5 Level-Specific Reforms

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

5.1 Ireland

Having experienced an impressive economic growth period in the first decade of the millennium, with a growth rate of above 5 % of GDP annually[137], Ireland's "Celtic Tiger" had lured the Irish policy-makers into a false sense of security. A range of "homegrown"[138] problems had led to an over-reliance of the Irish economy on external funding and foreign direct investment, and the housing and construction bubble of the pre-crisis years rendered the government reliant on property taxes before it burst and created major economic recession.[139] What began as a banking crisis due to struggles to generate enough liquidity from the markets soon developed into a sovereign debt crisis with competitiveness, financial, and

137 Walter, op. cit., 112–113.

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

139 Cardiff, op. cit., 102.

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

The Irish government did step in early on in the crisis years, introducing multiple adjustments before the EU intervened in an effort to ease the situation.[143] These changes included a fiscal "National Recovery Plan",[144] the establishment of the National Asset Management Agency (NAMA), adjustments to the public finance sector, and an attempted but unsuccessful financial sector reform in 2008.[145] Whilst the impact of these adjustments was limited, they proved that the Irish government was willing to take responsibility in the crisis and improve its credibility, an important attitude that enabled swift reform implementation once the EU stepped in in 2010.

The Irish EU/IMF bail-out of November 2010 came as a "breakthrough"[146] to Ireland by injecting an overall € 85 billion into the country and simultaneously imposing rigorous reforms that finally managed to have an effect: coming with strict conditionality, the EU and the IMF provided clear guidelines, deadlines, and structural benchmarks[147] on adjustments that included step by step instructions[148] on the restructuring and reduction in size of the banking sector, deleveraging, the creation of a Fiscal Advi-

140 Kitromilides, op. cit., 174.
141 Ibid.
142 Interview 2 (Interview with a senior official from the Central Bank of Ireland, conducted on 20/03/2023, online.).
143 Ibid.
144 Cardiff, op. cit., 105.
145 Interview 2.
146 Ibid.
147 Cardiff, op. cit., 107.
148 European Commission, Memorandum of Understanding on Specific Economic Policy Conditionality. Ireland. 3rd December 2010. Accessed on 17/04/2023 at: https://ec.europa.eu/economy_finance/articles/eu_economic_situation/pdf/2010-12-07-mou_en.pdf

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

By mid-2012, the Irish economy had started to grow again,[152] proving Ireland's rapid and willing implementation of the imposed reforms. The system had been successfully stabilised, with the Irish Central Bank more activist on the macro-economic front, a smaller and more resilient banking sector, and employment rates rising.[153] In sum, Ireland's dramatic crash in 2008, triggered by domestic errors and a weak banking system, was substantially reformed with the help of the EU/IMF programme. Changes that had failed to be implemented prior to the supranational intervention were finally realised and provided rapid results that allowed Ireland to return to economic growth and improved domestic conditions, exiting the bail-out programme in December 2013.[154]

5.2 Spain

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

149 Kitromilides, op. cit., 174.
150 Interview 2.
151 Walter, op. cit., 114.
152 Cardiff, op. cit., 109.
153 Ibid.
154 Walter, op. cit., 114.
155 Royo and Steinberg, op. cit., 162.

times of economic recession.[156] While the Spanish government did take action in the years from 2007 to 2012,[157] these measures turned out to lack effectiveness in the countering of the onsetting crisis, with the adjustment strategy not following a stringent plan: while the Spanish government stubbornly pursued fiscal expansion until 2009, a policy error that not improved, but deteriorated the domestic situation[158], a policy reversal was introduced in 2010 by implementing internal adjustments to the labour market, privatisation, and fiscal consolidation.[159]

These inconsistent adjustments made by the Spanish government not only had little success in improving the situation, with non-performing loans rising and a dangerous interdependence developing between the government finances and the banking system[160], but the reform efforts in Spain also faced substantial domestic opposition and constraints by a powerful lobby and veto players.[161]

It thus became inevitable, if continuedly unwanted,[162] that Spain entered an ESM-funded bail-out programme in mid–2012. This supranational aid was constructed as a partial bailout aimed specifically at restoring solvency and reforming the banking sector[163], the conditionality of the programme finally providing a "catalyst element [and] political momentum"[164] for much-needed change. The bailout, encompassing €40 billion for bank recapitalisation and the restructuring of the financial sector, triggered wide-reaching banking and taxation reforms that provided a step-change in the previously slow-moving and ineffective adjustment efforts.[165]

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156 Ferreiro, op. cit., 248–250.

