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The European Rescue of the European Union

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Introduction: in crisis, again

It is a platitude to say that Europe is in crisis. It is much less of a platitude to define what we mean when we say that Europe is in crisis. On the standard public narrative (abundantly reflected in the media), the European crisis is equated with both the financial crisis since the fall of Lehman Brothers in September 2008 and with the sovereign debt crisis since the Greek state became incapable to finance its huge deficit and massive debt in late 2009. Yet, is this an adequate characterisation of the crisis? Are spectacular developments such as the fall of Lehman Brothers or the financial troubles of Greece critical episodes in themselves or merely the epiphenomena through which latent crises became rather suddenly virulent phenomena? Can we reduce the European crisis to its financial and a "public debt" dimensions? Or is not the European Union as a polity challenged? And can we say that the functioning and normative soundness of democratic process is not being tested? Can we trust the capacity of European leaders to turn these crises into an occasion to advance European integration, as is widely perceived to have been the case in previous crises in the days of old? Are we actually having a "European spring" or will we soon mourning the death of the Europe and of the European Union? (perhaps to be followed by a European war, as already prophesised by an American economist in 1997?)

In order to address these uneasy questions, this essay proceeds in three steps.

Firstly, we argue that the EU is indeed facing a multidimensional crisis. In particular, we distinguish among: the economic crisis; the financial crisis; the public debt crisis; the crisis of the fiscal and monetary pillars of the institutional architecture of EMU; and the constitutional crisis resulting from the emergency actions to address the crisis. These five crises mutually affect each other, and are thus deeply interconnected (§ 1).

Secondly, we reconstruct the main policy decisions and the legislative reforms by the EU and its Member States with a view to overcome the financial and sovereign debt crises (§ 2).

Thirdly, since all signs indicate that we are at a foundational period of a new mode of European integration, we look back at the real foundational period of the European Community and try to draw some parallels as to the way forward. Our main argument here is that the European response to the financial and sovereign debt crisis has resulted in a partial renationalisation of the EU, may have jeopardized the basic constitutional principles and institutional framework defined in the Treaty, and seems to have opened the way to the rise of executive emergency constitutionalism. We stress that such multidimensional crisis may finally lead to the failure of the whole project of European integration, either through outright collapse or through its mutation into a new and different integration project (§ 3).

We conclude by arguing in favour of the European rescue of the EU, which inevitably is the result of a federalist vision. Drawing on the three steps of our analysis, we put forward the three conditions that need to be met for the rescue.

1. Unpacking the origins of the European Crisis: five crises, not just one

In this section, we put forward the claim that what is usually regarded as *the* European crisis should be unpacked, and five dimensions of the crisis should be distinguished.

We propose to distinguish five crises: the economic, the financial, the fiscal, the polity and the constitutional crisis of the European Union which well *predate* the fall of Lehman Brothers in September 2008. These five crises mutually affect each other, and are thus deeply interconnected. This is why we offer a brief account of the sequence of the present crises. But only by means of introducing a modicum of analytical clarity it would be possible to avoid oversimplistic or one-sided analyses of the complex causal relationships between them.

1.1 The economic crisis: the "neoliberal" turn

In the "economy of turbulence" following the collapse of Bretton Woods in the early seventies, the rates of growth of western economies, including those of the Member States of the European Union, slowed down significantly. The major structural and asymmetric shock resulting from a sudden and steep rise in the price of oil unleashed the infamous stagflation of the seventies. In this context, uncoordinated "state Keynesianism" failed to revive national economies as the structural capacity of nation-states to control their socio-economic environment had dramatically decreased. Trade liberalization and of the slow but steady recovery of international money markets as the City redefined itself in the wake of the end of empire as the turning plank of the emerging Eurodollar market.

Both social-democratic and conservative politicians across Europe abandoned their commitment to "state Keynesianism". The fight against inflation and the search of "price stability" superseded full employment as the top policy priority. This structural shift was very marked after the second oil crisis of 1979. But in some European countries it took place much earlier. This was the case of Germany, where the dominance of ordoliberal ideas and the constitutional role acknowledged to the Bundesbank had kept Keynesianism at bay until the late 1960s. The Keynesian moment under Kurt Schiller as Chancellor of the Exchequer was a rather brief one. For rather different reasons, the turn was also visible in the UK from the mid

seventies. The balance of payments problems of Britain deteriorated markedly in the early seventies and led to the UK government seeking financial aid from the IMF in 1976. In other countries, the abandonment of state Keynesian policies took place only in the eighties.

Once inflation became the ultimate goal of macroeconomic policy, the ground was ready for the progressive shift in the economic policy paradigm, from "State Keynesianism" to one form or another of "neoliberalism." This resulted in the progressive weakening of the structural position of labour, especially intense in some states (characteristically, the UK). The labour share of income has been in the decline since, while profits have been on the rise. However, this resulted in a short-term solution to one problem (the declining rate of profit) at the price of creating a long-term one, namely, the structural viability of the economic model. Expanding the share of capital re-establishes profitability in the short run, but creates two obvious problems. The first is that the pool of capital in search of a good enough profitable investment increases, aggravating the scarcity of investment outlets. Second, a lesser labour share turns private consumption weaker and depresses economic activity, thus reducing even further investment opportunities.

This basic contradiction at the core of neoliberalism explains three other policies which have come to be closely associated to it, and which have been progressively endorsed by European states (more rapidly in the case of the United Kingdom and Ireland, more slowly in the case of core Euroland countries, and markedly late but then in earnest by the GIPSI). The first policy is privatization, a means of creating new investment slots, new domains where capital could be invested and result in profits, either through the full privatization of companies or by means of opening the private provision of public services. The second policy is globalization as the renunciation to economic borders, which expanded the scope of investment opportunities *in space*. The third, and perhaps fundamental, is the growth of private debt. This created the conditions under which a lower labour share did not immediately contract consumer demand. The expansion of debt was thus used as a (temporary) substitute for the stabilizing role of the state under "state Keynesianism". This is why it is proper to refer to neoliberalism as implying a form of "private" Keynesianism.

Both privatization and massive private indebtedness, increased the weight of the financial sector in the economy, and allowed it to obtain in the mid-term levels of profitability much higher than those in the non-financial sector. The more that the financial sector became an alluring investment opportunity offering rates of return much higher than those of the non-financial sector, the higher the amounts of capital that looked for a financial placement. And the more that the relationship between production, service provision and financial activities became transformed, as a result of the dramatic growth of the latter (as can be seen in the spectacular rise in the

proportion of debt to the GDP). Indeed, the more that financial and non-financial activities became mixed, the more that all corporations engaged into financial activities as a way of boosting profits.

Privatisation, globalisation and private indebtedness reconcile the inner contradictions in the neoliberal model. But only for a time. There are obvious limits to the geographical expansion of markets. There are obvious limits to what can be privatized. And there are obvious temporal limits to how much debt can be piled before the debt is shown to have lost contact with economic reality, as the present crisis illustrates painfully well.

1.2 The financial crisis: financiarisation and the banking crisis

Three structural transformations converged to trigger a process of financiarisation of the economies of Member States of the European Union, and later to accelerate the speed of the process. First, the increase of the income capital share, in the terms that we have already discussed. Second, the momentous decision to alter the normative discipline of free movement of capital, which multiplied several fold the size and relevance of offshore finance as the conduit for financial investment and/or speculation. Third, the development of mathematical models which created the illusion that the endemic instability which plagued financial markets could be overcome.

The growth of the financiarisation process tended to feed itself. The higher the degree of return of financial products, the bigger the capital surplus in search for a reinvestment slot, and thus the higher the demand for financial products. This led to structural shifts such as the role played by rating agencies, which became a fundamental gatekeeper in the process of money creation. Several private actors acquired a power which should have immediately attracted the attention of political scientists and constitutional lawyers. Too large to fail banks, with liabilities exceeding by far the economic might of their state of incorporation, and rating agencies became for all material purposes constitutional actors. The fact that such power did not turn up in the public radar released them from any companion obligations.

