

Nicolas Jabko

Which Economic Governance for the European Union?

Facing up to the Problem of Divided Sovereignty

Nicolas Jabko

Which Economic Governance for the European Union?

Facing up to the Problem of Divided Sovereignty

- SIEPS 2011:2 -

Report No. 2
March 2011

Publisher: Swedish Institute for European Policy Studies

The report is available at
www.sieps.se

The opinions expressed in this report are those of the author and are not necessarily shared by SIEPS.

Cover: Svensk Information AB
Print: EO Grafiska AB
Stockholm, March 2011
ISSN 1651-8942
ISBN 978-91-86107-24-6

Preface

The global financial crisis and the subsequent eurozone debt crisis have revealed several flaws in the governance structure of the Economic and Monetary Union (EMU). The current governance system exhibits clear asymmetric features, with a common monetary policy at the EU-level while economic policy is still in the hands of national governments.

In order for the EU to better tackle future crisis, European leaders now seems determined to reform the current system by strengthening the coordination concerning certain aspects of economic governance of the EMU which gives rise to a number of questions concerning, not least, sovereignty.

In this report, Professor Nicolas Jabko explores the critical issues of economic governance by tracing the origins of the problem and the quest for a stronger economic governance structure at the EU-level. The report highlights some of the key political obstacles that must be resolved. Derived from the current political discussion, the author considers three crucial problem areas for establishing stronger economic governance in the short term. In doing so, this report is not only timely but also constitutes a highly policy relevant contribution to the discussions ahead.

Stockholm, March 2011

Jörgen Hettne

Acting Director

SIEPS carries out multidisciplinary research in current European affairs. As an independent governmental agency, we connect academic analysis and policy-making at Swedish and European levels.

About the author

Nicolas Jabko is Associate Professor of political science at Johns Hopkins University and at Sciences Po-Paris. He has been a member of the political science department at Johns Hopkins since 2011. After receiving his PhD from UC Berkeley in 2001, he joined the research faculty at Sciences Po-Paris, where he retains a secondary affiliation. He is the author of *L'Europe par le Marché: Histoire d'une stratégie improbable* (Presses de Sciences Po, 2009) and *Playing the Market: A Political Strategy for Uniting Europe, 1985-2005* (Cornell University Press, 2006), and co-editor of the 8th volume of the *State of the European Union* series (Oxford University Press, 2005). His current research deals with the evolution of the state and democracy in the age of economic liberalization.

Acknowledgements

I would like to thank Sverker Gustavsson and an anonymous reviewer for their feedback on an earlier version of this report, as well as the many officials who granted me anonymous interviews and helped me understand actors' motivations on the topic of economic governance.

Table of contents

Executive summary	7
1 The second wind of <i>gouvernement économique</i>	10
2 A state of the art on economic governance.....	15
2.1 Economic governance as a tractable problem	15
2.2 Economic governance as a critical problem.....	18
2.3 Dilemmas of sovereignty and the split personality of the euro area	21
3 The elusive <i>gouvernement économique</i> of the euro	25
3.1 Groping for a new vision of sovereignty.....	25
3.2 The reemergence of a French aspiration.....	29
3.3 The global financial crisis as a spur for economic governance.....	35
3.4 Europe's debt crisis as a crisis of economic governance	39
4 What next.....	45
4.1 Why the status quo is not tenable.....	45
4.2 Toward a crisis-proof economic governance structure for the EU	47
Sammanfattning på svenska.....	55
References.....	58

Executive summary

For a long time, successive French governments were a voice in the wilderness in favor of stronger economic governance (*gouvernement économique*) within the European Union. In February 2010, however, German Chancellor Angela Merkel mentioned for the first time the necessity of a European economic government (*Wirtschaftsregierung*). Merkel's unexpected rapprochement with President Nicolas Sarkozy gave a second wind to the notion of *gouvernement économique*, yet the path to stronger economic governance remains elusive. The main difficulty today no longer stems from lingering French-German disagreements, but from an originally unforeseen conflict between national sovereignty and a new conception of sovereignty that called for its exercise at the European level. Sovereignty over Europe's Economic and Monetary Union is fundamentally divided – monetary policy is unified at the EU level, yet most other powers remain firmly in the hands of national governments.

In fleshing out this argument, this report considers critical issues of economic governance from the perspective of sovereignty in the European Union and highlights key political obstacles that must be surmounted if these issues are ever to be addressed in a satisfactory manner. Far from being new, the problem of economic governance emerged with the origins of the euro at the time of the Maastricht Treaty – and it has nagged policymakers ever since.

The report begins by reviewing the existing literature on economic governance. Despite the fact that French politicians have talked about *gouvernement économique* for many years, there are few academic and policy papers fleshing out the notion in concrete terms. Some scholars have envisioned the problem of economic governance as a tractable problem that would be resolved over time. Others have considered economic governance as a critical problem that could undermine the very existence of the euro. The report highlights both the lessons and the shortcomings of this literature. While the second interpretation has become more salient over time and especially since 2008, the literature suggests no magic formula to strengthen the European Union's economic governance without further encroaching on the economic sovereignty of its member states.

After reviewing the literature, the report dissects political actors' aspirations for a *gouvernement économique* as they have manifested themselves since the origins of the euro. It interrogates the remarkable resilience of this aspiration, not only within but increasingly beyond French political circles. Europe's political leaders started groping for a more collective way to exert their sovereignty at a time when the European Monetary System was periodically the object of speculative attack and when many member states resented the dominance of the German central bank in monetary policy. Until 2010, however, the longstanding French aspiration to stronger economic governance seemed like a non-starter at the EU level. German political leaders were especially critical of *gouvernement économique*, suspecting the French of a desire to curtail the independence of the European Central Bank. Yet the global financial crisis acted as a spur for new political initiatives on economic governance. As early as the second half of 2008, the French presidency of the EU pushed for an orderly European response to the banking crisis and to the risk of a Europe-wide recession. By 2010, the sovereign debt crisis revealed a crisis of economic governance within the euro area and led to a flurry of new initiatives.

The question now is whether member states are ready to continue moving toward greater sovereignty at the EU level, or whether they will want to reassert the national locus of sovereignty. Assuming that the member states will not want to jettison the euro, the report concludes with policy guidelines toward a more crisis-proof economic governance structure at the EU level. It starts by explaining why the current status quo of sovereignty divided between the EU and the member states in the governance of the euro has become increasingly untenable. The Greek and then the Irish debt crises have demonstrated that the euro area is not immune from a major crisis of confidence that would cut access to capital markets for its most vulnerable member states and potentially spread across the region. The challenge at this point is to shift toward an economic governance model that is realistic for the member states to adopt, yet bold enough to convince financial markets that the EU has found a credible development scenario for its Economic and Monetary Union.

The report considers three boundary conditions that dictate clear guidelines for establishing stronger economic governance in the short term. First, the

member states are not willing to hear of any kind of transfer union. This dictates that member states must find better ways to enlist the support of financial markets for debt consolidation and fiscal discipline. Second, the member states are reluctant to delegate more power to Brussels. This implies that the debt consolidation framework must be externalized to non-EU bodies or independent European agencies as much as possible. Third, the member states are reluctant to see their autonomy curtailed. Any new economic governance framework must therefore give as much say as possible to governments in the decision-making process, in order to foster ownership of potentially painful decisions by all euro-area governments.

The above guidelines are no panacea to resolve the deep problem of divided sovereignty within the euro area. The newly found discursive consensus in favor of stronger economic governance will be tested, and it may not survive under stress. At that point, more radical action may become necessary. In the long run, a need to rebalance divided sovereignty within the EU is almost certain to emerge. If they want the euro itself to survive, the member states must be prepared to put their money where their mouth is.

1 The second wind of ***gouvernement économique***

Today's widespread calls for stronger European economic governance are anything but new. Since the early days of the euro, all French political leaders up to Nicolas Sarkozy have championed the notion of an “economic government” (*gouvernement économique*) at the level of the European Union. In this vein, Sarkozy declared at the European Parliament that “the euro area cannot keep working without a clearly identified economic government” (Sarkozy 2008, my translation). For a long time, however, this longstanding French aspiration seemed like a non-starter at the EU level. German political leaders were especially critical of *gouvernement économique*, suspecting the French of a desire to curtail the independence of the European Central Bank. In the face of a sovereign debt crisis in the euro area, this situation has changed quite dramatically. In February 2010, German Chancellor Angela Merkel mentioned for the first time in public the necessity for the heads of state and government to act as an economic government (“*Wirtschaftsregierung*”) of the European Union (Merkel and Sarkozy 2010). In March 2010, the European Council asked its president Herman Van Rompuy to lead a high-level taskforce on the topic. On October 21, 2010, the taskforce published its report, titled “Strengthening economic governance in the EU” and promptly endorsed by the European Council on October 28-29. The member states are now discussing the contents of a potentially far-reaching “competitiveness pact” – an initiative jointly introduced at the European Council by Germany and France on February 4, 2011.

There is no doubt that the sovereign debt crises of 2010, starting with Greece, considerably raised decision-makers' awareness of the shortcomings in the economic governance of the euro area. But in a sense, it reasserted a problem that had always been known and recognized, despite important nuances, in many European policy circles – not only in France. Signed by all member states, the Lisbon Treaty (and before that the EU constitution) formally recognized the need for an “ever-closer coordination of economic policies within the euro area” within the framework of the so-called Eurogroup (or “Euro Group”, in the official designation of the treaty's “Protocol on the Euro Group”). When Jean-Claude Trichet expressed,

concerning the Irish crisis, the need to give flesh to the “E” in EMU (Economic and Monetary Union), he expressed a concern widespread not merely among the French but also and even within the confines of Europe’s independent central bank. As early as 2000, Tommaso Padoa-Schioppa, a former Commission official who would move to the European Central Bank before becoming Italy’s finance minister, had written about the “institutional loneliness” of a completely federalized central bank within the framework of an incompletely federalized European Union (Padoa-Schioppa 2000, p. 37). Going back to the pre-history of the euro, even the toughest critics of European monetary unification within the German central bank kept repeating that there could be “no monetary union without political union” (Marsh 1992, ch. 9). Thus, the idea of strong economic governance was neither new, nor merely a French obsession. Economic union was originally conceived as complementary to monetary union – even amongst actors who were most suspicious of French intentions and least supportive of the move to a single currency.

Why have EU member states, especially France, championed stronger governance arrangements in this area of economic policy coordination? And why does it remain an uphill battle in view of the widespread recognition that stronger economic governance is needed? As I argue, the puzzling gap between the resilient aspiration for and the embryonic nature of *gouvernement économique* must be understood against the background of the original motivations for Europe’s Economic and Monetary Union. The aspiration of stronger economic governance remains both alive and in limbo because of a largely unforeseen contradiction between the longstanding concern for national sovereignty and a new conception of sovereignty that called for its exercise at the European level. France’s attitude toward economic governance is probably the epitome of this contradiction. Successive French governments consistently saw the euro as a way to counteract the loss of sovereignty that they felt was occurring in the 1980s, and yet French officials were never prepared for a complete delegation of sovereignty to the European level. Current and future controversies about the “competitiveness pact” and the future shape of economic governance of the euro area must be interpreted in this light. The fact that Germany, France and other EU member states have different views of what should be included in this pact is arguably not the main difficulty. More importantly, the introduction of genuinely strong

European economic governance may have a considerable impact on core areas of *national* economic governance, such as tax policies, labor laws, or pension financing schemes.

This unresolved contradiction goes to the heart of the institutional architecture of Europe's Economic and Monetary Union (EMU). Although the integration of Europe is often described today in official EU language as an example of "pooled sovereignty" – a term borrowed from the scholarly literature on the EU (see especially Keohane and Hoffman 1991, Keohane 2002) – the reality on the ground is much more complicated. A pooling of sovereignty would imply a contractual and potentially reversible delegation of powers by member states that remain sovereign yet forego their veto power in the interest of international cooperation. In the case of the EMU, however, it cannot be said that sovereignty is so neatly pooled at the EU level. Fundamentally, this is a case where sovereignty is *divided*. On the one hand, the transfer of sovereignty goes far beyond "pooling" in the area of monetary policy. Powers are clearly unified at the EU level within the European System of Central Banks. On the other hand, many other economic policy powers – especially fiscal policy – remain for the most part national prerogatives. Although many European leaders aspire to stronger economic governance, they are not always ready to face the consequences of such an evolution in terms of diminished national prerogatives. In this light, French policymakers who call for "*gouvernement économique*" are for the most part not trying to revert to the glorious days of *dirigisme* (i.e., French-style government intervention in the economy), or to diminish the independence of the European Central Bank. More prosaically, they are groping for new levers of action in the face of an unprecedented situation of divided sovereignty.

In the context of Europe's debt crisis, this effort has become ever more frantic. France's idea of strengthening macro-economic governance no longer appears so outlandish and self-interested. After more than a decade of stalemate and often sour French-German controversies on euro-area governance issues, there has been a considerable rapprochement between French and German views of the euro. As German officials increasingly came to accept the French view that stronger governance was needed, French officials became more acutely aware of the problems posed by diverging economic policies and the potentially devastating effects of

public or private indebtedness on the integrity of the euro area. This was an important turnaround for a country whose leaders had often minimized the importance of macro-economic convergence and eschewed firm commitments on deficit reduction. In other words, the French became more German (so to speak) at the same time as the Germans became more French. German officials had always been worried about the risk of macro-imbalances within the euro area – even though they did not always follow the low-deficit principles that they professed.

This considerable rapprochement between Germany and France does not necessarily mean, however, that the implementation of stronger economic governance has become easier. There is still little agreement between the French and the German governments, as well as other member states and EU bodies, as to the concrete forms that stronger economic governance should take. Some member states, including Ireland, have balked at the potential introduction of fiscal harmonization through the back door. Others, like Belgium, are concerned about the direct impact of the future “competitiveness pact” on key aspects of their labor legislation. The sudden increase in the political stakes of Europe’s future economic governance framework is underscored by the fact that EU treaty modifications are being discussed and that even member states outside the euro area have demanded to be closely involved in the debate. Britain, Poland and Sweden have thus become especially active in recent discussions, since they are concerned about potential consequences for some of their sovereign prerogatives. The British government of David Cameron has made it very clear that it would not accept any encroachment of the future pact on British sovereignty.

How can efficient and timely decisions be taken at the EU level in critical times? Is it possible to improve the coordination of national economic policies and prevent crises from happening? How constraining should the revised Growth and Stability Pact and the future “competitiveness pact” really become? Should there be a possibility of default on sovereign debts? What should be the relative importance of the International Monetary Fund (IMF) in crisis resolution? Should the euro area be allowed to issue euro bonds on behalf of its member states? How closely should non-euro area members be involved in the economic governance of the EU? These are all contentious and largely unresolved issues at this point. This report

does not claim to provide all the answers to these complex questions, but it considers them from the perspective of sovereignty in the contemporary EU. It thus highlights a few key political issues that must be resolved if these questions are ever to be resolved in a satisfactory manner. Accordingly, the report is organized to perform three successive tasks:

- First, it reviews the existing literature on economic government/governance. Despite the fact that the notion of *gouvernement économique* has been discussed for many years in France, there are few academic and policy papers fleshing it out in concrete terms. The report highlights both the lessons and the shortcomings of this literature.
- Secondly, the report dissects political actors' aspiration for a *gouvernement économique*. It interrogates the remarkable resilience of this aspiration, not only within but increasingly beyond French political circles. It highlights these actors' increasing awareness of a largely unforeseen conflict between a longstanding concern for national sovereignty and a new conception of sovereignty that called for its exercise at the European level.
- Third, the report speculates on the future and offers a few policy guidelines for a crisis-proof economic governance structure at the EU level. It starts by explaining why the current status quo of divided sovereignty between the EU and the member states in the governance of the euro has become increasingly untenable. The challenge now is to shift toward an economic governance model that is realistic for the member states to adopt, yet bold enough to convince financial markets that the EU has found a credible development scenario for its Economic and Monetary Union.

