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Clara Isabella Siegle

EMU Reform Mechanisms

A Multi-Level Analysis of the European
Sovereign Debt Crisis in a Case Study
of Ireland and Spain

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Edited by Prof. Dr. Christian Lequesne
and Prof. Dr. Wolfgang Wessels

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With a Foreword by Prof. Dr. Wolfgang Wessels

Tectum Verlag

The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliografie; detailed bibliographic data are available on the Internet at <http://dnb.d-nb.de>

ISBN 978-3-8288-4965-5 (Print)
978-3-8288-5104-7 (ePDF)
978-3-8288-5105-4 (ePub)

British Library Cataloguing-in-Publication Data

A catalogue record for this book is available from the British Library.

ISBN 978-3-8288-4965-5 (Print)
978-3-8288-5104-7 (ePDF)
978-3-8288-5105-4 (ePub)

Library of Congress Cataloging-in-Publication Data

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Young Academics: EU Studies; Vol. 1

ISSN 2941-9328

100 pp.

Includes bibliographic references.

ISBN 978-3-8288-4965-5 (Print)
978-3-8288-5104-7 (ePDF)
978-3-8288-5105-4 (ePub)

1st Edition 2024

© The Author

Published by

Nomos Verlagsgesellschaft mbH & Co. KG

Waldseestr. 3–5 | 76530 Baden-Baden

www.nomos.de | www.tectum-verlag.de

Production of the printed version:

Nomos Verlagsgesellschaft mbH & Co. KG

Waldseestr. 3–5 | 76530 Baden-Baden

ISBN 978-3-8288-4965-5 (Print)
978-3-8288-5104-7 (ePDF)
978-3-8288-5105-4 (ePub)

DOI <https://doi.org/10.5771/9783828851047>



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<https://doi.org/10.5771/9783828851047>, am 18.05.2024, 11:40:54
Open Access <https://www.tectum-elibrary.de/agb>



Onlineversion
Tectum eLibrary

Foreword

Confronted with the serious consequences of a polycrisis, it is highly relevant to study the EU's mechanisms to deal with the Sovereign Debt Crisis as a case study to understand the reactions of the EU and its Member States to past and present challenges.

Clara Siegle's MA thesis, written at the College of Europe during the academic year 2022/2023 under supervision of Professor Westlake, a leading expert on EU policies, presents a stimulating analysis of the interplay between the national and the European level. As a considerable added value, we can profit from Siegle's approach to develop – with a critical review of the theoretical literature on the EU's multilevel system – a theoretical framework of an “upward spiral of mutually perpetuated reform”. We can also benefit from her test of three hypotheses by using the empirical evidence of two different countries as highly significant case studies.

The conclusion offers a valid contribution to the academic research on the EU's crisis management and to the political debate on how the EU and its members should deal with major challenges.

Prof. Dr. Wolfgang Wessels

Acknowledgements

This paper has been made possible with the kind support of Prof. Martin Westlake of the College of Europe in Bruges who followed its development throughout the months prior to its completion. His continued advice and suggestions were of great value in the creation of this paper. Special thanks are also due to Alexandre Piron who assisted Prof. Westlake in the thesis supervision and provided strong academic and personal support.

Further acknowledgements are extended to Prof. Michele Chang, Prof. Gabriel Glöckler, and Prof. George Pagoulatos of the College of Europe whose classes on the European sovereign debt crisis, the European Economic and Monetary Union, and the Political Economy of European Integration provided me with profound background knowledge on the thesis topic.

I would also like to express my profound gratitude to Prof. Wolfgang Wessels for his continued support of my research activities and his key role in enabling the publication of this thesis. I am thankful to him and the team of the Tectum Verlag for their valuable help towards this publication.

Abstract

This paper explores the mechanisms behind the emergence of reform on the national and on the European level during the European sovereign debt crisis by asking itself how these adjustments were enabled when reform had faced substantial constraints on both levels in the years prior to the crisis. The paper establishes a theoretical framework of an *upward spiral of mutually perpetuated reform* by basing its approach on a multi-level analysis of reform-enhancing and -restraining factors in the national and the supranational realm. This approach regards the high level of interdependence between the member states and the Economic and Monetary Union (EMU) as the reason behind the accelerated reform implementation in the crisis years, claiming that the exceptional situation of the eurocrisis created a unique window of opportunity for change on the national and on the supranational level. More precisely, adjustments were enabled by each level possessing weaknesses whose change however was constrained due to level-specific factors. Thus, only the pressure exercised by the respective other level enabled the implementation of reform once the urgency of the crisis necessitated adjustments as the only remedy against collective failure.

To exemplify its claims, this paper analyses two of the most affected countries of the European sovereign debt crisis, Ireland and Spain, and assesses the interaction of these member states with the supranational level in the establishment of reform. With the help of three hypotheses, a holistic analysis of the mechanisms behind the eurocrisis reforms is enabled, regarding the interconnected system both in its entirety and in its individual levels of member states and the EMU.

The first hypothesis claims that the high degree of interdependence between the two levels existed in the implementation of reforms due to the integrated, yet incomplete nature of their relation, rendering each level dependent on the other to implement much-needed reform to counter the crisis effects. The second hypothesis concentrates on the member-state level, arguing that change in Ireland and Spain would not have been possible without the intervention of the European level as national reform was constrained by domestic factors. The member states' dependence on the EMU's financial assistance created the necessary impetus to establish reform due to the strict conditionality that the supranational aid encompassed. In a mirrored logic, the third hypothesis claims that previously impossible change to the supranational level of the EMU was only enabled in the crisis context when member state failure necessitated the intervention by a strong and credible EMU that was only attainable through the implementation of change to its lacking architecture.

Applying the real-world evidence of reforms achieved in Ireland, Spain, and the EMU to its claims, the paper concludes that the substantial reforms which each level implemented during the crisis can be explained with the highly interconnected nature of the member states and the European level because it created the necessary pressure that facilitated reform in an exceptional situation where the contextual urgency and risks at stake allowed for change that had previously been constrained.

Keywords

EMU

Reform

European integration

European sovereign debt crisis

Two-level interdependence

Ireland

Spain

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List of Abbreviations

CEBS	Committee of European Banking Supervisors
EBA	European Banking Authority
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EFSF	European Financial Stability Facility
EFSM	European Financial Stability Mechanism
EIP	Excessive Imbalance Procedure
EMU	Economic and Monetary Union
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
EU	European Union
GDP	Gross Domestic Product
H	Hypothesis

List of Abbreviations

IMF	International Monetary Fund
MIP	Macroeconomic Imbalance Procedure
NAMA	National Asset Management Agency (Ireland)
OHIO	“Own House In Order”
OMT	Outright Monetary Transactions
PEPP	Pandemic Emergency Purchase Programme
SAREB	Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (Spanish “bad bank”)
SGP	Stability and Growth Pact
SMP	Securities Markets Programme
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
TFEU	Treaty on the Functioning of the European Union
USA	United States of America

1 Introduction

On April 26th, 2023, the European Commission presented a new legislative proposal to reform the budgetary rules of the Stability and Growth Pact (SGP). The Commission's goal was to revise the strict thresholds of 60 % for public debt and 3 % for the deficit ratio, rendering the rules of the SGP more flexible and adapted to each member state. These efforts by the Commission triggered controversial reactions, with orthodox member states such as Germany on the one hand opposing laxer economic and fiscal rules within the eurozone and the southern states on the other hand welcoming a relaxation of the current framework.¹

The reform to the European Union's (EU) economic and monetary governance thus comes with the challenge of heterogeneous member state preferences and complicated constellations of reform-constraining and -supporting factors. To gain an understanding of these mechanisms, this paper revisits the European sovereign debt crisis of 2008–2013 with specific focus on the aspect of reform in order to find replies to the following questions: What are the factors that enable and restrain change in as complex a structure as the eurozone? In a time of crisis, how can these adjustments be used to counter the threats of the situation?

These questions are of particular interest seeing as scholarly literature does not agree on a common assessment of the reforms implemented during the European sovereign debt crisis, including the establishment of new surveillance mechanisms to the European Economic and Monetary

1 “On EU Budget Rules Reform, Member States Stand”, *What's up EU*, 12/04/2023, accessed on 02/05/2023 at: https://whatsupeuenglish.substack.com/p/member-states-divided-over-budget?utm_source=substack&utm_medium=email

Union (EMU), a European banking union, fiscal and economic adjustments, and changes to the national banking and administrative sectors.² While one string of literature regards these adjustments of the crisis as a “far-reaching [...] major leap”³, “dramatic shifts”⁴, and “wide-ranging adjustment”⁵, the other camp limits its assessment of the changes to “incremental”⁶, “piecemeal”⁷, and “not sufficient”⁸. In fact, disaccord exists on whether these reforms are beneficial to the European system at all: While some scholars call for adjustments to the eurozone to implement “common standards”⁹ in a real “political union”¹⁰ as a remedy against “contagion” by weaker states¹¹, this opinion clashes with worries about the “self-em-

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- 2 Michele Chang, Federico Steinberg, and Torres García Francisco, eds. 2020, *The Political Economy of Adjustment Throughout and Beyond the Eurozone Crisis What Have We Learned?* Routledge Advances in European Politics (Abingdon, Oxon: Routledge, 2021), 9–12.
 - 3 Frank Schimmelfennig, European Integration in the Euro Crisis: The Limits of Post-functionalism, *Journal of European Integration*, 36:3 (2014), 323.
 - 4 Jens van 't Klooster, “Technocratic Keynesianism: a paradigm shift without legislative change,” *New Political Economy* 27(5) (2022), 2.
 - 5 George Pagoulatos, “Integrating through Crises: Revisiting the Eurozone’s Reform Conundrum” in *Europe’s Transformations – Essays in Honour of Loukas Tsoukalis*, eds. H. Wallace, N. Koutsiaras, G. Pagoulatos (Oxford: Oxford University Press, 2021), 150.
 - 6 Gabriel Glöckler Marion Salines and Zbigniew Truchlewski, “Existential Crisis, Incremental Response: The Eurozone’s Dual Institutional Evolution 2007–2011.” *Journal of European Public Policy* 19 (5) (2012): 665.
 - 7 Erik Jones, R. Daniel Keleman and Sophie Meunier, „Failing Forward? The Euro Crisis and the Incomplete Nature of European Integration”, *Comparative Political Studies* 49(7) (2016), 1010.
 - 8 Miguel Otero-Iglesias, “Stateless Euro: The Euro Crisis and the Revenge of the Charalist Theory of Money.” *JCMS: Journal of Common Market Studies*, 53 (2014), 351.
 - 9 Jan Kees de Jager, “Structural conditions for a viable EMU”, speech from 24/05/2011, accessed in *Europa in Der Welt: Von Der Finanzkrise Zur Reform Der Union* [Europe in the World: From the Financial Crisis to the Reform of the Union], eds. Pernice, Ingolf and Rüdiger Schwarz (Baden-Baden: Nomos, 2013), 289.
 - 10 Otero-Iglesias, op. cit., 361.
 - 11 Christoph Ohler, “Die Bewältigung der Schuldenkrise in Europa“ [The Tackling of the Debt Crisis in Europe], speech from 01/11/2011, accessed in *Europa in Der Welt : Von Der Finanzkrise Zur Reform Der Union* [Europe in the World: From the Financial Crisis to the Reform of the Union], eds. Pernice, Ingolf and Rüdiger Schwarz (Baden-Baden: Nomos, 2013), 313.

powerment”¹² of some actors and a “weakened [...] discipline” of others in the context of reform attempts.¹³ Common to these diverging scholarly claims however is the view that the implementation of change to the eurozone entails implications for all involved actors of European integration, thus both the member state level and the European level.¹⁴

What existing scholarly literature does not take into account enough is the mechanism that makes reform possible in the first place in this complex multi-level system of the EU. This gap in research is regrettable as debating on the benefits and threats of the reforms as outlined above only becomes possible once an understanding has been reached on the process of reform establishment. Thus, while taking into account the extant work in scholarly literature, this paper aims to shed light on the precise mechanisms of reform in the European sovereign debt crisis. This approach promises to help understand *how* change is introduced in the eurozone despite of, or due to, the different levels involved, and what the aspects are at play that accompany these reforms. Only by knowing which were precisely the enabling and the constraining factors to reform on the national and the European level in the European sovereign debt crisis can a credible assessment of their effect be reached.

The theoretical approach of this paper claims, in reliance on the definition of the European multi-level administration by Benz¹⁵, that there is a high degree of interdependence within the eurozone between the national and the European level as they constitute a fusion of separate, yet interconnected actors that co-exist in a symbiosis of constant contact and influence. This complex interdependence can provide both promises

12 Eugénia Heldt and Tony Mueller, “The (self-)empowerment of the European Central Bank during the sovereign debt crisis.” *Journal of European Integration* 43(1) (2021), 84.

13 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

14 Michael Bauer and Stefan Becker, “The Unexpected Winner of the Crisis: The European Commission’s Strengthened Role in Economic Governance.” *Journal of European Integration* 36 (April 2014): 222.

15 Arthur Benz, “European Public Administration as a Multilevel Administration: A Conceptual Framework” in *The Palgrave handbook of the european administrative system*, eds. M. Bauer and J. Trondal (Cham: Palgrave Macmillan, 2015), 34.

and constraints to the implementation of reform, as adjustments on each individual level have implications for the respective other level due to the interconnected nature of the union. Thus, each level tries to exert influence on the other in the implementation of reform while at the same time trying to regulate its own-level change to its maximum advantage. Trying to minimise the costs of own reforms, each level prefers changes to be made on the other level. Hence, reform on the own level tends to be constrained while change on the other level is encouraged. As this leads to a deadlock situation where the pushing and pulling factors of reform keep each other in balance, only an exceptional situation can break this stagnation and provide enough impulse for each level to implement change. This paper thus claims a complicated circle of interconnection where not only internal, level-specific aspects, but also external factors influence the establishment of change. The paper tries to identify these aspects of each level and their degree of interaction to provide a holistic understanding of reform mechanisms in the eurozone crisis, showing that the national and the European reform implementation depended on enabling and constraining elements of both levels simultaneously in the context of the crisis.

In sum, to better understand how reform was implemented in the European sovereign debt crisis and what the interaction mechanisms between the two levels were, this paper regards the specific aspects that characterised the emergence of reforms to the European level and to the national level. Based on two case studies of Ireland and Spain, the paper addresses the following research question: “To what extent were the reforms pursued during the European sovereign debt crisis sparked by an interconnection of the European and the national levels?”

A clarification is due here regarding the technical terms applied in this paper: The “European sovereign debt crisis” is used synonymously with “euro area crisis” and “eurocrisis”; and the “European level” is equal to the “supranational” level. “Reform” is regarded as a synonym to “adjustment” or “change”. The term “institution” as used in this work does not necessarily refer to the seven official European institutions but also describes the structures and organisations created during the euro area crisis.

This paper recognises the high degree of interplay that exists between the national and the European level in the emergence of any type of

change and thus takes into account the complexity of arguments surrounding reforms in the eurozone as outlined above. Thus, the analysis includes both the facilitating and the restraining mechanisms in the establishment of reforms by creating a theoretical framework which bases its argument upon a high degree of multi-level interdependence: Due precisely to the restricting and the facilitating aspects of reform on each level, it is only by taking into account all aspects on both levels simultaneously that the reform mechanisms in the eurozone can be wholly understood. To this end, the paper establishes a theoretical frame of an *upward spiral of mutually perpetuated reform* between the member state and the European level in the eurocrisis, claiming that the crisis formed an exceptional circumstance in which the respective restraints to reform were broken up on the national and on the supranational level simultaneously as each level managed to exert pressure on the other to introduce reform in the face of looming collapse.

