EMU and Sustainable Integration

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ABSTRACT This paper considers what will be required to make Economic and Monetary Union (EMU) sustainable following the successive crises of recent years. It starts by laying out the policy benchmark, namely the successive ‘President Reports’ produced by EU institutions. It then suggests three dimensions of sustainable integration relevant to EMU, namely the pursuit of sustainable growth, the need to take into account what we call ‘varieties of modernisation’ and the ‘ownership’ of democratically sustainable reforms. It then evaluates the recasting of EMU governance against the benchmark of sustainable integration.

KEY WORDS: EMU, sustainable integration, sustainable growth, varieties of modernisation, ownership of reform

1. Introduction
Managing the crises affecting Europe’s Economic and Monetary Union (EMU) has been top of the policy agenda for the last five years. EU member states have managed the fallout of the crisis and implemented reforms in emergency mode while at the same time laying the foundations for a more resilient system. Opinions differ on the effectiveness of these reforms in addressing short-term challenges, but, the increasingly urgent question is whether they offer a lasting solution to the well-known shortcomings of the single currency.

Here, we argue that EMU reform must result in a more effective form of integration, capable of assessing and reconciling short-term actions against long-term goals (Nicolaidis 2010). This is very simply a new governing idea of integration calling for the reconfiguration of the integration process away from the old remedies of ‘deeper and faster’. Instead, EU actors should embed in institutions and procedures a systemic commitment to sustainable integration, defined as something that is durable, resilient and politically acceptable. Such an approach entails both an ethos and practice, a state of mind and benchmarks for decisions by all actors involved in economic and policy action in the EU. It also means changing the way change occurs in the EU and recognizing that intergovernmental bargains need to be sustained by inter-societal and inter-generational bargains.

Such an attitude chimes with principles underpinning the internet revolution, with its emphasis on empowerment, resilience, robustness and adaptive learning. Concretely, the EU should foster a sustainable integration culture and take more account of long-term objectives in managing current problems, thereby creating the preconditions for later action. Sustainable integration is not about policy blueprints but about the negotiation of guidelines for action, linking multiple agenda and actors around a set of shared long-term goals.

To make EMU sustainable, the first imperative is to acknowledge that it had been left incomplete at Maastricht due to divergent Member State preferences (Torres 2009). Expectations that these preferences would converge over time across all member states have been dashed and the consequences exposed by the euro crisis. Before 2008, there was little felt urgency to address the known frailties in EMU’s governance construct (see Giavazzi and Wyplosz, 2015), yet as the crisis unfolded EMU’s very existence was threatened. Major advances in economic governance were subsequently adopted, mainly driven by the short-term imperatives of system survival. The question now is whether they also put EMU on the path to a long-term sustainable future, defined in terms not just of the basics of monetary economics, but also of the viability of the underlying economic model and public support.

EMU was set up as a political project in the knowledge that the EU was not an optimum currency area. Nevertheless, monetary union was achieved rapidly, with the smooth launch of the euro and the transition to the European Central Bank (ECB) for the conduct of monetary policy. By contrast, the economic union side — the ‘E’ in EMU, including provisions for coordination of budgetary and structural policies — was left incomplete. As a result, the many interdependencies between member states of a currency union and higher coordination needs were neglected, while the tentative attempts to enhance coordination processes for economic reform (i.e. the Lisbon Strategy) did little to curb the large negative spillovers from the unfinished economic into the monetary sphere. Subsequent efforts to complete the economic union part of EMU have gone some way to strengthen EMU’s resilience in the face of market pressures. However, institutional innovation was conditioned by the needs and constraints of the moment: sometimes within and sometimes outside the Community framework; sometimes through variations on intergovernmental cooperation, sometimes by reverting the Community method; sometimes restricted to the Euro area level, sometimes extending to the EU as a whole. The
result has been the creation of new institutions and mechanisms, at an extraordinary pace but not necessarily always with a view to long-term sustainability.

This article goes beyond the proposals to counter the crisis by completing EMU through ‘a coherent governance architecture’ or a ‘Genuine’ EMU. The latter was adopted in various versions of the Presidents’ Reports (EMU through ‘a coherent governance architecture’ or a ‘Genuine’ EMU. Its building blocks are an integrated financial framework (mostly a banking union), an integrated budgetary framework (implicitly fiscal union), an integrated economic policy framework (economic union) and enhanced democratic legitimacy and accountability of EMU governance (closer political union).

