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Sharing the Eurocrats' dream: a demoicratic approach to EMU governance in the post-crisis era

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Prologue: an iron cage in a bubble

We do not need to master the skills of *Inception's* hero, Leonardo DiCaprio, to understand the Eurocrats' dream. The dream involves flying over the plains, rivers and mountains of Europe on a constant mission to monitor and battle the dark shadows. In other words, to protect the European common good entrusted to them by the Treaties against the uncertainties of globalization, the selfishness of markets and the short-termism of politics. Europe's citizens often seem to be on the same wavelength, with their huge distrust of politicians, abandonment of political parties and worries about the fate of their children. Eurocrats are here to make Europeans' dreams of security and prosperity come true.

Why then should we remotely wish to tamper with the Eurocrats' dream? The reasons go back a long way indeed, we believe, to the foundational moment itself: our Eurocrats' rationalization of their desire to 'govern at a distance'. One could argue that the temptation to govern at a distance was a trope inherited from good old imperialism of yesteryear (Behr 2015, Nicolaïdis and Fisher Onar 2015). But in its post-war functionalist guise, such rationalization had much going for it. Weber had famously heralded organized bureaucratic hierarchies as the most efficient and rational way to organize human cooperation, maintain order, maximize efficiency and eliminate favoritism. Functionalists saw peace as only attainable by

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restructuring transnational links between bureaucracies along functional lines and deliberately excluding nationalistic publics organized within state boundaries from this worthy project. Belief in bureaucratic expertise serving complex coordination and legal sophistication needs became the powerful underpinnings of the Eurocrats' ambition to govern at a distance under the broad messianic conviction that worthy ends can justify contestable means. And, indeed, the supranational version of functionalism with its many checks and balances against abuse of central power seemed to absolve it from its imperialist undertones. Monnet may not have called for 'democracies across Europe unite' but his 'central planners across Europe unite' seemed pretty convincing at the time.

Disenchantment did not wait for the euro crisis. After all, Weber himself had come to fear the unfettered bureaucratization of social life as a threat to individual freedom particularly in Western capitalist societies where individuals would become trapped in systems based purely on teleological efficiency, rational calculation and rule-based control. Would his 'iron cage,' 'the polar night of icy darkness' trap the European dream too? To be fair, the Eurocrats' dream did accommodate domestic politicians, but with a major caveat: domestic politicians without domestic politics. This involved a Faustian bargain: politicians commit to the European dead, Eurocrats tacitly accept to serve as scapegoat. The latter did not mind the blame given their messianic convictions and the former were generally neither able nor willing to resist co-optation in the functionalist governance logic. With time, they too would become euro-crats, shielding the enterprise from mass domestic politics. In short, Europe has long been courting Weber's polar night, but with a technocratic logic once removed, an iron cage crafted in Brusssels' glass towers, an iron cage in a bubble.

Thankfully, the enterprise had seemed to step back from the brink over the last 20 years with the post-Maastricht wake-up call, the constitutional democratic angst and talk among Eurocrats of participatory and deliberative democracy, input legitimacy, local empowerment, and ownership. European citizens somehow were starting to try to break free. And Eurocrats seemed to be listening, tweaking their dream to stay in control.

The euro crisis taught us how fragile these timid developments were. Its management staged Eurocrats as the star *dramatis personae* on a stage they now shared under full limelight with national politicians and the beast they had been trying both to empower and control all along: the markets. But, this time around, the mission and the means it seemed to justify somehow got out of control. In a world where financial markets magnify manifold the many unavoidable follies, mistakes, or misdeeds of politicians, but where

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publics, especially vulnerable publics, pay for their mistakes, Eurocrats more than ever believe that they need to protect politicians against themselves. For some, they dramatically failed: 19 European leaders were sacrificed on the altar of euro-survival in the course of three years. But, for others, and above all Germany's iron lady, EMU has been reformed to be even truer to the Eurocrats' dream: rules now reign supreme. In the process, supranationalism seems to have truly lost its two redeeming features, namely symmetry, whereby big states refrain from bullying smaller ones at the center, and autonomy, whereby the center refrains from coercing the parts. Little wonder that citizens feel trapped in a Eurocrats' dream only outsiders can extract them from. Bring it on Leonardo!

This chapter argues that Europe can do better. Indeed, the euro crisis should be treated as an opportunity for European citizens to appropriate the Eurocrats' dream and make it their own, even while embellishing and subverting it in the process. In other words, at least some parts of the euro-cracy seem to want to achieve *supranational entrenchment of creditor-designed 'governing at a distance'*. Instead, we hope and believe that a new EMU architecture can evolve away from crisis mode towards a steady state inspired by a different model: *supranational management of governing together but not as one.* In other words, we argue for a 'demoicratic' approach to EMU governance and believe that many, inside and outside EU institutions, actually support this vision.

The idea that Europeans ought to 'govern together but not as one' is associated with the belief that the EU's normative benchmark ought to be that of a 'demoicracy,' or a Union of peoples (Nicolaïdis 2013). Accordingly, the Eurocrats' dream may have been a necessary original sin as it is this dream that put the EU-to-be on such a demoicratic path. But that logic has run its course. The dream must be democratized, or, better, demoi-cratized. Today, we need to explore the translation in monetary and economic governance terms of a simple fact: that fifty years and more of European integration may have led to a steady strengthening of the European *cratos* according to the Eurocrats' dream, but that the demos has mainly remained domestically constituted (Cheneval and Schimmelfennig 2013; Crum 2013; Nicolaïdis 2004; Nicolaïdis 2013). As a result, the dramatic shift of competences to the supranational level as witnessed in the last five years while legitimation processes remains with national politics is bound to create a legitimacy crisis especially if social costs are so high: no amount of supposed democratization of EU-level decision-making will do the trick. Instead, it is desirable for the EU to design its institutions and rules in the spirit of demoicracy for reasons not only of political legitimacy but

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also of socio-economic rationality. The management of the Eurozone has yet to reckon fully with the deeply pluralist nature of the European project (Weiler 1999). Using the crisis simply as a fulcrum to embed centralizing and intrusive approaches, for application *en temps normal*, would be philosophically undesirable, politically unviable, and economically ineffective. Instead, the most EU-friendly response to the flaws of current EMU governance is to ask what are the least centralizing approaches that will nevertheless do the work.

