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### Eurozone Crisis and European Integration: Functional Spillover, Political Spillback?

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# Eurozone Crisis and European Integration: Functional Spillover, Political Spillback?

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**ABSTRACT** This paper analyzes the decisions taken since the start of the financial and economic crisis in the European Union and assesses them in the light of the traditional debates of integration theories. It discusses the key characteristics of the process of responding to the crisis since 2008–2009 when the problems of Greece have been increasingly publicized, the main actors involved, and provides an interpretation of the key decisions dealing with the crisis and their implications in terms of further European integration. First assessing these events in the light of the neo-functional and liberal intergovernmentalist debate, it then presents a framework linking the accounts of the integration process with a domestic politics approach. In this respect it contributes to the literature on European integration as well as the changing nature of EU polity, policy-specific effects of politics and how politics in member states constrains decisions on the further deepening of the Economic and Monetary Union and efforts to move towards transfer union. The incremental process of centralizing redistributive policies accompanied by the debates about financial transfers from some EMU countries to the others have altered popular ‘permissive consensus’ about the process of European integration and exposed territorial cleavages which became a key constraint in responding to the crisis and pressures for further integration.

**KEY WORDS:** Economic and Monetary union, eurozone crisis, theories of European integration, regulatory and redistributive policies, domestic politics

## Introduction

Recent years have seen a significant change in the European Union (EU) agenda and its politics compared to the widespread euphoria a decade ago when the single currency has been introduced, EU has been preparing for

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enlargement into Central and Eastern Europe and economic growth in most its countries fuelled optimism over the implementation of the Lisbon Strategy goals. This optimism has given away to a growing pessimism since the start of financial crisis in 2007–2008, which soon turned into a crisis of sovereign debt and competitiveness, exposing serious problems of public finances, lack of structural reforms and excessive borrowing during the first decade of the EMU in many eurozone countries. It revealed persistent divergences among members of the eurozone against the hope of the ‘founding fathers’ of the EMU that monetary integration and fiscal and economic policy coordination would lead towards convergence of these economies. It also prompted talks about the deficiencies of EMU institutions which have been left since the adoption of the Maastricht Treaty. This was expressed by calls to complete the institutional architecture of the EMU, to create ‘a genuine’ EMU with the adoption of fiscal or transfer union also referred to as ‘its own fiscal capacity’ or ‘shock absorption function’ (European Commission (2012), Van Rompuy (2012b)).

Most of the debates about the substance and direction of reforming the EU’s economic governance are characterized by a strong normative element, often reflecting the underlying preferences of analysts and other actors, their ideas about the desired division of functions between the EU and its member states, and desired limits to these interventions, on the one hand, and the functioning of markets, on the other. Many recommendations about how to solve the eurozone crisis and what the EU should do are informed by ideas regarding the prospect of the federal EU as well as the degree of interventionism of the federal and national institutions into the markets. Much less has been written about the actual direction that EU integration has been taking since the start of the crisis, its defining characteristics and limits to different scenarios proposed by economists and policy-makers on both EU and national levels.

This contribution analyzes from a positive perspective the decisions that the EU has taken in recent years, the vectors of reforms and constraints to further deepening of integration. It draws on the insights of the main integration theories to describe the characteristics of the response of the EU and its member states to the crisis. In doing so it links the traditional debate about the causes, motives and process of European integration with the more recent discussions of EU’s polity, its policies and politics which have drawn on the insights of comparative politics. It assumes that the current state of the EU and EMU in particular requires a combination of insights from both integration theory and domestic politics approaches to understand better the reforms that EU has been implementing, the dominant actors and the constraints which are posed by these interconnections between international, EU and domestic levels.