The paper bases its claim on three hypotheses, the first of which forms the main working hypothesis by explaining the spiral of interconnectedness. H1 thus reads, “Because the failure of one or more countries impacted the whole union in a mechanism of interdependence, reform solutions were enabled only in a constellation of mutual influence.” In a system of interconnectedness, integration deepens through crisis in an ever-tighter spiral by mutual perpetuation on the national and European level because one is dependent on the other’s support or survival. In principle, reform was desirable in the eurocrisis on each level to counter respective own weaknesses and lacks, such as a fragile banking system on the national level and an incomplete integration on the European level, but internal factors such as political constraints or restraining preference constellations hindered these reforms. Due to the interconnected nature of the eurozone, however, the functioning of the system relied on the very strength and resilience of the respective other level as the collapse of one level would have brought the other down with it. Thus, each level became dependent on the other to implement reform but was under pressure to similarly induce change on its own level: Nationally constrained member state reform was only made possible due to the intervention by the EMU, on whose financial assistance the member states were dependent.

At the same time, previously hindered EMU reform was only enabled in the context of national failure, on whose survival the continuation of the common currency depended. Due thus to mutual weaknesses and the wish of one level for the other to change in order to provide relief to the first, a mechanism of interdependence developed that allowed the national and the European level to influence each other to implement previously impossible, unwanted, or unperceived reforms respectively. In the specific context of the eurocrisis, the threat of the collapse of the euro and thus of the entire eurozone, paired with the financial struggles and subsequent dependence of the member states, created mutual incentives for the member states and the EMU both to introduce change themselves and to pressure the other to implement reforms in their turn.

These claims are the focus of the second and third hypotheses which analyse each level of this spiral individually. They argue that national reform would not have been possible in the eurocrisis without the influence of the European level; and change to the supranational level of the EMU would not have been implementable without the influence of the member states. H2 zooms in on the specific aspects of the national level, claiming that a range of elements, including domestic constraints and policy errors, restrained reform until the financial dependence on the European level made reform possible as part of the EMU's bail-out conditionality. Change that had been impossible to make on the national level thus became implementable once the European level came into play, as H2 summarises: "The Irish and Spanish economic and banking failures necessitated EU intervention to implement national reforms due to domestic constraints to change."

Similarly, as H3 provides, the European level faced limitations to reform abilities prior to the crisis, with diverging member state preferences, a weak EMU architecture, and a restrictive policy towards financial aid to the member states rendering reform possible only once the crisis struck with such force that the common currency became endangered, hereby creating a window of opportunity for the EMU to finally introduce reform. H3 thus claims that "Reforms to the EMU's incomplete state at the time were facilitated by national failures, combined with the need for effective results."

The added value that this approach brings along is its holistic character which takes into account all aspects influencing reform to such a complex symbiosis as the eurozone: as scholarly literature commonly focuses only on one of the two levels, it cannot regard the entirety of contributing aspects, and thus comes to distorted conclusions. By analysing the interdependence of the specific aspects of reform that literature offers on a one-level basis, this paper thus creates the connection between the member state and the European level and enables a complete understanding of the changes introduced in the eurocrisis. Due to space constraints, the paper focuses on two member states as case studies, Ireland and Spain. The choice has been made for these two countries as they reflect interestingly similar, yet differing cases, both having experienced substantial economic growth in the pre-crisis years and yet becoming dependent on European bail-outs during the crisis. The methodology of this paper is thus a case-based multi-level comparative analysis that includes elements of process tracing and uses interviews for background knowledge and inside views on the topic.

The paper is structured as follows: after a brief elaboration on the methodology and choice of cases in chapter 2, a review of three important integration theories that analyse reforms during the eurocrisis shall be made in chapter 3, including Schimmelfennig's neofunctionalist and intergovernmentalist approach, Jones et al.'s "Failing forward" theory, and Ojala's neoliberal work. While Schimmelfennig claims that spill-over effects and national preferences created the possibility in the eurocrisis for major steps to be made in terms of eurozone reform, Jones et al. regret that these changes remained incremental in a constant vicious circle of "failing forward" towards new minimum compromises. Ojala rejects the entire principle of reform to the eurozone in form of a strengthened supranational level as it violates the neoliberal principle of free market discipline.

These findings are taken into account in chapter 4 which establishes the theoretical framework, introducing the spiral of mutually perpetuated reform by claiming an interdependence between the national and the European level in their reform endeavours. Chapter 5 then provides a brief overview of the precise reforms that were introduced in Ireland, Spain, and the EMU, to provide a context to the paper's claims. These chang-

es include adjustments to the banking sector and the public finances in Ireland as well as the establishment of the Irish Fiscal Advisory Council; reforms to the banking sector and the labour market in Spain; and the introduction of unconventional measures, bail-outs, legislative packages, and new institutions on the EMU level. These empirical findings shall be used in chapter 6 to test the hypotheses set up in this paper, applying the claims of the hypotheses to the real-world changes of the eurozone crisis. Chapter 6 thus poses itself the following questions: How were the member states and the EMU interconnected in the implementation of their reforms (H1)? How did the EMU lift the national reluctance to reform (H2)? How did the member states enable reform on the European level (H3)?

The paper concludes that reforms made in the eurocrisis were enabled in a mechanism of interdependence between the member state and the European level. Thus, the mutual dependence of each level on the other to implement change for its own survival created a circle of simultaneous reform action on both levels. The paper hence provides an explanation of the reform mechanisms of the eurozone crisis, showing that changes were made in a situational context of two-way influence, and thus proving that reform was only rendered possible in the crisis in an interplay of both individual-level and level-combining aspects.

2 Added-Value and Methodology

Scholarly literature has extensively treated the topic of the European sovereign debt crisis over the course of the last decade, analysing its causes, developments, and legacies to abundance. However, most academic work focuses on one actor in the crisis at a time, developing either on specific member states or on the crisis governance by the EMU. To the knowledge of the author, few works exist that concentrate on the interrelation between the member states and the European level on the specific issue of reform. Therefore, the present paper contributes two points of added value to the scholarly work: first, by analysing the interdependences between the member state level and the European level in the crisis, and second, by focussing this research on the aspect of reform. Combined, these two points of focus create a paper that treats the mostly disregarded topic of reform mechanisms in the eurozone crisis *in an interdependent relation* between the member state and the supranational level.

The findings of this paper are of course not independent of existing work, with this paper's claims of an upward spiral of mutually perpetuated reform taking into account existing literature on the topic as well as important theoretical works on European integration in times of crisis by Schimmelfennig, Jones et al., and Ojala. This paper combines the claims of these extant works to an own line of argument that aims to give a better understanding of how reform can be introduced in difficult times in as complex a construction as the EU. The conclusions of this paper contribute to scholarly research on future implications for reform to the Union in times of crisis by outlining both the weaknesses of continuous

dependence between the member states and the supranational level and the strengths of mutually incentivised reform.

It is thus of importance to analyse both the member state and the European level in this paper. For reasons of spatial constraints, not all failing member states of the eurozone crisis (commonly defined as the periphery states including the Southern European countries and Ireland) can be regarded in this paper. Ireland and Spain have been selected as the case studies due to their similar, yet different set-up and development in the crisis. The high economic performance of both Ireland and Spain in the years prior to the crisis and their nevertheless severe struggles during the crisis years indicate that the national struggles had not only domestic origins, but were also connected to the countries' adherence to the eurozone and the subsequent interdependences. This is an aspect that renders Ireland and Spain interesting in their points of analysis.

An additional aspect of similarity is the fact that Ireland and Spain both suffered from *national* weaknesses and thus received *supranationally* provided bail-outs, representing the two-level scope of the crisis that this paper aims to analyse. Furthermore, Ireland presents the first case of a banking crisis in the eurozone¹⁶, giving it special relevance.

At the same time, Ireland and Spain showed sufficient differences in their crisis response and reform developments to allow for a representative comparison: the timing of the crisis was different for Ireland and Spain respectively, with diverging national circumstances such as openness to reform versus domestic adjustment constraints allowing for a differentiated analysis. Furthermore, the types of reform implemented in Ireland and Spain differed, with Ireland's adjustments imposed in a range of areas, while the Spanish reforms as demanded by the European Stability Mechanism (ESM) concentrated on the banking sector. As Ireland and Spain thus both showed mechanisms of dependence on the European level in their reform processes although their national starting positions and circumstances differed, this allows for a differentiated comparison.

16 Barry Eichengreen, "The Irish Crisis and the EU from a Distance", in IMF European Department, *Ireland: Lessons from Its Recovery from the Bank-Sovereign Doom Loop* (2015), 109.

These two countries represent sufficiently diverging cases due to the fact that Ireland formed one of the smaller countries also of the eurozone while Spain was the fourth-largest economy of the EU, and Ireland represents a culturally and geographically different case from the other failing member states that all adhere to the Southern European area.

The methodology applied in this paper can be described as a comparative analysis, focussing on the two relevant levels of the crisis – member states and the EMU – with a concentration on the cases of Ireland and Spain. Process tracing is also used to understand the respective crisis evolutions and reform developments in the respective areas¹⁷.

The paper makes use of existing scholarly literature for its analysis and also consults contemporary official documents such as International Monetary Fund (IMF) files, government and bank reports, and the Memoranda of Understanding between the European authorities and Ireland and Spain respectively. To enhance the research and provide inside information, six semi-structured interviews have been conducted with representatives of the (central) banks of Ireland and Spain and the ECB as well as with two academics in European political economy. The identities of the interviewees are known to the author but shall remain anonymous when quoted in this paper.

17 Pascal Vennesson, “Case Studies and Process Tracing: Theories and Practices” in *Approaches and Methodologies in the Social Sciences: A Pluralist Perspective*, eds. Donatella Della Porta and Michael Keating (Cambridge: CUP, 2008), 223–239.

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 work¹⁸ 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-

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?" paper¹⁹ 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 institutions²⁰ 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"²¹ 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.²² 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.²³ 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.²⁴ 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 countries²⁵, 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.²⁶ 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.²⁷ 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

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.²⁸

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.²⁹ 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”³⁰. 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.³¹ 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.³²

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.³³ 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”³⁴ 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.³⁵ 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.³⁶ At the same time, however,

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.³⁷

For Jones et al., the incomplete nature of the EMU was therefore both cause and response to the eurozone crisis³⁸, 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.³⁹ 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.⁴⁰

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”⁴¹ 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.⁴² While the accumulation of multiple incremental reforms during the euro crisis therefore created, in sum, an exceptionally rapid and intense phase of deepening integration⁴³, the willingness behind these adjustment and the aim to create a stable mechanism of cooperation and delegation

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”⁴⁴, 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”⁴⁵ 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

44 Ibid., 1025.

45 Ojala, op.cit., 204.

there is no one to rescue them if they run into trouble”⁴⁶. 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.⁴⁷

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”⁴⁸, 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”⁴⁹.

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”⁵⁰, 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.⁵¹ While the existence of political institutions is justified to formalise the market’s conditions by enforcing laws, rules, and regulations, their reform

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 framework⁵², 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 eurocrisis⁵³, 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 stability⁵⁴, 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.

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-

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.

4 Theoretical Framework / Approach

4.1 The Upward Spiral of Mutually Perpetuated Reform

Chapter 2 has summarised the views of some of the most important European integration theories regarding reform mechanisms in the euro-crisis and their impacts, which provide a differentiated overview of the current state of scholarly literature on the subject. This paper takes these findings into account as the basis to elaborate upon and question, using some of the above claims to back its own arguments and dropping others as unconvincing or unjustified. The current chapter outlines the theoretical framework developed in this paper and provides a description of the arguments that the following chapters then detail on.

The theory that this paper develops regarding the adjustments achieved within the context of the European sovereign debt crisis can be described as an *upward spiral of mutually perpetuated reform*. The paper claims that the eurozone crisis created a unique and unprecedented situation which offered both the national and the European level the chance to implement reform where it had previously not been possible due to domestic or supranational constraints. Member states such as Ireland and Spain and the architecture of the EMU had experienced substantial weaknesses before the crisis set in, but both levels had failed to implement change prior to the crisis.⁵⁵ The fact that reform was eventually introduced both on the member state level and at the supranational level during the crisis – in form of structural and financial reform in Ireland and Spain and in form

55 Walter, op. cit., 113/124; Michele Chang, Federico Steinberg, and Torres García Francisco, op. cit., 9.

of new institutions and elaborated centralised mechanism in the EMU – shows that the crisis presented a context which finally enabled the previously impossible change. The aim of this paper is to understand the mechanisms behind these adjustments and to gain insight into which aspects led to a reformational turn *on both levels simultaneously and within a relatively short time span*. It appears, as derived from the empirical evidence, that reforms were made to an accelerated extent both on the national and on the European level during the crisis,⁵⁶ and that an interconnection exists between the two levels. Therefore, this paper focuses on the understanding of this interconnection of the two levels as a trigger of reform.

The claim of the paper is that a *reciprocal* reform enhancement took place during the eurocrisis, enabled not by a one-sided way of authoritarian enforcement of change but by a mechanism of mutual weakness and threatening failure linked with respective dependence on the functioning of the other level. In a rare setting of simultaneous potential collapse at the national and at the European level – with national banking systems failing as much as the common European currency was facing realistic threat of collapse – a once-off concoction of parallel struggle developed which created only two possible outcomes: mutual failure, and the abandonment of the euro as well as the dramatic fall of national systems; or mutual reform, with the promise of saving the common currency and rescuing member states.

While existing literature agrees that the EU has proven to be surprisingly resilient in and against crisis in the decades that it has existed⁵⁷, as well as sharing the view that the eurozone crisis led to some change, whether incremental or substantial⁵⁸, scholarship has not so far created the link between national and supranational reform. This paper therefore looks into this research gap, asking what exactly the mechanisms were that allowed the EU to be as resilient as it turned out to be in the eurocrisis, and how change became possible suddenly, both domestically and on

56 Hemerijck and Matsaganis, op. cit., 42.; Schwarzer, op. cit., 35–38; Bauer Becker, op. cit., 216–225; Henning, op. cit., 171 and box 8.1.

57 Marianne Riddervold, Jarle Trondal and Akasemi Newsome, “European Union Crisis: An Introduction” in *The Palgrave Handbook of Eu Crises*, eds. Marianne Riddervold, Jarle Trondal and Akasemi Newsome (Cham: Palgrave Macmillan, 2021), 6.

58 Cf. chapter 2 and Schimmelfennig’s versus Jones et al.’s contradictory evaluations of the reforms as “large steps” and “incremental” respectively.

the European level, when member states such as Germany, treaty-given constraints, and domestic politicisation had repeatedly hindered reform in the years before the crisis.

Answering these questions, this paper argues that it was the simultaneous failure of both levels which put the EMU as a whole under such pressure that reforms, previously still circumventable, became inevitable even in the eyes of the strongest opponents. A mutual spirit of giving in and conceding meant that reforms became acceptable on both levels *as long as* the other level showed similar willingness to change: national reforms, so the paper claims, would not have been possible without the dependence of the failing member states such as Ireland and Spain on the EMU's financial assistance and the subsequent subordination of the struggling member states to European pressures to reform. Similarly, changes to the EMU architecture and scope of action would not have been achievable without the looming threat of member states' financial and banking systems collapsing and the common currency consequently failing, imposing a similar pressure on the supranational level to implement reforms that would previously have been unthinkable. The paper, in sum, shows that national and supranational reforms mutually perpetuated each other in a circle of interdependence, with one level relying on the other's reform to prevent a collapse of the system and exerting pressure on the other level accordingly, yet being forced to implement simultaneous changes due to existing own weaknesses, pressures from the other level, and the urgency of the crisis situation.