The remainder of the chapter is organized as follows. Part I lays out the three governance deficits to be filled by EMU reform and the constraints for addressing them provided by the demoicratic referent. Part II discusses the political-economic diagnosis of the euro-area crisis – exploring where errors of analysis, and pressures of political convenience, have led to ill-advised approaches, and how the circumstances of the crisis have threatened to derail the EU from its demoicratic path in part because it has made possible the merger between two hitherto separate logics, namely that of conditionality and that of polity-building. Part III asks what the crisis suggests should be a stable pattern of EMU governance if one believes that the demoicratic character of the EU should not be betrayed. We seek to disentangle where insights gained during the crisis truly do call for a permanent strengthening of central institutions and/or a heightened role for markets – and where by contrast the longer run imperative is to internalize more deeply the nature of interdependencies at the national level.

I Governance deficits and the demoicratic lens

Critical analysis requires normative benchmarks. Along with the other authors in this volume, we believe that the euro crisis has amplified existing failures in the integration process. We highlight three kinds of governance deficits brought to the fore by the euro crisis that EMU reform has failed to mitigate and indeed sometimes magnified when assessed against the benchmark of a sustainable demoicratic polity.

The compliance deficit

If a first core question raised by the EU in general and EMU in particular is how to ensure compliance with shared international obligations in the absence of coercive state-like structures, what are the options available? If compliance is predicated on the *legitimate* enforcement of shared rules, then the most universal response is well known: reciprocity. Reciprocity is

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one of the most deeply entrenched social norms. But in the international realm as elsewhere it can come in many shapes and forms. It can be symmetric (e.g., reciprocal right to resort to trade barriers) or asymmetric (aid in exchange for conditions having to do with domestic policies); proportionate or disproportionate; legal or political; unilateral or multilateral in decisions over (mutual) punishment and rewards. Moreover, and most importantly, reciprocity can range from the most specific to the most diffuse reciprocity (across time and partners). When the granting of rights is a function of simple membership in a club (as with the most-favored-nation treatment under GATT, or, indeed, membership in the EU), we are dealing with very diffuse reciprocity. To be sure, even then, enforcement can end up relying on specific reciprocity methods against free-riding behavior (e.g., sanctions). Conditionality is a form of specific reciprocity, requiring deeds in exchange for cash, for instance.

The EU has traditionally been a creature of diffuse reciprocity. It gave up at birth the option of resorting to specific reciprocity among its member states as a way to ensure compliance with its rules: competition law instead of antidumping; single-market rules instead of retaliatory trade barriers in case of breach. To make up for banning reciprocity as an enforcement mechanism, and in the absence of state-like enforcement capacities, common disciplines were to be grounded on the force of law as a both an object and an agent of integration (Joerges and Zurn 2005; Joerges in this volume). In practice, infringement action by the European Court of Justice (ECJ) was to be supplemented by supranational or peer pressure as well as, rarely, notional fines.

There has been much debate on the sources of legitimacy of the law when it carries so much onus in upholding social order. At a minimum, on the output side, its authority stems from the character of the law itself, the perception that it be non-arbitrary or serving particularistic interests. On the input side, it must be seen as emanating from representative government which Fritz Scharpf calls in the EU context 'legitimacy intermediation' by member state governments (Scharpf 2013). In a polity-building project, cooperation and its rewards are a public good underpinned either by the common social contract of a demos or a contract among demoi.

A deficit in the realm of *legitimate enforcement of shared rules* – which we refer to in short as a *compliance deficit* – results when polity-building through law ceases to be sufficiently legitimate while classic reciprocity is not part of the toolkit. The gap is best closed by addressing the former: bolstering the demoicratic ethos of individual member states and the demoicratic character of its shared institutions. But if this does not happen, the

temptation is great to rediscover the latter, the kind of specific reciprocity that had been eschewed by the EU from the start: conditionality as a mode of external governance, or governing at a distance, by parts of the Union over other parts. This is indeed what has happened with EMU as the policies aimed at the euro crisis eroded the perception of impartiality attached to EU law and therefore its effectiveness. The demoicratic ethos has been tested to its limits in part, we argue, because of the logic of conditionality that has come to pervade EU policies, merging with that of polity-building.

The stabilization deficit

Even if the legitimacy deficit could be addressed, structural asymmetries remain between states, as well as regions and cities. The second governance deficit in managing a common currency without a state therefore has to do with the mechanisms that serve to ensure stabilization in the face of these asymmetries. What happens with economic cycles and the fact that periods of expansion and recessions are not synchronized between states? What to do with the fact that states or regions can be subject to asymmetric shocks – through, for instance, different levels of vulnerability to external shocks? The EU is never likely to benefit from the kind of share of GDP (25 percent in the USA) which allows the federal level to provide the kind of automatic stabilizers making the adoption of a common currency among heterogeneous economies possible (even if in the USA the stabilization function is also provided by financial markets, a point to which we will come back). Even were a common EU budget to jump from 1 percent to 5 percent we would still be far from the mark. So the question remains: how can the EU's political economy be stabilized over time? And at which level of governance?

The justice deficit

There are various options for addressing the two deficits above. But underlying these questions is a third and last justice deficit which acknowledges that no technical approach can fully do justice to the distributional issues at stake in addressing crisis (Kochenov et al. 2015; Sangiovanni 2013). In other words, how should the costs of adjustment and the risks associated with them be distributed not only among countries but also among different social and economic actors within a transnational polity like the EU? This has to do above all with what philosophers discuss as 'duties of fairness,' which always arise between the winners and losers of integration in

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steady state, but which are magnified under crisis. Simply put, polities are sustainable when they distribute and redistribute the bads as well as goods of integration fairly, including the distribution of risk in the EU context (Beck 2009).

Fairness in the EMU context is about the distribution of economic and social risks, and the redistribution of the gains and losses stemming for mis-distribution of these risks in the first place. Even if this was not considered an EU-level matter (say through cross national transfers), EMU has a crucial impact on how member states themselves are able to provide core tasks of government, including those that determine the state's capacity to comply with requirements of distributive justice, such as welfare policies and the provision of public goods (for a discussion, see Viehoff and Nicolaïdis 2015). How then should the justice deficit be addressed? It has long been clear that national macroeconomic policy can no longer shield labor-market institutions and social-protection arrangements from the need to adjust to international competition – but adjustment does not need to mean destruction (Hemerijck and Ferrera 2004; Menéndez in this volume). EMU winners have obligations to EMU losers, especially if the latter cannot be compensated through purely intra-national logics. If monetary union restricts member states' ability to implement redistributive principles of social justice, what should balance ought to be struck between restoring this capacity at the national level and delivering on duties of fairness at the EU level?

