The Sustainability of Currency Unions
Lessons from Europe

Tal Sadeh*

March 2017

Eighteen years since the launch of Europe's single currency, this paper revisits existing hypotheses about the institutional requirements and the interstate relations that underpin a sustainable currency union among sovereign states. I argue that the presence of a locally dominant state is not necessary for the sustainability of currency unions, even if it results in less compliance with commitments, because currency unions are open contracts, in which commitments are occasionally renegotiated. I also argue that strong central supranational institutions are necessary for the sustainability of currency unions, because they make exit very expensive. Finally, I argue that even in democracies strong legitimacy of central institutions is not necessary for a currency union to be sustainable. Five recent books published by top university presses in IR are reviewed in order to debate and ultimately support these arguments. Far from being a determined guardian of commitments, Germany was at times a rule-breaker at its own convenience, and often an undecided actor riven by internal cleavages. Germany was sometimes out-maneuvered by institutions and member states. Unprecedented centralization of policies took place as a necessary minimum for the survival of the euro area, in particular in fiscal and banking affairs. And while the euro crisis motivated some expansion of the intergovernmental method, survival of the euro area necessitated a great expansion in the powers of the Commission and the CJEU, and especially the ECB. The institutions of the euro area suffer from low input and output legitimacy, and from the failure to foster a pan-European identity. However, member states' institutions do not necessarily enjoy more legitimacy than supranational ones. Popular support for the euro has remained relatively high in many member states, even if voters dislike its rules and institutions, and reject the policies that could on aggregate deliver better economic results. Many national identity projects remain incomplete, without putting the national currencies at risk of collapse.

Keywords: Euro area; Sustainability; Hegemony; Intergovernmental governance; Supra-nationalism; Legitimacy

Word count (exclusive of cover page): 12,351

<u>Books discussed in this review essay</u>

Caporaso, James and Martin Rhodes (eds.). 2016. *Political and Economic Dynamics of the Eurozone Crisis*. Oxford: Oxford University Press.

Fabbrini, Sergio. 2015. *Which European Union? Europe After the Euro Crisis*. Cambridge: Cambridge University Press.

Howarth, David and Lucia Quaglia. 2016. *The Political Economy of European Banking Union*. Oxford: Oxford University Press.

Majone, Giandomenico. 2014. *Rethinking the Union of Europe Post-Crisis - Has Integration Gone Too Far?* Cambridge: Cambridge University Press.

Matthijs, Matthias and Mark Blyth (eds.). 2015. *The Future of the Euro.* Oxford: Oxford University Press.

* Department of Political Science, Tel Aviv University, P.O. Box 39040, Tel Aviv 69978, ISRAEL. Fax (972) 3-640-9515 talsadeh@post.tau.ac.il

<u>Acknowledgements</u>

The author is grateful to Benjamin Cohen, David Howarth, Erik Jones, André Sapir, Gerald Schneider, Alfred Tovias, Stefanie Walter, Charles Wyplosz and participants in a research workshop at the University of Zurich in May 2016 and in the annual meeting of the Israeli Association for the Study of European Integration in October 2016 for their comments on earlier drafts of this paper. Parts of this paper are based on research conducted while the author visited the Graduate Institute Geneva and the University of Konstanz.

Introduction

The merit of a single currency shared among sovereign states has long occupied scholars. Economists analyze aggregate costs and benefits of currency pegs and unions. Political Realists view currencies as a tool of sovereignty, and as a means of domination by a great power over its satellites. Institutionalists regard currency unions as issue-area regimes. Neo-functionalists understand currency unions as another technical step on the road to political unification.

This review contributes to IR literature on the sustainability of currency unions. Cohen originally argued that the survival of currency unions (but not necessarily good results) depends on their ability to lock-in commitments and make defection prohibitively expensive. Crucially, "compliance with commitments is greatest in the presence of either a locally dominant state willing and able to use its influence… or a broad network of institutional linkages sufficient to make the loss of monetary autonomy tolerable…" Cohen (1993, 187). In contrast, he maintained that organizational factors, such as centralization of institutions, and economic factors, are not necessary for sustainability.

The first of four questions that this review ponders, one in each of the following four sections, flows directly from Cohen's theory: Does the existence of a dominant member state, help or hinder the sustainability of currency unions? Two more questions are inspired by Cohen: Is institutional centralization necessary for sustainability? Do supranational institutions serve sustainability better than intergovernmental institutions? The euro crisis highlighted a fourth question: Assuming democratic politics, does the survival of a currency union depend on the popular legitimacy of its central institutions? This question is more related to Dyson's (2000) understanding of sustainability as based on a shared Kantian political culture and identity among the member states, privileging the principles of partnership and mutual assistance.

Many scholarly contributions have focused on the euro area.[1] Were it to unravel it might bring down the entire European Union (EU) and potentially spark a global economic crisis. Arguably, the euro area is a unique currency union, consisting of a relatively large number of democratic member states, some very rich, some very large (Cohen, 2015, 188). Sometimes regarded as *sui generis* (Eichengreen, 2008), insights based on its experience may not all be relevant in other contexts. At 18, it is also still a young currency union. Therefore, the conclusions of this review are suggestive rather than definitive. However, not economically optimal, nor an empire, the euro area has so far survived extremely adverse conditions, and offers important lessons.

Five new books, published over the last three years by two of the top university presses in IR, are especially helpful in answering the questions posed above. In their edited volume, Caporaso and Rhodes argue that the efforts to resolve the euro crisis did not involve simple interstate power shifts, even if politics in the euro area shifted into more intergovernmental policymaking. In intergovernmental institutions, even powerful member states are at most veto players, but not dictators. Furthermore, this development has not necessarily come at the expense of supranational actors. Some loss of national policy autonomy and democracy is an inevitable cost of currency union.

---

[1] There is no scope here to do justice with all of the vast literature on the euro area. Other recent reviews have highlighted the errors of policy makers (De Grauwe, 2013), provided comparative-political analysis based on the varieties of capitalism literature (Iversen, Soskice and Hope, 2016) surveyed the causes of the crisis, and emphasized domestic and international distributive conflicts (Frieden, and Walter, 2017).

Fabbrini emphasizes that intergovernmental institutions pool sovereignty and thus are part of a political union, not a manifestation of disintegration. He argues that supranational and intergovernmental institutions do and should co-habit at the euro area's center. Popular legitimacy for the union can be bolstered with a directly elected executive president and letting the European Parliament (EP) elect the president of the European Commission without member state interference.

Howarth and Quaglia focus on the politics of Europe's Banking Union (EBU), a particular aspect of currency union that IR literature missed before the 2008 crisis. They use a comparative political economy analysis to demonstrate how the configuration of national banking systems shaped member state preferences. Germany's veto power was constrained by its internal divisions, and by the need to internalize banking externalities in order to restore calm to bank and bond markets. While not part of their main argument, Howarth and Quaglia provide a wealth of evidence, which points to weak intergovernmental coordination and insufficient supra-nationalization in the public control over banks. The outcomes of negotiations on EBU only partly address the problems in the euro area's banking sector.

Majone's differs from the other four books included in this review with regard to all of the questions posed above. He decries the neo-functionalist institutional sprawl, based on decisions taken by elites. Majone argues that the superiority of supranational institutions over national ones in problem-solving is overestimated. Invoking Buchanan's theory of clubs he argues in favor of integration *à la carte*, based on efficient assignment of tasks between different levels of governance. The EU, and thus the euro area, as a club of clubs. This would also relieve Europeans of German dominance.

Finally, in their edited volume, Matthijs and Blyth argue that the euro crisis resulted from insufficiently developed financial union, fiscal union, and political union. This unfinished institutional design exacerbated economic divergence between core and periphery member states. As the crisis unfolded, the excessive expansion in the intergovernmental method at the expense of the old Community method tilted the balance of power in Germany's favor, and impaired the legitimacy of EU institutions. Important decisions to move forward were often thrust on national leaders by threats of imminent breakdown.

Based on this literature, I argue that the presence of a locally dominant state is not necessary for the sustainability of all currency unions, even if it results in less compliance with some commitments, because currency unions are open contracts, in which commitments are occasionally renegotiated. I also argue that strong central supranational institutions are necessary for the sustainability of currency unions, because they make exit very expensive. Finally, I argue that strong popular legitimacy of central institutions is not necessary for a currency union to survive, if national institutions suffer legitimacy problems too, or if national identities are not solid.

A German Hegemony?

It is a common argument that Germany was dominant in designing Economic and Monetary Union (EMU) (Bulmer, 2014). As the largest member of the euro area, with the most competitive industry, it always had effective veto power in important intergovernmental institutions, notably ECOFIN (Council of EU finance ministers) and the euro group (Council of euro area finance ministers).

That being said, throughout most of its history the euro area was led and balanced by both France and Germany (Krotz and Schild, 2013). France has historically been the unofficial representative of those member states that prefer political discretion over hard rules; Germany has represented the opposite approach. As such, Fabbrini (2015, 137-9) argues that other member states did not resent the joint Franco-German leadership, especially if they could “multilateralize” the policy outcome.

Writing in Matthijs and Blyth's volume, Jabko (2015) explains that for Germany the euro area was supposed to de-politicize money and impose fiscal discipline. At the same time, for France it was a means to preserving its sovereignty and preventing German dominance. Similarly, in the same volume, Vail (2015) argues that France tied its economic destiny to Germany's in order to leverage itself as a leader of a new international reserve currency, at the center of a newly empowered economic bloc, rivaling the United States (US).

