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Maris, Georgios

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WHAT FORM OF GOVERNMENT FOR THE EUROPEAN UNION AND THE EUROZONE?

EDITED BY
FEDERICO FABBRINI
ERNST HIRSCH BALLIN AND HAN SOMSEN

BLOOMSBURY

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Intergovernmentalism and the New Framework of EMU Governance

GEORGIOS MARIS AND PANTELIS SKLIAS

I. INTRODUCTION

THE EUROPEAN CRISIS, which manifested itself through the Greek economic crisis, is the best case study for examining both the vulnerabilities of Europe's framework for economic governance and the very process of European integration itself. That is so for various reasons. First, because the European crisis is the most serious crisis the European Union (EU) has faced to date; secondly, as a result of the crisis, the limits on the process of economic integration in Europe have been put to the test; and thirdly, because the main causes of the crisis are tied into the framework of economic governance which has been developed over the last decades, and therefore are connected to the very process of European unification itself. The primary aim of this chapter is to demonstrate whether, and to what extent, the new framework for economic governance in Europe is mainly a result of interstate bargaining, and consequently whether national preferences continue to play an important role in its general transformation.[1] Although the process of European integration is too complex to be understood from one single theoretical viewpoint, the crisis has raised old questions about European integration concerning the centrality of the state, and interstate interactions. Does intergovernmentalism triumph over supranationalism? As is clear to us, the issue of how the framework of economic governance has been transformed is no longer an issue of 'low politics' but a major issue of 'high politics' since the autonomy and sovereignty of national governments within the realm of economic policy are now at risk. That is to say, the nature of the changes being put forward in the context of economic governance in Europe today is no longer in line with a less confrontational environment. At the level of Economic and Monetary Union (EMU),

[1] For other significant contributions on the governance of the euro crisis, see S Fabbrini, 'Intergovernmentalism and its Limits: Assessing the European Union's Answer to the Euro Crisis' (2013) 46 *Comparative Political Studies* 1003, 1029; C Bickerton et al, 'The New Intergovernmentalism: European Integration in the Post-Maastricht Era' (2014) 52 *Journal of Common Market Studies* 1, 20.

the more the integration process advances, the less room there is for transferring national sovereignty to supranational bodies, and the more the importance of an intergovernmental stance is highlighted. The economic crisis showed that important issues in economic policy which had been 'swept under the carpet' over recent decades, concerning the change in economic governance and the role of the nation state, must be resolved so make the European venture viable.

This chapter also claims that intergovernmentalism has been the key factor of change the economic governance in Europe. To understand the process of change in economic governance in Europe, it is first necessary to understand the role of interstate bargaining at a European level, primarily as a result of the national preferences and interests of Member States. Moreover, it is essential to stress the role of other factors which could interfere with this change. Therefore, in addition to evaluating the new framework of economic governance in Europe, one also needs to examine the conditions under which the specific changes took place, were adopted, and have been supported at the European level. It would appear that even though a series of other factors are involved in the process of transformation of the framework of economic governance in Europe, the interests of national governments which reflect the preferences of various socio-economic actors, continue to affect the final outcome to a large degree. This chapter stresses that to a large extent, behind any decisions concerning further unification of economic policy within the EMU, lie important intergovernmental elements. Thus the process of transforming the framework of economic governance continues, to a very significant extent, to be an intergovernmental game based on the interests of Member States.

Of course, that does not mean that we should downplay the role of the political and moral arguments, which were primarily developed after the end of World War II, about the creation of the EU. Moreover, the Community method continues to affect the framework of economic governance in Europe in its own way. That is most clear in the case of the monetary aspect of EMU. In this way the supranational decision-making method plays an important role in the process of changing the framework of economic governance in Europe. However, in the economic dimension of EMU from 2010 onwards, it has been primarily Germany, and also France, that have attempted to change the framework for economic governance in Europe based on an intergovernmental approach and focused on the sovereignty of the nation state compared to supranational players; focused on the intergovernmental method over the Community method. In this regard, our aim is also to examine in depth the behaviour of France and Germany in changing the new framework for economic governance in Europe. We have taken these two countries as examples because they are the EU Member States which are decisively influencing the development and transformation of this framework. That occurs because as Heipertz and Verdun have argued, 'when Member States governments bargain with one another, the largest countries have the greater influence'.[2] Over all these years it

[2] M Heipertz and A Verdun, *Ruling Europe: The Politics of the Stability and Growth Pact* (Cambridge, Cambridge University Press, 2010) 20.

has been Franco-German relations which have driven the integration process to a significant degree.[3] Unless the views of these two countries converge, no important issue of 'high politics' can advance in the EU. To a significant degree, when it comes to transforming economic governance in Europe, the more restrictions related to the interests and sovereignty of those two countries that are introduced, the clearer the limits on the process of European unification that emerge, and the more EMU appears that it will remain in a prolonged stated of imbalance.

The chapter is structured as follows. Section II studies the theories of European integration which constitute our theoretical context. Section III describes the conditions under which the initial framework of economic governance in Europe emerged. Section IV shows not only how the EU responded to the crisis but also how Germany and France affect the transformation of the new framework of economic governance in Europe. Section V concludes.

II. THEORIES OF EUROPEAN INTEGRATION

This section of the chapter attempts to synthesise the various viewpoints about the creation of EMU into a wider theoretical framework. This is necessary because the EU and the process of European integration are too complex to be viewed from any single theoretical perspective.[4] The literature contains a series of references as the key factors that have shaped the European monetary framework. This chapter will primarily focus on the old debate between neo-functionalism and intergovernmentalism. We argue that the European crisis brought us back to old questions about European integration. In our view, what plays—and will continue to play—a dominant role is the nation state and its interests.

The reasons why EMU was set up can be classified in various different ways. The political science literature to date has mainly presented two approaches. The first refers to Amy Verdun's attempt to classify the reasons why EMU was set up by looking at a set of political theories of integration which ties together hypotheses and forecasts.[5] Verdun argues that we can group the factors that play an important role in the development of European monetary unification into three main categories: (a) the role of actors and institutions, (b) mechanisms, and (c) international structural factors. The second approach presents the framework within which monetary integration emerged by looking at four different levels of analysis: the global, the European, the national and the domestic.[6] According to Sadeh and Verdun, EMU is the result of a European reaction to global challenges which was

[3] A Cole, 'Franco-German Europe' in K Dyson and A Sepos (eds), *Which Europe? The Politics of Differentiated Integration* (New York, Palgrave Macmillan, 2010).

