

### 3 Literature Review

The European sovereign debt crisis having formed the most dramatic challenge to the eurozone and its common currency since their establishment, it is not surprising that a vast amount of scholarly literature exists on the topic. Numerous works have been published treating all thinkable aspects of the crisis, spanning the range of analyses of its historical development and background, theoretical assessments of the integration mechanisms surrounding the crisis, and examinations of the crisis consequences and future implications.

To serve the purpose of the present paper, which focuses on the specific aspect of reform in the crisis and its mutual initiation on the respective European and national levels, special attention shall be given to a select choice of literature that contributes to this paper's area of interest. This chapter thus summarises the current state of scholarly evaluation of the eurocrisis in terms of reform mechanisms and actor constellations from the view of some of the most important theories of European integration. A detailed regard shall be shed here on three path-defining works of literature that provide a theoretical backbone to this paper's claims and form the basis upon which this paper expands and develops in the forthcoming chapters.

First, Frank Schimmelfennig's much-regarded work<sup>18</sup> on integration mechanisms in the crisis from a neofunctionalist and intergovernmentalist view shall be regarded, explaining how profound steps towards further integration were developed in the crisis in opposition to postfunc-

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18 Frank Schimmelfennig, "European Integration in the Euro Crisis: The Limits of Post-functionalism", *Journal of European Integration*, 36:3 (2014), 321–337.

tionalist claims. Secondly, Jones et al.'s ground-breaking "Failing forward?" paper<sup>19</sup> shall be looked at, a work that explains the EU's continuous step towards further integration through incomplete and incremental reforms. Finally, Marcus Ojala's neoliberalist criticism of the crisis governance by supranational institutions<sup>20</sup> shall be assessed.

### 3.1 Integration Leaps during the Eurocrisis

Frank Schimmelfennig claims in his work "European Integration in the Euro Crisis", published shortly after the eurozone challenge had ebbed down, that the crisis enabled "major steps"<sup>21</sup> of reform and formed an important facilitator of increased integration. He argues that a wide-reaching reconstruction of the EMU was made possible in the crisis years, not only achieving the goal of preserving the common currency but also strengthening integration in the technocratic, fiscal and financial fields.<sup>22</sup> These developments included the establishment of a common financial body, the European banking union, the increase of fiscal rules and surveillance by means of the Six Pack, the Two Pack, and the Fiscal Compact, and the intervention by the European Central Bank (ECB) in the form of Outright Monetary Transactions (OMT), the Securities Market Programme (SMP), and the provision of long-term cheap credit to failing member states.<sup>23</sup> Additionally, the establishment of permanent institutions such as the European Financial Stability facility (EFSF) and ESM formed bodies that provided the framework for the deepening of integration in the field.

19 Erik Jones, R. Daniel Keleman and Sophie Meunier, „Failing Forward? The Euro Crisis and the Incomplete Nature of European Integration”, *Comparative Political Studies* (2016), 1519–1536.

20 Markus Ojala, "Doing Away with the Sovereign: Neoliberalism and the Promotion of Market Discipline in European Economic Governance", *New Political Economy*, 26:1 (2021), 203–215.

21 Schimmelfennig, op.cit., 331.

22 Ibid., 323.

23 Ibid., 325.

Schimmelfennig explains these developments towards increased integration, collaboration, and supranationalisation by combining two strands of integration theories: intergovernmentalism and neofunctionalism. According to the intergovernmental logic, he claims, national preference constellations enabled deeper integration due to the common preference of all actors to preserve the euro and introduce reforms to the euro area.<sup>24</sup> The interdependence between member states and the European level which was the result of the already extant deep monetary union allowed for a shift in the structure of intergovernmental bargaining from opposing national preferences to a common goal of saving the euro by introducing reforms. With the costs of a possible renationalisation of monetary and financial policy high and the risk of contagion granting weaker countries valuable bargaining power while remaining dependent on financial assistance from stronger countries<sup>25</sup>, the member states found themselves in a constellation of mutual dependence that helped align their preferences. Interestingly, this mechanism enabled the repeated overriding even of dominant countries such as Germany, a renowned opposer in all things concerning financial integration, to align with the common position regarding controversial issues such as loans to Greece and the expansion of EFSF and ESM.<sup>26</sup> Schimmelfennig hence shows that the eurocrisis presented a unique situation of aligned actor preferences, paving the way towards further integration despite – or because of – the high stakes at play.

