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Deliberative Supranationalism in the Euro Crisis? The European Central Bank and The European Council in Times of Conflict

HENNING DETERS
BREMEN

I. INTRODUCTION: CONFLICT, CRISIS, AND DELIBERATION

THIS CHAPTER APPLIES Conflicts-Law Constitutionalism (CLC) as a theoretical framework to examine the conflicts about the European Central Bank's (ECB) monetary-policy decisions at the height of the euro crisis. The crisis has been a particular challenge for CLC's vision to defend law-mediated legitimacy in a post-national constellation. Premised on the notion of supreme emergency,[1] fundamental treaty provisions have been blatantly neglected,[2] national democratic self-government has come under attack,[3] and executive and administrative power has slipped further away from parliamentary control.[4] Moreover, there is reason to worry that the quality of political contestation has also suffered, because the crisis has finally dredged up the always latent conflict[5] between the competitive eurozone core that managed to weather the storm in relatively good health and those uncompetitive economies in the euro periphery that were hit particularly hard. With conflicts over re-distributive issues becoming more salient, the chances of arguing about these differences in a reasonable

[1] K Dyson, 'Sworn to Grim Necessity? Imperfections of European Economic Governance, Normative Political Theory and Supreme Emergency' (2013) 3 *Journal of European Integration* 207–22; C Kreuder-Sonnen, Comment in this volume.

[2] M Ruffert, 'The European Debt Crisis and European Union Law' (2011) 6 *Common Market Law Review* 1777–1806.

[3] S Kouvelakis 'The Greek Cauldron' (2011) 72 *New Left Review* 17–32.

[4] A Benz, 'An Assymetric Two-level Game. Parliaments in the Euro Crisis' in B Crum and JE Fossum (eds), *Practices of Inter-parliamentary Coordination in International Politics* (Colchester, ECPR Press, 2013); D Curtin, Chapter eight in this volume.

[5] B Eichengreen and JA Frieden (eds), *The Political Economy of European Monetary Unification* (Boulder CO, Westview Press, 1994).

and consensus-oriented fashion—which, in a Habermasian sense, 'includes the other'—diminish.

From the theoretical perspective of this volume, this development would be troubling, since CLC has relied on deliberation—the free exchange of reasonable arguments in search of a co-operative solution that is more than a pure modus vivendi—as a way of structuring political contestation in such a way that it would enhance social acceptance and normative acceptability. CLC has found 'deliberative supranationalism' to be a crucial feature of the EU's institutional set-up, which is both normatively desirable and explains part of the Union's dynamism and problem-solving capacity. Theoretically, this chapter submits that the reality of deliberative supranationalism rests on the question of whether or not we can still regard the European Union (EU) mainly as a regulatory state. Since the regulatory state is essentially a world of common interests, there are few incentives for strategic bargaining behaviour. Nothing, however, could be further from an accurate account of the eurozone's current state.

Empirically, this chapter examines the conflicts and politics surrounding the ECB's response to the crisis. It asks how the new quality of the intergovernmental conflict that emerged during the crisis has affected the political interactions around monetary-policy decisions. The busy emergency actions at European Council level have distracted scholarly attention somewhat from the important decisions of the Central Bank.[6] Consciously designed as a politically-independent institution governed by experts, the ECB would appear to be a stronghold of both deliberation and supranationalism. By contrast, the chapter's main empirical thesis is that, far from being an example of deliberative supranationalism, the monetary-policy response has been the subject of fierce contestation, recourse to formal voting, arguing from inflexible positions, and partial deadlock. The following section (II) provides a short background on the euro crisis and re-visits how the associated conflicts are rooted in socio-economic diversity. Section III explains the concept of deliberative supranationalism and its place within CLC. It also argues at a conceptual level that the applicable domain of deliberative supranationalism is the regulatory state, and situates monetary policy within this realm. After a few methodological reflections in Section IV, Section V looks at the European crisis response and asks to what extent decisions were taken in a deliberative mode of interaction. In this main section, I advance three observations: Member States initially found themselves in a political stand-off (Section V.1), at which point the ECB flew in like a rescue helicopter (Section V.2). The conflict between the eurozone periphery and the core also affected ECB decision-making, leading to isolation and inflexible positions (Section V.3). Each observation implies that the new degree of conflict, which the euro crisis has brought about, has discouraged deliberative interaction in monetary politics. It also shows how the ECB did not

[6] G Menz and MP Smith, 'Kicking the Can Down the Road to More Europe? Salvaging and the Future of European Economic Governance' (2013) 3 *Journal of European Integration* 195, 203.

succeed in exploiting the intergovernmental differences to expand its mandate in the long run. Section VI discusses some implications of this conclusion.

II. BACKGROUND

A mere 10 years after its inception, the euro has faced a crisis that was severe enough to challenge its very existence. Several eurozone members, namely, Greece, Ireland, Italy, Portugal and Spain (the GIIPS),[7] are, or were, unable to re-finance government debt at sustainable rates—or simply not able to finance it at all. They found themselves forced to cut public spending at a time of economic recession and surging unemployment. The proximate cause of the euro crisis was the 2007/2008 global banking and financial crisis. It originated in the collapse of the sub-prime segment of the United States mortgage market and culminated in the insolvency of Lehman Brothers and other high-street banks and insurance companies. Bankruptcies then spread to certain European financial institutions that had invested in 'toxic' US securities. Those considered 'too big to fail' had to be bailed out by their respective governments, straining public finances. More importantly, while credit supply was over-abundant before the financial crisis, after the failure of Lehman Brothers, the global economy was suddenly hit by a serious credit crunch that was particularly hurtful to the GIIPS economies.

While the prescribed cures differ, there is a rough consensus about the structural cause of the euro crisis. Its root is seen in the heterogeneity of national economies that, within the Procrustean bed of a unitary currency, produced economic imbalances. One line of thought emphasises how the centralised monetary policy could not address asynchronous national business cycles.[8] Thus, during the first years after Maastricht, the German economy, given its low rates of growth and inflation, suffered from real interest rates that were too high, a situation that led to stifling domestic demand and economic stagnation, and encouraged an export-led growth strategy. The situation in the GIIPS was reversed: the ECB's prime rate locally translated into very low or even negative real interest rates at a time when the EMU periphery was already overheating. The large demand, fed by cheap private credit, absorbed much of German exports. But as long as money remained cheap, the system kept running in spite of the accumulating trade imbalances. It stopped working with the arrival of the financial crisis, when credit became scarce and banks started to scramble for cash. Another line of thought, sympathetic to the 'varieties of capitalism' school, does not deny the relevance

[7] The acronym GIIPS has been chosen to avoid the use of the offensive acronyms, PIGS and PIIGS.

