.[111]

As a result, it appears that the three instruments adopted throughout intergovernmental decision making were far less effective than the ones adopted by a supranational institution. It is then necessary to

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[111] The general level of spreads is considerably low after the launch of OMT with respect to the levels of 2011-2012 (see appendix, fig. a5): even the banking crisis in Cyprus didn't manage to skyrocket bonds spread as it happened for the prior waves of the crisis.

understand why the Eurozone witnessed such dichotomy between supranational effectiveness and intergovernmental deadlocks. The response to the question can be found in the institutional setting that was in place before the outbreak of the crisis. First of all, the institutional setting precluded the adoption of policy outcomes through the community method: co-decision indeed is the normal legislative procedure for those competencies which states have already devolved in the hands of the EU. Financial assistance to states in need, on the contrary, was never set up as an official policy of the EU, so the community method could not be used. By consequence, decision making was carried out through two main processes: intergovernmental crisis management, in which states at unanimity ruled out their decisions, and supranational decision making, in which a quasi-federal institution, the ECB, independently decided the development of its monetary policy in response to the crisis.

According to scholarship, a comprehensive solution among member states could be found at the very beginning of the crisis, i.e. before May 2010, and this would be far less costly than the ones then implemented (Bastasin 2012: 148). Even lacking any counterfactual argument, one can easily imagine that a cheaper and less fatiguing solution could certainly have been found. As an intergovernmental policy, at the basis of much of the problems occurring in the last years, there was the necessity of getting the unanimity of all governments in the face of divergent preferences, which is a challenging operation due to the eminently redistributive nature of the policy at stake. Moreover, states have been confronted with the classical dilemmas of intergovernmental negotiations (Fabbrini 2014), and with the veto dilemma in particular. This refers to the necessity of neutralizing opposition and multiple veto players in a unanimity rule regime, a direct consequence of which is the adopting of non-optimal decisions, representing the only possible minimum compromise, in a longer span of time than a majority vote would suggest. This is at the core of the "too little, too late" label given to much of the policy responses adopted by Eurozone governments.

Moreover, treaty provisions acted as an obstacle to a linear development of the policy, in particular due to the presence of some articles precluding the creation of EU-wide rescue facilities, namely the already cited articles 123 and 125 TFEU – the no-bailout clause.[112] As a result, some comprehensive solution which was proposed, could not be implemented because of major limits of the treaties – see for example the proposition of a European Monetary Fund, which was abandoned because it required a treaty change. Likewise, the long negotiations that occurred for the set up of the ESM were partly due to the necessity of a treaty change (article 136 TFEU) to be reached by unanimity of member states. This necessary step considerably weighed on the speed of the process. In this perspective, at least two institutional rules – formal treaty provisions, and the unanimity regime in intergovernmental decision making – represented a main obstacle to the effectiveness of policy outcomes.

Besides, another type of institutional rule was fundamental in shaping the policy process: the defense of the independence of the ECB, equally foreseen by EU treaties at article 282 and by the ECB mandate, preventing a politicization of the institution, and by consequence an earlier and more direct intervention in the bond markets. In this sense, the ECB could not be called to act by governments – even if some of them often lobbied the bank for active intervention – but the Governing Council independently decided to act when it considered it necessary.[113] Nonetheless, a stretched interpretation of the treaties was functional to an intervention of the ECB. Indeed, in the presence of article 123 TFEU, the ECB did not present the two non-standard measures as instruments of financial rescue, but as unconventional monetary instruments to re-

[112] In the end, the presence of the no-bailout clause did not prevent the set up of rescue facilities nor the interventions of the ECB, as a loose interpretation of the article prevailed (Louis 2010; Bianco 2012). Nonetheless, the presence of the clause made the creation process of the ESM considerably more difficult and time-consuming an undertaking.

[113] Within the Governing Council decisions are taken by majority. As a result, there are fewer possibilities of having blockage minorities. Actually, the opposition of the German representatives of the ECB Board to a progressively more interventionist approach of the ECB was not sufficient to block the process. Moreover, in order to reinforce the independence of the single members, transcriptions of the board meeting are kept secret for thirty years, which makes the monetary policy definition easier and less politicized, by limiting internal fractures as compared to, say, the European Council.

address dysfunctional financial markets. From a theoretical point of view, the fact that both the ECB mandate and the no-bailout clause were loosely interpreted, confirms that incremental institutional change can occur through open interpretation of formal rules that can evolve in line with external contingencies (Mahoney and Thelen 2010). All in all, in line with the theoretical assumptions of the dissertation, institutional rules appear to be fundamental in two main aspects: on the one hand, their presence influences the nature of policy outcomes, which are not a pure reflection of actors' bargaining powers, but they're mediated by the existent institutional settings; on the other hand, policy outcomes are themselves the product of an institutional change, sometimes formal – i.e. a treaty modification, the creation of a new agreement – sometimes informal – i.e. a more flexible interpretation of rules.

As a result, the discussion of the empirical data offers a clear-cutting confirmation of the second hypothesis of the dissertation for this second case study. Namely, intergovernmental policy making resulted in incremental and ineffective policy outputs – "too little, too late" – and in institutional deadlocks, as the creation of the ESM shows. Conversely, supranational policy making carried out independently by the ECB resulted in successful and more effective outputs, which contributed, if not to put a definitive end to the Eurozone crisis, at least to a certain relief of states in need.

5.4.3. Hypothesis n. 3

According to the third hypothesis, "In the case of policy failure due to irreconcilable conflicting interests or institutional deadlocks, a process of delegation to a neutral – i.e. supranational – actor occurs, resulting in an empowerment of supranational institutions *vis-à-vis* member states". Here, the empirical data provide only a partial confirmation. Indeed, on the basis of the clear distinction made between the limited effectiveness of intergovernmental decision making and the more successful intervention of the ECB in the field of financial support to member states, it may appear that the ECB was delegated to act by member states in order to provide better policy solutions. Nonetheless, due to the independent nature of the central bank, there was never an explicit and formal delegation of authority towards the ECB – as it happened for the European Commission and the ECJ in the previous case study. Rather, this process of supranational empowerment was more an unintended consequence of failed intergovernamentalism, than a formal delegation of powers.

In other words, even if ECB actually stepped into the policy making process in order to counterbalance the problems created by intergovernmental crisis management, such activism was not a consequence of a formal act of delegation by Eurozone governments, but the independent choice of the Governing Council of the ECB enjoying its positional resources and full discretion as an independent actor (Héritier and Prakash 2015). Of course, a coalition of states have always been lobbying for bold intervention of the ECB in bond purchases. However, these claims, by France, Italy and peripheral states in general, and fiercely opposed by northern countries, were there, but they were not the source of any formal *de jure* delegation of power, which indeed never took place.

As a consequence, even if there seemed to be a *de facto* delegation to the ECB for the solution of the sovereign crisis, such delegation was not formally required, nor decided, by member states – as it would also be illegal under EU treaties. Rather, this policy sector has seen a process of unintended delegation of powers towards the ECB, which turned out to be better equipped to offer long-term solution to the crisis. In this sense, the third hypothesis is partially confirmed: institutional deadlocks created by intergovernmental management of the crisis may have seen a *de facto* supranational delegation of powers toward the ECB, but such delegation was neither formally required, nor causal of formal transfer of competencies to the supranational level. In other words, it is simply an "emergency delegation" that the ECB assumed on its shoulders and that will likely disappear when the crisis is over.

While out of the scope of the research, it is worth noticing as well that at least one formal act of delegation toward supranational institutions was ruled out during the crisis with regard to the "bailout policy". The Troika, composed by officials of the supranational ECB, European Commission and IMF were denied the power of monitoring the respect of the conditionality in the countries under financial assistance.

5.5. A progressive supranationalization of bailouts? An assessment

As a general conjecture underlying the dissertation, economic crisis is considered as a trigger of the supranationalization of the European polity. It is then necessary to assess wether this happened or not for this case study. As a general consideration, since there was no rescue mechanism at the European level to support member states *before* the crisis, the mere fact of having provided a series of them throughout the crisis, can be considered to be an advancement toward a more integrated Europe. Nonetheless, the analysis will be carried out by applying for this case study the different indicators functional to build up an index of supranationalization .[114]

It has to be noticed that, in lack of a defined policy of financial assistance before the outset of the crisis, a sort of "intra-crisis" comparison will be carried out. That is, the first set of measures adopted to counteract the financial crisis – i.e. the provision of bilateral loans – will be compared to the institutional setup at the end of 2014 – i.e. when financial assistance to states in need is composed by the ESM and OMT, working together. Some references, in case, will be devoted to what can be considered as a mid-range level of institutionalization of the policy, the EFSF.

The index of supranationalization for this case study is composed of three main dimensions, each of them having policy-specific indicators (see table 4). Concerning the first dimension of the index (the overall supranational management of the policy cycle), the indicators correspond to the four different phases of the policy management: agenda setting, policy formulation, implementation and monitoring. For each of them, the role of governments or supranational institutions will be checked, so as to assess the overall level of supranational management of the policy. The second dimension (power of supranational institutions) is assessed by looking at eventual delegation of competencies and authority to the supranational level for this policy area, the level of policy politicization and the role of supranational institutions in enforcing eventual rules of conditionality. Finally, the

[114] For further references, see the methodological section, §2.5.3

third dimension finds its policy-specific indicator in the assessment of the supranational level of the combination between ESM and OMT, that at the end of 2014 represented the policy framework reigning the policy of financial assistance to member states. Like the previous case study, each indicator will be assigned a value, ranging from 1 (very low level of supranationalization) to 5 (very high level of supranationalization). The elaboration of different values of the indicators is then functional to make an assessment on the level of supranationalization of the whole policy at stake.

	ONSET OF THE CRISIS	**LATE 2014**
- Agenda-setting	1	1
- Policy formulation	1	1
- Implementation	2	3
- Evaluation	2	4
= (1) SUPRANATIONAL MANAGEMENT OF THE POLICY	**1.5**	**2.25**
- Delegation of competencies	1	3
- Policy politicization*	2	3
- Enforcement of conditionality	3	4
= (2) POWER OF SUPRANATIONAL INSTITUTIONS	**2**	**3.3**
- Instrument of financial assistance (ESM+OMT)	1	3
= (3) SUPRANATIONAL MECHANISM	**1**	**3**

* The value of supranationalization is to be considered as the inverse of the hypothetic value of the indicator (e.g. a low level of politicization corresponds to a high level of supranationalization).

Table 4. Instruments of financial support: Index of supranationalization.

To start with, it is necessary to note that as a general rule, the policy is mostly intergovernmental in the phase of agenda setting and policy formulation. Indeed, since the beginning of the crisis, short of any EU competence in the field, member states' governments have been the protagonists of the policy making, and the legislative competences in this sector was not even partially transferred to the supranational level. It has been noticed, for instance, that the community method was not undertaken and that the Commission's proposition for the creation of Eurobonds was never seriously tackled by the European Council.

As a matter of fact, the multiplication of EU summits at governmental level perfectly reflects this sort of "intergovernmentalization" of the policy making in the field. This is translated into a very low value (1) for two indicators (the phases of agenda setting and the one of policy formulation) both at the onset of the crisis and in late 2014. Nonetheless, the policy of financial support saw a certain increase in the involvement of supranational institutions, namely the Commission and the ECB, in the phases of implementation and evaluation. Indeed, from the start of the crisis, being part of the Troika, the two institutions progressively obtained the power of monitoring compliance with conditionality for those states under assistance programs – conditionality that was, for its part, progressively strengthened and formalized in the different instruments created. More importantly, the ESM foresees the elaboration of a Memorandum of Understanding between the European Commission and the country in need, to set up policy conditions (ESM 2015), which was not foreseen for the delivering of bilateral loans. This signals a certain involvement of EU institutions in the two other phases of the policy management, the implementation and the evaluation. As a result, though being the policy still managed eminently at intergovernmental level, during the last years the level of co-management at supranational level slightly increased (from an overall level of 1.5 to 2.25). In other words, the policy passed from a level in which there was no coordination at all among European governments and institutions to one in which a certain coordination is observed.

Concerning the power of supranational institutions in the broad field of financial support to states in troubles, empirical observation highlighted the progressive empowerment of the ECB, mainly as a response to unsuccessful intergovernmental policy making. According to the result of the third hypothesis' test, the economic crisis seems to trigger a sort of informal and unintended delegation to the ECB of the burden of financially rescuing states in need. If in May 2010 states tried to organize the rescue program through fully intergovernmental processes, in late 2014 there was a far deeper integration of supranational instruments, namely the OMT and ESM.

Moreover, the crisis triggered a higher level of policy politicization, aimed at involving more actively the ECB in policy making. If at the outset of the crisis there was an attempt to include the central bank (at that time rejected by Frankfurt), empirical observation has showed that the launch of the OMT, though consistent with ECB independence, was a highly coordinated negotiation between Paris, Berlin and Frankfurt. This signals that the policy underwent a progressive politicization through the active involvement of the ECB.

In the end, a third indicator indicates the discrete empowerment of supranational institutions, i.e. their involvement on the enforcement of conditionality. This element, though being present in any instrument of financial assistance, finds its main representation in the complementarity between OMT and ESM – that is, in order to be helped through OMT, a state has to apply for ESM aids. And in this case both the European Commission and the ECB have the power of closely monitoring the respect of conditionality measures, triggering a certain empowerment since 2010. As a result, in the context of an intergovernmental policy as the one under scrutiny is, European institutions succeeded in increasing their powers, as the overall level of the indicators demonstrates (from 2 to 3.3), meaning that the policy finds a certain joint management among governments and supranational institutions.

The third dimension considered in the assessment of the eventual supranationalization of the policy is the presence of an EU-based mechanism. When it comes to financial support, the Eurozone has experienced a progressive supranationalization of financial assistance, from the provision of bilateral loans up to the creation of a permanent rescue mechanism – the ESM. The ESM is certainly not a *pure* supranational instrument, as it is based on an intergovernmental agreement among governments, and requires the unanimity of member states for its activation and it is funded by states' and not the EU.

However, with respect to the first bilateral loans and to the EFSF, it presents some distinct elements of supranationalization. In particular: it is based on EU treaties, which have been modified in order to create it (article 136), it involves European institutions in the enforcement phase, it is integrated with a quasi-federal program – OMT by the ECB – and it is explicitly directed towards the members of the Eurozone. As a point of contrast in this context: bilateral loans, a pure form of intergovernmental coordination, are assigned a level of 1 in the scale of supranationalization, while the ESM obtains 3, signaling that though being formally an intergovernmental agreement, in reality it reflects a medium level of supranationalization .

Overall the analysis shows that the policy of financial support to states in need resulted in a process of progressive, though discrete, supranationalization. The policy remains *formally* intergovernmental and member states' retain much of the power in the definition of the policy. Nonetheless, the final value of the index of supranationalism (final value: 2.85) shows a medium level of supranationalization in comparison to the low value of the first measures implemented in 2010 (initial value: 1.5; see figure 6). Following the scale proposed by Borzel (2005), we are left to conclude that the policy is now structured along a medium level of supranationalization with respect to both scope and intensity. Indeed, the character of the instruments progressively set up to provide financial assistance to troubled countries have changed slightly, whereby the involvement of supranational institutions both formal and informal – has increased, and the EU legal framework is used progressively more. Unlike the case of the rules of fiscal discipline, there was no formal upload of competencies to the supranational level, but the fact itself of having set up a policy of financial support may be seen as a strengthening of the links of solidarity among member states, and in the final analysis as a discrete deepening of the European integration.

