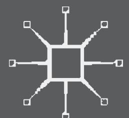
Palgrave Studies in European Political Sociology

After the Financial Crisis

Shifting Legal, Economic and Political Paradigms

Edited by
Pablo Iglesias-Rodríguez,
Anna Triandafyllidou and Ruby Gropas



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For those who work for a Europe of justice and solidarity

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The aim to explore whether a paradigm shift was underway as a result of the crisis took shape in late 2013 and led to a workshop hosted by the Global Governance Programme of the Robert Schuman Centre of the EUI, in San Domenico di Fiesole in March 2014. Many of the debates and discussions that were exchanged among paper-givers and participants during this workshop eventually led to this volume. We would like to thank the series editors of Palgrave's European Political Sociology series for supporting this volume's thesis and giving us the opportunity to put pen to paper, or rather keyboard to screen, and bring together a group of scholars across disciplines, countries and continents to discern what changes have or have not been taking place in the economic, political, legal, regulatory and civic life in Europe and the US since the outbreak of the global financial crisis.

As every book, this one too is the result of teamwork, cross-pollination of ideas and constructive collaborations. We would therefore like to thank all the participants of the 2014 workshop at the EUI and even

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Florence, Brighton and Brussels
27 October 2015

Anna Triandafyllidou
Pablo Iglesias-Rodríguez
Ruby Gropas

Contents

1	**Has the Financial Crisis Led to a Paradigm Shift?** *Pablo Iglesias-Rodríguez, Ruby Gropas, and Anna Triandafyllidou*	1
Part I	**A Change in Regulation Paradigms**	21
2	**Paradigm Shift in Financial-Sector Policymaking Models: From Industry-Based to Civil Society-Based EU Financial Services Governance?** *Pablo Iglesias-Rodríguez*	23
3	**Changing Perceptions of Systemic Risk in Financial Regulation** *Caroline Bradley*	75
Part II	**Shifts in Monetary and Economic Policy Dogma**	107
4	**From National to Supranational: A Paradigm Shift in Political Economy** *Guido Montani*	109

5 **Growth and Welfare: Shifts in Labour Market Policies** 139
Henri Sneessens

6 **Rethinking E(M)U Governance from the Perspective of Social Investment** 173
Anton Hemerijck

Part III Politics and Civil Society Under Pressure 213

7 **Creative Resistance in Times of Economic Crises: Community Engagement, Non-Capitalist Practices and Provoking Shifts at the Local Level. From Catalonia to Experiences in Greece** 215
Ruby Gropas

8 **EU Civil Society and the Crisis: Changing Channels and Organisational Patterns in European Transnational Civil Society** 241
Alison E. Woodward

9 **The Restructuring of the Western European Party Space in the Crisis: A Comparative Study of Austria, France and Germany** 269
Jasmine Lorenzini, Swen Hutter, and Hanspeter Kriesi

10 **'TINA' Revisited: Why Alternative Narratives of the Eurozone Crisis Matter** 303
Ulrike Liebert

11 **From One-directional to Multi-directional Paradigm Shift** 335
Pablo Iglesias-Rodríguez, Anna Triandafyllidou, and Ruby Gropas

Index 347

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List of Figures

Fig. 5.1 Unemployment rates in the EU-15, USA and UK, 2006–2014 142
Fig. 5.2 EU 15: Unweighted average unemployment rate in the EU-15 (*continuous line*), ±1 standard deviation (*dashed lines*) 143
Fig. 5.3 Contribution to EU-15 unemployment in percent of total EU-15 change, over the sub-periods 07/2008–12/2010 and 01/2011–06/2013 144
Fig. 5.4 Real GDP, index 100 in the year 2000 145
Fig. 5.5 Current account surplus (percent of GDP) 146
Fig. 5.6 The relationship between wage adjustments and aggregate unemployment 147
Fig. 5.7 Competitiveness index defined by the inverse of competitiveness-weighted relative unit labour costs for the overall economy in dollar terms 148
Fig. 5.8 The dynamics of the labour market 152
Fig. 5.9 Public spending on labour market programmes in 1993 and 2012 (2010 for the UK, 2011 for Spain), in percent of GDP 165
Fig. 6.1 Social spending as % GDP over the crisis 189
Fig. 6.2 Employment rate, all population 194
Fig. 6.3 Employment rate, Women 194

Fig. 6.4 Correlation between capacitating social spending and employment rate 195
Fig. 6.5 Life-long learning rate and older age employment rate 196
Fig. 6.6 Fertility rate and female employment rate 196
Fig. 6.7 Capacitating social spending across the crisis 197
Fig. 9.1 Salience and polarisation of economic and new cultural issues over time (1970s–2012/2013) 283
Fig. 9.2 Shifts in average issue positions 291
Fig. 9.3 The political spaces in the 2000s and 2012/13 compared 293

List of Tables

Table 2.1 Examples of participation in Commission's consultation procedures by stakeholder group 33
Table 2.2 Composition of the stakeholder groups (mid-2015) 38
Table 6.1 Core differences between EMU's original 'retrenchment-deregulation' social policy regime and the macroeconomic policy framework in support of social investment return optimization 202
Table 9.1 Issue categories 280
Table 9.2 Conflicts over specific issues: crisis elections and change with respect to pre-crisis period 287

1

Has the Financial Crisis Led to a Paradigm Shift?

Pablo Iglesias-Rodríguez, Ruby Gropas, and Anna Triandafyllidou

Introduction

Before the outbreak of the global financial crisis (GFC) in 2007 (Federal Reserve Bank of St. Louis 2015), the ways in which financial markets, institutions and actors functioned reflected, to a great extent, specific paradigms about how financial markets and institutions ought to work and how investors behave. Markets were perceived as informationally efficient, and financial innovation was considered an effective tool of risk management and economic growth (see for example Greenspan 2000). Equally, self-regulation of the markets by the financial industry was considered an

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effective regulatory tool. The pro-self-regulatory approach of policy-makers before the crisis was patent in the opposition of the US Treasury, the Securities and Exchange Commission (SEC) and the Federal Reserve to the attempts of the Commodity Futures Trading Commission (CFTC) to strengthen the public regulation of over-the-counter derivatives in the late 1990s (Nutting 1998). Gradually, in the last couple of decades, politics had come to be seen as subordinate to the markets. Ever since Francis Fukuyama's post-1989 'end of history' idea became prevalent (Fukuyama 1992), suggesting that Western-style liberal democracy combined with capitalism had prevailed over other socio-economic paradigms, the neoliberal version of free market economy with a limited role for the state became the dominant one. In the second half of the 2000s, markets were increasingly less subject to political scrutiny while regulatory institutions and mechanisms were further relaxed. Nobody questioned the entanglement of vested interests within such institutions and mechanisms, and financial rating agencies became hegemonic in making the day or predicting doom and gloom for entire countries and economic activity sectors. International organisations such as the Organisation for Economic Co-operation and Development (OECD) and the World Bank or the International Monetary Fund (IMF) did little to effectively contest this subtle erosion of their power in favour of less accountable private actors such as banks, multinationals and rating agencies. The roles of the IMF and of the World Bank before the GFC generated much dissatisfaction among global civil society (Higgott 2012: 20).

The credit crunch of 2007 challenged the hegemonic neoliberal pre-crisis paradigm. Several commentators in the political and academic arenas criticized the pre-crisis assumptions concerning the financial markets and questioned their validity in light of the crisis events. They also called for a return to politics and questioned the democratic legitimacy of the then prevailing paradigm.

The responses to the economic crises that followed the financial crisis of 2007 have also sparked debates on whether some monetary and economic policy dogmas, specifically the economic rescue packages and the austerity policies, that have been applied are indeed adequate to deal

with the root causes of the crisis. Werner-Sinn's meticulous account of the crisis in his 2012 book suitably entitled *Casino Capitalism* has become a point of reference in this respect (Sinn 2010). Throughout the outbreak of the crisis and in more recent years, increasing levels of concern have been raised about the ways in which these policies are distributing the burden of the recovery both within and between countries, and economists such as Joseph Stiglitz or Paul Krugman have consistently advocated for the end of austerity measures and the need to 'put an end to this cruel nonsense' (Krugman 2012).

Much thought and ink has focused on the causes of the crisis and even more on the consequences of the crisis. In this volume, rather than simply analysing the ways in which different countries or institutions have dealt with the financial and ensuing economic and political crises, we engage with the notion of paradigm and paradigm shift.

The notion of paradigm finds its origin in Thomas Kuhn's work on the history of science. Kuhn (1962) developed the concept of paradigm with a view to making sense of why scientific theories are accepted and why they are changed. A paradigm is a dominant approach to solving problems in a given area of science. Kuhn argued that 'normal science' is a puzzle-solving activity conducted under a dominant 'paradigm'. The paradigm is inspired by a great theoretical achievement (as is, for example, Einstein's theory of relativity) and provides a guide on how to do scientific research. While a paradigm does not involve a clear set of rules, it clearly shows how to go about investigating things. However, an anomaly arises when a problem cannot be solved, and this anomaly cannot be discarded as an ill-conceived research project but rather requires an explanation and probably a change in the dominant model—that is, in the dominant way of conducting scientific research. In this case, a crisis period starts and new methods and approaches are devised to solve the 'anomaly'. This opens up a window of opportunity for views and research procedures previously considered 'heretical' to be explored, and when one of these approaches manages to solve the puzzle, it can lead to a 'paradigm shift' and a new paradigm may be established.

Kuhn's contribution has been particularly important as he has critically engaged with the notion that science follows a steady linear progression where theory is added to theory in search of the 'truth'. Kuhn pointed out the tensions within the progress of scientific knowledge (hence, he spoke about scientific revolutions) and showed how there had been fundamental paradigm shifts in different historical periods. Through his critical approach, Kuhn has cast light on the idea that there is a fundamental and objective truth that can be found through scientific research. Indeed, the essence of Kuhn's concept of paradigm is the rejection of the positivistic notion of progress of knowledge.

This volume adopts the notion of paradigm shift to point out a situation in which a fundamental change in approach or underlying assumptions is taking place as a consequence of a social, economic and political crisis situation. We argue that the financial crisis of 2007 and the ensuing economic and political crises in Europe and North America have triggered a process of paradigm shift in the fields of economics, law and politics. They have activated a process of reconsidering the nature of the market, the role of the state as a market regulator and provider of welfare and social protection, the role of political parties in representing society's main political and social cleavages, the role of civil society in voicing the concerns of citizens and interest groups, the role of the citizen as not only the ultimate source of power in a democracy but also a fundamentally powerless subject in a global economy, and the ways in which wealth distribution and inequality may affect the quality of democracy.

Our book questions whether a paradigm shift has consolidated in different legal, economic and political activity areas. It looks at the actors and processes that have carried it forward and seeks to explore whether indeed this paradigm shift has materialised or rather has fallen short of becoming a new political and economic 'revolution'. We actually propose the notion of 'incomplete paradigm shift' to emphasise that a paradigm shift has multiple dimensions and that not all dimensions develop synchronically. Rather, there may be gaps and contradictions between what happens in law, the economy, the political sphere and society.

This book has a twofold aim. On the one hand, it analyzes whether, how and why the legal and economic responses to the financial crisis encompass real paradigm shifts in the governance of financial systems

and economic and social policies and the extent to which these are reshaping not only national economies but also the way in which the global economy functions. It also assesses whether the post-crisis reforms and reactions that have been and are being operated across Europe tackle the structural causes and shortcomings of the crisis and constitute an effective path to recovery.

On the other hand, it questions whether the crisis has, indeed, led to changes in the politics of European liberal democratic societies. It investigates whether a new era of democratic politics is emerging through a different type of transnational political protest and participation, whether we may discern seeds of what may eventually lead to change in certain fields, or whether, in fact, the paradigms that were dominant prior to the crisis have remained so in spite of the consequences of the crisis.

In short, the book explores whether we are witnessing a paradigm shift or an incomplete paradigm shift, with changes in some areas and less in others. Are we witnessing radical transformations across all spheres, or are the shifts in some areas more substantial than in others? We explore these questions in the chapters that follow by studying the changes that have or haven't occurred with regards to financial regulations, economic models, welfare systems and the political sphere.

Shifting Financial, Economic and Welfare Paradigms

Among the economic theories that have driven economic policy in the last decades, probably the most influential is the efficient market hypothesis (EMH). This theory, introduced in 1965 by Eugene Fama in his seminal work 'Random Walks in Stock Market Prices' (1965), claims that the prices of financial assets immediately incorporate and reflect all the available information. Proponents of the EMH argue that markets are self-correcting and that, as a result, there is no need for extensive government regulation. During the last 40 years, legislators and regulators in several jurisdictions around the world have, indeed, been encompassing the EMH in their policy decisions, and this frequently resulted in *laissez-faire* regulatory regimes where important rule-making, monitoring and

enforcement duties concerning financial markets, institutions and actors were allocated to the financial industry—with very low degrees of government intervention (see Arias and Costas 2015).

The application of this policy approach to countries whose economies were highly dependent on the financial sector has had dramatic consequences. In this respect, as the crisis that started in 2007 has shown, the financial sector did not always succeed in providing a sound and orderly regulation of the financial markets. On the contrary, many of the phenomena that contributed to the financial meltdown—for example, credit default swaps (Stulz 2010) and securitization of subprime mortgages (Segoviano et al. 2013)—were the result of creations, uses and/or abuses by the financial services industry in major capitalist economies, such as the USA or the UK.

In regards to the prevailing paradigms in the regulation of the global economy and the market, Soros (2009) has argued that the crisis has fundamentally shaken perceptions about the efficiency of the markets and proposes a return to regulation and economic policies centred on employment and price stability. In effect, though we are still far from seeing the end of what decades ago Susan Strange described as 'casino capitalism' (Strange 1986), the most immediate result of the crisis and the subsequent shattering of the ideological belief in the capacity of financial markets for self-regulation has been the return of state intervention in the management of the economy (Black 2010). Notably, in the countries that were hit hard by the crisis, legislators and policy-makers reacted by intensifying the degree of public regulation and supervision of the financial markets (Moloney 2010; Coglianense 2012), with a particular focus on those financial instruments (such as derivatives, see Scalcione 2011) and market participants that were blamed for the financial meltdown.

Other works put their focus on the political determinants of and investigate reactions to the crisis, challenging well-established political models. For example, McCarty, Poole and Rosenthal (2013) question the rationale of market democracies and the beliefs and actions of the political order behind them, which, in the view of the authors, contributed to the financial bubble. Posner (2011:7) describes the political reactions to the 2008 downturn in the USA as 'premature, overly ambitious, too political, too interventionist'. While he questions the merits of capitalist democ-

racies in addressing the challenges posed by modern financial systems, Streek (2011) takes the argument further, identifying inherent contradictions of democratic capitalism that result from the often-incompatible demands of citizens, on the one hand, and the markets, on the other. Other scholars such as Reich (2007) go further still, arguing that capitalist regimes with high degrees of market self-regulation actually harm democracy.

Overall, a rather vocal academic consensus has emerged advocating the need to reconsider some pre-crisis paradigms regarding the functioning of the financial markets, and the effects of neo-liberalism on European democracies. However, the political and social reactions in society and policy-making are still limited in scope and do not reflect radical shifts. For instance, in the post-crisis framework it remains unclear whether there has been a real shift in the allocation of regulatory, oversight and enforcement responsibilities between public and private actors with regard to the functioning of the financial system. This suggests that, despite the consensus about the need to move away from the EMH, this has not translated into real changes in the way in which the financial system functions. This casts doubts about the extent of the paradigm shift—if any. It also raises some questions about why, in spite of the extensive evidence concerning the damaging effects of some policies and behaviours that encompass pre-crisis paradigms, these continue to persist.

This leads us to one of the most sensitive and urgent areas that have been affected by the crisis, namely social protection and the welfare state. Until the 1970s, the establishment of a welfare state and the protection of social rights were considered to be at the heart of democracy across Europe (Barbier 2013). In recent decades, however, welfare states have increasingly been criticized for distorting the market by destroying incentives to work, save and invest while fuelling high dependency ratios, particularly among some segments of the population. In addition, the case has been strongly made that demographic and social changes, in particular Europe's ageing society, renders welfare states fiscally unsustainable. Finally, it has been claimed that the pressures of globalization and global competition impose new disciplines on governments, forcing them to restrain spending and curtail social protection in order to remain globally competitive. Governments have attempted to adapt to these pressures

by favouring new patterns of working lives, new household and family structures seeking a new demographic and labour-welfare balance (Cox 1999; Hemerijck 2001; Jordan 1998; Sapir 2006).

The crisis seems to have presented the opportunity to retrench and reform the welfare state, essentially bringing the tension between contemporary capitalism and globalization, on the one hand, and social justice and inequality, on the other, to the forefront of political debates (Diamond and Lodge 2013; Hay and Wincott 2012). However, with inequalities between and within countries becoming ever more severe, it is necessary to reflect on how this pre-crisis mindset served as a dominant template that has been put forward in order to define the aims of national social policies and restructure the welfare states so as to cope with new risks and needs. The old paradigm of the three worlds of welfare capitalism and of the changing notion of work in the 'new capitalism' (Esping Andersen 1990; Sennett 1998) may have exhausted their explanatory potential, but a new paradigm for explaining the work and welfare relationship is not yet here.

The Political Repercussions of the Crisis

Since the collapse of Lehman Brothers in 2008, the spectre of the 1930s has hung heavy over most analyses and debates on the political repercussions of the crisis. Intellectuals from very different backgrounds, such as Juergen Habermas, Amartya Sen, Joseph Stiglitz, Paul Krugman, Saskia Sassen and Slavoj Žižek, have repeatedly called for the urgent need to rethink the ways in which our societies are governed and the dangerous repercussions of the unfolding tensions between neo-liberal capitalism and democracy. Strong concern has even been expressed for the very survival of the European project (Tsoukalis 2014) and even more so of democracy in the face of the grave economic consequences of the crisis; see, in particular, the work of Fritz W. Scharpf (2011) and Wolfgang Streeck (2012).

Political scientists, sociologists and anthropologists have explored the effects of the crisis on the structuration of political conflict in Europe, on the evolution of social behaviour, and on citizens' choices focusing on

a wide range of dimensions. Scholars working on cleavage politics and political parties have concentrated on the ways in which the crisis has impacted the long-term trends in the development of political conflict in Europe—as defined in the works of Hooghe et al. (2002); Hooghe and Marks (2009); Inglehart and Welzel (2005); Kitschelt (1995); Kriesi et al. (2008 and 2012); and Hutter (2012 and 2014), among others.

Prior to the outbreak of the crisis, Kriesi et al. had convincingly argued that across Western Europe an increasing conflict between universalistic/integrationist cosmopolitans and particularistic/isolationist nationalists had been growing. This was mainly the result of the resurgence of nationalist reactions against the economic, political and cultural forces of globalization driven by the radical populist right in the electoral channel—see also Enyedi and Deegan-Krause (2010) and Ellinas (2010)—and of the mobilization by the new left in the electoral and the protest channels. The crisis indeed seems to have severely heightened this trend raising much concern about the ways in which citizens' grievances are being expressed in economic or in cultural terms, fuelling cultural conflicts that may have already been shaping up before the crisis—Kriesi (2014). The crisis also seems to be magnifying what Peter Mair described as a diminishing capacity on behalf of political parties to govern and to represent—see Bosco and Verney (2012).

The political impacts of the crisis are obviously not only limited to the way political contestation in the electoral arena has been affected in recent years. In effect, Castells, Caraça, and Cardoso (2012), have highlighted the emergence of new economic cultures that react against traditional economic models. At the same time, scholars studying Europe's civil society and social movements—such as Della Porta (2012, 2013) and Liebert and Trenz (2011)—have extensively researched the different ways in which protest has been expressed in the civil society arena, in the public sphere and through social protest movements since the outbreak of the crisis. And, while Seferiades and Johnston (2012) have concentrated on the more violent forms protest has taken, Kaldor and Selchow (2012) have noted that what is remarkable with protest movements such as Occupy and the *Indignados* is their widespread resonance with mainstream public opinion. Looking at another facet of mobilization, Anduiza et al. (2012, 2013) have studied the ways in which online

social networks offered the possibility for citizens to mobilise and express their protest against the political establishment and its handling of the crisis and its consequences. Extensive research in this field has indeed tried to illustrate the role that new social media have played in allowing ordinary citizens to connect in ways that elude censors, amplify the voice of marginal groups in politics, and generate new paths of democratic discourse (see *inter alia* Avril and Neem 2015). In short, innovative research has been undertaken as the crisis has been unravelling to try to map and explain its socio-political consequences presenting the alternative, destructive and constructive ways in which citizens have expressed their discontent, protest and resistance to the crisis, its management and the ensuing austerity policies (Anduiza et al. 2012, 2013; Emmanuelle and Neem 2015; Kaldor and Selchow 2012; Liebert and Trenz 2011; Seferiades and Johnston 2012).

Liberal democracy is obviously an evolving concept. Democracies are perpetually faced with the challenge of quality; they have to reform, change and enlarge (vis-à-vis their constituencies) in order to include and empower their citizens and efficiently manage social tensions, mitigate the effects of inequalities and offer prospects of growth and betterment. Democracy is unavoidably associated with normative notions of justice, rights and freedoms, equal opportunities, protection of the more vulnerable and progress (Diamond and Morlino 2005; Diamond 2007; Eriksen et al. 2003; Moravscik 2004; Schmitter 2004; Siedentop 2000; Torreblanca 2011; Zielonka 2007). Liberal democracies in the European Union (EU), in spite of their shortcomings, are overall considered to be consolidated democracies; EU Member States are, by and large, perceived as substantive, quality democracies. However, it is becoming increasingly pressing to examine whether European democracies are responding with a real shift in their political paradigm as well as whether current politics challenge the formerly hegemonic neoliberal model and create a new synthesis of democratic politics, welfare policies and citizenship.

Across Europe, citizens have expressed protest, anxiety, fear, disillusionment and opposition to their governments' policy options in different ways. They have ousted governments because of their policy choices—either in applying austerity programmes or approving bailouts; they have demonstrated peacefully or, in some cases, increasingly vio-

lently; they have abstained from elections altogether; or they have voted for extremist, populist and radical parties that are Euro-sceptic if not outright Euro-phobic on both the left and right. Yet, given the magnitude of the crisis in many countries, has mobilisation been as far-reaching as one might expect? And is this mobilisation leading to substantial changes and transformations? Is it leading to any meaningful shifts in the structure and dynamics of European politics or in Europe's democracies? For the time being, and in spite of political developments in Greece and Spain in 2015, it remains unclear whether and in what ways these forms of protest or alternative—or even anti-systemic—political participation and mobilisation are leading to a new type of post-crisis politics where the links between the state, the market and the citizen are cast in a new framework. It also remains unclear to what extent mainstream political parties are able to represent the current core societal cleavages and to what extent civil society is able to voice the concerns of citizens and interest groups in the wider context of increasingly scarce resources. We wish to build further on the research that has been undertaken on these issues and explore whether and what kind of paradigmatic shift is taking place in the politics of European liberal democratic societies.

Rationale and Structure of the Book

The financial downturn that started in 2008 and the economic, social and democratic crises that followed have generated a great deal of attention in different academic disciplines. Publications in this field can be classified along two main lines: those that try to explain the causes of the financial and economic crises and those that address the changes brought about by the crisis in different fields—such as the economy, the legal system, policy-making or social relations. Among the latter works, some focus their attention on the issue of how certain pre-crisis paradigms have changed after the financial meltdown.

Whereas the mainstream literature on the effects of the crisis has contributed to a better understanding of how contemporary societies—and their ways of thinking—are being transformed, it somehow fails to evidence whether the post-crisis changes and developments encompass real

shifts in paradigm. Such omission is, to a great extent, related to the prevalent views about the concept of paradigm and of paradigm shift.

First, most analyses to date generally interpret paradigms as cognitive phenomena bound to certain policy, social, economic or regulatory spaces—e.g., economic (Balling et al. 2012), socio-political (Baumgartner 2013; Janos 1986), or regulatory (Ruhl 1996)—with potential policy reflections. Second, this interpretation of paradigms results in a one-dimensional analysis of paradigm shifts, normally limited to one field of knowledge. As a consequence, changes in paradigms are generally explained as mere reactions of actors and forums from a given realm to the failures of certain core assumptions within such realm to provide solutions to critical problems. Those analyses dismiss the fact—precisely explained in this book—that paradigms have several dimensions and that such multi-dimensionality is critical to understand how paradigms change over time or why, in fact, they may be resistant to change.

This book creates a new conceptual framework for understanding the effects of the financial crisis that is based on a redefinition of the concept of paradigm and a better and more integrated vision about the mechanisms of paradigm shift. In doing so, we aim at providing a meaningful contribution not only to the literature on financial regulation but also to the study of economic crises and their wider consequences as well as to the scholarship on paradigm shift in the social sciences.

In the first place, we challenge the traditional notion of paradigm. Departing from the analysis of the financial crisis, we adopt a holistic and multidimensional approach to the concept and its traditional meaning in the social sciences. Notably, we argue that paradigms comprise several dimensions—scientific, legal, political, social—that are interconnected and that complement each other. Hence, a single paradigm, such as the paradigm about the efficiency of the financial markets, is not analysed as a phenomenon bound to a specific field (e.g., economic policy) but rather as a cognitive phenomenon with reflections on several areas of institutional activity and social relations that have been traditionally dismissed (e.g., consumer and social behaviour).

Second, unlike prevailing literature, which often traces the paradigm shifts to scientific and academic developments, through this book we

wish to illustrate that paradigm shifts may source from any dimension—e.g., policy, legislative, social—and may then expand to others. Notably, through the different contributions gathered in this volume, we intend to explore whether and in what ways important post-crisis changes in paradigms have emanated from social reactions rather than from within policy forums and have, only subsequently been incorporated in the actions and decisions of policy-makers and legislators.

Third, one of the main innovations that we propose through this volume consists of the explanation of the mechanisms of the change in paradigm. In this regard, we argue that a true change in paradigm and its continuity over time requires its encompassment by actors and forums corresponding to each of the dimensions of a paradigm—intellectual, social, political, regulatory.

Linked to this idea, we introduce the notion of *incomplete paradigm shift* to explain cases where changes in paradigm are embodied by actors, forums and institutions operating in one of the dimensions but rejected by actors, forums and institutions from other dimensions. We argue that instances of incomplete paradigm shift ultimately lead to a full reinstatement of the former paradigms. The notion of incomplete paradigm shift is, in turn, used to explain why paradigms that lead to socially inefficient outcomes—such as, for instance, the efficient markets hypothesis and its policy reflections (Ball 2009)—persist over time and, also, why the financial crises of the last 100 years share several common elements, such as major changes in credit volume and asset prices, as well as balance sheet problems (Claessens and Ayhan Kose 2013; Schularick and Taylor 2009).

Fourth, through this book we intend to fill a gap in the rapidly increasing literature on protest politics and radicalization (Marquand 2011; Roberts and Garton Ash 2009). Indeed, recent research coordinated by Mary Kaldor (Kaldor et al. 2012) suggests that protests are increasingly about the failures of democracy in the way it is practiced within formal politics across Europe. There is dissatisfaction with the decision-making process and institutions, while the perception that mainstream governing political forces and Europe are too detached, inconsiderate and disinterested in citizens' concerns has become widespread across Member States and social groups (Balme and Chabanet 2008; Kopecký and Mudde

2002, Leconte 2010; Mair 2007; Szczerbiak and Taggart 2008). This book pieces together these different strands of literature, questioning the extent to which protest—whether against austerity politics and its effects, loss of sovereignty to Brussels, or 'intrusive' government policies—is indeed leading to a paradigm shift in democratic politics in Europe. Given the results of the first European Parliament elections (in May 2014) that were held after the outbreak of the crisis in Europe, the implementation of austerity policies and bailouts and the 2015 national elections in Greece and Spain, this is a timely and important question for research.

Fifth, we examine the ways in which social policies and the welfare systems across Europe have been affected by the crisis at a time where social justice and social cohesion are severely threatened in an unprecedented manner.

Finally, the contributions to this collective volume examine the aforementioned paradigm shift at different levels and through a range of approaches. We thus study developments at the global level (by examining the regulatory developments), the regional or supranational level (by focusing specifically on economic and political developments in the context of the EU), at the transnational level (through the study of civil society's responses), as well as at the national and local levels (mainly through the focus on welfare and employment policies, citizens' initiatives and civil society organisations). We also propose a rich multi-disciplinary approach and a combination of research methods to study the extent to which the crisis has, indeed, led to a paradigm shift and how complete or incomplete this shift has been so far.

The book is organized into three parts, which correspond to different areas of regulation and policy-making as well as to different disciplinary perspectives. Part I concentrates on changes in the legal and political perspectives on how to regulate markets, paying special attention to the efficiency of the regulatory paradigm (Chap. 2) as well as on systemic risk (Chap. 3).

Part II concentrates on the changes in monetary and economic policies examining the shift that has taken place in economic policy from the national to the global (Chap. 4) and whether the basics of employment and welfare policies in Europe remain the same (Chaps. 5 and 6).

Part III turns to the social and civic aspects of the crisis and examines whether and how protest politics have changed during the last five years

and asks whether such changes are, in fact, leading to a paradigm shift away from the hegemony of neoliberal democratic politics. Chapters 7 and 8 focus on the reactions of citizens and civil society organizations in response to the economic recession and dramatic socio-economic consequences of austerity policies, while Chap. 9 examines the extent to which a restructuring of the political space and political party system in Western Europe has been affected by the crisis. Chapter 10 re-examines the 'there is no alternative' narratives of austerity in light of the Eurocrisis experience.

The book's concluding chapter critically recapitulates the dimensions of change and continuity in the economic, legal, regulatory, social and political spheres examined in the individual chapters and draws some conclusions as to whether and to what extent a paradigm shift has indeed taken place and which factors have contributed to or hindered this process.

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Part I

A Change in Regulation Paradigms

2

Paradigm Shift in Financial-Sector Policymaking Models: From Industry-Based to Civil Society-Based EU Financial Services Governance?

Pablo Iglesias-Rodríguez

Introduction: The Efficient Market Hypothesis, the Global Financial Crisis and the Process of Paradigm Shift

Before the Global Financial Crisis started in 2007, the financial and economic policies of several jurisdictions with 'highly developed' financial markets were, to a large degree, based on two economic theories, namely the Efficient Market Hypothesis and the Rational Expectations Hypothesis. The Efficient Market Hypothesis is a very influential economic idea formulated by Eugene Fama in his seminal work *Random Walks in Stock Market Prices* (Fama 1965). One of the postulates of the Efficient Market Hypothesis is that the prices of financial instruments reflect all the available information; hence, 'in an efficient market at any point in time the actual price of a security will be a good estimate of its intrinsic value' (Fama 1965, p. 56). As to the Rational Expectations Hypothesis, it was first proposed by John Fraser

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Muth in his paper *Rational Expectations and the Theory of Price Movements* (Muth 1961) where he claimed that economic outcomes reflect, to some extent, the expectations of economic agents (Muth 1961, p. 316). The Rational Expectations Hypothesis constitutes a pillar of the Efficient Market Hypothesis; for instance, according to it, the price of financial instruments partially depends on what the buyers and sellers of those instruments expect it to be in the future (Sargent 2008). These two theories were at the core of the so-called equilibrium paradigm, according to which financial markets tend towards a state of equilibrium (Soros 2008, p. vii).

The equilibrium paradigm was reflected in financial services policymaking – the latter broadly understood as including not only formulation of policies but also lawmaking and regulatory activities performed by legislators, regulators as well as other actors or forums with rulemaking responsibilities. In this respect, policymakers tended to perceive public intervention in the financial markets as an element of disruption. This was, for instance, the view of Alan Greenspan—former Chair of the Board of Governors of the Federal Reserve System—in regards to the regulation of over-the-counter derivatives (Greenspan 1998). They instead believed that an industry-based financial regulatory system would lead to market—and even social—efficiencies (Stefanadis 2003). These ideas were, in turn, echoed in the financial services regulatory governance: policymakers adopted a *laissez-faire* approach to the regulation of the financial system, markets and institutions whereby the regulation and even the supervision of important areas of the financial system were largely delegated to the financial services industry (Arias and Costas 2015, p. 71).

The Global Financial Crisis and the shedding of light on its underlying causes, which included financial industry self-regulation—as explained by Visco (2013) and Rudd (2009, p. 29)—triggered a widespread questioning of the validity of the equilibrium paradigm and the rationale of its policy and regulatory manifestations (Roubini 2009). This, in turn, prompted a process of shift in paradigm in both the academic and policy fields. In the academic arena, whereas some scholars, such as Malkiel (2011), still defend the validity of the Efficient Market Hypothesis, mainstream economic thinking acknowledges its weaknesses and the dangers of economic policies based on it (Shiller 2003; Fox 2009; Krugman 2009; Volcker 2011). At the policy level, the post-crisis financial ser-

vices regulatory overhaul clearly evidences a shift from self-regulation to greater public intervention in the policing and regulation of the financial system, markets and institutions. For instance, since the outset of the Global Financial Crisis, in the European Union (EU), policymakers have been progressively moving to the public regulatory realm areas of financial services that, before the crisis, were essentially self-regulated, such as clearing and settlement (Iglesias-Rodríguez 2012a), credit rating agencies (Utzig 2010), hedge funds (Ferran 2011), and over-the-counter derivatives (Cœuré 2013).

The shift from self-regulation to public regulation reveals, to a certain extent, a change of legitimacy paradigm in financial services policymaking. In the pre-crisis setting, the output-legitimacy of financial sector policies was linked to weak input-legitimacy processes in which financial sector rules were largely the result of the input provided by the financial services industry—through *inter alia*, self-regulation. Output-legitimacy is linked to the idea of 'government for the people' and concerns the acceptance of policies by the persons affected by them (Scharpf 1999, p. 11), whereas input-legitimacy is related to the notion of 'government by the people' (Scharpf 1999, p. 7) and refers to 'whether policy-outputs reflect the direct or indirect participation, ex-ante consensus and will of the persons actually or potentially affected by those policies' (Iglesias-Rodríguez 2012a, p. 453). In the post-crisis setting there seems to be a greater acknowledgement of the positive correlation between input-legitimacy and output-legitimacy. In this regard, in order to guarantee the latter, regulatory processes must be more responsive, inclusive and embrace the participation of all the actors with an interest in and/or affected by financial sector policies and rules. Representative and deliberative mechanisms encompassed by public lawmaking/regulatory processes—as opposed to industry self-regulation—partially ensure a broader civil society engagement in the creation and implementation of financial sector policies—and, hence, contribute to enhancing their output-legitimacy. In this chapter we use a broad notion of 'civil society' that includes all non-state actors and forums affected directly or indirectly by financial services policies (Iglesias-Rodríguez 2014, p. 10).

The academic literature that aims to explain the post-crisis political economy of financial services regulation in the EU has attempted to do so by

primarily focusing on the analysis of the formal allocation of rulemaking responsibilities between private and public actors, the intensity of the latter's intervention in financial regulation as well as the content of financial sector laws—see for example Utzig (2010), Ferran (2011), and Véron (2012). This stream of literature tends to highlight the fact that the global financial crisis has brought about a major reallocation of regulatory responsibilities from the private to the public realm—evidenced *inter alia* by a major increase in the amount and scope of financial laws in the EU—and that in this new setting the influence of the industry in financial policymaking has been reduced (Véron 2012, p. 8).

Whereas these works contribute to the understanding the EU post-crisis financial services regulatory space, they fail to answer an important question: does the EU post-crisis financial services overhaul embrace a shift in paradigm from an industry-based to a civil society-based financial services governance? Answering this question requires an analysis, not only of the allocation of regulatory responsibilities between private and public actors but also of other direct and indirect mechanisms of potential financial industry influence in financial services policymaking that may be explicitly or implicitly encompassed by the EU policymaking architecture.

This chapter carries out an analysis of the operation and regulation of two of these mechanisms, namely stakeholder engagement in financial services policymaking and revolving doors, with a focus on the EU and its post-crisis institutional machinery in the financial services field, notably, the European System of Financial Supervision (ESFS)—and within it, the European Supervisory Authorities (ESAs)—and the Banking Union. From a theoretical viewpoint the chapter uses both regulatory capture and democratic theory frameworks to answer the abovementioned question. First, it looks at whether, how and why the regulation and operation of stakeholder engagement and revolving door mechanisms is resulting and/or may result in industry capture of the EU financial services policymaking processes. Second, it uses the results of such analysis to assess whether there has been a shift in the legitimacy of the EU post-crisis financial services governance.

The results of the research carried out in this chapter are relevant not only to ascertain the extent and completeness of the post-crisis shift in paradigm in a jurisdiction that was hit hard by the crisis, namely the EU, but also to answer the question of where the EU financial system is going and whether the EU post-crisis financial services governance is properly addressing some

of the mistakes that propitiated the Global Financial Crisis. Owing to the relevance of the EU financial system within the global financial system, the findings of this contribution are also important to understand the process of paradigm shift in global finance.

There are various reasons that justify the choice of the mechanisms of stakeholder engagement and of revolving doors as core subjects of the research. In the first place, they both represent major but yet under-researched avenues of potential industry capture in financial services policymaking. Also, they are embraced in different ways by the EU institutional and legal frameworks and, consequently, they suit very well the targets of our legal analysis. In addition, the EU financial services overhaul has brought about important regulatory changes in respect of the operation of these two mechanisms –as well as related disputes before EU institutions; therefore, from a regulatory perspective, their analysis is of particular relevance and topicality.

As regards, the ESFS and the Banking Union, they are the two pillars upon which the EU post-crisis financial services architecture rests. The rationale for the focus on these structures is twofold. First, their creation has resulted in an important transfer of rulemaking, supervisory and enforcement responsibilities from the member state level to the EU level and therefore they play a central role in the EU financial regulatory architecture. Second, both the ESFS and the Banking Union encompass forms of stakeholder engagement and/or influence that may result in industry capture and whose analysis is critical to assess the legitimacy of the EU post-crisis financial services governance.

The ESFS is a four-level network made of a European Systemic Risk Board (ESRB)—a body in charge of macro-prudential oversight at the EU level—, three European Supervisory Authorities (ESAs), a Joint Committee that acts as a forum of coordination of the latter, and the financial regulation and supervision authorities (FRSAs) from the EU member states, which carry out the day-to-day regulation and supervision of their respective financial markets, institutions and actors (on the ESFS, see Iglesias-Rodríguez 2014, pp. 190–200).

Within the ESFS the ESAs play a central role. The three ESAs are the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA), respectively instituted by Regulation (EU) No 1093/2010 (EBA Regulation), Regulation (EU) No 1094/2010 (EIOPA

Regulation) and Regulation (EU) No 1095/2010 (ESMA Regulation) (to be collectively referred to as the ESAs Regulations). The ESAs operate as EU agencies primarily composed of representatives of FRSAs of the EU member states and are in charge of quasi-regulatory and supervisory functions. For example they draft technical standards and issue guidelines and recommendations in their respective areas of competence; moreover, the ESAs have, with respect to some matters, binding powers vis-à-vis the FRSAs and the financial market participants of the EU member states (see article 8.2 ESAs Regulations). Also, particularly relevant for this chapter, the ESAs incorporate as part of their internal structure, stakeholder advisory bodies that provide a forum of interaction among stakeholders from various sectors and among the latter and EU policy-makers.

The Banking Union consists of two structures, namely the Single Supervisory Mechanism (SSM)—instituted by Council Regulation (EU) No 1024/2013 (SSM Regulation) and Regulation (EU) No 1022/2013—and the Single Resolution Mechanism (SRM)—established by Regulation (EU) No 806/2014 (SRM Regulation). The SSM is a supervisory structure led by the ECB whose primary task is the prudential supervision of credit institutions in the Euro area and in other member states that decide to join the SSM. The SRM, led by a Single Resolution Board and supported by a Single Resolution Fund, is entrusted with managing resolutions of failing credit institutions that are under the supervision of the SSM (European Commission 2015g). The establishment of the SSM has led to a transfer of important supervisory responsibilities from FRSAs of the EU member states to the ECB. These supervisory duties are extensive and include, *inter alia*, the granting and withdrawal of authorisations to credit institutions, ensuring their compliance with EU laws—and, where relevant, national laws—as well as imposing prudential and governance requirements on credit institutions (article 4 SSM Regulation).

This chapter will show that, despite the greater degrees of public intervention in financial services policymaking processes, the EU post-crisis legal and regulatory frameworks still give pre-eminence to the financial services industry in those processes. This is both an indication and a cause of a lack of complete shift in paradigm from an industry-based to a civil society-based financial services policymaking architecture. These results challenge scholarly views that postulate the decrease of the influence of the financial industry in financial services policymaking after the crisis.

The rest of the chapter will proceed as follows: the next section addresses direct mechanisms of stakeholder participation in financial services policymaking processes, with a focus on the European Commission Expert Groups and the Stakeholder Groups of the ESAs. The chapter then tackles the topical phenomenon of revolving doors, which may create avenues for the industry's shaping of financial services policies. The concluding section summarises the main findings of this chapter and provides some insights in regards to the role that organised civil society may play as a driver of change towards a more inclusive financial services policy framework.

Deliberative Democracy and the Institutionalisation of the Financial Industry's Pre-eminence Over Financial Services Policymaking Processes

Stakeholder Participation in EU Financial Services Policymaking in Perspective

The right of stakeholders to participate in EU policy and rulemaking processes is embraced by the EU constitutional setting. The Treaty on European Union (TEU) institutes the right of citizens to 'participate in the democratic life of the Union' and a corresponding duty of the EU to make decisions 'as openly and as closely as possible to the citizen' (article 10.3 TEU). The TEU additionally specifies that the EU institutions must 'give citizens and representative associations the opportunity to make known and publicly exchange their views in all areas of Union action' (article 11.1 TEU) and 'maintain an open, transparent and regular dialogue with representative associations and civil society' (article 11.2 TEU). For instance, the European Commission must, in the performance of its duties, carry out consultations with the parties concerned (article 11.3 TEU). More broadly, the Treaty on the Functioning of the European Union (TFEU) determines that, 'in order to promote good governance and ensure the participation of civil society, the Union's institutions, bodies, offices and agencies shall conduct their work as openly as possible' (article 15.1 TFEU). These requirements are fulfilled through *inter alia* various mechanisms of the EU policy and rulemaking machinery that pro-

vide forums of debate, exchange and interaction between EU institutions and bodies, on the one side, and stakeholders, on the other. A key mechanism of stakeholder engagement consists of public hearings; for example, on 08 June 2015, the Commission organised a *Public Hearing on the Next Steps to Build a Capital Markets Union* (European Commission 2015a) where representatives of the EU institutions, bodies, including the ESAs, and stakeholders with interests in financial regulation, debated about different aspects of the Commission's plans for a Capital Markets Union. Public and private meetings with stakeholders are also used as forums of exchange of views and of input gathering; for instance, the agenda of Jonathan Hill (the Commissioner for Financial Stability, Financial Services and Capital Markets Union) corresponding to 15 April 2015 shows that he met with the President of the Swiss Bankers' Association, the President of the German insurers' association and gave a keynote speech at a British Bankers' Association Reception (European Commission 2015b). In addition, the EU institutional framework embraces public consultations as a mechanism of stakeholder participation in financial services policymaking; for example, the ESAs and the Commission are required to conduct public consultations on draft technical standards (articles 10.1, 10.2, 15.1 and 15.3 ESAs Regulations). EU institutions and bodies also rely on the advice provided by expert/advisory groups composed of stakeholders with particular interests in a relevant area. As will be explained below, the Commission uses Expert Groups—whose members often include stakeholders—in order to get advice and input on specific areas of regulatory reform. Moreover, the ESAs have incorporated within their structures stakeholder groups that are consulted on a wide range of issues related to the ESAs' regulatory and supervisory activities. The EU institutional design also encompasses stakeholder engagement in policy and rulemaking activities through the European Economic and Social Committee (EESC) (articles 301-304 TFEU), which operates as a multi-stakeholder consultative body of the EU institutions, providing a forum of functional representation of stakeholders in EU rulemaking activities.

Before the Global Financial Crisis, the models and patterns of participation of stakeholders in EU financial services policymaking processes suffered from certain caveats that resulted in the financial services policy debate being largely conducted between only two actors: the EU institutions and bodies on the one side and the financial services industry on the other (EESC 2012, sections 1.1, 1.2 and 3.2).

In the first place, there was a problem of unbalanced representation of different categories of stakeholders in EU institutional mechanisms of stakeholder participation in financial services rulemaking. Whereas the financial services industry generally occupied a preeminent position within those mechanisms, the presence of other civil society stakeholders, such as retail investors and consumers of financial services was much more limited.

Such uneven representation was, for instance, fairly evident in the composition of the Commission Expert Groups in the financial field. Commission Expert Groups are consultative bodies established by the Commission, composed of public and/or private sector members and aimed at providing expert advice to the Commission on matters pertaining to various areas of policymaking, lawmaking, regulation, and implementation of EU laws, programmes and policies (European Commission 2010a, p. 3). According to Kohler-Koch and Finke (2007, p. 209), the Commission uses consultations to experts as a means of ensuring stakeholder's support for its legislative initiatives. Bowen (2004, p. 340) sees the relationship between EU institutions and business interests as an exchange of resources; in return for getting access to EU agenda-setting and policymaking, business interests must provide EU institutions certain informational goods such as expert knowledge. Expert Groups, hence, do constitute a potential relevant source of functional representation in EU policymaking processes. In the financial services field, the input provided by these Expert Groups has, indeed, contributed to the shaping of important EU rules pertaining to banking, insurance and securities. For example, the European Securities Markets Expert Group (ESME)—active from 2006 until 2009—gave input to the Commission in areas such as short-selling or credit rating agencies (European Commission 2015c). Before the Global Financial Crisis, and in its immediate aftermath, the composition of the Commission Expert Groups in the financial realm was rather asymmetrical, with the financial industry keeping a dominant position within them. For instance, data produced by civil society organisations estimate that, in the year 2009, within the Expert Groups providing advice on financial aspects and operating under DG Internal Market, 84 % of its civil society members came from the financial industry, whereas only 4 % of them came from consumer organisations (ALTER-EU 2009, pp. 9–11).

Another illustration of a pre-crisis institutionally endorsed asymmetrical functional representation was the composition of the Market Participants

Consultative Panels (MPCPs) of the so-called Lamfalussy Committees. The Lamfalussy Committees—the predecessors of the ESAs—namely the Committee of European Securities Regulators (CESR), the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) were Committees set up by the Commission in 2001 (the CESR) and 2003 (the CEBS and the CEIOPS) in charge of *inter alia*, advising the latter on implementing measures concerning EU financial legislation as well as issuing standards, guidelines and recommendations in their respective areas of competence with a view to ensuring a consistent implementation of EU financial sector laws in the member states—see Iglesias-Rodríguez (2014, p. 187). The MPCPs were multi-stakeholder bodies that advised the Lamfalussy Committees in the carrying out of their tasks. Their composition, which was discretionally decided by the Lamfalussy Committees themselves, included representatives from market participants, the financial industry, consumers and end-users of financial services. The quantitative weight of these different categories was, however, highly asymmetrical (Di Noia and Gargantini 2015, p. 133; Iglesias-Rodríguez 2014, p. 256). For example, the initial membership of the MPCP of the Committee of European Securities Regulators comprised 11 members of which only two were representatives on non-financial industry (NFI) stakeholders (Committee of European Securities Regulators 2002, pp. 1–2).

These features of the pre-crisis financial services governance constituted a policy reflection of the equilibrium paradigm. They evidenced the prevailing underlying assumption that, in order to achieve market efficiency, the financial services industry should not only be in charge of setting the rules pertaining to different areas of financial regulation—through self-regulation—but also play a leading role in financial services public policymaking processes.

A second drawback of pre-crisis financial services deliberative processes was the unbalanced participation of different categories of stakeholders in financial services policymaking activities. On the one side, civil society stakeholders representing non-regulated entities, such as consumers of financial services or retail investors, tended to show a very limited engagement in those processes. On the other side, the financial services industry—either directly or through industry associations or lobbying platforms representing its interests—engaged very actively in those very

same processes. For example, the consultation process launched by the Commission in the year 2001 on the transparency obligations of publicly traded companies (European Commission 2001a) received 90 responses; of these, only five (circa 6 % of the total) were provided by civil society organisations operating in the consumer/retail investor realm (European Commission 2001b). These divergent participatory patterns were also present in the immediate aftermath of the Global Financial Crisis. For example, as shown in Table 2.1, the responses to key consultation processes launched by the Commission in the years 2010 and 2011 still evidenced the big gap between the involvement of the financial industry, on the one side, and that of NFI stakeholders, on the other, despite the high relevance and potential impact for the latter of the issues under consultation.

These asymmetries in participation can, in the first instance, be explained by asymmetries in means. The partaking in EU financial services policymaking processes requires a vast amount of resources, such as time, staff or a thorough knowledge of the relevant financial regulatory fields. For instance, consultation documents may be highly complex and address very technical areas of financial regulation that require a thorough and costly expert analysis. Participation in consultative stakeholder bodies or other similar fora involves stakeholder representatives trav-

Table 2.1 Examples of participation in Commission's consultation procedures by stakeholder group

	Regulatory procedure		
Respondent group	Bank capital counterparty credit risk	Holdings financial sector	Tying retail financial services
Public authorities	5/34 (15 %)	3/9 (33 %)	9/55 (16 %)
Financial industry stakeholders	26/34 (76 %)	5/9 (56 %)	33/55 (60 %)
Non-financial industry stakeholders	3/34 (9 %)	1/9 (11 %)	13/55 (24 %)

i European Commission (2011a)
ii European Commission (2011b)
iii European Commission (2010b). A summary of the results of the consultation—which has been used to elaborate this table—is provided by European Commission (2010c, p. 3)
Source: Iglesias-Rodríguez (2014, p. 251)

elling in order to attend the relevant meetings. Whereas the financial services industry counts on a vast amount of resources to engage in these activities, NFI stakeholders—especially those acting individually or in non-organised forms—have much less means at their disposal (Prache 2011 and 2015, pp. 195–197).

Although EU policymakers have long since acknowledged the relevance of NFI stakeholder input in the creation of EU rules in the financial sector (European Commission 2005, pp. 4, 5, 7–8 and 15), their financial support for it before the Global Financial Crisis was rather limited (Prache 2015, pp. 194–195). Such lack of institutional support indeed constituted another policy reflection of the pre-crisis paradigms whereby industry ascendancy over financial services policymaking was consistent with the Efficient Market Hypothesis and the Rational Expectations Hypothesis.

The consequences of the pre-crisis policy approaches towards stakeholder engagement on the legitimacy of financial sector policies were twofold. On the one hand, from an input-legitimacy perspective, financial sector policy processes were largely one-sided and based on the input, views and advice provided by the financial services industry. From an output-legitimacy viewpoint, the aforementioned input-legitimacy features contributed to the creation, implementation and enforcement of financial rules that primarily fostered the interest of the financial services industry, often in detriment to the interests of other stakeholder groups or society at large (Iglesias-Rodríguez 2012b).

The EU Post-Crisis Regime on Stakeholder Participation and the Role of the Industry in Financial Services Policymaking: The Persistence of Old Paradigms

Statements by the EU institutions and their members in the immediate aftermath of the Global Financial Crisis seemed to encompass the need for a change of paradigm from an industry-based financial services regulatory regime to a model of wider representation. For instance, in a letter sent to the Alliance for Lobby Transparency and Ethics Regulation (ALTER-EU) in the year 2010, Michel Barnier—Commissioner for

Internal Market and Services between the years 2010 and 2014—wrote: 'I remain convinced that more needs to be done to enhance the active participation of civil society organisations in Internal Market policymaking in order to fully achieve a fair balance on non-industry stakeholders' representation in our consultation process' (Barnier 2010). Also, in the same year, the Commission published the *Framework for Commission Expert Groups*: *Horizontal Rules and Public Register* (European Commission 2010d), according to which: 'when defining the composition of expert groups, the Commission and its departments shall aim at ensuring a balanced representation of relevant areas of expertise and areas of interest' (European Commission 2010d, pp. 3–4). Moreover, the reform of the EU financial regulation and supervision architecture formally encompasses the 'balanced' representation of various interests groups in the so-called Stakeholder Groups, which constitute the first instance of institutionalised stakeholder participation in financial services policymaking at the EU level (article 37.2 ESAs Regulations).

Despite such formal embracement of a greater inclusiveness of financial services policymaking processes, the analysis of the actual configuration of post-crisis forums of functional representation evidences a major gap between policy statements and policy actions.

In the first place, when it comes to the Commission Expert Groups in the field of financial services, their post-crisis configuration reveals a more balanced composition in which the financial services industry plays a more limited role than in the pre-crisis scenario. For example, data corresponding to July 2014 showed that, in overall terms, 25 % of the members of the Commission Expert Groups in the financial field were industry representatives—4 % from general industry and 21 % from the financial services industry—whereas consumers and non-industry civil society held 18 % of the membership in those Expert Groups (European Commission 2015d, p.1). This suggests a change in respect of the pre-crisis setting and a greater balance among various categories of stakeholders in the Expert Groups.

Nonetheless, the composition of some key Expert Groups still indicates a biased allocation of seats that tends to favour financial corporations. For example, according to the data regarding the composition of the Payment System Markets Expert Group—created in the year 2009—of its 40 members, 28 represented financial industry interests or interests

linked to the financial industry and only 9 represented the interests of consumers (European Commission 2015e).

Secondly, from a participatory perspective, one of the main innovations of the ESFS consisted of the institutionalisation of civil society participation in EU financial regulation and supervision through the creation within the ESAs of the so-called Stakeholder Groups (Iglesias-Rodríguez 2011 and 2014, pp. 257–265; Di Noia and Gargantini 2015). The Stakeholder Groups are multi-stakeholder bodies aimed at facilitating consultations with stakeholders; they provide advice and input to the ESAs with regard to the latter's regulatory and supervisory activities (article 37.1 ESAs Regulations). Before the ESAs issue technical standards, guidelines or recommendations, they must first consult the Stakeholder Groups (articles 10.1, 15.1 and 16.2 ESAs Regulations). The advice and input provided by the latter, in turn, contributes to the shaping of important regulatory and supervisory decisions with an impact on stakeholders within the financial services realm and, more generally, society. Each of the ESAs has its own Stakeholder Group, namely, the Banking Stakeholder Group (BSG) in the EBA (European Banking Authority 2015), the Securities and Markets Stakeholder Group (SMSG) in the ESMA (European Securities and Markets Authority 2015a), as well as the Insurance and Reinsurance Stakeholder Group (IRSG) and the Occupational Pensions Stakeholder Group (OPSG), both within the EIOPA (European Insurance and Occupational Pensions Authority 2015a; European Insurance and Occupational Pensions Authority 2015b). The Stakeholder Groups are composed each of 30 stakeholders from various sectors with interest in the relevant financial services area (article 37.2 ESAs Regulations).

On the one side, the creation of the Stakeholder Groups as multi-stakeholder consultative bodies within the ESAs denotes a policy approach embracing the idea that deliberative processes in the field of financial services ought to incorporate the views of all the parties affected by financial services policymaking.

On the other side, the specific configuration of the Stakeholder Groups and, notably, the asymmetrical allocation of powers to the different categories of stakeholders within them, implicitly encompass the pre-crisis paradigms about the virtues of industry-based regula-

tory systems. For instance, according to article 37.2 of the ESMA Regulation:

> The Securities and Markets Stakeholder Group shall be composed of 30 members, representing in balanced proportions financial market participants operating in the Union, their employees' representatives as well as consumers, users of financial services and representatives of SMEs. At least five of its members shall be independent top-ranking academics. Ten of its members shall represent financial market participants.

The wording of this provision is somewhat contradictory. On the one hand, it requires that the SMSG represents 'in balanced proportions' the main categories of stakeholders affected by or with an interest in financial regulation. On the other hand, contemporarily, it embodies a highly uneven allocation of seats among stakeholder categories that guarantees the financial services industry at least 10 members—hence, one third of the seats of the SMSG. In addition, the same provision reserves five places to 'academics'. This means that the representatives from all the remaining categories of stakeholders enumerated in article 37.2 of the ESMA Regulation share the remaining 15 seats. This statutorily-driven asymmetry explicitly gives pre-eminence to the financial services industry within the Stakeholder Groups, as shown in Table 2.2.

The composition of the Stakeholder Groups brings about potential problems of input-legitimacy in the EU post-crisis regulatory framework. Notably, the ascendancy of the financial services industry within the Stakeholder Groups may result in the latter providing the ESAs inputs that reflect, above all, the interests of financial corporations. Such inputs may, in turn, influence the adoption by the ESAs of regulatory and supervisory actions that are biased towards the financial services industry. Such risk is aggravated by two facts.

First, the internal rules of procedure of the Stakeholder Groups encourage but do not require their members to adopt decisions by consensus. For instance, in the BSG, if consensus is not reached, a simple majority of its members present suffices to adopt a decision, opinion or report (article 7 Rules of Procedure of the BSG (European Banking Authority 2013a)). In the IRSG and the OPSG, the requirement is of simple majority of

Table 2.2 Composition of the stakeholder groups (mid-2015)

	BSG	IRSG	OPSG	SMSG
Financial industry[a]	10	10	10	10
Academics[b]	5	5	5	8
Consumers[c]	5	6	5	4
Users[d]	4	6	4	5
Employee representatives	2	2	5	2
SMEs	2	1	1	1

[a]Namely, credit and investment institutions (Banking Stakeholder Group), insurance and reinsurance undertakings and insurance intermediaries (Insurance and Reinsurance Stakeholder Group), institutions for occupational retirement provision (Occupational Pensions Stakeholder Group) and financial market participants (Securities and Markets Stakeholder Group)—article 37 ESAs Regulations;
[b]Independent top-ranking academics—article 37 ESAs Regulations;
[c]Consumers of banking services (Banking Stakeholder Group), consumers of insurance and reinsurance services (Insurance and Reinsurance Stakeholder Group), representatives of beneficiaries (Occupational Pensions Stakeholder Group) and consumers of financial services (Securities and Markets Stakeholder Group)—article 37 ESAs Regulations;
[d]Users of banking services (Banking Stakeholder Group), users of insurance and reinsurance services and representatives of relevant professional associations (Insurance and Reinsurance Stakeholder Group), representatives of relevant professional associations (Occupational Pensions Stakeholder Group) and users of financial services (Securities and Markets Stakeholder Group)—article 37 ESAs Regulations

members present, if a quorum of two-thirds of members is reached—(article 7 Rules of Procedure of the IRSG (European Insurance and Occupational Pensions Authority 2014a) and article 7 Rules of Procedure of the OPSG (European Insurance and Occupational Pensions Authority 2014b)). In the SMSG, the requirement is of two-thirds of the members present—(article 7 Rules of Procedure of the SMSG (European Securities and Markets Authority 2014a)). This voting system and, most notably, that applied to the Stakeholder Groups of the EBA and the EIOPA, generally favours the stakeholder category with a greater number of seats within the Stakeholder Groups, namely the financial services industry.