[8] FW Scharpf, 'Monetary Union, Fiscal Crisis and the Preemption of Democracy' (2011) 11 MPIfG Discussion Paper; J Leaman, 'The Size that Fits No-one: European Monetarism Reconsidered' in E Chiti, AJ Menéndez and P Texeira (eds), *The European Rescue of the European Union?: The Existential Crisis of the European Political Project* (Oslo, ARENA, 2012) 229–55; T Mayer, *Europe's Unfinished Currency: the Political Economics of the Euro* (London, Anthem Press, 2012).

of the aforementioned mechanism, but draws further attention to the role of heterogeneous national growth models and institutions of wage co-ordination.[9]

The EU has been struggling in the last few years to resolve these problems without breaking up the eurozone. By the end of 2012, the main political crisis responses had been set up: a reform of economic governance institutions at EU level and a series of emergency funding packages, which were finally transformed into standing institutions and coupled with economic adjustment ('conditionality') programmes.[10] These measures were accompanied by, and partly preceded by, a set of exceptional measures implemented by the ECB.[11] The same diversity that led the eurozone into the crisis also makes it difficult to find viable ways out of it beyond mere emergency programmes. The euro rescue requires some sorts of transfer between the GIIPS and the euro core, but the EU has no way to do this other than via the arduous process of intergovernmental negotiation. This problem is further exacerbated by the differences among those who believe that the crisis can be resolved at its root by implementing fiscal austerity in the GIIPS countries and by adopting the northern, export-centred growth model as a 'one-size-fits all solution', and those who argue in favour of reflationary measures.[12]

III. DELIBERATIVE SUPRANATIONALISM AND THE LIMITS OF THE REGULATORY STATE

III.1. Conflicts Law and Deliberative Supranationalism

CLC as a normative re-constitution of European law draws on the basic notion of democracy as self-rule. Citizens must be able to conceive of themselves as the (indirect but) ultimate authors of the laws by which they are bound.[13] CLC is also inspired by private international law (ie, 'conflict of laws')—the legal methodology by which to determine the legal system that applies in a dispute with cross-border elements. Because they may subject citizens to foreign law, these disputes pose a challenge to the notion of democratic authorship: national democracy in transnational problem-settings is democracy curtailed. A simplistic solution to deal with such externalities is to integrate the conflicting elements into a hierarchy. But long before a European super-state, there are obvious limits to further integration, most notably pertaining to the accountability of supranational

[9] PA Hall, 'The Economics and Politics of the Euro Crisis' (2012) 4 *German Politics* 355–71; M Höpner, 'Die Verschiedenheit der europaeischen Lohnregime und ihr Beitrag zur Eurokrise: Warum der Euro nicht zum heterogenen Unterbau der Eurozone passt' (2013) 5 MPIfG Discussion Paper.

[10] See Ruffert, n 2 above; M Buti and N Carnot, 'The EMU Debt Crisis: Early Lessons and Reforms' (2012) 6 *Journal of Common Market Studies* 899–911.

[11] See F Drudi, A Durré and FP Mongelli, 'The Interplay of Economic Reforms and Monetary Policy: The Case of the Eurozone' (2012) 6 *Journal of Common Market Studies* 881, 886–89; Mayer, n 8 above, 108–11.

[12] Hall, n 9 above.

[13] See C Joerges, Chapter one in this volume, and D Schneidermann, Chapter two in this volume.

institutions and the heterogeneity (economic, regulatory, cultural) among the EU Member States. CLC puts itself forward as a middle ground that steers clear of the excessive demands of transnational constitutionalism, on the one hand, and a legal pluralism that is overly optimistic about the legal system's potential for self-regulation, on the other. It emphasises the procedural and pragmatic character of conflict resoluion through litigation that eschews carving solutions in stone, and it underlines the 'other'-regarding logic behind private international law principles such as comity.[14] Thus, CLC has set its hopes on the *deliberative* forms of conflict-handling among national democracies, and has called upon the EU to 'lay down a legal framework which structures political deliberation'.[15] Examples of deliberative procedures were found and critically examined in the myriads of 'comitology' committees.[16] Such institutionalised deliberative supranationalism was seen as a way to complement the national democracy that is curtailed by not including all those affected. It would give a voice to 'foreigners' and allow them to find normatively satisfying solutions to what would be understood as common problems. While the outcomes of interest-based bargaining tend only to replicate the negotiators' unequal starting positions,[17] the logic of deliberation is transformative to the extent that it requires taking the 'other' into account as an equal counterpart in a mutual truth-seeking endeavour.

III.2. Deliberation

The deliberative features of the EU's decision-making system have been identified and advertised as a way of coping with the problem of externalities that inevitably arise in a common market. The notion has subsequently been extended to other settings, and, with a certain optimism befitting the decade following Maastricht, it has also become an attractive theoretical framework that seemed to explain, or, in fact, did explain, a lot of the European Union's unexpected dynamism and problem-solving capacity in those years.[18] Thanks to the conflict-taming qualities of deliberative supranationalism, the tensions which a transnational 'market

[14] C Joerges, 'Rethinking European Law's Supremacy: A Plea for a Supranational Conflicts of Law' in B Kohler-Koch and B Rittberger (eds), *Debating the Democratic Legitimacy of the European Union* (Lanham MD, Rowman & Littlefield, 2007) 311, 312–15.

[15] C Joerges and J Neyer, 'Deliberative Supranationalism Revisited' (2006) EUI Working Papers Law, 23.

[16] C Joerges and J Neyer, 'Transforming Strategic Interaction into Deliberative Problem-solving. European Comitology in the Foodstuffs Sector' (1997) 4 *Journal of European Public Policy* 609–25.

[17] FW Scharpf, *Games Real Actors Play: Actor-centered Institutionalism in Policy Research* (Boulder CO, Westview Press, 1997) 146.

[18] J Neyer, 'Explaining the Unexpected. Efficiency and Effectiveness in European Decision-Making' (2004) 1 *Journal of European Public Policy* 19–38.

without a state'[19] would inevitably provoke[20] neither stalled nor disrupted the integration project.

Deliberation and bargaining are two ideal-typical interaction styles in negotiations. Putting aside long-winded conceptual discussions about what constitutes 'real' deliberation, I content myself, for the purpose of this study, with a rough-and-ready analytical definition:[21]

— **Deliberation** (synonym: 'arguing') refers here to an exchange of arguments in search of the best solution to common policy-problems. Negotiators strive for a reasoned consensus and conceive of their discussion as a collective truth-seeking endeavour. They try to persuade, rather than to pressure, their counterpart(s) into agreement, and are open to being persuaded by the 'unforced force of the better argument'.[22] Deliberation may transform individual preferences.
— **Bargaining** is an exchange of threats and promises in search of a modus vivendi. Through offers and counter-offers, negotiators strive for a deal that renders them better off than their individual 'best alternative to a negotiated agreement',[23] which may be very unequal and is therefore a resource of bargaining power. They try to get as close to their preferred negotiation outcome as possible, taking the preferences of their counterparts into account only strategically. Bargaining may, therefore, induce negotiators to mis-represent their preferences and engage in all sorts of opportunistic behaviour.

In real-world interactions, deliberation and bargaining blend into each other.[24] Some studies try to measure quantitatively the degree to which negotiations conform to perfect deliberation or bargaining.[25] My aim is less sophisticated. I wish to examine whether policy-makers have met minimum requirements for deliberation (see Section IV) during the political negotiations surrounding the euro crisis.

[19] Joerges and Neyer, n 16 above.
[20] K Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston MA, The Beacon Press, 2001).
[21] T Risse, '"Let's Argue!" Communicative Action in World Politics' (2000) 1 *International Organization* 1, 7; J Elster, *Explaining Social Behaviour. More Nuts and Bolts for the Social Sciences* (Cambridge, Cambridge University Press, 2007) 405–9.
[22] J Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy* (Cambridge MA, The MIT Press, 1996) 306.
[23] R Fisher and W Ury, *Getting to YES: Negotiating Agreement without Giving in* (New York, Penguin Books, 1981).
[24] J Lewis, 'How Institutional Environments Facilitate Co-operative Negotiation Styles in EU Decision-making' (2010) 5 *Journal of European Public Policy* 648–64.
[25] J Blom-Hansen and GJ Brandsma, 'The EU Comitology System. Intergovernmental Bargaining and Deliberative Supranationalism' (2009) 4 *Journal of Common Market Studies* 719–40.

III.3. Regulation and Re-distribution

The quality of political interaction is obviously affected by the intensity of political conflict. The intensity of conflict varies across policy types. This relationship is captured by Theodore Lowi's famous dictum that 'policies determine politics'.[26] The substance of a political issue thus affects the mode of interaction among political actors. More specifically, following Lowi, it has become commonplace in policy analysis to distinguish between (re-)distributive and regulative policies, and to expect that political interactions differ, depending on these policy types.