When the global financial crisis broke, this strategy seemed initially to pay off. In October 2007, Sarkozy convened leaders of the euro area's member states to issue a €1.3 trillion plan to save European banks. Sarkozy celebrated this as the first successful exercise of *Gouvernement Economique*: European institutions responsible for fiscal policies, balancing the European Central Bank (ECB), which represents German-inspired discipline (Wallace, 2015, 38). Through the Franco-German joint leadership France seemed at that stage to protect its national economic interests, temper Germany's hard-edged monetarism, and mediate between Germany and the crisis-hit euro periphery member states.

However, Fabbrini (2015, 85) argues that as the euro crisis reduced the resources available for EU-level redistribution, it demonstrated the economic dependence of small member states on the large ones, Germany in particular. Germany's influence is especially strong in the new frameworks that enforce fiscal discipline and disburse government bailout funds – the Fiscal Compact and the European Stability Mechanism (ESM) (Howarth and Quaglia, 2016, 175). These two international agreements abolished unanimity in decision making and left Germany with the largest voting share (Fabbrini, 2016). With relatively moderate deficits and debt (indeed, surpluses since 2014), and very low financing costs, Germany does not need any fiscal help from the union's institutions, further increasing its leverage in negotiations. Its high sovereign credit ratings make it an indispensable backstop to any rescue program of euro area governments. On top of this, Germany's Constitutional Court heard challenges to various ECB policies, strengthening the impression that Germany dominates the euro area (Bulmer, 2014; Matthijs and Blyth, 2015, 259).

Furthermore, during the euro crisis France lost its bargaining edge and could not resist Germany's positions. As both Jabko and Vail write, Germany became dominant because of the weakness of France's economy and its difficulties in obeying fiscal rules. According to Vail, French economic performance declined even before the crisis, due to eroding competitiveness. France's government deficits exceeded those of Germany and even Italy, and its current account turned from surplus to deficit during the 2000s. Even if some member states accepted the French vision of greater *Dirigiste*, since 2005 Germany's economic success has legitimized its economic model and constrained France's ability to advance its own (Matthijs and Blyth, 2015, 259).

Rather than an act of balance, the duo leadership of the euro area became the German leadership of the euro area, as Germany increasingly imposed decisions on the other member states (Schimmelfennig, 2015b). Majone (2014, 179-80, 199-200) emphasizes how Germany uses the Fiscal Compact and other EU institutions to impose fiscal discipline according to its own wishes. What Fabbrini regards as "verticalized" decision-making, turned intergovernmental institutions into vehicles for German dominance, which far from strengthening the euro area, unleashed centrifugal forces. For France, the sacrifice of the “statist liberal” vision, as Vail labels it, was rewarded with harsh austerity. A project supposed to tame Germany (Majone, 2014, 225) had instead reinforced its power (Wallace, 2015, xiv). The implication is that France may have lost its main interest in EMU. Since many member states might follow France if it ever left the euro area, the implication is that German dominance threatens the sustainability of the euro area.

Majone (2014, 258) is not surprised: Kindleberger would have predicted the ineffectiveness of the Franco-German duopoly. Only Germany, if any, could save the euro, a harsh fact acknowledged by all member states and institutions, in Majone’s (2014, 225) view. However, Majone admits that there are limits to German power. For a start, while Germany's industry is famous for its international competitiveness, its services sector (accounting for roughly 70 percent of all jobs) is a laggard. Germany is not as internationally dominant as were 19th century Great Britain or post-war US (Majone, 2014, 261-4). Germany is not big enough to shoulder responsibility, nor small enough to be irresponsible. Germany has the power to destabilize the currency union, but not enough power to stabilize it. And Germany in particular is extremely reluctant to play the role of a hegemonic power, for historical reasons. Indeed, no member state wants German hegemony. So while the crisis showed that only Germany could provide the euro area with leadership, that leadership may not be permanent (Majone, 2014, 258-9; Scholer, 2017).

Caporaso and Rhodes (2016) disagree altogether that Germany has a hegemonic position and that it imposed its ordo-liberal approach across Europe. At most, since 2010 Germany has led a small group of creditor countries to minimize costly cross-border liabilities and solidarity, and won some policy disputes. However, as Hallerberg (2016) writes in their volume, in the first half of the 2000s Germany was a violator of fiscal discipline, together with France and Portugal, and in 2008-09 it applied fiscal expansion. Mabbett and Schelkle (2016) add that Germany's patchy fiscal record since 1999, expanding when in recession, preaching austerity to others later (Bulmer, 2014), is inconsistent with the constructivist view of Germany imposing an “austerity delusion” on the minds of Europeans. Indeed, within the euro area's core member states, austerity has competing ideas (Hallerberg, 2016).

Different coalitions, consisting of the ECB, the Commission and various member states, induced or coerced Germany into transfer of sovereignty, for example in banking supervision and surveillance, as Epstein and Rhodes (2016a) note in Caporaso and Rhodes’ volume. In the February 2011 Pact for Competitiveness, Germany wanted all euro area member states to dovetail its economic and social policies, but had to accept a substantial watering down of the resulting Euro+ Pact, and ultimately its abandonment in December 2013 (Majone, 2014, 196; see also Begg *et al.*, 2015; Schäfer, 2016; Steinberg and Vermeiren, 2016; Wallace, 2015, 209). As another example, in May 2003 the ECB decided to base its monetary policy more on macroeconomic assessment and transparent inflation targeting (below but close to 2 percent) and less on monetary aggregates (the Two Pillars strategy), which was the method preferred by Germany's central bank (Wallace, 2015, 65).

Nor is Germany monolithic. The legislature and the Constitutional Court, increasingly limit the German government's freedom of action in EU affairs (Majone, 2014, 261).

Indeed, the 1992 Treaty of Maastricht empowered domestic authorities at the expense of the federal government (Bulmer 2014). The German central bank, federal government, and Constitutional Court took different positions with regard to the ECB's policies. As Henning (2016) explains in Caporaso and Rhodes' volume, the Chancellor and the finance ministry shared their central bank's desire for fiscal conservatism, but the ECB's indirect monetary help to distressed governments of euro area member states saved them the need to seek approval from the legislature for fiscal programs that would have had similar effect. Consider the bitter controversy over an ECB program to support distressed governments in secondary markets, as part of which the president of Germany's central bank argued at the Constitutional Court against a German economist sitting on the ECB's Executive Board, which the Chancellor supported (Bulmer, 2014; Wallace, 2015, 191-3).

Howarth and Quaglia (2016) agree that domestic factors are an important driver of German policy. They agree with Epstein and Rhodes (2016a) that Germany has been reluctant to support EBU and had to compromise over its terms. Its veto power in negotiations was constrained, because some kind of EBU agreement was necessary to protect its own banks, some of which have been, and still are heavily exposed to borrowers in the euro area's periphery. Big German commercial banks want EBU, while domestically-focused cooperative and savings banks seek to escape it. These internal division give some bargaining leverage to other member states (Howarth and Quaglia, 2016, 22-3).

Blyth and Matthijs (2011) find that Germany failed to meet any of the five aspects of hegemonic stability according to Kindleberger. If any, Germany's behavior was more unilateralist than hegemonic (Bulmer, 2014). Germany's emphasis on member states' responsibility for their policies, placing almost all of the current account adjustment burden on the deficit countries (Bini Smaghi, 2015; Kincaid and Watson, 2015), and its reluctance, or inability to act as regional stabilizer should be surprising given its economic interdependence with its neighbors. After all, 60 percent of German exports go to other member states, tying Germany's growth to their success. However, writing in Matthijs and Blyth's volume, Newman (2015) explains this attitude as a legacy of Germany's reunification experience, solidarity exhaustion after subsidizing and restructuring eastern Germany. For many Germans the painful but export-boosting mid-2000s reforms justified similar demands of other member states. In addition, as Jacoby (2015) notes in the same volume, during the euro crisis Germany enjoyed inflows of capital and cheap skilled labor, and a depreciating euro that allowed it to diversify its trade away from the euro area. The crisis seemed like other people's problem. In short, Germany is unwilling and unable to lead Europe.

It is true that Germany wields a veto right in the ESM, but so does France. Germany's Constitutional Court has heard challenges to ECB programs and policies, but to date has always eventually rejected these challenges. And different euro area institutions and policies have faced domestic challenges in other member states too. Germany did not stop the ECB's various intervention programs in bond markets (Wallace, 2015, 180, 196), including its monetary policy of Quantitative Easing (QE), which has very few supporters in Germany and is not endorsed by the German government (Wallace, 2015, 206).

To conclude, the euro area was established as a compromise. Germany indeed is an indispensable member state, essential for the currency union's sustainability, but so are other member states. Politically, France is just as indispensable, and economically, any Italian exit would be very costly to other euro area member states. The euro area survives not because of a supposed German domination, but, at least in part, because of a balance of interests among its major member states. As Jabko (2015) notes in Matthijs and Blyth's volume, emphasizing the intergovernmental method of decision-making in the euro area (see below), which allowed Germany to better leverage its position, was no less (and perhaps even more) important to France's political economy than to Germany's. Indeed, any perception of German dominance breeds more popular resentment rather than political stability, in a currency union that at least since 2010 has become a salient issue in the domestic politics of its member states. Thus, the presence of a locally dominant state is not necessary for the sustainability of at least this currency union, refuting any generalization that all currency unions must be led by a dominant power.