Second, the internal rules of the Stakeholder Groups do not always encompass the mandatory reporting to the ESAs of all the dissenting views within the Stakeholder Groups. For example, in the IRSG, the OPSG and

the SMSG, the incorporation of dissenting views in the opinions transmitted to the EIOPA and the ESMA, respectively, require the agreement of at least three members of those Stakeholder Groups (article 7 Rules of Procedure of the IRSG, Rules of Procedure of the OPSG and Rules of Procedure of the SMSG). Therefore, despite the multi-stakeholder nature of the Stakeholder Groups, the input that they deliver to the ESAs might not always provide the latter a complete account of the spectrum of views of the stakeholder categories represented in the Stakeholder Groups. In contrast with the more limited approach of its counterparts in insurance and securities, article 7 of the Rules of Procedure of the BSG requires that, in cases of dissent, all minority opinions are included in the opinions submitted to the EBA.

In addition to these statutorily-based asymmetries, the Board of Supervisors of the EBA, which is in charge of appointing the members of the BSG (article 37.3 EBA Regulation), made a rather biased interpretation of the term 'users of banking services' (article 37.2 EBA Regulation) by appointing, as representatives of such category persons from within the financial services industry as well as providers of services to the financial industry. Indeed, of the five persons initially appointed as 'users of banking services' at the Banking Stakeholder Group, four came from consulting and auditing firms with major clients in the banking sector, namely Deloitte, KPMG, Mazars and PwC, and one from a credit rating agency, namely Standard & Poor's (European Banking Authority 2011 and 2013b, p. 24).

The initial appointments of the members of the Stakeholder Groups at the EBA and, more precisely, the allocation of seats among different categories of stakeholders as well as the interpretation of the concept of 'users of financial services' and 'users of banking services' resulted in complaints being brought before the European Ombudsman (EO).

The first of these cases decided by the EO was the UNI case (Case: 1966/2011/LP), concerning a complaint filed by UNI Europa, a European Trade Union Federation. UNI Europa pointed out various instances of alleged maladministration by the EBA in the appointment of the members of the BSG in its initial configuration, which concerned, *inter alia*, the lack of balance among different categories of stakeholders and the misinterpretation of the concept of 'users of banking services'.

With regard to the first claim, one of the criticisms made by UNI Europa was that, despite the possibility of appointing various representatives of employees to the BSG, the EBA only appointed one and that this was in contravention of the requirement of balanced representation among stakeholder categories consecrated by the EBA Regulation. UNI Europa claimed that, as a result, such category remained under-represented (Case: 1966/2011/LP, paras 35–37). The EO indeed questioned the rationale of the EBA's appointments and found an instance of maladministration (Case: 1966/2011/LP, para 41):

> Even though the Regulation [EBA Regulation] does not fix the number of members to be appointed to this category [employees' representatives] and the EBA, therefore, has discretion as to how many members should be foreseen, the decision to limit this number to just one raises serious questions. In effect, even though the Regulation does not provide specific numbers for these categories [users, consumers, employees' representatives and SMEs], the fact that they are mentioned without any distinction would suggest that the legislator considered it appropriate that these categories should, in principle, comprise similar numbers of members. (Case: 1966/2011/LP, para 40)

When it comes to the second issue, one of the contentions of UNI Europa was that the EBA made an incorrect interpretation of the term 'users of banking services' by appointing, as representatives of such stakeholder category, persons from entities that acted primarily as providers rather than users of services to the banking industry (Case: 1966/2011/LP, para 46). UNI Europa argued that persons from entities providing remunerated services to banking institutions should instead be considered as representatives of the financial industry (Case: 1966/2011/LP, para 50).

The decision of the EO implicitly acknowledged and strongly criticised the biased nature of the EBA's appointments concerning 'users of banking services', finding unacceptable that the seats corresponding to such stakeholder category were granted to entities that acted as suppliers of services to the financial industry:

> Although the term 'users' could encompass entities which because of their specialised knowledge and experience of the workings and mechanics of the

> financial and banking sector could make a positive contribution to the Banking Stakeholder Group, it is not acceptable for profit-making suppliers of remunerated services to the financial and banking sector to be included in that category. Such entities would be likely to be perceived as representing commercial interests rather than those of the wider category of 'users'. In the Ombudsman's view, if the Union legislator had indeed intended to include representatives of such professions in the Banking Stakeholder Group, the Regulation would have used a term other than 'users of banking services'. Thus, by failing to exclude from the 'users' category applications from entities which are clearly providers of remunerated services to the financial sector, not users of the latter's services, the EBA committed an instance of maladministration. (Case: 1966/2011/LP, para 54)

In the decisions 1321/2011/LP (Consumatori Associati), 1876/2011/LP (BEUC) and 1875/2011/LP (EuroFinUse), which addressed, among others, related claims in regards to the interpretation of the term 'users' by the EBA, the EO applied a similar reasoning as in the case of UNI Europa. Although by the time the decisions of the EO were published, the EBA had already appointed a new BSG—with a revised composition (EBA 2013c) that was, however, criticised by some stakeholder organisations on the grounds of underrepresentation of end users (Better Finance 2013)—these cases showed the potential of organised civil society activism and pressure as drivers of change towards civil society-based financial services policies.

From Regulator to Regulatee and from Regulatee to Regulator: Revolving Door as a Potential Channel of Industry Capture of Financial Services Policymaking

The Regulatory Dimension of Revolving Doors

In a regulatory context, a revolving door is the phenomenon whereby a person or group of persons holding relevant positions in (primarily public) entities vested with regulatory responsibilities shift to positions

in (primarily private) entities that operate or operated under the regulatory umbrella of the former or in entities whose interests are linked to those of the regulated entities, and vice versa (OECD 2009). An example of revolving door is the head or a senior officer of a Financial Regulation and Supervision Authority (FRSA), such as an independent administrative agency in charge of financial supervision, leaving her/his position and taking up a job in a financial institution that is or was under the supervision of that very same FRSA. Revolving door may also occur if, for example, a person working in an FRSA moves to a consultancy firm with important clients in the financial sector or to an association or lobby group advocating for the financial industry's interests. The revolving door from regulated entity to regulator is also known as reverse revolving door; reverse revolving door would include cases such as senior employees of financial services corporations moving to senior positions in FRSAs.

Revolving door is not only limited to purely 'regulatory' environments but instead operates across several levels of the policymaking pyramid. For example, members of the legislative or the executive shifting to a private corporation may also constitute cases of revolving door, especially whenever the former carried out legislative work with an impact on the latter.

People may engage in revolving door-like behaviours because, in doing so, they expect to obtain gains of a different nature, such as economic, reputational or personal. For instance, public officials moving to the private sphere may benefit from a much higher compensation in the latter (Protess 2013). A senior employee of a private corporation may see an appointment in the public sector as a prestigious achievement and a sign of recognition of her/his merit within a particular field. More generally, people may also move across sectors because of changes in their professional preferences and interests over time.

Regulators and regulatees may also profit from the skills, experience and knowledge of staff moving across sectors. For instance, a former member of the staff of an FRSA may have extensive experience in regulatory processes, and such experience may help financial corporations develop more efficient compliance strategies and policies. Conversely, former staff of financial services corporations may provide FRSAs with

substantial knowledge about practical aspects of the functioning of the financial sector that may be particularly useful for regulators to adopt regulatory and supervisory decisions that effectively address problems in the financial markets.

Whereas a revolving door may bring about legitimate gains for both employees and employers, it also poses potential problems that might result in the quality of financial sector policies, regulations and supervision being diminished and costs being borne by society at large. These problems may essentially arise in four scenarios.

In the first place, an individual working for a regulator who wishes to move to the regulated sector might intentionally behave in a biased manner when she/he considers that, in doing so, the chances of such a move being materialised are higher. For example, a member of the staff of an FRSA may deliberately supervise one or some financial firms leniently in the expectation that in the future she/he will be rewarded with a position in the latter (Dal Bó 2006, p. 214).

Second, employers in the regulated sector may propitiate and bonus the transition of their employees to regulators, in the expectation that those employees will, in their new occupations, maximise the agenda and interests of their former employers; in this respect, research has shown that financial corporations often offer their executives generous compensation if they take up positions in government and/or agencies (Smallberg 2013).

Third, employees from the regulating sector may be hired by employers in the regulated sector who expect to obtain gains, such as greater influence, from the privileged access of those employees to policymaking arenas. For example, in a study of revolving door lobbying in the US Congress, Blanes i Vidal, Draca and Fons-Rose (2011) claim that ex-government officials who become lobbyist and are well connected to powerful serving politicians 'cash in on their connections'.

Fourth, a more complex and subtle problem may appear when people coming from the regulated sector suffer from certain biases that render their decisions in the regulator partial (Dal Bó 2006, p. 214). In principle, a person shifting from the financial services industry to an FRSA may be able to carry out her/his responsibilities within the latter with independence, in the best interests of the FRSA and with

a view of achieving the statutory targets of financial regulation and supervision in the jurisdiction in which such FRSA operates. However, a professional who has primarily worked within the financial services sector and who moves to an FRSA may have certain preconceptions about how the financial markets, actors and institutions work and how they should be regulated. For instance, individuals educated and trained in the Efficient Market Hypothesis may believe that the best way to pursue the maximisation of key statutory objectives of financial regulation, such as the protection of investors or the stability of the financial system, is by promoting the interests of the financial services industry. This may, in turn, result in pro-industry regulatory/supervisory approaches.

The common feature that all the revolving doors scenarios described above share is that they bring about risks of regulatory capture of the regulator by the regulated. As put by Levine (2010, p. 2): ‘While there are good reasons for having highly skilled individuals with private sector expertise help in regulating the financial sector, there are equally good reasons for worrying about conflicts of interest’.

The Financial Crisis and Revolving Doors in the Financial Sector

The Global Financial Crisis has brought about increased scholarly and policy interest on revolving doors (OECD 2009). Some commentators argue that this phenomenon was among the contributing factors to the financial crisis—through regulatory capture—and propose policy reforms that address the potential conflicts of interest sourcing from it (Igan and Mishra 2011). However, empirical evidence about the impact of revolving doors on regulatory capture is mixed. Some studies claim that there is not a positive correlation between both; for example, after analysing the career transitions of 34,064 individuals who worked in both federal and state FRSAs in the banking sector in the USA, Lucca et al. (2014) find no evidence supporting the view that the future prospects of employment in the private sector lead to less strict regulatory and supervisory actions by

regulators. Other works suggest that revolving doors result in regulators favouring the interests of the financial services industry. For instance, Veltrop and de Haan (2014) show that supervisors who before worked in the financial sector are more likely to identify with the latter and that such identification negatively affects their supervisory performance.

Although the EU has long since encompassed the idea that revolving doors may bring about some potential conflicts of interest and has consequently established pre- and post-employment restrictions applicable to former or incoming individuals performing policy and/or regulatory responsibilities in the EU institutions and bodies, those rules have often been criticised by commentators who saw them as lenient and not tailored to the protection of the public interest (ALTER-EU 2011, p. 3).

The next subsections analyse the rules and recent reforms—or lack of reforms—operated on the pre- and post-employment regimes applicable to individuals performing policy and/or regulatory functions in the field of financial services. They also address specific instances of revolving doors as well as the stand of EU institutions and bodies with respect to individuals who wish to move from or to the financial services industry. The purpose of this analysis is to assess the extent to which the post-Global Financial Crisis EU framework on revolving doors is bringing about a real qualitative change on the potential undue influence of the financial industry in financial services policymaking. The answer to this question is, in turn, relevant for the discussion about the shift from an industry-based to a civil society-based financial services policy framework. Consequently, the analysis covers all the levels of the financial services regulatory architecture, including the rules pertaining to the European Supervisory Authorities and the European Banking Union.

MEPs and Revolving Doors

Some of the most controversial cases of revolving doors at the EU level concern former Members of the European Parliament (MEPs) shifting to private sector activities in areas highly related to their previous work as MEPs. The rules applicable to MEPs do not contain anti-revolving

doors provisions, and, therefore, MEPs are not required to seek any previous authorisation from the EU to take up a position after leaving the European Parliament (EP), even in cases in which those new positions may entail potential conflicts of interest. Although the *Code of Conduct for Members of the European Parliament with respect to financial interests and conflicts of interest* (European Parliament 2013) contains one rule regarding the activities of former MEPs (article 6), its scope is extremely limited: 'Former Members of the European Parliament who engage in professional lobbying or representational activities directly linked to the European Union decision-making process may not, throughout the period in which they engage in those activities, benefit from the facilities granted to former Members under the rules laid down by the Bureau to that effect'. The appointment of Sharon Bowles—the ex-chair of the EP's Committee on Economic and Monetary Affairs (ECON)—as non-executive director of the London Stock Exchange Group (LSEG) in 2014 (London Stock Exchange 2014) sparked criticism among commentators and other members of the ECON Committee. The main focus of concern regarded the apparently close relationships between Ms. Bowles and the LSEG in the immediate years before her appointment to the latter's board and the potential industry's regulatory capture of the EP's ECON while Ms. Bowles was its chair (Cann 2014). More broadly, others questioned whether Ms. Bowles should use her knowledge and experience in financial regulatory affairs to benefit the financial services sector. As put by Molly Scott Cato—member of the EP's ECON:

> ECON is at the heart of parliamentary work on all European legislation to regulate financial markets in the wake of the financial crisis. Bowles has personally chaired almost all crucial negotiations between the European Parliament, member states and the European Commission. She represented the ECON committee in other institutions, including at meetings of the member states' finance ministers (ECOFIN). Clearly this has left her with a network of invaluable contacts and a thorough knowledge of how to play the game of negotiation. Such knowledge can now be used to help financiers rather than citizens. (Scott Cato 2014)

Despite the calls for a new framework that addresses conflicts of interest of MEPs in instances of revolving doors (Transparency International 2014), no reforms have yet been adopted in this respect to date. Indeed, besides the case of Ms. Bowles, there are several other instances of revolving door involving MEPs; these are referred in detail by Corporate Europe Observatory (2015).

Commissioners, EU Staff and Revolving Doors

The staff working for EU institutions and bodies, including the ESAs, is subject to the Regulation No 31 (EEC), 11 (EAEC), laying down the Staff Regulations of Officials and the Conditions of Employment of Other Servants of the European Economic Community and the European Atomic Energy Community (EU Staff Regulations), which contain, among others, provisions aimed at avoiding revolving doors practices with a potential negative impact on the EU. This regime is primarily based on a threefold mechanism. First, whenever an EU official seeks to engage in an occupational activity within two years of leaving service, she/he is required to inform the EU entity that appointed her/him (article 16 EU Staff Regulations). Second, if the professional activity that the EU official intends to perform is related to her/his work during her/his last three years of service and if such activity 'could lead to a conflict with the legitimate interests of the institution', the EU appointing entity will decide, in light of 'the interests of the service', whether to prohibit the EU official concerned from undertaking the new activity or authorise her/him instead; such authorisation may nevertheless be subject to compliance with certain conditions by the EU official (article 16 EU Staff Regulations).

Fairly similar rules apply to EU Commissioners, who are bound by the provisions of the Code of Conduct for Commissioners (European Commission 2011c). However, strikingly, for them the duty to notify the Commission about prospective occupations only applies within the first 18 months after they ceased to hold office (section 1.2 Code of Conduct for Commissioners), instead of the two-year period to which the EU staff is subject. This, however, constitutes an improvement with respect to the

former version of the Code of Conduct before it was amended in 2011, which only required notification within one year after leaving office (section 1.1.1 former version of the Code of Conduct for Commissioners; European Commission 2004).

From the point of view of the effective avoidance of potential conflicts of interest, both regimes suffer from obvious limitations. In the first place, the time during which the post-employment notification duty by the EU official applies, namely two years for EU staff and 18 months for Commissioners, seems somehow inconsistent with the reality of EU law making and regulatory procedures. In this respect, in the financial services sector, these processes may take several years to complete; for example, the work leading to the enactment of the Directive 2014/65/EU on markets in financial instruments and of the Regulation (EU) No 600/2014 on markets in financial instruments started in the year 2010 (European Commission 2015f). Therefore, a potential conflict of interest may persist well beyond the aforementioned periods. Second, the EU appointing entity is granted substantial discretion in the process of evaluation and eventual authorisation or rejection of the prospective occupation. With regard to this point, commentators have often criticised that the decisions allowing the shift of Commissioners and senior EU officials to the private sector have frequently lacked consistency and/or transparency. For example, the authorisations given by the European Commission to former Commissioners of the Barroso I executive, such as Benita Ferrero-Waldner—former Commissioner for External Relations—who took a position in the insurance company Munich Re (Munich Re 2010) or Meglena Kuneva—former Commissioner for Consumer Protection—who moved to the credit institution BNP Paribas (Novinite 2010), generated major concerns among civil society organisations, such as Transparency International (Transparency International 2010) and Corporate Europe Observatory. The latter commented the following about the Commission's authorisation of Ms. Kuneva's move to BNP Paribas:

> Mrs Kuneva's move to BNP Paribas was shocking, coming as it did in the middle of the EU's economic and banking crises. Once again, the Commission's procedures to scrutinise such revolving door moves lacked

> credibility and the approval for this role was handled in a way which implied that it was keener to provide a speedy and positive response to Ms Kuneva, rather than to ensure a thorough analysis of the role for possible conflicts of interest. (Corporate Europe Observatory 2010)

These and other controversial cases of revolving doors triggered reforms of both the Code of Conduct for Commissioners and the EU Staff Regulations (Phillips 2010), which were amended in 2011 and 2013, respectively. These reforms have toughened the rules on revolving doors, notably, through the introduction of cooling-off periods, of 18 months for EU Commissioners and 12 months for EU senior officials. During such periods they must refrain from exercising professional lobbying or advocacy activities at their respective institutions with respect to matters for which they were responsible—during the whole mandate in the case of Commissioners, or during the last three years of service in the case of senior staff (section 1.2 Code of Conduct for Commissioners and article 16 EU Staff Regulations). Despite evidencing a greater concern of the EU institutions about the phenomenon of revolving doors, these reforms are very limited in scope, as they only address lobbying activities and establish minor time restrictions. As a result, these regulatory developments are unlikely to result in major changes, neither on the behaviour of former civil servants of the EU nor on the quality of the post-employment decisions by EU institutions and bodies.

The ESAs and Revolving Doors

According to the ESAs Regulations, the staff of the ESAs, including their chairpersons and executive directors, is subject to the EU Staff Regulations (recital 61, articles 47.4, 49, 52, 68 and 70 ESAs Regulations). The internal rules of the ESAs on conflicts of interest and ethics of staff, such as the *Conflict of Interest and Ethics Policy-ESMA Staff* (European Securities and Markets Authority 2015b), do indeed replicate to a large extent the provisions of the EU Staff Regulations concerning revolving doors and, hence, suffer from similar weaknesses. For instance, former staff members must notify the ESMA if they wish to take on an occupational activity within two years after their departure. Moreover, senior staff of the

ESMA, namely the Chair, the Executive Director, the Heads of Unit/Division and the Team Leader of the Communication Unit, are subject to a 12-month cooling-off period in regards to professional lobbying/advocacy vis-à-vis staff of the ESMA pertaining to matters for which they were responsible during the last three years of their service (section 7.10 Conflict of Interest and Ethics Policy-ESMA Staff).

Interestingly, article 70 of the ESAs Regulations extends the applicability of the EU Staff Regulations to the members of the ESAs' Boards of Supervisors and Management Boards, which are primarily composed of heads of FRSAs of the EU member states:

> Members of the Board of Supervisors and the Management Board…shall be subject to the requirements of professional secrecy pursuant to Article 339 TFEU and the relevant provisions in Union legislation, even after their duties have ceased. Article 16 of the Staff Regulations shall apply to them. (Article 70 ESAs Regulations)

Widening the applicability of the EU Staff Regulations and, more precisely, of article 16 of the latter to the members of the Boards of Supervisors and the Management Boards has a twofold rationale. In the first place, both the Boards of Supervisors and the Management Boards constitute the main governing organs of the ESAs and are in charge of adopting the key organisational, regulatory and supervisory decisions within the ESAs. For example, the tasks of the Boards of Supervisors include, among others, the appointment of the ESAs' Chairpersons, the adoption of the ESAs' annual and multiannual work programmes, budgets and annual reports, as well as the adoption of the ESAs' regulatory and supervisory decisions, such as draft technical standards and guidelines (article 43 ESAs Regulations). The Management Boards are in charge of, *inter alia*, proposing the ESAs' annual and multiannual work programmes as well as annual reports to the Boards of Supervisors for approval (article 47 ESAs Regulations). Therefore, it is important that their members operate under a conflict of interest policy that precludes them from engaging in revolving door practices with negative effects on the ESAs and, eventually, EU financial regulation and supervision. Second, the decision-making powers within the Boards of Supervisors

and the Management Boards are primarily held by representatives from the FRSAs of the EU member states, who operate under a variety of conflict of interest policies according to the regimes of their respective national jurisdictions; therefore, the EU Staff Regulations may constitute a very useful complement—or even a supplement—of national laws, regulations and codes, especially with regard to those EU member states where the rules concerning the FRSAs' staff post-employment restrictions are lenient.

Still, subjecting the members of the Boards of Supervisors and the Management Boards to article 16 of the EU Staff Regulations poses some conceptual difficulties.

In the first place, the reference made by article 70 of the ESAs Regulations—which deals with the issue of the 'Obligation of professional secrecy'—to article 16 of the EU Staff Regulations—which focuses on post-employment restrictions—is somehow incoherent. Probably, the intention of the EU legislator was to stress that the provisions of the EU Staff Regulations concerning professional secrecy, and, notably, the duty instituted by article 16 to 'behave with integrity and discretion' after leaving office, also bind the members of the Boards of Supervisors and the Management Boards.

Secondly, the EU Staff Regulations are applicable to 'officials of the Union' (article 1 EU Staff Regulations), who are persons appointed to a post on the staff of an EU institution or agency by such institution or agency (article 1(a) EU Staff Regulations). However, the membership of the heads of the FRSAs of the EU member states in the Boards of Supervisors and the Management Boards is ex officio—that is, not by appointment of the ESAs.

The ESAs have solved this quandary through the creation of 'light' conflict of interest policies for the voting members of the Boards of Supervisors and the members of the Management Boards (European Banking Authority 2014; European Insurance and Occupational Pensions Authority 2014c; and European Securities and Markets Authority 2014b), who, according to such policies (the ESAs' Conflict of Interest Policies for Non-Staff), are required to inform the ESAs about their employment within two years after their departure from the Boards of Supervisors or the Management Boards (article 6 ESAs' Conflict of Interest Policies

for Non-Staff). After receiving the information, the ESAs must evaluate whether the prospective employment entails a conflict of interest (article 9.3 ESAs' Conflict of Interest Policies for Non-Staff). However, the ESAs' Conflict of Interest Policies for Non-Staff do not make explicit reference to any power of the ESAs to forbid the former members of the Boards of Supervisors or the Management Boards to take up a new occupation—unlike article 16 of the EU Staff Regulations, which expressly does so. Moreover, also in contrast with the EU Staff Regulations, the ESAs' Conflict of Interest Policies for Non-Staff do not contemplate cooling-off periods for the former members of the Boards of Supervisors and Management Boards. Hence, it is ultimately the laws, regulations, rules and codes applicable to the representatives of the FRSAs in their member states that will, in practice, determine the extent and scope of the activities that those representatives can pursue before and after their ex officio membership in the ESAs' Boards.

The Single Supervisory Mechanism and Revolving Doors

The creation of the Banking Union and, notably, the allocation of supervisory responsibilities to the European Central Bank (ECB) within the former have brought about important changes in the post-employment restrictions applicable to the persons who exercise supervisory tasks at the ECB.

From an accountability perspective, the new ECB's operational framework establishes a separation between the ECB's monetary policy tasks, on the one side, and the ECB's prudential supervisory tasks, on the other. For instance, the ECB's staff in charge of prudential supervision must be 'organisationally separated from, and subject to, separate reporting lines from the staff involved in carrying out other tasks conferred on the ECB' (article 25.2 SSM Regulation). In addition, the EU legislator has created within the ECB two new bodies, namely, the Supervisory Board and the Administrative Board of Review, which are specifically aimed at performing tasks related to the SSM. The Supervisory Board is primarily composed of representatives from the competent FRSAs of

each of the member states that participate in the SSM and is in charge of the planning and execution of the ECB's prudential supervisory tasks at the SSM (article 26.1 SSM Regulation). The Administrative Board of Review is made of five individuals of high repute with relevant knowledge and expertise and carries out an administrative review of ECB's supervisory decisions adopted in the framework of the SSM (article 24 SSM Regulation).

The ECB's staff responsible for prudential supervision, the members of the Supervisory Board and the members of the Administrative Board of Review all perform key functions with direct impact on credit institutions. This gives rise to a new typology of potential revolving door-like conflicts of interest at the ECB. Such risks are acknowledged by the EU legislation setting the SSM, which require the ECB to adapt its internal rules to those potential conflicts:

> The ECB shall establish and maintain comprehensive and formal procedures including ethics procedures and proportionate periods to assess in advance and prevent possible conflicts of interest resulting from subsequent employment within two years of members of the Supervisory Board and ECB staff members engaged in supervisory activities. (article 31.3 SSM Regulation)

The ECB has implemented these legal requirements through a revision of the ECB's staff rules, on the one side, and the creation of a Code of Conduct applicable to the members of the ECB's Supervisory Board, on the other (European Central Bank 2014). These reforms institute post-employment restrictions in the form of notification duties and proportional cooling-off periods applicable to the ECB's supervisory staff and to the members of the Supervisory Board. In certain respects, the new framework establishes stricter post-employment limitations than the EU Staff Regulations and the ESAs' staff policies. For example, the amended *European Central Bank Staff Rules as regards the ethics framework* (Decision of the European Central Bank of 3 December 2014 amending the European Central Bank Staff Rules as regards the ethics framework (ECB/2014/NP26)) introduce cooling-off periods for the former members of the staff of the ECB, not only in relation to advocacy activities vis-

à-vis the ECB but also in regards to employment in credit institutions. For instance, according to Part 0.2.8.3 of the European Central Bank Staff Rules regarding the ethics framework:

> (a) members of staff who were during their employment with the ECB involved in supervisory activities for at least six months may only start working for: (1) a credit institution in the supervision of which they were directly involved after the expiry of: (i) one year if they are at salary band I or above (which may in exceptional circumstances be increased to up to two years).

The SSM's post-employment policies have however excluded from their reach the Administrative Board of Review, which, as has been referred above, plays a key function within the SSM, namely the internal administrative review of the decisions of the ECB within the SSM. The Decision of the European Central Bank of 14 April 2014 concerning the establishment of an Administrative Board of Review and its Operating Rules (ECB/2014/16) is silent on this issue and only mentions the professional secrecy requirements even after the duties of the members of the Administrative Board of Review have ceased (article 22.1 ECB/2014/16). Such exclusion seems unjustified, especially in light of the potential conflicts of interest to which the members of the Administrative Board of Review may be exposed. For instance, the latter may decide on requests of review made by banking institutions concerning decisions of the SSM affecting them (article 24.5 SSM Regulation). Hence, the lack of revolving door policies that address the employment relationships between the members of the Administrative Board of Review and the financial industry may potentially trigger biased decisions by the former in respect of the latter.

When it comes to the issue of the post-employment conflict of interest procedures applicable to the members of the Supervisory Board who are representatives of the FRSAs with membership in the SSM, the ECB's *Code of Conduct for the Members of the Supervisory Board of the European Central Bank*, has established a set of harmonised rules that apply, *inter alia*, to all the national representatives seating at the SSM. These rules also include cooling-off periods. For instance, according to article 8.1

of the *Code of Conduct for the Members of the Supervisory Board of the European Central Bank:*

> Members of the Supervisory Board shall inform the President of the ECB of their intention to engage in any occupational activity, whether gainful or not, in the two-year period from the date of their ceasing to hold office. They may only engage in an occupational activity with: (a) a credit institution that is directly supervised by the ECB after the expiry of a period of one year from the date of cessation of their membership of the Supervisory Board; (b) a credit institution that is not directly supervised by the ECB, but where a conflict of interest exists or could be perceived as existing, after the expiry of a period of one year from the date of cessation of their membership of the Supervisory Board; (c) an institution other than a credit institution, save where a conflict of interest exists or could be perceived to exist, in which case the relevant activity may commence only after the expiry of a period of six months from the date of cessation of their membership of the Supervisory Board.

However, as in the case of the ESAs, the scope of the applicability of those post-employment restrictions to the national representatives with ex officio membership in the Supervisory Board may be limited. In this respect, according to the SSM Regulation:

> Those procedures [on post-employment conflict of interest] shall be without prejudice to the application of stricter national rules. For members of the Supervisory Board who are representatives of national competent authorities, those procedures shall be established and implemented in cooperation with national competent authorities, without prejudice to applicable national law. (article 31.3 SSM Regulation)

Whereas this provision indicates that whenever national rules are stricter than those of the ECB, the former would prevail, the reference to 'without prejudice to applicable national law' would also suggest that if the post-employment restrictions at the national level were more lenient than those set by the ECB, the former would prevail as well. Article 8.6 of the *Code of Conduct for the Members of the Supervisory Board of the European Central Bank* also seems to acknowledge the prevalence of national laws in this respect by indicating that when a national FRSA

considers that there are impediments for the implementation of a recommendation of the ECB about a cooling-off period applicable to a member of the Supervisory Board, the FRSA concerned must inform the Supervisory Board about such impediment.

Reverse Revolving Door

The reforms of the EU Staff Regulations of the year 2013 introduced pre-employment conflict of interest policies which require that, before the appointment of EU officials, the latter inform the relevant EU institution/body—in writing—about any actual or potential conflict of interest. The EU institution or body concerned must then examine the case and, if necessary, adopt measures such as the relieving of the official from duties concerning matters to which conflicts of interest refer (article 11 EU Staff Regulations). The ESAs have complemented this regime with the introduction of cooling-off periods that ban members of the staff of an ESA who were employees of or provided consultancy services to entities supervised by that ESA during the year of or before joining such ESA from exercising direct supervisory activities in relation to those entities for at least one year (section 7.2 Conflict of Interest and Ethics Policy-ESMA Staff). The revised *European Central Bank Staff Rules* regarding the ethics framework also include—in section 0.2.1.4—a pre-screening mechanism aimed at spotting conflicts of interest of candidates before their appointment.

Unlike some of the post-employment restrictions discussed earlier, which may temporarily impede the undertaking of a new occupational activity by a former member of the staff of an EU institution or body, the pre-employment restrictions have a much more limited reach. This has allowed the incoming flow of staff from the financial services industry to the EU financial supervision structures. For example, the Head of Regulations of the EIOPA, Manuela Zweimueller, immediately prior to her appointment in the year 2013, was a member of the Senior Management of Munich Re, an insurance undertaking (European Insurance and Occupational Pensions Authority 2015c).

In addition to regulatory mechanisms providing for the pre-employment screening of conflicts of interest, political instruments of *ex ante* accountability may play a similar function. This is, for instance, the case of confirmation or pre-confirmation hearings at the EP, where candidates to posts at different levels of the EU financial regulation/supervision infrastructure are subject to scrutiny by MEPs, who may object the proposed candidates. The EU Commissioners, the President of the ECB, or the Chairs and Vice Chairs of the ESAs are among the posts that require such hearings at the EP (rules 118 and 122 Rules of Procedure of the European Parliament and articles 48.2 and 51.2 ESAs Regulations). Nevertheless, the operation of these instruments of political accountability has not prevented the allocation of key roles within the EU financial services institutional machinery to persons with former strong links to the financial services industry. Two examples are paradigmatic in this respect.

The first is the appointment of Mario Draghi as President of the ECB in the year 2011 (European Council 2011). During the period 2002–2005, Mr. Draghi was a Managing Director at the investment bank Goldman Sachs, serving as Vice Chairman of Goldman Sachs International (Goldman Sachs 2002). His senior role within a financial institution strongly linked to the 2007 meltdown (United States Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs 2011) indeed raised some concerns among commentators—such as Thomas and Ewing (2011)—and some policymakers about whether Mr. Draghi should be in charge of the ECB. Indeed, during his confirmation hearing at the European Parliament, some MEPs questioned Mr. Draghi on this issue and, notably, about whether he had any involvement and/or knowledge about the swap deal between Goldman Sachs and Greece (EurActiv 2011).

A second example of reverse revolving doors at top levels of EU policymaking is the appointment of Jonathan Hill as Commissioner of Financial Stability, Financial Services and Capital Markets Union in 2014 (European Council Decision appointing the European Commission, EUCO 199/14, INST 489, CO EUR 15). Mr. Hill's previous professional occupations primarily consisted of lobbying activities for firms that had, among their clients, major financial services corporations (Barker

and Pickard 2014). The hearings of Mr. Hill as Commissioner-Designate in October 2014 evidenced the reluctances of various MEPs and parliamentary groups to the appointment of Mr. Hill as a Commissioner with responsibilities in the financial services sector (European Parliament, The Committee on Economic and Monetary Affairs 2014). These concerns were intensified by the fact that Mr. Hill refused to provide precise answers to the questions of MEPs about the clients that he had among the financial industry while he was a lobbyist (Brunsden 2014). In contrast with the lack of consensus at the EP, the financial services industry across Europe generally and warmly welcomed the appointment of Mr. Hill as a Commissioner (Backie 2014).

The Shift from Industry-based to Civil Society-based Financial Sector Policies: Inter-institutional Accountability and Organised Civil Society Activism as Drivers of Change

The analysis carried out in the previous sections evidences the persistence of old ideas about the role that different categories of stakeholders should play in the financial system. Indeed, despite the major shift from self-regulation to public regulation of several areas within the financial services field in the EU, we cannot yet speak of a shift from an industry-based financial system to a civil society-based financial system.

In the first place, policymakers have devised a legal framework that gives the financial services industry a preeminent role in the post-crisis financial governance architecture. This is, for instance, evidenced by the statutory composition of the Stakeholder Groups of the European Supervision Authorities and by the leniency of the revolving doors regime, which allows the move of individuals between public and private functions even in instances where conflicts of interest may be present.

Second, the interpretation of the legal and regulatory framework by EU institutions and bodies has often been biased towards the financial

services industry and/or has dismissed the potential risks of industry's regulatory capture. The initial decisions concerning the appointment of the 'users' category at the Banking Stakeholder Group, or certain authorisations of EU institutions and bodies granted to individuals in highly controversial cases of revolving doors, constitute examples of these biased behaviours by EU policymakers.

These features of the EU post-crisis financial services governance constitute both an indication and a cause of incomplete paradigm shift. In the first place, they denote that EU policymakers do not fully acknowledge the need to move towards a more responsive financial services governance in which financial sector policies are the result of inclusive and balanced deliberation processes. Second, they prevent the consolidation of the shift in paradigm because they largely perpetuate the control of the financial services industry over financial services policymaking.

As has been referred, the industry ascendancy over financial services policymaking—both through self-regulation and control of regulatory processes—seemed to be one of the factors contributing to the Global Financial Crisis. If that were the case, the (social) efficiency rationale of the post-crisis policies and actions concerning stakeholder engagement in financial services policymaking as well as revolving doors—which partially encompass such ascendancy—would be questionable. What then are the reasons for this policy behaviour?

Endogenous motives may provide an answer to this question; as referred in the introduction of this chapter, in the aftermath of the Global Financial Crisis several areas of financial services that before the crisis were largely self-regulated were subject to increasing degrees of public regulatory intervention. The financial services industry may have reacted to this change of rulemaking power by capturing the process of financial reform so as to maintain alternative channels of influence over financial services policymaking. As a result, in the post-crisis framework, the loss of direct regulatory power has been compensated with the configuration of a system in which the financial industry keeps a dominant position and through which it is able to exercise substantial influence on the content of financial services rules.

The pervasive position of the financial services industry in the EU post-crisis financial services governance can also be explained by the

presence of vested interests that deter policy changes. For example, a reform of the rules on revolving doors, towards a more restrictive regime would negatively affect the interests of policymakers who wish to leave EU institutions or bodies and take up a job in the private sector—and who may, hence, be reluctant to support policy changes in such direction.

Despite the evidence about the incompleteness of the shift in paradigm, the analysis has also shown that there are certain elements that are driving change towards a more inclusive civil society-based financial services policy framework.

Inter-institutional Mechanisms of Accountability and Paradigm Shift

In the first place, inter-institutional mechanisms of accountability may push stakeholder participatory models in financial services rulemaking processes towards greater input-legitimacy through a more balanced engagement of civil society. Notably, in the post-crisis setting, the actions and decisions of the European Parliament and the European Ombudsman—as well as their relationships vis-à-vis the Commission and the ESAs—are acting as drivers of change in such a direction.

The EP has repeatedly demanded a more symmetrical composition of the Commission Expert Groups. In 2008, the EP called upon the Commission to review the configuration of its Expert Groups and notably to 'take action to ensure a balanced representation of interest groups in the membership of expert groups' as well as 'develop an open, transparent and inclusive process for selecting members of new expert groups' (European Parliament resolution of 19 February 2008 on transparency in financial matters (2007/2141(INI)), paras 37–38). The lack of responsiveness of the Commission to the demands of the EP resulted in the latter holding to account the former in the year 2011 through a freeze of part of the budget corresponding to the functioning of the Expert Groups (Friends of the Earth Europe 2011). The Parliament set a series of conditions to be followed by the Commission in order for the budgetary reserve to be released; these included the provision of 'safeguards against

capture from special interests and corporate interests', the ban of 'lobbyists and corporate executives from sitting in expert groups in a "personal capacity"', the establishment of 'common selection criteria throughout all Directorates-General, that guarantee balance among different categories of stakeholders' as well as the adoption of greater transparency about the Expert Groups and their functioning (Definitive Adoption of the European Union's general budget for the financial year 2012 (2012/70/EU, Euratom)). This freeze was lifted in September 2012—after the Commission agreed to implement new rules addressing the concerns of the EP (Nielsen 2012). However, the EP introduced a new freeze in 2014 on the grounds of the lack of progress of the Commission in fulfilling the conditions set by the EU legislator (EUBulletin 2014).

In the post-crisis institutional setting, the EO is also playing a central role in the reshaping of the role of different categories of stakeholders in financial services regulatory processes.

In the first place, as has been explained in this chapter, the decisions of the EO with respect to the complaints brought by civil society stakeholder platforms have induced important changes in the configuration of the ESAs' Stakeholder Groups, correcting some of the imbalances resulting from the ESAs' biased appointment decisions in the early life of the ESFS.

Second, besides the inquiries conducted at the request of civil society stakeholders, the EO has also taken a very active stand with regard to the question of the representation of interests in EU financial services rulemaking processes.

For example, in May 2014 the EO launched an own-initiative inquiry into the composition and transparency of the Commission Expert Groups (Case OI/6/2014/NF). The inquiry, which involved extensive consultations with stakeholders concluded with the EO making some recommendations of reform to the Commission (European Ombudsman 2015a). The latter included that the requisite of balanced representation of stakeholders in the Commission Expert Groups is made legally binding and that the Commission adopts for each Expert Group an individual definition of what 'balance' means in light of 'the particular objective/tasks of the group; the expertise required; which stakeholders would most likely be affected by the matter; how those groups of stakeholders are organised;

and what the ratio of the represented economic and non-economic interests should be' (European Ombudsman 2015a).

Also, in 2013, in response to complaints brought by some non-financial industry stakeholder platforms—Corporate Europe Observatory, Greenpeace EU Unit, LobbyControl, Spinwatch and Friends of the Earth—the EO decided to launch an inquiry into the issue of revolving doors at the Commission (Cases 2077/2012/TN and 1853/2013/TN). The EO's investigation revealed a 'systemic maladministration in the implementation of some aspects of the Commission's approach to the "revolving doors" phenomenon' (Draft recommendation of the European Ombudsman in the inquiry based on complaints 2077/2012/TN and 1853/2013/TN against the European Commission). For example, the EO noted that the Commission often failed to fully and clearly justify its decisions authorising EU officials to take up jobs outside the Commission (Draft recommendation of the European Ombudsman in the inquiry based on complaints 2077/2012/TN and 1853/2013/TN against the European Commission, para. 20) and, also, that some of the persons in charge of assessing the potential conflicts of interest affecting those officials may include 'people with whom they [the officials] have worked very closely' (Draft recommendation of the European Ombudsman in the inquiry based on complaints 2077/2012/TN and 1853/2013/TN against the European Commission, para. 39). The EO consequently made recommendations aimed at improving the quality and transparency of the assessment of conflicts of interest in revolving doors instances at the Commission.

The recommendations of the EO resulting from both inquiries, in turn, prompted certain commitments by the Commission, which agreed to implement some of the recommendations put forward by the EO (European Ombudsman 2015b and European Commission 2015h).

Organised Non-financial Industry Civil Society and Paradigm Shift

In addition to EU inter-institutional instruments of accountability, organised NFI civil society stakeholder activism constitutes another driver of

change towards greater input and output-legitimacy of EU financial services policymaking processes.

The aftermath of the Global Financial Crisis has witnessed the emergence of various EU-level NFI stakeholder platforms that actively participate in EU financial services policymaking processes. Better Finance and Finance Watch constitute examples of such stakeholder activism momentum.

Better Finance—formerly known as EuroInvestors (the European Federation of Investors) from 2009 until 2012, and later as EuroFinUse (the European Federation of Financial Services Users) (Better Finance 2015a)—is a non-profit association incorporated in Belgium and primarily composed of NFI stakeholder organisations from the EU member states and the European Free Trade Association (EFTA) (articles 1,2, 4 and 5 EuroFinUse Bylaws). The main target of Better Finance is: 'fighting for better governance of financial regulation with as overall objective the establishment of an open, transparent and efficient real economy served by financial institutions that have the interests of customers and society in mind' (Better Finance 2015b). Finance Watch is an international non-profit organisation created in 2011, incorporated in Belgium and composed of NFI organisations and individuals (article 5 Articles of Association of Finance Watch) from various countries—both within and outside the EU (Finance Watch 2015b); its main purpose is: 'to act as a public interest counterweight to the powerful financial lobby…to strengthen the voice of society in the reform of financial regulation by conducting advocacy and presenting public interest arguments to lawmakers and citizens' (Finance Watch 2015b).

These crisis-driven stakeholder platforms have led to a qualitative reconfiguration of the relationships between civil society stakeholders and the EU institutions and bodies in the context of financial services policymaking procedures. In the new setting, the position of non-financial industry stakeholders in such processes has been substantially reinforced through a twofold mechanism. First, EU non-industry stakeholder organisations have been very actively engaging—jointly with other member state level associations—in institutional instruments of stakeholder input to financial services rulemaking, through their participation in the ESAs Stakeholder Groups as well as in the Commission

Expert Groups in charge of advising on financial sector reforms. For example, as of May 2015, Guillaume Prache—the Managing Director of Better Finance—was a member of the ESMA SMSG, the EIOPA OPSG and the Commission's Financial Services User Group (European Securities and Markets Authority 2015a and European Commission 2015i). They also consistently respond to relevant consultation processes launched by EU institutions and bodies, providing relevant input to EU policymakers about the interests and needs of consumers and users of financial services (European Securities and Markets Authority 2014c). Second, non-industry stakeholder platforms are making use of accountability mechanisms to strengthen and consolidate their role within the EU financial rulemaking architecture. For instance, the complaints filed with the EO by EuroFinUse (Case 1875/2011/LP), Bureau Européen des Unions de Consommateurs (BEUC) (Case 1876/2011/LP), or UNI Europa (Case 1967/2011/LP) have contributed to reshaping the composition of the ESAs Stakeholder Groups, making it more balanced and representative of the various interests in financial regulation.

The emergence, greater coordination and activism of organised NFI stakeholders at the EU level constitutes a logical response to the failure of both traditional channels of input-legitimacy—embedded in the concept of representative democracy—and of the pre-crisis mechanisms of stakeholder engagement, which failed to ensure a balanced contribution of various categories of stakeholders to financial services policy and rulemaking and contributed to the creation and implementation of policy approaches and rules that encompassed, above all, the ideas behind the Efficient Market Hypothesis and the interests of the financial services industry. From this viewpoint, organised NFI stakeholder action constitutes not only a reaction to the caveats of the pre-crisis EU financial markets' governance but also, and especially, a necessary condition for change towards a more inclusive and responsive EU financial policy framework.

Rather than a full change in paradigm, the aforementioned instances of post-crisis inter-institutional accountability and of NFI stakeholder activism evidence an incomplete paradigm shift—from industry-based financial regulation to civil society-based financial regulation—which has not yet been sufficiently encompassed in all the dimensions relevant to such paradigm shift. Interestingly, this—yet incomplete—process

of change in paradigm has largely sourced from non-state dimensions; notably, organised groups of NFI stakeholders have, through their organised action and engagement, started to drive change towards financial sector regulatory models in which the interest of non-industry groups has a greater weight in the provision of policy input. This post-Global Financial Crisis rebalancing of the sources of and driving forces behind policymaking in the field of financial services bears some promise. In this new setting, NFI stakeholders are influencing change and helping to drive a shift in paradigm not only through a more organised collective action but also by way of their formal participation in institutional mechanisms of financial services policymaking. The main challenge for achieving a full shift of paradigm still lies at the political reticence to such change, which, as this chapter has shown, is to a certain extent motivated by the too close relationships between political and financial powers.

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3

Changing Perceptions of Systemic Risk in Financial Regulation

Caroline Bradley

After the onset of the financial crisis in 2007, official reports noted that the crisis demonstrated failures of pre-crisis financial regulation. Since the crisis, governments, international organizations and regulators have emphasized systemic risk and financial stability as a core concern of financial regulation. A focus on interconnectedness is a critical component of the analysis of financial stability: financial market activity interconnects across territorial borders, across market sectors and through transactional linkages in ways that pre-crisis financial regulation did not effectively address. The institutional arrangements for transnational financial regulation have also changed: the G20 countries committed to a new co-ordination of financial regulation emphasizing financial stability, an enterprise commentators have characterized as a departure from the pre-crisis paradigm of networks of regulators. Public pronouncements by governments, regulators and international organizations suggest that there has been a transnational paradigm shift in financial regulation.

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However, there are reasons to doubt that there has, in fact, been a paradigm shift rather than an evolution of pre-crisis financial regulation. Systemic risk was a concern of regulators before the crisis, and the new Financial Stability Board is the renamed Financial Stability Forum, established in 1999 in response to the Asian financial crisis. Progress in development and implementation of new transnational standards of financial regulation is slow, and the new standards are developments of, rather than substitutes for, earlier standards. Financial regulation remains excessively complex in ways that impede effectiveness and make it hard for non-experts in financial regulation to understand what the rules are. Enforcement actions arising out of pre- and post-crisis events suggest that there has been and remains a systemic problem in the culture of finance.

The Financial Crisis and Systemic Risk

Before the global financial crisis, banking regulators and the markets generally behaved as though risk was under control: there were financial assets that were risk-free, and regulators and market participants trusted in risk mitigation techniques with respect to assets that were perceived as involving risk. Indeed the Joint Forum was arguing already in 2008 that credit risk transfer 'allows credit risk to be more easily transferred and potentially more widely dispersed across the financial market. CRT has made the market pricing of credit risk more liquid and transparent. But CRT also poses new risks. A failure to understand and manage some of these risks contributed to the market turmoil of 2007' (The Joint Forum 2008).

The Basel Committee on Banking Supervision (Basel Committee) developed standards for banking regulation, generally, and capital adequacy, in particular, which aimed to identify and neutralize a range of risks associated with the business of banking (Goodhart 2011). The crisis demonstrated that this faith in the control of risk had been misplaced. Many commentators noted before the crisis, or have emphasized subsequently, that the prevailing paradigm in financial regulation was one of decentring of financial regulation (Black 2012) or, less subtly, that the markets should regulate themselves with as little governmental

intervention as possible (Dorn 1993). Investigations of the financial crisis identified deregulation broadly (Born 2011; Levine 2012), or excessive faith in mathematical models more narrowly (Financial Services Authority 2009), as an important cause of the crisis, and initial responses to the crisis emphasized the need to bolster regulation: 'We are determined to enhance our cooperation and work together to restore global growth and achieve needed reforms in the world's financial systems' (G20, 15 November 2008 Declaration).

After the onset of the financial crisis, governments acknowledged the need for governmental and even international governmental action (see, again, G20 declaration of 2 April 2009) to promote and maintain confidence in the financial markets. As Claessens et al. (2010: 3) argue, 'the crisis highlights that the international financial architecture is still far from institutionally matching the closely-integrated financial systems'. Money provided by governments and the International Monetary Fund (IMF) and new rules were employed to support the financial markets (see US Department of the Treasury Office of Financial Stability, October 2010 and IMF Response, Coffee 2012). But the mutual dependence of banks and governments led to new difficulties (Bradley 2014). In the European Union (EU), government bailouts of financial institutions increased stresses on public finances (Sutherland et al. 2012), which in turn led to market participants worrying about sovereign credit risk and a reduction in the value of some sovereign debt held by banks (ECB 2010; Lane 2012). The EU experienced a sovereign debt crisis on top of the financial crisis, and the EU and IMF imposed austerity measures as a condition for loans to states that needed financial assistance (Featherstone 2011; IMF 2010; Matsaganis 2011). More generally, policy-makers have emphasized the need to solve the problem that financial firms that are 'too big to fail' are subject to moral hazard and could cause financial crises in the future (European Commission Communication 2010/579; Siegert and Willison 2015). And regulators and market participants recognize that the idea of a risk-free financial asset is an illusion (Bank for International Settlements 2013).

The scale of the crisis and governmental financial support for troubled financial institutions, a US foreclosure crisis and EU sovereign debt crisis, domestic policies of austerity implemented with or without the

involvement of the IMF—as Ulrich Beck argued (2013: 68), 'the risks posed by big banks are being socialized by the state and imposed on retirees through austerity dictates'—led to financial regulation becoming part of the general political conversation in a way that it had not been before the crisis when financial regulation was a matter for technocrats and market participants rather than politicians and citizens. Citizens engaged in public protests about austerity and failures of government from Syntagma Square to Wall Street (Calhoun 2013). The Occupy movement has spawned groups that have produced long and detailed critiques of regulatory proposals (Appel 2014; Occupy the SEC 2012), but citizens generally lack the expertise and resources to participate effectively in political and regulatory discussions of the complexities of financial regulation (Levine 2012). And the politics surrounding financial regulation can be incomprehensible: in the USA the Chairman of the House Financial Committee on Financial Services asked, 'who will protect consumers from the overreach of the Consumer Financial Protection Bureau?' (House Committee on Financial Services 2015).

The causes of the financial crisis included phenomena that had been present in other financial crises: asset bubbles, credit booms, build-up of risk and failures of regulation (Claessens et al. 2010: 4). But policymakers identified what they described as new or newly significant phenomena that exacerbated the crisis: innovation involving complex and opaque financial instruments, increased interconnectedness of financial institutions and markets and increased leverage of financial institutions (Claessens op. cit.: 7).

Governments, international organizations and regulators reacted to the financial crisis by announcing that they would develop new and better rules of financial regulation. In 2008, the G20 states announced that they would do whatever was necessary to stabilize financial markets (G20, Declaration of 15 November 2008, also Buckley 2014). Although the G20 Declaration of 2008 referred to the need to improve financial regulation, there was no detail about what changes were planned, although there was an agreed Action Plan that assigned tasks to various actors:

> We commit to protect the integrity of the world's financial markets by bolstering investor and consumer protection, avoiding conflicts of interest,

> preventing illegal market manipulation, fraudulent activities and abuse, and protecting against illicit finance risks arising from non-cooperative jurisdictions. We will also promote information sharing, including with respect to jurisdictions that have yet to commit to international standards with respect to bank secrecy and transparency. (G20, 15 November 2008, *Declaration of the Summit on Financial Markets and the World Economy*)

The new measures to deal with risk in the financial system would be developed through international standards, and the G20 reiterated this plan the following year (G20, 2 April 2009) together with a commitment by the G20 states to implement the new standards (G20 ibid.). The Financial Stability Forum, which was established in 1999 to address issues of financial stability revealed by the Asian financial crisis (Carrasco 2010), would be reconstituted as the Financial Stability Board (FSB) with a broader mandate and with increased institutional capacity (G20 ibid.).

The G20 committed to 'implement international financial standards (including the 12 key International Standards and Codes)'[1] and to 'undergo periodic peer reviews, using among other evidence IMF/World Bank public Financial Sector Assessment Program reports' (G20, 2 April 2009). Transnational standards for financial regulation would be improved and expanded and would be implemented more effectively. A significant component of the project was an intensification of the institutional arrangements for developing and ensuring implementation of international standards of financial regulation.[2] In the EU, the crisis led to new institutional mechanisms for the control of banking risks with

[1] The International Standards and Codes are the IMF's Code of Good Practices on Fiscal Transparency, Code of Good Practices on Transparency in Monetary and Financial Policies, General Data Dissemination System, and Special Data Dissemination System the Basel Committee's Core Principles for Effective Banking Supervision, IOSCO's Objectives and Principles of Securities Regulation, IAIS' Insurance Core Principles, The Basel Committee and IADI's Core Principles for Effective Deposit Insurance Systems, the World Bank's Insolvency and Creditor Rights Standard, the OECD's Principles of Corporate Governance, the IASB and IAASB's International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA), the CPMI/IOSCO Principles for Financial Market Infrastructures, and the FATF Recommendations on Combating Money Laundering and the Financing of Terrorism & Proliferation. *See* http://www.financialstabilityboard.org/cos/key_standards.htm date accessed 17 June 2015.

[2] See, for example, Financial Stability Board (29 January 2015). *First Annual Report: 28 January 2013–31 March 2014*, at ii (noting that the Financial Stability Board 'became a separate legal entity in the form of an association ("Verein") under Swiss law on January 28, 2013'.)

the creation of a European Banking Union and the transfer of powers to supervise eurozone banks to the European Central Bank (Moloney 2014).

In addition to redeveloping the architecture of international financial regulation, the G20 emphasized that systemic risk and financial stability are a core concern of financial regulation (G20, 2 April 2009). The FSB has taken on the task of evaluating states' implementation of international standards by means of country peer reviews (Financial Stability Board, 23 September 2010) and has also carried out thematic peer reviews that focus on issues the FSB regards as important for financial stability (Financial Stability Board, 8 February 2012). The FSB characterizes a major function of both types of peer review as encouraging dialogue and the sharing of experiences between FSB members.[3]

In 2009, in addition to commitments with respect to capital adequacy, credit rating agencies, pay and compensation, banking secrecy and accounting standards, the G20 announced that the FSB and IMF would collaborate to identify and warn of macroeconomic and financial risks and that regulation would take account of macro-prudential risks and would deal with 'systemically important financial institutions, instruments and markets' (G20, 2 April 2009). The G20 countries also committed to 'conduct all our economic policies cooperatively and responsibly with regard to the impact on other countries' (G20 ibid.). Thus, the G20 recognized that maintaining financial stability required focusing on risks in three different but inter-related ways: through the lenses of micro-prudential risk (risks affecting individual firms), macro-prudential risk (systemic risks) and monetary policy (Tarrullo 2014).

In a number of ways, the G20 program of stabilizing financial markets looked like a dramatic shift away from the pre-crisis paradigm of financial regulation in which technocratic regulators acknowledged and deferred to the expertise of market actors in identifying and controlling risk; governments were taking charge of financial regulation (Mackintosh 2014, 2015). The financial crisis was a political rather than merely a regulatory problem, and it required political as well as regula-

[3] See, for example, Financial Stability Board (8 February 2012) *Thematic Review on Deposit Insurance Systems Peer Review Report*, 2. For a description of the procedures for FSB peer reviews see Financial Stability Board (7 January 2014b). *Handbook for FSB Peer Reviews.*

tory solutions. Governments stated publicly that they would take control of systemic risk domestically and through intensified transnational arrangements. The next sections of the chapter explore the extent to which the new transnational arrangements and the new approaches to systemic risk do and do not represent a paradigm shift in transnational financial regulation.

The New Transnational Arrangements for Addressing Systemic Risk

The G20's commitment to a new co-ordination of financial regulation emphasizing financial stability is a departure from the pre-crisis paradigm of networks of regulators (Gadinis 2013). The Basel Committee, the International Organisation of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) had been developing transnational standards for financial regulation since the 1980s. The Basel Committee published the Basel Accord in 1988 (Goodhart 2011), but central bankers and banking regulators had been focusing on issues raised by the internationalization of financial markets since the early 1970s (Goodhart 2011). IOSCO was formed in 1974 as a forum for discussion of issues relating to securities regulation and was formalized a decade later when it was incorporated in Quebec (Sommer 1996). In 1987, IOSCO established a Technical Committee that would be 'responsible for the co-ordination of international co-operation on the regulation of securities transactions' (IOSCO 1989: 2).

The IAIS was formed in 1994 (Braithwaite and Drahos 2000). These three organizations developed as international policy networks, linking policy-makers from different jurisdictions with common interests and facing common problems (Slaughter 2004). Indeed, as Reinicke (1999–2000: 45) argued, 'Trapped by the territoriality of their power, policy makers in traditional settings often have little choice but to address the symptoms rather than the causes of public problems'.

Although the transnational standard setters for financial regulation developed a range of agreed standards, the standards are not formally

binding, even on states that participate in the relevant networks (Alford 2005). States may feel pressure to comply with the standards (Brummer 2011; Feldman 2013), the IMF can focus on standards as a component of conditionality with respect to its borrowers, and the IMF and World Bank have developed a Financial Sector Assessment Program (FSAP) to examine the extent to which states' laws are consistent with the international standards (Brummer 2011). But the standards have often been drafted in language that is vague and open to multiple interpretations (Barr and Miller 2006).

