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Le choc de la nouvelle? Maastricht, déjà vu and EMU reform

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LE CHOC DE LA NOUVELLE? MAASTRICHT, DÉJÀ VU AND EMU REFORM

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This paper explores the extent to which current reforms of the Eurozone's governance remain encased in the constraints of the Maastricht Treaty –the narrowness of its underlying paradigm; the gaps and imbalances of its design –and the implications for the future of the euro. With a model of "sound money, sound finances", based on the precepts of German ordo-liberalism, a vulnerability was exposed: it lacked the instruments, not only to aid, but also to police. This was exacerbated by the shallowness of public legitimation, ignored from the outset. The uncertainty, delays and division displayed by the Eurozone's response to the crisis owed much to the "lock-in" of Maastricht. The paper includes a critical reassessment of Dyson and Featherstone (1999).

The governance of the Eurozone undoubtedly faces its biggest challenge in the context of the on-going debt crisis. At its heart is the strategic issue of how to manage a heterogeneous group of economies and states. This involves rule-setting and compliance, but it also raises a more complex agenda of cross-national solidarity and the ability of European Union institutions to intercede domestically to steer and uphold necessary adjustments. Indeed, the two bailouts for Greece in 2010-2012 questioned the ability of the EU to micro-manage domestic structural reform. Much attention has been paid to the crisis by economists, but these are issues which are very much in the territory of political science. The aim of this paper is to establish how current reform efforts remain encased in the constraints of the Maastricht Treaty –the nar-

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rowness of its underlying paradigm and, the gaps and imbalances of its design– and the implications for the future of the euro. In essence, the questions come down to matters of foresight and policy learning, as well as of path dependency and lock-in.

The Maastricht constraint has reinforced the EU's tendency to economic orthodoxy in other cases. As Lütz and Kranke observed, in their study of Hungary, Latvia and Romania, "the EU's recent lending policies amount to a European rescue of the Washington Consensus. While the IMF has –at least in part– relaxed its formerly tight stance on economic conditionality attached to its loans, the EU has actively promoted orthodox measures in return for loans to those countries that are designated to join the single currency area and hence have to meet certain economic criteria".[1]

The importance of the euro to the EU means that there are wider implications drawn from the effectiveness and nature of its policies and governance. The confrontation in Greece between the reforms encouraged by the "Troika" and the domestic resistance to the costs of austerity poses unprecedented questions about European integration –its norms, processes and purposes– and its reliance on a foundation of popular legitimacy. "Europe", previously synonymous with modernisation, progress and economic gains, was now associated with a level of austerity not known in recent peace-time. At the same time, the EU was being drawn into a process of monitoring, supervision and conditionality –penetrating the domestic state administration via a seemingly permanent "Troika" office in Athens– that risked clashes of cultural frames and of acceptability. From a starting-point of limiting Eurozone level domestic intervention in the name of governments building their own stability cultures, "Europe" had been dragged into a highly fraught political contest, questioning its ability to manage the process.

The agenda advanced by the Troika in the context of the bailouts owes much to previous IMF actions in states in crisis, but it also shows the extent to which the Eurozone remains "locked-in" to the normative underpinnings of the Maastricht Treaty agreed in December 1991. In order to establish this constraint and its current implications, this paper will:

- Clarify the notions of path dependency and "lock-in" to be applied here;
- Re-examine the expectations and assumptions prevalent in the Maastricht

1. S. Lütz - M. Kranke, "The European Rescue of the Washington Consensus? EU and IMF Lending to Central and Eastern European Countries", *LSE "Europe in Question" Discussion Paper Series* No. 22, London School of Economics and Political Science, 2010, p. 15.

negotiations –with some critical self-reflection on the account given in Dyson and Featherstone.[2]

- Consider the fragility of the Maastricht construct in the context of the limits of any parallel political integration.
- Outline the failure to escape from the Maastricht principles as the euro-crisis took hold in 2010-11.
- Assess the implications for the immediate future of the Eurozone.

1. BARGAINING, LOCK-IN AND INEFFICIENCY

In a basic sense a treaty like that of Maastricht is intended to create enduring commitments, to tie the signatories in to a set of rules and mutual obligations. But the claim developed here goes further.

Path dependency can be a glib reference and it needs careful application. In its strongest form, path dependence (in historical institutionalism) contradicts the neo-classical economic model of consistently rational behaviour leading to efficient and predictable outcomes. At issue, is the extent to which errors were made at the point of the original agreement and how far these were knowable and avoidable. This is what Liebowitz and Margolis, in their severe (rationalist) challenge to the field, refer to as "Third-degree path dependence". Thus, it is not merely that the original decision appears inefficient in retrospect –their "Second-degree path dependence"– but that at that point there were alternatives and the knowledge to avoid a regrettable outcome. They judge the likelihood of such conditions existing to be very low.[3] But, as Pierson points out, politics differs from economics: there is even less reason to assume anything like a market mechanism will be self-correcting and the institutional setting matters.[4]

The "Third-degree path dependence" is a bold proposition: the study of bargaining processes, like that leading to Maastricht, can assume voluntary decisions by "utlity-maximisers" (the assumptions of rational choice). The

2. K. Dyson - K. Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union*, Oxford University Press, Oxford 1999.

3. S.J. Liebowitz - S.E Margolis, "Path Dependence, Lock in and History", *Journal of Law, Economics and Organization*, Vol. 11, No. 1, April 1995, p. 2.