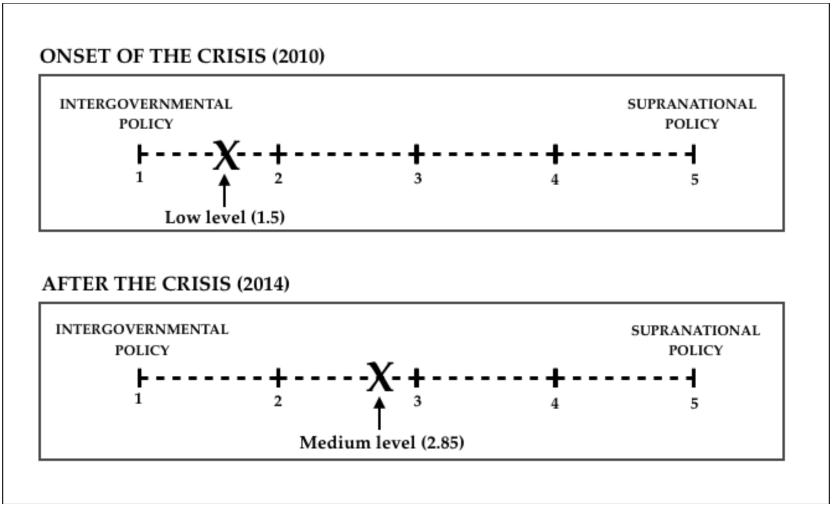

Figure 6. Evolution of supranationalization rate of the policy of financial support.

Chapter 6
The creation of a banking union in the Eurozone

The object of the third case study is the process of progressive creation of the so-called banking union in the European Union, which according to some observers can be judged as the most important achievement in Europe since the breakout of the crisis, though it often goes unnoticed in the public debate (Véron 2015:8). As a matter of fact, the sovereign crisis has contributed to the creation an entirely new policy sector, through the progressive transition from an un-coordinated structure – i.e. the powers of banking regulation being in the hands of national competent authorities – through to "soft" legislation, and finally to hard–law instruments (Hennessy 2013).

The term "banking union" was used for the first time in 2011 (see Véron 2011) and its first appeared in official documents from 2012 (see European Commission 2012a). Banking union refers to both the *process* whereby authority over banking policy is transferred from the national to the European level, as well as to the European banking *policy framework* resulting from that transfer (Véron 2014). In this sense, the banking union represents an entirely new policy area in which European governments decided to transfer competencies to the supranational level, by empowering supranational institutions to act in the sector. In general terms, the banking union is composed of different pillars, representing the main components of banking policy. These pillars include a set of common rules for European banks – the so-called single rulebook – a single framework of banking supervision, a common deposit guarantee, a single framework for banking resolution, and a fiscal backstop for temporary financial support[115] (Constancio

[115] Common regulation and supervision can be seen as applying at the preventive stage, while the other three pillars concern the crisis management stage.

2013). The single rulebook contains a number of directives aimed at harmonizing some aspects of the banking sector, so as to guarantee the fair competition within the internal market, e.g. the capital requirements of banks. A single framework of banking supervision means that the power to give and retire banking license, as well as to check the financial health of credit institutions, is assigned at a single European authority, thus it is centrally exercised. In parallel, a single resolution framework is a common set of rules and procedures to be followed in case of risk of bank default. The common deposit guarantee would be a European fund to protect banking deposits up to €100.000 in case of bank default, and finally a common fiscal backstop represents a facility to temporarily finance failing banks.

Though a number of scholars have observed that all these five aspects should be collectively adopted to ensure stability of the banking sector (Schoenmaker 2012), as a new institutional creature, the banking union structure created in the last years does not cover all of these aspects. In particular, while some rules were already present for what concerns common rules for European banks, and these have been progressively strengthened, only two main pillars out of four remaining emerged in the discussions in these last years. These were the framework of banking supervision and that of banking resolution. A preliminary agreement has also been reached to let the ESM represent a common backstop for temporary financial support,[116] but major cleavages on the setup of a common deposit guarantee prevented the creation of such instrument and up to now the coordination over a pan-European deposit guarantee scheme is only foreseen on a voluntary base (European Commission 2014c).

Thus, the process of creating a banking union is still in its infancy. Two concrete measures have emerged, one related to the Single Supervisory Mechanism (SSM – that is, the common supervision of European banks) and the second to the Single Resolution Mechanism (SRM – setting

[116] To be more specific, European governments decided to let the ESM provide financial support to member states, which in turn can use these funds to help national banks. Thus, it is a form of indirect financial backstop for the banking union (see infra).

common procedures for bailing-out failing banks). The whole process started in June 2012, when the Eurosummit agreed to establish the SSM, which was effectively created in October 2013. The SRM was created in July 2014, through the creation of a Single Resolution Board for the management of banking crisis and the provision of a Single Resolution Fund whose details were worked out in an intergovernmental agreement held in May 2014, and whose ratification process is still ongoing.

As for the two other case studies, the aim of the empirical reconstruction is to collect data concerning the progressive setup of a banking union and then use them to test the three main hypotheses of the dissertation, as well as the underlying conjecture according to which economic crises do foster an effective supranationalization of EU policies. As discussed in the theoretical section (§2.4), the three main hypotheses of the dissertation are as follows:

> H1: An economic crisis is a fundamental driver of major institutional changes, both in terms of their quantity and quality;
>
> H2: Intergovernmental policy making tends to have incremental and ineffective policy outputs and to create institutional deadlocks; conversely, supranational policy making tends to have successful and more effective outputs;
>
> H3: In the case of policy failure due to irreconcilable conflicting interests or institutional deadlocks, a process of delegation to a neutral – i.e. supranational – actor occurs, resulting in an empowerment of supranational institutions *vis-à-vis* member states.

Each of the three hypotheses will be tested by linking specific independent and dependent policy-specific variables (table 5). Among the policy-specific indicators, there are also some of those used to create the original index of policy supranationalization .

	TYPE OF VARIABLE	POLICY-SPECIFIC VARIABLE	POLICY-SPECIFIC INDICATOR
H1	**INDEPENDENT VARIABLE**	Pressure on policy makers	- Course of yields' spreads and Credit Default Swap (2010-2014)
	DEPENDENT VARIABLE	Policy outcome	- Creation of new tools in the sector of financial regulation and in the banking sector at large
H2	**INDEPENDENT VARIABLE**	Modes of decision making: intergovernmental/ supranational	- Presence of int.al agreements - Presence of intergov. negotiations - Presence of unanimity regime (or, conversely) - Adoption of community method - Adoption of new instruments by supranational institutions
	DEPENDENT VARIABLE	Policy success	- Capacity of the outcome of decreasing market pressure and avoiding new banks-driven crises
H3	**INDEPENDENT VARIABLE**	Policy failure	- Incapacity of the outcome of relenting market pressure or solving the original problem - Insurgence of new wave of banking crisis - Contagion of banking crisis in a new country
	DEPENDENT VARIABLE	Supranational delegation	- Formal act of delegation of new competencies to supranational institutions (e.g. via new Treaty) - Upload of competencies for policy management at supranational level - Informal act of delegation (e.g. via open interpretation of rules)

Table 5: Banking union setup: Relevant variables and indicators of the case study.

The chapter is structured as follows. After a discussion on the origins of the banking union as part of the larger framework of financial supervision in the European Union, the divergent preferences of the actors involved in the decision making for the banking union will be presented. After that, the analysis will focus on the two main pillars of the banking union, namely the SSM and SRM. The empirical data presented will be then functional to test the main hypotheses of the dissertation, as well as to construct the policy-specific index of supranationalization.

6.1. Banking union and financial regulation: Origins and legislative framework

The debates on the opportunity of designing a common framework for the banking sector in Europe are largely precedent to the financial and economic crisis of last years. Actually, a system of banking supervision in the hands of the European System of Central Banks was already advocated by the Delors Committee's report (1989: 22) which was precedent to the creation itself of the common currency, but it was postponed because of the opposition of European governments to upload to the supranational level such a fundamental aspect of financial regulation (James 2012: 19). The claims for a comprehensive regulation of European banks stems from the recognition of the fundamental importance of credit institutions in Europe, which is at least twofold: on the one hand, the banking sector can be assimilated to any other economic sector which needs to be regulated at European level in order to avoid intra-European competition problems and to guarantee uniformity of rules within the internal market (Delors Committee 1989:31); on the other hand, in a highly integrated financial environment, banks represents a key component of the European economic infrastructure – and of capitalist societies at large – which has to be duly regulated so as to avoid that banking crises spread to real economy (Cassis 2011) – as it precisely happened in the last years' crisis. In this light, it is not a case that the contingencies of the Eurozone crisis pushed for accelerating the path toward the creation of a banking union.

Indeed, the sovereign crisis in Europe was highly interconnected with a banking crisis, through the so-called banks-sovereigns vicious circle (also called "sovereigns-banks loop"), which has been a negative aspect of the strict interdependence among banking institutions and sovereign bonds' market (Véron 2015:14; Howart and Quaglia 2014: 106), resulting in a deadly embrace. In short, the weaknesses of peripheral European banks and the falling value of sovereign bonds created a downward spiral of contagion: with sovereign bonds being a key determinant of banks' strength because of their essentially national structure, the erosion of bonds' value contributed to weaken banks' structure, transforming banks and bonds into "two sick Siamese twins" (Ruding 2012:1). This occurred at a time when European banks kept on holding increasing shares of domestic bonds, which exacerbated the situation. To be sure, banks' weakness is not only a problem at the micro level, but it creates a downward spiral because of the role that banks play in the broader economy, since they contribute to finance investments in the real economy, and their general weakness decidedly contributes to deteriorating trust among financial operators. Moreover, through the "sovereigns-banks loop", such weaknesses are directly linked to public finances.

The vicious circle of the "banks-sovereigns loop" was impossible to break on the side of sovereign bonds – that is, by artificially decreasing the instability of bonds market, thus increasing their value – because this would imply the creation of a transfer union in the Eurozone.[117] So European decision makers decided to progressively tackle the problem on the side of the banking sector, trying to decrease banks' weaknesses through a more credible and comprehensive supervision. It is not a case that the Eurosummit declaration that triggered the banking union in June 2012 started by assessing that "it is imperative to break the vicious circle between banks and sovereigns" (Eurosummit 2012).

Banks-sovereigns loop, for its part, was not the sole determinant of banking fragility during the crisis, but it coupled with a collective action problem. Indeed, Europe witnessed quite a widespread attitude of "banking nationalism" (Véron 2014), that is, the conflict of interest of domestic supervisory authorities which tried at the same time to ensure financial stability of national banks and protect them from foreign competitors, under the consideration that largest banks are "national

117 See chapter 4 on the policy of financial assistance to member states.

champions" that can contribute to domestic general wellness.[118] Thanks to the exclusive power of supervision over domestic banks, national authorities unwisely took domestic interests into account in their task, without a broader consideration of eventual cross-boarder externalities created by bank failures (Schoenmaker 2013), more likely to happen in case of imperfect supervision dictated by national interests' considerations. In other words, national authorities have been quite reluctant in denouncing banking weaknesses, which contributed to exacerbate their already fragile situation, making banking crisis more likely.

Taken together, the banks-sovereign loop and the banking nationalism revealed the necessity for creating a credible Europe-wide system of banking supervision to ensure financial stability (Gros and Schoenmaker 2014). The urgency of the situation was also demonstrated by the progressive dis-integration of the European financial sector, once the most integrated aspect of the single market. The economic crisis, indeed, decidedly contributed to the fragmentation of the European financial market (Howart and Quaglia 2014: 104), as a direct consequence of the distrust spread throughout financial operators. Such financial disintegration can be appreciated by looking at several indicators, among them the dispersion in CDS premiums across the Eurozone, the divergence of national lending rates, the sharp decline of cross-border mergers and acquisitions, the decline of inter-bank loans in the EU, and the much discussed decrease of cross-boarder bond holdings (for further figures and for a thorough discussion on financial dis-integration see ECB 2012). This increasingly dysfunctional character of the financial sector was enough to push European decision makers to take some decisions on reversing the course of European finance and economy. Hence, the double necessity of stabilizing the financial sector in order to avoid a recurrence of the crisis and a further deterioration of financial integration.

Notwithstanding the clear necessity of tackling the problems of the banking sector, European decision makers' attentions turned only

[118] For the policy of "keeping banks' problems under wraps" carried out by national authorities, please refer to Bastasin (2012: 106-108).

progressively to banks. Actually, they firstly tried to correct some shortcomings in the sector of financial regulation at large, which was progressively amended starting from 2009. Indeed, the aspect of banking supervision can be placed in the broader context of financial regulation, which underwent an incremental normative change from the beginning of the crisis. Indeed, the creation of the banking union itself can be seen as the end point of a long process of changes in the field of financial markets and institutional regulation. More specifically, the setup of common rules in financial regulation can be seen as the first step leading to a solid and credible banking union (Gros and Schoenmaker 2014: 534).

The financial turmoil in 2007-2008 revealed that Europe lacked a comprehensive system of macro-prudential analysis and that it suffered from fragmented micro-prudential control (Hennessy 2013: 156).[119] Given the impressive integration of European capital markets in the late 1980s and in the 1990s, European decision makers did not create any common institutional framework to ensure financial stability but instead kept on relying on national institutions for banking supervision and regulation (Jones 2015). That is, there was scarce attention at the macro-level for the possible consequences of financial disorder, and the control of individual banks was entirely remitted to national authorities. That is why, at the outset of the crisis, the European Commission mandated Jacques de Larosière, former governor of the Bank of France, to issue a report on the future of financial regulation and supervision in Europe. The report (De Larosière 2009) considered letting the ECB coordinate the work of national supervision authorities as the best option, thus empowering Frankfurt only with macro-prudential, and not micro-prudential, supervision fearing for the risks to its independence that micro-prudential supervision may endanger (ibid: 43).

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[119] In the field of financial regulation and supervision, a micro-prudential approach differs from a macro-prudential one in that the former attempts to prevent failure of individual financial institutions and attends to the risks for investors and deposit holders, while the latter adopts a macroeconomic view in order to safeguard the financial system as a whole and to reduce the costs of financial instability (Geeroms et al. 2014: 275).

On the basis of the recommendations issued by the report, the European Council in June 2009 decided to establish a European Systemic Risk Board (ESRB) and a European System of Financial Supervisors (ESFS), the two first institutional innovations in the field of financial regulation since the outbreak of the crisis. The ESRB should have been the institution in charge of macro-prudential oversight, with the aim of preventing systemic risks for the financial stability in Europe – by collecting information, issuing warnings and recommendations (Geeroms et al. 2014: 276). Composed of members of the three agencies of banking supervision recently created (see infra), by staff of the ECB and the European Commission, it mostly relies on measures of soft coordination, but its power is largely undermined by the fact that it can only issue recommendations without the power to enforce. On the side of micro-prudential control, European governments decided to establish three different supervisory authorities, each composed of a steering committee and national supervisory authorities and direct to specific tasks (ibid: 277): the European Banking Authority (EBA) aims at safeguarding the stability of banks and other credit institutions; the European Insurance and Occupational Pensions Authority (EIOPA) deals with institutions for occupational retirements provisions; the European Securities and Markets Authority (ESMA) supervises capital markets and carries out the supervision of credit rating agencies (figure 7).

Taken together, the three agencies should have offered a comprehensive micro-prudential control of European financial institutions. But their weak powers (i.e. mere coordination role, as in the case of the ESRB), as well the competing role of national authorities, meant the the three authorities were less than successful. This was demonstrated by the fact that since their establishment in 2011, the banking sector in Europe has undergone a further deterioration (ibid.). A vivid example of such deterioration is represented by the break up of new banking crisis in some European countries, such as Spain and Cyprus.

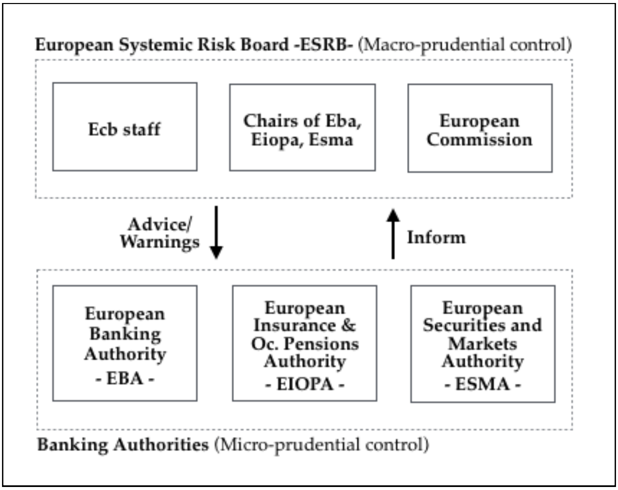

Figure 7. Structure of the European Systemic Risk Board.
Source: www.esma.europa.eu

In general terms, we may say that due to the financial shock in 2007-2008, European governments tried to address the main shortcomings that emerged in the system of financial regulation, but the very first phase of institutional innovation saw the adoption of instruments with limited effectiveness, mainly due to the nature of soft coordination among actors, the absence of binding rules and of a credible and solid enforcement system. Nonetheless, they opened the way to more effective measures, thus the establishment of a banking union in the years to come, on whose features, however, actors at stake were deeply divided.