Even Basel II, which was much more detailed and specific than the original Basel Accord, provided states with significant leeway in implementation (Kane 2007). In responding to the crisis, the G20 and the Financial Stability Board have emphasized the need to develop transnational standards to be more demanding and to give states less discretion with respect to implementation (G20, 2 April 2009).

It was the G20, rather than the transnational regulatory networks, that took the lead in responding to the crisis at the international level. States collaborated outside the established networks to implement responses to the crisis (although a history of co-operation through the networks may have facilitated this collaboration) (Zaring 2010). The G20 set out the parameters for the regulatory responses that the Financial Stability Board and the transnational networks would implement, thus giving political direction to processes that had previously seemed to be technocratic (Zaring ibid.) As Pan (2010: 245) argued, 'for financial law scholars, the G20, both in its existence and in the types of actions it puts forward, represents only a temporary solution to an on-going problem of regulation of international financial markets and institutions'.

That financial regulation seemed more political during the crisis, when states were bailing out financial firms, was not surprising. And it was necessary for states to co-ordinate their behaviour at the transnational level because individual states could not control a transnational crisis on their own. Meanwhile, the international responses to the crisis, in particular the implementation and imposition of austerity measures, have also led to a new emphasis on the international financial system and financial regulation as political issues within domestic systems.

The FSB and the transnational standard setters have worked on implementing the G20 program for financial reform, but domestic legislators and regulators have taken steps to implement reforms to some extent independently.[4] The G20 established some general principles for reform of financial regulation. Although the transnational standard setters have developed more detailed standards to flesh out the general principles, states have been implementing their own versions of reformed regulation at the same time (Deutsch 2014; Financial Markets Law Committee 2015).

Thus the G20 principles have been implemented according to different timetables in different places (specifically in the EU and the USA), and the details of the new domestic regulatory regimes are not always consistent with each other (see, for example, Deutsch 9 July 2014 and GAO 3 April 2014). Market participants have critiqued these regulatory inconsistencies (GFMA et al. 30 May 2014).

The G20 committed to a new FSB peer review process to improve implementation of international standards, and, in addition, the standard setters have focused more attention on implementation of their standards than they had in the pre-crisis period. The Basel Committee had established an Accord Implementation Group to focus on implementation of the Basel II capital adequacy framework, and in 2009, the AIG was renamed[5] the Standards Implementation Group, and it was given a broader task of focusing on the Basel Committee standards more generally (BIS, 8 January 2009).

In 2011, the Basel Committee announced that it would be reviewing states' implementation of Basel III (Basel Committee on Banking Supervision, Oct 2011), and this initiative developed into a Regulatory Consistency Assessment Program (Basel Committee on Banking Supervision, Oct 2013). IOSCO carried out rather formal exercises in evaluating implementation of its resolutions and standards beginning in the 1990s (for example, IOSCO 1996, May 2000). More recently

[4] Note that it may sometimes be complex to achieve co-ordination of regulatory efforts domestically. See, for example, Government Accountability Office (2014).

[5] This renaming may or may not be connected with the bailout of the other AIG, which occurred in 2008. As to the bailout, see, for example, Sjostrom, W. K. Jr. (2009). The AIG Bailout, *Washington & Lee Law Review*, *66*, 943–991.

IOSCO has carried out significantly more detailed assessments of the extent to which states are implementing some of its standards. These assessments include evaluations of implementation of IOSCO standards and principles relating to benchmarks (IOSCO, 2015), credit rating agencies (IOSCO, March 2009) and financial market infrastructures (IOSCO, April 2013). Thus, during and after the financial crisis, the Basel Committee and IOSCO intensified their existing interest in issues of implementation rather than developing an entirely new interest in implementation: an evolution rather than a change of paradigm.

In addition to the work of the Basel Committee and IOSCO, the IMF and World Bank continue to monitor implementation of the standards through the FSAP process. Within the IMF structure, FSAPs were originally conceived as voluntary technical assistance, but the IMF decided to make Financial Sector Assessments a mandatory component of surveillance for countries with systemically important financial sectors (assessed based on criteria of size and interconnectedness).[6] Originally, the IMF identified 25 such countries, notably Australia, Austria, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, Russia, Singapore, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the USA (see IMF, 27 September 2010a), and in 2013 the number of such countries was increased to 29 (all of the original 25 and Denmark, Finland, Norway, and Poland) (IMF, 15 November 2013). The list includes a large number of European countries because of the emphasis on interconnectedness (IMF, 15 November 2013).

The FSB peer reviews were intended to demonstrate that the G20 countries were leading by example: their compliance with transnational standards, established by the peer reviews, would allow them more credibly to encourage other countries to comply (FSB, 9 January 2010). But the FSB peer reviews do not, in fact, demonstrate compliance with international standards. They build on FSAP assessments rather than duplicating them: for example, they may assess how a state has responded

[6] IMF (21 September 2010b). *Decision No. 14736-(10/92)*. See also IMF (27 August 2010c). *Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance: Background Material*. The IMF's approach to surveillance has been evolving. See, for example, IMF (30 July 2014a). *2014 Triennial Surveillance Review—Overview Paper*.

to FSAP recommendations (Financial Stability Board, 7 January 2014b). The FSB Handbook for Peer Reviews states that, 'unlike the FSAP, a country review does not comprehensively analyse a jurisdiction's financial system structure or policies, nor does it provide an assessment of its conjunctural vulnerabilities or its compliance with international financial standards' (Financial Stability Board, 7 January 2014b: 2).

What the decision not to reproduce FSAPs means is that the peer reviews are carried out on the basis of data in FSAPs that are not current, and on the basis of statements of regulators about what they are doing. For example, the Peer Review of Canada, published in January 2012, noted that it was 'largely based on the Canadian financial authorities' responses to a questionnaire designed to gather information about the actions taken in response to the relevant recommendations of the most recent Financial Sector Assessment Program Assessment for Canada' (FSB, 30 January 2012: 3). This FSAP assessment of Canada had been carried out four years earlier, in 2008 (IMF, February 2008). The FSB suggests that its peer reviews are geared to examining the responsiveness of the states subject to the reviews to recommendations made in the FSAP process rather than to monitoring compliance with international standards. In the case of Canada, the time lag was significant: Canada's FSAP was completed in the early stages of the financial crisis, so a focus on how Canada responded to recommendations made at that time does not help very much to instil confidence about what Canada was doing with respect to changes in thinking about standards between 2008 and 2012. At the same time, the peer review report does include a lot of information about Canada's reactions to the financial crisis (see, for example, FSB, 30 January 2012). And the Canadian financial system fared well during the crisis.

The FSB says that one of the main functions of the peer reviews is to encourage dialogue between the participants:

> The added value of the FSB comes in significant part from the cross-sectoral, cross-functional, system-wide perspective brought by its members. Dialogue with peers and the sharing of lessons and experiences are a key benefit of FSB peer reviews (FSB, 7 January 2014b).

The FSB is not the only body that can promote dialogue, but unlike the Basel Committee or IOSCO it includes participants who focus on different sectors of finance. As some of the complex issues financial regulators need to deal with relate to regulatory perimeters, gaps and arbitrage—shadow banking is this type of complex issue, for instance (Schwarcz 2013, and Financial Stability Board, 14 November 2014a)—a body that can bring together people who understand the different parts of the overall picture is useful. The FSB's decision to focus on thematic and country peer reviews reflects this idea: the objective of thematic peer reviews is to evaluate (where possible) the extent to which standards and policies have had their intended results, to identify gaps and weaknesses in reviewed areas and to make recommendations for potential follow-up (including via the development of new standards) by FSB members (FSB, 7 January 2014b).

This idea of the benefit of dialogue among regulators was cited before the financial crisis as an advantage of the regulatory networks that proved to be unable to limit the crisis without governmental intervention. What the FSB describes is a process that involves a wider range of technocrats than participated in the individual standard-setters: it is cross-sectoral, cross-functional and system-wide rather than being limited to banking, securities or insurance. But the cross-sectoral communication is not entirely new; beginning in 1993, the sectoral regulators did co-operate in a Tripartite Group, later renamed the Joint Forum, to address issues raised by the 'growing emergence of financial conglomerates and the blurring of distinctions between the activities of firms in each financial sector' (Basel Committee on Banking Supervision 2001b: 5). The Joint Forum met three times a year between 1996 and 2001 (Basel op. cit.), and it has established working groups to focus on particular issues. For example, in 2000, the Joint Forum established a working group to compare the core principles that had been developed by the sectoral standard-setters (Basel Committee on Banking Supervision, November 2001a: 1).

In 2004, the IMF published a paper that identified a number of emerging risks and cross-sectoral issues the standard-setters should address (IMF, 4 August 2004). The Joint Forum had convened an indus-

try roundtable to address cross-sectoral issues in 2003; it established a Working Group on Regulatory and Market Differences, noted the IMF's paper and published its own paper on cross-sectoral issues in 2006 (Basel Committee on Banking Supervision 2006: 1). These are only a few examples of the Joint Forum's work, but they do illustrate that cross-sectoral discussions were occurring before the financial crisis, and that the FSB's cross-sectoral work is not really new.

The Joint Forum's 2006 cross-sectoral issues paper noted that there had been some convergence in market practice and regulation across sectors (Basel Committee on Banking Supervision 2006: 3). For example, the paper identifies risk management within financial conglomerates as an area of convergence in market practice (Basel Committee on Banking Supervision 2006: 4–5). Generally, the Joint Forum characterized this development as positive, although the paper did note that 'supervisors recognise that models are only one tool in a firm's risk management process and that they have their limitations' (Basel Committee on Banking Supervision 2006: 5). In 2013, the Joint Forum decided to survey regulators and firms in order to 'understand the current state of credit risk…management given the significant market and regulatory changes since the financial crisis of 2008' (The Joint Forum, February 2015: 1).

This brief sketch of some aspects of the work of the transnational standard setters, individually and together through the Joint Forum, with the co-operation of the IMF, illustrates that the work of the FSB is another step in an evolving process of transnational co-ordination of financial regulation rather than a new phenomenon. The developing discourse among financial regulators is also an example of evolution rather than something that is novel. While a more comprehensive and regulator dialogue among regulators may be useful, we should also note that groupthink has been identified as an issue in the lead-up to the crisis (Independent Evaluation Office of the IMF 2011: 1), and the new processes are not guaranteed to produce better thinking. Nor are they guaranteed to apply an appropriate level of scepticism to the claims of financial market participants. Indeed, Admati and Hellwig (2013), too, argue that not much has really changed in banking regulation.

Systemic Risk After the Financial Crisis

Just as the structures and processes for international cooperation in financial regulation seem to be an evolution rather than a paradigm shift, the regulatory approaches to systemic risk can be characterized as an evolution of pre-crisis financial regulation. The language policy-makers use to describe their focus on systemic risk has changed: macro-prudential regulation is added to micro-prudential regulation (a development that has been characterized as dramatic) (Baker 2013: 418; Mackintosh 2015), and monetary policy must take account of financial stability concerns.[7]

In its Financial Stability Report in December 2014, the Bank of England analysed market liquidity from microstructural and macrofinancial perspectives, describing how market liquidity can build up systemic risk (Bank of England, Dec 2014: 54–56). During the financial crisis, securitizations involved liquidity problems (Bank of England op. cit.: 56), and the Report states that 'efforts are now underway internationally to improve the simplicity and transparency of securitisations' (Bank of England, December 2014: 56).

The example of securitization clearly comes from the last crisis and the acknowledgment of the relationships between firm safety and soundness, systemic stability and monetary policy reflects a complex thinking about financial stability, which, as of December 2014, also included issues relating to damage to market confidence from bank misconduct:

> Recent misconduct and other operational failings have highlighted that rebuilding confidence in the banking system requires more than financial resilience. That, and changes to banks' business models in response to commercial and regulatory developments, make it important for banks to continue to enhance the effectiveness of their governance arrangements. (Bank of England, December 2014: 48)

[7] Although compare Yellen, J. (2 July 2014). *Monetary Policy and Financial Stability, Remarks at the 2014 Michel Camdessus Central Banking Lecture, International Monetary Fund*, Washington, D.C. ('In my remarks, I will argue that monetary policy faces significant limitations as a tool to promote financial stability'.)

In March 2015, the Bank of England, noted that it is 'one of a handful of institutions internationally with responsibility for monetary macroprudential and microprudential policy', and published an agenda for research on the inter-relationship between these policy areas (Bank of England, March 2015b: 1). The agenda recognizes that recent changes in the regulatory environment and the conduct of monetary policy demand further research to understand their implications for financial stability (Bank of England, March 2015b: 3–4).

Policy-makers did not begin to think about issues of financial stability (or even macro-prudential regulation) in 2007. The Bank of England published the first financial stability review in 1996 after the failure of Bank of Credit and Commerce International (BCCI) and Barings (Oosterloo et al. 2007). Claudio Borio at the Bank for International Settlements, the institution that houses the Basel Committee's secretariat, advocated a macro-prudential approach in 2003 (Borio 2003), and some years earlier than that he wrote about regulation and financial stability (Borio and Filosa 1994). The European Central Bank has published a Financial Stability Review since December 2004 (European Central Bank, December 2004: 7). Recent developments in thinking about financial stability thus look, as do the changes in the institutional arrangements for setting international standards for regulation, like an evolution rather than a dramatic change.

Although the terminology of macro-prudential regulation has spread since the crisis, policy-makers were concerned about similar issues under the rubric of financial stability before 2007: financial crises with varying causes and characteristics had preceded the global financial crisis (Krugman 1999). Other financial crises have involved losses of confidence in financial institutions (Bernanke 1983). So rules of financial regulation aim to boost confidence in the safety and soundness of financial institutions, particularly, commercial banks. Rules to address safety and soundness address issues within individual financial firms, but they also address the risk of contagion, which is a systemic issue. And the concern about panics is not new: Alex Preda notes that 'panics became an object of systematic description in the 1860s' (Preda 2009: 221).

Speculative bubbles are frequently a component of crises. De Long and Shleifer (1991: 677), studying the 1929 stock market bubble, esti-

mate that, at the peak, the stock index was more than one third above its fundamental value. Legislators and regulators have, however, designed rules of financial regulation to reduce the likelihood of speculation (Bradley 2000). The margin requirements that apply to securities and derivatives trading are meant to limit speculation (Furbush and Poulsen 1989). Bubbles are phenomena that do not affect only individual firms or investments but also categories of investments: tulips, securities of high-tech firms, or real property (Eichengreen 2015).[8] Housing markets and speculation in real property were part of the background to the financial crisis:

> While the vulnerabilities that created the potential for crisis were years in the making, it was the collapse of the housing bubble—fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages—that was the spark that ignited a string of events, which led to a full-blown crisis in the fall of 2008. (Financial Crisis Inquiry Commission 2011: xvi)

Policy-makers worried about the transnational transmission of risk through the financial system before 2007. Charles Goodhart identifies concerns relating to systemic risk and the Euromarkets dating back to the early 1970s but which were exacerbated by the collapse of Bank Herstatt in 1974 (Goodhart 2011: 3–4). In 1985, the Governors of the G10 Central Banks established a study group to focus on international banking (Goodhart 2011: 352–3). When the group reported the following year, it warned that innovation in the financial markets could be contributing to systemic vulnerabilities (Bank for International Settlements 1986). This was the beginning of the process that led to the development of the transnational standard-setters. As Goodhart shows, over the period between the early 1970s and the collapse of Lehman Brothers, policy-makers and academics worried about risks to financial stability, including those which derived from the internationalization of the financial markets. In 1998, Benjamin Cohen warned that 'monetary geography

[8] Describing the Florida property market bubble of the 1920s, Peter Garber has written: 'Gathered around the campfires early in their training, fledgling economists hear the legend of the Dutch tulip speculation from their elders, priming them with a skeptical attitude toward speculative markets'. Garber (1989: 535). Compare Roubini (2006) and Posen (2006).

needs to be re-conceptualized in functional terms, to focus on evolving networks of currency transactions and relationships' (Cohen 1998: 5).

The post-financial crisis developments with respect to micro-prudential risk are refinements of and additions to regulatory standards that applied before the financial crisis: banking regulators have been revising capital adequacy requirements for banks so that they address credit risk more effectively (Basel Committee on Banking Supervision, March 2015) and also so that they now address liquidity risk (Basel Committee on Banking Supervision, March 2015: 3–4).

These refinements of capital adequacy requirements are designed to make sure that risks are contained within banking firms. Banking regulators evaluate the effectiveness of the new requirements by carrying out stress-tests that examine how a bank's capital would deal with adverse events (Board of Governors of the Federal Reserve System, March 2014). In order to bolster the internal containment of risks, policy-makers argue that banks should issue contingent convertible bonds (CoCos) as a component of capital. CoCos are bonds designed to absorb losses either by means of a writedown of principal or because they are convertible into equity on the occurrence of defined events, such as when the issuer's regulatory capital falls below a specified proportion of risk-weighted assets (Avdjiev et al. 2013). The regulatory focus on liquidity, stress-testing and instruments to ensure that capital actually absorbs risks reflect reactions to the circumstances of the last crisis. It is a perennial characteristic of regulation that it tends to address issues that are historic, and policy-makers' ability to predict the future is limited. Regulation introduced to control risks that developed in the past may create their own new risks as market participants manoeuvre around the rules.[9]

Like the new rules to address micro-prudential risk, the recent developments in thinking about macro-prudential risk are designed to address the issues that policy-makers can identify based on past events. The need to identify, analyse and control for interconnectedness is a critical component of the thinking about financial stability since the crisis (Gai et al.

[9] Compare, for example, Jackson et al. (April 1999: 2): 'over time the banks have learnt how to exploit the broad brush nature of the requirements—in particular the limited relationship between actual risk and the regulatory capital charge. For some banks, this has probably started to undermine the meaningfulness of the requirements'.

2011); financial market activity interconnects across territorial borders, across market sectors and through transactional linkages in ways that pre-crisis financial regulation did not effectively address. Transnational financial regulation had, in the past, sought to address some of these issues. For example, the Joint Forum had studied cross-sectoral issues (Basel Committee on Banking Supervision, The Joint Forum 2006) and credit risk transfer (Joint Forum, March 2005) before the crisis. But this focus did not prevent the problems that led to the bailout of AIG, an insurance firm that took on excessive amounts of credit risk via credit default swaps (Sjostrom 2009). So in the post-crisis period, regulators seek to identify firms that, like AIG, pose risks to financial stability; such firms are systemically significant financial institutions (SIFIs) (Financial Stability Board, 4 November 2011).

As the Basel capital adequacy requirements focused on the need for capital to address credit risk, banks could comply with the requirements by increasing capital or by reducing the credit risks to which they were exposed. Banks developed various strategies designed to have the effect of transferring credit risk to firms that were not regulated as banks and not subject to the same capital adequacy requirements as banks.[10] Firms that perform functions similar to the functions we associate with banks are now known as shadow banks, and policy-makers have been trying to address a range of issues associated with shadow banking.[11] This includes new rules to address risks associated with securitization (see, for example, Department of the Treasury Office, 24 December 2014; Segoviano et al. 2015), securities lending and repo transactions (Financial Stability

[10] See, for example, Joint Forum (March 2005): 'In recent decades, loan syndication and securitisation activities experienced significant growth. The present report, however, focuses more narrowly on the newest forms of CRT, in particular on those activities associated with credit derivatives'. And compare with Eichengreen (2015) who notes that the focus on regulating banks obscured the risks developing in nonbanks.

[11] See, for example, EU Commission (9 April 2013a). *Shadow Banking—Addressing New Sources of Risk in the Financial Sector, COM (2013) 0614 final*; EU Commission (19 March 2012). *Shadow Banking Green Paper, COM (2012) 102 final*; Financial Stability Board (29 August 2013a). *Strengthening Oversight and Regulation of Shadow Banking Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities*; IMF (October 2014b). *Global Financial Stability Report: Risk Taking, Liquidity, and Shadow Banking—Curbing Excess While Promoting Growth*, Chapter 2.

Board, 29 August 2013b) and money market funds (EU Commission, 9 April 2013a).

Money market funds and asset management firms are an important part of the new focus on financial stability because of their 'systemic interconnectedness…with the banking sector on the one hand and with corporate and government finance, on the other hand' (EU Commission, 9 April 2013a: 2), and they are perceived as vulnerable to runs (EU Commission, 9 April 2013a: 3).

In the USA, the Office of Financial Research published a report on the asset management industry in 2013 that identified possible risks to financial stability from asset management firms and concluded that there was a need for more data to allow for effective macro-prudential analysis (Office of Financial Research, September 2013: 24). In December 2014, the US Financial Stability Oversight Council, the body responsible for designating SIFIs in the USA, published a notice in the Federal Register asking for information about asset management (Financial Stability Oversight Council, 24 December 2014: 77488, Financial Stability Oversight Council, 11 February 2015: 7595).

Meanwhile, the Financial Stability Board has been working on developing criteria for identifying non-bank, non-insurer (NBNI), global SIFIs (NBNISIFIs), publishing an initial consultative document in 2014 (Financial Stability Board, IOSCO, 8 January 2014), which generated a number of comments and was followed by a second consultation document in 2015 (Financial Stability Board, IOSCO, 4 March 2015, FSB NBNI Consultation 2015: 1). The initial consultation document identified three ways in which an NBNI could have an impact on financial stability: through the impact of its failure on counterparties, through the impact on the market from asset liquidation forced by its failure, and from its failure to provide a service on which other market participants relied (FSB NBNI Consultation 2014: 3). The FSB noted that the task of identifying NBNISIFIs was a complex one because many different types of firm with different characteristics might be implicated: 'the methodologies have to allow sufficient flexibility to capture different risks (or externalities) posed by entities in each type/sector appropriately while maintaining a certain degree of consistency across the entire NBNI financial space' (FSB NBNI Consultation 2014: 5). The FSB's criteria

for evaluating systemic significance are: size, interconnectedness, substitutability, complexity and global activities (cross-jurisdictional activities) (FSB NBNI Consultation 2014: 5, see also FSB NBNI Consultation 2015: 6).

Even this very brief outline of the work that policy-makers have been doing to identify and seek to control macro-prudential risks makes it clear that the endeavour is time- and resource-intensive, and that the policy approaches are as complex as the phenomena they address. The events leading up to and during the financial crisis provoked policy makers to think about macro-prudential risks. The idea of focusing on interconnectedness and complexity derives from the crisis. At the same time, the policy-makers are trying to develop methodologies for identifying risks in more nuanced ways. And the ongoing process of working to understand systemic risk more completely—as illustrated, for example, by the Bank of England's One Bank Research Agenda—gives some hope for the future, because it does not take the easy or obvious route but attempts to engage with the real substance of market activity (Bank of England, March 2015b, Bookstaber and Glasserman, 11 February 2015).

Monetary policy does have implications for financial stability, and recognition of this fact is part of the new approach to thinking about financial institutions and markets. As Roubini argues (2006: 93): 'Although the precise magnitude of the effect may be uncertain, the fact that bubbles have an impact on the economy—on the way up and on the way down—means that monetary policy needs to take them into account'. But the idea of considering financial stability a component of monetary policy is not new, it is difficult to implement, and different policy-makers have different views about the extent to which monetary policy should take account of financial stability, price stability and employment. Those who argue that monetary policy should address issues of financial stability note that 'financial institutions have a natural tendency to accumulate assets that are too risky and to hold too little capital' (Cechetti and Kohler 2014: 208). Increasing interest rates could reduce asset price bubbles (Cechetti and Kohler 2014: 209). But the actions of central banks in managing monetary policy to address domestic issues have implications not only for domestic financial stability but also for international financial stability (Bush et al. 2011: 4).

Together, new approaches to micro-prudential, macro-prudential and monetary policy are designed to address the risks that policy-makers worry about as a result of their understanding of the global financial crisis. But our understandings of crises are only partial, and fixing the problems we can see may disguise the fact that other problems are building up (Eichengreen 2015: 379). Progress in development and implementation of new transnational standards of financial regulation is slow, and the new approaches are often developments of, rather than substitutes for, earlier standards. Financial regulation remains complex in ways that impede effectiveness and make it hard for non-experts in financial regulation to understand what the rules are. The development of complex research and analysis of risk in central banks and financial regulators provides a useful expertise counterpoint to the expertise claims of market participants, perhaps reducing risks of over-reliance on market-based expertise. However, there are contexts in which regulators depend on information they acquire from market participants (see, for example, Joint Forum, February 2015: 1), and market participants and trade associations are not shy about expressing their views on financial regulation (see, for example, Cross-Border Regulation Forum 23 February 2015 and Public Comment on the Task Force on Cross Border Regulation, ISDA, 23 February 2015).

Conclusions

This chapter characterizes policy responses to the financial crisis as evolutionary rather than as a paradigm shift (Helleiner 2014), in contrast to the views of some commentators who have argued that there has, in fact, been a paradigm shift in financial regulation as governments have moved away from deregulation (Mackintosh 2014).

This chapter shows that regulators have engaged in more and different transnational co-operation than they did before the crisis. Before the financial crisis, regulators behaved as though risks in financial market activity could be controlled. Since the financial crisis, we know that risk-free financial assets do not exist, but regulators continue to fine-

tune the mechanisms of risk-control. Rather than moving away from models-based approaches to risk management, regulators have refined the models. Both in terms of the institutional structures of transnational co-operation and in terms of the mechanisms of risk management, the post-crisis environment is a response to the problems that surfaced during the crisis. The urgency of the problems demanded quick responses, which could explain an evolutionary response. As Tsingou (2014: 418) argues, 'fast-burning crises are characterised by alarm and an urgent demand for political action. In fast-burning crises, the time available for reaction is limited. Such crises are times at which knowledge is "hot" in addressing problems, where policy-makers seek clear ideas that can put out the flames'.

At the same time, the scale of the problems raised more fundamental questions about the role of finance in society and about how financial regulation should develop. Financial regulation was seen to involve political rather than merely technocratic questions, and deregulation was seen to involve costs as well as (or even rather than) benefits. If financiers' irresponsible behaviour (Crouch 2014) led to bailouts and austerity measures that reduced support for the most vulnerable members of society—Crouch (2014: 118) noted that 'the policies that the EU, with others, has imposed on the problem economies of the euro zone call overwhelmingly for the exposure of workers to radical insecurity'—then a fundamental rethinking of the relationship between finance and society was necessary: 'If the financial system is a public good, it should be regulated like one, with the public interest in stability as the guiding consideration' (Mügge 2014: 415).

There is evidence that a new era of strong government regulation cannot be taken for granted in finance or in other arenas. Financial firms complain about over-regulation (American Bankers Association 2014) or suggest they might move their headquarters to jurisdictions with lower regulatory costs (Colchester 2015). Meanwhile, other commentators worry about the dangers of regulatory capture (Boyer and Ponce 2012), revolving doors between regulators and financial firms (Lucca et al. 2014, Project on Government Oversight, 11 February 2013) and new buildups of risk (Segoviano et al. 2015).

Debates about what the appropriate level of regulation might be do not just involve financial firms and those who wish to regulate them. Negotiations over a Transatlantic Trade and Investment Partnership include negotiations about harmonizing impact assessment of regulation (see, for example, EU Commission 2013b). Impact assessment of regulation tends to reduce, rather than increase, the amount of regulation (OECD 2009). Proponents of increasing the application and effectiveness of regulatory impact analysis argue that it can prevent regulation, which is excessively costly given the anticipated benefits (OECD 2009). But regulatory impact analysis also has critics who worry that it merely disguises exercises of discretion (Coates 2015) and can impede useful regulations (Kennedy 1981). Regulatory policy is an arena of contestation, and deregulatory imperatives have not been overcome.

But other developments suggest that simple deregulation may still not win out. Ulrich Beck has argued, that 'global risks—like climate change or the financial crisis—have given us new orientations, new compasses for the 21st century world' (Beck 2015: 79). Financial stability has been threatened by cultural problems in finance that are different from the problems the post-crisis regulatory reforms were designed to fix. Manipulation of Libor and other benchmarks led IOSCO to focus on ensuring the integrity of benchmarks (see, for example, IOSCO 2015). In the UK, the Treasury, the Bank of England and the Financial Conduct Authority established a Fair and Effective Markets Review to examine how misconduct occurred and how it can be prevented for the future (Fair and Effective Markets Review, June 2015, and October 2014). Following on from this review, the Bank of England announced a discussion of 'Building Real Markets for the Good of the People' (Bank of England, June 2015a).

Financial regulation continues to be the subject of evolving thought, and central banks and financial regulators are exploring risk in new and serious ways. Andrew Haldane of the Bank of England has given a number of speeches in which he has argued for a financial reformation (Haldane, 29 October 2012), a more radical rethinking of financial regulation that

takes on the complexity of financial regulation rather than taking it for granted (Haldane and Madouros, 31 August 2012).

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Part II

Shifts in Monetary and Economic Policy Dogma

4

From National to Supranational: A Paradigm Shift in Political Economy

Guido Montani

The International and Supranational Paradigms

The financial crisis of 2007–2008, which erupted in the USA, had a widespread impact on the global economy, especially that of the European Union (EU). These events have been analysed in various studies, but a thorough understanding of the world economic crisis calls for a more general examination of the international economic order, the main pillars of which were erected at the end of World War II. These pillars are now tottering and unable to withstand new global challenges, in terms of not only economic and financial stability but also international security and the looming ecological crisis. In short, US leadership is in decline and a new multipolar world is taking shape, heralding a dangerous phase of political tensions and ethnic and religious conflicts. The so-called global governance could lead humanity either towards a new global order or

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into catastrophe. A new political paradigm to regulate the relationships between nation-states is urgently required.

In this chapter we posit that a supranational approach is needed to reform the old international institutions. But before discussing the need to make the transition from the traditional national approach to a new supranational approach, it is advisable to discuss the process of paradigm shifts in social sciences. Thomas Kuhn examined shifts in scientific paradigms, especially in terms of natural sciences. He says that: 'insulation of the scientific community from society permits the individual scientist to concentrate his attention upon problems that he has good reason to believe he will be able to solve' (Kuhn 1962: 163). He has to convince the well-defined community of the scientist's professional compeers. Subsequently, in *Essential Tension*, Kuhn specifies: 'A paradigm is what the members of a scientific community, and they alone, share. Conversely, it is their possession of a common paradigm that constitutes a scientific community of a group of otherwise disparate men' (Kuhn 1977: 294). According to these statements, a scientific revolution is successful when all, or a large part, of the scientific community adopts the new point of view. For social sciences, this process is unlikely because a new paradigm is not completely successful until the political class and society at large adopt the new point of view. This process can take decades, sometimes centuries. Let's consider a few examples. Many historians agree that the Enlightenment movement was the breeding ground for the US and French revolutions. Rousseau's notion of people's sovereignty was crucial for the collapse of the *Ancien régime* and the success of the republican paradigm, but many monarchies survive today, albeit with much less power. Cesare Beccaria argued for the abolition of the death penalty, but many countries continue to practice it. Adam Smith made a convincing argument against mercantilism and in favour of free trade, but today, while the principle of free trade is well established within nation states, and despite the phenomenon of globalization, we are yet to see a genuine international free market.

The reason for the uncertain and only gradual success of new paradigms in social sciences is due to the fact that the subject matter of social sciences is humanity itself and not a subject external to members of the scientific community, as is the case with natural sciences. The anthropologist Clifford Geertz says that man is an incomplete or unfinished animal, who

completes himself through culture or, to be more precise, 'it is through the construction of ideologies, schematic images of social order, that man makes himself for better or worse a political animal' (Geertz 1973: 218). Social sciences study particular aspects of the social order: social scientists usually explore some specific structure of human society and, within a theoretical framework, analyse the behaviour of individuals and their relationships. Their specific inquiries are necessarily part of a more general ideological point of view, even if social scientists are not always aware of the connection. For instance, Rousseau's concept of people's sovereignty is part and parcel of the democratic ideology. Beccaria's rejection of the death penalty is based on the modern notion of fundamental rights. Smith's support of free trade is one of the tenets of economic liberalism. Therefore, in social sciences, the transition from an old paradigm to a new one has the practical effect of causing a change in human affairs, such as a different organisation of political power or a change in the distribution of wealth. It is inevitable that a paradigm shift not only ends up concerning the scientific community but also raises more general (ideological) issues for the people involved in the change and the political class that has to reform the old order. For this reason, in social sciences, it is more accurate to talk about an incomplete paradigm shift rather than using the general notion of paradigm shift.

'Normal' phases, when the whole of a scientific community essentially shares a certain paradigm, are more the exception than the rule. Social science communities—political scholars, sociologists, economists, jurists, and so on—are more fragmented than natural science communities: one or more progressive schools usually stand in opposition to one or more conservative schools. Given that some proposals, free trade for instance, entail damage to certain interest groups, it is inevitable that some social scientists support them while others support the opposite view. The permanent struggle among different paradigms and ideologies is the true driving power of history. Because of this, unlike in natural science, the study of a specific social science must always be grounded in the knowledge of history and the history of ideas.

These brief remarks on the relationship between normal and revolutionary social paradigms can help us understand why studying the distinction between international and supranational institutions calls for a historical approach. The first supranational institution was the European Coal and Steel Community (ECSC), which was conceived as the first step towards

a European Federation. Other steps followed it, and we can rightly assert that the present EU is the outcome of a gradual constitutional process of supranational integration. However, the EU developed within the more general framework of international organisations established after World War II and the political, military and ideological conflict between the two superpowers, the USA and the USSR. We can, therefore, understand why many historians and social scientists do not take due account of the distinction between international and supranational institutions. Andrew Moravcsik, for example, when explaining the meaning of the Treaty of Rome, writes: 'This framework was embedded in a set of quasi-constitutional institutions unique among *international* organisations, notably the European Commission, a regulatory bureaucracy with powers (often sole powers) of initiative; a Council of Ministers where national governments took decisions by unanimous or qualified majority vote; the European Court of Justice; and a parliamentary assembly. This 'small Europe' customs union, with provisions for agriculture, atomic energy, and *supranational* institutions, was only one of at least three broad alternatives considered at the time' (Moravcsik 1998: 86; the italics are mine). In this short passage, the European Community is described as both international and supranational; and, indeed, there is no clear distinction between these two concepts in the whole book. This kind of exercise can be carried out for the works of many other scholars of European integration, but this is not our task here.

Our aim is to show that Europe's supranational institutions could represent a model for the reform of the current international political and economic order. The process of European integration can be analysed to draw a more precise dividing line between international and supranational institutions and contribute to the construction of a Supranational Political Economy. Today, in several universities International Political Economy (IPE) is taught as a discipline that studies the struggle for power and wealth in international relations. It offers a complementary point of view to political science and economics, because in the present world order it is impossible to understand the main events in the international community without examining the political roots of economic developments and the economic roots of political decisions (for a survey, Cohen 2014). In a previous work we asserted that, in a world becoming a community of fate, scholars of Supranational Political Economy 'act as

European (or Latin-American, African, etc.) citizens and as citizens of the world persuaded that people's fundamental values and rights could be better achieved by a supranational system of government, with limited but adequate power to provide supranational public goods' (Fiorentini and Montani 2014: 5). The following pages do not go further into the history of European integration but try to draw two main ideas from it. The first is that, during its existence, when the European Community was unable to face a new challenge, it reformed its constitutional bases to improve its union—that is, by building more effective supranational institutions. In the history of ideas, this is not a new approach. *In Discourses on Livy* (Book III, 1), Machiavelli says that kingdoms, republics or political parties sometimes need to renew themselves by going back to the virtues of their constitutive principles to find new impetus: 'For all the beginnings ... must have some goodness in them' (Machiavelli 1998: 209). The second idea is that the constitutional development of the European Community involved the provision of some European public goods, such as the Single European Market (SEM) and the Economic and Monetary Union (EMU). These two supranational public goods can only work effectively within the framework of supranational institutions and, in the last resort, supranational democracy. In the last section, we show how the supranational approach to political economy should be viewed as an incomplete paradigm shift.

Theories of European Integration and the Birth of a Supranational Community

Political institutions usually evolve from previous ones, as a result of minor or major innovations. In some extraordinary cases, namely revolutions, new institutions come into being. The new institutional set-up, built on new political principles, is usually interpreted by its contemporaries in different ways. Historical innovations inevitably have many different aspects and meanings. We should not, therefore, be surprised by the existence of several theories of European integration. A recent handbook of the EU (Jones et al. 2012, Part I) contains papers concerning the following approaches: realism, intergovernmentalism, institutionalism,

neo-functionalism, supranational governance,[1] constructivism, sociological perspectives and multilevel governance. We are not necessarily in disagreement with any of these approaches, as each one accounts for an interesting aspect of the process, but we wish to single out the principle of supranationality as the main characteristic of the process of European integration and show why it is original compared to the principle of internationalism on which the wider international order is built.

In the literature on European integration, the supranational principle is understood as a transfer of sovereign powers from the nation states to European institutions. This definition is correct, but it should be completed with two other features: (a) the history of European integration shows that the advent of the supranational principle went hand in hand with the principle of supranational democracy, even if the latter was not at the forefront in the beginning and only developed slowly in subsequent years; and (b) although the crucial political framework after World War II was the bipolar division of the world into two opposing empires, the supranational principle was an autonomous European idea that could not have been conceived within the US administration, as is evident in the main post-war international institutions proposed by the USA, such as the United Nations and the Bretton Woods institutions.

The birth of the first supranational community was not the product of intergovernmental diplomacy but an autonomous proposal that Jean Monnet presented to the French foreign minister Robert Schuman, without the knowledge of Quai d'Orsay officials. It was, of course, agreed with the German government, but once again, outside of diplomatic channels.

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[1] In this chapter we prefer the terms 'federal government' and 'European democratic government' rather than 'supranational governance' because our aim is to show the relationship between supranational institutions and supranational democracy. In their book, Sandholtz and Stone Sweet (1998: 1) propose 'a theory of European integration focusing on the process through which supranational governance—the competence of the European Community to make binding rules in any given policy domain—has developed', and they consider the European Community 'a quasi-federal polity'. Further on they explain that they avoid the more precise term federal politics, 'in order to avoid an argument about the precise nature of the EC polity and how it compares with other federal polities' (pp. 8–9). As we shall show further on with regard to European public goods, if we accept this approach, in theory the process of European integration could go ahead without an upper limit towards the creation of a European super-state. On the contrary, in a federal union the various levels of governance and competences have to be clearly defined in a Treaty or a Constitution. In our view, the EU needs federal government and federal democracy

In his *Memoirs,* Jean Monnet recalls that, after Churchill's proposal for 'a kind of United States of Europe' in 1946, the debate on the future of Europe was intense and productive. In 1948, in The Hague, a Congress of Europe was held. It was attended by 800 people, including many heads of government and leaders of political parties. But Monnet did not take part because, although the problem was evident, no method for solving it was envisaged. The political class and diplomats were aware of the problem but were not able to overcome the national point of view. 'Change', says Monnet, 'can only come from external forces under the influence of necessity' (Monnet 1976: 339). From his experience as Deputy General Secretary (1920–1923) of the League of Nations, Jean Monnet drew the lesson that the general interests of a group of sovereign nation states cannot be fulfilled by means of intergovernmental methods, because the main goal of each government is to defend its national interests. 'The veto is the root cause and the symbol of the inability to overcome national egoisms' (Monnet 1976: 113). For this reason, when the problem of German recovery became acute, and the French government was obliged to accept the German reconstruction of the coal and steel industry (a means for the reconstruction of German military forces too), Monnet decided to propose a federal solution: a Franco-German political union. He was aware of the fact that the French government was not ready to accept a fully fledged federation and the method proposed by the federalists, a constituent assembly. Therefore, at the end of April 1950, in view of the London conference on the future of Germany on May 10, Monnet sent Schuman a draft project concerning the creation of a Coal and Steel High Authority, as the first step towards a European Federation. This draft was the basis for the Schuman declaration of May 9. 'The whole operation', writes François Duchêne (1994: 201), 'was conducted with a secrecy and speed totally foreign to the Fourth Republic. As the British ambassador wrote, "shock tactics" ensured the Schuman Plan "could not be strangled at birth". The steelmasters, potential stranglers, proud of having eyes and ears in every ministry, were deeply shaken to have detected no hint of the coming earthquake.…The French had taken a major decision without turning to the Americans first. London was not informed'.

The creation of the ECSC required new political terminology. Monnet recalls that, during the drafting of the plan, he was obliged to utilize the

term ‘Supranational Authority,’ but he admits that he did not like this word (Monnet 1976: 352); he should probably have mentioned the federal model. In any case, after May 9, during the debate with the national delegations of the other five countries (Germany, Benelux and Italy), he was frequently obliged to defend the principle of supranationality, especially in the face of objections from Dirk Spierenburg, who wished to give more power to the Council of Ministers and, as a consequence, to national governments. The innovative feature of supranationality was also the main reason for the refusal of the British government, which rejected the French memorandum since ‘a commitment to a pool of common resources and to set up a High Authority endowed with sovereign powers’ was a preliminary condition for taking part in the conference establishing the ECSC (Monnet 1976: 365). Monnet’s stance was clear and resolute: ‘The Schuman proposals are revolutionary or they are nothing. The indispensable first principle of these proposals is the abnegation of sovereignty in a limited but decisive field. A plan which is not based on this principle can make no useful contribution to solving the major problems which undermine our existence. Cooperation between nations, while essential, cannot alone meet our problem. What must be sought is a fusion of the interests of the European peoples and not merely another effort to maintain the equilibrium of those interests’ (Roussel 1996: 566).

The High Authority was endowed with limited but effective powers to regulate the common market for coal and steel, including the power of taxation, and to issue bonds on the international market. It was necessary, therefore, to give this form of European government democratic legitimacy. During the conference with the countries involved in the creation of the ECSC, Monnet said: ‘The High Authority will not be an irresponsible supranational authority. It is established in compliance with the democratic principles of the member states, including the democratic sanction’ (Roussel 1996: 555). Indeed, among its institutions, the ECSC Treaty established not only the High Authority and the Council of Ministers but also the Parliamentary Assembly and the Court of Justice. For the Parliamentary Assembly, provisionally comprising members elected by national parliaments, direct election by universal suffrage was envisaged. The ECSC was basically built to evolve towards a federal union.

The potential democratic elements of the supranational project were revealed on occasion of the proposal to found the European Defence Community (EDC), presented by the French President Pleven on October 24, 1950. In order to avoid the rearmament of Germany, as proposed by the USA and UK governments, France posited a common European army, with a European uniform, as part of the NATO framework. Monnet conceived the EDC as an enlargement of the ECSC, but it also proved an unwelcome hurdle on the road he had planned for the political development of the ECSC. The debate on the EDC took a crucial turn in 1951: in July, Altiero Spinelli, the leader of the Italian *Movimento Federalista Europeo*, sent a *Memorandum* to the Italian President of the Council, De Gasperi, highlighting the democratic weakness of the French project, which envisaged creating a European army as a simple coalition of national armies, without setting up a European democratic government. In such a case, Spinelli said, 'by avoiding creating a fully-fledged sovereign European body, the Conference stealthily proposes that the American general becomes the European sovereign' (Albertini 1977: 6). The way forward, Spinelli coherently observed, was to instruct a democratic constitutional assembly to draft a European constitution. De Gasperi agreed with the federalist *Memorandum*, and on the occasion of the Council of Foreign Ministers of December 11, 1951, with the full support of Adenauer and Schuman, he achieved a consensus on the proposal to convene a constituent assembly to create a European Community based on a 'federal or confederal structure'. The events that followed are common knowledge: in 1952 the Foreign Ministers of the Six asked to enlarge the parliamentary assembly of the ECSC, which took the name of *Assemblée ad hoc*, to draw up a plan for a European Political Community (EPC) based on a parliamentary assembly elected by universal suffrage, the division of power and a bicameral system. On March 1953, the draft plan for the European Political Community was ready. But in France the majority in favour of the EDC and the EPC faded away, and in August 1954, the French national assembly rejected the EDC.

The failure of the EDC marked a turning point in European integration. As Duchêne (1994: 256, original italics) remarks: 'The word *federal* was reserved as the political equivalent of Latin for the rare religious

occasion. Even *supranational*, itself a fig-leaf at first and a word Monnet disliked, tended to be used only when another fig-leaf could not be found. The idea of a Europe in some sense above the nations was no longer openly stated'. Nevertheless, the EDC episode is crucial to understand the subsequent stages of European integration, both its success and its failure, because European integration was only furthered as a result of an increase in supranational power, and more supranational power meant more supranational democracy. In the following sections we will analyse this relationship, which is clear if we admit that creating European public goods—such as the Single European Market (SEM) and the Economic and Monetary Union (EMU)– provides benefits for citizens but also some constraints. The various crises of the EU can always be accounted for in terms of structural flaws in its supranational power or a democratic deficit. Nevertheless, these observations should not detract from the most important achievement of European integration: enduring peace among France, Germany and all the countries taking part in Community life. 'By introducing a rule of law into relations between Western European Countries, [the Community] has cut off a whole dimension of destructive expectations in the minds of policy makers.…With all its imperfections, the Community domesticates the balance of power into something which, if not as "democratic" as domestic norms, has made the international system in Europe take a huge step in that direction' (Duchêne 1994: 405).

Two European Public Goods and the Principle of Supranationality

In this section we focus on the creation of two crucial European public goods: the SEM and EMU. Since Adam Smith we have known that the duty of the sovereign 'is that of erecting and maintaining those public institutions and those public works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expenses to any individual or small number of individuals' (*Wealth of Nations*, Book V, Part III). Modern economic theory says that public goods have two features: (a) they are non-rival in consumption—for instance, the use of a street by

one individual does not reduce the benefits to other walkers; and (b) non-excludable—nobody can be excluded from the consumption of public goods. So the streets of my town and the personal security that police officers provide are public goods. But in order to supply public goods, governments must have the power to prevent free rider behaviour among citizens, given that not everyone is willing to contribute to the costs involved. The government, therefore, needs to have the power to impose taxes or oblige individuals to comply with certain rules.

These common sense rules are accepted as far as domestic public goods are concerned, but when it comes to global (or supranational) public goods, national governments do not follow them. This problem is aptly described by Scott Barrett, who says: 'If the power of compulsion were given to an international authority, if a world government were established, then global public goods could be supplied by the same means employed domestically' (Barrett 2007: 17). But since a world government does not exist, the international scenario is somewhat anarchic: 'Lacking a supranational authority capable of compelling states to behave differently, the only alternative available is *international cooperation*—a kind of organized volunteerism' (Barrett 2007: 19, original italics). Indeed, there are many examples of successful voluntary cooperation among sovereign states, such as the eradication of smallpox, the battle against ozone depletion (with the Montreal Protocol) or cooperation for big science, like the Large Hadron Collider and space exploration. Globalization means that national policies trigger external effects on other national peoples. If states wish to avoid waste or war, they are obliged to cooperate. But international cooperation is difficult, slow and often doomed to fail. Its inherent flaws come to light in many issues, such as the fight against climate change, international security, international economic stability, international public health, and so on. In the international community we can observe not only the failure of the market but also the failure of international cooperation. When the provision of supranational public goods is at stake, some national governments deliberately play the role of free rider. It is therefore interesting to examine how the EU succeeded in providing a number of crucial European public goods and compare these cases with similar scenarios in the international order.

If we consider the creation of the SEM from the end of World War II to the present in light of the neo-Ricardian theory of economic integration, we can single out three phases (Montani 2010). The mercantilist phase comprises the years before the Marshall Plan and the first common institutions of cooperation, such as the creation of the Organization for European Economic Cooperation (OEEC) in 1948. The lack of organisation of intra-European trade is evinced by the number of bilateral agreements, in excess of 200, and the tremendous difficulties each country faced attempting to keep their trade in balance. Bilateral trade was only slowly replaced by multilateral trade during the 1950s, with the creation of the ECSC and European Economic Community (EEC). Indeed, the second phase, namely international integration, was only heralded by the Rome Treaty in 1957, which permitted the free trade of goods but was hazy on the free movement of factors of production. The third phase, namely supranational integration or economic union, in which not only commodities but also workers, capital and services were allowed to circulate freely within the Union, only came about with the Single European Act (1986).

Yet this Neo-Ricardian integration theory, in which labour productivity increases from phase I to phase II and again in phase III, does not fully account for the European process because it ignores the creation of supranational institutions during phase II and III. In the Rome Treaty, the goal of the Common Market—that is, the abolition of internal tariffs and the creation of a common external tariff—is covered in Part I, while the free circulation of workers, services and capital is covered in Part III (Part II concerns agriculture). Therefore, for the Hallstein Commission, it was reasonable to implement the abolition of internal tariff barriers at once and set up the external tariff in order to protect European production and employment from external competition. However, after the Common Market was completed in 1968, it took 16 years—and the drafting of a new Treaty (SEA)—for the creation of the SEM.

The long interlude between phase II and III was marked by two major crises of European integration. The first was caused by de Gaulle's resolute opposition to the implementation of the European budget proposed by the Hallstein Commission, which was necessary for the Common Agricultural Policy (CAP), and the majority vote in the Council, as

established by the Treaty of Rome. This deadlock was overcome with the Luxembourg compromise (1966), which granted the right of veto when vital national interests were at stake. The second crisis was the breakdown of the Bretton Woods system of fixed exchange rates: the basis for both the Common Market and the CAP. It was not until 1979 that this second crisis was partially resolved with the direct election of the European Parliament and the creation of the European Monetary System (EMS).

Only after these two crucial reforms was it possible to revive the original project of the Common Market. The creation of the SEM required the approval of 300 directives by 1992. The Delors Commission achieved this goal only thanks to the new co-decision procedure in the Council (voting by majority rule, according to the SEA) and the European Parliament. It also entailed the active support of the European Court of Justice (ECJ), which established the principle of the supremacy of European laws over national ones. In conjunction with national courts, the ECJ 'played a key role in invalidating protectionist measures. Although case law was primarily shaped in the field of goods, the Court, in its efforts to deal with national measures affecting market access, substantially increased member states' obligations to mutually recognize their respective standards, regulations, and certifications' (Egan 2012: 410–11).

It is interesting to compare the functioning of the international trade regime with the SEM. The World Trade Organization (WTO) is the institutional framework that regulates multilateral trade among member countries. International trade law is established at the end of specific negotiation rounds when an agreement is reached and ratified. It includes institutions, which can be compared to a kind of WTO Court for dispute settlements among member countries. We could, therefore, posit that the WTO, a body of law enacting compulsory jurisdiction, can be considered a supranational institution. But that is not the case. Armin Von Bogdandy remarks that the aim of the WTO is merely to concretize the principle of non-discrimination, to prevent circumvention of tariff reduction. The statute of the WTO does not mention the goal of market integration. If compared with the EU, a further difference is 'the crucial role the relevant jurisprudence gives to the supranational political process: the whole jurisprudence on the four freedoms is based on the premise that the political process can correct judicial deci-

sions, a possibility the WTO lacks' (Von Bogdandy 2001: 647). There is a deficiency in the legislative function of the WTO, despite the rapidly changing panorama of trade flows, technologies and company organization in the recent period. The ECJ succeeded in establishing the doctrine of direct effect, the supremacy of European law over national law and the principle of mutual recognition. On the contrary, the WTO has not been able to tackle these problems because 'there are still no international procedures which guarantee sufficient democratic legitimacy at the global level.…As a consequence we have a body of law which is linked to the political process only through extremely cumbersome procedure' (Von Bogdandy 2001: 650).

Now let's take a look at the creation of the second supranational good, the EMU. As in the previous case, three different phases can be identified. The first is the transition from national currencies to the use of the dollar as a European currency; the second is European intergovernmental cooperation on national monetary policies and the third is a fully fledged supranational monetary union. Market integration and monetary integration are necessarily parallel processes: tariff barriers can be removed while keeping exchange rates stable, but the creation of a single market, with the free movement of people, services and capital, requires a single currency.

Shortly after the end of World War II, the most pressing issues for European countries were industrial reconstruction, economic recovery and, as a consequence, international trade with other European countries and the USA. Since gold and dollar reserves were low in all countries, the only alternative, as previously mentioned, was bilateral trade, with the obvious drawback that intra-European trade was very limited. The only way of creating more opportunities was to introduce a multilateral system of payments. A common currency was needed. Indeed the Bretton Woods agreement was already ratified, but in order to implement it, European currencies had to be convertible into dollars and gold.

The way out of 'dollar scarcity' was made possible by two initiatives: the Marshall Plan and the creation of the European Payment Union (EPU). The EPU was set up in 1950, by 18 OEEC countries, in order to make national currencies convertible. The EPU functioned as a clearing union, allowing countries with a deficit at the end of each month to compensate

a certain quota of it with surplus countries. This mechanism saved dollars and gold for intra-European trade: 'With the EPU the balance of payments position of each member country ceased to be a purely national problem and became a legitimate concern for all the other participants as well' (Gros and Thygesen 1992: 7). The EPU was a success. It was dissolved in 1958, after the Rome Treaty, when the full convertibility of the European currencies into gold and dollar was ensured. The Japanese yen became convertible in 1964. With the convertibility of European currencies, the Bretton Woods system started to work as planned in 1944.

Thus, when the Rome Treaty was drafted, nobody raised the problem of framing a monetary union for the Common Market. For national governments it was clear that the dollar was the international anchor of European exchange rates and that the International Monetary Fund (IMF) was the real central bank of the EEC. During the 1950s and 1960s, the dollar was tacitly viewed as the European currency: it was the benchmark for the CAP and the Community budget. The European Unit of Account (EUA) had a gold content that was equal to the US dollar. Only towards the end of the 1960s did it become clear that the Bretton Woods system was creaking. At The Hague, in 1969, the European Council appointed Pierre Werner, the Prime Minister of Luxembourg, to draft a plan for an EMU. The Werner Report was presented in 1970 and endorsed by the Council in March 1971. It identified the specific objectives of the EMU and the fundamental consequences for monetary and budgetary policies: 'A monetary Union—says the Report—implies inside its boundaries the total and irreversible convertibility of currencies, the elimination of margins of fluctuation in exchange rates, the irrevocable fixing of parity rates and the complete liberalization of movements of capital'. As for the Community budget, the Report stated: 'it will undoubtedly be more important at the beginning of the final stage than it is today, but its economic significance will still be weak compared with that of the national budgets, the harmonized management of which will be an essential feature of cohesion in the union'. Finally the Werner Report stated that the creation of the EMU involved a transfer of responsibilities to a European 'centre of decision,' politically accountable to the European Parliament. Despite this clear identification of the goals, or perhaps because of it, the Werner Plan was not implemented after the breakdown of the Bretton

Woods system on August 1971 and the Common Market, both the industrial and agricultural market, risked collapse during the s1970s due to the chaotic fluctuations in exchange rates.

The severe crisis of the Common Market obliged the French and German governments to formulate a plan for stabilizing the exchange rates market. They presented a scheme for creating an EMS as the first step towards the EMU. The EMS was a compromise due to the Bundesbank's opposition to the EMU. 'Nobody, least of all in the Bundesbank, would have spoken of a European central bank in 1978'—because this step would have entailed the risk of more inflation—'creating an integrated and graduated mechanism for financing external imbalances in a new institution seemed to greatly increase these risks' (Gros and Thygesen 1992: 55). In any case, in 1979, eight governments (not including the UK) decided to set up the EMS, a zone of monetary stability in Europe, linking national exchange rates to the European Currency Unit (ECU), a weighted basket of European currencies. For the first time, the reference point for European exchange rates was not the dollar but a European anchor, a shield protecting the Common Market from the dangerous fluctuations of the dollar. It was also decided that a European Monetary Fund should be set up, but this commitment was subsequently completely ignored by national governments. All in all, the EMS was conceived as a symmetrical monetary system, similar to the nineteenth-century gold standard, as all the central banks were committed to keeping the value of their national currency constant in terms of ECU.

The EMS rapidly became an asymmetric system. Instead of taking the ECU as a point of reference for their monetary policy, the central banks were obliged to keep their monetary policy in line with the Bundesbank, which was able to guarantee the lowest rate of inflation in the system. When the national rate of inflation of one of the other countries was higher, sooner or later a devaluation of the currency vis-à-vis the Deutsche Mark would become unavoidable. The Bundesbank was effectively the central bank of the EMS. Owing to this state of affairs, in 1988, the French and Italian governments called for genuine monetary union: better to have a common currency and a common central bank than to passively accept the monetary policy of the Bundesbank. In June 1988, in Hannover, the European Council agreed to appoint Jacques

Delors, the President of the European Commission, to draft a plan for the EMU. Delors presented his report in Madrid in 1989, but this was followed a few months later, on November 9th, by the fall of the Berlin Wall. Europe now had a new issue to tackle, that of German reunification. The dilemma was basically this: a German Europe or a European Germany? In the end, Kohl's Government came up with a solution: a united Germany in a united Europe. The road was open for the creation of the EMU, which was agreed on at Maastricht on December 10, 1991. For the first time in history, a group of national sovereign states agreed to transfer their monetary sovereignty to a supranational body, a European Central Bank, within the institutional framework of the EU.

The Maastricht Treaty established not only the EMU but also European citizenship, a common foreign and security policy, internal policy, and environmental and social policies. More power was allocated to the European Parliament. 'The introduction of the new co-decision procedure, arguably the most important institutional novelty, took the EU towards a bicameral system. And the power to approve the Commission President was also important, even if it did not amount to the kind of power parliaments have to appoint ministers in parliamentary systems. Maastricht did not create a fully-fledged federal system, but it empowered the European Parliament further and opened up new possibilities and accountability' (Laursen 2012: 129).

Supranational Institutions and Supranational Democracy

In order to unravel the tangled relationship between supranational institutions and democracy, it can be useful to recall 'Kant's disanalogy' (Montani 2014). In his political writings, Immanuel Kant examined the notion of a world federation as an alternative to international anarchy. At an early stage in his research, he drew an analogy between the original state of nature and international anarchy among sovereign states. Only later did he realize that this analogy was misplaced: individuals willing to leave the state of nature can accept a despotic state, provided that the state is able to guarantee civilian peace, but people living in republics

(or democracies) cannot accept a despotic supranational union, with the power to breach the freedoms and rights already attained. The creation of a fully fledged federation is, therefore, probably or necessarily preceded by a voluntary union (or league) of sovereign states willing to cooperate with one another. The institutional gradualism that characterized the history of European integration would appear to confirm this idea.