Although some of the reform proposals under these headings can be criticized for going further than is needed, many are undeniable necessary and some are quite bold, but they will arguably not be sufficient to render EMU sustainable over the long term. In particular, despite the institutional resilience on display, they have largely failed to mobilize support from governments and citizens for sustainable European integration. The challenge now is to promote growth in a form compatible with fiscal consolidation and reduced indebtedness while at the same time ensuring long-term sustainability.

In the end, restoring public support for EMU will depend on the delivery of common goals that serve the broader purpose of sustainable integration. The ECB (2015) recognizes that public support for the EU, especially in its EMU incarnation, will rest on the prospects for sustainable growth as the sine qua non for the smooth functioning of EMU. For that to happen, the development of the integrated economic policy framework building block will have to be embedded in a sustainable growth strategy, which pursues structural reform in a logic of modernization of national economies with ownership of reforms at the national level.

The next section examines the concept of sustainable integration more closely, focusing on sustainable growth, approaches to modernizing national economies and the issue of ownership of reforms. Section 3 evaluates the progress made to date and the reform initiatives needed to render it sustainable. Section 4 analyses EMU governance in the light of sustainable integration, with reference to the above discussed properties. Section 5 concludes.

2. The Mainstream: EMU Reform and the Presidents’ Reports

The smooth functioning of a currency union, as compared to a less ambitious economic union, makes additional demands on labour, product and financial markets to become more flexible as a means of adjusting to shocks, given that monetary policy is no longer available for this purpose and fiscal policy has to be constrained. Coordination of national policies is, however, vital to prevent damaging spillovers from actions in one member state to others, weakening the overall coherence of the union’s economic policy.

Efforts to create a ‘genuine EMU’ (see also Mongelli et al., 2015), have only led to limited progress in creating what the Four Presidents’ report (Van Rompuy 2012) calls an ‘integrated economic policy framework’. Dealing with the legacy costs of the crisis, restoring growth and reducing imbalances, although essential, is not enough. Underlying competitiveness problems also need to be addressed, but moving the Euro area closer to an optimal, or at least sustainable, currency area requires reforms in areas where competencies have remained at the member state level.

The various Presidents’ reports on EMU governance provide orientations for a policy framework that would not only correct many of the known flaws in EMU, but also anticipate future problems. Actions in four areas were set out, with a distinction made between short- and long-term ambitions, providing for:

- An integrated financial framework to ensure a financially stable system; a common interpretation of this pillar is banking union, and a key objective is to break the so-called doom-loop (Gaspar, 2015) in which problems for banks become problems for national public finances and vice versa.
- An integrated budgetary framework with the dual aim of assuring fiscal discipline and developing new, common fiscal policy instruments, measures which would steer the Eurozone in the direction of fiscal union, albeit one which falls well short of the extensive cross-regional fiscal flows found in most other monetary unions.
- An integrated economic policy framework able to reconcile growth, employment and competitiveness with the sustainability of EMU, while avoiding negative spillovers across national borders.
- Enhancement of democratic legitimation and channels of accountability which is justified particularly by the loss of national autonomy in budgetary and other economic matters of greater top-down constraints on national autonomy in economic decision-making.

Proposals for developing each of these building blocks were presented in a ‘blueprint’ by the European Commission (2012), but progress has been mixed, with only banking union having been substantially advanced. Fiscal union has made scant progress since 2011 and there is, as yet, no strong sense of what will be done to improve legitimation, not least in relation to the enhanced powers of oversight conferred on the EU institutions (Schmid 2013). The spread of political protests and institutional conflicts, both within and between Member States, highlights the challenges because the economic governance model is one based increasingly on executive rather than representative power.

In paving the way for further reforms, Juncker et al. (2015a) pose a series of questions about the future governance framework and, implicitly, the reform initiatives needed to render EMU sustainable. These questions fall into three main categories. The first can be summarized as asking whether the current rules and institutions are robust enough to prevent a recurrence of problems, and whether the mechanisms in place will ensure sufficient resilience against future shocks, including through structural reforms. A second theme is whether risk pooling, both through private and public interventions, can be enhanced and can forestall further episodes of...
financial instability. Third, the paper returns to one of the original four themes: the accountability and legitimacy of governance. Although many proposed solutions had been canvassed in the 2012 contributions, that they are still unresolved testifies to the difficulties of completing EMU’s governance framework.