6.2. The political economy of banking union: Assessing actors' preferences

As a recurrent feature in European decision making during the crisis, and even more with respect to such a sensitive issue as the creation of a banking union, the preferences of actors over final outcomes were divergent and possibly irreconcilable in some aspects. As for the other case studies analyzed here, the policy at stake is a redistributive one, that is, one suggesting a different redistribution of resources among actors in a zero-sum game, where one actor wins and another loses as a consequence of the institutional change. For instance, the provision of a common resolution fund for failing banks might determine flows of money from certain countries towards certain financial institutions based in other countries. At the same time, the project of a banking union implies the transfer of a certain amount of competencies to the supranational level, which is understandably resisted by some governments.

The actors involved in the negotiations occurred for the creation of the banking union, in line with the methodological assumptions of the dissertation, can be identified in the two recurrent groups of states (creditor/northern countries, debtor/southern countries), as well as three main European institutions: the European Commission, the ECB and the European Parliament. When it comes to the ECB, as specified in the methodological section, since it has no formal decision making powers, it is considered as an actor with *de facto* political weight which stands on the side of one of more actors that do have formal decision making powers. Again, as occurred in other policy sectors, negotiations witnessed different alliances among actors, namely the convergence of one of the two groups of states with one or more European institutions. As a general feature, the negotiations over the creation of a banking union saw a harsh contraposition between Germany and a few other northern countries (the Netherlands and Finland) against all the other actors, i.e. European institutions and southern countries, all oriented toward similar positions.

In general terms, states were not divided on the issue of creating a stricter regulatory framework in the field of banking supervision and a single supervisory authority for all European banks, as the necessity of such a new institutional setting was quite clear after the disorder created by the banking crisis in Ireland (Donovan and Murphy 2013). The two main issues at stake, on the contrary, were the timing of the banking union setup and its scope – that is, the number of banks falling under centralized control. In this respect, southern countries (France, Italy and Spain in particular) were the main supporters of the rapid creation of a banking union, hoping that a break up of the banks-sovereigns loop may relieve market worries over unstable banks, and over public finances in the end (Howart and Quaglia 2013: 111). French President Hollande, in particular, declared that a banking union should come before a political union (Euractiv 2012). Such a vision was basically backed by the document issued by the Van Rompuy Task Force (2012), that called for an "integrated financial framework". As a second aspect, France and southern countries were ready to put all European banks under a centralized control, so as to make the mechanism more credible and more quickly able to counteract the financial instability. French attitudes on an enlarged scope for the banking union was also driven by a consideration of its domestic banking structure. The banking sector in France is highly concentrated in a few very big financial groups; obviously such groups would fall under centralized control, and fearing an unequal treatment of French banks, Paris was adamant to establish a comprehensive supervision covering all European banks (Howart and Quaglia 2013: 112).

Such a scheme was comprehensively resisted by Germany and other northern governments, namely those of Finland and the Netherlands: in their view, signing a good deal was more important than having a speedy agreement (ibid: 111). Germany resisted the idea of having unitary supervision for all European banks, and its preferences were oriented towards a greater role of supervision of national authorities, which would retain their control over small banks. In this scenario, an eventual central authority for supervision would have merely a coordination role over the operations of national authorities. Such consideration was mainly based on the German banking system: though hosting some of the largest banking groups in Europe (e.g. Deutsche Bank), the most part of German banks consists of regional and local institutions – *Landesbanken* and *Sparkassen* – considered to have an important public and social role.

The German government was adamant to defend regional and local banks from centralized and external control (Barker 2012a). Moreover, Berlin feared the moral hazard likely to emerge among banks in case of a setup of a resolution mechanism (Howart and Quaglia 2014). In this sense, it carried out the idea of creating first of all a supervisory system as a precondition for the discussions on a resolution scheme, even though the idea has been contested on economic bases by some analysts and observers.[120]

Beside the timing and scope of the banking union, decision makers were divided over another fundamental issue related to the new policy, that is, the features and scope of the resolution fund to be created. As a potential net contributor to the fund, and with its longstanding concerns about moral hazard, Germany was reluctant to create a pan-European redemption fund (Howart and Quaglia 2014). The German government advocated leaving responsibility of distressed banks primarily with national governments (Howart and Quaglia 2013), and that eventual European funds could be activated only behind strict rules of conditionality. From a political economy perspective, moreover, considering the structure of its banking system, Germany feared it would be forced to contribute beyond its share to the redemption fund but that very few German banks – the biggest ones – would ever benefit (Howart and Quaglia 2014). Germany, however, was rather isolated, as southern countries were ready to create a pan-European fund, according to the idea that such a common fund would be more credible and more functional to calm down financial instability and distrust.

Following the typical pattern during the crisis, the United Kingdom stood between the two opposed blocs, and tried to impose its vision over policy outcomes. Hosting the biggest financial center on the continent, London was particularly sensitive to the issue of financial regulation, and the UK government tried to avoid the creation of a Eurozone-limited banking union, fearing that such configuration may impose detrimental measures to the British financial sector (Howart and Quaglia 2013: 115). In other words, the UK feared the creation of new standards in the banking sector triggered by the putative banking union, which the country would be compelled to adhere to in the future. By consequence, London envisaged a flexible mechanism of "opting-in" for non-Eurozone members, that is, the possibility to join the banking union even for those countries outside the Eurozone, as well as the constitution of a double majority mechanism in order to take

[120] For a discussion on the timing of the establishment of the banking union and its main elements, see Elliott (2014: 14-19).

into account even the interests of those countries outside the common currency in case of prominent decisions on the resolution of failing banks (ibid).

All European institutions agree on the need for supranational delegation of the powers of banking supervision, although their positions vary slightly. Quite understandably, the ECB sought first and foremost a quick stabilization of the whole financial and banking sector in the Eurozone. This is evidenced by the increasing interventionism of the institution in policy making through standard and non-standard measures – including the two rounds of LTRO to sustain banking sector.[121] The ECB advocated the rapid establishment of a comprehensive system of banking supervision – i.e. covering all European banks (Howart and Quaglia 2013: 117-118) – whose tasks were to be remitted in the hands of the same central bank. Thus, the ECB backed the position of France and southern countries, as well as that of the European Commission, as it was issued in the draft of the legislative proposition (European Commission 2012b).

In the Commission document, the European executive suggested transferring to the ECB the task of supervising all European banks, in strict collaboration with national authorities, which would maintain day-to-day control on financial institutions. Moreover, the proposition aimed at including into the banking union only the members of the Eurozone, against the claims of the European Parliament to include all EU countries (EU Observer 2012). In line with its traditional claims oriented to larger democratic accountability, the EP demanded through its committee for economic and monetary affairs an increased role in the legislative process for the creation of the banking union, as well as more effective powers in the implementation of the mechanisms (European Parliament 2012b), such as access to information in the procedures of SSM and SRM and the possibility of hearing the candidates of the bodies in charge, e.g. the SRB.

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[121] The two rounds of Long-Term Refinancing Operations, implemented in the autumn 2011, aimed at easing financing conditions of European banks, so as to boost economic growth, stabilize their fiscal position and let them buy sovereign bonds to relieve market pressure on peripheral states.

As a result of these divergent preferences, thus, both the geographical scope of the new banking union and its institutional nature is irregular. Concerning the geographical scope, thanks to the "opting-in" system of voluntary admission to the banking union for non-Eurozone members, it would be larger than the simple Eurozone, but smaller than the EU (Véron 2014). That is, the membership of the banking union is automatic for the members of the Eurozone, and voluntary for those outside the common currency. At the same time, the banking union has a mixed institutional nature, from intergovernmental coordination to the community method. Indeed, the provisions concerning the set of common rules for banking institutions, falling under the umbrella of the internal market, are taken according to normal procedures of the community method, that is co-decision by the Council and European Parliament. Beside, aspects of the new mechanisms – the SSM and the SRM – are to be taken by unanimous consensus of European governments, or at least of those members of the Eurozone, as they represent the transfer of new competencies unforeseen in the treaties or a form of special coordination among a limited group of states. When it comes to the SRM, for instance, the creation of its resolution board was by the community method, while the setup of a common resolution fund responds to intergovernmental logics, as discussed in the following section.

6.3. The setup of a banking union: The two main pillars

The progressive setup of a banking union in Europe has passed through successive steps. After the setup of the new mechanisms of coordination (the three banking authorities EBA, EIOPA, ESMA and the ESRB for the assessment of systemic risk) in the field of financial regulation, decision makers' attention progressively turned to European banks. In particular, two main pillars of banking policy were tackled. The framework of banking supervision and that of banking resolution, were institutionalized, through the creation of the SSM, and of the SRM, respectively.

For sure, the complex banking policy includes also other aspects, that were either tackled through the traditional community method because they somehow concerned the internal market – i.e. the directives and regulations to be applied to financial institutions such as the Capital Requirements Directives (Geeroms et al 2014: 278-284) – or temporarily left in the background, such as the common deposit guarantee, because of irreconcilable positions of governments (Howart and Quaglia 2013: 109). The main obstacle to the creation of a common deposit guarantee is its peculiarly redistributive nature: indeed, such fund should cover deposit holders up to €100.000 per family and per bank, in order to reimburse them in case of bank failure. But at the moment states are not ready to pool so many resources, and the project of the common deposit guarantee has been left in the background and it will unlikely been implemented in the next future.

6.3.1. The establishment of a Single Supervisory Mechanism

The Single Supervisory Mechanism (SSM) is one of the most important institutional innovations in the EU since the break out of the sovereign crisis. It consists in a centralized mechanism of banking supervision according to which European countries delegate the power of granting and withdrawing banking license to the supranational level, as well as the related duties of banking control. In other words, European governments decided to shift from a system of national banking supervision to a more supranational one, where the ECB has been given the power of granting banking licenses to a part of European banks, namely the most significant ones. More specifically, the ECB in strict collaboration with national authorities can conduct supervisory reviews, inspections and investigations, it can grant or withdraw banking licenses and it can ensure banks' compliance with EU prudential rules.

The process of creating the SSM began at the Eurosummit on June, 28th, 2012, when the members of the Eurozone agreed on the urgency of a Europe-wide supervision mechanism (Eurosummit 2012). In particular, they mandated the European Commission to issue an official proposal for the creation of a SSM, to be quickly taken into account by the European Council "within the end of the year". As a matter of fact, the European executive issued its proposition in September (European

Commission 2012b), but the formal approval of the SSM came only in October 2013 (Council of the European Union 2013) on the base of art. 7 of the TFEU, giving to the ECB the power of banking supervision starting from November 2014. Indeed, the translation into practice of the principles stated in June 2012 was a difficult operation (Barker 2012b), and EU governments failed to meet the deadline of December 2012 to conclude the negotiations, due to irreconcilable cleavages over some features of the new instrument (Barker and Spiegel 2012), namely the scope of centralized supervision and the membership of the SSM.

Concerning the scope of banking supervision, the features of the SSM represent significant progress with respect to the three authorities for financial regulation created in 2011. Indeed, if the micro-prudential control of the three banking authorities EBA, EIOPA and ESMA, as well as the ESFS relied on a system of coordination where the ultimate power was in the hands of national supervisors, the SSM designs a different scenario with an effective delegation of authority. The new mechanism is composed of the ECB and of national competent authorities, working together under ECB control (Geeroms et al. 2014: 300). It covers all 6000 credit institutions present in the Eurozone, with a differentiation based on the size of the banks – the formal criterion is "systemic significance".

A bank is considered to be significant if the total value of its assets exceeds €30 billion, or if the ratio of its total assets over GDP exceeds 20%, or again if the national competent authority designs the institution as relevant for the domestic economy (ibid: 301). In those three cases, the ECB is responsible for the supervision of the bank. Furthermore, the ECB takes the supervision of at least three banks for each member state, in order to avoid a situation in which countries without significant financial institutions fall outside any centralized control. Translated into figures, only 130 out of 6000 (2.5%) banks of the Eurozone are significant, although comprehensively this group controls 85% of all assets banks. Less significant institutions fall under the supervision of national authorities, who work nonetheless under the guidelines and regulations issued by the ECB.

The design of the SSM – a two-tier structure determined by bank size – is clearly a compromise that emerges from the diverging preferences of member states, even in the face of evidence this approach is economically suboptimal[122] (Munchau 2012). In particular, as noted above, Germany was particularly adamant to retain national control on *Sparkassen* and *Landesbanken*, considered to cover a significant social and political role. Indeed, according to the thresholds identified by the regulation, they are not considered as systemically significant. The official proposition by the European Commission aimed at covering all the Eurozone banking system, in line with southern countries preferences. Germany doubted that a single institution, the ECB, could efficiently supervise all 6000 European banks, thus demanding strict cooperation among national authorities and the ECB. A second concern was relative to the possible influence that the task of banking supervision may have on ECB's monetary policy (Barker and Spiegel 2012). In line with the recurrent German preoccupations for the independence of the central bank, minister Schäuble feared that the fact of knowing banks' situation may interfere with a regular conduct of the monetary policy. In the end, Berlin got satisfaction of its demands, and gained a commitment that smaller banks could continue under the control of national authorities, as the agreement of October 2013 demonstrates.

A second issue that made negotiations over the SSM particularly complex was the question of membership of the system of common supervision. In this respect, in its proposition the European Commission suggested that only Eurozone members would join the SSM, against the position of the European Parliament, which was adamant to include all EU members. At the basis of the cleavage there were legal as well political concerns. From a legal point of view, a pan-European supervision system held by the ECB was problematic because the ECB Governing Council only represents Eurozone members, and it cannot enforce its decisions in non-Eurozone members. A possible solution may come only through the change of the voting system in the

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[122] It is arguable that the size of a bank is perfectly related to its systemic significance, and systemic risk in the end. Indeed, the Spanish banking crisis was triggered by smaller banks, the *cajas*. Moreover, there is the risk that the threshold of €30 billion may become a limit to circumvent in order to avoid centralized control (Munchau 2012).

ECB Governing Council, that would prove to be difficult and politically fatiguing, requiring a treaty change (Barker 2012b). Germany in particular was very sensitive to this argument. On the other hand, as noted, the UK feared that an Eurozone-exclusive banking union might be problematic for those outside the monetary union, and might possibly impose technical regulations that they could not control.

As a result, the final agreement significantly differed from the Commission proposal: according to the regulation of the Council, participation to the SSM is automatic for member states of the Eurozone, but those countries outside the common currency may enter into a "close cooperation agreement" in order to submit their banking system to the new European supervision, whose details are outlined in a ECB decision (2014a). If voluntarily entered, the close cooperation involves a gain of a seat in the ECB Supervisory Board, so as to circumvent the legal problems related to the ECB voting system and its representativeness. Following the agreement found in October 2013, the ECB started its tasks of banking supervision from November 2014[123], and at that time no state outside the Eurozone formally asked to join the SSM, but the ECB received only some informal expressions of interest[124] (ECB 2014b: 16).

6.3.2. The establishment of a Single Resolution Mechanism

The Single Resolution Mechanism (SRM) is the second leg of the European banking union, set for launch on January 2016. The SRM aims at managing an eventual failure of a credit institution in the EU, that is, its orderly resolution in case of risk of insolvency. Technically, it is composed of two main pillars, of which the first is a EU regulation on banking resolution procedure, which sets up the rules to be followed in case of a banking failure and which creates the Single Resolution Board

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123 The start of the new centralized supervision was preceded by an "Asset Quality Review" carried out by the ECB so as to test the adequate capitalization of banks and boost the credibility of the new supervisory framework.

