OXFORD

THE POLITICAL AND ECONOMIC DYNAMICS OF THE EUROZONE CRISIS

EDITED BY

JAMES A. CAPORASO AND MARTIN RHODES

The Political and Economic Dynamics of the Eurozone Crisis

The Political and Economic Dynamics of the Eurozone Crisis

Edited by
James A. Caporaso and Martin Rhodes

OXFORD
UNIVERSITY PRESS

OXFORD
UNIVERSITY PRESS

Great Clarendon Street, Oxford, OX2 6DP,
United Kingdom

Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship,
and education by publishing worldwide. Oxford is a registered trade mark of
Oxford University Press in the UK and in certain other countries

First Edition published in 2016

Impression: 1

Published in the United States of America by Oxford University Press
198 Madison Avenue, New York, NY 10016, United States of America

British Library Cataloguing in Publication Data

Data available

Library of Congress Control Number: 2015955648

ISBN 978–0–19–875573–9

Printed in Great Britain by
Clays Ltd, St Ives plc

To Ann and Rachel

Acknowledgments

A book project such as ours inevitably involves a lot of support, both institutional and personal. Our primary thanks are owed to the authors themselves since they were the critics and shapers of our internal debate. Three conferences provided the venue for presentation of drafts of our chapters. The first was held at the University of Denver in October 2012 and was supported by the University of Denver and by the European Union Center of Excellence at the University of Colorado, Boulder. The second workshop was held in Seattle in November 2013 and was funded by the European Union Center of Excellence and Center for West European Studies at the University of Washington. Those two meetings provided an opportunity for vigorous criticism and feedback and resulted in revisions which were presented at the meetings of the Council of European Studies (CES) in Washington, DC, in March 2014. We would also like to thank Peter Hall and Wade Jacoby for their incisive comments on our project's papers as discussants at the CES conference.

Apart from the contributors, our greatest debt goes to the European Union and its delegation in Washington, DC, for funding the Denver and Seattle workshops and to the staffs at the EU Centers of Excellence at the University of Colorado (UC) at Boulder and the University of Washington (UW). In particular, we want to single out Phil Shekleton and Eva Dunn at the Seattle campus and Felicia Martinez and Elina Avanessova Day at the UC Boulder campus. Their assistance was also critical in securing new Jean Monnet funding for the UW and University of Denver in 2015, EU support that will continue to strengthen European Union and Transatlantic studies in the United States.

Contents

List of Figures

List of Tables and Box

Tables

Box

List of Contributors

Bergljot Barkbu, International Monetary Fund's Deputy Resident Representative to the European Union.

James A. Caporaso, Professor, Department of Political Science at the University of Washington, director of the European Union Center of Excellence, and holder of a Jean Monnet Chair.

Barry Eichengreen, George C. Pardee, and Helen N. Pardee, Professor of Economics and Political Science, Department of Economics, Berkeley, University of California.

Rachel A. Epstein, Professor and Co-Director of the Colorado European Union Center of Excellence, Josef Korbel School of International Studies, University of Denver, Colorado.

Sergio Fabbrini, Director of the Luiss School of Government and Professor of Political Science and International Relations at LUISS Guido Carli University in Rome, where he holds a Jean Monnet Chair in European Institutions and Politics.

Mark Hallerberg, Professor of Public Management and Political Economy and Director, Fiscal Governance Centre, Hertie School of Governance, Berlin.

C. Randall Henning, Professor, School of International Service, American University, Washington, DC.

Erik Jones, Director of European and Eurasian Studies and Professor of European Studies and International Political Economy at the Paul H. Nitze School of Advanced International Studies and Director of the Bologna Institute for Policy Research, Johns Hopkins University.

Min-hyung Kim, Associate Professor, Department of Political Science, Illinois Wesleyan University.

Deborah Mabbett, Professor of Public Policy, Department of Politics, Birkbeck, University of London.

Benedicta Marzinotto, Lecturer in Political Economy at the University of Udine and Visiting Professor at the College of Europe (Natolin Campus).

Ashoka Mody, Charles and Marie Robertson Visiting Professor in International Economic Policy and Lecturer in Public and International Affairs, Woodrow Wilson School of Public and International Affairs, Princeton University.

Jonathon Moses, Professor, Department of Sociology and Political Science, Norwegian University of Science and Technology.

Martin Rhodes, Professor and Co-Director of the Colorado European Union Center of Excellence, Josef Korbel School of International Studies, University of Denver, Colorado.

Waltraud Schelkle, Associate Professor of Political Economy, European Institute, London School of Economics and Political Science.

1

Introduction

The Political and Economic Dynamics of the Eurozone Crisis

James A. Caporaso and Martin Rhodes

The focus of this book is on the interlinked origins and impacts of the Eurozone crisis and the policy responses to it. Each of the authors identifies an important question and undertakes careful empirical, theoretically informed analyses that produce novel perspectives on the crisis. The book is distinguished from existing research by its avoidance (and rejection) of the too-often simplistic analysis that has characterized political, media, and regrettably some academic coverage of the crisis. We engage in a number of important issues and themes in the book prompted often by disagreement with existing literature.