The follow-ups of the Four Presidents’ report (Juncker et al. 2015a, 2015b) advocate the need for an immediate strengthened commitment to growth-enhancing structural reforms so as to create a virtuous triangle of structural reforms, investment and fiscal responsibility, and a deepened single market to improve adjustment capacity. While these are worthy aims, they fall short of defining an economic development model that can guide the long-term sustainability of EMU. While we do not pretend to provide such a model, we aim to suggest the principles that might sustain it under the broad heading of sustainable integration.

3. A Vision for EMU: The Three Pillars of Sustainable Integration

We believe that the notion of sustainable integration offers a more comprehensive perspective on what is needed. We suggest that in the field of EMU, it rests on three main pillars, namely the pursuit of sustainable growth, reform strategies adapted to the modernization paths of national economies and national ownership of reforms. Each of these pillars of sustainable integration, in turn, requires new approaches to overcome the shortcomings exposed by the crises.

3.1. Sustainable Growth

Sustainable growth is central to the EU’s economic narrative and is enshrined in the treaties as a fundamental objective. Though most often connected with environmental objectives, sustainable growth in the EU lexicon encompasses social and economic dimensions, as set out, notably, in the Europe 2020 Strategy (Bongardt and Torres 2013). It can provide both a crisis exit strategy and a renewed long-term agenda for EU sustainable integration, and requires long-term commitments and necessary public investments (Lenschow 2010; Sachs 2012).

A sustainable polity is one that endures through time and changes in circumstances, including shocks. The EU is future friendly, which is, somewhat paradoxically, the silver lining of its so-called democratic deficit or lesser direct accountability since institutions are less susceptible to short-term electoral concerns and pressures than its Member States (Nicolaids 2010).

In this spirit, a durable economic recovery from the crisis starts with action today (ECB 2015). However, economic growth will be neither politically nor economically sustainable unless environmental damage, excessive resource depletion and long-term, inter-generational effects are internalized, while engendering greater resilience to natural hazards (Hallegatte et al. 2011). Combating climate change by accelerating decarbonization can, through well-designed policies, have positive growth effects in the short and long run — see for instance Fay et al. (2015), Nordhaus (2006), Spence (2014), Stern (2006, 2015). A call for ‘whatever kind of growth’ risks ignoring the economic case for environmentally and socially sustainable solutions.

Critically, the environment sector has managed to create employment since the outbreak of the crisis in 2009, notwithstanding the fact that in the approach towards sustainable growth, soft coordination has so far failed to realize the innovation, competitiveness and growth potential that it promises (EEA 2015). A more systematic look at the transmission mechanism between the completion of the single market and Europe 2020 strategy is warranted (European Commission 2010).

Progress towards sustainable growth therefore hinges on decision-making for the long term and on an economy capable of flexible adjustment with an innovation-friendly business environment, given that it involves both structural change within the economy and in society and a long-term-oriented governance system (Pearce and Turner 1990, 24; Randers 2012).

Policies and instruments that are consistent with long-term objectives need to provide the right incentives while minimizing possible short-term trade-offs between environmental protection and growth. However, the governance of sustainable growth relevant areas is piecemeal and methods and enforcement possibilities vary significantly and rely on soft coordination processes (typically, characterized by sweeping ambitions, but a dearth of disciplining tools). These included the Lisbon (2000–2010) and Sustainable Development strategies (2001, revised in 2006), before coming together in the Europe 2020 (2011–2020) strategy. Diverse governance methods are not intrinsically a problem, but the EU still lacks a coherent strategy for sustainable growth. As a result, and although the EU environmental sector expanded and created employment since 2008 in the midst of the crisis, its full potential remains to be exploited (EEA 2015).

3.2. Varieties of Modernization

Although monetary union enjoyed a benign first decade, the slow pace of national reforms in some member states and the incapacity of financial markets to distinguish between Eurozone sovereigns contributed to growing intra-EMU macroeconomic imbalances. EMU’s governance institutions were unable to encompass increasing policy interdependence, let alone capable of dealing with the effects of the crises. Monetary union brought about a qualitative change in the economic context, resulting, on the economic side, in unsustainable tensions.