4. P. Pierson, "Increasing Returns, Path Dependence, and the Study of Politics", *American Political Science Review*, Vol. 94, No. 2, June 2000, pp. 256-257.

frame of historical institutionalism, however –and the interpretation of pre-Maastricht bargaining offered in Dyson and Featherstone– emphasises the structuring of choices and decisions over time, with distinctive "paths" of rationality that may be sub-optimal for some negotiating parties and for the collective outcome.[5] Learning itself is path dependent: an actor's understandings are filtered by existing mental maps.[6]

For some writers, path dependence is predicated on "increasing returns" or positive feedback processes over time, though others are not so restrictive. The notion refers to how the costs of switching from one alternative path to another will, in certain social contexts, increase markedly over time. In the case of EMU, a resistance to change can be readily identified over the last decade. This may be attributed to a set of policy beliefs being sustained over time that gave primacy to monetary stability, a desire to build-up the credibility of the original Treaty provisions, and recognition that a shift would impose disproportionate costs on the pivotal partner, Germany. The latter was and is clearly crucial to the maintenance of the system and was also the progenitor of the principles underpinning the original design. Even when a systemic shock occurred in 2009-10, with the Greek debt crisis, the steer remained tied to the original course.

So, what exactly was being "locked-in" after Maastricht?[7] The following sections will justify a claim of lock-in to a paradigm of "sound money, sound finances" and one based on an ordo-liberal belief of responsibility being held at the level of national governments. This same paradigm curtailed the options considered for reform of Eurozone provisions in response to the systemic shock. Indeed, it served to re-define the content of "economic governance" when the notion reappeared in political debate. In sum, the prime discourse remained one of penalties and tightened regulation for governments not abiding by the rules set by Maastricht –to better overcome the "moral hazard" they posed to the original construct – rather than a return to the Keynesian-inspired ideas of the Werner Report on EMU of 1970, for example.

5. K. Dyson - K. Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union*, op.cit.

6. P. Pierson, "Increasing Returns, Path Dependence, and the Study of Politics", op.cit.; K. Thelen, "Historical Institutionalism in Comparative Politics", *Annual Review of Political Science*, Vol. 2, June 1999, pp. 369-404.

7. W.B. Arthur, "Competing technologies, increasing returns, and lock-in by historical events", *Economic Journal*, Vol. 99, No. 116, 1989, p. 31.

2. THE "LOCK-IN" OF MAASTRICHT

For Keynesians, the Werner Report of 1970 –also concerned with outlining the requirements of EMU– appeared intellectually superior to the provisions of the Maastricht Treaty.[8] The latter had referred to the need for a "centre of decision for economic policy", with powers to coordinate fiscal policy and issues of investment and consumption, infrastructure, and policy coordination to address the need for growth and employment. The Report foresaw a fiscal transfer system to provide "automatic stabilisers" and a coordinated investment programme to help states in difficulty.

In the Inter-Governmental Conference negotiations, the Commission had promoted some Neo-Keynesian ideas: its own paper of May 1990 had advocated that the European Council should formulate "economic policy guidelines" and Delors himself had shown support for a structure of "economic governance" at the EU level, though he avoided using the term directly. Delors would associate himself with the need for collective bargaining and an industrial policy at the EU level. His experience at the French Planning Commission (1962-69) had left its mark. The French Finance Minister, Pierre Beregovoy, had been the first to talk of the need for a "political pole" to balance the "monetary pole" of EMU in the lead-up to Maastricht. The Elysée later termed the notion "un gouvernement économique". Indeed, President Mitterrand equated economic governance with a strengthening of the European Council in a speech in October 1990. The idea became the most distinctive and overriding theme of the French negotiating position prior to Maastricht. It reflected the intellectual influence of Social Catholic and Social Radical traditions of economic policy. "Economic governance" was a key part of Beregovoy's paper to the IGC of 5 December 1990. Its rationale was based on the need for a democratic legitimation of EMU, but also of the risks of a divergence between monetary and budgetary policy. There would be the need to prevent excessive deficits and to apply sanctions: a matter on which France took the lead in the IGC. It figured in the French Draft Treaty on EMU of 5 January 1991.

Be that as it may, references to "economic governance" shocked the German Finance Ministry and the Bundesbank. Instead, its own dominant

8. This section draws on K. Dyson - K. Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union*, op.cit. The research for this book involved some 175 personal interviews and extensive archival searches.

paradigm was of "sound money" and the precepts of Ordo-liberalism. This entailed priority to disinflation; budgetary discipline; and currency stability, underscored by the vital importance of the credibility of policies within the financial markets.[9] Indeed, the re-launch of the EMU debate in 1988 had owed much to a confluence of support for the "sound money" approach amongst EC central bank governors and the EC Monetary Committee, alongside Germany. This consensus was a response to what were seen as the policy failures of the 1970s and of France, in particular, in 1981-83. In political science terms, an epistemic community had emerged of shared normative and causal beliefs that would be credible in the financial markets and this helped to forge the unanimity of the Delors Committee in its report on EMU in 1989. A new primacy was given to monetary policy instruments and price stability was seen as the priority objective.[10] Not only would it not jeopardise other objectives, like growth and employment; it was a necessary condition for their long-term attainment. Thus, the EMU negotiations gave little attention to any €-level responsibility for stabilising aggregate demand and the avoidance of negative demand shocks. This agenda had been discredited with the demise of Keynesianism. There would merely be "soft" law processes applied to the coordination and monitoring of national fiscal policies and borrowing levels under the "Broad Economic Policy Guidelines" and, after 1997, the "Stability & Growth Pact".