Re-distributive policies allocate benefits to certain recipients, and, at the same time, impose costs on others. These costs and benefits are assigned unequally. Re-distribution, more often than not, takes place via the budgetary process, be it at national level or—in very few areas, such as the Common Agricultural Policy or the Cohesion Funds—at the level of European expenditure policy. By re-allocating values, re-distributive policies create clearly identifiable winners and losers, and are therefore likely to be contested and to become subject to intense bargaining. Regulatory policies, by contrast, are about normative rules. They do not distribute charges and benefits, but, instead, assign rights and duties. Regulations do not impinge on the budget, be it the notoriously minute budget of the EU or that of its Member States. For the regulator, regulatory policies are, therefore, all but cost-free. While regulations may have indirect and unequal cost effects, these are borne by the regulated.[27]

The distribution of the indirect costs and benefits of regulatory policies is often opaque and therefore escapes distributive bargaining. Moreover, regulatory policy-making takes place 'against a backdrop of common benefits'.[28] It is, in other words, either an issue of pure positive-sum co-ordination or at least a mixed motive situation, in which decision-makers have to negotiate both about the production *and* the distribution of value. While, in the latter case, the problem of finding the Pareto frontier may be complicated by conflicts along the distributive dimension, Pareto-efficient solutions, by definition, do not exist for (re-) distributive policies.

Turning back to the issue of the quality of political interaction, the literature on the 'negotiator's dilemma'[29] tells us that the attitudes and orientations required to jointly create value, that is, the deliberation part of the negotiations, differ

[26] TJ Lowi, 'Four Systems of Policy, Politics, and Choice' (1972) 4 *Public Administration Review* 298, 299.

[27] G Majone, 'The European Community between Social Policy and Social Regulation' (1993) 2 *Journal of Common Market Studies* 153, 161.

[28] JA Caporaso, 'The European Union and Forms of State: Westphalian, Regulatory or Post-Modern?' (1996) 1 *Journal of Common Market Studies* 29, 40.

[29] DA Lax and JK Sebenius, *The Manager as Negotiator: Bargaining for Cooperation and Competitive Gain* (New York, Free Press, 1986).

systematically from those required for distributing value, that is, the bargaining part of the negotiations.[30]

From the bird's eye view, the conflicts about the crisis response resemble a giant 'battle of the sexes' game. For the north, 'the spread of contagion across the eurozone rendered the cost of bail-out potentially less than the cost of adhering to rules of fiscal federalism'.[31] While, at the beginning of the crisis, northern policy-makers were still uncertain about the repercussions of letting individual countries default—until autumn 2012, German Chancellor Angela Merkel still considered letting Greece exit from the Euro[32]—they finally settled on the notion that the fall-out would be too costly. The consequences of non-agreement came to be seen as less and less acceptable. 'It was thus in the interest of all in Europe to find a solution to the sovereign debt crisis'.[33] But this, of course, did not settle the issue of who should bear the costs of the crisis.

With its minute budget and its few truly re-distributive policies, on the one hand, and its ever-expanding regulatory powers, on the other, the dominant image of the EU in recent years has been that of a 'regulatory state'.[34] Ideally, regulation is about producing outcomes in everyone's interests—'public interest policies' with Pareto-efficient outcomes. It is precisely with regard to the safeguarding of the public interest that the delegation of regulatory powers to supranational institutions has been explained and justified. This notion maintains that governments have, in their long-term interest, delegated, for example, the monitoring and implementation of the single-market and competition-policy rules to independent agents—the European Commission and the European Court of Justice—to prevent them from free-riding[35] and from adopting policies in the short-term interest of frequently changing electoral majorities.[36]

The concepts of the regulatory state and of deliberative supranationalism were first tested in the early 1990s, and each first examined the newly-emerging field of 'social regulation'.[37] The handling of external effects is a central issue in the regulatory state, just as it is for deliberative supranationalism. As James Caporaso observes:[38] 'the regulatory state is … essentially an international and arguably

[30] Scharpf, n 17 above, 130–32.

[31] Menz and Smith, n 6 above, 202.

[32] L Bini Smaghi, *Morire di Austerità: Democrazie Europee con le Spalle al Muro* (Bologna, Il Mulino, 2013) 39.

[33] L Gocaj and S Meunier, 'Time will Tell: The EFSF, the ESM, and the Euro Crisis' (2013) 3 *Journal of European Integration* 239, 241.

[34] G Majone, *Regulating Europe* (London, Routledge, 1996).

[35] MA Pollack, 'Delegation, Agency, and Agenda Settings in the European Community' (1997) 1 *International Organization* 99, 105.

[36] G Majone, 'Europe's Democratic Deficit: The Question of Standards' (1998) 4 *European Law Journal* 5, at 17–18.

[37] G Majone, 'The Development of Social Regulation in the European Community. Policy Externalities, Transaction Costs, Motivational Factors' (1995) 50 *Aussenwirtschaft* 1, 79–110.

[38] Caporaso, n 28 above, 9.

supranational state specializing in the control and management of international externalities'.

With the euro crisis, the regulatory state has been severely challenged. The international bail-out programmes are only the most prominent examples of recent political decisions with a re-distributive purpose. The distributive implications of monetary-policy decisions taken by the politically independent ECB have also come into view and were politicised accordingly. This is particularly interesting, because the independence of the ECB has been justified for so long precisely along the lines of the regulatory state argument: monetary policy should be shielded from the re-distributive pretensions of governments catering to their particular clientele; and the delegation of monetary policy to an independent central bank committed exclusively to price stability would, therefore, improve aggregate welfare in the long term.[39] If it is true that, as critics have argued, the ECB has, in its handling of the crisis, introduced fiscal policy through the monetary back-door,[40] a distributive conflict should affect decision-making among central bankers. Accordingly, the second part of the following analysis examines the emerging conflicts around the hitherto apolitical issue of central banking and how they affect the mode of interaction among responsible decision-makers.

IV. METHODOLOGICAL REMARKS

The following analysis examines the crisis response of the European Central Bank, on the one hand, and the European and ECOFIN Council, on the other. As will become apparent, the responses of both actors are closely intertwined, with the supranational ECB partly stepping into the breach for a paralysed inter-governmental Council. From a theoretical point of view, deliberative supranationalism should be expected of the ECB, rather than of the Council(s). The latter are highly salient venues, staffed by high-ranking politicians, who are directly accountable to their domestic electorates. The function of the European Council, moreover, is to define 'the general political directions and priorities' (Article 13 TEU) of the Union, so that agreement over political goals cannot be taken for granted. The Council thus seems already prima facie an unlikely place for policy-makers to deliberate. Yet, even so, it has recently been argued that the Council has emerged during the crisis as a prime site for open-minded deliberation.[41]

[39] KR McNamara, 'Rational Fictions: Central Bank Independence and the Social Logic of Delegation' (2002) 1 *West European Politics* 47, 54. This is not to say that Majone has not been quite critical about the degree of the ECB's independence, calling it even a 'constitutional monstrosity', for example, in: McNamara, *Europe as the Would-be World Power: The EU at Fifty* (Cambridge, Cambridge University Press, 2009) 34.

[40] W Schelkle, 'European Fiscal Union: From Monetary Back Door to Parliamentary Main Entrance' (2012) *CESifo Forum* 1.

[41] U Puetter, 'Europe's Deliberative Intergovernmentalism: the Role of the Council and European Council in EU Economic Governance' (2012) 2 *Journal of European Public Policy* 161.

