

## 6 Test of Hypotheses

Having outlined in the previous chapter the reforms and adjustments that Ireland, Spain, and the EMU implemented over the course of the crisis, this chapter now applies this empirical evidence to the hypotheses presented in chapter 4, thus testing whether this paper's claims are justified. To this end, the theoretical arguments for each hypothesis shall be put into connection with the real-world reforms introduced on the respective level as outlined in chapter 5, explaining the mechanisms which enabled the changes and testing whether the argued interconnections really exist.

### 6.1 H1 – Interdependence between National and European Reform

**“Because the failure of one or more countries impacted the whole union in a mechanism of interdependence, reform solutions were enabled only in a constellation of mutual influence.”**

H1 claims that the ability to reform the weak banking sectors and the fiscal governance in Ireland and Spain relied on the influence exercised by the supranational level. At the same time, changes made to the surveillance and coordination instruments of the EMU equally depended on the willingness to delegate these competencies from the national level to the European level. H1 argues that as both levels faced substantial constraints to their ability to reform in the years prior to the crisis, they each had to break out of their reluctant attitude at the same time to achieve

the changes they desired in the other. Due to the complicated preference constellation and qualms to change their existing frameworks, each level had to make concessions to the other to avoid a deadlock situation where none of the two would budge.

The reason why the situation had become untenable both in Ireland and Spain and in the EMU once the crisis hit lies in their fragile systems of insufficiently complete architecture, tainted with repeated policy errors that rendered them even more fragile and lacking resilience. On the European level, this weakness was characterised by an incomplete degree of integration where only the monetary pillar of the EMU was strongly enforced while the financial, economic, fiscal, and political pillars suffered from lacking comprehensiveness.<sup>191</sup> Additionally, the EMU had made policy errors by carelessly underrating the importance of exercising surveillance and monitoring of its member state governance: no centralised monitoring instrument had been implemented before the eurozone crisis, with the EMU relying in good faith on the member states' discipline to keep themselves in order in absence of a supranational body.<sup>192</sup> Additionally, by being insufficiently foresightful regarding the possibility of a crisis to the eurozone, the European level rendered itself unprepared once the crisis started, forced to act quickly to implement in a context of urgency and pressure the range of instruments that it had failed to introduce beforehand. An additional weakness to the EMU was the constraint it faced internally by its members and policy-makers: famously, Germany opposed any notion of further (fiscal) integration and some of its allies followed this preference.<sup>193</sup> The treaties prohibited any bail-outs or monetary financing to eurozone members on principle<sup>194</sup>, forming an additional difficulty to enabling the secure functioning of the eurozone in the case of failure of one or more member states.

Just as the EMU thus can be shown to have borne many limitations, both Ireland and Spain portrayed similar fragility on the national level: for both of them, the adherence to the eurozone lifted the previous-

191 Glöckler, Salines and Truchlewski, op. cit., 665–666., Otero-Iglesias, op. cit., 350.

192 Glöckler, Salines and Truchlewski, op. cit., 666.

193 Copeland and James, op. cit., 9.

194 Art. 123 and 125 TFEU.

ly extant responsibility to manage themselves and ensure national fiscal discipline.<sup>195</sup> Spain in particular had faced substantial domestic opposition to attempted reforms prior to the crisis<sup>196</sup>, rendering the government unable to implement urgently needed change before disaster struck: fiscal consolidation, paired with wage cuts, a reduction in public spending, tax raises, and increased risk of poverty, were powerfully lobbied against in Spain.<sup>197</sup> Furthermore, the Spanish government reacted unwisely to the onset of its economic recession by promoting fiscal expansion in 2009 when all indicators pointed towards the necessity of introducing austerity and fiscal contraction.<sup>198</sup> Similarly, Ireland also made a range of bad decisions in the dawn of the crisis, providing a government blanket guarantee to two its major banks, Anglo-Irish and Irish Nationwide Building Society, in 2008<sup>199</sup> and being dependent early on the ECB and the Central Bank of Ireland to provide liquidity to national banks unable to raise funds from the market.<sup>200</sup>