A demoicratic lens

Adopting a demoicratic lens means coming to terms with the fact that these deficit cannot be addressed through classic federal remedies: there are no 'feds' to enforce common law, no EU central budget can be big enough to serve as automatic stabilizer, and no EU federal welfare system can compensate losers permanently across national lines. In response, the demoicratic ideal refuses the presumed binary choice between constructing an ever-closer fiscal union to approximate these solutions or, alternatively, entrenching more deeply the primacy of the sovereign state. To be sure, we accept that both sides in this debate have a point. As per the latter, stable governance architecture for EMU must include strong elements of national responsibility – internalizing the disciplines of monetary union. At the same time, some elements of centralization, or at least 'soft' coordination among governments, may also be needed to preserve stability and foster growth.

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But in contrast with the classic representation of the EU as an 'in-between,' the idea that the EU is a 'demoicracy in the making' represents a third way against both these alternatives each of which equates democracy with a single demos – national or European. What is special about peoples engaged in a demoicratic project is that if they are to retain a high degree of political autonomy while managing their interdependence in acceptable and sustainable ways they better be greatly open to each other and set up institutions that help them do so. This implies a system of multiple but connected national politics where the notion of shared responsibilities is fundamental: the system depends on states taking responsibility for the ways in which they deal with their own externalities. Eurocrats should help make it happen, not supplant it.

Demoicratization theory is a theory of correspondence between shifts in power and the democratic anchoring of such powers, emphasizing the disconnection between the locus of managerial authority (the combination of shifting competences and institutional roles) and the locus of political life in Europe. The management of the euro crisis has been based on the assumption that if the euro suffers from being a currency *without* a state it must acquire one. Instead, we argue that it must evolve from a currency *without* a state to a currency *among* states. The EU as demoicracy is not a political waiting room for fuller union, or an economic emergency ward for nations experiencing financial stress, but the normative frame to inform long-term EMU governance architecture.

More specifically, a demoicratic frame of analysis takes European diversity seriously not simply by accepting it as a constraint we must overcome through the right kind of pedagogy or the right kind of incentives for convergence at all costs. Instead we must acknowledge the fact that each member state is an arena for different social bargains, state–society relationships as well as different debates which echo across borders but are also grounded in different constitutional languages. The role of the EU should be to engineer their permanent compatibility and horizontal contagion, not their homogeneity.

This is not the place to discuss specific blueprints on how to translate such a broad ethos into policy (Cheneval, Lavenex, and Schimmelfennig 2015; Nicolaïdis 2015). Suffice to say that if EMU is to be managed *qua demoicracy* without crossing the Rubicon to a classical federal form of governance, the three deficits laid out above must be addressed while respecting the integrity of *national* democracies, enhancing *transnational* democracy, or the demoi commitment to their common 'cratos,' and constraining the *supranational* locus of democracy through genuine politics.

II Demoicracy at risk: the political economy of the euro-area crisis

There is clearly no dearth of diagnosis of the euro crisis and ours concurs with the widespread acknowledgement that the management of the crisis to date has demonstrated what everyone should have known in the first place: one cannot manage a currency shared among nations without some kind of stable agreement on how to share the bounty and risks of the system. The messianic mantra that *the euro cannot fail even if it cannot succeed* has meant that bounty and risks have been distributed according to power relations and in the shadow of implosion. And moral hazard, an initially sound principle to guard against skewed incentives, has been invoked to legitimize what we referred to as the *supranational entrenchment of creditor-designed 'governing at a distance'* along four broad questions.

Who to blame?

As is well known, there are two competing diagnoses concerning the sources of the euro-area crisis (see, inter alia, Schmidt 2014): the 'creditor discourse,' embraced by euro-area states that were running current account surpluses as the crisis developed is essentially a discourse of blame. The roots of the crisis are held to lie in lax fiscal policies and inadequate structural reforms, with Greece cited as the archetypal crisis country. On this view, the policy requirements for living in a non-optimal currency area need no re-examination in light of the crisis. The instability resulted, it is held, from poor observance and enforcement of the rules, not from the scope and substance of the rulebook. In this world, conditionality will be needed to make sure that taxpayers of creditor countries 'get their money back.'

The alternative diagnosis, which can be termed the 'debtor discourse,' comprises three main counter-arguments: (1) It takes two to tango: the crisis involved undisciplined lenders and complacent supervisors in the surplus countries of the euro area, as well as undisciplined borrowers in the deficit countries – so the blame for imprudent lending is shared. (2) Prior to the crisis, Spain and Ireland were running fiscal surpluses; had low public debts; and, in the case of Ireland, had a flexible and highly reformed economy – yet both fell into deep crises: this was not a problem of flaunting top-down fiscal rules. (3) The dynamics of the crisis in fact took all parties by surprise, including the surplus countries and the euro-area elite, due to flawed analyses, whether from the European

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Commission, the IMF, or academic experts who failed to foresee the crucial feedback effects between the financial sector, the real economy, and public finances (Kincaid and Watson 2013). The implication of this second – 'debtor' – point of view is that the crisis reflected a systemic malfunctioning of adjustment incentives and mechanisms in the euro area, encompassing both creditors and debtors, public and private sectors, as well as wage-price mechanisms and risk *premia*.

We are still far from any synthesis of these two views – and, more generally, between neo-liberal and neo-Keynesian readings of the crisis. Logically and empirically, some key aspects of the case made in the 'debtor discourse' seem hard to refute, even if the creditors' concern with moral hazard cannot be dismissed. But the genesis of the crisis is complex, and, more prosaically, 'he who pays the piper calls the tune.' Thus the crisis solutions, and the politics surrounding them, remain heavily determined by the surplus countries and their dominant narrative enhancing a sense of unfairness in debtor countries and a sense of self-righteousness in creditor countries when taking the EU down the road of permanent conditionality schemes to address the deficit as they see it.

Who should adjust?

Episodes of systemic instability, including the euro-area crisis, are typically treated as liquidity crises – at least initially. Debt reduction is ruled out. Provided debtors adjust, it is claimed that there is no threat to the integrity of bank lenders. The reason for this is pragmatic rather than analytic. Creditor countries (such as Germany and France in this case) need time to recapitalize their banks and run down the banks' risky exposures through transfer of claims from banks to the public sector, and, if feasible, to jointly owned institutions such as the IMF or the ECB, which dilutes the national fiscal cost and shifts claims (perhaps at par) to a preferred creditor entity. The Latin American debt crisis of the 1980s is, on all points, the *locus classicus* of the incentives for creditor countries to frame policy in these ways.

