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Public finances in Europe: fortifying EU economic governance in the shadow of the crisis

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ABSTRACT

The Eurozone crisis resulted in a decisive change of Europe's fiscal surveillance regime that brought the question of public finance oversight sharply into focus. The Stability and Growth Pact, the fiscal cornerstone of Europe's Economic and Monetary Union (EMU), was fortified, expanded and supplemented by the so-called 'Six Pack', the 'Fiscal Compact' and the 'Two Pack'. These substantial initiatives all aimed at strengthening the credibility and enforceability of the EMU's rules-based economic coordination regime through further formal competence transfer and an improvement of the EU's problem-solving capacity. This article explains that from a process perspective, their adoption showed an ability of the EU polity to produce agreement and find a way out of its chronic institutional paralysis.

KEYWORDS

Economic and Monetary Union; economic governance; fiscal union; Lisbon Treaty; euro crisis

1. Introduction

The Eurozone crisis brought the question of public finance oversight sharply into focus. In February 2010, as the global financial crisis morphed into a deep crisis of the single currency, the attendant problems were framed as fiscal profligacy in the Eurozone state of Greece. Over the next four years, as the Union struggled to bring the acute phase of the crisis to an end, the question of Eurozone economic governance came to the fore. Agreement was reached on a host of new regulations — 'Six Pack', 'Fiscal Compact' and 'Two Pack' — designed to oversee the public finances and macro-economy of the member states, particularly members of the Eurozone. Without the crisis there would have been no pressure to reform the economic governance regime or to agree on the Fiscal Compact. These economic governance reforms aimed at both enhancing crisis management and crisis prevention. They involved intense negotiations among the member states and EU institutions in the heat of the crisis. Legal instruments and the relative weights of different EU institutions varied depending on the negotiations in question.

Retracing the process of the multiple negotiations leading to the adoption of those instruments, this article asks how the key strategic actors of the EU political system developed their problem-solving capacity when confronting the crisis, thus overcoming the classic joint-decision trap (Scharpf 1988). It first sketches out that, as functional

pressures were both major and urgent, governments in the creditor countries needed to tell their parliaments and publics that the design faults in the Eurozone's rules-based governance were being addressed, which in turn entailed an enhanced problem-solving capacity. Second, the negotiations provide an important lens into the power and strategies of various institutional actors which allows us to probe the decision-making style in this period, the traditional 'Community method' or a 'new intergovernmentalism' (Puetter et al. 2014). Third, the analysis of the policy outputs of these three negotiations enables us to address the question of the importance of the reforms in terms of Hall's categorisation of different orders of change (Hall 1993).

Overall, the euro crisis has resulted in a decisive change of Europe's fiscal surveillance regime. Among the number of policy initiatives undertaken at the height of the crisis, i.e. over the period 2010–2013, to reform EMU's incomplete economic governance, three key developments are particularly noteworthy: (1) the Stability and Growth Pact (SGP), the fiscal cornerstone of Europe's Economic and Monetary Union (EMU) which was strengthened and expanded by the so-called 'Six Pack'; (2) a new international agreement branded 'Fiscal Compact' and (3) the so-called 'Two Pack' designed to further institutionalise the European Semester and to lay down a community framework for the provision of financial assistance. The common thread of these substantial initiatives is that they aimed at strengthening the credibility and enforceability of the EMU's rules-based economic coordination regime through further formal competence transfer and an improvement of the EU's collective problem-solving capacity. Although all three sets of negotiations were intended to enhance economic governance, the legal nature and basis of the policy instruments differed as did the constellation of actors (and hence veto players) involved in the negotiations. Table 1 below provides an overview of the legal nature and decision rule that governed the adoption of the new instruments.

The Eurozone crisis provided an important testing ground for the newly adopted Lisbon provisions which foresaw the creation of two new actors who became a central part of the EMU scene: the permanent President of the European Council (art. 15 TFEU) and the European Parliament (art. 121-6), which had a role in relation to the multilateral surveillance procedure (i.e. most aspects of the SGP) as part of the wider extension of co-decision foreseen by the Lisbon Treaty. When implemented under the pressure of the crisis, that fundamentally changed the institutional landscape of EMU. Overall, major innovations in terms of actors involved, policy processes and policy content have occurred. This goes against the expectations of an institutional paralysis or gridlock driven by a joint-decision trap. Ways out have been found to reach common solutions, and with the exception of the Fiscal Compact, reforms have enhanced the problem-solving capacity of the Union. The article proceeds as follows: the negotiations on the Six Pack and Two Pack are analysed sequentially as they were both negotiated on the basis of treaty provisions, followed by the analysis of the outlier, the Fiscal Compact, which was negotiated as an international treaty.