One disagreement concerns whether the financial crisis has its origins in a single factor, such as competitiveness, imbalances in trade or capital flows, structural flaws in the institutional design of the Economic and Monetary Union (EMU), or defects in the regulatory environment of banking and investment. It is tempting to look for a taproot for the syndrome of causes associated with the crisis, a kind of generative cause from which the others are derivative. Some have found this taproot to lie in the single interest rate and cheap money made available by the European Central Bank (ECB) to all countries in the Eurozone, including the countries on Europe's periphery. But this capital imbalance approach can carry the story only so far, and in any case it takes uniform borrowing costs as a given rather than a contingent outcome of a market in pricing risk. It also does not explain the imbalances between center and periphery even before the euro was in place in 1999.

There are other examples which emphasize a single cause of the crisis. Some scholars have seen competiveness as the key problem and have subordinated many other factors to the growing gap (in wages, productivity, real exchange rates) between the periphery of the Eurozone and the core (e.g. Hancké, 2013; Hancké, Johnson, and Pant, 2013). Peter Hall (2012, 2014) sees the crisis as the expression of two different varieties of capitalist systems, one based on high savings and reliance on exports and the other based on low savings, consumption, and high levels of imports. Much official discourse,[1] as well as academic analysis, has focused on the loss of competitiveness of the southern countries and the need to reduce labor costs via labor-market reforms to bring their levels of competitiveness up to the northern Eurozone countries. While the labor cost gap that widened between core and periphery over the last decade is indisputable, as noted in this volume by Caporaso and Kim (Chapter 2), Marzinotto (Chapter 5), and Barkbu et al. (Chapter 3), a closer examination reveals significant variation across the member states of the periphery and questions the policy credibility of focusing on labor costs as a corrective for the Eurozone's problems. As Erik Jones points out in Chapter 4, this volume, the standard competitiveness argument works poorly in terms of the timing of labor cost changes and the worsening of current account deficits across the southern Eurozone. In addition, while real effective exchange rates (REERs) improved for the periphery, the improvements were nowhere near enough to correct the trade deficits that had accumulated. Most of the rebalancing, to the extent it took place at all, occurred through a reduction of imports of peripheral countries from the core, rather than through an increase in exports. As Jones forcefully argues (Chapter 4, this volume), the policy upshot is that cutting labor costs will not be able to restore competitiveness and rebalance external accounts as these countries seek to emerge from recession, particularly if inflation rates in the creditor countries remain low.

Another example of a monocausal interpretation of the crisis, more prevalent among policymakers than academics, is provided by fiscal policy. Both the Treaty on European Union (TEU) and the Stability and Growth Pact (SGP) focused heavily on the development of procedures to avoid large annual deficits and excessive accumulated debt. Yet the first manifestations of the crisis were not fiscal (this did not come until the fall of 2009). Instead, the origins of the crisis first manifested themselves in Europe between 2003 and

[1] For example, the European Commission, especially the Directorate General for Economic and Financial Affairs, has made a number of proposals for monitoring macroeconomic imbalances, which include current account balances, movements in real effective exchange rates, unit labor costs, and housing prices. See "Monitoring Macroeconomic Imbalances in Europe: Proposal for a Refined Analytical Framework," Director General for Internal Policies, Economic and Monetary Affairs, 8 September 2010, Brussels, Belgium, pp. 1–16 and "Scorecard for the Surveillance of Macroeconomic Imbalances," European Economy, Occasional Papers number 92, February 2012, Brussels, Belgium, General Directorate Economic and Financial Affairs, pp. 1–30.

2007 with a rapid increase in credit and resulting booms in several countries, including Greece, Ireland, and Spain. This was not necessarily seen as a bad thing as long as growth was occurring (it was in Greece, Ireland, and Spain). By 2008, private capital markets had gotten wind of the problems with resulting capital flight and a tightening of credit (Lane, 2012: 54). By the fall of 2009, when Greek Prime Minister Papandreou came into office, he announced that the deficit would be over 12 percent of GDP, a figure twice as large as the original forecast. At this point, fiscal issues were highlighted, not only in Greece, but also in other countries in the Eurozone.

