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Socio-Legal Reflections on the Eurozone's Crisis Management Strategy

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Abstract

The aim of this study is to examine from socio-legal perspectives the state of play in respect of the Eurozone crisis and the EU's ability to resolve it through austerity, fiscal consolidation and the enforcement of coordination among members to meet agreed fiscal goals. How effective is the Eurozone's crisis management strategy of increased coordination, increased surveillance by the Commission and the introduction of binding rules to impose fiscal discipline? Are these measures an adequate substitution for absent EU fiscal powers? Are they sufficient to restore growth and arrest the slide in support for EU economic governance? The paper argues that the EU will continue to lose support unless it places citizens at the centre of its policies and acts swiftly to restore trust in EU institutions.

Key words: *Eurozone crisis, fiscal powers, austerity, lack of trust, governance*

1. Introduction

For some years Europe has endured a multidimensional crisis of unprecedented proportions in the post-war period. Sovereign debt, financial and banking stress, economic recession and unemployment have resulted in contagion, widespread economic malaise and social and political instability in many member states of the Eurozone.

Economic and monetary union based on 'a one size fits all' approach has proved sub-optimal. There is insufficient EU competence over spending and budgets to complement the EU's monetary powers. The EU has responded with a crisis management strategy based on more coordination between the member states to meet agreed financial targets, increased surveillance by the Commission over national spending, and the introduction of binding rules to impose fiscal discipline. But are these measures sufficient to restore growth and prosperity in the EU?

The Eurozone is beset with disagreement, which is eroding trust. There are many cleavages and sites of disagreement within the Eurozone including: the necessity for austerity; debt mutualisation or *Eurobonds*; the legality of Outright Monetary Transactions (OMT); and the need for a program of Quantitative Easing (QE) such as that recently introduced by the European Central Bank (ECB). Solidarity among the member states of the EU is not in evidence. All the while, negative sentiment for austerity and deepening economic distress are playing into the hands of populist, anti-EU political parties, increasing political instability.

While the Eurozone needs growth and stability, to date the EU's current policies have not been conducive to either. This paper will assess the effectiveness of the crisis management strategy from socio-legal perspectives.

2. Literature Review

Scholars have sought to ascribe a label to the EU for some time, to bring it within one theory or another of European integration, but this endeavor has been problematic as the EU does not readily conform to established constitutional forms. The EU may be described as a constitutionalised system of interest mediation between different levels of governance within a quasi-federal paradigm (Longo 2006). While federalist theory may be a starting point for discussions about the future form of the EU (Burgess and Gagnon, 1993; Burgess, 2000), the EU is fundamentally contested. Some realist scholars have viewed the EU simply as a product of intergovernmental bargains in the European political regime; the expression of the preferences of powerful member states (e.g. Moravcsik 1993, 1995, 1998, 2002; Garrett 1992, 1995). Others, chiefly neofunctionalists, depict the EU in a continuum. Driven by processes beyond national choices and preferences, the establishment and refinement of EU policy competence in one area ultimately widens the integration process by 'spilling over' into another related area of policy (Hass 1958; Stone Sweet and Sandholtz 1997). The historical indeterminacy surrounding the EU's constitutional identity and status is only one aspect of the problem. As a *sui generis* construct, a hybrid between a nation state and an international organisation, the EU's actions and practices defy interpretation according to statist methods using ordinary tools of political science. Thus the Eurozone crisis has been extremely difficult to read, as the Group has implemented a crisis management strategy that has at times confounded outsiders. The development of the Eurozone crisis and its purported solutions are a reflection, perhaps a symptom, of the EU's status as a hybrid entity - neither here nor there on the spectrum of political organisation.

If neofunctionalism holds true as a theory of European integration we can expect to see the deepening of European governance in the field of fiscal policy to complement the powers the EU has acquired in respect of monetary policy. At the heart of the neofunctionalist logic of European integration is the idea of economic determinism. Marquand (2011, p.106) has characterised this as the idea that 'integration would spread ineluctably, like an inkblot, from one policy domain to another'. Even so, this would not disprove the validity of intergovernmentalism since it may also ultimately be in the interest of powerful states to conclude bargains that confirm supranational powers in the area of fiscal policy. This is to acknowledge a convergence between the interests and preferences of member states and the need for deeper integration. This alludes to another theory, social constructivism, which traces the transformative effects that European institutional interactions and practices have on the processes of preference formation in the EU. This theory directs research 'at the origin and reconstruction of identities' (Christiansen, Jørgensen and Wiener 1999, 538); it recognises the constitutive role that norms, rules, discourse, learning and deliberative processes play in the formation of actors' interests.