This mechanism of dependence is further explained by Schimmelfennig with reference to the neofunctionalist theory. The increased creation of new supranational institutions is thus shown to be the result of path dependency and spill-over effects, where the formerly decentralised financial and fiscal policies underwent a similar integration as monetary union had in prior decades.<sup>27</sup> Due to the situational constellation of national economic preferences, the functional spill-over towards more institutionalisation and integration as a crisis solution mechanism was preferable to an equivalent disintegration, and the high-pressure context of the crisis

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24 Ibid., 330.

25 Ibid., 329–330.

26 Ibid.

27 Ibid.

with the possibility of crash created a further push for cooperation as a response to the urgency of the situation.<sup>28</sup>

The point that Schimmelfennig makes is thus that the crisis development followed a neofunctionalist and intergovernmentalist logic rather than a postfunctionalist one as supported by fellow scholars Hooghe and Marks.<sup>29</sup> The latter claim that the austerity measures introduced in the crisis had a negative effect on the welfare of member state citizens, led to wage and pension cuts and induced tax increases, hereby sparking a decrease in the support for the EU and tendencies towards disintegration and nationalisation in a logic of “constraining dissensus”<sup>30</sup>. However, despite the crisis having provided all pre-conditions for a postfunctionalist turn, Schimmelfennig claims that the national governments were able to avoid said constraining dissensus by transferring competencies to the supranational level, shielding themselves from domestic political pressures.<sup>31</sup> Thus, supranational delegation enabled national governments to avoid politicising referendums contesting national reforms, a wide-spread rise of anti-EU parties, and the risk of rising demands to abandon the common currency.<sup>32</sup>

In sum, Schimmelfennig’s main claims consist in the identification of substantial reforms of the eurozone paired with a simultaneous increase in supranational integration at the European level. These developments were made possible due to a contextual setting of aligned national preferences of the member states put under pressure by the severity of the crisis and by the unsupportable costs in case of collapse. Avoiding a postfunctionalist turn towards nationalisation and disintegration, reforms on the national level were welcomed as a means to shield national governments from political pressures. Strikingly, Schimmelfennig combines intergovernmentalism and neofunctionalism to one consistent line of argument, claiming that their only difference lies in the identification of

28 Ibid., 329.

29 Liesbet Hooghe and G. Marks, “A postfunctionalist theory of European integration: from permissive consensus to constraining dissensus”, *British Journal of Political Science* 39, no. 1 (2008), 1–23.

30 Ibid., 5; Schimmelfennig, op.cit., 322.

31 Ibid., 334.

32 Ibid., 323.

the actor benefitting from power increase: for intergovernmentalism, it is the national governments, while neofunctionalism regards supranational institutions as empowered by integration.<sup>33</sup> This duality shows that a certain interdependence exists between the national and the supranational level, with no clear “winner” or “loser” discernible, rather creating a kind of balance between the two levels. This finding, alongside Schimmelfennig’s link between reform creation and integration, shall be taken up in the forthcoming chapters of this paper.

### 3.2 Failing Forward with Incremental Reforms

In a similar combination of the two integration theories of intergovernmentalism and neofunctionalism, Jones, Kelemen and Meunier explain the integration patterns of the eurozone crisis in their break-through “Failing forward?” work of 2016. Their main distinction from Schimmelfennig’s assessment lies in their evaluation of the reform developments and integration steps as incremental and “piecemeal”<sup>34</sup> rather than complete and sustainable. The logic that Jones et al. apply to adjustments made in the context of the crisis follows a vicious circle of incomplete reforms due to intergovernmental bargaining resulting in only the lowest common denominator solutions which are so unsustainable that they soon trigger further crises. These in turn lead to renewed lowest common denominator solutions.<sup>35</sup> Thus, deeper integration is achieved only in small steps that are repeatedly characterised by their incomplete nature.

Jones et al. explain the reluctance of policy-makers to engage in more comprehensive reform in a fusion of the intergovernmental and the neofunctional theories. The reservations of member states to apply substantial adjustments is attributed to their national preferences, therefore rendering the domestic self-interest and bargaining power responsible for lowest common denominator solutions.<sup>36</sup> At the same time, however,

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33 Ibid., 334–335.