Table 1. The varying decision rules in economic governance reform

Reform Initiative	Legal Nature	Decision Rule	Member State Involvement
Six Pack	Secondary EU Law	QMV among the member states (Art 121)	All
Fiscal Compact	International Treaty	Unanimity among signatures	All except UK and Czech Republic
Two Pack	Secondary EU Law	QMV among Eurozone states Art 136	Eurozone member states

2. Agreeing on the six pack in the shadow of Lisbon

The context of the Six Pack reform was the urgent crisis induced pressure to act to ‘restore the credibility of the EU vis-à-vis the markets’ (Interviewee 3). The historic resistance to reform the central economic policy coordination in EMU (the SGP) abated: ‘this new framework had to be created in a rush’, as a Commission official puts it (Interviewee 2). The SGP reform was indeed the first policy action undertaken by European leaders to counteract the volatility of the bond markets and to ensure that bailouts would pass muster in the creditor states. Far from anticipating the systemic effects that the large-scale Greek fiscal data falsification would have on Europe’s financial stability, the first reaction of European leaders in 2010 was to address the design failures of the SGP and restore its credibility. As an EP official highlighted (Interviewee 4), ‘non-compliance with rules was identified as the cause of the crisis, not the good or bad performance of economies’. Consensus to act emerged quickly. Although the Six Pack was adopted in first reading, it proved to be a lengthy first reading process: 14 months passed between the issuing of the Commission proposals (September 2010) and the adoption of the legal acts (November 2011). Two crucial elements may explain this lengthy and novel process: a power game between the Commission and the European Council in agenda-setting, and a struggle between the European Council, the EP and the Commission in law-making.

2.1. *An arm-wrestling contest*

Agenda-setting on the Six Pack was novel as consensus-building on the key provisions occurred upstream of the Commission proposal, as part of the so-called Task Force Van Rompuy (TFVR), named after the President of the European Council. In March 2010, European Council President Van Rompuy and the Commission were requested by the European Council, in its conclusions (European Council 2010), to draw up a new programmatic agenda to reform the fiscal governance of EMU with a view to ensuring ‘better budgetary discipline, exploring all options to reinforce the legal framework’ (European Council 2010). The presence of the new office of President of the European Council provided the EU’s leadership with an alternative actor to the Commission in agenda-setting. This marked the start of an agenda-setting contest between the Commission, which traditionally cherished its policy-shaping power, including on the EMU (the Delors Committee is a telling precedent), and the European Council. An interviewee involved in the early work of the Task Force witnessed ‘French-German pressure to take the lead and to not leave the initiative to the Commission’ (Interviewee 5). This view supports the characterisation of the TFVR as acting as the European Council’s ‘policy patrol’ (Chang 2013) by constraining the Commission’s autonomous agenda-setting power. The latter, on the other hand, showed no willingness to surrender, with EU Commissioner Olli Rehn allegedly declaring at the first TFVR meeting: ‘I take note of this Task Force but I will make proposals in independence’ (Interviewee 5). In line with this statement, the Commission published a communication to set the agenda of the SGP reform on 12 May 2010, just 10 days before the first and most strategic meeting of the TFVR held on 21 May 2010.

Another Commission Communication followed a few weeks later on 30 June 2010. The substantive content revealed that the Commission was keen to seize the momentum of the Eurozone crisis to fix some of the EMU’s fiscal governance flaws and to challenge the

institutional status quo, a strategy that was apparent in the Commission's discourse (and in the end was quite successful, see next section). The Commission repeatedly referred to functional arguments, highlighting the clear 'interdependence' (European Commission 2010, 1) or the 'deep economic and financial linkages within the euro area' (European Commission, 2010, 5) to justify its own task expansion in the EMU's surveillance (European Commission, 2010, 2010b). The institutional rivalry with the European Council continued until the end of the Task Force proceedings. One Council official recalled: 'in September [2010], there was the feeling that the TFVR would adopt conclusions that did not conform to the Commission's views, and which were not going in the direction of the Community method' (Interviewee 5). When the Commission unveiled its comprehensive package on 29 September 2010, i.e. one month before the final adoption of the Van Rompuy report (Van Rompuy 2010), the same interviewee remembered that 'Schäuble was very angry' (Interviewee 5).