Different EU states have followed different paths to modernization in terms of their socio-economic make-up, the attributes of their states, their state-society relations, their social and institutional traditions as well as the distribution of costs and benefits and the obstacles stemming from modernization dynamics. These varieties in turn determine the fit between the requirements of EMU and the country or countries in question.

Since the publication of the 1993 ‘Delors’ white paper on growth competitiveness and employment, the EU has launched a series of initiatives intended to bolster structural reforms within its member states. Their common objective has been to strengthen the EU’s and individual countries’ competitiveness in a world characterized by new realities and challenges,
such as globalization, the information society, demographic ageing, climate change or enlargement. For example, the Lisbon Strategy highlighted the imperative of advancing the EU as a knowledge economy in tandem with building a socially more cohesive society. Despite having wide-ranging goals, the strategy lacked a specific EMU dimension and thus did not take enough account of how different progress on structural change affected other euro area members. Although the Europe 2020 strategy sought to be more comprehensive, it has faded from view during the crisis years and has been supplanted by the much more short-term semester process. A possible explanation is that the instruments for policy coordination were not always differentiated enough to take into account the varieties of modernization faced across member states. On the fiscal side, the Stability and Growth Pact (SGP) was flouted (most notoriously, by France and Germany in 2002/2003), without a reckoning as to what its limitations were and how to accommodate the evident need for flexibility in the governance design itself. The resort to the open method of coordination (OMC) to engineer domestic reform had very differentiated success across states, suggesting that relying on tools such as benchmarking or best practice was insufficiently reinforced by public and peer pressure (Bongardt and Torres 2012). Analysts can disagree as to whether the culprit was the absence of binding and/or enforceable rules (in the Lisbon Strategy and in the SGP), only limited financial market pressure or, alternatively, the insufficient attention to the need for domestic institutions and habits that would inter-

The sovereign debt crisis highlighted the large negative spillovers from economic divergences and the urgency of more systematic reform affecting policy domains with divisive political and distributional effects, in and between member states. The Euro Plus Pact (2011) subsequently introduced an EMU dimension to economic reforms, but had little impact due to its weak (intergovernmental, non-binding) method. Similarly, a Compact for Growth and Jobs was established in 2012, but has had few visible effects. Proposals to incentivize reforms in member states through contracts for Growth and Jobs was abandoned when nearly all member states rejected them at the December 2013 European Council. A new impetus has been given to reforms and their relevance has grown in a context where fiscal policy is also constrained due to the need for an enduring correction of budgetary imbalances (Bini-Smaghi, 2015). Taxa-
tion instruments – including environment related – can once again supplement tighter regulation as European countries slowly exit from crisis management. There has been an acceleration of structural reforms in lag-
gard countries as a result of market and peer pressure and of formal and informal conditionality (Schmieding and Schalte 2014; OECD 2015). Yet, enforcing conditionality while at the same completing EMU’s governance framework is a perilous exercise for political legitimacy (Nicolaïdis and Watson 2015).

The choice of the OMC ostensibly reflected a perceived need for ownership of reforms (as a process of slow-moving and bottom-up convergence of preferences on institutions) and the notion of convergence as a gradual learning process. The approach was intended to foster reforms tailored to member states’ heterogeneous situations and preferences, yet the EMU process largely failed to foster true ownership of reforms in line with the member states’ own modernization goals. The fact that member states’ political systems (governments, oppositions and even social partners) may have agreed to EMU-sustaining reforms in the 1990s and committed to them under the Lisbon Strategy (2000–2010) during EMU’s first decade did not prevent many of them — to differing degrees — from backsliding and thus putting at risk their respective welfare states and the quality of life.

In the process, the question of the collective acceptance of EMU’s redistributive implications has become more politicized. This is in part due to the increased resort to executive decisions in economic governance, leading to significant divergences and political conflicts, both among and within Member States, as well as between them and supranational EU institutions, which have tended to be bypassed by intergovernmental or even bilateral bargaining. Many old conflicts about the ideal configuration of EMU, including within the European System of Central Banks and the ECB, have resurfaced. Clearly, EMU reforms cannot be sustainable if what they impose on individual member states is not democratically sustainable, both in terms of the electorate and in terms of the political leadership. Formerly vague references to European rules in national political debates have become more explicit constraints, better understood by citizens, thereby reducing the opacity of domestic political and policy processes and poten-
tially raising policy effectiveness. But the visibility of constraints also leads to their contestation when they are perceived as sacrificing domestic democ-

racy and autonomy (Rodrik 2011). Ideally, ‘fiscal disciplines’ enforced from Brussels will be progressively replaced by political ‘commitments’ in line with shared rules and expectations — admittedly, a tall order.