Far from being purely internal domestic weaknesses in Ireland and Spain that would not affect the eurozone as a whole, there existed a realistic risk of contagion from one country to another, creating the link from the national to the supranational level: Spain forming the fourth-largest economy of the eurozone created a high dependence of the EMU on the good functioning of the Spanish governance<sup>201</sup>, but the risk of moral hazard prevented the European level from simply providing financial support to the failing country due to the danger of inadequate discipline of the aided country once bailed-out.<sup>202</sup>

Thus, in line with H1's claims, both levels had to break out from their weak and constrained architecture, implementing change in order to incentivise the other level to similarly do so: Ireland and Spain were

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195 Hemerijck and Matsaganis, op. cit., 11/41.

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

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

198 Ferreiro, op. cit., 257.

199 Walter, op. cit., 113.

200 Kitromilides, op. cit., 174–176.

201 Interview 6.

202 Brunnermeier, Markus Konrad, Harold James, and Jean-Pierre Landau. 2016. *The Euro and the Battle of Ideas*. Princeton: Princeton University Press., 4.

under pressure to finally introduce reforms as a prerequisite to receive financial assistance from the European level, while at the same time the EMU was forced to create the supervisory and coordination bodies that such assistance would require. Each level thus held substantial bargaining chips that forced the other level to adjust, creating the spiral of perpetuated reform that H1 supports.

The precise mechanisms of mutual pressure-building and pressure-receiving in the cases of Ireland, Spain, and the EMU can be described as thus:

Firstly, Ireland and Spain both desperately required financial aid from external bodies during the crisis, if at different times. Ireland having made the mistake of creating a blanket to its banks and thus creating a full-fledged sovereign debt crisis from the initial banking crisis<sup>203</sup> applied for a bail-out in 2010, while Spain circumvented such measures until 2012, when its insufficient reform efforts forced it to formally request help. The EMU agreed to provide such funding and bail-outs only under strict conditionality that required dedicated willingness and discipline in Ireland and Spain to reform, a no-nonsense approach that dismissed any half-baked changes such as the ones previously introduced by the Irish and Spanish governments. The bail-outs were thus no free-rides for Ireland and Spain, coming with targeted ambitious demands for reform from the European side. Thus, Ireland received clear instructions by the ECB and IMF to restructure and deleverage its banking sector, reduce public spending, follow a line of fiscal consolidation, and strengthen monitoring by establishing the Fiscal Advisory Council.<sup>204</sup> Spain, when receiving its partial ESM bail-out, was obliged to restructure and recapitalise its banking system, notably by reducing the number of weak *cajas* and establishing a “bad” bank, SAREB.<sup>205</sup> Reform hence was not an option, but a requirement for Ireland and Spain, clearly linked to the EMU intervention and enabled only, after years of half-fledged adjustments, by the imperatives of the European level.

203 Kitromilides, op. cit. 174.

204 Ibid.

205 European Commission, Memorandum of Understanding on Financial-Sector Policy Conditionality. Spain. 20<sup>th</sup> July 2012. Accessed on 18/04/2023 at: file:///C:/Users/Clara/Downloads/pol\_guide\_to\_referencing\_2022-23-7.pdf