2 A state of the art on economic governance

Although French politicians and government officials have always been the keenest promoters of *gouvernement économique*, a much wider circle of analysts and actors have discussed the topic of economic governance in the euro area. Since the early days of the euro, two dominant views have emerged on this topic. According to a first view, the governance mechanisms of the euro area were more or less adequate, even though they could be improved at the margin. By contrast, a second group of analysts are much more markedly critical of the existing mode of macro-economic governance. As we will see in the following literature review, the second school of thought has become increasingly large and vocal since the start of the financial crisis.¹ The crisis, I argue, has reopened certain dilemmas about the locus of sovereignty in the EU. The member states confronted these dilemmas at the time of the Maastricht Treaty, yet more or less managed to sweep them under the rug. Only recently have these dilemmas come back to haunt the euro, while exposing in a very crude light the split personality of the European Union.

2.1 Economic governance as a tractable problem

As early as the first discussions on the creation of an Economic and Monetary Union, experts and member state officials started to discuss the topic of economic governance within the euro area (on these discussions, see especially Dyson and Featherstone 1999; Jabko 2006). Yet a much more publicized academic and policy debate really took off only after the introduction of the euro, after Germany and France breached the deficit-spending ceilings of the Stability and Growth Pact (SGP) and the member states decided to reform the pact. It had become clear that the SGP in its original form had become obsolete, but many analysts at the time thought that economic governance in the euro area was a tractable problem that could be addressed by reforming the SGP so as to make it more effective.

1 Readers familiar with the recent scholarship and policy debates on the economic governance of the euro may want to skip the detailed exposition of the main theses in the literature. They should go directly to section I.3, where I discuss the current state of the economic governance debate.

From this perspective, the problem of economic governance was perceived as relatively circumscribed. Member states were running “excessive deficits”, i.e., above the 3% ceiling set by the Maastricht Treaty and reinforced by the SGP. In the context of the post-9/11 recession, many analysts recognized that there may be good short-term reasons for governments to run excessive deficits. It was important therefore to ensure a degree of flexibility in the enforcement of the SGP, which was impossible under the first version of the Pact (Amttenbrink and Haan 2003; Fatas et al. 2003; Coeuré and Pisani-Ferry 2005). In this reasoning, the main problem of economic governance consisted in finding a way to ensure long-run fiscal sustainability, while ensuring necessary flexibility at the same time. The problem was that the SGP was almost entirely focused on the risk of excessive deficits, above 3% of GDP, yet was remarkably hands-off about the need to cut deficits considerably below the 3% ceiling during economic upturns (Mayes and Viren 2004). Thus, the SGP had failed because it was not a credible way of governing the euro area, and a revision of the Pact was necessary (Hefeker 2003). Framed in this way, the solution that some economists advocated consisted in creating a “sustainability council” or a “fiscal policy committee” of independent experts to advise governments on how to keep their deficits under control (Fatas et al. 2003; Wyplosz 2005). This solution thus recognized the fiscal prerogatives of the member states and attempted to keep economic coordination at a relatively minimal level. The goal of many analysts in this vein was to make the SGP more effective and recession-proof and above all to “de-politicize” economic coordination (Amttenbrink and Haan 2003) – not to overhaul the entire governance of the euro area.

In the event, the reception of the 2005 reform of the SGP was mixed. Some considered it as a rather timid step in the right direction. Before the reform was adopted, many analysts had feared that the European Commission’s reform proposal would weaken the Pact and further erode fiscal discipline on the part of the member states (Gros and Mayer 2004). In effect, the 2005 reform attempted to respond to such criticisms not only with more flexibility, but also with new legal provisions for deficit and debt reduction during economic upturns. Most importantly, it mandated that member states must not only keep their deficits under 3% of GDP, but also aim for structurally balanced budgets. Yet many analysts remained skeptical. Some predicted severe enforcement problems in the future (Calmfors

2005; Alvès and Afonso 2007). The most charitable interpretation of the reform viewed it as a good second-best for lack of a politically feasible alternative (Heipertz 2003). The SGP was inevitably a compromise between the argument in favor of transferring more policy competences to the EU level and the argument in favor of keeping the existing balance an EU monetary policy and a primary competence of the member states in the area of fiscal policy (Mortensen 2004). For defenders of fiscal discipline – especially within the European Central Bank – radical critiques of the SGP and calls for “*gouvernement économique*” were counterproductive, since it was important first and foremost for the member states to abide by the new rules. These rules could be further improved, but there was no need for a comprehensive strengthening of economic governance (Bini-Smaghi 2007).

Aside from their limited qualms about the SGP and its revisions, analysts who saw economic governance as a tractable problem focused on the capacity of Europe’s Economic and Monetary Union (EMU) to adequately respond to a number of different demands and problems. First, the euro was seen as compatible with a certain level of macro-economic divergence among the member states. There was considerable concern, of course, on the part of economists who had argued that the euro area was not an optimal currency area – in the absence of financial transfer mechanisms among the member states and of high cross-national labor mobility, macro-economic divergence among the member states could generate considerable tensions in the event of asymmetric economic shocks (Eichengreen 1992). More optimistic observers, however, pointed out that the diversity of its member states could make the euro area more resilient. Not only was the preservation of their diversity a powerful source of motivation for euro-area membership, but the euro could help maintain that diversity in the face of adverse forces (Jones 2002). Although macro-economic convergence remained imperfect, the hope was that differentiated paces and forms of “transverse integration” among the member states of the euro area would remain possible within the EMU (Dyson and Marcussen 2010).

Secondly, the analysts who saw economic governance as a tractable problem saw hope in the increasing level of informal coordination among the member states. Peer pressure, it was argued, was a powerful form of economic governance. The Eurogroup, i.e., the caucus of euro-

area finance ministers, was singled out as a particularly promising example of coordinated economic governance (Puetter 2001; Schwarzer 2005). Although the Eurogroup remained informal and therefore had no binding decision-making powers under the Treaty framework, its great advantage as an economic governance forum was to enable deliberative and consensus-oriented decision-making among the member states. Some analysts did highlight the fact that this consensus was a product of technocratic discussions that were not necessarily in tune with domestic political debates and preferences (Schwarzer 2005). Yet it could also be hoped that the remaining shortcomings of economic governance in the euro area would be resolved over time by the progress of European integration and the evolution of EU policies, without leaping ahead of the curve to a French-style *gouvernement économique* (Verdun 2003). Such optimism must obviously be understood in a historical context. Until at least the second semester of 2008, the claim of European Commission president José Manuel Barroso that the euro has been “a key steadying force” sounded quite plausible – and was judged accordingly by many analysts (Martens and Zuleeg 2008). Although the euro area took a major hit from the sovereign debt crisis in 2010, it had weathered the financial crises of the late 1990s and early 2000s remarkably well.

2.2 Economic governance as a critical problem

The financial crisis that peaked in 2008 and especially the sovereign debt crisis of 2010 have given new currency and urgency to discussions about the deeper shortcomings of the economic governance of the euro area. Some of these shortcomings were identified as potentially critical by a number of scholars long before the advent of the sovereign debt crisis. First, there were growing concerns about the persistence of macro-economic divergence. Political scientists noted that the problem was a deep one, since there was no easy way to engineer convergence among different national political systems and policies (Crouch 2000). And contrary to those analysts who saw divergence among the member states as a tractable problem, many saw divergence as a potentially quite destabilizing trend (Gros, Mayer, and Ubide 2005; Gros 2006; Sadeh 2006). Although member states were able to enjoy roughly similar conditions for the financing of their sovereign debts, this situation was premised on the assumption that member states were permanently locked into the EMU and that none would be allowed by the others to default on

its sovereign debt (Leblond 2006). Since the 2008 crisis, these critics of divergence have become ever more vocal, as the spreads between different national debt securities started to increase among member states of the euro area. Through their membership in the euro area, peripheral states had gained protection against asymmetric shocks, but as their policies were no longer completely immune from market scrutiny, their domestic problems could potentially affect the euro area as a whole (Fratzscher and Stracca 2009; Cartapanis 2010). The euro area had thus become larger and more insulated, but it remained unable to act decisively in the face of internal or external problems.

Second, there has also been increased skepticism about the power of peer pressure alone as an incentive for economic policy coordination. This skepticism surfaced at the time when debates on the revision of the SGP were raging. It is remarkable because the EU's famed "open method of coordination" was hailed by Commission President Barroso as the main tool of the Lisbon Agenda's objectives of economic and social convergence. Even though the "hard" coordination embodied by the formal rules of the SGP no longer seemed to work, many analysts doubted that "soft" coordination would be a more effective alternative (Begg, Hodson, and Maher 2003; Hodson 2004). A measure of flexibility was desirable when it came to fiscal policy and the interpretation of the SGP. Yet the introduction of more flexibility could come at the expense of compliance with the SGP, thus undermining the incentives for public finance sustainability (Hodson and Maher 2004). As early as 2004, it was clear that Portugal's breach of the Pact illustrated the failure of "soft" coordination (Hodson 2004). Although "naming and shaming" under the SGP could be effective in countries where public opinion cared about fiscal deficits, the effect was much less visible in other countries where politicians were better able to get away with it. Again, this is something that was visible early on for analysts who compared Ireland with Germany (Meyer 2004). For all these reasons, the Treaty framework of multilateral surveillance could quickly turn into a pointless exercise – unless it was backed up with credible sanctions.

As a result of such glaring shortcomings, calls for overhauling the economic governance of the euro area have become more frequent and more comprehensive over time – and explicit mentions of the French notion of

gouvernement économique started to emerge at the beginning of the decade (Boyer and Dehove 2001; Begg 2003; Collignon 2004). Although analysts did not all agree on what this notion should encompass, several themes crystallized over time. The first and most prominent theme was the need for more institutional cohesiveness in the definition of euro-area economic policies. Analysts quickly advocated a reinforcement of the Eurogroup of finance ministers (Collignon 2001; Jacquet and Pisani-Ferry 2001). There were also many proposals to reinforce the external representation of the euro area by centralizing chairs in international economic bodies such as the IMF, or by designating clear representatives of Europe who would be authorized to speak on topics such as the exchange rate policy of the euro. Some analysts even went much further and called for “the creation of a European government accountable to European citizens” (Collignon 2004).

A second prominent theme, obviously related to yet somewhat distinct from the institutional theme, was that of reinforcing the capacity of the EU to reach collective decisions in various policy areas (Jacquet and Pisani-Ferry 2001). Most recurrently mentioned was the need for a coordinated fiscal stance among euro-area member states. In line with other critiques of the a-political nature of coordination under the Pact, more integration was recommended between EU national decision-making processes. As for policies vis-à-vis the outside world, many analysts underscored the need for a monetary integration strategy involving candidate EU member states in Central and Eastern Europe (Schelke 2004), as well as the need to clarify the euro area’s exchange rate policies vis-à-vis the rest of the world (McNamara and Meunier 2002; Taylor 2004). The most radical critics of economic governance under the SGP went so far as to say that it was completely misguided, in the absence of “clear cross-border externalities” from debt and deficit-spending (Buiters 2006). Although this point now appears debatable in light of the 2010 sovereign debt crisis, it remains true that the SGP does not guarantee any kind of rational deliberative process that would deliver a coherent macro-economic policy mix for the euro area.

2.3 Dilemmas of sovereignty and the split personality of the euro area

Crises are testing times not just for economic and political actors, but also for observers of the world and their analytical frames. It is clear that the sovereign debt crisis of 2010 has not been kind to those who saw the economic governance of the euro area as a tractable problem that might be resolved over time and was unlikely to put Europe's Economic and Monetary Union under severe stress.² With the benefit of hindsight, it is strange to reflect on the remarkable modesty of the recommendations issued by the many balanced articles and reports published on the occasion of the tenth anniversary of the euro (see, for example, Aghion et al. 2008). A few observers and actors saw the potential for a major sovereign debt crisis and the absence of adequate structures to deal with financial instability, but they remained a minority until recently (Tilford 2009; Cecchetti and Schoenholtz 2010).

After the Greek crisis hit, observers increasingly came back to reflect on the underlying problems of economic governance within the euro area. The official discourse, especially coming from the European Central Bank (ECB), still repeated the need for structural reforms and the priority of fiscal consolidation (ECB 2010, pp. 83-86). A number of observers wondered, however, if such adjustment would be sufficient and underscored the need for a stronger SGP but also a clearer growth orientation for economic governance (Padoan 2010). There was a growing sense that delaying tactics would not work, and that a call to restore macro-economic convergence without a revisiting of fundamental principles of economic governance would not address the deep problems of the euro (Pisani-Ferry 2010a, 2010b). A more centralized, more reactive, and more discretionary decision-making process may be needed in order to buttress the euro area against market speculation (Pisani-Ferry and Sapir 2010). It is probably not a coincidence that French analysts were especially vocal in this critical vein (Fitoussi 2010; Jamet 2010; Le Cacheux 2010). They often criticized the EU's tendency to focus exclusively on its structural reform agenda; they renewed calls for economic policy coordination and the need for a rule-oriented yet sufficiently flexible fiscal policy coordination at the EU level;

2 Insofar as I probably overestimated the resilience of the euro area up to the Greek crisis in early 2010, I include myself in this group (see Jabko 2010, pp. 331-332).

and they stressed the need for stronger European economic governance, focusing mostly on greater accountability and a clearer economic strategy for the EU.

Although the peculiarly French trope in favor of *gouvernement économique* was not new, it came back to the fore with unprecedented momentum. In the past, French government officials had often been suspected of catering to the French public for electoral reasons and of shifting the blame on to the independent European Central Bank and away from their own policy mistakes. ECB officials are especially vocal in expressing this view (see, for example, Bini Smaghi 2007; Stark 2008). Yet the suspicion was quite widespread and articulated by other observers as well (Verdun 2003; Howarth 2007). As France was having difficulties adhering to the SGP, the government had a tendency to blame the ECB's "anti-growth" policies – just as it had blamed the German central bank's high interest rates for slow domestic growth in the 1990s. While this may have been the case to some extent, I will argue that such accusations overstate the opportunism of French policymakers. The fact that France's entire political elite has supported the idea of *gouvernement économique* over two decades suggests that the roots of this idea are deeper.

