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Making the politically unfeasible feasible: The Commission's approach to EMU reform design

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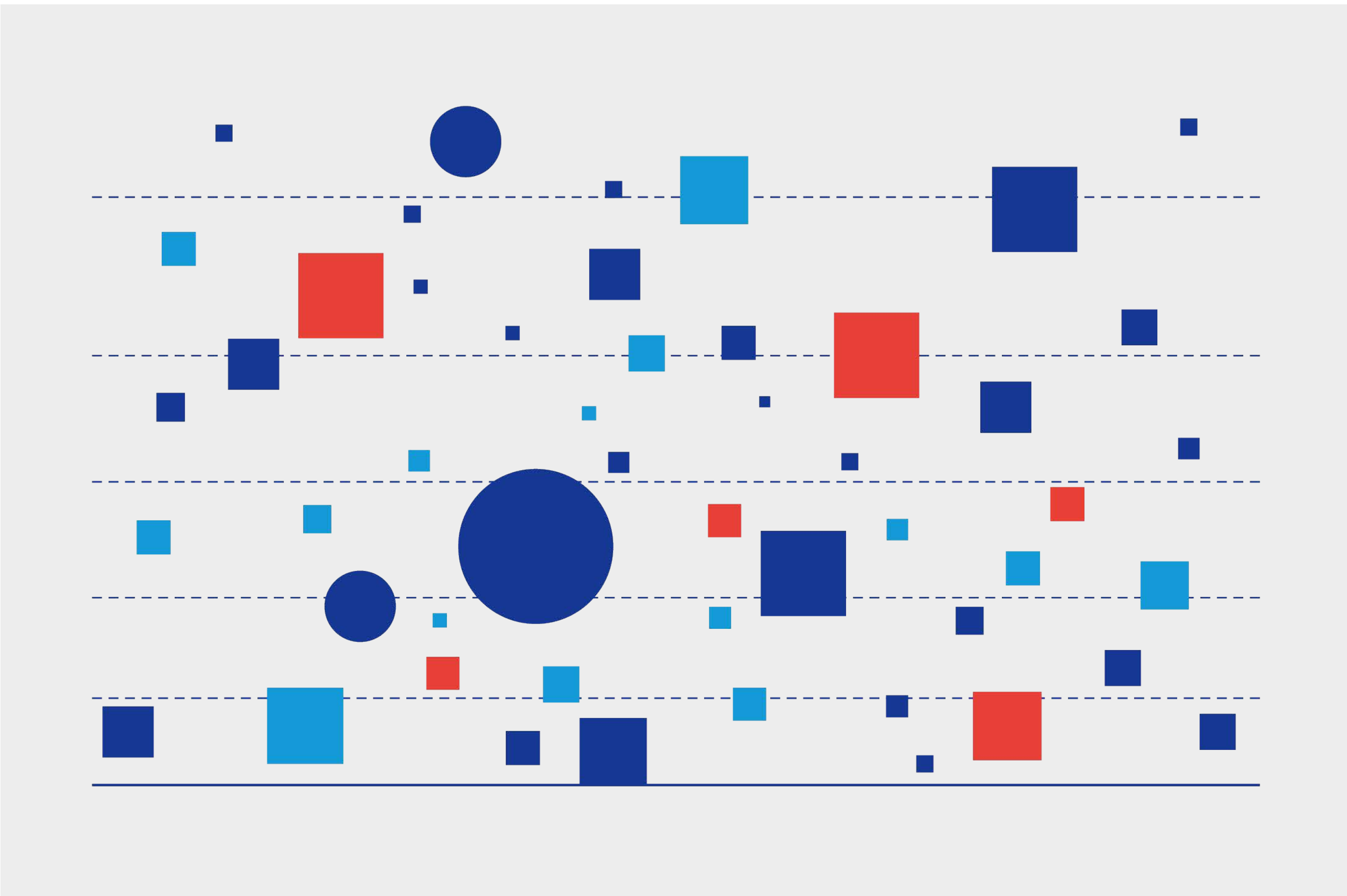
EMU CHOICES WORKING PAPER SERIES 2018



This project has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No. 649532

Making the politically unfeasible feasible:

The Commission's approach to EMU reform design

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First draft for the SGEU conference in Paris.

Abstract: This paper analyzes the evolution of Commission's policy proposals designed to increase the political feasibility of various contested aspects of the Economic and Monetary Union (EMU) reforms. It starts from the 'North-South' divisions and identifies adaptations to initial policy designs that the Commission introduced in order to make contested reforms acceptable. The evolution of three policies, common deposit insurance, fiscal backstop for bank resolution and EU funding for national reforms, indicates that in comparison to initial proposals from 2012/13, their 2017 versions have been watered down in terms of additional funding or additional risk-sharing. Moreover, their proposed timing was lengthened and the role of the Commission was reduced. The Commission strategy thus aims at obtaining the agreement of the 'North' by making these EMU reforms economically irrelevant, but potentially scalable in future.

Keywords: EMU reforms, join-decision trap, deposit insurance, structural reforms, EMU risk-sharing

1. Introduction

The Eurozone is in need of further reforms in order to complete its architecture. At the same time, the policy preferences of member states are deeply divided, which makes agreements on EMU reforms very difficult, if not impossible. However, divided preferences are nothing new and the EU has developed various strategies to bridge such divides by turning politically unfeasible reforms into proposals that can pass respective majorities in the Council and European Parliament. This paper analyzes the strategies of the Commission in striving to make three divisive EMU reform proposals politically feasible.[1]

The combination of deeply divided preferences and highly consensual decision requirements in the EU has been conceptualized as joint-decision trap by Scharpf (1988, 2006, 2011). His insight started a gradually expanding empirical literature mapping various exit mechanisms from the joint-decision trap (see Falkner 2011 for overview). This literature has documented exit strategies in various policy domains that occasionally succeed in turning politically unfeasible proposals into ones that can secure the necessary agreement. The joint-decision trap concept thus provides a suitable framework for the analysis of Commission strategies with regard to the contested EMU reforms.

[1] The paper is an input for the broader feasibility assessment of EMU reforms that is being developed by the research consortium EMU Choices (www.EMUchoices.eu), which is funded by the Horizon 2020 program.