The fiscal misbehavior narrative was imposed retroactively on other countries which were in trouble for other reasons. Differences among countries in terms of the causal origins of the crisis got submerged in favor of one master narrative of bad fiscal policy. Spain and Ireland's budget surpluses were either forgotten or reinterpreted (they should have harvested extra revenues during the boom periods to be used during slack times). Portugal's problems centered on its low growth, increasing (but not unusually high) debt, and large trade deficits, which had been growing since 1998 (Lourtie, 2012: 56). Italy's problems were low and even negative growth and structural rigidities in the economy, especially labor markets (Perissich, 2012: 98–99). These differences were downplayed in favor of a fiscal interpretation. In addition, Germany was not entirely innocent of fiscal transgressions itself. Not only did it violate the Stability and Growth Pact limits in 2003, but in late September 2008, less than two weeks after the collapse of Lehman, Chancellor Merkel used taxpayers' money to bail out a German bank—Hypo Real Estate Holding AG (or HRE)—to the tune of 100 billion euros by the German government and 90 billion euros by the ECB. This bailout is scarcely mentioned in most accounts of the crisis but is well documented by Bastasin (2012: 30–36).

For most of the authors in this book, many factors are important but none operates as a satisfactory explanation by itself. The broader literature supports a multicausal interpretation. Marzinotto, Pisani-Ferry, and Sapir (2010) argue that there are two separate crises, a fiscal one and one starting with capital flows resulting in competitiveness problems. Shambaugh (2012) sees the problem in terms of three interlocking and mutually reinforcing crises: a banking crisis, a sovereign debt crisis, and a growth crisis. De Grauwe (2010, 2011) argues that EMU is built on a political foundation that has serious structural flaws (no lender of last resort, no guarantee against market-induced panic), and that multiple triggers interact with these flaws to produce undesirable outcomes. Phenomena that would not necessarily be difficult issues, such as competitiveness differences, trade imbalances, and debt-fueled growth, become serious problems in a monetary union with institutional defects. Other scholars such as Mody (2013) recognize institutional problems in principle but background them, since they essentially reflect the political givens of a sovereign nation-state system. National control of fiscal policies may be a limitation from the theoretical standpoint of optimal currency areas (OCA) but if states are not going to transfer sovereignty over monetary affairs to central institutions, it is best to work on solutions that start from the premise of state sovereignty, no matter how much functional pressure is exerted to centralize political control. Of course, the degree to which fiscal and regulatory powers are shifting to the supranational level is still very much a live issue.

In short, the crises bear all the marks of situations that befuddle analysts: multiple causation, interactions among variables and shifting parameters rather than simple additive causes, and multiple paths to the same outcomes. Just one example of shifting parameters is the varying yields on government bonds, which can jump erratically depending on such vague notions as market sentiment. Despite efforts to parse the crisis into its constituent parts, we presently do not have adequate knowledge of how to model these factors as a coherent whole. Better to accept causal complexity as a starting point, as most of our authors have done, and focus on some aspect of the crisis as a reference point, introducing complications as seems appropriate.

A second theme of this book has to do with the implications of the crisis, the policy responses to it, and the resulting institutional adaptations. Here our disagreement is with interpretations—in both academic analysis and the media—that contain simplistic portrayals of power shifts at the European level during the crisis. Much analysis of the crisis has focused on the revival of intergovernmental policymaking at the expense of supranational actors and the "community method" (Pisani-Ferry, 2012). That development is usually viewed critically by advocates of the community method, rather than as a necessary means to give greater legitimacy to the tough choices that had to be made quickly, often to ensure the confidence of the financial markets. For example, Pisani-Ferry (2012) argues that two models of governance are struggling for a dominant position in the institutional system of the European Union (EU), one based on "mutual assurance" and the other on "federalism." Pisani-Ferry argues that the European Council has gained in power much more than envisaged by the Lisbon Treaty (Pisani-Ferry, 2012: 68) and that the ascendance of the European Council is supported by strong forces at the national level, in particular in Germany: the CDU, Merkel, and the Constitutional Court in Karlsruhe. Schwarzer (2012) is broadly supportive of this view. She argues that the European Council has taken over much of the institutional ground previously occupied by the Commission, in particular the crucial role of the Commission in setting the agenda and monopolizing legislative initiatives.

In Chapter 11, this volume, Fabbrini makes a similar argument: that the traditional community method is losing out to intergovernmental forces. He focuses on the constitutional challenges that are created between the standard EU policymaking method, which relies on the institutional triangle of Commission, Council of Ministers, and European Parliament, on the one hand, and the more ad hoc modes of summitry and non-treaty-based intergovernmental arrangements which are dominated by member states. Fabbrini argues that there are different constitutional orders within the EU: one for the single market, which is largely hierarchical (the rulings of ECJ—European Court of Justice—apply) and where the community method predominates, and one for EMU and the emerging policies in the areas of banking and fiscal policy. This second constitutional order is marked by the Fiscal Treaty and the European Stability Mechanism (ESM), both of which have a distinctive intergovernmental character.