As the regulatory framework of the financial sector became increasingly weakened, and as the growth of offshore activities allowed to circumvent the remnant regulations, financiarisation exploded. This is the context in which all the financial innovations of the last three decades emerged, including subprime mortgages transformed into derivatives and later into synthetic financial products. From a maiden role in the 1970s, finance had outgrown the non-financial sector at the end of the 2000s.

This created the conditions under which a major financial crisis was due to happen. While financiarisation was based on the illusion of financial markets becoming emancipated from non-financial activities, the longer this was believed to be the case, the harder the fall was bound to be.

1.3 Structural public deficits: a public debt crisis in the making

While levels of public debt tended to decline steadily in the *treinte glorieuses*, public debt rose markedly once the "economics of turbulence" became entrenched in the seventies. This growth of public debt was closely associated to the contradictions inherent to the new "neo-liberal" economic model. While the stagnation of the non-financial sector of the economy reduced the sustainable tax base of national exchequers, social expenditure increased markedly to iron out the social consequences of the structural growth of unemployment; similarly, discretionary fiscal policy was used to foster economic growth. This led to a sustained increase in the levels of public debt in most Member States of the European Union.

Such a trend seemed to be halted and reversed at some point in the nineties. While the disciplinary effects of the Maastricht Criteria of access to monetary Union (later spelled out in the Stability and Growth Pact) may account for part of this decrease, the fact of the matter is that this decrease was facilitated both by a progressive adaptation of the tax capacity of the state to the growth of finance, resulting in an apparent robust growth of the financial tax base (in spite of the decrease of the structural power of states to monitor financial income flows in the absence of coordination at the European level), very marked in states such as the UK, Ireland or Spain, and perhaps even more so by the emerging pattern of "private indebtedness" and "private Keynesianism", which resulted in an alternative process of social pacification through credit aimed at unsustainable real estate investment or unsustainable levels of private consumption.

At the same time, the levels of the structural deficit kept on growing despite figures pointing to the contrary. National accounts were not registering two silent but very problematic developments.

In the case of the GIPSI states, the late but radical turn towards the model of private indebtedness created an appearance of growth at the cost of major future financial burdens for the state. A model of growth based on unsustainable growth drivers hampered the sustainability of public finance, as tax revenues were increasingly extracted from non-sustainable economic activities. This trend was fuelled by the perspective of short-term political advantage. By means of reducing the actual burden resulting from personal taxation while keeping or improving the level of provision of public goods, politicians increased the chances of being reelected, only at the price of

weakening the capacity of the state to make use of conjunctural macroeconomic policies when the downturn came. Furthermore, an unsustainable pattern of economic growth could not but result in a sudden and dramatic increase of unemployment when the financial bubbles were punctured. This will not only reduce overnight the revenue at the disposal of the state, but also result in a fast increase of the financial cost of the welfare state, in terms of unemployment benefits. Finally, the rapid growth of financial institutions, in some cases (as in the Irish) outstripping by far the economic basis of the home state, created massive contingent liabilities for the exchequer.

1.4 An asymmetric Monetary Union

The coming of age of the economics of turbulence in the early seventies created a major constitutional problem for the European Union. Community policies were built on the assumption that the Bretton Woods international architecture would provide financial stability through steady exchange rates. This in its turn was supposed to have rendered protectionism through currency manipulation close to improbable, hence paving the way for the creation of the internal market. The snake in the tunnel, the snake without the tunnel and the ERM were attempts at recreating Bretton Woods at a European scale. While they provided a modicum of stability for a while, they failed. Thus the constant although variable political and economic constituency pressing for monetary integration. The reason why the actual realization of monetary integration took so long was that while it will provide a remedy to the turbulence caused by free floating currencies, going with monetary union required deciding how monetary and fiscal policy will be related, an issue which affected the sinews of the social Rechtsstaat, the tax system and the expenditure structure of the state.

There was wide agreement over the board that monetary union required fiscal union, and that fiscal union could not but lead to political union. The crux of the matter was, however, that different understandings of fiscal union were at stake. “State Keynesians” favoured the transfer of sizeable taxing powers to the Union and the creation of a full-fledged constitutional government at the European level, with the European Parliament playing the key role in the new configuration. For them, monetary union should be the driver of political integration through the redistributive force of the European state. That clashed deeply both with the traditional German ordo-liberal ideas and with the emerging neoliberal economic paradigm. In the case of ordo-liberals, monetary union should be the “crowning” of a process of economic convergence, which in practice meant the transformation of the socio-economic constitutions of all other Member States in the semblance of the German model. Neoliberals were largely skeptical of monetary Union as a whole, in the absence of a community we-feeling (something which reveals the strong communitarian component underlying neoliberalism).

This impasse was not solved when fiscal and monetary Union was decided in 1992. Under the strong pressure of the fall of the Berlin Wall, it resulted in a hybrid monetary union *without* a political union. Federal and depoliticized monetary policy went hand in hand with several national fiscal policies shaped by discretionary political choices. The reconciliation of these apparently incompatible models was said to result from a series of governance arrangements characterized by a set of constitutional principles, informal common action norms, a low degree of institutionalisation and the renunciation of collective means of enforcement other than *positive morality* sanctions (group-pressure, shaming and naming).[1]

The basic constitutional principles of the European fiscal constitution were five: (1) full political autonomy for the ECB and the national central banks; (2) a "rigorous" model of public finance, which restricted state revenues to either taxes or borrowing at market conditions (excluding not only the "printing" of money, but also borrowing from the central banks, and forced borrowing from financial institutions and citizens); (3) exclusive national control of and responsibility for national finances (which ruled out any transfer mechanism either in terms of revenue or debt); (4) monetary policy aiming at the stability of prices, and ancillary to the realization of other basic goals of the European Union; (5) fiscal policy could not result in deficits of more than 3% or the accumulation of debt over 60%.

The effective implementation of these principles was based on the decision-making processes of the European System of Central Banks and on the national fiscal decision-making processes, in which governments typically play a leading role but in which national parliaments have the final say through the annual budgetary process. The monitoring of the constitutional limits imposed on national fiscal policies were only thinly defined in the Stability and Growth Pact, and were in fact developed customarily through the years, periodically reflected in the Code of Conduct guiding the process.

The institutional structure of the Eurozone was the result of inserting national central banks into a federal structure, and of formally (but rather not substantially) turning national governments into part of the European decision-making process. The system was intentionally lacking a central unit of decision. The Eurogroup emerged in constitutional practice as the meeting of the treasuries of the states member of the Eurozone, but was expected only to police the quantitative development of deficits. And national fiscal processes remained purely national.

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[1] On the latter point, it is true that both the Treaties and the Stability and Growth Pact did foresee hard-law sanctions. But as the 2003 crisis on the French and German excessive deficits showed, these sanctions were merely symbolic, as applying them would result in massive negative consequences *for all* European citizens, and not only for the government which breached the Pact, or even for the citizens who were responsible of the election of such a government.

Finally, there were no means of enforcement of the informal action norms that made up the fiscal constitution of the Union. In that regard, governance could be seen as an elite variant of positive morality. As already indicated, the formal sanctions foreseen in the Treaties and on the Stability and Growth Pact to be imposed upon states running excessive deficits were meant to be symbolic.

This model of asymmetric monetary Union was designed to be crisis-prone. For at least three reasons. Firstly, it resulted in a monetary union deprived of active means of ensuring economic convergence. Ordoliberalism promised that by means of conditioning monetary integration to complete economic convergence. Social-democratic and Christian democratic conceptions pointed to institutional structures capable of redistributing resources and reducing economic divergence. None of these models were followed, and actual convergence was trusted to the free play of market forces, helped by what were in overall terms modest and temporary structural and convergence funds. Secondly, no crisis resolution mechanism was foreseen. Crises were expected to be largely ruled out by market discipline over the euro area governments. Thirdly, the removal of the ability of national treasuries to print money, borrow from the central bank or force loans, would prevent the formation of fiscal imbalances. However, for this to fully work, the expansion of the single financial market would have required the transfer of the function of the lender of last resort to financial institutions to the European level. Retaining national competences was partly a factor in the sovereign debt crisis, as mentioned above.