[4] B Rosamond, *Theories of European Integration* (Hampshire, Palgrave Macmillan, 2000).

[5] A Verdun, 'Why EMU Happened: A Survey of Theoretical Explanations' in PM Crowley (ed), *Before and Beyond EMU: Historical Lessons and Future Prospects* (London, Routledge, 2002).

[6] T Sadeh and A Verdun, 'Explaining Europe's Monetary Union: A Survey of the Literature' (2009) 11 *International Studies Review* 277, 301.

feasible because European institutions had been set up, and was primarily put forward by the Franco-German pact.[7] As a result, if we suppose that the Member States place their interests on a scale just like the theory of instrumental rationality argues that humans do, then they try to satisfy as many interests as they can, starting from what they consider to be their most important issue. In this case, the Member States prefer to remain protected in the global political and economic environment.

It is very difficult to analyse the process of economic integration of Europe from realist or neo-realist perspectives either because theorists have not given them particular importance,[8] or because they are faced with important theoretical problems.[9] The same also appears to hold true for Marxist analyses. Furthermore, although early theories of European integration significantly affected the subsequent course of developments in European studies, these theories were called into doubt because of empirical developments within the EU. In effect, almost all early attempts are theoretical constructions designed to eliminate international conflict.[10]

Under those conditions, attention must be given to theories that were developed from the 1950s onwards. First of all is neo-functionalism, which was primarily developed in the works of Haas[11] and Lindberg and Scheingold.[12] Neo-functionalism stresses that integration is the result of functional pressures exerted because of integration in low politics sectors. An important role is played in this process by higher, supranational actors which have been set up for this purpose, and which contribute a great deal to the unification process. Under these conditions, wider social groups transfer their loyalty to the new supranational institutions. Although neo-functionalism can explain to a significant degree the first attempts to unify Europe from the Treaty of Paris onwards, since integration in one economic sector (the European Coal and Steel Community (ECSC)) created functional pressures that led to the European Economic Community (EEC), it cannot explain the creation of EMU with the same degree of cogency. It is true that from 1985 to the end of 1990, following a period of extreme criticism, neo-functionalism began to be revived because of changes that were occurring at that time.[13] The key elements of this revival were, inter alia, the White Paper on Completion of the Internal Market,

[7] ibid 277, 301.

[8] A Stone, 'What is a Supranational Constitution? An Essay in International Relations Theory' (1994) 56 *The Review of Politics* 441, 474.

[9] JM Grieco, 'The Maastricht Treaty: Economic and Monetary Union and the Neo-realist Research Programme' (1995) 21 *Review of International Studies* 21, 40.

[10] Rosamond, *European Integration* (n 4).

[11] EB Haas, *The Uniting of Europe: Political, Social, and Economic Forces 1950–1957* (Stanford, Stanford University Press, 1958); EB Haas, *Beyond the Nation State: Functionalism and International Organization* (Stanford, Stanford University Press, 1964).

[12] LN Lindberg and SA Scheingold, *Europe's Would-be Polity: Patterns of Change in the European Community* (Englewood Cliffs, Prentice Hall, 1970); LN Lindberg and SA Scheingold, *Regional Integration: Theory and Research* (Cambridge MA, Harvard University Press, 1971).

[13] J Tranholm-Mikkelsen, 'Neo-functionalism: Obstinate or Obsolete? A Reappraisal in the Light of the New Dynamism of the EC' (1991) 20 *Millennium-Journal of International Studies* 1, 22.

the Single European Act and the Delors Report. Neo-functionalism seems unable to explain why EMU has today not advanced to a more integrated stage of unification. This is mainly because the supranational institutions that have already been set up do not have the appropriate jurisdiction to proceed with the economic integration of Europe on their own. This means that the transition to a supranational level is not such a reasonable dynamic, automatic and depoliticised process since political union could not be developed without taking into account the views of European citizens.[14] Despite that, there is an element of neo-functionalism which over recent years has become worthy of further attention. This is the fact that supranational decision-making would become increasingly more technocratic.[15]

The response to neo-functionalism came quickly from the intergovernmental approach. Intergovernmentalism stresses that in areas of high politics, where either the autonomy of governments or important issues of national identity are at risk, unification would be difficult to achieve.[16] Although Hoffmann's view that states are the key players in global politics reflected realistic positions, he considered that national interests were the result of domestic forces,[17] which sets his views apart from the stance taken by the realists. Therefore, one of the most important elements of the theory of intergovernmentalism was that it emphasised the supremacy of interstate bargaining in setting the pace and degree of European unification.[18] According to intergovernmentalism theory, supranational institutions, such as the European Commission and the European Court of Justice, do not play an important role in the process of European integration. The same holds true for the role and influence of international players and coalitions and the extension of functional objectives.[19]

Intergovernmentalism played an important role in the subsequent development of liberal intergovernmentalism, which is thought to be the most important example of an attempt to theorise European integration.[20] Moravcsik in effect constructed a two-level game model which consists of a liberal theory of preference formation and an intergovernmentalist analysis of strategies for Member States reaching agreement.[21] Therefore, liberal intergovernmentalism, which relies

[14] PC Schmitter, 'Ernst B Haas and the Legacy of Neofunctionalism' (2005) 12 *Journal of European Public Policy* 255, 272.

[15] Rosamond (n 4).

[16] S Hoffmann, 'Obstinate or Obsolete? The Fate of the Nation-State and the Case of Western Europe' (1966) 95 *Daedalus* 862, 915.

[17] S Hoffmann, *The European Sisyphus: Essays on Europe 1964–1994* (Boulder, Westview Press, 1995).