This theoretical construction thus creates a formerly unregarded link between the two levels, addressing the following questions: How did the shortcomings of each level respectively facilitate change on the other? What are the mechanisms of interconnectedness that enabled such substantial change on both levels at the same time, and in a relatively short time span, when they had been vigorously prevented before?

The paper, while claiming that the eurozone crisis created a window of opportunity that allowed for substantial changes on both levels which greatly improved the economic and financial architecture both nationally and supranationally, recognises the yet existing shortcomings of the EMU a decade after the crisis, with the banking union as yet remaining incom-

plete, fiscal union a project of the future, and a real political union currently lacking. Nevertheless, the paper argues that an upward spiral of deepening integration through unity-enabling reforms emerged during the crisis years.

This assessment of the crisis adjustments relies, in part, on the claims made in previous scholarly literature as summarised in chapter 2, while also in part contradicting the arguments of extant works. Thus, this paper aligns with Schimmelfennig's estimation of the eurozone crisis having enabled substantial steps towards deeper financial and fiscal integration and profound technocratic adjustments⁵⁹, an impressive reform development that Jonest et al. second by recognising the eurozone crisis as "one of the most rapid periods of deepening of integration in EU history"⁶⁰. Such integration took the form of the establishment of a banking union in 2012 and the creation of institutions tasked with financial and fiscal surveillance such as the ESM and the SSM, as well as the change of tools applied by the ECB towards non-standard measures of financial assistance including OMT, SMP, and bail-outs of struggling countries. The paper however also emphasises the simultaneous development of reform on the national level, including the restructuring of the banking system, financial surveillance, and changes to the labour market, showing that reforms were not only made in the supranational, but also in the domestic field.

To explain these parallel developments, the paper takes up Schimmelfennig's dual intergovernmentalist and neofunctionalist argumentation which claims that both national governments and the European institutions experienced a certain empowerment. The equilibrium created between the two level is a key reason behind the mutual reform perpetuation between the national and the supranational level because both levels managed to pressurise the other in a mechanism of respective dependence: for the EMU, it was the risk of possible contagion and the threats to the common currency that provided pressure to create centralised supranational solutions, while the national governments were put under pressure by the EMU due to their reliance on financial assistance from the European level.⁶¹ Reform obstacles that national governments had previously faced to domestic polit-

59 Schimmelfennig, *op.cit.*, 326.

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

61 Schimmelfennig, *op.cit.*, 329.

ical constraints⁶² were overcome in the crisis because of the positive feedback loop of common national preferences to reform the eurozone⁶³, with the pressure exerted by the European level for domestic reforms finally granting national governments enough leeway to implement change without facing the responsibility of single-handedly battling national political pressures.⁶⁴ Thus, in opposition to Hooghe and Mark's theory of a post-functional turn in times of crisis and an ensuing constraining dissensus, this paper argues that national reforms were in fact facilitated by the European level when domestic governments had previously intended, but struggled, to implement long-needed change.⁶⁵

The latter point is one where this paper contradicts Jones et al.'s claims of continuous lowest common denominator solutions: going against the failing forward-logic of incremental change due to the unwillingness of actors to introduce substantial reforms and delegate power to the supranational level⁶⁶, this paper claims that national governments in fact welcomed the pressure imposed by the EMU to implement reform due to the above-described former domestic constraints. Rather than Jones et al.'s rather negative assessment of the crisis management, this paper claims that the spiral of deepening integration was one of positive motion rather than failure. In this light, this paper also argues that the reforms implemented both nationally and supranationally, spanning from the establishment of the banking union to new institutions, surveillance mechanisms, tighter fiscal rules, and unprecedented unconventional measures creating a lender of last resort of sorts,⁶⁷ went further than mere unintended spill-over effects and incremental change. Rather, this paper argues, the

62 Sebastián Royo and Federico Steinberg, „Using a sectoral bailout to make wide reforms”, in *The Political Economy of Adjustment Throughout and Beyond the Eurozone Crisis What Have We Learned?*, eds. Michele Chang, Federico Steinberg, and Torres García Francisco, Routledge Advances in European Politics (Abingdon, Oxon: Routledge, 2021), 177.

63 Schimmelfennig, op.cit., 330.

64 Ibid., 334–335.

65 Royo and Steinberg, op. cit., 177.

66 Kincaid, op. cit., 19.

67 Kathleen R. McNamara, “The Forgotten Problem of Embeddedness: History Lessons for the Euro”, in *The Future of the Euro*, eds. Matthias Matthijs, and Mark Blyth (New York, 2015), 21.

reforms implemented during the eurozone crisis were surprisingly substantial, going far beyond what national and supranational willingness would have conceded before the crisis, in a unique situation of high pressure and urgency that created a once-off window of opportunity.

After all, dominant member states such as Germany, and the treaties themselves, had constrained the implementation of any bail-out or lender of last resort-options⁶⁸ before the crisis, and the circumvention of these impediments⁶⁹ must be assessed as utterly substantial, considering the restrictive nature of the financial union prior to the crisis. It is in this aspect that this paper contradicts the claims made by Ojala, who argues that the intervention by the supranational institutions in form of the involvement of the ECB in government bond markets and the provision of bail-outs by the EMU reduce the system's stability.⁷⁰ According to Ojala, the European institutions acted coercively and authoritatively, endangering the stability that market discipline should otherwise provide and thus rendering the system susceptible to further crisis by stripping the market of the necessary risk of sovereign insolvency. Here, this paper claims to the contrary that the implementation of reform at the European and at the national level in fact *enhanced* stability by implementing increased mechanisms of surveillance, oversight, and order. The paper argues that the reforms which were mutually imposed by the national and the supranational level in fact brought about *more* market discipline by imposing strict conditionality⁷¹ that demanded national reforms, increased credibility and accountability in the case of European reforms.⁷² These reforms were thus necessary precisely to maintain the functioning of a market that would have crumbled had suitable reforms not strengthened the respective banking and structural systems.

68 Schimmelfennig, op. cit., 327–328.

69 Nicole Scicluna, “Integration through the disintegration of law? The ECB and EU constitutionalism in the crisis.” *Journal of European Public Policy* 25 (12) (2018), 1881.

70 Ojala, op.cit., 210.

71 Miguel Otero-Iglesias and Federico Steinberg, “The restructuring of Spain’s banking system. A political economy approach” in *Economic Crisis and Structural Reforms in Southern Europe : Policy Lessons.*, eds. Paulo Manasse and Dimitris Katsikas (Abingdon, Oxon: 2018), 228.

72 Scicluna, op. cit., 1884.

It is, in fact, the very lack of institutional authority and of a political union that had created weakness to the EMU in the first place, rendering it fragile due to a missing European sovereign⁷³ and a wanting institutional structure⁷⁴: In opposition to Ojala, Otero-Iglesias claims in his 2015 work “Stateless Euro” that only reforms to the EMU, introducing a lender of last resort and non-standard measures such as the SMP and OMT programmes, ensured the survival of the union.⁷⁵ For the EMU to function, so the arguments of scholars such as Otero-Iglesias and McNamara, a credible union and deep integration are vital for the EMU to be able to function.⁷⁶ In an architecture of 28⁷⁷ sovereign member states only loosely integrated financially and economically such as they were before the crisis, only reform could create the integrated banking, fiscal, regulatory, and political union that would provide more strength and stability, rendering it sustainable on the long term.⁷⁸ These aspects had all been repeatedly circumvented prior to the crisis, establishing the weakness that finally allowed the EMU to reach the brink of failure, and it was only in the face of the euro’s death that the eurozone crisis finally made increased integration through reforms possible.

The upward spiral of mutually perpetuated reform as suggested in this paper provides the explanation as to *how* these changes were made possible, finally enabling the long-needed yet ever-constrained adjustment of the EMU towards a real union. Admittedly, the spiral has not yet reached the top, and the union as it exists today remains incomplete, with neither a fiscal nor a political union a reality.⁷⁹ However, the crisis managed to finally force both national and supranational policy-makers to acknowledge the weaknesses of their systems and to tackle them in an unprecedented reform effort, leading if not to a complete, then to a greatly improved union defined by deeper and stronger integration. The following sections shall outline the precise mechanisms behind these developments by presenting the hypotheses made in this paper.

73 Otero- Iglesias, op. cit., 350.

74 McNamara, op. cit., 25–26.

75 Schöller, op. cit., 74.

76 Otero-Iglesias, op. cit., 356.

77 Due to the UK still adhering to the EU in the crisis years.

78 McNamara, op. cit., 28.

79 Glöckler, Salines and Truchlewski, op. cit., 677–679.

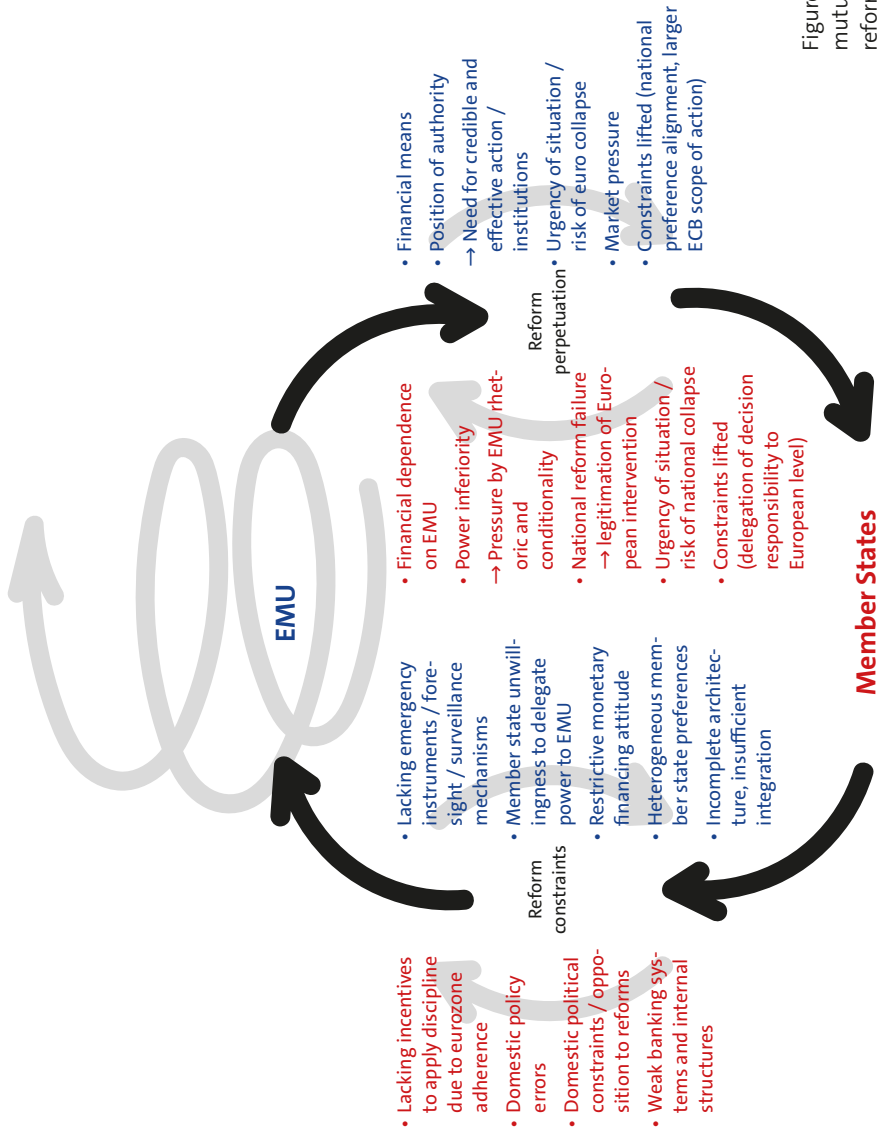


Figure 1: The spiral of mutually perpetuated reform. Own image.

4.2 Hypotheses

This paper establishes three hypotheses which support the claim of the spiral of interconnectedness. The hypotheses are created in such a way that all aspects constituting the complex spiral are regarded justly, explaining the interaction of the two levels while still not overlooking the individualities of the national and the supranational level. To this end, H1 focuses on the spiral as a whole, analysing in a holistic view the strong interdependence between the national and the European level. The level-specific reform mechanisms are then regarded in detail in two sub-hypotheses, H2 and H3, which shall each focus on one level at a time – first on the mechanisms of change in Ireland and Spain, and then on the adjustments made to the EMU. Thus, while H1 explains the spiral as a whole, H2 and H3 zoom in on the two constituting levels of the spiral. All three hypotheses taken together enable a comprehensive analysis of the eurozone reform mechanisms.

H1 – “Because the failure of one or more countries impacted the whole union in a mechanism of interdependence, reform solutions were enabled only in a constellation of mutual influence.”

H1 constitutes the main working hypothesis of this paper, establishing the above-introduced spiral of interdependent reform perpetuation. The main argument is that the reforms eventually introduced both nationally and on the European level during the eurozone crisis were enabled by a complex mechanism of mutual influence that goes beyond the one-way reform causes identified in common scholarly literature. H1 tries to explain the crisis reform constellation by applying more than a simplistic explanation of national and supranational adjustments as separate, non-connected processes. Such limited explanations would claim that national reforms were introduced in a one-sided fashion by the EMU through enforced conditionality in failing member states in an authoritative move⁸⁰, or that the EMU governance made adjustments simply in a self-empow-

80 Ojala, op. cit., 211.

ering strive of the ECB⁸¹ to gain strength and influence. This paper's circle of interdependence rather shows that the changes achieved during the crisis can only be explained holistically by not only taking into account level-specific, individual aspects, but by looking at level-combining factors and understanding the influence that both levels had on the respective other, creating reforms that would not be explainable in a one-way analytical approach. Thus, H1 argues that the circle creates a much more complex network of interdependent reasons for achieved reforms which promises to offer a comprehensive understanding of the intricate reform mechanisms in the crisis.

Herman Van Rompuy, the first-ever permanent president of the European Council and one of the European leaders during the eurozone crisis, verbalised in a 2012 speech the interconnection of the national and the European level that H1 claims. According to Van Rompuy, the common currency had created such an "economic and political interdependence"⁸² that a downright "Europeanisation of national political life"⁸³ developed, putting member states and the supranational level in a relationship marked by co-responsibility and cooperation. Once the crisis hit, its unprecedented response mechanisms including strengthened supervision and stability, so Van Rompuy, became possible only due to this interdependence between the European and the national level.⁸⁴

While thus Van Rompuy claims that the crisis was resolved thanks to the strong connection between the two levels, scholarly literature (Otero-Iglesias, McNamara, Jones et al., Copeland, Glöckler) shows at the same time that a main crisis-*creating* aspect was the very same interdependent, yet only partially integrated nature of the eurozone. Member states and the supranational governance formed a connected symbiosis between the two levels that had thus become dependent on each other but could not

81 Heldt and Müller, op. cit., 84.

82 Herman Van Rompuy, President of the European Council, "The discovery of co-responsibility: Europe in the debt crisis", speech, Speech at the Humboldt University, Walter Hallstein Institute for European Constitutional Law, 6th February 2012, accessed on 22/04/2023 at: https://www.eerstekamer.nl/eu/documenteu/_the_discovery_of_co/f=/vixnbijrsod.pdf

83 Ibid.

84 Ibid., 89–90.

however rely on the sufficient functioning of this union due to holes and lacks in the interconnection: Whilst monetary union had been established and deepened for decades before the crisis entered into existence, financial and fiscal policies remained firmly national⁸⁵, just as much as member states refused to delegate oversight and regulatory power to the European level for fear of competency and power loss. What followed was financial fragmentation and a dangerous imbalance within the eurozone⁸⁶ that rendered the EMU prone to crisis. EU governance was being formed on two different levels simultaneously⁸⁷, creating precisely the interdependence that made the crisis, once it formed in single member states, a European one in a domino effect.