It is argued that the changing nature of politics in Europe, with new types of policies being gradually transferred to the EU level, has altered the ‘permissive consensus’ about the process of European integration. Traditionally regulatory policy has been the main instrument used by the EU in advancing the objectives set in its treaties and creating legal obligations for member states and their citizens. Redistributive policy has been

relatively limited and restricted to specific policy areas like agriculture. However, since the start of the crisis most debates have focused on significant transfer of competences, which involved important elements of redistribution between different member states. To be sure, many popular debates simplify those centralized mechanisms—such as the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM)—portraying them as outright transfers rather than lending and guarantee. However, the issue of redistribution between member states goes to the essence of politics, compared to mostly very technical issues of regulatory policies. The public disapproval of financial transfers from their countries to other EMU members or public protests in recipient countries against conditionality which links bail-out support to a set of domestic reforms has become a new and increasingly important constraint on further processes of European integration. The widely criticized response of EU member states, especially Germany, in dealing with the crisis—expressed by the phrase ‘too little too late’—can be understood better if we take into account the importance of domestic politics for any new step in the direction of central pooling of resources. Moreover, every decision on financial assistance from EFSF and ESM as well as ECB interventions into bond market should be seen in the context of the debate about how to advance reforms in the recipient eurozone countries. Every decision regarding financial assistance to countries in trouble is linked directly to taking politically unpopular and difficult measures aimed at regaining competitiveness and reducing fiscal imbalances. The main contribution of this analysis is in highlighting the importance of domestic politics as a constraint to the creation of joint supranational transfer mechanisms, due to the much higher politicization of redistributive policy compared to regulatory policy.

The article first presents the main characteristics of the EU’s response to the eurozone crisis in the light of the debate between neofunctionalism and liberal intergovernmentalism, discussing the differences of these accounts and pointing out the issues which are left unaddressed by these approaches. It then proposes how to link the analysis of European integration during the crisis with the concepts of comparative politics, in particular, the differentiation of policies and their salience to the public. Finally, it concludes with observations and the implications of this analysis to further processes of crisis resolution and reforms of European economic governance as well as their conceptualization.

### **Revenge of Neofunctionalism?**

The proliferation of the debates about the need for EU- or EMU-wide fiscal, banking, transfer or some other type of union which could constitute an important step towards political union provides a good background for employing the concepts of the traditional integration theories to describe what has been taking place in the EU during the last several years. Here, the response of the EU to the crisis is discussed by assessing the process, key actors and the outcomes of EU decision-making at the time of crisis using the propositions of neofunctionalist and liberal intergovernmentalist accounts of European integration.

The neofunctionalist account, especially its original version, which has been most widely referred to in scholarly work on European integration, places emphasis on several elements which describe the process of integration: integration is an incremental process which is driven by the demands of interest groups for market integration and supranational institutions responding to these demands following the functional logic which characterizes highly interdependent economies and linkages between different policy areas (Haas 1968b; Rosamond 2005). The process is characterized by a gradual transfer of competences from member states to the EU, the process which itself is likely to lead in the future to further demands from economic interest groups to integrate functionally linked policy areas. Incrementalism, dominance of interest groups and supranational institutions, and the transfer of competences to the EU in functionally linked policy areas are the key characteristics of a neofunctionalist account.

How could the process of responding to the crisis by the EU be described in terms of its nature, the key actors and outcomes achieved so far? First, it should be noted that the language of many EU leaders and analysts has an implicit reference to the 'spill-over' process. The talk about 'incomplete', 'unfinished' projects of the EMU implies that single monetary policy established by the Maastricht Treaty and the introduction of the single currency in 1999 has gradually exposed the need to move ahead with other functionally linked policy areas, which due to political reasons were left under the competences of member states when the eurozone was created. Fiscal union and banking union as well as central transfer mechanism to deal with the instances of divergent economic cycles in eurozone members are the most often cited policy areas where centralization would stabilize financial markets and strengthen the monetary union, equipping it with better tools to react to the future crisis. Thus, it is not surprising that some scholars have been quick to announce the 'vindication of the first grand theory of European integration' and the 'revenge of neofunctionalism' (Copper 2011). It took almost 20 years after the Maastricht Treaty and about a decade after the introduction of the euro, until, according to this view, the functional pressures for spill-over worked at full force. According to this account, the EFSF and the ESM are just the first steps towards the central pooling of resources that in the future is likely to become a federal transfer mechanism. Paralleled by the adoption of centralized regulation of financial institutions and the move towards a harmonization of corporate tax rules, regularly discussed in such documents such as *Pact for Competitiveness* and European Commission proposals, this would represent a spill-over process from the monetary policy to the fiscal policy of the EMU.