Consider, by contrast, the ECB. The choice for the ECB as a second case is motivated not only because of its being *the* relevant actor in European currency issues; as a politically independent, supranational body governed by policy experts, it is also an excellent test case for deliberative supranationalism. In fact, the ECB is the most politically independent central bank in the world, and the Member States defined, in the Treaty of Maastricht, its sole purpose and mandate: to preserve price stability. Accordingly, Kathleen McNamara believes, '[i]f the ECB is staffed by professionals largely educated and socialized along similar lines, consensus is relatively likely in the ECB as national policy traditions become less dominant over the past decades of monetary co-operation'.[42]

Political independence, expert staff, and general agreement over the goals of monetary policy suggest that the ECB should be very much shielded from political contestation, and should thus embody a prime example of the consensus-oriented, arguments-based interaction captured by deliberative supranationalism. However, my analysis demonstrates that deliberative supranationalism has a hard time *even* in the 'most likely case'[43] of the ECB.

The empirical information for the case study stems from news sources and publicly available documents generated by the European institutions. I do not attempt a fine-grained measurement of the extent to which speech-acts of each individual actor were deliberative in individual decisions. The case studies take a more distanced and broader view, and examine whether crisis negotiations have met the minimum requirements for deliberation. To operationalise the theoretical notion of deliberation, I use a list of simple and established indicators: if deliberation prevailed, policy-makers would strive for reasoned consensus, offer arguments for their positions (referring to shared norms and rules), show willingness to being persuaded, avoid insisting on an isolated position or outright obstruction of a decision as well as avoid pushing others into isolation. If bargaining prevailed, policy-makers would rarely reach consensus, maintain inflexible positions and offer no—or only perfunctory—arguments for them, disregard collectively-shared norms and rules, engage in brinkmanship and arrive at lowest-common-denominator agreements by a quid pro quo exchange of concessions (package-deals, side-payments, log-rolling, etc). In deliberation, all Member States bear equal weight as the participants in a collective use of reason. In bargaining, large Member States may use their power to influence the outcome.[44]

[42] KR McNamara, 'Economic Governance, Ideas and EMU: What Currency does Policy Consensus have Today?' (2006) 4 *Journal of Common Market Studies* 803, 813.

[43] J Gerring, *Case Study Research: Principles and Practices* (Cambridge, Cambridge University Press, 2007) 116–19.

[44] MA Pollack and GC Shaffer, 'Risk Regulation, GMOs and the Limits of Deliberation' in D Naurin and H Wallace (eds), *Unveiling the Council of the European Union: Games Governments Play in Brussels* (Houndmills, Palgrave Macmillan, 2010) 144, 149; A Dür and G Matteo, 'Bargaining Power and Negotiation Tactics: The Negotiations on the EU's Financial Perspective 2007–13' (2010) 3 *Journal of Common Market Studies* 557, 561; Lewis, n 24 above.

V. ANALYSIS

The combination of national socio-economic diversity and centralised monetary policy played a major role in unleashing the euro crisis. The same heterogeneity also means that Member States have been affected by the crisis differently and disagree about the way in which it should be managed. The following analysis suggests that the increased level of inter-governmental conflict has frustrated deliberative supranationalism during the management of the crisis. In particular, I advance three claims: first, the Member States were stuck in distributive bargaining and therefore could not agree fast enough on decisive emergency action (Sub-section V.1.). Secondly, this *nolens volens* empowered the ECB to the point of stretching its legal mandate (Sub-section V.2.). Yet, finally, even the Central Bank's internal decision-making was affected by controversy about how financial risks should be distributed. This had implications for the effectiveness and perceived legitimacy of its decisions (Sub-section V.3.). The analysis of the negotiations on the emergency responses in the inter-governmental Council and the supranational ECB thus casts doubt on the notion that deliberative problem-solving thrives in times of crisis.

V.1. Political Stalemate and Incrementalism

It would be a gross overstatement to claim that the eurozone governments remained completely inactive in response to the crisis. In order not to put the life of the common currency at risk, the more affluent Member States have, in their own best interest, made hundreds of billions of euros available to the GIIPS in rescue loans and guarantees. Given the heretofore sacrosanct 'no bail-out' clause (Article 125 TFEU), this is nothing short of a paradigmatic innovation (and its implications are currently up for debate). Nevertheless, the initial response of the Member States was slow, incremental and ultimately ineffective. The underlying reason for this is that distributive conflict impaired deliberative problem-solving.

V.1.(a). The Greek Vortex

That the response was slow can be seen first of all from the fact that the eurozone Member States needed more than half a year to agree on providing emergency loans to Greece, the first eurozone country on the verge of sovereign default. Already in early October 2009, the newly-elected finance minister Giorgos Papakonstantinou disclosed the dismal state of the Greek finances,[45] but it was not until April 2010, after Greek bonds had been downgraded to junk status, that

[45] The preceding government had—with a little help from Goldman Sachs and JP Morgan—tweaked the fiscal statistics, meaning that inter alia the Greek deficit was more than three times higher than previously reported and would hence exceed the Maastricht convergence criteria by far.

the eurozone governments finally agreed on the details of a loan guarantee. It was the first of several 'rescue packages' to come. In the meantime, the Member States, and most of all Germany, had been reluctantly kicking the proverbial can down the road. In the beginning, they hoped that the combination of rhetorical commitments to solidarity, on the one hand, and calls to fiscal discipline, on the other, which they put forward in the 11 February 2010 informal summit meeting, would calm down the bond markets.[46]

But when these hopes turned out to be in vain, and the break-up of the euro with its transnational fallout came to be regarded as an actual possibility, the German stance changed, at least to some extent. Following a Franco-German initiative, the eurozone governments declared on 11 April 2010 that they would provide a package of co-ordinated bilateral loans in the amount of 30 billion euros, which the International Monetary Fund (IMF) would top off with another 15 billion. After the markets had reacted 'with a burst of scepticism',[47] the eurozone governments finally adopted the first Greek bail-out package on 2 May 2010, which now consisted of 110 billion euros; 80 billion in bilateral loans pooled by the Commission, and 30 billion provided by the IMF. The programme was supposed to run for three years but it had to be ramped up twice. Thus, one piecemeal response was followed by another.

V.1.(b). The EFSF: Too Little, Too Late

Instead of calming the situation, the original Greek bail-out once more renewed fears that the risk of sovereign default might spread to other European countries such as Spain, Italy, Portugal and Ireland.[48] It was at this moment that the idea of an institutionalised European rescue fund finally gained leverage. Immediately after the original emergency deal for Greece was adopted, the Member States announced the semi-permanent European Financial Stability Facility (EFSF) on 10 May 2010, a special purpose vehicle that would issue bonds backed by the guarantees on the part of eurozone Member States. It was to be large enough to cover the needs of countries such as Portugal or Ireland and thereby assure the bond markets that those states would remain able to service their debt. Under the new mechanism, the Commission, following a formal request, and assisted by the ECB and the IMF, would negotiate an aid programme with the respective country, the conditions of which were fixed in a 'memorandum of understanding'. The final decision before the EFSF is allowed to act remains with the ECOFIN Council, however, and thus firmly within the hands of the Member State governments, each of which holds a veto. Originally, the fund was charged with managing 440

[46] D Schwarzer, 'Griechenland enthuellt Schwaeche der EWU' (2010) *SWP-Aktuell*; European Council, 'Statements by the Heads of State or Government of the European Union', 4 February 2011, EUCO 2/1/11.

[47] Gocaj and Meunier, n 33 above, 239, 241.

[48] Bini Smaghi, n 32 above, 79; Mayer, n 8 above, 109; Gocaj and Meunier, n 33 above, 242.

billion euros backed by Member State guarantees in proportion to their share in the paid-up capital of the ECB. By including loans from the IMF and an existing European balance-of-payments assistance facility, the combined volume was 750 billion.