[18] ΜΙ Τσινισιζέλης και ΔΝ Χρυσοχόου, 'Πολιτική Θεωρία της Ευρωπαϊκής Ενοποίησης: Από τον Λειτουργισμό στο νέο Ρεπουμπλικανισμό' στο Ν Μαραβέγιας και Μ Τσινισιζέλης (επιμ), *Νέα Ευρωπαϊκή Ένωση: Οργάνωση και Πολιτικές 50 Χρόνια* (Athens, Θεμέλιο, 2007).

[19] ibid.

[20] Rosamond (n 4).

[21] A Moravcsik, 'Preferences and Power in European Community: A Liberal Intergovernmentalist Approach' (1993) 31 *Journal of Common Market Studies* 473, 524; A Moravcsik, 'Liberalism and International Relations Theory' Harvard University Center for International Affairs, Paper 1993; A Moravcsik, *The Choice for Europe: Social Purpose and State Power from Mesina to Maastricht* (Ithaca NY, Cornell University Press, 1998).

on the interaction between domestic and international politics, and attempts to explain the EU as a successful example of an intergovernmentalist regime, also includes elements from realism and from neo-liberalism.[22]

Liberal intergovernmentalism is a model comprised of three different stages that combine: (a) a liberal theory to explain how national preferences are formed; (b) an intergovernmentalist bargaining model at EU level; and (c) an 'institutional selection' model that places emphasis on the role of institutions and on the provision of reliable commitments to the governments of Member States.[23] Therefore, liberal intergovernmentalism emphasises both the role of economic interests and the importance of institutions in the process of European integration, and stresses the central role of the state, the importance of domestic economic interests, and negotiations between national governments.[24] The principles on which the theory of liberal intergovernmentalism rests argue that political integration is the result of Member States' interests, which transfer various competences and powers to the European supranational institutions only if they can take control in various policy sectors.[25] In order for integration to advance the economic or trade interests of the Member States must overlap. According to intergovernmental theory the most important, historical intergovernmental agreements, such as the Treaty of Rome or the Treaty of Maastricht, were the result of a periodic process of preference convergence among the most powerful Member States, who offered incentives to the smaller states and transferred limited powers to the European supranational institutions, which effectively remained the servants of the Member States.[26]

Both the neo-functionalist and intergovernmentalist approaches have received severe criticism over recent decades primarily because they could not explain day-to-day European politics since the EU is dominated by the actions of non-state actors. For that reason, over recent decades theorists of European Studies have shifted their focus to medium-range theories. This has happened because both neo-functionalism and intergovernmentalism cannot comprehend the full complexity and dynamism in which politics is conducted within the EU.[27] For example, one cannot ignore the fact that over recent decades supranational institutions, such as the Commission or the European Parliament, have come to play an important role in EU affairs and the European Court of Justice (ECJ) has traditionally acted as an engine of integration even in times when the consensus between states for further integration was lacking. Under these conditions, over

[22] M Cini, 'Intergovernmentalism' in M Cini (ed), *European Union Politics* (Oxford, Oxford University Press, 2007).

[23] MA Pollack, 'Theorizing EU Policy-Making' in H Wallace, W Wallace and MA Pollack (eds), *Policy-Making in the European Union* (Oxford, Oxford University Press, 2005).

[24] R Gilpin, *Global Political Economy: Understanding the International Economic Order* (Princeton, Princeton University Press, 2001).

[25] CS Jensen, 'Neo-functionalism' in M Cini (ed), *European Union Politics* (Oxford, Oxford University Press, 2007).

[26] Pollack, 'Theorizing EU Policy-Making' (n 23).

[27] Rosamond (n 4).

recent years a series of new approaches have emerged in the attempt to theorise the EU. For example, multi-level governance attaches importance to the existence of a set of super-imposed multi-level coalitions.[28] According to Marks et al, the sovereignty of nation states within the EU has been reduced because of collective decision-making and supranational institutions.[29] Alternatively, the new institutional approach treats institutions as tools for developing and shaping political behaviour, which go beyond typical governmental bodies and introduce fixed operating procedures.[30]

This chapter pushes forward the intergovernmental aspect of the factors that change the economic governance in Europe. In this regard, we analyse not only whether, and to what extent, the new framework of economic governance in the Eurozone can be understood under the prism of intergovernmentalism, but also to what extent the interstate bargaining and the national preferences are reflected and shaped.

III. THE CONDITIONS UNDER WHICH THE INITIAL FRAMEWORK OF ECONOMIC GOVERNANCE IN EUROPE EMERGED

The initial framework for economic governance in Europe was created by the Treaty of Maastricht. The Treaty of Maastricht was not the result of straightforward, unproblematic negotiations. Wyplosz argues that during the negotiations that led to the Treaty, it became clear that France's views did not match those of Germany.[31] Germany placed emphasis on the importance of economic policies and of convergence, while France stressed the creation of new institutional tools. The strategy adopted in the Treaty of Maastricht emphasised the importance of two principles: gradual transition and convergence.[32]

Due to the differing approaches taken by France and Germany, which reflected the old dispute between 'economists' and 'monetarists',[33] the Treaty of Maastricht

[28] G Marks, L Hooghe and K Blank, 'European Integration from the 1980s: State-Centric v Multi-level Governance' (1996) 34 *Journal of Common Market Studies* 341, 378.

[29] ibid 341, 378.

[30] S Bulmer, 'The Governance of the European Union: A New Institutional Approach' (1993) 13 *Journal of Public Policy* 355.

[31] C Wyplosz, 'European Monetary Union: The Dark Sides of a Major Success' (2006) 21 *Economic Policy* 207, 261.

[32] P De Grauwe, *The Economics of Monetary Union* (Oxford, Oxford University Press, 2009).

