The EU’s incremental adjustments to the eurocrisis may not be enough to meet the coming challenges to its governance and democratic legitimacy.

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Since the beginning of the eurozone debt crisis three years ago, the member states have been forced to change the governance of the eurozone in a long period of crisis management. **Daniela Schwarzer** *looks over the major changes to the EU’s governance structure, arguing that the European Council, Germany, and the European Central Bank have moved to the centre stage, often leading to the marginalization of other supranational actors and smaller member states in decision making. She argues that while the eurozone has shown a remarkable capacity to adjust thus far, it may need far more fundamental reform to its institutional set-up if it is to cope with looming problems of governance and legitimacy.*

Since the sovereign debt crisis hit the euro area in 2010, most attention has been paid to crisis management decisions, i.e. financial aid packages, debt restructuring or behind-the-scenes-action by the European Central Bank. In order to fully understand the evolution of the euro area, it is crucial to also look at the considerable degree of explicit and implicit changes which impact today’s governance set-up of the euro area and hence decision-making dynamics and power relationships.

A first observation is that, in the course of crisis management and in particular through its first permanent President installed by the Lisbon Treaty, the European Council and later the Eurozone summit, have become the center of decision-making. This not only implies a potential loss of influence for the European Commission and the European Parliament, two of the supranational institutions of the EU, it also means that member states matter more and that they matter according to their relative weight.

European Council Summit Credit: President of the European Council (Creative Commons BY NC ND)

Second, and this is closely related to the first point, the German government has, partly involuntarily, moved to center stage. Germany not only has by far the largest economy, but recently also one of the most dynamic ones in the EU. Thanks to painful adjustments in previous years, it had turned into Europe’s engine of growth by 2010. It is the most important guarantor and creditor for fellow euro area member states through its contribution of 27% of the European Stability Mechanism. Meanwhile, domestic conditions have imposed serious constraints on Germany’s government that have rarely been seen in the period of post-war European integration.

This has consequences: Germany was initially reluctant to help Greece, and has pushed for tougher rules and sanctions in policy coordination and for the creation of a European insolvency procedure. Germany's unusually uncooperative strategies to push for its interests have made its role and commitment to the EU one of the key issues in the debate on the future of Europe, in particular since it seemed to give up its previous support for supranational institutions by calling for more intergovernmentalism. German efforts to export its own economic policy agenda have also resulted in a bilateralisation of conflicts over measures to cope with the debt crisis.

For two years, Germany's chancellor Merkel teamed up with France's President Nicolas Sarkozy to define the agenda of the European Council or the Euro Area Summit. But if decisions of crisis management and governance reform are taken among the Heads of States and Government without a major contribution by supranational actors, this marginalizes small and medium-sized member states. Unsurprisingly, they have harshly criticized the dominant role of the large member states, for instance the Franco-German Deauville compromise on the reform of the euro area of October 2010.

Third, if there is one institution whose factual role in economic governance has changed, it is that of the European Central Bank (ECB). It no longer only runs the euro area's monetary policy, but has evolved into the only crisis manager that is willing and able to ensure the survival of the euro area. Its prominent rule in day-to-day crisis management also leverages its political influence in two regards. First, when it came to debating governance reforms. Second, the ECB at a certain point became directly involved with disciplining member states to implement reforms on the domestic level. Moreover, it is also part of the so-called Troika composed of European Commission, ECB, and IMF representatives who negotiate with, and monitor progress in those member states which have received an aid package.

Fourth, the establishment of the permanent European Stabilisation Mechanism (ESM) has changed the political economy of the euro area. First of all, conditionality attached to loans has proven to be the most effective disciplining device for disciplining national economic and fiscal policies. In the future, it is conceivable that the ESM may be at the core of budgetary and economic policy coordination for those member states that require loans in times of liquidity shortage. The ESM could perhaps even develop into a more pro-active actor, if should one day be able to provide "preventive loans" before a crisis actually hits, meaning it can extend its role in supporting structural adaptation processes. If it indeed turns into the institutional hub for policy coordination, this raises questions of democratic accountability and legitimacy.
Fifth, a number of new procedures for closer surveillance and coordination of budgetary and economic policy have strengthened attempts to realign domestic policy choices with jointly defined European targets. European Financial Supervisory structures have been established, and a banking union is in the making. Euro summit meetings are now to be held after European Council meetings at least twice a year to "provide strategic orientations on the economic and fiscal policies in the euro area". However, none of these measures actually involves a transfer of competencies or a re-gaining of joint decision-making capacity, for instance, in the field of macro-economic policy, which has been long lost by member states which have given up monetary authority.

While the euro area has shown a remarkable capacity to adjust the functioning of its governance below the levels needing Treaty change, a more explicit and fundamental reform may be required in order to account for problems of governance efficiency and, increasingly, problems of legitimacy. The current institutional set-up has thus far only incrementally adapted to the inner and outer challenges faced by the eurozone. It has largely found success by not impacting more strongly on national sovereignty and by not strengthening supranational policy making based on its own sources of legitimacy. However, this arrangement will not be able to solve the collective action problems inherent in the EMU's asymmetric set-up, namely a centralized monetary policy and insufficient integration in the fields of economic, budgetary and financial policy.

This article is based on The Euro Area Crises, Shifting Power Relations and Institutional Change in the European Union, from the December 2012 issue of Global Policy.

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