124 Beyond the temporal scope of the dissertation, in April 2015 Denmark expressed its intention to join the banking union (Matze and Tangen 2015).

(SRB), aimed at managing banking crises. The second is an intergovernmental agreement concerning the Single Resolution Fund (SRF), the fund entrusted to the SRB to be used to relieve banks' financial difficulties (Véron 2014). Unlike the SSM, the SRM is not operational, as the decision of resolving a bank is taken at European level in the Single Resolution Board, but the effective management of a resolution procedure is allocated at national level.

The importance of the SRM is fundamental in light of the events of the Eurozone crisis. Indeed, if duly implemented, the SRM may avoid another banking crisis in the EU, preventing member states to bear costly banking bailouts, and the consequent unbearable public deficits, as happened in Spain and Ireland. More specifically, the structure of the SRM foresees an important change in the case of banking failure, whereby a bank might be wound up even without the permission of its home state (Barker 2013). This aspect is of particular importance, considering that during the crisis national supervisory authorities often encountered clashes of interests, trying to protect their national champions from failure.

Moreover, the new rules and procedures redefine the burden-sharing of banking resolution costs, creating a sort of cascade mechanism in case of banking resolution (Hadjiemmanuil 2015). In case of bank resolution, existing stakeholders – i.e. shareholders, junior creditors, senior creditors and depositors with deposits in excess of the guaranteed amount of €100,000 – are required to contribute to the absorption of losses of the bank up to 8% of liabilities, the so-called bail-in procedure. Then, resources from national deposit guarantee schemes can be collected. If these resources are not enough, national resolution fund – or the SRF since its effective implementation – will contribute to the medium-term financing of no more than 5% of total liabilities. In this case, the money comes from the banking industry at large, because the resolution fund is financed by banks.

Finally, in case still more resources are needed – that is, above the threshold of 13% of total liabilities – public money is used (ibid). In other words, the design of the SRM marks the progressive passage from a "near absolute pro-bailout stance" present in Europe at the beginning of the Eurocrisis, to a "new normal", that is, the bail-in of banking institutions (Véron 2015: 20-22). In this respect, the establishment of the SRF brings about also a certain mutualisation of resources, so that member states are called to pool resources in order to save a bank from another country, thus making the policy redistributive in nature.

Quite understandably, in the presence of such a delicate pooling of resources and revolutionary rules, the establishment of the SRM has been a progressive process lasting a few years, and actually still *in fieri* given some future political decisions to be taken in the next months and the very progressive implementation of the whole mechanism over the years. Started in June 2012 with the Council declaration of its willingness to create a banking union, the first formal step for the establishment of the SRM came a year later, when in July 2013 the European Commission issued its regulation proposition (European Commission 2013b). In December the European Council agreed on the general approach to be taken in the creation of the SRM and on the main features of the SRF, and in spring 2014 both the European Parliament and the Council approved a revised version of the Commission's text,[125] so that the regulation was published in the Official Journal at the end of July. In the meantime, in May 26 out of 28 EU member states – the UK and Sweden did not join – signed the intergovernmental agreement governing the SRF, which is at the moment undergoing the process of national ratification.[126]

As resulted by the negotiations, the SRM structure is headed by the Single Resolution Board, the resolution authority that works in close cooperation with the ECB, the European Commission and national resolution authorities. Composed of six members[127], the board has the

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[125] The EP agreed under codecision on the SSM only after signing an inter institutional agreement with the ECB to obtain information access in the field of banking supervision (Héritier and Schoeller 2015).

[126] At the time of writing only four out of 26 states already ratified the agreement (Latvia, Slovakia, Finland and France). It will enter into force when 90% of weighted votes of SRM participants will ratify the agreement.

[127] Given the restricted membership of the board, only six nationalities are represented: not unexpectedly, it is chaired by the German Elke Konig and vice-chaired by the Finnish Timo Löyttyniemi. The other members of the Board come from Italy, France, Spain and the Netherlands.

task of avoiding disorderly insolvency of any European bank. At the same time, the SRB has the task to manage the SRF, so as to diminish the costs of a banking failure for taxpayers.

In the process of gradual creation of the whole structure of the SRM (thus, the establishment of the resolution board and the resolution fund), actors were confronted with multiple cleavages, reflecting their preferences over final outcomes. The most important elements of disagreement were related to four issues: the decision making organization – that is, what institution entrust with the power of shutting banks; the scope of the SRM – which banks are to be covered; the amount, the sources of funding and the implementation stages of the resolution fund; and finally, the fiscal backstop to cover the SRF in case of insufficient endowment. Around these main issues, beside the traditional two groups of states confronting their visions – northern creditor vs southern debtor countries – European institutions actively entered into the negotiations with regard to the creation of the SRM, while they were left more in the background for what concerns the creation of the SRF, which mainly followed intergovernmental logics.

In general terms, European governments did agree on the necessity of creating a banking union, including some sort of resolution mechanism, but they disagreed on its practical features. It has to be noticed, however, that European executives soon appeared to lose that sense of urgency expressed in the declaration of June 2012 – most probably due to the bold intervention of the ECB through the OMT that contributed to a decisive relief of European economies from financial market pressures.[128] At a certain moment Germany, indisputably the most powerful and best-placed negotiator, seemed to lose any attraction toward the project, due to three elements: the fear of becoming a net contributor to the SRF, the recognition that very few of German banks would be covered by the SRM and the fear of moral hazard for banks, which would be more likely to engage in riskier activities in presence of a resolution mechanism (Howart and Quaglia 2014). Such attitude translated in a certain isolation during negotiations (Agence Europe

[128] For a discussion on OMT, see §4.3.5

2013), which however Germany carried out finally obtaining outcomes mostly – though not perfectly – reflecting its initial preferences.

The first element of disagreement was the identity of the resolution authority, thus the level of the centralization of the decision making operations. In its initial proposal, the European Commission selected itself as the resolution authority in the EU, in line with the vision of the ECB and of southern states – in particular, Italy, France and Spain – but this choice was poorly received by Germany (Peel and Barker 2013). More specifically, the Commission designed a system in which a resolution board would, under suggestion of the ECB, take the key decisions on how to manage any bank resolution, but the fundamental decision to enter into a resolution would be made by the European Commission itself. National authorities would retain the power of enforcing the decisions taken by the SRB, which for its part oversees national authorities.

Germany raised legal concerns on the resolution scheme as designed by the Commission. More specifically, Berlin questioned the use of internal market legal bases made by the Commission to justify an expansion of its powers to apply only to Eurozone members (ibid.). According to Germany, such a fundamental empowerment of the Commission should be sanctioned by a treaty change. For its part, Berlin proposed to give the ultimate decision making power over resolution to the European Council, so that each state could retain its veto power (Barker and Spiegel 2013).

As a final compromise, the co-decision procedure created a system in which most of the power is given to the ECB, which has the power of triggering the whole process of a bank resolution, and in case of reluctance by the ECB, the SRB can autonomously decide to trigger the process. After the resolution decision is taken, the SRB adopts a resolution scheme and the action plan to address the specific case of the failing bank, whose compliance with state aid policy is assessed by the European Commission. The European Council is involved in the process only if the Commission contests the public interest in resolving the bank and considers it could be put into normal insolvency instead[129] (European Commission 2014d). In this case the Council can express its opinion and reverse the Commission's decision. In this sense, the final text of the SRM scheme appears to be less politicized than the one proposed by Germany, where the Council would in any case retain the final word over the resolution decision. At the same time, the role of the Commission is also reshaped and limited, as recognized by the Commissioner in charge of the reform, Michel Barnier (ibid.).

As one of the most important features, the whole process of banking resolution, according to policy makers, could be finalized in a weekend: a resolution scheme could therefore be approved in the span of time going from the closing of the US markets on Friday to their opening in Asia on Monday morning. This was deemed fundamental to the credibility of the mechanism and for financial stability. And which is, in the end, a concrete improvement with respect to the first agreement found at the European Council in December 2013, according to which a resolution scheme could have even involved the voting of more than one hundred people at the ECB supervisory board, the ECB Governing Council, two committees at the single resolution board and finally the European Commission; or even worse in case of a a contested decision (Barker and Fleming 2013). Such a simplification was highly demanded by the ECB, which strove to enhance the credibility of the new institutional creature.

The second issue of disagreement has been related to the scope of the SRM, that is, the number of banks to be covered by the resolution scheme – resounding the discussions held while creating the SSM. According to the initial Commission's proposal, the SRM scheme should be comprehensive and applying to all European banks, following the rationale that even non transnational banks and smaller ones (e.g. the Spanish *cajas*) could produce major dangers (European Commission 2013b) – as the contingencies of the crisis demonstrated,

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[129] This has been referred to as the "silence procedure", whereby if the European Council does not raise any opposition to the decision of the SRB within 24 hours, its approval the resolution scheme is considered implicit.

actually. Much as in the case of the SSM, southern countries were in line with the proposal, while Germany resisted the idea again.

As a rich and solvent state, Germany has a banking sector that is comparatively small and geographically limited (Howart and Quaglia 2014:131). Moreover, Germany had already set up a national resolution procedure, one of the few states to do so. In this sense, the German government did not see any incentive in establishing a comprehensive resolution mechanism, in which it would have likely played the role of net contributor. As a result, the final scheme expressed a compromise mainly reflecting the division of tasks resulting in the SSM. The SRM is comprehensively responsible for the resolution of all banks in Member states participating in the banking union (around 6000), but the SRB is directly responsible only for the resolution of those institutions directly supervised by the ECB (the "significant" banks) and for cross-border groups, while the national resolution authorities are responsible for all other entities. Nonetheless, if a resolution scheme implies the use of the SRF, the board becomes competent for the resolution of the entity concerned regardless of its size (European Commission 2014e).

A third and major issue of dispute, one that created major difficulties and time-consuming deadlocks during the negotiations, was about the creation of the Single Resolution Fund and its main features: endowment, funding sources and timing of establishment. According to the initial proposal of the Commission, in line with the experience of those states where a resolution fund is already in place, the fund is a pre-financed one, its endowment coming from contributions of banks, to be gradually built up in a span of time of several years (European Commission 2013b). This model found the support of the ECB and of southern countries (Howart and Quaglia 2014:133) but the resistance of Germany. Berlin indeed favored a network of national funds, claiming that a Europe-wide fund should be created via a Treaty change (Barker, Spiegel and Wagstyl 2013). A decisive compromise was found thanks to the proposal of Dutch government, which suggested, in case of activation of the fund, to use first national funds coming from the home-state of the bank to be rescued, and then other member states' funds (Howart and Quaglia 2014:133). On the figures of the contribution of single banks, Germany and France found an agreement only in December 2014, when they agreed that the banking sectors of the two countries would contribute the same amount – around €15 billion (Barker 2014). As a result, the SRF will be endowed with €55 billion[130], to be collected in a span of time of ten years[131] – twelve in case more than half of the fund is activated before that deadline – so as to be fully operational by January 2026. In order to circumvent German fears about the legal basis of the fund, some aspects were delegated to an intergovernmental agreement which is undertaking the ratification process. In particular, the intergovernmental agreement aims at governing the modalities of national contributions to the fund and some other aspect relate to its endowment over time (European Commission 2014c).

A final point concerns the fiscal backstop of the SFR. That is, what happens if the amount of the fund proves to be insufficient to cover bank resolutions. According to Germany, in case of insufficient endowment, taxpayers of the home state of the failing bank should be called to finance its resolution (Howart and Quaglia 2014: 134), while other states supported the idea of having the ESM contributing to such operation. As the main net contributor to the ESM, Berlin resisted the idea of transforming the ESM into the fiscal backstop for a pan-European banking resolution scheme. As a compromise, in December 2013, member states agreed that extra-funds should be provided by member states, which if necessary could demand a loan to the ESM. In this sense, it has been adopted German Minister Schäuble's line of negotiation, according to which the ESM cannot directly finance banks, but it can only lend money to member states, which then can direct those money to their banks. Moreover, as usual for the access to European funds, measures of conditionality are foreseen.

As it is designed today, for sure, the SRM is incomplete. First of all, it still lacks the provision included in the intergovernmental agreement

[130] €55 billion representing around 1% of all European banks' covered deposits.

[131] Formally, such a long transitional phase has been created in order to avoid short and medium-term effects on banks accounts due to their contributions to the fund. In the meanwhile, the resources are collected via national compartments, to be gradually merged into a common fund.

about the SRF, which is still undertaking the ratification process. Secondly, even if in the medium-term it will contribute to restore credibility in the European banking sector, it is unlike that the SRM as it is designed today will be able to address a systemic crisis in Europe, because of the insufficient endowment of the SRF and the lack of clear rules on the fiscal backstop of the system (Dullien 2014). To achieve the possibility of credibly avoiding – or at least facing – a new systemic crisis, more improvements should be added to the scheme (e.g. the provision of clear rules for extraordinary public support to banks at European level and a clear transformation of the ESM into the fiscal backstop for the banking union) but political interplays have limited such possibilities, at least up to now (ibid.).

6.4. Empirical assessment of hypotheses: The case of the banking union

The case of the banking policy is partially different both from the two discussed in the previous chapters. Indeed, the fiscal policy rules case study is a policy that incrementally changed during the crisis – it was already regulated at European level and such regulation underwent a progressive transformation as the crisis unfolded. The financial assistance policy, by contrast, was never foreseen by the framers of European integration, and was thus created *ex novo* to deal with the crisis. The case of the banking union, for its part, its somehow in between: some prior institutional arrangement was there, in particular in the sectors of banking supervision and resolution, but they were not organized at the European level, rather they were fully managed within national borders, with an extremely loose coordination at the supranational level.

If it is true that the SSM and the SRM are new institutional devices set up as a response to the crisis, it is however possible to compare the institutional environment today with the one that was present at the onset of the Eurozone crisis. The test of the three hypotheses, as well as of the conjecture underlying the dissertation, will be carried out in this perspective, thus appreciating the progressive institutional change that has been carried out by policy makers in this specific policy sector all over the years of the crisis, up to late 2014.

6.4.1. Hypothesis n. 1

The first hypothesis states that "an economic crisis is a fundamental driver of major institutional changes, both in terms of their quantity and quality", that is to say that policy making is multiplied during economic downturns in response to the challenges coming from external market pressure. We expect, then, a certain coincidence in chronological terms between the main peaks of the crisis[132] and the major evolutions in the field of the banking union setup, namely the adoption of the main pieces of legislature on the SSM and SRM.

A preliminary consideration stems from the recognition that in absence of markets' pressure in the first years of the common currency, major divergences among member states prevented to implement those early propositions for a banking union elaborated in the late Eighties (see Delors Committee's report 1989). Which is a very preliminary confirmation that, even in presence of a certain necessity of a policy change, policy makers tend to postpone the adoption of policy arrangements it that is not absolutely urgent. However, the events here recalled make it is easy to appreciate how much the events of the Eurozone crisis were functional to a policy evolution (see appendix, fig. a7).

A first example is given by the most important day for the creation of the banking union, June 28th, 2012, when the European Council decided to start the process for its creation, which occurred during one of the most dramatic peaks of the crisis. In particular, in those weeks markets were nervous for the double elections held in Greece, for the fear of a Grexit, and for the return of the pressure on Italian and Spanish bonds, which determined a new peak of the spreads on the bonds of the country after some months of relative calm (see fig. 5.2 in the appendix). The case of Spain, in particular, and the banking crisis

[132] For an account of the Eurozone crisis, as well as for the identification of its six main peaks, please refer to chapter 2.

which menaced its public finances[133], was decisive to let policy makers understand that something was to be made in order to "break up the vicious circle between sovereigns and banks", as in that day the heads of states and government declared (Eurosummit 2012).