Just like the Greek aid programme, the new rescue mechanism was also amended repeatedly to keep pace with the bond market developments. The EFSF began functioning only on 4 August 2010, after sufficient Member States had confirmed their guarantee commitments. The first country to slip under the new 'rescue blanket' was Ireland. In November 2010, Ireland reluctantly accepted a 67.5 billion euro EFSF programme after the ECB had threatened to cut the lifeline it had thrown to ailing Irish banks, while the EFSF was not yet operational.[49] At this point, it was foreseeable that contagion would soon spread to Portugal, Spain, and maybe Italy. The bail-out fund had only just been set up and already needed amendment.

The negotiations about the EFSF amendment were coupled with other economic governance issues. By and large, the eurozone core, led by Germany and including Finland and The Netherlands, demanded more fiscal discipline and self-reliance. They were sceptical about another extension of the rescue umbrella. In particular, Chancellor Merkel was extremely cautious, wanting to limit the cost to the German electorate. Federal elections were held in September 2013, and several *Länder* elections took place during the negotiations of the rescue umbrellas, such as the election of the *Landtag* in the largest federal State, North Rhine-Westphalia. In May 2010, Merkel's options were also constrained by the uncertain stance of the Federal Constitutional Court, with several pending cases on the constitutionality of the bail-out measures.[50] Germany's primary goal was, therefore, to limit future bail-outs, and, instead, to strengthen the 'stability union' by de-politicising the budgetary rules of EMU. On the receiving end, the euro periphery pushed for more joint liability—be it under the EFSF structure or in the form of Eurobonds. The French position stood between these extremes, with a banking sector heavily exposed to the GIIPS debt but less constrained than Germany by the judiciary and the electorate.

The compromise was an exchange of concessions between France and Germany, the two eurozone heavyweights.[51] Accordingly, there would be future bail-outs, but the private sector was to be involved. These 'haircuts' were a strategy hatched out by Merkel's advisors to appease a domestic electorate to whom the notion of 'using taxpayers' money to bail out banks' was anathema. At first, the French President Nicolas Sarkozy had fiercely opposed this notion due to the exposure of French financial institutions to periphery debt. He was supported,

[49] Bini Smaghi, n 32 above, 167–68.

[50] H Deters, 'National Constitutional Jurisprudence in a Post-National Europe: The ESM Ruling of the German Federal Constitutional Court and the Disavowal of Conflict' (2014) 20 *European Law Journal* 2, 204.

[51] Bini Smaghi, n 32 above, 80; Mayer, n 8 above, 171.

albeit for different reasons, by the president of the ECB at the time, Jean-Claude Trichet, who, on the eve of the Irish EFSF bail-out, was struggling to re-build investor confidence. At Deauville in October 2010, during a series of sunset strolls, the President of the French Republic conceded the private sector involvement in return for the German Chancellor dropping her demand for automatic sanctions under a tightened excessive deficit procedure.[52]

The ECOFIN met the same day in Luxembourg and was, much to the assembled finance ministers' chagrin, presented with a fait accompli. With the exceptions of Finland and The Netherlands, the remaining eurozone countries could live with the fact that the excessive deficit procedure would not entirely be delegated to the Commission. But the ECB remained strictly opposed to the private sector involvement, and Trichet thus lobbied the Member States at least to dilute the haircut in order not to shatter market confidence completely. The governments did not, however, dare to pick the Franco-German compromise apart, most likely to avoid further delays. In front of journalists, Sarkozy declared the 'victory of politics over technocracy',[53] alluding to Trichet's cautioning against the potentially disastrous effects of unsettling private bondholders. At the same minute, traders began to divest their GIIPS bonds wholesale. Yield spreads between core and periphery bonds rose again, frustrating the efforts that the ECB had undertaken following the first Greek bail-out to stabilise markets with its large-scale bond market interventions in May (see Section V.1.(a)). Only after the mistake had become apparent, did Sarkozy silently instruct his technical experts to re-discuss some of the aspects of private sector involvement with the central bankers. In the December 2010 European Council conclusions, the clause about private sector involvement was, to some extent, alleviated,[54] but the issue would flare up again.

V.1.(c). The ESM: A Permanent Makeshift

When the ECOFIN approved the Irish programme, it also presented the details of a permanent fund, the European Stability Mechanism (ESM) that would run in parallel with and ultimately replace the EFSF. The new mechanism was owed to the insight that it needs more than a temporary fix to restore a crisis of confidence. In particular, Germany had, for a long time, tried to avoid a permanent rescue fund. Pressured by these developments, Member States agreed, at the March 2011 Council summit, to raise the effective lending capacity of the EFSF/ESM to 500 billion euros, to lower the interest rates by 100 basis points, and to equip the institution with bond-buying powers in primary markets. These changes notwithstanding, the new institution was not re-built from the ground up. As Gocay and Meunier observe, the 'creation and existence of the EFSF structured the

[52] C Forelle et al, 'As Ireland Flails, Europe Lurches Across the Rubicon', *Wall Street Journal*, 27 December 2010.

[53] Ibid.

[54] Bini Smaghi, n 32 above, 78–83.

subsequent terms of the debate'.[55] An initial makeshift response, that had emerged in an 'atmosphere of confusion, panic, and desperation'[56] and that was determined more by the desire of Member States to retain sovereignty than by effective crisis-management, became locked in. The ESM therefore inherited the main shortcomings of its predecessor, namely its limited firepower, which depends on the contributions of its fiscally sound Member States, and the vulnerability to its own downgrades, which depend on the credit ratings of its Member States.[57]

The reformed institution thus again turned out to be insufficient to restore confidence in the bond markets and lastingly depress borrowing costs for the GIIPS countries. Greece needed another bail-out, and in May 2011, Portugal was forced into a rescue programme as well. The issues of another extension of the EFSF/EMS structure and of how the private haircut should be implemented in the upcoming bail-out programmes were back on the agenda. In July 2011, Member States agreed to shore up the fund's capital guarantee once more from 440 to 780 billion euros. Controversy over these extensions delayed the ratification until October 2011. After considerable international pressure, the last country to ratify the extension was Slovakia, after the first attempt to muster a parliamentary majority had failed and had led to the fall of the governing coalition under Prime Minister Iveta Radičová.

The details of the second EFSF/ESM reform were hammered out at another Franco-German summit. The European accord finally presented in July 2011 was based on a position Sarkozy and Merkel had jointly drafted in Berlin. This time, Trichet also attended the meeting.[58] The second Greek bail-out was now to be conducted under the auspices of the ESM. Merkel again insisted that the private sector should participate in a re-structuring of the Greek debt. In order not to send bond markets down the rollercoaster this time, the compromise, for which the German government managed to gain the assent of national financial institutions, assured that the haircut be 'voluntary'. France conceded the haircut in return for Germany accepting additional powers for the ESM, namely, giving states precautionary credit lines even before they are cut off from the market, to re-capitalise banks, and to intervene in secondary markets. Germany had previously blocked these proposals. Also the Finnish and Dutch parliaments had been unlikely to sign the deal without a haircut. A more ambitious proposal supported by France and other eurozone countries was to prop up the rescue fund with a banking licence. The ESM's market interventions could then have been backed by the ECB's unlimited firepower. Although secondary market interventions would have been made contingent on prior assessment by the *Troika* of the IMF, the ECB and the European Commission, the German government and the *Bundesbank* rejected the notion, pointing to the risk of moral hazard. Even in its 'voluntary'

55 Gocaj and Meunier, n 33 above, 248.
56 Ibid, 243.
57 D Gros and T Mayer, 'Refinancing the EFSF via the ECB' (2011) *CEPS Commentary*.
58 Reuters (21 July 2011).

form, the haircut agreed in July amounted to a loss in value of roughly a fifth of private creditors' exposure. This was a major reason why in August 2011, investors began to ditch Spanish and Italian bonds.[59] By the end of July, Spain and Italy were paying more than six per cent for 10-year bonds.[60]

V.1.(d). Crisis Bargaining or Crisis Deliberation?