The explanation that I propose in this paper for the uncanny resilience of *gouvernement économique* is premised on the existence of a divided sovereignty over economic governance within the European Union. This divided sovereignty is itself the historical product of a French (but also European) refusal to choose clearly between national and EU sovereignty at the time of the Maastricht Treaty. Under Europe's Economic and Monetary Union (EMU), monetary policy was completely federalized and sovereignty was effectively relocated at the level of the European System of Central Banks. The French were at the outset the staunchest supporters of this transfer of sovereignty. The reason they welcomed this change did not only stem from a pro-European consciousness, however. It was also rooted in their desire to end a situation in which their *national* sovereignty was battered. From a French perspective, EMU was a way to escape France's second-class status (below Germany) in the pecking order of the previous European Monetary System. The French government was therefore adamant that fiscal policy and most aspects of microeconomic policies should remain national prerogatives – even though member states

would be obliged to consider their fiscal policies a “matter of common interest” and would agree to abide by certain common rules (the Maastricht Treaty’s convergence criteria and later the SGP). To this day, the notion of *gouvernement économique* embodies this contradiction. Everybody realizes that the EMU is an imperfect construction from the perspective of economic efficiency and political effectiveness. Yet the difficulty is to make EMU more effective without upsetting the fragile balance between national and European sovereignty.

The result of this state of divided sovereignty is that *gouvernement économique* remained for many years a rather hollow aspiration. The Europeans and especially the French did not find a magic formula that would enable a strengthening of the EU’s economic governance without further encroaching on the economic sovereignty of its member states. Over time, and in the absence of any serious EU-wide desire to part from the status quo, the notion of *gouvernement économique* as developed in multiple speeches by French politicians came to appear increasingly incoherent (Howarth 2007). This does not mean that French politicians were not serious in their criticisms of the existing economic governance of the euro, or that they had a hidden agenda of subordinating the ECB to the will of governments. The fact is that, until the Greek sovereign debt crisis, any French attempt to discuss *gouvernement économique* at the EU level was viewed with suspicion by other member states. The situation had not fully decanted. As suggested above, it was not even clear that the reform of economic governance posed a fundamental rather than a tractable problem. In the face of this situation, the French complaint appeared as a rather odd concern.

It is only since the Greek crisis that a productive debate has emerged on economic governance and a consensus on the necessity to introduce fundamental reform. Even so, this consensus remains sharply circumscribed and it is by no means obvious that member states will be able to agree on a fundamental reform that would truly address the problem of divided sovereignty. So far, they have only begun to scratch the surface of the problem, following proposals to create a “European monetary fund” (Schaüble 2010) and a European sovereign debt market for “E-bonds” (Juncker and Tremonti 2010). On the face of it, these proposals built on and fueled a rather sophisticated economic policy debate involving

established Brussels-based economic policy think tanks (Delpla and von Weizsäcker 2010; Gros and Mayer 2010; von Hagen et al. 2010). Yet they each met important opposition as they threatened to re-open the Pandora's box of potential limitations on the sovereignty of the member states and transfers of power toward the EU level. Does the EU need to move squarely toward fiscal federalism? Would such a move be desirable and above all realistic at this point of the crisis and in the present development stage of the euro? These remain for the most part unanswered questions. The debate on economic governance meanwhile just serves to magnify the split personality of the European Union, torn between its federal monetary institutions and its decentralized economic policy institutions.

The advantage of this explanation in terms of divided sovereignty is that it reads the resilience of *gouvernement économique* as an expression of split motivations, rather than French political culture and national interest. Taken as a whole, the French political-administrative elite are neither stuck in a bygone culture of *dirigisme*, nor driven simply by national interests. Instead, they are groping for new objectives in the face of a relatively new institutional situation. Other observers have also commented upon the remarkable uncertainty and novelty of the situation. Starting with the Bundesbank in the late 1980s, many have lamented the fragility of Europe's economic and monetary union in the absence of "political union" (De Grauwe 2006). In the context of reforming the SGP, it has also been said that "Europe is still searching for its fiscal soul" (Buti and Franco 2005). As long as actors do not completely come to terms with the situation of divided sovereignty, there is no other game in town. What we may be witnessing today, however, is the painful birth of stronger economic governance in the context of growing market pressures. Whether the baby will survive – and, if so, in what condition – remains to be seen. Before moving to an examination of this process, I will retrace the groping efforts of the French to define what they mean by *gouvernement économique*.

3 The elusive *gouvernement économique* of the euro

To demonstrate the argument, I proceed in three steps. First, I explain what I mean by the conflict between national and European sovereignty by tracing it back to the historical origins of *gouvernement économique* in the late 1980s. I show in particular how French leaders originally intended the euro as a way to reassert sovereignty at the EU level. Second, I consider the reemergence of the idea of *gouvernement économique* in the late 1990s, when the euro was introduced. In the following decade, that French idea hit a wall of criticisms and went nowhere. Caught in contradictory aspirations, successive French governments were unable to close the gap between their *gouvernement économique* rhetoric and their apparent flouting of existing European economic governance in the form of the Stability and Growth Pact (SGP). Third, I show how the recent sovereign debt crisis gave a new boost to the idea of strengthening the economic governance of the euro. If EU leaders perceive a need for a vastly more unified European approach, they may one day decide to shift gears and create an EU-level institutional framework for economic governance. Yet the deep underlying dilemma between the concern for national sovereignty and the aspiration for European sovereignty is unlikely to go away any time soon. There are many reasons to doubt that renewed efforts to strengthen economic governance will yield revolutionary results in the short term. If EU leaders feel that they can muddle through the current and future crises without any fundamental institutional re-engineering, they will naturally be tempted to rely on mechanisms of emergency coordination.

3.1 Groping for a new vision of sovereignty³

Although the euro is sometimes presented as a “de-politicized” currency, the political concern for sovereignty was in fact central to its advent – at least from the perspective of the French government. France’s concern for sovereignty, in and of itself, was nothing new, but for a long time it opposed the idea of an economic and monetary union at the European level. In the 1960s and 1970s, many French politicians as well as citizens

3 This section draws on my account of the politics of Europe’s economic and monetary union (Jabko 2006, 147-178).

feared that monetary union at the European level would amount to an unacceptable dilution of sovereignty.⁴ By the 1980s this state of affairs had changed radically. Contrary to the way it was often interpreted abroad, President Mitterrand's 1983 decision to stick with the European Monetary System was anything but a sign of resignation to France's subordinate status vis-à-vis Germany. The French increasingly perceived the European Monetary System as a "deutsche mark zone" rather than as an egalitarian European arrangement. As national monetary policies were aligned with Germany's, the Bundesbank had *de facto* become "the bank that ruled Europe" (Marsh 1992). The return to floating exchange rates was ruled out on political grounds, because it was equated with macroeconomic mismanagement and the "illusion" that France could durably pursue a different course than its main trade partners in Europe. Yet many in the French political elite were unhappy with a status quo that reduced France's sovereignty over its national currency to empty formalism. Mitterrand's choice foreclosed the option of securing France's sovereignty through a free-floating currency, but the French continued to resent any diminution of France's sovereignty.

In this context of deep dissatisfaction with the European Monetary System, French political actors were increasingly seduced by the notion that EMU would reinvigorate, rather than dilute, French sovereignty.⁵ The currency crisis of January 1987, in which France was forced to devalue the franc and raise interest rates despite its unflinching commitment to the *franc fort* (strong franc) policy, was a turning point. For clear historical and electoral reasons, the preservation of national policy autonomy remained a potent symbol as well as a policy objective – especially in relation to Germany. Whereas small countries like Belgium and even the Netherlands could accept living in a deutsche mark zone, and even turn it to their advantage, the bigger states like France and Italy increasingly perceived it as an unacceptable subordination to German power. At that point, the French demand for a reform of the European

4 Stanley Hoffmann, in his famous article "Obstinate or Obsolete?" (reprinted in Hoffmann 1995), identified the French concern for sovereignty as a permanent obstacle to monetary union.

5 Note that this was apparently not a prominent motivation in the 1970s: "From the French point of view, monetary integration used to be desirable only as a means of promoting EEC unity in external relations. In this respect, French politicians were torn between the objective of having a common external monetary policy and their fear of loss of national sovereignty." (Tsouaklis 1977, p.80).

Monetary System became more pressing than ever.⁶ For many French political actors, the fact that EMU might entail a transfer of sovereignty to the EU level was clearly secondary to the desire to escape the strictures of German dominance.

From this perspective, the independence of the future European central bank and other treaty provisions that diminished the government's economic powers were but the necessary concessions for bringing Germany on board. In 1988, the members of the Delors Committee quickly understood that EMU would have to proceed on terms that were roughly agreeable to the German central bank.⁷ From then on, France became more willing to accommodate German demands if this was the price it had to pay for monetary union. Of course, after nearly a decade of relatively successful "competitive disinflation", many French policymakers had become convinced of the virtues of low inflation and fixed exchange rates within the European Monetary System.⁸ Clearly, many French policymakers around the finance ministry and the central bank (including former French finance minister Jacques Delors) clearly saw the European Monetary System as a valuable way to avoid the inflationary spiral of an easy-money policy. Yet there is little evidence that the traditional French political preference for growth and social order over monetary stability had been fundamentally changed.⁹ The

6 French finance minister Edouard Balladur authored an article titled "EMS: Advance or Face Retreat" (Balladur 1987). By 1987–88, mainstream French policy circles were actively discussing the EMS, and monetary reform was one of the issues at stake in the 1988 electoral campaign. See "Barre, Balladur, Bérégovoy: Les projets des '3 B'", *La Tribune de l'Expansion*, April 22, 1988.

7 The press echoed the strong German flavor of the Report: "One committee member said the document contained 'a lot of German thinking.' Another said Mr Pöhl 'had good reason to look happy.'" ("Bankers Agree on EC Route to Unity", *Financial Times*, April 13, 1989). One committee member was reported as saying that "Karl Otto got everything he wanted" (Institutional Investor, May 1989).

8 Interviews with French, Belgian, and Dutch monetary officials, Brussels, July 1, 1997, and September 17, 1997; Amsterdam, February 10, 1998. For an official retrospective justification of the French policy of "competitive disinflation", see Trichet 1992. For the argument that France was converted to Germany's monetarist ideas, see McNamara 1998.

9 An assessment by two French economists of France's deflationary policy during the 1980s and 1990s suggests that the "implicit framework [of policymakers] was a neo-Keynesian model under fixed exchange rates, in which disinflation automatically translates into real exchange rate depreciation, gains in market shares, and growth." See Boissieu and Pisani-Ferry 1998.

independence of the central bank remained an especially difficult measure to swallow for a country where the government was used to steering the economy and had been the main overseer of postwar growth.

France's reluctant acceptance of a depoliticized monetary policy and its strong desire to increase sovereignty by other means are at the root of the idea of *gouvernement économique*. Pierre Bérégovoy, the French finance minister in the late 1980s and later prime minister at the time of Maastricht, publicly explained France's support for a *gouvernement économique* very clearly: "If I came over to the idea of central bank independence, which Germany considered a *sine qua non* [for EMU], it is because it appeared to me that the central bank would be counterbalanced by a strong and democratic economic authority that would determine the most important things: the general orientation of economic policy and exchange rate policy." (Bérégovoy 1992, my translation). Far from completely aligning with Germany's economic priorities, then, the French government considered that "the general orientation of economic policy and exchange rate policy" would be in the hands of a yet undefined "strong and democratic economic authority".

Yet it remained unclear how the French government intended to foster that "strong and democratic economic authority" at the EU level without in effect infringing upon the independent democratic authority of *national* governments. Already in the Delors Report it is mysteriously stated that "subsidiarity" would be the rule of Europe's economic union, except insofar as "uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the community" (Committee for the Study of Economic and Monetary Union 1989, p. 19). The Maastricht Treaty remained equally vague, stating both that fiscal policy remained a government prerogative and at the same time governments agreed to consider their respective fiscal policies as subject to "budgetary discipline".¹⁰ Before the actual advent of the euro, nobody seriously wanted to be more precise. Any precise articulation of how EU economic governance would operate in practice threatened to undermine the fragile consensus reached at Maastricht. German chancellor Helmut Kohl faced a difficult political battle to impose monetary union on reluctant German central bankers and citizens. As for French government

¹⁰ Maastricht Treaty, Article 104c (now Article 126).

officials, they had trouble envisioning a permanent regimen of deficit reduction – especially after the massive strikes in December 1995 that led to the resignation of Prime Minister Alain Juppé for introducing a plan to cut welfare expenditures. Thus, everybody in Brussels concurred to defer this potential source of conflict between France and Germany. The idea of *gouvernement économique* was quietly put aside for better days.

3.2 The reemergence of a French aspiration

The debate on economic governance was rekindled in the late 1990s, when the member states started to implement Europe’s Economic and Monetary Union (EMU). From that point onward, the underlying conflict between different visions of sovereignty became increasingly obvious. The French government officially continued to advocate a *gouvernement économique* at the European level, but was remarkably modest when it came to fleshing out the concept – for fear that its fiscal freedom would be diminished. What remained of the original attempt to rebuild sovereignty at the European level was a sense that “ever closer union” is desirable in order to offset the adverse effects of global market forces and power dynamics. This yearning led to a few modest developments in the direction of stronger economic governance in the 2000s. Yet until the turning point of Europe’s debt crisis, this progress was overshadowed by powerful centrifugal forces.

The gap between rhetoric and actions

There is little doubt that the notion of *gouvernement économique* long served as a convenient fig leaf for “intellectual and legal weaknesses” (Pisani-Ferry 2006). The heart of the problem is that the institutional architecture of EMU reflected, but did not resolve, the deep tension between the German and the French conceptions of monetary union. The SGP and the underlying conception of a rule-based EMU was as reviled in France as it was worshipped in Germany. As the notion of *gouvernement économique* seemed to suggest a more active macro-economic management and a greater role for politics, it soon became an easy sound-bite in many French political speeches. Politicians could freely talk about it without ever being very specific on what they meant. The first outburst in this direction came in the spring of 1997, when socialist leader Lionel Jospin was scrambling for campaign themes in the surprise legislative election called by President Chirac. As it happened, the election campaign came shortly after the European Council of December 1996 in Dublin, where

the member states had agreed on the principle of a “stability pact” to ensure continued fiscal consolidation in the future EMU. Jospin argued in favor of a *gouvernement économique* and a rewriting of the stability pact in a direction more conducive to growth. He ultimately obtained a re-labeling – with the addition of the word “growth” – but not a rewriting of the pact. The latest illustration of the French rhetorical bubble around *gouvernement économique* was the presidential election of 2007. When Nicolas Sarkozy started to champion the idea – and later instructed his new finance minister to work toward it – he was simply echoing the proposals of his two main opponents that were in exactly the same vein (Bayrou 2006; Royal 2007, esp. proposal #89; Sarkozy 2007).

Although the need for a *gouvernement économique* became an easy object of agreement across the French political spectrum, the official French position on European economic governance clearly evolved after the 1980s. On the one hand, the overwhelming majority of French politicians no longer called for a straightforward return to *dirigisme*. A majority had slowly come to terms with the existence of a powerful European central bank. Although many remained critical of the actions of the ECB, they rarely criticized the principle of its independence. The difference is clear in comparison with the early 1990s, when central bank independence was completely foreign to the French tradition. The shift was even more evident among French financial officials, who were perfectly aware that central bank independence was here to stay. On the other hand, many in the French political elite expressed their desire for a different and “more political” kind of economic and monetary union – and for a more “political” Europe as well. What they meant by that was, first, a capacity to react quickly and coherently to economic and political problems. In other words, the EMU process could not be left on automatic pilot by relying only on rule-based governance. EU policies should be authoritative, and they should be pursued boldly. Thus, French officials often criticized the EMU process for its excessive legalism and insufficient openness to political debate. Rules were acknowledged as necessary, but they must leave sufficient space for discretionary action, especially in difficult or emergency situations. Policies that are highly reactive to changing economic circumstances should thus not be overly constrained by preexisting rules.