2.2. *The EP joins the party*

The second institutional novelty which contributed to slowing down the legislative process of the co-decision procedure to revise the SGP was the newly gained co-decision power of the European Parliament (EP). This also entailed the development of a cooperative relationship between the EP and the incumbent EMU actors (the Council and the Commission) who previously had no need to interact with the Parliament on EMU matters. As a first-time participant in the definition of the new economic governance regime, the EP had an active role during the negotiations of the Six Pack but it took some time for the establishment of a constructive relationship with the Commission. Although formally not all of the legislative proposals required co-decision (4 out of 6 texts), the EP used the package deal nature of the negotiations to influence all provisions of the Six Pack and always worked with one team of negotiators. One trilogue participant recalled that 'the trilogues were enormous in size in the Six Pack' (Interviewee 6) since all aspects were negotiated as a package. Another EP interviewee confirmed that there was 'much discussion in the EP before the ECON¹ vote' and to illustrate this, added 'making a rough calculation of meeting hours, an MEP reached the figure of 200 hours' (Interviewee 3). In the account of EP officials, the Commission was rather passive and immune to suggestions coming from the Parliament, an attitude that can be partly explained by the fact that 'DG ECFIN was not used to co-decision procedure, they were in Beaulieu,² far away, doing forecasts' (Interviewee 6). For example, although the European Semester was an old Commission idea, it was the 'EP which codified the European Semester into the Six Pack ... ECFIN said it wouldn't happen' (Interviewee 7). Overall, the degree of centralisation agreed in the Six Pack owed a lot to the crucial contribution made by the EP who strongly advocated further sovereignty transfers to the EU level to enforce fiscal discipline. In the words of one of the most active EP *rapporteurs* on the package, the EP clearly favoured a reduction of 'horse-trading'³ (Goulard 2011, 3) in Council deliberations about sanctions and was a key problem-solving actor when it promoted the Reversed Qualified Majority Voting in the Council over sanctions, thereby undoing the outcome of the grand French–German bargain previously made in Deauville (Economist 2011).

While the SGP remained broadly in line with the minimal requirements of the Maastricht Treaty in its first (1997) and second (2005) versions, its 2011 reform by the Six Pack was a critical juncture in competence distribution, despite representing a continuation of rules-based coordination. Through regulatory means, it broadened and deepened centralised

control over domestic economic policies and in particular over fiscal policies. It subjected Member States to a higher and more intrusive scrutiny by the European Commission (Bauer and Becker 2014; Salines et al. 2012). The pattern of policy change can be summarised as 'more of the same': more rules, more sanctions, and more regulatory control. Previous policies and earlier institutional designs (the Maastricht Treaty and the SGP) pre-determined the final outcome to a large extent,⁴ which uncovers a path-dependence mechanism: 'the euro-zone is not breaking-free of the Maastricht legacy' (Featherstone 2012, 24). This view has been confirmed by a policy-maker who stated 'you foster the system in which you have been operating'; 'we tried to defend the system and improve it' (Interviewee 1). The reform process also saw the novel involvement of the European Council and of the EP as it evolved under the shadow of the Lisbon Treaty's innovations (permanent President of the European Council; EP as actor in the multilateral surveillance procedure, i.e. most aspects of the SGP).

3. The two pack: strengthening the arsenal

In May 2013, a package of two EU regulations, known as the Two Pack entered into force, following a year and a half of negotiation between the European Commission, the EP and the EU Council as part of the ordinary legislative procedure. The Two Pack's primary goal was to strengthen the central control over the fiscal and macro-economic policies, but only for Eurozone members. Overall, the Two Pack affected both the vertical distribution of powers, creating a clearer budgetary hierarchy between the centre and member states as enshrined in the budgetary timeline, and the horizontal distribution of powers — the Commission gained autonomy vis a vis the Council. The process was marked by a year-long blockade of the texts by the Parliament.