The austerity and harshness of the supranational level towards Ireland and Spain came however as a necessity stemming from equal pressure on the EMU to perform: the risk of contagion with the ensuing possible collapse of the euro and a lack-of-confidence-spillover from the national to the European level<sup>206</sup> forced the EMU to act quickly and effectively in a short span of time. Bail-outs and monetary funding were formally prohibited by the treaties, and many of the non-standard measures that the ECB applied were deeply criticised within the eurozone as going beyond its official mandate.<sup>207</sup> Thus, the supranational level became pressurised to create credible institutions<sup>208</sup> that would formalise the intervention by the ECB and by the EMU intervention. Furthermore, such institutional reform was a technical necessity on the European level to be able to provide the supervisory and coordinative authority that it exercised by way of imposing reform on the national level: only a strong European architecture, after all, would justify demands for a similarly strong national architecture. Thus, the EMU introduced a range of measures over the course of the crisis, aimed at improving the monitoring, surveillance, and financial governance capacities at the European level. Most notably, the banking union was established, a move that would have been inconceivable had the crisis not taken place<sup>209</sup>, creating a single rulebook and authority (EBA) to improve the financial pillar of the EMU. Surveillance was enabled by the establishment of institutions including EFSF and EFSM, later to be replaced by ESM, and the SSM and SRM mechanisms. Fiscal legislative packages such as the SixPack and the TwoPack, as well as the Fiscal Compact, a reformed SGP, and the European Semester, all provided improved monitoring and disciplining measures on the EMU level.<sup>210</sup> To better coordinate national policies, the Euro Plus Pact and Europe 2020 were introduced. Thus, the interconnection between national and European policy-making was decidedly strengthened with a substantial range of new institutions, instruments, and measures over the course of the cri-

206 Interview 4 (Interview with a senior official from the ECB, conducted on 31/03/2023, Bruges.).

207 Heldt and Müller, *op. cit.*, 94.

208 Schöller, *op. cit.*, 84.

209 Interview 5.

210 Bauer and Becker, *op. cit.*, 216–225.

sis. While these innovations had been unimplementable before the crisis due to the constraints of opposing member states, heterogeneous national preference constellations, and a reluctance to introduce wide-reaching financial and fiscal centralisation, these restraints were lifted in the crisis context: the member states, including Germany eventually,<sup>211</sup> aligned in their common preference to save the euro, forming an enabling ground for deeper change, and the pressure by the market added to the EMU's ability to adjust its architecture and actions. Reforms were the only solution to save the common currency and the functioning of the eurozone, and the crisis allowed for this change to be made whatever the prior impediments,<sup>212</sup> as reflected famously in Draghi's "Whatever it takes" speech.

While a substantial amount of pressure was thus at play between the member state level and the European level, the reforms were equally *facilitated* rather than coerced by the respective other level. This becomes apparent when taking into account the domestic opposition to reform that notably Spain had faced prior to the crisis<sup>213</sup>, with only incremental change having been implemented in the labour market<sup>214</sup>, and none in the banking sector, before the ESM's intervention in 2012. Similarly, Ireland failed to introduce real change in 2008 when it attempted to reform its financial sector<sup>215</sup>, showing that while a certain will to change existed, it had been constrained by domestic factors both in the Irish and in the Spanish case. When the European level took the initiative to finally implement change in Ireland and Spain through its bail-out conditionality, it thus eased the national restrictions by, to a certain extent, taking over the accountability and responsibility for these unpopular reforms.<sup>216</sup> By delegating decisions and competencies to the European level, Ireland and Spain thus gained the leverage to introduce reforms.

211 Schimmelfennig, op. cit., 330.

212 Westlake, op. cit.

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

214 Carlos Cuerpo, Federico Geli and Carlos Herrero, "Some unpleasant labour arithmetics. A tale of the Spanish 2012 labour market reform" in *Economic Crisis and Structural Reforms in Southern Europe : Policy Lessons.*, eds. Paulo Manasse and Dimitris Katsikas (Abingdon, Oxon: 2018), 140–144.

215 Interview 2.

216 Schimmelfennig, op. cit., 334.

Finally, the EMU experienced a similar facilitation of reform by the pressure imposed through the failing member states: the struggles of countries such as Ireland and Spain gave the European level an excuse to finally deepen integration, a project that had stalled in the previous years, and that was now imposed on the EMU by the member states increasingly relying on its support: the willingness of Ireland and Spain to delegate competencies to the European level and grant it surveillance and coordination capacity required in turn a credible and well-functioning EMU to manage these increased powers. Thus, Ireland's and Spain's reliance on the European level facilitated the creation of reforms such as the banking union, ESM, and SSM as well as the fiscal disciplining instruments.