A second element to consider is that, chronologically, there is another coincidence between a main peak of the crisis and the evolution of the banking union. This second aspect is related to the crisis in Cyprus – another one peculiarly related to the banking sector – and the main evolutions of policy making, both for the SSM and the SRM. Indeed, the events in Cyprus took place in early 2013, and they were functional to make policy makers realize, at a time when major difficulties seemed to stop negotiations, that it was necessary to finalize the project of banking union (Jones 2013). In the same year, after the Cypriot crisis, the SSM found its decisive implementation, and the SRM found a key agreement among member states at first, and then the one between the European Parliament and the Council.

One last point related to the chronological coincidence among crisis events and the adoption of policy outcomes can be found in the institutional deadlock occurred in late 2012, when after the formal declaration of June the European Council seemed to lose the urgency to implement the banking union. Indeed, if on the one side that statement was the critical enabler for the launch of the OMT by the ECB (Véron 2015) as recognized also by top decision makers (Van Rompuy 2014), on the other side the creation of the OMT itself contributed to relieve markets, and consequently also European decision makers, that seemed to lose that sense of urgency of some weeks earlier (Jones 2014).

As a result, then, the events related to the progressive setup of the banking union, as reconstructed in this chapter, seem to confirm the first hypothesis of the dissertation. In particular, the main evolution of the policy making in the field are to be found in those "windows of opportunity" created by financial market pressure, that resulted functional to the adoption of policy outputs thought to solve the crisis.

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133 In those days, between May and June 2012, Spain received financial aids to recapitalize its weak banking sector (for the chronicles of these days see Hewitt (2013:277-295).

Some aspects of the policy also confirm that, conversely, when not pressed by external enablers, policy makers tend to postpone the timing of agreements. Such aspect, in particular, is both confirmed in a general way – though it was proposed, the banking union was not created before the Eurozone crisis – and in the specific span of time of these last years, when European governments procrastinated on the adoption of major policy outcomes when markets seemed to be less demanding.

6.4.2. Hypothesis n.2

The second hypothesis of the dissertation inquires about the relation between decision making processes and whether or not outcomes are successful. In particular, the hypothesis claims that intergovernmental decision making would result in incremental and ineffective policy outcomes, including the possibility of institutional deadlocks, while supranational decision making would produce successful outcomes and solve eventual institutional deadlocks. That is to say that the outcomes of negotiation processes are not a pure reflection of states' and institutions' bargaining powers, but they are mediated by the existing institutional setting. Institutions, then, coordinate actors' behavior toward certain outcomes and shape the information structure.

As a preliminary step to test the hypothesis, it is necessary to find a policy-specific indicator of the degree of success of a policy outcome. A basic, though effective and immediate, way to assess whether an outcome in this specific policy sector is effective or not is that of looking at the occurrence of bank-driven crises in one of the member states. A policy outcome can be judged as effective if it prevents the emergence of new banking crises, and thus further economic turmoil. A vivid representation of this is given by the recalled "banks-sovereigns loop", which directly links banks' weaknesses to public finance, and vice versa. We may say that the main representations of the "banks-sovereigns loop" have been the Irish, the Spanish and the Cypriot cases, respectively occurred in 2010, 2012 and 2013.

We've seen that, on the base on the De Larosière Report in 2009, the first instruments of crisis management for the banking sector were the creation of a European Systemic Risk Board and of three brand-new agencies with the aim of increasing financial regulation in the EU (EBA, EIOPA, ESMA), occurred between 2009 and 2010. Events demonstrate that their effectiveness was scarce, due to their institutional features. Indeed, due to their intergovernmental character – e.g. mere role of coordination of national authorities, no enforcement powers – they did not succeed in avoiding the rise of the banking crises in Spain and Cyprus. Moreover, the analysis highlighted that a certain "banking nationalism" characterized the crisis management during the Eurozone crisis. That is, in absence of binding rules at European level, national authorities were prone to defend the interests of their national banks, in what can be seen as a concrete manifestation of moral hazard and scarce attention to externalities in the banks' perspective. Taken together, then, in the first phase of the crisis, two essential intergovernmental elements contributed to the deterioration of the banking sector in Europe: banking nationalism, on the one hand, and a design of limited effectiveness of the new financial supervision framework, set up in 2009-2010, on the other.

In this light, the effectiveness of those outcomes adopted before the Cypriot crisis can be judged as poor, while after the setup of the two main pillars of the banking union – even though the construction is still incomplete as noted above – bank-driven crises did not reoccur.[134] In this perspective, one may say that a comprehensive setting of banking regulation set up at European level was decisive to tackle the "banks-sovereigns loop", and more in particular that the progressive abandonment of intergovernmental logics was functional to increase the effectiveness of policy outcomes. Moreover, at the time of writing, the sole intergovernmental piece of legislation, the international agreement for the definition of national contribution to the SFR, is a major part of the banking union which is still *in fieri*. For such a politically sensitive issue, indeed, states preferred to retain most of their powers and agreed to undertake the issue via a new international treaty – alike what happened for the Fiscal Compact in 2012. But the necessity

[134] For sure, future events may disconfirm this claim, and this is even more likely considering the very short span of time passed since the effective implementation of the two mechanisms. Nonetheless, this is an unavoidable consequence of dealing with so recent a political and social phenomenon.

of collecting the unanimous consensus among member states, and even more in case of a redistributive policy, made it very difficult and fatiguing the decision making process. In this sense, the unanimity rule made it difficult to find an agreement on national contributions – that came only in late 2014 – and all the institutional necessities of a new international treaty make of this piece of legislature the one who took more time to be effectively implemented. This demonstrates that intergovernmental logics often create a slower decision making or even institutional deadlocks.

A second aspect related to this second hypothesis is the role played by the institutional setting prior to the adoption of policy outcomes. When it comes to decision making processes characterizing the banking union, it has been noticed that its complex architecture is composed of different pillars, each one of them responding to different institutional logics of decision making. In particular, the SSM was created by community method, as well as part of the SRM, while the SRF is mainly based on intergovernmental logics. The rationale of this choice is to be found in the treaty's provisions. Indeed, according to the article 127(6) TFEU, "the Council (…) may confer specific tasks upon the ECB concerning policies relating to the prudential supervision of credit institutions and other financial institutions (…)", which allows member states to take those measures within the community method – even if this measure is circumscribed only to Eurozone members.

At the same time, the possibility to create the SRM via the community method was granted by art. 114 TFEU, the milestone of the internal market legal basis, according to which "The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures (…) which have as their object the establishment and functioning of the internal market." In this sense, the creation of a common resolution scheme can be seen as necessary completion of the internal market, in order to assure its fine functioning. The same article 114, however, claims that fiscal provisions are not included in the measures that can be adopted through this procedure. Which made it necessary for European governments to engage in an intergovernmental agreement to establish national contributions to the SRF.

As a result, the institutional setting prior to the adoption of policy outcomes in the field of banking sector somehow shaped their nature, orienting policy makers toward certain policy making processes and procedures, and orienting in the end their behavior. Which is a confirmation of the hypothesis of the dissertation according to which policy outcomes are not a pure reflection of actors' bargaining powers, but these are mediated by the institutional setting.

In conclusion, the second hypothesis is confirmed by the empirical data collected for the case study on the creation of the banking union. Though more time is needed to assess the real effectiveness of some outcomes that were adopted only a few months ago, the pieces of legislature adopted through the community method seem to be more effective in counteracting banking crises than the precedent ones adopted according to intergovernmental logics. At the same time, the empirical reconstruction confirms that the nature of policy outcomes adopted was not a pure reflection of actors' preferences and bargaining powers, but they were oriented by the preexisting institutional setting, which contributed to orient the course of negotiations.

6.4.3. Hypothesis n.3

The third hypothesis of the dissertation claims that "in the case of policy failure due to irreconcilable conflicting interests or institutional deadlocks, a process of delegation to a neutral – i.e. supranational – actor occurs, resulting in an empowerment of supranational institutions *vis-à-vis* member states". In the case of banking union, a comprehensive delegation of competencies is still incomplete – see for example the postponement of the common deposit guarantee – but the crisis undoubtedly contributed to a delegation of certain tasks at the supranational level.

An example of delegation occurring in the sector of banking regulation is the empowerment of the ECB with the task of banking supervision at European level under the scheme of the SSM. Unlike previously, when in every state the competent national authority was empowered of the supervision of national credit institutions, part of the 6000 European banks is supervised in a day-to-day centralized way (only 2.5% of the banks, but representing 80% of total assets of the European banking sector). It is true that such delegation is not complete – non significant banks still fall under national supervision – but the delegation of new tasks at supranational level is indisputable.

Parallel to the supervision, even some tasks for banking resolution have been centralized at the European level, with the creation of a new European "institutional creature", the Single Resolution Board, which works in close collaboration with the ECB and national authorities. More importantly, the European Commission now has the power of deciding whether and how to resolve a failing bank, and unlike the first drafts of the agreement, such process is less politicized since the European Council can enter the process only through the so-called "silent procedure". Even the other institution empowered to initiate a bank resolution scheme, the ESRB, though not being a supranational institution, responds mainly to supranational logics, as not all the members of the banking union are represented. In this sense, the whole instrument triggered a significant delegation of powers from national borders to the European institutions, or at least to *ad hoc* committees.

As a result, even the case of the setup of the banking union in Europe seems to confirm that in response to institutional deadlocks and urged by the contingencies of the crisis, European governments found the way to confer new competencies through the formal – or sometimes informal – delegation to supranational institutions, or to new committees and authorities created in order to deprive national competent authorities of their exclusive powers, which were often at a basis of a dysfunctional management of the policy. Unlike the precedent case study on financial assistance to member states, in the field of banking union there was not any form of informal delegation, as all the competencies upload at the supranational level were sanctioned by a treaty change or by a piece of European legislature.

6.5. Assessing the supranationalization of EU polity: The case of the banking union

As a comprehensive banking policy at the European level was lacking before 2010 one should expect that it is this area that witnessed the most impressive increase in the "rate of supranationalism" over the course of the crisis. As with the other case studies, in order to construct an index of supranationalism of the policy, three different dimensions are taken into account, namely: the whole management of the policy cycle, the power of supranational institutions in the same policy, and the eventual presence – or even creation – of supranational mechanisms. Taking together these indicators, it is possible to asses whether and how much the policy in question has changed in terms of scope and intensity of its supranational character (Borzel 2005), shifting from the pole of intergovernamentalism (index value=1, meaning very loose measures of coordination at European level) up to high supranationalism (index value=5, meaning a complete centralization of the policy) (table 6).

As the tasks of supervision and resolution were mainly left in the hands of national authorities before the crisis, the value of the indicators before 2010 are almost completely oriented towards a very low rate of supranationalism (that is, value close to 1), which reveals a very low level of coordination among governments, an absence of binding rules and of enforcement structures, and also of effective shared decision making. Actually, it is difficult to label this set of rules as a consistent policy of the banking sector. In reality, the decision making was almost completely defined at the national level, where governments and competent authorities were free to set up rules – and by consequence, to initiate the legislative process, to adopt and implement those measures and to finally evaluate the whole process – in an almost completely national policy cycle. The sole exception in the management of the policy can be seen the phase of the policy formulation, as some rules adopted at European level (e.g. the one on capital requirements, as part of the single rulebook) set a certain framework for national policy makers. As a result, the final value of the first indicator is very close to 1 (1.25 to be precise).

	BEFORE THE CRISIS	AFTER THE CRISIS
- Agenda-setting	1	2
- Policy formulation	2	3
- Implementation	1	3
- Evaluation	1	3
= (1) SUPRANATIONAL MANAGEMENT OF THE POLICY	**1.25**	**2.75**
- Delegation of competencies	1	3
- Policy politicization*	1	3
= (2) POWER OF SUPRANATIONAL INSTITUTIONS	**1**	**3**
- Single Supervisory Mechanism	1	4
- Single Resolution Mechanism	1	4
= (3) SUPRANATIONAL MECHANISM/PROCEDURE	**1**	**4**

* The value of supranationalization is to be considered as the inverse of the hypothetic value of the indicator (e.g. a low level of politicization corresponds to a high level of supranationalization).

Table 6: Banking regulation policy: Index of supranationalization .

That changed a lot after the set up of the two pillars of the banking union. In particular, though the agenda setting has been mainly in the hands of governments – which played the role of initiators of the policy in the declaration of June 2012, giving to the Commission the mandate to make legislative proposition – the other phases of the process (formulation, implementation and evaluation) can be judged to be at an average rate of supranationalism. In particular, most of the legislative pieces have been adopted by community method, they have been proposed by the Commission and voted by the Council and the European Parliament; they are implemented partially at European level and partially at national one, and the Commission has its traditional powers of evaluation on the correct implementation. As a result, the policy management today can be globally rated as "medium supranational", with a value of 2.75, which means that this policy dimension is managed through a balanced joint decision making among member states and supranational institutions.

Much like the indicators of the policy cycle management, when looking at the rate of supranationalism referred to the power of supranational institutions in the policy before the Eurozone crisis, the values are very low. In particular, there was no delegation of powers at all at European level in the field of banking sector (supervision, resolution, deposit guarantee) and the policy was highly politicized at national level – see the behavior of national competent authorities to defend their "national champions". As a result, the set of rules were not supranational at all, and national actors were free to conduct the policy within national borders. That slightly changed after the creation of the three banking authorities in 2010, but states' room for manoeuvre and discretion remained quite relevant in absence of binding rules and enforcement powers of the same authorities.

At the end of the period considered here (up to late 2014), the situation is almost radically changed: both the European Commission and the ECB obtained decisive powers, respectively of deciding the resolution of a bank and of supervising European banks. At the same time, the policy is considerably less politicized than before: the provision of a centralized supervision of significant banks restricted states' room for manoeuvre, decreasing the possibility for competent authorities to carry out their tasks in a politicized way. For sure, considering that the tasks of supervision, as well as the others of resolution, were not completely uploaded at European level, but national authorities and European body still retain part of those powers, the value of the indicators has been rated as medium (that is, 3).

Finally, when considering the third aspect of the index, the one of the presence of any mechanism or peculiar procedure at supranational level, it is clear that they were completely lacking before the crisis (hence, value=1 for the indicators), while the creation of the SSM and the SRM makes it possible to rate the indicators at medium-to-high (value=4). Of course, the two mechanisms do not run under fully supranational logics (i.e. national authorities still have some powers, the European Council can intervene in some phases of the process), which prevents to obtain a value of 5, which would correspond to a complete centralization at European level.

As a result, by combining the three aspects, we find that, as expected, the policy of banking regulation at European level underwent a significant increase of its "supranationalism rate", shifting from a very low level before the crisis (index value=1.08), up to a medium level of consolidation of supranationalism in late 2014 (value=3.25), sanctioning the greatest increase in absolute terms (2.2 points) with respect to the two other policy sectors (figure 8). Translated into words, this means that at the beginning of the crisis the policy as a whole was very poorly structured at European level, foreseeing only very loose forms of coordination among governments, if any. The contingencies of the crisis, for their part, contributed to set up a European infrastructure for the policy, as well as to depoliticize it, which results in a overall characterization of the policy as one jointly managed by member states and EU institutions.

