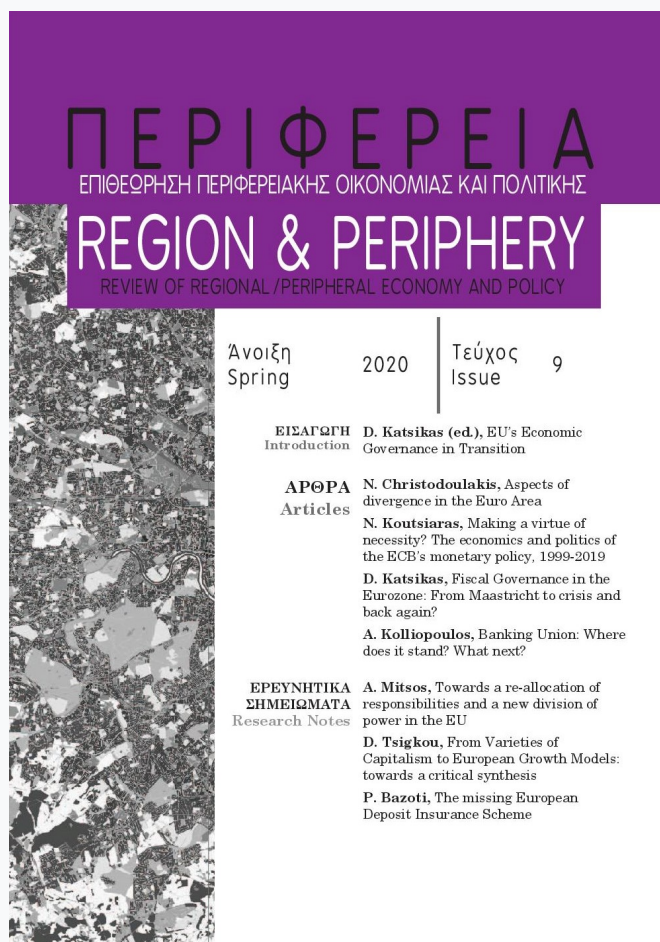


## Περιφέρεια | Regional Integration: Politics, Economics, Governance

Αρ. 9 (2020)

Περιφέρεια | Region & Periphery



### EU's Economic Governance in Transition

Δημήτρης Κατσίκας

doi: [10.12681/rp.24446](https://doi.org/10.12681/rp.24446)

Copyright © 2020, Dimitris Katsikas



Άδεια χρήσης [Creative Commons Αναφορά-Μη Εμπορική Χρήση 4.0](https://creativecommons.org/licenses/by-nc/4.0/).

### Βιβλιογραφική αναφορά:

Κατσίκας Δ. (2020). EU's Economic Governance in Transition. *Περιφέρεια | Regional Integration: Politics, Economics, Governance*, (9), 5–8. <https://doi.org/10.12681/rp.24446>

## **EU's Economic Governance in Transition**

**T**he European Union's (EU) economic governance is in a transitional phase. After the outbreak of the global financial crisis, and in the midst of the eurozone debt crisis that followed, the EU embarked on an ambitious reform effort. Reforms ranged from addressing loopholes and updating regulations in all areas of financial activity, to the strengthening of monitoring and coordination processes for fiscal policy and macroeconomic developments, and from establishing unconventional monetary policy facilities to setting up entirely new institutions, including bailout mechanisms.

The progress made notwithstanding, the reform of EU's economic governance remains incomplete. The main cause for this is the way reforms were designed in the first place. Both the handling of the crisis and the EU's economic governance reform were subject to substantial political pressures. The asymmetrical nature of the shock, where some countries in the periphery of the European Economic and Monetary Union (EMU) suffered a deep economic crisis, whereas countries in the European North went largely unscathed, and the lack of institutional preparedness for such an eventuality, turned the policy responses and the reform effort into a highly political process. Negotiations took place in an increasingly intergovernmental framework, where the states contributing the funds for the bailout of crisis-hit economies had a *de facto* negotiating advantage, which allowed them to determine the terms of both bailouts and reforms.