There is another resemblance of the process of decision-making at the time of the crisis to the incrementalism so prominent in the neofunctionalist account. It is this muddling through the decision-making in the EU from one 'historic' summit to another implementing gradual reforms of the economic governance rules, for example, strengthening the coordination and monitoring procedures in the form of European semester, aligning two processes of national convergence programs and national reform programs,

introducing stricter financial sanctions by the secondary legal acts such as the 'six pack' or introducing limited treaty change. Since the start of the crisis until mid 2012, there have been around 20 EU summits dealing with reforms of economic governance and discussing measures of further integration. Although there have been many declarations about 'historic' decisions, they seemed mostly aimed at calming down financial markets, while the real work has focus on incremental procedural change. Besides, many of these procedural changes are rather technical and are actually 'tying the hands' of national governments without major popular debates. An introduction of the rules of the fiscal discipline into the national law to restrict excessive spending during good times and over the political cycles is expected to further constrain the governments of member states which signed up to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG).

Furthermore, in terms of the key actors pushing for the process of further integration international financial markets as well as supranational institutions such as the European Commission and the ECB merit attention. Financial markets, investors into the bonds of the eurozone countries are probably the most visible actors that have constantly been fuelling political debate about the measures required to maintain confidence in the project of European integration and preserve the eurozone. The introduction of the euro and resulting drop of risk premium on less productive eurozone members' bonds fostered investments into those periphery economies and contributed to growing financial integration. However, when the crisis started and doubts over the ability of those countries to service their obligations grew, financial markets started pressing for centralized solutions in order to minimize possible losses if countries like Greece left the eurozone or/and defaulted. The financial markets have been motivated by a maximization of profits, or rather insuring against possible losses, rather than ideological support for a federal EU.

Compared to the lobbying of the European business associations and other interests groups, the pressure exerted by financial markets is different. Instead of, or in addition to, directly interacting with policy-makers and demanding for centralized solutions, they are indirectly pushing EU institutions and member states to look for measures on how to bring down the costs of borrowing for eurozone members in trouble. But the actual effect of this pressure is arguably the same as that described by neofunctionalists: to pressure the EU and its member states to look for centralized solutions to the problems of particular member states which belong to the common currency area because, due to economic and financial interdependencies, the default of one of them would cause serious problems for the others.

In addition to this indirect pressure exercised by the markets, centralized solutions are elaborated by commercial bank analysts who provide regular commentary on EU's response to the crisis. They are often presented in the form of possible scenarios for the eurozone, which predicts a gloomy future in the case of the default of some countries, and a possible disintegration of the eurozone. For example, some studies have discussed the

breaking up of the eurozone forced by financial markets unconvinced by EU decisions and the lack of progress towards fiscal union; this is described as a worst case scenario, possibly even leading to civil unrest and military conflict (Deo *et al.* 2011a, b). Similarly, integration scenarios have been advocated by prominent investors (Soros 2011). The underlying idea of the need for centralized solutions to the eurozone crisis in order to avoid possible disintegration has also been taken up by some leaders in the European Parliament and EU member states calling for political union.