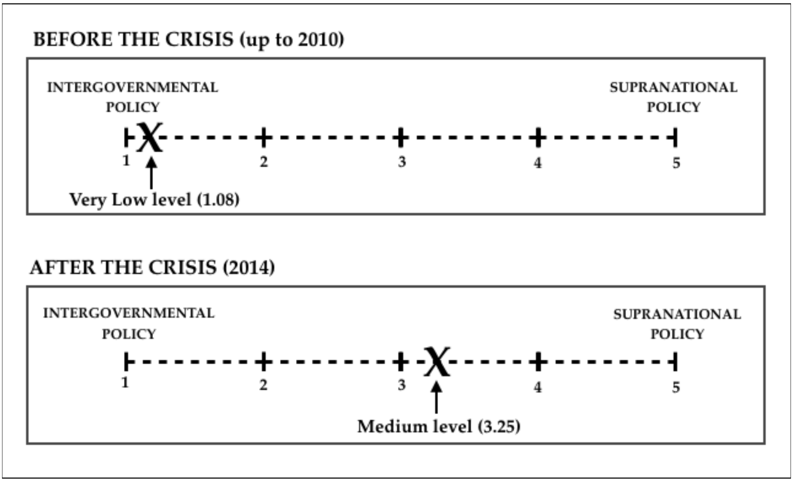

Figure 8. Evolution of supranationalization of the policy of banking regulation

Chapter 7
Conclusions

This study has been framed by following research questions: What is the institutional impact of economic crises on the process of European integration? How did the effects of the crisis translate into policy outcomes? And how did these changes impact the balance of power between the national and supranational levels? In order to answer these questions, I have conducted an analysis of three different case studies, covering the development of different policy areas during the Eurozone crisis; namely, the redefinition of fiscal obligations for member states; the instruments of financial assistance to countries in troubles; and the setup of a banking union. Taken together these three cover more or less the entirety of economic and monetary integration in Europe. Moreover, all three are characterized by a fundamentally redistributive logic. In each case, a redistribution of resources from northern creditor countries to southern debtor ones was a direct consequence of policy transformation. Methodologically, the three case studies also provide variation in the independent variables identified (i.e. presence or absence of crisis pressure, and the presence of supranational or intergovernmental decision making), so as to understand whether its variation corresponds to a similar variation in the dependent ones.

The research has had two theoretical objectives. The first, focused at the policy level, aimed at understanding how individual institutional rules were developed or altered as a reaction to the impact of the economic crisis, and how institutional rules in place prior to the crisis shaped decision making process and policy outcomes in the end. Secondly, the research considered the system level, and aimed to assess consequences of major economic distress on the broader political and social structures of the European Union. Taking a set of different policies together, this macro-level analysis sought to understand the extent to which the economic crisis influenced European integration dynamics, both in terms of scope and intensity.

Adopting a strategic choice analytical approach (Lake and Powell 1997; Frieden 1997) and making rationalist assumptions about the characteristics of actors, the research proposed an explanatory model linking the independent and dependent variables identified, with three hypotheses to guide the research. These hypotheses were then assessed empirically, drawing on three case studies, so as to answer to the original research questions. This concluding chapter aims to present and discuss the main findings of the dissertation, and to offer some preliminary avenues for possible future research in the field. In the first section, I will briefly discuss the main findings of the empirical assessment of the leading hypotheses for each of the three case studies. Following this, I will shift to the systemic dimension, presenting results related to the elaboration of the supranationalism index, an original index created to assess whether European integration has progressed or retreated over the crisis era. Then, I will discuss the main theoretical contributions of the research in the debate over European integration and its institutional features. Finally, I will present some broader implications deriving from the research, as well as possible further elaborations of this particular study area.

7.1. Empirical assessment of the hypotheses and model refinement

The research was guided by the following three hypotheses:

> H1: An economic crisis is a fundamental driver of major institutional changes, both in terms of their quantity and quality;
>
> H2: Intergovernmental policy making tends to have incremental and ineffective policy outputs and to create institutional deadlocks; conversely, supranational policy making tends to have successful and more effective outputs;
>
> H3: In the case of policy failure due to irreconcilable conflicting interests or institutional deadlocks, a process of delegation to a neutral – i.e. supranational – actor occurs, resulting in an empowerment of supranational institutions *vis-à-vis* member states.

These hypotheses combine in an explanatory model of institutional change in the context of European integration during a major economic crisis (fig. 9). If validated, the model suggests that the occurrence of an economic crisis fundamentally influences the adoption of policy outcomes, because the effects of the crisis put pressure on decision makers, restricting their range of available actions, and making it necessary to reconcile divergent preferences. The model also specifies that the nature of the policy making process directly shapes the quality of policy outcomes. It shows that fully intergovernmental decision making tends to generate institutional deadlocks that result in outcomes of limited effectiveness, while supranational decision making tends to result in more effective outcomes. Finally, the model indicates that institutional deadlocks generate a process of delegation, which invests supranational institutions with new competencies, in order to resolve the original policy problem.

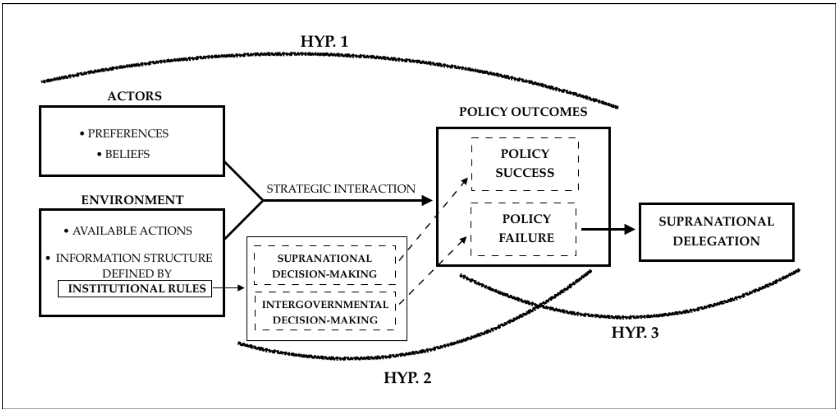

Figure 9: Explanatory model of the dissertation.

As observed at the end of each chapter, the empirical findings suggest that the leading hypotheses of the dissertation are confirmed. This thus provides comprehensive validation of the model, which needs only slight refinement. To restate, the first hypothesis was confirmed for each of the three case studies. The reconstruction of the events related to the redefinition of fiscal obligations for member states, the creation of new instruments of financial assistance to troubled states, as well as the setup of the banking union, all confirmed a chronological overlap between the main peaks of the crisis and the adoption of policy outcomes.[135] In this sense, the European Union seems to be reactive to the external pressure put by the crisis, in line with the claims of the first hypothesis.

Methodologically, the case studies confirm that assuming a variation in the independent variable – i.e. different pressure on policy making according to the policy at stake – we observe the development of a similar variation in the dependent one – that is, adoption of major policy outcomes. Indeed, the main policy outcomes related to each policy were adopted – or proposed, in case of new legislative instruments – in strict chronological coincidence with one of the main peaks of the crisis. This demonstrates how much the external pressure of financial markets shaped policy adoption. Empirical observation thus confirmed the initial proposition that the Eurozone crisis constitutes a "pressing functional demand" for EU institutional structures. Following Lindseth (2010: 13), the concept of "pressing functional demand" is understood as an objective set of external circumstances that exerts sufficient pressure on existing institutional structures and legal categories to result in substantive transformation, as was observed in Europe during the years of the crisis.

Moreover, policy inertia during periods in which crisis pressures resided presents a sort of *a contrario* confirmation of the first hypothesis. Empirical analysis shows a clear tendency among decision makers to either procrastinate or delay action when circumstances pressed no urgency. Indeed, during the first ten years of monetary integration (1999-2009) when it was widely understood that a set of instruments for a banking union and the reinforcement of fiscal obligations would be eventually necessary, European governments failed to act. As discussed, in the case of the SGP, regulations were actually *weakened*.

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[135] The course of the crisis has been reconstructed in chapter 2, and six peaks of the crisis were identified, each corresponding to periods of particular instability of financial markets.

Such a tendency to avoid action unless compelled to do so was also clearly in evidence once the crisis got underway. During periods of relative financial calm, for example, decision makers tended to discard certain measures – e.g. the establishment of a common resolution mechanism – even though at peak moments of crisis they had been recognized as vital. All in all, then, the empirical findings clearly confirmed the correlation suggested in the first hypothesis, establishing a significant link between the external pressure brought to bear by financial markets and the adoption of policy outcomes in the field of economic and monetary integration.

The second hypothesis, which links the features of the policy making process to the degree of success of policy outcomes, was found to be partially confirmed by the empirical assessment of the case studies. Analysis demonstrated that the hypothesis proved correct with regard to the link existing between intergovernmental policy making and outcomes of limited success. Whenever European governments undertook fully intergovernmental negotiations, requiring unanimity, the outcome was either an insufficiently effective policy response or a politically fatiguing institutional deadlock. Véron's observed, "Europeans have to explore the unwieldy intergovernmental options until they realize that it doesn't work when tested" (in Barker and Fleming 2013).

Both the development of the Fiscal Compact in late 2012, with its major implementation problems, and the process of bilateral loans accorded to Greece in 2010 showed how difficult intergovernmental decision making could prove. Relatedly, major aspects of the EFSF and ESM mechanisms developed under the intergovernmental aegis were clearly not credible. Finally, intergovernmental attempts to establish a resolution fund during the development of the banking union failed, due to the divergent and possibly irreconcilable preferences of European governments over its features. As a consequence, then, the model is accurate in foreseeing that intergovernmental decision making and its related institutional rules, such as the requirement of unanimity among participants, is suboptimal. Either the adoption of effective outcomes is precluded or the process is subject to indeterminate incrementalism or even institutional deadlock.

A slight refinement to the model is needed in respect of the hypothesized link between supranational decision making and policy outcomes. A significant correlation between the two variables – supranational decision making and policy success – was not observed across the three policy cases.[136] While it is true that in general policy outcomes adopted via supranational decision making were more effective than intergovernmental ones, it is also true that those policy instruments were not immediately a policy success. It was observed that either amendment or policy fine tuning was often in order to achieve maximum effectiveness. Both the Two Pack (which was seen as a necessary addition to the Six Pack) and the OMT (adopted by the ECB, to rectify SMP deficiencies) are good examples. As a result, the initial model requires a slight refinement, admitting the possibility that supranational decision making may need a policy amendment in order to obtain fully effective outcomes (fig. 10). Thus, the link among the variables identified is not perfect, but it is somehow mediated by the apparent eventuality that the policy success does not come as a result of the first outcome adopted, but after a policy amendment or after the adoption of a new policy outcome to complete the previous one.

Such refinement does not come as a disconfirmation of the model, as it highlights the fact that when confronted with imperfectly effective outcomes, supranational decision making does not engender an institutional deadlock, as is that case for intergovernmental negotiations, and provides a relatively straightforward corrective mechanism to engender policy success.

[136] The successful nature of a policy outcome was qualitatively assessed relying on policy-specific indicators, identified and clearly stated for each policy sector.

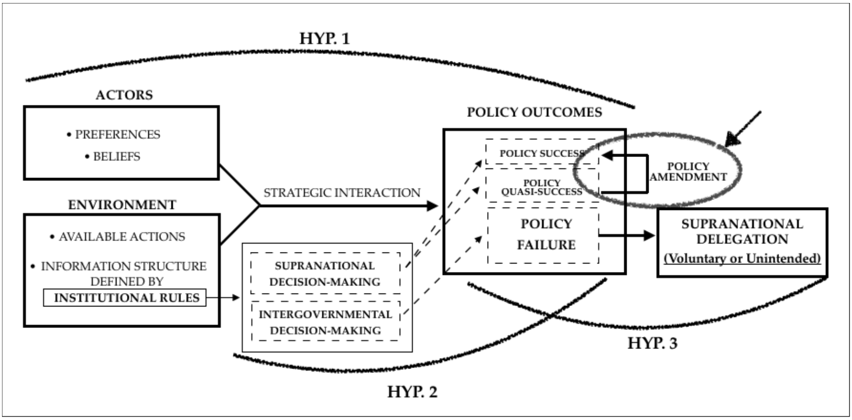

Figure 10. Refinement of the explanatory model of the dissertation.

Finally, the empirical analysis led to a confirmation of the third hypothesis of the dissertation, which claims that an institutional deadlock resulting from an intergovernmentally-led policy failure – i.e. the independent variable – may result in a supranational delegation – the dependent variable. In each of the three policy cases observed, a blockage engendered by intergovernmental decision making, led to supranational institutions being granted new competences, in order to overcome the institutional deadlock. In the case of the redefinition of fiscal obligations, where the creation of new rules – or a new interpretation of existing ones – both the European Commission and the ECJ were granted new competences in the monitoring and enforcement phases of the policy. With respect to the two other policies, it was the ECB which benefited the most from the transfer of new competences to the European level. The central bank obtained a major role in the granting of financial aid to member states – via the new power to purchase sovereign bonds – as well as in the supervision of European banks.

The confirmation of this third hypothesis is of fundamental importance for the argument of the dissertation, as it suggests that for every policy analyzed a transfer of competences occurred, in the form of a partial or complete delegation of powers and authority to one or more supranational institutions (Tallberg 2002). As will be discussed further below, taken together, the set of competences and the degree of sovereignty transferred to the supranational level represents a widening of the remit of the European Union *vis-à-vis* national governments.

What the explanatory framework did not consider is that this delegation of powers from the national to the supranational level does not always comes as a voluntary and formal political decision. Sometimes, indeed, the process of power shifting has reflected a sort of unintended consequence of crisis circumstances, and has been at least partly resisted by European governments. Critically, however, unintended delegation is not the same as informal delegation, the possibility of which, was initially included in the model. That is to say, the model considered that the delegation might be either formal (i.e. sanctioned with a formal institutional change) or informal, (i.e. obtained via a flexible interpretation of existing rules). The possibility that circumstances might generate such unintended consequences was not considered by the original model. However, this omission does not disconfirm the model, but rather must be included as a necessary *addendum* to complete the analysis (see infra).

7.2. A more integrated Europe after the Eurozone crisis

The analysis of the three policies also included an assessment of the eventual power shift from the national up to the supranational level, that is, the possibility that because of the contingencies of the crisis, the scope of supranational competences produced a widening. While the degree varied somewhat, the analysis highlighted that for each policy the Eurozone crisis did in fact engender an enlargement of the European institutions' powers and a transfer of certain competencies to the European level, thus a *de facto* supranationalization of the policies, and of the European Union at large.

The creation of an original "supranationalization index" revealed the extent of this supranationalization. The index is composed of a set of indicators measuring the degree to which a certain aspect of the policy was managed at national or supranational level. The value of each indicator spans from 1, i.e. no coordination at all at European level, up to 5, i.e. complete centralization at supranational level. Derived mainly from policy-specific indicators, the index considered three main aspects of a policy – the variation of the power of supranational institutions, the transformation that occurred in the overall management of the policy, and the eventual creation of new pan-European instruments.[137] The attempt to measure the eventual variation of the supranational dimension of a policy was applied to each case study, resulting in the assessment that all the three policies underwent a process of significant supranationalization.[138]

Supranationalization was more evident in the case of the banking union, which was not fully structured as a policy before the crisis, but it is significant even for the two others. In particular, the application of the "supranationalism index" reveals that in many aspects the crisis engendered an enlargement of European institutions' powers. This is represented by the act of supranational delegations discussed above,the creation of new Europe-wide instruments or agencies, as well as a certain centralization at the European level of the overall management of the policy cycle. Interpreting the results of the index measurements, I found that if at the beginning of the crisis the three policies were organized along the categories of loose coordination among governments or they were only partially linked with the community method, after the crisis the same policies present a decidedly more supranational character, spanning from the full organization by

[137] For the methodological aspects related to the construction of the index, see §2.5.3

[138] That is to say, when comparing the value of the indicators before and after the crisis for each policy, it resulted an increase of the supranationalization rate. For further information on the development of the index for each policy, refer to the last section of chapters 3, 4 and 5.

community method[139] up to the complete centralization at European level of some of their aspects.[140]

All in all, then, the empirical observation confirms the underlying conjecture of the research, which states that major economic crises do contribute to the supranationalization of the European polity, even if such supranationalization comes at different rates of intensity depending on the policy observed. We may say that the economic crisis triggered a particular process of integration based on a paradox: although institutional structures of the post-Maastricht era allowed European governments carry out decision making through deliberative and consensus seeking procedures, the ineffectiveness evidenced by this kind of decision making created the functional conditions for the supranational deepening of the EU. Such a dynamic may come as a confirmation of the concept of functional spillover, proposed by neo-functionalist scholarship (Lindberg 1963:10), whereby the crisis represented the functional enabler for the advancement of integration, as it revealed contradictions and major limits of the policies initially implemented. As one of the theoretical contributions of the research, this aspect is discussed in the following section. What is important to point out in this respect, is that such integration was first and foremost experienced by Eurozone members, rather than all the 28 members of the EU as a whole, with significant implications for the so-called "two-speed Europe". It seems, indeed, that membership of the common currency brings about far more responsibilities over peers, making it more likely the integration process to further strengthen. It is not a case, then, that major evolutions concerned inner dynamics of the Eurozone.