1.5 A polity in crisis

The economics of turbulence hit very badly the political project of European integration. The gathering momentum of the late sixties and early seventies came to a grinding halt once the effects of the two oil crises revealed that the Communities had integrated so much that national solutions were no longer really possible, but not enough to allow European institutions to take effective autonomous decisions to address the crisis.

This crisis is the background condition of the long European constitutional season, opened in earnest after the direct election of the Members of the European Parliament in 1979 and not yet closed. Many attempts have been made to overcome the crisis by means of redefining what the European Union is and should be. The Single European Act and Maastricht seemed to combine a basic respect for the "pluralistic" (synthetic perhaps) character of the European polity with further integration. But this only exacerbated the tensions within the institutional structure of the Union and in the coherent definition of its policies.

1.6 The crises explode

The capital returns of financial investments well in excess of the capital returns of investments in non-financial activities may well have led many to believe that financial activities have become emancipated from non-financial activities. The continuous exponential growth of financial activities reached the dimensions of a generalized Ponzi scheme in the early 2000s. The burst of the dot.com bubble did not have the effect of dispelling the myth of the "new economy", but merely resulted in a change of perception of what was "new" in the economy. The technological bubble was substituted by a real estate bubble based on the massive production of new mortgages (many of which were structured in such a way that foreclosures were closed to guarantee to happen within two to three years of the sale of the house), the transformation of scores of mortgages in derivative financial products, the acceptance by rating agencies that the complex mathematical models used in the process made the miracle of turning the financial products fully safe, and the selling of these derivatives (and synthetic products based on them) to financial institutions all through the globe, very significantly in Europe. The unsustainable character of this set of economic activities was revealed rather suddenly in 2006 and 2007, leading then to Lehman.

Public intervention proved absolutely necessary to stabilise financial institutions. Simultaneously, the effect of the automatic stabilizers, reinforced by conjunctural measures aimed at fostering economic activity put forward by governments, and lax monetary policies by central banks avoided that the financial meltdown became a great depression. Still, the means and scale of the intervention could not avoid a major economic slump. Within the European Union, as the structural imbalances of the economic model of the GIPSI plus the inadequacy of their socio-economic arrangements to absorb structural shocks were revealed, the asymmetric character of the economic crisis became obvious.

The sovereign debt crisis is foremost a crisis of the GIPSI (and among them, of some more than others).[2] While the transfer of liabilities has been a process that has happened in all Member States, including the eurozone core Member States, it has proceeded further in the case of the GIPSI, generating a vicious circle and downwards spiral in which public and private debt mutually endanger each other. This is paradigmatically clear in the case of Ireland, as the public debt of this state has increased more than threefold as the result of the guarantee of all bank deposits (the debt may increase even further as the full extent of the contingent liabilities assumed by Ireland remains still uncertain). On what concerns conjunctural anti-cyclical

[2] Greece was (together with Italy and Belgium) the only three Member States which had public debts exceeding or close to 100% of their GDP. Any dynamic of debt increase is bound to be much more problematic if the state departs from such high levels of indebtedness.

expenditure, GIPSI have incurred in more expenditure because unemployment has increased more significantly (Spain, Greece and Portugal; to a lesser extent, Ireland).

Finally, the presence of a large structural fiscal deficit is rather exclusive to the GIPSI. The growth of debt was faster and bigger, and consequently affected not only the economic structure of the country as a whole, but resulted in the silent reconfiguration of the financial basis of the state. Personal income taxes burdening sustainable economic activities were lowered while the level of provision of public services was increased. The gap was covered by the growing tax returns of the unsustainable economic activities, creating the illusion that high levels of public provision could be sustained with light touch tax systems. When the financial crisis halted the unsustainable economic activities related to private indebtedness, the hidden structural fiscal deficit became a very real one. Hence, the extremely fast deterioration of the public finances of these states. The catch 22 of the public debt crisis is that when debt creation reaches the Ponzi stage, economic activity can only be restarted by means of bringing debt back to levels coherent with productive economic activity. That can only be done by means of repudiating debt, either explicitly or implicitly.

The economic, the financial and the public debt aspects of the European crisis have exposed the shortcomings of the fiscal and monetary EU institutional architecture.

Firstly, its structural features created the conditions under which fiscal policy was used in ways which materially contradicted the aims of monetary union. This is in particular to be traced back to the lack of a unity of decision and the compartimentalisation of tasks. Governance arrangements that were designed and were said to be applied with a view to realize the most basic precondition for monetary integration, (and even more so for asymmetric monetary union), namely actual economic convergence of the Member States of the Eurozone, led to the opposite results. The economic and financial crises have revealed that the fiscal constitution of the Union has only fostered policies which created the illusion of convergence in the mid-run, but which have resulted in divergence in the long-run.

Secondly, the constitution of monetary Union was based on the expectation that the mere prohibition of certain states of affairs (large deficits and large debts) would be enough to turn these events impossible. But law has no such magical power. Consequently, the governance arrangements were simply utterly ineffective when it came to dealing with the crisis, as this was not only not foreseen, but seemed to have been ruled out by law. Not only there was no specific resolution mechanism (as indeed emergency provisions which existed before Maastricht, as the balance of payments fund or the possibility of Member States applying safeguard measures) but the fundamental principles of the fiscal constitution of the Union were suddenly revealed to be a serious obstacle to any crisis resolution.

2. The responses to the crisis: drifting outside Europe

The financial crisis unfolded in Europe in July 2007 with the first reports of sub-prime related losses suffered by the European banks. It undermined market confidence on the soundness of banks and ultimately led to the freezing of interbank markets when BNP Paribas announced the freezing of three of its investment funds. On 9 August 2007, as the first European response to the crisis, the ECB announced it had provided 95 billion euro of liquidity to banks.[3]

Since the fall of Lehman Brothers on 15 September 2008, the financial crisis in Europe involved momentous events of financial instability which included a loss of confidence in the soundness of European banks, bank-runs, the failure of cross-border and domestic financial institutions, and even the collapse of Iceland – which was part of the single financial market as a member of the European Economic Area. The financial crisis was followed by a sovereign debt crisis in the euro area. It started with Greece in early 2010 and quickly spread to Ireland, Portugal, as well as Italy and Spain at the time of writing (November 2011).

The successive European responses to the crisis thus far may be grouped in the following five legal and institutional phases.

2.1 Institutional paralysis and re-nationalisation at the start of the crisis

First, a phase of institutional paralysis and re-nationalisation of markets. This is well evidenced by the fact that there was no response within the Treaty after Lehman Brothers - in particular, no proposal by the Commission or decision by the Council and the Parliament, or even common measures agreed among Member States.

There was instead a domino effect of national measures as each Member State took unilateral measures to safeguard their respective national financial systems. This included bank rescues in the UK, Germany, Belgium, Netherlands and Luxembourg, and deposit guarantees in Ireland, Germany, Belgium, Greece, Luxembourg, Netherlands, Portugal and Spain. The financial support was provided only domestically and in uneven terms and conditions across Member States.

A major consequence in this phase was a structural shift from the principles underpinning the single market, which at the time laid the seed of the sovereign debt crisis. The fact that financial institutions depended on the support of their respective

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[3] For a full chronology and description of the global financial crisis, see the 79th Annual Report of the Bank for International Settlements (1 April 2008-31 March 2009), Basel, 29 June 2009, available at http://www.bis.org.

national government implied that their soundness was perceived as being directly related to the budgetary capacity of the Member State backing them. This led to an immediate renationalisation both of financial institutions and of their respective liabilities in national governments' balance sheets. This particularly affected large cross-border banking groups whose balance sheet exceeded the GDP of their respective home-countries – such groups could not be rescued by their home-country and were therefore likely to fail. In the Fortis case, this led to the breaking-up of the group in national components given the unwillingness of Member States to share the costs of a financial rescue.