The three proposals analyzed in this paper are: the single deposit insurance for banks, EU financial support for structural reforms and the fiscal backstop for the Single Resolution Fund (SRF). All three proposals linger in the EU policy pipeline for over 5 years and they are subject to deeply divided preferences between the 'South' of the Eurozone that generally supports their introduction and the 'North' that opposes them due to the inevitable risk-sharing that these reforms imply. The Commission has submitted several proposals since 2012/13 and, by analyzing the adaptations of these policy design, it is possible to traces strategies adopted by the Commission in the search for a feasible compromise.

In comparison to the initial reform designs, all three proposals have been watered down and their implementation deadlines were either extended or removed altogether. Moreover, the central role of the Commission was also reduced, especially with regards to the money for reform scheme. While such adaptations may improve political feasibility, they also make them less economically relevant. The watered-down proposals no longer provide for additional risk-sharing or EU-level resources in addition to the existing EU budget, hence their potential contribution to the stability and resilience of the Eurozone is also increasingly marginal. Consequently, Commission's reform strategy has been reduced to creating new institutions, with the expectation that their limited economic significance can be scaled up, whenever political opportunity presents itself.

The paper is structured as follows. The next section identifies the 'North - South' divide[2] and briefly reviews the joint-decision trap exit strategies identified in the recent literature. The third section briefly outlines the evolution of the three reform proposals, which identifies adaptations in their design during the 2012 to 2017 period. The forth section summarizes the findings across all three proposals, while the conclusions discusses possible interpretations of these findings.

2. Bridging the North-South divide: exiting the joint-decision trap

The North-South divide with regards to the EMU reform proposals is taken for granted in the media and policy literature.[3] A group of French and German economists striving to formulate feasible set of reforms use this observation as their starting point:

> "[There is] a deep disagreement among euro area members on the direction that reforms should take – including between its two largest members, Germany and France. France (along with other members such as Italy) has called for additional stabilisation and risk-sharing mechanisms as well as stronger governance and accountability at the euro area level. In contrast, Germany (along with other members such as the Netherlands) takes the view that the problems of the euro area stem mostly from inadequate domestic policies, that additional euro area stabilisation and risk-sharing instruments could be counterproductive, and that what is really needed is

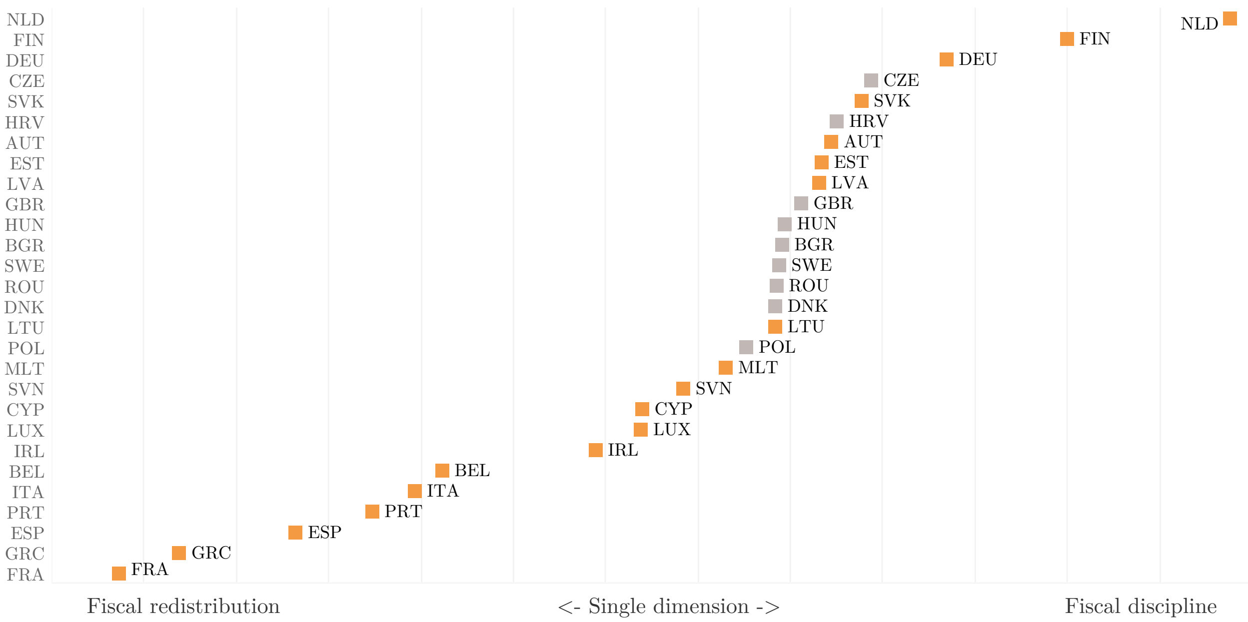
[2] The grouping labels are in quotes to indicate they are geographical and political approximations. While the division is clearly observable (see Figure 1), many member states are the in middle - especially the non-Eurozone countries.

[3] See also the letter of 8 finance ministers from the 'North' https://www.government.se/statements/2018/03/finance-ministers-from-denmark-estonia-finland-ireland-latvia-lithuania-the-netherlands-and-sweden/

tougher enforcement of fiscal rules and more market discipline." (Bénassy-Quéré et al. 2018:1).

The divide is also confirmed by systematic empirical studies of member state preferences. Wasserfallen and Lehner (2018) analyzed member states positions on 47 economic and fiscal integration policies during the 2010 to 2015 period and used scaling methods to identify key dimensions of policy conflicts. They found that these negotiations are dominated by a one-dimensional conflict between Southern countries advocating for more fiscal transfers and the Northern countries prioritizing fiscal discipline. Such a conflict structure makes the reform consensus difficult as preferences of all large member states are polarized (see Figure 1).

Figure 1: Estimated ideal points of member states



Source: Estimates from Wasserfallen and Lehner (2018). Grey indicates non-Eurozone countries.

Sharply divided policy preferences in combination with decision rules requiring unanimity (for EMU reforms requiring a Treaty change) or qualified majority (for reforms passed as secondary legislation), present a definitional set up for the joint-decision trap (Scharpf 1988, 2011). This concept was developed as an explanation of the prevalence of suboptimal policy outcomes in multi-level political systems, whereby lower-level governments can *de iure* or *de facto* block the decision on the higher-level, due to unanimous or nearly unanimous decision rules. It has sparked four decades of research that is largely dedicated to the identification of strategies that enable joint-decision systems to avoid the trap and secure viable compromises despite the divided preferences (Scharpf 2006).