Supranational institutions have also been active in proposing solutions to the eurozone crisis, which would delegate more competences to the EU level, set stricter common rules of monitoring and control, and centralize financial resources. Leaders of EU institutions—for example, the President of the European Commission M. Barroso and the President of the EU Council H. Van Rompuy—have been calling to draw lessons from the past and to improve the economic governance of the EU (EMU) by integrating further economic policies of the member states (Barroso 2011, 2012; Van Rompuy 2011, 2012a, 2012b). In terms of concrete legislative proposals, the European Commission has drafted the ‘six pack’ and the ‘two pack’. The European Commission also publicly circulated proposals for the introduction of euro bonds and creation of a banking union. Some of the initiatives have been coordinated among several EU institutions, for example, between the European Commission and the President of the European Council as in 2010 which led to the adoption of the ‘six pack’. Among more recent joint initiatives is the so-called ‘report of four’, officially presented by the President of the European Council H. Van Rompuy but prepared in ‘close cooperation’ with the President of the European Commission, the Eurogroup and the European Central Bank (Van Rompuy 2012a). The latter is expected to serve as a basis for further debates about the creation of a banking union, the integration of fiscal policies and reforms of EU institutions; it was followed in the second half of 2012 by the ‘blueprint for a deep and genuine EMU’, presented by the European Commission (2012) and another ‘report of four’ (Van Rompuy 2012b).

The ECB is another supranational institution which has been at the center of efforts to deal with the eurozone crisis. Despite resistance from some eurozone members—in particular, Germany—the ECB has gradually become active in intervening in financial markets with the aim of reducing the costs of borrowing and stabilizing the financial system. It intervened in financial markets several times throughout 2010–2011. At the end of 2011 and again in the winter of 2012, the ECB started its three-year long-term refinancing operations to provide liquidity to the banking system, totaling around one trillion euro; this was credited with driving down the costs of borrowing and servicing the obligations of such countries as Spain and Italy (Chancellor 2012). The most forceful and widely commented pronouncement came from the ECB governor M. Draghi in July 2012 when he declared that ECB will do ‘whatever it takes’ to save the euro, followed in September 2012 by the publicly announced intention to start a program of purchasing eurozone member state’s short-term bonds in the secondary market (Steen *et al.* 2012). These measures

imply a redistribution of financial obligations from eurozone member level to the ECB.

Finally, the ideas of epistemic communities also merit attention as they can play an important role as supporters of supranational solutions. Indeed, the advocates of further integration and centralized solutions to the eurozone crisis included many leading commentators and European economists. It can be maintained that it is the supporters of centralized solutions who dominate the debates most vocally criticizing EU policy-makers—in particular, Germany's Chancellor A. Merkel for 'doing too little too late' (The Economist 2011). The key lesson to be drawn from the experience of the EMU exposed by the crisis, according to those analysts, is that the fiscal (transfer) union should complement the monetary union because uniform interest rates can lead to divergence of economic cycles in different euro area members and the financial transfers are required to stabilize the economies negatively affected by a single monetary policy and asymmetric shocks (see, for example, the report of the T. Padoa-Schioppa Group 2012).

It should be noted that the concept of a fiscal union can refer to quite different institutional and redistributive arrangements. For example, some economists proposed a 'limited fiscal union' which would include 'a euro area finance ministry' able to veto 'national budgets that could threaten euro-area sustainability' and 'provide support to illiquid but solvent governments' relying 'on federal tax resources' (Marzinotto *et al.* 2011). This arrangement would also imply setting up a euro-area deposit insurance corporation with banking supervision and resolution authority as well as the ECB becoming a lender of last resort. Other analysts have discussed the creation of a fiscal union, characterizing it by the introduction of the euro bonds, harmonization of taxes and the key feature of a possibility to transfer resources from a country in a boom state to a country experiencing recession (Morelli *et al.* 2011).

Establishing fiscal union would require a new EU treaty with new provisions delegating powers to supranational institutions with authority on the fiscal, structural and banking policies of its members, even though the fiscal union might be created only among euro area members (or euro plus pact members). In particular, a more active role of the ECB in addressing what are perceived to be the short-term pressures of the financial markets on some eurozone members, spreading the contagion to increasingly more countries and endangering the existence of the EMU itself, has been advocated by a number of economists (see De Grauwe 2011; Wolf 2011). All these recommendations have been summarized before the EU Council meeting of December 2011 into three categories of, first, the ECB providing unlimited guarantee of a maximum bond spread and increasing short-term liquidity for the banking sector; second, a firm time table for a eurozone bond; and, third, a fiscal union with a treasury (Munchau 2011).