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

158 Ferreiro, op. cit., 256.

159 Walter, op. cit., 124.

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

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

162 Kincaid, op. cit., 20.

163 Walter, op.cit., 124.

164 Interview 1.

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

Assessed by the IMF as introducing "dramatic"[166] improvement to the Spanish system, the reforms implemented new structural elements in all areas of the economy[167] including public administration and a complete restructuring of the weak banking system. Changes to the latter included the creation of a bad bank, SAREB, as a new asset management company, the improvement of bank regulation, expansive recapitalisation of the Spanish banks while reducing the number of *cajas*, decreased dependence of the Spanish economy on domestic demand and construction, and the improvement of risk management and transparency in the Spanish banking sector.[168]

Spain managed to exit the bail-out programme in 2013, already showing signs of recovery in economic growth, with a return to pre-crisis levels achieved by 2017.[169] In sum, having suffered from erroneous and inconsequent policy-making in the beginning years of the crisis, Spain had become dependent on supranational assistance by mid–2012. The ESM's aid, linked to strong pressure to reform and a conditionality targeting specifically the weak Spanish banking system, provided the possibility to overcome domestic reform constraints and substantially restructure the country's financial and banking sectors.

5.3 EMU

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

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

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

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

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

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

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

Policies that were aimed at pressurising member states into keeping fiscal and financial discipline such as OHIO (each member state keeping its "own house in order"), the SGP of 1997 as reformed in 2005, the no bailout clause of the treaties[174], and the Broad Economic Policy Guidelines (which remained non-binding), turned out to be insufficient to maintain the functioning of the eurozone.[175] In sum, the EMU was far from constituting a full-fledged union in all of its four pillars – monetary, financial, fiscal, and economic – with a consistent scapegoat rhetoric of weak and undisciplined southern states versus strong and responsible northern countries impeding national willingness to further unite in the years prior to the crisis.[176]

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

171 Walter, op. cit., 15.
172 Glöckler, Salines and Truchlewski, op. cit., 666.
173 Pagoulatos, op. cit., 148.
174 European Union, "Consolidated Version of the Treaty on the Functioning of the European Union of 13 December 2007", *Official Journal of the European Union*, C115, 26 October 2012., art. 125.
175 Glöckler, Salines and Truchlewski, op. cit., 666.
176 Pisani-Ferry, op. cit., 83.
177 Klooster, op. cit., 2.

of the eurozone".[178] The strategy that the EU followed in its crisis-solving endeavours was one of austerity and reform[179] which was aimed at securing the crumbling architecture of the eurozone. The urgency of the crisis allowed for prior oppositions to increased integration, notably from Germany, to falter[180], and a spill-over mechanism from one novel policy or institution to another helped accelerate the process.[181]

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

On the financial level, the establishment of a banking union in 2012 came as a "breakthrough"[183] in the crisis, introducing supranational supervision and resolution capacities by the ECB instead of the previously national responsibility for these tasks. The ECB, exploiting its treaty-given mandate of independence[184], introduced a range of unconventional measures including a more generous monetary policy as well as interest rate reduction[185], arguably making the ECB the most powerful supranational body and a "self-empowered" supranational bank supervisor.[186] Financial surveillance and prevention was heavily increased by establishing new permanent institutions on the European level, including ESM (which replaced

178 Interview 6 (Interview with academic in the field of European Political Economy, conducted on 22/03/2023, Bruges.).
179 Pagoulatos, op. cit., 150.
180 Schimmelfennig, op. cit., 330.
181 Schwarzer, op. cit., 38.
182 Klooster, op. cit., 6–7.; Heldt and Müller, op. cit., 91.
183 Pisani-Ferry, op. cit., 149.
184 Heldt and Müller, op. cit., 84.
185 European Parliament, op. cit., 11–12.
186 Heldt and Müller, op. cit., 83–84.

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

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

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

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

187 Schwarzer, op. cit., 30.

188 Pagoulatos, op. cit., 151.

189 Andor, op. cit., 236.

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

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

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

190 Kincaid, op. cit., 35.

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