3.1. Under the radar screen

The power game surrounding the Two Pack evolved in parallel to and in the shadow of two more salient policy discussions: the elaboration and ratification of the Fiscal Compact and the European Stability Mechanism (ESM) Treaty. These two Treaties captured headlines: a basic search in the archives of the FT.com for example provided 408 results for the Fiscal Compact, 750 results for the ESM and only 15 results for the Two Pack.⁵ Interviews held in Brussels confirm that the Two Pack was more technical and more specific than the Six Pack and has been negotiated in a different climate: 'everyone in the EP had an opinion on the Six Pack, it wasn't the case for the Two Pack'. (Interviewee 3) Yet, as we can see, the Two Pack is probably the legislation that goes the farthest in terms of the centralisation of fiscal powers, in particular for Eurozone member states receiving financial assistance.

In a context marked by a the de-escalation of market pressure and decreasing interest within the Council and Parliament compared to the Six Pack, the Two Pack gave additional centralised powers to the European Commission. Such an EMU-focused legislative package was made possible by a new article of the Lisbon Treaty that allowed for those member states who share the euro and are exposed to higher externalities/interdependence to 'strengthen the coordination and surveillance of their budgetary discipline' (art. 136-1), i.e. further pooling their sovereignty. This new legal basis enabled a relaxation of the consensus requirements among the EU28 countries and provided EU leaders with an escape route from the joint-decision trap. Proposed in November 2011 and adopted in May 2013, the Two Pack

occurred in a policy context made up of escalating and then, after July 2012, de-escalating crisis induced pressure. Perhaps for this reason, the Commission found space to act as a core actor. Interviews conducted point towards the crucial role played by the Commission in conceptualising and bringing forward the Two Pack: 'The Two Pack? It was the Commission'. The same EP official recalled 'a top-down push from the cabinet [Olli Rehn's cabinet] to do more and to do more Community method and a bottom up attention in DG ECFIN services where the staff became more aware of what happens in the corrective arm of the SGP, after the Six Pack implementation'. In a context where there was an 'outside pressure to do a bit more, the European Commission took the chance' (Interviewee 8).

Interviewees also pointed to the swift consensus-building on the Two Pack within the Council with no major opposition to be noted. In fact, the EU Council reached political agreement on the Two Pack on 21 February 2012, just three months after the Commission made the proposal (on 23 November 2011) which implied a broad alignment with the Council. This suggests that the crisis may have had lasting effects on the awareness among EU governments of the need to act together on fiscal coordination because of the deep interdependence of Eurozone countries, illustrated during the course of the crisis and more than two years after the outset of the Greek fiscal crisis.

The ease of translating the Council consensus into law was considerably slowed down by another innovation provided by the Lisbon Treaty — the extension of co-decision to multilateral surveillance which implied the involvement of the EP. The final agreement with the EP was reached one year later in May 2013, since the EP was determined to withhold its vote until the Commission tabled more ambitious proposals on the mutualisation of debt: 'the whole process of negotiation of the Two Pack was a fight' (Interviewee 4). In line with the mechanisms underscored by Rittberger (2014), the EP leveraged on its bargaining power and obtained concessions (see e.g. De La Parra 2013).

3.2. *Crowning the Commission's executive powers?*

The term Two Pack gives the misleading impression of a unifying logic in its objectives. At a minimum, some unity resides in its scope (a strict focus on the Eurozone) and in its broad aim to reinforce the EMU surveillance mechanisms to prevent contagion/spillover in the EMU. Its true rationale was, however, to deal with institutional leftovers and complete the unaccomplished work which had not been performed by the previous reforms of the EMU's economic governance (e.g. mainly the Six Pack legislations). Apart from this, the two regulations pursued two different goals: Regulation 472/2013 aimed at clarifying the procedure and competences to address member states experiencing financial difficulties under so-called 'enhanced surveillance'. Among others, the Commission may autonomously decide on the basis of objective criteria to subject a Member State to enhanced surveillance and can prolong it if it deems it necessary. From a legal perspective, this regulation also strove to ensure consistency between intergovernmental agreements and EU law, notably on conditionality. As such it largely elaborated on the so-called operational guidelines of both the European Financial Stability Facility (EFSF) and the ESM and lays down the legal frame of 'macroeconomic adjustment programmes' for euro area countries requesting financial assistance (European Commission 2013).