'[I]n a period of crisis, each country defends its own interests while attempting to benefit from "free-rider" tactics', maintains Michel Aglietta with respect to the euro crisis.[61] This certainly captures the narrative presented above more adequately than the notion that the crisis has pushed the European and ECOFIN Council into a mode of 'deliberative intergovernmentalism'.[62]

In terms of its effectiveness, the response of the Council has certainly not been an example of deliberative problem-solving: My analysis confirms Peter Hall's assessment, according to which the response 'has been largely unsuccessful and far more costly than it might have been if decisive action had been taken earlier'.[63] As a typical example of incremental muddling-through, the EFSF only came about after other ad hoc experiments had failed; and because it quickly turned out to be 'wholly inadequate'[64] the instrument had to be amended time and again. In many respects, it was the result of ineffective compromises on the least common denominator. Policy-makers, time and time again, failed to reach consensus. Decisions were taken in the last minute, mostly disappointed bond market expectations, and thus failed to lower the cost of borrowing in Southern Europe. Partly, the effects were even counterproductive, and with every disappointment, the promise that EU institutions were capable of resolving the crisis became less credible. Potentially more effective solutions were blocked by inflexible positions, such as the granting of a banking licence to the EFSF or any other future rescue facility, so as to back up the structurally fragile rescue umbrella with the unlimited firepower of the ECB.

In procedural terms, Council interactions even more suggested a bargaining rather than deliberative image of policy-making. Each step forward was preceded by protracted negotiations from fixed positions. The major bargains were concluded under what was euphemistically termed the joint 'leadership' of France and Germany, effectively reducing the remaining governments to mere bystanders. The Franco-German pairing moreover had little traction in itself, as it moved forward only when bilateral conflicts could be bridged via a series of package deals, as in Deauville and Berlin.

59 Bini Smaghi, n 32 above, 168; Mayer, n 8 above, 109–10.
60 Gros and Mayer, n 57 above, 2.
61 M Aglietta, 'The European Vortex' (2012) 75 *New Left Review* 15, 24.
62 Puetter, n 41 above.
63 Hall, n 9 above, 364.
64 Menz and Smith, n 6 above, 199.

The fixed positions and by extension the lukewarm, piecemeal response were due to the ultimately re-distributive quality of the issues at hand. The GIIPS countries, which suffered from excessive risk premiums demanded more time to implement economic reforms and requested increased joint liability to ease the pressure in the meantime. Core eurozone states such as Germany, Finland and The Netherlands resisted these calls. They benefited from their low borrowing costs—the flipside of the risk premiums—and rejected the notion of being held accountable for what in their view were the self-inflicted results of fiscal profligacy and other bad economic policy decisions made by foreign governments. Relatively new eurozone members such as Slovakia joined the northerners.

V.2. The ECB as a Technocratic Stand-In

The collective abdication of Eurozone governments has temporarily empowered another, supranational, institution: the ECB.

The conflictive and cumbersome political decision-making on the rescue packages delayed their implementation, left markets insecure and even had perverse effects. Spreads between Eurozone bonds kept augmenting and Southern European Member States remained more or less cut off from market funding. The failure of deliberative problem-solving thus had created a governance vacuum, and the ECB set out to fill it. The bank found itself caught between a rock and a hard place. It could either interpret its mandate tightly, strictly observe the prohibition of monetary state financing, avoid getting tangled up in fiscal policy, watch periphery states default and thereby risk the disorderly break-down of the eurozone. Or it could point to a greater responsibility (vaguely derived from Article 127 TFEU) for the integrity of the currency and adopt measures that would momentarily ease the burden on the periphery, while possibly circumventing Article 123 TFEU. On several occasions, the ECB decided in favour of a more activist stance and thereby, as German central Banker Weidmann put it bluntly, 'took up the slack' that governments had left behind when they 'deliberately avoided decisions'.[65] In addition to its standard interest rate policy, it funnelled liquidity to sovereign debtors either through the secondary market or through the banking system by means of various non-standard measures, namely (1) the Securities Market Programme (SMP), (2) Longer-term Re-financing Operations (LTROs), and (3) the Outright Monetary Transactions Programme (OMT).

(1) As noted above, the first Greek bail-out came too late, was too small, and hence only incited new nervosity. Next, Irish and Portuguese bonds came under pressure, and the EFSF was set up. It took policy-makers longer than planned, however, to get the fund working.[66] The ECB therefore began to buy the

[65] S Böll, M Sauga and A Seith, 'Mario Draghi's New Euro Rescue Plans Sow Strife in ECB Council', *Spiegel Online* (July 2012).

[66] Bini Smaghi, n 32 above, 167.

sovereign debt of troubled EMU members on the secondary market in order to bring their bond yields down. Starting in May 2010, the year following the first Greek bail-out, it acquired Greek, Irish and Portuguese bonds in the amount of some 75 billion euros. This initial bond-buying policy later became known as the 'Securities Market Programme' (SMP). The European Council, in Summer 2011, finally decided on augmenting the Greek programme and on the details of a European rescue fund. The deal was based upon the Franco-German agreement that included a 'voluntary' haircut on Greek debt held by private investors. The haircut incited nervosity among private bondholders. When Italian and Spanish bond markets came thus under pressure, the ECB begun to 'actively implement'[67] SMP. Between late June 2011 and the end of the year, it more than re-doubled the volume of government and covered bonds on its balance sheet.[68] The ECB linked its purchases of Italian and Spanish bonds to promises of fiscal consolidation and economic reform, which these countries accepted in two confidential letters, blurring the line between (supranational) monetary and (domestic) fiscal policy.[69] The intervention temporarily brought Italian bond yields down from almost 6.5 per cent to 5.0 per cent during the summer, but they went up to 7.5 per cent in November 2011, when the Berlusconi government did not implement austerity as markets and the ECB had expected.[70] While Germany and the *Bundesbank* criticised the SMP, they also rejected the ESM banking licence that would have relieved the ECB from pursuing the programme.

(2) In December 2011 and February 2012, the ECB conducted two three-year Longer-term Re-financing Operations (LTROs). These instruments ran much longer than the main re-financing operations, which have mostly two-week or one-month maturities, and they also ran longer than any LTRO before 2008, the maximum having been three months. Financial institutions were offered 1.2 trillion euros at a low one per cent interest rate. The ECB, moreover, relaxed its collateral requirements to the effect that those banks that participated in the LTROs could deposit 'bad' sovereign debt at the ECB. In particular, the ECB waived credit rating requirements for Greek, Irish, and Portuguese bonds. The stated aim of the three-year LTROs was to prevent inter-bank lending from freezing, as it did when the global financial crisis first hit Europe in 2008, and thereby keep the transmission of the ECB's interest rate policy to the real economy working.[71] However, the LTROs also encouraged financial institutions to buy government bonds, and thereby indirectly helped distressed sovereign debtors and pushed their bond yields down. Most of all, GIIPS banks used the cheap LTROs to stock

[67] European Central Bank, Statement of the President of the ECB, 7 August 2011.

[68] Bini Smaghi, n 32 above, 165–66; Drudi, Durré and Mongelli, 'The Interplay of Economic Reforms and Monetary Policy' n 11 above, 889.

[69] Bini Smaghi, n 32 above, 168–69.