However, as shown elsewhere in this book—by Mabbett and Schelkle (Chapter 6), Epstein and Rhodes (Chapter 9), Caporaso and Kim (Chapter 2), and Henning (Chapter 8)—the shifting power dynamics and institutional configurations that are emerging in the crisis suggest that we should avoid the easy assumption that either states or supranational institutions win out as a result of the crisis. We make three points about the institutional evolution of the EU and its key institutional actors. First, the crisis is resulting in new actors and new relationships and does not only involve the reshuffling of old actors and relationships. There is more at stake than the redistribution of power among a fixed constellation of players. The ECB is surfacing as a major actor which is expanding the scope of its actions during the crisis (Henning, Chapter 8, this volume). Henning models the relationship between the ECB and member states as a game of chicken in which each seeks to extract concessions from the other. As the crisis progressed, the ECB expanded its functions from assuring price stability to stabilization, employing an expanded toolkit including quantitative easing and forward guidance (Henning, Chapter 8, this volume). From its initial mandate of providing price stability, the ECB has taken on functions of crisis management that intrude into fiscal policy (Genschel and Jachtenfuchs, 2010). Moreover, the troika comes onto the scene as a new collective actor, one comprising the ECB, the Commission, and the International Monetary Fund (IMF). It is impossible to parse out the separate powers of these three institutional actors and assign weights to their distinctive influences. On the contrary, the troika is a “team actor” in the true sense.

Second, in line with what we have said above, there is little doubt that the Commission has lost some of its powers of initiative to the European Council, the latter having seized on the crisis as an opportunity to give greater overall strategic direction to the agenda of the EU. This can be seen as a continuation of the institutional evolution of political cooperation that pre-dated the crisis, but it would be hard to deny that the vigorous role of the European Council in agenda-setting during the crisis constitutes an important inflection point in this trajectory. Since the Commission does not operate alone, but exercises its institutional influence along with the Council of Ministers and European Parliament, it follows that the supposed decline of Commission influence has implications for its institutional partners as well.

Third, while the Commission's powers of initiative and agenda-setting, as well as its role within the triangle of Commission, Council of Ministers, and European Parliament may have been reduced, in other ways its powers have been increased by the crisis. Intergovernmental arrangements have sometimes been put together quickly, with crisis dynamics generating crisis responses and with the need to legitimate decisions a pressing force. How this settles into a more enduring constitutional equilibrium (Moravcsik, 2005) is a question that will take some time to decide. Neo-functionalists have always made an important distinction between short-term solutions and longer-term institutional control and development (Pierson, 1996). This cannot be an open-ended argument in favor of neo-functionalism, but it cautions that we should not be too quick to draw the opposite conclusions about the resurgence of the state.

We do not argue that long-term institutional drift always advantages supranational forces. Perhaps the secular development of the EU's institutions from 1957 (Treaty of Rome) to the present allows that inference. To be sure, the EU has expanded the scope of its policymaking and the depth of its decision-making procedures over the years. But a description of a secular change is not the same as a theory; it does not provide the conditions to explain what has been observed. In addition, it is easy to forget that there were periods of slow growth and stagnation in the development of the EU's institutions. From February 1966, the end of the "empty chair crisis," to July 1987, when the Single European Act (SEA) came into effect, very little task expansion and institutional development took place, though admittedly the ECJ laid down some of its most important jurisprudence during this period.

Nevertheless, functionalists and neo-functionalists believe, almost as an article of faith, that crises present opportunities for advancing the supranational agenda. Even if problem-solving is not synoptic and farsighted (Jupille, Mattli, and Snidal, 2013: 6) but is characterized by incrementalism and muddling through, the belief is that once the institutional dust settles, power is likely to shift in a supranational direction. The underlying rationale is that the scale of political solutions on average tracks the scope of the externalities and the economies of scale in the provision of public goods. In other words, large problems, problems, that is, with significant territorial externalities and economies of scale in public good provision, argue for political authorities with a corresponding political jurisdiction. In this sense, neo-functionalism aligns with fiscal federalism. It adds to this an incremental and indirect style of decision-making where high-stakes confrontations with political authorities are avoided. The hypothesis is that muddling through and incremental decision-making, marked by trial and error, will often result in outcomes that shift the locus of authority to the supranational level, regardless of who the central actors involved in the process are. The reluctance to make a working distinction between the central actors involved in the everyday process of crisis decision-making and the institutions which accumulate long-term responsibility for governing may be at the root of current disagreements over who gains and who loses from the financial crisis.

We can think of different logical possibilities resulting from the intersection of who is centrally involved in crisis decision-making (states or supranational actors) and which institutions are responsible for ongoing governance once the period of crisis decision-making is over. The first possibility represents the intersection of state actors controlling crisis decision-making and states controlling subsequent institutionalized governance through tight principal–agent relations. Once key decisions are made, authority for implementation is delegated to agents and closely monitored for agency drift and fidelity of objectives. This is the pure intergovernmental model where little autonomy migrates to supranational institutions. Institutionalization, in this model is intended to preserve the intertemporal stability of bargains (Moravcsik, 1998: 69).