What Kant did not see, because during his time there were no serious experiments in international integration, is that sometimes voluntary cooperation among states only partially, and imperfectly, solves the common problem (i.e., unemployment), when the creation of supranational institutions is required in order to provide supranational public goods (i.e., growth and full employment).[2] In such cases, the lack of supranational institutions has negative consequences, because national governments lose the power to provide various national public goods to their citizens effectively yet are unable to replace them with new supranational public goods. National democracy can end up being the unwitting victim of this conservative policy. In the EU, the economic and political cost of 'non-Europe' is the by-product of an imperfect decision-making system based mainly on intergovernmentalism.

To briefly explain the economic cost of non-Europe, let's consider the EU's reaction to the financial crisis. The European crisis began in earnest in 2010, when the Greek 'scandal' was discovered. Greece's deficit and debt were found to be much higher than the official figures made out. The harsh reaction of the German government—which threatened to expel Greece from the EMU—disclosed the lack of fiscal solidarity in the EMU and led to a sovereign debt crisis in Ireland, Spain, Portugal and Italy. This heralded the introduction of a dogmatic austerity policy. The main error was the failure to recognize and remedy the basic flaw in the construction of the EMU, namely monetary union without fiscal union. In the real world, no monetary area works without fiscal union, because different rates of growth and unemployment inevitably exist in every

[2] The alternative between voluntary cooperation and supranational cooperation can be explained in terms of game theory, by the 'stag hunt' game; a game with two Nash equilibriums and no dominant strategy.

country, region and district (Montani 2013). To avoid social protests and unrest, fiscal policy must complement monetary policy to ensure poor regions converge towards the average EU income. Some member states defended the principle that every country should put its house in order, following the rules of the GSP, even if the EMU was clearly flawed. It is true that some countries, such as Greece, Italy and France, have to reform their spendthrift administrative systems and reduce waste, but it is a grave error to ignore the fact that the EU budget (1 % of GDP) is not enough to provide the public goods necessary to fill the gap caused by 'the cost of non-Europe.' A Report of the European Parliament on 'The Cost of Non-Europe' shows that 'the absence of common action at European level may mean that, in specific sectors, there is an efficiency loss to the overall economy and/or that a collective public good that might otherwise exist is not being realised' (EPRS 2014: 3). The Report lists 24 policies, among them the completion of the single market, the energy market, investment policy, research and development, security and defence. The general estimate of the Report is that the cost of non-Europe is at least 6 % of EU-GDP.

The second area where the political cost of non-Europe is manifest is the so-called Foreign and Defence policy. This policy does not exist. Anthony Giddens correctly observes that national governments claim to be working towards a European foreign policy, but the reality is different: 'Their strategic policies emphasise interdependence, but their concrete actions are national.…There are perhaps two underlying reasons for the "cacophony", apart from the reluctance to concede formal sovereignty. One is the aforesaid moral hazard element: NATO is always there as an ultimate resource. The other is the divisions of outlook which security brings to the fore' (Giddens 2014: 198). European foreign policy does not exist because there is no such thing as a European defence force. The history of European monetary unification shows that the intergovernmental mechanism of the EMS worked imperfectly until the ECB was created. A European military force—at least a Rapid Reaction Force, as already decided—is the linchpin of an effective foreign policy. In an emergency, just as a central bank can act as a lender of last resort, so a military force can act when diplomacy fails.

The third area that bears the political cost of non-Europe is the so-called European democratic deficit. The EU can be considered an imperfect federal construction because of the imbalance between the Council, which represents the member states, and the European Parliament, which represents the European citizens. A democratic federal system can work effectively if the Parliament is a legislative body on the same footing as the Council; but this is not the case in the EU because the Council (the European council and the Council of Ministers) preserves the veto right on important issues, such as fiscal policy and foreign and defence policy. The sovereign debt crisis and the austerity policy showed that European citizens view the Council as the real decision-making body, not the European Parliament or the Commission, which are seen as bureaucratic agents of the Council. Indeed, the Council is both a legislative and executive organ. There is no real division of power in the EU. The spread of euro-scepticism and populism in all the member states is the inevitable by-product of this non-democratic mechanism.

The European democratic deficit existed before the end of the Cold War, but it only became a serious problem after the Maastricht Treaty, which was the watershed between the negative phase of European integration, when Europe exploited the US protectorate, including the monetary stability of the Bretton Woods system and NATO, and the new positive phase, when the EU was obliged to act as an international (soft) power. At Maastricht, France and Germany did not see the need to create a real political union: they only proposed one step forward, an important but limited one. This imperfect architecture worked fairly well while the myth of an international unipolar world, led by the USA, was credible. But today, the post-WWII international order is under stress, and a new multipolar order (or disorder) is emerging. Indeed, many US scholars recognize that: 'the world may never again see the kind of global dominance by a single power as it once experienced under Britain and the US. Global governance and order in this post-hegemonic era will depend on multiple actors and cross-cutting drivers' (Acharya 2014: 116). In this highly uncertain international environment, the EU looks like a blind man walking along the edge of a cliff. Machiavelli would say that to recover its original virtue and

tackle internal and external challenges, the EU needs a democratic (federal) government.

The Key Issue of Supranational Political Economy

Whatever the future of the EU, we can draw a number of lessons from past experience that can help us identify the main problems of the international order and outline possible reforms. Of course, when it comes to world order, the level of economic and political integration is very different from that of Europe, but the old international order, built by the USA after WWII, requires radical reforms: the USA no longer plays a hegemonic role. Today its main responsibility ought to be to lead a transition, in agreement with the other great world powers, to a more integrated, peaceful and stable multipolar world. On this point, the experience of European integration, which started with economic integration and light supranational institutions, leaving the military and foreign policy aspects to a later stage of integration, shows a reasonable way forward. The first task of the global policy-makers willing to strengthen peaceful cooperation among old and emerging powers should be a reform of multilateral institutions in order to build an effective governance of the world economy. This strategy would have important political consequences, not only because 'multilateral institutions can enhance domestic constitutional democracy' (Keohane et al. 2009: 26) but also because they can help spread democracy to non-democratic states.

Before discussing what we consider the key issue of supranational political economy, it is necessary to clarify the limits of this approach, namely to explain why it is an incomplete paradigm shift. As we said in the introductory section, we believe that the academic approach known as IPE, which is widely used to study the market-state relationship in the international system of states, is not sufficient when it comes to tackling all the challenges of the contemporary age. IPE is based on a state-centric dogma—that is, national sovereignty. We believe that people's fundamental values and rights would be better served by a supranational system of

government with limited but adequate power to provide supranational public goods: this is the subject matter of Supranational Political Economy (SPE). Nevertheless, we are aware of the limits of SPE: it is possible to study a certain problem—for instance, the 2008 financial crisis—from a market-state perspective or a state-market perspective, that is, using either an economic-political approach or a political-economic approach. The SPE approach proposed here should be viewed as complementary to the theory of supranational political order, which currently requires further research. The theory of supranational political order would study security and military relationships among states, explore how supranational institutions could provide these global public goods and, of course, how the citizens of the world can democratically control their global institutions. Here we will limit ourselves to recalling that a number of political scientists are already exploring this new incomplete paradigm shift, which they call cosmopolitan democracy (Archibugi 2008; Brown and Held 2010; Held 2010).

The financial crisis was proof of the high degree of integration of the global market, albeit badly regulated or not regulated at all. After the crisis every country accepted the need to implement national policies with the double goal of stimulating the home economy without endangering international monetary, financial and commercial cooperation. The global recovery process is slow and uncertain. The task in hand is to improve regulation of the global economy or, in other words, to implement better governance. Two light supranational institutions for the governance of the world economy can be singled out. For national economies, monetary policy and public finance are the crucial tools, whatever the national policy. The same is true for European integration: the recent crisis showed that the focus of the debate in Europe concerned the relationship between the monetary policy of the ECB, national fiscal policies and the creation of fiscal union. In a previous work (Montani 2015), we called this problem 'Hamilton's problem', because Alexander Hamilton, one of the founding fathers of the US federal state and Secretary of the Treasury of the Washington government, was the first to face the challenge of the market-state relationship in a political system that sought to establish monetary union and a financial system among 13 states and the federal government. The crucial task now at hand is tackling Hamilton's problem on a global

level. The global market, especially the private financial system, is becoming stronger and stronger when compared to the dwindling regulatory power of nation states, including the USA. Many national governments are psychologically and materially in thrall to stateless finance, which eats away at their taxing power; funds for education and social services get diverted towards bailing out the banking system or preventing default on unsustainable public debt.

Firstly, let's take the international monetary problem. The USA is a declining economic power and the dollar is a sort of stateless currency, still useful for international trade but highly unreliable due to the inward-looking monetary policy of the Federal Reserve and the high level of US indebtedness. China is working towards making the yuan convertible as soon as possible, and the euro is slowly gaining status as the international currency. A multipolar world with several competing currencies is a dangerous place for trade and finance. Many economists agree that this is an alarming prospect, but the major governments seem to be ignoring the question. At the end of an authoritative analysis, Benjamin Cohen remarks: 'Governments seem unable to agree even on what the most important problems are, let alone how to deal with them'. Further on he adds: 'In the Westphalian system, reform does not come about without a struggle. As the Bretton Woods experience suggests, what is needed is an effective political strategy combining two critical elements. First is the need to find some common ground on key issues that goes beyond vague pronouncements of principle. And the second is the need to assemble a winning coalition of influential states. All of that is easier said than done, of course. But when the alternative could be outright chaos, neither element seems entirely out of reach' (Cohen 2013: 47–48).

This realistic but bleak outlook is based on the traditional international paradigm, and we agree that, within the Westphalian system, outright monetary chaos is the most likely outcome. We, therefore, need to look for a new political and economic paradigm as the basis for a cooperative world order. A supranational path is possible, even if a world currency and world central bank such as the euro and the ECB are certainly not yet on the agenda of world politics. What is possible is that the USA, the EU, China, Japan and all the states willing to take part in the creation of a new global monetary system agree on a common plan. Of course,

they would have to accept the idea of pooling part—but not all—of their national currency sovereignty. Here we recall three proposals. Fiorentini and Montani (2012) propose creating a World Monetary Union led by a board of central banks with the task of keeping the monetary and the financial system stable, considering that virtually all monetary and financial transactions are made by this leading group of states. National currencies would not need to be converted into a world currency, as happened in the euro-area, but the global board of central banks would have the task of keeping rates of exchange among the different currencies as stable as possible. A similar scheme was put forward by the Chinese economist Lin (2013: 201) who posited that an international central bank could issue a new currency dubbed 'paper-gold.' This would become the key currency of a new global system, with the proviso that countries would 'retain their national currencies but have to fix their exchange rates to paper-gold. Parity adjustment would require the permission of the international monetary authority'. The last proposal comes from a group of economists in the Triffin International Foundation (2014) and involves using Special Drawing Rights (SDR) as a multilateral currency for the private market as the first step towards a reform of the IMF, enabling it to act as a central bank with the national central banks holding all their reserves as claims on the IMF.

Now we must consider the international financial problem. The financial crisis forced several national governments to dramatically increase their public debt, both to avoid the failure of the banking system and to tackle exceptional rates of unemployment. As a consequence, for the first time, national governments are starting to cooperate to save their fiscal power. The Organisation for Economic Co-operation and Development (OECD) is actively working on a project to help countries avoid losing revenue by means of a multilateral effort to tackle aggressive practices, which erode the tax base of companies and artificially shift profits to low-tax jurisdictions. Nevertheless, base erosion and tax shifting is only a symptom of more general problems, which require radical changes in the international financial system. We will limit our analysis to the question of global inequality and sustainable development.

According to a UN Report on the global economy, 'international income inequality increased quite sharply between 1980 and 2000'

(UN 2013: 26), with or without China in the equation, but inequality declined after 2000, and the decline is steeper if China is included, showing the crucial role played by the growth of this great country. Since 2000, the decline has continued, even without taking China into account, thanks to the development of many countries in Asia, Africa and Latin America. However, income distribution has worsened in many developed and developing countries. 'Between 1990 and 2012, inequality in disposable income, that is, income after taxes and transfers, increased in 65 out of 130 countries…two thirds of the world population…including [European] Nordic countries with traditionally low levels of inequality. The rise in income inequality has been particularly fast in Eastern Europe' (UN 2013: 29). In countries where inequality is rising, the top section of the population is getting richer and richer. 'The share of income owned by the top quintile of the population increased in the majority of countries (61 out of 111)…income shares have risen significantly among the top 5 % and, particularly, among the top 1 % of the population.…In the United States of America…the top 1 % captured 58 % of income growth [between 1976 and 2007]…the wealthiest individuals have become wealthier, both in developed and developing countries' (UN 2013: 31–33).

One of the causes of this growing inequality, especially in developed countries, is the change in tax policies since the 1970s. Progressive income and inheritance taxes have been substantially reduced. 'While top tax rates were equal to or above 70 % in half of the OECD countries in the mid-1970s, this rate had been halved in many countries by the end-2000s' (OECD 2014: 5). Moreover, 'the average statutory corporate income tax rate declined from 47 % in 1981 to 25 % in 2013 and taxes on dividend income for the distribution of domestic source profits fell from 75 % to 42 %.…Realised capital gains are concentrated at the top of the income distribution' (OECD 2014: 7). The conclusion of this survey is that, in order to avoid fiscal competition among countries, it is necessary to increase 'transparency and international cooperation on tax rules to minimise "treaty shopping"…and tax optimisation'. Moreover, it is necessary 'to ensure the automatic exchange of information between tax authorities' (OECD 2014: 8).

It is not possible in this chapter to summarize world debate on sustainable development, from the UN conference 'Only One Earth' in 1972 to the present. Since then, many proposals and policies have been discussed and approved, but the outcome is not only disappointing, it is disquieting. With regard to climate change, the Fifth Report of the IPCC says that there is the serious risk that by the end of the twenty-first century global temperatures will have risen by more than 2 °C compared to pre-industrial levels. 'Continued emission of greenhouse gases will cause further warming and long-lasting changes in all components of the climate system, increasing the likelihood of severe, pervasive and irreversible impacts for people and ecosystems.…Surface temperature is projected to rise over the twenty first century under all assessed emission scenarios. It is very likely that heat waves will occur more often and last longer, and that extreme precipitation events will become more intense and frequent in many regions. The ocean will continue to warm and acidify, and the global mean sea level to rise' (IPCC 2014: 7–8). With a view to the UN conference in Paris in 2015, numerous proposals and studies are being produced. One very interesting study is 'Better Growth, Better Climate', from the Global Commission on the Economy and Climate, co-chaired by the economist Nicholas Stern. The central idea of the study is that growth does not necessarily have to cope with environmental cleaning, because we now have the opportunity to invest in greater efficiency and technological change in three key systems of the economy: cities, land use and energy. 'Well-designed policies in these fields can make growth and climate objectives mutually reinforcing in both the short and medium term. In the long term, if climate change is not tackled, growth itself will be at risk' (p. 3). The proposal is a clever one and the final recommendations are sensible, such as formulating a strong, equitable international climate agreement; introducing strong, predictable carbon prices; stopping deforestation by 2030; and fostering innovation in key low-carbon technologies. However, the study does not suggest any remedies for avoiding the main cause of the failure of previous UN conferences and agreements: the free-rider problem. The Kyoto Protocol is a very good example of the stumbling blocks involved in implementing a voluntary agreement among several countries with different and sometimes opposing national interests. Even the EU, which warmly supported the Kyoto Protocol and

set up the Emission Trading System (ETS) in order to comply with its rules, failed. The crucial problem we have to face is the following: is it possible to coordinate the policies of 100 national states (and their local governments) for the creation of global public goods, which require steady consensus for decades, without a supranational authority endowed with the power to coordinate them?

The two issues addressed here, namely global inequalities and sustainable development, could be solved by setting up a World Tax Authority (WTA). In his influential study on the historical, national and global causes of inequality, Thomas Piketty shows that the market economy contains powerful forces of convergence, such as the spread of knowledge and skills, and powerful forces of divergence, which threaten democratic societies. Indeed it happens that 'wealth accumulated in the past grows more rapidly than output and wages.…The entrepreneur inevitably tends to become a rentier, more and more dominant over those who own nothing but their labour' (Piketty 2014: 571). According to Piketty, it would be possible to regulate global capitalism with a global tax on capital, '"a solution that has the merit of preserving economic openness while effectively regulating the global economy and justly distributing the benefits among and within nations' (p. 516). The first step in this direction is international transparency and exchange of fiscal data among national governments, as the OECD is proposing. But Vito Tanzi (2013) proposes another necessary step: the creation of a WTA to combat tax competition among countries. 'Spontaneous agreements among a group of countries, or unilateral or bilateral measures, are not likely to lead to rules about unfair tax competition by countries and against aggressive tax planning, by multinational corporations or rich individuals.…There are just too many actors and the incentives among them are too divergent to lead to spontaneous solutions emerging' (Tanzi 2013: 16). Tanzi proposes an intermediate plan, with a WTA acting only as a coordinating agent for national governments, and a more radical plan in which the WTA is authorized to collect tax and redistribute it to national governments.

We conclude this section devoted to international fiscal issues with an institutional proposal. If nation states wish to avoid losing tax revenue due to international fiscal competition and tackle the dramatic problem of sustainable development, they should consider the advantages of

creating a UN budget, financed by a percentage of the tax collected by the WTA in proportion to their GDP. This budget would not have to be huge: 1 % of the world GDP, the same amount as the budget of the EU, should be enough to provide some crucial global public goods (Fiorentini and Montani 2012; ch. 6), such as a permanent police force, under the authority of the Security Council, a fund for R&D in the field of low-carbon infrastructure investments and clean energy, a fund to stop deforestation, mitigation and adaptation policies in developing countries, a fund to fight epidemics and improve health infrastructures in poor countries. A supranational UN budget is in itself a global public good, because: (a) it is the best guarantee for market forces that the international community has made an enduring commitment to a new model of growth; (b) it obliges national governments to interact and explain how their national needs can be balanced with the needs of others; (c) as long as the common budget is used to provide effective public goods for each member state, the free rider risk is greatly reduced; and (d) if people active in national governments, local governments and NGOs can take part in global projects in their native countries, the cost-effectiveness of the world fund will increase, because every single citizen will be aware of contributing to the well-being and survival of the human community.

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5

Growth and Welfare: Shifts in Labour Market Policies

Henri Sneessens

Introduction

The burst of the housing market bubble in the USA in 2007 ignited a long-lasting worldwide economic crisis, now known as 'the Great Recession'. For the first time since the Great Depression of the 1930s, financial markets played a key role both in generating and propagating the crisis across countries. Both the European Union (EU) and the USA were hit by the recession, although with differences. Differences may stem from different economic 'institutions'—that is, differences in the set of rules and norms that govern the functioning of specific markets. Differences may also reflect different economic policy responses. The Great Recession was followed in 2011 by the sovereign debt crisis that hit debt-ridden countries and produced a widening gap between the core and the periphery countries of the Euro area (EA).

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This chapter focuses on labour market policies in the EU in the aftermath of the Great Recession. Labour market policies have two objectives: promoting growth and welfare, and enhancing the resilience of the economy to economic shocks. These policies are typically implemented through institutional arrangements like job protection legislation, unemployment insurance schemes, formal wage bargaining processes, and so on. Institutions are only slowly changed, and the same applies to the labour market's. Pressures for changes are not new. They appeared with world globalisation and the development of knowledge-based economies. They gained strength, however, after 2010, three years after the start of the crisis. We explain the motivation for this shift and why it did not take place earlier in the crisis. Although this policy shift should be seen as a change of emphasis rather than a sudden change of paradigm, it may ultimately contribute to a complete overhaul of labour market institutions in the current context of world globalisation.

The chapter is organised as follows. We first document the main consequences of the crisis on income and employment, the rise of inequalities and cross-country imbalances. We next discuss how (in)effective market mechanisms have been in paving the way towards recovery. Against that background, we discuss the motivation and the relevance of the economic policies implemented in EU countries. We distinguish two sub-periods, before and after 2010. Until 2010, the focus was on the 'European Economic Recovery Plan' and its national counterparts. With the onset of the sovereign debt crisis and the implementation of EU-wide fiscal consolidation policies, the focus shifted towards labour market policies and so-called competitiveness recovery plans. We discuss the contents and motivation of such plans and the difficulty of implementing them successfully at a time of fiscal austerity. We conclude the chapter with a discussion about conflicting economic paradigms and their connection with ongoing economic changes.

The Crisis

There are several ways to look at the crisis. The crisis started in the financial markets, but it propagated throughout the economy with a severity

never seen since 1929, pushing unemployment rates in some countries at levels never seen for decades. It is a worldwide phenomenon, albeit with profound differences between the USA and the EU reflecting differences in the working of these economies as well as different economic policies. This crisis revealed the vulnerability of indebted countries and led after 2010 to a sovereign debt crisis, also named Euro crisis as the constraints imposed by the single currency proved to be a key ingredient in the development of the crisis. The result is a deep divide between core and periphery countries of the EA, reflecting country specificities as well as loopholes in the single currency institutional setup. In the next section, we explore these aspects from the point of view of the labour market, with particular emphasis on EU-15 countries[1] for which long-run comparisons are more relevant.

The Unemployment Rise

The contrast between the EU and the USA is illustrated in Fig. 5.1. The contrast is twofold. During the first part of the crisis, the so-called Great Recession that took place from 2008 to 2010 after the burst of the housing bubble, EU countries seemed to better resist the crisis than the USA. At the onset of the crisis, the unemployment rate was historically low in the USA (below 5 %) but next jumped to 10 %. In the EU-15 the initial unemployment rate was significantly larger at 7 % but remained below 10 %. However, after 2010 and the development of the Euro crisis, the comparison is at the disadvantage of the EU-15. While the unemployment rate decreased steadily in the USA, sliding below 6 % in late 2014, it started rising again in EU-15 countries. The EU-15 unemployment rate remained above 11 % for most of the year 2011 and was still above 10 % in January 2015.

The situation within the EU-15 area is far from homogeneous though. The years that immediately followed the launch of the Euro had been characterised by sustained growth together with relatively low unemployment

[1] EU-15 includes Austria (AT), Belgium (BE), Denmark (DK), Finland (FI), France (FR), Germany (DE), Greece (EL), Ireland (IE), Italy (IT), Luxembourg (LU), the Netherlands (NL), Portugal (PT), Spain (ES), Sweden (SE) and the United Kingdom (UK).

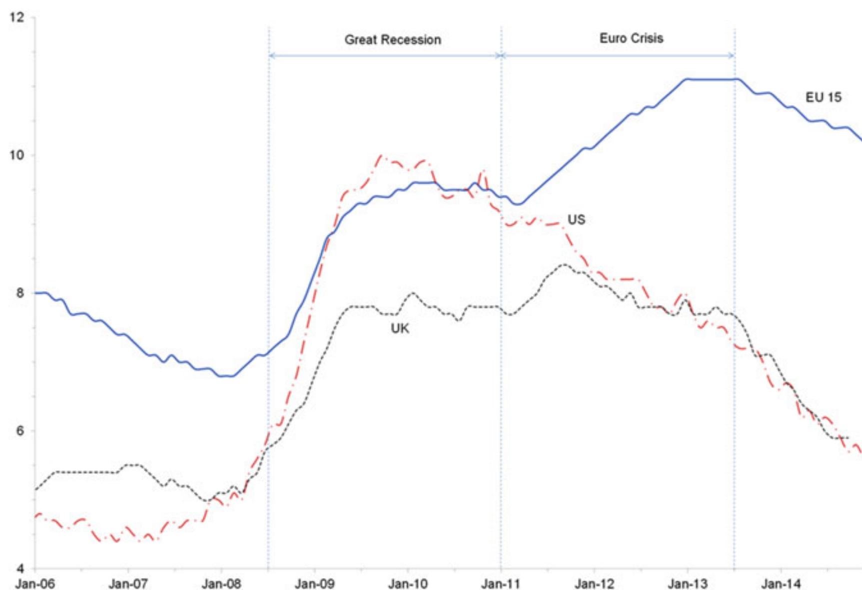

Fig. 5.1 Unemployment rates in the EU-15, USA and UK, 2006–2014. Data sources: Eurostat

rates (at least as seen from today). At the same time, unemployment rate differences (measured, e.g., by the standard deviation) were decreasing too, as Fig. 5.2 illustrates. These trends were abruptly reversed after 2007. Cross-country differences were on the rise again, the standard deviation increased from 1.9 % in 2007 to 7.0 % in 2013. The contrast is especially pronounced between the so-called core and periphery countries. Eighty percent of the total unemployment rise that took place in the EU-15 between 2007 and 2013 was concentrated in only four countries representing no more than 25 % of total EU-15 GDP: Portugal, Italy, Greece and Spain, often referred to by the derogatory acronym PIGS. The figure is even higher (92 %) if one focuses on the sovereign crisis sub-period after 2010 (see Fig. 5.3). There are marked differences as well among core countries, however. For instance, while unemployment continued to decrease in Germany after 2010, it continued to increase in France, remained stubbornly high in Denmark and did not decrease in the UK until the second half of 2013. In all countries, the unemployment risk was particularly high for young, unskilled workers aged 20–25. From

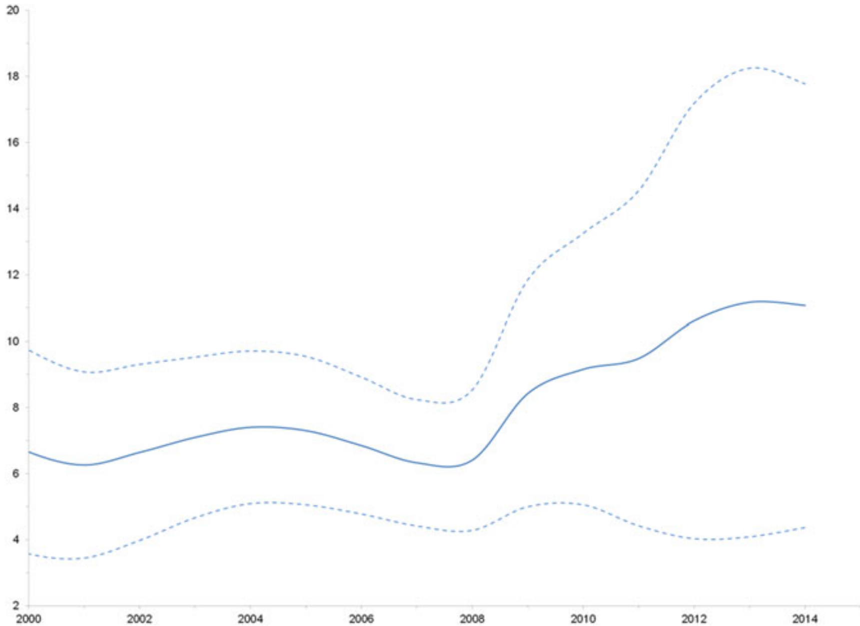

Fig. 5.2 EU 15: Unweighted average unemployment rate in the EU-15 (*continuous line*), ±1 standard deviation (*dashed lines*). Data sources: Eurostat

2007 to 2013, the unemployment rate of workers less than 25 rose from 15 % to 23 % for the EU-15 as a whole and from 21 % to 48 % in PIGS countries (unweighted average).

Rising Income Inequalities

These huge unemployment rises were associated to record low output growth rates. The average real GDP growth rate had been pretty high at 2.4 % from 2000 to 2007 for the EU-15; it fell to −0.25 in 2008–2014. Again there are huge cross-country differences, as Fig. 5.4 illustrates. The figure shows the cumulative effects of growth after the year 2000 (index 100). In France and Germany, despite a severe recession in 2009, the real GDP level in 2014 is 15 % higher than at the start of the century; the UK fares even better, with a 27 % gain between 2000 and 2014. At the other extreme, Italy and Greece had in 2014 lower real GDP values than 14

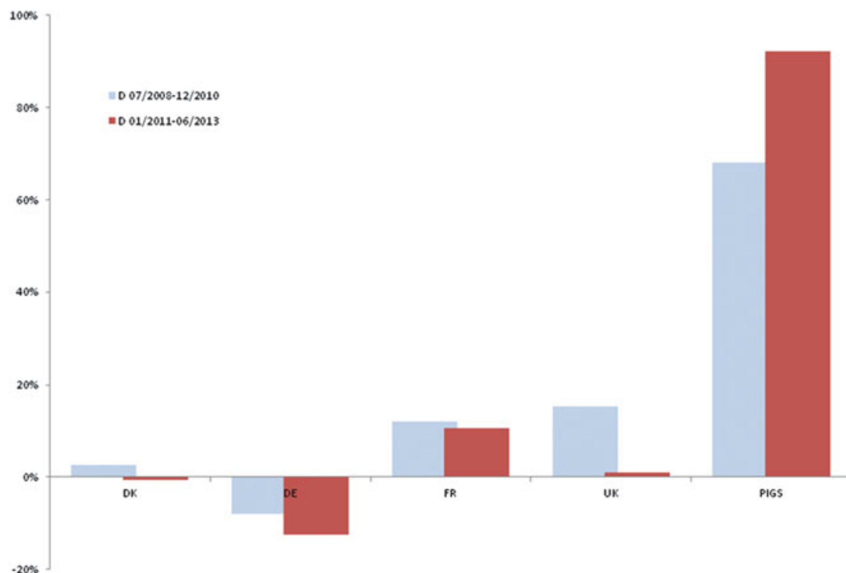

Fig. 5.3 Contribution to EU-15 unemployment in percent of total EU-15 change, over the sub-periods 07/2008–12/2010 and 01/2011–06/2013. Data sources: Eurostat

years earlier! It is a particularly cruel reversal of fortune for Greece. After the start of the Euro at the turn of the century, Greece enjoyed a period of exceptionally high growth rates, as if it were catching up with its EU partners. Just before the Great Recession in 2007, Greece's GDP was 32 % higher than in 2000. In 2014, after six years of negative growth, it was back to the 2000 level.

As is often the case in such circumstances, it is the most vulnerable who suffers most. Although fiscal and social transfers have been helpful in compensating the rise of market inequalities, poorer households tend to lose more or gain less. The rise in youth unemployment led also to a significant shift of the poverty risk from the elderly to the young. In countries like Spain and Greece, the poverty rate[2] increased 7 and 15 %, respectively, between 2007 and 2011.

[2] In this computation, the poverty line is 'anchored' at 50 % of the 2005 median income. See OECD (2014) for more details on changes in income inequalities during the crisis.

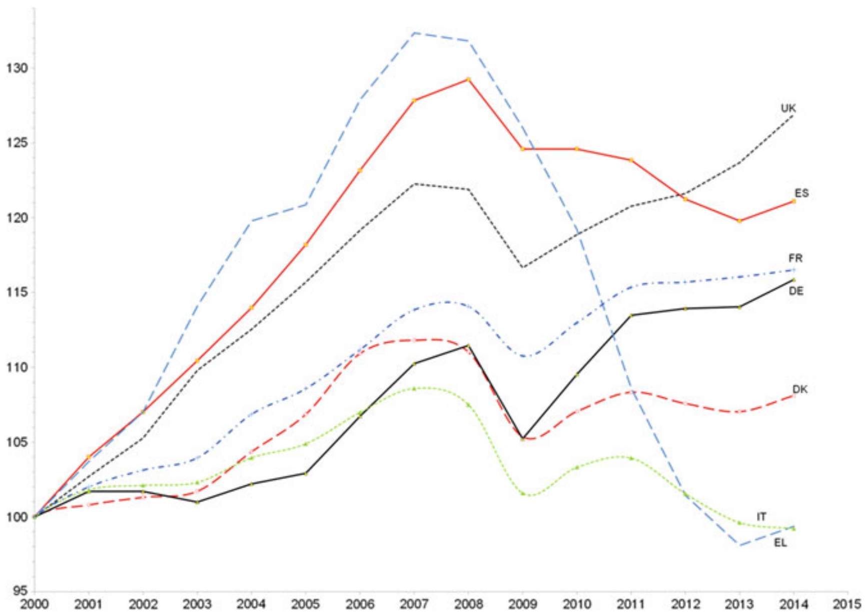

Fig. 5.4 Real GDP, index 100 in the year 2000. Data sources: OECD

Structural Imbalances

There were already signs of mounting structural imbalances before the onset of the crisis in 2008. Greece's public deficit had been at 6 % or more for several years, despite the high growth rates of the economy, which means that after correction for cyclical effects the structural deficit was even much larger, way above any sustainable level. It is thus no surprise that the Greek public deficit rose above 15 % with the crisis. The fact is that financial markets continued to lend to Greece at low interest rates (almost the same as for Germany) until 2008, which is suggestive of the blind euphoria that was then prevailing.

The evolution of current account imbalances is even more telling (see Fig. 5.5). While core countries like Germany, the Netherlands and Denmark were running substantial surpluses, periphery countries, especially Greece, Spain and Portugal, were confronted to mounting deficits well before the start of the crisis in 2008. It took several years of recession and a huge demand contraction to get these countries out of the red.

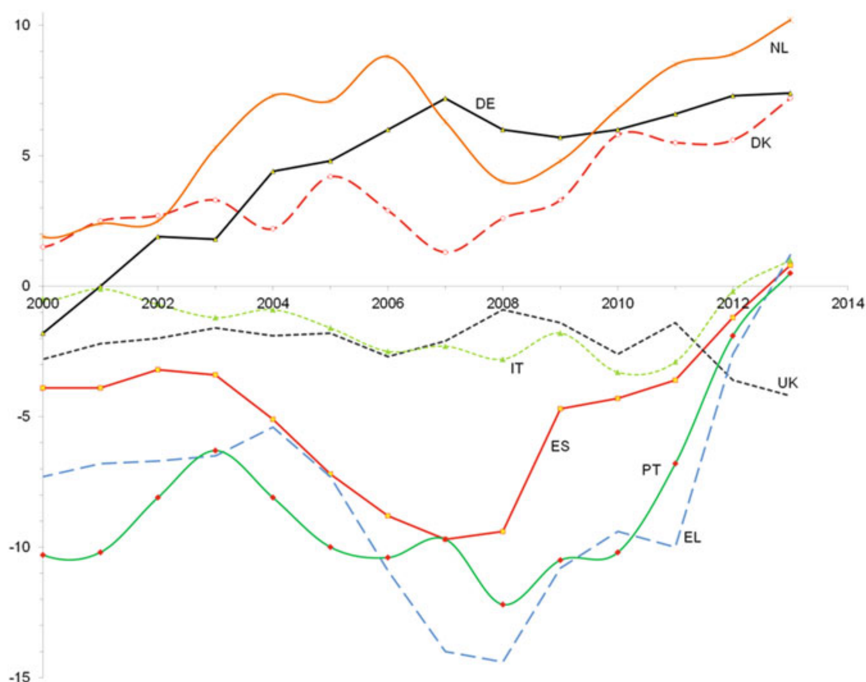

Fig. 5.5 Current account surplus (percent of GDP). Data sources: OECD

Stabilising Mechanisms

Once a recession is started and produces or reveals underlying disequilibria, market prices (i.e., goods prices, wages, exchange rates, interest rates, primary commodities and raw material prices, and so on) progressively adjust to reduce these disequilibria and mitigate the effects of the shock.

At normal times, interest rates play a stabilizing role, going up in booms and down in recessions, which helps sustain investment and consumption. In this instance, though, financial disruption generated increased financial uncertainty, led to financial market segmentation and generated considerable risk premium increases in the most vulnerable countries. Financial markets did not play their stabilizing role. The crisis actually started on financial markets with the burst of the housing bubble, which next contributed to trigger the sovereign debt crisis. The precise mech-

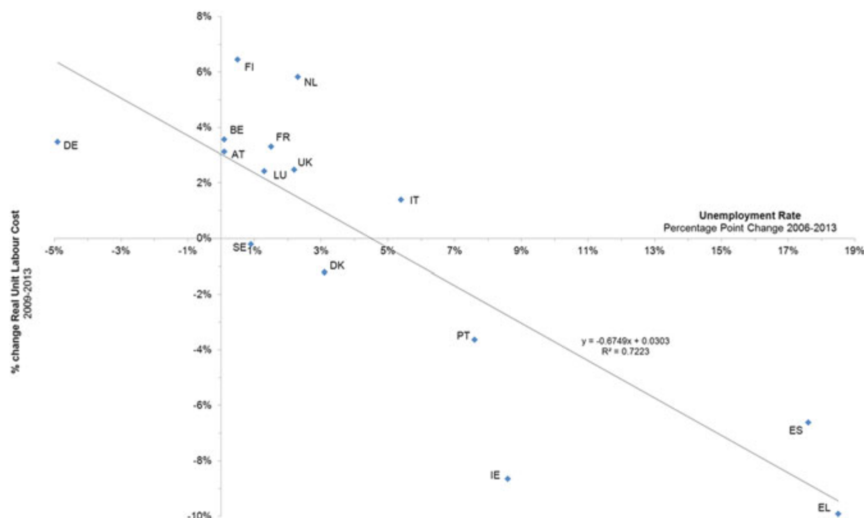

Fig. 5.6 The relationship between wage adjustments and aggregate unemployment. Data sources: Eurostat

anisms by which financial shocks are transmitted to the real economy with such devastating effects remain too poorly understood. Beliefs and liquidity constraints seem to play a crucial role.

Substantial relief came from raw material markets. The worldwide recession led to a fall in raw material prices, which contributed to mitigate the recession in Western countries and bring inflation down. At the EU level though, one of the most important stabilizing mechanism happened to be in the labour market. An unemployment rise is synonymous of labour market disequilibrium, which generates downward pressures on wages. This negative relationship between unemployment and wage growth, known as the Phillips curve,[3] is illustrated in Fig. 5.6. The figure shows that nominal wages increased less than prices and productivity in countries suffering from high unemployment (mainly Portugal, Greece, Italy), so that in those

[3] The initial Phillips curve was a relationship between nominal wage growth and deviations of the unemployment rate from its normal value. The latter is assumed here to be the 2006 value. By using real unit labor cost changes rather than nominal wage changes, we also take into account the effects of productivity and of inflationary expectations changes.

countries real unit labour costs (measured on the vertical axis) went down. The fall has been particularly large in Greece (–10 % over five years).

It is worthwhile putting these developments in context. Although EU unemployment rates seemed to converge during the period that just preceded the crisis, competitive positions were changing and diverging rapidly, especially in comparison with Germany. At the turn of the century, 10 years after reunification, Germany was regarded as the 'sick man of the Europe'. After the German reunification of 1989 and the European monetary crisis of 1992–1993, Germany entered the Euro agreement with an overvalued currency and too high wages. As Fig. 5.7 suggests, Germany was suffering in 1995 from a substantial lack of competitiveness. The German unemployment rate was above the EU-15 average and the gap was widening. This situation motivated the Hartz reforms and the deregulation of the German labour market that was implemented between 2003 and 2005. However, the adjustment of German wages and the return to a more competitive position had started much earlier. Dustmann et al. (2014) explain how and why existing wage bargaining institutions in Germany turned out to be flexible enough to permit these adjustments.

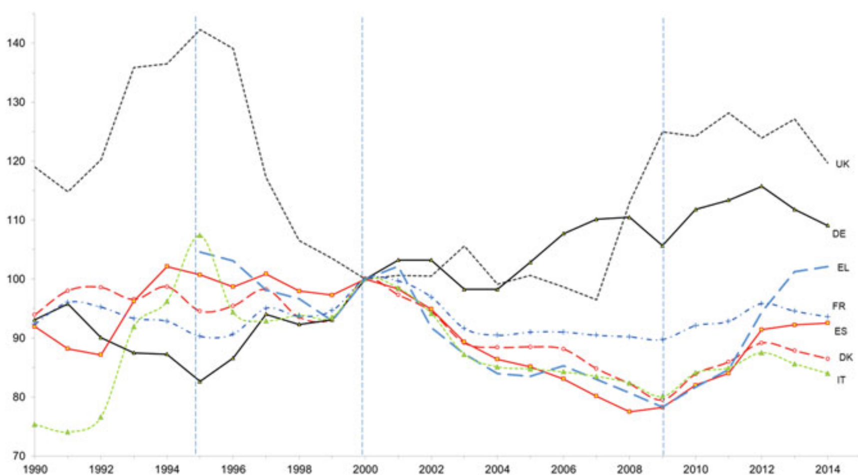

Fig. 5.7 Competitiveness index defined by the inverse of competitiveness-weighted relative unit labour costs for the overall economy in dollar terms. Data sources: OECD (ECB Harmonized Competitiveness Indicator based on unit labour costs for Greece)

As shown in Fig. 5.7, Germany's competitiveness improved steadily after 1994. From 1995 to 2000, Germany's competitiveness improved by 20 %. After the year 2000, Germany continued to improve its competitiveness. From then on, the gap with most other EU countries widened. Excessive wage increases led to significant competitiveness losses in several other EA countries, in particular Italy, Greece, Denmark, Spain, until the 2008–2010 crisis and the readjustments that took place then.

Wage Adjustments Versus Currency Depreciation

For many households, labour income is the main if not the sole source of income. Because it reduces households' purchasing power, wage cuts have a negative impact on private consumption. In an open economy context, such an adjustment has, however, a positive effect on competitiveness and foreign demand. Wage cuts lead to a shift from domestic to foreign demand for domestic products, which may be a desirable (albeit painful) adjustment process when countries face current account deficits.

Currency depreciation is an alternative way to reach the same result. Even when wages remain unchanged, the depreciation of the currency decreases the purchasing power of domestic households and increases that of foreign households. The advantage of currency depreciation over wage cuts is that it takes place instantly, while wage adjustments are slow to come by. While there is only one exchange rate, there are millions of wages to adjust. Because wages are bargained at many different places and determined by labour market conditions, wage adjustments typically start only after unemployment has significantly increased. Econometric estimates[4] suggest that it can take up to 1 % of extra unemployment to

[4] See, for instance, the summary of the available empirical evidence in Pissarides (2009). Wages are more sensitive to labour market conditions for job movers than for job stayers. The semi-elasticity of wages to unemployment (the percentage change in wages induced by a 1 % change in unemployment) is estimated at around 1–2 % for job stayers and around 2–3 % for job movers. But the estimates vary substantially across studies and countries. Font et al. (2015) obtain much lower figures (smaller than 1 %) for Spain. Gregg et al. (2014) find that the sensitivity of wages to unemployment in the UK has substantially increased after 2000, possibly as a result of changing labour market institutions.

get a 1 % decrease in wages, ceteris paribus. Moreover these adjustments take time, possibly several years.

Thanks to the 25 % depreciation of the pound sterling in 2008, the UK restored its competitiveness rapidly (see Fig. 5.7). For other countries belonging to the EA for which currency depreciation is not an option, like Greece and Spain, the process is much slower and costlier in terms of unemployment and is still going on. The unemployment cost to be paid by Greece and Spain to restore their competitiveness and current accounts is huge.

Economic Policy Responses

There is a strong asymmetry between the USA and the EU in terms of economic policy capability. The USA has the institutions needed to implement and coordinate economic policy responses at the level of the entire country. This is especially true for fiscal and monetary policy. Although the Federal Reserve is independent, it largely shares objectives with the US Administration in terms of macroeconomic outcomes, with emphasis on both inflation and unemployment stability. There is, thus, room for efficient coordination of fiscal and monetary policies. Things are not so easy in the EU. Monetary policy may be defined differently for members and non-members of the EA. Within the EA, the mission of the European Central Bank (ECB) is strictly limited to inflation control and financial stability. There is also no EU-wide fiscal policy, although the EU may coordinate actions of its members.[5]

2008–2009: The European Economic Recovery Plan

From 2008 to 2009, the fiscal stance within the EU was clearly counter-cyclical. In November 2008, the EU commission presented its 'European Economic Recovery Plan,' covering the following two years and aimed at coordinating national plans and sustaining growth. EU members were

[5] For more discussion on this theme, see, for instance, Mody (2015).

temporarily allowed to run deficits in excess of the 3 % rule. The aim was mainly to increase investment in infrastructure, strengthen automatic stabilizers (for instance, by reinforcing unemployment and other social benefits), and directly support employment via targeted employment subsidies or short-time working schemes.

These containment policies were certainly successful and contribute to explain why the unemployment rise remained smaller in the EU compared to the USA although the GDP loss over those two years was larger in the EU. It is worth noticing that the fiscal stimulus was larger in the USA. EU public deficits increased on average by 5.5 % (from 0.6 to 6.2 %) between 2007 and 2009. Over the same period, the USA government deficit rose by about 10 % (from 2.9 to 12.8 %).

2010–: Fiscal Retrenchment and Competitiveness Recovery

By 2010, the EU seemed to emerge from the Great Recession. In June 2010, the EU Council adopted the Europe 2020 strategy, a framework to organise the coordination of economic policies across the Union over the years 2010–2020, as the Lisbon Strategy had done for the previous decade. The main theme was (and still is) the achievement of 'smart, sustainable and inclusive growth' via the implementation of all the structural reforms needed to cope with the challenges of globalisation, climate change and population ageing. The associated employment guidelines focus on the needs to foster labour market participation, develop new skills, improve education and training and combat social exclusion. These initiatives seek to foster labour market reforms aiming at improving the EU's competitiveness while maintaining its 'social market economy model'.

It quickly became clear, though, that the recovery would be short-lived. The sovereign debt crisis was already underway and motivated additional reforms to improve EU economic governance, banks and financial markets supervision. Fiscal surveillance was strengthened by a set of regulations known as the 'six-pack' (December 2011), later complemented for EA members by the 'two-pack' (May 2013), and further consolidated by the 'fiscal compact' included in the Treaty on Stability, Coordination

and Governance (January 2013). As a result, fiscal policy became contractionary in all EU countries at the same time. Not surprisingly, the unemployment rate started rising gain, especially in periphery countries directly affected by the sovereign crisis.

In this context, the Commission launched in 2012 a series of initiatives known as the employment package. Without the fiscal instrument to boost domestic demand and fight unemployment, all the emphasis shifted to labour market policies apt to promote a competitiveness recovery by supporting job creation and efficient reallocation. This view fitted well within the Europe 2020 strategy, especially with one of its seven flagship initiatives defined as an 'agenda for new skills and jobs, to improve employment and the sustainability of social models'. This initiative aims at encouraging 'flexicurity', worker and student training and older workers employment. The next section is devoted to an in-depth discussion of labour market policies.

Labour Market Policies

The role of labour market policies is best understood by looking at the dynamics of the labour market. Even at a fixed number of (un-)employed workers, there are constant flows in and out of (un-)employment (see Fig. 5.8). These flows are, in part, due to churning at unchanged number and types of jobs, as employers and/or employees separate to look for matches that better fit their needs. The largest part, however, comes from the reallocation of jobs across firms and industries, as the less successful firms/industries contract and others expand. Such job reallocations reflect Schumpeterian creative job destruction processes connected to technological innovations and productivity growth. Altogether these flows are far from negligible. In most continental European countries, the average yearly separation and hiring rates over the period 2000–2005

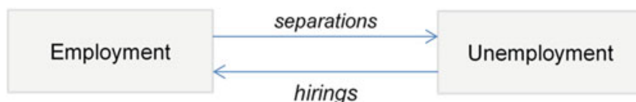

Fig. 5.8 The dynamics of the labour market.

were between 15 and 20 %—that is, more than 15 % of all job matches are destroyed every year and replaced by new matches within the same firm or with other firms in case of job reallocation across firms or industries. In other words, about one third of all workers are hired and/or separate from their employer every year. The proportion goes up to 50 % in the USA.

Such worker and job reallocations are costly. Destroying matches and creating new ones involves firing and hiring costs stemming from administrative constraints and also from the time devoted to the search and training activities associated to reallocations. Reallocations introduce also for the worker an income risk that is not insured by the market. The efficiency of the labour market in dealing with these reallocations depends on a host of factors related to what economists call the 'institutions' of the labour market—that is, the set of rules and norms that govern employers-employees relationships and affect their behaviours and incentives. These institutions include minimum wage regulations, wage bargaining procedures, employment protection legislation (EPL), unemployment insurance (UI), and so on. Such institutions are motivated by market imperfections coming mainly from imperfect and asymmetric information and impeding the achievement of an optimal outcome.

The fear today is that institutions that were appropriate in the post-war era, at a time of economic reconstruction with still predominant agricultural and industrial sectors and stable employment relationships, may no longer be so appropriate today in front of the deep structural changes associated to technological innovations and their impact on globalisation and organizational changes. Globalisation has two facets, because the increase in economic integration of countries goes hand-in-hand with the disintegration or fragmentation of production processes. Both facets have implications for the labour market. Worldwide economic integration is synonymous with more competition from low-wage countries; disintegration of the production processes means substantial reallocations of labour across activities and more flexible production systems. The fear is that, without adequate labour market institutions, these changes would lead to lower employment rates and a significant loss of income and social welfare. Lower employment rates would also endanger

the viability of our social security systems by reducing contribution revenues and increasing social expenses.

Another and more recent challenge arises from population ageing. As a result of both lower fertility and increased lifetime expectancy, the old-age dependency ratio is expected to almost double in less than 50 years. The relative number of people aged 65 or more and of people of working age (25–64) is expected to increase from 27 % to 50 % between 2013 and 2060 in the EU-28. This trend will put additional strains on social security budgets as it implies a substantial reduction of the financial basis of current public pension schemes. One response is to adapt the generosity of public pensions and preserve financial viability by reducing expenses. Still, one can avoid too Malthusian an approach by improving the employment rate of people of working age so as to foster contribution revenues. Increasing the employment rate for women and men aged 20–64 from 68 % (average value observed in the EU-28 in 2013) to 75 % (the Europe 2020 objective) is equivalent to a reduction of about 5 % of the old-age dependency ratio (from 50 % to 45 %).

This is the context motivating the call for structural reforms of the labour market. It dates back to the 1980s, well before the crisis, although the latter has made the need for changes even more striking and visible (the oil crisis had the same effect in the mid-1970s). It is tightly connected to the challenge of permanently reallocating labour resources without weakening workers or firms. The difficulty when reforming the labour market is to define and combine adequately the different institutions so as to take into account their interactions or complementarities and to strike the right balance between the needs of employers and of employees. What matters is the coherence of the overall construct. The concept of 'flexicurity' advocated by the European Commission has to be seen in that perspective. It is defined by the Commission as 'an integrated strategy for enhancing, at the same time, flexibility and security in the labour market' (EU 2007); 'it attempts to reconcile employers' need for a flexible workforce with workers' need for security—confidence that they will not face long periods of unemployment' (EU 2011). After several years of discussion and consultations, the concept was endorsed by the EU Council of December 2007 (before the start of the crisis), as a means to reinforce the implementation of the Lisbon

strategy. It was later also included in the integrated guidelines of the Europe 2020 agenda.

The concept of flexicurity dates back to labour market reforms implemented in Denmark and in the Netherlands during the 1990s. In 2007, both countries had been able to reach remarkably high employment rates (above 75 % for men and women aged 20–64) and low unemployment rates (below 4 %), a success ascribed to their labour market reforms and given as an example of good practices to inspire other countries. The Danish and Dutch labour market reforms[6] had actually quite different contents. Labour market reforms in the Netherlands effectively started with the Wassenaar Agreement signed in 1982 between the employers' federations and trade unions. Trade unions accepted to restrain wage demands in return for labour redistribution via a reduction in work hours and the expansion of part-time employment. The 'flexicurity' reforms of the 1990s in the Netherlands were meant to normalise atypical forms of work, especially part-time work (47 % of employment in 2007) and temporary contracts (mainly agency and on-call workers), without reducing flexibility. Labour market reforms were also introduced progressively in Denmark. Social partners signed a 'common declaration' in 1987 to ensure employment-friendly wage developments. This paved the way for the complete overhaul of the welfare system and the implementation of the flexicurity principles in the 1990s. In Denmark, the focus was on the combination of three key institutions: EPL, UI and so-called active labour market policies. The novelty of the reforms implemented in Denmark in the mid-1990s was the introduction of these active labour market policies aimed at increasing unemployed workers' incentives to search for a job. In the sequel, we focus on the Danish approach.

The starting point is the fact that reallocating labour across firms creates an income risk for workers who may suddenly lose their job and lose with it their main source of income. Because of asymmetric information and moral hazard problems, there exists no market insurance against the risk of losing one's job. There are two ways to (partially) remedy this market failure (see Blanchard and Tirole 2008): either one reduces the unemployment risk by the means of an EPL restricting the firm's freedom to lay

[6] See Bovenberg et al. (2008) for the Netherlands and Andersen and Svarer (2008) for Denmark.

off workers, or one compensates the worker for the income loss by setting up a public unemployment insurance (UI) scheme. Different countries combine these two mechanisms in different proportions. The canonical Scandinavian model provides low EPL but high UI; at the other extreme, the Mediterranean model has high EPL and low UI. The Anglo-Saxon system has both low EPL and low UI, while many continental European countries have intermediate EPL and UI levels. There is no easy way to simultaneously ensure efficient job reallocation and reduce the unemployment risk. Each of these models has its drawback. We briefly review the pros and cons of EPL and UI. We will next discuss the case for active labour policies and the role of wage setting institutions.

Employment Protection Legislation

The expression 'employment protection legislation' covers all the rules that may interfere with the firm's freedom to hire or fire. It may be laws passed by parliament or rules agreed upon by social partners. It includes the type of contracts that the firm can use (fixed-term vs. open-ended contracts, e.g.) and the dismissal procedures and severance payments attached to a given type of contract. It includes, also, the possibility for a worker to go to court to defend his/her rights.

Low EPL (as in Anglo-Saxon countries) facilitates job reallocation across firms and an efficient allocation of resources. Too lax a system may be counterproductive, though, and may lead to excessive job destructions as private firms do not take into account the social costs associated with unemployment spells. These costs include the loss of activity, the payments of unemployment benefits, and the loss of human capital when the skills accumulated by the worker were specific to the destroyed job and/or when the worker's human capital depreciates during the unemployment spell. Too lax an EPL might also exacerbate the volatility of the economy over the cycle by producing large employment fluctuations.

A protective EPL (as typical of Mediterranean countries) facilitates long-lasting employment relationships, which may have positive effects on productivity as both the employer and the employee have an incentive to make longer term investments in human capital. The drawback,

of course, is that it makes reallocation costlier and slower when an activity ceases to be profitable. The failure to reallocate work adequately from old to new activities leads to a loss of efficiency and a loss of aggregate income, a disadvantage that is particularly important at times of deep structural changes. More surprisingly, perhaps, firing costs have also a negative impact on hirings when they deter firms from starting new risky activities by making the exit cost too large in case of failure. A restrictive EPL will thus impact on aggregate unemployment in two opposite ways. It reduces the number of separations, which decreases unemployment, but it also reduces the number of hirings, which makes it more difficult for the unemployed to find a job and creates long-term unemployment. The net effect on aggregate unemployment is ambiguous. There are also distributive aspects. A tight EPL is favourable to incumbent workers but unfavourable to the unemployed and to new entrants. As a result countries with tighter EPL tend to have both lower separation and hiring rates and a higher incidence of long-term unemployment as it is more difficult to get out of unemployment (see for instance Andersen 2012, Blanchard et al. 2013, OECD 2010, ch. 3).

The poor performance of most European economies after the oil shocks of the 1970s and the persistence of high unemployment rates during the 1980s was blamed on inappropriate labour market institutions, in particular, excessive hiring and firing regulations leading to sclerotic labour markets (Bentolila and Bertola 1990). Already back then, several countries changed their regulations to increase flexibility. To ensure a majority to vote these reforms, the latter were, however, typically at the margin, affecting only new contracts and leaving incumbent workers unaffected. The use of temporary contracts was facilitated and allowed firms to bypass the tough regulations associated to regular contracts. Such a two-tier reform leads to dual labour markets, as the insiders (incumbent workers with permanent contracts) enjoy maximum protection against the unemployment risk while outsiders, mainly younger workers entering the labour market, receive only a temporary contract with negligible protection against the unemployment risk. As argued by Blanchard and Landier (2002), this type of reform can actually have perverse effects as it may lead to a worse outcome with both higher unemployment and lower welfare. They suggest that the introduction of temporary contracts

in France in the early 1980s increased turnover for young workers and reduced their welfare.

Spain provides another illustration of the drawbacks of two-tier reforms (see Bentolila et al. 2008). Spain inherited from the Franco era a tough EPL. The partial labour market deregulation that took place in the 1980s maintained a quite effective EPL for incumbent workers with open-ended contracts but introduced the possibility of temporary contracts. The incidence of temporary work in total employment rose from 16 % in 1983 to more than 30 % throughout the 1990s and early 2000s. During the Great Recession, total employment decreased by about 18 % and the proportion of temporary contracts in total employment fell to 24 %. This means that the non-renewal of temporary contracts accounted for 85 % of all job losses in Spain after 2008. In other words, the unemployment risk fell almost entirely on one category of workers, those who did not have the time yet to secure a permanent contract, mainly new entrants (younger workers) in the labour market. There is also evidence that workers on fixed-term contracts suffered the largest wage reductions (Orsini 2014). As long as job and wage security provisions remain so different between the two types of contracts, firms have a strong incentive to ensure as much flexibility as possible by never converting fixed-term contracts into open-ended ones. This is especially true at times of macroeconomic uncertainty. It is suboptimal because it is unfair and because of its negative impact on human capital acquisition and the employability of the younger generation.

Unemployment Insurance

A UI scheme is desirable as it contributes to welfare by providing income insurance to workers with typically little access to financial markets and self-insurance. There exists, however, no market UI. The reason is asymmetric information. The asymmetric information problem comes from fact that the potential insurer has too little information about the specific characteristics of a would-be insured worker to evaluate the risk correctly. Knowing a worker's diploma or other observable characteristics is not enough to evaluate his/her genuine risk of unemployment. Increasing

the insurance premium to play safe and cover the cost of the insurance scheme provides no solution. It would create an adverse selection problem as only the most risky workers would then be interested in buying the insurance. The adverse selection problem can, of course, be solved by making the insurance compulsory for all workers, but compulsory insurance does not solve the other problem associated with asymmetric information between the insurer and the insured worker, the so-called moral hazard problem associated with the difficulty of monitoring the unemployed worker's search behaviour and making sure that he/she does his/her best to find a new job and get out of the UI scheme. This explains the absence of market UI and motivates the implementation of compulsory public UI schemes. The moral hazard problem is typically contained by offering only partial insurance. At the start of the unemployment spell, the unemployment benefit may represent a sizeable fraction of the previous wage income but then decreases over time. Gross replacement rates vary a lot from country to country, ranging in the EU-27 from 80 % in Luxembourg to 13 % in the UK. Because of the progressivity of taxes, net replacement rates are often significantly larger than gross replacement rates. Benefit duration in normal times is limited to 26 weeks in the USA and varies a lot across EU countries, ranging from more than two years on average in the EA (with considerable variation) to around 30 weeks on average for non-Euro countries (Esser et al. 2013).