All of these theories can act as predictive tools to help us to map the likely trajectory of European integration in the area of fiscal policy. It must also be said that the existence of mediating factors such as citizen opposition can interfere with elite decision-making. In other words, citizens *can* derail the integration process. Many parties on the far-right of the political spectrum who denounce the EU and globalisation are striking a chord with many voters whose sense of insecurity has grown as the crisis has deepened. A loss of support for the EU raises fresh questions about the EU's legitimacy. A EU which is not seen as fully legitimate in the eyes of its citizens will not find it possible to implement necessary solutions to the crisis, especially if those solutions involve the expansion of the EU's powers into the sensitive realm of fiscal policy – spending and taxation (see Longo and Murray 2015, forthcoming). The Eurozone crisis is ultimately a crisis of legitimacy.

The legitimacy of EU governance has been notoriously difficult to pin down. Of itself a difficult concept, by virtue of its shifting and contested nature, the difficulty has been compounded by lack of agreement as to the EU's legitimate objects. Scholars have explored the many permutations and patterns of legitimacy as understood to apply to the EU (Banchoff and Smith, 1999; Steffek, 2000; Lord and Magnette 2004; Longo 2006). For present purposes it suffices to say that legitimacy is a complex, multi-dimensional concept that demands to be contextualised, constantly assessed and justified. For current purposes, legitimate powers are those exercised in ways that invoke acceptance by citizens. The degree of public contestation in the EU suggests that many citizens in Greece, France, Italy, among others, are not viewing the EU's actions and policies with respect to the Eurozone crisis as legitimate.

3. Methodology

The focus of this paper is neither exclusively legal nor political science. The debates over the EU's crisis management strategies draw on traditional and contemporary theories, understandings and explanations within both these disciplines. Accordingly, the investigation gives rise to a number of conceptual questions that invite an interdisciplinary approach, an approach that assumes convergence between law and political science in the study of the EU (see for example Dehousse, 2002; Longo, 2006). The methodology is informed by concepts and theories such as constitutionalism, legitimacy, neo-functionalism, intergovernmentalism, federalism and social constructivism.

To seek the explain the Eurozone crisis in purely economic or legal terms – solely as a failure of economic governance or of institutional shortcomings respectively – would be to misunderstand the nature of the problem as purely technical. The Eurozone crisis has serious social and political impacts and therefore the crisis demands to be understood from multidisciplinary perspectives.

3.1 Research Questions and Data

The specific questions addressed in this paper are as follows: are the EU's crisis management strategies effective in restoring stability, growth and prosperity to the Eurozone; if not, what needs to happen to improve the effectiveness of the strategy; what are the obstacles to further integration; can citizens derail further European integration? In this paper I engage in critical analysis of legal instruments and political developments within a theoretical framework to posit answers to these questions. Eurobarometer survey data will also be employed to support claims relating to citizen perceptions of the EU and its institutions.

4. Discussion

4.1 Contextualising the Problem

The EU evidences a regulatory approach. It has quite extensive powers of regulation in policy areas covered under the Treaty on the Functioning of the European Union (TFEU). Its powers are directed towards the harmonisation or approximation of member state laws through legal instruments such as regulations and directives. By the same token the EU has limited powers of redistribution. The EU has competences or power to the extent that member states have agreed to assign such power to the EU. The history of the EU is therefore a history of expansion, specifically the expansion of competence in policy areas as agreed by the member states.

External factors have always contributed to new waves of European integration, as the EU has sought to make the most of fresh potentialities originating from beyond its borders. The end of the cold war, punctuated by the fall of the Berlin wall, created conditions receptive to a strengthening of the single market, monetary union and enlargement. It is also true that internal factors such as the charismatic leadership of former Commission President, Jacques Delors, and possibly the spillover effect from one policy area to another (captured by the theory of neo-functionalism) gave impetus to the new integration program with monetary union at its core. It was the convergence of member state interests, and interaction between those interests and global factors, that led to the single market and then monetary union. Even if the EU's systematic expansion of reach can be explained by a neofunctionalist logic, it does not rule out the validity of intergovernmentalist explanations of European integration in that the expansion of competences was the result of intergovernmental bargains. In turn, it is thought by many that monetary union demands fiscal union, for without it monetary policy cannot correct macroeconomic imbalances. This outcome too is predicted by the theory of neofunctionalism.