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139 For instance, it is the case of the redefinition of fiscal rules for member states. Before the crisis the definition of these rules was in the hands of the European Council – which adopted the Stability and Growth Pact – while today a large part of the budget rules representing the substantial revision of the SGP have been set up following the community method (Six Pack and Two Pack).

140 See for example the transformation undertook in the field of banking supervision and regulation, passed from a very soft coordination among European governments before the crisis up to an almost complete centralization in the hands of the ECB for most of its aspects.

7.3. Particular patterns of integration: Theoretical contributions

The current study makes no claims to provide a general theory of the European integration process, but rather to elaborate a mid-range explanation of some dynamics of integration arising during periods of economic crisis. In this respect, while trying to empirically assess the validity of the explanatory framework proposed, I encountered some specific patterns of decision making that can contribute to the theoretical debate about European integration. This comports with the empirical approach adopted by this research which takes a position that the EU has been mostly driven by the development of individual policies, rather than on abstract and *a priori* theorizations on its nature (Wallace et al. 1977). As a result, these theoretical contributions derive from the empirical observation.

In particular, the dissertation offers a clear contribution to the debate on European integration through the identification of three specific patterns of crisis-driven European integration, which I will call "progressive supranationalization", "unintended delegation" and "technocratic supranationalization".

7.3.1. The idea of "progressive supranationalization"

By "progressive supranationalization" I refer to the incremental nature of the policy outcomes adopted as response to the external challenges of the economic crisis. That is, the supranationalization of a policy did not occur instantaneously through the adoption of a single policy instrument, but rather passed through phases of incremental empowerment of supranational institutions, and through the progressive set up of diverse and increasingly more supranational instruments. The financial assistance policy, began as a loosely coordinated system of bilateral loans, but result in the end in the formal establishment of a pan-European facility mechanism, the ESM, with the development of the EFSF as an intermediate phase. In parallel, the banking union emerged progressively, from non-coordinated organization before the crisis, up to the formal setup of the SSM and

SRM, passing again though intermediate measures represented by the three banking authorities and the ESFS.

"Progressive supranationalization" is not a new concept, in so far as it resembles aspects of the concept of path dependence widely deployed in the field of historical institutionalism, as well as with the neo-functionalist concept of spill-over. The underlying idea is that despite the existence of exogenous shocks, institutional change is rather incremental, more than abrupt (Streeck and Thelen 2005), giving rise to incremental dynamics of change, following for the most part the legacy of precedent institutional changes (Gocaj and Meunier 2013).

As with the concept of functional spillover[141], the idea of progressive supranationalization holds that a major integration process – in our case, the maintenance of fiscal, economic and financial stability in the Eurozone, thus the safeguard of the common currency itself – can be secured only through incremental steps of integration, each demanded by functional pressures. In other words, contingencies of the crisis represented a functional necessity triggering increasing integration. However, the concept of functional spillover, though significant to describe this integration dynamic, does not capture a fundamental aspect of policy making, namely the nature of the decision making process. That is, in the neo-functionalist perspective functional spillover may come under any form of policy process, either intergovernmental or supranational, wit the result of the institutional transformation as the key focus.

The original dimension of the concept of progressive supranationalization as it presented here is that supranational decision making is more reactive than the intergovernmental approach in the process of policy amendment, elaborating new outcomes when those

141 Within neo-fuctionalist scholarship, the concept of spillover has found different characterizations (Tranholm-Mikkelsen 1991): *political* spillover refers to the role played by interest groups in the integration process; *cultivated* spillover emphasizes the interests of supranational institutions in enlarging their competencies; *functional* spillover is the idea that a major integration objective can be reached only through incremental integrative actions due to functional pressure.

adopted previously present a critical shortcoming. This is mainly due to the set of institutional rules governing each policy. Given that the unanimity rule and the multiplication of veto-players make it difficult to find an agreement in the intergovernmental area of decision making, an agreement once settled upon is more difficult to amend. As a result, functional spillover is elaborated more quickly through supranational decision making, thanks to the majority rule and the lower number of veto-players, which makes this particular decision making process more reactive than the intergovernmental one in responding to functional demand, and then in speeding up the integration process.

7.3.2. Voluntary vs unintended delegation

The idea of "unintended delegation" is particularly suitable in describing the case of financial assistance policy, where the empowerment of the ECB resembled to an effective delegation by member states but it did not come from a formal act of delegation – much like the case of banking union. Rather, it happened through the independent initiative of the ECB, which took advantage of its positional resources to implement the two systems of financial assistance to member states, the SMP and the OMT.[142] Actually, the ECB exploited the formal delegation of managing monetary policy in order to enlarge its powers in the realm of financial assistance to member states, which resulted in a strange form of "delegation without delegation".

Scholarship on delegation and principal-agent theory (Pollack 2003) claims that authority delegation occurs because it enhances policy credibility through the use of neutral actors – the delegate – as arbiters among conflicting interests, and because it improves outcomes thanks to technical expertise of the delegated actor. Such delegation can be

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142 For sure, the two instrument do not represent a mechanism to directly finance Eurozone members – i.e. European governments do not get loans though SMP or OMT – rather they aim at lightening the burden of debt serving through limited (in the case of SMP) or unlimited (for OMT) purchases of sovereign bonds on secondary markets. In any case, they have been considered as an instrument of financial support to troubled states.

sanctioned formally, via formal legislative initiative such as a treaty change, or informally, through the open interpretation of existing rules without any particular innovation. In any case, the underlying rationale is that the act of delegation is a voluntary process to circumvent a policy deadlock or to confer more credibility to the policy, through the empowerment of an agency or an institution with new tasks, which were previously exerted by delegating actors.

The empirical analysis of the three policies reveals that such a process is *not* always voluntary or rational; that is to say, decided through the adoption of a formal act of delegation or even by informal operations. Indeed, for the financial assistance policy, there was no formal or informal act of delegation, even though the ECB emerged *de facto* as the institution guaranteeing financial aid to peripheral states. Here, the delegation is clearly unintended, occurring only a response to the failure of intergovernmental measures. Moreover, in this kind of delegation there is no control by the principal (member states) over the agent (the ECB): indeed, though the launch of OMT was more or less negotiated with European governments, they cannot nevertheless control either the amount of money used by the ECB or the timing of financial assistance. The process was enabled by the positional resources in the hands of the ECB, as well as its organizational structure, rather than by explicit will of European governments – many of whom, indeed, resisted such empowerment.

”Unintended delegation” is not a trivial phenomenon, since it demonstrates that integration can advance even against member states' will, in sharp contrast with liberal-intergovernamentalist claims (Moravcsik 1998) and more recent new-intergovernamentalist ones[143] (Bickerton et al. 2015). For sure, this observation doesn't come as a total disconfirmation of these strands of scholarship, but rather as an empirical limit of their theorization, given that supranational

[143] According to new-intergovernamentalism, in the post-Maastricht era integration has advanced at the detriment of supranational institutions, being primarily driven by intergovernmental coordination and deliberative and consensus-seeking policy making at governmental level. New-intergovernamentalism concludes that integration comes without supranationalism.

institutions during the crisis appeared to be decidedly more active than expected by the theory, and over all European governments seemed to be passive rather than active with regard to this particular institutional change. In other words, rather than an incentive to ameliorate policy making, this act of unintended delegation can be seen as a constraint on European executives.

7.3.3. Technocratic (or illegitimate) supranationalism

Finally, the concept of "technocratic supranationalization" – or illegitimate supranationalism (Sacchi 2014) – seeks to describe a particular aspect of delegation dynamics occurring during – and as a consequence of – the crisis. The newly empowered institutions – the European Commission and the ECB – do not represent European citizens, either directly nor indirectly, but are rather non-majoritarian and technocratic bodies. The European Commission is a non-representative institution advocating the European interest, and the ECB is a technocratic body aimed at managing Eurozone monetary policy.

In the complex institutional balance of the EU structure, the institution called to directly represent European citizens is the European Parliament. As a matter of fact, however, the role of the Parliament during the crisis was controversial. On the one hand, it was one of the key players in some of the negotiation phases and it also contributed to decisive changes with respect to initial propositions – namely those cases when co-decision was the legislative procedure to follow. On the other, it was completely marginalized in the adoption of certain policy outcomes, such as the Fiscal Compact or the Single Resolution Fund, and it did not find any enlargement of its competences in the broad field of policy innovations occurring in the monetary and economic sector – aside from the slight increase of the consultative role of the parliamentary committee for economic affairs in certain policy aspects. In other words, although participating in those policy processes carried out by community method, the European Parliament did not see any increase of its competencies as a result of the institutional changes that occurred (Schmidt 2012). To be sure, for each one of the three policies, the European Parliament might have been more unequivocally included, but this did not happen. Indeed, the EP did not obtain any role in the definition of conditionality measures for member states under financial aid programs, nor the power of controlling European Commission's monitoring operations over governments' fiscal behavior, nor any role in the newly created institutional infrastructure of the banking union.

The crisis, in this sense, has sanctioned a transition from the intergovernmental, which at least reflect second–order legitimation through national governments, to supranational delegation to non-representative institutions. As a result, the European Union undertook a process of supranationalization to the detriment of representativeness, with serious consequences for the democratic legitimacy of the whole polity. In other words, supranationalization went hand in hand with a process of depoliticization of the EU, given that more and more powers and tasks were conferred to the technocratic level, without any democratic counterbalance. What is more important is that such enlargement of supranational tasks went so far to include very sensitive policy aspects, such as the power of monitoring over national taxation and public spending, which are traditionally one of the cores of national sovereignty, with severe implications for the democracy of the European polity, as discussed below.

7.4. Beyond the Eurozone crisis: Which future for Europe?

As a mid-range explanation of particular dynamics of the integration process, the research does not have the ambition of predicting the future of European integration, being in this sense quite agnostic on eventual evolutions of institutional structures even in the very near future. Indeed, if one can learn anything from the experience of the crisis, it is that policy making is highly volatile and more exposed to external pressures and external contingencies than one might imagine, making it very difficult to trace future evolution for the integration process. If it is true that institutional change follows some patterns already traced, thus confirming the validity of the path dependence ideas, it is also the case that external circumstances are critical in shaping institutional change, adding a considerable amount of indeterminacy to the theory. It is thus more or less impossible to assess precisely how the European Union and the Eurozone will appear in a few years. Nonetheless, the findings do "travel" beyond the current Eurozone crisis, offering a contribution to thinking about the broader consequences of institutional changes conditioned by economic crisis in this general sense.

This focuses us on the question of what challenges Europe will face if the dynamics highlighted by the research continue to characterize policy making in Europe.[144] The crisis engendered a number of particular patterns of integration. The limited effectiveness of intergovernmentally-led procedures of decision making was one, as were the delegation of powers towards non-representative and technocratic institutions, and the persistent cleavage between northern/creditor countries and southern/debtor ones. Were such dynamics to persist in the European institutional setting, Europe the existing democratic and legitimacy deficits in Europe, which are already widely accepted in the literatures (Follesdal and Hix 2006; Hix 2008; Scharpf 1999), are likely to worsen.

Scholars attribute different origins to the EU's current democratic deficit. Some focus on the limited responsiveness and accountability of executives at the European level compared with the national level, while for others the weakness of the European Parliament in the institutional architecture of the EU is a key factor. Finally, the lack of democratic contestation as well as the excessive powers in the hands of non-elected bodies have been noted.[145] The crisis served to highlight

[144] The following discussion then stems from the hypothesis that the patterns of technocratic supranationalization and the poor effectiveness of intergovernmental decision making do not represent a parenthesis of the integration process, but a long-standing feature. Such conjecture, for sure, could not be the case.

[145] Agreement among scholars on the democratic deficit in the EU is not unanimous. Other scholars claim that, as a regulatory state, the EU does not have to be democratic, but essentially credible and effective in its policy making (Majone 2000; Moravcsik 2002).

some of these factors, particularly the marginalization of the European Parliament and the empowerment of technocratic institutions. Herein lies yet another paradox of the integration process revealed during the Eurozone crisis: as the scope of the European polity expands, the rise of an eventual break up of the union increases as a consequence of unsustainable democratic and legitimacy deficits.

It is important to note that the crisis has actually exacerbated the the democratic deficit in the EU in several respects. Most significantly, it has heightened the perception among citizens that the economic model proposed as a response to the crisis – i.e. implementation of austerity measures and structural reforms – has been implemented without democratic engagement, and absent any serious debate on possible alternatives (Blyth 2013). The lack of involvement of the European Parliament in the delineation of austerity measures – as well as the very limited role that national parliaments can play in challenging the prescriptions coming from Brussels – actually translate into a perception that these prescriptions are unsustainable. Where non-democratic intrusions from non-elected and non-representative bodies are made in the core of political debates, such as the power of directing citizens' resources and national redistribution, this is perhaps inevitable.

The legitimacy deficit is the product of two distinct factors. The first is the obvious failures of European policy making in effectively solving problems (Fabbrini 2013). As the present study has shown, effective policy outcomes often follow only after difficult institutional deadlocks, never–ending negotiations at the intergovernmental level, and eventual refinement and amendment of policies to correct deficiencies. The delay between the emergence of problems and the effective implementation of solutions is therefore often significant.

A second source of the legitimacy deficit is the increasing divide between member states, most obviously reflected in the economic, political and ideational cleavages between northern and southern states. As a consequence of the crisis, Europe witnessed a dramatic shift in the traditional balance of power within the EU. Northern creditor countries (Germany in particular) acquired an unprecedented degree of power in leading and shaping the political and economic response to the crisis. For southern countries, the austerity-cum-reform package – i.e. austerity measures plus wage compression – has been perceived as an unfair, and ultimately illegitimate, imposition by northern countries (Schmidt 2015). As observed in chapter 2, the most successful narrative of the crisis spoke to the supposed distinction between "profligate" southern states and rule-abiding northern countries, rather than to the idea of complex interdependence among states in the EU, and the individual responsibilities of each actor. This narrative engenders a sort of moral hierarchy among countries, which has been used by creditors to impose their economic design on supposedly errant southern states. These sentiments exacerbated perceived contrasts among the different groups of states, and among their respective publics over all, undermining the underlying sense of solidarity and resulting in a further disaffection for the EU among citizens.[146]

These two patterns of disaffection, on the base of democratic and legitimacy concerns, may ultimately produce a shift in European public opinion away from permissive consensus to euroscepticism, a possibility that Hooghe and Marks (2014) have termed "constraining dissensus". Simply put, if in the first decades of the integration process citizens were happy to leave the process of sovereignty pooling at the European level in the hands of political elites (Haas 1958:17), following the Maastricht Treaty, and to an increasing extent, European issues increasingly shape political debates and as a consequence the EU has become the subject of growing opposition from citizens. European integration has thus become a contested issue among voters, and even more in those states more negatively affected by the Eurozone crisis, such as Greece (Clements et al. 2014). The crisis therefore represents a powerful catalyst for the disaffection of European citizens towards further European integration. If left unaddressed in the medium- and long-term, these problems may represent a serious obstacle for the integration process, which might lose its political significance. That is,

[146] At the time of writing, the sense of solidarity among states is even more put into question with regard to the issue of refugees coming in Europe and their redistribution among member states. This gives the idea that economic dissonance may produce negative spillovers on other sensible policy fields.

Europe may become merely "policy without politics" (Schmidt 2012), which for any political system is in the long run clearly unsustainable.