[70] Mayer, n 8 above, 155.

[71] P Cour-Thimann and B Winkler, 'The ECB's Nonstandard Monetary Policy Measures: the Role of Institutional Factors and Financial Structure' (2013) Working Paper Series 1528, European Central Bank.

up on more profitable government bonds. This was the case in particular with Italian and Spanish banks. In Italy, this operation together with the replacement of the Berlusconi government by a technical government under the leadership of ex-Commissioner Mario Monti in November 2011 brought yields back towards five per cent, but it did little for Spain.[72] Since southern European banks preferred bonds of their own governments, as Hall remarks, 'an increased proportion of southern debt is now held, outright or as collateral, by the ECB, and the transnational character of financial flows in Europe has eroded'.[73] Instead of funding government debt directly, which the ECB is not allowed to do, commercial banks, as it were, functioned as intermediaries. Nicolas Sarkozy was well aware of this mechanism, when he told reporters that the ECB's huge liquidity injection 'means that each state can turn to its banks, which will have liquidity at their disposal'. The 'Sarko-Trade', as it was dubbed then, comes with side-effects. As Mayer warns, 'entire national banking sectors become dependent on the ECB funding their assets when the financial market regards the government debt these banks hold as impaired'.[74]

(3) At the end of July 2012, the height of another crisis wave, ECB president Mario Draghi at a conference in London famously announced that 'within our mandate, the ECB is ready to do whatever it takes to preserve the Euro. And believe me, it will be enough'.[75] Behind this statement stood the plan to buy sovereign bonds on the secondary market (which, in contrast to direct purchases from governments—the 'primary market'—it is allowed to do) to bring bond yields down. Financial markets and periphery states picked up this announcement with delight, seeing it as the long-awaited 'bazooka' that would finally restore confidence. Draghi's announcement was later implemented as the Outright Monetary Transactions (OMT) programme. It came after another round of bad news: Moody's had cut the outlook of its triple-A rating for the EFSF. Spanish bond yields had crossed the magical line of seven per cent, and also Italy's re-financing costs had again been steadily increasing after the two big LTROs had brought them down. Moreover, speculation about 'Grexit', the Greek exit, surged since it became obvious that Greece would hardly be able to implement the conditionalities that it had accepted in return for the second bail-out package. With an economy the size of the German State of Hesse, a Greek bail-out was manageable, but the EFSF was not large enough to bail out Spain or Italy. In early September 2012, the ECB Council decided on the modalities for the OMT programme, which supplanted the temporary and limited SMP. Under this programme, the ECB announced to buy unlimited volumes of sovereign debt from troubled eurozone members on

[72] Mayer, n 8 above, 157.
[73] Hall, n 9 above, 364.
[74] Mayer, n 8 above, 132.
[75] European Central Bank, Speech by Mario Draghi, President of the ECB at the Global Investment Conference in London, 26 July 2012.

the secondary market. The primary aim of the programme was to depress yields for Spanish and Italian bonds.[76]

V.3. The ECB Response: Activist or Constrained?

While the European Council was stuck in distributive conflict, the ECB had thus taken up the slack and implemented measures that would help Latin European governments in distress to return to the financial markets. The ECB's decisions were relatively successful, at least compared to the long-term wrangling and piecemeal approach taken by the European Council. Since the crisis was to a large extent a crisis of confidence, ie a social situation in which bad expectations fed on themselves, and thus yield spreads were no longer justified by economic fundamentals, all it took was to assure bondholders that a sovereign default was out of the equation[77]—at least as a way to buy time.[78] Hence the sighs of relief, when Mario Draghi announced the launch of his rescue helicopter in London.

A joint decision-making body like the European Council that tends to become paralysed over distributive conflicts is not able to restore confidence effectively, because investors remain insecure as to whether the next rescue package will suffice or whether and how they will be affected by some kind of debt re-structuring. When the ECB decided to apply the non-standard measures mentioned above, it could do this not because they were uncontested but because, unlike the intergovernmental European or ECOFIN Council, the ECB Council decides by simple majority and thus remains able to act even when its members disagree. In that case, the dissenters may simply be outvoted. Acting as a non-majoritarian, supranational institution, the ECB can then impose its decisions in the mode of hierarchical direction.

But while the ECB was much more flexible than the European Council, this is not to say that the bank was completely unconstrained or engaged in unfettered activism. Indeed, the ECB did not stray very far from its mandate.[79] For the bank to restore confidence, the most effective way would have been to indicate that it would buy, when push comes to shove, unlimited amounts of sovereign debt[80]—an operation that was structurally impossible for the EFSF to undertake.[81] Draghi's announcement in London that the ECB would do 'whatever it takes' was interpreted along these lines and had the desired sedating effect. A possible

[76] European Central Bank, Statement of the President of the ECB, 7 August 2011.

[77] P De Grauwe, 'Design Failures in the Eurozone: Can they be Fixed?' (2013) Tech rep 57/2013 London School of Economics, 16–18.

[78] Bini Smaghi, n 32 above, 163–79.

[79] J Yiangou, M O'Keeffe and G Glöckler, '"Tough Love": How the ECB's Monetary Financing Prohibition Pushes Deeper Euro Area Integration' (2013) 3 *Journal of European Integration* 223–37.

[80] Hall, n 9 above, 365; C Wyplosz, 'The ECB's Trillion Euro Bet' (2012), available at: www.voxeu.org/article/ecbs-trillion-euro-bet.

[81] Gros and Mayer, n 57; De Grauwe, n 77 above.

way to underwrite this commitment would have been for the bank to subscribe to a ceiling of yield spreads and to quasi-automatically engage OMT as soon as the ceiling was exceeded.[82] With the unlimited liquidity of a central bank in the background, bond markets would refrain from 'testing' the solvency of sovereign debtors, making the actual implementation of a large-scale intervention redundant. But instead, in what appears to be a back-paddling move, when, a few weeks later, on 6 September 2012, the ECB Council decided on the modalities of the OMT programme, it attached a number of conditions.

In particular, the ECB demanded that it would only purchase government debt under OMT from a country that has applied for an ESM programme and committed itself to the supervision of the Troika, consisting of the ECB, the Commission and the IMF. In Germany, the permissibility of OMT was also part of a lawsuit that was mainly directed against the ESM.[83] Hence, at least with the OMT and its connection with the ESM, central bank interventions have been re-politicised. Under the ESM treaty, the Member States decide whether a government qualifies for ESM funding. With the linkage between OMT and ESM they also decide, by extension, whether a Member State may benefit from the secondary market interventions the ECB implements under OMT. After the ESM decision of the German Federal Constitutional Court, this virtually means that the implementation of OMT is contingent on the assent of the German *Bundestag*. Depending on the normative viewpoint, the ECB thereby has been made hostage to politics (ie, inter-governmental, re-distributive conflict) or finally forced back into its narrow mandate and cut off from politics. In any case, such political conditionality limits the announcement effect of OMT. With this decision, the ECB and Member States have decided against making the central bank a lender of last resort to governments.

After the ECB first took up the slack, why has it subsequently been constrained? First, central bankers were fiercely divided ideologically and—not coincidentally—along national lines. When the ECB buys sovereign debt from illiquid Member States, its balance sheet deteriorates. As a result, Germany, first and foremost, which holds the largest share of ECB capital, but also other members of the eurozone core such as Finland and The Netherlands oppose this move. In their view, it re-distributes fiscal risk between governments and taxpayers from different Member States. Moreover, while GIIPS suffered from high-risk premiums, the

[82] Bini Smaghi, 'A Lifeline is Thrown Into Periphery' (2012) *Financial Times*; Wyplosz, n 80 above. In a similar vein, the Swiss Central Bank set a 1.2 ceiling on the exchange rate between the euro and the Swiss Franc and vowed to defend it with quasi-automatic and unlimited currency interventions in September 2011. Investors had been pulling out of the Eurozone and sought a safe haven in the Franc, thereby pushing its exchange rate close to parity; see B Eichengreen, 'Die Zentralbank als vorlaeufiger Retter', *Handelsblatt* (6 June 2012).