The recent events following the near collapse of the international financial system and the global recession, manifested in Europe by the enduring Eurozone crisis, are generating a need for further change. It was thought by policymakers that the sovereign debt crisis that commenced in Greece and spread to other members of the Eurozone – Ireland, Portugal, Cyprus (some would add Spain and Italy to this list) – was the consequence of careless spending and a failure to comply with fiscal rules set out in the Stability and Growth Pact (SGP). The reality is that there are different reasons for the blowout of debt in different countries. The worst effects of the Global Financial Crisis (GFC) were managed through stimulus spending while the near collapse of banking sectors in countries such as Ireland and Spain necessitated bank bailouts, which have significantly contributed to public debt. To creditor countries the crisis demonstrated the need for fiscal rigor in the Eurozone. Strict new rules would be implemented through the Fiscal Compact and the European Commission would ensure, through heightened surveillance of member state budgets, that the rules were complied with. Fiscal consolidation was to be accompanied by structural reforms to improve the business environment and austerity to balance the books. Having implemented these rules systematically since the emergence of the crisis in 2010, the Eurozone is still struggling to emerge from repeated recessions; growth is stagnant; social unrest is increasing and populist political parties are winning electoral support across Europe.

At the height of the crisis the smaller member states (Greece, Portugal, Ireland) experienced very rapid deterioration of their finances, necessitating bailouts. The larger states (Spain and Italy) held on tenaciously and rode the initial storm until the ECB came to the rescue in 2012 with its carefully chosen words to save the euro 'whatever it takes' and matching instruments. The announcement of a new government bond purchasing program – the OMT – by the ECB marked a turning point in the crisis, giving rise to renewed market confidence in debtor states which has largely persisted to this day. Positive market reaction to the OMT program made it unnecessary to use the program as the spreads between the interest rates on bonds of both Italy and Spain on the one hand and Germany on the other narrowed sharply. Nonetheless, the crisis continues to rumble on, much like a recently active volcano now in a less active, but still threatening, phase. So how effective have the EU's crisis management strategies been and where is the Eurozone heading?

4.2 Economic Solutions to the Crisis Depend on Political Considerations

Political instability, economic recession, unemployment, ballooning debt, financial and banking stress can all contribute to a worsening of conditions bringing on crisis and contagion. Thus, if a larger state becomes caught in a deflationary debt trap, and economic conditions deteriorate causing further political instability, what is to prevent the euro crisis from returning with a vengeance? Markets have demonstrated just how quickly they will respond to negative economic data and downgradings by rating agencies. If the OMT were to be used, German tensions could boil over. It would be unwise to underestimate German societal opposition to transfers and the effects of a renewed crisis on Germany's own anti-euro political party, *Alternative for Germany*. The party is already angry about the part Germany has played in what it sees as illegal German bailouts of undisciplined debtor states in Southern Europe. Even if optimal functioning of economic and financial systems demands integrative solutions, those solutions may never see the light of day if citizens in powerful member states are opposed to them.

The EU project is still perceived by many Europeans as elite driven. Recent developments – for example, the failure of referendums in France, the Netherlands and Ireland to ratify European initiatives to advance European integration – suggest that while the legitimacy of EU governance is being questioned there may be little public support for an expansion of EU policy competence into policy areas traditionally within the competence of nation states. As unemployment blows out, social unrest intensifies and casts further doubt on the EU constitutional value of solidarity. There have always been doubts as to whether EU solidarity carries any meaning for ordinary Europeans or whether union remains an elite-inspired aspiration. Certainly, the continuation of the crisis erodes trust among Europeans. With the erosion of trust in the EU comes greater opposition to EU governance generally. This discussion is relevant to the question of proposed solutions to the Eurozone crisis because the viability of certain solutions depends as much on political as economic considerations. A EU whose legitimacy is contested and whose institutions evoke distrust will struggle to advance its agenda because the EU relies on the political cooperation of its member states. If anti-EU political parties become governing parties or it they begin to influence political choices (arguably political influence is already apparent) towards the repatriation of national powers, then integrative solutions may be sidelined in favor of protectionist or related policies. Political forces can impact upon the choice of economic policies to do with distributional conflicts.