Regulation 473/2013, on the other hand, sought to lay down a procedure for the assessment of draft budgetary plans in the euro area. To further reinforce the central control over

fiscal policies, it set out both the conditions and procedures for the assessment of draft budgets in the Eurozone and specified the corrective provisions in the case of excessive deficits in euro area member states. Its purpose was to further institutionalise a crucial novelty of the Six Pack — the European Semester. The Two Pack pushed the intrusiveness of the European Commission into domestic politics and policy-making to a higher level. It foresaw a clear and binding timetable for the elaboration and discussion of national draft budgetary plans. It required Eurozone member states to submit medium-term fiscal plans by 30 April each year followed by the blueprint of national budgets by 15 October. In case of serious non-compliance with the rules of the SGP, the Commission may request a revised draft budgetary plan. Several interviewees pointed to the fact that with the Two Pack, Treaty provisions were stretched to their maximum: ‘we are using the existing coordination provision to their full potential’ (Interviewee 2). The Two Pack impinges on core state powers, which carries longer term implications for legitimacy. As a Commission official summarised it, ‘with some historical distance, it is a folly. Never on earth could we have imagined this a few years ago’ (Interviewee 9).

4. The Fiscal Compact: An intergovernmental subterfuge?

In contrast to the Six Pack’s and Two Pack’s reliance on the Community method, the adoption of the Fiscal Compact’s debt brake rule was meant to be implemented through a Treaty revision in its initial conception. Its ultimate legal form, an international treaty negotiated outside the EU framework directly resulted from the UK veto of an EU Treaty revision. The Compact’s innovative shape should thus be considered as a second best outcome for the EU and its main sponsor, Germany. The Compact’s rationale was part of a conditionality compromise made to Germany (and its moral hazard concerns) for the injection of liquidity through the EFSF/ESM and the ECB in a context marked by continuously rising Italian and Spanish bond spreads. Its adoption did not alter the EU’s distribution of powers either horizontally or vertically, nor did it result in the transfer of significant formal powers to the EU. Its key contribution was rather symbolic: it sent a signal of commitment to sound finances at a time when financial assistance was deployed throughout Europe.

4.1. A novel intergovernmental process

On 9 December 2011, when a first outline of the Fiscal Compact was discussed by heads of state and government at a European Council meeting, UK Prime Minister David Cameron surprised many when he vetoed the text and attempted to obtain numerous exemptions on financial markets regulation for the City of London as a condition for its opt-out (i.e. the UK’s classic way to exit the EU’s joint-decision trap). However, these requests were side-payments that all other EU member states were not prepared to grant to the UK: ‘Cameron arrived with an unrealistic and unacceptable list of opt-outs’ (Interviewee 5). As the same official from the EU Council concluded: ‘Cameron is someone who is blinkered ... he underestimated the consensus for an intergovernmental treaty’ (Interviewee 5). Faced with a UK veto, agreement to proceed without the UK outside the formal treaty framework was reached quickly.⁶ Working discussions on the text carried on and within one month, on 30 January 2012, ‘heads’ endorsed the text. The treaty was signed a month later, on 2 March 2012, by 25 European member states (all EU member states at the time excluding the UK and the Czech Republic).

Over the following weeks, the ESM Treaty was modified to make a financial assistance request conditional on the ratification of the Fiscal Compact while, on 21 December 2011, the ECB had already extended its Long-Term-Refinancing Operations from 12 to 36 months to support bank lending further.

The process through which the treaty was elaborated was completely novel. The Commission's traditional monopoly of initiative was sidelined and the same occurred within the Council: 'we by-passed everything, the COREPER⁷ and the General Affairs Council' (Interviewee 5). In addition, new delegation patterns emerged. The Economic and Financial Committee, an economic policy forum made up of Treasury directors, was assigned the task of chairing the intergovernmental conference leading to the elaboration of the new international treaty. In the background, the political preparation was delegated to the Sherpas, the diplomatic advisors of EU leaders, located in the Prime Ministers' or in Presidential offices. The EP was granted the right to send three representatives and one observer to the Sherpa group. Members of the EP began by snubbing the Sherpa Meetings 'but they quickly understood that it was there that the power was' (Interviewee 5). Despite these new delegation patterns, it would be an exaggeration to conclude that the elaboration of the Compact side-lined all formal EU actors at all times. Both the Commission and the Parliament did influence the process. They obtained for example a provision under article 16 which specified that within five years following the entry into force of the Treaty, 'necessary steps shall be taken... with the aim of incorporating the substance of this Treaty into the legal framework of the EU' (TSCG 2012, art. 16).