Structural changes also served to advance the new policy consensus. The success of the European Monetary System (EMS) in the late 1980s reinforced such ideas. This, together with the onset of the single European market, was seen as essential preconditions that had not existed at the time of the Werner Report and they proved influential in Bundesbank thinking. The growth and impact of capital mobility (under the single market) had itself shifted the debate. The free movement of capital facilitated the disciplinary effects of the financial markets on national budgets and was seen as efficient in the allocation of resources. The financial services sector gained in political influence and facilitated the ascendancy of the "sound money" paradigm. Alongside these shifts was some optimism with respect to the general macro-economic cli-

9. *Ibid.*, p. 2

10. K. McNamara, *The Currency of Ideas: Monetary Politics in the European Union*, Cornell University Press, Ithaca, NY 2008; M. Marcussen, "Ideas and Elites: Danish Macro-Economic Policy Discourse in the EMU Process", *PhD Thesis*, University of Aalborg, September 1998.

mate –growth across the EMS had been relatively high for the previous four years– and the "feel-good" factor promoted a sense of inclusiveness.

There were also institutional sensitivities at play. The failure to address fiscal policy issues prior to Maastricht was, in part, the result of an unwillingness to cede political autonomy over such matters to the EU level. The risks inherent in an heterogeneous monetary union were to be left for adjustment at the national level. Ordo-liberalism advocated that a stability culture –matching sound money with sound finances– could only be developed "bottom-up" –that is, from the domestic level– and it could not be imported from outside or "faked". It might also be added that the convergence criteria for entry into the "euro" could serve as a means of importing discipline from outside for reform advocates at the domestic level.[11] Thus, there were philosophical reasons to deny competence for fiscal management at the EU level.

In the years after Maastricht, conditions changed but the policy regime, with very minor exceptions, did not. The Italian economic performance looked promising and the government of Constantine Mitsotakis in Greece was embarked on a dash for qualification, based on an over-confidence in the speed of domestic adjustment. The Maastricht negotiators had –in the main– not expected all member states to join the convoy of euro-entrants at the outset, but the political imperative ebbed. When it came to judging whether the entry conditions had been met, there was a shared interest in fudging or massaging the tests. In particular, debt levels above the required 60% of GDP were set aside.

Thus, the Maastricht Treaty had bequeathed:

- A rejection of EU institutional competence not only to coordinate and set economic policy for the euro-area, but also to delve, police and adequately punish national governments deviating from the convergence rules. The "moral hazard" of governments manipulating the data and of sustaining uncompetitive paths was not addressed properly.
- An expectation that the Eurozone would not be fully inclusive at the outset, but a shift of political interest that made it difficult to block all but Greece –and her only temporarily.
- An assumption that heterogeneity and asymmetric shocks could be handled by the disciplinary power of the financial markets, strengthened by the rules on no bailouts (Art.125) and the "excessive deficit procedure" (Art. 104) for lax national governments.

11. G. Carli, *Cinquant' anni di vita Italiana*, Editori Laterza, Rome 1993.

• A belief that matters of demand management did not belong to the EU level and, given the failures of Keynesianism, national governments were best served by priority to monetary stability (sound money) as the necessary policy regime for growth in the long-term.

The Maastricht provisions comprised contradictions and gaps. On the one hand, the strictures were of no bail-outs, the importance of abiding by the rules, and sanctions for those that do not. Solidarity was to be created by the imposition of penalties, though the democratic underpinnings of EMU governance were minimal. There would be no facility to expel errant member states nor would the latter have a specified legal right of exit. When faced with a deep economic crisis –inevitably eliciting strong political and social reactions– what would happen with states unable to deliver compliance? Immediately after Maastricht the disciplinary rules were already appearing unenforceable.[12]

In Dyson and Featherstone, we charted the ideational, institutional, and strategic underpinnings of the "road" to Maastricht. Inevitably, in trying to examine the negotiations from the "inside", there was a risk of absorbing the instinctive assumptions of the key actors involved. Thus, in the light of the recent debt crisis, we were not explicit enough in accounting for the progress of the "no bail out" rule. We considered it in the context of preference-formation in different national contexts –especially Germany– but it seemed so inevitable and essentially uncontested that we chose not to highlight it as a theme in the index. Perhaps more acutely, we gave insufficient attention in our conclusions –as, indeed, had the negotiators themselves– to the implications of the heterogeneity of national politics and administrative systems with respect to the ability to abide by the rules set. The issue was one of a different kind of asymmetric "shock": the incapacity to implement reforms and accept fiscal rules consistent with the Treaty. In a sense, the neglect was strange: how could negotiators not be sensitive to the risks of striking deals with politicians like Guilo Andreotti, Prime Minister of Italy, for example –an embodiment of a "partitocrazia" known for its fiscal laxity? Other member states had sustained high debt to GDP ratios for a long period: Greece and Belgium, being two such instances. How could they be expected to deliver "sound finances"?