The euro-area crisis has proved no exception. The initial focus has been on fiscal adjustment to 'restore' the solvency of the debtor, and liquidity provision to buy time for this adjustment and for a recapitalization of creditor country banks. The burden of adjustment – as is typical – has been viewed by creditors in a very asymmetrical manner. The underlying fiscal adjustment implemented between 2009 and 2012 amounted to 15 percent of GDP in Greece, 4 percent in Ireland, 5 percent in Portugal

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and 4 percent in Spain, accompanied by vast levels of unemployment and declining output. Only at the end of 2013 did Germany and the other EU creditor countries start to accept implicitly some responsibility for adjusting their economies away from structural surpluses through modest wage increases, while the period of fiscal consolidation in Germany was probably coming to an end. Overall, the nature and symmetry of private sector imbalances, the role of creditor bank indiscipline, and the impact of systemic creditor surpluses were camouflaged.

The difficulty of overcoming asymmetries in the burden of adjustment, where surplus countries escape discipline, has been a feature of debates since Keynes's advocacy of a more balanced system at Bretton Woods. In the euro-area context, however, this asymmetry became systemically dangerous for the living standards of all of the parties leading both to generalized deflationary bias and then to placing countries in an oscillating cycle of insufficient and then excessive competitiveness, excessive to the extent that demand will have been overly depressed in the process (Allsopp and Vines 2008). Nevertheless, it was entrenched in the EU's new rulebook, thus failing adequately to address the stabilization deficit.

Who should pay?

But what happens when adjustment is too slow and insufficient? Who, if anyone, should be bailed out, and by whom? EMU had ruled out fiscal transfers between member states based on three assumptions which were to prove optimistic, to say the least. First, national fiscal deficits were to be limited by EU law, as embedded in the Stability and Growth Pact; second, national *private sector* deficits were declared to have been abolished as Eurostat ceased to publish balance of payments statistics for euro-area members on the grounds that, with the advent of monetary union, their national balance of payments had ceased to exist. However, given the existence of predominantly national budgets, labor markets, and bank resolution systems, this assessment defied economic gravity and the hubris of dismissing this risk came home to roost; third was the failure to perceive the scale on which liabilities might migrate from private to public balance sheets in a crisis. When all three of these hazardous premises crumbled the question of who should pay for the failure of different actors involved in the crisis – for example, governments, banks, firms – came back with a vengeance.

If the question of who should pay started with who *can* pay, the answer could rest on prior capacity to pay – asymmetric wealth – but more

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importantly on capacity added by the crisis itself. Before we reach arguments regarding duties of assistance on various grounds of commonality or humanity, the justice deficit stems from the fact that asymmetric benefits fail to be acknowledged by creditors as a ground for fair distribution claims. Indeed, at least until 2015, surplus countries have benefited disproportionately not only from monetary union but also from the crisis itself (Sergio 2013). They may have taken a risk in further lending to bail-out countries but they have avoided major bank losses in connection with poor lending decisions within the euro area; they are seeking to avoid losses on inter-government loans, so, if the strategy works, their support loans and associated interest are good investments; their economies and exports continue to boom because membership of the euro holds down their implicit exchange rates; they have benefited from very low real interest rates as a result of the 'flight to quality'– indeed, since the peak of the crisis, Germany has even experienced negative interest rates; and as a result they have benefited from the spread between the cost of capital for them and the lending rates to the debtor countries. Yet the case that debtor countries and their citizens must pay for most of the legacy costs of a systemic failure remains the predominant discourse.

The eventual setting up of the European Stability Mechanism (ESM) in 2012 did help address temporarily the need for stabilization, especially when coupled with the ECB's commitment to 'do whatever it takes' by buying government bonds on the secondary market through the so-called Outright Monetary Transactions (OMTs) in order to contain the increasing rise in debtor country spreads. In essence, the fabric of economic and financial connections between members of the euro area had turned out to feature much greater degrees of interdependence than the architects of EMU had dreamed. Support for addressing a systemic failing in this network had to be rooted directly in national rather than supranational responsibility, unsurprisingly involving veto power; and even then the process required an external ring-holder (the IMF) as regards adjustment design and financing.

Unsurprisingly, EMU governments ruled out holding in common bad debts resulting from bad national approaches to banking stability. Hence the agreement that the ECB should centralize and carry out the supervision of major euro-area banks. We are thus left with the question of how and to what extent should the EU provide a central backstop for public and private debt (for example) and insurance or last-resort for raising capital or guaranteeing loans. For all the talk of a banking union, the taste for committing unlimited amounts of government money to support banks

headquartered in other countries simply seems to be lacking. This leaves the euro area in the strange position of having the ECB doing supervision centrally, but member states (mainly) paying for its errors. In this sense, supranational intermediation has also been first and foremost a multilateralization of the orthodox creditor stance.

Who should set the rules?

Critically, a monetary union requires rules. The question remains, whose rules? This is not the place to describe how the orthodox narrative sketched above led to the supranational entrenchment of creditor-designed reformed EMU (see, inter alia, Pisani-Ferry 2014). Suffice to say that that Eurocrats and political leaders in tandem have progressively operationalized the new 'Six Pack' and 'Two Pack' legislation flanked by the ESM agreement and the Fiscal Compact through a new system of macroeconomic policy coordination. This is carried through the 'European Semester,' a process lasting almost half the year whereby the Commission with the input of the member states produces a hierarchy of EMU members: all members are subject to broad 'preventive' surveillance (generic country recommendations); most countries at different times fall under various degrees of 'corrective' measures (e.g., 'excessive deficit procedures'); and so-called programme countries are subject to macroeconomic adjustment programmes (memoranda of understanding administered by the Troika). The rationale is clear. The extent and effect of surveillance is a function of the risks which each member state's economic policy creates for others. On what grounds can we question the Eurocrats' architecture designed to deal with a world of externalities and moral hazard?