Falkner (2011:9) provides a systematic overview of this literature summarizing various exit mechanisms, some of which are relevant for the question of the political feasibility of EMU reforms. She lists five key factors that can provide an exit from the joint-decision trap (see also Table 1). First, it is the applicable decision rule, whereby majoritarian rule makes any reform decision more feasible. This is fully reflected in EMU reform debates that strive to avoid Treaty change or base decisions on Treaty Articles requiring unanimity. Second, is the decision style, where the shift from bargaining to problem-solving[4] increases the political feasibility. Such a shift was observable during the Euro crisis as the ESM or

[4] Problem-solving is defined in opposition to bargaining style of decision-making, when perceptions of common identity, common fate, or common vulnerabilities induce member governments to adopt a solution based on common interests, values, or norms, despite conflicts with their immediate interests (Scharpf 1988: 261)

banking union became possible only after member governments accepted that long-resisted reforms were necessary to contain the euro crisis and sustain the single currency. The third factor is the mode of representation, which can change when governments delegates decisions to experts. These might be capable of forging complex technical compromises that are difficult to achieve on political level. Such a strategy was enabled by the Lisbon Treaty, which expanded the delegation of legislative decisions, and is often used in technical fields, including the financial regulation that defines the single rulebook pillar of the banking union (Kudrna 2011). Fourth, the joint-decision trap can be avoided by interventions of EU institutions that can maintain the problem-solving approach and prevent the rise of hard bargaining in the Council. The Commission, or under specific circumstances the European Central Bank, can act as honest broker and foster generally acceptable compromises. Similarly, under some circumstances the Court of Justice or European Parliament intervention may limit the bargaining space for member governments. Finally, the preference may not be as stable, either because government changes or due to processes of learning and socialization can reduce initial divides. The role of the five general mechanism has been demonstrated under various institutional circumstances, including successive generations of the EU treaties (see Falkner 2011, Heritier 1999, Peters 1997, Tsebelis 1994) as well as numerous policy domains (see chapters in Falkner 2011).

Table 1: Potential exit mechanisms from the joint-decision trap

Factor	Examples of exit mechanisms
Decision rule	Treaty-base games to change quorums; arena-shifting to change actors involved
Decision style	Inducing consensus by strategic reinterpretation of the status quo, threat of litigation or by excluding/coopting powerful private actors Minimizing conflict by sequencing, resizing or watering down; by providing exceptions or opt-outs; arranging side-payments and package deals
Representation	Delegating contested negotiations to expert level for complex technical compromises
Intervening actors	Depending on a policy domain, Commission, ECJ or ECB can steer MS towards a compromise
Preference change	Changes of governments after elections Shocks and crises facilitate change Framing and second-round effects; policy learning and socialization; shadow of future cooperation

Source: Based on Falkner (2011, tables 1.1 and 1.4)

Müller and Slominski (2013) formulated an important extension of this literature by discussing the role of time in providing exit from the joint-decision trap situations. They point out that a difference between myopic time-horizons of member governments and longer-term views of EU institutions provide opportunities for gradual exit strategies, when a cumulation of shallow compromises provides a solution even for very divisive policy issues. They illustrate how procrastinating on the most contested aspects, while developing the less controversial ones, allows “overcoming present deadlock by singling out difficult issues and tackling them at a later point in time” (Müller and Slominski

2013: 1429).

The menu of factors that can facilitate exits from the joint-decision trap provides a framework for the analysis of the evolution of EMU reform designs. It provides focus onto strategies that the Commission and other relevant actors employ, when striving to identify politically feasible compromises on the most divisive policy proposals. Specifically, this paper analyzes the proposals for the single deposit insurance, fiscal backstop for the single resolution fund and EU funding for structural reforms. In some form, all these ideas were discussed in the specialized economic literature for decades,[5] but only the euro crisis experience put them on the EU's policy agenda. However, unlike other reforms including macroeconomic stabilization (EMS, six- and two-packs) or banking union (SSM and SRM), there was hardly any progress achieved between 2009 and 2017.

3. The evolution of Commission's proposals

The starting point for the comprehensive EMU reform was the "Blueprint for a deep and genuine economic and monetary union" (Commission 2012) and the subsequent "Four presidents' report" (van Rompuy et al. 2012). These documents have established the long-term goals of the reform process, that became known as the four unions (see Juncker at al. 2015). The economic union refers to national

[5] See, for example, Mourlon-Druol (2016) or James (2015) for historical overview of discussions on banking union or Schuchnecht et al. (2011) for Stability and Growth Pact reforms.

structural reforms that enable each member states to prosper within the constraints of the single currency. The financial union comprises of the banking and capital markets unions that ensure stability of banks and increased risk-sharing with private sector, respectively. The fiscal union is to deliver the sustainability of debts and public expenditures as the macroeconomic stability. Finally, the political union is to provide democratic legitimacy and accountability that is adequate for the deeper integration instituted by the economic, financial and fiscal unions.

Individual reform steps towards these goals were specified and followed upon in many further documents, including the Five Presidents' report on completing the EMU (Juncker et al. 2015), White Paper on the future of Europe (Commission 2017c), Reflection paper on the deepening of the EMU (Commission 2017a) and the Roadmap for a more united, stronger and more democratic union (Commission 2017b).

The reform measures contained in these documents can be categorized into three groups. Those reforms that were accomplished, such as the Single Supervisory Mechanism, Single Resolution Mechanism or redesign of the Stability and Growth Pact by the six- and two-pack reforms. The second group are usually long-term reform proposals put on hold or sidelined until pre-requisite reform steps are completed. This group includes proposals such as the fiscal stabilization function on the Eurozone level or integration of the social rights pillar to the EMU, but also proposals that were sidelined from the reform agenda such as the eurobonds, eurobills or redemption fund.

The third category consists of reform proposals that were neither completed nor completely sidelined. Although they were put on the agenda almost a decade ago, they are yet to be accomplished. At the same time, they continue to evolve as the Commission and other EU actors search for an acceptable deal. This group includes the single deposit insurance, the fiscal backstop for bank resolution as well as the EU funding of structural reforms that are analyzed in the next sections.