Despite French political actors' broad agreement on this basic conception, until 2010 they made remarkably little progress in fleshing out and promoting the *gouvernement économique* at the European level – for three main reasons. First, they often had a hard time controlling their own rhetoric. The ECB (like the European Commission) was often an easy scapegoat at home. The fact that the ECB was there to stay and that it would remain independent was something that many French citizens had not yet internalized. Of course, no political actor with any passing acquaintance of the EU seriously believed that the ECB's independence would go away. Yet the anti-ECB rhetoric worked marvels with a domestic public that resented Europe's perceived "neo-liberalism". The problem for French politicians was that their partners in other member states paid (intermittent) attention to an anti-ECB rhetoric primarily intended for a domestic audience. In turn, that rhetoric produced the impression that France seriously questioned the ECB's independence. Its unintended effect was therefore to turn France's EU partners – especially Germany – against the idea of *gouvernement économique*. Coupled with a highly popular anti-ECB rhetoric, France's insistence on *gouvernement économique* sounded worrisome to German ears.

Secondly, and perhaps more fundamentally, the French position became increasingly strained in the 2000s, as successive French governments repeatedly neglected their partners' attempts to agree on common fiscal policy positions. This was first the case of course in the fall of 2003, when France overshot the EU budget deficit limit of 3%. At that time, France worked hand in hand with Germany to criticize the excessive rigidity of EU rules until the March 2005 reform of the Stability and Growth Pact. Yet the government's political standing among its partners subsequently became increasingly weak and isolated, as France – unlike Germany – continually postponed the date of its eventual return to a balanced fiscal position.¹¹ This produced the devastating impression that French political leaders were not willing to practice what they preached. They appeared to

11 In 1999, the French government first promised a return to fiscal balance by the year 2003. After September 11, 2001, this was postponed to 2004. In 2002, President Chirac's incoming government made the same promise for 2007. In 2007, the government postponed the consolidation again to 2010. As soon as President Sarkozy was elected in May 2007, he asked for another deferral to 2012 – i.e., even before France entered the Great Recession and its public deficits ballooned way over the 3% limit.

welcome the *gouvernement économique* if it increased Europe's collective capacity to act; but they seemed unprepared to accept that this capacity to act may require some discipline and thus constrain France's individual capacity to act. This is a contradiction that French leaders did not resolve in the 1990s, and that many still did not appear to fully grasp a decade later (see also Pisani-Ferry 2006, especially p. 841). As a consequence, France's cherished slogan of *gouvernement économique* sounded increasingly hollow and hypocritical, as France kept resisting its partners' (modest) attempts to achieve fiscal coordination.

Third, and at a more conceptual level, certain widespread misgivings about France's proposal of economic government revealed deep disagreements among euro-area member states about the appropriate form of economic coordination at the EU level. In contrast to the French insistence on the importance of discretion in economic policy-making, German officials stressed the importance of rules as a necessary framework for any policy-making exercise. They were wary of grand pronouncements that were not followed by concrete effects. Perhaps because of their domestic experience of federalism, they favored a system in which responsibilities are relatively clear and where member states are not forced to follow policies that they do not favor. More prosaically, they also refused to be placed in a position of bearing the heaviest financial burden of decisions made in Brussels or elsewhere in the EU. In addition to these French-German tensions, other member states often feared that a French-style economic government would quickly become a prerogative of the biggest and most powerful member states. From their perspective, the independence of the European Commission and of the ECB, as well as the reliance on a rule-based EU economic governance model, guaranteed against the risk that big countries would throw their weight around in a primarily intergovernmental policy-making exercise.

Modest achievements, mounting pressures

Despite all these contradictions, some modest progress was achieved in the 2000s toward a stronger economic governance of the euro area. In an increasingly concrete way, the idea of *gouvernement économique* found its first embodiment in the form of the Eurogroup. With no recognized existence in the treaties until 2004, the Eurogroup was an informal subdivision of the Council of Economics and Finance Ministers. It

worked mostly as a discussion forum, on the basis of consensus among its members. Formal voting rules and decision-making power were still in the hands of the Economic and Financial Affairs Council (EcoFin), made up of the finance ministers of the member states. After 2004, the Eurogroup was endowed with a stable chairmanship of two and a half years (a position currently held by the Luxembourg prime minister, Jean-Claude Juncker). Its creation was motivated by the member states' desire to "develop ever closer coordination of economic policies within the euro area", as proclaimed in the Lisbon Treaty.¹² From the beginning, French officials clearly hoped that the Eurogroup would be a forerunner to stronger forms of euro-area governance in the future.

Historically, the Eurogroup itself was a creature of pragmatism, since it was born at a time when member states were confronted with concrete problems. Of course, all member governments, especially Germany, were aware of the French desire for an "economic government" at the EU level. But they also had good common-sense reasons for backing this institutional innovation. The Maastricht Treaty had provided for the multilateral surveillance of budget deficits among the member states, and a procedure to prevent excessive deficits;¹³ but it had not explicitly envisioned a sanction mechanism in case of improper behavior. Neither had the drafters envisioned that the membership of the euro area would be smaller than the membership of the European Union as a whole. At Maastricht, Britain's "opt-out" clause was seen as the exception that confirmed the rule. A few years later, it became clear that euro-area members needed at least a forum to conduct discussions and to define their common interests vis-à-vis the outside world. For both these reasons, German finance minister Theo Waigel needed to rally France's support for the proposed "stability pact", and offered to create a "stability council" in order to oversee the implementation of the pact. At the time, the French government was looking for ways to flesh out the "economic coordination" envisioned by the Maastricht Treaty.¹⁴ Therefore, France's finance minister Jean Arthuis quickly decided to support Germany's demands both for a stability pact and a stability council.

12 Lisbon Treaty, Protocol on the Euro Group.

13 Article 104c, now article 126.

14 Interview with French government official, Brussels, May 2, 1997.

The fact that the monthly Eurogroup meetings progressively became the real locus of deliberation among euro-area members on EMU issues illustrates the possibilities of informal evolution for the European Union. The requirement for not only a unified monetary policy, but also at least a periodic coordination of economic policies among member governments, has become an important frame of reference. Although treaty articles about the “coordination of economic policies” (Articles 102 and 103, now Articles 120 and 121 in the Treaty on the Functioning of the European Union) are extremely vague in comparison with the monetary policy provisions, Maastricht did open the way for such coordination. What can be achieved without negotiating a major new European treaty and creating new institutions is therefore significant. The “voice of the euro” on the world stage is probably the area where a stronger euro-area governance became most immediately evident after the creation of the Eurogroup in 2004. The Treaty grants the member states a right to define the “orientation” of the euro’s exchange rate policy, but entrusts the independent ECB with the power to decide any appropriate action on currency markets. After the appointment of Jean-Claude Juncker as chair of the Eurogroup, he increasingly traveled along with ECB President Jean-Claude Trichet to the G8 meetings and to China in 2006. Thus, the voice of the euro now came “out of two mouths”.¹⁵ This enabled governments, if they managed to agree on a common exchange rate orientation, to assert their interests vis-à-vis outside partners like China, Japan, or the United States. In the same vein, the Europeans were also able to make significant progress toward a more unified EU representation at the IMF without any major EU treaty change.

On the other hand, there were clear limits to this kind of informal build-up of economic government, as starkly revealed by the member states’ handling of the financial crisis and ensuing recession since the fall of 2008. President Sarkozy cleverly turned France’s presidency of the EU in 2008 into a high-powered crisis-management exercise. Of course, crisis management is necessary for economic governance to emerge. Yet events since 2008 have also shown that *ad hoc* crisis management is insufficient to address the divergence in macro-economic situations and policy priorities across euro-area member states. From this perspective,

15 Interview with ECB official, Brussels, January 22, 2008.

there is a bumpy road ahead for truly coordinated European responses to economic problems – let alone a smoothly functioning model of economic governance among EU member states. What the crisis has done, most clearly, is to at least re-ignite interest in and debate on the economic governance of Europe's Economic and Monetary Union.

3.3 The global financial crisis as a spur for economic governance

When the global financial crisis started in 2007, it initially seemed that the euro area was better equipped than the United States and Britain to weather the crisis. As in the US, inter-bank lending in the EU became increasingly scarce. Yet the ECB rushed to provide liquidity to EU banks in the summer of 2007, thus preventing an immediate stalling of the European financial system. Major European stock market indices went down slightly, but not nearly as much as in the United States. The euro was up against the US dollar continuously in 2007 and early 2008, reaching a historically high point in April 2008 above \$1.60. By then, Europe seemed to be doing reasonably well, and European political actors were only vaguely aware of the US subprime crisis. Before the semester-long French presidency started in July 2008, President Sarkozy had recognized the reluctance of France's partners and had actually almost given up his initial hope of promoting *gouvernement économique*.¹⁶ It was conspicuously not one of the four main items on the French presidency's agenda. There was still a sense that Europe, with some deft monetary policy tweaking by central bankers, might be spared from a predominantly American financial crisis.

Then, in 2008, the financial crisis suddenly intensified – and gave a golden opportunity for Sarkozy to change the EU agenda. In October, European leaders found themselves under pressure to prevent a meltdown of the European financial sector in the wake of the Lehman Brothers bankruptcy but also several bank runs in Britain and Germany. It was becoming clear that the European continent risked being engulfed not only in a financial crisis but also in a major recession. Acting as chair of the European Council, Sarkozy called for a meeting of euro-area

¹⁶ In an off-the-record comment that later became public, President Sarkozy said: "The best way of f—ing up the French presidency of the EU would be to launch an initiative on the euro, the European Central Bank, and economic governance" (sic, as reported by *Libération* journalist Jean Quatremer (2008)).

member states at the level of heads of state and government, to which he also invited the British prime minister, Gordon Brown. EU leaders then issued a “European Action Plan” to shore up the fledgling European banking sector. It spelled out a total commitment of more than €1,300 billion in governmental loans and underwriting of bank capital – well above America’s TARP expenditures, even though only a portion of that money was actually disbursed. The French president hailed the plan as the first successful exercise of *gouvernement économique*. By going to the European Parliament to make that point, Nicolas Sarkozy also wanted to broaden the support for a beefed-up economic governance framework. The European Parliament’s favorable response in a (non-binding) resolution passed on October 22 underscores the fact that its members now saw stronger euro-area economic governance in a positive light, as a further step toward economic and political integration.

Europe’s October 2010 “action plan” is particularly interesting for what it revealed about Nicolas Sarkozy’s vision of *gouvernement économique*. From then on, the French president repeatedly expressed his view that the core meaning of economic governance was the coordination and periodic steering of European economic policies by national political leaders. This vision does not necessarily involve new transfers of formal power to the EU level, however. A decision to organize regular euro-area meetings at the levels of heads of state and government is a simple decision to make. Yet such meetings could be an important impulse for EU governance, as shown by the precedent of the European Council – a body that started an informal existence in 1974 and was only recognized in 1991 with the Maastricht Treaty.¹⁷ This vision is also in line with the pre-crisis *de facto* evolution of economic governance as a primarily informal coordination within the Eurogroup and between the Eurogroup and the ECB, with the Commission bringing mostly technical expertise to the table. Sovereignty thus remains primarily in the hands of the member states, who are collectively in charge of economic governance at the highest political level.

Sarkozy’s quintessentially French vision of economic governance has the merit of being more concrete and pragmatic than earlier vague calls for *gouvernement économique*. It can work very well when economic

17 Interview with French government official, Paris, November 6, 2008.

interests and policy priorities converge. This is what happened initially at the outset of the global financial crisis. National leaders were on the same wavelength in the face of an emergency situation. In the face of a clear threat, European leaders went full steam ahead in favor of international economic coordination – both among themselves, and vis-à-vis the rest of the world. Internally, the Europeans managed to cooperate among themselves even in the absence of formal treaty provisions for collective decision-making. The Brussels buzz in 2008 was about changing the course of European economic policies. As the Stability and Growth Pact was shelved away for better times, Keynesian ideas were suddenly fashionable again among European policy circles. Likewise, there was a remarkable European willingness to show a united front vis-à-vis the outside world, especially between France and Germany. At the insistence of European leaders, President George W. Bush called for a G20 meeting in Washington on October 2008 to discuss international economic governance. At the peak of the US subprime crisis, France and Germany increasingly stood together in opposition to financial deregulation, and in favor of greater international regulatory cooperation. European leaders focused their demands on strengthening international bodies such as the IMF and the G8, as well as relatively new forums like the Financial Stability Forum (now Financial Stability Board) or the G20.

Yet Sarkozy's conception of European economic governance does not fundamentally surmount the contradictions of divided sovereignty that the Maastricht Treaty planted at the heart of Europe's Economic and Monetary Union. In particular, it does little to clarify what happens when national interests clash. Viewed from this perspective, Sarkozy's "European action plan" already signaled a problem that would beset subsequent efforts to achieve a coordinated EU response to the financial crisis. As many observers noted, the plan was a stop-gap juxtaposition of national rescue plans, rather than a truly European bank rescue and economic stimulus plan. A week before the successful announcement of the EU action plan, a meeting of the four EU member governments of the G8 ended in a complete failure. Only when it became clear that all member states shared the same immediate interest in preventing a financial panic did Germany and others come to terms with Sarkozy's idea of a rescue package. The principles of action were adopted in common, but individual governments were careful to make separate announcements for the national details and amounts of

funds that they committed to rescuing their national banking systems. The “action plan” that was decided in common is therefore better described as an accumulation of national action plans than as a truly European action plan. The fact that these measures were coordinated at the EU level thus does not necessarily mean that a durable European economic governance model was born.

In fact, divisions quickly surfaced on the desirable scale of the stimulus package – especially between Germany and France. French president Nicolas Sarkozy initially wanted EU member states to adopt ambitious stimulus plans, so as to kick the regions’ banking system and economy back onto a normal mode. The fact that France held the presidency of the EU in the second half of 2008 also certainly played a role in the French government’s high ambition, as Sarkozy wanted the French presidency to be perceived as a success at home and abroad. German chancellor Angela Merkel was much more weary of the growing financial burden of public deficits and debts. She initially gave a very lukewarm endorsement to the European action plan, and only announced the details of the German plan in January 2009 – one month after the end of the French presidency. Throughout 2009, European leaders thus continued to muddle through the financial crisis. Stimulus plans were implemented, but there was little or no coordination between the different member states.

More generally, the emergence of a truly durable form of economic governance that would go further than *ad hoc* coordination in a situation of extreme emergency has been extremely difficult since 2008. Only when faced with emergency situations and repeated calls for help coming from the European Central Bank did euro-area member states finally resolve to act in a bold way. Likewise, only when confronted with immediate deadlines or challenges did the Europeans make a serious effort to show a united front toward the rest of the world. The Europeans acted first in 2008, to prevent a meltdown of the financial system, and later in 2010, to prevent a contagion of sovereign debt crises and a potential collapse of the euro area. These examples of emergency coordination may come to be seen, in retrospect, as the first milestones in the building of stronger European economic governance. Alternatively, they may go down in history as exceptional and excruciating instances of national policy coordination in response to imminent threats. This unforgiving possibility of defective

European economic governance became considerably more vivid in 2010, when Europe was hit by a severe debt crisis.