In sum, thus, the connection between the two levels created both the *cause* and the *remedy* to the eurozone crisis, for as much as the incomplete integration of the EMU formed weaknesses that triggered the crisis, the revival of the eurozone depended on the crisis outcome in the peripheral member states.⁸⁸ Each level had become so dependent on the other that they both suffered from the other's weaknesses, yet relied on the other to exit the crisis. The only cure to the crisis, due to this extant yet wanting interconnection of member states and the European economic governance, lay therefore in the patching up of its weaknesses. It is according to this rationale – heavy dependences in an insufficiently integrated relationship having created weaknesses which perpetuated the crisis – that adjustments were implemented: the crisis reforms responded *to* the weakening aspects of interconnection *with* increased interconnection by introducing more financial oversight of the EMU over national policies, tighter fiscal rules for member states monitored on the European level, and coordination of national policies in a centralised manner by the EMU. The hope was, with increased surveillance and improved coordination, that imbal-

85 Jones, Kelemen and Meunier, op. cit., 1021.

86 Jean Pisani-Ferry, *The Euro Crisis and Its Aftermath* (Oxford: Oxford University Press, 2014), 97.

87 Bauer and Becker, op. cit., 226.

88 Jonathan Hopkin, “The Troubled Southern Periphery: The Euro Experience in Italy and Spain”, in *The Future of the Euro*, eds. Matthias Matthijs and Mark Blyth (New York, Oxford University Press, 2015), 161.

ances and differences between the member states rooting in insufficient integration would be overcome, thus avoiding looming disaster.

It becomes apparent that reforms made in the wake of the crisis were not simply adjustments applied to the EMU or the national level in order to strengthen each domain one-sidedly, but rather the reforms aimed at improving the conditions for a successful interplay of the two levels. One level, so the hypothesis claims, was dependent on the other level's reform in order to avoid collapse, while reform was simultaneously enabled in the first place by the other level. The crisis thus became a dramatic, sudden, and unique window of opportunity where the fate of the eurozone relied on the crisis outcome in the periphery⁸⁹, the member states however in turn relying on supranational assistance to survive their national struggles and reform their systems.⁹⁰ Similarly, national recovery was only rendered possible when the EMU decided to create supervisory and coordinating institutions and to implement unconventional measures to aid struggling countries, while this change to the EMU was enabled in turn only by the exceptional national crisis situation⁹¹. Reform was hence a parallel event on the national and European level, stemming not from one-sided sudden change but from the falling together of looming collapse on the national and the supranational level due to existing own fragility and the dependency on the respective other level to overcome these weaknesses.

89 Hopkin, op. cit., 161.

90 Royo and Steinberg, op. cit., 163–165; Kevin Cardiff, “Back to a different normal”, in *The Political Economy of Adjustment Throughout and Beyond the Eurozone Crisis What Have We Learned?*, eds. Michele Chang, Federico Steinberg, and Torres García Francisco, Routledge Advances in European Politics (Abingdon, Oxon: Routledge, 2021), 104.

91 László Andor, “Risks of a Slow-Motion EMU Reform.”, *European Journal of Economics and Economic Policies* 16 (2) (2019), 232.; Paul Copeland and Scott James, “Policy windows, ambiguity and Commission entrepreneurship: explaining the relaunch of the European Union’s economic reform agenda”, *Journal of European Public Policy*, 21:1 (2014), 1.

H2 – “The Irish and Spanish economic and banking failures necessitated EU intervention to implement national reforms due to domestic constraints to change.”

H1 has shown that the member states and the EU were so closely interconnected that they became dependent on one another to overcome the crisis. It turned out, however, that both levels were not able to provide this support on their own due to weaknesses and instability. The only way out of this mutual fragility lay in the simultaneous reform of each part: both on the member state and on the European level, changes had to be made. For the system to survive, both levels would have to become strong and reliable; the construction would collapse as soon as one of them failed. Each level's ability to become stronger however relied on the other's equivalent strengthening, and as long as one side remained weak, the other would come crashing down with it because it depended on the support of the first.

Both a strong member state level and a strong European level therefore follow as necessities from the interconnection shown in H1, and the way to achieve this strength lay in the pursuit of reform by both levels respectively. H2 and H3 focus on the mechanism that enabled these reforms nationally (H2) – here, in Ireland and Spain – and in the EMU (H3), explaining by zooming in on the two levels individually which precisely were the circumstances that enabled change.

Following the logic of interdependence, H2 claims that reform in Ireland and Spain was only made possible by the intervention of the European level which pressurised and facilitated change that had previously been unimplementable. Ireland and Spain constituted similar, yet diverging cases in the eurozone crisis, as both economies had benefitted from massive economic growth in the years prior to the crisis⁹², only to suffer immensely once the expansionary curve dropped. With growth rates of up to a staggering 5% of GDP per annum, Ireland and Spain had entered in the years before the crisis into a similar economic expansion due to strong inward capital flows and a booming housing market. However, Ire-

92 Stefanie Walter, Ari Ray and Nils Redeker, *The Politics of Bad Options: Why the Eurozone's Problems Have Been so Hard to Resolve*. (Oxford: Oxford University Press, 2020), 5.

land and Spain similarly became fatally dependent on these housing and – in the Irish case – construction bubbles. In Spain, additional weaknesses in the banking sector existed, with the *cajas* system of small banks not being sufficiently diversified⁹³. When the Lehman Brother collapsed in the USA in 2008, the fragile architecture of the Irish and Spanish economies was unveiled as interest rates rose and capital outflows increased. Both the Irish and the Spanish governments endeavoured to save the increasingly deteriorating situation by introducing national reforms – in the form of a fiscal consolidation package in Ireland and a labour market reform in Spain.⁹⁴ In both cases, these national efforts proved insufficient to counter the increasingly critical situation, first in Ireland – who received an ECB/IMF bailout in late 2010 – and later in Spain – who's partial bail-out aimed specifically at restructuring its banking sector was provided by the ESM in May 2012. For both Ireland and Spain, the European intervention created the reversing element that set their respective economies back on track and enabled the gradual return to pre-crisis levels of economic performance.⁹⁵ It appears, thus, that the interference by the supranational level formed the vital ingredient towards recovery in both cases, both Ireland and Spain having become dependent on EU-level assistance in order to exit from the crisis after their national adjustments had failed to provide relief.⁹⁶ Only with European help did Ireland and Spain manage to create stronger national structures that allowed them to eventually exit from the supranational assistance programmes and return to self-sufficiency and independence.⁹⁷ What, though, was the remedy that the European level introduced in Ireland and Spain that helped them recover from the crisis when national efforts had missed this goal?

Reforms came hand in hand with supranational assistance both in the Irish and in the Spanish case. Bail-outs and assistance programmes as received by both struggling member states were linked to individual, country-specific conditionality that included detailed instructions on the

93 Ibid., 123.

94 Ibid., 113/124.

95 Chang, Steinberg and Torres, op. cit., 9–12.

96 Walter, op. cit., 113/124.

97 Chang, Steinberg and Torres, op. cit., 9–12.

adjustment of the respective national systems – focussing not only on the banking sectors but reaching as far as increased competitiveness, productivity, administration and fiscal adjustment.⁹⁸ What national governments had failed to implement due to a range of domestic constraints, the European level managed to impose thanks to its power advantage and a both pressurising and facilitating influence on national reform endeavours. H2 claims, in a connection of these two counterparts, that the spectrum of national impediments paired with numerous impulse-giving aspects on the European side constituted the reason why reform became possible on the national level once the supranational level entered into play.

These mechanisms can be summarised as follows: On the domestic level, both Ireland and Spain had developed profound weaknesses in their banking sectors and economic drivers, relying heavily in times of economic growth on capital inflows, foreign investment,⁹⁹ and a national banking system that lacked oversight¹⁰⁰ and resilience. Having enjoyed long periods of strong economic growth since, and thanks to, their adherence to the eurozone,¹⁰¹ Ireland and Spain had quickly developed a reliance on the continued expansion of their economies, lacking incentives to be fiscally prudent and control inflation once they had been admitted to the select club of eurozone members.¹⁰² National policy errors¹⁰³ that had accelerat-

98 Luís A. V. Catão, “Reforms and external balances in Southern Europe and Ireland”, in *Economic Crisis and Structural Reforms in Southern Europe: Policy Lessons.*, eds. Paulo Manasse and Dimitris Katsikas (Abingdon, Oxon: 2018), 107–109.

99 Walter, op. cit., 112/123.

100 Yiannis Kitromilides, “The Irish Tragedy”, in *The Euro Crisis*. International Papers in Political Economy, eds. Arestis, Philip, and Malcolm C Sawyer, (Basingstoke: Palgrave Macmillan, 2012), 179.

101 G. Russell Kincaid, “The euro crisis”, in *The Political Economy of Adjustment Throughout and Beyond the Eurozone Crisis What Have We Learned?*, eds. Michele Chang, Federico Steinberg, and Torres García Francisco, Routledge Advances in European Politics (Abingdon, Oxon: Routledge, 2021), 17.

102 Anton Hemerijck and Manos Matsaganis, “The legacy of the eurozone crisis”, in *Who’s afraid of the welfare state now*, eds. Hemerijck and Matsaganis, (Oxford: Oxford University Press, forthcoming 2023). 11/41.

103 Jesús Ferreiro and Felipe Serrano, “The Economic Crisis in Spain: Contagion Effects and Distinctive Factors”, in *The Euro Crisis*. International Papers in Political Economy, eds. Arestis, Philip, and Malcolm C Sawyer, (Basingstoke: Palgrave Macmillan, 2012), 247–248. Kitromilides, op. cit, 180.

ed the crisis – such as the blanket guarantee introduced by the Irish government in 2008 – and domestic reform efforts that had failed to ease the national struggles¹⁰⁴ were accompanied by the further deteriorating factor of domestic opposition to intended reforms.¹⁰⁵ These national political constraints paired with architectural weaknesses of the economy and the banking sector provided the range of national restrictions to change that only the intervention by the European level was able to break up.

What precisely were hence the mechanisms that allowed the supranational level to achieve what national policy-makers had repeatedly failed to implement? First and foremost, a certain power asymmetry existed between the European and the national level. While the struggling member states were regarded as the “southern sinners”¹⁰⁶ that had failed to match their obligations as economically capable eurozone members, the European level managed to represent with the help of a scapegoating rhetoric¹⁰⁷ and a general demeanour of exercising immense pressure on Ireland and Spain an authoritative, disciplining entity superior to the struggling member states.¹⁰⁸ While this power imbalance put Ireland and Spain under substantial pressure, it also worked as a facilitating environment for the struggling countries to finally achieve full-fledged reforms: what had previously been constrained on the national level was now non-negotiable due to the strict conditionality imposed by the European level in their bail-out and assistance programmes¹⁰⁹, ridding the national governments to a certain extent of the political responsibility for the unpopular reforms and moving the political accountability for the implemented decisions to the European level instead.¹¹⁰

104 Walter, op. cit., 113/124.

105 Royo and Steinberg, op. cit., 169; Walter, op. cit., 125.

106 Hemerijck and Matsaganis, op. cit., 37.

107 Pagoulatos, op. cit., 151.

108 Ibid., 149.

109 Wolfgang Schäuble, Bundesminister der Finanzen “Reform der europäischen Finanzregeln – für eine bessere Verfassung Europas“ [Reform of the European financial rules – for a better European constitution], speech, 26/01/2011, accessed in *Europa in Der Welt : Von Der Finanzkrise Zur Reform Der Union*, eds. Pernice, Ingolf and Rüdiger Schwarz (Baden-Baden: Nomos, 2013), 229–231.

110 Schimmelfennig, op. cit., 334–335.

Additionally, it was a range of situational factors linked specifically to the unique crisis context that allowed for a spurt in national reforms that would have been unthinkable in other circumstances. These aspects include the overlap of domestic preferences to save the euro as the first-most goal in the crisis¹¹¹, creating an enabling atmosphere where pulling at the same end of the rope became possible. The very real and immediate risk of national collapse formed such urgency to the crisis situation that both Ireland and Spain, if not simultaneously, hit a dead end where the only solution became the acceptance of supranational aid, whatever the conditions attached to this. Having put off much-needed reforms prior to the crisis by turning a blind eye on the existing weaknesses of their respective domestic structures, Ireland and Spain were finally faced with the undeniable truth of their fragile architecture once the crisis hit. With the stakes high, and collapse looming around the corner, the supranational level quite simply offered the rescuing buoy to Ireland and Spain, the ECB forming the only entity that was financially and politically able to aid the struggling member states out of their mess.¹¹²

What followed, thus, were unprecedented internal reforms to the banking sector, fiscal policy, labour market, productivity, and competitiveness that were made possible only due to an environment of dependence of Ireland and Spain on the European level who in turn managed to use pressure and its financial power to mould the Irish and Spanish structures as it wished. Paving the way to economic recovery and improved domestic architecture, the European level both imposed and facilitated change in the failing member states that the countries on their own would not have been able to implement. H1 hence claims, in sum, that the changes made to the Irish and Spanish domestic level were done so in a mechanism of dependence on the supranational level which acted both as a discipliner and as an enabler in a time when the national governments struggled from major domestic constraints to implement on their own some much-needed change.

111 Ibid., 328.

112 Magnus Schöller, "Leadership by Default: The ECB and the Announcement of Outright Monetary Transactions." *Credit and Capital Markets – Kredit und Kapital* 51 (1) (2018), 85.

H3 – “Reforms to EMU’s incomplete state at the time were facilitated by national failures, combined with the need for effective results.”

H2 having focused on one side of the spiral – the member states and how they were able to introduce reform during the European sovereign debt crisis – H3 now does the equivalent for the other side of the spiral, the supranational level of the EMU. Just as reforms in the member states – here, Ireland and Spain – were possible due to the intervention by the supranational level, H3 claims that a similar mechanism existed simultaneously for the reforms undertaken on the level of EMU: the national crisis context created a situational impulse to the supranational level that enabled reform where it had previously been undermined.