34 Jones, Kelemen and Meunier, *op.cit.*, 1012.

35 Ibid., 1017.

36 Ibid., 1014.

each incomplete step towards integration triggers spill-overs in a neofunctional logic which with time strengthens further cooperation and a delegation to the supranational level.<sup>37</sup>

For Jones et al., the incomplete nature of the EMU was therefore both cause and response to the eurozone crisis<sup>38</sup>, with a weak EMU architecture rendering it fragile in the first place and national reluctance to reform forming a subsequent constraint to the tackling of this weakness. According to Jones et al., the European goal of a common currency applied to the single market was lacking from the start due to weak coordination and adjustment mechanisms, with regulatory power remaining distinctly national, hereby forming a critical factor enabling the crisis.<sup>39</sup> While national leaders by all means recognised these shortcomings of the eurozone prior to the crisis, their inhibitions to transfer authority to the supranational level and the heterogeneous national preference constellation allowed them only to achieve minimum improvements to the fragile eurozone architecture.<sup>40</sup>

In the “Failing forward” circle, hence, any substantial integration steps arise only in a secondary effect logic from minimal adjustments made as lowest common denominator solutions: for example, the agreement on direct capital injections by the ESM – a minimum compromise to avoid full-fledged bailouts in Spain and Italy – in turn led to further and more substantial integration in an effect of “unintended consequences”<sup>41</sup> such as the creation of the Single Supervisory Mechanism (SSM), the establishment of a single rulebook, the Single Resolution Mechanism (SRM) and the Single Resolution Fund (SRF), and institutionalisation of such bodies.<sup>42</sup> While the accumulation of multiple incremental reforms during the euro crisis therefore created, in sum, an exceptionally rapid and intense phase of deepening integration<sup>43</sup>, the willingness behind these adjustment and the aim to create a stable mechanism of cooperation and delegation

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37 Ibid., 1014–1015.

38 Ibid., 1010.

39 Ibid., 1011.

40 Ibid., 1018.

41 Ibid., 1024.

42 Ibid.

43 Ibid., 1012.

remained superficial, so Jones et al.: as soon as Mario Draghi managed to calm the crisis with his “Whatever it takes” speech in 2012, any intentions for deep and comprehensive reforms were instantly “off the table”<sup>44</sup>, proving that adjustments were regarded only as unavoidable nuisances in the face of threatening collapse.

Jones et al. show, hence, that the reforms undertaken in the context of the eurozone crisis were the result of reluctant compromises made as a last resort to avert catastrophe, with increased integration taking place not due to willingness, but rather due to a mechanism of spill-over and subsequent unintended consequences of deeper collaboration. While Jones et al. grant that the eurozone crisis created a specific situational context that allowed for a period of accelerated reform, they simultaneously claim that this was done so in a grudging, reluctant, and incomplete way, each reform established rather as a side-effect stemming from urgency and pressure than from political intention. Both these aspects – the situational accumulation of exceptionally many reforms, and the pressure-driven creation of these adjustments from necessity rather than conviction – provide theoretical claims to the crisis-induced introduction of reforms that the following chapters of this paper shall critically elaborate upon.

### 3.3 Supranationalisation as a Driver of Crisis

In contrast to Schimmelfennig and Jones et al., Marcus Ojala criticises in his work “Doing Away with the Sovereign” of 2021 that increased supranationalisation undermines the power of a disciplining free market. In this neoliberal logic, Ojala claims that the increased intervention by eurozone institutions as a “supranational economic sovereign”<sup>45</sup> illegitimately oppresses the market as the rightful driving force of economic processes. According to the neoliberal theory, the disciplining effect of the free market prohibits excessive state or supranational intervention as stability can only be achieved “when all economic actors are convinced that

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44 Ibid., 1025.

45 Ojala, op.cit., 204.

there is no one to rescue them if they run into trouble”<sup>46</sup>. Thus, the interventionist role of a sovereign must be restricted, the state must be supervised by the market – and not vice versa – and the capacity of a supranational body to intervene must be limited.<sup>47</sup>

Ojala therefore regrets the interventionist introduction of bail-outs, the involvement of the ECB in government bonds markets, and the strengthening of supranational authority in the euro crisis as an unrightful “authoritarian turn”<sup>48</sup>, with fiscal discipline being enforced through institutions rather than by the market and the European supranational bodies unjustifiably violating the exclusive creditor-government relationship by protecting vulnerable governments from speculative attacks, thus “imposing [...] sovereign powers over the market”<sup>49</sup>.