The specificity of the Danish system is the combination of lax EPL with pretty generous unemployment benefits, both in terms of initial replacement rates and benefit duration, although the latter has been substantially reduced over the last decade. This may seem an ideal combination as it provides income insurance to the worker without impairing the flexibility of the firm. Furthermore, by supporting private income and expenses in downturns, unemployment benefits act as an automatic fiscal stabiliser and contribute to dampen cyclical fluctuations. Generous unemployment benefits may also contribute to growth by increasing the quality of labour matches, as they give job seekers the possibility to search for jobs that best fit their skills. The system had worked well in Denmark before 1975, at a time where jobs were much more stable and longer lasting. Once globalisation and technological/organisational changes called for more flexibility and job reallocations, the system started malfunctioning and led

to abnormally large unemployment rates even at times of strong demand pressure. As pointed out by Andersen-Svarer (2007), a system combining pure flexibility (low EPL) and pure security (high UI), as the Danish system continued to do till 1995, is unlikely to be optimal because it fails to address adequately the moral hazard problem, especially when reallocations become important. Too generous unemployment benefits may then have adverse effects on employment and growth as they imply too high reservation wages, reduce job seekers' search effort or make them too choosy. Without additional policy instruments to tackle the problem of monitoring search behaviours, it may thus be difficult to reconcile the need for adequate income insurance and the need to maintain adequate incentives to search actively and to accept jobs at reasonable wages. The Danish response was the implementation of so-called active labour market policies (ALMP).

Active Labour Market Policies

The reforms initiated in the mid-1990s progressively added a third leg to the Danish welfare system by complementing EPL and UI with ALMP aimed at strengthening search incentives and reducing reservation wages. The expression 'active labour market policies' refers to all the programmes and initiatives helping the unemployed worker to return on the labour market and find a job. This includes public employment services, job training schemes and other labour market relevant education, subsidised employment and direct job creation. The Danish reforms of the 1990s made participation in activation programmes necessary to remain eligible for benefits. The passive period, that is, the period during which an unemployed worker can claim benefits without having to participate in activation programmes, was progressively reduced from seven to four years and then zero. Another aspect of the Danish reform was the increased duration dependence of unemployment benefits. The benefit period was progressively reduced from seven to two years, after which the unemployed moves to social assistance. It now takes 12 months of regular work to regain entitlement to unemployment benefits, while in the past it sufficed to participate in a job training programme, which in effect

implied that the benefit period was unlimited. The implementation of these reforms helped reduce the unemployment rate from 9.6 % in 1993 to 3.8 % in 2007. One should also emphasize that these reforms were implemented at a time of sustained demand growth, which made a rapid decline in unemployment possible and provided the necessary political support for the implementation of the reforms.

Wage-setting Institutions

Incentivising workers to search actively and to accept job offers can successfully contribute to reducing unemployment if and only if there are enough job creations. A prerequisite is the existence of a supportive macroeconomic environment and of employment-friendly wage-setting institutions. Lower unemployment benefits (sanctions, shorter benefit duration, and so on) and more ALMP can accelerate the return to employment and increase hirings if and only if there are vacancies to be filled. If for some reasons wages are too high, the demand for labour will be too low, firms will post few vacancies and increasing ALMP will have little impact on actual hirings. The way wages are determined is thus crucial for the effectiveness of activation programmes.

The expression 'wage-setting institutions' refers to the set of rules and customs that govern wage determination. Collective wage bargaining remains a dominant model in continental European countries. There are, however, many different ways to organise and implement collective wage agreements. Calmfors and Drifill's influential paper (Calmfors and Driffill 1988) emphasised the impact of the degree of centralisation and/or coordination of wage bargaining on macroeconomic performance. At the time, Scandinavian countries were characterised by highly centralised wage systems, with bargaining between national trade unions and employer federations. At the other extreme in Anglo-Saxon countries, wage bargaining was (and still is) quite decentralised and takes place mostly at the local level, with possibly a very limited role for collective agreements. Many continental countries were in between, with wage bargaining taking place predominantly at the intermediate (industry) level or with a mixed system combining different levels of decision with

more or less coordination across industries or articulation across levels. Calmfors and Driffill (1988) suggested that industry-level wage setting was likely to be the worst system, especially so when there is little cross-industry coordination.

The intuition goes as follows. When wages are discussed at the individual firm level, workers recognise that their employer would not be able to pass a wage increase on prices because of the pressure from competitors. A wage increase would thus mean a direct increase in real labour costs and would mean job losses within the firm. This configuration leads to moderate, employment-friendly wage demands. In contrast, when wages are set at the industry or sector level, all direct competitors face the same situation, the menace for employment is thus thought to be lower and wage demands are consequently stronger. The problem is that, if the same situation prevails in all sectors, the economy-wide wage level becomes too high and aggregate employment goes down. This misperception of aggregate effects may disappear with centralised wage bargaining. National trade unions and employer federations are fully aware of these economy-wide employment effects and take them into account when setting wages. Centralised wage setting furthermore avoids insider effects, whereby incumbent workers set wages to maximise their own welfare and totally disregard the fate of long-term unemployed workers. In other words, centralised bargaining would be superior to industry or sector bargaining because it allows the internalisation of externalities.

The trend since the mid-1980s has been, however, towards more and more decentralisation (see for instance Visser 2013). Decentralisation can take place either via changes in the dominant level of negotiation (wage bargaining becoming sectoral where it was national, and local where it was sectoral), or in case of multi-tiered bargaining by weakening the articulation between lower and higher levels of decision (fewer restrictions imposed on lower bargaining levels), or by facilitating/activating opt-out clauses. Sweden has combined all three forms; the third one (opt-out clauses) has been predominant in Germany (see Dustmann et al. 2014). France abolished automatic wage indexation and introduced the obligation of firm-level bargaining in 1982. What does explain the drift towards decentralisation? One explanation might be the trade-off between the benefits from internalising externalities in a centralised sys-

tem and the capacity to adapt to idiosyncratic productivity shocks in a decentralised system. Globalisation and technological/organisational changes have created a considerably larger diversity of situations across workers and firms. Wage decentralisation is one way to cope with this challenge and to avoid job losses.

The case of Germany is particularly interesting. The pressure on wages coming from globalisation and technological/organisational changes was considerably reinforced by the consequences of the German reunification and the strong currency policy of the Bundesbank. The proximity with Eastern Europe made the displacement of activities in these neighbour lower-wage countries much easier for German producers than for any other European country, which further increased the pressure for more firm-specific and differentiated wage agreements in order to avoid job losses and deindustrialisation. Dustmann et al. (2014) explain how the specificities of the German system of industrial relations led it to respond to these pressures by decentralising wage formation. This decentralisation took place without any change in existing rules and without government intervention. The key to this flexibility was the role traditionally given to (local) works councils and their independence from trade unions when a firm's survival is at stake. Even when a collective wage agreement has been reached at the industry level between a union and an employer association, a given employer may still choose not to recognise the agreement and go for firm-level agreements. And even if an industry-wide agreement was first recognised, the firm can later choose to opt out to secure jobs by using so-called opening or hardship clauses, provided the firm's work council agrees. Both mechanisms contributed to the decentralisation of wage setting in Germany well before the Hartz reforms.

The general trend towards more wage decentralisation is also connected to the development of new, non-standard forms of employment. These changes allowed significant reductions in the German unemployment rate but also produced significantly larger wage inequalities. This would not be a problem[7] if there could be enough fiscal redistribution to avoid

[7] Besides its unfairness, an increase in income dispersion may have undesirable effects on macroeconomic performance. Kumhof et al. (2015), for instance, suggests that larger income inequality may increase the indebtedness of low- and middle-income households and contribute to the emergence of financial crises.

excessive disposable income inequalities. It is easier said than done, however, if only because fiscal redistribution can only be implemented if there is political support for it. Targeted labour tax cuts (as recommended by the OECD and the EU; see, for instance, OECD 2006) are one form of fiscal redistribution that may contribute to reduce market wage inequalities by reducing the wedge between the firm's labour cost and the worker's labour income for the least skilled workers (see for instance Batyra and Sneessens 2010).

Recent Trends

Figure 5.9 illustrates how public spending on labour market programmes changed over almost two decades in some key countries corresponding more or less to the four models[8] alluded to before: Scandinavian model (Denmark, Netherlands), Continental (France, Germany), Mediterranean (Spain) and Anglo-Saxon (UK, USA). The comparison is between 1993 and 2012, which were both years of recession in the EU-15, with negative average real GDP growth and similar average unemployment rates. All public expenses are grouped into four categories: passive policies (mainly unemployment benefits and assistance and early retirements), training and employment subsidies, subsidised employment and direct job creation, public employment services and administration (PES). There is, from 1993 to 2012, one notable change and one remarkably stable feature. The change is that total public spending on labour market programmes (in percent of GDP) has been reduced in all countries, moderately so in some countries (−5 % in Spain, −19 % in France, −14 % in the USA), considerably in Denmark (−47 %), the Netherlands (−32 %), Germany (−57 %) and the UK (−53 %). Overall, for the six European countries it represents a decrease from 3.2 % of GDP in 1993 to 2.0 % of GDP in 2012. The stable feature is the relative importance of public spending on passive labour market policies, which in all countries but two continues to represent more than half of the total expenses. The two exceptions are Denmark and the UK where the

[8] We do not discuss the case of Eastern countries for which there are specific transition problems.

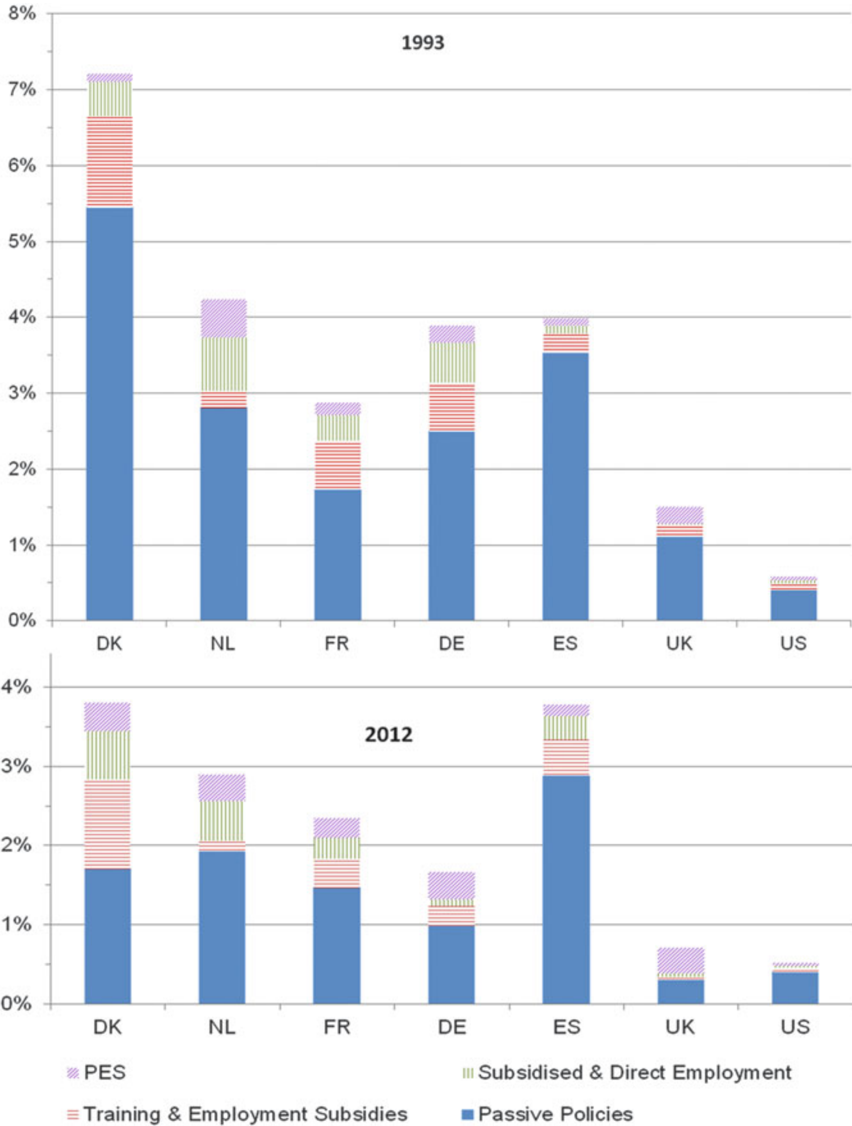

Fig. 5.9 Public spending on labour market programmes in 1993 and 2012 (2010 for the UK, 2011 for Spain), in percent of GDP. Data sources: OECD

amount spent on passive policies was considerably reduced and partially compensated by increased spending on active policies, mainly training and subsidised employment in Denmark and public employment services in the UK. There is, however, a huge difference between Denmark and the UK. In the former country, total expenses on labour market programmes amounts to 3.8 % of GDP, in the latter it is not more than 0.7 % of GDP. Finland and Sweden (not shown in Fig. 5.9) have features very similar to Denmark.

The Danish example illustrates well the merits but also the difficulty of the flexicurity model. The combination of UI and ALMPs has allowed Denmark to provide generous UI without creating long-term unemployment, but this combination cost 3.8 % of GDP in 2012. One of the challenges of the flexicurity model advocated by the European Commission is the cost associated with labour market programmes. Even in a country like Denmark where spending has successfully shifted away from passive policies towards activation, the cost of labour market programmes is substantial. Before the onset of the Great Recession, at a time where the Danish labour market was extremely tight, the cost of labour market programmes still represented more than 2.5 % of GDP. Many indebted countries cannot afford such expenses. This financial constraint may bias the reform process towards flexibility rather than security. For many there is 'a perception [that] in the context of the crisis there has been growing pressure towards labour market liberalisation without counterbalancing efforts to achieve greater employment and social security' (EU 2012). Turrini et al. (2014) show that, immediately after the start of the crisis, reforms were especially important in the domain of activation, unemployment compensation and labour taxes. The main objective was to sustain income and employment to dampen the effects of the crisis. After 2010, the crisis became more structural and affected predominantly countries with large current account or budget deficits. In this context, the emphasis moved on reforms introducing more flexibility (lower EPL, more decentralised wage setting) and reducing the work disincentive effects of UI by reducing its generosity and duration. Active labour market policies are less of a priority.

Portugal had its reforms in 2011, Spain in 2012. Greece has reduced significantly its EPL for permanent contracts and facilitated decentralised wage bargaining in two phases in 2010 and 2011. Italy has overhauled the legal framework for layoffs and established a single contract for new workers. The latter should progressively replace the old system and give the means to combat labour market segmentation between those who enjoy a permanent contract and those who do not. The timing and content of these reforms in Mediterranean countries is obviously explained by the magnitude of the unemployment rise and of the sovereign debt problem. It is hard in this context to spend more public money on active labour market policies. Over the long run, such reforms should reduce inequalities between incumbent workers and new entrants on the labour market. It is less clear that inequalities across skill levels will be reduced. One key ingredient of the flexicurity model is the provision of adequate (lifelong) education and training. This may be the ingredient (still) missing in all countries.

Conclusions

The purpose of this chapter was to examine whether the current crisis did lead to a shift in labour market policies and whether this shift should be interpreted as a change in paradigm. To set the stage, we first recalled the economic consequences of the crisis and compared the economic policy responses in the EU and the USA. We next examined how and why European economic policies changed through the Great Recession and the Euro crisis. We explained why after 2010 the emphasis in EU countries shifted away from countercyclical macroeconomic policies towards fiscal consolidation and labour market policies. We focused on labour market policies viewed from a longer run perspective in the context of the so-called labour market institutions.

We discussed the respective merits of different labour market institutions and the factors that motivated labour market reforms. The prevailing view is that labour market institutions (EPL, UI, wage-setting

procedures, and so on) that were appropriate at a time where the agricultural and industrial sectors were still predominant and employment relationships were remarkably stable may no longer be so appropriate when world globalisation and technological/organisational changes induce frequent job reallocations and call for more flexibility. Increasing labour market flexibility has in this context two advantages. By making the labour market more flexible one allows firms to reallocate more easily their resources across different activities, which should increase growth and employment. More flexibility is also a means to reduce the segmentation of the labour market and bridge the huge divide between, on the one hand, senior workers with open-ended contracts and maximum job protection and, on the other hand, junior workers with fixed-term contracts and maximum risk of unemployment. Flexibility has its limits, though, as it may imply non negligible economic and social costs. The corollary of an increased flexibility for firms is an increased unemployment risk for workers. This risk can be contained by providing adequate UI and adequate support to help the unemployed worker find a new decent job.

The need to reconcile flexibility and security explains the emphasis given to the so-called flexicurity model, which actually combines three elements: limited job protection, significant UI and effective activation policies to help the worker return on the labour market. The latter should take into account the need to retrain displaced workers. The increased flexibility called for by world globalisation and technological/organisational changes cannot become truly effective without a larger capacity to update skills and competences. Part of this retraining effort can be done spontaneously within the firm in the context of long-lasting labour relationships but will be more problematic for less skilled workers. Labour market institutions have a role to play in giving incentives (both to firms and workers) to retrain the least skilled workers. Active labour market policies aim to contribute to that objective.

Has there been a paradigm shift? The evidence is that the pressure for labour market reforms started already in the 1980s, well before the Great Recession of 2008–2010. Many countries started adjusting their labour market institutions already then, although most of them did so only at

the margin. France abolished automatic wage indexation and introduced the obligation of firm-level bargaining in 1982. Spain removed all existing barriers for the use of temporary contracts in 1984. Many countries progressively reduced the generosity of unemployment compensations. Few countries implemented radical reforms. One exception is the Netherlands with the Wassenaar Agreement signed in 1982 between the employers' federations and trade unions. Trade unions accepted to restrain wage demands in return for labour redistribution via a reduction in work hours and the expansion of part-time employment. These reforms were continued and consolidated in the 1990s so as to promote both flexibility and security. A similar scenario took place in Denmark. Social partners signed a 'common declaration' in 1987 to ensure employment-friendly wage developments. This paved the way for the complete overhaul of the welfare system and the implementation of the flexicurity principles in the 1990s. The working of the German labour market started changing completely at about the same time, well before the Hartz reforms of 2003–2005.

Clearly the shift in labour market policies started well before the Great Recession. If there has been a paradigm shift, it took place progressively during the 1980s and has continued to motivate labour market reforms over the following decades. The Great Recession of 2008–2010 actually suspended the emphasis on labour market reforms for a few years. To avoid reinforcing the negative effects of the economic downturn, more emphasis was then temporarily given to employment and income support policies. Persistently large unemployment rates, however, put enormous strain on welfare systems. Sovereign debt problems and the Euro crisis that started in 2010 reignited and substantially reinforced the call for structural labour market reforms, especially so in countries with fragile public finances. Financial strain also explains why relatively more emphasis has been given to the flex component of flexicurity reforms.

Last but not least, it is worth repeating that the financial crisis has also made more visible than ever the need for better integrated macroeconomic policies at the EU level. Labour market reforms can be implemented more easily in a supportive macroeconomic environment. Moreover, labour market policies are no substitutes for macroeconomic policies. Ongoing reforms on both the financial/monetary and fiscal sides may pave the way

for more macroeconomic integration in the future. Imposing tight fiscal limits on EU members may be justified to avoid an excessive default risk taken by one member having detrimental effects on the entire Union. It is also a needed step towards more fiscal integration, if one wishes at some point to endow the Union with adequate fiscal policy tools. This is not the perspective so far though.

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6

Rethinking E(M)U Governance from the Perspective of Social Investment

Anton Hemerijck

Europe's 'Double Commitment' in Jeopardy

Since its inception in 1957 with the Treaty of Rome, the core idea behind European integration was based on the political promise of achieving *both* economic prosperity *and* social progress in upward convergence in an 'ever closer union' of the peoples of Europe. In defining the European project to this end, the Lisbon Treaty explicitly commits the European Union (EU) to work towards a highly competitive 'social market economy', combining full employment with high levels of social protection and cohesion, gender equality and inter-generational solidarity, across all of its current 28 Member States (TFEU 2009: art. 3). The fallout of the Eurozone crisis unveils a highly tragic infringement on the EU's 'double commitment' of economic prosperity and social solidarity progressing in tandem across and within EU member states.

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Widening economic divergences and social imbalances between the competitive North and the Mediterranean laggard economies cast serious doubts about the return of upward economic convergence and even calls into question the viability of the Economic and Monetary Union (EMU). As unemployment soared to a peak of 27 million in 2013, about 9.5 % (2013, Eurostat) of the EU's working age population, considerable EU job growth achieved over the previous decade was wiped out practically overnight. Most worrisome is the surge in youth unemployment in the most troubled economies to, respectively, 52.4 % in Greece, 53.2 % in Spain, and 42.7 % in Italy (2014, Eurostat). Close to a quarter of the EU population is living at risk of poverty today. Most dramatically, poverty leaped from 28.3 in Greece in 2007 to 35.7 % in 2013. As the European economy has entered a seemingly protracted period of sluggish growth and weak job creation, in all likelihood the 'scarring effects' of economic disparities, social inequities and 'lost generations' will linger for decades.

Unable to deliver on economic prosperity *and* social progress puts national governments under enormous pressure, as electorates continue to hold national leaders responsible for socio-economic (mis-)fortune. Because political accountability is bound up with widely cherished national welfare states, it is close to impossible to renege established social contracts in hard economic times. But this is what the 2013 'Fiscal Compact,' stipulating a 'balanced budgets rule' with debt ceilings and automatic sanctions, is forcing some member states to do. Harsh austerity reform, together with protracted failures to resolve the Eurocrisis at the supranational level, are increasingly met with anti-establishment political mobilization and EU-sceptic domestic pressures to water down ruling governments' commitments to European solutions. Where and when stagnation prevails, widening economic imbalances, high unemployment and rising poverty and inequality become the breeding grounds for xenophobic anti-EU populism. Betwixt rising anti-establishment populism and the EU's inquisitive austerity reform imposition, unsurprisingly, a 'political-institutional vacuum' has emerged at the heart of the European integration project. This has been brought home by the results of the elections to the European Parliament in 2014 and also by the 2015 national elections in, respectively, Greece and the United Kingdom. The landslide victory of the radical left Syriza party, under the charismatic

leadership of Alexis Tsipras in crisis-struck Greece, raised the prospects of a 'Grexit.' But also in the more affluent United Kingdom, the victory of the Conservative party under David Cameron set the stage for a 'Brexit'-referendum by 2016. With the deepening of the Eurozone crisis, the EU has been transformed—practically overnight—from a benign technocracy monitoring the internal market and stability of the Euro currency into a highly contested *political* union.

At the centre of the troublesome state of play lies an uncongenial inter-institutional friction between the two most successful feats of post-war social engineering: the modern welfare state and the European integration project (Dolvik and Martin 2015; Scharpf 1999, 2010; Ferrera 2005, 2009, 2013). This predicament has been germinating for decades under relatively benign economic conditions. Therefore, it is unlikely that a new 2015 Commission, under the helm of Jean-Claude Juncker, will be able to cross the Rubicon of creating a safe institutional haven for the besieged currency and its member-welfare-states, in a manner that does justice to widely shared aspirations of economic freedom and social fairness across the European continent, against the rising tide of anti-EU and anti-establishment populism in hard economic times.

In the midst of the Eurocrisis, it is tempting to see ongoing *internal devaluations* that the besieged economies are pushing through under the surveillance of the Troika of the European Commission, the European Central Bank (ECB) and the International Monetary Fund (IMF), as epiphenomena of the ultimate victory of 'single-market totalitarianism' over the democratic compromise of welfare capitalism between market liberalization and social protection, as Wolfgang Streeck intimates in his impressive and provocative book *Buying Time: The Delayed Crisis of Democratic Capitalism* (Streeck 2014). According to Streeck's reading of the delayed Hayekian revenge on the Keynesian welfare state, the crisis aftermath put global financial elites, the ECB, and the European Commission, in an overpowering position to exploit the emergent political vacuum by reinvigorating EU market, currency and fiscal integration on the ticket of the most aggressive version of welfare state recommodification ever tried in recent history. I share Streeck's appraisal of European integration having intensified market-oriented reform pressures on national systems of social protection since the late 1980s. But I take issue with his dour conclu-

sion that European welfare states are imploding under the yoke economic internationalization, pushed for by the IMF, the ECB and the European Commission, and the powerful high-finance elites of Wall Street and the City of London. Levels of social spending, on average, have been relatively stable over the past decades and have increased slightly since the onslaught of the Great Recession.

The draconian submission of domestic social policy to EU macroeconomic governance should not be exaggerated for two reasons. Most importantly, institutional configurations never add up to integrated policy systems and coherent political arenas. The fundamental insight that prevailing rules structures inevitably harbour internal ambiguities, giving rise to a range of unintended and unforeseen consequences, goes back to the writings of Max Weber (1978). In recent years, many scholars studying the dynamics of policy change, including Marie-Laure Djelic and Sigrid Quack (2003), Colin Crouch (2005) and Wolfgang Streeck as co-author of Kathy Thelen (Streeck and Thelen 2005), have revealed how different layers of social and economic governance, often embodying contradictory logics, can coexist under different historical circumstances. National welfare states and E(M)U economic governance framework, and their inter-relationships, are no different in this respect. National welfare states are made up of manifold interdependent provisions, including social insurance, public assistance, employment policy, labour regulation, gender equality legislation, family and long-term care provision, and so on. EU economic governance is perhaps less politically sensitive than national welfare programs, but its governance structure is equally policy-centric, with single market and competition policy, steered by the Commission and enforced by the European Court of Justice (ECJ), monetary policy managed independently by the ECB, and budgetary policy, falling squarely into a sovereign jurisdiction of Member States, albeit in the shadow of the Stability and Growth Pact (SGP) as a fiscal disciplining device. It should, thus, come as no surprise that, over the past half-century, the multi-level institutional order produced by the loosely coupled co-evolution of national welfare states and EU economic integration deepening and widening from six to 28 member states raised the propensity of inter-institutional friction between national social protection and supranational market-making on numerous occasions. In the

second place, EU membership has definitely reshaped the political incentive structure of macroeconomic and social policy making over the past half century but not merely in a regressive fashion. Decision-makers at various levels of government are not per se blind followers of policy fashion, and this also applies to both the level of national welfare states and supranational regional market integration. Inter-institutional friction in the process triggers, depending on the weight of relevant problems, voluntarist and proactive search and learning processes for alternative domestic policy responses and novel supranational compromises, thereby opening up unforeseen avenues of interconnected institutional change across constitutive layers of EU and domestic socioeconomic governance. On balance, the EU's commitment to open markets incentivized Member States to develop modern welfare states as an alternative to 'beggar-thy-neighbour' protectionism and authoritarian nationalism reminiscent of the interbellum.

This contribution traces the *dynamic* co-evolution and interconnection of the two most successful feats of post-war social engineering: the modern welfare state and the European economic integration project, from the perspective of their underlying, at times converging but also sometimes conflicting, policy paradigms and related institutional structures and political resources, with a strong focus on contingent unintended and unforeseen consequence in national and European policy making arenas. First I offer a stylized survey of the relationship between two macroeconomic policy paradigms and the role of social policy ideas in governing the mixed economy of post-war European welfare capitalism. Next, I, examine the neoliberal turn in EU economic integration process, epitomized by the launch of the Single Market Act of 1986 and the introduction of the rule-based EMU in 1999, and how the internal market and the currency union have come to shape—but not determine—social and employment reform agendas across different welfare regimes. We then turn to empirics of national welfare reform of the past two decades, when 'social investment' ideas were put on the policy agenda, revealing a rather wide menu of unforeseen reform variations, including important 'productive' social and labour market policy innovations that are anathema to the regressive one-size-fits-all 'structural reform' agenda that the architects of the single market and currency integration union had in mind.

The conclusion reflects on the recent 'transitional' phase of Eurocrisis management, which, inevitably, displays the deep ambiguities. To wit, the Commission presents itself today as a 'social investment cheerleader', in line with the important publication of the *Social Investment Package* of 2013, but at the same time as the 'fiscal austerity headmaster', consistent with the Fiscal Compact of the same year; two positions that seem hard to reconcile.

The political challenge today is a move towards a coordinated two-level reform agenda of making long-term social investments and medium-term fiscal consolidation mutually supportive with at both the EU and the member-welfare-state levels, consistent with the self-image of Europe as laid down in the 2009 Lisbon Treaty and the Europe 2020 policy strategy of 'smart, inclusive and sustainable growth'.

Macroeconomic Policy Paradigms and the Welfare State

The post-war recasting of Europe's battered nation-states as welfare states together with the intensification of European cooperation arose from the economic, social and political catastrophes of the Second World War and the Great Depression. The defining innovation of the modern welfare state was that social protection came to be firmly anchored on the explicit commitment to grant 'social rights' as positive freedoms to citizens in areas of human need and wellbeing. By contributing to economic growth, European market integration, in turn, allowed national welfare states to expand and prosper from the 1950s on. In the process, a benign equilibrium materialized whereby the technocratic 'low politics' of free trade and market integration was relegated to the supranational institutions of the EU, while the 'high politics' of jobs and social security became core prerogatives of national democracies. In the process, the EU became a union of welfare states, thereby making modern capitalism fit for liberal democracy (Hemerijck 2013: Chap. 8).

Intellectually, the dual shift of welfare state expansion and progressive European economic cooperation was firmly undergirded by the broad endorsement of the Keynesian macroeconomic policy paradigm after

1945. Policy paradigms are best viewed as coherent, causal and normative frameworks for understanding economic reality from which stable policy choices habitually ensue. A fully fledged economic policy paradigm thus ties together a privileged *cognitive understanding* of causal relations between policy efforts and outcomes and a *political consensus* over social and economic priorities. The Keynesian revolution in economic theory, based on an understanding of inherently volatile financial markets, not merely provided a new technique for managing the post-war mixed market economy, as Peter Hall reminds us in his seminal writings on the role of ideas in economic policy (Hall 1989, 1993). By showing how the political objective of (male) full employment can be supported by demand management and fine tuning, Keynesian economics changed the very interest perceptions of post-war political elites and organized capital and labour, after a decade of depression and war, by altering the basic categories through which they can understand economic conditions, diagnose social problems, and select policy solutions. In the event of a recession, comprehensive social insurance, for which the 1942 and 1944 Beveridge reports gave the necessary ideational ammunition, was to operate as an effective demand stabilizers, protecting families from cyclical unemployment and economic hardship. The so-called post-war peace settlement, supported by the Keynesian economic policy paradigm, thus allowed the modern welfare state to expand unabatedly over the era of the *trente glorieuses* from 1950s to the 1970s with sustained economic growth, rising wages and better living standards for all. Part and parcel of the Keynesian-Beveridgean welfare compromise, it should also be emphasized, was that male breadwinner full employment and social protection at the household level was to be underpinned mothers as unpaid housewives doing all the domestic work while caring for children and the frail elderly. Each advanced West European political economy developed its own country-specific brand of welfare capitalism (Esping-Andersen 1990).

Far from being polar opposites, European economic integration and national welfare states prospered together in a mutually beneficial manner. The reassertion of the nation-state as welfare state was an integral part of the European integration project of the 1950s and 1960s. The painful memories of the Great Depression and the Second World War remained

ever present in the minds of post-war policy makers. In this respect, the impetus for the path-breaking establishment of the male-breadwinner welfare state, protected by the international regime of embedded liberalism after 1945, was as much progressive in design, based on organized labour support and class compromise, as it was conservative in intent. As Charles Maier (1987) notes, post-war reconstruction reflected, above all, a quest for normalcy and a search for stability.

Once a policy paradigm is firmly established, intellectual inertia naturally prevails. Even when policy outcomes go off track, accepted doctrines enjoy a considerable comparative advantage over untried policy proposals based on alternative cognitive orientations and normative preferences. The rise of an alternative policy theory, even when it gains considerable empirical backing in academic circles, is never sufficient as a primary force for policy change. Superior policy ideas, according to Hall, only become relevant when they start to provide solutions to newly arising political problems (Hall 1989: 391). Changing social and economic conditions, as they alter the functioning of prevailing policies and institutions, can sometimes modify power positions of stakeholders, which in turn can ignite processes of reorientation on how to steer policy in new (and old) directions, albeit with considerable time lags.

The *Wahlverwandtschaft* (elective affinity) (Weber 1978) or 'positive sum' relationship between post-war welfare state expansion and European market opening was put to the test by the breakdown of the Bretton Woods monetary system and by the two oil price shocks of the 1970s. In the process, the Keynesian welfare state proved increasingly less effective in managing a full employment economy.

If Keynesian macroeconomics was the brainchild of the Great Depression, the revival of neoclassical economic theory in various guises was the intellectual product of the crisis of stagflation, the malignant combination of cost-push price inflation, economic stagnation, and structural unemployment (Scharpf 1991). From the perspective of mainstream neoclassical economics, likewise unemployment is not a macro problem of deficient demand but rather a microeconomic problem of supply-side 'hysteresis,' poor motivation and low search intensity 'likewise,' between 'economics,' and 'unemployment'. Economic cycles were to be understood as outcomes of exogenous shocks—the oil shocks of the

1970s being the clearest cases in point—combined with slow transmission through the real economy as the result of market rigidities, including distortions related to welfare provision. Blanchard and Summers (1987) offered the paradigmatic explanation of 'hysteresis' to explain why wages did not fall and unemployment remained high in Europe in the 1980s: structural rigidities of job preservation for employed workers was achieved at the expense of labour market outsiders, and this prevented real wages from falling enough to restore full employment. The welfare state, by trying to reduce inequality through a politics of income redistribution, reinforced existing labour market distortions, leading to lower labour supply, less training, more net wage compression, and higher unemployment among the old, the young, and the low-skilled, was inevitably besieged by what the American economist Arthur Okun coined the 'big trade-off' between equality and efficiency (Okun 1975). Overgenerous social standards and employment protection, in combination with progressive taxation create negative 'moral hazard' and 'adverse selection' externalities, incurring lower labour supply, higher unemployment, less investment in training and education, and, as a result, hampering growth and competitiveness (Bertola et al. 2000).

The new supply-side diagnoses of the problem of stagflation, and trade unions associated prescriptions of labour market deregulation, welfare state retrenchment, was politically spearheaded by the neoconservative revolution of Margaret Thatcher and Ronald Reagan in the UK and the USA, both of whom were inspired by the neoliberal ideologues Friedrich von Hayek and Milton Friedman. A key political background factor behind the subsequent success of neoliberalism and neoconservatism in the 1980s was the weakening of organized labour, as a consequence of de-industrialization, rapid technological advance, the expansion of the service sector, and the feminization of the labour market. With heavy industry no longer accounting for the bulk of economic growth, the potential for industrial conflict and the need for class compromise gradually waned. In addition, the compromising of the political affiliations between socialist and Christian democratic parties and associated trade unions further lessened the political salience of class conflict.

By shifting political priorities from fighting unemployment to reigning in inflation, the neoliberal paradigm was swiftly endorsed by international

organizations, the IMF, the World Bank, and the OECD. In the early 1990s, the latter institution received a mandate to examine the labour market performance of its Member Countries. The *OECD Jobs Study*, published in 1994, launched a critical attack on the 'dark side' of double-digit unemployment of many European OECD members (OECD 1997, 2006). These reports proved highly influential in terms of the debate on welfare state reform. Hovering around 10 % with few signs of improvement, unemployment rates in France, Germany and Italy were twice as high as in the USA. The employment rate was about 12 points below the USA. The OECD economists argued that Europe's generous welfare states, with their overprotective job security, high minimum wages and generous unemployment insurance, heavy taxation, and overriding emphasis on coordinated wage bargaining and social dialogue, had raised the costs of labour above market clearing levels. Moreover, strong 'insider–outsider' cleavages with unfavourable employment chances for the young, women, the old, and the unskilled prevented the rigid European labour markets from reaching employment rates on a par with the USA, the UK, or New Zealand (Lindbeck and Snower 1989; Rueda 2007).

On the wing of neoclassical economic doctrines of monetarism, rational expectation macroeconomics, efficient capital market hypothesis, inefficient labour markets, rent-seeking collective action, and principal-agent New Public Management theory, the post-war settlement of 'embedded liberalism' and Keynesian full employment was replaced by the so-called Washington Consensus of giving free reign to markets through hard currencies, balanced budgets, capital market liberalization, labour market deregulation, welfare retrenchment, and the privatization of public services, compromising, in the process, the national state as the guardian of social rights.

The E(M)U's Regressive Social Policy Regime and Macroeconomic Failing

The Single European Market Act of 1986 and the EMU of 1999 were negotiated at a time when the Washington Consensus was riding high. Unsurprisingly, the Single Market project and EMU, developed over the 1980s and 1990s, were very much inspired by the ascending neo-

liberal policy paradigm rooted in mainstream neoclassical economics. After the demise of national Keynesianism in mitigating the crisis of unemployment, leading European Social Democrats, including Helmut Schmidt, Francois Mitterrand and Wim Kok, felt that if Keynesian macroeconomic management was to be salvaged it had to be reconstituted through fiscal and monetary policy coordination at the European level. Eventually, what came to fruition in Europe, however, did not take after the kind of supranational Keynesianism that social democracy hoped for. Fritz Scharpf, already in the late 1980s, foresaw a rule-based monetarist regime with an independent ECB, modeled after the German Bundesbank, with a singular mandate for price stability and no explicit concern for (un)employment (Scharpf 1991 [1986]). The economic benefits of the EMU seemed plentiful, ranging from greater market transparency to improved terms of trade without conversion cost and exchange rate unpredictability, further integration of financial markets without the risk of competitive devaluations, reduction and convergence of inflation and, finally, the establishment of a European Central Bank singularly committed to price stability, thereby eliminating high inflation risks in member-country economies (Dyson 2000; Dyson and Featherstone 1999).

The social policy consequences of monetary integration were more indirect but no less consequential. Descending from the stagflation crisis of the 1970s and early 1980s, the EMU policy framework was firmly grounded in a rejection of Keynesian demand-management and the use of deficit social spending to counter economic recessions and mitigate social hardship. Erik Jones (2013) has aptly described the EMU policy framework in terms of an interlocking triptych of three basic supply-side ingredients: price stability, fiscal conservatism, and local- or domestic-factor market liberalisation, which together were believed to best guarantee productivity and employment growth. The doctrinal triad thus combined a German *ordo-liberal* macroeconomic policy framework of the need to impose austerity so as to insure low inflation and sound public finance, together with a more Anglo-Saxon *neo-liberal* microeconomic preference for market-driven 'structural reforms' in national welfare states and labour markets as the answer to raise growth and competitiveness (Schmidt and Thatcher 2013). The architects of the EMU generally, in effect, believed that the single currency would push Member Countries

forward to adopt converging market-conforming structural reform agendas in social and employment policy systems, as competitive devaluations were no longer available (Heipertz and Verdun 2010).

Closely associated with a 'market-distorting' of generous welfare provision and rigid labour markets, there is the conjecture of low (public) service productivity, often associated with so-called Baumol cost disease (Baumol 1967). At its core, the Baumol cost disease conjectures that productivity improvements in labour-intensive services such as health and education consistently lag behind productivity improvement in competitive industries. When public service pay increases following wage developments in the more dynamic capital-intensive private sector, low productivity services become relatively more expensive. Consistent with the Baumol cost disease thesis, Torben Iversen and Anne Wren (1998) have argued that welfare states are confronted not with an inescapable 'trade-off' between equality and efficiency but rather with what they term the 'trilemma of the service economy'. Their central claim is that, with the shift from an industrial to a service economy, it has become inherently more difficult for welfare states to attain simultaneously the triple goals of budgetary restraint, earnings equality, and employment growth. Governments may pursue any two of these goals but no longer all three at the same time. Since international competition and technological innovation restrict job creation in the tradable (mainly manufacturing) sector, employment growth in advanced economies may be achieved either in well-paid public services, thereby undercutting budgetary restraint, or in low-paid private services, sacrificing income equality (see also Wren 2013).

All in all, the intellectual repertoire upon which EMU and Single Market were raised provided a powerful ideational basis for an intrusive restructuring of Europe's expensive welfare states and rigid labour markets by giving employers greater freedom to hire and fire, aborting minimal restrictions on working hours, lowering taxes, reducing welfare spending, privatising pension liabilities, and curtailing trade union power and other 'distributive coalitions' in collective bargaining and social dialogue, as well as ensuring that states keep stagnant social services to a minimum, as 'wasteful' welfare provision tend to 'crowd out' private economic initiative and investment.

EMU Design Faults

A powerful macroeconomic policy paradigm of stable money and sound public finances, in combination with a coherent agenda of microeconomic structural social and employment reform, is no guarantee for consistent implementation. From the perspective of macroeconomics, EMU never lived up to the textbook criteria of an Optimum Currency Area (OCA), because of low regional labour mobility, but perhaps more so because of the deliberate choice not to make way for a central fiscal authority, proper financial regulation, and a 'lender of last resort' facility (De Grauwe 2012). The incomplete design of EMU unleashed an array of unintended negative consequences, bringing the single currency close to the brink of extension in the wake of the Eurozone sovereign debt crisis after 2010, before the President of ECB Mario Draghi pledged 'to do whatever it takes to preserve the euro' in the summer of 2012 (Martin 2015).

The ECB's singular and independent mandate to maintain price stability as a *primary* objective, together with the overriding commitment to fiscal consolidation by Member State governments, demanded by the SGP and the Excessive Deficit Procedure (EDP), pushed member-state governments to launch incisive social policy and labour market reforms in a regressive convergent fashion. In hindsight, however, we observe how different varieties of welfare capitalism under the single currency roof of EMU followed strikingly divergent and unforeseen reform trajectories, as will be surveyed in more depth in the next section. Let's first take a closer look at the unintended macroeconomic consequences of single currency before and after the financial crisis of 2007–2008 (Eichengreen 2012).

The EMU entrance exam required a budget deficit below 3 % of GDP and a debt level below 60 % of GDP. Evidently, the public debt benchmark was ignored as quite a few prospective members of the Eurozone serviced debt levels far above 60 % of GDP. Italy is a case in point. At the moment of EMU entry, Italian public debt reached about 120 % of GDP. Failing to partake in the Eurozone would have pushed up Italian interest rates to possibly unsustainable levels, which could have provoked a default on Italian debt with negative repercussions for the entire European economy. On a more positive note, a devaluation of the lire would have temporarily mitigated an Italian downturn. This scenario did

not ensue. Heavily indebted countries like Italy, Belgium and Greece were admitted to the currency union. On entry in 1999, their interest rates fell to German levels. The ECB's single nominal interest rate meant that real interest rates were relatively high with a dampening effect on domestic demand, causing high unemployment in Germany (Carlin et al. 2015) In peripheral economies, real interest rates were relatively low, thereby boosting domestic demand and inflationary pressures. In Ireland, Portugal and Spain, households were stimulated to take on massive private debt to buy property and reconstruct homes. Asset-price bubbles, largely financed by capital inflows from the low-inflation Northern economies, including Germany, next, resulted in large current account deficits.

Paradoxically, entry to EMU reduced pressures on debt-ridden countries to bring their fiscal house in order through 'structural reform', as was implied by the EMU's social policy regime. Again Italy is exemplary. To prepare for the EMU, the Amato and Dini governments enacted important pension reforms in the face of high interest rates in the first half of the 1990s (Ferrera and Gualmini 2004). After Italy was allowed into the EMU, the incentive for 'structural reform' waned dramatically as borrowing became cheap. The SGP should have taken precedence in making sure that indebted economies remained committed to lowering debt. However, on various occasions the stability pact was violated by France, Germany, Italy and Portugal. Spain and Ireland continued to adhere to fiscal conservatism, but this did not prevent excessive asset-biased inflation. The 'one-size-fits-all' interest rate policy together with the ineffective enforcement of the SGP set the scene for growing imbalances within the Eurozone far before the onslaught of the credit crunch of 2008. With their short-sighted focus on price stability and short-term public finance consolidation, policy makers in Frankfurt and Brussels were entirely ignorant of the economic imbalances created by their cherished policy paradigm. Strikingly, 'structural reform' came to a halt where it was needed the most, that is, in the Southern periphery with the most rigid labour and insider-biased welfare and pension systems (De la Porte and Hiens 2015; Perez and Rhodes 2015; Sacchi 2015).

Ultimately, the global financial crisis exposed the macroeconomic failings in the EMU policy paradigm, ending a decade of illusory catch-up convergence, based on low interest rates and credit and real estate booms.

Housing and construction bubbles broke in Ireland and Spain triggering an array of bank failures. Without EU financial regulation to support failing banks, national bailout programs turned private debt into public debt. Capital flows subsequently shifted into reverse gear from the periphery back to the Eurozone core. Overnight, a credit boom turned into a credit crunch, plunging the Eurozone periphery economies into sovereign debt crises. The competitiveness gap between the North, paying close to zero interest rates on moderate levels of public debt and deficits at manageable rates of unemployment, and the uncompetitive South, facing exceedingly high spreads on their debt and deficits at two-digit levels of unemployment, further widened, ultimately threatening to destabilise the entire Eurozone. Eventually, the ECB and the European Commission, together with the IMF, came to the rescue of Ireland, Greece and Portugal, making financial assistance conditional of draconian austerity, thereby intensifying the recessionary downturns in the bailout countries. Barring the option of currency devaluations, pro-cyclical 'internal devaluation' was the only strategy left on the menu of macroeconomic adjustment to Eurocrisis to restore the stable money and sound budget policy framework. Austerity reform cuts in wages, pensions, education, health care, prescribed by the Troika and the reinforced Stability Pact offered little fiscal relief as public debt levels grew between 2011 and 2013 in Greece from 136 % to 160 %, in Spain from 73 % to 88 %, in Portugal from 112 % to 127 % and in Italy from 123 % to 130 %, from 2011 to 2013. As generals are said to be always ready to fight previous rather new wars, it seems that the EMU architecture armed policy makers with outdated artillery, based on a policy paradigm well-equipped to resolve another stagflation crisis but ill-disposed to foster recovery in the face of demand-deficient deflation in the wake of a deep financial crisis (see also IMF 2012; OECD 2014a).

Welfare Recalibration and the Microeconomics of Social Investment

Since the 1980s, the single market and single currency added new supranational governance layer onto the existing national welfare policy repertoires. However, the progressive deepening of the EU project did not

unleash a full-blown regressive remaking of national welfare states. Far from it! Since the late 1980s, a majority of European governments have come to enact a wave of social reforms to make their social policy systems more efficient and employment-friendly, with the exception of countries such as Greece and Italy for reasons already laid out earlier. Alongside retrenchments, there have been deliberate attempts to rebuild social programmes and institutions and thereby accommodate welfare policy repertoires to the new economic and social realities of the knowledge-based economy. The European welfare states' gradual self-transformation is best told in terms of a sequence of cumulative policy alterations across a wide range of interconnected policy areas.

In *wage policy*, wage moderation in many countries was pursued through social pacts among the trade unions, employer organisations, and government, often linked with wider packages of negotiated reform. The EMU entrance exam of the mid-1990s played an especially critical role in helping to forge national social pacts in the hard-currency latecomer countries, such as Italy, Spain, and Portugal, as an alternative to straightforward labour market deregulation and collective bargaining decentralisation (Avdagic et al. 2011). With respect to *social insurance* and *assistance,* most countries today preside over universal minimum income protection programmes, coupled with 'demanding' activation and 'enabling' reintegration measures, targeting labour market 'outsiders' such as young, female or low-skilled workers (Clasen and Clegg 2011). The area of *employment policy* saw a considerable increase, from the 1990s onwards (Bonoli 2013), alongside social security activation, of spending on active labour market policies, and training and education servicing to improve life course employability. With respect to *labour market regulation*, several European countries have moved towards a greater acceptance of flexible labour markets, with new elements of security introduced for labour market outsiders, governed by more flexible employment relations (Schmid 2008). For *pensions*, financing problems due to population ageing and lower growth have prompted the reversal of the trend towards early retirement policies, together with initiatives to promote longer and healthier working lives. A key shift has been the growth of (compulsory) occupational and private pensions and the development of multi-pillar systems, combining pay-as-you-go and fully funded methods, with rela-

tively tight (actuarial) links between pension benefits and contributions, with a view to factoring in life-expectancy (Ebbinghaus 2011). *Family policy*, covering childcare, parental leave and employment regulation, and work and family life reconciliation policies, has experienced a profound upgrade in both scope and substance (Orloff 2010). Even though social spending has largely been consolidated at the levels reached in the 1980s, practically all advanced European welfare states have been recasting and reconfiguring their basic policy repertoires. Figure 6.1 shows the most recent changes in social spending before and after the onslaught of the economic crisis, revealing significant spending hikes since the crisis.

Since the mid-1990s, also, the social policy ambitions of the EU experienced significant reorientation. Strikingly, EU social policy makers at DG Employment, Social Affairs and Social Inclusion, working closely with rotating Presidencies of the EU over the late 1990s and the early 2000s, raised the flag for 'social policy as a productive factor' in a manner that increasingly transcends the hegemonic market-liberal paradigm of the ECB, DG ECFIN and national finance ministries. Thus, while macroeconomic and internal market policy makers stepped up efforts to perfect the Single Market and the currency union as indirect welfare state disciplining devices, DG Employment embarked on the development of an alternative policy paradigm of social investment, which became part and parcel of the Lisbon Agenda with its ambition to turn Europe into the 'most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth and more and better jobs and greater social cohesion' (EC 2000).

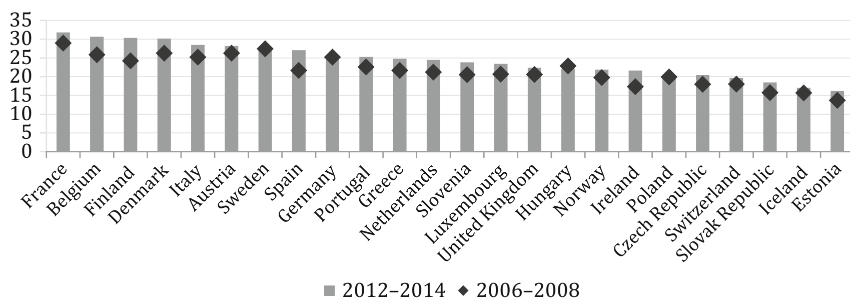

Fig. 6.1 Social spending as % GDP over the crisis. Source: OECD

The intellectual underpinnings of the social investment perspective were given explicit impetus with the publication of a collective book by Esping-Andersen, Gallie, Hemerijck and Myles, *Why We Need a New Welfare State* (2002), commissioned by the Belgian Presidency of the EU in 2001. The central argument of *Why We Need a New Welfare State* was that the staying power of male-breadwinner employment-based social insurance increasingly fostered suboptimal life chances for large parts of the population. To effectively respond to the coming of post-industrial knowledge-based economy, Esping-Andersen et al. (2002) advocated a 'social investment' renewal of the welfare state aimed at securing improved social resilience over the family life course, with the eradication of child poverty taking pride of place. In terms of policy theory, *Why We Need a New Welfare State* took issue with the neoliberal claim that generous welfare provision implies a loss of economic efficiency. As a consequence of critical life-course transitions (ranging from the move from education to the first job, childbearing while establishing a stable career, the incidence of reduced working hours due to caring responsibilities or other forms of inactivity) welfare states in advanced OECD democracies should provide for 'capacitating social services', a term coined by Charles Sabel (2012), aimed at equipping and assisting individuals and families to mitigate the unforeseeable hazards they face, alongside 'compensatory' social insurance provision. Subsequent publications emphasized how social investment is not a substitute for protection, and that adequate minimum income protection is a critical precondition for an effective social investment strategy (Vandenbroucke with Bart Vanhercke 2014; Morel et al. 2012; Hemerijck 2013). The long-term emancipation of the social investment paradigm came full circle with the Social Investment Package for Growth and Social Cohesion of the European Commission of February 2013 (EC 2013a, b, henceforth SIP), arguing that novel welfare policies are needed to 'prepare' individuals, families and societies to respond to the new risks of a competitive knowledge economy, by investing in human capital and capabilities from early childhood through old age, rather than in policies that simply 'repair' damages after moments of economic or personal crisis.

The *SIP* is a remarkable document by making a strong case for not treating social investment reform as 'fair weather' policy when times get

rough, which is what happened with the Lisbon Agenda in 2005 when the mid-term review criticized the Lisbon Strategy for lack of focus (Kok 2004). A careful reading of the extensive background documentation of the *SIP* reveals a quiet paradigm revolution in comparison to the regressive social policy regime underlying the original EMU architecture. On various occasions, the *SIP* explicitly distances itself from the traditional stable money, fiscal austerity and structural reform paradigm by arguing that active social policies 'crowd in' economic growth and competitiveness, high productivity job creation and tax revenues, thereby reducing long-term fiscal pressures. Based on the recent crisis experience, the SIP underlines the critical importance of social insurance 'buffers' in times of recession. By so doing, the *SIP* breaks away from the 'negative theory of the (welfare) state' of the EMU policy paradigm. The provision of capacitating social servicing, moreover, harbours important consequences for the poor economic understanding of (public) service sector productivity, associated with the Baumol cost disease and service-sector trilemma. The expectation of Baumol and Iversen and Wren, first of all, do not stand up to empirical evidence of the competitive successes of Europe's most service-intensive Nordic welfare states before and after the onslaught of the financial crisis. This is because the Baumol framework is entirely ignorant of the important indirect effects of high-quality employment-intensive capacitating welfare services as contributing in important ways to productivity growth in competitive private sectors.

By taking a long-term life-course perspective, finally, the *SIP* pushes policy makers to think more creatively and imaginatively about policy design enhancing the long-term resilience of social policy systems in terms of public investment, strengthening governance, gender equality and institutional capacity building, especially in the area of training and education from early childhood to active ageing. A particularly welcome stronghold is the empirical evidence in the *SIP*, revealing how substantial portions of the social investment policy agenda have already been adopted across a wide range of EU member states with positive social and economic results across various European countries, making a strong case for productive social policy 'crowding in' growth, employment, social protection and fairness. There are potential 'multiple dividends' or 'life-course multipliers' at work. Quality childcare services, alongside effective parental

leave arrangements, supported by appropriate tax and benefit incentives and active labour market policies, enable more parents to engage in gainful employment without career interruptions, improving the chances of finding jobs, especially for mothers, thereby boosting household incomes, while at the same time helping their offspring to a strong start. In the more mature phases of the life course, high investment in lifelong learning is associated with enlarged older worker employment participation and a higher average exit age.

The social investment policy paradigm, unlike the antipodes of Keynesian macroeconomics and neoclassical economy theory, is far more synthetic in character. As such, it contains a policy compromise, linking demand-oriented 'buffers' to the quality supply and allocation of human 'stock' and efficient employment 'flow' in the knowledge based economy, which may not easily lend itself to partisan mobilization. However, by bringing different dimensions and findings together (the positive role of 'capacitating' social policy, the re-appreciation of social protection, a richer and more contextualized understanding of policy intervention in a life course perspective, building on the gender revolution in demography and labour markets, supported by strong social investment evidence), the SIP adds up to nothing less than a (quiet) paradigmatic rethink of the welfare state for the twenty-first century knowledge-based economy (Hemerijck 2015).

An extremely timely synthesis survey, with a strong focus on early-childhood education and care, family services, parental leave, active labour market policy, long-term care and minimum income protection, compiled by European Social Policy Network (ESPN) (Bouget et al. 2015), commissioned by the European Commission, broadly identifies three stylized country groupings among the 35 countries under review (Bouget et al. 2015). The first cluster consists of 13 countries with relative well-established social investment portfolios with strong linkages between different policy areas (through 'one-stop-shop' centres), including Austria, Belgium, Germany, France, the Netherlands, Slovenia, and the Scandinavian countries. With their tradition of high-quality dual-earner care provision and high employment rates for older workers, the Nordic countries display the most robust social investment profile. ESPN experts also observe strong social investment recalibration in Austria (long-term care innovation and activation for youngsters), the

Netherlands (social activation), Germany (enhanced support for dual-earner families), France (minimum income protection for labour market outsiders). In Slovenia, policy integration focuses on mutually reinforcing interventions in child development and parental employment prospects and income protection. The second country cluster is characterized by the absence of an integrated social investment approach, but where targeted policy initiatives have been introduced, which could provide the basis for further upgrading and more effective policy linkages across policy areas in order to generate improved synergies across the life course. This nine-country cluster includes the United Kingdom (fighting child poverty), Spain (long-term care), Portugal (leave arrangements), Ireland (education and training) and the East European member states of Hungary (countering child poverty and early intervention), Poland (education) and Slovakia (social services). Finally, the ESPN identifies a third stylized grouping of 13 countries, where social investment orientations have not entered the policy-making radar screen, although more isolated initiatives are being pursued. Here we find Greece, Italy, Romania, Bulgaria and the Baltic states. The ESPN report also observes how social investment policy initiatives across the post-communist new Member States of Poland, Slovenia, Hungary, Bulgaria, Croatia and the Czech Republic, together with Greece and Spain, in the areas of active labour market and family policy, are being financially supported by the EU.

Consistent with the relatively wide adoption of social investment policy priorities across Europe, the quantitative evidence for social investment also suggests widespread positive effects. Over the Lisbon era from 2000 to 2010, employment rates in Europe rose by an impressive 8 %, including a massive hike in female employment and a significant increase in the employment rate of older workers. Since the beginning of the Great Recession, employment rates stayed put with the exception of Denmark, Italy and Spain (see Fig. 6.2). Interestingly, female employment levels have been most resilient, revealing that the feminization of the labour market is here to stay (see Fig. 6.3).

