

Editorial

## Reforming the Institutions of Eurozone Governance

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### Abstract

The Eurozone has faced repeated crises and has experienced profound transformations in the past years. This thematic issue seeks to address the questions arising from the changing governance structure of the Eurozone. First, how have the negotiations, pressures of the crises and reforms impacted the relationships between key actors like EU institutions and Member States? Second, where did national positions come from and what role did domestic politics play in the negotiations? And finally, to what extent has the evolution of Eurozone governance left room for adequate control mechanisms and democratic debate? The articles in this issue highlight the developing role of Member States, domestic politics and democratic and legal control mechanisms.

### Keywords

democratic deficit; domestic politics; Economic and Monetary Union; European Central Bank; Eurozone checks-and-balances; Eurozone governance; sanctions

### Issue

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### 1. Introduction

Eurozone governance was in the beginning of this century dominated by an asymmetric institutional structure mostly relying on a strong monetary pillar and fiscal constraints stipulated in the Stability and Growth Pact (SGP; Howarth & Verdun, 2020). The contagion effect of the international financial crisis painfully highlighted the inadequacy of this governance structure and available response mechanisms, as Eurozone Member States struggled to protect their economies and contain the growth of public debt. In the course of successive crises since 2007, a wide range of reform ideas were launched to strengthen the governance structure with more integrated financial, fiscal and economic policy tools (Chang, 2016). In parallel, the European Central Bank (ECB) introduced non-standard measures to cushion the adverse impact on banks.

Economic policy coordination was enhanced by the so-called ‘Six-Pack,’ ‘Two-Pack’ and the Fiscal Compact,

which strengthened the SGP and introduced the Macroeconomic Imbalance Procedure. These reforms, streamlined under the European Semester, were intended to facilitate sanctions under the SGP, reinforce fiscal discipline and make surveillance more elaborate so that imbalances could be identified and addressed earlier (Bauer & Becker, 2014).

The introduction of the multi-pillar structure of the banking union was intended to reinforce the stability of the European banking system, for example through a single rule book for banks and several instruments for Eurozone banks. The main objective was to break the sovereign-bank doom-loop by putting financial institutions under a common supervisory and resolution framework and to create a common deposit insurance system (Dehousse, 2016). The Single Supervisory Mechanism and a Single Resolution Mechanism were adopted in 2013 and 2014, whereas political deadlock prevented the adoption of a European Deposit Insurance Scheme (Howarth & Quaglia, 2016). Likewise, agreements on

detailed implementation of banking union components such as the Single Resolution Fund, the financial backbone of the Single Resolution Mechanism, proved to be problematic.

The crises also highlighted the lack of an effective financial support structure within the Eurozone. Member States created various bailout funds in and outside of the EU legal framework with the European Stability Mechanism becoming the centrepiece for Eurozone assistance in 2012 (Ioannou, Leblond, & Niemann, 2015). Between 2010 and 2015, EU and Eurozone Member States channelled assistance through the European Stability Mechanism and other mechanisms often accompanied by International Monetary Fund support and strict austerity measures. The ECB also created monetary stabilisation instruments by enlarging its long-term lending operations and engaging in bond purchases on the secondary market, with the latter creating controversy on both the national and European level.

However, disagreements between Member States or between national governments and European institutions delayed some decisions and led to foot-dragging and slow implementation of others, as is the case with the banking union. A few years after the beginning of the reform efforts, the so-called *Five Presidents' Report* called for new efforts in reforming Eurozone governance and for completing the Economic and Monetary Union. Amongst other elements it particularly emphasised the need to establish the European Deposit Insurance Scheme, a backstop for the Single Resolution Fund and to setup a common fiscal capacity to cushion macroeconomic shocks (Juncker, 2015). However, disagreement on the detailed design of these and other issues remained and curtailed the reform process of Eurozone governance.

The repeated crises faced by the Eurozone and the profound transformations it has experienced raise important questions that this thematic issue seeks to address. First, how have the negotiations, pressures of the crises and reforms impacted the relationships between key actors like EU institutions and Member States? Second, where did national preferences come from and what role did domestic politics play in the negotiations? And finally, to what extent has the evolution of Eurozone governance been accompanied by the creation of adequate control mechanisms and democratic debate?

## 2. An Overview of This Thematic Issue

The first section of this issue examines the evolving roles of European and national actors in Eurozone governance and the continuous renegotiation of their influence and relationship to other actors in the system.