The second possibility is that states are still the key decision-makers but after decisions are made, they delegate authority to govern to international institutions. The difference here is that institutionalized decision-making (governing through institutions) is in the hands of actors with greater autonomy and the potential for migration of decision-making to the international level. A third possibility results from the dominance of supranational actors during the crisis phase and the subsequent institutionalization of these procedures by supranational actors (e.g. the ECB or Commission puts in place certain programs to contain the crisis and then continues to institutionalize these programs and play a central role in implementing them).

While numerous combinations are possible, those of greatest theoretical interest lie in the intersection of state control of crisis decision-making and delegation to international institutions. This combination raises interesting theoretical issues since it is here that we explore the intersection of crisis decision-making by states and the possibility that supranational actors acquire more influence, either through slippage in principal–agent relationships or other logics (e.g. socialization, institutional resources to overcome collective action problems).

Some would argue that institutional power is already shifting to varying degrees in different policy arenas. For example, the Six Pack has strengthened the role of the Commission in budgetary matters and economic policy coordination more broadly. Just as the Commission's powers of initiative have been restrained, its role in macroeconomic surveillance, budgetary oversight, and crisis negotiations have been broadened and strengthened. As neo-functionalist analysis argues, the EU's supranational institutions have been adept at interpreting the crisis and defining the solutions—from budgetary policy (see in this volume Mabbett and Schelkle, Chapter 6, and Hallerberg, Chapter 7) to banking union proposals (Epstein and Rhodes, Chapter 9), and crisis management. Mabbett and Schelkle, in particular, show that there has been a spread of functions, from regulation of markets, to regulation of state budgets, to stabilization policy, even to fiscal matters, since "the ECB was in effect drawn into monetary financing of government deficits . . . " (Chapter 6, this volume).

However, the overall conclusion of the book is that neither a neo-functionalist nor a liberal intergovernmentalist (LIG) approach on its own can explain all periods of the crisis. As Caporaso and Kim show (Chapter 2, this volume), neo-functionalism does a better job of explaining the forces at work during the development of the crisis, while LIG is better adapted to the agenda-setting phase of the EMU construction. Politics dominated the construction of EMU and economic–functional arguments about optimum currency areas were downplayed. Once the euro was in existence and currencies were locked, many of the missing conditions for an effective currency area, in particular divergent economies and lack of fiscal resources, came back to haunt the euro members. The third and most important phase has to do with crisis bargaining outcomes and whether they will favor intergovernmental or supranational forces. The jury is still out on the long-term institutional consequences of the crisis. Intergovernmentalists stake their claim to the continuing importance of states by appealing to their underlying resources (in fiscal, bureaucratic, or legitimacy terms) while neo-functionalists bet on the advantages accruing to the coordinating role of centralized institutions, in particular, their ability to overcome collective action problems and social dilemmas among national actors.

A third distinctive theme of this book is that, in addition to focusing on EU institutions, it broadens the field to include the member states, in particular Germany. Indeed, as Bastasin (2012) forcefully argues, the roots of the crisis are not completely structural. There is a strong agentic story to be told, both positive and negative. After structural causes of the crisis are taken into account it must still be acknowledged that "the crisis actually was produced by a vast array of short-sighted national policy choices enacted intentionally by all countries . . . in substantial disregard of the consequences for Europe as a whole" (2012: 7). With specific reference to Germany, public intellectuals, journalists, and—sometimes—academics have routinely argued that the crisis has seen the triumph of German hegemony (even if sometimes assumed reluctantly) and the imposition of a German "ordo-liberalism" across Europe. This argument typically comes in two forms.

The first—a rationalist argument—is one in which Germany has led a group of creditor countries in preventing a neo-Keynesian response to Europe's problems for rational reasons, that is to ensure that it is not encumbered by costly cross-border liabilities, revealing an incapacity for solidarity or even a "retreat from Europe" (e.g. Paterson, 2011) with deleterious consequences for European democracy and stability. In this argument (see e.g. Beck, 2013), Germany is presented as the winner in a series of policy disputes, spanning the agreements attached to IMF loans, the creation and use of new supranational policy instruments (the European Stability Mechanism, the various elements of banking union), and the fate of Eurobonds and other mechanisms for producing greater cross-border "solidarity." In particular, the incorporation into the Fiscal Treaty of elements present in the German Basic Law, particularly "debt brakes" or "*Schuldenbremse*," is taken as evidence of a hegemonic German influence in Europe.

In this volume, this view is contested by Marzinotto on resolving debt problems (Chapter 5), Mabbett and Schelkle on fiscal discipline (Chapter 6), Hallerberg on budgetary policy (Chapter 7), and Epstein and Rhodes on banking union (Chapter 9). In all four, a much more nuanced picture emerges in which Germany plays the role one would expect of the largest Eurozone economy, but one which is regularly countered by and often cornered in power games featuring the ECB and the Commission as well as coalitions of other member states.