Moreover, countries that invest most in early childhood and positively facilitating labour market ‘flow’ through the expansion of gender-equitable leave arrangements reach the highest levels of male and female employment participation (Fig. 6.4) without compromising on fiscal

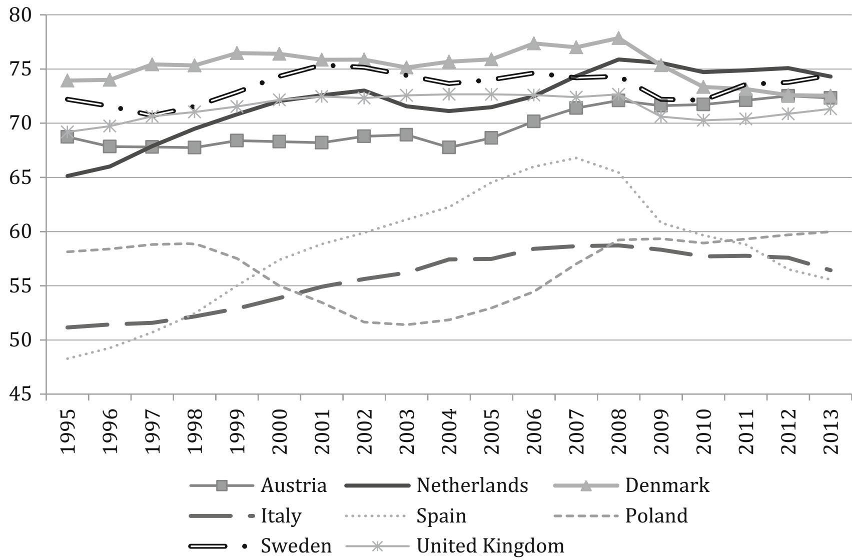

Fig. 6.2 Employment rate, all population. Source: OECD.

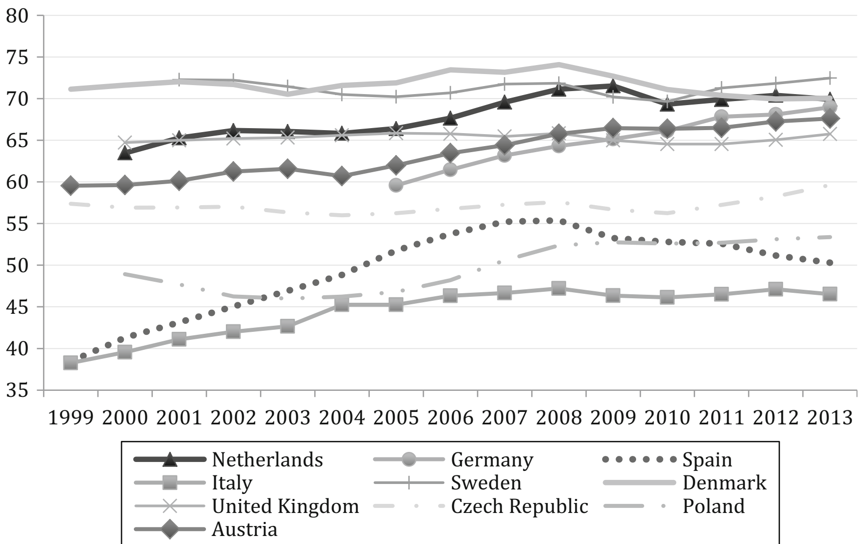

Fig. 6.3 Employment rate, Women. Source: OECD

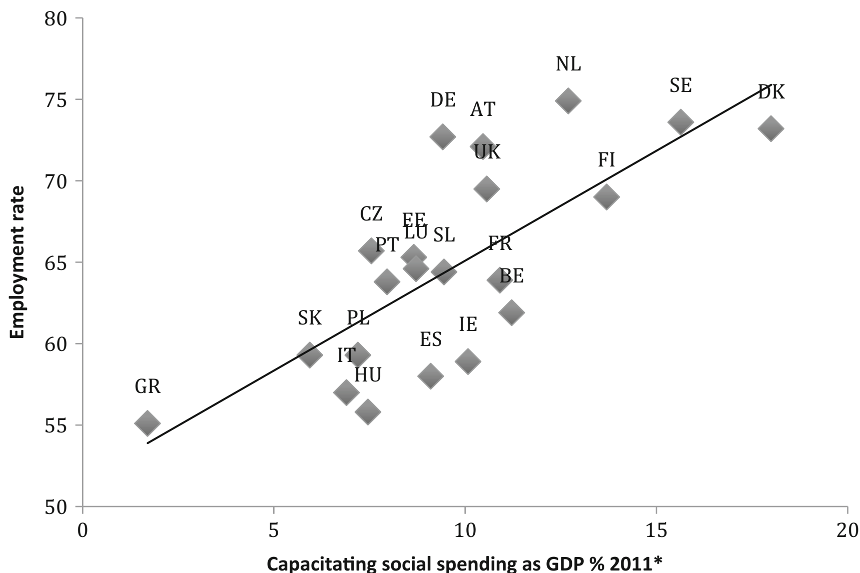

Fig. 6.4 Correlation between capacitating social spending and employment rate. Source: OECD. *Asterisk* Capacitating social spending is author computations on OECD SOCX database and includes expenditure on education, on ECEC, on rehabilitation service, ALMP and elderly care as % of GDP.

consolidation. Likewise, lifelong learning spending has a positive impact on older worker employment levels and the exit age (Fig. 6.5).

What really stands out in terms of family demography is the positive relationship between fertility and higher female employment (Fig. 6.6).

Poverty reduction, it is true, has not kept up with employment growth over the Lisbon era (Cantillon 2011; Cantillon and Vandenbroucke 2014). Admittedly, the link between social investment policies and poverty and inequality is far from straightforward (OECD 2008, 2012). By and large, as revealed in Fig. 6.6, capacitating service provision does contribute to higher employment without negatively affecting relative poverty, as high employment contributes to greater fiscal revenues, which in turn allows for better income protection for those most in need. Finally and quite remarkably, the shift to social investment or capacitating spending seems to have held firm over the course of the crisis (Fig. 6.7). History will tell whether the tranquil composure of the social invest-

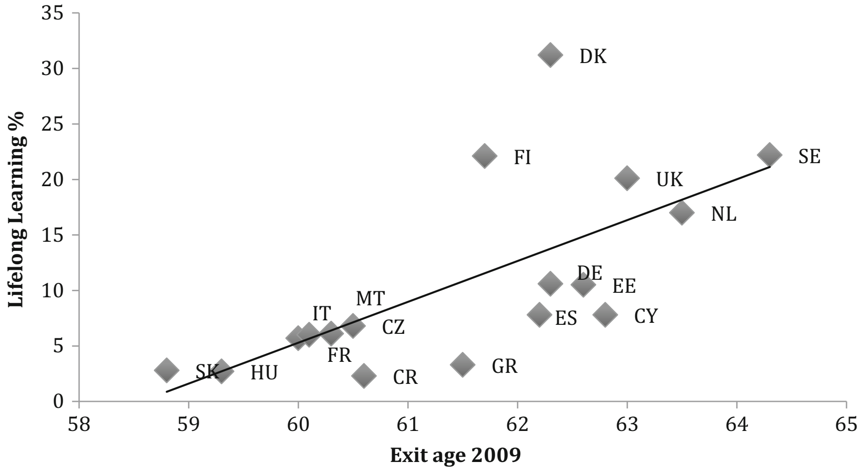

Fig. 6.5 Life-long learning rate and older age employment rate. Source: Eurostat

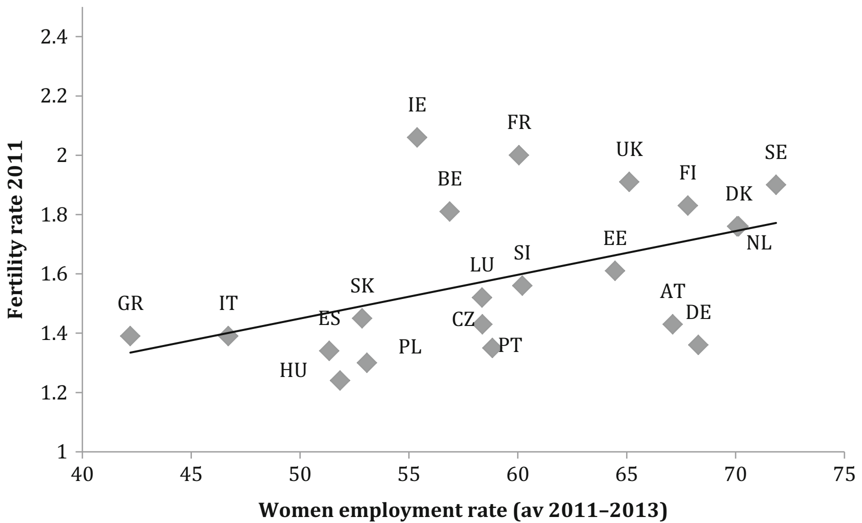

Fig. 6.6 Fertility rate and female employment rate. Source: OECD

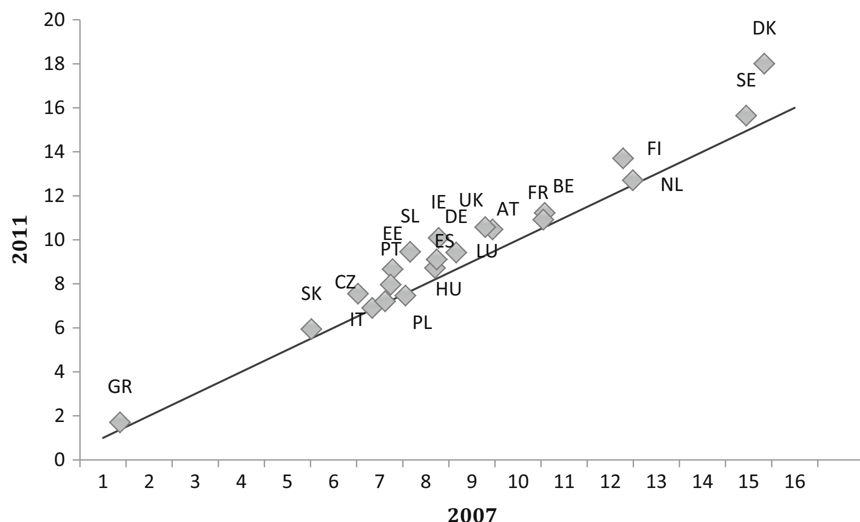

Fig. 6.7 Capacitating social spending across the crisis. Source: OECD, author's computation on SOCX database

ment paradigm is strong enough to overcome the malignant context of austerity-biased E(M)U fiscal governance.

Nesting Capacitating Solidarity in Growth-friendly Macroeconomic Governance

The aftermath of the global financial crisis has brought European welfare states and the integration project to a crossroads, calling into question a whole range of taken-for-granted policy beliefs. Beyond damage control, however, crisis management today continues to be riddled with deep ambiguities. The timing of the launch of the *Social Investment Package*, highlighting important returns from capacitating social policy by the European Commission in February 2013, a month after the Fiscal Compact came into force on the 1st of January, aptly captures the contradictory orientations at play in the aftermath of the Eurozone crisis. Having exposed the deep flaws in the efficient-market-hypothesis

economics, policy-makers seem reluctant to embrace a novel economic policy paradigm. This reluctance should not surprise us, as institutional ambiguity is a fact of contemporary political life. The daunting question that remains is ultimately whether we escape from the impending social Darwinism portrayed in Wolfgang Streeck's dark *Buying Time* book?

Two experiential lessons can be drawn on the basis of the previous analysis and its focus on unintended and unanticipated consequences: a positive and a more negative one. To begin with the latter, the sovereign debt crisis exposed important deficiencies in the architecture of EMU. A regime of stable money, sound finances, and efficient markets cannot shield member states from adverse asymmetric shocks and trade imbalances in a highly heterogeneous regional economy. A common central bank with a restrictive mandate to foster price stability can do very little to accommodate intra-currency union economic divergences, as a monetary union by its very nature sets interest rates for entire currency area. Before the credit crunch, social and labour market reforms were not forthcoming where they were needed the most, because without effective fiscal incentives, the ECB's low interest rate policy resulted in weak reform ownership, most notably in Greece and Italy. After the sovereign debt crisis, the reinforced stability pact wiped out the necessary fiscal space for problem countries to allow automatic stabilizers to operate effectively behind overdue reforms. While future developments remain difficult to predict, economic divergence will not subside in the absence of counter-cyclical adjustment mechanisms, 'lender of last resort' facilities, effective procedures for resolving cross-national bank failures, and most likely collective bond issuance at the level of the EMU.

On a more positive note, the paradigmatic shift to supply side economics did not result in a fully fledged neoliberal submission of national welfare provision in the Scandinavian countries, Austria, Germany and the Netherlands. On the contrary, these countries were eventually able to show how (public) social investments 'crowd in' growth and employment. Thus while the incomplete design of EMU galvanized a number of unintended negative macroeconomic externalities, proactive social investment reform across an increasing number of welfare states produced a range of unforeseen positive externalities. In these countries, welfare state upgrading, at already high levels of social spending, was used to support the

competitive knowledge economy through social policy, but also product market, innovation rather than retrenchment and deregulation. From a macroeconomic perspective, it matters a whole lot whether national welfare regimes, spending between 16 to 30 % of GDP on social policy, use that money in a productivist fashion of raising human capital 'stock,' improving labour market 'flow,' while maintaining effective economic and income stabilizing social protection 'buffers,' backed by determined social investment agenda-setting by from the European Commission and the OECD (Kersbergen and Hemerijck 2012; Vis et al. 2014).

Can we bring these two experiential lessons on the limits of market-driven E(M)U integration and austerity-biased structural reform and the more positive track record of effective social and economic synergies in social investment innovation together in a new policy synthesis behind a currency union based on an employment-friendly macroeconomic framework that would allow active and ambitious European welfare states to prosper in a currency union? It is crucial to recognize that the social investment paradigm is by and large a 'supply side' alternative to the neoliberal retrenchment-deregulation reform agenda. As such, social investments are no substitutes for effective macroeconomic management and prudent financial regulation in times of depressed demand. Under the 2013 Treaty on Stability, Coordination and Governance for Eurozone member countries experiencing dire fiscal straits, the social investment message is immediately lost. Fiscal consolidation required them to slash active labour market policies and retrench education spending and cut preventive health care programmes—a strategy which we know, in the long run, critically erodes job opportunities for men and women and thereby undermines the capacity of the economy to shoulder the ageing burden.

The good news is that, since the fallout of the sovereign debt crisis, we do observe a substantial deepening and improved coordination in E(M)U 'economic governance,' including the introduction of fiscal backstops, stricter EU surveillance of member-state budgets, a timid step towards the creation of a Banking Union, together with increasingly unorthodox interventions by the ECB. After Mario Draghi's pledge to 'do whatever it takes to preserve the euro' in July 2012, in September the ECB made way for Outright Monetary Transactions (OMT) of buying unlimited

amounts of distressed bonds in secondary markets, effectively turning the ECB into a 'lender of last resort' (De Grauwe 2013). By 2015, in an attempt to stave off the threat of a deflationary spiral, the ECB turned to the even more aggressive strategy of 'quantitative easing' (QE) of 1.2 trillion euros monetary financing after the example of the US Federal Reserve and the Bank of England earlier. These developments reveal the recognition on the part of the ECB of the need to pursue a broader objective of sustaining real economic activity cum financial stability, rather than merely securing low inflation.

The more real stumbling bloc to overcome relates to fiscal policy. In stark contrast to the turn to ECB heterodoxy, national governments of the stronger EU economies have steered the fiscal reaction to the crisis towards prolonged austerity. A more equitable and progressive social market economy is incompatible with the current austerity consensus. Faced with a deep intergovernmental 'joint-decision trap,' Eurozone political leaders inevitably fell back, after much procrastination, on the rules-based framework of the status *quo ex ante* as the best available 'lowest common denominator,' thereby obliging besieged Member States to take individual responsibility in domestic austerity reforms (Scharpf 2010, 2013). The fiscal fault line runs deep. Speaking at the 2013 World Economic Forum, the German Chancellor Angela Merkel dramatized the European predicament by highlighting that the continent 'represents 7 % of the world's population, 25 % of the world's GDP and 50 % of the world's social spending', suggesting that these ratios are unsustainable in an era of intensive global competition. As I have argued in this contribution, more likely the causal arrow runs the other way in that high levels of social spending and taxation are consistent with high levels of GDP per capita, depending, of course, on how effective taxation and efficient social (investment) spending is used and allocated across welfare policy repertoires. The Friends of Europe (2015) in a recent publication also reminds us that five out of the ten most successful economies in the world, according to the Global Competitiveness Index of the World Economic Forum, are generous and active European welfare states, including Germany, with levels of social spending edging up to 30 % of GDP.

Many proposals have been tabled for improved (countercyclical) macroeconomic management for the Eurozone (Marzinotto et al. 2011;

Pisani-Ferri 2014). Some of these advocate the centralization of the EU budget (Bofinger et al. 2011; Enderlein et al. 2013). Others emphasise a structured solidarity 'interstate insurance' instrument using Eurobonds for debt mutualisation (De Grauwe 2011, 2012, 2013; Dreze and Durre 2013). There is also the proposal for developing a pan-European 'basic unemployment insurance' scheme to mitigate business cycle shocks (Dullien and Fichtner 2013), strongly supported by former social affairs commissioner Laszlo Andor. Finally, there is the idea of introducing an EU-level minimum income scheme (Pena-Casas and Bouget 2014). Together with Frank Vandenbroucke, I have advocated a macroeconomic demand stabilisation device that incentivises member-states to pursue social investment reforms. What is needed, we argue, is a balanced macro-economic coordination process inciting governments to pursue medium-term budgetary discipline *and* long-term social investment reforms (Hemerijck and Vandenbroucke 2012; Vandenbroucke et al. 2011), by giving greater breathing space with tangible support to Member States that opt for social investment strategies based on the well-defined Europe 2020 ambition of 'smart, sustainable and inclusive growth', also by making maximum use of mutual learning through EU processes of 'open coordination'. From this perspective, it is crucial for embattled countries opting for a social investment strategy to receive necessary support to enable them to move forward with ample reform ownership. Conditional social investment contracts, bolstered perhaps by specially designed social investment project bonds, could be based on access to structural funds at low interest rates. Another strategy would be to discount social investments in national budget accounts, thereby exempting them from SGP deficit requirements, as an alternative to the prevailing cul-de-sac of lecturing 'profligate' countries on their homework without correcting the deep flaws in EU macroeconomic governance. To reverse the trend of rising inequalities, in addition, a broad political agreement on curtailing tax competition, extricating tax evasion and harmonized rules on capital taxation is imperative.

Table 6.1 summarises the core differences between EMU's original 'retrenchment-deregulation' policy regime and the macroeconomic framework that would allow the Eurozone to enhance social investment reform.

Table 6.1 Core differences between EMU's original 'retrenchment-deregulation' social policy regime and the macroeconomic policy framework in support of social investment return optimization

	EMU's implicit 'retrenchment-deregulation' social policy regime	Macroeconomic support 'nesting' for social investment synergies
Policy problem	Cost-containment (cuts)	Revenue-raising (returns)
Policy imperative	Engineer a 'risk shift' to the private sphere (Baumol cost disease)	Maximise employment in the open economy (social service productivity bonus)
Policy theory	'Trade-off' between equity and efficiency, 'crowding out' private economic initiative by 'moral hazard' (*axiomatic*)	Social investments 'crowd in' positive economic and social synergies (*empirical*)
Social policy instruments and settings	Minimum poverty provision ex post (income inequality inevitable and fair in the new global economy) supported by deregulated labour market and private welfare provision	Mitigate life cycles contingencies ex ante through capacitating policy provisions, optimising labour market 'flow' and human capital 'stock' with strong safety net 'buffer' supports in hard times
Macroeconomic policy	Hard currency and rule-based balanced budgets orthodoxy (labour market hysteresis best tackled by pro-cyclical discipline at EU level)	Macro stabilization more than fighting inflation and balanced budget. Additional need to also sail anti-cyclically against the wind with a focus on long term growth and employment
Institutional capabilities (Theory of the state)	Take out market barriers through contracting out welfare provision, while disciplining low-trust 'rent-seeking' distributive coalition (especially trade unions)	Positive role public policy; institutions as both *constraints* and *resources*, including high-trust public regarding 'productive coalitions' and quality social service provision
Political discourse	TINA (There is no alternative)—'European model is long gone' (Draghi 2012)	Caring, capacitating and competitive European 'social market economy'

Source: Adapted from Hemerijck (2014c)

Thus far, practically all of the previously mentioned proposals have fallen on deaf ears with the stronger Member States. Counter-movements at the level of EU institutions are observable but continue to lack teeth. The June 2013 European Council reached a consensus over monitoring and benchmarking social and labour market conditions in the 'European Semester' process, bringing together different strains of EU economic and social policy coordination under one umbrella, with the aim of increasing coherence across different policy instruments and heterogeneous coordination procedures. In October 2013, the European Commission issued an important Communication on 'Strengthening the Social Dimension of the Economic and Monetary Union', based on a scoreboard of social indicators for systematic benchmarking, including unemployment rates and changes therein, the proportion of youngsters not in education, employment, or training (so-called NEETs), real disposable income of households, at-risk-of-poverty rates, and income inequality (EC 2013c). In spite of these examples of gradual policy reorientation, the empirical record reveals that the 'European Semester' and associated national reform programmes (NRPs) have remained ruggedly pro-cyclical (Fernandes and Masuauskaite 2013; Natali 2013; Tsoukalis 2014). Particularly disappointing is that the January 2015 Communication on 'Making the best use of the flexibility within the existing rules of the Stability and Growth Pact' (EC 2015) does not even mention social investment or the SIP.

By 2016, it is fair to say that, at best, we have reached a halfway paradigm shift, with a clear endorsement of the economic logic of social investment, a more balanced monetary policy of monitoring 'real' economic activity, rather than enforcing 'nominal' price stability, but with a deep and regressive 'joint-decision trap' over fiscal policy at the EU-level. The belated fully fledged endorsement of the social investment perspective by the Commission, the rekindling of the social dimension of EMU, after Draghi's vow to rescue the Euro in 2012, therefore, do not constitute the silver bullets for overcoming the deeper fault lines of fiscal austerity, but they are important seeds of policy redirection. The decisive factor, in terms of fertilization, will be the political resources and institutional backing that the European governments,

political parties, economic interest groups, and social movements are able to muster, behind a novel macro- and microeconomic social investment policy synthesis. Ultimately, as we know from Peter Hall, economic ideas only gain paradigmatic hegemony if they answer for urgent political problems. In conclusion, this begs the question of the political merits of social investment and its supportive macroeconomics. Colin Crouch (2016) observes how today the prevailing austerity-consensus and xenophobic populism are breeding on each other. Even so, austerity biased neoliberalism and anti-EU xenophobic populism are strange political bedfellows. The neoliberal primacy is 'open' markets, whereas for anti-EU populism national 'closure' is imperative. To the extent that the radical advocates of 'winner-take-all' market liberalism believe that a welfare compromise is no longer required in the Hayekian dreamland of market globalization, the EU integration project they support, Crouch intimates, may ultimately run against rising xenophobic nationalism. European social democracy and Christian democracy have, in the past, supported the opening of European markets and EU enlargements. In the 1990s, however, they gave in on the prerequisite of domestic welfare state viability for open markets. Given the extent of political fragmentation, centrist political families are today unlikely candidates to muster enough political clout to counter the dual challenge of neoliberal austerity in the name of globalization, causing economic insecurity, and the populist temptation of national closure, reinforced by neoliberal social instability. For the EU to survive, a more capacitating and caring welfare state is a *sine qua non*. Open markets are ultimately best served by coalitions of progressive Christian, social democrats, social liberals and green parties, and their preferences for social investment and activating social protection, supported by key producer interests of workers and employers. This is not only an issue of policy feasibility but also a political question of normative commitment to a European 'social market economy' as a shared purpose for the wellbeing of European citizens, anchored in the Lisbon Treaty (Ferrera 2013; Friends of Europe 2015; Hemerijck 2013; Vandenbroucke 2013; Vandenbroucke and Vanhercke 2014).

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Part III

Politics and Civil Society Under Pressure

7

Creative Resistance in Times of Economic Crises: Community Engagement, Non-Capitalist Practices and Provoking Shifts at the Local Level. From Catalonia to Experiences in Greece

Ruby Gropas

Introduction

Crises, and even more so their aftermath, are transformative experiences for democracies and their citizens. In times of crisis, we see efforts aimed at protecting the status quo that is challenged by the crisis; we also see attempts aimed at transforming institutions, processes, behaviours and narratives in order to address the causes that led to the crisis, their consequences, or create new, more adaptable or resilient conditions. Existing power structures and relations may be further consolidated through these processes or they may be fundamentally altered.

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In the countries most hard hit by the crisis in Europe, the foundations of what most Europeans held as 'certainties' have been severely shaken, apparently irreversibly so. Public services have been cut back and social services have been rolled back leaving the most vulnerable even more vulnerable than before and magnifying inequalities and non-income disparities within European societies. Incomes have declined sharply, and savings have been spent to make ends meet. Precarity, job insecurity, underemployment or simply outright unemployment have peaked. People's everyday realities and their planning for their professional and also personal future have been severely disrupted. In these conditions, citizens have been feeling increasingly distrustful of formal political institutions and consider that conventional politics are not providing the necessary solutions to an increasing number of difficulties and challenges. This has led to an environment conducive to the emergence of new forms of civil society mobilisation.

Over the past six years, there has been much concern about the socio-political consequences of the crisis that has been unravelling across Europe, and particularly in Southern Europe. Scholars and researchers have explored the impact of the crisis on the structuration of political conflict in European liberal democracies. They have explored the resurgence of nationalist discourses expressed by the radical populist right, and the mobilisation of the far left through electoral and protest channels. They have documented the ways in which citizens' grievances have been expressed through protest voting and support for anti-systemic actors, participation in peaceful sit-ins or violent riots, engagement in 'uncivil' organisations, support of collective expropriation tactics, or mobilisation via online social networks (Anduiza et al. 2012 and 2013; Avril and Neem 2014; Emmanuelle and Neem 2015; Pianta 2013; Liebert and Trenz 2011; Kaldor and Selchow 2012; Seferiades and Johnston 2012). Overall, resistance and protest to the crisis and ensuing austerity policies have been studied through expressions of disobedience, anger and disaffection. The focus has been mainly on the destruction of citizens' human capital and how this has affected their social capital. In the last couple of years, however, there has been a notable turn in studying the effects of the crisis from a resilience perspective. Resilience means different things in different contexts, but overall, it is associated with coping strategies. These coping strategies tend to have three dimensions. They involve the

potential of a system, an organisation, an individual or a group to deal with a crisis and to recover while maintaining essential attributes and functions; to self-organise in order to address changing circumstances in the face of risk, adversity and vulnerability; and to adapt and also learn in the context of change.

Resilience can thus be conservative or it can be transformative. In the former, it can be about resisting shocks, maintaining pre-existing structures and restoring to pre-crisis conditions. In the latter, it can be about using crisis events to trigger renewal and innovation and to address the ensuing challenges and difficulties through alternative solutions and on the basis of new interests, objectives and values. It is, therefore, crucial to examine how crisis situations impact citizens' life and rights, and how citizens react and develop resilience in order to protect, enact and claim their rights. Understanding what drives citizens' reactions and their choices in times of crisis is important for the legitimacy of democratic governance. The ways in which crises, their aftermaths, and citizens' resilient behaviours in response are handled by political actors and public authorities impact the quality of a country's democracy and, in turn, may further define citizens' behaviours and choices.

Against this background, this chapter contributes to an area that is still under research. It explores 'alternative' (for lack of a better word) ways in which European citizens' responses to the crisis have been expressed in order to understand whether there have been changes in people's views of the purposes of community engagement; whether their involvement in various acts of creative community engagement and solidarity can be seen to be acts of resistance aiming to tackle not only the consequences of the crisis but also the wider system that led to the crisis; and whether the forms of engagement that they have been involved in has led to a paradigm shift, either complete or incomplete.

In this chapter, we take the Greek case to argue that citizens became engaged and active in community initiatives in order to provoke a paradigm shift in the mentality of the society they are part of. They undertook specific initiatives driven not only by personal sensitivities but also by the wish to *inspire others to engage in new economic cultures and solidarity driven initiatives*. They sought ways through which simple community engagements would serve as catalysts for their co-citizens at the most local level, in their

neighbourhoods, parks and markets, *in order to provoke ruptures with the previous system that had led to the crisis*. Many initiatives undertaken by citizens and civil society actors during these crisis years have aimed to unclench the mechanisms that will lead to a shift away from what is often simply referred to as the neo-liberal paradigm that is perceived to be dominating the European economy and its political life and magnifying socio-economic inequalities.

The material collected through desk research and a set of 11 qualitative interviews with engaged citizens in Athens aims to try to shed some light on these intentions as drivers of change. As the crisis continues to unravel in continuously unexpected ways in late 2015 (during the time of writing) developments are still too fluid to be able to draw any meaningful conclusions as to the results of these efforts (which are for another project, in the future). There are positive indications in the civic landscape, however. There are signs suggesting that more and more individuals—citizens and third country nationals—are mobilising with grassroots initiatives that propose simple ways through which they can re-build trust and reclaim public spaces and the dynamics of neighbourhood interactions; through which they can express community solidarity towards each other and towards the more vulnerable members; and through which they can take ownership of their everyday actions and engage in constructive, creative and collaborative projects that are outside formal and institutionalised channels—whether state or non-state. There are signs of conscious engagements on the part of individuals who are fed up with what was the pre-crisis reality of the state being expected to step in to provide solutions, however mediocre, and who are also fed up with an '*indignado*' approach of protest, contestation and dismissal of all that existed prior to the crisis. This disconnect with both ends of the spectrum is opening a space for positive, constructive engagement, it is characterised by a desire to propose small, meaningful alternatives through collaborations, through re-building trust and through re-building a sense of immediate neighbourhood and community. It is argued that these signs are contributing to the dynamics of a shift at the very local and individual level, dynamics that may shape in forming a partial paradigm shift within civil society. The term 'partial' is used purposefully here instead of the term 'incomplete' in order to suggest a positive connotation, some-

thing in the process rather than something not achieved. It is also 'partial' because the aim of these initiatives described in this chapter are not to lead to a landslide revolution or to change and replace the entire system; they are rather aimed at re-building trust and community solidarity and improving the quality of everyday life through greater ownership, creativity and independent exchange and to open a space between formal and informal, state and non-state institutions and processes.

Scope of the Paper and Research Methods

In the countries most hard hit by the crisis, there are fascinating examples of citizens mobilising in spontaneous initiatives aimed at provoking positive change. Driven by principled notions of solidarity, altruism, social justice, community-building, self-sufficiency, environmental protection and democracy, citizens have engaged to provoke change at the most local level, while keeping a distinctive global outlook. Castells, Caraça and Cardoso (2012),[1] have highlighted the emergence of new economic cultures that react against traditional economic models. Through studying citizens' behaviours in Catalonia during the outbreak of the crisis, Castells et al. documented a wide range of economic practices that don't have a for-profit motivation—barter networks; social currencies; co-operatives; self-management; agricultural networks; networks informally set up by citizens to provide services for free to others in the expectation that someone will also provide to them when/if in need; and support for the de-growth movement. This research undertaken in Catalonia, documents fascinating examples of citizens' resistance and resilience in these times of crisis and hardship. While noting that there has been a rise of alternative economic practices in a variety of contexts (see Adaman and Madra 2002; D'Alisa et al. 2013; Gibson-Graham 2002, 2006; Leyshon et al. 2003; Miller 2006; North 2005), the 'rebellious, innovative culture of Catalonia has provided a fertile ground to these transformative processes' (Conill et al. 2012: 212).

[1] Castells M., Caraça J., and Cardoso G. (Eds.) (2012). *Aftermath. The Cultures of the Economic Crisis*, Oxford: Oxford University Press.

In the next sections, we examine similar alternative practices that were developed during the outbreak of the crisis in a very different national context, one in which civil society has been generally regarded as 'under-developed' and where the civic activism that has been provoked by the crisis has been described as 'not always been beneficial for democracy' (Sotiropoulos 2014:3).

By looking at specific initiatives that have mushroomed in Athens and across Greece, we explore the ways in which citizens have mobilised to offer their support and assistance to more vulnerable groups or to their peers in order to mitigate the effects of the crisis or defend issues of principle, and how they have done this by presenting themselves as role models of alternative lifestyles diffusing non-capitalist economic practices. Through setting up local neighbourhood markets or web-based platforms where goods are bartered, exchanged or recycled within the community, active citizens have engaged in initiatives aimed at restoring a sense of ownership and civic responsibility and building social trust in their neighbourhoods. They have claimed public spaces and organised not-for-profit activities in order to demonstrate how little is needed to 'break' from socio-economic practices and political behaviours that may have contributed to the crisis or that, in any case, do not offer meaningful alternatives to exit the crisis, and to encourage others to follow their example.

While the previously mentioned examples do not constitute 'new' behaviours and find much of their roots in the social movements of the 1970s, I examine the ways in which these initiatives are framed as 'acts of resistance' and 'protest' to the dominant economic and political paradigms that led to the crisis or to the consequences of the crisis. The case study of Greece is particularly insightful here because of the magnitude of the crisis in Greece and because of the shortcomings of the third sector in this country.

The chapter is organised as follows. In the next section, I outline the alternative economic practices that have developed during this period of crisis and austerity politics by drawing from the fascinating experiences of Catalonia. I then discuss the particular challenges that characterise the Greek civil society landscape and subsequently present three forms of alternative economic practices that have developed in Greece since the outbreak of the crisis. This section includes excerpts from the unstructured interviews I conducted in 2014–2015 in Athens. I interviewed 11 indi-

viduals who have been actively and regularly involved in setting up and putting into action these initiatives (i.e., not occasional participants but regularly engaged at a weekly and daily level). I interviewed seven women and four men and almost all had been civically engaged before the crisis broke out. However, this crisis in all cases had made them critical towards the way in which Europe's and Greece's political economies had been structured, and it had deeply motivated them to engage in actions aimed at provoking some sort of rupture from the dominant model and mind-frame. These ruptures took the form of collaborative and constructive initiatives, new economic practices and active engagement with public spaces, rather than protest sit-ins, occupations or squattings. The interviewees range from Athenians in their mid-to-late 20s working mainly in NGOs, to medical doctors in their late 40s to early 50s working for public hospitals but also holding their private practices. Interviews were done both in person and via Skype, and discussions lasted between two and three hours in all cases. Among these 11 respondents, almost half were among the co-founders or initial mobilising forces of these initiatives. They were then asked to provide recommendations of other people to be interviewed, as a snowball method. These discussions took place in October 2014, December 2014, July 2015 and October 2015.

In the last section I return to this volume's concept of paradigm shift arguing that in this case study we can observe the dynamics of a partial paradigm shift from below.

Background: On Alternative Economic Practices

Conill et al. (2012) have distinguished between two types of alternative economic practices: those consciously aimed at creating a new way of being, and non-capitalist practices that permeate people's everyday life out of necessity or out of persistence of non-commodified social forms. Through an in-depth observation of transformative processes that were underway in the Catalan society between 2009 and 2011, they observed networks, organisations and individuals that, at least part time, consciously lived apart from capitalist patterns of economic behaviour, in accordance

with rules and values that they found meaningful for themselves. They also investigated the extent to which these practices were integrated in the behaviour of the population at large in times of crisis. They argue that there is more resonance than is usually acknowledged between a conscious alternative economic culture and the culture of a mainstream society shaken by the economic crisis (Conill et al. 2012: 211–212).

They have identified the following alternative economic practices (Conill et al. 2012: 213–221):

- agro-ecological farming and food processing—this involves producing organically while maintaining the health of soils, ecosystems and people; and many such production initiatives were supported by municipal governments—as well as non-farming activities that aim at self-subsistence production such as baking bread, raising poultry for eggs and meat and cultivating vegetables in the terraces and gardens of private homes;
- agro-ecological consumer cooperatives—these associations are based on stable commitments between producers and consumers bound by mutual solidarity and aim to ensure a fair balance between the interests of both sides;
- exchange markets and networks that engage in the barter of goods and services—these tend to be organised in public squares on a regular basis and serve primarily local residents; they are based on a voluntary valuation of the barter; exchange of goods and of services;
- social currency and ethical banking—this is a formal printed note that indicates a value unit that is accepted only within a local network for the purchase of goods and services; the goal is to remain linked to local production and distribution and to avoid accumulation, inflation and unfair exchange, as the value depends on the participants in the network—the aim is to develop an alternative currency system based on trust and equivalence;
- communication and information technology—these include networks that offer 'free' Internet access; similarly, radio stations and free software;
- alternative cultural activities—a blossoming of all cultural creations from music to theatre performed in streets, public places and social centres to reach an audience outside high culture sites.

Based on their in-depth observation and qualitative research, they proposed that individuals who engaged in these practices correspond to three groups of behaviour:

- the culturally transformative individuals who consciously and actively engage in such practices;
- the alternative practitioners who are involved but not deliberate; and,
- the culturally adapted who engage in mainstream economic practices and only rarely engage in the alternative ones identified earlier.

Even though the gravity of the crisis in Spain and its effects were fully appreciated by all three groups, interpretations and perceptions of the crisis differ hugely, as do their motivations and the reasons that drive them into 'alternative' practices. For the transformative ones, the crisis was predictable in that it is a consequence of the logic of capitalism, and it is for precisely this reason that they had already rejected living according to capitalist rules prior to the breakout of the crisis. In this sense, their 'preventive' move of setting up an alternative lifestyle in pre-crisis Catalonia makes them feel vindicated. They address the crisis from an ideological perspective and wish to address the root causes of the crisis rather than adapt to the effects of its aftermath. They have a strong identity and rely on networks of trust to engage and experiment in these practices. For the second group, the alternative practitioners, the crisis has shaken their beliefs and has altered their realities. This has led them to change their practices and, in reactive ways, experiment with alternative practices that are better suited to the unpredictability of their current situation. The final group is considered to be unable to accept the new conditions and is enduring the 'bad patch' as they await the end of the crisis. As the crisis and its effects take a more prolonged reality, it is interesting to see how and to what extent this third group moves towards the second group of practitioners. This shift is described by Conill et al. as one of the most decisive trends in ongoing social change associated with the current culture of austerity.

What is particularly interesting in this research is that their survey suggests that engagement in non-capitalist economic practices such as the ones previously identified is not a marginal movement but rather that there is a breadth of such activities going on and a depth in the ways

people have engaged with these. They have then grouped these practices into three categories:

- self-sufficient practices—i.e., where individuals do things for themselves rather than go to the market to pay for goods and services (e.g., home repairs, clothes repairs, growing vegetables on their terrace; transforming goods they find for their own use);
- altruistic practices involve performing a service for others that is worth something on the market without receiving compensation (e.g., offering care to children and elderly who are not family members; assisting others repair goods/home/car; lending money without interest);
- exchange and cooperation practices involve exchanging goods and services without using money as a medium of exchange, barter trade essentially (e.g., car sharing; exchanging clothes/books/tools).

Through their survey they found that students and foreign born engaged mostly in self-sufficient and exchange practices, unemployed mainly in self-sufficient practices and the ones who exhibited the highest level of altruistic practices are those who are employed, in middle management and with a college degree.

People engaged in these activities to lower the cost of living, to connect with others in their community, to help others and to fulfil their needs (Conill et al. 2012: 243). They also engaged in these practices driven by their dissatisfaction with capitalism and its trappings hoping that, through these alternative practices, they can be part of change for the better. It is this latter point that is particularly interesting for the scope of this book and the Greek case.

Greece and Its 'Uncivil' Civil Society?

There has been a mushrooming of initiatives on the part of citizens in Greece that range from self-sufficient practices to altruistic alternative economic practices. Three phenomena in particular are of interest in order to examine how the crisis has affected the country's civil society landscape:

- the emergence of an informal network of citizens in Athens in the peak of the crisis that engaged in day-to-day management of urban spaces while diffusing non-capitalist, alternative economic practices that fall mainly within the two categories identified earlier, namely, altruistic and exchange and cooperation practices;
- the emergence of alternative, social currencies (such as Ovolos in Patras, TEM in Volos) and informal barter exchanges; and
- the emergence of solidarity initiatives outside the solidarity networks towards the more vulnerable parts of society, for instance, in support of the migrant and refugee population.

All three are examined in the following section, but it would be useful here to briefly discuss the state of Greece's civil society landscape in order to explore the extent to which these practices constitute markers of change and rupture with past legacies or whether, in fact, they are largely the result of the structural weaknesses that characterise Greek civil society.

Greece has been characterised by a very limited tradition of voluntarism and community work. Greek civil society has been described as under-developed vis-à-vis both the political parties and the state (Clarke et al. 2015; Sotiropoulos 2014; Sotiropoulos and Bourikos 2014), as it has been overwhelmingly economically dependent on the state, and in general, under the ideological influence of particular political parties. Levels of social trust and associational density have consistently ranked the country lower than other southern European member states such as Italy or Spain.

As research by Sotiropoulos and others has indicated, the crisis has opened new opportunities to civil society, but these have not been fully exploited (2014: 29). The opportunities that have been seized are seemingly less the work of NGOs that pre-existed the crisis and more the result of informal groups and networks of citizens' initiatives. A notable number of citizens' initiatives emerged at the municipality or neighbourhood level following the Greek '*indignados*' movement in Syntagma square in 2011 suggesting that much civil society activism in recent years has an anti-government character.

Data from the European Social Survey suggested that in 2011 only 14 % of Greeks participated in voluntary activities (far behind the EU average at 24 %), only 7 % donated money and an average of 3 % devoted their time to community activities. The data were collected only two years into the crisis so it can, of course, be argued that it was still too soon to see changes of massive magnitude in such a short time frame, but the justification for this has long been that the primary social institution upon which Greeks fall back on in times of crisis is neither the welfare state nor NGOs but rather the extended family.

Moreover, as the crisis erupted, social solidarity groups emerged in a spontaneous, informal manner preferring, in fact, to remain informal thus avoiding interactions with the state (which is largely mistrusted), side-stepping official channels and processes of registration. This informal activism has been regarded as rather challenging for the country's democratic life as it has been associated with forms of protest and resistance that pose significant challenges to the quality of Greece's democracy. At the same time, the preference for informality rather than any sort of interaction with the Greek state is not surprising, particularly given that a Eurobarometer survey data registered levels of trust in political parties in Greece oscillating between 5 and 9 % (Eurobarometer 2010; Exadaktylos and Zahariadis 2012).

Citizens' Engagements in Greece

The number and range of citizens' initiatives throughout Greece, in both larger and smaller urban settings, has in the past five years been rather unprecedented. These have taken the form of tangible, result-oriented projects such as collective solidarity kitchens, medical centres, school support centres and solidarity pharmacies, targeting the most vulnerable people and social groups (Kavoulakos et al. 2012; Nikolaou 2015; Roumeliotis 2013) or aimed at changing citizens' relation with their neighbourhood and city and at triggering active citizens to make the mental shift in how to cope and deal with the crisis through tangible projects. These initiatives have also taken the form of awareness-building

initiatives and open discussions aimed at disseminating information on the disastrous results of austerity policies and their impact on Greece's social substrate. They have further taken the form of new economic practices and initiatives aimed at triggering and encouraging collective initiatives that break or at least challenge the system that is in place and that led to the crisis.

In the subsequent subsections I focus on three examples of citizens' initiatives as a result of the crisis. The desk research I conducted led to a myriad of initiatives ranging from solidarity cafes and collective kitchens and gardens to direct producer-to-consumer networks. I decided to focus on three quite well-known initiatives because of their success in getting a large number of citizens, who in most cases had no or very little experience with such forms of social activism, to participate and engage. Their outreach and the level of engagement they have triggered from their users or participants made these initiatives relevant so as to understand not so much what they were doing but rather the reasons for which the citizens were engaged, what they were expecting to arrive at and whether this engagement may be part of a wider change.

The Atenistas

In September 2010, a few weeks after yet another set of violent demonstrations that led to the burning of a bank on one of Athens' largest high-streets and the killing of three bank employees, a small group of friends and acquaintances kick-started the idea of creating a 'task group for Athens'.

At a time where fear, mistrust, anger, depression and uncertainty had reached sky-high levels, such an initiative appeared too naive. At the core of this initiative that brought together eventually more than 2000 civically minded young Athenians were two individuals who were able to set in motion a network of volunteers that came to be known as the 'atenistas'. A journalist and a graphic designer triggered a network that has chosen to remain informal and not become institutionalised as a formal NGO as a matter of principle as its aim has been to provoke tangible, positive change and through this to catalyse people's sense of responsibility,

ownership and agency. The atenistas' initiatives depended on voluntary participation and resources (time and material), and they took on a set of small challenges that aimed at concrete changes in people's everyday life.

The aim was to encourage personal agency and civic responsibility, to trigger respect for the public space, and to 'break' from the generalised depression and tendency to blame 'others' regardless of whether these might be the German creditors, the Troika, the Greek politicians, the Greek state, or 'capitalism' writ large. As Gerodimos has argued, the normalization of a populist rhetoric of blame, victimhood and violent revenge well before the onset of the economic crisis reflected an underlying weakness of the country's civic culture (Gerodimos 2013a, b), which has had a direct effect on the urban landscape. From the vandalism and riots of far-left anarchist groups, to the bombings of terrorist groups, to the racist and homophobic attacks by neo-Nazi militias, to the massive anti-austerity demonstrations and gatherings by mainstream protesters, the public space of Athens has become the central arena of political interaction and struggle with groups seeking to challenge, occupy or even destruct public space with buildings and public sites consistently vandalised, destroyed, looted or left to degenerate.[2]

In contradiction to this environment, the atenistas organised actions aimed at cleaning neighbourhood parks or organised exchange markets to 'show that community sharing is an alternative even though it is perceived as being "outside" Greek culture' (Interview #2, 10-10-2014):

> We would go to a neighbourhood park on a Sunday morning, clean it, plant new flowers and then walk up to the kiosk owners at the corner and hand him a watering can and ask if he could just water the flowers we had just planted as often as he could. The response was amazing. The same people who would just throw out their rubbish in the park and kick the finished pack of cigarettes in the bush behind them, seemed transformed when they would see us clean it, paint the benches, plant fresh flowers…by the way, the local florist had donated them to us when we told them what we planned to do and asked for their help.…We wanted to show that if each one of us, together, wanted, we could provoke change that could

[2] See http://www.romangerodimos.com/wp-content/uploads/2014/06/Chapter-4_Med-Comm_Gerodimos_final_pub.pdf

> make our life better, more beautiful,…in very simple ways.…We did not want to step in and fix the problems. That's not our job, but we can't expect everything to be done by the 'state' especially as there wasn't much of a 'state' to do much. We did not want to 'normalise' depression and destruction that austerity and the crisis were imposing on us. It's as simple as that. Simple actions, together can provoke change. (Interview #1, 8-10-2014)

Another account of the changes that they wanted to provoke among Greek citizens emphasised initiatives that aimed at cultivating a sense of solidarity between population groups as well as a desire to distance citizens' initiatives from ideological confrontations. While making very tangible political statements of civic responsibility, ownership and solidarity, the aim of this network was to create a space within civil society that would be free from political influence as has tended to be the case in Greece so far. A space where common concerns about the ways in which the crisis and its effects had to be addressed could be developed by citizens free from the ideological framing of pro- or anti-memorandum that had polarised and paralysed Greek political life.

> We organised market exchanges. The response was overwhelming. We used the media and the social media to inform people of a meeting place for anyone who wanted to come and bring clothes, blankets, shoes, and other times food. Anything that they didn't need but that so many others in Athens did need. In a matter of weeks, word of mouth had spread so much that we had thousands of people turning up at every action we organised. We collected tons of clothes and then disseminated to local NGOs, proper, organised NGOs that work with homeless people, with migrants in the poorer parts of the city centre [Athens]…of course many didn't like these initiatives. We had many 'enemies' and surprisingly, many of these came from the left. Because we stepped into the space they wanted for their political rhetoric of the destruction caused by the crisis and the austerity measures.…But we wanted to show that there are positive lessons out of this crisis. And each one of us can make a positive difference.…This motivates others to change. Soon we were hearing of similar actions and initiatives by citizens in cities across Greece.…We didn't want to be connected with any political party or organisation.…It was not political in the sense of organised. It was however a very political statement to show that we can

> be a self-sufficient community. But not part of the left or the right or any political party.…Not dependent on the state and not restricted by our increasing poverty. That this capitalist system that had come to define every aspect of our life and of our future was not going to limit our humanity, and our ability to help ourselves, our neighbourhood and others who needed us. Basically to show that we are not all driven just by profit, and that we are not all corrupt like this system that went broke. That this orchestrated bankruptcy and the corrupt system that led to this crisis in the first place, we were not a part of it. We never were, and we won't let it define our relations with our other co-humans (syn-anthropous mas). (Interview #7, 7-7-2014)

Mobilising a different set of values that would enable both a critical reflection on what led to the crisis and what needs to be changed is also relevant. Thus, a mindset change within local societies and groups through small, tangible and realistic projects has been considered as a fundamental added value that citizens' initiatives of this sort can bring to the current reality.

> Why did we get to this situation [the crisis] in the first place? Simply because everyone was just looking out for himself. For his interest, for himself. And at any expense. This mentality of I don't care for the other as long as I am well. This individualism that had just dominated every part of our life and of public life. It was all about getting more, having more, spending more- and spending not what was earned in reality but what all this capitalist construction by the banks and the media had created, this uncontrolled consumerism through borrowing for this or for that, for things that we didn't need but that we had all become convinced we needed to be cool, to be modern, to be successful. It was all about show and all that really matters was just seeming irrelevant. It mattered to have a smart phone, it didn't matter if you put out your cigarette in the sand and left the stub there just littering the beach. It mattered if you went to the right clubs, not whether you gave some of your time to a charity that was barely trying to survive.…Everything that was public belonged in our mind to the state—to this abstract, foreign state that we didn't care or respect—we didn't realise, we were not being educated to make us treat the public spaces, public resources like they were our common resources. When the public employee just didn't turn off the light leaving his office he didn't care

> because he wasn't paying the bill, as if the bill wasn't being paid through his taxes. When he was expecting an envelope with cash in order to do his job for the citizen, he wasn't aware that his job was to provide a public service. He had turned his public position into a private, profit-making business. With all the benefits of the profits but obviously no risk. And he felt entitled to do it. Because the mentality has always been what do I get out of it? It's all about profit, personal profit at the expense of the others. This consumeristic approach to everything destroyed any sense and value to the 'common.' It's time to bring this back in to our life. And to make people realise that value is not in how many credit cards you have in your wallet, but how your actions can be independent and responsible. And how your life is not defined by how much you spend but how what you do makes a difference and it can be defined by you, not by the banks, or the government, or the Troika. (Interview #4, 28-12-2014)

Similar findings have been documented by Vathakou (2015) who also conducted qualitative interviews with active members and founders of citizens' initiatives. She notes that her interviewees declared a strong sense of ownership over their common projects and approached their initiatives as platforms for those seeking new solutions to austerity policies. Her interviewees held the conviction that these initiatives had the potential to shift cultural norms advocating consumerism and individualism towards a new set of non-material values. Similarly, one young Athenian woman I interviewed who was at the time both professionally active in an NGO providing social services to those in need and deeply involved in the mobilisation of the atenistas network, is telling in this regard:

> The actions we took did not aim to replace the state. We wanted to demonstrate solidarity, social solidarity.…Not formal.…Always informal. Except in the southern suburbs of Athens. There they wanted to take a formal shape to be able to have more leverage with the local authorities. Not in the centre of Athens.…It was a political decision to not formalise the atenistas. It's about citizens, voluntarism. Showing responsibility and devotion. And commitment. In 2010–2011 it was at its peak. The atenistas are still active now but not as much as in 2010–2011. And now it's more younger people involved. 18 year olds. In the beginning it was people in their late twenties, early thirties. Employed. We were almost all employed. But eventually some of us became less active because it took up a lot of our

> time. Every Sunday.... We still get involved and follow the activities but not as regularly. I think it is younger people now that are more regular. (Interview #5, 28-10-2014)

The limited tradition of volunteerism within Greek civil society before the crisis may be contrasted with the impressive involvement in both numerical terms and in terms of regular involvement of young Greeks in networks such as the atenistas after the crisis had broken out. Thus the increase in volunteerism and grassroots activism in tackling the social repercussions of the crisis in creative and inclusive ways is a qualitative change that has occurred in recent years. An additional dimension that merits further attention is the ways in which the nature of the relationship and the degree of dependence or independence between Greek civil society and the state may also be shifting. In the case of the atenistas, maintaining a distance from the state in order to ensure that these are citizen-driven initiatives and in order to retain ownership and a sense of asserting civic responsibility and independence is combined with regular collaborations with local governments and municipalities in order to efficiently pool resources together to improve aspects of urban life, for instance, in cleaning and renovating neighbourhood squares, or refurbishing public buildings that are empty in order to fill in specific needs from those in the neighbourhoods that are in need of social services and assistance.

Alternative Currencies and Barter

The complicated relationship between civil society and the state is also evident in the case of alternative economic practices that we have witnessed burgeoning across Greece. Here, the relationship becomes even more complicated as, essentially, these practices constitute an outright challenge to the authority of the state. Alternative economic practices essentially defy the state while amply underlining the failures of state policies and politicians in being able to secure and ensure a functional economy in which all constituents can participate.

In 2010, a system that combines an alternative currency with an informal barter network was set up in the city of Volos. The TEM—which stands for Local Alternative Unit (Τοπική Εναλλακτική Μονάδα) corresponds in principle to the value of a euro, but it has no value outside of the 'Network'. The Network of Exchange and Solidarity was set up in June 2011 in the region of Magnisia and by 2013 counted over 1300 participants. As sociologist Yannis Grigoriou who was one of the first members and founders of the Network explained, the TEM 'is not a currency nor does it exist in competition to the euro. It is a unit that corresponds to the value that we attribute to the exchanges that we perform between us' (Translation from Greek text).[3]

> The TEM is based on an online system in which any network member is able to offer or search for products and services. The members sign up online and get access to the specific database where they can offer or search for services or products. The exchanges are conducted with the use of TEMs which are transferred into and out of each others' accounts online. A maximum of 300 TEMs can be borrowed but have to be repaid within specific time-periods. For those who don't have internet access or are weary of internet transactions, the Network regularly organises open markets where members of the network provide assistance to citizens in registering themselves as members and exchanging goods with the use of TEM. These organised open markets also provide an opportunity for people to gather, exchange views and opinions and familiarise themselves with this alternative means of exchange. The network's organisers have established a close collaboration with the local municipal services so that they can have access to trading points hosted in the city. The network also provides its members with printed vouchers of the TEM which can be used like cheques. Several shops and local business participate in the network by accepting these vouchers in exchange for a discount on the price in Euro, or they support them by offering facilities or equipment to the

[3] http://ellas2.wordpress.com/2011/04/30/βόλος-αντικατέστησαν-το-ευρώ-με-την-το/; https://www.tem-magnisia.gr/index.php; http://p2pfoundation.net/TEM_Local_Alternative_Unit_-_Greece

network (e.g. the server for the network was donated by a private company).[4]

The municipal authorities in Volos supported and encouraged the use of the TEM as it has been a core life-support mechanism for many families in a period and a region of extremely high levels of general unemployment.[5] A similar system that was set up in Greece's third largest city, the port of Patras since 2009 was the Οβολός also known as the Social Currency[6] and was framed as the 'Greek response to the crisis'.

This grassroots initiative was a direct response to the consequences of the crisis and the ensuing austerity measures that led to a dramatic loss of people's income and plunged many into severe poverty. These initiatives are essentially coping strategies in contexts where the risk of socio-economic exclusion of a significant portion of the local community is real. Solidarity and the importance of community are stressed in all statements made by participants in these networks who express very intensely that there are tensions between capitalism and democracy that risk endangering the latter. In this tension, their disconnect with the state is magnified as it is perceived not only to have failed them but also to have compromised the quality of democracy.

Memory also plays a significant role here as the older generations have memories of similar informal practices during the German occupation of World War II or the civil war that followed. In reading the interviews and descriptions of some of the participants in these Networks, it could almost be perceived as a 'return' to old local practices and exchanges within a very familiar community. One that is very distinct from the present day impersonal, standard consumer exchange. In this context, this 'romanticised' approach to alternative economic practice was emotionally legitimated as a form of resistance to the current phase of capitalism. Taking up and returning to traditional forms of exchange is thus

[4] http://p2pfoundation.net/TEM_Local_Alternative_Unit_-_Greece ; http://reviews.in.gr/diafora/socialeconomy/article/?aid=1231128134

[5] http://www.theguardian.com/world/2013/jan/02/euro-greece-barter-poverty-crisis; http://www.bbc.com/news/world-europe-17680904

[6] http://www.ovolos.gr/el/ποιοι-είμαστε.html

perceived as rupture with an externally defined and controlled system that is provoking inequalities and injustices. Engagement in such practices is not limited to the need to fulfil certain real and existing subsistence needs, it is also a symbolic action of opposition to a system that is perceived as corrupt, unjust and rent-seeking and as an action to protect the quality of democracy and independence.

Solidarity Outside the Solidarity Networks

Since the outbreak of the crisis there has been an explosion of informal solidarity networks across Greece. Driven by individual initiative they take a lot of their ideological inspiration from similar initiatives in Latin American countries (notably the *piqueteros* of Argentina during the country's respective economic crisis). Framed by a narrative of solidarity and anti-systemic responses to neoliberalism and austerity politics, examples include: The Alternative Solidarity Network in Corfu; the network for teaching Greek to migrants; the self-regulating municipal market in Kipseli; Kallithea Solidarity Network, which is part of the No-Intermediaries action; organised community kitchens; and the Social Medical Clinics that have been set up, particularly in urban centres.[7]

These networks have been set up in direct response to the crisis and flag out that the solution to the crisis is 'Solidarity'. 'Solidarity' is framed as a form of resistance[8] (to neo-liberal economics) and as an active and constructive response to the transformed social and economic conditions as a result of the crisis. Indeed, Vathakou also finds that participants in solidarity structures position themselves as activists and not volunteers in order to underline the political and ideological dimension of their engagement. They seek to provide comprehensive alternatives to the failed, collapsing or intensely bureaucratic system of neo-liberal governance (2015, pp. 185).