The assumptions made by H1 have been tested by applying them to the real-world changes made in Ireland, Spain, and the EMU and finding a distinct connection between the creation of reforms and the dependence of one level on the other. Change in Ireland and Spain became possible only when the European level intervened, and reforms to the EMU were simultaneously enabled due to the member states' dependence. Thus, H1 has been verified, confirming the claim of a spiral of mutually perpetuated reform towards a positive development of deeper integration in all four pillars of the EMU. It remains important to emphasise, however, that H1 does not claim completeness of the EMU as each area still lacks instruments towards full integration: within the banking union, no single deposit guarantee scheme or single resolution mechanism exists, and an added fiscal capacity to overcome the problem of "currency without state"<sup>217</sup> remains to be implemented.<sup>218</sup> However, the advancements made within the eurocrisis, thanks to the mutual incentivisation of the member state and the European level, form an important step in the direction of full EMU integration.

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217 Pagoulatos, *op. cit.*, 152.

218 Otero-Iglesias and Steinberg, *op. cit.*, 237.

## 6.2 H2 – European Influence on National-Level Reform

**“The Irish and Spanish economic and banking failures necessitated EU intervention to implement national reforms due to domestic constraints to change.”**

Having verified with H1 the claim that an interconnection between the European and the member state level existed to promote reform in the respective other level during the eurozone crisis, H2 shall now be tested. This hypothesis focuses on the member state level specifically, aiming to outline which were precisely the mechanisms influenced by the EMU that enabled Ireland and Spain to implement change.

For both countries, H2 argues that a weak architecture of the national financial and fiscal governance and fragile economic set-up, depending heavily on unstable factors, led to a pre-crisis economic growth that created a false sense of security in both Ireland and Spain. Subsequent reform efforts by the Irish and Spanish governments failed due to substantial domestic opposition – as in the Spanish case<sup>219</sup> – and policy errors – as in both cases.<sup>220</sup> Due to this insufficient national capacity to introduce adjustments, both Ireland and Spain became dependent, at different moments of time, on financial and reform assistance by the EMU. Change was, in fact, a condition of the Irish and Spanish bail-outs, meaning that the European level both functioned as a pressurising and facilitating entity to implement change in Ireland and Spain. This mechanism of national dependence on the European level to enable domestic reforms is the core argument of H2 which shall be tested in the following by applying it to the real-world happenings of the crisis in Ireland and Spain.

Ireland represented all elements identified by H2 as crisis-driving<sup>221</sup> in the years prior to its onset, including a weak national architecture in the banking and structural sector, lacking incentive to introduce national reform due to a strong economic growth that however relied on excessive external financing, and numerous policy mistakes that did not reduce,

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

220 Ferreiro, op. cit., 247–248.; Kitromilides, op. cit., 180.

221 Cf. chapter 3.



but increased the susceptibility to failure.<sup>222</sup> More specifically, the weak Irish banking system stemmed from its high dependence on the housing and construction sectors,<sup>223</sup> an insufficient supervision of the national banks, and a high level of deficits and indebtedness of the banks.<sup>224</sup> To counter this problem, the Irish government introduced a blanket guarantee in 2008 which turned into a vicious circle where the government and the banks became interdependent, Ireland thus increasingly relying on ECB credit in absence of a clear resolution strategy.<sup>225</sup> What had started as an internal banking crisis became a sovereign debt crisis, including financial, fiscal, and competitiveness elements.<sup>226</sup>

Reforms that the Irish government tried to introduce following these dangerous developments included the nationalisation of the Anglo-Irish bank, many smaller bank recapitalisations, and the establishment of the NAMA.<sup>227</sup> These instruments proved the Irish willingness to adjust, but failed to provide sufficient solutions to the country's struggles.

Thus, it was only when the European level stepped in after Ireland's application for a bail-out in 2010 that the path for far-reaching reforms was paved through the conditionality which was linked to the EU's and the IMF's financial assistance. The conditions that the bail-out set included a wide range of reforms to the Irish financial and fiscal management and to its public administration, leaving Ireland no choice but to finally adjust these areas. The reforms which the supranational level imposed on Ireland included mainly two areas, the banking sector and public finances.<sup>228</sup> For the former, bank recapitalisation and stabilisation were introduced, reducing the size of the sector by merging banks and decreasing staff numbers, and an alignment of assets with deposits was undertaken; while for the latter, the budget deficit was reduced, VAT and vehicle taxes

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222 Kitromilides, op. cit., 180.