The 1985 White Paper's paradigm of European integration through the unlimited expansion of the provision of services on basis of home-country control and mutual recognition (the single passport) was abolished as a result. Such paradigm was accepted as the cornerstone of the single market since it spread the benefits of the pooling of financial resources, thus feeding economic development through Member States. However, no provision had been made for managing the different scope and nature of risks that emerged from market integration. The justification was that any burden-sharing mechanism would conflict with fiscal sovereignty, on whether and how to deploy taxpayers' funds in a crisis situation. Accordingly, in the lack of any such mechanism, the first phase of the European response to the crisis led to a rapid re-nationalisation of the single financial market. The spiral of disintegration reached a peak in October 2008 with the failures of several banks and the domino effect of national protective measures across Member States triggered by Ireland's unlimited guarantee of the deposits in Irish banks. The single financial market was effectively shutdown.

2.2 The "European branding" of national measures to address the financial crisis

As fully defensive national measures were quickly leading to a breakdown of the single market, with all the economic and financial consequences that would follow, Member States resorted to a "European branding" of national measures, since there was no agreement or Treaty framework for sharing the risks and costs of the crisis.

Such European branding started on 6 October 2008, when the members of the Council issued a statement pledging to take whatever measures necessary to safeguard the financial system.[4] The ECOFIN of the following day took a number of mostly empty

[4] Statement of the 27 European Heads of State and Government on the Stability of the Financial System (6 October 2008): "All the leaders of the European Union declare that each of them will take whatever measures are necessary to ensure the stability of the financial system – whether by injecting liquidity from central banks, by measures targeted at certain banks or by enhanced measures to protect

commitments, which basically corresponded to the measures already taken, such as recapitalising financial institutions, while also pledging to put the burden on their shareholders and managers, and protecting retail depositors. It reflected the very late realisation of the seriousness of the financial crisis at the level of the Council as well as the fact that the crisis at that stage was affecting mostly a few Member States, which made an agreement on a common response impossible.

As the re-nationalisation of the single financial market was increasingly affecting the integrity of the euro area – and as it was clearly difficult to reach agreement among all the twenty-seven Member States for concrete actions with substantial impact for national taxpayers – Sarkozy called the first ever meeting (in almost ten years since the introduction of the euro) of the euro area Heads of State and Government in Paris on 12 October 2008. In substance, they merely agreed at the summit to take a number of national measures within a broadly coordinated framework in terms of conditions for financial support. As they put it, in order to "avoid that national measures adversely affect the functioning of the single market and the other Member States."[5] The only remaining European policy instrument in this context was the application of state aid rules, but the Commission was requested to act quickly and apply flexibility in state aid decisions, providing in practice a wide discretion to Member States.

Throughout the remainder of 2008 and 2009, Member States implemented their respective programmes of financial support, mostly in the form of recapitalisation and nationalisation of their respective financial institutions. In turn, the restructuring of these institutions led to a large divestment from their holdings in other Member States, thus consolidating the reversal in financial integration. At the same time, as mentioned above, the costs of financial support fell on the governments' balance sheets inflating their liabilities to an extent that financial assistance was ultimately required (particularly in the case of Ireland).

2.3 The emergence of the "Union method" to provide assistance to Greece

The third phase in the European response corresponded to the rise of the intergovernmental mode to address the Greek crisis, after the attempt to keep national measures under the European branding.[6] This was made explicit with the "Union

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deposits. No depositor in the banks of our countries has suffered losses and we will continue to take the necessary measures to protect the system and depositors. In taking these measures, European leaders acknowledge the need for close coordination and cooperation". Available at http://www.ue2008.fr.

[5] See "Summit of the euro area countries: declaration on a concerted European action plan of the euro area countries", 12 October 2008, available at www.ue2008.fr

[6] Three Eastern European countries (Hungary, Latvia, Romania) also entered into crisis between the end 2008 and early 2009. The rescue packages set the pace of how the European Union reacted to the crisis. (1) Decisions were adopted by the European Council on the framework of Art 143 TFEU and

method", coined by Chancellor Merkel in a speech in Bruges on 2 November 2010. She argued that the Community method could only manage EU competences explicitly transferred by Member States, while the intergovernmental mode should be followed for coordinated action of Member States in areas of non-EU competence. Accordingly, the Community method could never have been used to address the crisis in Greece.

On 20 October 2009, the finance minister of Greece disclosed at the ECOFIN that his nation's deficit would reach 12,7% of GDP from an estimated 6% provided by the former government. On 7 May 2010, following a significant deterioration in the ability of the Greek state to fund itself in the markets – due to rising bond yields and following successive rating downgrades – a summit of the Heads of State or Government of the Euro Area agreed to provide bilateral loans to Greece in the amount of 80 billion euros in a joint package with the IMF reaching 110 billion euros.

The economic and monetary constitution of EMU lacked any mechanism to address the crisis. This was an intentional choice, as it was assumed that the commitments made in the Stability Growth Pact together with market discipline would provide the appropriate incentives for fiscal discipline. In this context, the "no bail-out" principle of Article 125 of the Treaty prevents the Union or any Member State to be liable or assume the commitments of another Member State. This limited to a large extent the scope for providing financial assistance to Greece. The lack of a crisis resolution mechanism, together with the no bail-out principle, was therefore expected to be a virtue-fostering mechanism. Yet, the crisis revealed that this was an unrealistic assumption of what could have been achieved through market discipline without any transfer of fiscal sovereignty to the EU.

Accordingly, there was a stalemate from October 2009 to March 2010 in which the crisis was simply not addressed. The EMU framework of the Treaty implied that Member States had to be largely left on their own to solve their fiscal problems. The German Constitutional Court's Lisbon judgment was also widely quoted as preventing any further steps in economic and fiscal integration, which could address the emerging sovereign debt crisis in the euro area (however, the key judgement of the Court in this regard is the Maastricht decision).

Regulation 332/2002. (2) The lack of proper financial means forced the Union to partially decomunnitarise the answer, by means of sharing the financial burden. In all cases, the IMF played a major role and there was a variable geometry in all three cases: in the Romanian case, funds were mobilized from the EBI and the EBRD; in the Latvian case, help was also coming from other Baltic States (Sweden, Denmark, Finland, Norway and Estonia) and from Center European States (Czech Republic and Poland); (3) The structural model of the assistance was the IMF conditionality model, i.e. credit line in exchange for structural reforms. (4) The rescue packages were articulated in the IMF soft law with hard financial sticks: Memorandum of Understanding plus periodic reviews on which the further credit depends. Latvia undertook a drastic internal deflation program; Romania introduced half way structural reforms; and Hungary, once the new Orban government reached power, it removed itself from the conditionality framework by not renewing the loan with the IMF.

The debate on the rescue of Greece concerned whether the solution should be fully internal to the European Union (reflective of the constitutional implications of monetary Union) or whether it should be external to the European Union, namely through recourse to the IMF. The latter would replicate the solution opted for Hungary, Latvia, and Romania and which also had been used in the 1960s when Italy experimented a balance of payments crisis and in 1976 when the United Kingdom had requested assistance from the IMF.

From March 2010 it became increasingly clear that any solution would have to square several circles. A European solution had to fit in the constitutional space – even constitutional niche - which could allow providing financial assistance to Greece. Any solution had to be minimally compliant with both the present Treaty framework and the German constitutional framework, something which reduced extraordinarily the number of available options.

A non-Community solution was thus chosen. It consisted of the collection of bilateral loans (to some extent replicating the framework of bilateral diplomatic sanctions to Austria in 2000, and also of the coalition of creditors in the case of Latvia in 2008), complemented by the IMF. The solution was made compliant with the no bailout principle by subjecting the loans to rather strict conditions. Loans were conditional upon an adjustment plan, compliance with which was to be followed quarterly, and on which follow up depended the disbursement of the tranches of the loans. The interest rate included a penal component, in the form of a rate of interest (5%) which was higher than that applied by the IMF, and even higher than that applied under the balance of payments fund to the Eastern European Countries. While the loans were extended for long periods of time (up to 7.5 years), funding was available only for a limited period of time, after which Greece was expected to return to the markets. The loans were going to be articulated and supervised by the IMF, with the European Commission and the ECB playing a role, both in the agreement on the adjustment programme and in the supervision of its implementation.