As in the case of the member states Ireland and Spain, the EMU had similarly been suffering prior to the crisis from a weak and incomplete architecture. As the very word says – “Economic and Monetary *Union*” – the strong and reliable functioning of the EMU would demand a stable, fully integrated cooperation between its constituents, the member states and the European level. This full-fledged political union, upheld by the four pillars of monetary, financial, fiscal and economic union¹¹³, however remained far from reality before the crisis, with only the monetary pillar having been strengthened over the course of decades, financial and fiscal policies however remaining distinctly national.¹¹⁴ The unwillingness of the eurozone member states to delegate surveillance and coordination competencies to the supranational level led to the pre-crisis inability of the supranational level to strengthen its fragile architecture, rendering the EMU an incomplete and only partially integrated body.¹¹⁵

To further constrain the ability of EMU to implement changes to its set-up in the crisis onset, strong member states such as Germany¹¹⁶ and the European treaties posed difficulties to a rapid response to the weaknesses of the EMU: Germany, following an ordoliberal and austere line, repeatedly put itself in the way of adjustments such as lending provisions

113 McNamara, op. cit., 26; Pagoulatos, op. cit., 148.

114 Jones, Kelemen and Meunier, op. cit., 1018, 1021.; Scicluna, op. cit., 1878.

115 Copeland and James, op. cit., 9.

116 Schimmelfennig, op. cit., 330; Walter, op. cit., 131.

and bail-outs,¹¹⁷ while the treaties formally prohibited monetary financing and primary market bond purchases.¹¹⁸ Another weakness lay in the European level's gullible attitude prior to the crisis, lacking formal emergency procedures¹¹⁹, failing to apply enough foresight and overview to recognise its crisis-prone architecture, and providing insufficient surveillance of its member states.¹²⁰ Rather than introducing change to the EMU in the pre-crisis years of calm by increasing surveillance, coordination, and integration beyond the monetary level, the EMU refrained from introducing preventive measures and thus was faced with a full-on crisis once the international financial balances changed.

It was precisely this situational context, however, that allowed the EMU in a unique window of opportunity to finally implement much-needed change once the crisis set in. In a reversed mechanism to that presented in H2, H3 claims that the crisis surrounding the eurozone's member states created a context in which the EMU was granted the room for action and the political excuse to adjust its architecture and mechanisms.¹²¹ Just as the struggling member states had been forced to become stronger in order to prevent the eurozone from collapsing, the EMU was under similar pressure to change and become a reliable constituent of the interdependent symbiosis. Reforms to the EMU that had been previously impeded by constraining member state preferences, a battle for sovereignty on the member state level and lacking proactive behaviour by the EMU, became suddenly implementable as the crisis threatened the common currency.

The high stakes that the crisis presented rendered the situation so urgent that previously procrastinated reform became no longer refusable. The risk of losing the euro and the connected potential collapse of the eurozone presented such a threat to the Union that the project simply had become

117 Schimmelfennig, *op. cit.*, 327–328.

118 Treaty article (See Chang rpresentation) art. 125 (bailout), art ? primary market.

119 Scicluna, *op. cit.*, 1886.; Kitromilides, *op. cit.*, 185.

120 Pagoulatos, *op. cit.*, 149.

121 Martin Westlake, EECSC Secretary General, speech, 03–04/05/2012, Dublin meeting of the Secretaries General of the national Economic and Social Councils and the European Economic and Social Committee. Accessed on 28/04/2023 at: <https://www.eesc.europa.eu/ceslink/sites/default/files/toolip-old-resources/docs/4-may-2012-dublin-speech-mw-to-national-esc-sgs.pdf>

“too big to fail”¹²². The dramatic extent of the crisis thus gave the European level a certain leeway of action and freedom to implement previously unthinkable measures and changes as has been famously reflected in the “Whatever it takes” speech by then-President of the ECB, Mario Draghi.¹²³

In fact, in a paradoxical mechanism, the very severity of the crisis actually provided the supranational level with several action windows that lifted previous resistance: The high risk of contagion¹²⁴ from one or few member states to the entire eurozone gave the EMU the excuse to become more invasive and authoritative in its policies than the situation before the crisis had allowed. The failing of the member states enabled the establishment of supranational institutions¹²⁵ such as the SSM, ESM, and banking union as measures to better monitor and coordinate the member states that had proven incapable of doing so on the domestic level. Furthermore, the common national preference of all member states to preserve the euro aligned the countries in such a way that a centralised European coordination became justifiable, as much as previously resisting member states such as Germany were finally overridden in the turmoil of the crisis.¹²⁶ Furthermore, earlier limitations to the ECB were similarly lifted¹²⁷ as it was able to legitimate its controversial unconventional measures¹²⁸ including interest rate reduction as well as bail-outs and secondary market bond purchases with the narrative of implementing these measures to save the struggling member states.¹²⁹ Hence, the ECB became freer in its use of a crisis response toolkit, with the framing of its actions as pay-

122 Otero-Iglesias, op. cit., 357.

123 European Central Bank, “Speech by Mario Draghi, President of the European Central Bank at the Global Investment Conference in London”, 26 July 2012, accessed on 19/04/2023 at: <https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html>

124 IMO, Schäuble, op. cit., 226.

125 Westlake, op. cit.; McNamara, op. cit., 40.

126 Schimmelfennig, op. cit., 330.

127 Daniela Schwarzer, “The Euro Area Crises, Shifting Power Relations and Institutional Change in the European Union.”, *Global Policy* 3, 34.

128 European Parliament, “EMU reform and the ‘new normal’ for economic policy”, *Monetary Dialogue*, Brussels: European Union, 2018, 11–12.

129 Heldt and Müller, op. cit., 94.

ing the way for change¹³⁰ allowing the ECB even to de facto take on the role of a lender of last resort¹³¹, a previously unthinkable development.

However, the change made to the scope of competency and interference by the EMU was not one of strategic self-empowerment¹³², but one made by the supranational level under high pressure to solve the crisis. The supranational level, equipped both with the financial means and the authority to take on a dominant role in the crisis, urgently needed to perform as a reliable, credible, and responsible body capable of helping its member states out of their struggle.¹³³ The introduction of reforms to surveillance, coordination, and regulatory bodies within the EMU became a necessity that the EMU had to implement quickly to create stability in the failing eurozone. All adjustments introduced on the supranational level aimed at providing a remedy to the apparent collective action problems within the eurozone¹³⁴, such reforms including the establishment of a banking union, of surveillance bodies such as SSM and ESM, of coordination devices including the Euro Plus Pact and Europe 2020, and of economic measures such as the European Semester and economic legislation packages. The supranational level was thus forced to respond to the increasingly critical situation, introducing adjustments to counter the profound market pressure¹³⁵ and the dependence on the EMU that member states portrayed.

Change, thus, became possible on the level of the EMU in unprecedented ways, with new institutions and mechanisms of surveillance and coordination being established rapidly and profoundly.¹³⁶ How was reform to such a static and heterogeneous body as the EMU made possible when heavy constraints had impeded any substantial change to the supranation-

130 Andor, op. cit., 232.

131 Randall Henning, “The ECB as a Strategic Actor: Central Banking in a Politically Fragmented Monetary Union”, in James A. Caporaso, and Martin Rhodes (eds), *The Political and Economic Dynamics of the Eurozone Crisis* (Oxford: Oxford Academic (2016), 168–169.

132 Heldt and Müller, op. cit., 94.

133 Schöller, op. cit., 82.

134 Schwarzer, op. cit., 29.

135 Ibid., 35.; Schöller, op. cit., 77/84.

136 Jones, Kelemen and Meunier, op. cit., 1012.

al level in financial, fiscal, and economic policy prior to the crisis? H3 has shown that the reforms introduced were the result both of an accumulation of adjustment-enabling conditions – such as member state preference alignment, financial dependence, and an unsupportable high stake – and of intense pressure and responsibility on the side of the EMU. The extent of the introduced reforms, reaching to the limits of what the treaties allowed and creating whole new institutions, was also the result of a spill-over mechanisms that facilitated change on the supranational level: one bail-out paved the way for the next, institutionalisation in one policy field enabled the centralisation of another, and with time came less contestation of the unconventional and unprecedented ways in which the EMU responded to the crisis. To summarise, hence, the EMU underwent substantial change in the years of the crisis enabled in a similar dependence on nationally provided circumstances that the member states, in a mirrored way, had experienced in the implementation of their respective reforms. H3 thus forms the EMU-focussed counterpart to H2's concentration on the member state level, both of them together explaining the precise mechanisms of level-specific change which the spiral of interconnectedness of H1 combines.

5 Level-Specific Reforms

This chapter functions as a brief empirical overview of the crisis developments and ensuing reforms that the individual levels of analysis – the EMU on the supranational level, and Ireland and Spain on the national level – implemented during the course of the eurozone crisis. This overview serves as a contextualisation of the crisis events as a basis for the test of the hypotheses in the following chapter.

5.1 Ireland

Having experienced an impressive economic growth period in the first decade of the millennium, with a growth rate of above 5 % of GDP annually¹³⁷, Ireland’s “Celtic Tiger” had lured the Irish policy-makers into a false sense of security. A range of “homegrown”¹³⁸ problems had led to an over-reliance of the Irish economy on external funding and foreign direct investment, and the housing and construction bubble of the pre-crisis years rendered the government reliant on property taxes before it burst and created major economic recession.¹³⁹ What began as a banking crisis due to struggles to generate enough liquidity from the markets soon developed into a sovereign debt crisis with competitiveness, financial, and

137 Walter, op. cit., 112–113.

138 “IMF Lending Case Study: Ireland”, *International Monetary Fund*, accessed on 17/04/2023 at: <https://www.imf.org/en/Countries/IRL/ireland-lending-case-study>

139 Cardiff, op. cit., 102.

fiscal contributors.¹⁴⁰ Mismanagement on the domestic level in numerous fields accelerated the crisis once the global conditions became less favourable with the Lehman Brother collapse, including weaknesses in revenue generating, public spending, bank recapitalisation and supervision, and law enforcement.¹⁴¹ Additionally, the crisis forming the first of its kind in Ireland, it rendered the country highly vulnerable as Ireland had not performed sufficient stress tests on its system in the pre-crisis years.¹⁴²

The Irish government did step in early on in the crisis years, introducing multiple adjustments before the EU intervened in an effort to ease the situation.¹⁴³ These changes included a fiscal “National Recovery Plan”,¹⁴⁴ the establishment of the National Asset Management Agency (NAMA), adjustments to the public finance sector, and an attempted but unsuccessful financial sector reform in 2008.¹⁴⁵ Whilst the impact of these adjustments was limited, they proved that the Irish government was willing to take responsibility in the crisis and improve its credibility, an important attitude that enabled swift reform implementation once the EU stepped in in 2010.

The Irish EU/IMF bail-out of November 2010 came as a “breakthrough”¹⁴⁶ to Ireland by injecting an overall € 85 billion into the country and simultaneously imposing rigorous reforms that finally managed to have an effect: coming with strict conditionality, the EU and the IMF provided clear guidelines, deadlines, and structural benchmarks¹⁴⁷ on adjustments that included step by step instructions¹⁴⁸ on the restructuring and reduction in size of the banking sector, deleveraging, the creation of a Fiscal Advi-

140 Kitromilides, *op. cit.*, 174.

141 *Ibid.*

142 Interview 2 (Interview with a senior official from the Central Bank of Ireland, conducted on 20/03/2023, online.).

143 *Ibid.*

144 Cardiff, *op. cit.*, 105.

145 Interview 2.

146 *Ibid.*

147 Cardiff, *op. cit.*, 107.

148 European Commission, Memorandum of Understanding on Specific Economic Policy Conditionality. Ireland. 3rd December 2010. Accessed on 17/04/2023 at: https://ec.europa.eu/economy_finance/articles/eu_economic_situation/pdf/2010-12-07-mou_en.pdf

sory Council, increased regulation in the financial sector, reduced public spending, fiscal consolidation, and labour market reforms.¹⁴⁹ Whilst these changes came as a “painful adjustment”¹⁵⁰, the Irish government welcomed the reforms as a means to re-establish economic growth.¹⁵¹

By mid-2012, the Irish economy had started to grow again,¹⁵² proving Ireland’s rapid and willing implementation of the imposed reforms. The system had been successfully stabilised, with the Irish Central Bank more activist on the macro-economic front, a smaller and more resilient banking sector, and employment rates rising.¹⁵³ In sum, Ireland’s dramatic crash in 2008, triggered by domestic errors and a weak banking system, was substantially reformed with the help of the EU/IMF programme. Changes that had failed to be implemented prior to the supranational intervention were finally realised and provided rapid results that allowed Ireland to return to economic growth and improved domestic conditions, exiting the bail-out programme in December 2013.¹⁵⁴

5.2 Spain

In a similar development to Ireland, Spain experienced a substantial economic growth of over 4% of GDP annually in the pre-crisis years, however building its economy on a weak banking and structural system. A high dependence on external funding and capital flows, a fragile banking sector that was built on a system of many small banks – *cajas* – which were not sufficiently diversified, and mounting current account deficits increasingly endangered the construction- and housing-funded economic surge.¹⁵⁵ The labour market was equally weak, with a fragile structure of collective bargaining and wage inflation rendering the economy insufficiently competitive and productive and making it susceptible to failure in

149 Kitromilides, op. cit., 174.

150 Interview 2.

151 Walter, op. cit., 114.

152 Cardiff, op. cit., 109.

153 Ibid.

154 Walter, op. cit., 114.

155 Royo and Steinberg, op. cit., 162.

times of economic recession.¹⁵⁶ While the Spanish government did take action in the years from 2007 to 2012,¹⁵⁷ these measures turned out to lack effectiveness in the countering of the onsetting crisis, with the adjustment strategy not following a stringent plan: while the Spanish government stubbornly pursued fiscal expansion until 2009, a policy error that not improved, but deteriorated the domestic situation¹⁵⁸, a policy reversal was introduced in 2010 by implementing internal adjustments to the labour market, privatisation, and fiscal consolidation.¹⁵⁹

These inconsistent adjustments made by the Spanish government not only had little success in improving the situation, with non-performing loans rising and a dangerous interdependence developing between the government finances and the banking system¹⁶⁰, but the reform efforts in Spain also faced substantial domestic opposition and constraints by a powerful lobby and veto players.¹⁶¹

It thus became inevitable, if continuedly unwanted,¹⁶² that Spain entered an ESM-funded bail-out programme in mid-2012. This supranational aid was constructed as a partial bailout aimed specifically at restoring solvency and reforming the banking sector¹⁶³, the conditionality of the programme finally providing a “catalyst element [and] political momentum”¹⁶⁴ for much-needed change. The bailout, encompassing €40 billion for bank recapitalisation and the restructuring of the financial sector, triggered wide-reaching banking and taxation reforms that provided a step-change in the previously slow-moving and ineffective adjustment efforts.¹⁶⁵

156 Ferreiro, *op. cit.*, 248–250.

157 Interview 1 (Interview with a senior official of the Central Bank of Spain, conducted on 04/04/2023, online.).

158 Ferreiro, *op. cit.*, 256.

159 Walter, *op. cit.*, 124.

160 Royo and Steinberg, *op. cit.*, 162.

161 Otero-Iglesias and Steinberg, *op. cit.*, 236.

162 Kincaid, *op. cit.*, 20.

163 Walter, *op. cit.*, 124.

164 Interview 1.

165 European Commission, Memorandum of Understanding on Financial-Sector Policy Conditionality. Spain. 20th July 2012. Accessed on 18/04/2023 at: file:///C:/Users/Clara/Downloads/pol_guide_to_referencing_2022-23-7.pdf

Assessed by the IMF as introducing “dramatic”¹⁶⁶ improvement to the Spanish system, the reforms implemented new structural elements in all areas of the economy¹⁶⁷ including public administration and a complete restructuring of the weak banking system. Changes to the latter included the creation of a bad bank, SAREB, as a new asset management company, the improvement of bank regulation, expansive recapitalisation of the Spanish banks while reducing the number of *cajas*, decreased dependence of the Spanish economy on domestic demand and construction, and the improvement of risk management and transparency in the Spanish banking sector.¹⁶⁸

Spain managed to exit the bail-out programme in 2013, already showing signs of recovery in economic growth, with a return to pre-crisis levels achieved by 2017.¹⁶⁹ In sum, having suffered from erroneous and inconsequent policy-making in the beginning years of the crisis, Spain had become dependent on supranational assistance by mid-2012. The ESM’s aid, linked to strong pressure to reform and a conditionality targeting specifically the weak Spanish banking system, provided the possibility to overcome domestic reform constraints and substantially restructure the country’s financial and banking sectors.