[83] BVerfGE, 2 BvR 1390/12 (2012). See M Everson and C Joerges, 'Who is the Guardian for Constitutionalism in Europe after the Financial Crisis?' SSRN Scholarly Paper ID 2287111 (Rochester NY, Social Science Network, 2013) and Deters, n 50 above, for a critical discussion on how the Federal Constitutional Court disregards the external effects of its judgment.

flipside of the yield spread is that states such as Germany become a safe haven. They can borrow extremely cheaply, with German *Bunds* temporarily bearing negative interest rates.

These conflicting distributive interests among governments partly extended into the ECB's main decision-making bodies. While a majority of eurozone countries were in favour of the ECB's interventions, ECB president Draghi could not completely ignore the opposition. The central bank had to strike a balance between opposing positions and hence could not actually do 'whatever it takes'. *Bundesbank* president Axel Weber and ECB executive board member and chief economist Stark were permanently isolated. In the course of 2010 to 2011, they stepped down over their principled opposition against the SMP. Also Weber's successor, Jens Weidmann, voted against OMT in the respective ECB Council session in early September 2012.[84] Thus, interactions among central bankers showed signs of bargaining rather than the truth-seeking deliberation based on common technical criteria that may be expected of discussions among independent experts. This confirms McNamara's conjecture, that 'severing ties to democratic representatives and relying on technocratic expertise does not apoliticise monetary policy'.[85]

The second constraint for the ECB's activism was the economic paradigm enshrined in the Maastricht economic constitution. According to this paradigm, monetary policy is 'constitutionalised' on the supranational plane with price stability as its only target, while each member state is to keep its own fiscal house in order. In particular, Article 123(1) expressly prohibits the monetary financing of sovereign debt. There is no exception that would permit the ECB to play the role of lender of last resort to governments in order to prevent a situation in which sovereign default becomes a self-fulfilling prophecy.[86]

In this conflictual constellation, positions remained inflexible, with German members of the governing council permanently being isolated. The ECB had to adopt its non-standard instruments with reluctance: from the beginning, it declared the SMP to be exceptional and temporary, and tied it to reform promises. Moreover, it ultimately subjected the SMP's successor, the OMT, back to intergovernmental decision-making. While the lifeline that it threw to ailing banks via the two large LTROs seems more like the long-awaited 'bazooka', it looks like a circumvention strategy. Since the ECB was neither permitted nor politically able to backstop public debt directly, it funnelled liquidity to governments through the commercial banking system—a strategy that comes with side-effects.[87]

Insecurity about its treaty-mandated competences not only further reduced the central bank's capacity to act but also challenged its credibility and legitimacy. The ECB weaselled out of legal constraints by emphasising that it purchased

[84] Bini Smaghi, n 32 above, 160.
[85] McNamara, n 39 above, 47–48.
[86] Mayer, n 8 above, 153; De Grauwe, n 77 above, 16.
[87] See Mayer, n 8 above, 157; Wyplosz, n 80 above.

state bonds only on the secondary market instead of directly from governments. The central bank argued that, since the money market was the transmission belt, which transmits interest signals to the economy, and since the crisis brought this transmission to stall, the ECB could no longer effectively control inflation with ordinary instruments only. According to the ECB, the open market operations therefore not only remained within the mandate of price stability, but were even necessary to fulfill the mandate effectively during the crisis.[88] This reasoning has been taken up with irritation.[89] The legal justification seems formally correct at face value, but critics argue that the ECB needed the 'transmission theory' as a perfunctory argument to legitimise its partial backstopping of public debt.

In conclusion, the ECB filled in the governance vacuum that the Member States had created through their distributive bargaining stand-off. However, it was not unconstrained, because the same distributive conflicts that affected ECOFIN and the European Council were mirrored in its own decision-making bodies. When the ECB acted as a quasi-lender of last resort, it was exposed to severe criticism both from within and without. Together with the vote-taking, constant isolation of German governing council members, and even their subsequent resignation, this created the image of a central bank in which delegates function as national representatives rather than supranational experts. In addition, these resignations attest to the inflexibility of positions. The extensive interpretation of its stability mandate together with the tailor-made 'transmission theory', moreover, conveyed the impression that the bank used perfunctory arguments to rid itself of legal constraints that prevented the bank from taking on a lender of last resort role and effectively backstop sovereign debt. Taken together, these observations challenge the deliberation image even of a supranational institution staffed with experts such as the ECB.

VI. OUTLOOK

I have argued that deliberative supranationalism—a core notion within CLC—has withered during the emergency response to the euro crisis. The politics surrounding the ECB's reactions to the crisis has served as empirical evidence substantiating this claim. Due to their socio-economic heterogeneity, core and periphery states have been affected differently and their policy preferences differ accordingly. The ensuing conflict is structured like a 'battle of the sexes' game with a huge conflict over distribution. Member States have therefore been deadlocked. They failed to adopt a co-ordinated response as quickly as was needed to assuage market fears. The ECB stepped in at this point and temporarily filled a dangerous governance vacuum by announcing and partly implementing several sovereign debt purchasing programmes. But conflict about the distribution of risks even

[88] Drudi, Durré and Mongelli, n 11 above, 891–92.
[89] See Ruffert, n 2 above, 1787–88.

affected deliberations inside the bank and led to bargaining from fixed positions, isolation and ultimately even resignation of certain ECB Council members. It indirectly also harmed the effectiveness and legitimacy of ECB interventions. One way of restoring these would be to accord the ECB the role of a true lender of last resort to governments, or at least to allow it to commit itself to a fixed target for spreads between sovereign borrowing costs. Core Member States reject such proposals, however, out of fear that it would ultimately pull down the boundary between a regulatory state and a fiscal union. Their arguments are understandable, but, at least to some extent, perfunctory, casting yet more doubt on the reality of deliberative supranationalism during times of crisis.

Since the ECB is an independent, supranational body staffed by experts, it is a rather likely case for deliberative supranationalism to be put into action. Hence, careful generalisation of the chapter's negative findings to other, more political venues should be possible. The political wrangling during the negotiations about the several bail-out programmes and the piecemeal, minimal compromise-fashion in which they were adopted cast doubt on the notion that the European Council has emerged as a site of 'deliberative inter-governmentalism'[90] rather than a venue of interest-based bargaining. On a more general level, the analysis confirms Lowi's old dictum, that 'policies determine politics'.[91] In the regulatory state envisioned by Majone, deliberation is probably widespread. It is in the regulators' best collective *and* individual interest to push the Pareto frontier. Regulatory problems are often pure co-ordination games, or at least distributive issues are not as salient and can be settled through diffuse *reciprocity* during repeated interaction among the same group of (administrative) negotiators. By contrast, the resolution of salient re-distributive conflicts presupposes some pre-established notion of *solidarity*. But although the delegation of monetary policy to an independent technocracy has been justified by its efficiency, it seems that at least in a crisis, monetary policy cannot be effectively de-politicised. In the crisis, central bank policy has become a stand-in for deadlocked political decision-making. Far from being purely efficient, it was criticised as fiscal policy by proxy. These political differences could be papered over during the boom period. In the crisis, they suddenly re-surfaced, and deliberative supranationalism has suffered under the increased salience of these distributive issues.

[90] Puetter, n 41 above.
[91] Lowi, n 26 above, 299.