Overall, the Fiscal Compact came to symbolise what was later regarded as an intergovernmental twist in EU decision-making. It is probably too early to tell whether the liberties taken with the standard *modus operandi* of the EU were only a result of the UK veto and the time pressure of the moment and therefore *ad hoc* in nature, or whether they were illustrative of a lasting and 'new intergovernmentalism' cooperation pattern (Puetter 2014).⁸ Due to the current lack of enforcement of the Fiscal Compact, one can doubt whether the working method that led to the Fiscal Compact provides any guide for action in the future. Interviews conducted revealed the inner tension of policy-makers on this issue: 'this mode of governance, it's not perfect but at the same time it is realistic' (Interviewee 5); 'it is more realistic politically but less efficient' (Interviewee 8); 'this informal process is useful but one should not forget that there is a COREPER' (Interviewee 5).

4.2. *A straightjacket, but only on paper*

From a substantive perspective, the main purpose of the Fiscal Compact was to enshrine a 'balanced budget' rule into national primary law, thus departing from the Maastricht requirement which focused only on avoiding 'excessive deficits'. The Compact provided that the 'budgetary position of the general government of a contracting party shall be balanced or in surplus' (TSCG 2012, art. 2), thereby limiting member states' budgetary discretion further. The structural budgetary position was operationalised as the 'lower limit of a structural deficit (is) of 0.5% of the gross domestic product at market prices' (TSCG 2012, art. 2). The Compact also foresaw that 'in the event of significant observed deviations from the medium term objective or the adjustment path towards it, a correction mechanism shall be triggered automatically' (TSCG, 2012, art. 3). Lastly, it stipulated that these rules should be transposed

into national law 'through provisions of binding force and permanent character, preferably constitutional' (TSCG 2012, art. 3).

The Fiscal Compact was a highly salient political issue at the time of its adoption. Yet, from the beginning, policy-makers questioned its added-value compared to the previously adopted Six Pack. A diplomat called it 'an important distraction' while Mario Monti, then Italy's Premier, described it as a 'decorative songbird' (Economist 2012); despite its entry into force, the Compact is by and large un-enforced (Alcidi and Gros 2014). Interviewees, both from the EP and from the EU Council, confirmed this interpretation: 'you do something on rules but then it is not followed' (Interviewee 8); 'the Fiscal Compact is dead' (Interviewee 7); 'no one cares about it' (Interviewee 7). In spite of its higher ranking in the hierarchy of norms, the Compact is no different than the ambitious EU declarations, such as Council conclusions, which remain empty agreements. It can be characterised as largely symbolic and a suboptimal political outcome in contrast to the problem-solving nature of the Six Pack and of the Two Pack: 'it's about legal symbolism and the Germans are always caught in this' (Interviewee 5). Analysing similar outcomes, H  ritier (1999, 18–19), following on Brunsson (1989), documented how the hypocritical creation of symbolic political outcomes by separating talk from action could be used as an escape route to the EU's tendency towards deadlock. In bargaining theory this is referred to as 'framework solutions' (H  ritier 1999, 19), i.e. political compromises which have been adopted despite a high diversity of interests among actors and which are 'not meant to be implemented because their realisation would bring irreconcilable conflicts to the fore' (H  ritier, 1999, 19). The Fiscal Compact seems to illustrate this phenomenon very well.

5. The overall significance of the reforms

Policies are complex constructs involving various institutional settings, instruments, techniques, and, most importantly, policy paradigms (Hall 1993). Hall identified three orders of change which was later refined by Daigneault (2014) who distinguished between policy output and change at the level of ideas (see Falkner, 2016).