Greece formally requested aid on 23 April 2010 and the rescue agreement was concluded on 2 May. It provided the Greek authorities with funding to meet their needs until the end of 2011, for a total of 110 million euro (30 lent by the IMF, 80 by Euroland states save Greece, according to their quota in the ECB capital). The Greek Parliament approved the agreement on May 5th, together with a new austerity package.

2.4 The institutionalization of the "Union method"

The fourth and last phase of the European response to the financial crisis is the institutionalisation of the "Union method", of the intergovernmental mode as the way

forward for European integration outside the Treaty. It started with the establishment of the European Financial Stability Facility (EFSF) on 9 May 2010.

Since the sustainability of public finances in the euro area continued to be questioned by the markets, leading to a rise in the bond yields of Ireland and Portugal, the Heads of State and Government of the euro area decided to respond with a new instrument, explicitly temporary and outside the EU framework. The EFSF was established as a private company in Luxembourg for three years and authorised to borrow up to 440 billion euro. All the national parliaments were asked to ratify the EFSF framework agreement. The EFSF was complemented by a European Financial Stabilisation Mechanism (EFSM) as a Commission fund authorised to borrow up to 60 billion euro (drawing on the Treaty's balance of payments' mechanism). The total of up to 500 billion euros (with the IMF providing an additional amount of 250 billion euros) would be available to provide financial assistance in the form of loans or credits to Member States in difficulties.[7]

On 18 October 2010, Chancellor Merkel and President Sarkozy agreed in Deauville that bondholders could suffer losses in euro area Member States deemed insolvent, starting in 2013. It openly implied that a country in the euro area could default, which basically had not happened in Europe since Italy in 1940.[8] This also aimed at increasing market discipline in the future euro area economic governance. The result was, however, that it further undermined market confidence in the sovereign debt of the euro area. Financial assistance to prevent defaults of euro area countries had been effectively denied.

Following further market deterioration, the temporary nature of the EFSF did not suffice. The constant market pressure, on 28/29 October the European Council agreed to set up a permanent crisis mechanism to safeguard the financial stability of the euro area as a whole, the European Stability Mechanism (ESM), replacing the EFSM/EFSF in mid-2013. For this purpose, they agreed to an amendment of Article 136 of the Treaty allowing for the creation of the ESM by the euro area Member States from 2013, thus dispelling any doubts as to the compatibility with Article 125. At the same time, the amendment also institutionalised in the Treaty the Union method, since it legitimised Member States to establish mechanisms through intergovernmental cooperation with the purpose to fulfil purposes inherent to the functioning of the EU.

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[7] Statement of Heads of State or Government of the Euro Area, Brussels 7 May 2010; and Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism, OJ L 118/1, 12.5.2010.

[8] Reinhart & Rogoff, This Time is Different

The EFSM/EFSF were activated for the first time at the request of Ireland on 28 November 2010 to cover financing needs of up to 85 billion euros.[9] On 30 March 2011, Portugal also requested financial assistance.[10]

A further step in the institutionalisation of the Union Method was the Euro Plus Pact. In March 2011, the euro area Member States, together with six non euro area, agreed a Euro Plus Pact, which was adopted as part of the European Council conclusions of 24/25 March 2011. The Pact represents the voluntary and self-binding commitment of these Member States, with mutual monitoring, to implement reforms in the areas of competitiveness, employment, sustainability of public finances and financial stability. It is also not anchored in the Treaty or EU legislation, although it clearly aims at fulfilling the key objective of the EU to increase competitiveness among Member States.

The European responses were however not limited to the Union method. There is also a process of reform of economic governance in the EU and the euro area. The underlying aim is to attempt repair the lack of credibility of the system of economic governance, based based on loose intergovernmental procedures, notably the Stability and Growth Pact (SGP), which provided no effective surveillance and control of imbalances, as demonstrated by the crisis in Greece. On 29 September 2010, in particular, the Commission put forward a package of legislative proposals on (i) strengthening the Stability and Growth Pact, (ii) preventing and correcting macroeconomic imbalances, (iii) strengthening national fiscal frameworks, and (iv) a stronger enforcement of fiscal discipline by imposing sanctions on non-compliant Member States.[11] Almost at the same time, on 21 October, a Task Force chaired by President Van Rompuy – which comprised the EU finance ministers - set out

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[9] See Statement by the Eurogroup and ECOFIN Ministers, 28 November 2010, available at www.consilium.europa.eu.

[10] At the time, the ECB also adopted a Securities Markets Programme (SMP) for the acquisition in open market of government bonds to ensure depth and liquidity in those market segments which are deemed dysfunctional. This was criticised by some circles as an infringement of the monetary financing prohibition of Article 123 TFEU.

[11] The Commission put forward on 12 May a Communication which called for reinforcing compliance with the Stability and Growth Pact and extending surveillance to macro-economic imbalances, as well as setting-up a crisis management framework for the euro area. Communication from the Commission on Reinforcing economic policy coordination, COM(2010) 250 final, 12.5.2010. The proposals in this Communication were further developed in the Communication from the Commission on Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance, COM(2010) 367/2. The Communication was then translated on 29 September 2010 into six legislative proposals: three regulations and one directive on the reform of the Stability and Growth Pact and budgetary surveillance, and two regulations for detecting and correcting, also through sanctions, emerging macroeconomic imbalances within the EU and the euro area. The Commission proposals are available at ec.europa.eu.

recommendations for strengthening economic governance, which were largely line with the Commission's proposals.[12]

The Commission proposed a wide use of the reverse majority voting, so as to make enforcement mechanisms quasi-automatic and not subject to political discretion. This includes voting in the adoption of the Commission's economic policy proposals and country-specific recommendations and most importantly in the imposition of financial sanctions on Member States deviating from fiscal targets and not compliant with recommendations. The economic governance package also includes the institutionalisation of the so-called European semester where Member States' budgetary, macro-economic and structural policies are coordinated in time so as to allow better interplay between them and EU-wide goals. In addition, a new surveillance framework for addressing emerging macro-economic imbalances is also proposed. The so-called "six pack" legislative proposals were adopted on 4 October 2011 and will enter into force in 2012.

Finally, in addition to reviewing the instruments for coordinating national economic policies, the EU reformed the architecture for financial supervision. Such reform is relevant as safeguarding financial stability is essential to support monetary and fiscal policies. The crisis of private finance may obviously hit and further weaken fragile public budgets, by forcing governments to rescue banks, financial institutions and strategic companies. The reform replaced the so-called Lamfalussy framework of committees with new European agencies: the European Systemic Risk Board (ESRB) and three new European independent authorities (the European Securities and Markets Authority, the European Insurance and Occupational Pensions Authority, and the European Banking Authority[13]). The new system does not lead to a radically new institutional framework. It confirms the reluctance to establish genuine supranational authorities, distinct from Member States' authorities and provided with regulatory powers. The overall rationale of the institutional reform is that of improving coordination among national regulators well within the limits of national fiscal sovereignty.

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[12] "Strengthening Economic Governance in the EU", Report of the Task Force to the European Council, 21 October 2010, available at www.consilium.europa.eu.

[13] See, respectively, regulations 1093/2010 (establishing a European Banking Authority), 1094/2010 (estabilishing a European Insurance and Occupational Pensions Authority) and 1095/2010 (establishing a European Securities and Markets Authority), in OJEU 2010 L 331. An account of the new institutional framework for financial supervision is provided by P.G. Teixeira, *The Regulation of the European Financial Market after the Crisis*, in P. della Posta and L.S. Talani (eds.), *Europe and the Financial Crisis*, Chippenham e Eastbourne, Palgrave McMillian, 2011, p. 9 ff.; S. Verhelst, *Renewed Financial Supervision in Europe - Final or Transitory?*, Egmont - Royal Institute for International Relations, Egmont Paper 44, Gent, Academia Press, 2011; F. Recine and P.G. Teixeira, *The new financial stability architecture in the EU*, available at http://ssrn.com/abstract=1509304.