[33] 'Economists' believed that before the creation of EMU the economic and financial conditions of its long-term viability should already exist. Thus, economic convergence is a precondition for monetary integration. This view was adopted by Germany and the Netherlands. 'Monetarists' believed that the process of monetary integration could create the necessary economic conditions for EMU's long-term viability. This view was adopted mainly from France, Belgium and Luxembourg. See L Tsoukalis, *The Politics and Economics of European Monetary Integration* (London, Allen & Unwin, 1977); DC Kruse, *Monetary Integration in Western Europe: EMU, EMS, and Beyond*, (London, Butterworths, 1980). Those who designed EMU were not clear about which approach to follow in setting it up. See A Verdun, 'Economic and Monetary Union' in M Cini (ed), *European Union Politics* (Oxford, Oxford

included both supranational and intergovernmental decision-making features. The main role in the supranational approach was first played by the European Central Bank (ECB), and subsequently by the Commission, the ECJ and the European Parliament. On the other hand, the intergovernmentalist method is identified with the increased role of the European Council in the unification process.[34]

In effect, during the negotiations for the Treaty of Maastricht, the Member States agreed to transfer significant aspects of their sovereignty to the supranational level only if national governments could control decision-making capabilities.[35] This means that in addition to being technocratic in nature, economic governance in Europe is above all political since it includes political agreements that satisfy the strategic interests of the Member States and their governments.[36] Thus the convergence of interests and preferences at European level produced two heterogeneous consequences relating to the initial framework for economic governance: (a) Europe acquired an unstable form of economic and social governance;[37] and (b) a stable and differentiated context of economic policies was put in place.[38] The result was the creation of an EMU with strong elements of asymmetry under which more wide-ranging economic governance was almost impossible.[39]

What was France and Germany's stance during the negotiations for the Treaty of Maastricht and under what conditions was agreement reached? The Treaty of Maastricht was the result of a bargaining game which is best explained by the principles of liberal intergovernmentalism. For that reason, during negotiations the two European leaders of France and Germany had kept the European Commission at a distance. As Dyson pointed out: 'The French favoured this rule from arguments rooted in national sovereignty and democratic legitimation; the Germans from arguments related to preserving the independence of the ECB.'[40]

University Press, 2007). In other words, the key players were not in agreement about whether, and to what extent, the convergence of economies ought to come before the transfer of sovereignty over monetary policy to a supranational level. See A Verdun, 'A Historical Institutionalist Analysis of the Road to Economic and Monetary Union: A Journey with Many Crossroads' in S Meunier and KR McNamara (eds), *Making History: European Integration and Institutional Change at Fifty* (New York, Oxford University Press, 2007).

[34] See U Puetter, 'The European Council—The New Centre of EU Politics' Swedish Institute for European Policy Studies, October 2013.

[35] Fabbrini, 'Intergovernmentalism and its Limits' (n 1) 1029.

[36] K Dyson, 'Economic and Monetary Union in Europe: A Transformation of Governance' in B Kohler-Koch and R Eising (eds), *The Transformation of Governance in the European Union* (London, Routledge, 1999).

[37] I Begg, 'Economic and Social Governance in the Making: EU Governance in Flux' (2010) 32 *Journal of European Integration* 1, 16.

[38] K Dyson and M Marcussen, 'Transverse Integration in European Economic Governance: Between Unitary and Differentiated Integration' (2010) 32 *Journal of European Integration* 17, 39.

[39] A Verdun, 'An "Asymmetrical" Economic and Monetary Union in the EU: Perceptions of Monetary Authorities and Social Partners' (1996) 20 *Journal of European Integration* 59, 81; A Verdun, *European Responses to Globalization and Financial Market Integration: Perceptions of Economic and Monetary Union in Belgium, France and Germany* (Basingstoke, Palgrave Macmillan, 2000).

[40] K Dyson, 'The Franco–German Relationship and Economic and Monetary Union: Using Europe to "Bind Leviathan"' (1999) 22 *West European Politics* 27.

For Germany, the creation of EMU was the best way to support the country's economic growth based on the neo-liberalist principles of the open market, free trade and deflationary monetary policy.[41] Moreover, the establishment of the ECB and the subsequent Stability and Growth Pact (SGP) was a means of promoting those objectives, as established by the monetarist revolution and its domination over Keynesianism.[42] After monetarist ideas were adopted, these objectives would be best promoted through an independent central bank, price stability and fiscal discipline (today, fiscal austerity) without it being possible to coordinate fiscal policy in the medium term.[43] In doing so, Germany was favouring its business interests. German businesses would enjoy advantages from the EMU-mandated ban on the devaluation of national currencies, as an opportunity to increase exports.[44] However, at the same time this also meant that other states would lose their ability to devalue their currency and thus the chance for their businesses' products to remain competitive. In addition, even if these countries followed different policies based on a more outward-looking strategy, the expected results would not accrue because of deviations that existed in the institutional structure of the peripheral states.[45] One could argue that Germany sacrificed the German currency in order to introduce a culture of economic stability based on specific rules across the entire EMU.[46] In fact, it was clear from the outset that Germany would not accept the euro if the monetary rules were not designed on the German model of economic growth.[47]

For France on the other hand, the creation of EMU was a way of being able to compete against Germany on an economic level and also to use EMU to make it come closer to its own economic model by increasing public spending, increasing wages, and inflation, in order to stop the foreign exchange crises and debt crises of the 1970s and 1980s.[48] France was attempting to balance its relationship with

[41] Germany's negotiating position in the discussions about the Treaty of Maastricht, were influenced by the economic philosophy of *ordoliberalism*. See K Dyson and K Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union* (Oxford, Oxford University Press, 1999) which is tied into a political approach based on the rules of *Ordnungspolitik* in which the state only lays down the legal framework within which private players can act as freely as possible. See W Mussler, 'EU Economic Governance: The German View' in JF Jamet, W Mussler and S De Corte (eds), *EU Economic Governance: The French and German View* (Brussels, Centre for European Studies, 2011). For a general overview of the main reasons for conflict between France and Germany up to the signing of the Treaty of Maastricht, see I Maes, 'On the Origins of the Franco–German EMU Controversies' (2004) 17 *European Journal of Law and Economics* 21, 39.

[42] KR McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (Ithaca, Cornell University Press, 1998).

[43] PA Hall and RJ Franzese, 'Mixed Signals: Central Bank Independence, Coordinates Wage Bargaining, and European Monetary Union' (1998) 52 *International Organization* 505, 535.

[44] PA Hall, 'The Economics and Politics of the Euro Crisis' (2012) 21 *German Politics* 355, 371.

[45] ibid 355, 371.

[46] JF Jamet, 'EU Economic Governance: The French View' in Jamet, Mussler and De Corte, *EU Economic Governance* (n 41).