5.3 EMU

The eurozone crisis was the first of its kind to hit the EU since its establishment, forming an immense and unprecedented stress test to the EMU.¹⁷⁰ Not only did it question the very heart of the eurozone, the common currency, but it also put the supranational level under extreme pressure to act fast and effectively in order to prevent contagion in a spill-over mecha-

166 International Monetary Fund, “Spain: Financial Sector Reform – Final Progress Report”, *IMF Country Report* No. 14/59, February 2014, 3.

167 Royo and Steinberg, op. cit., 165.

168 European Commission, Memorandum of Understanding on Financial-Sector Policy Conditionality. Spain. 20th July 2012. Accessed on 18/04/2023 at: file:///C:/Users/Clara/Downloads/pol_guide_to_referencing_2022-23-7.pdf

169 Royo and Steinberg, op. cit., 166.

170 Glöckler, Salines and Truchlewski, op. cit., 665.

nism from failing member states to other countries.¹⁷¹ The problem was that while the EMU formally united the member states in their monetary and economic policies, the reality of the union was a lot more incomplete, rendering the pre-crisis EMU unable to withstand the pressures for solutions that overflowed it from 2008. While the monetary pillar of the EMU was integrated most strongly, financial, fiscal, and economic policies remained national competencies,¹⁷² supranational surveillance mechanisms lacked, and an all-encompassing political union that created a reliable symbiosis between the member states and the European level was still inexistent.¹⁷³

Policies that were aimed at pressurising member states into keeping fiscal and financial discipline such as OHIO (each member state keeping its “own house in order”), the SGP of 1997 as reformed in 2005, the no bailout clause of the treaties¹⁷⁴, and the Broad Economic Policy Guidelines (which remained non-binding), turned out to be insufficient to maintain the functioning of the eurozone.¹⁷⁵ In sum, the EMU was far from constituting a full-fledged union in all of its four pillars – monetary, financial, fiscal, and economic – with a consistent scapegoat rhetoric of weak and undisciplined southern states versus strong and responsible northern countries impeding national willingness to further unite in the years prior to the crisis.¹⁷⁶

A clear shift was therefore desperately needed from the EMU’s restrictive policy-making as the eurozone became more and more affected by an increasing number of its member states failing.¹⁷⁷ Reform on the European level thus was not an ornate embellishment to improve the architecture of the union, but rather a “minimum necessary to avoid the disintegration

171 Walter, op. cit., 15.

172 Glöckler, Salines and Truchlewski, op. cit., 666.

173 Pagoulatos, op. cit., 148.

174 European Union, “Consolidated Version of the Treaty on the Functioning of the European Union of 13 December 2007”, *Official Journal of the European Union*, C115, 26 October 2012., art. 125.

175 Glöckler, Salines and Truchlewski, op. cit., 666.

176 Pisani-Ferry, op. cit., 83.

177 Klooster, op. cit., 2.

of the eurozone”.¹⁷⁸ The strategy that the EU followed in its crisis-solving endeavours was one of austerity and reform¹⁷⁹ which was aimed at securing the crumbling architecture of the eurozone. The urgency of the crisis allowed for prior oppositions to increased integration, notably from Germany, to falter¹⁸⁰, and a spill-over mechanism from one novel policy or institution to another helped accelerate the process.¹⁸¹

Over the course of half a decade, the EMU managed to implement a range of changes that had previously been inconceivable and that affected all four pillars of the union. On the monetary level, in a dramatic shift of strategy, the prohibition of monetary financing was circumvented, with the ECB turning into a *de facto* lender of last resort and support for public borrowing becoming justifiable.¹⁸² The start of the supranational bail-out programmes happened with the Greek case in 2010 and triggered a whole succession of further bail-outs in a number of failing member states. Other government debt purchase instruments included SMP and OMT, each marking a substantial change in the EMU’s policy-making.

On the financial level, the establishment of a banking union in 2012 came as a “breakthrough”¹⁸³ in the crisis, introducing supranational supervision and resolution capacities by the ECB instead of the previously national responsibility for these tasks. The ECB, exploiting its treaty-given mandate of independence¹⁸⁴, introduced a range of unconventional measures including a more generous monetary policy as well as interest rate reduction¹⁸⁵, arguably making the ECB the most powerful supranational body and a “self-empowered” supranational bank supervisor.¹⁸⁶ Financial surveillance and prevention was heavily increased by establishing new permanent institutions on the European level, including ESM (which replaced

178 Interview 6 (Interview with academic in the field of European Political Economy, conducted on 22/03/2023, Bruges.).

179 Pagoulatos, *op. cit.*, 150.

180 Schimmelfennig, *op. cit.*, 330.

181 Schwarzer, *op. cit.*, 38.

182 Klooster, *op. cit.*, 6–7.; Heldt and Müller, *op. cit.*, 91.

183 Pisani-Ferry, *op. cit.*, 149.

184 Heldt and Müller, *op. cit.*, 84.

185 European Parliament, *op. cit.*, 11–12.

186 Heldt and Müller, *op. cit.*, 83–84.

the previous instruments of EFSF and the European Financial Stability Mechanism, EFSM), SSM, the European Single Resolution Board (ESRB), and the European Banking Authority (EBA).

On the fiscal and economic front, the European authorities aimed to strengthen the member states' budgetary and fiscal discipline by increasing supranational coordination and oversight. To this end, instruments including the SixPack, the TwoPack, the Fiscal Compact, and the Euro Plus Pact were established, enforcing tougher monitoring and discipline, notably through the Macroeconomic Imbalance Procedure (MIP) and the Excessive Deficit Procedure (EDP). The European Semester was introduced in 2011 with the goal of coordinating economic policy on the European level, and the SGP was reformed by introducing the Excessive Imbalance Procedure (EIP) and by taking into account to a greater extent specific national economic and budgetary conditions.¹⁸⁷

In sum, the adjustments introduced on the supranational level thus applied to a range of different policy areas, creating a far-reaching and profound change to the EMU's landscape. The previously existing problems of decentralisation, incomplete coordination, asymmetries, and a common currency lacking governance were finally approached when the crisis laid blank the insufficiencies of the EMU.¹⁸⁸

It was thus by facing the threat of national failure and a break-up of the fragile union which the EMU represented before the crisis that change was introduced between 2008 and 2013 on the supranational level. While the completeness of the EMU is as yet lacking ten years after the crisis, with a political union waiting to be created by introducing a joint deposit insurance scheme, a fiscal union enabling risk sharing and convergence, and a centralised debt instrument,¹⁸⁹ many steps in the direction of a deeper integrated and more complete EMU were made in the context of the euro-zone crisis. These included improved surveillance instruments, crisis resolution and prevention mechanisms, a reformed economic governance of the common currency, an expansion of ECB powers and a circumvention of the no-bailout clause, as well as the establishment of permanent institu-

187 Schwarzer, *op. cit.*, 30.

188 Pagoulatos, *op. cit.*, 151.

189 Andor, *op. cit.*, 236.

tions such as ESM, ESRB, and SSM.¹⁹⁰ In sum, thus, the crisis granted the EMU a window of opportunity to implement change that had previously been constrained by member state reluctance to further integrate and by the EMU’s lacking ability to implement missing elements in the union. While the EMU still remains incomplete in some areas, the adjustments made during the crisis strengthened its capacities substantially.

Table 1: EMU- and member state-specific factors influencing reform.

	EMU	Member states
Reform-constraining factors	Lacking emergency instruments / foresight / surveillance mechanisms Member state unwillingness to delegate power to EMU Restrictive monetary financing attitude Heterogeneous member state preferences Incomplete architecture, insufficient integration	Lacking incentives to apply discipline due to eurozone adherence Domestic policy errors Domestic political constraints / opposition to reforms Weak banking systems and internal structures
Reform-enabling factors	Financial means Position of authority → Need for credible and effective action / institutions Urgency of situation / risk of euro collapse Market pressure Constraints lifted (national preference alignment, larger ECB scope of action)	Financial dependence on EMU Power inferiority → Pressure by EMU rhetoric and conditionality National reform failure legitimization of European intervention Urgency of situation / risk of national collapse Constraints lifted (delegation of decision responsibility to European level)

190 Kincaid, op. cit., 35.

Level-specific reforms

<p>Introduced reforms</p>	<p>Monetary pillar: non-standard measures (OMT, SMP, lender of last resort, bail-outs), ESM</p> <p>Financial pillar: banking union, EFSF, single rulebook, SSM, SRF, EBA</p> <p>Fiscal and economic pillars: reformed SGP, Two Pack, Six Pack, Fiscal Compact, MIP, EDP, EIP, Euro Plus Pact, Europe 2020</p>	<p>Bank sector restructuring, recapitalisation, deleveraging</p> <p>Creation of institutions (SAREB, NAMA, Irish Fiscal Advisory Council)</p> <p>Labour market and public administration reforms</p>
<p>Reform outcomes</p>	<p>Increased European supervision, coordination, regulation, institutionalisation</p> <p>Stronger architecture / integration</p> <p>Better crisis resilience</p>	<p>Increased national supervision, regulation, institutionalisation</p> <p>Improved banking and administrative sectors</p> <p>More efficient and resilient labour markets</p>

6 Test of Hypotheses

Having outlined in the previous chapter the reforms and adjustments that Ireland, Spain, and the EMU implemented over the course of the crisis, this chapter now applies this empirical evidence to the hypotheses presented in chapter 4, thus testing whether this paper's claims are justified. To this end, the theoretical arguments for each hypothesis shall be put into connection with the real-world reforms introduced on the respective level as outlined in chapter 5, explaining the mechanisms which enabled the changes and testing whether the argued interconnections really exist.

6.1 H1 – Interdependence between National and European Reform

“Because the failure of one or more countries impacted the whole union in a mechanism of interdependence, reform solutions were enabled only in a constellation of mutual influence.”

H1 claims that the ability to reform the weak banking sectors and the fiscal governance in Ireland and Spain relied on the influence exercised by the supranational level. At the same time, changes made to the surveillance and coordination instruments of the EMU equally depended on the willingness to delegate these competencies from the national level to the European level. H1 argues that as both levels faced substantial constraints to their ability to reform in the years prior to the crisis, they each had to break out of their reluctant attitude at the same time to achieve

the changes they desired in the other. Due to the complicated preference constellation and qualms to change their existing frameworks, each level had to make concessions to the other to avoid a deadlock situation where none of the two would budge.

The reason why the situation had become untenable both in Ireland and Spain and in the EMU once the crisis hit lies in their fragile systems of insufficiently complete architecture, tainted with repeated policy errors that rendered them even more fragile and lacking resilience. On the European level, this weakness was characterised by an incomplete degree of integration where only the monetary pillar of the EMU was strongly enforced while the financial, economic, fiscal, and political pillars suffered from lacking comprehensiveness.¹⁹¹ Additionally, the EMU had made policy errors by carelessly underrating the importance of exercising surveillance and monitoring of its member state governance: no centralised monitoring instrument had been implemented before the eurozone crisis, with the EMU relying in good faith on the member states' discipline to keep themselves in order in absence of a supranational body.¹⁹² Additionally, by being insufficiently foresightful regarding the possibility of a crisis to the eurozone, the European level rendered itself unprepared once the crisis started, forced to act quickly to implement in a context of urgency and pressure the range of instruments that it had failed to introduce beforehand. An additional weakness to the EMU was the constraint it faced internally by its members and policy-makers: famously, Germany opposed any notion of further (fiscal) integration and some of its allies followed this preference.¹⁹³ The treaties prohibited any bail-outs or monetary financing to eurozone members on principle¹⁹⁴, forming an additional difficulty to enabling the secure functioning of the eurozone in the case of failure of one or more member states.

Just as the EMU thus can be shown to have borne many limitations, both Ireland and Spain portrayed similar fragility on the national level: for both of them, the adherence to the eurozone lifted the previous-

191 Glöckler, Salines and Truchlewski, op. cit., 665–666., Otero-Iglesias, op. cit., 350.

192 Glöckler, Salines and Truchlewski, op. cit., 666.

193 Copeland and James, op. cit., 9.

194 Art. 123 and 125 TFEU.

ly extant responsibility to manage themselves and ensure national fiscal discipline.¹⁹⁵ Spain in particular had faced substantial domestic opposition to attempted reforms prior to the crisis¹⁹⁶, rendering the government unable to implement urgently needed change before disaster struck: fiscal consolidation, paired with wage cuts, a reduction in public spending, tax raises, and increased risk of poverty, were powerfully lobbied against in Spain.¹⁹⁷ Furthermore, the Spanish government reacted unwisely to the onset of its economic recession by promoting fiscal expansion in 2009 when all indicators pointed towards the necessity of introducing austerity and fiscal contraction.¹⁹⁸ Similarly, Ireland also made a range of bad decisions in the dawn of the crisis, providing a government blanket guarantee to two its major banks, Anglo-Irish and Irish Nationwide Building Society, in 2008¹⁹⁹ and being dependent early on the ECB and the Central Bank of Ireland to provide liquidity to national banks unable to raise funds from the market.²⁰⁰

Far from being purely internal domestic weaknesses in Ireland and Spain that would not affect the eurozone as a whole, there existed a realistic risk of contagion from one country to another, creating the link from the national to the supranational level: Spain forming the fourth-largest economy of the eurozone created a high dependence of the EMU on the good functioning of the Spanish governance²⁰¹, but the risk of moral hazard prevented the European level from simply providing financial support to the failing country due to the danger of inadequate discipline of the aided country once bailed-out.²⁰²

Thus, in line with H1's claims, both levels had to break out from their weak and constrained architecture, implementing change in order to incentivise the other level to similarly do so: Ireland and Spain were

195 Hemerijck and Matsaganis, op. cit., 11/41.

196 Royo and Steinberg, op. cit., 169.

197 Otero-Iglesias and Steinberg, op. cit., 236.

198 Ferreiro, op. cit., 257.

199 Walter, op. cit., 113.

200 Kitromilides, op. cit., 174–176.

201 Interview 6.

202 Brunnermeier, Markus Konrad, Harold James, and Jean-Pierre Landau. 2016. *The Euro and the Battle of Ideas*. Princeton: Princeton University Press., 4.

under pressure to finally introduce reforms as a prerequisite to receive financial assistance from the European level, while at the same time the EMU was forced to create the supervisory and coordination bodies that such assistance would require. Each level thus held substantial bargaining chips that forced the other level to adjust, creating the spiral of perpetuated reform that H1 supports.