However, when the EU's response to the crisis in terms of the actual outcomes rather than recommendations and initiatives publicly suggested by supranational institutions, investors and analysts is assessed, the decisions made and adopted by the EU member states so far seem to focus



mostly on strengthening the implementation of already existing norms governing fiscal policy coordination and structural reforms. Besides, so far no country has been sanctioned because of the excessive imbalances. Hungary has been warned by the European Commission threatening to suspend almost 500 million euro of structural funds in 2013 if it does not follow its deficit reduction schedule, but it remains to be seen if such warnings and possibility of sanctions are really effective. Therefore, it is difficult to find any evidence of both functional and political spill-over in terms of the delegation of new competences to the EU or the eurozone. Even the proposals on the banking union which have been given most urgency were still being debated by the end of 2012, and some basic elements such as its supervisory structure and its mandate were contested by member states such as Germany. Agreement on euro bonds or a deposit guarantee scheme seems still further away.

### Still Divergent National Preferences?

Liberal intergovernmentalism maintains that European integration is driven by EU member states, especially those which are relatively less dependent on other EU economies and therefore have stronger bargaining power. Governments of EU member states responding to the demands of domestic economic interests are the key actors, using the EU and its institutions to better manage growing flows of economic activities across borders and in such a way enhancing their capacities to manage these interdependencies (Moravcsik 1991, 1998). The current eurozone crisis has also been explained by the divergences of eurozone economies rather than by the lack of a central transfer mechanism (Moravcsik 2012).

Thus, despite the fact that the incrementalism of dealing with the crisis resembles closely the process described by neofunctionalists, it is because the member states, first of all, Germany set the pace and the tone for the search of the joint solutions acting strategically with a view to their economic interests and domestic politics. Yet again, as at the time when the Maastricht Treaty was adopted, the terms of the debate and the mechanisms adopted reflect the preferences of Germany. Decisions on a stricter enforcement of the rules governing fiscal discipline and structural reforms as well as the adoption of the TSCG are examples of the German influence (Kreilinger 2012). It can be maintained that the muddling through the eurozone crisis can be interpreted as a sequence of strategic decisions coordinated by Germany and ECB aiming at preventing full scale market panic, on the one hand, and keeping the pressure and incentives to undertake structural reforms for the eurozone countries and bring their finances into order, on the other. At the same time, reports of eurozone banks pulling out from troubled economies indicate that actual interdependency has been decreasing as a result of the crisis, decreasing exposure and reducing the costs of disintegration. According to some accounts, consolidated BIS bank exposure to Greece went down to \$72bn in mid 2012 from a peak of just above \$300bn in 2009 (Nordvig 2012). Thus, Berlin rather than Brussels has been the center of the crisis resolution, although Frankfurt has taken important short-term measures. The resistance of the member

states to the idea of completely automatic sanctions in cases of breaching budgetary discipline and excessive imbalance rules also shows the limits of supranational entrepreneurship.

The divergence of national preferences has also manifested itself in the growing differentiation of EU membership. The initial division into eurozone members and non-members was further supplemented in March 2011 by the newly formed group of euro-plus countries, comprising 23 members who joined the initiative for closer cooperation on economic reform measures and the reviewing of each other's progress. Furthermore, the negotiations of the TSCG resulted in 25 EU members signing to the Treaty, with the United Kingdom and Czech Republic deciding to stay out of this process. Although after the negotiations of the TSCG the supranational institutions of the EU such as the European Commission and the European Court of Justice were assigned important roles, the proliferation of different groups of EU members complicates the application of the Community method and exposes the limits to the supranational delegation of powers in the fields of fiscal and economic policies. Some eurozone members have signaled their readiness to move ahead with the adoption of a financial transaction tax, but not all of them. Moreover, non-members of the eurozone also have divergent preferences regarding the centralization of competences. Some, which have permanent opt-outs like UK, are increasingly distancing themselves from further efforts of integration, provided that the single market is not affected by this process. Others like Sweden are supporting the measures of fiscal discipline and structural reforms but have postponed the introduction of the euro indefinitely and regard initiatives aimed at harmonizing taxation with caution. Still others like Poland urge the EU to forge ahead with fiscal integration, but react quite sensitively to any new measure which is likely to exclude non-eurozone members, adopting a 'wait and see' approach with regards to euro introduction before the eurozone sorts out its difficulties. The latter approach seems to be shared by most other non-eurozone members as well.