[47] W Mussler, 'EU Economic Governance: The German View' in Jamet, Mussler and De Corte (n 41).

[48] A Moravcsik, 'Europe after the Crisis: How to Sustain a Common Currency' (2012) 91 *Foreign Affairs* 54, 68.

Germany by reducing the credibility of the German economic model.[49] However, that required a compromise with Germany and the other countries which was never achieved, and that is considered to be EMU's greatest failure.[50] In addition to being a political plan,[51] the creation of EMU also incorporated a 'Bind Leviathan' which represented an immense challenge for French views about the sovereignty of the state and legitimacy.[52]

As the theory of liberal intergovernmentalism explained, Germany would not have set up EMU if the other European countries did not agree to adopt the German economic model at Maastricht, since it—in contrast to France—was the only country which could persuade them of the superiority of its model of economic growth. France's economic (in)effectiveness in the 1970s and 1980s left no doubt about that.[53] However, Germany overlooked the fact that the other Member States did not meet the political, economic and cultural requirements to adopt it in reality. Even if it was debated occasionally, EMU's ability to achieve real convergence was overlooked as EMU never became an Optimal Currency Area, and never acquired the necessary mechanisms for fiscal transfers and for rescuing the Member States in times of crisis.

IV. DEALING WITH THE CRISIS

Until 2008 any reactions to the global economic crisis were based on the expectations and interests of each individual state, and varied widely.[54] The size of the global economic crisis, however, increasingly prompted actions at the European and global level. However, the challenge proved to be exceptionally difficult for the Europeans, especially outside the field of monetary policy where there was already a well-organised supranational decision-making system in place, centred on the ECB.[55] For the major part of 2009, the European crisis in the eyes of EU leaders was still primarily a banking crisis. The bad thing about this, according to Pisani-Ferry and Sapir was that,

> the management of the crisis has taken place according to the assignment of competences that exists in the EU: the ECB and national central banks outside the euro area have acted as liquidity providers, national governments have dealt with financial stability, and the European Commission has enforced competition disciplines. Although some of

[49] Dyson (n 40).
[50] Moravcsik (n 48).
[51] K Dyson, *Elusive Union: The Process of Economic and Monetary Integration in Europe* (London, Longman, 1994); Dyson and Featherstone, *The Road to Maastricht* (n 41).
[52] Dyson (n 40).
[53] ibid 25, 44.
[54] SA Schirm, 'Varieties of Strategies: Societal Influences on British and German Responses to the Global Economic Crisis' (2011) 19 *Journal of Contemporary European Studies* 47, 62.
[55] L Quaglia, R Eastwood and P Holmes, 'The Financial Turmoil and EU Policy Co-operation in 2008' (2009) 47 *Journal of Common Market Studies* 63, 87.

> these players, notably the ECB, have gone beyond the pre-existing script, none has gone beyond its pre-existing role. Especially, there has been no EU-financed bail-out of ailing transnational institutions.[56]

The Greek debt crisis officially became a European problem for the first time on 8 December 2009, and from then on at the European level there was only one topic of discussion: how can the European crisis be resolved? In light of that, from early 2010 to 2013, a new, highly complex framework of economic governance was put in place.[57]

At the Euro Summit of 7–9 May 2010 European leaders announced that all European institutions were duty bound to combat the economic crisis and ensure the euro area's economic stability. As they characteristically said: 'All the institutions of the euro area (Council, Commission, ECB) as well as all Euro Area Member States agree to use the full range of means available to ensure the stability of the Euro Area.'[58] From that time on, in addition to the bailout packages for peripheral countries, important changes have been made to the framework of economic governance in Europe.

Paul Craig has examined in detail the wide range of legal and policy measures adopted to respond to the Euro-crisis in another chapter of this book. So we will not dwell on their analysis here. Instead, we want to focus on another question: under what circumstances was the new framework for economic governance in Europe set up? What factors primarily affected this transformation? In a speech in Cologne on 13 September 2011, the President of the Bundesbank, Jens Weidmann, stated that there were two paths the new economic architecture of Europe could take: either we had to return to the principles set out in the founding treaties or we had to move towards a federalist transformation of the system, with everything that entailed.[59] The second solution is quite clearly a move towards political union. Weidmann's statement hides the essence of the process of European integration, whose most important aspect affects developments in the transformation of economic governance. That element is none other than the issue of transferring national sovereignty to European supranational institutions. In other words, when the European crisis occurred, even though Member States declared they were willing to accept greater control over economic policy at national level, the majority of them were putting forward solutions which were based on the intergovernmentalist game.[60] It is no coincidence that even in the Treaty establishing the European Stability Mechanism (ESM), the European Commission only played an

[56] J Pisani-Ferry and A Sapir, 'Banking Crisis Management in the EU: An Interim Assessment' Bruegel Working Paper 07/2009, 21.

[57] F Fabbrini et al (eds), *The Constitutionalization of European Budgetary Constraints* (Oxford, Hart Publishing, 2014).

[58] See Statement of the Heads of State or Government of the Euro Area, 7 May 2010, 2.

[59] See Jens Weidenmann's speech at the Association of Family Enterprises in Cologne on 13 September 2011.

[60] Fabbrini (n 1).

advisory role, which further reduced its credibility.[61] Furthermore, the European Parliament appears to have found itself in an even worse position.[62] According to Sergio Fabbini, the 'deepening of the euro crisis has led to new treaties that do not recognize the EP as a policy-making actor'.[63] Under these conditions, the new framework for economic governance in Europe (which to some degree was imposed by the economic developments after the crisis) in effect came about more from an intergovernmental procedure than via the Community method.