In tackling the debt crisis, as Marzinotto (Chapter 5, this volume) argues, although Germany did take on the stick part of the carrot-and-stick function played by hegemons in other monetary regimes, it was the ECB that provided the carrot with long-term refinancing operation (LTRO), the securities market program (SMP), and the outright monetary transactions (OMT) initiative. Further, as Mabbett and Schelkle argue in Chapter 6, while the Commission kept in line with Germany's preference about fiscal discipline, in practice Commission officials recognized that "adherence to the fiscal rules was an insufficient basis for stability in the euro area" and they have adjusted the strictness of their surveillance accordingly. Hallerberg notes Schelkle's (2012) point that although often described as "austerian," Germany was in fact one of the activists of a fiscal expansion at the beginning of the crisis (passing three stimulus packages in a matter of months), and goes on to argue that the adoption in the crisis at the supranational level of strict rules of fiscal governance has not been a strictly German enterprise. Epstein and Rhodes (Chapter 9, this volume) strongly counter the argument that Germany has been able to dictate the timing and extent of banking union by pointing to the power of the ECB, and parts of the European Commission, in alliance with a coalition of member states, in inducing or coercing Germany into agreeing to a transfer of national sovereignty in banking supervision and surveillance that it initially opposed.

The second—a constructivist argument—is that Europe is in the grip of an "austerity delusion" (Blyth, 2013) because of the power of ideas promoted by Germany and the supranational institutions. Some commentators take a similar line: economist Paul Krugman (2012) talks of an "austerity doctrine" and *Financial Times* journalist Wolfgang Münchau (2013) talks of "perma-austerity" as an ideological fixation on the part of European policymakers.

Those arguments are countered in this book by Mabbett and Schelkle (Chapter 6) and Hallerberg (Chapter 7) in particular, both of whom find that institutions are more important than ideas, though there are many ways in which the two phenomena are intertwined. Thus, as both show, there has been fiscal expansion and not just austerity in the complex policy response to the European recession, and that in many cases policy outcomes in member states are better accounted for by domestic factors, including electoral politics (Schelke, 2012; Bermeo and Pontusson, 2012: 14–15) and fiscal positions at the start of the crisis (Cameron, 2012: 91–129). Mabbett and Schelkle argue that rather than a single ideology such as austerity there were multiple ideas in opportunistic competition, ideas such as norms of good statistical governance. However, in striking contrast to the influence of domestic politics among core countries, the countries on Europe's periphery took their marching orders from the ECB and the IMF. As Armingeon and Baccaro argue in *Coping with Crisis*, "In this case (i.e. the periphery), there is only one policy response and it is imposed from the outside" (2012: 162). While the financial crisis demonstrates the external influence of globalization, it exacts a higher price and a more uniform response among weaker countries. In sum, domestic politics is more influential in the core; less so in the periphery.

Furthermore, the argument is made that the EU's inability to provide a fiscal stimulus on the scale of the USA, for example (the counter-example to which Paul Krugman always refers), is not due to ideological blindness but rather to the rudimentary and fragmented nature of the EU's institutional set up, which has prevented it from resolving bank failures and conducting an effective counter-cyclical policy. The same argument is made by Marzinotto (Chapter 5, this volume), who argues that, given the institutional unpreparedness of the EU for the debt component of the crisis, the problem had to be solved *ex post* when the crisis had already hit, explaining why the provision of financial assistance to vulnerable countries was suboptimal, mostly organized along intergovernmental lines, and subject to a severe structural adjustment program. This is a story of institutional inadequacy and ill-adaptation—and the problems that any polity (let alone an imperfectly federalized one) would face in a financial crisis—rather than a unicausal story of the power of a particular political and economic ideology.

A fourth and final way in which this book departs from many others is that it is attentive to a variety of distributive questions. At the core of the crisis are disagreements among creditors and debtors. While distributive issues have assumed a territorial form (North vs. South plus Ireland) in the European financial crisis, there are other cleavages present. Creditors and debtors are not exclusively in different countries. There are bankers and mortgage companies, home owners and borrowers, troubled areas within countries and areas relatively unscathed. The crisis could have been framed as a global class conflict between creditors and debtors, but for the most part it has not. Since most of the damage caused by the crisis tends to locate itself within identifiable territorial areas (North and South, or core and periphery), it makes sense that the definition of the problem, as well as potential solutions, have followed this spatial representation.

However, the spatial signature of the crisis, the fact that the divisions are primarily across countries, even across regions (North and South), does not augur well for a compensatory solution, one based on significant interregional transfers. Pablo Beramendi (2012) argues that if one starts with territorial cleavages and territorial systems of representation, which then withstand a shock such as the financial crisis, the resulting institutional and policy outcomes will reflect the initial cleavages. In short, institutional responses are endogenous to initial conditions in terms of cleavages and patterns of representation (Beramendi, 2012: 67–8).