The precise mechanisms of mutual pressure-building and pressure-receiving in the cases of Ireland, Spain, and the EMU can be described as thus:

Firstly, Ireland and Spain both desperately required financial aid from external bodies during the crisis, if at different times. Ireland having made the mistake of creating a blanket to its banks and thus creating a full-fledged sovereign debt crisis from the initial banking crisis²⁰³ applied for a bail-out in 2010, while Spain circumvented such measures until 2012, when its insufficient reform efforts forced it to formally request help. The EMU agreed to provide such funding and bail-outs only under strict conditionality that required dedicated willingness and discipline in Ireland and Spain to reform, a no-nonsense approach that dismissed any half-baked changes such as the ones previously introduced by the Irish and Spanish governments. The bail-outs were thus no free-rides for Ireland and Spain, coming with targeted ambitious demands for reform from the European side. Thus, Ireland received clear instructions by the ECB and IMF to restructure and deleverage its banking sector, reduce public spending, follow a line of fiscal consolidation, and strengthen monitoring by establishing the Fiscal Advisory Council.²⁰⁴ Spain, when receiving its partial ESM bail-out, was obliged to restructure and recapitalise its banking system, notably by reducing the number of weak *cajas* and establishing a “bad” bank, SAREB.²⁰⁵ Reform hence was not an option, but a requirement for Ireland and Spain, clearly linked to the EMU intervention and enabled only, after years of half-fledged adjustments, by the imperatives of the European level.

203 Kitromilides, op. cit. 174.

204 Ibid.

205 European Commission, Memorandum of Understanding on Financial-Sector Policy Conditionality. Spain. 20th July 2012. Accessed on 18/04/2023 at: file:///C:/Users/Clara/Downloads/pol_guide_to_referencing_2022-23-7.pdf

The austerity and harshness of the supranational level towards Ireland and Spain came however as a necessity stemming from equal pressure on the EMU to perform: the risk of contagion with the ensuing possible collapse of the euro and a lack-of-confidence-spillover from the national to the European level²⁰⁶ forced the EMU to act quickly and effectively in a short span of time. Bail-outs and monetary funding were formally prohibited by the treaties, and many of the non-standard measures that the ECB applied were deeply criticised within the eurozone as going beyond its official mandate.²⁰⁷ Thus, the supranational level became pressurised to create credible institutions²⁰⁸ that would formalise the intervention by the ECB and by the EMU intervention. Furthermore, such institutional reform was a technical necessity on the European level to be able to provide the supervisory and coordinative authority that it exercised by way of imposing reform on the national level: only a strong European architecture, after all, would justify demands for a similarly strong national architecture. Thus, the EMU introduced a range of measures over the course of the crisis, aimed at improving the monitoring, surveillance, and financial governance capacities at the European level. Most notably, the banking union was established, a move that would have been inconceivable had the crisis not taken place²⁰⁹, creating a single rulebook and authority (EBA) to improve the financial pillar of the EMU. Surveillance was enabled by the establishment of institutions including EFSF and EFSM, later to be replaced by ESM, and the SSM and SRM mechanisms. Fiscal legislative packages such as the SixPack and the TwoPack, as well as the Fiscal Compact, a reformed SGP, and the European Semester, all provided improved monitoring and disciplining measures on the EMU level.²¹⁰ To better coordinate national policies, the Euro Plus Pact and Europe 2020 were introduced. Thus, the interconnection between national and European policy-making was decidedly strengthened with a substantial range of new institutions, instruments, and measures over the course of the cri-

206 Interview 4 (Interview with a senior official from the ECB, conducted on 31/03/2023, Bruges.).

207 Heldt and Müller, *op. cit.*, 94.

208 Schöller, *op. cit.*, 84.

209 Interview 5.

210 Bauer and Becker, *op. cit.*, 216–225.

sis. While these innovations had been unimplementable before the crisis due to the constraints of opposing member states, heterogenous national preference constellations, and a reluctance to introduce wide-reaching financial and fiscal centralisation, these restraints were lifted in the crisis context: the member states, including Germany eventually,²¹¹ aligned in their common preference to save the euro, forming an enabling ground for deeper change, and the pressure by the market added to the EMU's ability to adjust its architecture and actions. Reforms were the only solution to save the common currency and the functioning of the eurozone, and the crisis allowed for this change to be made whatever the prior impediments,²¹² as reflected famously in Draghi's "Whatever it takes" speech.

While a substantial amount of pressure was thus at play between the member state level and the European level, the reforms were equally *facilitated* rather than coerced by the respective other level. This becomes apparent when taking into account the domestic opposition to reform that notably Spain had faced prior to the crisis²¹³, with only incremental change having been implemented in the labour market²¹⁴, and none in the banking sector, before the ESM's intervention in 2012. Similarly, Ireland failed to introduce real change in 2008 when it attempted to reform its financial sector²¹⁵, showing that while a certain will to change existed, it had been constrained by domestic factors both in the Irish and in the Spanish case. When the European level took the initiative to finally implement change in Ireland and Spain through its bail-out conditionality, it thus eased the national restrictions by, to a certain extent, taking over the accountability and responsibility for these unpopular reforms.²¹⁶ By delegating decisions and competencies to the European level, Ireland and Spain thus gained the leverage to introduce reforms.

211 Schimmelfennig, op. cit., 330.

212 Westlake, op. cit.

213 Royo and Steinberg, op. cit., 169.

214 Carlos Cuerpo, Federico Geli and Carlos Herrero, "Some unpleasant labour arithmetics. A tale of the Spanish 2012 labour market reform" in *Economic Crisis and Structural Reforms in Southern Europe : Policy Lessons.*, eds. Paulo Manasse and Dimitris Katsikas (Abingdon, Oxon: 2018), 140–144.

215 Interview 2.

216 Schimmelfennig, op. cit., 334.

Finally, the EMU experienced a similar facilitation of reform by the pressure imposed through the failing member states: the struggles of countries such as Ireland and Spain gave the European level an excuse to finally deepen integration, a project that had stalled in the previous years, and that was now imposed on the EMU by the member states increasingly relying on its support: the willingness of Ireland and Spain to delegate competencies to the European level and grant it surveillance and coordination capacity required in turn a credible and well-functioning EMU to manage these increased powers. Thus, Ireland's and Spain's reliance on the European level facilitated the creation of reforms such as the banking union, ESM, and SSM as well as the fiscal disciplining instruments.

The assumptions made by H1 have been tested by applying them to the real-world changes made in Ireland, Spain, and the EMU and finding a distinct connection between the creation of reforms and the dependence of one level on the other. Change in Ireland and Spain became possible only when the European level intervened, and reforms to the EMU were simultaneously enabled due to the member states' dependence. Thus, H1 has been verified, confirming the claim of a spiral of mutually perpetuated reform towards a positive development of deeper integration in all four pillars of the EMU. It remains important to emphasise, however, that H1 does not claim completeness of the EMU as each area still lacks instruments towards full integration: within the banking union, no single deposit guarantee scheme or single resolution mechanism exists, and an added fiscal capacity to overcome the problem of "currency without state"²¹⁷ remains to be implemented.²¹⁸ However, the advancements made within the eurocrisis, thanks to the mutual incentivisation of the member state and the European level, form an important step in the direction of full EMU integration.

217 Pagoulatos, *op. cit.*, 152.

218 Otero-Iglesias and Steinberg, *op. cit.*, 237.

6.2 H2 – European Influence on National-Level Reform

“The Irish and Spanish economic and banking failures necessitated EU intervention to implement national reforms due to domestic constraints to change.”

Having verified with H1 the claim that an interconnection between the European and the member state level existed to promote reform in the respective other level during the eurozone crisis, H2 shall now be tested. This hypothesis focuses on the member state level specifically, aiming to outline which were precisely the mechanisms influenced by the EMU that enabled Ireland and Spain to implement change.

For both countries, H2 argues that a weak architecture of the national financial and fiscal governance and fragile economic set-up, depending heavily on unstable factors, led to a pre-crisis economic growth that created a false sense of security in both Ireland and Spain. Subsequent reform efforts by the Irish and Spanish governments failed due to substantial domestic opposition – as in the Spanish case²¹⁹ – and policy errors – as in both cases.²²⁰ Due to this insufficient national capacity to introduce adjustments, both Ireland and Spain became dependent, at different moments of time, on financial and reform assistance by the EMU. Change was, in fact, a condition of the Irish and Spanish bail-outs, meaning that the European level both functioned as a pressurising and facilitating entity to implement change in Ireland and Spain. This mechanism of national dependence on the European level to enable domestic reforms is the core argument of H2 which shall be tested in the following by applying it to the real-world happenings of the crisis in Ireland and Spain.

Ireland represented all elements identified by H2 as crisis-driving²²¹ in the years prior to its onset, including a weak national architecture in the banking and structural sector, lacking incentive to introduce national reform due to a strong economic growth that however relied on excessive external financing, and numerous policy mistakes that did not reduce,

219 Royo and Steinberg, *op. cit.*, 169.

220 Ferreiro, *op. cit.*, 247–248.; Kitromilides, *op. cit.*, 180.

221 Cf. chapter 3.

but increased the susceptibility to failure.²²² More specifically, the weak Irish banking system stemmed from its high dependence on the housing and construction sectors,²²³ an insufficient supervision of the national banks, and a high level of deficits and indebtedness of the banks.²²⁴ To counter this problem, the Irish government introduced a blanket guarantee in 2008 which turned into a vicious circle where the government and the banks became interdependent, Ireland thus increasingly relying on ECB credit in absence of a clear resolution strategy.²²⁵ What had started as an internal banking crisis became a sovereign debt crisis, including financial, fiscal, and competitiveness elements.²²⁶

Reforms that the Irish government tried to introduce following these dangerous developments included the nationalisation of the Anglo-Irish bank, many smaller bank recapitalisations, and the establishment of the NAMA.²²⁷ These instruments proved the Irish willingness to adjust, but failed to provide sufficient solutions to the country's struggles.

Thus, it was only when the European level stepped in after Ireland's application for a bail-out in 2010 that the path for far-reaching reforms was paved through the conditionality which was linked to the EU's and the IMF's financial assistance. The conditions that the bail-out set included a wide range of reforms to the Irish financial and fiscal management and to its public administration, leaving Ireland no choice but to finally adjust these areas. The reforms which the supranational level imposed on Ireland included mainly two areas, the banking sector and public finances.²²⁸ For the former, bank recapitalisation and stabilisation were introduced, reducing the size of the sector by merging banks and decreasing staff numbers, and an alignment of assets with deposits was undertaken; while for the latter, the budget deficit was reduced, VAT and vehicle taxes

222 Kitromilides, op. cit., 180.

223 Cardiff, 98–100.

224 Kitromilides, op. cit., 176–179.

225 Eichengreen, op. cit., 114.

226 Kitromilides, op. cit., 174.

227 Cardiff, op. cit., 103.

228 “IMF Lending Case Study: Ireland”, *International Monetary Fund*, accessed on 17/04/2023 at: <https://www.imf.org/en/Countries/IRL/ireland-lending-case-study>

increased, and capital spending limited.²²⁹ Additionally, increased financial regulation and supervision were introduced as well as fiscal budget consolidation. On the institutional level, the Irish Fiscal Advisory Council was created.

While these reforms came as a strict condition for the EU/IMF bail-out and thus put the Irish government under substantial pressure, they aligned with the existing Irish willingness to introduce changes to its architecture and to commit to reforms.²³⁰ Providing clear guidelines and instructions, the EMU served as a facilitating entity to enable the much-needed adjustments. Where Ireland had attempted but failed in the early crisis years to adapt its banking system and fiscal governance, it was able to transfer a certain responsibility to the European level by accepting its bail-out and connected conditionality. The result was a rapid implementation²³¹ of the changes and a subsequent fast recovery of the Irish economy, with a clear upwards trend in employment rates and economic growth established by late 2013 and an Irish banking sector characterised by increased oversight, an improved ability to invest, and strengthened confidence.²³²

Just as in the Irish case, the ingredients for domestic struggles that eventually led to dependence on the European level were present in Spain, if under different circumstances: the Spanish banking sector, built on a large number of insufficiently diversified *cajas*, provided weak support to an economy that fuelled its growth with a massive inflow of capital and external funding.²³³ Rather than tackling these weaknesses, the Spanish government however relied for too long on its economic surge, lacking the incentive to reform its system early on. An additional difficulty was the wrong diagnosis²³⁴ of its struggles by the Spanish government once its weaknesses became apparent, pursuing fiscal expansion until 2010 rather than consolidation, and introducing disciplining measures late and to little effect, such as labour market regulation and privatisation.²³⁵ The

229 Ibid.

230 Eichengreen, op. cit., 18; Interview 2.

231 Walter, op. cit., 114.

232 Cardiff, op. cit., 110.

233 Ferreiro, op. cit., 247.

234 Otero-Iglesias and Steinberg, op. cit., 232.

235 Walter, op. cit., 124.

Spanish struggles to implement reform were further increased by a high level of domestic constraint that created another powerful barrier to the improvement of the national situation.²³⁶

The result of these circumstances combined was a low level of economic growth paired with high unemployment, an inefficient labour market structure based on unsustainable collective bargaining, and lacking fiscal adjustment.²³⁷ With the national banks holding too much government debt, an interdependence between the sovereign and the banks developed similarly to that in Ireland, leading to bank insolvencies and a doom loop that could only be broken by the assistance of an external body. Thus, as in the Irish case, the European level became the funder that Spain relied on, accepting a partial ESM bail-out in 2012 after having circumvented such measures in the previous year.²³⁸

The financial dependence on a bail-out thus rendered Spain, after years of incremental reform and lacking political will to change, unable to resist adjustments any longer as the ESM assistance was linked to the targeted condition of restructuring the Spanish banking sector. Spain was able to overcome the restrictive national mood opposing reform by delegating authority to the supranational level and ridding itself of exclusive accountability and responsibility. The urgency of the crisis, which threatened not only the future of the national economy but also its common currency, and the past failures of having insufficiently addressed the weaknesses of its own system, allowed Spain to regard the EMU not only as a pressurising entity, but as one enabling reform when it had been previously impossible. Quite contrary to an assessment as coercive, the Spanish government used the pressures by the European level strategically as a window of opportunity to finally make the change that it had intended but failed to implement in the previous years.²³⁹

A factor that benefitted Spain was the fact that its important role as the EU's fourth-largest economy, creating a strategically vital member state of the eurozone, influenced the conditionality of the Spanish bail-out

236 Royo and Steinberg, *op. cit.*, 177.

237 Ferreiro, *op. cit.*, 249–250.

238 Kincaid, *op. cit.*, 20.

239 Cuerdo, Geli and Herrero, *op. cit.*, 144; Royo and Steinberg, *op. cit.*, 177.

in a favourable way: targeted uniquely at restructuring its banking sector, the conditionality imposed on Spain was less harsh than that linked to bail-outs in other failing member states.²⁴⁰ The changes that the ESM instructed Spain to introduce in its banking sector nevertheless created a far-reaching restructuring of the system, including the establishment of SAREB as a “bad” bank tasked with managing toxic assets, improving the sector’s transparency and risk identification, and managing legacy assets.²⁴¹ By setting a clear timeline and pushing for the rapid implementation of these measures, the ESM created a framework for Spain to credibly commit to reform without the limitation of domestic opposition. Thus, the country’s employment rates, economic performance, and banking sector managed to start recovering from mid-2013.²⁴²

Both Ireland and Spain thus proved to rely on European assistance in the implementation of reforms and the subsequent revival of their economies based on improved banking sectors and fiscal discipline. H2 can be regarded as verified, having shown that the member state level became heavily dependent on the EMU to adjust their domestic systems due to national constraints, structural weaknesses, and policy errors having impeded such reform in a national capacity. The financial dominance of the supra-national level and the authority that it brought along hence allowed for the EMU to impose changes on Ireland and Spain that had continuously been questioned and failed on the domestic level beforehand. In sum, H2 has thus proven the dependence of the national level on the European level in the creation of domestic change to the banking and economic sector.