3.1 Single deposit insurance: from risk-sharing to institution-building

The importance of the deposit insurance was reaffirmed during the financial crisis as all member states increased the level of deposit guarantees in order to reestablish the confidence in their banking sector. However, this has been done in an uncoordinated manner in tumultuous days of September 2008, when it contributed to the cross-border destabilization.[6] The Commission responded by a proposal to increase minimum protection for bank deposits to EUR 100,000 in October 15, 2008, which was delivered by the amendment of the directive in 2009[7]

[6] This was particularly relevant in Ireland, where the government guarantee triggered inflow of deposits from the UK, thus necessitating an increase of deposit guarantees in the UK as well.
[7] http://europa.eu/rapid/press-release_IP-08-1508_en.htm

and further harmonization of national guarantee schemes in 2014[8].

However, the escalation of the euro crisis in 2012 has demonstrated that higher national guarantees are insufficient. Depositors in 'Southern' states continued to shift their savings to the 'North', where the economies were less indebted and thus more able to provide credible fiscal backstop for their banks. This has contributed to the vicious circle between the solvency of banks and sovereigns, whereby banking losses threatened solvency of states, which in turn further undermined the financial stability of banks in the given country.[9] Ultimately, it was only the commitment of the European Council to the construction of the banking union — underpinned by the ECB commitment to do whatever it takes to preserve integrity of the single currency — that managed to contain further crisis escalation after June 2012. A single deposit insurance scheme was part of this commitment as one of the pillars of the banking union.[10]

The Commission made first proposal to curb the differences in the credibility of deposit insurance schemes in 2010. It proposed a mutual borrowing mechanism among individual national schemes, which was to be instituted by an amendment of the directive on Deposit Guarantee Schemes (DGS).[11] The idea was that if a

[8] http://europa.eu/rapid/press-release_IP-10-918_en.htm?locale=en

[9] https://voxeu.org/article/completing-europe-s-banking-union-means-breaking-bank-sovereign-vicious-circle

[10] https://www.consilium.europa.eu/media/21548/20141020-banking_union_-_relevant_ec_conclusions.pdf The idea of the single deposit insurance scheme was facilitated by the BU commitment, but it has been discussed before - see the de Larosiere report.

[11] http://europa.eu/rapid/press-release_MEMO-10-318_en.htm?locale=fr

national deposit guarantee scheme finds itself depleted, it could borrow from another national fund up to a pre-set limit. Any such borrowing would then be repaid by the national schemes (which is itself financed by the national banks holding insured deposits). While the Commission presented this part of the proposal as the first step towards a pan-EU deposit guarantee scheme, it was fully aware of political unfeasibility. Indeed, member states immediately sidelined[12] any imposed solidarity among national DGS by making it voluntary.[13] At the time, any considerations of reducing the effects of the sovereign-bank loop were trumped by concerns of the 'North' that a premature introduction of EDIS would undermine reform commitments of the 'South' and result in the 'North' paying for legacy losses.

The Commission unveiled its next proposal, the European Deposit Insurance Scheme (EDIS), in November 2015 with the view to address the concerns of the Northern coalitions of member states.[14] It carefully packaged the step-by-step introduction of risk-sharing on the one hand, with ample time for the removal of the past losses from banks on the other. In the first three years it would be based only on a reinsurance model, whereby a new Deposit Insurance Fund (DIF) would

[12] https://www.parliament.uk/documents/commons-committees/european-scrutiny/12386-Financial.pdf

[13] Article 12; http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32014L0049. To date no such voluntary lending scheme has been agreed, which illustrates the symbolism of this option (see https://ec.europa.eu/info/sites/info/files/161011-edis-effect-analysis_en.pdf; p. 7)

[14] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015PC0586

be funded by the national schemes, but only with repayable loans. This would limit the risk-sharing to liquidity assistance, because all losses to national schemes would be eventually repaid. In the next four years, the national schemes could access liquidity support before they exhausted their own funds, and the DIF would share a progressively larger proportion of any losses, but never the full amount. This increases the risk-sharing in EDIS to a co-insurance level. In the final phase, national schemes would be fully insured through the DIF, which would have to absorb all losses in the event of a failure or resolution a covered bank. Within 8 years the EDIS would be fully mutualized and provide a genuinely single deposit insurance for the Eurozone.[15]

The EDIS proposal mimicked the SRM design not only in the gradual timing, but also in its governance. It is to be administered by the existing Single Resolution Board and use similar decision-making procedure for release of any funds. To address the moral hazard concerns, the benefits of EDIS are limited to countries that comply with all EU rules, fund their deposit scheme properly and use the risk-based methodology to calculate contributions of individual banks. The risk-based contribution is particularly important, because in principle it could require riskier banks operating in riskier EU markets to pay higher deposit insurance. While such framework could reduce incentives for moral hazard, it would also

[15] The non-Eurozone countries are allowed to opt-in to the banking union through close cooperation agreement. Thus, they would be able to benefit from the EDIS as long as they

preserve the sovereign-bank loop and penalize banks in less stable economies. In any case, the EDIS proposal did not provide the method of calculation and only suggested that it would be set by a Delegated Act decided by the Commission with the support of a qualified majority of Member States.[16] The Commission thus deliberately avoided specifying one of the most controversial issues.

Nonetheless, the EDIS proposal failed to garner any consensus among members, with Germany opposing the start of any negotiations very openly.[17] The absence of the method for setting the insurance fees actually provided a convenient justification for shifting the negotiations to the technical level for the next two years. The tacit assumption was that 'Southern' banks will use the time to resolve some of their legacy losses and diversify their sovereign bond portfolios.[18]

The Commission tried to restart political negotiations in October 2017, by introducing a watered-down proposal catering to 'Northern' objections.[19] The EDIS is to be introduced even more gradually and the schedule would not be predetermined, but conditional on the reduction of the legacy losses. Moreover, the third phase of EDIS — full mutualization — has been removed from the proposal, which now expects that national losses would be covered only partially.

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submit to the SSM supervision and SRM resolution arrangements.