If the patterns presented here result in a permanent paradigm shift in the institutional structure of the EU, we could imagine that Europe might find itself in fundament a political crisis, triggered by the necessity of rethinking political equilibria among member states and regaining the support of European citizens. This is the case even as the present economic crisis eases. In order to survive and acquire more legitimacy in the eyes of voters, the EU must develop a more effective and reactive policy making framework. Moreover, it should repoliticize policy processes, which is to say that European integration should go hand in hand with an expansion of the European political space, not with its restriction and depoliticization (Rodrik 2015). Several solutions to cast new political bases for the European polity in a more democratic framework has been proposed by scholars (Hix 2008; Schmidt 2012). For instance, the process may pass through the direct election of the President of the European Commission, so as to politicize the role of the European executive, and the European Parliament might be increasingly involved in the economic and monetary affairs.

In any case, to be sure, major institutional changes are needed in order to re-establish a certain "goodness-of-fit" between European citizens and the EU, which the Eurozone crisis has strained to an unprecedented degree. Such a transformation, for sure, will be politically challenging, and if one wants do the mental exercise of translating the findings of the research, it is possible to imagine that such institutional change will appear progressively, and likely – even if not hopefully – in concomitance with the break–out of a major political crisis, i.e. the birth of firmly anti-European governments in a core state, or a major political clash among member states. This kind of crisis, then, could be the functional enabler of another wave of major institutional changes.

7.5. Europe in hard times: Further research indications

The idea of looking at institutional consequences of economic crisis comes not as a surprise during a time of economic distress. As quoted in the introduction of the dissertation, “The production of books on financial crises is counter-cyclical” according to Charles Kindelberger (2005:7). Hopefully, after at least seven years of challenging financial and economic crisis, with major social consequences, the issue of the economic crisis might soon disappear and leave room to a renewed economic growth. This does not mean that the attention of scholarship for economic crises should disappear. In this sense, the present dissertation – though clearly working within the body of existing scholarship on European integration processes, decision making analyses and institutional change studies – might possibly open up the space for further research on the issue, in at least two directions.

The first could be an enlargement of the scope of the research, both in synchronic and diachronic terms. That is to say, it would be interesting to conduct an empirical validation – or to find disconfirmation – of the explanatory model proposed here by looking at similar policies in different times, as well as at other policies in the same period. A natural line of research here, for instance, might be the observation of the evolution of economic policies during other crisis periods, such as the monetary instability in Europe that occurred during the 1970s, which opened up the space for fundamental institutional innovations – i.e. the creation of the European Monetary System. At the same time, it could be possible to enlarge the scope of the observation of the policy transformation during the Eurozone crisis by looking at other policies from other sectors, such as the foreign policy, or the set of social policies, so as to understand how much external contingencies of the crisis and the pressure of financial markets were determinant in their eventual evolution. Preliminary analyses on the development of core state powers at European level suggest that the picture is rather ambiguous (Genschel and Jachtenfuchs 2015). That is, although increasing integration seems to be at work in Europe, this is developing within the context of institutional fragmentation, territorial differentiation and political segmentation.

A second strand of scholarship concerns an aspect largely overlooked in this research, that is the effective implementation of the policy outcomes observed. In other words, it would be interesting to look at how the outcomes observed will find effective implementation in the months and years to come, and what their long-term impact is. In particular, it would be interesting to see if the rationale of these policy outcomes is maintained. Will an effective supranationalization of competences, and not only on paper continue? Or, lacking new, and hopefully softer, external pressures, would procrastination and ineffective implementation of rules come back again, as happened for the SGP during the very first years of the monetary integration? In light of the proverbial "You never want a good crisis to go to waste"[147], directing research toward these strands may help discovering whether Europe will finally learn from its errors or if it effectively, and sadly, let this unprecedented crisis to go to waste.

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[147] Often used in the political and economic debate in the last few years, the real origin of the statement is uncertain. It was supposedly created by Winston Churchill, even though there is little evidence of it. For sure, it has been used by US President Obama's former chief of staff Emmanuel Rahm in an interview, and the concept has been often repeated by European leaders since then.

Appendix

Chapter 2

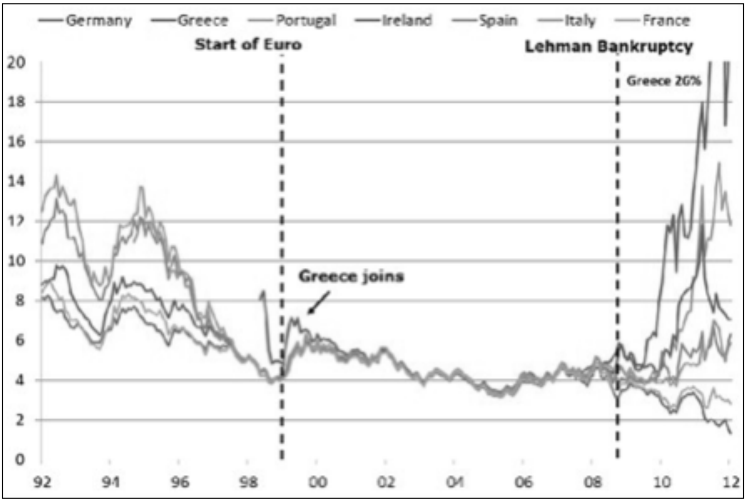

Figure a1: Course of spreads on sovereign bonds of seven European countries (1992Europe-2012).

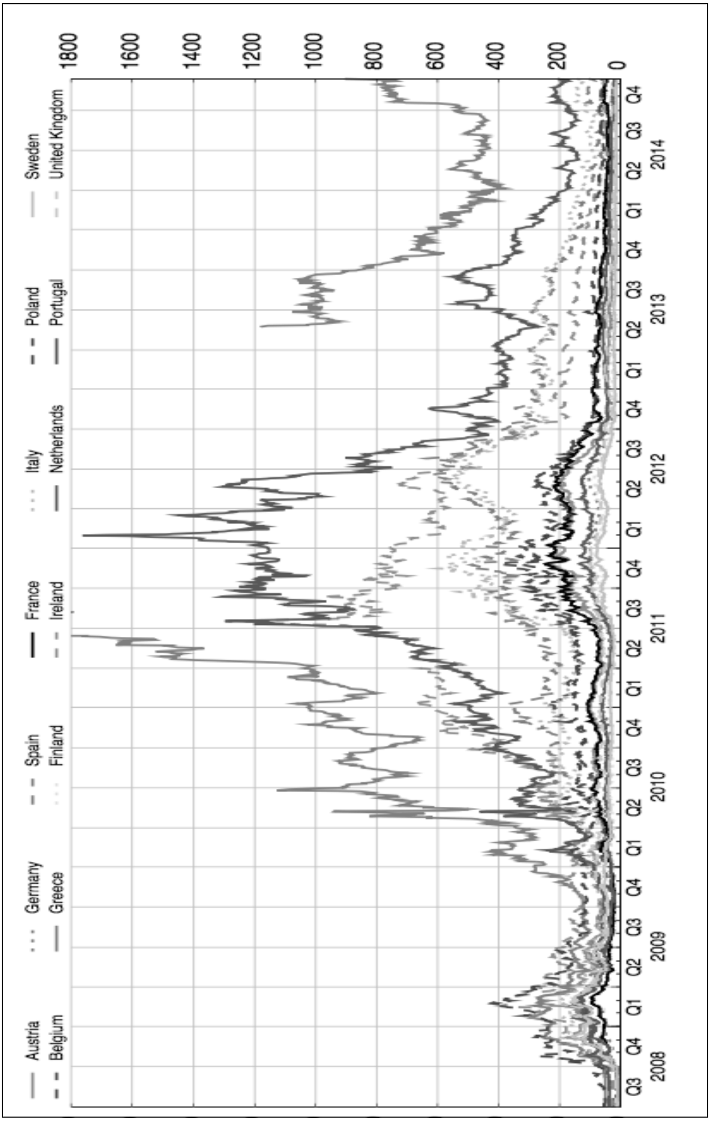

Figure a2: Course of CDS on sovereign bonds in (2008Europe-2014).
Source: European Systemic Risk Board

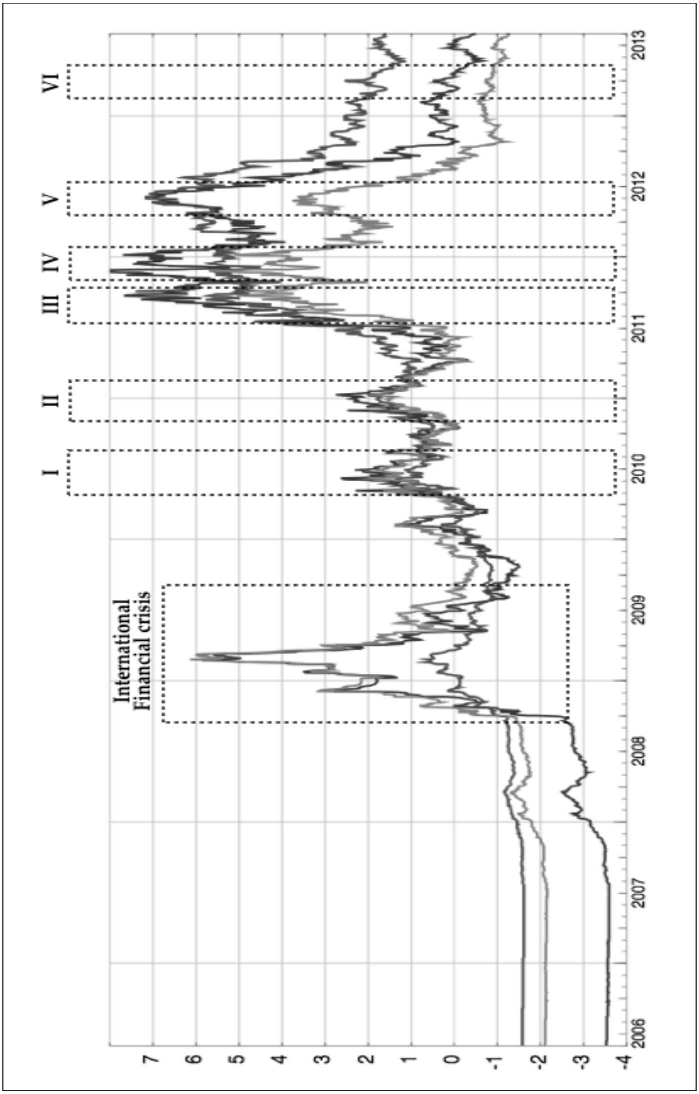

Figure a3: Course of co-movements of CDS on sovereign bonds in Europe and identification of main peaks of the crisis.
Source: European Systemic Risk Board.

Chapter 4

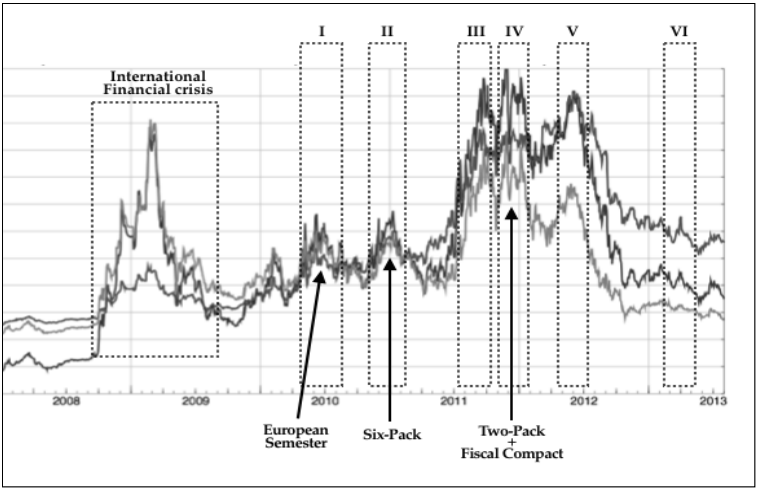

Fig. a4: Chronological overlapping between the peaks of the crisis and the reform of SGP

Chapter 5

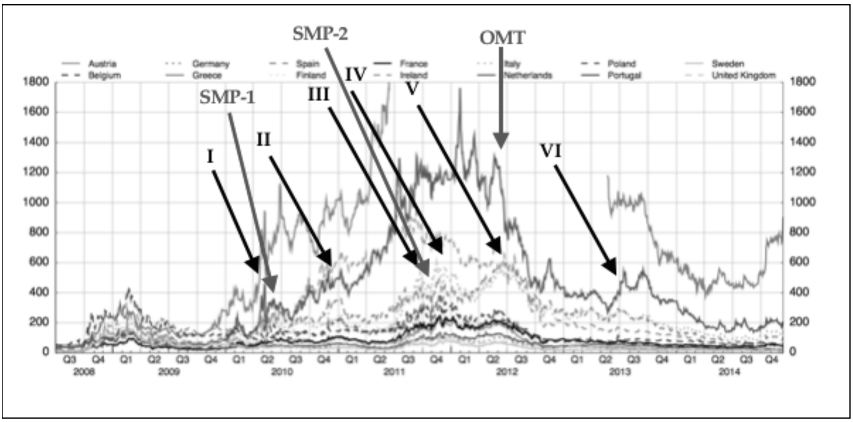

Fig. a5: Main waves of the Eurozone crisis and programs of financial support adopted by the ECB

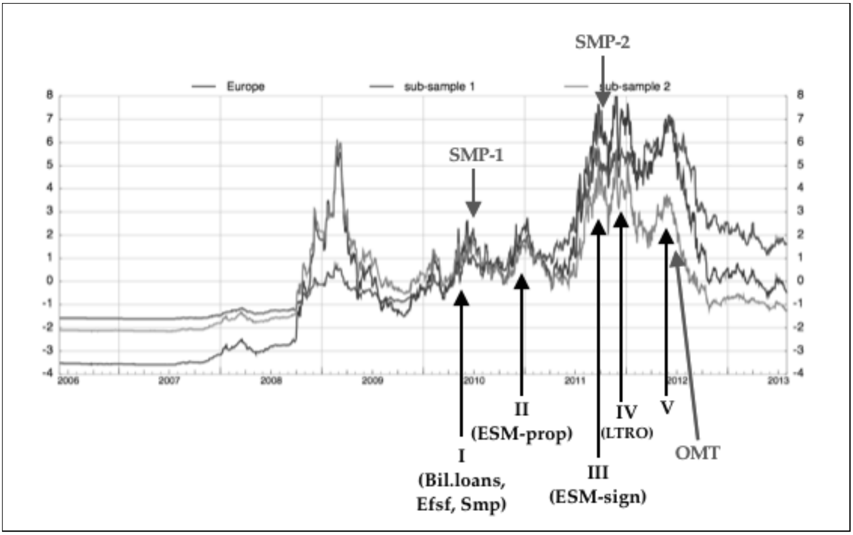

Fig. a6: Chronological overlapping between the peaks of the crisis and the adoption of instruments of financial aid.

Chapter 6

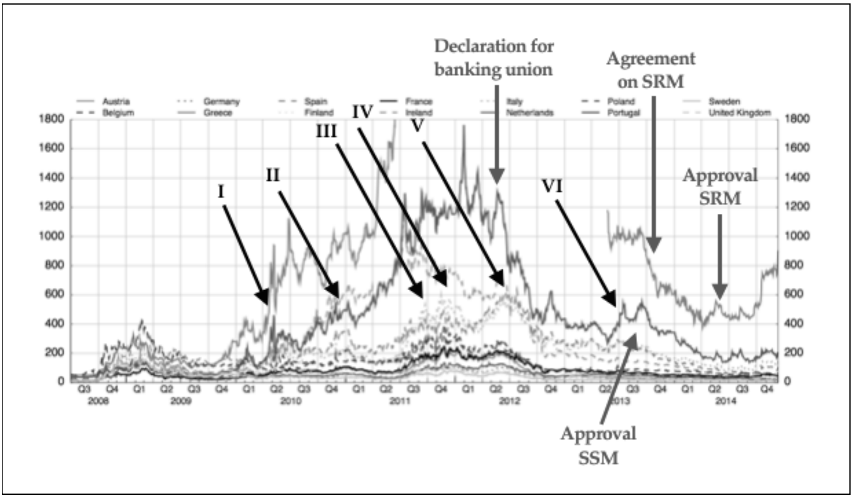

Fig. a7: Chronological overlapping between the peaks of the crisis and the progressive setup of a banking union.

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