At a most general level, we can grasp the dramatic increase in Eurocrats' authority to 'govern at a distance' by noting the implied shifts between two notional boundaries which define the intensity and scope of EU involvement in internal member state affairs. The first notional boundary is between what national systemic capacity is assumed as a matter of course (a capacity to comply with European values and norms and which warrants mutual trust; see Von Bogdandy and Ioanidis 2014) and what cannot be assumed in such ways and will therefore be subject to explicit rules. The second notional boundary is within this second realm, the boundary between what we could call national 'commitments,' whereby states explicitly commit (through primary or secondary law or political declarations) to uphold a number of shared policy ends translating these values through nationally designed means and common 'disciplines' whereby not only

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ends but means are specified in a top-down manner. We argue that EMU governance reform has shrunk the space where national capacity can simply be assumed, while at the same time widening the space of disciplines at the expense of commitments, thereby deepening the penetration of EU 'law' in national contexts. To be sure, the shift is obviously most dramatic for countries falling under loan conditionality, the most extreme case of expansion of the 'disciplines' logic.

Is this simply the natural consequences of the EU political bodies having to become players in an IMF-type world? No. In fact, it would be wrong to assume that the EMU reform saga has simply followed IMF operating procedures. For the last 20 years, and drawing lessons from the Argentina debacle, the IMF has been seeking to coral undue bilateral influence (from, say, the USA) among the different creditors vying seniority in repayment. As its officials say they see it, because the bilateral official creditors have a biased interest in the outcome, defining the boundaries between their interest (which inspires strict disciplines) and common interest is a difficult exercise, in particular when it is clear that debt restructuring ought to happen early on. But these lessons were selectively applied in the EU context as the Troika refused to contemplate debt restructuring at the outset given the 'orthodox narrative' discussed above. When a haircut had to be accepted for Greece in 2012, its magnitude was not enough to do away with the structure of a situation whereby Greece (and possibly other debtors in the Eurozone) would continue to be subject to external governance in the foreseeable future, with debt write-offs big enough to keep it afloat but small enough to keep it dependent or in a 'bond relationship' bypassing extant notions of citizenship as analyzed by Damian Chalmers in this volume. But the bond narrative has progressively blended into the risk regulation (see also Chalmers 2013).

Bail-out programmes may be outliers in the new EU governance system but the difference is in degree rather than in nature. First, because *fiscal determinism* has underpinned the drive to govern at a distance in the whole Eurozone. Admittedly, the main preoccupation that has informed responses to the crisis has been to prevent member states of the Eurozone from falling into Troika-ESM territory – thus subjecting them to disciplines short of credit conditions. As if the 2012 Fiscal Compact compelling member states to introduce requirements of fiscal balance in their own constitutional arrangements was not to be trusted, EMU governance has orchestrated the dramatic curbing of the political discretion of all EMU governments not only when it comes to deficits *per se* (a legitimate concern) but on the entire set of choices that may lead

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directly or indirectly to such deficits. To make this possible, the *modus operandi* of EMU governance stems from overriding the disjunction between short-term recommendations regarding fiscal policy (the old Stability and Growth Pact) and long-term structural policy embedded in the Lisbon strategy and the Open Method of Coordination (OMC) – two processes which before the crisis belonged to different worlds of governance. While scholars have disputed for the last 15 years their relative merits, this key innovation has blurred the distinction between rules-based and coordination-based governance in the EU in fascinating ways (Armstrong 2013).

This may have been a good thing: in an evolving demoicracy, the consensual development of recommendations corresponded to the search for more legitimate forms of governance as the EU started to interfere with core state powers (Borrás and Radaelli 2014). There had been attempts to strengthen the preventive arm of the Stability and Growth Pact much before the beginning of the crisis, and the idea of synchronizing fiscal and structural assessments corresponds to a sense that there is a realm of post-legislative governance that can only be implemented through hybrid forms of governance. But, as Armstrong points out, this has happened with a twist: the OMC has been hardened through the community method, with a preponderant role for the Commission in the interpretation, monitoring and enforcement of rules. In other words, the management of the euro crisis has allowed the wolf of supranational conditionality to penetrate the EU den in OMC sheep's clothing. Witness the European Semester's Macroeconomic Imbalance Procedure (MIP) under which countries can in principle be subject to fines for the failure to take structural measures assumed to help reduce their imbalances in the long run.

Second, and relatedly, governing at a distance has been justified in the Eurocrats' world view by a profound suspicion of agonistic politics throughout the Eurozone, in other words the idea that politics is about open conflicts resolved through democratic competition. The member states should be able collectively and the Commission concurrently to suggest ways of making shared membership in EMU sustainable. But the question is whether in doing so they can assume one 'right approach' to macroeconomic policy and to the handling of redistributive trade-offs made through national budget deals. Technocracy often relies on this (ordoliberal) belief. Unsurprisingly, we have witnessed a great deal of resistance since 2011 to the idea that the Commission can decide how pension reform or wage de-indexation can increase a given country's competitiveness. In some cases, say Malta and Belgium on de-indexation, it

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even had to backtrack. At the time of writing, there are signs that the new 2014 Commission has started to show marginally more flexibility.

In the end, the shrinkage of political space under EMU takes us back to asymmetric supranationalization, subject to creditor countries' dominance. The very definition and status of 'law' has changed with crisis management and the reconfiguration of sovereignty it has involved. How and to what extent do the conditions contained in the Troika's memorandum correspond to classic understandings of 'law'? They are indeed approved by the Eurogroup and the process has been sanctioned by Treaty, but the traditional EU checks and balances, including parliamentary involvement, are absent. This is true, albeit to a lesser extent, regarding the European Semester process.

Let us assume even that, subject to improvements in design and execution, such departures from previous euro-area practices could be defended as dealing with legacy costs in countries which exploited the structural flaws of the euro to borrow above their means in EMU's first decade after having accumulated deficits for much longer. But can we imagine these practices as part of the longer run design of economic surveillance under EMU?

The political drama acted out across debtor countries of the Eurozone between 2010 and 2015, with politicians one after the other sacrificed on the altar of euro-survival, clearly speak to the unsustainability of an approach which channeled the opprobrium of European publics – and not only in the south – against a new kind of supranational democracy preemption. To pursue rule surveillance and enforcement along these lines during normal times would simply continue to erode Brussel's legitimacy. The conditionality mindset sees the EU as an instrument to bring governments into line rather than to develop shared notions of proper division of labor between levels of government and proper incentive structures to go along with it. Is it in the interest of Eurocrats to give 'Brussels' the look-and-feel of the IMF but to do so 'in the name' of a common polity – not an ad hoc, temporary outside institution like the IMF? Their strategy has partially backfired as the attempt to borrow from the EU's political legitimacy to make the new conditionalities more effective was turned on its head with symbolic borrowing the other way around: the EU has become the scapegoat for the most unpopular set of policies experienced in Europe since the Second World War, while the political and economic wisdom of these policies came to be questioned by the IMF itself (International Monetary Fund 2013). Indeed, it seems that at times all clarity and transparency was lost as to what 'Brussels' meant – as the distinct and respective

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roles of the Commission, the Eurogroup, the Council, the ECB and individual creditor governments became impenetrable to outsiders.