[16] https://publications.parliament.uk/pa/cm201719/cmselect/cmeuleg/301-xv/30105.htm

[17] https://uk.reuters.com/article/uk-eu-deposits-germany-idUKKCN0RB23X20150911; https://www.ft.com/content/df1cf84a-57be-11e5-a28b-50226830d644ů https://www.ft.com/content/ba8a7064-77f5-11e5-933d-efcdc3c11c89; https://www.ft.com/content/611b7212-b263-11e7-aa26-bb002965bce8

[18] https://www.ft.com/content/7c62d518-a9a5-3550-8df3-ce1a6b69c6b8

Furthermore, the second stage arrangement also became stricter as access to EDIS funding would be provided only after the national scheme runs out.[20] In addition, the Commission announced a separate initiative to target non-performing loans[21] that are still plaguing Italian and other 'Southern' banks.

Despite such adaptations, Germany and other 'Northern' members remain reluctant to start political negotiations.[22] While the technical discussions continue the EDIS proposal — as the rest of the EMU reform agenda — awaits new impulse from the French-German cooperation prior to the Euro summit planned for June 2018.[23] The related policy debate remains centered on the search for political feasibility, whereby new proposals concentrate on further reduction of risk-sharing that would enable at least the institutional integration of national schemes into a single EU body (Schnabel and Véron 2018).[24]

As the Commission strove to make the EDIS politically feasible, it relied on several strategies from the menu of joint-decision trap exits (see Table 1). As the immediate crisis threat subsided, the 'Northern' governments clearly shifted to

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19 http://europa.eu/rapid/press-release_IP-17-3721_en.htm

20 http://europa.eu/rapid/press-release_IP-17-3721_en.htm; https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2017%3A592%3AFIN

21 https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/managing-risks-banks-and-financial-institutions/non-performing-loans-npls_en

22 https://www.euractiv.com/section/banking-union/news/eu-weakens-plan-on-bank-protection-risks-ecb-clash-on-bad-loans/

23 http://www.consilium.europa.eu/en/meetings/euro-summit/2017/12/15/; http://www.consilium.europa.eu/en/meetings/euro-summit/2018/03/23/

24 https://cepr.org/sites/default/files/policy_insights/PolicyInsight91.pdf;

bargaining mode and protect their narrow interests to the point of disregarding broader concerns about long-term stability of the Eurozone. In order to placate them, the Commission has repeatedly watered down the proposal, first by backtracking from compulsory to voluntary lending among national schemes and later by reducing dropping the full mutualization in favor of limited co-insurance within EDIS. The Commission also tried to defuse political controversy by shifting negotiations of the crucial aspect — who will pay how much — to the expert level, although this backfired in the sense that 'North' refuses to reengage in political negotiations ever since. Finally, the Commission tried to improve the feasibility of the proposal by stretching its implementation deadlines and making them less binding. Initially, EDIS was supposed to be completed in 8 years, currently the proposed deadline is effectively whenever the 'North' agrees that the 'South' has done its banking stability home-works.

The combination of watered-down risk-sharing and prolonged deadlines is effectively reducing EDIS to an empty institutional shell that is devoid of economic substance. Unless the Franco-German tandem manages to propose a more substantive reform, the whole process may end with an adoption of single deposit insurance in name only. It may include some shift of powers to the Single Resolution Board, but as long as the commitments to reinsurance, co-insurance or mutualization of national schemes remain open-ended, it will not have any

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http://bruegel.org/2018/03/breaking-the-stalemate-on-european-deposit-insurance/

immediate economic effects in terms of cutting the sovereign-bank loop or levelling the playing field for stable banks in the 'South'.

While it would be easy to interpret such an outcome as a failure, it could also be seen as part of the time-based JDT exit strategy (see Müller and Slominski 2013:1430). However, the new scheme could be developed over time and, in case of another financial turbulences that may force a shift from bargaining to problem-solving, the EU could provide the EDIS with economic substance by adopting a quickly increased co-insurance or even the full mutualization of national schemes. In this interpretation, the ultimate Commission strategy to make EDIS politically feasible, is to lay down the legal and organizational groundwork and wait until the next crisis forces member states to make it economically relevant part of the EMU architecture.

3.2 Fiscal backup for Single Resolution Fund: recourse to ESM

The sovereign-bank loop that re-emerged during the euro crisis was a demonstration of the fact that the stability of a banking system ultimately depends on the credibility of its fiscal back up (Gros and Schoenmaker, 2014). After Greece, Ireland, Portugal and Spain were not able to contain their banking crises without external financial assistance, the Eurozone decided to create the banking union. The Single Supervisory Mechanism (SSM) was designed to reduce the risk of the next banking crisis, while the Single Resolution Mechanism (SRM) aims to resolve failed banks. For the latter the Single Resolution Fund (SRF)[25] provides the common funding - about EUR 55 bn cumulated from bank levies is to be available in 2024, when the gradual mutualization of the SRF is completed.

The problem with the SRF is its limited size, which would suffice for resolution of only one large cross-border bank (EPSC 2015: 2). The SRF is intended as the last resort lender that can be called upon only after private investors have borne losses via bail-in,[26] but if there was a systemic banking crisis or several bank resolutions in rapid succession, its resources are likely to be insufficient for the desired contributions. The implication is that the SRF limits the sovereign-bank loop but does not eliminate it. If bank stabilization requires more funding than available from SRF, then the economic necessity may force member governments to supply it, even if their risk sovereign bankruptcy within the Eurozone. While the ESM could provide additional resources, the member state in question would be required to accept corresponding ESM conditionality and add the ESM contribution to its sovereign debt, which — paradoxically — reinforces the sovereign-bank loop.

[25] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014R0806. Intergovernmental agreement on transfer and mutualization of contributions to SRF: https://www.ris.bka.gv.at/Dokumente/RegV/REGV_COO_2026_100_2_1105493/COO_2026_100_2_1106424.pdf

[26] The SRF can make contribution to a bank resolution only if 2 conditions are met: (i) shareholders and the holders of relevant capital instruments were bailed-in to absorb losses and recapitalize not less than 8% of the total liabilities, and (ii) the SRF contribution does not exceed 5% of the total liabilities including own funds of the institution under resolution (SRB 2017).