Nearly all the authors in this volume assume the North–South or core–periphery framing of the problem. One exception is Jonathan Moses (Chapter 10). His focus is on Ireland, Iceland, and Latvia—an interesting choice for a three-way comparison since Ireland is in the Eurozone, Iceland is not (and does not want to be), and Latvia, which is now a member (since January 2014), was not a member during the time period of analysis for Moses. The choice of these three countries makes sense on a number of research design grounds: all three countries are small economically, so they face similar challenges from the global and regional economy; all three have strong links with the EU, so isolation is not really an option; all three experienced bubbles in real estate and stock markets; and all three relied on international capital markets to stay solvent. Moses exploits these similarities to control for a broad range of macroeconomic conditions, while using the different orientations of these countries to the Eurozone as the major explanatory factor. The distributive outcomes in the three cases were quite different, particularly if the comparison is between Iceland (which allowed its banks to go bankrupt) and Ireland and Latvia, which had to undergo severe contraction in their economies as a result of their close association with the euro.

The Eurozone crisis is ongoing and will not end quickly. Breakup of the EMU would be very costly for all parties. There is no easy way out either for supposedly powerful Germany or for the weaker and more vulnerable countries. In addition, there are political and ideological factors. No doubt, having played such a central role in the launching of the European integration project, Germany does not want to be responsible for its breakup. There is also the sense that leaders have taken their measure of the crisis and know how to contain it. Spreads between interest rates on German Bunds and domestic rates are now low, and more important, political leaders know (or think they know) how to contain these spreads when they get "too large." The long-term financing operations and Draghi's "whatever it takes" comments were followed by market calm. No doubt leaders think they can play these cards again.

Nevertheless, vulnerable countries continue to stagnate. Greece remains in serious crisis with doubts as to whether its budgetary position is sustainable. The Greek elections of January 2015 put the Syriza party in power, resulting in bargaining dynamics between Greece and Germany that were tense and outcomes initially are unknown, though bargaining theory tells us to expect that the outcomes would be closer to Germany's ideal point than to Greece's—as indeed turned out to be the case with the third Eurozone bailout deal for Greece struck in July 2015. These problems are not subject to an easy fix. Emergency financing, structural reform of domestic economies, centralized banking regulation, and reform of fiscal finances are all on the table. The contributors to this volume have each taken on an important but specific aspect of the causes and/or consequences of the crisis. We hope that the chapters, individually and collectively, have contributed to a better understanding of it.

Acknowledgments

We have benefited from the comments of all contributors to this volume. Workshops at the University of Denver (2012), University of Washington (2013), and conference panels at the Council of European Studies meetings in Washington, DC (March 2014) were especially useful. We are in particular indebted to Waltraud Schelkle and Deborah Mabbett for careful reading of the Introduction.

References

Armingeon, K. and Baccaro, L. (2012). "The Sorrows of Young Euro: The Sovereign Debt Crisis of Ireland and Southern Europe," in: Bermeo, N. and Pontusson, J. (eds.), *Coping with Crisis: Government Reactions to the Great Recession*. New York: Russell Sage Foundation, pp. 162–97.

Bastasin, C. (2012). *Saving Europe: How National Politics Nearly Destroyed the Euro*. Washington, DC: Brookings Institution.

Beck, U. (2013). *German Europe*. Oxford: Polity Press.

Beramendi, P. (2012). *The Political Geography of Inequality*. Cambridge: Cambridge University Press.

Bermeo, N. and Pontusson, J. (2012). "Coping with Crisis: An Introduction," in: Bermeo, N. and Pontusson, J. (eds.), *Coping with Crisis: Government Reactions to the Great Recession*. New York: Russell Sage Foundation, pp. 1–31.

Blyth, M. (2013). *Austerity: The History of a Dangerous Idea*. Oxford and New York: Oxford University Press.

Cameron, D. R. (2012). "European Fiscal Responses to the Great Recession," in: Bermeo, N. and Pontusson, J. (eds.), *Coping with Crisis: Government Reactions to the Great Recession*. New York: Russell Sage Foundation, pp. 91–129.

De Grauwe, P. (2010). "The Financial Crisis and the Future of the Eurozone," *Bruges Economic Policy Briefings*, College of Europe, 21, Bruges, Belgium, pp. 1–17.

De Grauwe, P. (2011). "Managing a Fragile Eurozone," *CeSifo Forum*, (2): 40–45.

Genschel, P. and Jachtenfuchs, M. (2010). "The Fiscal Anatomy of a Regulatory Polity: Tax Policy and Multilevel Governance in the EU," *TranState Working Papers*, Bremen, Germany, 114, pp. 1–31.

Hall, P. A. (2012). "The Economics and Politics of the Euro Crisis," *German Politics*, 21(4): 355–71.

Hall, P. A. (2014). "Varieties of Capitalism and the Euro Crisis," *West European Politics*, 37(6): 1223–43.