4. Progress and Pitfalls: Towards a Sustainable EMU?

The flaws in EMU’s governance framework exposed by the sovereign debt crisis have been examined in a growing number of critical papers which exhibit a fair degree of consensus on the broad directions for reforms needed to render EMU sustainable (see for example: De Grauwe 2013; Eichengreen 2014, De Graauwe and Ji 2015, Giavazzi and Wyplosz, 2013; Juncker et al. 2015a). In parallel, rapid (by EU standards) agreement since

3.3. Democratically Sustainable Reforms

The crisis has highlighted the need for citizens’ political ownership of both reforms undertaken in their own countries and of the European integration project as a whole, in response to questions such as ‘why (more) Europe? or ‘sacrifices in the name of what?’ To the extent that institutional limits to integration come to constrain the capacity to resolve European common concerns, without a democratization of reforms, the long-term political sus-

tainability of the European project is in doubt. The flaws in EMU’s governance framework exposed by the sovereign debt crisis have been examined in a growing number of critical papers which exhibit a fair degree of consensus on the broad directions for reforms needed to render EMU sustainable (see for example: De Grauwe 2013; Eichengreen 2014, De Graauwe and Ji 2015, Giavazzi and Wyplosz, 2013; Juncker et al. 2015a). In parallel, rapid (by EU standards) agreement since
2010 on a range of measures to strengthen fiscal discipline and economic coordination has dealt with some of the acknowledged shortcomings. These responses, together with the creation of the European Stability Mechanism (ESM) as a permanent rescue fund, new arrangements for financial regulation and supervision and better tools for macro-prudential supervision, arguably reduce the risk of future crises and strengthen the capacity for crisis management. But how do these measures fare against the three pillars of sustainable integration for EMU suggested above?

First and most broadly, greater macroeconomic stability calls for the recast of EMU governance and its embedding within a broader set of instruments meant to promote sustainable growth. Efforts to promote growth and jobs through the Europe 2020 strategy and the Compact for Growth and Jobs have had little obvious impact, while it remains to be seen how successful the Juncker Commission’s flagship idea of a new European Fund for Strategic Investment (EFSI), with its headline target of 315 billion of new investment, will be (see Claeyys 2015, for a sceptical view). Second, by disallowing either Euro-exit or a credible threat of default, and in the absence of a common fiscal stance, the functioning of EMU neglects the possible divergences resulting from distinctive national pathways to and progress on modernization.

Nor does the Five Presidents’ report of June 2015 inspire confidence that what is in the pipeline will be sufficiently transformative to address these pitfalls. Although the report calls for a new ‘fiscal stabilisation function’, it has apparently jettisoned the idea of a euro area budget for stabilization purposes. Since 2012, little progress has been made on risk pooling as a form of fiscal union. Unsurprisingly, creditor countries resist calls for jointly and severally guaranteed Eurobonds; indeed, the very term Eurobond has become unmentionable in some Member States ( Matthijs and McNamara 2013). There is still no easy means of arriving at an aggregate Eurozone-wide fiscal stance, despite extensive debate on the matter, which precludes agreeing an appropriate macroeconomic policy mix as a facet of economic sustainability. As various contributors to this issue also argued, it is necessary to tackle both the current need to stimulate domestic demand in surplus countries and the implementation of structural reforms to reduce built-up disequilibria in deficit countries. The link between fiscal policy and structural reforms is not irrelevant as the former is constrained by the need to ensure a proper adjustment of the budgetary imbalance and the latter can increase the credibility of the adjustment programme and thereby achieve a more gradual fiscal adjustment ( Bini-Smaghi 2015).