223 Cardiff, 98–100.

224 Kitromilides, op. cit., 176–179.

225 Eichengreen, op. cit., 114.

226 Kitromilides, op. cit., 174.

227 Cardiff, op. cit., 103.

228 “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>

increased, and capital spending limited.<sup>229</sup> Additionally, increased financial regulation and supervision were introduced as well as fiscal budget consolidation. On the institutional level, the Irish Fiscal Advisory Council was created.

While these reforms came as a strict condition for the EU/IMF bail-out and thus put the Irish government under substantial pressure, they aligned with the existing Irish willingness to introduce changes to its architecture and to commit to reforms.<sup>230</sup> Providing clear guidelines and instructions, the EMU served as a facilitating entity to enable the much-needed adjustments. Where Ireland had attempted but failed in the early crisis years to adapt its banking system and fiscal governance, it was able to transfer a certain responsibility to the European level by accepting its bail-out and connected conditionality. The result was a rapid implementation<sup>231</sup> of the changes and a subsequent fast recovery of the Irish economy, with a clear upwards trend in employment rates and economic growth established by late 2013 and an Irish banking sector characterised by increased oversight, an improved ability to invest, and strengthened confidence.<sup>232</sup>

Just as in the Irish case, the ingredients for domestic struggles that eventually led to dependence on the European level were present in Spain, if under different circumstances: the Spanish banking sector, built on a large number of insufficiently diversified *cajas*, provided weak support to an economy that fuelled its growth with a massive inflow of capital and external funding.<sup>233</sup> Rather than tackling these weaknesses, the Spanish government however relied for too long on its economic surge, lacking the incentive to reform its system early on. An additional difficulty was the wrong diagnosis<sup>234</sup> of its struggles by the Spanish government once its weaknesses became apparent, pursuing fiscal expansion until 2010 rather than consolidation, and introducing disciplining measures late and to little effect, such as labour market regulation and privatisation.<sup>235</sup> The

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229 Ibid.

230 Eichengreen, op. cit., 18; Interview 2.

231 Walter, op. cit., 114.

232 Cardiff, op. cit., 110.

233 Ferreira, op. cit., 247.

234 Otero-Iglesias and Steinberg, op. cit., 232.

235 Walter, op. cit., 124.

Spanish struggles to implement reform were further increased by a high level of domestic constraint that created another powerful barrier to the improvement of the national situation.<sup>236</sup>

The result of these circumstances combined was a low level of economic growth paired with high unemployment, an inefficient labour market structure based on unsustainable collective bargaining, and lacking fiscal adjustment.<sup>237</sup> With the national banks holding too much government debt, an interdependence between the sovereign and the banks developed similarly to that in Ireland, leading to bank insolvencies and a doom loop that could only be broken by the assistance of an external body. Thus, as in the Irish case, the European level became the funder that Spain relied on, accepting a partial ESM bail-out in 2012 after having circumvented such measures in the previous year.<sup>238</sup>

The financial dependence on a bail-out thus rendered Spain, after years of incremental reform and lacking political will to change, unable to resist adjustments any longer as the ESM assistance was linked to the targeted condition of restructuring the Spanish banking sector. Spain was able to overcome the restrictive national mood opposing reform by delegating authority to the supranational level and ridding itself of exclusive accountability and responsibility. The urgency of the crisis, which threatened not only the future of the national economy but also its common currency, and the past failures of having insufficiently addressed the weaknesses of its own system, allowed Spain to regard the EMU not only as a pressurising entity, but as one enabling reform when it had been previously impossible. Quite contrary to an assessment as coercive, the Spanish government used the pressures by the European level strategically as a window of opportunity to finally make the change that it had intended but failed to implement in the previous years.<sup>239</sup>

A factor that benefitted Spain was the fact that its important role as the EU's fourth-largest economy, creating a strategically vital member state of the eurozone, influenced the conditionality of the Spanish bail-out