Sacher (2021) analyses why the European Commission is reluctant to impose sanctions on Member States, despite the importance of this tool for the Economic and Monetary Union since its inception. In addition, provisions on sanctions have empowered the Commission

and have become stricter in the aftermath of the financial and sovereign debt crises. An analysis of three post-crisis cases using process-tracing methods in combination with a normative institutionalist analysis shows that the Commission is reluctant to impose sanctions, as it does not perceive punitive action as appropriate.

Rehm (2021) analyses the development of financial assistance in the Eurozone since 2010. His liberal intergovernmentalist analysis finds that reforms to assistance mechanisms are best explained by a re-occurring pattern of mixed preferences. On the one hand, the threat to Eurozone stability encouraged Member States to expand and deepen the assistance formula. On the other hand, potential creditors and debtors tried to shield themselves from incurring direct costs or protect their economies. The resulting reforms advanced financial support in size and scope but failed to effectively address the difficulties at hand.

Kavvadia (2021) focuses on the role of the European Investment Bank (EIB) in promoting a greener agenda for EU development. She argues that the EIB's announcement of its metamorphosis into a 'Climate Bank' in the context of the EU's Green Deal makes it an important actor in the EU's climate agenda. She analyses the EIB's climate pivot by examining the bank's rational interests within a sociology of markets analytical framework and uses a principal-agent model to illustrate the changing relationship between the European Commission and the EIB.

The second section of this issue focuses on domestic politics. The goal is to understand the factors that determine how national governments act at the European level. The articles in this section contribute to the literature on the domestic politics of Eurozone reform, which tends to analyse government preferences through the prism of a competition between structural economic factors and political considerations (Tarlea, Bailer, & Degner, 2019; Van der Veer & Haverland, 2019).

Commain (2021) argues that national positions on the EU's adoption of harmonized capital requirements between 2008 and 2010 can be explained by structural factors and the 'varieties of financial capitalism' approach (Howarth & Quaglia, 2013; Story & Walter, 1997). Regulating banks, he argues, requires policy-makers to balance restrictions of the risk-taking behaviour of banks and the economy's reliance on bank lending for growth. Therefore, while governments generally support the proposed increase of bank capital requirements, they seek targeted preferential treatments aimed at preserving the domestic supply of retail credit.

Van Loon (2021) applies a societal approach to governmental preference formation inspired by Schirm (2018, 2020) to examine the Economic and Monetary Union's impact of issue salience and actor plurality, subsequently triggering material and ideational considerations on government preferences towards the Financial Transaction Tax introduction. By analysing the German, French and Irish cases of domestic preference formation, she argues

that the lack of consensus on the European level was shaped by governments' responsiveness towards both societal dynamics and material interests within the domestic societies of these member states.

Similarly, Högenauer (2021) studies the extent to which the banking union was scrutinized by the French and German parliaments and to what degree this reflects ideas and material interests. An analysis of parliamentary salience and polarization shows that—in line with public salience—the German Bundestag was indeed a far more active scrutinizer. However, the positioning of parliamentarians in the two countries is largely explained by structural economic factors and the interests of domestic banks.

Donnelly (2021) studies the degree of domestic support in German political parties for the country's change of stance on the issue of European grants to Member States, and its impact on intergovernmental negotiations on the Eurozone budget between 2018 and 2020. He argues that Christian Democratic politicians and voters are likely to limit Germany's support for a larger EU budget or European grants in the future, despite Social Democratic efforts to keep the door open.

Finally, the thematic issue ends with two articles looking at the checks-and-balances in Eurozone governance and the democratic nature of reforms.

Fontan and Howarth (2021) analyse the national-level reaction to the problematic combination of the ECB's strong independence and ever broader interpretation of its own mandate. Applying elements of a principal-agent approach, they argue that the ruling of the German Federal Constitutional Court of May 2020 demonstrates the relative importance of national—as opposed to European-level—actors exercising ex-post control over ECB policies.

Sebastião (2021) examines the democratic nature of Eurozone governance reforms from an interdisciplinary perspective and closes the thematic issue on a normative note. She uses process-tracing methodology to argue that, while the Eurozone and Covid-19 crises evidenced different kind of policy outcomes, the EU democratic deficit remains. Economic crises convert economic power into 'representative' political power, thus perpetrating the political over-hegemony of previous surplus economies. Ideological debate is constrained and national interests prevail over politicisation. Political representative power and democracy are losing out in the process.

The contributions of this thematic issue highlight the persistent divisions among Member States, the negative impact on democracy of the crises and the latent distrust within creditor states. They also provide insights into the factors that shape Member State positions and the new roles of several EU institutions in Eurozone governance.

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### Conflict of Interests

The authors declare no conflict of interests.

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