Arguably, a hegemonic power at the center of the euro area would have enforced its rules more strictly (Howarth and Quaglia, 2015b). Indeed, the euro area is characterized by weak compliance, especially with its fiscal rules, as Hallerberg (2016) notes (see also Baerg and Hallerberg, 2016; Wallace, 2015). However, as with any long-term commitment, currency unions are open contracts, in which some rules must occasionally be renegotiated. Even a locally dominant state would want to change the rules at some point. As long as the member states comply with rules that directly maintain a single currency (ensuring capital mobility and determining a single money base), a currency union may yet survive weak compliance with its other rules, even if it does not prosper.

Centralization in the Euro Area

The euro area's governance structure was incomplete when it was launched, and work is still in progress. The euro area has no fiscal mechanism for countercyclical redistribution and no effective macroeconomic adjustment mechanisms to mitigate politically-sensitive large cross-border labor flows. Financial markets were integrated but until recently oversight of banking and cross-border financial services remained principally national (Howarth and Quaglia, 2015b; 2016, 44; Jones, 2015). The ECB was not initially understood to have a mandate to act as a lender-of-last-resort to euro area banks, and only hesitantly and belatedly assumed this role *de facto* (Giavazzi and Wyplosz, 2015).

However, a series of reforms adopted in response to the euro crisis led to one of the most rapid periods of deepening of integration in the history of the EU (Caporaso *et al*., 2015). This section focuses, for reasons of scope, on two major issue areas – fiscal union and banking union. Sustainability of a currency union is likely to be weaker to the extent that national governments continue to exercise control over policies that are essential to the functioning of the currency union (Cohen, 1993). Hence, centralization of a currency union (solving problems at the union level) increases its sustainability, insofar as it increases the potential cost of exit from the currency union.

This political view of centralization as an unequivocal measure to increase exit costs contrasts with the economic approach, according to which centralization increases the costs of leaving the currency union only to the extent that it is more efficient than decentralization (i.e. it better provides public goods and corrects externalities). Centralization in the provision of public goods enjoys economies of scale, but comes at a cost due to heterogeneity of national preferences and information asymmetry. Decentralization can encourage interstate competition to improve local dysfunctions (Eichengreen and Wyplosz, 2016; Wyplosz, 2015). Majone (2014, 137) notes that centralization increases influence costs incurred in any government when attempting to selfishly bias decisions of central institutions, attempting to resist such pressures, and the resulting degradation of quality of decisions. Majone (2014, 16-8) suggests that efficient assignment of tasks between different levels of governance need not include all member states, nor necessarily coincide with national boundaries. Majone advocates a state-centered *à la carte* integration method.

However, centralization of policies in the euro area came after a struggle among highly reluctant member states. As Parsons and Matthijs (2015) highlight in Matthijs and Blyth's volume, in the euro crisis disaster truly loomed and it was acutely political, highlighting interstate distributional and party-ideological conflicts (Bechtel, Hainmueller and Margalit, 2014; Frieden and Walters, 2017; Leupold, 2016; Streeck and Elsässer, 2016). Markets responded better to central solutions than to national responses (Chang and Leblond, 2015). In such an environment, almost any agreement among the member states to centralize policy, no matter how incomplete and wanting, reveals that not centralizing would have been costlier (Jones, Kelemen and Meunier, 2016; Papadia, 2014; Schimmelfennig, 2015a). Thus, the more centralized is the euro area, the costlier it is to leave it, all else being equal (Majone, 2014, 265).

Scholars such as Majone (2014, 68-9) sometimes conflate centralization with the establishment and development of supranational institutions, and interpret a greater reliance on intergovernmental institutions as evidence of decentralization of policy. However, Fabbrini (2015; 2016) distinguishes between intergovernmental politics inside the EU (intergovernmental union) and outside it. Intergovernmental union consists of a permanent structure of institutions and procedures, functioning on a regularized basis and pooling member states' sovereignties. Intergovernmental union is not an arena for bargaining over exogenously formed national preferences, but a process to which member states' preferences are endogenous. Intergovernmental union leaves decisions not in member states' hands, but in institutions, such as ECOFIN or the euro group (Fabbrini, 2015, 124-9). Even Majone (2014, 127-9) agrees that repeated intergovernmental interactions in EU institutions allow member states to build and use reputation, as a technology of commitment. Accordingly, this section regards the evolution of intergovernmental institutions in the euro area as indicating its centralization, rather than its decentralization (for dissenting view see Wyplosz, 2015).

The Ever Incomplete Fiscal Union

The negative externalities associated with a currency union among sovereign states that lacks a fiscal union have been extensively discussed ever since EMU was negotiated in the early 1990s. In brief, the concern is that each member government has an incentive to over-borrow in the common currency, as any consequent rise in the interest rates on its debts (or the cost of any bailout by the central bank) will be shared with other member governments. This concern assumes of course that lenders charge the same interest rate on the debt of all governments, regardless of the risk of their default, an assumption which was vindicated by the experience of the euro area before 2010. In an attempt to preempt this problem, fiscal discipline and a no-bailout norm were enshrined in the Maastricht Treaty, and the 1997 Stability and Growth Pact (SGP) sought to apply a regime of sanctions to violators. However, the euro area was launched and continues to operate without any mechanism of fiscal transfers among the member states (Cohen, 2015, 192-4).

Majone (2014, 45) argues that the euro area's fiscal regime lost some of its credibility on its launch, when the Maastricht criteria were applied flexibly in order to maximize membership. Further credibility was lost when in 2003 ECOFIN decided effectively to suspend a disciplinary process that might have eventually applied sanctions to France and Germany (Heipertz and Verdun, 2010, 160). The regime was again loosened in March 2005, when the member states decided to allow cyclical deficits, excessive deficits under negative growth, and longer deadlines for correction, and to set their own medium-term objectives (Henning, 2016; Wallace, 2015, 50-1). Member states were also allowed to exclude spending fostering international solidarity (such as defense spending in France), unification of Europe (German unification costs), and fiscal effects of major structural reforms. Majone (2014, 35) documents how in October 2008, when the global financial crisis erupted, the SGP was effectively suspended to allow offsetting recessionary risks with fiscal expansion, raising government deficits and debt in the euro area. On top of this, electoral politics and opaque budgets motivated creative national accounting (Alt, Lassen and Wehner, 2014). Indeed, since the launch of the euro the Commission never recommended fines and ECOFIN never imposed any (Baerg and Hallerberg, 2016; Cohen, 2015, 199). While debate continues on their causes, the subsequent sovereign debt crises in the periphery of the euro area, and deteriorating sovereign credit ratings in other member states since 2010 clearly motivated a return to greater centralization in fiscal matters.

Fabbrini (2015) and Mabbett and Schelkle (2016) review the complex array of fiscal centralization measures agreed in the euro area since the crisis erupted. Regulations and directives known as the European Semester and the Two Pack coordinate *ex ante* fiscal policies of all EU member states, including the composition of member states' budgets, as a framework for crisis prevention. The Six Pack introduced automatic financial sanctions, limits on excessive debt (not just deficits), decision rules that make it harder for member states to suspend disciplinary measures (reverse qualified majority voting), and greater independence to national and EU statistical offices.[2]

Fabbrini (2016) and Mabbett and Schelkle (2016) review the Fiscal Compact, in force since January 2013. Member states are committed to adopting binding balanced-budget laws (debt brake). Structural deficit are not to exceed 0.5 percent of Gross Domestic Product (GDP) (or 1 percent if debt is very low).[3] Importantly, financial assistance to distressed governments (or banks – see below) from the ESM is conditional on signing up to the Fiscal Compact, which according to Fabbrini (2015, 56) formalizes previously informal summit meetings of the member states' leaders as the center of governance of the euro area. According to Fabbrini (2016) France wanted intergovernmental institutions to coordinate the member states' economic and fiscal policies, assuming it had leverage over Germany in ECOFIN.

The Emerging European Banking Union

Capital market integration and cross-border banking liberalization in the late 1980s and early 1990s left regulation, supervision and resolution of financial services in the hands of member states' authorities (Howarth and Quaglia, 2015a; Jones, 2015). Howarth and

---

[2] In 2009 the Treaty of Lisbon also excluded member states from voting on their own case in ECOFIN (Baerg and Hallerberg, 2016).

[3] Others are more skeptical of the centralizing effects of the Fiscal Compact, pointing out that only four member states have incorporated debt brakes into their national constitutions (Wallace, 2015, 106; Wyplosz, 2016).

Quaglia (2016, 26-34) describe how prior to the global financial crisis of 2008-09, EU banking and securities market law set only a minimum common denominator, and member states kept much discretion in applying it. Cross-border cooperation and information pooling was insufficient. National institutions were too small and too narrowly-focused to assume responsibility for the stability of the entire euro area.

A banking union was absent because national governments preferred to preserve their autonomy and privileged access to credit markets (Jones, 2015). The dangerous interdependence between governments and banks, often referred to as the Doom-Loop, was strengthened as the advent of the euro in 1999 stimulated cross-border banking. National autonomy in banking regulation also allowed governments to promote internationally competitive national champions, while simultaneously protecting alternative (public, savings and cooperative) banks from foreign competition and takeovers, partly using them to subsidize preferred sectors of the economy. These negative externalities could be corrected with central institutions, mandated to monitor and manage systemic risk in the euro area, impervious to pressure from banks and governments (Epstein and Rhodes, 2016a).