In sum, today's EMU governance approach is far from an optimal steady state, except to the extent that EU decision-makers may succeed in extirpating member states from the crisis, albeit at prohibitive social costs. Yet this merger between the conditionality and polity-building logics seeks to make permanent some elements of conditionality that were forged in the heat of the moment as technocratic rather than political solutions to EMUs woes. Hard cases make bad law, unless great care is taken; and the stress of crisis resolution is not an easy setting in which to shape a new permanent architecture for EMU. To be sure, the short-run dictates of conditionality are hard to disentangle from the enduring requirements in a steady state. But conditionality implies an intrusiveness – and fosters a divisiveness – that do not belong in the operating process of a successful European polity over the long run. Ultimately, governing at a distance will spell the end of common rules.

III Demoicracy recovered: a non-federal EMU governance

What kind of a paradigm shift – both analytical and political – is required in order for the economic governance of EMU to evolve to a viable steady state? If measures designed in 'emergency mode' to deal with the flawed structure inherited from the original EMU design become the blueprint for long-term EMU governance then all three deficits – compliance, stabilization, and justice – are likely to remain.

Instead, and under a demoicratic paradigm, EMU's continued governance reform ought to navigate a third way between unity in the name of the euro and fragmentation because of it. First, because, political leaders must allay public resentment of intrusive centralization, or indeed the perceptions of hegemony within the EU by surplus countries which necessarily accompanies enforcement-through-conditionality. Second, because EMU governance reform needs to be framed much more systematically in terms of the political architecture not just of the euro area but of the wider EU. Some call for the EU to become a 'club of clubs,' with the supranational level mainly responsible for monitoring competition and cooperation among different territorial and/or functional clubs (Majone 2014; Majone in this volume). But, in our view, our key collective concern ought to be sustainable integration in the overall Union to hold together the ins and the outs of monetary union, whose relationships ought to vary in intensity but not in nature.

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In the spirit of the demoicratic approach, therefore, we argue that the goals of EMU governance over the long run be thought through in three interconnected realms of responsibility:

(1) markets: we need to understand key interdependencies and externalities involved and the extent to which these can be addressed by market-based mechanisms, including through better financial integration;
(2) governments: we need to prove fiscal disciplinarians wrong by strengthening the incentives for national governments to conduct and coordinate policies on a more forward-looking basis, taking account of spillovers and externalities to determine national responsibilities;
(3) union: we need to engineer the minimum centralized financial support mechanisms needed to allay public fear of euro-area or banking disintegration.

These, to be clear, are indeed 'elements,' not sequential steps. The qualities of a unique EU system will be to a significant degree emergent. Constructing a demoicratic governance of EMU is to be seen as an exploration, not an entelechy.

The role of markets and financial integration in an EMU context

The stabilization deficit is due to EMU's nature as a closed system with high interdependencies. In a non-optimal currency area that is subject to economic 'shocks' (external and internal) where members are affected in different ways, economies will at times converge and at time diverge. But, provided they do not overshoot, these swings are natural and needed to help bring economies back to balance under the common monetary policy rather than long-run gains or losses of 'competitiveness' in the deep structural sense of relative skills, labor-market efficiency, and technology, which matter for medium-term growth. Each adjustment process carries risks. Current account deficits within EMU emerge and widen over quite long periods, as relative competitiveness changes; low or negative real interest rates may make credit and asset price booms more likely (as occurred in Ireland and Spain); or spending may increase during the boom in the presence of these low interest rates (as was the case in Greece and Portugal); but people do not move easily enough to compensate for these swings. There will always be adjustment crisis but the question is how to prevent them from becoming full-blown economic and financial crises.

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Two market-based mechanisms can in principle stop this process becoming dynamically unstable. First and foremost, Europe needs to unlock the benign potential of financial integration. To be sure, the highly integrated financial market system in the pre-crisis euro area facilitated the financing of destabilizing trends, thereby potentially increasing the scale of risks involved (Jones 2013). But financial integration can also offer private-sector mechanisms to help absorb country-specific economic shocks. When referring to financial integration, we mean three things: the spider's web of cross-border financial flows; the spreading out of a network of bank branches and subsidiaries; and the web of cross-holdings of companies across borders. The last two of these processes (if well structured) can particularly act as buffers to national shocks, as agents – including firms – borrow across borders and as their incomes are 'smoothed' by their holdings in other states that are unaffected by a shock. Thus, the integration of financial markets under EMU along these lines can mitigate the need for either fiscal transfers between member states or a sizable federal government to play a role in cushioning shocks and spreading economic risks. This phenomenon prevails in the USA and was emerging in the euro area before the crisis (Asdrubali, Sorensen, and Yosha 1996; Artis and Hoffman 2008). In short, financial integration, as it deepens over time (assuming current developments are progressively reversed), offers a private sector channel for risk-sharing which we believe is more congruent with a demoicratic polity than full-blown fiscal integration. But, of course, this diagnosis is predicated on the assumption that such financial market integration would not again lead to heavy over-borrowing, which in turn calls for more restrictive regulatory constraints – a topic beyond the scope of this chapter.

Second, markets respond to loss of competitiveness through the slowdown of a booming economy, bringing it back in line with euro-area interest rates. If this does not happen enough, the current account deficit gets troublingly wide, and banks or governments start to over-extend themselves, risk *premia* should rise in a gradual fashion and start to constrain borrowers. For these mechanisms to work, however, consumers, wage-setters, and financial market participants all need to behave in a forward-looking manner. If not, the unchecked imbalances may get dangerously wide, and the correction process can exhibit destabilizing lags. This means in particular that defaulting on debt needs to remain an option and need not imply exit from the euro area (for a forceful argument in this regard, see, inter alia, Mody 2014). But allowing governments to default will not appear a credible option unless the sovereign-bank link is broken,

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since the default of a sovereign would be likely to trigger a run on its banks. Thus a full banking union, with mutual fiscal support for banks, is a sine qua non for introducing default as a credible option to strengthen national incentives under EMU (see below).