240 Walter, op. cit., 131.

241 European Commission, Memorandum of Understanding on Financial-Sector Policy Conditionality. Spain. 20th July 2012. Accessed on 18/04/2023 at: file:///C:/Users/Clara/Downloads/pol_guide_to_referencing_2022-23-7.pdf

242 Royo and Steinberg, op. cit., 170–174.

6.3 H3 – National Influence on EMU-Level Reform

“Reforms to the EMU’s incomplete state at the time were facilitated by national failures, combined with the need for effective results.”

The final element that remains to be analysed is the EMU and the mechanisms that allowed it to introduce reform during the crisis after having refrained from further integration in the financial and fiscal fields for many years. H3 claims, in a mirrored argument of H2, that the EMU was similarly dependent on the member states to enable reform on the supranational level as the member states relied on the European level to implement domestic change.

One of the main reasons why member state failure became possible so dramatically and in such a high number of countries at the same time lies in the fact that the eurozone states were intertwined, yet incompletely integrated when the eurocrisis set in. Having delegated competencies to the European level, the member states had committed to a dependence on the EMU in the hopes of benefitting from the common currency and the centralised governance that the euro brought with it. However, this union remained incomplete, with oversight, coordination and regulation lacking.²⁴³ In a relationship characterised by the reliance of the member state on the authoritative body of the EMU, this incompleteness turned out to be a dangerous risk to the functioning of the union and to the entire existence of its shared currency and governance.

Due to the lack of surveillance and harmonisation, an imbalance developed over the years prior to the crisis between the imperatives of the EMU and the applied national policies,²⁴⁴ meaning that member states did not follow the same line of financial and economic governance due to the lack of centralised organisation. The result was a non-integrated set of semi-independent member states whose diverging policies were not connectable on the European level. The weak coordination of the Irish financial governance with the European level, including the establishment of a blanket guarantee for failing banks by the Irish government in 2008

243 Pagoulatos, op. cit., 152.

244 Henning, op. cit., 178.

without consulting the EU,²⁴⁵ is one example, just as much as the Spanish unwillingness to delegate responsibility to the EMU level as late as 2011 when the Spain successfully aimed to circumvent an EMU-funded bailout and preferred to keep policy-making national.²⁴⁶ It was, however, not only lacks on the side of the member states that impeded comprehensive coordination between the national and the European level, but also faults on the side of the EMU: the Committee of European Banking Supervisors (CEBS) – the predecessor of the EBA – failed to sufficiently scrutinise the Irish banking sector, just as the IMF did not pay enough attention to the Irish lending and control practices.²⁴⁷ Thus, the pre-conditions of the EMU before and at the beginning of the eurozone crisis were wanting, with the incompleteness of the union due to lacking oversight and coordination perpetuating the developing troubles in Ireland and Spain.

Furthermore, the EMU did not possess the necessary instruments, and thus the ability, to fulfil its task as a supervisor and coordinator. Monitoring, regulation, disciplining measures, and thus the creation of a sense of union all failed to be achieved sufficiently by the European level²⁴⁸ due to this architectural weakness of an authority lacking implementing tools. Before the crisis, few to no institutions existed to formalise the supervisory and harmonising competencies of the EMU, rendering it useless to counter any crisis that threatened the financial and economic integrity of the eurozone. Efforts to reform the EMU and further integrate it had been heavily restrained in the past by diverging member state preferences, first and foremost by Germany who followed an austere and “Ordnungspolitik”-oriented line of national self-responsibility in the financial and economic areas, a constraint to integration that was enhanced by member states’ reluctance to delegate powers to the supranational level.

Thus, in a paradoxical combination of elements, the eurozone crisis came as a favourable window of opportunity to an EMU that was in dire need to change but had been heavily restricted in doing so by its own members in the previous years. With the common currency under

245 Eichengreen, *op. cit.*, 112.

246 Kincaid, *op. cit.*, 18.

247 Eichengreen, *op. cit.*, 111–112.

248 Andor, *op. cit.*, 226–227.

threat and failing member states turning to the European level for help, an intervention by the EMU became necessary in order to save the struggling countries. This interference, in turn, finally offered the EMU the possibility to strengthen integration. With the eurocrisis creating a legitimacy crisis to the EMU²⁴⁹, after all, only a strengthened and more credible EMU would be in a position to provide adequate assistance to the weakened member states. Change to the European level, so the rationale, was a pre-requisite to the saving of the single member states including Ireland and Spain, the reform to the EMU thus acquiring its legitimation through the delegation of responsibility from the national to the European dimension.²⁵⁰ With the high risks at stake, the EU became liberated from previous constraints to increasing its competencies because the crisis urgency meant that “the ends (above all, overcoming the crisis) ha[d] to justify the means”²⁵¹.

The mechanisms that enabled reform on the supranational level hence stemmed from the member state level, with prior constraints being lifted from the EMU and the ECB²⁵² due to the urgency of the crisis and subsequent decreased opposition by the member states to an adjusted line of action by the EMU.²⁵³ Additionally, the increased emergence of the EMU as the only entity able to provide guidance and financial assistance in the eurozone crisis granted it a parallel surge of legitimacy and power,²⁵⁴ paving the way for reform to be accepted as a credible commitment by the European level.

Reform thus became possible in the light of the need for a strengthened EMU as a condition to help the struggling member states, leading to a range of adjustment in many policy areas on the supranational level: cen-

249 Scicluna, *op. cit.*, 1884.

250 Interview 4.

251 Martin Westlake, EECs Secretary General, speech, 03–04/05/2012, Dublin meeting of the Secretaries General of the national Economic and Social Councils and the European Economic and Social Committee. Accessed on 28/04/2023 at: <https://www.eesc.europa.eu/ceslink/sites/default/files/toolip-old-resources/docs/4-may-2012-dublin-speech-mw-to-national-esc-sgs.pdf>

252 Schwarzer, *op. cit.*, 35.

253 Schimmelfennig, *op. cit.*, 330; Schwarzer, *op. cit.*, 34.

254 Heldt and Müller, *op. cit.*, 83; Schöller, *op. cit.*, 81.

tralised supervision was strengthened by institutions such as SSM, ESRB, and ESM; supranational coordination of national policies was improved by introducing the SixPack, the TwoPack, the Fiscal Compact, the European Semester, and by reforming the SGP; better regulation was enabled by the establishment of a banking union including the Single Rulebook, the Single Resolution Mechanism (SRM) and the Single Supervisory Mechanism (SSM); funding mechanisms were introduced with ESM, the European Resolution Fund (ERF), and in the form of non-standard measures, such as OMT, SMP, bail-outs, and the ECB's new function as a de facto lender of last resort.²⁵⁵ Through these new instruments and institutions, the EMU thus managed to implement measures that improved its oversight of the financial governance on the member state level, strengthened budgetary discipline by increased monitoring capacities, and coordinated national policies by creating designated supranational tools.

In a mechanism of interconnection, the EMU hence reached an unprecedented level of integration in its four pillars, developing the ability to assist member states including Ireland and Spain in their recovery by improving its own architecture, which in turn was enabled by the specific context of member state failure. Applied to the cases of Ireland and Spain, it becomes apparent how the EMU's reforms were connected to the crisis situation on the national level: demanding change in the banking and structural systems of Ireland and Spain, the EMU needed to provide an accordingly strong banking system to appear credible, thus introducing the banking union with its harmonised regulation and recapitalisation instruments. Similarly, requests for member states to reform their national fiscal policies was reflected on the European level by the improvement and establishment of fiscal instruments such as the SixPack and the TwoPack. Criticism of Ireland's and Spain's lacking supervisory capacities only became credible once the EMU established its own monitoring bodies with ESM and ESRB, and a centralisation of the national banks and financial entities required a parallel institutionalisation of the European authorities, for example the EBA.

Thus, just as Ireland and Spain experienced both pressure and facilitation by the European level to implement reform, the EMU found itself in

255 Hemerijck and Matsaganis, op. cit., 42; Bauer and Becker, op. cit., 216–225.

the analogous situation: under pressure to assist its failing member states and to rescue the common currency, the EMU was forced to implement change that had been previously impossible to achieve, while the lifted reform constraints on the supranational level and the subsequent freedom to act enabled it to introduce new and unprecedented measures.²⁵⁶ A strong and reformed EMU was needed by Ireland and Spain to help them out of their troubles, while at the same time the EMU required the severity of their national failures to give it an adequate excuse to implement substantial change.

In sum, the EMU thus managed to introduce adjustments due to the struggles of its member states including Ireland and Spain to all four of its pillars, with the banking union forming the most important change to the financial pillar; more discipline and monitoring through the legislative packs, the Fiscal Compact, and the reformed SGP strengthening the fiscal pillar; the economic pillar being improved with the European Semester; and the already strongly integrated monetary pillar experiencing adjustments through previously inconceivable financing tools via the ECB's unconventional measures. Thus, even though the political union that the EMU ideally constitutes²⁵⁷ still awaits its completion today, the changes introduced to the EMU in the eurozone crisis rendered this project more realistic.

The EMU exited the crisis with a stronger architecture and improved crisis resilience stemming from a window of opportunity created by member state struggles. H3 has thus been verified, showing that the national level influenced reform on the European level in a mechanism of influence and facilitation. Measures used to counter the later Covid19-crisis by adapting eurocrisis instruments, such as the Pandemic Emergency Purchase Programme (PEPP), prove the sustainability and longevity of the changes introduced to the EMU's policy-making in the eurozone crisis. With the Covid19-crisis presenting a similar pathology to the eurozone crisis²⁵⁸, the programmes applied in this crisis – PEPP constituting a facilitation to government borrowing and circumventing the prohibition of

256 Schwarzer, op. cit., 35.

257 Jager, op. cit., 288.

258 Pagoulatos, op. cit., 155–156.

primary debt purchases – show that the changes introduced in the euro-crisis were made to stay. Thus, a stronger and more crisis-resilient EMU has been proven with H3 to be the result of an interdependence with the member state level, hereby completing the spiral of mutually perpetuated reform that this paper conceptualises.

7 Conclusion

This paper has established a framework that explains how reforms were enabled during the eurozone crisis in a mechanism of interdependence between the member state and the European level. Each level being dependent on the other's reliable functioning created an upward spiral of mutually perpetuated reform and thus a process of deepening integration. The paper has shown that this high degree of interconnectedness was induced by weaknesses on both levels and a simultaneous inability of each level to single-handedly introduce changes to strengthen its architecture due to internal constraints. Thus, the intervention by the respective other level became necessary to achieve the outstanding reforms. Only in the situational circumstance of simultaneous weaknesses and dependencies was reform thus established, as the national level required a reformed EMU to survive domestic failure while in turn the European level relied on reformed member states to guarantee the survival of the common currency and of the entire eurozone.

These claims have been tested in three hypotheses that each focus on one relevant aspect of the spiral: H1, arguing that only the interdependent nature of the eurozone allowed for profound reforms during the eurozone crisis, has formed the main argument of the paper. It has shown that weaknesses of the national levels, here Ireland and Spain, were perpetuated by bad internal policy choices, failed national reform attempts, and domestic opposition to adjustments. Thus, the increasingly struggling member states became dependent on external intervention by the EMU to provide financial assistance, which in turn was linked to strict conditionality to reform the national systems. Only when the European

level intervened, reforms to the Irish and Spanish banking sectors, public spending, labour market, and public administration became possible. At the same time, the EMU experienced similar weaknesses due to its lacking supervision and coordination instruments pre-crisis and a thus incomplete nature that rendered the European level vulnerable to crisis. Constrained by diverging member state preferences and restrictive treaty clauses, substantial reforms to the EMU's policy-making and architecture remained impossible until the urgency of the eurocrisis with the threat of contagion and ultimate euro collapse provided the EMU with a sufficient impulse to finally introduce change. By imposing but also enabling reform respectively, the national and the European level both pressured and facilitated reform on the other level.

The second and third hypotheses focused on the individual levels separately. H2 argued that national reform was enabled only due to intervention by the European level. As both Ireland and Spain suffered from massive economic collapses after huge growth in the years prior to the crisis, they came unprepared to the weaknesses that their banking sectors and structural systems exposed. While both countries tried to introduce national reforms, they failed due to policy errors and, especially in Spain, domestic opposition. Both Ireland and Spain thus required financial assistance from the EMU and faced conditionality which finally implemented the long-necessary reforms: in Ireland, it was mainly the restructuring and recapitalisation of the banking sector, the reduction of public spending, an increase in surveillance and regulation, and a broadened tax base that constituted change, whereas the Spanish reforms consisted in a complete restructuring of the banking system, the establishment of a bad bank, labour market adjustments and changes to the public administration. While the conditions set by the EMU imposed austerity and short-term constraining effects, both Ireland and Spain exited the crisis strengthened by the European interference and hence benefitted from the reforms imposed.

H3 concentrated on the parallel EMU-level reforms, showing that its lacking surveillance and harmonisation instruments had rendered the EMU incomplete and thus fragile. German opposition to increased fiscal and economic integration, a lacking cohesiveness between the eurozone

member states, and an anti-monetary financing attitude of the supranational level hindered reforms in the years prior to the crisis. It was only when the member states started to struggle to an extent that endangered the very existence of the euro and proved their financial dependence on the EMU that the European level was able to implement change: the need for a strong and resilient EMU equipped with better monitoring and coordination capacities enabled the establishment of new institutions such as ESM, SSM, and the banking union, surveillance mechanisms, legislative packages in the fiscal and economic area including the Six-Pack, the Two-Pack, the Fiscal Compact, and the European Semester, as well as unconventional measures of the ECB such as OMT, SMP, and the new role of the ECB as a lender of last resort. Thus, the crisis circumstances created a window of opportunity for the EMU to introduce substantial changes to its architecture that had been previously impossible to establish and that finally rendered it better furnished in terms of surveillance, coordination, and regulation instruments, creating a more, if not wholly, complete political union.

Thus, by carefully analysing all factors that constrained and enabled reform on each level separately and combining these aspects to a multi-level analysis of the reforms introduced in the eurozone during the crisis, this paper has provided a holistic explanation of how reform becomes possible in such a complex and interconnected symbiosis as the eurozone. With the help of its three hypotheses, the paper has shown that national and European factors create an interplay of elements that both limit and facilitate reform, and only a situational exception such as the European sovereign debt crisis allows for the simultaneous and shortly timed implementation of substantial reforms.

While these changes rendered the eurozone as a whole, on the level of the individual member states and of the supranational governance, more resilient to ensuing crises, including Covid19, it remains to be seen in what way the instruments implemented in the eurozone crisis shall be further reformed now, as recently proposed by the European Commission, and in the future. The path towards a complete and full-fledged monetary, financial, fiscal, economic, and political European union remains long and rocky, but the changes made to the system during the eurozone cri-

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sis with their positive impacts on its durability have proven that the very defining element of the European Union, its interconnection of 27 individual member states to one complex symbiosis, enables its improvement and development. The reforms made in the eurozone crisis have shown that only the interplay of the national and the European level enables the union's growth and strengthening, and the complexity of this multi-level interconnection thus remains its foremost asset: United, and strengthened, in diversity.

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