Initial post-crisis institutional innovations were modest (Howarth and Quaglia, 2016, 34-5), and lost credibility when Dexia bank required rescue merely three months after passing their tests (Wallace, 2015, 135). It took serious banking scares in autumn 2011 and summer of 2012 (Wallace, 2015, 189-91) for the member states to recognize the importance of greater centralization of banking regulation to the survival of the euro area.[4] France and the Mediterranean member states sought fast expansion of EU bank

[4] For as long as banks and/or governments can be bailed out, sub-optimal bank-supervision may not threaten the survival of the euro area. However, should such

rescue funds and supported the Commission on this. Clear and present systemic risks cajoled the reluctant northern member states. The Cyprus crisis of March 2013 helped focus minds, instituting a bail-in (where bank depositors and lenders pay first) and demonstrating that each member state might face a banking crisis on its own (Jones, Kelemen and Meunier, 2016).

Fabbrini (2015), and especially Howarth and Quaglia (2016), describe the centralization measures taken since in the field of banking: EBU is in the making, consisting by now of a fully operational common bank supervision regime, a partly-operational common bank resolution regime, and eventually, a common fiscal backstop (De Rynck, 2016; Epstein and Rhodes, 2016b; McPhilemy, 2016).

Under the Single Supervisory Mechanism, since November 2014 the ECB directly supervises the euro area's 128 systemically important banks (80 percent of the euro area's banking assets), and may intervene in the supervision of any of 6,000 smaller banks if national supervisors do not act. All bank supervisors in the EU adhere to the Single Rulebook (Howarth and Quaglia, 2016, 180).

The EU's resolution regime stipulates that bail-in is the first recourse, and sets rules, priorities and exemptions. It forbids state aid to banks, and stipulates that national resolution funds are to be established, financed by banks (Howarth and Quaglia, 2016, 117-20). Since 2016, a centralized resolution board replaced national resolution authorities and oversees a centralized resolution fund, to be fully financed by 2024 (Barkbu, Eichengreen and Mody, 2016; Fabbrini, 2015, 58-60; Wyplosz, 2016). The ECB is authorized to trigger a resolution process (Epstein and Rhodes, 2016a). A

bailouts ever overwhelm the euro area's financial capacity or its legal constraints, EBU could indeed become essential for its sustainability.

common deposit guarantee system would eventually protect households and small business and prevent bank runs, if German concerns about its potential redistributive effects can be alleviated (Howarth and Quaglia, 2016, 138-45).

After exhausting bail-ins and resolution funds, systemically risky banks must receive fiscal help. Indeed, the mere existence of a fiscal backstop can help prevent bank runs (Howarth and Quaglia, 2016, 138). In 2013, the European Council agreed that the ESM can directly recapitalize supervised banks (Epstein and Rhodes, 2016a), although Howarth and Quaglia (2016, 164-5) point out that given its limited capacity the ESM is not yet the fiscal backstop that EBU needs.

Supra-nationalization in the Euro Area

While theoretically distinguishing the intergovernmental union at the heart of the euro area from the supranational parliamentary union at the center of the Single Market, Fabbrini (2015, 127-9) concedes that neither union is in practice pure. In reality the EU operates with a mixture of intergovernmental and supranational methods, even if one method dominates over the other in any given issue area (Bickerton, Hodson and Puetter, 2015). Writing in Caporaso and Rhodes' volume, Caporaso and Kim (2016) also point out that the deep engagement of supranational institutions in the EU rules out any pure intergovernmental method.

Indeed, following the Treaty of Lisbon, Fabbrini (2015, 244) identifies in the EU a quadrilateral system of governance, with a dual legislature (made of the EP and the Council) and a dual executive (made of the Commission and the European Council).

Each of these branches of government is thus made of a supranational institution and an intergovernmental one. Electoral differentiation between the two institutions within each branch prevents homogeneous policy majority. In the euro area, the EP plays no significant role, so one would conclude that the governance structure is trilateral, with a unicameral legislature. However, Fabbrini (2015, 244) admits that ECOFIN (and by implication the euro group) acts both as an executive and a legislature.

This section reviews the evolving balance between supranational and intergovernmental institutions in the euro area, emphasizing the growing role of supranational institutions in response to the euro crisis. Since the member states have always tried to minimize the role of supranational institutions in the euro area, any prominence given to those institutions represents the necessary minimum for its survival in a crisis environment (Niemann and Ioannou, 2015). The next paragraphs review this balance in the euro area in general, followed by a more specific account of two euro-related issue areas.

Some evidence suggests that the euro area's governance model became more intergovernmental, or executive-federal in recent years (Crum, 2013). A protocol to the Treaty of Lisbon institutionalized the meetings of the euro group, chaired by an elected president (Fabbrini, 2015, 47; Jabko, 2015). When the euro crisis erupted, its management put even greater emphasis on intergovernmental institutions (Fabbrini, 2015, 143-5; Fabbrini, 2016), in what Merkel termed "Union method" (Matthijs and Blyth, 2015, 258). Fabbrini points out that the European Council and the euro group gained unprecedented decision-making independence and prominence. As a rough indicator of this, during 2010-14 the European Council met at least six times per year, much more than the stipulated twice-annual rate (Fabbrini, 2015, 50). In contrast, the

EP and national parliaments remained isolated from decision making (Fabbrini, 2015, 143-5; Fabbrini, 2016).

However, it is also possible to see evidence of growing supranational patterns in EU decision-making. The intergovernmental institutions may come to resemble supranational ones when governments make collective decisions that exceed their legitimate electoral mandates (Wyplosz, 2015). And as Caporaso and Kim (2016) note, the ECB, a supranational institution, also gained much agenda-setting power, and developed in practice into a lender-of-last-resort. During the euro crisis the Commission was certainly indispensable, even if in technocratic and auxiliary capacity (Becker *et al.*, 2016), but sometimes also as a policy entrepreneur (Nielsen and Smeets, 2017; Schön-Quinlivan and Scipioni, 2016). Hard rules gained priority over political bargaining, and the Commission and the Court of Justice of the EU (CJEU), in charge of enforcing the rules, were given disciplinary powers (Fabbrini, 2015, 144-5). Governments need the Commission to overcome dilemmas of collective actions (Fabbrini, 2016). And as Caporaso and Rhodes (2016, 294-316) explain, while the Commission does not dominate short-term solutions, it exerts longer-term institutional control. In a neo-functionalist fashion, the Commission's decision-making style is incremental and indirect in the short term, avoiding high-stakes confrontations with political authorities. However, incrementally the outcomes may shift the authority locus to the supranational level.

Evidence of Supra-nationalization in Fiscal Policy

The Treaty of Lisbon reiterated the prohibition on bailing out of governments of member states, as agreed in the Maastricht Treaty. However, in May 2010 that meant that the Greek government would default on its debt, and might have to exit the euro area as a result. This was politically undesirable, but more urgently, such default would trigger the collapse of banks all over Europe and beyond, possibly plunging the world into another financial crisis.

In order to avoid that eventuality, ECOFIN established a financial support facility, excusing it as assistance to member states hit by disasters beyond their control. Another support facility was established as a private company, outside EU law (Fabbrini, 2015, 50-1), funded by the euro area member states (Wallace, 2015, 96-8). In March 2011 the European Council established the ESM, through an intergovernmental agreement under international law. The ESM is allowed to lend directly to governments, and its board of governors is composed of treasury ministers of the euro area member states, chaired by the president of the euro group (Fabbrini, 2015, 53-4, 140-1; Howarth and Quaglia, 2016, 170).

While scholars generally perceive the establishment of the above financial support facilities as an expansion of the intergovernmental union in the EU, from the perspective of the euro area, which has always been relatively more intergovernmental than the rest of the EU, they represent a continuation of the same method. The main innovation in these facilities is that they were formed outside the EU legal framework in order to circumvent the prohibition on bailouts and in order to further isolate the euro area non-members (the UK in particular).

Seen from this perspective, it is interesting to note how many governance innovations restricted the intergovernmental method in the euro area and introduced supranational elements in the fiscal issue area. According to Caporaso and Rhodes (2016) and Fabbrini (2015, 140), ECOFIN's discretion was reduced by the new fiscal commitments and disciplinary process, which rely on the Commission or the CJEU for enforcement, surveillance, budgetary oversight, and crisis negotiations.

Under the new legislation, each EU member state submits its annual macroeconomic program to the Commission. The Commission evaluates and submits a report and recommendation for corrective measures to ECOFIN, deciding whether to launch the disciplinary procedure (Baerg and Hallerberg, 2016). It has discretion over trading-off deficit reduction against progress in structural reforms, and over extending deadlines for reducing deficits (Wallace, 2015, 107). Furthermore, writing in Matthijs and Blyth's volume, Schmidt (2015) argues that the Commission is very autonomous about its statistical methods, providing little explanations to outsiders, and there is no way to challenge its data. Mabbett and Schelkle (2016) agree that the statistical methods are adopted with little governmental interference but come to shape ECOFIN debates (Gandrud and Hallerberg, 2016).

In response to Commission reports, ECOFIN issues a formal statement to a member state, possibly declaring it in excessive deficit (Baerg and Hallerberg, 2016). However, the new decision rules reduced ECOFIN's discretion, making it harder to resist the Commission (Caporaso and Rhodes, 2016; Fabbrini, 2015, 140). And Schmidt (2015) suggests that the Commission was central to the drafting of the new legislation, and the Fiscal Compact. Anecdotal evidence may suggest that the Commission has been lenient with France in 2015 (Wyplosz, 2016), and with Portugal and Spain in the summer of 2016. However, in a more systematic study Baerg and Hallerberg (2016) find that during the euro crisis the propensity of member states to weaken the Commission's assessments subsided.