236 Royo and Steinberg, *op. cit.*, 177.

237 Ferreiro, *op. cit.*, 249–250.

238 Kincaid, *op. cit.*, 20.

239 Cuerdo, Geli and Herrero, *op. cit.*, 144; Royo and Steinberg, *op. cit.*, 177.

in a favourable way: targeted uniquely at restructuring its banking sector, the conditionality imposed on Spain was less harsh than that linked to bail-outs in other failing member states.<sup>240</sup> The changes that the ESM instructed Spain to introduce in its banking sector nevertheless created a far-reaching restructuring of the system, including the establishment of SAREB as a “bad” bank tasked with managing toxic assets, improving the sector’s transparency and risk identification, and managing legacy assets.<sup>241</sup> By setting a clear timeline and pushing for the rapid implementation of these measures, the ESM created a framework for Spain to credibly commit to reform without the limitation of domestic opposition. Thus, the country’s employment rates, economic performance, and banking sector managed to start recovering from mid-2013.<sup>242</sup>

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Both Ireland and Spain thus proved to rely on European assistance in the implementation of reforms and the subsequent revival of their economies based on improved banking sectors and fiscal discipline. H2 can be regarded as verified, having shown that the member state level became heavily dependent on the EMU to adjust their domestic systems due to national constraints, structural weaknesses, and policy errors having impeded such reform in a national capacity. The financial dominance of the supranational level and the authority that it brought along hence allowed for the EMU to impose changes on Ireland and Spain that had continuously been questioned and failed on the domestic level beforehand. In sum, H2 has thus proven the dependence of the national level on the European level in the creation of domestic change to the banking and economic sector.

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240 Walter, op. cit., 131.

241 European Commission, Memorandum of Understanding on Financial-Sector Policy Conditionality. Spain. 20<sup>th</sup> July 2012. Accessed on 18/04/2023 at: [file:///C:/Users/Clara/Downloads/pol\\_guide\\_to\\_referencing\\_2022-23-7.pdf](file:///C:/Users/Clara/Downloads/pol_guide_to_referencing_2022-23-7.pdf)

242 Royo and Steinberg, op. cit., 170–174.

### 6.3 H3 – National Influence on EMU-Level Reform

**“Reforms to the EMU’s incomplete state at the time were facilitated by national failures, combined with the need for effective results.”**

The final element that remains to be analysed is the EMU and the mechanisms that allowed it to introduce reform during the crisis after having refrained from further integration in the financial and fiscal fields for many years. H3 claims, in a mirrored argument of H2, that the EMU was similarly dependent on the member states to enable reform on the supranational level as the member states relied on the European level to implement domestic change.

One of the main reasons why member state failure became possible so dramatically and in such a high number of countries at the same time lies in the fact that the eurozone states were intertwined, yet incompletely integrated when the eurocrisis set in. Having delegated competencies to the European level, the member states had committed to a dependence on the EMU in the hopes of benefitting from the common currency and the centralised governance that the euro brought with it. However, this union remained incomplete, with oversight, coordination and regulation lacking.<sup>243</sup> In a relationship characterised by the reliance of the member state on the authoritative body of the EMU, this incompleteness turned out to be a dangerous risk to the functioning of the union and to the entire existence of its shared currency and governance.

Due to the lack of surveillance and harmonisation, an imbalance developed over the years prior to the crisis between the imperatives of the EMU and the applied national policies,<sup>244</sup> meaning that member states did not follow the same line of financial and economic governance due to the lack of centralised organisation. The result was a non-integrated set of semi-independent member states whose diverging policies were not connectable on the European level. The weak coordination of the Irish financial governance with the European level, including the establishment of a blanket guarantee for failing banks by the Irish government in 2008

243 Pagoulatos, op. cit., 152.

244 Henning, op. cit., 178.

without consulting the EU,<sup>245</sup> is one example, just as much as the Spanish unwillingness to delegate responsibility to the EMU level as late as 2011 when the Spain successfully aimed to circumvent an EMU-funded bailout and preferred to keep policy-making national.<sup>246</sup> It was, however, not only lacks on the side of the member states that impeded comprehensive coordination between the national and the European level, but also faults on the side of the EMU: the Committee of European Banking Supervisors (CEBS) – the predecessor of the EBA – failed to sufficiently scrutinise the Irish banking sector, just as the IMF did not pay enough attention to the Irish lending and control practices.<sup>247</sup> Thus, the pre-conditions of the EMU before and at the beginning of the eurozone crisis were wanting, with the incompleteness of the union due to lacking oversight and coordination perpetuating the developing troubles in Ireland and Spain.