Moreover, perhaps for reasons of institutional and constitutional propriety, the report fails to encompass developments in the governance of monetary policy, such as the de facto recognition that the ECB has to be a lender of last resort or intervene in sovereign bond market in ways that have fiscal policy impacts potentially affecting growth prospects by lowering debt servicing costs ( De Grauwe and Ji 2015). While the establishment of the ESM fills a gap in emergency funding for Member States in (temporary) difficulty, it is less clear that there is adequate provision for the sort of comprehensive crisis management of an adjustment programme provided by the IMF.
be prioritized, and private investment encouraged in ways compatible with fiscal constraints and incentives ( Pisani-Ferry 2014 ). However, if we are to tinker with fiscal instruments we should create the right incentives for long-term stability at the same time. The use of fiscal instruments opens up the perspective of promoting sustainable growth by shifting taxation onto inefficiencies (pollution), and away from taxing productive factors (labour). This requires in turn enough coordination among states to forestall a race to the bottom on corporate taxation, which in the last 20 years has hollowed out the tax base across European states ( Piketty 2014 ). Also, subsidies like the ones on coal and other fossil fuels should be abolished as they encourage their use, which is in conflict with trying to curb CO2 emissions besides increasing budgetary expenditures and distorting incentives and competition ( IEA 2014 ). Moreover, astute regulation can foster private green investments without incurring fiscal expenditure and provide a push for EU green innovation and cost-efficiency. The circular economy package – an approach to resource use that builds-in recovery, recycling and regeneration as fundamental components of economic management – is a case in point where demand-resource use that builds-in recovery, recycling and regeneration as fundamental components of economic management – is a case in point where demand-

5. Conclusion: Towards EU Sustainable Integration?
The sovereign debt crisis has exposed flaws in the governance framework of EMU that were partially remedied, most emphatically in the area of banking union, arguably reducing the risk of future crises and strengthening the capacity for crisis management. The principal challenges now to sustainable integration are, on the one hand, to strengthen economic coor-
dination of the structural reforms needed to render EMU more resilient and to restore growth to the top of the political agenda; on the other, for integration to be sustainable, citizens have to be convinced that EMU is working for them.

A lack of national ownership and the conditionality of structural reforms have led to greater politicization, putting into question the collective accep-
tance hitherto of their redistributive implications. Political protests and institutional conflicts have marked the Eurozone in the last five years. Those frictions offer the EU an opportunity to address what we consider to be its greater challenge: pursuing a path of sustainable integration, grounded in enhanced societal capacity and propensity to act for the long term.

The sustainable integration paradigm offers a long-term vision for the EU integration project in the crisis context and beyond. To kick-start it, sustainable growth can be the basis for an exit strategy from the crisis in the shorter term (complementing the financial integration discussed by Jones 2015 ) and a prerequisite for a smooth functioning of EMU in the long term which would bring about wider benefits from EU integration for EU citizens. But there is a long way to go. The EU approach to sustainable growth is piecemeal and driven by the artificially separate realm of ‘climate policy’, with a recent boost under the heading of the Energy Union. As yet, it falls short of a coherent development strategy for sustainable growth. Within such a sustainable integration logic, EU actors must engage in a continuous discussion on the relationship between short-term actions and long-term objectives. This process, if properly implemented, and aligned with citizens’ priorities can contribute not only to the sustainability of EMU per se, but to the wider political sustainability of the European integration project as a whole.

Acknowledgements
We would like to thank an anonymous referee, seminar participants at earlier presentations in Oxford and London, and, particularly, Paul De Grauwe, Erik Jones, Russell Kinkaid, Benedetta Marzzinotto, Waltraud Schelkle and Max Watson, for very valuable comments and discussions. Of course, the usual disclaimer applies.

Disclosure statement
No potential conflict of interest was reported by the authors.
EMU and Sustainable Integration 815

Funding
Iain Begg is grateful for financial support under the Horizon 2020 research programme for the FIRSTRON project, grant agreement number 649261.

Notes
1. Negative spillovers were rooted in factors such as unsustainable debt paths, inadequate national financial supervision, the feedback loop between weak banks and over-indebted sovereigns, and lower growth potential associated with insufficient modernization of national economies.

2. The objective of sustainable development was not well integrated in the Lisbon Strategy on growth and employment. The Europe 2020 strategy’s green growth objective is based on climate targets (the 2007–2009 climate energy package), which have become insufficiently ambitious to promote innovation and investment with the crisis-induced downturn in economic activity.

3. De Wilde and Zara (2012) suggest that crises have a strong bearing on the acceptability of greater politicization in EU integration.

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