However, it is not only these solidarity networks that are interesting in this context. These solidarity networks have been fundamental in provid-

[7] http://www.solidarity4all.gr/el/support-article/κοινωνικά-δίκτυα-αλληλεγγύης-της-ελένης-πορτάλιου ; http://solidaritykallithea.wordpress.com ; http://greecesolidarity.org/?page_id=1114

[8] http://archive.avgi.gr/ArticleActionshow.action?articleID=573739

ing a network of support and assistance to substantial portions of Greek society as the crisis was unravelling. The Social Medical Clinics have been at the heart of such initiatives contributing in fundamental ways to basic core health needs that were left uncovered as the country's welfare system was being rolled back. What is more insightful to explore, however, in the context of the paradigm shift concept are the networks that have been created outside this ideological framework and independently from formalised solidarity structures (that basically pre-existed the crisis) and NGOs that have very strong symbiotic relations with political parties that were in opposition before the crisis and that were catapulted to government during the crisis.

The example of the organisation Melissa is telling in this context. Melissa was founded in 2013 as a network of migrant women who mobilised their resources, networks, experiences and creativity to help other migrants in more vulnerable situations. As co-founder Nadina Christopoulou underlined (Interview #11, 25.10.2015):

> People are seeking positive examples, they are looking for inspiring examples of positive change. And when they see it from others, especially from those who are in more vulnerable or precarious situations than themselves, then they are triggered to also engage, contribute and make a difference. This crisis unleashed an amazing positive potential in people to rebuild trust and solidarity. To make a meaningful positive difference and to do this independently from state, political or organised institutions which they have grown to mistrust deeply.…But people seek positive initiatives and behaviours which once they recognise they are keen to support. This crisis has triggered people's interest to re-claim a space for themselves, to see positive examples lead and to feel that they too can contribute through small, simple actions that make however a world of a difference to those more in need.

Concluding remarks

The extent of the crisis has led civil society groups, intellectuals and citizens to seek alternatives to what are perceived to be the dominant narratives and economic recipes that have both led to the crisis and to its

perpetuation. Alternatives aimed at dealing with or mitigating the effects of the crisis have been increasingly sought out by citizens and civil society groups. Some of these alternatives neatly fit in to fill the gap that has been created by the roll back of the state's social services. Others defiantly challenge the state's ability to provide socio-economic cohesion and protect from poverty and instead seek alternatives in order to by-pass it and work outside the formal economic realm over which the state has oversight. Others still seek to find space for independent civic action so as to underline the fact that there is a private space, a state space, and a common public space where the two may meet and where there may be room for synergies but where it is important to strengthen and catalyse citizens' agency and their active civic engagement. The crisis provided opportunities to all three of these. The case of Greece has been particularly insightful in this context because the limited existence of these forms of civic engagement before the crisis meant that the changes that were provoked by the crisis and its aftermath are quite easily identifiable.

The examples previously mentioned have underlined the need to work on developing sustainable alternatives and changing our model of growth and governance in order to balance out the tensions between capitalism and democracy that have been growing throughout the crisis. So, what kind of transformations and continuities has the crisis provoked in the civil society landscape? And, though certainly too soon to be able to derive any firm conclusions yet, has it provoked a paradigm shift, or a partial paradigm shift?

Today's crisis has been compared to the crisis of the 1930s that Karl Polanyi described in *The Great Transformation*. The push to deregulate the markets has been weakening communities, fraying families and rupturing solidarities (Fraser 2013). If one were to look at the big, public reactions from civil society that have captivated the public space such as the *indignados* or the protestors of Syntagma square, so far these have been intense but rather ephemeral, lacking programmatic content. In the political sphere, potential for a paradigm shift appears quite limited. But when one takes a closer look at the smaller, everyday events there, there do appear to be certain trends and development within local civil societies that are suggesting that the crisis has led to meaningful changes. Citizens' behaviours and attitudes to the way they can respond

to state failures and shortcomings or to the state's inabilities to manage crises and their effects have been shifting even in countries with weak civil societies and low associational density such as Greece. The examples traced in this chapter are by no means exceptional to the case of Greece. On the contrary, they have been increasingly appearing in varying degrees across Europe. The crisis has catalysed such initiatives even further. Thus, although we are far from being able to identify a complete paradigm shift, there are substantial changes and transformations occurring within European civil society and among European citizens to suggest that this crisis is catalysing European citizens to pursue greater involvement and engagement in public matters, to express solidarity to others and to seek it when the state and other private sources are unable to cover the social, cultural and political needs. When putting these initiatives and changes together, the dynamics of a partial paradigm shift seem to be emerging. One which is inserting trust and positive, creative resistance and resilience in Europe's neighbourhoods, among European citizens and third country nationals at the most local levels, where it matters for the quality of people's everyday life.

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8

EU Civil Society and the Crisis: Changing Channels and Organisational Patterns in European Transnational Civil Society

Alison E. Woodward

Introduction

Blind and unorchestrated austerity measures in response to the ongoing financial and economic challenges in Europe hit at the heart of citizen efforts to maintain the fabric of civil society. Local governments cut subsidies to groups while at the same time levying new costs on them by raising the rent in public buildings or restricting the use of public administration personnel. At the individual level, those who voluntarily offer their time are in many countries hard hit by restructuring and job loss, curtailing their engagement. To what extent are the unrelenting austerity pressures leading to paradigmatical shifts in strategies by organised civil society actors?

In the European Union (EU) we see paradoxical developments. There is a growth and change in formal civil society structures. At the same time, the grassroots movements that have been their feeding ground struggle with economic challenges and erupt in new social forms (della

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Porta 2015; Johansson and Kalm 2015). The role of civil society in the integration and democratic processes of the EU is exceedingly complex. The very definition of 'civil society' is contentious, let alone understandings of the notion of civil society at different levels of governance. This definitional problem derives in part from the fact that European civil society is a moving target in constant evolution. It takes on new forms due to the opportunities offered by new forms of communication and governance, as well as new challenges thrown up by transnational connections. These include the various 'crises' ranging from the financial and economic and attendant austerity responses to global insecurity and terrorism and the state of energy and the environment (Clark 2011; Hanfstaengl 2010).

European transnational networks and formal organisations of civil society interests at the local and member state levels form a specific actor in the noisy sphere of citizen interests and expressions. The fora where these actors speak and act are ever-evolving scenes of relatively recent construction (Garcia 2015; Greenwood 2011; Kohler-Koch 2011; Libert and Trenz 2011). Although social collective actors, specifically the social partners, were included from the beginning in the founding institutions of the European Community in the European Economic and Social Committee (Smismans 2006), the actors in national civil society evolved to include many other topics beyond social and economic relations (Imig and Tarrow 2000). These groups increasingly sought audiences at an international level, with the UN and the EU being logical targets.

Considering where to put these actors in any analysis of state-society relations is a significant puzzle and no small matter because of the nature of the EU itself. As the EU is neither state nor pure intergovernmental organisation, it is difficult to typologise. Equally so, it is difficult to speak of a 'European society', let alone a European 'civil society'. This still begs the question of what 'civil society' actually is. In overviews attempting to delineate what is meant by civil society in Europe (Heidbreder 2012; Kohler-Koch and Quittkatt 2011; Lang 2013; Maloney and van Deth 2010; Pérez-Diaz 2014), there seems to be a dichotomy. On the one hand, there are those who see European civil society as a public space dis-

tinct from the state, family and the economy and argue that it is a potentially emergent European public sphere. On the other hand, there are those focusing on civil society actors as organised participants in multilevel governance.

Liebert and Trenz (2011b) believe in a new politics of European civil society, with a focus on a transnational intermediary sphere. They focus on the first definition of a pluralist social space beyond borders (2011a:2), yet they also have an eye for the fact that formal organisations acting in partnership or interaction with the state have a role in 'top-down activation' and thus become actors in governance, whereas other sorts of collective actors, more akin to the public sphere framing, are important in bottom-up mobilisation.

An important empirical study by Kohler-Koch and Quittkatt (2011) attempted to unravel how the concept of civil society is used today by academics. They offered academic experts four options distilled from the literature. Civil society could represent the citizen's voice in governance. Secondly, it could be central in public discourse and deliberative democracy, as the public sphere approach previously mentioned. Thirdly, it could be defined as a self-constituting sphere between the economy, state and intimate sphere. Here it is a sphere of association and mediator between society and state. Finally, in a communitarian type framing, it could be seen as aimed at the well-being of the larger public. The third definition, focussing on a third sector vision, had the most supporters, even if it is clear in EU governance that these organisations are sometimes framed as having a 'representative function'. For example, the trade unions claim this status. This third definition fits best with the sorts of organisations that are particularly discussed in this chapter, the transnational platforms for social and equality issues.

A general working definition of this approach is Kohler-Koch's formulation: 'Civil society encompasses the wide range of voluntary associations that follow a logic of action that is distinct from that of the market or the private sphere. It includes all different kinds of organisations ranging from member-based interest groups to advocacy groups promoting rights and values as postulated in the Charter of the Union. Social partners have a privileged position in the system and functional representation is

institutionalised in the EESC' (Kohler-Koch in Liebert 2011: 61–62). However, the focus here is particularly on the civil society actors aiming for equality issues at the European level and their understandings of the problems of their members at the national level.

This curiously difficult animal of formally organised actors in an EU civil society plays a role as a transmission belt and interpreter of what is going on at the societal level in Europe. Sometimes they act as self-named or self-mandated representatives and often as direct opinion makers. As a player outside of state and the economy, the impact of austerity measures could particularly be expected to be felt. Here the focus is on a particular subset of European civil society actors that are particularly institutionalised in the EU process. Their formal recognition and position has them acting as the voice of civil society interests in consultation procedures and dialogues with EU institutions and other stakeholders. In a network analysis, Garcia (2012, 2015) identifies such organisations as those studied here as the centre of networks that have helped build the participation frameworks in operation in the EU today.

EU platform organisations representing the social interests of the discriminated or disadvantaged—such as women's organisations (The European Women's Lobby), anti-racism groups (European Network Against Racism) and poverty networks (European Anti-Poverty Network)—are among the most likely to be hurt by austerity policies. The socio-economic austerity crisis can be expected, as Clark (2011) argues in terms of global civil society, to provide a triple whammy effect; as their finances are eroded, they are found to lack expertise on financial matters and the shortage of resources promotes division and competition among them (2011: 244–246). There could be an impact at all levels. Here the question is, to what extent have the organisations acting as platforms for national and local organisations at the level of the EU made such fundamental changes that we can speak of a paradigm shift resulting from the austerity crisis and attending pressures? It is likely that other factors such as the neo-liberal shift in politics, the enlargement of the EU and the impact of social and technological media developments have also played a role. Austerity measures are but one of many factors working at the European level. These have not led to a dramatic shift but rather to the reorientation of transnational civil society organisations focussing on social issues in Europe.

These organisations represent sectors with substantial involvement from citizens. In civil society organisations, citizens act both as deliverers and clients of services and as demanders and participants in policy making. In many parts of Europe, civil society has become increasingly professionalised in its delivery of voice and service, in part because of the encouragement and support of the state that finds in civil society a partner in its own legitimation (Greenwood 2011; Saurugger 2006). But this process, which transformed new social movement emanations into formal civil society organisations, came with a price tag. The organisations sometimes became dependent on state funding to allow them to professionally participate and influence the state as an equal partner.

These pressures and their impact on civil society and social movement organisations have meant that such organisations have adapted, to the extent that some expert voices argue that they have become more focused on their own survival than on their original goals (Klüver and Saurugger 2013; Kröger 2013; Lang 2013). In the case of civil society organisations, researchers identify what Lang calls the NGO-isation of social movements, the pull to consolidate and behave as formal organisations, to fulfil the compelling laws of bureaucratisation to be able to interact with other bureaucracies (2013:65; Paternotte 2015). There is considerable tension between the grassroots members and the organisations (Glasius and Ishkanian 2014). For Europe, this process is visible from the mid-1990s on as changes in the interface between EU institutions and civil society provide new openings. The EU, on the one hand, shapes the landscape through funding, while at the same time organisations push for different kinds of consultation and influence structures. These processes have been well-documented in recent case research by scholars looking at interest groups in the EU (for instance, Flesher Fominaya and Cox 2013; Johansson and Kalm 2015).

The financial crisis and ensuing austerity measures sent a deep shock through many such organisations. The larger platforms had relative stability thanks to support from the state, but organisations dependent on the state suffer when spending cuts come. Whether this will lead to a new paradigm in terms of their role and workings is another question.

European Civil Society and the Austerity Crisis: Is There a New Paradigm?

In this chapter the focus is particularly on the consequences of the responses to the financial developments since 2007 on one particular aspect of European civil society—that of transnationally constituted organisations on social issues that are peak partners in EU decision making. To what extent can we speak of a fundamental rethinking of their role as a consequence of the measures undertaken by governments in response to the financial crisis? Do we see here evidence of a paradigm shift, a paradigm on the rebound or of an incomplete shift, as is argued in the project of this book?

This chapter builds on interviews with representatives of EU transnational civil society organisations working for social equality, including gender, migration and anti-poverty groups.[1] In 2012, these organisations reported varying strategies for maintaining a presence and voice in Europe given the altered economic climate. They reported a changing opportunity structure within European policy making requiring new partners and new discourses as well as different approaches to forming coalitions. Far from being side-lined, they discovered new organisational tactics and creative use of technological networking tools to retrench and maintain voice under conditions of resource scarcity. The institutions of the EU have also shown a multi-lateral response that has not always meant closing doors. However, the experiences vary dramatically in the different regions of Europe. Budgetary decisions since 2012 have extensive ramifications in increasing inequalities while lowering resources for resilience. This chapter discusses the results in the context of the shifts in the economic, political and legal environments that organised civil society now faces.

[1] Interviews with European social organisations were carried out in the framework of a project funded by the European Economic and Social Committee: 'The Impact of the Crisis on Civil Society Organizations in the EU: Risks and Opportunities' (EESC/COMM/12/2012) submitted in 2013 (European Economic and Social Committee 2013). The results are also discussed in an article by Jamal Shahin, George Terzis and Alison Woodward that appeared in *Open Citizenship* 4:1 2013. Many of the observations reported here are to be found in the EESC publication on pages 27–31.

Method

To explore these issues in 2012, we did telephone and in-person interviews based on a previously circulated interview guide with 29 representatives of civil society organisations in several member states (Greece, Spain, UK, Hungary, Poland, Sweden and Belgium) and spokespeople for EU-level hubs, the Brussels-based umbrella organisations representing social concerns. The reviewed material also included information on the responses of officials in the EU's Economic and Social Committee as well as several case studies on the impact of the socio-economic crisis and austerity measures on membership and activities locally. These data provided a bird's eye view of the impact of the crisis on civil society for the European Economic and Social Committee. They were not intended to be representative but to provide qualitative insights into the various concerns at both the local and international levels among civil society activists. In the 2012 research, the civil society organisations included the wide panorama of voluntary associations, NGOs and networks of associations that are the formal constituents of civil society. These findings provide background for the discussion in this chapter. In the first half of 2015, ten new interviews (including some with the original interviewees) with representatives from Brussels transnational meta-associations dealing with social equality (see list at end of chapter) were re-contacted by phone and e-mail for their reflections on the changes since the European elections in 2014. Here they were specifically asked also to comment on the extent to which they see a 'paradigm change' due to the crisis and austerity measures that began in 2007.

A Paradigm for European Union-focused Civil Society Organisations?

In terms of European civil society in all its variations, it is difficult to speak of a 'paradigm'. We see more of a '*modus vivendi* and *modus operandi*' given the constantly changing situations beyond economics. First of all, there is the changing nature of social movements and civil society

itself as it takes on global and new forms in the last decades thanks to new communication forms, better educated and/or well-off citizens and new channels. The appearance of transnational formations at the EU level is a symptom of this. Secondly, such changes in social movements also led to different kinds of responses to the socio-economic shocks. Thirdly, there is the evolving EU context, with institutional and treaty developments that create new environments for civil society involvement, on the one hand, and the increasing scope of the EU with new member states and thus new civil societies, on the other.

Transnational civil society at the global and regional (EU) level has been evolving for more than 25 years, with scholars identifying the transformation of international non-governmental politics with the appearance of an increasing number of cross-border transnational advocacy groups (Keck and Sikkinck 1999; Smith and Johnston 2002). The crisis and the following neo-liberally motivated austerity measures spawned anti-austerity movements, including many participants with social movement histories from the trade union, solidarity, anti-globalist, and anti-capitalist movements (Castells 2013; della Porta 2015). These groups found their precursors in earlier demonstrations of dissatisfaction around Laken, Seattle, Milan and around climate and welfare agreements, but often took new forms (Flescher Fominaya and Cox 2013; Pianta and Gerbaudo 2015). They were frequently transnational, tying into networks already formed for other purposes (protest against EU, G8 movements and also established networks), but also with feelers out in the streets. The anti-austerity movements attracted new and fleeting participants (Indignados, Occupy), such as the young (Sloam 2014), accompanied by old social actors, such as trade unions, and formally organised civil society organisations.

Although the indignation against economic injustice is a global phenomenon, here the focus is on the European arena of formal organisations. In these times of austerity, formally organised representation structures are caught between the distress of the street level protest movements, on the one hand, and the closed doors of the traditional policy partners, on the other. This is combined with an increasing lack of resources to carry out business as usual, due to austerity cuts.

The European institutions have explicitly and formally included spaces for civil society. As social movement scholars have long argued, open channels for communication can encourage outings of protest (della Porta 2015: 6). The special Brussels EU situation was already a harbinger of a paradigm shift in terms of civil society's role in politics, as it moved from national level lobbying to an increasing focus on an EU-Brussels forum (Beyers 2004). This shift began in the mid-1990s, in parallel with negotiations for the Treaty of Amsterdam, which had a particularly social face (Wiercx 2011). A number of the more important European level platform associations around social issues were founded at that time, as well as broader meta-platforms grouping social issues, (Social Platform), environmental issues (Green 10), peace and development issues (Concord), and so forth. These groupings were encouraged by the European institutions. They had a stake in creating a European civil society (Kohler-Koch 2011) that could provide input legitimacy. However, these organisations developed a dependency on EU support and funds (Greenwood 2011; Kutay 2014; Sanchez Salgado 2014a, b). Further, empirical research increasingly indicates that such organisations use similar methodologies to make interests known and press for solutions (Klüver 2013). As Liebert and Trenz (2011a) argue, the constitutional changes of Europe and continuing enlargement brought with it a 'new politics of European civil society'.

A very important contextual factor for EU civil society was the enlargement of the EU in the mid-2000s. This coincided with the beginning of the financial crisis, meaning that changes in strategies for EU transnational organisations are probably due to more than the economic challenges. Given the inclusion of a much wider base of citizens, EU civil society transnational organisations had to discover new ways of being. According to interviewees, this was more because of the political and cultural challenges of enlargement than of economic constraint.

Given the ongoing nature of these developments, it is probably more correct to say that there is not yet a real 'paradigm' concerning the role of civil society organisations in the EU. These organisations were already in strong evolution at precisely the same period as economic uncertainty peaks.

Effects of Crisis as Seen from Brussels Yesterday and Today

As the fall-out from the financial crisis continues to affect all areas of society, it is not surprising that a considerable academic literature has appeared on how the crisis and particularly austerity has affected civil society at all levels from the global (Clark 2011; della Porta 2015; World Economic Forum 2013) to the most local. The World Economic Forum reported on the challenges to global civil society in 2013, speculating through a scenario approach that the organisations would need to adapt and change. Funding and fiscal pressures, demography, hyper connectivity and the democratic deficit were all factors that they speculated would challenge societal organisations (World Economic Forum 2013: 15–16). These issues affect some groups, such as women (Karamessini and Rubery 2013) or migrants (Collett 2011), more dramatically than others. Further, there are stark regional differences with areas, such as Spain or Greece (Clarke et al. 2015), showing particular patterns.

Not surprisingly, the EU transnational umbrella organisations quickly took the temperature of their own membership. The changing economic times struck an alarm bell with the transnational civil society platforms. The organisations treated the theme in their annual conferences and in dedicated symposiums. At the end of 2012, for example, the European Trade Union chose the theme 'austerity' for its annual solidarity action theme. Most of the platform organisations initiated research into how the crisis was affecting member organisations at the national and grass root levels. These studies were primarily published between 2009 and 2013 (see references in footnotes). Although in 2015 it may seem that the attention to the austerity theme has abated, it is still alive given the continuing shocks in the system, such as the Greek crisis and increased refugee and migration flows. For the European platform organisations dealing with social issues, a main concern was the need to address resources for democratic representation, voice and service in a climate of increasing scarcity. The cries for help from the south of Europe and from the nascent organisations in Central and Eastern Europe were no stranger to this need to look at the situation and its threats and potentials. In many regions,

the financial crisis struck with a double-edged sword. For example, as the Central and Eastern European new member states were taken into the fold of the EU, transatlantic and Nordic supporters of the nascent civil society in transition countries (such as the Soros Foundation) withdrew or refocused their support. They turned to new challenges such as building civil society in the Middle East after the Arab Spring. The post-socialist countries had relatively short experience with voluntary and non-governmental organisations, and no tradition to fall back on. This lack, confounded by the lack of resources, was fatal for many groups and for their ability to have voice in the larger EU framework of reaction to the austerity measures. However, some argue that one should not expect civil society organisations in these countries to take the same paths as their northern European counterparts (Jacobsson and Saxonberg 2013).

In the initial reactions to the crisis, representatives of the umbrella EU civil society organisations emphasised their continued ability to give voice to the needs of their publics as based on continuing resources in terms of funding and in terms of access to channels to influence policy making. Their own research indicated that the vulnerable were hardest hit by the crisis. This was especially true for groups who were already targets of inclusion measures of the EU, such as ethnic minorities (Roma), the disabled, the young and the old, women and sexual minorities (European Social Platform SPC report 2012). Given that the majority of the responding organisations work with disadvantaged or minority populations and have progressive and social concerns, there was also concern about the changing political environment. Respondents feared a growing neoliberal atmosphere and the extent to which this might lead to both a decrease in resources and a closure of civil society dialogue.

The austerity approaches affected EU Civil Society Organisations (CSOs) in terms of their ability to give voice to constituent concerns since resources were cut and governmental channels rearranged. Voice, in terms of the construction of a European public sphere, continues to be critical as the disjuncture between citizens and politicians seems to be growing in many national European polities. Voice is the crucial delineator of civil society. Mary Kaldor quotes Michael Edwards 'civil society is a voice not a vote' (Kaldor 2014 citing Edwards 2009). For civil society to have a voice involves both having financial and social resources to do

this and being able to have continuing access to political decision making thanks to open channels and possibilities to present professional files.

In terms of financial resources, the organisations surveyed reported in 2012 that their national and local members were suffering un-coordinated local cuts. Local, regional and national governments in countries ranging from the Netherlands to Poland took a knife to social, cultural and civic organisations in an attempt to balance the budget, even as this often meant that directed social services, such as shelters for women, were affected. To preserve their autonomy, many organisations were looking at alternative business models, including taking pay for services, and finding new pathways to mobilise charity and voluntary funding, including ideas from 'crowd funding', and offering/selling alternative services (such as catering and socio-economic enterprises in the UK).

Interviewed organisations also explored additional pathways besides membership fees and the state, but these pathways could have unintended consequences for their autonomy. Initially in the crisis, many USA foundations that funded transatlantic projects, particularly with Eastern Europe, were affected by declining income due to shifting interest rates. However, reports show that, after an initial large downturn in the USA, (Hanfstaengl 2010) some foundations recovered and increased funding, while many showed very mixed records. European foundations had often had more conservative investment strategies (Clark 2011:244) allowing them some leeway. Thus, philanthropy provided some groups with alternative forms of funding. While often putting conditions on funding, these channels offered a diversity of opportunities. Activist organisations that had trouble complying with the increasingly rigid bureaucratic accounting schemes of public authorities turned to some of the newer radical or alternative funding schemes that had sympathy for their goals and tied fewer strings to their grants. An interview with an umbrella philanthropy association in Brussels provided the ironic insight that one aspect of the crisis was that the rich, those with profitable investments or capital, had gotten richer and were looking for places to put their money.

The Brussels EU umbrella organisations reinterviewed in 2015 frequently reported that their national members found small or grassroots groups were knocked out by austerity measures. If they did not have sufficient resources to seek help from alternative pathways such as new

philanthropy, they faced grave difficulties. Such organisations, working with volunteers, had no buffer to be able to continue to operate at a professional level. This necessarily meant silencing of their voice in some countries, while in other countries, such as Germany, the crisis led to an increase in volunteering and civic concern. Naturally, not every government turned to austerity measures. Some of the northern respondents, such as in Sweden and Germany, had not felt much financial impact from the crisis on their working costs, but almost universally there were reports of worsening situations on the ground with clients.

Although the Brussels-based umbrella organisations are frequently maligned for their dependence on EU funding (Greenwood 2011; Klüver 2013; Sanchez Salgado 2014a, b) as this, of course, compromises their independent voice, this dependence has perversely allowed them some stability against the worst fall-outs from the crisis. Many had multi-year EU contracts which helped them ride out the crisis. Further thanks to their expertise and contacts, some reported being able to help national associations by acquiring EU projects with civil society components in which local or grass roots organisations could profit. However, the Brussels-based platforms faced an additional constraint due to the increased level of bureaucratic control and reporting responsibilities during this period. As noted earlier, these organisations were already professionalising. Now they are and faced with detailed reporting duties, which increased with the introduction of framework contracts. Some respondents linked this to rising neo-liberal managerial approaches from the EU, although these pressures were present before the crisis. Many of these groups were already living on projects that entailed considerable bureaucracy. Multiple year funding packages also required considerable bookkeeping talent. A few, therefore, reported that these constraints had pushed a further professionalisation of their operations in terms of management and accounting. One or two of the organisations viewed this as an actual improvement in their ways of working, as waste was discovered, and new methods of coordination were introduced. In 2012, at the level of the EU umbrella organisations, funding was still stable, but the transnational organisations feared the results of the renegotiation of EU framework contracts in 2014. By 2015, some interviewed European organisations reported cuts in their EU funding from 20 to 40 %.

In terms of access for giving voice to member concerns, with decision-makers, all these socially focused organisations acknowledged the changing political winds after 2007. They felt that the opportunities for interacting with political institutions were changing in drastic ways. Political decision-makers in EU social affairs saw their territory being curtailed or reorganised. For example, for gender and other equality groups lobbying in Brussels, the responsibility for these issues moved from the DG for Employment and Social Affairs to the DG for Justice (Cullen 2014) and received an anti-discrimination frame rather than the social justice approach that hallmarked policy from the DG for Employment.

> There is an element of organizational culture- there is a different culture in relation to civil society between the two DG's (Employment and Justice) and so you cannot attribute the changes solely to austerity measures. The DG Justice web site has no space for us and it is extremely minimal. (ILGA 2012)

Yet, on the other hand, some doors opened to those involved with fiscal, financial and productivity alternatives. This produced a challenge as the social civil society actors seldom had financial and economic insight and lacked contacts in the DG's devoted to these issues.

> Once upon a time it would have been enough to talk to equality bodies, but the bodies and actors have changed and now it is economic actors like finance ministers [that we talk to]. Traditionally we have not been talking to this sort of actor and they do not have a tradition of talking to civil society actors…we have noticed we need to multiply our efforts—the decisions are made in different sets of bodies that do not communicate with each other.(EWL)

Further, the ability to be heard when the key of the music is shifted is important. Talking about civil society interests was perceived to be occurring in a different language, studded with concepts such as competitivity, financial accountability and the new public management discourse so characteristic of neo-liberal interactions. Generally, civil society organisations in the social sphere had very few actors with skills to contribute to offer relevant financial policy input as the crisis emerged (Anheier 2014;

Anheier 2012 in Heidbreder 2012: 28). As Sylvia Walby (2015) writes on the women's movement, feminist insight into the importance of the economy and of understanding finance has received inadequate attention. This insight also applies to other social interest groups.

As one organisation commented,

> I think being heard is not the problem—they hear what we say but it is their willingness to respond to what we say that has changed—response is lacking as is willingness to implement things. (EAPN)

Several different organisations commented that the difference is a lack of political will, with the crisis being used as an argument not to do things.

The changing political winds were only enhanced by the new shifts of power towards the centre right with a Euro-sceptic accent as a result of European elections in 2014 and the composition of a new European Commission. In terms of tactics, several organisations talked about making new coalitions or alliances with other civil society organisations, as going it alone with an issue became increasingly risky. While in the early 2000s the lobbying terrain for social organisations was very contentious (Cullen 2005, 2010) and alliances were sometimes hard to forge, the post-2007 period sees ever more alliance formation such as in the Contact Forum at the European level. For example, the European Trade Union in the past held itself somewhat aloof to the platform formation among social organisations, arguing that it was a member-based organisation rather than a lobby. Now the European Social Platform has cooperated with the European Trade Union Confederation (ETUC) and formed a Spring Alliance with trade unions and environmental groups, and trade unions have joined various temporary platform actions. However umbrella CSOs reported that, at the local level, organisations were increasingly competing against each other to retain support and funding, to some extent undermining the efforts to forge alliances at the apex.

Strange new networks, including unusual bedfellows, are appearing with confusing names and conflicting contents. For example, the Plus Europe network, which groups chambers of commerce and business organisations and some civil society partners, such as Rotary International,

aims ‘to achieve a European Civic Alliance by promoting a new model of European governance based on mutual respect between the citizen and the different levels of European governance’ (Web site Plus Europe Association Civic participation in Europe http://pluseurope.org/association/ consulted June 13, 2015).

Plus Europe seems to have been operating since 2014, primarily with a Spanish base but holding conferences on Business and Youth in Brussels. On the other end of the spectrum is EU Plus (http://euplus.org/?page_id=41 consulted June 13, 2015), a coalition of over 40 civil society organisations. They seemingly share with Plus Europe the aim of calling for a process of democratic renewal. On the basis of their website, their goals would seem interchangeable. Yet EU Plus has a membership composed of international and civil society organisations including the labor movement, the Citizen Action Service, the European Network Against Racism and many of the members of the European Social Platform. This group, founded in 2014 claims to be a ‘ broad grass-roots alliance in which the **European Movement International** joins over 40 civil society organisations to call for renewed and better functioning of democracy in the EU’ but in fact it is a meta association of umbrella associations. A definite post-2007 phenomenon is an increase in the density of ties between these transnational organisations (World Economic Forum 2013), even if some of the networks are ephemeral. Brussels organisation representatives wondered about the sustainability of these collaborations and the extent to which they would last beyond being a website. The extent to which this forging of ties is an evidence of a paradigm shift due to the constraints of the austerity crisis is hard to estimate.

The reorganisation of EU competencies on social questions in 2010 and 2014 also played a role in spurring new thinking about voice and access. As previously noted, issues such as gender equality and sexual orientation moved from the DG focusing on social issues and employment to the DG concerned with Justice and Fundamental Rights. These new dialogue partners also posed challenges for access for the CSOs in Brussels at the very moment they had stagnating or decreasing resources. Nonetheless, several organisations also reported unexpected opportunities to raise their issues in EU directorates dealing with finance and competition. For example, gender equality could be framed

in a neo-liberal approach as a way to increase competitivity thanks to further mobilisation of female labour power. However, cuts to social services undermined the chances to stimulate further female participation on the labour market. For these sorts of arguments, the financial directorates were more sympathetic. Still, as noted earlier, informants reported that their organisations often lacked the necessary expertise about financial and economic matters to be able to make a convincing argument.

Thanks to the Treaty of Lisbon and the new and more powerful role for the European Parliament in co-decision processes, channels for voice have increased for organised civil society. However, austerity measures strangling organisational resources at a lower level mean that transnational organisations cannot always provide nuanced and evidence-based arguments from the member state level to convince policy makers. This brings us to another facet of the voice of transnational civil society, which is the engagement of citizens.

The European 'people' are sociologically different than 20 years ago thanks to enlargement but also thanks to the new possibilities for communication and organisation. Thus on the peripheries of organised civil society, social movements on the progressive left ranging from the continuing Social Forums, through ATTACK and Occupy to the Indignados of Spain displayed new tactics and arguments (Anduiza et al. 2014; della Porta 2015; Doerr 2009 and 2012). Organised both locally and transnationally, they have transformed the protest and tactical repertoire. Petitions, once requiring door-to-door canvassing are now possible through the Internet. Participation and debate about policy is now electronically facilitated by channels opened by the EU for consultation. Communication about how to meet and protest occurs through the burgeoning resources of social media. Further, thanks to technology, the issues of financing find new solutions through methods such as 'crowd funding'. These options allow organisations to be more flexible and encourage easy creation of more ephemeral networks and coalitions. These developments also provide tactical alternatives for the hard-strapped formal organisations.

As far as the ability of the EU civil society organisations to be relevant to the problems of local civil society activists of many types, the recent

London School of Economics (LSE) project on Subterranean Politics, which examined changing forms in social movements in 2011–2012, found that mobilisations are different than the last decade and seem to have a larger mainstream audience (Kaldor et al. 2012; Kaldor and Selchow 2013). However, the local and national organisers surveyed by Pleyer (2015) saw little relevance in addressing the European level, indicating a continuing disjuncture between the transnational umbrellas and lower levels. If a paradigm shift means that there is a stronger and more powerful reflection of national engagements through the European level of transnational platforms, it is evident that the lower levels do not see particularly much added value in the EU.

The extent to which engagement and participation are issues at the level of the transnational platforms and federations can be debated. Kotzian and Steffek (2013) found that it made little difference whether associations had actual members (such as trade unions) or were composed of other associations in terms of their voice and input into policy debates. There is considerable contestation about the level of engagement of citizens in social movements and debates, with studies looking at the kinds of people that turn out for street protests, or social media action (Norris et al. 2005) showing a bias towards those that already have considerable social capital. Our interviews with EU umbrella organisations referring to their own member studies showed what might be expected. With financial uncertainty, loss of jobs and insecurity, civil society formal organisations were having trouble maintaining formal paying membership as well as mobilising members for actions. The rise in unemployment and restructuring of employment into temporary and part-time statutes has been accompanied by falling membership rates.

Yet all is not bleak in terms of engagement. The unemployment of graduates in places such as Spain and Italy has perversely meant that the Brussels organisations can profit from a bounty of young talent willing to work in short-term internship and trainee positions (sometimes funded by the European Region Action Scheme for the Mobility of University Students (Erasmus)). Some jokingly refer not to the professionalisation or NGO-isation of civil society, but to the 'intern-ization' of civil society. This development has meant that some organisations

have been able to profit in professionalising their services thanks to the input of an ICT specialist with a commitment to a specific social issue who is willing to donate time. The un- or under-employed help a struggling civil society organisation with their know-how. The increase in such 'volunteering' leads to an ironic win-win situation of an additional line on an individual curriculum vitae, while the CSO is able to better compete in the new public management and communication jungle.

Is There a Paradigm Shift?

This book launches the notion of an 'incomplete paradigm shift', where we see changes in the ways of working and beliefs in some actors, forums and institutions while others persist in business as usual. In many ways we can see that the responses of social European civil society organisations in a changing civil society landscape reflect this. At the peripheries and on grassroots levels, we know that social movement organisations are revising revolutionary tactics on both the right and the left. This chapter addresses the established Brussels umbrella organisations, working in a complex context. In many ways, in this context, the organisations studied here have only partially revised their approaches, primarily in strategies of survival rather than rethinking their very purpose. However, these shifts reflect developments in global civil society more generally, as reported by the World Economic Forum (2013). The changing contexts of not only austerity but also other factors such as information technology, demography and politics lead to increasingly blurred roles. Organisations network in new and more complex ways and develop new forms for both participation and voice.

European transnational civil society organisations and meta-organisations have been heavily affected by the crisis but not always in expected ways. Organisations report varying strategies for maintaining voice, as well as a changing opportunity structure within European policy making requiring new partners and new discourses as well as different approaches to forming coalitions. Far from being side-lined, the results show new organisational tactics and creative use of techno-

logical networking tools to retrench and maintain voice under conditions of resource scarcity. The institutions of the EU have also shown a multi-lateral response that has not always meant closing doors. However, the experiences vary dramatically in the different regions of Europe and recent budgetary measures are having extensive ramifications in increasing inequalities while lowering resources for resilience. We see what looks like surgical cutting for politically less popular causes, with some groups that do not strongly challenge neo-liberal frames such as the European Women's Lobby experiencing less of a budget cut than others that focus on for example poverty reduction (Interview European Anti-Poverty Network 2015).

By 2015, many of the formal platforms and socially focused CSOs based in Brussels seem to have reached a new sort of status quo that has not fundamentally revised either their methods of working or their beliefs in the nature of democracy and participation. As these groups are orchestrated players in the process, they perhaps have little reason to fundamentally question the foundations. Yet they are working in a much more difficult environment than a decade ago. While the Treaty of Lisbon opened some possibilities for greater voice in decision making, the turn to the right in EU politics with a higher representation of Conservative and Eurosceptic parliamentarians and a continuation of the Center-Right dominated European Commission have meant a colder environment for social questions. As far as these sorts of organisations in the social sector are concerned, we see evolution rather than revolution and, thus, a further example of incomplete shifting.

EU Official Documents

- 2010 Update of the Joint Assessment by the SPC and the European Commission of the social impact of the economic crisis and of policy responses, November 2010
- Second joint assessment by the Social Protection Committee and the European Commission of the social impact of the economic crisis and of policy responses, November 2009

– Reports are accessible on the Social Protection Committee's webpage: http://ec.europa.eu/social/main.jsp?catId=758&langId=en

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ANNEX I. List of Brussels-based European Social Interest Civil Society Organisations and Informants

November-December 2012 and *recontacted May–July 2015

*European Trade Union Institute
*Social Platform
Koning Baudewijn Foundation
* European Women's Lobby
Professor Annette Zimmer
Institute for Political Science, Münster University, GERMANY
CONCORD, The European NGO confederation for relief and development

* European Network Against Racism ENAR
* EAPN European Anti Poverty Network
* EASPD: European Association of Service Providers for people with disabilities
* European Students Union
* ILGA-Europe
*European Foundation Centre

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9

The Restructuring of the Western European Party Space in the Crisis: A Comparative Study of Austria, France and Germany

Jasmine Lorenzini, Swen Hutter, and Hanspeter Kriesi

Introduction

In 2008, Western economies were shaken by the burst of the housing bubble in the USA and since then Europe is caught in the Great Recession. Many European countries have been confronted with a long-lasting economic recession with, in some countries, limited prospects of improvement for a foreseeable future (e.g., Kahler and Lake 2013; Schäfer and Streeck 2013). Over the recent years, these countries also faced a financial crisis as a result of the need to rescue banks that are too big to fail and of the related public debts. European citizens, mostly but not only in the South of Europe, are confronted with rising unemployment, loss of purchasing power, and increased risks of poverty. In this context, the economy is on top of political agendas and figures among the most central concerns of citizens. Some political actors advocate the introduction of Keynesian measures in order to stimulate the economy

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and break from the dominant idea of austerity politics. Yet, altogether few alternatives to austerity and neo-liberal reforms are presented and discussed. It is important to note that, the longer the economic crisis lasts, the more likely it is to influence politics and to create the potential for a political crisis reinforcing trends of political cynicism among citizens who distrust political parties and either turn away from electoral participation or resort to protest voting.

Considering these trends, we study how the prolonged economic crisis contributes to the structuration of party politics or, in other words, how the crisis shaped the supply-side of politics. In so doing, we contribute to the debate about the paradigmatic transformations resulting from the Great Recession. More precisely, we analyse the effects of the euro crisis on the structure of party competition in the national electoral arena in three Eurozone member states, namely, *Austria, France, and Germany*. These three countries held national elections in 2012 or 2013—that is, in times of prolonged economic recession in many European countries—and after the bailouts of individual Eurozone members and the adoption of a comprehensive strategy to cope with the crisis by the European Council in late 2011. We ask whether and how the structure of party competition in the electoral arena in times of crisis differs from previous periods: Does the crisis trigger systematic and extensive change? Or does it rather reinforce trends that were already under way before the current crisis? It is important to note here that we are interested in the systemic level. In particular, we analyse changes in the key issues addressed in electoral campaigns, the dimensions structuring the political space and the configuration of parties within this space. The key issues are defined both in terms of the attention they gain—their salience—and in terms of conflict over these issues—polarisation.

We advance and explore two alternative scenarios. On the one hand, one may expect that in times of economic crisis the economy is at the core of the political campaigns—that all parties position themselves on economic questions during the campaign in order to attract voters whose main concerns are the state of the economy and the way out of the crisis. This follows from the idea that economic voting is accentuated in times of crisis and, thus, parties will position themselves on economic issues in order to gain votes (Duch and Stevenson 2008; Lewis-Beck and

Stegmaier 2000). On the other hand, faced with such a crisis, political parties may have limited options or alternatives to offer in economic terms. Thus, they may try to steer the campaign away from economic issues on to issues on the cultural dimension, on which they have more leverage and can differentiate themselves more from each other. This follows from the idea previously introduced by Kriesi et al. (2006, 2008, 2012) that the cultural dimension of the political spectrum has gained in importance in structuring political conflict due to the rise of a new 'integration-demarcation' cleavage induced by globalization. According to this scenario, immigration and European integration (as the main issues dividing supporters and opponents of globalization) have become decisive for structuring political conflict. Furthermore, as political parties have limited capacity to change economic policies, and as parties converge to the centre on the left–right economic dimension (Kitschelt 2007), they also tend to reinterpret economic conflicts in cultural terms.

In order to address the broad question of whether and how the party political space is restructured by the Great Recession, we use data on the parties' programmatic stances in election campaigns collected by Kriesi et al. (2012, 2008). We updated these data to include all elections that took place after the onset of the financial and economic crisis in 2008. So our data span the period from the 1970s to the latest electoral campaigns in the three countries in 2012 and 2013, respectively.[1] This allows us to put the most recent campaigns in a long-term perspective and to assess whether they reflect 'business as usual' or 'extraordinary change' along one of the two scenarios introduced before. While the economic prospects and party systems of the three countries differ, all three belong to the group of the so-called creditor countries in the Eurozone. The impact of the euro crisis on the national party systems has definitely been most impressive in the (southern European) debtor countries. This was exemplified most spectacularly in the Greek election in January 2015, which brought the radical left-wing party Syriza into power. With its focus on three creditor countries, our study provides a conservative test

[1] Apart from the three countries under scrutiny here, the original dataset also covers Britain, Switzerland, and the Netherlands. While the former two countries are not Eurozone members, the Dutch data has not yet been updated.

of the ‘paradigm change hypothesis’ introduced by Iglesias-Rodriguez et al. in the introduction to this book. However, we would argue that if we do not observe drastic transformations beyond the countries hardest hit by the current crisis, it seems not (yet) warranted to speak of changing paradigms in European party politics.

It is important to stress that political parties do not completely control the political agenda. Some key socio-political events or, in the crisis in particular, the media and the citizens’ attention may turn towards specific issues parties did not plan to address. Thus, in the Irish elections of February 2011, dramatic events such as the bank guarantee or the withdrawal from the bond market attracted most media attention and were highly influential in shaping the citizens’ opinion (Marsh and Mikhaylov 2012). In other words, political parties may have to take a stance on such events whether they are in line with their core program or not.

In what follows, we proceed in four steps, each addressing a specific research question. In the first step, we ask whether economic or cultural issues are most salient and polarised in times of crisis. More specifically, we compare the salience and polarisation on issues closely embedded in the two dimensions over the period from the 1970s until the latest elections. This allows us to assess to what extent one of these dimensions dominates the electoral campaigns in times of crisis and whether there is any departure from previous trends in this respect. In a second step, we turn to the questions of how much and what kind of change we observe. Here, we zoom in on specific issues that are part of either the economic or the cultural dimensions in order to see whether some specific issue gained prominence during the latest electoral campaigns. Then, in the third step, we examine the positions held on these issues and ask whether political parties jointly moved to the left or to the right of the political spectrum. Finally, bringing together all these constitutive aspects of political configurations, we inquire about the overall transformation of the political spaces: How many (and what kind of) dimensions structure party competition in times of crisis? What does the actors’ configuration look like? Do all these aspects differ from previous campaigns?

Taken together, our findings do not point to a systematic and strong change induced by the crisis in the three countries under scrutiny. The German campaign in 2013 has been rather depoliticised, and we observe

no major changes from the pre-crisis period. In France, we find the reinforcement of long-term trends towards increasing polarisation on the cultural dimension, while Austria saw increasingly salient and polarised conflicts over both dimensions. But even in Austria, this has not led to any major restructuring of the political space. In all three countries, two dimensions continue to structure the political space in 2012–2013, and in all three countries we still observe tri-polar party configurations. Interestingly, however, the issue of European integration is no longer as firmly embedded in the cultural dimension, and it is not structuring the overall political space since most parties have converged on a more Euro-critical position.

Theoretical Expectations

During the Great Recession, the economic mood—the citizens' perception of how well the economy is doing in relation to unemployment, inflation, and growth—fluctuated across time and space. Anderson and Hecht (2014) identified three phases in this respect. In a first phase, from 2007 until 2009, the economic mood became rather pessimistic and remained at a negative level. In a second phase, during the whole year of 2009, it improved again. Eventually, between 2009 and 2011, differences appeared between countries—in some countries, like Germany, we observe a return to a more positive economic mood, while in other countries the mood remains more negative as in the case of France.

According to the economic voting literature, these negative perceptions of the economy should lead to economic voting, that is the incumbents are expected to be punished for the poor economic performances of their country (Duch and Stevenson 2008; Lewis-Beck and Stegmaier 2000). Although the incumbents may want to avoid campaigning on their bad economic performances, they may not be able to do so because these issues constitute a top priority for the electorate and because the opposition will seize the opportunity to campaign on the poor economic performance of the governing parties and these issues gain a high salience in the party-system agenda (Green-Pedersen and Mortensen 2010). Thus, we may expect to find a reinforcement of the economic dimen-

sion in the electoral campaigns during the crisis. Here, we analyse three electoral campaigns that took place in 2012–2013, after the economic mood and the economic situation of the countries diverged most. We may expect to find the strongest re-politicisation of the economy in the countries where we observe a persistence of the negative economic mood and economic indicators that signal a recession. In our case, France is the country confronted with the most pessimistic economic situation. Hence, we anticipate the French electoral campaign to be most focused on the economic dimension.

Yet, following convergence argument, it is all but certain that parties will focus on economic issues under crisis conditions. According to this argument, political parties have moved to the centre on the economic left-right dimension and, although centre-right and centre-left parties may alternate in power, in terms of policies limited variations appear among mainstream parties (Kitschelt 2007). Thus, we may expect that the mainstream political parties have little to offer in economic terms—they have increasingly lost control over the economy as they delegate power to the supranational agencies and offer limited differentiation in terms of the economic policies they defend (Mair 2006, 2013), This is mostly the case with regard to macro-economic policies, less so with regard to labour market and social policies. Thus, due to the crisis we may anticipate an increase in conflict on specific aspects of the economic dimension. Among the specific aspects on which political conflict may focus are the welfare state and potential targets of retrenchment or labour market policies since political parties have more leverage on these issues than on other macro-economic issues.

Alternatively, the focus of political campaigns may generally draw away from the economy as part of the parties' strategies. Political parties may try to shift attention away from the economy—where they have a limited margin of action and no alternatives to offer—and rather try to focus on issues on which they can better differentiate themselves from their adversaries. In this perspective, we would expect to see a reinforcement of the second dimension that structures the political space—the cultural dimension introduced by Kriesi et al. (2006, 2008). According to this line of argument, we would suggest that the crisis strengthened the new 'integration-demarcation' cleavage identified by these authors. This new

cleavage is based on the opposition of 'winners' and 'losers' of globalization, that is, between those who see globalization in terms of new opportunities and enhanced life prospects, and those who feel threatened by the opening of borders in terms of social status, social protection, and life chances. In as much as parties tend to articulate this cleavage, they would seize the crisis as an opportunity to reinforce their stance on the cultural dimension. On the one hand, political parties may focus on European integration either defending or opposing transfer of authority and opening of the borders. On the other hand, parties may centre on immigration either supporting multiculturalism or defending national identities and boundaries. As indicated by Kriesi et al. (2006, 2008) changes in party structure since the 1990s are mainly due to the rise of the radical right in general and to the increased importance of conflicts over immigration in particular (see also Bornschier 2010; Ivarsflaten 2008; Van der Brug et al. 2005).

Design and Methods

Three Eurozone Member States

We focus on three Eurozone member states, which held elections after the height of the financial turmoil in Europe—Austria, France, and Germany. In 2010, the Eurozone countries, confronted with unsustainably high indebtedness of Greece, Ireland, Portugal, and Spain, organized the bailouts of these countries in collaboration with the IMF. Moreover, the Eurozone countries agreed on the creation of the European Stability Mechanism as a permanent bailout fund and on a renewal of the Stability and Growth Pact (the Six-pack and the Fiscal Compact). The bailouts were accompanied by demands for austerity—reduction of public sector employment and social protection—and for neo-liberal reforms in the form of privatization and increased flexibility in the labour market. Thus, budgetary rigor was at the core of policy-making. Importantly, for us, the European measures adopted to comply with budgetary rigor and the required reforms in the economy were highly debated and adopted in

the period prior to the elections we analyse in this chapter (Grande and Kriesi 2016).

The three countries we analyse share similar situations in terms of their position in the EU in general (the three are part of the core of Europe without any major opt-outs)[2] and in the Eurozone more specifically (the three are creditor countries). However, they differ in terms of their importance in the Eurozone crisis. Germany and France were at the forefront of the negotiations between debtor and creditor countries. In fact, Merkel and Sarkozy personified European austerity politics (Crespy and Schmidt 2014). Austria is also a creditor country, yet it played a less central role during the crisis and the negotiations processes at the European level. Regarding the welfare state, all three countries correspond to continental welfare state models.

In economic terms, the three countries fared differently during the crisis. Austria is the typical example of a country that was little affected by the crisis, indeed Austria saw high growth rate and even increases in the employment rate in 2011. Similarly, the German economy fared well during the crisis after a first shock in 2009. Already in 2010 it started to recover. Germany experienced a slow growth in the beginning of 2013. Although internal consumption was stable, exports were slow due to the negative economic prospects in other European countries. Nonetheless, the election year 2013 was characterised by a moderate growth and a stable employment situation with a slight increase in employment. On the contrary, while also experiencing a return to growth in 2010 the French economy did not pursue its recovery in 2011. At the end of 2011, the economy sharply slowed down again. The exports suffered in particular during this period, which resulted in employment cuts as well as a raise in unemployment. Among the three countries studied here, France had the worst economic outlook at the time of the electoral campaign.

Turning to politics, the three countries differ in terms of the supply-side. In particular with regard to the presence or absence of a political party from the radical right: the radical right has successfully challenged the mainstream parties in France and Austria since the early 1990s (e.g.,

[2] Because of its, at least formal, status as a neutral state, the only exception is Austria's reservation about military cooperation.

Betz 2004; Kitschelt 1995; Mudde 2007), but—for historical, institutional and party-internal reasons—it has failed to establish itself at the national level in Germany (Dolezal 2008: 216ff.). However, the German campaign in 2013 saw the rise of a new challenger, the Alternative for Germany (AfD), which can be regarded as 'functional equivalent' to the populist radical right in other European countries (Berbuir et al. 2014).

Let us briefly present the main political parties in these three countries and the most important candidates in these campaigns. In *France*, we analyse the campaign leading to the first round of the presidential election in April 2012. This election opposed the incumbent Nicolas Sarkozy of the centre right (UMP) and the socialist François Hollande (PS). Both made it to the second round of the election with 27.2 % and 28.6 % of the vote. In the second round, Hollande won by a margin of 3.3 %. The 2012 presidential campaign in France appeared as a plebiscite against Sarkozy, who suffered from low popularity (Hewlett 2012; Kuhn and Murray 2013). In the first round of the campaign, Marine Le Pen (Front National), Jean-Luc Mélenchon (Front de Gauche), François Bayrou (Mouvement Démocrate), and Eva Joly (Greens) were among the most visible contenders of the two main candidates. Marine Le Pen achieved the best ever result for the Front National with 17.9 % of the vote, whereas Mélenchon (11.1 %) and Bayrou (9.1 %) remained below expectations.

In *Germany*, we study the federal election of September 2013. In this electoral campaign, the main opponents were the incumbent Angela Merkel of the Christian Democracts (CDU) and the Social Democrat Peer Steinbrück (SPD). The campaign has been characterised by candidate-centred campaigning on the side of the CDU, surfing on the good economic figures and the popularity of Merkel, whereas for the Social Democrats the campaign was hampered by the limited credibility and mobilizing capacity of Steinbrück, who was caught in a scandal over the high fees he received for his public appearances (Faas 2014: 240f.). The other competitors were the liberals (FDP) (who had governed together with the Christian Democrats), the Greens, the radical left (die Linke), and the AfD. The election ended with a triumphant victory of the CDU (41.5 %). As the SPD also gained 2.7 % in vote shares (25.7 %), the 2013 elections mark a certain break with the trend

of ever-declining vote shares for the two mainstream parties. All other parties represented in the national parliament lost votes. This was most dramatic in the case of the liberals, who, for the first time in post-war Germany, lost parliamentary representation as they fell short of the five percent electoral threshold. With 4.8 % of the vote, the liberals obtained only little more votes than the newly established AfD (4.7 %).

In *Austria*, the parliamentary elections also took place in September 2013 and the two main candidates belonged to the prior coalition government: Werner Faymann from the Social Democrats (SPÖ) and Michael Spindelegger from the Christian Democrats (ÖVP). Their competitors were the populist radical right Freedom Party (FPÖ), the Greens, as well as a new party, Team Stronach, which was founded one year before the elections by the Austrian-Canadian businessman Frank Stronach. The second populist right party, the Alliance for the Future of Austria (BZÖ), faced difficulties with the death of its charismatic leader Jörg Haider in 2008. The BZÖ lost all representatives in the regional parliaments and some members of its national parliamentary group left to join either the FPÖ or the Team Stronach (Dolezal and Zeglovits 2014: 645). Furthermore, the campaign saw the rise of a new liberal party, NEOS. In addition to economic topics, the electoral campaign was focused on some corruption scandals about illegal party financing and other offenses. Some of the cases dated back to the early 2000s and involved not only members of the current governing parties but also of the FPÖ and the BZÖ (Dolezal and Zeglovits 2014: 644f.). The two mainstream parties, the SPÖ (26.8 %) and ÖVP (24.0 %), had to face the worst electoral results since 1945. The FPÖ (20.5 %) and the Greens (12.4 %) gained respectively 2.5 % and 2.0 % of votes, and also Team Stronach and the NEOS made it above the electoral threshold of 4 %. The BZÖ, by contrast, lost its parliamentary representation.

Data and Methods

In order to analyse political parties and their positions during the electoral campaigns, we rely on a relational content analysis of newspaper articles. Our content analysis rests on the analysis of two newspapers per

country: one quality newspaper and one tabloid. More specifically, we selected articles from *Die Presse & Die Kronenzeitung* (Austria), *Le Monde & Le Parisien* (France), and *Süddeutsche Zeitung* & *Bild* (Germany). From these papers, we selected all articles that were published within two months before the relevant national Election Day and reported on the electoral contest and national politics more generally. We then coded the selected articles by means of core sentence analysis (CSA) (for more details on the method and data, see Dolezal et al. 2012).

Following this type of relational content analysis, each grammatical sentence of an article is reduced to its most basic 'core sentence(s)', which contain(s) only the subject, the object, and the direction of the relationship between the two. For this chapter, we are only interested in relations between political actors (subject) and issues (objects) (actor-issue sentences). The direction between actors and issues is quantified using a scale ranging from −1 to +1, with three intermediary positions.

The following analyses are based on a dataset of more than 24,000 actor-issue sentences from nineteen election campaigns in the three countries (one campaign from the 1970s and all campaigns in the period from 1988 to 2013).[3] For the study of the 'crisis' elections, we can rely on 1040 actor-issue statements for France, 1160 for Germany, and 1756 for Austria. The actors were grouped according to their party affiliation. The issues were also coded in great detail (with more than 200 coded categories per election campaign). Following Kriesi et al. (2008: 58ff.), we aggregated them into a set of twelve broader issue categories. Note that the twelve categories cover statements in favour and against the respective proposals. Table 9.1 lists the categories and indicates what a positive statement towards a given issue stands for in our representation of the political spaces.

To assess our two scenarios, we are most interested in six of these categories for the purpose of this chapter. The first three issues—*welfare, economic liberalism, and budget*—refer to the traditional opposition between state and market. Conflicts over these three issues have usually struc-

[3] Since we are here specifically interested in the political consequences of the euro crisis, we have excluded the German 2009 campaign from our analysis. Strictly speaking, this campaign was also taking place in the shadow of the Great Recession, that is, after the financial crisis broke out with the collapse of Lehman Brothers in September 2008.

Table 9.1 Issue categories

Categories	Description (a position of +1 stands for……)
Welfare	Support for an expansion of the welfare state; objection to welfare state retrenchment; support for tax reforms with a redistributive character; calls for employment and health care programs
Economic liberalism	Opposition to market regulation, economic protectionism in agriculture and other sectors of the economy; support for deregulation, more competition, and privatization
Budget	Support for a rigid budgetary policy; reduction of the state deficit and of taxes without direct redistributive effects
Cultural liberalism	Support for the goals of new social movements, excluding environmental protection; support for cultural diversity, international cooperation, gender equality, homosexuals; opposition to national traditions and traditional moral values
Europe	Support for European integration (incl. enlargement)
Anti-immigration	Support for tough immigration and integration policies
Culture	Support for education, culture, and scientific research
Army	Support for the armed forces, a strong national defence, and nuclear weapons
Security	Support for more law and order, fighting crime, and denouncing political corruption
Environment	Support for environmental protection; opposition to nuclear energy
Institutional reform	Support for various institutional reforms of the political system
Infrastructure	Support for improving the country's roads, railways, and other physical infrastructure

tured the economic dimension of the two-dimensional political space. By contrast the other three issues—*cultural liberalism, Europe, and anti-immigration*—are labelled as new cultural issues since they have emerged since the 1970s and have restructured the second, non-economic dimension. The rise of cultural liberalism in the 1970s predated the increasingly salient and polarised conflicts over immigration and Europe which have emerged since the 1990s. The remaining six categories are culture, army, security, environment, institutional reform, and infrastructure. According to the empirical findings of Kriesi et al. (2008, 2012), the first three issues are usually also integrated into the cultural dimension of the

political space, whereas the last three issues are not consistently embedded in any of the two dimensions.