3.4 Europe's debt crisis as a crisis of economic governance

The roots of the European disorder in the face of the crisis are manifold. One bone of contention was the increasingly obvious divergence in competitiveness and external vulnerability among EU member states. Despite a precipitous drop in its export markets in 2008, Germany emerged stronger from the crisis. Its relatively conservative stimulus plan kept the public deficit under control in comparison to others (well under 6% of GDP in 2010). Above all, its export competitiveness allowed it to extirpate itself from the depth of the recession much more quickly than its partners as soon as world markets began to recover. The contrast was especially striking between Germany and the so-called “PIGS” countries (Portugal, Ireland, Greece and Spain). After accumulating severe public or current account deficits during the boom years of the 1990s and the 2000s decades, these countries were most severely hit by the crisis. They increasingly experienced soaring interest rates on sovereign debt markets – the roots of the European debt crisis that broke out in 2010 when Greece and Ireland had to seek assistance from the IMF and their EU partners. While Germany and (to a lesser extent) other continental European economies weathered the crisis relatively well, the PIGS countries began to look like the European equivalent of subprime borrowers in the US.

This macroeconomic divergence translated into a marked difficulty for Europe to take a united stance on global economic governance issues such as trade or current account imbalances. As it experienced an export boom, Germany increasingly stood accused of free riding on other countries' fiscal stimulus plans. The debate became especially acrimonious in late 2009 and early 2010, after Greece elected a new government that revealed a massively underestimated level of public deficit and public debt. Greece's sovereign debt was immediately hit by a confidence crisis. As the country was forced to adopt austerity measures, there emerged a clear rift between Germany and other EU partners' approach to the problem. German chancellor Angela Merkel took a very hard-nosed approach in the context of a strident anti-Greece public opinion campaign and an important regional election affecting the upper house of Parliament. Many European political actors responded, sometimes officially, by blaming Merkel's for

making the problem worse by reacting too slowly to the Greek crisis. Many also pointed their finger at Germany for its massive accumulation of trade and current account surpluses with the rest of Europe.

The attribution of credit and blame among EU member states could be debated forever. Like all political systems in hard times, the European Union was stuck in the mire of distributive politics. As it became clear that the crisis would entail clear winners and losers, a variety of constituencies tried to shift the burden of adjustment toward others. The more interesting fact, however, is that the euro area's average debt level remained reasonable, especially when compared with the United States or Japan. A few indebted member states led to the downfall of an entire continent. Structural budget deficits are generally deemed sustainable, however, except possibly in Greece. While private indebtedness reached worrisome levels, especially in Ireland or Spain, there was no obvious situation of insolvency as long as interest rates on sovereign debt remained reasonable. The problem is that the euro area revealed itself incapable of collectively managing its highly localized indebtedness problems. In other words, this was primarily a crisis in the economic government of the euro area. As interest rates shot through the roof, a clear risk emerged that local liquidity crises would turn into contagious insolvency crises. Only after a year of bickering is the situation starting to change. The open question now is whether the euro-area member states' belated realization of vulnerability will be sufficient to upgrade EU economic governance beyond emergency measures in the face of imminent threats.

A common realization of vulnerability – hurdle or milestone for future integration?

As European leaders slowly came to terms with the vulnerability of their economic governance framework in the face of crisis, they began to take more drastic action in the second half of 2010 and the beginning of 2011. First, the euro area – under intense market pressure in the wake of the Greek crisis – has begun to move toward a framework for dealing with internal macro-economic divergence. On May 2, 2010, the member states agreed to a €110 billion rescue plan in the form of three-year bilateral loans from euro-area countries to Greece amounting to €80 billion, in addition to an IMF loan of €30 billion. This rescue plan was put together relatively late after the Greek crisis erupted, as European leaders were

forced to ratchet up considerably their earlier plans of emergency lending limited to €30 billion. In addition to this plan, the member states of the euro area decided to establish a European Financial Stability Facility that could issue state-guaranteed loans for up to €440 billion. Finally, the ECB decided, on May 10, to start a controversial program of euro-area sovereign debt purchases. However expensive and tardy, all these new measures successfully stemmed immediate worries about Greece's possible debt default. They put to rest widespread speculations about an impending implosion of the euro and a return to national currencies.

Second, and potentially most significant, the EU has started to move toward a treaty revision that could reshape the landscape of economic governance in Europe and beyond. At the European Council on October 29, 2010, EU member governments endorsed the idea of a "crisis resolution mechanism" that would be established permanently at the EU level in order to ensure the stability of the euro area. In essence, this means that the three-year European Financial Stabilization Facility (EFSF) established to address Greece's sovereign debt crisis would become permanent beyond 2013. In exchange for accepting such a crisis resolution mechanism and for giving up the demand for automatic sanctions under the Stability Pact, German officials obtained support from France for a treaty revision that would authorize economic assistance to other member states only as a tool of "last resort" to preserve stability. France also gave cautious support to Germany's desire to force private investors to accept "haircuts" on their sovereign debt portfolios after the expiration of the EFSF in 2013; and it accepted the idea of imposing stiff sanctions to deviant member states, including a temporary suspension of national voting rights under EMU.

Despite vocal criticisms of France and Germany for short-circuiting the European Council, the importance of the French-German deal for the future economic governance of the euro area can hardly be overstated. These two core member states managed to find a compromise despite longstanding differences on the desirable model for EU economic governance. While Germany's chief concern was to avoid a repetition of the Greek crisis and renewed demands on German taxpayers, France's main overt goal was to establish an economic governance capacity to improve economic policy coordination. The European Council on December 17 basically endorsed the French-German proposals with little modification (except on the

issue of voting rights). It will take time to flesh out the proposals, not only because treaty revisions are needed to ensure compatibility with the treaty's so-called "no bail-out clause", but also because the bargaining situation is complex and will probably involve package deals. Yet euro-area leaders have indicated a willingness to further boost the level of state guarantees and the borrowing capacity of the EFSF (to be renamed the European Stability Mechanism after 2013). They are also considering the possibility of allowing the EFSF to engage directly in sovereign bond purchases.

This new momentum is also visible in international economic discussions. Past the first shock of the global crisis, European leaders are trying to assert their domestic and EU priorities at the global level. In October 2010, they agreed to a broad reform of IMF voting rights and a relative retrenchment of European power within that institution, for the sake of letting emerging economies become more involved in global economic government. This is consistent with the Europeans' oft-repeated commitment to greater multilateralism in international economic governance. President Nicolas Sarkozy – who conveniently took up the chair of the G20 and the G8 in the second half of 2010 – has been especially vocal on this topic. He has called for a "new international monetary order" to prevent a spiral of competitive devaluation and "currency war" between the world's main economic powers. Whether the French exchange rate policy initiative meets any success remains to be seen – especially in the context of Chinese obstruction to a revaluation of the yuan and the US reluctance to envision anything that could jeopardize the dominance of the US dollar or the current domestic focus on quantitative easing in order to jumpstart the US economy. Yet stronger economic governance would surely enable the Europeans to have a more powerful voice on international monetary issues – and Sarkozy is trying to move in that direction.

If we take a step back, there are two ways to view the increasing European resolve in addressing the sovereign debt crisis. A positive assessment is that the core European member states are cautiously reaching out to their embattled partners by offering conditional assistance, in order to avoid creating a problem of moral hazard. With the blessing of the ECB, they are also aiming for an orderly exit from stimulus measures and a return to long-term fiscal sustainability. In this narrative, European leaders are truly

doing their best to build up their economic governance and avert macro-economic imbalances and the danger of future sovereign debt crises. They are not only adopting the French idea of stronger economic governance, but also making it more compatible with German concerns. Over the course of 2010, the French president and the German chancellor came to an agreement that they would work together on new economic governance initiatives – and that “*gouvernement économique*” would henceforth be translated as “economic governance” in joint policy documents.¹⁸ Thus, in July 2010, the French and German finance ministers presented to the Van Rompuy taskforce a joint position paper titled: “European economic governance: a French-German paper”; and, in French, “Gouvernement économique européen: papier franco-allemand”.

A more critical assessment is that the Europeans are still mostly in reactive mode. Concerns about fiscal sustainability are undoubtedly fuelled by higher borrowing costs of capital for many member states. Pension reform and more generally welfare reform and deficit consolidation are back on the policy agenda across the EU. Yet these objectives are partly designed to placate financial markets and to protect sovereign debt ratings. Many observers are critical of this orientation, since fiscal conservatism clearly comes at the expense of other economic priorities, including growth stimulation. The controversies that erupted over the tough conditionality of the Greek and Irish rescue plans are enlightening. In the absence of direct levers on Greek budget expenditures or Irish corporate tax rates, core euro-area member states were willing to commit only limited resources. In particular, they did not want to endorse a bold plan like the Juncker-Tremonti idea of a shared “Eurobond” market with indebted countries. Consequently, it remains to be seen whether the result of French-German economic governance initiatives will succeed in steering the euro-area economy back to the path of prosperity. In order for this to happen, the new future governance framework will have to surmount not only the European debt crisis, but also the deep-seated tensions between the aspiration for European sovereignty and the desire to maintain national sovereignty. Are the Europeans merely fooling themselves by trying to obfuscate the difficult problem of divided sovereignty? Although there is no easy answer to this question, one thing is clear. Whether or not European leaders are

18 Interview, French President's office, Paris, November 2, 2010.

making the right choices, they are increasingly aware of the necessity to considerably upgrade their economic governance capacity.

In sum, European political leaders have started to develop a variety of common responses to the crisis. This is in and of itself remarkable, because their predecessors in the 1970s were not able to forge any kind of common response. This time, the Europeans have been more inclined to work together, despite deep initial misgivings. There is little doubt that the depth of economic integration today and the fact that euro-area member states share a single currency is responsible for this relatively new perception of being all in the same boat. Yet the Europeans are still muddling through and have not yet adopted any clear road map of where to go next. One difficulty is that interdependence among EU member states remains asymmetric. Some member states on the periphery of the EU are much more vulnerable than the big continental member states. This difference in vulnerability is obviously all relative. When Greece experienced its sovereign debt crisis, even the most hawkish Europeans soon realized that this was a European problem, not simply a Greek tragedy. The question now is whether this new realization of interdependence will lead the Europeans to go beyond the situation of divided sovereignty and develop coherent responses beyond the immediate future – or whether the bickering about the costs of international cooperation and the fear of further compromising national sovereignty will return and supersede the dynamic of building sovereignty at the EU level.

4 What next?

The main reason why fundamental reforms of economic governance have proved so difficult, I have argued, is that the Maastricht Treaty was designed both to centralize the management of a stable currency in the hands of the ECB and to keep economic policies decentralized at the level of the member states. Since they no longer control monetary policy, member governments have often become extremely jealous of their *national* sovereignty in the area of fiscal policy. What the debt crisis has made clear is that the resulting status quo can easily become unsustainable. In order to avert further crises, therefore, *something* must give. Before moving to what could be done realistically at this stage, I explain why stronger governance is, at this point, more likely than a re-nationalization of currencies and policies. It is not clear that governments will be able to fully surmount the deep contradiction between their deep-rooted concern for sovereignty and their increasing recognition of the need for stronger European economic governance. Fundamentally, the fact that governments are caught in this contradiction helps to account for the excruciatingly slow pace of economic governance reform. Yet stronger economic governance in some form is clearly in the cards for the foreseeable future – and there is a light at the end of the tunnel, if the member states are ready to show good will.

4.1 Why the status quo is not tenable

Although the contradictions of the European Union's situation of divided economic sovereignty are blatant, one could argue that such contradictions are inherent to any federal system. After all, federalism as a political theory is premised on the existence of multiple levels of sovereignty (Hamilton, Madison, and Jay 1987; especially #31, 39, and 62). Even though the division of sovereignty between the states and the center may evolve over time, there is no *a priori* reason to declare this situation unsustainable. The current situation may not be optimal or even stable in the long run. Yet as long as Europe's political leaders and central bankers manage to stave off the threat of a euro-area collapse, it is possible for the EU to muddle through crises with a succession of piecemeal reforms. Governments can very well decide that it is their best interest to coordinate in case of emergency, but to retain as much autonomy as possible for economic policy-making in normal circumstances. Crises being by definition

exceptional, the contradictory logic of EMU could thus persist for a long time. From this perspective, there is little doubt that a perfectly robust economic governance of the euro area will require considerable time and political capital. Whether and when member states will take major new initiatives in the future is an open question.

The concrete existence of the euro is promising for the future of economic governance, however. Although there is no guarantee that economic union will ever become a full-fledged reality, it is important to remember there was also no guarantee that monetary union would ever become a reality until the late 1980s. And although treaty changes are inherently difficult in a European Union of 27 members, the Maastricht treaty left a lot of room for institutional innovation – precisely because it combined contradictory visions and entailed a situation of divided sovereignty. Today, the ideal of a stronger governance of the euro area is alive and well. It is also a treaty-sanctified aspiration for “ever closer coordination of economic policies” – in direct reference to the Treaty of Rome’s call for “ever closer union between the peoples of Europe”. Above all, European governments that have adopted the euro as their currency have a stake in its survival as a stable currency – as long as they are not willing to question their participation in Europe’s Economic and Monetary Union. Despite the marked retreat of federalist ideals since the 1990s, no government so far has indicated any clear desire to consider the nuclear option of a euro exit. Some political leaders, including German chancellor Angela Merkel, have sometimes implicitly threatened to do so. But they have always issued such threats in situations of hard bargaining with their EU partners, and they have always quickly retreated thereafter.

Once a member state in the EU has adopted the euro, there is actually no easy way to exit. First, and as many observers have remarked, the economic costs of exiting the euro are potentially astronomical. The most fragile members of the euro area would face capital flight on an unprecedented scale. Although core countries would be conceivably better able to exit the euro, they would then face currency appreciation and losses of competitiveness and, possibly, higher financing costs for their public and private debts. Only Germany might conceivably be spared higher debt financing costs – but a German exit would immediately send the reborn deutsche mark to unprecedented heights and reduce Germany’s

hard-won competitiveness gains to nil. Second, although less often commented, the political costs and uncertainties associated with exiting the euro area are categorically devastating. The citizens of euro-area member states have become accustomed, albeit sometimes reluctantly, to their new currency. In peripheral member states that often made huge efforts to join the European Union and then the euro, citizens would therefore probably experience as a national humiliation an exit from the euro area and the predictably massive appeal for IMF assistance that this would trigger. In core countries, such as Germany or France, any national claim to responsible membership – let alone leadership – of the EU would instantly dissipate. These harsh political realities make it quite impossible for governments to seriously contemplate exit from the euro area at this stage. The chances of a government surviving an exit from the euro area are slim; and democratically elected governments are rarely suicidal. More generally, an exit from the euro area would jeopardize politically established actors and parties who made the choice to join the euro; it would lead to the rise of political extremism, thus running against the interests of virtually all mainstream politicians across the euro area.