A key consideration of creditor countries was the issue of moral hazard; i.e. the likelihood that debtor countries would use fiscal solidarity instruments to avoid implementing politically costly, but economically necessary, reforms. The desire to limit moral hazard, itself rooted in underlying ideological and material considerations, dictated the harsh conditionality that accompanied bailout programs, but also the design of reforms, with a view to enhance supervisory and control mechanisms, while minimizing the commitment of resources and the delegation of powers at the supranational level.

The outcome is, unsurprisingly, not satisfactory. Many of the reforms adopted are not considered effective or sufficient, and more ambitious proposals failed to progress. What is more, many of the proposed reforms remain unfinished or incomplete, as economic recovery has weakened the catalytic pressure of the crisis for reform. In view of the widely acknowledged need to complete the reform process, in recent years, the European institutions have put forward a wide array of proposals, often highly ambitious. Unfortunately, the political economy stakes involved remain significant; dealing with the adverse legacy of the crisis for a number of member states, requires further adjustment, which comes at

substantial economic and political cost. The distribution of this cost is a highly political issue, which continues to divide the Union, between risk reducing and risk sharing options. In view of this political economy struggle, the potential for substantial further reform of EU's economic governance seems limited.

This is a problem for the EU because the European economy has not yet fully recovered from the crisis and continues to face many challenges, old and new. The crisis casts a dense and long shadow; its legacy includes non-performing loans, high levels of public debt and output gaps. The crisis' legacy also includes the need for a smooth exit from the loose monetary policy regime, whose adverse impact on individual and institutional (e.g. pension funds) savers and distorting effect on asset prices is starting to be increasingly felt. The new challenge of the coronavirus, now in full swing over Europe is going to deepen these legacy problems and add new ones, particularly as the countries that seem most badly hit at the moment, are some of the countries that also suffered during the Eurozone debt crisis.

In addition, the EU is also facing a number of broader challenges; some of them are linked to global economic competition, such as managing the impact of the US trade dispute with both itself and China, improving the productivity of European economies and promoting the policies necessary for the transition to the 4th industrial revolution; others are linked to long-term structural challenges, like its poor demographic dynamics. These issues need to be addressed in an increasingly Eurosceptic political environment, itself a legacy of the debt and refugee crises. Although the recent European elections did not verify fears of a large anti-European wave, the new landscape does not create optimism for the necessary coalition building to move forward with more ambitious reforms.

The objective of this special issue is to elaborate on these issues by critically examining progress in the ongoing effort to reform the EU's economic governance, in the aftermath of the eurozone crisis. The issue includes four research papers and three research notes dealing with different aspects and debates on EU's economic governance.

The first research article by Nicos Christodoulakis provides the background for the rest of the issue, as it offers an overview of the development of the EMU since the 1990s and examines the asymmetries that led to the crisis. Christodoulakis focuses on what is arguably the most important parameter, the convergence of per capita income among member states, which is after all, one of the fundamental objectives of European economic integration. Christodoulakis shows initially a weakening of the convergence process following the launch of the common currency and later, after the outbreak of the crisis, a reversal of convergence, particularly between the core member states and the old member states of the Southern periphery, which were hit by the crisis and were affected adversely by

the bailout policies that followed. The article focuses on certain key factors -public indebtedness, institutions and investment activity- to account for the polarization between the North and South of the euro area and proposes an EU investment plan as the most effective policy to foster growth and restore convergence.

The next article by Nikos Koutsiaras, offers a detailed analysis of the 20-year old journey of the European Central Bank (ECB) from a bastion of monetary orthodoxy to a qualified lender and investor of last resort. Koutsiaras shows how, despite the ECB's proclaimed independence from political interference, being a stateless monetary authority, effectively has entailed striking political compromises. The political influence of the dominant member states became particularly evident during the crisis. It delayed and constrained the ECB's policy reaction, and prioritized the provision of liquidity to the banking industry. Mario Draghi's later policy reversal, which according to Koutsiaras was only partial, came with restrictions and was in any case, inevitable, given the critical stage to which the crisis had deteriorated and the stern refusal of creditor countries to consider fiscal responses. As a result, ECB's new facilities and unconventional policy initiatives became, unreluctantly, the 'only game in town'.