These remarks may be quite significant since they indicate the limits on the potential for change in the method of economic governance in Europe. It appears that it will be very difficult to take the next steps towards fiscal and political union in Europe and that the Community method has reached its limits, as long as the interests of Europe's powerful states do not allow it to advance.[64] Having said that, it has to be acknowledged that significant new elements in the EU architecture of economic governance (such as the European Semester, the six-pack and two-pack) which were the result of the Community method, fostered the role of the Commission and bolstered the supranational aspect of EMU.[65] Nevertheless, most of the measures which were realised through the Community method were initially promoted by intergovernmental institutions, notably the European Council and its President.[66]

Almost all attempts at reform designed to improve and bolster the framework for economic governance, even the bailout plans for the Member States, fall within the same framework of analysis. However, we should remember that during the last decades one important factor has changed. France and Germany are the most powerful EU Member States, but their global and peripheral economic power and influence has not remained stable and equal. Moreover, one ought not to forget that in addition to being an imperfect economic and political framework, EMU is also a zone within which major divergent interests have emerged over recent years, especially between France and Germany.[67] These divergences appear to have created an utterly confrontational environment concerning EMU issues. As we explained in the previous section, initially, France and Germany interpreted

[61] RM Liddle et al, 'Where Next for Eurozone Governance? The Quest for Reconciling Economic Logic and Political Dilemmas' Policy Network Paper 07/2012.

[62] C Fasone, 'The Struggle of the European Parliament to Participate in the New Economic Governance' EUI Working Paper RSCAS 45/2012; P Manoli and G Maris, 'The Role of the European Parliament in Managing the International Economic and Financial Crisis' in S Stavridis and D Irrera (eds), *The European Parliament as an International Actor: Assessing the First 35 Years of a Directly-Elected "Supranational" Parliamentary Institution's External Relations* (Routledge, 2015).

[63] S Fabbrini, 'After the Euro Crisis: A New Paradigm on the Integration of Europe' ARENA Working Paper 5/2014, 9.

[64] H Kundnani, 'Europe and the Return of History' (2013) 11 *Journal of Modern European History* 279, 286.

[65] See the contribution of P Craig, ch 2 in this volume.

[66] See the contribution of U Puetter, ch 14 in this volume.

[67] S Tombazos, 'Centrifugal Tendencies in the Euro Area' (2011) 19 *Journal of Contemporary European Studies* 33, 46.

the Euro-crisis in two completely different ways. Both France and Germany saw the crisis as an opportunity to promote changes in the economic governance of Europe based on their separate interests and preferences. However, neither France nor Germany had clear-cut plans about that transformation. The views of both countries overlapped in that believing that the euro and the Eurozone had to be rescued in some way. However, there was disagreement about how to bail out Member States and the way in which the framework for economic governance ought to be transformed. Germany argued that it had to be done based on already agreed principles and rules, while France stressed that the process of economic integration in Europe had to be advanced to create economic governance.[68]

To be more specific, the Germans viewed the European crisis as the result of the fiscal condition of the Member States. At the outset, the European crisis for the Germans lacked a European dimension. What existed were separate and unique fiscal and banking crises within the Member States. To address this, Germany suggested the same tried-and-tested recipe which is based on three principles: (a) the independence of the ECB based on the monetarist approach; (b) the application of stricter rules in relation to SGP and the Excessive Deficit Procedure (EDP); and (c) fiscal consolidation of the Member States via harsh, oftentimes catastrophic, austerity and structural reforms. Why, however, did German Chancellor Merkel accept the French idea of creating economic governance for Europe? As Jamet argues, this move was purely tactical, intended to win a leadership role for herself in this debate, to mark the goalposts about rule-based governance, and to prompt France to put forward more specific, practical ideas about what economic governance would entail.[69]

One ought not to forget that since Germany is the country which reaped the most benefits from the moment EMU was created, even if it left it to the last moment it would do everything to stop the Eurozone collapsing, while keeping many peripheral Member States in a 'coma' due to its unwavering and intransigent policy. Germany only makes compromises when it knows that this will not have a negative impact on the interests of German businesses or if in practical terms disaster is just one step away. It is the country which stands to lose the most from the collapse of the Eurozone and its export sector would be irreparably hit. According to a Bertelsmann Stiftung report,[70] default on Greece's part and its exit from EMU might not have major impacts on the Member States since Greece only represents a very small part of the European economy overall, but because of the domino effect that would very likely occur, it could provoke the collapse of the money markets in Spain, Portugal and Italy and reduce the overall GDP in the world's 42 largest countries by a figure of around €17.2 trillion. On the other hand, to be fair, it is essential to stress that Germany is the country which has contributed the most to

[68] Mussler (n 47).
[69] Jamet (n 46).
[70] Bertelsmann Stiftung, 'Economic Impact of Southern European Member States Exiting the Eurozone' Bertelsmann Stiftung Policy Brief 06/2012.

financing bailout packages for Greece, Ireland, Portugal, Spain and Cyprus given its participation in the programmes and the country's simultaneous exposure to European Financial Stability Facility (EFSF) and ESM solidarity obligations of 27 per cent,[71] while the initial potential cost is around €79.4 billion.[72]

At the same time, from the onset of the crisis Germany has been in the most advantageous position compared to other Member States. EMU not only generates immense economic benefits for it but also gives it (as the theory of liberal intergovernmentalism states) a very major comparative advantage in negotiations at European level. Even though, for example, it initially disagreed with the bailout plans for the peripheral states or the establishment of the EFSF or ESM because they violated the Treaty of Maastricht, or with ECB policy on the purchase of bonds from deeply indebted states from the secondary market, it did in the end make certain concessions which, in a very smart way, did not undermine German interests. Among other things, Germany did not want to pay the bill alone. Germany refused for a long time to rescue Greece, so that the issue of the Greek crisis was left hanging by a thread. In doing so, Germany reduced the negotiating power of the other European players and limited the ability to present alternative forms of bailout to a minimum. Clearly, Germany appears to have adopted this strategy so that it could lay down its own terms and conditions in the new framework for economic governance and so as to safeguard German economic interests in the best possible way. The bailout plans of deeply indebted Member States resulted in the EU offering

> the most cost-effective and politically expedient way for Berlin to ensure that German banks and bondholders get paid back for their imprudent international loans. It is no surprise then, that strong support from German business has been decisive in ensuring a multiparty majority in the Bundestag behind committing resources to defend the euro.[73]

From 2010 onwards Germany stressed the need for changes in the framework of economic governance; changes that needed to be based on robust legal foundations. The alibi of the German Constitutional Court was always very credible. For example, during the Euro Summit of 9–10 May 2010, Germany reacted to a much more ambitious attempt at bailout put forward by the European Commission and in particular to its proposal to set up a bailout fund to purchase the bonds of indebted Member States.[74] The German delegation argued that if such a proposal were to be adopted there would be problems with the Constitutional Court.[75] According

[71] J Bibow, 'Germany and the Euroland Crisis: The Making of a Vulnerable Have' Levy Economics Institute Working Paper 767/2013.