2.5 *The change of national governments and the technocratic move to undertake economic and structural reforms*

The last and current phase relates to the failure of successive Euro summits and respective decisions to stem the sovereign debt crisis by themselves, particularly in Greece, Italy and Spain. The emphasis now turns to the swift and credible enactment of economic and structural reforms at the national level.

These dynamics started with the Euro summit of 21 July 2011, which was confronted with the continuing lack of confidence in the ability of Greece to fulfil its economic programme, and with the increase in the bond yields of Member States spreading to Spain and Italy. The summit decided to (i) support a new financial assistance programme to Greece through the EFSF (instead of bilateral loans) with lower interest rates and extended maturities to improve the debt sustainability and refinancing profile of Greece; (ii) accept private sector involvement in the financing of Greece through debt exchanges and roll-overs; (iii) improve the effectiveness of the EFSF and of the ESM by allowing them to act on the basis of a precautionary programme, finance recapitalisation of financial institutions through loans to governments including in non programme countries, and intervene in the secondary markets on the basis of a decision by mutual agreement of the euro area Member States to avoid contagion; and (iv) extend to Ireland and Portugal the lending rates and maturities applied to Greece.

However, this again continued to prove to be insufficient to stem contagion. In early August, the spreads of the government debt of Italy and Spain reached levels, which could put at stake the sustainability of their respective public debt. The ECB announces on 7 August that it will actively implement the Securities Markets Programme, and on 8 August it reportedly started purchasing Italian and Spanish government bonds in secondary markets bringing down the market yields of these securities.

Another round of Euro summits took then place on 23 and 26 October 2011 to address the Greek problem and the lack of confidence in the ability of the euro area to stabilise the sovereign debt crisis. There was a need for two summits since Chancellor Merkel needed to obtain prior consent of the Bundestag to agree to increase the financial capacity of the EFSF through leveraging of its resources. The need for such prior consent was reinforced by a decision of the German Constitutional Court of 7 September 2011, which assessed whether the financial assistance to Greece infringed the Bundestag's budgetary autonomy (which the Court replied in the negative).

Accordingly, on 26 October the euro area Member States agreed: (1) to contribute to a new financial assistance programme to Greece depending on the willingness of private investors to take a 50% nominal discount on their Greek government bonds; (2) to leverage the resources of the EFSF, so as to increase its ability to support other

Member States, if need be; and (3) on ten measures to improve the economic governance of the euro area, including more regular Euro summits with a more permanent administrative infrastructure. Furthermore, they agreed that each euro area Member State would introduce rules on a balanced budget at constitutional level or equivalent by the end of 2012.

Once again, the Euro summit failed to stabilise the markets. On 1 November, Georges Papandreou announced a referendum in Greece. The following day, at the Cannes G-20 Summit, Merkel and Sarkozy declared that, if there was a referendum, it should be on the exit of Greece from the euro area. They opened thus the door to a possibility that had been refuted until then, particularly in the absence of Treaty mechanisms for such exit. Papandreou resigned on 11 November to enable a national unity government led by Lucas Papademos, a technocrat former ECB Vice-President.

In Italy, the continuing rise of government debt spreads led to the resignation of Silvio Berlusconi on 12 November. The political parties agreed to support a technocratic government led by Mario Monti, which took office on 16 November.

At the time of writing, five countries of the euro area changed government before their respective term as a direct consequence of the sovereign debt crisis: Ireland, Portugal, Greece, Italy, and Spain. Three changed following early elections and two stemmed from parliamentary agreement on technocratic governments. They all changed as a result not only of the lack of market confidence, but also of the increasing pressure of other Member States and EU institutions for economic and structural reforms to be undertaken so as to restore fiscal discipline.

2.6 Three problematic directions: in and out from the EU legal framework; the rise of the Union method; an incomplete institutionalization

Admittedly, the European institutional response to the public debt crisis is an extraordinarily complex process, which tends to escape neat representations. Yet, three main dimensions of such process deserve to be highlighted, together with the problems that they raise.

First, the European response to the public debt crisis has been, and still is, a contradictory and problematic combination of responses external and internal to the EU legal framework, i.e. external and internal to the constitutional architecture of the fiscal and monetary Union. Among the various possible examples one could make that of May 2010, when the clear political will to comply with the existing Treaty framework, from the “no bail-out clause” to the preservation of financial stability, paradoxically led to searching a non-EU solution to the Greek crisis, found in the collection of bilateral loans, complemented by the IMF. A second example is the Euro

Plus Pact. This Pact, agreed by the euro area Member States together with six non euro area Member States, is not anchored in the Treaty or EU legislation, but it was adopted as part of the European Council conclusions of 24/25 March 2011 and it is aimed at fulfilling the EU objective to increase competitiveness among Member States. Thus, it is formally outside the EU legal framework, but substantially internal to it.

This legal ambiguity of the European institutional response to the sovereign debt crisis is particularly relevant because of its alarming implications. Two of them are prominent. To begin with, the European response has implied in certain cases an open breach of the EU constitutional standards. For example, in May 2010 both the principle of exclusive national responsibility for public debt and the "rigorous" model of public finance were simply set aside, as the Greek bailout and the temporary structure of the European Financial Stabilisation Mechanism and the European Financial Stability Facility broke away from the principle of purely national public debt. Moreover, the "in and out" from the EU constitutional framework operates as a precondition for the rise of executive emergency constitutionalism, as it tends to minimize public debate and to avoid the ordinary filters of the democratic constitutional state. The European institutional response to the sovereign debt crisis, in other terms, brings with itself the breach of the EU constitutional standards and may open the way to executive emergency constitutionalism. In this sense, while aiming at solving a public debt crisis, the European response generates or feeds other European crises, which we may characterize as institutional crises, thus making the European crisis a multidimensional crisis.

Second, the European response to the public debt crisis has been developed mainly through an intergovernmental mode (but one, as we will argue, where the reality of socio-economic power has trumped even formal equality). The Union method was subsequently consolidated and institutionalized in several moves, one of which was the agreement within the European Council on 28/29 October 2010 to amend Article 136 TFEU: the new provision, as it has been already said, institutionalises in the Treaty the Union method, by providing the Member States the power to establish mechanisms through intergovernmental cooperation with the purpose to fulfil purposes inherent to the EU.

Pointing to the intergovernmental mode of the European response is important because of the implications of such a mode. The main implication for our purposes is the possible renationalisation of the EU, the prominence of the interests of the States over the general interest of the Union, the search for a balance among the voices expressed by the EU political institutions very different from that underlying the Community method.

Finally, the European response to the sovereign debt crisis has consisted in a partial and incomplete attempt to modify the existing EU fiscal and monetary institutional

architecture. The European response has tried in several ways to correct the existing institutional architecture: for example, by reviewing the instruments for coordinating national economic policies, and by establishing a number of crisis management mechanisms, in parallel with the reform of the architecture for financial supervision. This type of institutional response has its own merits, in particular in so far as certain crisis resolution mechanisms are established. At the same time, however, it has proved unable to correct the fundamental asymmetry of the EU fiscal and monetary union. The fiscal and monetary architecture had and still has a composite nature: federal monetary policy is accompanied by several national fiscal policies shaped by discretionary political choices, which reflects an inter-governmental understanding of the Union. And the governance mechanisms still provide the glue for the overall system, for example through monitoring the constitutional limits imposed on national fiscal policies.

In the lack of a European response aimed at establishing a political union in the form of a true economic government for the euro area allowing for federal taxation, the path has been towards the renationalisation of the EU, away from basic constitutional principles and institutional framework defined in the Treaty. This has been largely the result of the well-diagnosed political, democratic and institutional deficits of the EU, which prevented the institutional architecture of a "community of mutual risks" to emerge to tackle the fallout from the "community of mutual benefits" at the origin of the EU and EMU.