Trust in institutions is essential to the legitimate exercise of power and power may be considered legitimate if it is believed to be legitimate. It appears an obvious truth that the validity of the order itself may be constituted by the 'subjective belief in the validity of the order' (Weber 1978, 33; Steffek 2000, 3). If this is correct, it may be fruitful to survey public commitment to European integration. It seems self-evident, as intimated above, that if citizens do not trust EU institutions they will not countenance the transfer of further sovereignty to those institutions. Standard Eurobarometer results for Spring 2014 indicate that the unpopularity of the European institutions has reached record highs (Eurobarometer 81, Spring 2014a, p.88). Less than a third of Europeans (32%) expressed trust in the European Commission and the European Central Bank (31%) in Spring 2014 (Eurobarometer 81, Spring 2014a, pp.88-89).

5. Conclusions and Recommendations

As suggested in this paper, there is considerable doubt as to the EU's future directions. Monetary union is flawed, while the mechanisms available to nation states to adjust for falling competitiveness and low consumption (e.g. currency devaluations and interest rate management) are no longer available to members of the Eurozone. Austerity has negatively impacted growth and aggravated the fiscal imbalances and loss of competitiveness in some states. There is uncertainty as to how the Eurozone crisis will be resolved. The crisis has increased pressure for greater regulation and a true single market in financial services.

According to the tenets of neofunctionalism, a degree of fiscal union might have been expected to follow from monetary union. However, European citizens are not currently receptive to their countries giving more power to the EU. French and Dutch referendums on the Constitutional Treaty in 2005 put a brake on the explicit process of constitutionalisation of the EU (Longo, 2006). The crisis has hardened anti-EU sentiment and opposition toward the EU among citizens as austerity has become associated with economic demise and pain

(Longo and Murray 2015, forthcoming). The crisis is further testing European solidarity and unity. Whether it will encourage protectionism; whether it will diminish or give impetus to further integration are open to conjecture. On the political union front, Europeans may not see how political union may be gained without giving up more of their national sovereignty and they do not currently appear ready to do so. The EU wants to speak with one voice on the crisis, but instead division is conspicuous.

The Eurozone members have different strengths, weaknesses and potentialities and the crisis has increased divergence between them. Some members are doing extremely poorly while others are doing reasonably well or better. Yet Eurozone monetary policy is a one-size-fits-all policy and macroeconomic imbalances have worsened. It is evident that fundamental changes will be necessary if *all* states are to prosper within the currency union. The current approach to crisis management does not appear to comprehend that some of the economic problems experienced in some member states are being exacerbated by the EU's choice of economic policies. Moreover, while some solutions have been vigorously pursued despite evidence of failure (e.g. austerity) others have not been properly assessed for political rather than economic reasons (e.g. debt mutualisation) (Longo and Murray 2015, forthcoming).

Having established a currency union, it may be argued that a single state cannot insist on measures that promote its own national interests to the detriment of other member states. It is incumbent on policymakers to work towards outcomes that achieve optimal outcomes for all or, arguably, to adjust for differentiated outcomes through transfers. Before the introduction of the euro there was considerable concern that a single currency would not work in a community of diverse states with control over spending. These concerns were inadequately addressed. Policymakers nonetheless pushed ahead with the currency. In response to a crisis that became entrenched because of the lack of convergence between, and the structural deficiencies within, member states as well as the failure of EU policies to redress imbalances, the EU has proposed solutions that have fallen short of the solutions that markets might have expected of a currency union. It is thought by some that monetary union is unable to function optimally without a degree of debt mutualisation and a real banking union – both present in nation states. If economic governance is proving problematic, policymakers are obliged to fully consider all options, facilitating debate on alternative solutions, including integrative solutions. Instead, the EU has adopted a suite of half measures to strengthen coordination and surveillance of national budgets without fostering debate on difficult (yet important) questions such as joint liability and redistribution.

There are conditions in the EU that currently seem to preclude the adoption of innovative integrative solutions to the crisis. These settings include the current institutional arrangements of the EU and the impossibility of achieving a democratic mandate to act decisively and boldly; the absence of a social dimension to European integration; and the likelihood of challenges to the legality of innovative integrative action.