More broadly, we know from experience during the run-up to the euro-area crisis that these market-based mechanisms did not work early and fast enough to prevent a 'sudden stop' in lending to some countries (Kincaid and Watson 2013). There had been far too great a complacency about the efficiency of unbridled financial markets. Interdependencies occur in the European monetary areas but not in the same way as they would in an integrated national space. The markets can help manage these interdependencies but only if individual member states are in a position to play a central role, an issue to which we now turn.

National discretion, capacity, and incentives: proving fiscal disciplinarians wrong

We are therefore back to the role of states individually and collectively in addressing our governance deficits. Certainly, strong public finances are part of the bedrock on which an economy's resilience is built. But can we prove the disciplinarian focus on public deficits and centralized rules wrong? How can we constrain democracies democratically in the EU?

Our preferred approach can be summed up as moving from the spirit of top-down EU disciplines to bottom-up national commitments. These commitments can of course be formalized as EU rules or at least guidelines. But the cardinal mindset here is that supranational governance is supposed to be deployed to limit the arbitrariness of its constituent actors' policies rather than their capacity to decide among meaningful alternatives – choices which may need to be constrained when it comes to the free riding on neighbors or on future generations, but meaningful choices nevertheless. When it comes to structural reforms in particular, only domestic politics, with all its flaws, can make them democratically sustainable.

Three dimensions need to be considered, namely national discretion, capacity, and incentives.

For one, while EU-led policy prescriptions may in part be valid, if the experience of the crisis has taught us anything, it is that when national economies in the euro area undergo huge swings in the financial sector – affecting credit, asset prices, and capital flows together – avoiding

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dangerous instability requires *more* not *less* national discretionary leeway on the fiscal front. Thus, the first priority in the crisis context was not to strengthen central fiscal rules but to lay a clearer basis for internalizing the risk of boom–bust cycles at the national level. Addressing destabilizing competitiveness swings requires a discretionary and proactive use of fiscal policy which need not conflict with the kind of prudent rules embodied in the Stability and Growth Pact, particularly when a surplus is being built. And when fiscal risks arise from private- and not only public-sector imbalances, as we saw with the tripling of the (initially low) public debt in Ireland and Spain, an approach dominated by top-down fiscal discipline misses the point.

This leads us to the second critical ingredient of the national equation, namely the importance of national capacity. In a nutshell, the MIP uses concurrent and lagging indicators, so that the eventual impact as the procedure moves through its stages could be so delayed as to end up being pro-cyclical. Indeed, it can be questioned whether pre-emptive action through national fiscal and macroprudential policies can realistically be managed centrally in this way, except as a back-up process in the case of national failure to take responsible steps. The interpretation of leading indicators and of detailed fiscal data of the kind needed to act in time on private sector imbalances in the absence of an independent monetary policy is something for which national governments need to assume responsibility. Forward-looking analysis of financial stability trends depends heavily on country-specific analysis at the national level, and has a large interpretative content. It can better be performed in real time, based on a painstaking review of fiscal and cyclical indicators at the national level, departing substantially from the simple lines of standard processes agreed at the EU level (Martinez-Mongay, Luis Angel Maza Lasierra, and Yaniz Igal 2007). To feed such a preventive fiscal policy, much more attention is needed at the national level to the analysis of economic shocks and their impact on the economy as an interdependent part of the euro area. And national governments are obviously better placed to assess the socio-economic fundamentals that will allow them to implement effective policies. Coordination is much more likely to deliver than centralization.

This suggests a need to strengthen domestic institutions so that both systemic stability risks and externalities – including those arising from interdependency under EMU – are better internalized. The Fiscal Compact, for instance, already requires member states to enact a domestic 'implementation law' establishing a self-correcting mechanism guided

by the monthly surveillance of a *governmentally independent fiscal advisory council*. Member states need to build on this commitment to establish Financial Stability Councils with a mandate both to engage in forward-looking analyses and to monitor the domestic implications of euro-area monetary conditions. But such councils must work in tandem with the political process to assess which branches of policy (and which institutional actors) are relevant to forestalling the identified risks. And when it comes to distributing risk the ultimate authority must be democratic accountable actors and transparently engaged.

A third, key, question, however, is how incentives are to be strengthened for behavior that internalizes the interdependencies of EMU, if this is not to be done by an intrusive, top-down approach along the lines of conditionality. For a demoicratic approach to EMU governance to prove viable, the private sector needs to face losses if banks engage in imprudent lending. Governments need to internalize the challenge to national fiscal and macro-prudential policies posed by country-specific shocks under the common monetary policy. For one, stabilization requires more symmetry in the Eurozone. The Macroeconomic Imbalances Procedure may be the first international procedure to seek to discipline large and protracted imbalances in surplus countries but remains asymmetrical as between current account surplus and deficit countries (trigger levels of 6 percent versus 4 percent). A most valuable role could well be as an aid to policy cooperation among member states in the long run rather than a disciplinary arm in the short run. And in this respect the Commission can affect incentives by sharing analysis with systemic risk experts at the ECB and the European Systemic Risk Board (ESRB) and above all national settings. And publics in surplus countries should be exposed to the counter-intuitive idea that their surpluses are risk-creating.

On the other hand, while the risk of falling under Troika conditionality procedures does represent a deterrent for deficit countries, some would argue that a genuine fear of default is needed to change the incentives facing both governments and those who lend to them. But it can be questioned whether greater default risk is a proximate enough concern to change incentives for governments at the stage when destabilizing financial trends in the economy are starting to emerge and pre-emptive action is needed. Overall default risk is a blunt instrument, a nuclear option, which all actors will want to avoid. Alternatively, the name of the game ought to be to create the conditions under which default is least likely, through both the strengthening of domestic institutions as discussed above and minimal centralized features to which we turn.

Spelling out why and when some centralized functions and backstops are indispensable

While centrally enforced fiscal disciplines should progressively become less necessary on the rule compliance front in the steady state, we still need to ask to what extent they may be necessary on the stabilization and justice front, to restore and sustain growth and a fair distribution of risks in the wake of the euro-area crisis. In this respect, EMU's longer-run architecture needs to address three areas introduced in Part II, which are distinct but ultimately interconnected. In each case we need to discuss what is the minimal degree of centralization deemed necessary for sustainable integration.

First, soft fiscal coordination may be needed if national budgetary actions are not to impart a deflationary bias to adjustment across the euro area as countries try to restore their fiscal situation simultaneously after a shock, rather than this effort being limited initially to countries experiencing and causing systemic risk. Coordination then must address overall deficiency of demand at the EMU level, made worse by ill-coordinated fiscal tightening.