To break the loop, the SRF needs a separate fiscal backstop that allows it to contribute to the resolution of systemic crises. This backstop can be fiscally neutral over time, because any losses suffered by the SRF would be covered from increased fees imposed on banks in the banking union. However, lending to SRF still exposes member states to temporary fiscal risk and the repayments by banks imply that financially stable banks and their customers (presumably in the 'North') would be paying for bank failures (presumably in the 'South'). When negotiating the SRM, EU governments were aware that the backstop is needed as well as of its potential redistributive effects. The 'North' was not prepared to commit to any risk-sharing, at least until the legacy losses from the 2008 crisis were resolved. The impasse was avoided only by procrastination, when the Council agreed to resolve the backstop issue within 10 years of SRF inception.[27]

The Commission has never made a legislative proposal for the design of the SRF backstop. However, it outlined the policy options for a related problem of bridge financing for SRF, which provides an insight into plausible designs. The bridge financing had to be provided, because SRF was operational from 2016, but is expected to reach its target size only in 2024. If there was a need for it to fund bank resolution, the EU had to make sure that money was available.

The internal think-tank of the Commission outlined three basic options, which could be combined (see EPSC 2015). The first was lending among member states

[27] https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/140190.pdf

national compartments, which was only relevant before full mutualization in 2024. The second one was providing member state guarantees for the SRF to borrow on private markets, i.e. replicate the mechanism that funds the ESM for the purpose of SRF. Finally, there was the option of the ESM providing financial credit line for the SRF. The advantage of using the ESM as a backstop for SRF was that member states would not have to share additional fiscal risks, there would be no increase in public debts and no need for member state approval of new risk-sharing.[28] At the same time, using the ESM does not provide any additional resources for dealing with the sovereign-bank loop, because the more money is used to boost SRF the less money is available for macroeconomic stabilization. In 2015, member states decided not to use the ESM for the SRF bridge financing[29] and decided to provide separate guarantees. They left the SRF backstop issue unresolved.

The Five Presidents' report argued in favor of a direct credit line from the ESM (Juncker et al. 2015: 11), but the Council has not addressed the issue until the Commission made another proposal in 2017 (Commission 2017a, 2017d). This time

[28] The difference between ESM providing a backstop to SRF and the ESM providing loan to the member state to restructure a bank, is that SRF funding does not increase public debt (because it is guaranteed jointly by all members and funded by banking sector levies), whereas ESM loans count towards national debts and also require acceptance of conditionality.

[29] The Council agreed on 8 December 2015 to provide a system of bridge financing arrangements. Member states have entered into a harmonized Loan Facility Agreement (LFA) with the SRB, providing a national individual credit line to the SRB to back its national compartment in the SRF. See http://data.consilium.europa.eu/doc/document/ST-8008-2017-INIT/en/pdf

it proposed to integrated the SRF backstop the European Monetary Fund (EMF) and used it to justify conversion of the ESM to EMF. The proposal is not any clearer on the financial design of the backstop. It simply obligates the EMF Board to adopt the applicable financial terms and conditions attached to the credit lines or guarantees provided to the SRF (Commission 2017d). The proposal also imposes initial ceiling of EUR 60 billion on the SRF backstop to ensure that the EMF has enough resources to provide stabilization loans to member states. However, the EMF Board would be later empowered to increase the ceiling. Moreover, the EMF should be able to take decision about the deployment of the backstop by the reinforced qualified majority, in which 85% of the votes are required, rather than unanimity.

As with the deposit insurance, the SRF backstop proposal was scaled down to improve political feasibility. Initial debates on the SRF design considered making additional resources available by increased risk-sharing among Eurozone members, who would provide credit lines and/or guarantees over and above those already accepted. In contrast, the current EMF proposal avoids any further risk-sharing beyond those already accepted for the ESM. Moreover, the backstop is capped at EUR 60 bn, which amounts to mere doubling of the SRF capacity.[30]

[30] The negotiations on the SRF backstop follow-on the initial SRF design, which was itself made politically feasible by shifting the funding burden fully on banks, limiting the SRF size to 1 percent of insured liabilities (about EUR 55 bn), spreading the build-up and mutualization over 8 years and keeping the risk-sharing under control of member states only

3.2 Money for reforms: from political contracts to pilot projects

The economic policies of Eurozone members have to respect the constraints imposed by the single currency. Absence of macroeconomic coordination creates imbalances, which in turn make the EMU vulnerable and fragile in the event of adverse economic shocks as was the global financial crisis. To prevent such vulnerability, member states need to respect preventive rules of the Stability and Growth Pact (SGP) and avoid national policies that could create destabilizing spill-overs for other Eurozone economies. This aspect of EMU architecture was addressed primarily by SGP reforms introduced by the six- and two-pack legislation and executed within the process of European Semester. However, sustainable compliance with macroeconomic criteria often requires deeper structural reforms of labor and product markets, education, health care and pension sectors or public administration and tax systems.

In order to encourage such structural reforms, the Commission proposed the Convergence and Competitiveness Instrument (CCI) in its 2012 Blueprint (Commission 2012: 21-23, 42-45) that was also discussed in the Four presidents' report (van Rompuy et al. 2012:13-16). The immediate motivation was to offer additional assistance to Greece and other program countries that were provided

(via the intergovernmental agreement). See https://srb.europa.eu/en/content/single-resolution-fund financing for stabilization but left to finance structural reforms on their own (Rubio 2013). At the same time, the CCI was also perceived as a stepping stone towards the Eurozone and/or EU fiscal capacity for crisis management (Commission 2012).

The initial design of the CCI was a classic package deal. It tried to offer limited reform financing coupled with credible commitment to reforms that prevent negative spill-overs within the Eurozone. The former was attractive for the 'South', while the latter offered something to the 'North'. In March 2013, the proposal was further specified in a Communication (Commission 2013) and there seemed to be an agreement on the basic parameters. It was to be embedded in the European Semester and focus on implementing country-specific recommendations within the Macroeconomic Imbalance Procedure (MIP). CCI contracts between the Commission and member governments were supposed to be tailored to the specific needs of each country and focused on a 'low-hanging fruits' — few micro-economic, sectoral or institutional impediments to 'growth and jobs' or to the smooth functioning of EMU (Rubio 2013, van Rompuy 2013). The CCI contracts were to be produced in a dialog between the Commission and the member state and approved by the Council, with the financial support serving as an incentive rather than a compensation for reforms. Unlike under Troika, funds would not be earmarked to specific actions, although they would be disbursed in tranches upon timely implementation of agreed reforms.