Although differentiated integration has been practiced since the adoption of the Maastricht Treaty, it has not been used so often to manage differences of national preferences as it has been during the recent years. The divergence of preferences regarding the new initiatives aimed at further integration of fiscal and economic policies among eurozone members and non-members alike is not so much an outcome of their diverging economic structures, patterns of mutual interdependence and lobbying of interest groups—factors stressed by liberal intergovernmentalism—but seem to be explained better by domestic politics. In other words, growing public interest in what takes place in the EU and eurozone and the negative sentiment towards centralized solutions of the eurozone crisis is becoming increasingly important as a constraint of European integration and supranational solutions to the eurozone crisis.

### **Popular Resistance to EMU Wide Redistribution**

Although neofunctionalism and liberal intergovernmentalism differ on the causes, processes and driving forces of European integration, both

approaches have one common feature—they prioritize elites (supranational or national) and economic interest groups over the population. In other words, it is elites who formulate and negotiate decisions in the EU, with an input from the transnational society and supranational institutions. However, in order to account properly for recent developments in the EU, this is not sufficient. It is argued here that popular opinion is becoming as important as it has never been before in the political debates on European integration. To be sure, the importance of domestic politics for the process of European integration was recognized at least 30 years ago when it was stressed that ‘electioneering may play an important part in a member state’s behavior in the EC’ (Bulmer 1983, 351). It has also been used recently by analysts explaining the creation of the Stability and Growth Pact (Heipertz and Verdun 2010). However, this contribution develops further the use of domestic politics in explaining the state of European integration by connecting the decisions of member state leaders with the popular resistance to the efforts to centralize redistributive policy. The changing nature of public policies being centralized can explain to a large extent this shift and the growing importance of public opinion as a constraining factor.

For most of the history of European integration the EC/EU has dealt with regulatory policies that have been linked to the removal of non-tariff barriers to the functioning of the single market or justified by the arguments of the need to correct ‘market failures’. Most of the EU policies have been about regulations which have been complex and too technical for the wider population to become interested in, becoming important only for those companies that have been subjected to those norms (usually businesses involved in cross-border activities) and regulators overseeing their enforcement. The process of integration has been taking place under ‘vague but permissive public opinion’ (Haas 1968, xii). Although the regulatory policies usually involve a redistributive element, as Central and Eastern European countries discovered during the process of adopting sometimes rather expensive EU norms, their redistributive effects have been indirect and hardly visible to the wider public. Also, though some redistribution has been established on the EU level it involved a relatively very small share of financial resources (around 1 per cent of EU’s GDP) compared to what has been redistributed in the member states, and covered only specific areas like agriculture. Even this highly limited redistributive policy has been criticized strongly by analysts who maintain that the EU is ‘a regulatory polity’ and does not possess required characteristics for the effective and democratic redistribution of resources through its budget (Majone 1993).

The debate about EU- or EMU-wide solutions to the eurozone crisis from the start revolved around the centralized pooling of financial resources to help countries in trouble now and to create an insurance mechanism in the situations of asymmetric shocks in the future. The dominant view among commentators and economists is that the crisis necessitates the creation of a fiscal or transfer union—something which had to be done at the outset when the EMU was established. In other words, this implies a significant redistribution of budgetary resources from member

states to the EU (EMU) or between member states, as it is more often perceived by the public. Redistribution of budgetary resources or 'who gets what when and how' is considered to be the essence of politics, and therefore the debates about the centralization of redistributive policies have been causing growing public interest with regards to the eurozone crisis and exposing territorial cleavages, often described as North versus South. The permissive consensus has been gradually replaced by public discontent, fuelled by the economic crisis, and growing uncertainty about the sustainability of the postwar welfare system.