[72] C Broyer et al, 'Impact of the Euro Crisis on the German Economy' Allianz Working Paper 154/2012.

[73] Moravcsik (n 48) 61.

[74] L Gocaj and S Meunier, 'Time Will Tell: The EFSF, the ESM and the Euro Crisis' (2013) 35 *Journal of European Integration* 239, 253.

[75] T Barber, 'Saving the Euro: Dinner on the Edge of the Abyss' *Financial Times* (London, 22 April 2010).

to the German Chancellor, the main changes ought to be made in three areas: (a) better fiscal discipline via the SGP; (b) improved coordination of economic policy; and (c) the setting up of a crisis management mechanism. For the German authorities, change in sector one was based on very clear-cut views, whereas the framework for changes in the other two areas was not quite so clear-cut. When it came to setting up a framework to encourage competitiveness and growth, Germany stressed that any changes ought to be made so as not to affect the German export sector. Moreover, the German government did everything it could to avoid setting up a 'European transfer union', along the lines proposed by the French approach. In September 2010 a German non-paper stated the need to accelerate fiscal consolidation procedures by putting in place automatic sanctions on states which violated the SGP. In this way, the German approach stressed the need to set up a much more de-politicised fiscal sanctions procedure. Any sanctions ought not to be a matter of the European Council's discretion but ought to be imposed automatically. In effect, all these developments brought the Franco–German dispute about rule compliance and the governance policy to the fore.[76] In fact, Germany wanted not just to make the sanctions under the SGP automatic and in that way depoliticise the Excessive Deficit Procedure, but also via the European Semester to make European fiscal supervision more compact.[77] At the same time, it introduced multilateral supervision based on specific metrics and sanctions on non-compliant states via the new Excessive Imbalance Procedure. In addition, Gocaj and Meunier have argued that the way the EFSF operated reflects the German attempt to control the new institution and to segregate it from the European technocratic management approach, since EFSF is a company based in Luxembourg and does not belong to either the Commission or the Council.[78] The same argument can be made for the creation of ESM. It is thus clear that even with the setting up and running of the EFSF and the ESM, there were political reasons at play which affected the final outcome. Germany also appears to have supported the French proposal concerning the Euro Plus Pact because it was in effect based on the intergovernmental process and not on the Community method. In effect, most European Councils from 2010 to 2012 entailed an asymmetric bargaining game between Germany and the other Member States. All the measures put forward do not appear to have negatively impacted on German economic interests despite being condemned numerous times by various interest groups within Germany.

Did France react in any way to all this? Back when EMU was being designed and planned, France supported the idea of creating a so-called '*gouvernement economique*', albeit one based on an intergovernmental mode. The idea of economic governance had been raised by Mitterrand during the negotiations for the Treaty of Maastricht. Moreover, while France supported the idea of creating the

[76] Mussler (n 47).

[77] J Schild, 'Leadership in Hard Times: Germany, France, and the Management of the Eurozone Crisis' (2013) 31 *German Politics & Society* 24, 47.

[78] Gocaj and Meunier, 'Time Will Tell' (n 74).

ECB and the SGP primarily to prevent French governments recklessly increasing public debt and public deficit, it refused to accept the blind nature of the economic governance rules which Germany imposed since it also wanted to ensure that it was possible for French governments to intervene in times of crisis.[79] From the French perspective, the establishment of a framework for economic governance in Europe ought to be based on four principles: (a) suitable coordination of EU economic policy and the development of a suitable economic policy mix by the ECB; (b) a more active role for the EU in stimulating economic growth and job creation; (c) more reliability and legitimation for EMU; and (d) challenging the objectives and independence of the ECB.[80] Of course, that did not mean that the French had taken a clear-cut, firm line about how the new framework for economic governance ought to look. The French had for a long time been stuck on the questions of whether and to what extent aspects of national sovereignty ought to be surrendered.[81] Howarth stresses that, 'the most common feature of French communicative discourse on economic governance has been the absence of any concrete proposal of transferring real economic policy competences from the national to the European level'.[82] That is perhaps why even today France has not fully clarified what the concept of economic governance in Europe means.

Over recent years France's approach to the creation of economic governance in Europe has not radically altered since it always appears to be closer to an intergovernmental rather than a supranational approach.[83] Although the current French approach to dealing with the debt crisis initially differed considerably from the German approach because of the fear that France would remain unprotected on the global markets, France came to accept Germany's stance on implementing a restrictive economic policy.[84] Of course, that does not mean that the French authorities stopped attaching importance to issues of economic growth and to fiscal stimulus and wider coordination and a degree of latitude when it comes to fiscal and monetary policy.[85] It is clear that today France prefers a 'weaker' euro so as to bolster the competitiveness of French businesses, while Germany wants a 'stronger' euro so it does not acquire European competitors in the global economy. That is why the French focused their attention on macroeconomic imbalances and the problems of competitiveness faced by the Member States.

In particular, in contrast to the German insistence on stability, France took the view that the focus should be on growth. The proposals to bolster European

[79] D Howarth, 'Making and Breaking the Rules: French Policy on EU "Government Economique"' (2007) 11 *Journal of European Public Policy* 1061, 1078.

[80] ibid 1061, 1078.

[81] JL Arnaud, 'France and Europe: The Debate in France at the Start of the French Presidency' Notre Europe Research and Policy Papers 10/2000; H Drake, 'France on Trial? The Challenge of Change Posed by the French Council Presidency of the European Union' (2001) 94 *Modern and Contemporary France* 453, 466.

[82] Howarth (n 79) 1075.

[83] Jamet (n 46).

[84] Fabbrini (n 1).