The answer we gave was that these limitations accrued from the Maastricht

12. W. Buiter - G. Corsetti - N. Roubini - R. Repullo - J. Frankel, "Excessive Deficits: Sense and Nonsense in the Treaty of Maastricht", *Economic Policy*, Vol. 8, No. 16, Apr., 1993, pp. 57-100.

negotiations being set as a politically-isolated, narrow "core executive" activity.[13] A "technically rational outcome on EMU" had been negotiated "free from the complexities of political-union negotiations" leaving "some critical gaps".[14] We did not specify the problem of divergent system capabilities, norms or logics as one such gap. Instead, we highlighted the political exposure of the ECB –without a location within a political union framework– and a "potentially highly problematic relationship between rulers and ruled".[15] Both were relevant to the subsequent history of EMU, but were incomplete as an account of the political risks.

More generally, the Maastricht set of rules, the philosophy and its assumptions would be very severely tested by the unprecedented growth of capital mobility over the euro's first decade. In fairness, the international economy had changed since the Maastricht Treaty was signed in 1992: "credit default swaps" had then been unknown, the credit rating agencies had barely entered the European market,[16] and sub-prime mortgages were not on the radar screen. No-one foresaw the collapse of major Wall Street institutions like Lehman Brothers in September 2008 or the ferocity of the gathering credit crunch. Thus, the euro's own failing regime and the wider structural changes in the international capital markets served to create a combustible set of conditions.

3. THE LIMITS OF POLITICAL INTEGRATION

The Maastricht agreement on EMU was left vulnerable by the absence of economic governance, but also by the risks with respect to cross-national solidarity. It was clear that, "The fundamental point remained that the German model failed to offer an adequate basis for a sustainable EMU", a "new sense of solidarity that would support "burden-sharing" within EMU" was likely to prove elusive, as "EMU's Achilles' heel was the prospect of people being asked to make sacrifices for others with whom there was a weak sense of identity".[17]

13. K. Dyson - K. Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union*, op.cit, pp. 746-7.

14. *Ibid.*, p. 747.

15. *Ibid.*

16. Before the 1990s, the three main credit rating agencies –Standard and Poor's, Fitch, and Moody's– had few, if any, analysts outside US.

17. K. Dyson - K. Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union*, op.cit., p. 796.

Even in the EMU negotiations, German representatives had displayed, "a deep-seated mistrust that began with the Greeks and ranged through Italy, Spain, and Belgium to include France".[18]

Moreover, well before the credit crunch and the debt crisis, the surveys of "Eurobarometer" published on behalf of the EU Commission showed a set of distinctly un-"communautaire" dispositions. Amongst the EU27 member states, only 16% of voters' equated Europe with "tolerance" and an alarmingly low level of 13% thought it synonymous with "solidarity".[19] More generally, in 1999 at the birth of the euro currency, "trust" in the EU averaged 40% marginally ahead of the 39% who had no trust in the EU. After six decades of the European integration process, such results suggested a surprising shallowness of its impact on contemporary attitudes. While some 60% equated Europe with "peace" –something of an historical reference point– the absence of solidaristic attitudes of relevance to current issues was not a strong base on which to face asymmetric economic shocks as Europe was soon to face.

The survey results were consistent with a number of academic studies exploring the roots and contours of European identity. In his study of public attitudes, Fligstein saw Europe as a transnational society, but one that was shallow.[20] The extent and depth of cross-national interaction was limited to a minority. He identified a variation across three social groups. The most pro-European were the young, the educated, the professional, and the business sections of the electorate. The most fearful of Europe tended to be the older, poorer, and less-educated voters. In-between was a middle class "swing" constituency, which sometimes saw itself as being "European". Unlike national identity, Europe lacked a cross-class attachment or appeal.[21] Again, the picture painted suggests vulnerability for the European project at a time of economic crisis.

The debt crisis when it arose could not easily be equated with a traditional left-right political cleavage across Europe. It was more a post-modern disaster for the EU. The crisis elicited responses that reinforced national stereotypes

18. *Ibid.*, p. 372.

19. European Commission, *Eurobarometer 69*, Brussels, November 2008.

20. N. Fligstein, *Euro-Clash: The EU, European Identity, and the Future of Europe*, Oxford University Press, Oxford 2008.

21. M. Bruter, "Winning Hearts and Minds for Europe: The Impact of News and Symbols on Civic and Cultural European Identity", *Comparative Political Studies*, Vol. 36, No. 10, December 2003, pp. 1148-1179.

and antagonisms. Societies turned insular when faced with economic demands. The popular media in Germany was critical of lazy, protected and overpaid Greeks. In 2010, the *Bild* newspaper suggested that the government in Athens should sell-off a few Aegean islands to raise funds or to turn the Acropolis into a theme-park, for example. In response, the Greek media rekindled attacks on Germany for not having paid sufficient war reparations and for being hypocritical given that in 1953 it had benefitted from (in real terms) a much bigger debt write-off. The British media found in the euro-crisis confirmation of its deeply-rooted euro-scepticism. The EU was being divided almost along a north-south divide; in any event, there was little popular base for a common solidarity in response to the crisis.