Members of the German Parliament, academics, NGOs and Eurosceptical citizens have proved ever willing to bring legal actions against EU institutions for going beyond the limits set out in the TFEU and breaching German constitutional law. The OMT program is either opposed or viewed with suspicion by many German policymakers and bankers. Doubts as to the legality of the program have given rise to legal proceedings. In a decision on 7 February 2014, the German Constitutional Court raised concerns that the OMT program exceeded the mandate of the ECB, which is restricted to the area of monetary policy (BVerfG, 2 BvR 2728/13 at paras. 63, 69), and referred the matter to the European Court of Justice (ECJ) for a preliminary ruling under Article 267 of the TFEU (*Gauweiler and Others*, ECJ Case C-62/14 (pending). Similar proceedings may be instituted against the ECB's January 2015 decision to institute a program of Qualitative Easing (QE). While it is expected that the ECJ will decide in favour of the OMT program, the institution of repeated legal proceedings by German citizens is yet another indication that there are very real domestic pressures on EU integrative action.

The Eurozone crisis and the response to it have produced conditions inimical to integration, exacerbating division and existing cleavages in the Eurozone as the following concluding points illustrate.

1. While the Eurozone needs public investment in infrastructure and public services, states have, in response to austerity, reduced funding for these essential services with the result that citizens have to take on more of the costs themselves, further dampening consumption and adding to deflationary pressures. This ensures that the costs of a poor policy choice are passed onto struggling citizens and that it rebounds strongly onto already struggling economies and political institutions.
2. There has been inordinate focus on market reform to make labor markets more flexible by loosening the rules of hiring and firing as well as keeping a lid on wages. Whether such reforms will have a positive effect in Eurozone economies is debatable but any positive effects will not be immediate. Nonetheless, EU policymakers see market reforms as a panacea for what ails the Eurozone. In this environment social unrest and political insecurity are increasing. There is evidence for this in recent voting trends in European Parliament (EP) elections where populist political parties made significant gains in France, the United Kingdom, Italy and elsewhere. It appears clear that what Europe needs most in the short term is growth and investment rather than austerity. The risk for many countries is that populist movements will mobilise support against governing parties for their acquiescence of austerity – a dysfunctional policy – imposed by Berlin and Brussels.

3. A continuing poor growth outlook for 2015 suggests that Europe is now in real need of fiscal expansion. Still, this premise is not universally accepted. The ECB's decision to commence a program of QE was met with varying degrees of hostility in Germany. Internal division among member states and within the ECB means that the Eurozone is obliged to implement suboptimal negotiated compromises. The Eurozone crisis has had a back-story of disagreement between economies demanding growth and others insisting on fiscal consolidation.

The uniform application of one policy for all the Euro area has produced turbulent results. The Eurozone arguably needs a differentiated policy response from Brussels to meet the specific requirements of member states with vastly different economies. Member states of the Eurozone are unable to make adjustments to monetary settings to regain lost competitiveness. They have given this up. Unfortunately, monetary policy in the EU is suboptimal. Centralised monetary policy requires the coordination of fiscal policies to meet common objectives but it also needs mechanisms to ensure that the interests of all member states are secured by the policies advanced by the strongest states. This may include the power of redistribution to remove the disadvantages that currently appear to be associated with monetary union. The Eurozone has thus far side-stepped these important debates.

The EU appears to be searching for solutions to complete economic and monetary union, on the one hand giving credence to neofunctionalism which predicts spillover from one policy area (e.g. monetary policy) to a related policy area (e.g. fiscal policy). However, the choices and preferences of member states do not currently converge towards the accretion and consolidation of supranational power in the fiscal policy area. Citizens in Germany and other creditor states do not currently countenance the idea of debt mutualisation or transfers to debtor states, despite mounting evidence that the debt load of some members is unsustainable and that membership of the Eurozone constrains the ability of debtor states to deal effectively with some problems. There is little evidence of solidarity among the members of the Eurozone, which is divided like never before (Longo and Murray 2015, forthcoming).

Citizens have indicated in the recent past that they will not merely rubber-stamp elite decisions that effectively transfer sovereignty to EU institutions, while trust in those institutions is at an all time low. The outcomes of referendums and elections provide support for this contention, as do recent Eurobarometer surveys. If EP election results in May 2014 and Greek election results in January 2015 are indicative, the failure of the EU to respond to citizen concerns about the demise of national economies will find its way onto the political agenda whether the EU approves or not. The EU's legitimacy will ultimately be confirmed or denied by citizens. This conclusion demonstrates how important it is for EU policymakers and national institutions to respond to citizen concerns, to restore trust in EU institutions, and to include citizens in their deliberations on European integration.

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