According to the Fiscal Compact treaty, any member state may take another member state to the CJEU for failing to respect its commitments, regardless of the Commission's opinion. According to the ESM treaty any dispute between the ESM and a member states shall be submitted to the CJEU, and the judgement shall be binding (Fabbrini, 2015, 140). EU law has precedence over the Fiscal Compact, and the CJEU has power to impose fines on member states that do not accommodate national law to the Fiscal Compact. And the fines on euro area member states benefit the ESM, not divided among the member states (Howarth and Quaglia, 2016, 175-6).

Evidence of Supra-nationalization in Monetary Policy

Fabbrini (2015, 18-9) argues that the ECB is a technocratic, non-political institution, not truly supranational like the Commission and the EP. However, politics abound inside the ECB. Members of its Governing Council, are supposed to seek the collective good of the euro area, but are inevitably biased towards helping their own national economies, even if they are independent from governments (Wallace, 2015, 53; Wyplosz, 2016). Executive appointments reflect political maneuvering (Wallace, 2015, 177), four positions informally attributed to the large member states (Giavazzi and Wyplosz, 2015). Splits in the Governing Council often reflect core-periphery tensions (Wallace, 2015, 177). Thus, the ECB is a political institution, but no more intergovernmental than the Commission.

The ECB was never explicitly mandated to act as a lender-of-last-resort to banks, and was forbidden from lending directly to governments. However, the ECB regulates how national central banks act as lenders-of-last-resort. It buys government securities in secondary markets, and inevitably the liquidity it provides to banks is used to buy sovereign bonds (Henning, 2016).

In the wake of the euro crisis, the ECB used these powers to become a lender-of-last-resort, to banks, and indirectly to governments too, in effect expanding the supranational method within the euro area (Krampf, 2016). A lender-of-last-resort is essential to the sustainability of a currency union with a no-bailout commitment, because governments are in effect borrowing in foreign currency, and are sensitive to variations in lenders' sentiment (Marzinotto, 2016). A true lender-of-last-resort must be able to help both governments and banks, because they are co-dependent (Howarth and Quaglia, 2016, 21): governments borrow from banks and eventually bail them out (Epstein and Rhodes, 2016a; Fabbrini, 2015, 58; Mabbett and Schelkle, 2016; Marzinotto, 2016). However, the prohibition on government bailouts forced the ECB to present its new policies as measures to support the smooth operation of the monetary policy, and to protect the euro area's banking system (Howarth and Quaglia, 2016, 158-65). Henning (2016) and Schmidt (2015) argue that the ECB used its policy innovations to pressure governments into greater fiscal consolidation and structural reforms in return for indirect bailout in secondary markets (funding private financial institutions that would then lend to governments).

For example, in order to ease the pressure on banks and governments, the ECB allowed itself and the national central banks to swap riskier collateral against the liquidity it provides (Henning, 2016), even bonds of governments in a bailout program (Wallace, 2015, 184). However, the ECB threatened to terminate emergency lending in Ireland (2010), Cyprus (2013) and Greece (2015) unless these countries accepted a bailout program, bank recapitalization and fiscal austerity (Bini Smaghi, 2015; Eichengreen and Wyplosz, 2016; Howarth and Quaglia, 2016, 37-8).

In 2010-12, the ECB's interventions in secondary bond markets seemed oriented towards assisting distressed governments (Mabbett and Schelkle, 2016). This conclusion rests on the timing of these operations (Wallace, 2015, 179) and the predominance of purchases of distressed governments' debt. Indeed, some members of the Governing Council interpreted these operations as an indirect bailout (Wallace, 2015, 94). The letters that the ECB sent to some governments, implicitly threatening to cut such operations if they failed to take appropriate measures (Henning, 2016; Howarth and Quaglia, 2016, 161-2) are also consistent with this view.

Perhaps the most important ECB action came in 2012, when President Draghi pledged to do "whatever it takes" to prevent market speculation from undoing the euro area, and promised unlimited purchases of sovereign bonds (Wallace, 2015, 187-8), conditional on structural reforms and fiscal consolidation (Jones, 2015). Marzinotto (2016) and Matthijs and Blyth (2015) argue that this pledge turned the ECB into a true lender-of-last-resort.

Another policy innovation came in 2015, when the ECB launched the QE program, committing to buying €60 billion in sovereign debt monthly until September 2016, later expanded and extended until March 2017. QE is an anti-deflationary tool, but it also indirectly reduces yields on sovereign debt, and subsidizes debt – interest payments are rebated (Wyplosz, 2016). Given that QE is riskier for central banks of the core member states, some see it as an implicit transfer to the periphery (Wallace, 2015, 203).

In addition, the €1 trillion Long Term Refinancing Operations since 2011, formally in order to bolster the banking system, gave banks liquidity to purchase more sovereign debt (Howarth and Quaglia, 2016, 37; Jones, 2015). Finally, the ECB has also communicated directly with the European public, again enhancing its supranational character (Bølstad and Elhardt, 2015; Genovese, Schneider and Wassmann, 2016).

Legitimacy, Democracy and Identity

It seems reasonable to argue that any club in which people cooperate democratically must be legitimate in the eyes of those it is supposed to serve, whether because they think its rules are fair, or because they expect to benefit from it, or because they identify with it. A democratic club may be hard to sustain for long if people do not want it (Cramme and Hobolt, 2015).

Writing in Matthijs and Blyth's volume, McNamara (2015) emphasizes that political solidarity and democratic legitimacy in the euro area are important to ensure that losers are compensated without alienating winners. It follows that any lack of legitimacy would not bode well for the sustainability of the euro area. Indeed, Fabbrini (2015, 164) is concerned that the popularity of the EP and turnout in EP elections have diminished recently. The EP seems to be losing legitimacy (Sani and Magistro, 2016), in spite of the graveness of the euro crisis, the gradual expansion in its powers, and attempts to promote its role in the policy process, such as by electing competitive *Spitzenkandidaten* for the office of the EP president. Majone (2014, 180) observes the same trends and concludes that voters mistrust the EP, feeling ignored and becoming indifferent to politics.

However, this section argues that greater legitimacy of central institutions among the wider public is not necessary for the survival of a currency union. Any currency relies on some design and coercion by elites. All currency unions involve some loss of national autonomy, with supranational unelected institutions and market forces restricting the menu for choice facing a national democracy. The EMU is no exception, although its poor performance and failure to foster a pan-European identity make things worse. Furthermore, there are unelected national institutions in the member states too, which global institutions and forces would constrain even without EMU, so they do not necessarily enjoy more legitimacy than supranational ones. In fact, popular support for the euro has remained solid in all twelve original euro area member states (Roth, Jonung and Nowak-Lehmann D., 2016), even if voters dislike its rules and institutions, and reject the policies that could on aggregate deliver better economic results. Finally, many national identity projects remain incomplete, without putting the national currencies at risk of collapse. To use Dyson's (2000) terms, Hobbesian and Lockean interest-based perspectives undermine the unity and legitimacy of many member states no less than they do for the entire euro area. It is not obvious that rescinding authority back to the member states would provide national central banks with a more solid intersubjective platform from which they could pursue economic stability.

Writing in Matthijs and Blyth's volume, Hopkin (2015) suggests that in the Mediterranean member states, the wider public's lack of interest in EMU-related policy processes resulted from a desire to fortify democracy through European integration of any kind. Fabbrini (2015, 78-9) goes further, arguing that people in many euro area member states believe that democracy can survive only by extending it at the supranational level (Innerarity, 2015).

However, the public became much more engaged in the affairs of the euro area when the crisis demonstrated for many people how its design flaws affected their living (Majone, 2014, 11). Suddenly, the public seemed to matter (Walter, 2016). Fabbrini (2015, 258) argues that the crisis exacerbated three main divisions in EU politics, one regarding the place of national sovereignty within the EU, another about the democratic legitimacy of EU institutions, and the last with respect to the right balance of diverse national identities within the EU.

The first two of these divisions are based according to Fabbrini on the pre-euro national differences discussed above, with regard to the legitimacy of national and supranational democracy. However, even within those member states for which membership in the euro area was expected to anchor democracy, the public was disappointed by two observations: First, national governments and national legislatures lost their autonomy over macroeconomic policy. Second, unelected supranational institutions were increasingly giving macroeconomic policy to national governments. The following discussion focuses on these observations and their implications for the democratic legitimacy of the single currency. I return later to the balance of national and pan-European identities.

Democratic legitimacy in the euro area

In the wake of the euro crisis, voters punished incumbent governments (Hernández and Kriesi, 2016). Center-left and center-right governments alternated in power, but all eventually remained committed to membership in the euro area and to fiscal tightening (Fernandez-Albertos and Kuo, 2016; Hopkin, 2015). Member states seemed to have even lost their freedom to quit the euro area (Crum, 2013). This, and temporary technocratic governments in some member states, suggested that national institutions lost their autonomy (Innerarity, 2015). Satisfaction with national legislatures and democracy declined dramatically (Armingeon and Guthmann, 2014).