3. A process of institutional and constitutional (de-)construction

We have attempted in this essay to put forward an analytical framework to start making sense of the “crisis” of the European Union. We distinguished among the several origins of the broader European crisis and offered a reconstruction of the institutional and legal (ultimately, constitutional) steps taken by Europe so far to address its existential crisis.

It seems to us that the European Union has drifted into a path of constitutional (de-) construction. Indeed, the Union may well be transforming itself into a self-undermining, self-destroying polity. That does not necessarily lead to an event in which the Union will collapse or be abolished, but more likely to a progressive mutation of the underlying political and economic project of European integration. This pushes us into asking ourselves, without a ready answer, how we will know when the European Union has failed, when we will be in a position to say that the Union has mutated into something *else*. We will now attempt to conceptualise the possible implications of such move for Europe.

3.1 Revisiting Exit, Voice and Loyalty in European integration

The European response resembles in many aspects the foundational period of the European Community, as narrated by Weiler.[14] In Hirschmannian terms, the Voice of Member States is increasing in replacement of the Union's institutional and legal frameworks. In particular, the Voice of creditor Member States is being raised in order to enforce back Loyalty in the euro area, which had been broken by the Selective Exit of debtor Member States from the fiscal discipline pact of EMU.

In the foundational period until the middle of the 1970s, the crises – such as the "empty chair" crisis – were overcome by reaching a equilibrium between the legal and the political. On the legal side, the Community legal order was progressively constitutionalised. Firstly, with the Court jurisprudence on the direct effect and supremacy of Community law. Secondly, with a reinforced enforcement of Community through the system of judicial review, particularly under the preliminary reference procedure of Article 177. On the political side, Member States acquiesced to a strengthening of the Community as long as it led to their own strengthening through increased political and economic benefits, which in turn were safeguarded by the legal discipline imposed by the Treaty and the veto power of each Member State (particularly, with the Luxembourg Accord of 1966).

If one wishes to find parallels between the foundational period and the current European existential crisis, we can conclude the following.

First, the rise of the Union method is indeed an expression of the Voice of Member States in addressing the crisis outside, and sometimes in denial, of the Treaty. The motivation to avoid the Community method, as made explicit by Chancellor Merkel, was the need to avoid any transfer of competences to the EU as a result of the crisis. The recourse to taxpayers' funds, and the related involvement of national parliaments and the German Constitutional Court, was certainly an additional motivation.

However, the latest developments already reveal the shortcomings of the Union method. Successive intergovernmental deals, led by Germany and France, do not provide lasting solutions and therefore fail to stabilise the markets. The reason is probably because the compromises reached under the Union Method do not lead to a new equilibrium between the legal and the political in the EU.

On the legal side, markets do not seem to have confidence in the future of the euro area without a new constitutional framework for EMU. In the view of the markets and some academics and policy-makers, such framework should consist of a hardened constitutional structure for economic governance. It should include the transfer of

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[14] Weiler, The Constitution of Europe.

fiscal responsibilities to the European level, accompanied by direct and automatic enforcement of fiscal rules. This, in turn, should allow the pooling of fiscal sovereignty in instruments such as Eurobonds. Punishment mechanisms for non-compliant states, as well as provisions for the exit from the euro area, could also be contemplated. The Court would be entrusted with the judicial review of economic governance. Within this framework, the Loyalty of Member States to EMU would be guaranteed, finally leading to the permanent state of the euro.

On the political side, it seems clear that Member States, in particular creditor Member States, will only agree to a hardened constitutional structure for EMU if it strengthens their respective influence, and thereby the political and economic benefits from participating in the euro area. The debtor Member States, on the other hand, appear more willing to further integration as their respective economic benefits are abundantly clear. Thus far, Member States are attempting to circumvent the need for reinforced European economic governance by engaging in intergovernmental agreements, such as the EFSF/ESM and the Euro Plus Pact, and by amending their respective national constitutions as agreed at the Euro summit of 26 October (rather than accepting fiscal discipline through European law). However, none of these seem to ensure as much Loyalty to EMU as it would be achieved by subjecting fiscal sovereignty to European competences. Therefore, they will in all likelihood fail to achieve the degree of economic governance to stabilise the euro area.

3.2 The mutation of constitutional principles: the principle of equality

The hardened European constitutional structure required to preserve EMU will challenge basic constitutional and legal principles, which are at the heart of "European ideology" of integration.

One of such major principles is the *equality among Member States*. The tension between the form and the substance of such principle was considerable *even* before the crisis. Building on long-standing precedents, and especially on those established at Maastricht, the Lisbon Treaty included extremely odd opt-outs to the Charter of Fundamental Rights (granted to the UK and Poland, promised to the Czech Republic). "Multispeed Europe", "reinforced cooperations" or a Europe of variable geometry never really took off because any formal break from equality was seen as problematic (and because in certain areas, like economic policy, required restricting the breadth and depth of economic freedoms). A too formal attachment to equality among Member States has only led to a Europe of opt-outs and materially unequal states.

The principle of equality is now being seriously put at stake by the current division between creditor and debtor Member States requiring, or close to, financial assistance. Such division is not only based on economic might. It is exacerbated by the inability

of some Member States to implement reforms due not only to social discontent, but also to shortcomings in the political and administrative structure of the state itself. In a way, some Member States are perceived as “failed states” which were able nor willing to reap the benefits and opportunities created by EMU.[15] Accordingly, in a new constitutional framework, a core of Member States will inevitably be de facto or de jure endowed with political rights over the others so as to be able to enforce the rules of economic governance over “weaker” states.

The mutation of the principle of equality of Member States also has implications for citizens, which will naturally be affected in the exercise of political and economic rights within their respective state. There is the risk that citizens become *materially and politically stateless within Europe.* Fiscal redistribution among Member States could ease the pain but, at the limit, the only way to compensate such potential loss of political rights would be to “abolish” national citizenship in favour of a new fundamental European citizenship. Otherwise, mass migration could be the only way through which some could recover their political and economic equality. This would be a reversed, dark version of free movement of persons, which would lead to many other tensions.

3.3 From a community of benefits to a community of risks

Linked to the principle of equality, another principle at stake would be the one contained in the no-bail out clause of Member States in Article 125 of the Treaty. This encapsulates the concept of the EU single market and of EMU, in particular, as a “community of benefits”, where all can share the increased economic opportunities from the expansion of business activities, the pooling of financial resources, and a single monetary policy. However, it is prohibited to share the associated increased risks, since this could give rise to moral hazard problems in the lack of legally binding enforcement of prudent economic behaviour by Member States.

In this context, also the principle of mutual recognition as the engine of market integration is being challenged. The approach of the 1985 White Paper was to foster the unlimited expansion of the cross-border provision of services, regardless of the country of origin (also as a corollary of the principle of equality). This, however, was based on a conception of the single market as a "win-win framework" which would lead to permanent economic and financial growth. With the crisis, the companies and financial institutions became intrinsically linked to their country origin. As a result,

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[15] For example, a common economic denominator to the vulnerable euro area countries is the extreme level of youth unemployment, which matches that of the countries engulfed in the wave of the Arab Spring.

some are considered more or less valuable and risky than others, undermining the free single market framework.

Therefore, as the crisis overthrew the ideology of the community of benefits, a new constitutional structure will necessarily turn Europe into a "community of risks", where the costs of economic imbalances and disturbances will be mutualised among Member States in exchange for a hard economic governance framework. Otherwise, EMU and the single market will simply be abrogated. Such mutualisation, which could also involve fiscal redistribution as mentioned above, will pose constraints to fiscal sovereignty and also challenge the fundamental tenet of no taxation without representation.

3.4 The principle of European unity

A final example of a constitutional principle in mutation is the unity of the European Union. The Treaty framework is all encompassing and inclusive, to an extent that a legal principle of European Unity may be conceived.[16]

The hardening of the EMU constitution will inevitably lead to a differentiation within the EU. Thus far, EMU has not affected the legal and institutional integrity of the EU, for the following reasons: (i) it is considered an inclusive and mandatory stage of integration (except for the UK) and therefore any mismatch between the EU and EMU is legally temporary; (ii) the EMU was designed as fully functioning within the EU's institutional framework – no new institutions were necessary other than the ECB; and (iii) the fact that it is short in institutionalisation as argued above, prevents and prevented until the crisis any conflict with the EU.