4. THE FAILURE TO ESCAPE FROM MAASTRICHT

The financial crisis that spread across the international system in late 2008 was exceptional in both its form and its environment. The sub-prime mortgage crisis in the US quickly had contagious effects. The latter were gauged by the three dominant credit rating agencies –Fitch, Moody's and Standard and Poor's– based in the US that constituted "governance without government".[22] Their power over sovereign states would be displayed in Europe where they downgraded the sovereign bonds of Greece, Portugal, Ireland, Italy and Spain. Fitch's downgrading of Greek bonds on 8 December 2009 and Standard and Poor's determination of them being of "junk status" on 27 April 2010 were particularly consequential for the financing position of Athens. As earlier with their reaction to the Far East crisis and US mortgages, the agencies were attacked for their poor forecasting and the pro-cyclical impacts of their announcements. A new debate was prompted in Europe as to their oligopolistic power leading to the question of whether Europe should foster its own agency.

In the changed international environment, the EU response showed uncertainty, but also much division and delay. The collapse of Lehman Brothers saw national governments hang loose and the EU Commission struggled to

22. T.J. Sinclair, "Passing judgement: Credit rating processes as regulatory mechanisms of governance in the emerging world order", *Review of International Political Economy*, Vol. 1, No.1, 1994.

establish a leadership role for itself.[23] A body of commentary soon identified this pattern of diverse responses as being prompted by structural deficiencies in the governance of the Eurozone. The institutional arrangements lacked the capacity for a speedy reaction to events, policy discretion was constrained, and the ability to act centrally was limited.[24]

Faced with the emerging sovereign debt crisis in Greece in the last months of 2009, the EU hesitated. The first reaction was to do nothing and to shift the responsibility –consistent with the German Ordo-liberal view– back to the domestic level. The following February, the Council [under Art. 126(9) TFEU] required Greece to cut its deficit and to correct its divergences thereby "removing the risk of jeopardising the proper functioning of EMU" (16.02.10). Soon afterwards there were press reports of EU governments pressing Greece to double the cuts it had announced thus far. The next stage saw the Commission monitoring the Greek situation. Its stance was more supportive: it confirmed that Greece was abiding by the Council's instructions [COM(2010)91] and that its budget measures were on course (09.03.10). But the bond spreads Greece faced in the markets were signalling that Athens would need a financial rescue. A third chapter saw EU leaders in the European Council at the end of March finally agreeing that there could be a rescue deal –with funding shared one third from the IMF, two thirds from EU governments– but it would only come about if all member states agreed and if all other options had been exhausted (26.03.10). If a bailout did happen, Greek finances and progress would be monitored on a quarterly basis to check that a set of conditions –highlighting targets and reform objectives– were being met. The Papandreou Government had attempted to protect its position by denying it would need a rescue, but one month after the European Council agreed the principle the PM announced that Greece did need to activate the loan that had been envisaged (23.04.10). Tensions rose both in the markets and on the streets of Athens, as protesters feared the austerity conditions to be imposed. George Papakonstantinou, as Finance Minister, told the Greek

23. The Commission did promote its European Economic Recovery Plan in 2008 in response to Lehman. See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0800:FIN:EN:HTML and http://en.wikipedia.org/wiki/2008_European_Union_stimulus_plan.

24. J. Pisani-Ferry - A. Sapir, "Weathering the Storm: Fair-weather versus stormy-weather governance in the euro area", *Bruegel Policy Contribution*, No.3, 2009; P. De Grauwe, "Crisis in the Eurozone and how to Deal with It", *CEPS Policy Brief No. 204*, 15 February 2010.

Parliament in a debate to back a bail-out that: "In less than two weeks, a 9 billion-euro bond comes due and the state coffers don't have this money... As we speak today the country can't borrow it from foreign markets and the only way to avoid bankruptcy and a halt on payments is to get this money from our European partners and the IMF". [05.05.10]

A game of brinkmanship was evident: the Greek government needed to give signals to both its domestic audience, but also to its Eurozone partners. Even then, the final chapter in the first rescue had not been closed: it took a further nine days before EU finance ministers sanctioned the loan. The package was set at €110bn with strict conditions. The uncertainty and delay in the EU acting undoubtedly had driven up the "ante" needed to have credibility to convince the international financial markets that the Eurozone would stand by one of its members.

Chancellor Merkel in Germany had felt under much domestic pressure to be tough on Greece. In the first months of 2010 she had waited for difficult state elections in North-Rhine Westphalia to be completed. She also had to take account of the German Constitutional Court's previous decisions on the legal conditions under which the Deutschemark had been abandoned for the euro which stressed the need for the new currency to be based on stable, disciplined monetary policies. German public opinion reacted badly to the idea of bailing-out Greece, given domestic news reports of Greeks being paid pensions too early and not working long enough. An ordo-liberal instinct eschewed rescuing a state and a society living beyond its means. Yet, ultimately, the governments of Germany and France, in particular, had been faced with the stark choice: bailout Greece or bailout your own banks. A default in Athens at that time would have had a devastating financial effect on the domestic banking systems elsewhere in Europe.