However, by the end of 2013 debates deteriorated into series of complex policy dilemmas so that it became difficult to clarify the potential value-added of CCI contracts (see Rubio 2013, van Rompuy 2013, D'Alfonso and Stuchlik 2016). It was no longer clear, whether financial assistance should be a grant or loan. It was also debated, whether commitments would be binding to foster credibility or easily renegotiable to preserve legitimacy. Neither was it clear whether specific commitments should be homegrown as the logic of domestic ownership suggests or imposed by the Commission as implied by the compliance with economic parameters reviewed in European Semester. It was also questioned, whether CCI contracts should apply to all EU/Eurozone countries in order to avoid stigmatization (and by implication favor 'Northern' member states with greater capacity to reform) or only to those under corrective arm of MIP or under adjustment program. Negotiators were unable to resolve these questions quickly enough so it became clear that the CCI tool cannot be included in the multi-annual financial framework for 2014-20. Consequently, negotiations faded with the expectation that the question of fiscal capacity for Eurozone will be taken up by the new Commission after the 2014 EP elections (D'Alfonso and Stuchlik 2016).

To date, the idea of high-level political contracts has not returned to the EMU reform agenda. However, the effort to develop systematic support for structural reforms continued. In June 2015, the Commission decided that the know-how with structural reform implementation in Greece and Cyprus needs to be preserved and used to support reforms in other member states.[31] It has initiated a Structural Reform Support Programme (SRSP) to provide technical assistance for member states. The SRSP is a small-scale pilot program reminiscent of capacity building schemes for new member states prior to Eastern enlargement or similar assistance programs offered by the World Bank group. It supports about 150 projects per year with the 4-year budget of EUR 143 million allocated from the performance reserves of European Structural and Investment Funds.[32]

When the Five presidents' report reviewed the progress and next steps in EMU reforms in 2015, it no longer referred to the CCI (Juncker et al. 2015). Instead, it suggested the European Fund for Strategic Investments (EFSI) as the stepping stone for the development of Eurozone fiscal capacity (Juncker et al. 2015: 15).[33] The 2017 Reflection paper on the deepening of the EMU definitely separated the discussion of the fiscal capacity for macroeconomic stabilization from the support for structural reforms, although it provided no details on the design of the latter (Commission 2017a:26). The next iteration of the 'money for structural reform'

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[31] http://europa.eu/rapid/press-release_STATEMENT-15-5218_en.htm

[32] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2017.129.01.0001.01.ENG

[33] European Investment Protection or the European Unemployment Reinsurance, were listed as options for the embryonic form of EMU risk-sharing and stabilization in the Reflection paper (Commission 2017:26).

scheme was outlined in the 2017 Roadmap on further steps towards completing Europe's EMU (Commission 2017b). The proposal aims to double the budget of the existing SRSP[34] and expand its scope to cover capacity building in member states on their way to joining the euro.[35]

From the political feasibility point of view, the evolution of the CCI proposal demonstrates a shift of strategy after the escalation of the euro crisis was contained in 2012. With dissipating crisis pressures, any willingness to consider some form of fiscal transfers disappeared in the Council. To preserve this item on the reform agenda, the Commission initiated the SRSP pilot program, which was politically uncontroversial,[36] because it avoids any long-term commitment, it uses limited funds from existing budgets, it is operated by a small group of Commission officials[37] and it also preserves the know-how from structural reforms.[38] However, there was a clear intent to use the SRSP as a successful 'proof of concept' and scale it up at the next opportunity. Within 6 months of its inception, the

[34] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017PC0825

[35] A complementary proposal was to create a option to multiply the SRSP budget using the ESIF performance reserves.http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017PC0826 The total budget of ESIF for 2014 to 2020 is EUR 450 bn and performance reserves may reach about 5 %.

[36] The SRSP regulation establishing a technical assistance program with 4 year budget of EUR 143 million was passed by the ordinary legislative procedure without any complications in just 18 months. See https://eur-lex.europa.eu/legal-content/EN/HIS/?uri=uriserv:OJ.L_.2017.129.01.0001.01.ENG

[37] The technical work on projects is largely outsourced so there are no new permanent structures for the program.

[38] Absence of this know-how was (together with funding) one of the key arguments for involving the IMF in the Troika programs at the onset of the euro crisis.

Commission asked for doubling its budget to EUR 300 million[39] and, for the 2020 to 2027 MFF, proposed further expansion to EUR 840 million (plus a rebranding of the SRSP to Technical Support Instrument). Even more importantly, the Commission proposed a new Reform Support Programme with total budget of EUR 22 billion to be included in the next MFF.[40] This indicates a return to the original CCI scale,[41] although it also admits that the Commission resigned on the initial ambition of securing the funding in addition to the standard EU budget.

The evolution of the 'money for reform' scheme provides insights into the feasibility strategy of the Commission. Establishing the small-scale pilot program after failed CCI attempt, can be interpreted as a time-based exit mechanism as defined by Müller and Slominski (2013). It avoids tackling the most difficult issue — any form of fiscal transfers or fiscal risk-sharing — now and instead opts for a series of small compromises, which can cumulatively establish novel institutional structure. The Commission is currently testing this strategy, as it tries to leverage the perceive success of the SRSP to create the 150 times larger Reform Support Programme.

[39] At the same time, the Commission laid the ground work for more funding in the next MFF, but proposing that ESIF performance reserves to be used to fund the SRSP . https://eur-lex.europa.eu/legal-content/EN/HIS/?uri=uriserv:OJ.L_.2017.129.01.0001.01.ENG Performance reserves are 5 to 9 percent of individual priorities (if 5% overall, then over EUR 20 bn?).

[40] https://ec.europa.eu/commission/sites/beta-political/files/communication-modern-budget-may_2018_en.pdf, page 33.

[41] The official documents did not define the expected size of the CCI, but they stated that it was intended to "serve as the initial phase towards the establishment of a stronger fiscal

4. Comparing initial and current reform designs

All three proposals share some basic features, beyond the fact that have been neither adopted nor dropped from the agenda. They are designed to fit within the current treaties and are framed as package deals offering the *quid pro quo* for the creditor countries in the 'North' and debtor states in the 'South'. At the same time, none of these proposals can escape the immediate distributional asymmetry, as resources from the 'North' are to help economies in the 'South'. Hence, the former group is motivated 'only' by the concern for the overall Eurozone stability, while the latter by immediate domestic interests. Consequently, the key challenge for political feasibility is getting reform proposals accepted by the member governments in the 'North'.