These legal assumptions have fundamentally changed. The crisis in the euro area put into doubt the willingness of out-Member States to ever join EMU. The EU institutional framework is not deemed sufficient to govern EMU. And the emergence of parallel institutions - notably the Euro Summits, the Eurogroup, and the EFSF/ESM - has constrained the political and legal role of EU institutions, including the Council, the Commission, and the Parliament. Indeed, how can the EU-27 institutions, and even the Court, ever function effectively for an EMU-17? Signs of attempts to conciliate EU and euro area institutions are visible but they are limited to symbolic decisions such as designating at the same time the President of the Euro Summit and the President of the Council, as well as the President of the Euro Working Group and the Chair of the Economic and Financial Committee (as decided at the Euro summit of 26 October).

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[16] Bogdandy, Principles of European Constitutional Law.

A deviation from the principle of constitutional and legal unity with a differentiation of the euro area from the rest of the EU will lead to further disintegration. It will strengthen the enforcement of Loyalty in EMU and will relax it across the EU as a whole. It will lock-in the euro area Member States but it may lead to a concomitant increase of Selective Exit of the other EU Member States. The political and economic benefits of the EU will be much less apparent, thus diminishing the incentives for Loyalty. This is already clearly emerging from the recent policy positions expressed by the UK government regarding the renegotiation of European policies.

3.5 From governance to (democratic) law

The enforcement of Loyalty as a condition for further European integration has consistently deepened the democratic deficit. This happened as a result of the loss of the ability of national governments and parliaments to control the outcomes from the hardened and increasingly quasi-automatic machinery of European governance. There are clear indications of this implication in the rise of social discontent about Europe and the euro area, for different reasons, across all Member States, together with some neutralisation of national politics through technocratic governments.

What then makes the current crisis so special might well be the challenge of reaching a new legal and political equilibrium, which (besides hardening Europe's legal structures and increasing Member States' political and economic benefits) also meets the democratic litmus test. A "post-democratic governance" will likely not be accepted and is not acceptable.[17]

The question of how to democratize the European Union, how to redemocratise the European political order, becomes a very tricky, perhaps odd one to pose. Democracy is *no longer* the big elephant in the room. There is the bigger issue of politics at large, in the sense of the capacity of exerting power and not merely drifting with events.

Democratic law has proved over time that it is an effective means of social integration that can properly articulate a democratic and effective decision-making process. Governance, as the paradigm followed for managing market integration without a federal transformation, has not reached that level. The crisis proves that law, not governance, is actually efficient when it comes to take decisions under stress which can then be implemented. Contrary to what is assumed, the Union does not have *primarily* a democratic deficit, but it actually suffers from incapacity to decide caused by a deficit of law, by an insufficient degree of juridification of power relations.

In this sense, the European crisis is a *legal crisis* and markets will not stabilise until the rule of European is imposed upon EMU.

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[17] Hans Magnus Enzensberg, Brussels, the Gentle Monster, Seagull Books, 2011.

3.6 Multi-Europa

Taken one by one, the consequences of the crisis and the reforms introduced would seem to have stretched the Union in different directions at the same time.

Just to illustrate this point. The initial rejection of a European common policy on the recapitalisation of financial institutions implied a significant move towards a mere intergovernmental solution to the financial crisis. However, the material constitutional decisions of May 2010 seem to have pushed the Union into a federal direction, even if one which is hard to characterize as democratic. As we argued so far, these decisions have pushed the Union beyond the Rechtsstaat into uncharted territory, without a clear democratic legitimacy to do so. And, in another direction, the main components of the six-part economic governance package aim at reengineering the Union as a post-national union.

This could be said to be the typical mode of evolution of the Union. However, there are limits to pluralism, which become lower, not higher, when crisis/crises hits/hit the polity and there is a need to re-stabilise its socio-economic order. This is especially the case when the crises themselves have an asymmetric impact on the Member States of the Union. When less not more pluralism seems to be required (so as to restore the necessary uniformity without which political bonds will become too stressed to resist), increasing pluralism is bound to trigger processes of disintegration.

In economic terms, the crises and the responses have increased divergence, not convergence. There is a maximum degree of underlying economic divergence that the Union can cope with. This is indeed a basic principle of the whole design of monetary union in the Treaties. In constitutional terms, the crisis and the responses have increased substantive inequality, not substantive equality, within the whole European Union. The principle of equality of Member States and of European citizens is now challenged.

It is only another of one of the many paradoxes of this crisis that the flat rejection of multi-speed Europe and variable geometry Europe in the name of European unity and equality has been superseded by a "Multi-Europa" in the constitutional, political, legal and social dimensions, in which some states and some citizens risk becoming more equal than others.

Conclusion: more integration, again?

We started this essay recalling that European integration has progressed through crises. Will this be confirmed once again? In an admittedly federalist vision, we think that the answer should be yes: we need to move from the current state of emergency to the emergence of a European state.

As mentioned above, crises of integration have been overcome by a combination of (1) a hardened constitutional, institutional and legal structure, with (2) the granting of more political and economic benefits to Member States. For instance, the ERM crisis was only overcome with the transfer of monetary policy to the European level on the basis of a fully federal structure safeguarded by the Treaty, while providing Member States with the political benefits of equal participation in the ESCB and the economic benefits of being part of a stable single currency.

At the current stage, the crisis does not seem to subside as the loose economic governance of EMU does not ensure the cohesion of Member States, while the discourses of national politics question the benefits of European integration. As a result, exit from the euro and the EU is now discussed as a real possibility.

Therefore, Europe faces the hopefully not impossible task of achieving further integration significantly constraining – if not transferring - one of the cores of national sovereignty (fiscal sovereignty), while paradoxically increasing the political and economic benefits of Member States of being part of the EU and EMU. All this has to be done within an enhanced democratic framework that is able to legitimise the further transfer of competences to the Union.

It follows from our paper that the following three conditions have to be met in the way forward.

1. **Law and institutions:** flawed soft economic governance arrangements, with extremely low degree of institutionalization, are partly at the origin of the crisis, and are central to the continuing instability. The framework for EMU should be based on law and new institutions (e.g. economic government, financial regulator) because we need enforcement of rules and not power relations. The seemingly paradoxical fact that the euro as a currency is not questioned by markets is partly due to the strength of its Treaty-based institutional framework.

2. **Politics:** it will only be possible to achieve hardened integration if Member States accept that there are substantial political and economic benefits in being loyal to the euro rather than exiting. This may only take place by openly recognizing the limits of the political, institutional and legal underpinning of European integration as a project

directed towards the establishment of a community of benefits that are spread and shared among Member States and the citizens of Europe. The mutualisation of risks, for instance through Eurobonds and other mechanisms, as well as the preservation of the principle of equality of Member States and the unity of Europe may underpin such benefits, as they did to some extent for the transfer of monetary policy and the abolition of national currencies. If there is a lesson to be drawn from the crisis, it is that a "community of mutual risks" should emerge to tackle the fallout from the "community of mutual benefits" at the origin of the single market and EMU.

3. **Democracy:** the above conditions, in turn, are not possible to fulfil without a democratic underpinning, a legitimisation process for a move in integration that will involve the transfer of core sovereign tasks, potentially leading to redistribution policies. Furthermore, the democratic process is not only essential for the transfer of powers, but more so for the exercise of such powers at the European level if we want to avoid an advance in integration leads to another deepening of the democratic deficit. This implies that the Union has to set-up the necessary constitutional structures to control its socio-economic environment and become a unit of political and democratic decision-making. Some suggestions seem to move in this direction, such as proposals for direct election of the President of the Commission. Such a move is however challenged by the synthetic nature of the Union as a pluralistic polity, which is thus apt to disperse power, but not to concentrate it.