Although the debates in the popular press about EU member states probably overstate the popular resistance to centralization and transfer of financial resources among EU member states, the rise of eurosceptical parties in a number of eurozone countries, changes in the ruling coalitions which took place in more than 10 EU countries during recent years, and growing popular protests in some countries provide indications which could be pointing to the changing political dynamics in Europe and new constraints to EU reform. The 'rift between north and south', which is not 'merely a matter of scathing articles in German or Greek newspapers', has been recognized by such figures in European politics as Delors (2012, 3). It is not just during the ratification of EU treaty changes in national referendums when policy-makers have to take popular opinion seriously. The growing public interest in the eurozone crisis and the potential solutions with their effects on the rest of the EU is becoming an important constraint in the day-to-day politics of the EU, with national leaders obliged to take popular opinion seriously when they gather in the EU summits for yet another attempt at calming down the financial markets with promises of centralized solutions. Popular debates in countries like Germany, Netherlands, Finland and Slovakia problematize the issue of transfers to Southern Europe when austerity continues to be enforced in the former. On the other hand, a significant share of the population in countries like Greece resist structural reforms and austerity measures, which are seen as imposed by the EU and IMF, with the Northern countries and their banks behind them.

These popular debates expose the absence of solidarity among EU member states, which in turn shows the absence of EU-wide polity comparable to the polities of its member states. While this observation is by no means new, the debate about the completion of the 'incomplete' EMU adds an additional element. It explains the incrementalism of the EU's response to the crisis and shows the limits of a possible centralization of powers and the transfer of resources. Although these limits could become especially constraining if new amendments to the treaty are required, they are also important in the current gradual movement of the EU in directions of both strengthening the enforcement of earlier agreed norms, implementing structural reforms, harmonizing some policies on the EU level without treaty changes and growing differentiation.

## Conclusions

The analysis presented here shows that the EU's response to the crisis of the eurozone cannot be understood by using dominant theories of

European integration without adding the dimension of domestic politics, previously often ignored due to the absence of public interest in the EU. Although at first glance the EU's economic governance reforms present a case of financial markets and supranational institutions gradually pushing the transfer of competences and resources to the federal level, closer examination of decisions taken so far reveal the dominant role of Germany and the diverging national preferences of both EMU and non-eurozone members.

The particularly striking feature of recent debates and attempts to reform the EU has to do with a disappearance of popular permissive consensus for the process of European integration that characterized most of its history. As calls for a fiscal or transfer union to supplement monetary union and save the euro imply that regulatory policies of the EU have to be supplemented by a much stronger redistributive element, the public becomes increasingly interested and concerned about the potential implications of these measures on their welfare. The growing importance of domestic politics creates new constraints for EU and national policy-makers, which have to be taken into account, and so far the ideas circulated by EU leaders on addressing the accountability and legitimacy issues do not seem to respond adequately to this. The need to watch for popular opinion at home, financial markets on the European and global scale as well as incentives for reforms in the recipient countries makes the process of reacting to the crisis slow and incremental.

This dynamic has resulted in diverging trajectories of EU reform, with measures taken to enforce already adopted norms coordinating fiscal and economic policies of member states, some procedural amendments to define more explicitly certain norms such as the 'golden rule' limiting structural annual deficit to 0.5 per cent of GDP or voting by reversed qualified majority voting, to more significant changes in introducing the EFSF to become a permanent ESM and short-term measures taken by the ECB. Besides this, different groups of countries have been taking part in different initiatives, further complicating the process and the application of centralized solutions. So far the resolution of the eurozone crisis presents a gradual move in several directions, all aiming at preserving the euro with instruments other than a big leap towards a federal transfer union to supplement the monetary union of the EU.

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