Table 2: The stylized comparison of initial and current reform designs

Proposal	Initial design	Current design
Common deposit insurance	Fully mutualized EDIS Phased-in gradually on fixed timing	Co-insurance EDIS Timing based on progress in resolving legacy losses
Fiscal backstop for bank resolution	Additional risk-sharing via guarantees or credits, not via ESM	ESM financing up to a pre-set limit
Money for reforms scheme	Binding reform contracts Funding in addition to existing EU budget	Technical assistance program based on small-scale pilot Funding from the EU budget

All three proposals have been watered down considerably since initial proposals in

capacity [for the EMU]" (Commission 2012: 12).

2012/13 (Table 2). The money for reform scheme no longer strives to introduce any additional source of EU-level funding as the current proposal is to include it in the EU budget for the next financial period. As the EU budget is unlikely to expand, if adopted, the scheme will be funded by shifting resources from other priorities. Similarly, currently proposed fiscal backstop to SRF will not introduce any additional risk-sharing on the Eurozone level, if it is based on the ESM. In contrast, the current EDIS proposal contains a new element of risk-sharing, but its scope is dramatically reduced in comparison to the 2015 proposal. The full EDIS mutualization is no longer the goal and losses are to be shared only partially through co-insurance arrangement, and only after national compartments are fully exhausted. However, even this limited risk-sharing is difficult to agree on and experts are already discussing proposals that practically remove risk-sharing altogether (Schnable and Véron 2018).

Proposed implementation schedules were also made more gradual and less binding in comparison with initial intent. Originally, the EDIS was to be completed within 8 years, but now the timing depends on the successful resolution of losses in the 'Southern' banks. The original money for reform scheme — the Convergence and Competitiveness Instrument — was to be implemented quickly as a part of the crisis response in 2012 but was replaced by a very modest pilot program in 2015. The pilot may be expanded in 2018 and re-introduced on the initially intended scale only in the 2020 to 2027 financial period. Perhaps only the SRF backstop will be introduced within the original deadline, because the Council gave itself in 2014 a whole decade to resolve the issue.

Another aspect, shared in various ways across all three cases, is the reduced role of the Commission as the current proposals are less supranationalized then the original designs. The Commission was particularly ambitious with the initial proposal of the money for reform scheme, where it was to play a central role. It was supposed to negotiate the CCI contracts with national governments, while the Council was to approve them subsequently. The Commission would also monitor implementation of reforms and take the decision on whether each tranche of EU funds should be disbursed. Such a role would be much more political, then the current reality of the SPSR, which is administered by the Commission staff and the technical assistance relies on the combination of the Commission's and externally in-sourced expertise. In retrospect, the CCI proposal seems like an over-reach, especially if the contracts were to include deeply political trade-offs related to structural reforms of health, pensions or social protection systems.

In the EDIS and SRF backstop proposals the Commission was to play less central, albeit still important role. Both schemes are to be operated by the Single Resolution Board, which is an independent authority embedded in the complex decision-making procedure that involves ECB and under specific circumstances may also involve the Commission and Council. However, in the case of EDIS proposal, the Commission made itself responsible for defining the crucial criteria for the calculation of the deposit insurance fees based on covered deposits and a bank's own degree of risk. While this may be formally adopted by the Commission, the member governments are unlikely to delegate this decision, because it impacts directly the competitiveness and stability of their banking sector as well as specifics of business models of their domestic banks (as was the case with the adoptions somewhat similar methodology for calculation SRF contributions).

5. Conclusion

The EMU institutional architecture is incomplete, because many reforms are considered politically unfeasible due to disagreements among member states. Yet, the recent crisis made many long-postponed reforms — such as banking union (Mourlon-Druol 2016, James 2015) — feasible, as was the case of other crisis-enabled EU reforms in the past decades (Parsons and Matthijs 2015). However, as the immediate crisis pressures receded so did the adoption of EMU reforms. This paper thus analyzes the strategy of the Commission to keep contested reforms on the agenda and adapt their designs to increase their political feasibility, given the deeply divided policy preferences of the 'North' and 'South' of the Eurozone/EU.

The Commission adapted its proposals for the common deposit insurance, money for reform scheme and SRF fiscal backstop, by diluting the key economic parameters, spreading implementation schedules in time and reducing its own role (see previous section for more details). Consequently, the risk-sharing element of the common deposit insurance (EDIS) proposal has been reduced and its timing is now conditional on improvements in the financial stability of banks in the 'South'. Similarly, the SRF backstop proposal evolved from additional risk-sharing to risk-sharing within the existing framework of the ESM, while it remains on schedule only because the Council set the deadline for 2024. The money for reform proposal — initially the CCI, later the SRSP — has also been downgraded from providing additional EU-level resources to a minuscule pilot program. While the Commission strives to scale it up again, it is only within the existing EU budget and with its own role reduced from political actor negotiating and monitoring EU governments to mere technical assistance.

Watering-down, extending deadlines and reducing the supranational elements is a pattern of policy adaptations consistent with the expectations of the literature on the joint-decision trap exit mechanisms. It is part of the process of searching for politically feasible policy compromises on contested reforms. However, the prediction of the same literature is that without some form of exit, the joint-decision trap is to lead either to a complete deadlock or, at best, to sub-optimal policies reflecting the lowest common denominator between the ‘North’ and ‘South’. Currently, the outlook for the three reforms – if they get adopted at all - points towards suboptimal outcomes, because creating new stabilization instruments without extending the risk-sharing within the Eurozone is unlikely to deliver more stability and resilience.

A more sympathetic interpretation is to view the Commission strategy as an effort to create a time-based exit from the joint-decision trap (Müller and Slominski 2013). While the current design of the EDIS, SRF backstop or SRSP may not be relevant for breaking the sovereign-bank loop and for economic and financial stability of the Eurozone, it can provide the institutional groundwork for scaling up new instruments. When the new bout of crisis forces member states into the problem-solving mode in the face of the Eurozone break-up risk, it would be easier to speed up implementation and increase the budget or risk-sharing of existing mechanisms than to build them anew. The obvious downside of the ‘at least get the foot in the door’ strategy is that is squanders the current period of relative growth and stability that provides a window for reforms. The outcome can simply be too little, too late to keep Eurozone together in the next (bout of) crisis.

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This project has received funding from the European Union's Horizon 2020
research and innovation programme under grant agreement No. 649532