4.2 Toward a crisis-proof economic governance structure for the EU

Given the extremely high costs and uncertainty of a return to national currencies, it is reasonably safe to assume that euro-area governments will do whatever it takes to preserve the euro. The consequences are clear: these governments will increasingly be led to strengthen their economic governance framework, even if this implies a *de facto* diminution of national fiscal autonomy. What they will seek – and what analysts can realistically propose – are ways to go toward stronger governance without seriously compromising their sovereignty. From this perspective, it is important to recognize three clear boundary conditions that must be taken into account. Three general guidelines for generating realistic policy proposals can then be derived from these boundary conditions.

Boundary condition #1: The member states are not willing to hear of a transfer union

As the Greek crisis and the debate about euro-bonds illustrates, core euro-area member states worry about the moral hazard of turning the euro area into a full-fledged transfer union. They understandably worry about

putting good money after bad by lending to their highly indebted partners in the periphery. Their biggest fear is that such lending would signal a willingness to fund profligate member states without limits. In turn, this would increase the risk that debt crises will occur again in the future, as well as the costs of financing their own debts. Although the concern about moral hazard is serious, the concern about debt financing smacks of shortsighted calculation by finance ministry officials who only look at the budgetary side of the equation. The bigger picture is that nobody will be sheltered from the risks of contagion from a debt crisis at the periphery – not even the core countries, whose banks remains exposed to potentially massive debt restructuring. Therefore, the euro area must find solutions that help peripheral member states maintain their debt financing costs at sustainable levels, without however resorting to unconditional transfers that might encourage further imbalances and more debt crises in the future.

Guideline #1: Enlist financial markets in debt consolidation and fiscal discipline

The most obvious way to resolve this problem is to enlist financial markets both in the provision of capital to and in the exercise of financial discipline against highly indebted member states. Although fears of sovereign debt crises within the euro area have significantly increased, market operators still consider government debt as a relatively safe investment. Their appetite for government bonds is therefore unabated. To be sure, there has been a flight to quality assets, which in 2010 has mostly benefited core member states with AAA credit ratings by decreasing the cost of servicing their public debts. Yet the relative success of many bond issues by peripheral states in 2010 and early 2011 means that investors are even ready to take calculated risks – as long as these risks are rewarded by higher interest payments. Thus, a massive transfer union is not the only solution to the European debt crisis in the short term. As long as investors are reassured that there is a credible debt consolidation framework and that the volume of debt remains sustainable, they will continue to supply capital. More coordination among member states and the creation of innovative financing instruments can therefore be a win-win solution to the problem of excessive indebtedness. This is the best form of private sector participation – one that does not scare investors with prospects of unlimited haircuts, but gives them a stake in Europe's recovery from its debt crisis.

So far, two types of market-based financing solutions have been prominently discussed. First, the EFSF can issue its own bonds as an AAA-rated limited liability company, with the backing of its subscribing member states. In January 2011, the first bond issue of €5 billion was massively oversubscribed. Such appeal to financial markets will enable the EFSF to leverage its limited capital in order to provide potentially large loans to indebted member states. Second, the Juncker-Tremonti proposal outlined a very ambitious solution, consisting in the introduction of “E-bonds”. These bonds would be underwritten collectively by all euro-area member states, but each member state’s access to European sovereign bonds would be capped at 40% of its GDP. The first solution is already being implemented – although still at a modest level – whereas the second solution has encountered considerable opposition from Germany and France. The difference may be only one of degree, however. In case of further crises, the needs for extra financing could *de facto* turn the EFSF into an important issuer of bonds, which would not be very different from the Juncker-Tremonti solution. Whether governments will resort to one or the other will probably depend on political circumstances – both their own reluctance to enter into any kind of transfer union, and the perceived likelihood of successfully selling the solution to suspicious domestic constituencies. The general direction of a market-assisted debt multilateralization framework is sound, however. Insofar as it diminishes the moral hazard and circumvents the member states’ reluctance over massive transfers, the appeal to investors deserves to be stepped up.

Boundary condition #2: The member states are reluctant to delegate more power to Brussels

There is a common perception that the European Commission already has too much power – and the member states do not want to reinforce it. Member governments often suspect the Commission of the blackest intentions. They do not like the idea of giving the Commission the last say on the desirable policy orientations of the Union, for at least three reasons. First, they fear that the Commission would pursue its own interests, including a further centralization of European economic policies and the build-up of a large budgetary capacity at the EU level. This recurrent fear was particularly obvious at the December 2010 European Council, during which the British government led an initiative to keep the EU budget under strict control. Second, they fear that the Commission will act in

a biased way – either by protecting the interests of certain states against others (for example, Portugal when the Commission president happens to be Portuguese); or, on the contrary, by focusing on deficit reduction in an overly rigid fashion in order to demonstrate that it is immune from political pressures. Many member governments are therefore reluctant to delegate powers any further because they feel such delegation could be harmful to their own interests or to the euro area's economic growth.

Guideline #2: Externalize the debt consolidation framework

There are various ways to address this problem by externalizing the emerging debt consolidation framework as much as possible. The simplest method is to create independent agencies and to put them charge of debt-related tasks. The European Financial Stability Facility is an example of this method. The EFSF is a limited liability company with a clear and relatively narrow mandate, in which euro-area member governments have decided to pool resources up to certain well-defined limits. The Commission is not involved in the management of the EFSF, even though it is headed by Klaus Regling, a former (German) director general from the European Commission's EcFin directorate. The European Stability Mechanism (ESM), as successor of the EFSF, will presumably inherit similar independence. Another example of idea of such externalization would be the creation of a European Monetary Fund, an idea introduced by German Finance Minister Schäuble in 2010 at the time of the Greek sovereign debt crisis. Such a fund would be able to issue conditionality requirements in exchange for loans to and/or sovereign bond purchases from highly indebted member states. Its action could also benefit initially from the technical advice of the IMF, an experienced body when it comes to structural adjustment programs. The ESM and the EMF proposals may also be merged into a single body in charge of elaborating both emergency loans and structural adjustment programs.

There is an immediate pragmatic rationale for building such new institutions, since the institutional framework of the EU has proved inadequate to address problems of debt consolidation. It is difficult to imagine how member states could solve problems on their own without resorting to clunky intergovernmental compromises that rest on fragile technical bases and thus do not fully respond to market expectations. Existing EU bodies have not been up to the task either. With its limited

resources, the European Commission has been unable to fully assert itself in this area. The ECB's program of government bond purchases was arguably a step in the right direction. But that program has remained limited, with overall purchases well under €100 billion. Furthermore, the program is premised on the notion that the financial stability of the euro area is in danger. Once this is no longer the case, the ECB cannot prolong it indefinitely without overstepping its mandate and endangering its balance sheet. Other specialized institutions are needed, and this can only be provided by creating new institutions with clearly defined technical mandates to assist the member states in the collective task of debt consolidation.

The broader political attraction of such externalization is to go beyond the existing defective institutional framework without revolutionary treaty changes or delegation of new powers to EU bodies. Member states can easily live with such specialized EU agencies because they do not view them as anything more than expressions of "pooled sovereignty". Of course, the member government's commitments to these agencies may eventually turn out to imply much greater obligations than is thought at the moment of their creation. Thus, in the end, member states' desire to limit the delegation of new powers and competences to the EU level may be frustrated by the exercise of these implied obligations. Yet this is, in a sense, the very story of European integration since its earliest days. Member governments have never been particularly enthusiastic about building sovereignty at the EU level. The most important achievements of the European Union have nonetheless involved a considerable federalization of powers, including the creation of a single currency – and few political actors today are prepared to advocate a return to national currencies. As long as the EU governance framework continues evolving and democratic oversight is strengthened over time, there is nothing inherently wrong with such an evolution.

Boundary condition #3: The member states are reluctant to see their autonomy curtailed

The difficulty of divided sovereignty is that neither the strongest nor the most fragile member states are willing to let go of their national policy autonomy, unless they are absolutely against the wall. This drives up the costs and the risks of membership in the euro area, and it casts doubts on

the credibility of collective statements by euro-area leaders. Governments often blame market operators for making huge amounts of money on the back of fragile member states and thus contributing to the debt crisis in the first place. But many governments are themselves guilty as charged, insofar as they fuel doubts on the sustainability of their indebted partners and demanded interest rate risk premiums not so far below what markets demanded for taking up the risks of financing states like Greece or Ireland. They want to hear neither about fiscal federalism, nor about any kind of debt restructuring at their taxpayers' expense. Although each of these two options would provide a clear avenue to resolve the crisis, it is at this stage politically impossible for governments to consider them.

In attempting to address a debt crisis that threatens to spiral out of control, governments are struggling to break out of an uncomfortably limited range of options. If devaluation is not on the table and massive direct fiscal transfers are excluded for political reasons, then all governments reason that they should maximize their room for maneuver. Governments of highly indebted member states have incentives to maximize their capacity to react, including with policies that do not please their partners. A good example was the Irish refusal to consider any increase of its corporate tax rate of 12.5%, arguing that this would impede the flow of foreign direct investments and hurt its chances of recovery. Conversely, governments that are in a better fiscal position have little incentive to help out partners that will do what they want and may end up restructuring their debts in any case. They want to make sure that member states who receive their assistance make a credible pledge to austerity policies – which is inherently difficult, since these policies have the immediate effect of lowering growth prospects.

Guideline #3: Give as much say as possible to governments in the decision-making process

In order to avoid deadlock between member states which cling to their sovereignty, a solution would be to engage governments in a collective decision-making process while recognizing the diversity of objectives that they pursue. Areas of agreement must be sought, even when governments' goals and interests are different. The events of 2010 demonstrate that such progress is possible, at least within certain limits. For example, everybody now agrees that the Stability and Growth Pact needs to be reinforced, and

that some form of permanent mechanism to ensure stability and avert crisis needs to be established. Although there remains strong opposition for now against a radical move toward a massive euro-area-wide bond market, it would be possible to go there incrementally through an upgrading of the EFSF's mandate. As long as it does not go too fast, a progressive externalization of the debt resolution framework is unlikely to be seen as a direct threat to member states' policy autonomy. Even though the new entities in charge of debt consolidation would benefit from the member states' guarantee when issuing bonds, their independence from EU institutions and the direct involvement of member states would surely reassure governments that they remain in control.

In the longer run, however, it is difficult to see how governments can both keep their autonomy and coordinate effectively. This is the EU equivalent of having your cake and eating it – and it takes us directly back to the paradox of divided sovereignty. Coordination, if effective, will by definition be sometimes very intrusive. The huge political science literature on capitalist diversity (e.g., Berger and Dore 1996) strongly suggests that national economic institutions follow idiosyncratic trajectories that do not always converge. The existence of several varieties of capitalism may even be a crucial foundation for the comparative advantage of nations, and it may therefore not be desirable to do away with national models (Hall and Soskice 2001). In this vein, scholars of EU politics have argued that the European Union may find it difficult to single-handedly impose its own logic on national models of political economy in areas such as fiscal governance and labor relations (Hallerberg 2004; Höpner and Schäffer 2010). An EU model of political economy can be superimposed on national models, but at this stage in its development the EU does not act as a supranational state able to supplant national models (Jabko 2006, ch. 9). In this context, any attempt to introduce a deep level of economic coordination will be a difficult exercise.

It is easy to get a foretaste of future EU headaches by watching some very negative first reactions against French-German proposals to introduce a “competitiveness pact” that might encroach on what member states view as their core sovereign prerogatives. In other federal systems, such as the United States, fiscal federalism works by allowing federal-level and state-level budgets to operate in relative independence from each other. The

fiscal stance of the federal government can sometimes be at odds with some states' fiscal policies, but direct clashes are avoided because the states and the federal government each have their own budget resources. As long as the EU budget remains capped around 1% of EU GDP, the only way in which the EU can have a fiscal stance is by imposing relatively uniform fiscal policy guidelines on its constituent member states. Thus, in calling for more coordination yet denying the EU a minimum level of autonomy in taxing and spending, the member states are implicitly depriving themselves of their much-cherished autonomy. There is no easy way out of this profound paradox, so the day of reckoning will predictably come sooner or later – if not during the current crisis of economic governance, then sometime in the future on the occasion of another crisis.

*

Even under the most propitious scenarios, the elaboration of an economic governance framework for the European Union will not take place overnight. It will require a major reshuffling of power and economic resources among the member states and EU institutions. In this sense, the newly found consensus in favor of stronger economic governance is only the beginning of the process. In the long run, there will certainly be a rebalancing of divided sovereignty within the EU. To preserve the current equilibrium between central EU bodies and the member states will be tricky, if not impossible. It is important for the member states not to pretend that the dilemma of divided sovereignty does not exist. To bury one's head in the sand is not the best way to face up to a crisis. This is arguably what led to the current crisis in the first place. Yet it is probably not in anybody's interest to overly press the issue of divided sovereignty in the short run. Stop-gap technical measures can probably work to remedy the current crisis – as long as the crisis remains under control and member states recognize that these measures are not long-term solutions. The discursive consensus in favor of stronger economic governance will be tested, and it may not survive under stress. At that point, more radical action will become necessary. And if they want the euro itself to survive, the member states must be prepared to put their money where their mouth is.

Sammanfattning

Åtskilliga franska regeringar har genom åren fått finna sig i att vara ensamma om att argumentera för en starkare ekonomisk styrning på EU-nivå ("*gouvernement économique*"). I februari 2010 nämnde dock Tysklands förbundskansler Angela Merkel för första gången behovet av gemensam ekonomisk styrning i Europa ("*Wirtschaftsregierung*"). Merkels oväntade närmande till president Nicolas Sarkozy resulterade i att idén om *gouvernement économique* fick en renässans, men vägen mot starkare ekonomisk styrning är fortfarande osäker. Idag är det dock inte den kvarvarande fransk-tyska motsättningen som är det största hindret. Istället är det den oförutsedda konflikten mellan nationell suveränitet och en ny slags suveränitet som utövas på den europeiska nivån som är det problematiska.

Suveräniteten över Europas ekonomiska och monetära union är i grunden delad – mellan en gemensam penningpolitik på EU-nivå och finanspolitiken som fortfarande är en exklusiv nationell kompetens. I denna rapport granskas centrala frågor om ekonomisk styrning utifrån ett suveränitetsperspektiv i dagens EU. Den belyser viktiga politiska hinder som måste övervinnas för att dessa frågor ska kunna lösas på ett tillfredsställande sätt.

Problematiken med ekonomisk styrning är långt ifrån ny. Den har sitt ursprung i Maastrichtfördraget – i och med eurons tillkomst – och har sedan dess orsakat politiker huvudbry. Rapporten inleds med en genomgång av den litteratur som behandlar frågan om ekonomisk styrning. Trots att franska politiker under många år har argumenterat för *gouvernement économique*, finns det dock få akademiska artiklar där man har försökt sig på att konkretisera själva begreppet. Vissa forskare har betraktat frågan om ekonomisk styrning som lätthanterlig, som något som med tiden skulle lösa sig automatiskt. Andra har sett det som ett mer allvarligt problem, med potential att underminera eurons existens.

Rapporten belyser de lärdomar och brister som redovisas i litteraturen. Men trots att en kritisk tolkning med tiden har blivit alltmer framträdande, i synnerhet sedan 2008, tycks det inte finnas någon magisk formel för hur

man ska stärka den ekonomiska styrningen på EU-nivå utan att ytterligare inkräkta på medlemsländernas ekonomiska suveränitet.