All three negotiations involved first-order change, i.e. urgent and major changes in the settings of the existing instruments. Second-order change, defined as change in the instruments and techniques deployed within the policy was also evident across all the three instruments. Both the Six Pack and Two Pack represented major changes in the processes and instruments of economic governance — enhanced rules, timeframes and sanctions. Taken together, they represent a major shift in the balance between the member states and the EU in relation to domestic budgets and public finances. The Fiscal Compact also represented a significant domestic change for most of the member states. Third-order change — change at the level of goals and priorities — requires a nuanced interpretation. The SGP was already committed to prudent budgeting and sound public finances and these goals and priorities remain at the core of the new system of economic governance. However, the salience of these priorities was greatly enhanced by the tumult of the crisis and the fragilities exposed in the currency union. In addition to sound public finances, a new priority was added. The new Macro-Economic Imbalance Procedure (MIP) represents a significant addition to euro area governance with its focus on competitiveness and country-specific recommendations in areas that do not fall within the remit of EU level competence. It could also be argued that fourth-order change — change at the level of overarching ideas — has occurred by stealth

with the elevation of competitiveness as a key goal. More overt paradigm breakers such as the mutualisation of debt have not occurred.⁹

6. Resilience and robustness in EU negotiations and policies

The Eurozone crisis acted as an exogenous shock to an ill-prepared system that lacked the policy instruments and toolkit to deal with the challenges it faced. Given the degree of market pressure and the clear evidence of contagion, doing nothing was not an option for Europe's leaders. Thus, notwithstanding the length and depth of the acute phase of the Eurozone crisis, the Union's decision-making process did not face gridlock. Rather, its capacity proved resilient¹⁰ as the member states found sufficient consensus to pass a complex range of legislative acts and an international treaty in the area of economic governance which, cumulated, amount to a step change of EMU. Path dependency was apparent in the key provisions on economic governance as the Six Pack and Two Pack represented a hardening and layering of the original SGP (see also Salines et al., 2012), not an entirely new invention. On top of this vertical dimension, the reforms reinforced the exercise of collective governance among EMU governments, i.e. to horizontally coordinate economic policies. The Fiscal Compact was largely symbolic and responded to the demands of the dominant member state, Germany, for legal assurances on debt and deficits. It formed part of the domestic political management of the development of new policy instruments, notably the EFSF and the ESM.

The Treaty of Lisbon had an important impact on the negotiations of many of the new measures because it pre-structured the negotiating process. The horizontal balance of power among EU institutions changed and process innovation was evident. Because there was a Council President in March 2010, the European Council could call on him to chair the Task Force on Economic Governance and lead the agenda-setting on economic governance. This ensured there was a contest in agenda-setting on the new economic governance provisions although the Commission retained the responsibility of making the formal legislative proposals on both the Six and Two Pack. The second major impact of the Lisbon treaty was the opportunity it gave the EP in the legislative process. Although only four of the six legislative acts that made up the Six Pack required co-decision, the EP was in a position to influence all the acts by treating them as a package deal and engaging intensively in the trilogues. The influence of the Commission varied across the different negotiations. It drafted all of the EU legislative acts. Constrained in its agenda-setting on the Six Pack, the Commission had a freer hand in relation to the Two Pack because of the de-escalation of the crisis and the activism of the Rehn cabinet and of its own services. The Commission's role in the implementation of the new economic governance regime was immensely strengthened as it was given enhanced powers of surveillance, monitoring, review and sanctioning.

The crisis had a major impact on the content of the new economic governance regime as it was crafted as a direct response to pressure from the markets and from the creditor countries in the Eurozone. Given market volatility and the constant threat of contagion, there was a need to reassure markets that the Eurozone could solve its problems and survive. The creditor countries were also determined that in addressing the problems of the programme countries, they would also address the design faults of the single currency. The ECB also demanded reassurance from the member states that if it engaged in non-standard measures, the governments would also address the problem of economic governance. Cumulatively, this led to a step change in economic governance characterised by a hardening of the rules

both on the preventive and corrective arms of the regime, a ratcheting up of monitoring and surveillance, and a strengthening of the sanctions regime. Both in terms of process and content, domestic budgets were encased in a set of procedures captured by the European Semester. Yet the crisis did not induce an agreement on fiscal federalism, which would be profoundly transformative for European integration. The member states remain deeply divided concerning core questions of fiscal and economic policy and capacity at the EU level. Agreement on the centralisation of banking supervision, the Banking Union (see Kudrna, 2016), was the high watermark of federalism and centralisation as a result of the crisis.