But with the loan, the Eurozone had entered new territory: for the first time, the EU and the IMF would engage in extensive monitoring and tough conditionality vis-à-vis the fiscal management and economic policy of one of its member states. A semi-permanent "Troika" Office was set-up in Athens to police the actions of the state administration. Regular meetings with ministers and officials were established, with teams sent into ministries to investigate procedures and examine "the books". Later, in September 2011, the Troika was flanked by a "Task Force" of the EU Commission, created to help the administration in Athens to identify and absorb more of the structural funds of the EU. Never before had a member state's administration been so penetrated by the EU. The combined monitoring was a major challenge for the EU's reach and capability, as well as for the recipient bureaucracy floundering in its own weaknesses and lethargy. It involved a difficult clash of attitudes and cultures between the two "sides": young, assertive middle-ranking officials from Brussels grilled senior (elected) politicians used to some deference. It was an unknown process that both parties had to work out.

The problems of the Greek state adjusting speedily enough and meeting the tough conditions became evident in spring 2011 as Athens missed the agreed targets. Crucially, it experienced a shortfall in the tax revenue it was raising and the Troika warned it might not be able to sanction the next loan instalment. The tensions in the Eurozone were spreading to other states: the fear of contagion was prominent. By July 2011, EU leaders had faced the inevitable and had agreed that a second Greek bailout would be needed. The new loan was set at €109 billion, it would come with a lower interest repayment rate and a longer period in which to pay it back (fifteen years). Merkel insisted that there should be a new element in this loan: the banks that had lent recklessly to Greece should suffer a hit. "Private sector involvement" (PSI) would mean they took a "haircut", forced to accept they would get less of their money back. At the same time, EU leaders agreed that the "European Financial Stability Fund" (EFSF) they had sanctioned the year before with some €780 billion of funding would be superseded by a larger "European Stability Mechanism" (ESM), with a greater leeway in how it could be utilised. The funds –and their increase– were a recognition that the problems of the Eurozone were no longer confined to Greece and that a bigger war chest was needed to assure the survival of the euro in the face of the market onslaught. Bailouts had earlier been agreed for Ireland (November 2010) and Portugal (May 2011).

But the July agreement began to unravel over the summer. Finland led an initiative to insist that the Greek government should provide collateral for the new loans, the Slovakian Parliament seemed that it might not agree the second bailout, and the political climate in Austria was also very antagonistic. The political clashes and uncertainty increased the speculation on a Greek default. The Commission denied it was preparing for such an eventuality, though German ministers said it could not be ruled out. By October 2011, the EU had edged further towards a second rescue deal but it awaited further assurances from Greece. A European Council meeting scheduled for mid-October was put back by a week. When it met on 23 October, a package for

Greece involving a €100bn-euro loan, a 50% (PSI) debt write-off, and more austerity measures in Greece was negotiated. New uncertainty was immediately introduced, however, by the surprise announcement a week later by Premier George Papandreou that he would ask for a referendum to be called in order to win public backing for the package. His announcement shocked and angered President Sarkozy and Chancellor Merkel, as it introduced a new conditionality into the protracted deal, and they invited him to emergency talks in Cannes just ahead of the G20 summit. Diplomatically, Papandreou was seen as having been humiliated at those talks. The reaction to the referendum idea within Greece was, if anything, even more hostile. The leader of the main opposition party, Antonis Samaras of New Democracy, had refused to say that he would support the deal that had been so long in coming. Parliamentarians within Papandreou's PASOK (the socialist party) and across the parties saw it as a gun to their heads –forced to accept the severe economic measures– and as too risky: the voters might put in jeopardy not only Greece's membership of the Eurozone, but also of the EU. Five days after Papandreou had made his surprise announcement, he told Parliament that he had agreed to step-down and a new coalition government would be formed. At least, he could claim that the referendum initiative had forced Samaras to declare that he would support the second bail-out. Lucas Papademos, a former Vice President of the ECB, became PM of a caretaker government established to implement the immediate measures required before the bailout would be sanctioned. Significantly, the leaders of Greece's two main parties were required to sign written undertakings to the EU Commission that if their parties were in government after the upcoming elections they would abide by the terms of the planned deal.

Greece's financial position had worsened during the long delay in securing the second bailout. Eventually, Eurozone finance ministers agreed (21.02.12) a €130 billion package (co-funded by the IMF and EU governments), which involved further unpopular budget cuts and a bigger PSI "haircut". Holders of Greek government bonds were pushed to accept losses of around 74% on the value of their investments. The arrangement was intended to reduce Greece's public debt by more than €100 billion. The pressure remained on Greece. Commission President, José Manuel Barroso, told the European Parliament in April 2012 that further measures would be needed in Greece after the looming national elections on 6 May. Fiscal retrenchment should prioritise expenditure cuts, rather than further tax rises. A quick recapitalisation of

Greek banks should be concluded by September 2012, in order to facilitate banks' loans to small and medium enterprises. In order to restore cost-competitiveness, nominal unit labour costs in the private sector should be lowered by 15% in the 2012-2014 period. A set of liberalisation measures to improve competitiveness in the Greek economy was listed. Military expenditures –and the potential to buy hardware from France and Germany– was, by contrast, not to be cut. This aside, it was clear that the second bailout was to be underscored by stronger pressure on, and monitoring of, Greece. There was rescue-fatigue on the part of Greece's partners.