Such limits on national autonomy are attributed to the rules of the euro area, enforced by its central institutions. Caporaso and Rhodes (2016), Parsons and Matthijs (2015) and Schmidt (2015) highlight how unelected supranational institutions dictated policy to crisis-stricken member states, under threat of imminent breakdown. The ECB pressed member states to engage in austerity and structural reform in return for its support (see previous section). In 2010 and 2015 it threatened to terminate emergency liquidity to respectively, Ireland and Greece (Eichengreen and Wyplosz, 2016). In 2011 the ECB implicitly threatened to withdraw support for Italy and Spain's bonds (Henning, 2016). According to Moses (2016), writing in Caporaso and Rhodes' volume, without democratic control over the ECB, policy is not designed to favor the majority.

Granting the Commission enhanced budgetary oversight powers, and sidelining the EP cast further doubts on the EU's democratic legitimacy (Schmidt, 2015). Elaborate Commission-designed reforms intrude on national sovereignty (Wyplosz, 2016), even if the Council occasionally moderated Commission recommendations (Baerg and Hallerberg, 2016; Kincaid and Watson, 2015). Legislatures of troubled member states cannot discuss their budgets before the Commission does (Majone, 2014, 199). Schmidt (2015) argues that all this weakens the input legitimacy of EU policymaking – governing by the people. Fabbrini (2015, 78-9) suggests that the growing role of unelected technocratic bodies in crisis-management strengthened calls to repatriate competencies back to the member states, which are seen as more democratic.

Majone (2014, 119-20) explains that the heterogeneity of the EU reinforces the complexity of political contracts and the difficulty in enforcing them. The EU lacks the opposition parties and political entrepreneurs that in national democracies help inform the public about. Other scholars agree that decisions at member states' level can be more democratic than EU-level decisions because smaller constituencies tend to be more homogeneous and to better control their politicians. However, small constituencies also run the risk of capture by vested interests, which is not necessarily greater at the EU level (Wyplosz, 2015).

According to Schmidt (2015), output legitimacy – coercion accepted because it is seen to serve the common good – could potentially compensate for the erosion in input legitimacy. However, output legitimacy suffered too, with rising unemployment, falling wages and economic stagnation (Armingeon and Guthmann, 2014; van Erkel and van der Meer, 2016). Majone (2014, 10-5) argues that neo-functionalists have long overestimated the superiority of supranational institutions over national ones in problem-solving. In most euro area member states only a minority believes membership is good, or think favorably of the ECB. Indeed, economic hardship and perceptions that the EU is constantly in need of reforms undermine popular support for integration (Jones, Kelemen and Meunier, 2016; Nicoli, 2017).

Might intergovernmental institutions enjoy more legitimacy than supranational ones (Bellamy and Weale, 2015; de Vries, 2015)? Schmidt (2015) indeed argues that the Council of Ministers has more input legitimacy than the ECB. However, the Council may lose legitimacy when its members make collective decisions that stray beyond national mandates (Wyplosz, 2015). Possibly, the involvement of intergovernmental institutions further obscures the policymaking process, if they act less transparently, or less predictably than supranational institutions (Majone, 2014, 120). For as long as such executive federalism escapes parliamentary oversight it cannot truly enjoy democratic legitimacy (Crum, 2013).

That being said, Majone (2014, 217-8) also offers some perspective. Even national democracies delegate significant powers to institutions that are not accountable to voters, and suffer too from low legitimacy (Innerarity, 2015), so greater competences for supranational institutions can sometimes actually increase the legitimacy of the union (Hobolt, 2015).Surveys show that trust in the EP exceeds trust in national parliaments (Wyplosz, 2015). The ECB's interest rate adjustments and announcements may have limited the potential for unrest in the member states (Genovese, Schneider and Wassmann, 2016). More broadly, joining a currency union inevitably leads to some loss of democracy at the member state level. Fixed exchange rates and high capital mobility leave little room for national policy autonomy (Crum, 2013; Rodrik, 2011). A common policy cannot aim at any single member state. Democratic choices in one member state may be sub-optimal to other member states.

Balance of European and national identities

In the single currency's early days, there was optimism that it could promote a common European identity, which would return to further support integration. For example, a common identity can legitimize more intra-union transfers from rich member states to poorer ones. Indeed, Risse (2014) argues that most Europeans developed dual identities that could sustain redistributive European policies. In similar fashion, Fabbrini (2015, 68) argues that the member states have redefined their identity and sovereignty within the EU context, even if this process has been uneven due to differing perseverance of national narratives.

However, other scholars argue that the euro crisis strengthened citizens' national identification at the expense of their European identity (Guiso, Sapienza and Zingales, 2016; Polyakova and Fligstein, 2016). Many citizens apply domestic lenses to EU politics (Wyplosz, 2015). Even Fabbrini (2015, 162-3) admits that during the crisis many MEPs were loyal to the interest of their member states. If support for the euro remains high (Roth, Jonung and Nowak-Lehmann D., 2016), not least in some of the hardest crisis-hit member states (Fernandez-Albertos and Kuo, 2016; Hopkin, 2015; Wallace, 2015, 262-3), it is mainly for utilitarian considerations (Hobolt and Wratil, 2015), not least because breakup is feared to be worse (Hobolt and Leblond, 2014). Most Europeans, in both creditor and debtor member states, are convinced that the collapse of the euro area or an exit of any member state would be much worse than the *status quo* (Tsoukalis, 2015). At the same time Europeans reject the policies that EU institutions and scholars suggest are necessary for sustaining their countries' membership in the block and resolving the crisis (Jacoby, 2015; Wallace, 2015, 13).

For Majone (2014, 15), the failure of the euro to foster a pan-European identity is endogenous to the neo-functionalist vision of the EU, which emphasizes decisions taken by elites, not by the wide public. Monnet and Haas never bothered about Europeanizing the masses, but attempted making "Europe without Europeans" (Majone, 2014, 160; quoting Schmitter, 2005). Unlike the 19th century process of nationalization, which engulfed all layers of society in forming collective identities, Majone (2014, 147) argues that post-war European integration Europeanized only elites. As a contrast, Majone (2014, 185-6) argues that James Madison invented an American people to discredit the states' pretensions of sovereignty. That identity project worked thanks to common language, English law, relative ethnic homogeneity and a common war of independence. All these elements are missing in EU. Shared institutions cannot create sense of belonging, rather a sense of belonging can legitimize institutions (Majone, 2014, 226).

While this may be true, Majone's analysis misses an important part of the picture. Any currency is simultaneously a project and a process (Checkel and Katzenstein, 2009). Money is a political construction project undertaken by national or supranational purposeful actors, even if it must be spontaneously adopted by social networks in order to be successful. A single currency among any group of people relies on a combination of coercion and social-structure-embedding. Thus, there is nothing exceptional in the euro as an elitist collective identity project; what is exceptional is that European elites are perhaps not sufficiently committed to this attempt.

Indeed, some studies suggest that member states actually have an incentive to encourage more Euroscepticism among their populations, in order to improve bargaining outcomes at the EU level (Hagemann, Hobolt and Wratil, 2016). There is evidence that member states with Eurosceptic populations were more successful in weakening Commission's warnings about their fiscal policies than member states with Europhilic populations. Euro-enthusiastic voters are likelier to side with the Commission against their own governments (Baerg and Hallerberg, 2016).

Conclusion

The purpose of this review is to contribute to IR literature on the sustainability of currency unions. Eighteen years since the launch of Europe's single currency, this paper revisits existing hypotheses about the institutional requirements and the interstate relations that underpin a sustainable currency union. Five recent books published by top university presses in IR are reviewed in order to answer four questions: Does the existence of a dominant member state, help or hinder the sustainability of currency unions? Is institutional centralization necessarily better for their sustainability? Do supranational institutions serve sustainability better than intergovernmental institutions? Must central institutions gain legitimacy among the wider public for a currency union to be sustainable?

To summarize, Caporaso and Rhodes, and Howarth and Quaglia suggest that Germany does not dominate the euro area, nor does the sustainability of the euro area require its domination. Fabbrini, Majone, and Matthijs and Blyth do see German domination, but agree it is a problem, not an advantage. Except for Majone, all of the other four books agree that greater institutional centralization is necessary for the currency union's sustainability, pursued through a mixture of supranational and intergovernmental institutions. According to Caporaso and Rhodes, Fabbrini, and Matthijs and Blyth such institutions may not enjoy popular legitimacy, given the inevitable limits they place on national policy autonomy. Thus, Fabbrini suggests developing supranational democratic institutions to compensate for such loses to national democracy. Matthijs and Blyth imply moving away from the intergovernmental method and back to the old Community method. In contrast, Majone believes decentralization of policymaking, especially at the expense of supranational institutions, could win the euro zone more legitimacy without losing too much efficiency. All authors recognize the euro area's legitimacy problems, which Majone traces to the elitist neo-functionalist vision of European integration. Fabbrini suggests a "compound union" to address, among other things, the euro area's legitimacy deficit. However, Caporaso and Rhodes argue that some loss of democracy is an inevitable cost of currency union, as a direct result of the limits on national policy autonomy

I argue that the presence of a locally dominant state is not necessary for the sustainability of currency unions, even if it results in less compliance with commitments, because currency unions are open contracts, in which commitments are occasionally renegotiated. Even a locally dominant state would want to change the rules at some point. I also argue that strong central supranational institutions are necessary for the sustainability of currency unions, not because they make the loss of monetary autonomy tolerable; rather they make the regaining of monetary autonomy intolerable. Currency unions survive not because they are cheap or beneficial to enter, but because they are very expensive to exit. Intergovernmental institutions are a second best in terms of sustainability, because they increase the costs of maintaining the union, making the exit costs seem less prohibitive. To make matters worse, intergovernmental institutions are no more legitimate than supranational ones. Finally, I argue that strong popular legitimacy of central institutions is not necessary for a currency union to survive, even under democratic politics, if national institutions suffer legitimacy problems too, or if national identities are not solid.