7. Conclusions

The crisis triggered a major policy response from the European Union, particularly within the Eurozone. It induced agreement on far-reaching changes in economic governance which will play out in the next phase of economic and monetary integration. The new system involves horizontal policy-making at the EU level and EU member state engagement on the annual recommendations that flow from the European Semester. How the member states respond to the changes and the policy prescriptions of the Commission and the Council will be a major test of the new regime. Will they display a high level of compliance with the new regime or will it trigger a domestic backlash given that many of the fields addressed in the economic governance regime are national competencies? The increased gradualism of the sanctions and the broader monitoring toolkit that the Commission has at its disposal lend support to the view that the rules' credibility has been strengthened. Yet, enforcing fiscal rules on national governments brings challenges of a more complex nature than enforcing criminal law on individuals. In the absence of automaticity, the enforceability of the new rules will indeed be contingent on the interaction dynamics between the centre and the Member States and in particular on the latter's domestic political and administrative capacity to reform. Moreover, how much flexibility the Commission will display in interpreting the rules is difficult to predict although it appears to recognise that the economic governance regime cannot become a straitjacket for the member states.

The EU and Eurozone are still faced with the challenge of creating a rewarding environment which is conducive to structural change of many sensitive areas of policy. Yet, the EU finds itself trapped in an unprecedented situation (Hallerberg 2013): while there is no substantial EU fiscal capacity, the EU has a strong central regulatory power to control national budgets. The member states and EU institutions brought the acute phase of the crisis under control in 2012 but did not address many of the underlying causes and legacies. Public and private debts remain very high, particularly in Greece. A cleavage has opened up between the core and periphery within the Eurozone and the overall macro-economic stance of the single currency area is far from optimal. To date, the resilience and robustness of the policy-making system has averted disaster and the implosion of the Euro but has not created a stable policy environment for the longer term. The resistance of the Union's policy-making system in the face of the crisis was accompanied by a fracture between policy-making and politics in the member states. The world of the Brussels beltway appeared immune to the political fallout within the member states. Across Europe incumbent governments lost power and volatility characterised electoral outcomes and party systems. Heads of government represented in the European Council were caught in the crosswinds of demands for collective responsibility, in the Eurozone, and the demands of their electorates. Responsibility to

the collective came at the cost of responsiveness to electorates. EU constraints on domestic economic policies have been increased at perhaps a longer term cost of legitimacy of both EU and domestic governance and governments. Electoral instability at the domestic level and the growing weight of Eurosceptic parties in the EP and the member states may not undermine the robustness of the Union's policy-making system in the short term but may do so in the longer term. The legacy of the crisis will play out over a very long time in the Union.

Notes

1. Economic and Monetary Affairs Committee of the EP.
2. Beaulieu refers to the building in which DG ECFIN, the Commission's Directorate General for Economic and Financial Affairs, used to have its offices until they got moved to the Charlemagne building in 2013. It is located outside of the Brussels 'quartier européen', six metro stops away from the Commission's Berlaymont.
3. i.e. an exchange of favours.
4. Other key policy transformations agreed upon also grew out of the SGP's traditional scope. This includes both the Macroeconomic Imbalance Procedure (MIP) and the European Semester.
5. The research was conducted on the 17 April 2015 using the search tool of the Financial Times web portal (ft.com).
6. <http://www.theguardian.com/world/2011/dec/09/david-cameron-blocks-eu-treaty>
7. Committee of Permanent Representatives, the usual preparatory instance of the EU Council.
8. For example, the Sherpas represent a continuity with the TFVR in which they were involved, as alternates.
9. However, this article has not analysed the role of the ECB which has broken the monetary policy paradigm by becoming a lender of last resort in practice if not de jure.
10. Introductory remarks by Joachim Schild conference on 'Lessons Learned and Paths Towards a Resilient European Monetary Union' University of Trier, October 9th–10th, 2014.

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List of interviews

Semi-structured, 'Chatham House rules' interviews were conducted in Brussels from 20 October 2014 to 12 December 2014.

Interviewee 1, EU Council official, 19 November 2014, Brussels.

Interviewee 2, European Commission official, 3 November 2014, Brussels.

Interviewee 3, European Parliament official, 1 December 2014, Brussels.

Interviewee 4, European Parliament official, 10 December 2014, Brussels.

Interviewee 5, EU Council official, 22 October 2014, Brussels.

Interviewee 6, European Commission official, 5 December 2014, Brussels.

Interviewee 7, European Parliament official, 29 October 2014, Brussels.

Interviewee 8, European Parliament official, 13 November 2014, Brussels.

Interviewee 9, European Commission official, 8 December 2014, Brussels.