[85] See J Pisani-Ferry et al, 'A European Recovery Programme' Bruegel Policy Brief 2008.

economic policy, to revitalise the European single market and to develop a single European investment strategy are all focused in this direction. France proposed that a Eurobond be created—a proposal Germany rejected based on moral hazard. France also supported the plans of the Commission's president for joint European borrowing to finance investment plans. In relation to the financial framework, France stressed the need to increase financial supervision and promoted the creation of the European Systemic Risk Boards as well as three other European authorities.[86]

On the issue of setting up a crisis mechanism, France initially agreed with Germany to the establishment of a permanent crisis resolution mechanism. However, it did not put forward detailed proposals about how such a mechanism would operate. In March 2010 Germany proposed that a European Monetary Fund be set up, to provide direct cash injections to Member States and to eliminate the risk of default. But France blocked such a development. There were two main reasons for this. First, France did not want the European Monetary Fund to be considered to be a regional competitor of the International Monetary Fund (IMF) in the context of the presidency of the G-20. And secondly, given a potential default, the markets would be looking for higher returns on sovereign bonds and the European banks would be weakened.[87] That is why France turned its attentions towards supporting the creation of the ESM which was promoted by Germany. It should be stressed that the French President, Sarkozy, had also proposed that the EFSF should have unlimited access to ECB funds. The ECB should also intervene (as it did) by buying up the bonds of deeply indebted Member States from the secondary markets. This provoked major reactions from German officials at the ECB. On the issue of the Greek bailout package, France was initially in favour of providing direct assistance to Greece and rejected any IMF involvement. In contrast, Germany examined the prospects of a 'Grexit', refused any bailout plan, and stressed that any bailout of Greece would have to be decided on with the active involvement of the IMF. The results are now known to all.

As far as the fiscal supervision framework is concerned, in October 2010 France reached agreement with Germany on supporting the imposition of strict sanctions on any Member States that violated the SGP. They even went so far as to agree on banning Member States that violated the fiscal framework from taking part in votes at European Councils, but this proposal was not accepted in the end.[88] France also promoted the strengthening of multilateral fiscal supervision via the adoption of the Euro Plus Pact on 25 March 2011. It added the idea of coordinated action being taken against countries with excessive surpluses to the debate, so as to support the effective demand of national economies. However, as one might have expected, that proposal was rejected by Germany which stressed the need for structural reforms.

[86] Jamet (n 46).
[87] ibid.
[88] W Kösters, 'Credible Rules, Not Discretion, Will Make the Euro Sustainable' (2010) 45 *Intereconomics* 340, 343.

V. CONCLUSION

The EMU is a 'major political issue' which touches upon the very 'heart of the issue of national sovereignty'.[89] The economic crisis showed that important issues in economic policy, which were 'swept under the carpet' over recent decades concerning the change in economic governance and the role of the nation state, must be resolved in order to make the European venture viable.

Since 2010, immense changes have occurred in relation to the economic and monetary aspects of EMU creating a new, complex system of economic governance. At the same time, the Euro-crisis brought up old questions about European integration concerning the centrality of the state, and transnational interactions. As this chapter has argued, the new framework of economic governance in Europe is largely the result of an intergovernmental approach. This shift towards the intergovernmental method undoubtedly shows us that the process of economic unification in Europe is not only moving forward one step at a time but that it can be affected by the interests of the Member States. In fact, as the process of integration continues, the issues of 'low politics' are substituted by the significant issues of 'high politics'. Yet, in this way the possibility of the transformation of economic governance in Europe becomes weaker. The more the process of integration moves forward, the more the margins for transferring national sovereignty to supranational institutions are narrowing, and the more the importance of the intergovernmentalist stance is highlighted. Of course, today Europe appears to have the will to overcome barriers and to surpass itself; however the end result of this process is not predictable.

As this chapter has suggested, from the institutional point of view, the crisis is the result of the structural choices made at Maastricht, as a corollary of the convergence of the interests and preferences of the powerful Member States. Even today the creation of a new framework for economic governance appears to continue to be a bargaining game. Although supranational actors have played or continue to play an important role in developments concerning changes in the framework for economic governance in Europe, especially in relation to the economic dimension of EMU, the intergovernmental approach has remained prominent. Sovereignty and the centrality of the nation states appear to be unchallenged, although in some cases they could be contested. Under these circumstances, any future changes in the framework for economic governance are not expected to significantly affect the centrality and importance of the nation state to such a degree that one could talk about the importance of intergovernmentalism diminishing. Therefore, the process of European unification and of transforming the new framework of economic governance can only advance to the extent that the interests of the strong Member States permit it.

[89] Λ Τσούκαλης, *Η Νέα Ευρωπαϊκή Οικονομία: Στο Κατώφλι του 21ου Αιώνα* (Athens, Παπαζήση, 1998) 247.

Without any doubt, the international and European bargaining game over economic relations is much more complex today than it was in the past.[90] However, the key factor affecting both negotiations and the outcome of negotiations on the new framework for economic governance is none other than the interests of the Member States. Both Germany and France turned to the intergovernmentalist approach to find solutions to the crisis. The basis of that approach is the sovereignty of the nation state over supranational players; the intergovernmental method over the Community method. Therefore, the changes and necessary adjustments required at EMU level, such as changes in the labour market or the setting up of fiscal transfer mechanisms or the introduction of Eurobonds or the promotion of banking union, will not be the result of some automatic or depoliticised process. Critical changes are not put forward unless there is convergence between the economic interests of the strongest Member States, namely France and Germany. This conclusion is consistent with the core of the theory of liberal intergovernmentalism. However, in a globalised world 'state interests' are no longer only determined by the domestic context. One could argue that the Member States place their interests on a scale just like the theory of instrumental rationality argues that humans do. From there they try to satisfy as many interests as they can, starting from what they consider to be their most important interests. So even within such a diverse union, integration can be promoted because all Member States recognise that in all events it is not in their interests to be isolated and to face the globalised environment on their own. However, that would not appear to change our basic conclusion that as long as restrictions relating to interests and sovereignty are included in the context of transforming economic governance, the clearer the limits on the transformation and on the general process of economic integration are, and the more EMU will, it seems, remain imbalanced for a long time to come. In this regard, it appears that the EMU will remain in a prolonged state of imbalance.

[90] B Eichengreen, 'European Monetary Integration with Benefit of Hindsight' (2012) 50 *Journal of Common Market Studies* 123, 136.