The second section demonstrates that far from being a determined guardian of commitments, Germany was at times a rule-breaker at its own convenience, and often an undecided actor riven by internal cleavages. Germany was sometimes out-maneuvered by institutions and member states, and when enforcement of the member states' commitments conflicted with the preservation of the euro area it preferred the latter.

The third section reviews evidence of increasing institutional centralization in the euro area since its launch (including the evolution of intergovernmental institutions), focusing, for reasons of scope, on two major issue areas – fiscal union and banking union. Since the member states tried to avoid centralization as much as possible, and proceeded to centralize only when faced with a serious crisis, the euro area's institutional evolution reflects the minimum centralization necessary for the survival of a currency union. A complex array of fiscal centralization measures were agreed in the euro area since the crisis erupted. In addition, EBU is in the making, consisting by now of a fully operational common bank supervision regime, a partly-operational common bank resolution regime, and eventually, a common fiscal backstop.

The fourth section reviews the balance between supranational and intergovernmental institutions in the euro area, and how this balance evolved since 1999, focusing on fiscal policy and monetary policy. Again, since the member states have always tried to minimize the role of supranational institutions in the euro area, any prominence given to those institutions represents the necessary minimum for its survival in a crisis environment. Indeed, although intergovernmental institutions have always dominated the euro area, and the European Council gained prominence during the euro crisis, the crisis has also greatly empowered the ECB, and provided the Commission and the CJEU with new powers.

In fiscal policy, the establishment of the bailout facilities expanded the intergovernmental method, but Council's discretion was reduced by rules that rely on the Commission and the CJEU for their operation. The Commission intrudes ever more deeply into member states' affairs. The Commission dominates EU statistics and retains discretion on deadlines and on the trading off of fiscal austerity against structural reforms. The CJEU gained binding judicial power over the member states in some fiscal affairs, including the power to impose fines. In monetary policy, the ECB used the euro crisis to effectively become a lender-of-last-resort to banks and governments, and to implicitly and explicitly pressure member states into compliance with euro area policies.

The fifth section argues that greater legitimacy among the wider public is not a necessary condition for its survival. All currency unions involve some loss of national autonomy to supranational unelected institutions and market forces. This may be especially true in EMU, and its poor performance in issues of high public profile, and failure to foster a pan-European identity, do not help. However, there are unelected national institutions in the member states too, and they do not necessarily enjoy more legitimacy than supranational ones. Any currency relies on some design and coercion by elites, and many national identity projects remain incomplete, without putting the national currencies at risk of collapse.

References

Alt, James, David Dreyer Lassen and Joachim Wehner. 2014. It Isn't Just about Greece. *British Journal of Political Science* 44 (4): 707-16.

Armingeon, Klaus and Kai Guthmann. 2014. Democracy in Crisis? *European Journal of Political Research* 53 (3): 423-42.

Baerg, Nicole Rae and Mark Hallerberg. 2016. Explaining Instability in the Stability and Growth Pact. *Comparative Political Studies* 49 (7): 968-1009.

Barkbu, Bergljot, Barry Eichengreen and Ashoka Mody. 2016. The Euro's Twin Challenges. In *Political and Economic Dynamics of the Eurozone Crisis*, edited by James Caporaso and Martin Rhodes, 48-78. Oxford: Oxford University Press.

Bechtel, Michael M., Jens Hainmueller and Yotam Margalit. 2014. Preferences for International Redistribution. *American Journal of Political Science* 58 (4): 835-56.

Becker, Stefan, Michael W. Bauer, Sara Connolly and Hussein Kassim. 2016. The Commission. *West European Politics* 39 (5): 1011-31.

Begg, Iain, Annette Bongardt, Kalypso Nicolaidis and Francisco Torres. 2015. EMU and Sustainable Integration. *Journal of European Integration* 37 (7): 803-816.

Bellamy, Richard and Albert Weale. 2015. Political Legitimacy and European Monetary Union. *Journal of European Public Policy* 22 (2): 257-74.

Bickerton, Christopher J., Dermot Hodson, and Uwe Puetter (eds.). 2015. *The New Intergovernmentalism*. Oxford: Oxford University Press

Bini Smaghi, Lorenzo. 2015. Governance and Conditionality.*Journal of European Integration* 37 (7): 755-68.

Blyth, Mark and Matthias Matthijs. 2011. Why Only Germany Can Fix the Euro: Reading Kindleberger in Berlin. Available at http://www.foreignaffairs.com/articles/136685/matthias-matthijs-and-markblyth/why-only-germany-can-fix-the-euro (accessed 2 March 2017).

Bølstad, Jørgen. 2015. To Bail Out or Not to Bail Out? *European Union Politics* 16 (3): 325-46.

Bulmer, Simon. 2014. Germany and the Eurozone Crisis. *West European Politics* 37 (6): 1244-63.

Caporaso, James, Min-hyung Kim, Warren N. Durrett and Richard B. Wesley. 2015. Still a Regulatory State? *Journal of European Public Policy* 22 (7): 889-907.

Caporaso, James and Martin Rhodes (eds.). 2016. *Political and Economic Dynamics of the Eurozone Crisis*. Oxford: Oxford University Press.

Chang, Michele and Patrick Leblond. 2015. All in: Market Expectations of Eurozone Integrity in the Sovereign Debt Crisis. *Review of International Political Economy* 22 (3): 626-55

Checkel, Jeffrey T. and Peter J. Katzenstein. 2009. The Politicization of European Identities. In *European Identity*, edited by Jeffrey T. Checkel and Peter J. Katzenstein, 1-25. Cambridge: Cambridge University Press.

Cohen, Benjamin. 1993. Betond EMU: The Problem of Sustainability. *Economic and Politics* 5 (2): 187-203.

Cohen, Benjamin. 2015. *Currency Power*. Princeton: Princeton University Press.

Cramme, Olaf and Sara B. Hobolt (eds.). 2015. *Democratic Politics in a European Union Under Stress*. Oxford: Oxford University Press.

Crum, Ben. 2013. Saving the Euro at the Cost of Democracy. *Journal of Common Market Studies* 51 (4): 614-30.

De Grauwe, Paul. 2013. The Political Economy of the Euro. *Annual Review of Political Science* 16: 153-70.

De Rynck, Stefaan. 2016. Banking on a Union. *Journal of European Public Policy* 23 (1): 119-35.

de Vries, Catherine E. 2015. Rethinking Electoral Democracy in Europe. In *Democratic Politics in a European Union Under Stress*, edited by Olaf Cramme and Sara B. Hobolt, 217-35. Oxford: Oxford University Press.

Dyson, Kenneth. 2000. *The Politics of the Euro-Zone.* Oxford: Oxford University Press.

Eichengreen, Barry. 2008. Sui Generis EMU. *European Economy - Economic Papers*, No. 303.

Eichengreen, Barry and Charles Wyplosz, 2016. Minimal Conditions for the Survival of the Euro. *Intereconomics* 51 (1): 24-8.

Epstein, Rachel A. and Martin Rhodes. 2016a. International in Life, National in Death? In *Political and Economic Dynamics of the Eurozone Crisis*, edited by James Caporaso and Martin Rhodes, 200-32. Oxford: Oxford University Press.

Epstein, Rachel A. and Martin Rhodes. 2016b. The Political Dynamics Behind Europe's New Banking Union. *West European Politics* 39 (3): 415-37.

Fabbrini, Sergio. 2015. *Which European Union?* Cambridge: Cambridge University Press.

Fabbrini, Sergio. 2016. New Institutional Dynamics in the European Union. In *Political and Economic Dynamics of the Eurozone Crisis*, edited by James Caporaso and Martin Rhodes, 258–82. Oxford: Oxford University Press.

Fernandez-Albertos, Jose and Alexander Kuo. 2016. Economic Hardship and Policy Preferences in the Eurozone Periphery. *Comparative Political Studies* 49 (7): 874-906.

Frieden, Jeffry and Stefanie Walter. 2017. Understanding the Political Economy of the Eurozone Crisis. *Annual Review of Political Science* 20.

Gandrud, Christopher and Mark Hallerberg. 2016. Statistical Agencies and Responses to Financial Crises. *West European Politics* 39 (3): 545-64.

Genovese, Federica, Gerald Schneider and Pia Wassmann. 2016. The Eurotower Strikes Back. *Comparative Political Studies* 49 (7): 939-67.

Giavazzi, Francesco and Charles Wyplosz. 2015. EMU: Old Flaws Revisited. *Journal of European Integration* 37 (7): 723-737.

Guiso, Luigi, Paola Sapienza and Luigi Zingales. 2016. Monnet's Error? *Economic Policy* 31 (85): 247-97.

Hagemann, Sara, Sara Hobolt and Christopher Wratil. 2016. Government Responsiveness in the European Union. *Comparative Political Studies* first published 12 January, DOI: https://doi.org/10.1177/0010414015621077.

Hallerberg, Mark. 2016. Fiscal Governance and Fiscal Outcomes Under EMU before and after the Crisis. In *Political and Economic Dynamics of the Eurozone Crisis*, edited by James Caporaso and Martin Rhodes, 145-66. Oxford: Oxford University Press.