Furthermore, the EMU did not possess the necessary instruments, and thus the ability, to fulfil its task as a supervisor and coordinator. Monitoring, regulation, disciplining measures, and thus the creation of a sense of union all failed to be achieved sufficiently by the European level<sup>248</sup> due to this architectural weakness of an authority lacking implementing tools. Before the crisis, few to no institutions existed to formalise the supervisory and harmonising competencies of the EMU, rendering it useless to counter any crisis that threatened the financial and economic integrity of the eurozone. Efforts to reform the EMU and further integrate it had been heavily restrained in the past by diverging member state preferences, first and foremost by Germany who followed an austere and “Ordnungspolitik”-oriented line of national self-responsibility in the financial and economic areas, a constraint to integration that was enhanced by member states’ reluctance to delegate powers to the supranational level.

Thus, in a paradoxical combination of elements, the eurozone crisis came as a favourable window of opportunity to an EMU that was in dire need to change but had been heavily restricted in doing so by its own members in the previous years. With the common currency under

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245 Eichengreen, *op. cit.*, 112.

246 Kincaid, *op. cit.*, 18.

247 Eichengreen, *op. cit.*, 111–112.

248 Andor, *op. cit.*, 226–227.

threat and failing member states turning to the European level for help, an intervention by the EMU became necessary in order to save the struggling countries. This interference, in turn, finally offered the EMU the possibility to strengthen integration. With the eurocrisis creating a legitimacy crisis to the EMU<sup>249</sup>, after all, only a strengthened and more credible EMU would be in a position to provide adequate assistance to the weakened member states. Change to the European level, so the rationale, was a pre-requisite to the saving of the single member states including Ireland and Spain, the reform to the EMU thus acquiring its legitimation through the delegation of responsibility from the national to the European dimension.<sup>250</sup> With the high risks at stake, the EU became liberated from previous constraints to increasing its competencies because the crisis urgency meant that “the ends (above all, overcoming the crisis) ha[d] to justify the means”<sup>251</sup>.

The mechanisms that enabled reform on the supranational level hence stemmed from the member state level, with prior constraints being lifted from the EMU and the ECB<sup>252</sup> due to the urgency of the crisis and subsequent decreased opposition by the member states to an adjusted line of action by the EMU.<sup>253</sup> Additionally, the increased emergence of the EMU as the only entity able to provide guidance and financial assistance in the eurozone crisis granted it a parallel surge of legitimacy and power,<sup>254</sup> paving the way for reform to be accepted as a credible commitment by the European level.

Reform thus became possible in the light of the need for a strengthened EMU as a condition to help the struggling member states, leading to a range of adjustment in many policy areas on the supranational level: cen-

249 Scicluna, *op. cit.*, 1884.

250 Interview 4.

251 Martin Westlake, EECS Secretary General, speech, 03–04/05/2012, Dublin meeting of the Secretaries General of the national Economic and Social Councils and the European Economic and Social Committee. Accessed on 28/04/2023 at: <https://www.eesc.europa.eu/ceslink/sites/default/files/toolip-old-resources/docs/4-may-2012-dublin-speech-mw-to-national-esc-sgs.pdf>