Altogether, the 2012 package constituted the biggest sovereign debt restructuring in history. The Commission's own estimates of the support given to Greece put it at some €380 billion, equal to 177% of the Greek GDP, or €33.600 for each Greek inhabitant.[25] The sum included loans, write-downs on loans and EU funds delivered to Greece since the beginning of the debt crisis. The Commission compared this to the Marshall Plan after 1947 which had involved transfers equal to around 2.1% of the GDP of recipient countries. This was somewhat disingenuous as the economic conditions between the two periods were very different, as were the impacts of the Greek austerity measures. The two bailouts resolved Greece's immediate financing needs, but the first and even the second were very unlikely in themselves to revive the domestic economy, which had already been in recession for five consecutive years.

The sovereign debt crises in Greece, Ireland and Portugal –and fears of them spreading to Italy and Spain, which soon proved valid– provoked a new debate on Eurozone governance. Not only had the EMU set-up been found wanting, its institutions had also been obliged to act in ways other than the expected manner. The bailouts themselves had been crafted in a way so as to circumvent the Treaty commitments: it was Eurozone governments, not the EU or the ECB that contributed the two-thirds funding alongside the IMF. At the same time, the European Central Bank had been forced to innovate in its support for governments and the banking systems. The ECB had been established to be even more independent than the Bundesbank, but now its actions seemed to some to be more comprising politically and to be leaning towards the monetisation of deficits.

A patchwork quilt of measures was initiated. The ESM was close to Sarkozy's

25. Euractiv, "Brussels to ask Greece for New Budget Cuts", 18 April 2012, http://www.euractiv.com/euro-finance/barroso-ask-greece-new-budget-cu-news-512227.

preference for a European Monetary Fund. The ESM would be able to help Eurozone states before they needed long-term aid and would be able to recapitalise banks through loans to governments. But the ESM could only act after EU unanimity. In late 2010, the EU Commission proposed six legislative acts to reform EMU governance. What was soon dubbed its "Six Pack" involved strengthening the automaticity of sanctions on errant governments; the possibility of the EU imposing non-interest bearing deposits leading to a fine on member governments; stronger Commission monitoring of debts and deficits; a Commission scorecard of macro-economic imbalances; and the establishment of consistent, clear reporting rules for national governments. In parallel, the EU Council President, Herman van Rompuy, delivered a report on further reforms in October 2010. Each was seen as correcting the gaps left by Maastricht.

Even Chancellor Merkel now used the term "economic governance", alongside President Sarkozy at press conferences. But, in reality, they were largely re-defining the term. An economic "pole" may be being established, but its character was of the stronger imposition of rules and the easier sanctioning of penalties to enforce compliance to "sound money, sound finances" across national governments –pressing them to live up to the obligations foreseen at Maastricht. In other words, it was more of the same, but with a new title: it was not a paradigmatic shift. Indeed, the frame lacked the institutional underpinning of economic governance. It was not clear whether the new fines would be viable in practice, given likely domestic challenges to their legitimacy. Nor was it clear how the *ex ante* validation of national budgets, during what the Commission saw as a budget "semester", would work –especially in the face of a strong domestic political challenge behind a deviant package.

A new "Fiscal Pact" was agreed at a European Council meeting on 2 March 2012 and signed by 25 of the 27 member governments.[26] David Cameron replicated John Major's stance at Maastricht by refusing to sign it –indeed, he had blocked the initiative to have it as a new EU Treaty at a similar summit on 8-9 December 2011– and he was joined by the Czech Government. The new intergovernmental Pact, formally entitled the "Treaty on Stability, Coordination and Governance", faced a ratification process within each signatory state. In Ireland a referendum was called, a vote that was won with some 60% supporting ratification. The intention was for the new Pact to take effect at the start of 2013 if at least 12 states had ratified it.

26. It had been agreed in principle at a European Council meeting on 31 January 2012.

The Pact sought to sanctify the debt and deficit rules. The relevant extracts are given in Fig. 1. Art. 3(ii) committed member states to put into their national laws or constitutions that such provisions be an obligation and that a "correction mechanism" for deviations be established. Art. 4 made it a re-

FIGURE 1

Key Fiscal Pact Provisions: extracts

Article 3 (i) [on debt and deficit rules]:
(a) the budgetary position of the general government of a Contracting Party shall be balanced or in surplus;
(b) the rule under point (a) shall be deemed to be respected if the annual structural balance of the general government is at its country-specific medium-term objective, as defined in the revised Stability and Growth Pact, with a lower limit of a structural deficit of 0,5 % of the gross domestic product at market prices. The Contracting Parties shall ensure rapid convergence towards their respective medium-term objective. The time-frame for such convergence will be proposed by the European Commission taking into consideration country-specific sustainability risks. Progress towards, and respect of, the medium-term objective shall be evaluated on the basis of an overall assessment with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, in line with the revised Stability and Growth Pact.