The third article by Dimitris Katsikas reviews the reform of EU's fiscal governance. Beginning with an overview of the literature, Katsikas shows that determining the optimal level and instruments of fiscal governance in a monetary union of sovereign states is a complicated task; it needs to balance different national preferences and economic idiosyncrasies, allowing enough flexibility to deal with asymmetric shocks, while discouraging fiscal mismanagement, and minimizing spillover effects when it happens. At the same time, it needs to provide the means for effective fiscal management over the business cycle and build the necessary mechanisms to deal with a common external shock. The political compromise that led to EMU did not meet these requirements. Its weaknesses, revealed by the global financial crisis, contributed to Eurozone's deterioration into a second, debt crisis. Creditor countries dictated the provisions of EU's new fiscal governance. Being essentially a reinforced version of the pre-crisis framework, the new fiscal governance has tried to balance conflicting objectives with little success and it is hardly more effective than its predecessor. As a result, the reformed fiscal governance, needs now to be reformed anew.

The final research article by Athanassios Kolliopoulos reviews the progress of the Banking Union, one of the most important reforms undertaken by the EU after the crisis. Kolliopoulos argues that a 'window of opportunity' was opened in 2012, facilitated by both the acute pressure of the debt crisis and a number of political developments in important countries. Initial progress notwithstanding, the completion of the original design has not been an easy task. Following the

establishment of the Single Supervisory Mechanism (SSM) and most of the components of the Single Resolution Mechanism (SRM), progress became difficult as economic recovery eased the pressures for reform, political developments created uncertainty and perhaps most importantly, the remaining reforms and particularly the European Deposit Insurance Scheme (EDIS) came up against the moral hazard issue, as it entails pooling of resources and mutualization of risk. For the moment this obstacle seems insurmountable and further progress seems unlikely.

The first of the research notes, by Achilleas Mitsos reviews the recalibration of policy, institutional and power relations in EU's governance as a result of the crisis. Mitsos describes how new intervening powers have been acquired by 'stealth' in the context of the new governance, as surveillance metrics and policy recommendations have expanded into areas not covered by EU legislation. This trend has been strengthened by the amplified use of conditionality in terms that get increasingly broader. In addition, there has been a major re-balancing in terms of decision-making institutions; the European Council has emerged as the dominant European decision-making organ, marginalizing the European Parliament and transforming the role of the Commission into an implementation service. This 'new intergovernmentalism' may be the most lasting legacy of the crisis.

The next research note, by Dimitra Tsigkou reviews the recent comparative political economy literature and the debate between the Varieties of Capitalism (VoC) and Growth Regimes theories. Tsigkou describes the different arguments, which are particularly relevant for the design of EMU's economic governance, given that the outcome of this debate may provide answers to the quintessential question of how to create a successful monetary union whose member states belong to very different models of capitalism. Tsigkou believes that some form of 'epistemological bridge-building' between the theories could improve our understanding of Eurozone's predicament.

The final research note, by Pery Bazoti examines in more detail the politics of the Banking Union's missing link, the European Deposit Insurance Scheme (EDIS). Bazoti describes the bank-sovereign 'doom-loop' and the moral hazard issues that constitute the justification and obstacle to EDIS' completion respectively. Bazoti goes on to explore different policy proposals on the institutional design of the EDIS, in order to limit the potential of moral hazard abuse. Bazoti concludes with some thoughts on the prospects of completing the EDIS; in her view unless rules are introduced to limit moral hazard to the satisfaction of Germany, further progress should not be expected.

**Dimitris Katsikas**, *Assistant Professor,  
National and Kapodistrian University of Athens*