Heipertz, Martin and Amy Verdun. 2010. *Ruling Europe: The Politics of the Stability and Growth Pact*. Cambridge: Cambridge University Press.

Henning, C. Randall. 2016. The ECB as a Strategic Actor. In *Political and Economic Dynamics of the Eurozone Crisis*, edited by James Caporaso and Martin Rhodes, 167-99. Oxford: Oxford University Press.

Hernández, Enrique and Hanspeter Kriesi. 2016. The Electoral Consequences of the Financial and Economic Crisis in Europe. *European Journal of Political Research* 55 (2): 203-24.

Hobolt, Sara B. 2015. Public Attitudes towards the Euro Crisis. In *Democratic Politics in a European Union Under Stress*, edited by Olaf Cramme and Sara B. Hobolt, 48-66. Oxford: Oxford University Press.

Hobolt, Sara B. and Patrick Leblond. 2014. Economic Insecurity and Public Support for the Euro. In *Mass Politics in Tough Times*, edited by Larry Bartels and Nancy Bermeo, 128-47. Oxford: Oxford University Press.

Hobolt, Sara B. and Christopher Wratil. 2015. Public Opinion and the Crisis. *Journal of European Public Policy* 22 (2): 238-56.

Hopkin, Jonathan. 2015. The Troubled Southern Periphery. In *The Future of the Euro*, edited by Matthias Matthijs and Mark Blyth, 161-86. Oxford: Oxford University Press.

Howarth, David and Lucia Quaglia. 2015a. The New Intergovernmentalism in Financial Regulation and European Banking Union. In *The New Intergovernmentalism*, edited by Christopher J. Bickerton, Dermot Hodson, and Uwe Puetter, 146-62. Oxford: Oxford University Press.

Howarth, David and Lucia Quaglia. 2015b. The Political Economy of the Euro Area's Sovereign Debt Crisis. *Review of International Political Economy* 22 (3): 457-84.

Howarth, David and Lucia Quaglia. 2016. *The Political Economy of European Banking Union*. Oxford: Oxford University Press.

Innerarity, Daniel. 2015. The Inter-Democratic Deficit of the European Union. In *Beyond the Crisis*, edited by Mark Dawson, Henrik Enderlein and Christian Joerges, 173-84. Oxford: Oxford University Press.

Iversen, Torben, David Soskice and David Hope. 2016. The Eurozone and Political Economic Institutions. *Annual Review of Political Science* 19: 163-85.

Jabko, Nicolas. 2015. The Elusive Economic Government and the Forgotten Fiscal Union. In *The Future of the Euro*, edited by Matthias Matthijs and Mark Blyth, 70-89. Oxford: Oxford University Press.

Jacoby, Wade. 2015. Europe's New German Problem. In *The Future of the Euro*, edited by Matthias Matthijs and Mark Blyth, 187-209. Oxford: Oxford University Press.

Jones, Erik. 2015. The Forgotten Financial Union. In *The Future of the Euro*, edited by Matthias Matthijs and Mark Blyth, 44–69. Oxford: Oxford University Press.

Jones, Erik, R. Daniel Kelemen and Sophie Meunier. 2016. Failing Forward? *Comparative Political Studies* 49 (7): 1010-34.

Kincaid, Russell and Max Watson. 2015. Avoiding Another Crisis in the Euro Area. *Journal of European Integration* 37 (7): 787-801.

Krampf, Arie. 2016. From Transparency to Ambiguity. *Journal of European Integration* 38 (4): 455-71.

Krotz, Ulrich and Joachim Schild. 2013. Shaping Europe: France, Germany, and Embedded Bilateralism from the Elysée Treaty to Twenty-First Century Politics. Oxford: Oxford University Press.

Leupold, Anna. 2016. A Structural Approach to Politicisation in the Euro Crisis. *West European Politics* 39 (1): 84-103.

Mabbett, Deborah and Waltraud Schelkle. 2016. Searching Under the Lamppost. In *Political and Economic Dynamics of the Eurozone Crisis*, edited by James Caporaso and Martin Rhodes, 122-44. Oxford: Oxford University Press.

Majone, Giandomenico. 2014. *Rethinking the Union of Europe Post-Crisis.* Cambridge: Cambridge University Press.

Marzinotto, Benedicta. 2016. "United We Fall". In *Political and Economic Dynamics of the Eurozone Crisis*, edited by James Caporaso and Martin Rhodes, 100-21. Oxford: Oxford University Press.

Matthijs, Matthias and Mark Blyth (eds.). 2015. *The Future of the Euro.* Oxford: Oxford University Press.

McNamara, Kathleen R. 2015. The forgotten Problem of Embeddedness. In *The Future of the Euro*, edited by Matthias Matthijs and Mark Blyth, 21- 43. Oxford: Oxford University Press.

McPhilemy, Samuel. 2016. Integrating Macro-Prudential Policy. *West European Politics* 39 (3): 526-44.

Moses, Jonathon. 2016. Free Sailing or Tied to the Mast. In *Political and Economic Dynamics of the Euro Zone Crisis*, edited by James Caporaso and Martin Rhodes, 233-57. Oxford: Oxford University Press.

Newman, Abraham. 2015. The Reluctant Leader. In *The Future of the Euro*, edited by Matthias Matthijs and Mark Blyth, 117-35. Oxford: Oxford University Press.

Nicoli, Francesco. 2017. Hard-Line Euroscepticism and the Eurocrisis. *Journal of Common Market Studies* 55 (2): 312-31.

Nielsen, Bodil and Sandrino Smeets. 2017. The Role of the EU Institutions in Establishing the Banking Union. *Journal of European Public Policy*, published on-line 3 February, http://dx.doi.org/10.1080/13501763.2017.1285342.

Niemann, Arne and Demosthenes Ioannou. 2015. European Economic Integration in Times of Crisis. *Journal of European Public Policy* 22 (2): 196-218.

Parsons, Craig and Matthias Matthijs. 2015. European Integration, Past, Present and Future. In *The Future of the Euro*, edited by Matthias Matthijs and Mark Blyth, 210-32. Oxford: Oxford University Press.

Polyakova, Alina and Neil Fligstein. 2016. Is European Integration Causing Europe to Become More Nationalist? *Journal of European Public Policy* 23 (1): 60-83.

Risse, Thomas. 2014. No Demos? *Journal of Common Studies* 52 (6): 1207-15.

Rodrik, Dani. 2011. *The Globalization Paradox*. New York: Norton.

Roth, Felix, Lars Jonung and Felicitas Nowak-Lehmann D. 2016. Crisis and Public Support for the Euro, 1990–2014. *Journal of Common Market Studies* 54 (4): 944-60.

Sani, Giulia M. Dotti and Beatrice Magistro. 2016. Increasingly unequal? *European Journal of Political Research* 55 (2): 246-64.

Schäfer, David. 2016. A Banking Union of Ideas? *Journal of Common Market Studies* 54 (4): 961-80.

Schimmelfennig, Frank. 2015a. Differentiated Integration Before and After the Crisis. In *Democratic Politics in a European Union Under Stress*, edited by Olaf Cramme and Sara B. Hobolt, 120-34. Oxford: Oxford University Press.

Schimmelfennig, Frank. 2015b. Liberal Intergovernmentalism and the Euro Area Crisis. *Journal of European Public Policy* 22 (2): 177-95.

Schmidt, Vivien A. 2015. The Forgotten Problem of Democratic Legitimacy. In *The Future of the Euro*, edited by Matthias Matthijs and Mark Blyth, 90-114. Oxford: Oxford University Press.

Schmitter, Phillip C. 2005. Ernst B. Haas and the Legacy of Neofunctionalism. *Journal of European Public Policy* 12 (2): 255-72.

Scholer, Magnus G. 2017. Providing Political Leadership? *Journal of European Public Policy* 24 (1): 1-20.

Schön-Quinlivan, Emmanuelle and Marco Scipioni. 2016. The Commission as Policy Entrepreneur in European Economic Governance. *Journal of European Public Policy*, published on-line 8 September, DOI: 10.1080/13501763.2016.1206140.

Steinberg, Federico and Mattias Vermeiren. 2016. Germany's Institutional Power and the EMU Regime After the Crisis. *Journal of Common Market Studies* 54 (2): 388-407.

Streeck, Wolfgang and Lea Elsässer. 2016. Monetary Disunion. *Journal of European Public Policy* 23 (1): 1-24.

Tsoukalis, Loukas. 2015. Rebalancing and Completing the European Monetary Union. In *Beyond the Crisis*, edited by Mark Dawson, Henrik Enderlein and Christian Joerges, 44-61. Oxford: Oxford University Press.

Vail, Mark I. 2015. Europe's Middle Child. In *The Future of the Euro*, edited by Matthias Matthijs and Mark Blyth, 136-60. Oxford: Oxford University Press.

Van Erkel, Patrick and Tom van der Meer. 2016. Macroeconomic Performance, Political Trust and the Great Recession. *European Journal of Political Research* 55 (1): 177-97.

Wallace, Paul. 2015. *The Euro Experiment*. Cambridge: Cambridge University Press.

Walter, Stephanie. 2016. Crisis Politics in Europe. *Comparative Political Studies* 49 (7): 841-73.

Wyplosz, Charles. 2015. The Centralization-Decentralization Issue. *European Economy - Discussion Papers*, No. 14.

Wyplosz, Charles. 2016. The six flaws of the Eurozone. *Economic Policy* 31 (87): 559-606.