Aiming to render government bonds safe through supranational intervention, so the neoliberal argument, goes against the logic of market discipline relying on the very existence of creditor risk. Crisis tools engaged by the European authorities such as the establishment of ESM, SMP, and OMT, created an artificial enforcement of fiscal discipline that is unsustainable as it undermines stability on the long run by erasing the vital market-disciplining principle of risk of insolvency. With the ECB having power-grabbed to the extent that it has become a “government of last resort”<sup>50</sup>, the neoliberal equilibrium of the market supervising the state has been reversed, endangering stability and functionality due to excessive supranational intervention.

Ojala claims, therefore, that reforms introduced in the eurozone must be aimed at re-establishing the dominance of market discipline and adjusting the institutions to contribute to the unimpeded functioning of the market by re-introducing investor uncertainty concerning government bonds.<sup>51</sup> While the existence of political institutions is justified to formalise the market’s conditions by enforcing laws, rules, and regulations, their reform

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46 Ibid., 210.

47 Ibid., 205.

48 Ibid., 208.

49 Ibid., 207.

50 Ibid., 210.

51 Ibid., 209.



must be aimed at the improvement of the market's operational framework<sup>52</sup>, thus rendering the supranational level subordinate to the market.

To summarise, Ojala criticises the excessive intervention of supranational bodies in the eurocrisis, with adjustments such as bail-outs and the interference in the government bond market inducing instability and rendering both the national and the supranational level more susceptible to crisis and weakness than providing sustainable solutions. Introducing reforms in a coercive one-way manner in the eurocrisis<sup>53</sup>, the supranational institutions exercised unjust power-grab that stripped the market of its self-regulating and stabilising forces, meaning that the reforms threatened to be unsustainable on the long term rather than providing a stable saving mechanism. According to Ojala's neoliberal critique, the supranational level should only have intervened by reforming its operational framework as a means to support the improved functioning of the market in an effort to secure prudence and stability<sup>54</sup>, rather than the institutions becoming the main driver behind the eurozone's economic governance. The weakness that the EMU continues to experience must therefore be attributed to the unjustified intervention by the eurozone institutions, so Ojala. His claims that the introduced adjustments contributed to a more crisis-prone, instable financial and economic environment in the EU shall be reassessed in this paper's forthcoming chapters.

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Schimmelfennig, Jones et al., and Ojala each provide a distinct assessment of the national and supranational response to the eurozone crisis, applying different theories to support their arguments. Schimmelfennig claims that the crisis brought about substantial reforms due to an interplay of aligned national preferences and the willingness of national actors to delegate powers to the supranational level to avoid politicisation and to centralise solution-finding. In this intergovernmental and neofunctionalist logic, the euro crisis presented a case where increased integra-

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52 Ibid., 211.

53 Ibid.

54 Ibid.

tion became possible, with substantial adjustments both nationally and at the European level resulting from the common fear of collapse and the need to delegate competencies to the supranational level to avoid domestic political pressures.

Jones et al. take a more subdued stance on the scope of the reforms introduced, agreeing that the eurocrisis saw an accumulation of numerous adjustments but arguing that these were of incremental and incomplete nature, creating a circle of repetitive lowest common denominator solutions that prove unsustainable and crisis-prone in the future. Rather than resulting from political will, as Schimmelfennig claims, Jones et al. regard integration and adjustments as a coincidental, unintended consequence of crises necessitating change, creating an ever-incomplete architecture of economic and financial governance.

While Jones et al. thus regret that reforms during the eurocrisis remained incremental and not far-reaching enough, Ojala claims in a neoliberal argumentation that the very intervention by the supranational level formed an unjustified empowerment of the eurozone institutions undermining the disciplining effect of the market. Rather than being desirable, reforms introduced by the supranational authority promote instability by reducing necessary creditor risks, the crisis-made reforms such as ESM and OMT therefore not improving but endangering the stability of the eurosystem.

These differing evaluations of the rationale behind the eurozone crisis reforms serve as a theoretical basis to the claims that this paper makes. The following chapter shall present the paper's own theoretical framework, indicating to which extent the arguments provided by Schimmelfennig, Jones et al. and Ojala have been implemented or, to the contrary, contradicted in this paper.