252 Schwarzer, *op. cit.*, 35.

253 Schimmelfennig, *op. cit.*, 330; Schwarzer, *op. cit.*, 34.

254 Heldt and Müller, *op. cit.*, 83; Schöller, *op. cit.*, 81.

tralised supervision was strengthened by institutions such as SSM, ESRB, and ESM; supranational coordination of national policies was improved by introducing the SixPack, the TwoPack, the Fiscal Compact, the European Semester, and by reforming the SGP; better regulation was enabled by the establishment of a banking union including the Single Rulebook, the Single Resolution Mechanism (SRM) and the Single Supervisory Mechanism (SSM); funding mechanisms were introduced with ESM, the European Resolution Fund (ERF), and in the form of non-standard measures, such as OMT, SMP, bail-outs, and the ECB's new function as a *de facto* lender of last resort.<sup>255</sup> Through these new instruments and institutions, the EMU thus managed to implement measures that improved its oversight of the financial governance on the member state level, strengthened budgetary discipline by increased monitoring capacities, and coordinated national policies by creating designated supranational tools.

In a mechanism of interconnection, the EMU hence reached an unprecedented level of integration in its four pillars, developing the ability to assist member states including Ireland and Spain in their recovery by improving its own architecture, which in turn was enabled by the specific context of member state failure. Applied to the cases of Ireland and Spain, it becomes apparent how the EMU's reforms were connected to the crisis situation on the national level: demanding change in the banking and structural systems of Ireland and Spain, the EMU needed to provide an accordingly strong banking system to appear credible, thus introducing the banking union with its harmonised regulation and recapitalisation instruments. Similarly, requests for member states to reform their national fiscal policies was reflected on the European level by the improvement and establishment of fiscal instruments such as the SixPack and the TwoPack. Criticism of Ireland's and Spain's lacking supervisory capacities only became credible once the EMU established its own monitoring bodies with ESM and ESRB, and a centralisation of the national banks and financial entities required a parallel institutionalisation of the European authorities, for example the EBA.

Thus, just as Ireland and Spain experienced both pressure and facilitation by the European level to implement reform, the EMU found itself in

255 Hemerijck and Matsaganis, *op. cit.*, 42; Bauer and Becker, *op. cit.*, 216–225.



the analogous situation: under pressure to assist its failing member states and to rescue the common currency, the EMU was forced to implement change that had been previously impossible to achieve, while the lifted reform constraints on the supranational level and the subsequent freedom to act enabled it to introduce new and unprecedented measures.<sup>256</sup> A strong and reformed EMU was needed by Ireland and Spain to help them out of their troubles, while at the same time the EMU required the severity of their national failures to give it an adequate excuse to implement substantial change.

In sum, the EMU thus managed to introduce adjustments due to the struggles of its member states including Ireland and Spain to all four of its pillars, with the banking union forming the most important change to the financial pillar; more discipline and monitoring through the legislative packs, the Fiscal Compact, and the reformed SGP strengthening the fiscal pillar; the economic pillar being improved with the European Semester; and the already strongly integrated monetary pillar experiencing adjustments through previously inconceivable financing tools via the ECB's unconventional measures. Thus, even though the political union that the EMU ideally constitutes<sup>257</sup> still awaits its completion today, the changes introduced to the EMU in the eurozone crisis rendered this project more realistic.

The EMU exited the crisis with a stronger architecture and improved crisis resilience stemming from a window of opportunity created by member state struggles. H3 has thus been verified, showing that the national level influenced reform on the European level in a mechanism of influence and facilitation. Measures used to counter the later Covid19-crisis by adapting eurocrisis instruments, such as the Pandemic Emergency Purchase Programme (PEPP), prove the sustainability and longevity of the changes introduced to the EMU's policy-making in the eurozone crisis. With the Covid19-crisis presenting a similar pathology to the eurozone crisis<sup>258</sup>, the programmes applied in this crisis – PEPP constituting a facilitation to government borrowing and circumventing the prohibition of

256 Schwarzer, op. cit., 35.

257 Jager, op. cit., 288.

258 Pagoulatos, op. cit., 155–156.

primary debt purchases – show that the changes introduced in the euro-crisis were made to stay. Thus, a stronger and more crisis-resilient EMU has been proven with H3 to be the result of an interdependence with the member state level, hereby completing the spiral of mutually perpetuated reform that this paper conceptualises.