Efter en granskning av litteraturen på området, behandlas i rapporten olika politiska aktörers strävan efter *gouvernement économique*. Författaren belyser också den påfallande uthållighet som har funnits i denna strävan, även utanför den snäva politiska kretsen i Frankrike.

I en tid då det europeiska monetära systemet (EMS) var föremål för spekulativa attacker och många medlemsstater motsatte sig den tyska centralbankens penningpolitiska dominans, började Europas politiska ledare att efterlysa ett mer kollektivt sätt att utöva suveränitet. Fram till 2010 sågs emellertid Frankrikes långsiktiga strävan efter att åstadkomma starkare ekonomisk styrning på EU-nivå som politiskt ogenomförbar. Inte minst var tyska politiker kritiska till begreppet *gouvernement économique*, eftersom man misstänkte att det var ett försök att inskränka Europeiska centralbankens oberoende.

Trots det har den globala finanskrisen sporrat till nya politiska initiativ vad gäller ökad ekonomisk styrning. Redan under andra halvåret 2008 drev det då franska EU-ordförandeskapet på för att få gehör för ett samlat europeiskt svar på bankkrisen och för att motverka en omfattande europeisk recession. Den statsfinansiella skuldkrisen kom under 2010 även att blotta brister i eurozonens ekonomiska styrning, vilket också har lett till en uppsjö av nya politiska initiativ.

Frågan kvarstår dock om medlemsstaterna är redo att acceptera en utveckling mot större suveränitet på EU-nivån eller om den ska vara förbehållen den nationella nivån. Genom att förutsätta att medlemsstaterna inte kommer att överge euron, avslutas rapporten med ett antal policyrekommendationer för upprättande av något som skulle kunna kallas en förebyggande krisförvaltning av den ekonomiska styrningen (*crisis-proof economic governance structure*) på EU-nivå.

Den slutsats som dras är att nuvarande *status quo* med delad suveränitet mellan EU och medlemsstaterna när det gäller ekonomisk styrning för eurozonen är ohållbar. De grekiska och irländska skuldkriserna har visat

att eurozonen inte är immun mot en förtroendekris som stryper tillgången till kapitalmarknaden för de mest utsatta medlemsstaterna och som kan sprida sig över hela regionen. Utmaningen är att gå mot en ekonomisk styrningsmodell som politiskt är realistisk för medlemsstaterna, men som samtidigt är djärv nog för att övertyga de finansiella marknaderna om att EU har hittat en trovärdig modell för den ekonomiska och monetära unionen.

I rapporten tas vidare upp de villkor som åtminstone på kort sikt begränsar utformandet av en förstärkt ekonomisk styrning. För det första är medlemsstaterna inte redo för en fiskal union med omfördelning av skattemedel, vilket betyder att man måste hitta ett sätt att med hjälp av finansmarknaderna åstadkomma skuldkonsolidering och budgetdisciplin. För det andra är medlemsstaterna ovilliga att delegera mer makt till Bryssel. Det innebär att ett ramverk för skuldkonsolidering måste skapas med hjälp av ett organ som inte är en EU-institution, alternativt delegeras till ett helt nytt oberoende europeiskt organ. För det tredje vill medlemsstaterna inte få sin autonomi begränsad. Varje nytt ramverk för ekonomisk styrning måste därför ge medlemsländerna så mycket inflytande över beslutsprocessen som möjligt, i syfte att få eurozonens regeringar att ta ansvar för potentiellt smärtsamma beslut.

Ovanstående riktlinjer ska inte ses som någon patentrösning på de djupa problem som är förknippade med delad suveränitet inom euroområdet. Det nyfunna samförståndet i frågan om starkare ekonomisk styrning kommer att utsättas för prövningar, och det kan visa sig att det inte överlever påfrestningarna. Mer radikala åtgärder kan alltså bli nödvändiga, men sannolikt kommer det på längre sikt att uppstå ett behov av att balansera den delade suveräniteten inom EU. Och om man vill att euron ska överleva, måste medlemsstaterna vara beredda att stötta projektet fullt ut.

References

- Aghion, Philippe, Alan Ahearne, Marek Belka, Jürgen Von Hagen, Jean Pisani-Ferry, and André Sapir. 2008. *Coming of age: Report on the euro area*. Bruegel. Brussels.
- Alves, Henrique, and Oscar Afonso. 2007. The “new” Stability and Growth Pact: More flexible, less stupid? *Intereconomics* 42, no. 4: 218-225.
- Amttenbrink, Fabien, and Jacob Haan. 2003. Economic governance in the European Union: Fiscal policy discipline versus stability. *Common Market Law Review* 40, no. 5 (October): 1075-1106.
- Balladur, Edouard. 1987. EMS: Advance or face retreat. *Financial Times*, June 17.
- Bayrou, François. 2006. La France de toutes nos forces. December 14, Lille. <http://www.bayrou.fr/discours/bayrou-lille-141206.html>.
- Begg, Iain. 2003. *Hard and soft economic policy coordination under EMU: Problems, paradoxes and prospects*. Minda de Gunzburg Center for European Studies, Harvard University. Working Paper 103. Cambridge MA.
- Begg, Iain, Dermot Hodson, and Imelda Maher. 2003. Economic policy coordination in the European Union. *National Institute Economic Review* 183 (January): 70-81.
- Bérégovoy, Pierre. 1992. *Pierre Bérégovoy's speech at the French Parliament*. Paris, May 9.
- Berger, Suzanne, and Ronald Dore. 1996. *National diversity and global capitalism*. Cornell University Press. Ithaca NY.
- Bini Smaghi, Lorenzo. 2007. *Speech at the HEC European Executive Campus*. Brussels, February 27.
- Boissieu, Christian de, and Jean Pisani-Ferry. 1998. The political economy of French economic policy in the perspective of EMU. In Barry Eichengreen and Jeffry Frieden (eds), *Forging an integrated Europe*. University of Michigan Press. Ann Arbor MI.
- Boyer, Robert, and Mario Dehove. 2001. Du “gouvernement économique” au gouvernement tout court. *Critique Internationale*, no. 11 (February).
- Buiter, Willem Hendrik. 2006. The sense of “sense and nonsense of Maastricht” revisited: What have we learnt about stabilization in EMU? *Journal of Common Market Studies* 44, no. 4. special issue: 669-864.

- Buti, Marco, and Daniele Franco. 2005. *Fiscal policy in Economic and Monetary Union: Theory, evidence and institutions*. Edward Elgar. Cheltenham, UK.
- Calmfors, Lars. 2005. What remains of the Stability Pact and what next? SIEPS Report no. 8.
- Cartapanis, André. 2010. Zone euro et union monétaire: dix ans plus tard, un rendez-vous manqué? *Revue d'économie politique* 120 (February).
- Cecchetti, Stephen G., and Kevin L. Schoenholtz. 2010. How central bankers see it: The first decade of ECB policy and beyond. In *Europe and the euro*. University of Chicago Press. Chicago IL and London.
- Coeuré, Benoît, and Jean Pisani-Ferry. 2005. Fiscal policy in EMU: Towards a Sustainability and Growth Pact. *Oxford Review of Economic Policy* 21, no. 4.
- Collignon, Stefan. 2001. *Economic policy coordination in EMU: Institutional and political requirements*. Minda de Gunzburg Center for European Studies, Harvard University. Cambridge MA.
2004. Is Europe going far enough? Reflection on the EU's economic governance. *Journal of European Public Policy* 11, no. 5: 909-925.
- Committee for the Study of Economic and Monetary Union. 1989. *Report on Economic and Monetary Union in the European Community*. Brussels.
- Crouch, Colin. 2000. *After the Euro: Shaping institutions for governance in the wake of European Monetary Union*. Oxford University Press. New York and Oxford.
- De Grauwe, Paul. 2006. What have we learnt about monetary integration since the Maastricht Treaty? *Journal of Common Market Studies* 44, no. 4. special issue: 669-864.
- Depla, Jacques, and Jakob von Weizsäcker. 2010. The Blue Bond Proposal. *Bruegel Policy Brief*. Brussels. May.
- Dyson, Kenneth, and Kevin Featherstone. 1999. *The road to Maastricht: Negotiating Economic and Monetary Union*. Oxford University Press. Oxford.
- Dyson, Kenneth, and Martin Marcussen. 2010. Transverse integration in European economic governance: Between unitary and differentiated integration. *Journal of European Integration* 32, no. 1: 17-39.
- ECB. 2010. European Central Bank monthly bulletin. Frankfurt (June)
- Eichengreen, Barry. 1992. Should the Maastricht Treaty be saved? *Princeton Studies in International Finance*, no. 74 (December).

- Fatas, Antonio, Jürgen Von Hagen, Andrew Hughes Hallett, Rolf R. Strauch, and Anne Sibert. 2003. *Stability and growth in Europe: Toward a better Pact*. Centre for Economic Policy Research. London.
- Fitoussi, Jean-Paul. 2010. Politiques macroéconomiques et réformes structurelles: Bilan et perspectives de la gouvernance économique au sein de l'Union Européenne. *Revue d'économie politique* 120, no. 2.
- Fratzcher, Marcel, and Livio Stracca. 2009. The political economy under monetary union: Has the euro made a difference? *Economic Policy* 24, no. 58 (April): 307-348.
- Gros, Daniel. 2006. *Will EMU survive 2010?* Commentary, January 17. Center for European Policy Studies. Brussels.
- Gros, Daniel, and Thomas Mayer. 2004. The dog that lost its bark: The Commission and the Stability Pact. *CEPS Policy Brief*, no. 58 (November), Center for European Policy Studies. Brussels.
2010. How to deal with sovereign default in Europe: Towards a Euro(pean) Monetary Fund. *CEPS Policy Brief*, no. 22 (February), Center for European Policy Studies. Brussels.
- Gros, Daniel, Thomas Mayer, and Angel Ubide. 2005. *EMU at Risk*. CEPS Macroeconomic Policy Group. Center for European Policy Studies. Brussels.
- Hall, Peter A., and David Soskice. 2001. *Varieties of capitalism: The institutional foundations of comparative advantage*. Oxford University Press. Oxford.
- Hallerberg, Mark. 2004. *Domestic budgets in a United Europe: Fiscal governance from the end of Bretton Woods to EMU*. Cornell University Press. Ithaca NY.
- Hamilton, Alexander, James Madison, and John Jay. 1987. *The Federalist Papers*. Penguin Books. London.
- Hefeker, Carsten. 2003. Credible at last? Reforming the Stability Pact. *Intereconomics* 38, no. 1: 15.
- Heipertz, Martin. 2003. The Stability and Growth Pact – Not the best but better than nothing. Reviewing the debate on fiscal policy in Europe's monetary union. *MPIfG Working Paper* 3, no. 10. Cologne. (October)
- Hodson, Dermot. 2004. Macroeconomic co-ordination in the euro area: The scope and limits of the open method. *Journal of European Public Policy* 11, no. 2: 231-248.

- Hodson, Dermot, and Imelda Maher. 2004. Soft law and sanctions: Economic policy co-ordination and reform of the Stability and Growth Pact. *Journal of European Public Policy* 11, no. 5: 798-813.
- Hoffman, Stanley. 1995. *The European Sisyphus: Essays on Europe, 1964–1994*. Westview Press. Boulder CO.
- Höpner, Martin, and Armin Schäffer. 2010. A new phase of European integration: Organized capitalism in post-Ricardian Europe. *West European Politics* 33, no. 2: 344-368.
- Howarth, David. 2007. Making and breaking the rules: French policy on EU “gouvernement économique”. *Journal of European Public Policy* 14, no. 7: 1061-1078.
- Jabko, Nicolas. 2006. *Playing the market: A political strategy for integrating Europe, 1985–2005*. Cornell University Press. Ithaca NY.
2010. The hidden face of the euro. *Journal of European Public Policy* 17, no. 3: 318-334.
- Jacquet, Pierre, and Jean Pisani-Ferry. 2001. *Economic policy co-ordination in the Euro-zone: What has been achieved? What should be done?* Centre for European Reform. London.
- Jamet, Jean-François. 2010. *Un gouvernement économique européen: du slogan à la réalité?* April 26. Fondation Robert Schuman. Paris.
- Jones, Erik. 2002. *The politics of economic and monetary union: Integration and idiosyncrasy*. Rowman and Littlefield Publisher. Lanham MD.
- Juncker, Jean-Claude, and Giulio Tremonti. 2010. E bonds would end the crisis. *Financial Times*, December 5.
- Keohane, Robert O. 2002. Ironies of sovereignty: The European Union and the United States. *Journal of Common Market Studies* 40, no. 4: 743-765.
- Keohane, Robert O., and Stanley Hoffmann. 1991. Institutional change in Europe in the 1980s. In Robert O. Keohane and Stanley Hoffmann (eds). *The new European community: Decisionmaking and institutional change*. Westview. Boulder CO.
- Le Cacheux, Jacques. 2010. How to herd cats: Economic policy coordination in the Euro zone in tough times. *Journal of European Integration* 32, no. 1: 41-58.
- Leblond, Patrick. 2006. The Political Stability and Growth Pact is dead: Long live the Economic Stability and Growth Pact. *Journal of Common Market Studies* 44 (December): 969-990.

- Marsh, David. 1992. *The Bundesbank: The bank that rules Europe*. William Heinemann. London.
- Martens, Hans, and Fabian Zuleeg. 2008. *Where would we be now without the euro?* Commentary. European Policy Center. Brussels.
- Mayes, David G., and Matti Virén. 2004. Pressures on the Stability and Growth Pact from asymmetry in policy. *Journal of European Public Policy* 11, no. 5: 781-797.
- McNamara, Kathleen R. 1998. *The currency of ideas: Monetary politics in the European Union*. Cornell University Press. Ithaca NY.
- McNamara, Kathleen R., and Sophie Meunier. 2002. Between national sovereignty and international power: What external voice for the Euro? *International Affairs* 78, no. 4: 849-868.
- Merkel, Angela, and Nicolas Sarkozy. 2010. Press Conference, February 11. Brussels.
- Meyer, Christoph O. 2004. The hard side of soft policy co-ordination in EMU: The impact of peer pressure on publicized opinion in the cases of Germany and Ireland. *Journal of European Public Policy* 11, no. 5: 814-831.
- Mortensen, Jorgen. 2004. *Economic policy coordination in EMU: What role for the SGP?* Center for European Policy Studies (CEPS), no. 202. Working Documents (June).
- Padoa-Schioppa, Tommaso. 2000. An institutional glossary of the eurosystème. *ZEI Policy Paper*, no. B16. Bonn.
- Pisani-Ferry, Jean. 2006. Only one bed for two dreams: A critical retrospective on the debate over the economic governance of the Euro area. *Journal of Common Market Studies* 44, no. 4: 823-844.
- 2010a. *EMU warfare: The Colin Powell doctrine has come to Europe*. Bruegel. Brussels.
- 2010b. Euro area governance: What went wrong in the euro area? May 26. Bruegel. Brussels.
- Pisani-Ferry, Jean, and André Sapir. 2010. *Weathering the storm: Fair weather versus stormy weather governance in the Euro area*. Bruegel. Brussels.
- Puetter, Uwe. 2001. The informal Eurogroup: A new working method and an institutional compromise. *Constitutionalism Web papers conWEGB*, no. 2.