Art. 8(ii) provided for penalties and fines:
Where, on the basis of its own assessment or that of the European Commission, a Contracting Party considers that another Contracting Party has not taken the necessary measures to comply with the judgment of the Court of Justice referred to in paragraph 1, it may bring the case before the Court of Justice and request the imposition of financial sanctions following criteria established by the European Commission in the framework of Article 260 of the Treaty on the Functioning of the European Union. If the Court of Justice finds that the Contracting Party concerned has not complied with its judgment, it may impose on it a lump sum or a penalty payment appropriate in the circumstances and that shall not exceed 0,1 % of its gross domestic product. The amounts imposed on a Contracting Party whose currency is the euro shall be payable to the European Stability Mechanism.

Art. 11 provided for closer economic policy coordination:
the Contracting Parties ensure that all major economic policy reforms that they plan to undertake will be discussed ex-ante and, where appropriate, coordinated among themselves. Such coordination shall involve the institutions of the European Union as required by European Union law.

quirement that national debt be kept within 60% of GDP. Art. 8(ii) allowed for one government to challenge the fiscal position of another before the Court and the latter could impose a lump sum payment or fine. The closer economic coordination of Art. 11 was designated as a shared learning process, but it also posed a common constraint on the options available.

More radical reform options were off the negotiating table in the on-going European debate. A number of economists urged the adoption of standard operating procedures for independent national monetary regimes: notably, the ability of the ECB to "print money" to help overcome liquidity problems. A parallel idea was to create common euro-bonds, to share the debt and bolster its financing with the credibility of the stronger economies. To criticisms that this would not help with "moral hazard" problems, the Bruegel think tank in Brussels proposed two types of euro-bonds –one for those governments with debt above 60% of their GDP, the other for those with lower debts. Printing money and sharing national debts, however, fundamentally clashed with the ordo-liberal tradition and German opposition made such options off limits. Bigger EU budget transfers –as proposed in the MacDougall Report of 1977 and paralleling the adjustment mechanisms of other federal systems– were also not considered.

Throughout the debt crisis, the EU kept faith with the Maastricht model on EMU. Far more than in 1991, the German government was able to set the terms and impose its leadership. President Sarkozy ceded more ground than had Mitterrand and was less assertive in the cause of economic governance, the most distinctive French position in the 1991 negotiations. The Fiscal Pact –overwhelmingly Chancellor Merkel's initiative– establishes the debt and deficit rules on the strongest legal basis, recalibrating the values set at Maastricht to make the policy constraint tighter.

5. CONCLUSIONS

It is evident that the model of governance established for EMU in the Maastricht Treaty rested on a paradigm of "sound money, sound finances" with its origins in German ordo-liberalism. From that base, the model became vulnerable in the face of a crisis: it lacked the instruments and capability of economic governance –to police, but also to aid. This risk was exacerbated by the shallowness of public legitimation –seen in attitudes towards solidarity, trust, tolerance– that would be needed if re-balancing actions were to be taken. The EU's response to the emergence of the euro-crisis –its uncertainty, division and delays– showed the extent to which it remained locked-in to the Maastricht frame. Even the new Fiscal Pact remains consistent with those provisions, recalibrating and toughening-up the rules. There is a new rhetoric of "economic governance" –redefined since 1990– and a mechanism by which governments should consult their partners, *ex ante*, on any domestic reform initiatives, but this is a provision free of budget transfers and simply facilitates mutual surveillance. The Eurozone is not breaking-free of the Maastricht legacy.

A path dependence akin to what Liebowitz and Margolis termed "Third Degree"[27] is evident: at the initial point of decision: alternatives were rejected (due to Germany's lead) that were accepted as more efficient by others (France, in particular) and the outcome proved sub-optimal for all, especially as the set course was maintained for too long in the light of the new conditions, increasing the adjustment costs.

The path risks an iteration of financial crises –in debt exposure and banking system viability– as "rescued" states are left on a path of austerity and a slow return to growth. Few expect the second Greek bailout to prevent a further re-structuring crisis.

The issues of governance and of solidarity remain to be addressed. The Eurozone has to deal with the risks of heterogeneity, not only of economic performance but of political system: of the weaknesses of domestic state administrations to oversee reform, of social dissensus blocking reform agendas. The Eurozone is now committed to a long-term domestic oversight function in Athens: its capabilities are being stretched like never before. Economically, the calls for a shift of emphasis towards growth, rather than internal devaluation policies, are set to be much stronger. The intellectual debate has shifted, along with public attitudes. The survival of the euro may well depend on the EU adopting a more fulsome economic governance, drawing on neo-Keynesian demand management and mutual support. If not, the euro may face retreat: a split in the Eurozone or a smaller bloc. The flagship policy of the EU –the euro– carries with it much baggage. If the fate of the European project is left exposed to the narrow paradigm of Maastricht, supported by IMF orthodoxy, it may be seriously undermined.

27. S.J. Liebowitz - S.E Margolis, "Path Dependence, Lock in and History", *op.cit.*