Second, there is a need for insurance on sovereign debt short of a 'transfer union' which would involve systemic funding of some countries by others – a topic which has been the object of much contention since the beginning of the crisis. As discussed above, this starts by allowing for national bankruptcy simply by pre-emptively dealing with spillover effects. But in light of the Greek restructuring, and market fears about countries leaving the euro area as a result, it seems necessary to have some form of long-run bail-out mechanism *in exceptional circumstances*. Creditors may continue to insist on consensus decision-making; and the associated conditionality may need to be intrusive, if domestic vested interests in a crisis-affected economy are jeopardizing recovery: but it needs to come as a last not first resort after all domestic-grounded policies have been allowed to enfold.

In this respect, we would not argue against the broad shape of the ESM/OMT system as it has evolved with four caveats. First, provided that it is held in reserve for this exceptional role. Second, with a recognition that it fulfills the essential backstop needs for medium-sized and small members but that the tax base of the euro area is not large enough to sustain the rescue of an economy as large as Italy which would have to be a G7 or even G20 affair. Third, the EU should consider outsourcing conditionality to the IMF in these cases, thus institutionally delinking the

kind of conditionality and polity-building that has been so detrimental to EU legitimacy. Last, but not least, provided that the kind of 'humanitarian' support advocated in some of the southern countries to support the most vulnerable segments of the population affected by debt-repayment measures be considered independently from financial incentive considerations. Restoring a sense of fair distribution of pain among European citizenry does not need to entail the kind of structurally entrenched transfer union dreaded by Germany.

Third, policy frameworks need to be in place in order to unlock the favorable potential of financial integration discussed above and prevent its potential destabilizing effects. This includes more effective and intrusive microprudential supervision, while diminishing the scope for regulatory capture and for 'group-think' in national financial communities – hence the role attributed to the ECB in supervising big banks. But, of course, macroeconomic imbalances financed by debt-creating private flows also affect the benign (or not) character of financial integration.

Finally, the role of the ECB in a demoicratic polity demands special attention. A central bank for a currency without a state presumably has an even greater role to play than traditional central banks. In the EMU context, the ECB can help foster long-run solutions that are politically sustainable, including by creating policy space to cope with the tensions of transition. The commitment of essential fiscal resources as a backstop to market stability (with troubled area-wide banks too large for one government to handle) seems a very favourable trade-off in order to secure the gains of financial integration jeopardized by renewed fragmentation. This in turn calls for a central supervisory function at the ECB both to avoid moral hazard as regards the availability of mutual funds for banking support (and in this connection it is also logical to leave some portion of banking losses at the national level, where much of the responsibility for dealing with imbalances and preserving financial stability still lies) and to encourage countries to show reciprocity in avoiding actions by their banks that could jeopardize macroprudential restraint in another, booming, euro-area member.

Two aspects of the ECB's current role prompt concerns in that regard. First, in spite of the ECB's role as supervisor of large euro-area banks, the mutual loss-bearing share will remain small. Second, its buying of bonds on the secondary market through the OMT is dependent on compliance with a Troika programme, a very surprising thing for a central bank to be doing, more akin to the IMF's traditional role, and only understandable as a way of buying political space for more durable policies to be put in place

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with democratic support. Indeed, and at the time of writing the reference by the German *Bundesverfassungsgericht* to the ECJ on OMT could well result in a delinking from Troika conditionality and a quantitative limitation in scale or time.

Conclusion: from top-down disciplines to mutual commitments

The current discussions on the governance of EMU can be seen as an extreme and skewed version of the wider, long-standing debate about the political architecture of Europe. In this chapter, we argue that EU politics are at their best when avoiding to cross the Rubicon to a federal state while engineering the kind of mutual responsibilities befitting a polity still grounded on the sovereign autonomy of its *demoi*. EU demoicracy may have been stretched to its limits by the kind of dependencies and governance requirements associated with EMU. It may even be argued that monetary union is not soluble in demoicracy. We have argued otherwise. We cannot wish away 20 years of integrative fits and starts. This does not mean that we must turn to the most centralizing variants under consideration of so-called fiscal, banking, or political union.

We have discussed the evolving debate on the governance of EMU in its own terms to suggest that it is possible to conceive of EMU governance not as consisting in a set of deep fiscal disciplines and transnational transfers, but rather as embedded in domestic politics accountable to the peoples of Europe. Dealing with crisis may have required the kind of emergency steps taken by European leadership in so-called bail-out countries although not the national democratic disempowerment that accompanied them. The 'conditionality capture' witnessed there has come to permeate the Eurozone as a whole. If some countries, small or with pegged currencies, are accustomed to being archetypal 'price-takers' in world markets we cannot expect most EU populations passively to accept being governed at a distance, not only regarding the fact of austerity but its form, content, and timing. Nor will structural reforms work when implemented under duress. The EU has allowed the growth within itself of a logic of governing at a distance which goes much beyond traditional (ad hoc and temporary) conditionality in the international system through organizations like the IMF. This alien logic should not be left slowly to invade its host, leaving it a very different creature than its former self.

Instead, the steady state needs to be envisioned in a positive manner as a discovery of the promise that interdependence holds and conditional on

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the responsibilities that it entails. Getting to such a steady state EMU will not be easy. The presence of legacy costs meant that it was always bound to be difficult to move to a new incentive system associated with a new regime. The state of public opinion in surplus countries has made it inconceivable to 'jump' straight to a long-run solution. A more balanced and constructive narrative in both debtor and surplus countries will need to take hold.

The hallmarks of a governance system for EMU that is true to the idea of demoicracy would be to minimize both the disciplinarian nature of relations between the Union and its member states and the extent of centralized mechanisms put in place to hold the union together. Markets can help – through financial integration that can mitigate the need for 'federal' transfers – but cannot do the trick by themselves. The onus is on national governments to internalize the implications of interdependence as they frame fiscal and macroprudential policies. And it is on coordination among states to ensure that externalities and spillovers are adequately addressed on both the micro-prudential and macro-prudential fronts.

In the end, there are at least two visions for a steady state in EMU governance. One is a centralized economic and monetary union in which the political and policy discretion of individual member states has been drastically curbed; the other consists in trying to stay faithful to the idea of demoicracy grounded in the autonomy and interdependence of its individual peoples even while attempting to manage a non-optimal currency area. The latter is a tall order. But one well worth aiming for if the euro is to remain the currency of a democratically sustainable union.

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