- Quatremer, Jean. 2008. L'Elysée vote Juncker et Barroso pour diriger l'Union. Blog. May 5. <http://bruxelles.blogs.liberation.fr/coulisses/2008/05/lelyse-vote-jun.html#more>.
- Royal, Ségolène. 2007. Pacte Présidentiel. February 11. Villepinte, Paris.
- Sadeh, Tal. 2006. *Sustaining European Monetary Union: Confronting the cost of diversity*. Lynne Rienner Publishers. Boulder CI.
- Sarkozy, Nicolas. 2007. Letter of instruction to Minister Christine Lagarde, July 11.
2008. Speech at the European Parliament, October 21, Strasbourg.
- Schauble, Wolfgang. 2010. Why Europe's Monetary Union faces its biggest crisis. *Financial Times*, March 11.
- Schelkle, Waltraud. 2004. EMU's second chance: Enlargement and the reform of fiscal policy co-ordination. *Journal of European Public Policy* 11, no. 5: 890-908.
- Schmidt, Vivien. 2006. *Democracy in Europe: The EU and national politics*. Oxford University Press. Oxford.
- Schwarzer, Daniela. 2005. Transnational consensus building in EMU economic governance: Elite interaction and national preference formation. *Transnational European Union: Towards a common political space*. Routledge. London.
- Stark, Jürgen. 2008. Speech at the HEC European Executive Campus, January 22, Brussels.
- Taylor, Christopher. 2004. An exchange-rate regime for the euro. *Journal of European Public Policy* 11, no. 5: 871-889.
- Tilford, Simon. 2009. *The euro at ten: Is its future secure?* January. Centre for European Reform. London.
- Trichet, Jean-Claude. 1992. *Dix ans de désinflation compétitive en France*. October 16. Notes bleues du Ministère des Finances. Paris.
- Tsoukalis, Loukas. 1977. *The politics and economics of European monetary integration*. George Allen and Unwin. London.
- Verdun, Amy. 2003. La nécessité d'un "gouvernement économique" dans une UEM asymétrique. *Politique européenne*, no. 10: 11-32.
- Von Hagen, Jürgen, Jean Pisani-Ferry, André Sapir, François Gianviti, and Anne O Krueger. 2010. *A European mechanism for sovereign debt crisis resolution: A proposal*. Bruegel. Brussels.
- Wyplosz, Charles. 2005. Fiscal policy: Rules or institutions? *National Institute Economic Review* 191, no. 1 (January): 64-78.

SIEPS publications available in English

2011

2011:1

The Financial Crisis – Lessons for Europe from Psychology

Author: Henry Montgomery

2011:1epa

How Small are the Regional Gaps? How Small is the Impact of Cohesion Policy? A Commentary on the Fifth Report on Cohesion Policy

Author: Daniel Tarschys

2010

2010:7

Recalibrating the Open Method of Coordination: Towards Diverse and More Effective Usages

Authors: Susana Borrás and Claudio M. Radaelli

2010:6

The Creeping Nationalisation of the EU Enlargement Policy

Author: Christophe Hillion

2010:5

A European Perspective on External Balances

Author: Philip R. Lane

2010:4

Immigration Policy for Circular Migration

Author: Per Lundborg

2010:2op

The 2010 Belgian Presidency: Driving in the EU's Back Seat

Authors: Edith Drieskens, Steven Van Hecke and Peter Bursens

2010:1op

The 2010 Spanish EU Presidency: Trying to Innovate Europe in Troubled Times

Author: Ignacio Molina

2010:14epa

Mollifying Everyone, Pleasing No-one. An Assessment of the EU Budget Review

Author: Iain Begg

2010:11epa

Social and Employment Policy in the EU and in the Great Recession

Author: Giuseppe Bertola

2010:10epa

The Socio-Economic Asymmetries of European Integration or Why the EU cannot be a “Social Market Economy”

Author: Fritz W. Scharpf

2010:9epa

Strengthening the Institutional Underpinnings of the Euro

Author: Stefan Gerlach

2010:6epa

The European External Action Service: towards a common diplomacy?

Author: Christophe Hillion

2010:2epa

Rethinking How to Pay for Europe

Author: Iain Begg

2010:1epa

Internal and External EU Climate Objectives and the Future of the EU Budget

Author: Jorge Núñez Ferrer

2009

2009:8

The Impact of the Euro on International Trade and Investment: A Survey of Theoretical and Empirical Evidence

Author: Harry Flam

2009:7

Aggregate and Regional Business Cycle Synchronisation in the Nordic Countries

Authors: Anna Larsson, Nevena Gaco and Henrik Sikström

2009:6

*Trade in Services and in Goods with Low-Wage Countries
– How do Attitudes Differ and How are They Formed?*

Authors: Lars Calmfors, Girts Dimdins, Marie Gustafsson,
Henry Montgomery and Ulrika Stavlöt

2009:5

How to Reform the EU Budget? A Methodological Toolkit

Author: Filipa Figueira

2009:4

*Climate Change and Energy Security in Europe:
Policy Integration and its Limits*

Authors: Camilla Adelle, Marc Pallemmaerts and Joanna Chiavari

2009:3

Empowering National Courts in EU Law

Authors: Xavier Groussot, Christoffer Wong, Andreas Inghammar
and Anette Bruzelius

2009:2

Migration as Foreign Policy?

The External Dimension of EU Action on Migration and Asylum

Author: Andrew Geddes

2009:1

Fiscal Federalism, Subsidiarity and the EU Budget Review

Author: Iain Begg

2009:4op

Which Common Policy for Agriculture and Rural Areas beyond 2013?

Editors: Nadège Chambon och Jonas Eriksson

2009:3op

The Swedish Presidency: European Perspectives

Editors: Fredrik Langdal and Göran von Sydow

2009:2op

The 2009 Czech EU Presidency: Contested Leadership at a Time of Crisis

Authors: David Král, Vladimír Bartovic and Věra Rihácková

2009:1op

Democracy Promotion in a Transatlantic Perspective

Contributions by Maria Leissner, Annika Björkdahl,

Roel von Meijenfeldt,

Tom Melia, Pavol Demeš and Michael Allen

2009:14epa

The Eastern Partnership: Time for an Eastern Policy of the EU?

Author: Anna Michalski

2009:13epa

Out in the Cold? Flexible Integration and the Political Status of Euro-Outsiders

Authors: Daniel Naurin and Rutger Lindahl

2009:12epa

From Zero-Sum to Win-Win?

The Russian Challenge to the EU's Eastern Neighbourhood Policies

Author: Hiski Haukkala

2009:11epa

The CAP and Future Challenges

Authors: Mark Brady, Sören Höjgård, Eva Kaspersson

and Ewa Rabinowicz

2009:10epa

A Legal Analysis of the Global Financial Crisis from an EU Perspective

Author: Sideek Mohamed Seyad

2009:9epa

An EU Strategy for the Baltic Sea Region:

Good Intentions Meet Complex Challenges

Author: Rikard Bengtsson

2009:8epa

What to Expect in the 2009-14 European Parliament:

Return of the Grand Coalition?

Author: Simon Hix

2009:7epa

The 2009 Swedish EU Presidency: The Setting, Priorities and Roles

Authors: Fredrik Langdal and Göran von Sydow

2009:5epa

When Lab Results are not Sufficient: On the Limitations of Science in Tackling Modern Food Regulatory Concerns

Author: Karolina Zurek

2009:2epa

Democracy Promotion in a Transatlantic Perspective:

Reflections from an Expert Working Group

Author: Anna Michalski

2009:1epa

Foreign Policy Challenges for the Obama Administration

Author: John K. Glenn

2008

2008:9

Immigrants from the New EU Member States and the Swedish Welfare State

Authors: Christer Gerdes and Eskil Wadensjö

2008:8

The EU as a Global Actor in the South

Authors: Björn Hettne, Fredrik Söderbaum and Patrik Stålgren

2008:6-7

Institutional Competences in the EU External Action:

Actors and Boundaries in CFSP and ESDP

Authors: Lisbeth Aggestam, Francesco Anesi, Geoffrey Edwards, Christopher Hill and David Rijks

2008:5

Transforming the European Community's Regulation of Food Safety

Author: Morten P. Broberg

2008:4

Turning the EU Budget into an Instrument to Support the Fight against Climate Change

Authors: Camilla Adelle, Marc Pallemmaerts and David Baldock

2008:3

Can Reforming Own Resources Foster Policy Quality?

Author: Jorge Núñez Ferrer

2008:2

The EU Budget Review:

Mapping the Positions of Member States

Editors: Tamás Szemplér and Jonas Eriksson

2008:1

Common Energy Policy in the EU:

The Moral Hazard of the Security of External Supply

Authors: Chloé Le Coq and Elena Paltseva

2008:3op

The French Presidency of 2008: The Unexpected Agenda

Authors: Christian Lequesne and Olivier Rozenberg

2008:2op

The 2008 Slovenian EU Presidency:

A New Synergy for Europe? A Midterm Report

Authors: Danica Fink-Hafner and Damjan Lajh

2008:1op

The Purse of the European Union:

Setting Priorities for the Future

Contributors: Iain Begg, André Sapir and Jonas Eriksson

2008:14epa

The Swedish 2009 Presidency – Possible Policy Priorities

Authors: Fredrik Langdal and Göran von Sydow

2008:11epa

EU Energy Policy in a Supply-Constrained World

Authors: Jacques de Jong and Coby van der Linde

2008:8epa

The Potential Impact of the Lisbon Treaty on European Union External Trade Policy

Author: Stephen Woolcock

2008:4epa

The Lisbon Treaty and EMU

Author: Sideek Mohamed Seyad

2008:3epa

The Lisbon Treaty and the Area of Criminal Law and Justice

Author: Ester Herlin-Karnell

2008:2epa

A Better Budget for Europe: Economically Efficient, Politically Realistic

Author: Filipa Figueira

2008:1epa

The Future of the Common European Asylum System:

In Need of a More Comprehensive Burden-Sharing Approach

Author: Eiko Thielemann

2007

2007:6

EU for the Patients: Developments, Impacts, Challenges

Author: Dorte Sindbjerg Martinsen

2007:3

Does a Family-Friendly Policy Raise Fertility Levels?

Author: Anders Björklund

2007:2

The Euro – What's in it for me?

An Economic Analysis of the Swedish Euro Referendum 2003

Authors: Lars Jonung and Jonas Vlachos

2007:1

Bargaining Power in the European Council

Author: Jonas Tallberg

2007:1u

New Criminal Law Developments in the Community Legal Order

Author: Hanna Goeters

2007:2op

Why Europe? Possibilities and Limits of European Integration

Authors: Andreas Føllesdal, Andrew Moravcsik, Jo Shaw,
Fredrik Langdal and Göran von Sydow

2007:1op

The 2007 German EU Presidency: A Midterm Report

Authors: Sebastian Kurpas och Henning Riecke

2007:6epa

Flexicurity – An Answer or a Question?

Author: Lars Calmfors

2007:5epa

Agenda 2014: A Zero-Base Approach

Author: Daniel Tarschys

2007:3epa

*A New Proposal for a Regulation on Mutual Recognition of Goods
– Towards a Harmonized Administrative Order?*

Author: Jane Reichel

2007:2epa

*Spillover or Activist Leapfrogging? Criminal Competence and the
Sensitiveness of the European Court of Justice*

Author: Maria Bergström

2007:1epa

Better Regulation of Mobile Telecommunications

Authors: Johan Stennek and Thomas P. Tangerås

2006

2006:12

The Legal Basis Game and European Governance

Author: Joseph Jupille

2006:11

Budget Allocation in an Expanding EU – A Power Politics View

Author: Mika Widgrén

2006:10

International Agreements in EU Neighbourhood Policy

Author: Marius Vahl

2006:5

*Freedom of Movement for Workers from Central and Eastern Europe:
Experiences in Ireland and Sweden*

Authors: Nicola Doyle, Gerard Hughes and Eskil Wadensjö

2006:4

The Dynamics of Enlargement:

The Role of the EU in Candidate Countries' Domestic Policy Processes

Author: Andreas Bågenholm

Turkey, Sweden and the European Union Experiences and Expectations

2006:2

Armed and Ready?

The EU Battlegroup Concept and the Nordic Battlegroup

Author: Jan Joel Andersson

2006:1

Leader or Foot-Dragger?

*Perceptions of the European Union in Multilateral International
Negotiations*

Author: Ole Elgström

2006:1op

The Austrian EU Presidency: A Midterm Report

Author: Paul Luif

2005

2005:10

*The Role of the National Courts in the European Union:
A Future Perspective*

Author: Xavier Groussot

2005:9

Is the Commission the Small Member States' Best Friend?

Authors: Simone Bunse, Paul Magnette and Kalypso Nicolaïdis

2005:8

What Remains of the Stability Pact and What Next?

Author: Lars Calmfors

2005:7

European Integration and Trade Diversion: Yeats revisited

Authors: Ari Kokko, Thomas Mathä and Patrik Gustavsson Tingvall

2005:5

From Policy Takers to Policy Makers:

Adapting EU Cohesion Policy to the Needs of the New Member States

Editors: Jonas Eriksson, Bengt O. Karlsson and Daniel Tarschys

2005:4

The Enigma of European Added Value:

Setting Priorities for the European Union

Author: Daniel Tarschys

2005:2op

The 2005 UK Presidency: Beyond the British Question?

Author: Edward Best

2005:1op

The 2005 Luxembourg Presidency:

A Presidency Devoted to the Stability and Growth Pact and to the Lisbon Process

Authors: Patrick Dumont and Philippe Poirier

2004

2004:9

The Political Dynamics of Turkish Accession to the EU:

A European Success Story or the EU's Most Contested Enlargement?

Author: Kirsty Hughes

2004:1u

European Governance – An Overview of the Commission's Agenda for Reform

Authors: Josefin Almer and Matilda Rotkirch

2004:1op

*The Netherlands 2004 EU Council Presidency:
Dutch EU Policy-Making in the Spotlights*

Author: Mendeltje van Keulenv

2003

2003:19

Industrial Structure and Industry Location in an Enlarged Europe

Author: Karolina Ekholm

2003:18

Coming of Age? Economic Management of the European Union

Authors: Per Molander and Allan Gustafsson

2003:17

Reinventing Cohesion: The Future of European Structural Policy

Author: Daniel Tarschys

2003:14

Decentralized Agencies and the IGC: A Question of Accountability

Authors: Carl Fredrik Bergström and Matilda Rotkirch

2003:9

Reforming the Council: A Work in Progress

Authors: Helen Wallace and Fiona Hayes-Renshaw

2003:8

Simply Simplification? The Proposal for a Hierarchy of Legal Acts

Authors: Carl Fredrik Bergström and Matilda Rotkirch

2003:7

*The Invisible Transformation of Codecision:
Problems of Democratic Legitimacy*

Authors: Henry Farrell and Adrienne Héritier

2003:1

The Open Method of Coordination:

A New Governance Architecture for the European Union?

Author: Claudio M. Radaelli

2003:1op

Contrasting Transatlantic Interpretations:

The EU and the US towards a Common Global Role

Author: Ludger Kühnhardt



Sieps●●●

Swedish Institute for European Policy Studies

Fleminggatan 20
SE-112 26 Stockholm
Ph: +46 (0)8-586 447 00
Fax: +46 (0)8-586 447 06
E-mail: info@sieps.se
www.sieps.se