Hancké, B. (2013). *Unions, Central Banks and EMU: Labour Market Institutions and Monetary Integration in Europe*. Oxford: Oxford University Press.

Hancké, B., Johnson, A., and Pant, S. (2013). "Comparative Institutional Advantage in the European Sovereign Debt Crisis," *LSE "Europe in Question" Discussion Paper Series* 66/2013, London: The London School of Economics and Political Science.

Jupille, J., Mattli, W., and Snidal, D. (2013). *Institutional Choice and Global Commerce*. Cambridge: Cambridge University Press.

Krugman, P. (2012). "The Austerity Debacle," *New York Times*, January 29.

Lane, P. R. (2012). "The European Sovereign Debt Crisis," *The Journal of Economic Perspectives*, 26(3): 49–67.

Lourtie, P. (2012). "Understanding Portugal in the Context of the Euro Crisis," in: Cline, W. and Wolff, G. B. (eds.), *Resolving the European Debt Crisis*. Washington, DC: Peterson Institute for International Economics, pp. 51–94.

Marzinotto, B., Pisani-Ferry, J., and Sapir, A. (2010). "Two Crises, Two Responses," *Bruegel Policy Brief* 2010/01, Bruegel, Brussels, pp. 1–8. Available at: <http://bruegel.org/2010/03/two-crises-two-responses/>.

Mody, A. (2013). "A Schuman Compact for the Euro Area," *Bruegel Essay and Lecture Series*, Bruegel, Brussels, Belgium, pp. 1–42. Available at: <http://bruegel.org/wp-content/uploads/imported/publications/essay_schumann_compact_1.3_01.pdf>.

Moravscik, A. (1998). *The Choice for Europe*. Ithaca, NY: Cornell University Press.

Moravscik, A. (2005). "The European Constitutional Compromise and the Neo-Functional Legacy," *Journal of European Public Policy*, 12(2): 349–86.

Münchau, W. (2013). "US Joins Misguided Pursuit of Austerity," *Financial Times*, January 6.

Paterson, W. E. (2011). "The Reluctant Hegemon? Germany Moves Centre Stage in the European Union," *Journal of Common Market Studies*, 49(s1): 57–75, September.

Perissich, R. (2012). "Italy and the Euro Crisis," in: Cline, W. R. and Wolff, G. B. (eds.), *Resolving the European Debt Crisis*. Washington, DC: Peterson Institute for International Economics, pp. 95–107.

Pierson, P. (1996). "The Path to European Integration," *Comparative Political Studies*, 29(2): 123–63, April.

Pisani-Ferry, J. (2012). "Assurance mutuelle ou federalisme: la zone euro entre deux modèles," *Journées de l'Économie de Lyon*, Dossier: 67–72, October 10, external publication of Bruegel. Available at <http://bruegel.org/wp-content/uploads/imported/publications/Pisani-Ferry_JECO_2012.pdf>.

Schwarzer, D. (2012). "The Euro Area Crises, Shifting Power Relations and Institutional Change in the European Union," *Global Policy*, 3(s1): 28–41, December.

Shambaugh, J. C. (2012). "The Euro's Three Crises," *Brookings Papers on Economic Activity*, Brookings Institution, Washington, DC, Spring, pp. 1–54.

Schelkle, W. (2012). "Policymaking in Hard Times: French and German Responses to the Eurozone Crisis," in: Bermeo, N. and Pontusson, J. (eds.), *Coping with Crisis: Government Reactions to the Great Recession*. New York: Russell Sage Foundation, pp. 130–61.

2

"States Choose but Not Under Circumstances of Their Own Making"

A New Interpretation of the Integration Debate in Light of the European Financial Crisis

James A. Caporaso and Min-hyung Kim

2.1 Introduction

Marx is often quoted for saying "Men make their own history, but they do not make it just as they please; they do not make it under circumstances chosen by themselves. . . ."[1] The quote captures both agentic and structural aspects of the human condition. The agentic view puts the individual in the driver's seat, actively shaping history by making choices that could have gone differently. History does not seem deterministic but rather open, fluid, malleable. The second part of the quote captures the force of structure. Here the same self-regarding agents are present but this time they are confronted with a menu of opportunities and constraints that are exogenous to their immediate choices. We exploit this dualism by probing an enduring theoretical conflict in regional integration theory.

What can theories of regional integration, particularly neo-functionalism (NF) and liberal intergovernmentalism (LIG), tell us about the European financial crisis? In the immediate aftermath of the crisis outbreak, the silence

[1] The full quote is "Men make their own history, but they do not make it just as they please; they do not make it under circumstances chosen by themselves, but under circumstances directly encountered, given and transmitted from the past. The tradition of all the dead generations weighs like a nightmare on the brain of the living." Karl Marx, *The Eighteenth Brumaire of Louis Bonaparte*.