The components of party competition that we are interested here are operationalized as follows: *salience* is measured by the share of core sentences on a given issue category in percent of all coded sentences related to any political issue. The indicator for the *polarisation* of party positions is based on Taylor and Hermann's (1971) index, which was originally designed to measure the degree of left-right polarisation in a party system. The polarisation of positions on a given issue category is computed as follows:

$$POLARIZATION = \sum_{k=1}^{K} \omega_k \left(x_k - \bar{x} \right)^2$$

Where ω_k is the salience of a particular issue category for party k, X_k is the position of party k on this issue category, and $\bar{X}$ is the *weighted average position of all parties*, where weights are provided by the party-specific salience of the issue category. Since actor positions are always measured on scales ranging from −1 to +1, the distance to the average (and our measure of polarisation) can range between 0 and 1. To measure the polarisation of a group of issues (in our case, economic vs. new cultural issues), we calculate the average of the polarisation of the individual issues, weighting them by the salience of the corresponding issue category.

Economic and New Cultural Issues: Trends Over Time

As a first step to determine whether the economy constitutes the core focus of electoral campaigns in the heat of the euro crisis or whether new cultural issues occupy a central place, we compare trends over time in terms of salience and polarisation (see Fig. 9.1). The graphs present the evolution of salience and polarisation of the economic and the cultural dimensions from the 1970s until the 2012–2013 electoral campaigns.

As stated, economic issues include party statements related to the welfare state, economic liberalism, and budget, whereas new cultural issues include statements on cultural liberalism, European integration, and immigration.

First, Fig. 9.1 highlights that in times of crisis both types of issues, economic and new cultural, are important. Jointly, they cover most of issue attention. Indeed, during the crisis electoral campaigns, in France and Germany, the economic and the new cultural issues capture each around 40 % of all discussed issues adding up to 80 %. In Austria, the share is distributed differently among the two dimensions with the economic one including 50 % of all discussed issues and the cultural including roughly 20 %. However, even in Austria, the remaining six issues (including environmental protection, security or institutional reform) include less than 30 %.

Turning to the trends over time, in the first part of Fig. 9.1, we see that the trends in terms of the salience of both the economic and the new cultural dimension do not move systematically in all countries in the crisis. Some shifts in the salience of one or the other dimension appear, but most of these shifts were set in motion before the crisis. If the crisis had an effect, it rather seems to be reinforcing earlier developments. Most importantly, in France, the salience of the economic issues follows a continuous downward trend that is not halted by the economic crisis, whereas the new cultural issues have become ever more salient. In Germany, we observe a temporary increase in the salience of the economic dimension during the early 2000s, corresponding to the hard times of the German economy, when Germany was seen as the 'sick man of Europe' (see Dustmann et al. 2014). However, in the German campaign of 2013, economic issues have become less salient again, while we observe a fairly strong increase in the new cultural issues. Only in the Austrian case, Fig. 9.1 indicates that the economic dimension has been regaining salience in times of crisis, but we also note that this reversal has started already in the 2000s. The new cultural issues have also become more important in the Austrian context in the 1990s, but their salience has remained stable since then.

Second, regarding the polarisation of the two dimensions (see second part of Fig. 9.1), we observe that the more salient dimension tends

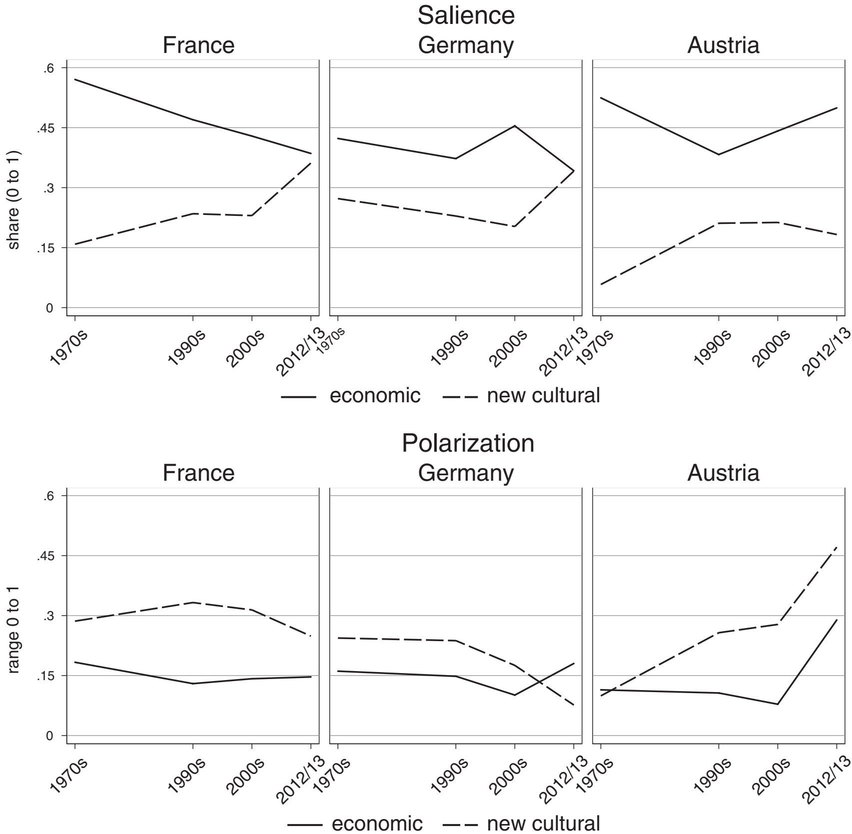

Fig. 9.1 Salience and polarisation of economic and new cultural issues over time (1970s–2012/2013)

to be the less polarising one across the three countries. This highlights the fact that a lot of the structuring capacity of new cultural issues is not due to their importance in terms of salience but rather because they divide the parties in terms of positions (Kriesi 2012: 119). Before the onset of the current crisis, conflicts over economic issues were clearly less polarised than those over new cultural issues. Yet, the polarisation of economic issues increased in both Germany and Austria in 2013. In Austria, the cultural dimension also became more polarised since the

early 2000s and increasingly so. As Fig. 9.1 highlights, the Austrian campaign in 2013 is characterised by polarised struggles over both economic and new cultural issues. By contrast, in Germany we do not observe a similar trend. The new cultural dimension has become less polarising in Germany in 2013, a trend that already started in the 2000s. And this declining trend is only partly compensated by a corresponding increase in polarisation for economic issues. Overall, the German campaign in 2013 saw comparatively little polarisation. Finally, in France, we observe no pronounced trends apart from a certain decrease in the average polarisation of the new cultural issues. However, note that French political parties are still far more divided on new cultural issues than on economic ones.

What can we conclude from these first figures for the question that interests us here? It seems that we are confronted with politics as usual (with country-specific variations of what can be considered as usual) or, at least, that the crisis did not trigger any consistent and fundamental shifts in the salience or in the polarisation of issue competition in the three countries we analyse here. Taken together, we see no increase in either the salience or the polarisation of economic issues that seems to be initiated by the crisis and neither do we find a shift of attention towards new cultural issues or increasingly polarised struggles over these issues. In the next step, we disentangle the two sets of issues into more specific issues as this may reveal changes in terms of salience or polarisation hidden behind the aggregate measures presented so far.

The Rise and Fall of Conflict Over Specific Economic and New Cultural Issues

In this step, we ask what the visible and polarised issues are in times of crisis. In addition to the two indicators used up to this point, we form a summary measure by multiplying the two indicators for salience and polarisation which captures the degree of politicisation of an issue. This measure indicates the structuring capacity of a given issue because it only

takes high values if both elements are given, that is, emphasis is put on the issue on which parties take diverging positions. Apart from the *level* of salience and polarisation by issue in 2012–2013, Table 9.2 also shows the issue-specific *changes* with respect to salience and polarisation from the pre-crisis period (2000–2008). To put these results into perspective, we have also calculated a benchmark by comparing issue-specific levels and changes in salience, polarisation, and politicisation to the averages over the whole time period (all values above the benchmark are highlighted in bold). This benchmark allows us to see (a) which issues are particularly salient and polarised and (b) whether the changes observed during the latest electoral campaigns are exceptional.

The findings in Table 9.2 confirm the general patterns found before, as the issues that became salient and polarised in the electoral campaigns held during the crisis show remarkable cross-national differences. Our measure of politicisation which captures the joint tendencies in salience and polarisation brings to the fore these diverging trends. In Germany, only conflicts over economic liberalism were highly politicised in the crisis election, whereas, in France, one economic (welfare) and two new cultural issues (cultural liberalism and immigration) crossed our benchmark in the latest campaign. The highly conflictual nature of the 2013 Austrian campaign is illustrated by the fact that we observe values above our benchmark for no less than four of the six issues: welfare, economic liberalism, cultural liberalism, and immigration. In other words, while Austria—and to a certain degree, France—saw highly politicised conflicts over new cultural issues in the last elections in times of crisis, this was not the case for Germany. We will discuss in detail, the salience and polarisation across the three countries and return to the comparison of the three at the end of this section.

In *France*, the campaign mostly focused on the controversial figure of Sarkozy and appeared as a plebiscite against his way of doing politics (Hewlett 2012; Kuhn and Murray 2013). In addition to the anti-sarkozysm, two themes were central to the campaign. First, Hollande took issue with the increase of the retirement age and the cuts in public sector jobs adopted by Sarkozy and proposed to overturn them. Second, in a more prospective tone, Hollande proposed the introduction of higher taxes for top incomes, a proposition that became a central theme in this

presidential campaign. This is reflected in the relatively high salience of welfare and economic liberalism in Table 9.2. Yet, for economic liberalism we observe a lower degree of polarisation and thus the multiplication of salience and polarisation does not result in an exceptionally high level of politicisation, while both welfare and cultural liberalism were much politicised in the 2012 French campaign.

In addition to cultural liberalism, Europe and immigration also received considerable attention. Hollande questioned the austerity promoted at the European level by Sarkozy and Merkel (Merle and Patterson 2014). Nonetheless, Europe was not a polarised issue as is indicated by the fact that Europe had the lowest degree of polarisation observed in the French case. This is due to the fact that all parties—including the governing UMP—had converged on a more Euro-critical position (Hutter and Kerscher 2014). This contrasts with immigration which was as salient as Europe but involved far more opposing issue positions. It is important to note here that a specific event partly drove the attention towards immigration. In March 2012, the affaire Merah (shootings in front of a Jewish school) opened a window of opportunity for debates over immigration and for the campaign themes of the Front National.

In *Germany*, the issues that are salient and those that are polarised are not the same ones (see Table 9.2). This explains the fact that there is only one issue—economic liberalism—that is highly politicised when compared to other electoral campaigns. The politicisation of this issue is mainly driven by polarised statements. In fact, economic liberalism received less than 10 % of the overall attention, while welfare and cultural liberalism received considerably more attention with, respectively, 23 % and 21 %, but we observe almost no polarisation on these issues. The German political parties agreed on what had to be done in terms of welfare state and cultural liberalism. They disagreed more on the issue of budgetary rigor, yet this was a low salience issue in the German campaign with only 3 % of all core sentences. Similarly to the French case, Europe received some attention (8 %), but was not a polarised issue. Lastly, unlike what we observed in the French case, immigration is both a low salience and only a moderately polarised issue in the German context. Thus, neither of the two issues associated with the new integration-demarcation cleavage had a structuring capacity.

Table 9.2 Conflicts over specific issues: crisis elections and change with respect to pre-crisis period

	France			Germany			Austria		
	Salience	Polari-sation	Salience × polarisation	Salience	Polari-sation	Salience × polarisation	Salience	Polari-sation	Salience × polarisation
Level in 2012/13									
Welfare	**0.18**	0.15	**2.71**	**0.23**	0.07	1.64	**0.25**	0.31	**7.88**
Eco-liberalism	**0.16**	0.12	1.91	0.09	**0.39**	**3.36**	**0.20**	0.29	**5.82**
Budget	0.05	0.21	1.03	0.03	**0.39**	1.17	0.04	0.17	0.74
Cult-liberalism	**0.15**	0.30	**4.64**	**0.21**	0.06	1.32	0.09	**0.47**	**4.15**
Europe	0.09	0.05	0.44	0.08	0.07	0.55	0.02	**0.56**	1.34
Immigration	0.12	0.34	**3.92**	0.05	0.14	0.74	0.07	**0.45**	**3.13**
Pattern of change									
Welfare	–0.03	0.06	0.65	0.04	0.02	0.73	–0.05	0.25	**6.01**
Eco-liberalism	0.00	–0.06	–0.95	–0.05	0.18	0.54	**0.12**	0.15	**4.70**
Budget	–0.01	–0.03	–0.36	**–0.11**	**0.28**	–0.28	–0.01	0.03	0.04
Cult-liberalism	0.05	0.08	**2.29**	**0.08**	–0.09	–0.69	0.02	0.13	**1.86**
Europe	0.05	**–0.39**	–1.58	0.04	–0.13	–0.26	–0.04	**0.41**	0.40
Immigration	0.04	–0.10	0.56	0.02	0.03	0.40	–0.01	0.10	0.24

Note: Salience refers to the number of core sentences on a given issue category as a share of all core sentences (0–1); polarisation indicates the degree to which the actors advocate different positions towards the specific issue (range 0–1). In addition, we report salience multiplied by polarisation (multiplied by 100). As a benchmark, we have calculated the mean plus one standard deviation for all measures based on the data for a set of twelve issues and all elections from 1988 to 2008 ($N = 156$; 12 issues multiplied by 13 elections). All values above these benchmarks are highlighted in *bold*. In other words, all values highlighted in *bold* indicate that an issue was either highly salient and/or polarised or we observe exceptional change

The rather depoliticised German campaign was partly due to the fact that the opponent, Peer Steinbrück—coming from the moderate wing of the SPD—had difficulties to sell the more left-wing agenda proposed by his party and to steer the campaign away from the liberal reforms he had defended back under the Schröder government and under the grand coalition in 2005–2009 (Mader 2014). For this reason, Steinbrück faced difficulties in differentiating the SPD from the CDU. Furthermore, the blurring of the opposition between the two parties was also due to the fairly consensual way of handling the euro crisis during the previous legislative period. Lastly, some central propositions of the SPD, such as the introduction of a minimum wage, were taken over by the CDU. This overall consensus in terms of campaign issues is reflected in the low degree of politicisation that we observe in this campaign. As Faas (2014: 241) states, the Christian Democrats' strategy to focus their message on Angela Merkel and to avoid conflict made it hard for the other parties to run their campaign and successfully challenge the chancellor's party. In addition, the liberals were hardly visible with their substantive claims, and—according to our data—the AfD did not yet have a major impact on the campaign, among other things, because the established parties opted for a dismissive strategy, that is, they chose to ignore the new party and its key issues (see Meguid 2005).

In *Austria*, the campaign centred on the economy and the welfare state, with a third issue, corruption scandals, also gaining importance (Dolezal and Zeglovits 2014). The government parties put the emphasis on the former two and the relatively good economic performance of Austria compared to other European countries, while the opposition focused on the corruption scandals. As highlighted in Fig. 9.1, welfare, economic liberalism, cultural liberalism, and immigration stand out in the 2013 campaign. The respective politicisation scores are driven by a very high salience—this is the case for welfare and economic liberalism—or by a very high degree of polarisation—as for cultural liberalism and immigration. However, even for the two economic issues, the Austrian polarisation measures are fairly high. This is mainly due to the SPÖ proposals in favour of more distributive justice, including a proposal to introduce a wealth tax. In contrast to Germany, the left faced strong opposition from all its competitors on the right. The ÖVP opposed these proposed

measures vehemently, and the BZÖ, in an attempt to distance itself more from the FPÖ, stressed economically liberal positions. The FPÖ still focused very much on its anti-immigration stance.

On all three new cultural issues, the Austrian parties adopted conflictive positions (see Table 9.2). However, in contrast to cultural liberalism and immigration, Europe received only 2 % of the overall attention during the campaign. This may reflect the fact that no major decisions were taken at the European level at the moment of the campaign (Dolezal and Zeglovits 2014: 648), but it may also reflect Austria's less important role in this supranational decision-making process more generally.

As indicated by these short descriptions, the issue-specific *levels* of salience and/or polarisation differ across the three countries and the crisis did not trigger a uniform reaction. Nonetheless, it might be that the crisis has led to major and systematic *changes* in case of some specific issues. To assess the pattern of change, the lower part of Table 9.2 shows the changes from the pre-crisis period (2000–2008) to 2012–2013. Again, changes that are above our benchmark are highlighted in bold.

Overall, we do not observe many instances of more than usual change. What has become far more politicised in France during the election in times of crisis is cultural liberalism. Although this issue was already high on the agenda of the previous presidential campaign during which Ségolène Royal led the socialist campaign (Tiberj 2013). Furthermore, we observe that the debate over Europe has become less polarised in 2012 and that the decline is rather sharp (–0.39). In Germany, there are no major changes for any of the issues in terms of the politicisation measure. Major changes in salience and polarisation can be observed for budget. However, these changes cancel each other out as conflicts over budgetary rigor became at the same time *less* salient and *more* polarised than in the 2000s. Moreover, in the 2013 campaign, cultural liberalism gained more salience in the debate but this was again linked with decreasing differences in corresponding party positions. Lastly, it is again Austria where we observe the most pronounced change compared to the pre-crisis period. In Austria, three of the four highly politicised issues have witnessed a radical change as compared to the 2000s: welfare, economic liberalism, and cultural liberalism. Additionally, Europe has become more polarised than in earlier elections but, as previously noted, with a very low salience.

Positions Adopted on These Issues

In this third step of our analysis, we discuss changes in the overall party positions on these issues. The issues discussed and the degree of conflict in a given electoral campaign may remain similar to what was observed during previous electoral campaigns. Yet, what may change is the average position on these issues, that is, the centre of gravity of the political system on given issues. Indeed, it is interesting to see whether the crisis results in issue-specific moves to the right or the left. Some observers suggested that, in the short run, parties from the right will gain votes and attract more voters, but that, in the longer run, we may expect to find a stronger move towards the left (Lindvall 2014). As indicated in the methods' section, the average position on a given issue may take values between −1 to +1. To assess whether the centre of gravity moved to the left or the right, we calculated the positions so that for the economic issues −1 corresponds to a right-wing position, that is to a position in favour of less state and more market (for instance more economic liberalism), while +1 stands for left-wing positions on the same issue, that is, a position in favour of more economic regulation. For the new cultural issues −1 identifies a position in favour of demarcation (for instance less supportive of European integration or immigration) and +1 identifies a more integrationist approach (in favour of European integration and immigration). Figure 9.2 presents the shifts in the average positions on the key issue categories for the three countries.

In line with our previous findings, we do not observe consistent shifts of the three political systems towards the right or the left. Most generally, we observe that the average position was more stable with respect to economic than new cultural issues. On the economic issues, be it welfare, economic liberalism, or budget, there is no change whatsoever in France. In Germany the average position on these issues shifted somewhat to the left, while in Austria, on welfare and economic liberalism, it shifted to the right. The difference between Austria and Germany mirrors our previous discussion on the different strategies of the political right when countering the Social Democrats' economic proposals. By contrast, the centre of gravity on some cultural issues has changed far more. Most importantly,

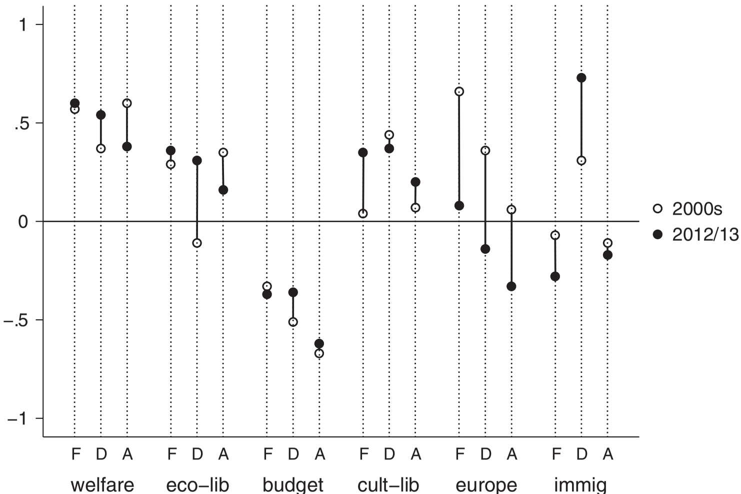

Fig. 9.2 Shifts in average issue positions. *Note*: The figure shows the weighted average positions towards the specific issues by country. The positions of the parties are weighted by the share of a given party's sentences relative to all core sentences related to the issue. For this figure, we calculated the average positions in a way that positive values indicate economically left-wing or culturally libertarian positions, while negative indicate economically right-wing and culturally authoritarian positions

on the issue of Europe, the average position has become more critical of Europe in each one of the three electoral campaigns in times of crisis as compared to the period 2000–2008. On the other cultural issues, the positions moved in different directions depending on both the country and the issue. Cultural liberalism was reinforced in both France and Austria, whereas we see hardly any change in Germany. Yet, on immigration, changes in position follow opposite trends—in Germany the average position has become more favourable to immigration, whereas in France and Austria positions against immigration were reinforced.

At the level of the party system, we cannot observe a consistent left or right turn in times of crisis. The only consistent shift involves the issue of European integration as the centre of gravity shifted to a more Euro-critical position in all three countries.

Issues and Parties: The Structure of the Political Spaces

In this last step, we turn to an analysis of the political spaces in these three countries. Using MDS for spatial visualization of both issues and parties, we compare the political spaces before (early 2000s) and in the crisis in each one of the three countries (Fig. 9.3). As can be seen, each of the three pairs of spaces is structured by two dimensions. The graphs have been drawn in such a way that the horizontal dimension corresponds to the conflicts on the economic issues, while the vertical axis corresponds to the cultural ones. Note again that the parties' positions towards an issue can range from −1 to +1 and that positive values indicate support for a given issue category (for the content and direction of the categories, see again Table 9.1). In each graph, the positions of the major parties have been linked to each other so that the dominant configuration in the party system becomes apparent. The larger the triangle (or the polygon) formed by this configuration, the greater the overall degree of polarisation between the major parties in a given system. The overall position of the triangle indicates the centre of gravity of the political structure, while its overall orientation—whether it is more aligned with the vertical or the

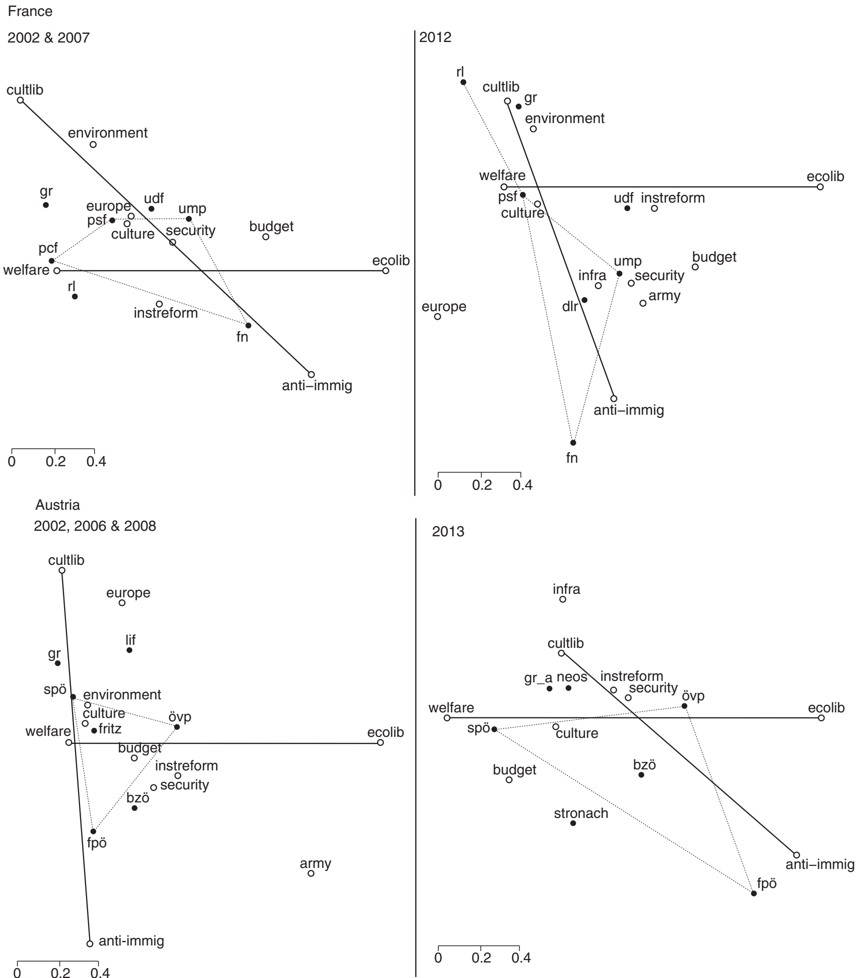

Fig. 9.3 The political spaces in the 2000s and 2012/13 compared

horizontal dimension—indicates the relative importance of the cultural and the economic dimension for the structuration of the system.

Starting with France, we see that the two dimensions of the political space are less integrated in the latest elections than previously, which means that the economic and the cultural dimensions are more independently structuring the political space than in the two electoral campaigns

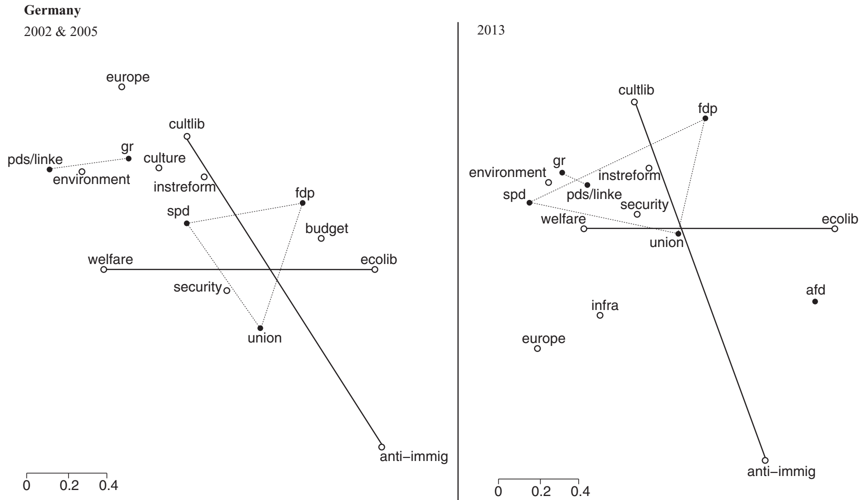

Fig. 9.3 (continued)

of the early 2000s. Furthermore, as we have seen before, with respect to the degree of polarisation, there is more conflict on the cultural dimension. Although the FN moved to the left on the economic dimension, it remains close to the anti-immigration issue. Overall the centre of gravity of the French political space shifted toward welfare and cultural liberalism. Although no political party was close to economic liberalism in the first place, even the parties from the right moved away from it. The FN stands not only close to anti-immigration, but it has also moved rather far away from economic liberalism, although it is not close to welfare either. This highlights that the FN adopted a more left-wing economic program (see Lefkofridi and Michel 2014) but that it is still mainly associated with its tough stance on immigration in the public debate. Lastly, it is important to note that Europe moved to the outskirts of the space, which reflects the fact that all parties have adopted a more critical position and indicates that it is no longer as clearly structuring the second, cultural, dimension of the space in the 2012 election.

In Germany, too, the space remains two-dimensional, with a slight increase in the independence of the two axes. This bi-dimensionality appears although the CDU moved up, slightly closer to welfare and

cultural liberalism and further away from economic liberalism. The left parties are located close to one another. The SPD has moved closer to the Green and die Linke in the latest electoral campaign. Overall, the changes are less striking in Germany as the structure remained roughly the same. Nonetheless, we see that here parties moved away not only from economic liberalism but also from anti-immigration. All parties, with the exception of the FDP, who failed in this campaign, and newcomer AfD, fall in or close to the upper left-hand quadrant—favouring welfare and cultural liberalism. Indeed, there is no radical right party standing close to the anti-immigration issue in Germany. However, the AfD with its anti-European and anti-immigration statements occupies a position in the political space where no other party stands, the bottom right-hand quadrant. Yet, as stated before, the AfD had a limited visibility in the media and, thus, it has hardly contributed to the structuring of the political space. Finally, we see again that Europe is not as integrated in the political space as it used to be. It is located at the margin and all parties stand apart from it, which again reflects the fact that Europe has not been a structuring issue at all in these elections—in spite of the euro crisis.

In contrast to the two previous cases, the Austrian political space appears more integrated in the latest electoral campaign as is shown by the fact that, in 2013, the economic and the cultural dimensions are less independent from each other. Nonetheless, the political space remains two-dimensional like in the other two countries. Importantly and as we have already noted repeatedly, we observe more competition on the economic dimension and more polarisation overall, as is indicated by the much larger triangle connecting the three major parties. In addition, each one of the main competitors is situated closely to its core issues—the SPÖ is close to welfare, the ÖVP close to economic liberalism and further away from welfare, while the FPÖ is close to anti-immigration. However, even if the three parties were driven further apart, this did not prevent the formation of yet another grand coalition in Austria. In this case, Europe is not even in the picture. Due to the few references to this issue in the campaign, Europe does not reach the threshold set to include an issue in the political space as we have only included issues with more than 3 % of the statements.

Conclusion

In this chapter, we analysed potential transformations of the structure of party competition in France, Germany, and Austria. We inquired whether the euro crisis critically transformed political conflict at the party systemic level. More specifically, we were interested in exploring whether electoral campaigns shifted their focus in terms of either attention (measured through salience) or conflict (measured through polarisation) on economic issues or on new cultural issues, and whether recent campaigns saw major restructuration of the political space. What can we conclude based on our analyses? Most importantly, we saw that, at the systemic level, there have hardly occurred any exceptional changes which would warrant speaking of a paradigm shift in the structure of party competition (see also Bermeo and Bartels 2014). Rather, the crisis seems to have reinforced trends already observed before its onset, namely, the emergence and growing importance of a second, cultural, dimension of the political conflict, driven by parties of the populist radical right.

First, we find that the economy has not become the only game in town. Two dimensions (an economic and a transformed cultural one) structure the political spaces in all three countries in 2012/2013 and we observe tri-polar party configurations as we did in the pre-crisis period (Kriesi et al. 2006, 2008, 2012). In all three countries, welfare and to some extent economic liberalism are salient issues, but not more than in the campaigns during the early 2000s. Especially in France, the country confronted with the most negative economic prospects, the crisis did not trigger any major re-politicisation of economic issues. By contrast, we rather see the continuation of the long-term trend of their declining importance.

Second, although political parties appear to be more polarised on the new cultural issues, the crisis did not uniformly boost their salience. Interestingly, the more salient conflicts over these issues become, the less polarised they get. It appears that the cultural dimension is reinforced as a structuring line of conflict because it gains prominence, not conflictive power. A uniform trend concerns European integration. The issue of European integration is no longer as firmly embedded in the cultural

dimension, and it is not structuring the overall political space as most parties have converged on a more Euro-critical position in times of crisis as compared to the early 2000s. The average position on European integration became more Euro-critical to the same extent in all three countries.

Third, we find that national trends remain important. The German campaign in 2013 can be labelled as rather depoliticised and we observe no major changes from the pre-crisis period. Interestingly, in Germany, the most salient issues are not polarised and the polarising issues gain limited attention. This reflects the Christian Democrats' strategy to focus their message on Angela Merkel and to move further to the left (by picking up issues emerging from the left and integrating them into her own program). This might have increased the niche in the political space occupied by the new challenger party AfD, which, however, did not (yet) have much influence on the overall structure of party competition at the time of the 2013 campaign. In France, the campaign further shifted to new cultural issues (Tiberj 2013). On the economic dimension, we observe limited change, although even the Front National adopted a more left-wing agenda. As a result, all parties are located further to the left in the political space and far more spread along the cultural dimension. Finally, in Austria, the picture is different as we observe increasingly salient and polarised conflicts over both dimensions. Unexpectedly, the economic dimension is even more salient. Indeed, in Austria, we find a strong increase in conflicts over economic liberalism, while Europe almost disappeared from the campaign. But it is important to again highlight that, even in Austria, this did not lead to any major restructuring of the political space.

As stated in the introduction, we submitted the idea of a paradigm shift to a hard empirical test as we did not include any of the countries which suffered most from the crisis and the related austerity packages. Had we observed this restructuring of the political spaces in France, Austria, or Germany, we would be confident that the crisis has had a strong impact on party politics across Europe. As the Greek example shows, the crisis may be an earthquake that shakes the foundations of the political system and greatly contributes to the emergence of new political parties and new lines of conflict in the political space. In future research, we propose to expand this research to Southern European countries not only to

study the rise of Syriza in Greece as a unique case of transformation of the political space but also to confront it with other similar phenomena in Spain or Italy, as well as divergent trajectories in Portugal. Indeed, the debtor countries from Southern Europe did not seem to uniformly witness the emergence of new challengers in the political arena. In Italy and Spain, the Movimento Cinque Stelle and Podemos challenge the established political parties, while in Portugal no comparable challenger has emerged yet. This will allow us to inquire whether the crisis in its medium-term evolution led to a restructuring of political spaces in the countries confronted with drastic austerity and widespread dissatisfaction with political elites and their management of the crisis.

To put these results into a broader perspective, let us again emphasise that the upshot of the cumulated effect of the Great Recession on the party systems in Europe does not indicate a shift in paradigm but rather the reinforcement of long-term destabilizing trends that have been transforming the party systems in the Northwest of Europe for more than 20 years before the crisis set in. And these trends seem to have belatedly reached Southern Europe as a result of the crisis. Indeed, as Hernández and Kriesi (2016) show, the main electoral beneficiaries of the economic hardship in Western countries have been new parties, as well as parties of the radical populist right and the radical left. By contrast, the impact of the Great Recession on the party systems of Central and Eastern European countries has been quite different. In these countries, incumbents have been punished less for economic hardship than for increasing corruption, and the party systems have followed an opposite trend as they have stabilized to some extent. While the volatility of the Central and Eastern European party systems is still a lot higher than in Western Europe, it is noteworthy that the volatility between established parties has actually decreased in these countries in the crisis period.

However, further research is needed to compare the effects of the crisis on the *structuration* of political conflict within and across European regions. In the light of the already apparent diverging trajectories found by Hernández and Kriesi (2016), the Great Recession may result in major transformations in specific countries or regions, but it may not lead to a 'new era of democratic politics' as hypothesised in the introduction of this book. Taking a long-term view, we might rather observe a conver-

gence of party systems in Europe. Lane and Ersson (1996: 130) already suggested some time ago that, in terms of volatility, fractionalization, and polarisation, the party systems of Eastern and Western Europe might have more in common than things that set them apart. While considering it still premature to speak of convergence of the party systems in the two parts of Europe, the contrasting experience of Western and Central and Eastern European party systems during the Great Recession suggest that the long-term trends may bring them closer together.

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10

'TINA' Revisited: Why Alternative Narratives of the Eurozone Crisis Matter

Ulrike Liebert

Introduction

During the dramatic negotiations over Greece's third bailout package on 11–13 July 2015, Europe's more than five-year-long euro-debt crisis took a significant turn, arguably changing the paradigm of the European Monetary Union (EMU). Spilling from the periphery over to the very core of the Eurozone, the Greek debt crisis triggered a larger conflict about whether the intractable problems of one of its member states could—in fact, needed to—be solved within the existing paradigm of the currency union or whether they made its break-off imperative. In fact, the German Finance Ministry claimed there were two alternatives: Either

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the Greek authorities guaranteed upfront 'debt sustainability' through a 'credible implementation perspective' of reforms aimed at financial market access after the new European Stability Mechanism (ESM) financial assistance programme was completed. Or, 'a time-out from the Eurozone' for Greece was the 'only way forward (that) could allow for sufficient debt restructuring since this would not be in line with the membership in a monetary union' (German Finance Ministry 2015).[1] The Peterson Institute for International Economics was quick to warn against the risks of bringing a 'Grexit' up in Eurogroup dealings: 'Doing so proved to be an extraordinarily effective negotiating technique.…At the same time, the spectre of a Greek exit undermined the sense of irreversibility in the euro area' (Kirkegaard 2015: 2). Former German Foreign Minister and Vice-Chancellor Joschkas Fischer advised not 'to dismiss the fierce criticism of Germany and its leading players that erupted after the diktat on Greece' (Fischer 2015).[2] The spectre of the 'ugly German' foreshadowed what British historian Timothy Garton Ash has foretold for the European Union (EU) of the twenty-first century: 'Europe is being torn apart—but the torture will be slow' (Ash 2015). Finally, resistance on the part of France, Italy, Luxembourg and Greece itself—and the latter's willingness to compromise—removed a 'Grexit' from the negotiation table. And despite the overwhelming majority of Greeks voting against the bailout conditions in the Greek referendum on 5 July, the Greek government committed to the Euro Summit's conditions in exchange for a three-year financial assistance package. These obligations include Germany's 'upfront' hard conditions, establishing a 'privatization fund', structural reforms and fiscal austerity under Troika control and acceptance 'that nominal haircuts on the debt cannot be undertaken'. Yet, the creditors also pledge to boost growth and job creation and to ensure that Greece's 'gross financing needs remain at

[1] The German Finance Ministry listed three specific conditions for Greece to make reform commitments credible: a Greek assets privatization fund for ensuring debt sustainability; capacity-building and de-politicising of the Greek administration under hospices of the European Commission; and automatic spending cuts in case of missing deficit targets for ensuring a successful implementation of the programme (German Finance Ministry 2015).

[2] Recalling the 'fundamental historical question at the heart of German foreign policy for two centuries' whether to aim at a 'European Germany' or a 'German Europe' (Beck 2012), Fischer argued this question 'was answered during that long night in Brussels, with German Europe prevailing over European Germany' (Fischer 2015).

a sustainable level' (Euro Summit Statement 12 July 2015). Nevertheless, over that haunting weekend in Brussels, EMU experienced a veritable, even if incomplete, paradigm change: Paradoxically, for the sake of fiscal stability it turned from an irreversible institution into a contingent, politically determined, more dynamic regime.

At this historical juncture what is being contested is how to qualify Greece's third rescue package: as 'utter humiliation or disaster averted', as appropriate to end the Greek debt crisis or as signalling that the spectre of Grexit will be back in the foreseeable future.[3] To better understand the potentials for paradigm changes, it is indispensable to explore the discursive dynamics of the European currency union. Some commentators have depicted EMU as a 'debilitating trap that countries cannot escape without suffering even more pain' (NYT 25. 7. 2015), yet the present analysis questions this depiction. I adopt the framework of 'contested narratives' for exploring the political discourses in support of and in opposition to the regulatory reforms that the Eurozone has developed in response to the financial crisis. Here, Greece is an outstandingly critical case for analysing how the dominant narrative has incited counter-narratives and how both interact in practice. In this narrative struggle, the Eurozone leaders have tried to defend their EMU paradigm—based on rules, monetary stability and competitiveness—by employing the narrative that there is no alternative to austerity. But their opponents have rejected this austerity narrative by means of alternative storylines. These not only provide different explanations and remedies to the euro debt crisis but also advocate unorthodox modes for governing the Eurozone.

The chapter seeks to clarify two questions in particular. First, by which narrative have Eurozone leaders defended the rules and austerity based paradigm of EMU governance especially in view of its anomalies, such as the failures of the Memoranda of Understanding for which Greece is an extreme case in point? And second, in which ways did alternative narratives that emerged from the on-going struggles about Euro-crisis governance in Greece matter in political practice? Both questions can be

[3] For critical verdicts on the 'toxic' deal reached on 13 July, see Habermas (2015a) and Lessenich (27. 7. 2015). A more optimistic view of the investor and growth-friendly stabilizing opportunities of the three-year ESM programme for Greece's future was held by the Institute for the German Economy (Hüther 14. 7. 2015).

summarized under the label 'TINA-paradox': the puzzle that a rules-based governance paradigm claiming 'there is no alternative' (TINA) will fail precisely because it triggers anomalies and helps empower alternative narratives that, however, it is not able to accommodate within an exclusively legalistic framework.

The following is structured in three parts: The first one explores how 'TINA'—the dominant narrative of the Eurozone crisis and prevention governance—has been articulated. The second analyses the ways in which the counter-narratives have been framed in response to the negative consequences—or anomalies—the dominant paradigm has triggered. And the final part draws conclusions as to whether there is scope not only for alternative narratives but also for paradigm change to the extent to which the established paradigm will not be able to resolve its failures.

The TINA Narrative of the Euro-crisis

'There is no alternative'—is there? TINA is an acronym ascribed to British Prime Minister Margaret Thatcher's famous declaration that there were no alternatives to market and competition oriented policy (Berlinski 2010; Jay 1996: 361).[4] Thirty years on, after the break of the Subprime Crisis in 2007 and the Global Credit Crisis in 2008 that became a systemic crisis of the Eurozone in 2009, German Chancellor Angela Merkel recovered this rhetorical device. In the German Bundestag, she made the case for saving the Single Currency, and that this ought to be achieved precisely by market and competition oriented policies: 'If the euro fails, Europe will fail', she stated, asserting that it was 'alternativlos' (without alternative) for Germany as a creditor state that the euro-states in sovereign debt crisis implemented deep spending cuts and structural reforms in exchange for bailouts (Merkel 19.5.2010). German Finance Minister Wolfgang Schäuble followed suit, defending the cut back of sovereign debt as 'alternativlos' (Schäuble 7. 7. 2010). In the aftermath of these governmental declarations, the term 'alternativlos' has been selected

[4] Margaret Thatcher at the Conservative Women's Conference, May 21st, 1980: 'We have to get our production and earnings in balance. There's no easy popularity in what we are proposing, but it is fundamentally sound. Yet I believe people accept there is no real alternative' (Jay 1996: 361).

as the 'Unwort' (un-word) of the year 2010, criticised for its depoliticizing rhetoric and substance that arguably fostered popular disaffection with politics: 'The term suggests inappropriately that a decision-making process lacks alternatives and, therefore, does not require discussion and argumentation'.[5]

The following will describe TINA—the established orthodox narrative of the Greek Euro-crisis—in five steps, starting with the euro-crisis explanation, describing then key policy ideas and Euro-governance rules, reviewing major issues of contention and addressing then the puzzle of its resilience despite its blind spots and manifest failures.

Explaining the Sovereign Debt Crisis

The emergence of the financial crisis in the Eurozone in late 2009 served as a wake-up call to make Europeans aware that the Eurozone was not immune to the financial crisis that had erupted in the USA during the preceding years. The crisis hit the Eurozone unexpectedly hard since it aggravated structural problems that had emerged previously: EMU was in trouble because it had been lacking control over its banks and over data from the member states, had no common fiscal and economic policies, and last but not least had a 'no-bailout clause' in the Lisbon treaty that allegedly prohibited common crisis solutions. The official narrative by political leaders from member states such as Germany was more limited: Other member governments were in trouble because of their lack of fiscal discipline, excessive budget deficits and mounting debt burdens aggravated by macro-economic imbalances due to their economy's loss of competitiveness. Their loss of access to financial markets was, therefore, blamed on their undisciplined spending and primarily conceived as a problem of deficient discipline and weak competitiveness. Thus, as the CEO of the EFSF (now ESM) Klaus Regling noted, the EMU design problem counted only in the second place (Regling 9. 11. 2011). This framing of the root causes of the crisis has informed and structured the responses subsequently chosen by the member states to cope with it. By contrast, had policy-makers prioritized the view that the break of the sovereign debt crisis in the Eurozone

[5] For the 'Unwort des Jahres 2010', see: http://www.unwortdesjahres.net/index.php?id=35; and http://de.wikipedia.org/wiki/Unwort_des_Jahres_%28Deutschland%29

was due to a major design shortcoming in the architecture of EMU, they might have chosen a different path for resolving the crisis. For instance, a joint debt redemption fund, or a common fiscal policy and EU budget could have been feasible options (German Council of Economic Experts 9. 11. 2011). Judged with hindsight, the Eurozone leaders' choice for crisis resolution was constrained by their assumptions regarding the nature of the crisis—namely that it was to be attributed to the member states in trouble. Therefore, the 'no-bailout clause' was taken for granted as a rule written in stone, except under exceptional circumstances and under hard conditions.

TINA's Policy Ideas: Solidity, Expansionary Consolidation, Moral Hazard

Eurozone leaders' policy choices are premised on specific beliefs regarding the root causes of the Euro-crisis deficits, attributing them to the lack of fiscal discipline and economic competitiveness for which Eurozone partners are held responsible. Moreover, the dominant leaders have deployed a range of captivating ideas to justify the anti-crisis measures and policies aimed at the over-arching objective to return the Eurozone to stability. Three such ideas stand out, in particular: first, a specific notion of 'solidarity' defined as solidity; second fiscal consolidation or adjustment ('austerity') conceived as a growth driver, especially if supported by structural reforms aimed at economic competitiveness; and third the problem of 'moral hazard' by national governments that requires surveillance by an external agency, the 'Troika'.

First, the principle of 'solidarity' defined as 'solidity' is used for justifying financial assistance programmes through ESFS or ESM loans that provide liquidity ('bailout') to member states in sovereign debt crisis only if two conditions are fulfilled: the crisis threatens the stability of the Eurozone, and debtor states will repay loans to creditors. Debtors are required to assume their 'responsibility' for 'solidity' by complying with the 'Memorandum of Understanding' that prescribes in detail the measures for fiscal consolidation and structural economic reforms that the debtor state needs to implement. Reform programmes follow a strict time line since loans are designed for limited time periods to exclusively help countries with temporary difficulties to re-access financial markets. 'Solidarity'

in the terms of EMU is, therefore, not conceived to support insolvent countries in the long run, as this would mean to transform the Eurozone into a transfer community, a transformation which Germany has resisted from the very inception of the EMU at Maastricht. In sum, Eurozone solidarity is limited to critical cases that threaten the stability of the Eurozone and, at the same time, are willing—and capable—to commit to 'solidity'.

Second, the economic idea of 'expansionary fiscal consolidation'—that is economic growth through budget cuts—has been launched for justifying austerity policies by the Ecofin meeting in Madrid on 15 April 2010. Here, EU finance ministers heeded guest speaker Harvard economist Alberto Alesina who established two persuasive claims: First, 'expansive consolidation' was possible, hence, economic growth could be generated through rigorous public budget cuts. Moreover, he suggested that there was a positive association between budget cuts (rather than raising tax revenues) and government re-election (Alesina 2010). The Ecofin was eager to take up these ideas in designing the bailout programs for Greece, Ireland and Portugal, to come.

Third, the rationalist economic idea of 'moral hazard' refers to the moral dilemma in a situation in which one party gets involved in a risky event knowing that it is protected against the risk and the other party will incur the cost. Strict surveillance is expected to resolve this moral dilemma that otherwise would undermine the credibility of any program or measure if some creditor countries (allegedly Greece under the Syriza government) negotiate softer commitments or even default on their debt, while others (such as Portugal) are expected to submit to painful obligations. To bring 'moral hazard' under control, supervision by a non-political agency—the 'Troika' composed by representatives from the International Monetary Fund (IMF), the European Central Bank (ECB) and European Commission—has been chosen as the appropriate instrument.

EMU Governance by Rules: Regulatory Framework Reforms Since 2010

In response to the global financial and economic crisis and to the public debt crisis in some European economies that broke in 2009, the

Economic and Monetary Union has considerably deepened the regulatory framework shared by the member states that have the single currency (Council of the European Union 2014). But rather than seeking to accomplish a comprehensive treaty overhaul for more coherently managing the financial and sovereign debt crisis, Eurozone leaders have worked around the established EMU treaty base by multilateral treaties and secondary legislation. Given that the EMU's 'Stability and Growth Pact' of 1997 had turned out to be too soft to prevent financial and sovereign debt crisis, the newly adopted instruments include corrective as well as preventive mechanisms. By correcting the 'no bailout clause' contained in the Treaty, the euro area countries in conjunction with the IMF issued financial assistance packages to crisis-hit Greece (110 bn in May 2010), Ireland (85 bn in November 2010) and Portugal (78 bn in May 2011), all in return for country specific reform programs. In June 2010, the euro area's first financial assistance fund, the temporary European Financial Stability Facility (EFSF) was established. In November 2010, the first 'European Semester' was kicked-off; that is a new procedure for monitoring and coordinating the fiscal and economic policies of the member states in line with the Commission's country specific recommendations for macroeconomic stability and with the EU's 'Europe 2020' strategy for jobs and growth.[6] In 2011 the European Council adopted three intergovernmental instruments, that is the Euro Plus Pact, the Treaty on Stability, Coordination and Governance (TSCG), including the Fiscal Compact, and the Treaty establishing the ESM.[7] In September 2011,

[6] The 'European Semester for Economic Policy Coordination' amends Council Regulation (EC) No 1466/97 (Section 1-A, Article 2-a) to regulate the EU's annual cycle of economic policy guidance and surveillance, see http://ec.europa.eu/economy_finance/economic_governance/the_european_semester/index_en.htm; 'Europe 2020' is the European Union's ten-year jobs and growth strategy that was launched in 2010 'to create the conditions for smart, sustainable and inclusive growth', see European Council Conclusions 17 June 2010; http://ec.europa.eu/europe2020/europe-2020-in-a-nutshell/index_en.htm

[7] The Euro Plus Pact—initially also called 'competitiveness pact' is an intergovernmental instrument adopted by the European Council on 24–25 March 2011 (Conclusions Annex I). Under the EU's open method of coordination (OMC) it sets the objective of 'stronger economic policy coordination for competitiveness and convergence' for the euro area and six non-euro area countries with the objective to strengthen economic convergence among the member states by promoting structural reforms, see: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/120296.pdf; the TSCG entered into force on 1 January 2013 as in international treaty, establishing automatic mechanisms to foster budgetary discipline by the Fiscal Compact, requiring signatory member

EU lawmakers adopted the 'six-pack', that is six new laws for monitoring, coordinating and enforcing the economic governance. To avoid negative spill over effects among EU economies, they introduced the 'Macroeconomic Imbalances Procedure' with multilateral surveillance to tackle imbalances early on, also by deploying sanctions.[8] In February 2013, EU lawmakers approved the 'two-pack' by which euro area member states commit to preparing their budgets according to common standards and a common timeline, to submitting drafts to the Commission and each other. Moreover, in June 2012, the Euro area agreed on the principles of a European banking union, however regulating only banks with Europe-wide operations. Finally, for a more efficient decision-making process the euro area reinforced its governance institutionally by establishing the Euro Area Summit, with at least two meetings of Eurozone Heads of States and Governments per year.

These significant advances of EMU notwithstanding, the European Parliament, the Commission, the European Economic and Social Committee and the European Council have outlined a roadmap with further steps needed to strengthen and achieve a better integrated economic, banking, fiscal and monetary union.[9] At the current state (late 2015), the governance of the Eurozone did not bring about a coherent set of community institutions, but rather (with respect to non-euro members) a differentiated set of rules, with increased internal fragmentation and imbalances between the responsible organisations and agencies (Closa 2015: 38ff.) Some, such as the ESM are governed by rules

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states to make the goal of balanced budgets part of their national constitutions. The Treaty establishing the ESM was adopted on 25 March 2011, creating an 'international financial institution', that is a permanent rescue fund for crisis resolution and prevention and to provide financial assistance to member states in financial or sovereign debt crisis; in October 2012, the ESM became operational.

[8] The 'Macroeconomic Imbalances Procedure' is part of the regulation on the prevention and correction of macroeconomic imbalances (EU No. 1176/2011, 16 November 2011).

[9] See European Parliament's resolution of 20 November 2012 with recommendations to the Commission on the report of the Presidents of the European Council, the European Commission, the European Central Bank and the Eurogroup 'Towards a Genuine Economic and Monetary Union': http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P7-TA-2012-0430+0+DOC+PDF+V0//EN; and the much less ambitious most recent report of the EU's five presidents 'Completing European Economic and Monetary Union' (July 2015): http://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report_en.pdf

established by international contracts outside the treaties. The Eurozone's ongoing Greek debt crisis, on the one hand, and the legal contentions accompanying ECB interventions on the other are cases in point indicating the institutional and political weaknesses of this legal construction.

One of the unresolved issues of the Eurozone is dealing with sovereign debt. In a recent account of 'How not to do it: the experience with Greece' renowned European economists claim that the architects of the Eurozone had failed to foresee sovereign debt crises, given that 'the no-bailout clause was supposed to act as a powerful deterrent. This turned out to be a mistake' (CEPR March 2015a: 38). Unfortunately, for bringing excessive sovereign debt back on a sustainable path, the options of collective debt restructuring or relief have been dismissed again and again. Constrained by established EMU rules and their excessively restrictive interpretations (Gerner-Beuerle 2015; Münchau 26.7.2015), national Eurozone leaders have refused to tackle the Eurozone's collective debt problem, arguing that debt relief would require changing the Treaty of Lisbon. Therefore, from the wake of the global financial crisis, when Eurozone members came under pressure and lost market access, up to the 2015 Greek bailout show-down, the Eurozone has not been prepared to deal collectively with debt as a systemic crisis. Debt restructuring is deterred by 'the make believe world of Eurozone rules' (Art. 125 TFEU).[10]

'Antagonistic Conditionality': The TINA Narrative Under Critique

Critical comments on the Eurozone's management of the Greek debt crisis abound in the international debate among economists, policy analysts, advisors and public commentators. Contentions about EMU financial assistance programmes take issue with four problems, in particular: First, 'fiscal austerity' that requires long-term, high primary budget sur-

[10] As Wolfgang Münchau contends: 'What is really happening is that Germany does not want to grant Greece debt relief for political reasons, and is using European law as a pretext. Likewise, when Mr Schäuble proposes a Greek exit from the euro, ask yourself what rule that is consistent with. The fact is they are making up the rules as they go along to suit their own political purposes' (Münchau 26 7. 2015).

pluses despite contractionary effects, fuels deep economic recession and even depression. Second, the issue of 'structural adjustment' excessively focuses on extensive liberalisation and privatisation reforms, yet sidelining debt relief that is too little and comes too late. Third, the overall too rigid approach to governance is being criticised. And finally, the 'Grexit' has come under attack.

First of all, critiques have taken issue with fiscal austerity as a condition for financial assistance, as it imposes harsh spending cuts with economically contractionary effects[11] The EU's austerity paradigm is being attacked as the 'wrong diagnosis of the problem (that) led to the wrong prescription' (Stiglitz 2014), in other words:

> It is wrong to ask Greece to commit itself to an old program that has demonstrably failed, been rejected by Greek voters, and which large numbers of economists (including ourselves) believe was misguided from the start. (Stiglitz et al. 2015)[12]

Most Keynesian economists have debated austerity and heaped scorn on the strategy of fiscal consolidation in contexts of economic recession. Undermining the credibility of the fiscal austerity conditionality, the so-called fiscal multiplier on which IMF models for programme countries relied upon has been shaken. Most notably, IMF chief economist Oliver Blanchard and others have acknowledged sizable gaps to exist between the IMF's theoretical forecasts and actual outcomes in Euro crisis coun-

[11] To name but a few vocal critics of the EU's austerity regime: Joseph Stiglitz, Paul Krugman, Susan Watkins, Yannis Varoufakis, Jean Paul Fitoussi, Ugo Mattei, Fritz Scharpf, Wolfgang Streeck, Henrik Enderlein, Hauke Brunkhorst; also by the Friedrich Ebert Stiftung, see Dauderstädt and Hillebrand (2013); for a more detailed discussion, see below 'Counter-narratives of the Euro-crisis'.

[12] In their joint letter to the Financial Times, Joseph Stiglitz, Thomas Piketty, Massimo D'Alema, Mary Kaldor and other international economists and social scientists argued that while it were important to distinguish austerity from reforms, 'austerity is undermining Syriza's key reforms, on which EU leaders should surely have been collaborating with the Greek government: most notably to overcome tax evasion and corruption. Austerity drastically reduces revenue from tax reform, and restricts the space for change to make public administration accountable and socially efficient. And the constant concessions required by the government mean that Syriza is in danger of losing political support and thus its ability to carry out a reform programme that will bring Greece out of the crisis' (Stiglitz et al., FT 5.6.2015).

tries (Blanchard 2015; cf. Alesina et al. 2014).[13] Critical economists have foregrounded the austerity policies' unintended long-term adversary consequences (EuroMemo Group 2015). Constitutionalists and political theorists have taken issue with European budgetary constraints on principles of democratic legitimacy, especially the budget sovereignty of national parliaments. The unprecedented power of nonelected agencies such as the 'Troika' has been blamed to be immune against procedures of democratic accountability and justification within the member states as well as in the European Parliament (European Parliament 2013). Even a key stakeholder in the international financial as well as the Greek sovereign debt crises has doubts. While endorsing harsh fiscal adjustment programs, former Deutsche Bank CEO Josef Ackermann admits errors in the implementation of budget cuts in Greece:

> As to possible flaws in the adjustment program, I find it hard to identify any significant flaws in the design of the program. If anything, we all underestimated the drag from the simultaneous fiscal retrenchment in many EU countries. In hindsight that would probably have called for somewhat longer adjustment paths. The crux of the matter lies not in design, but in the implementation. (Ackermann 2015)

Moreover, the structural reform programmes for Greece have been disparaged as unsustainable and unrealistic, since 'forcing the eurozone to mimic Germany's path to adjustment makes stagnation likely' (Wolf 2013; cf. CEPR March 2015a, b). Open Europe Co-Director Raoul Ruparel claims that neither austerity nor the design of the structural reform programmes were the major problem, but the failure to do a proper debt restructuring had been the biggest mistake committed in Greece, with important implications for the path forward (Ruparel, 11.6.2015). More than five years earlier, Barry Eichengreen had been arguing that letting Greece default on its debts within the Euro would

[13] Alesina et al. refuted the data based criticism by Blanchard as 'empirically weak', yet, unfortunately, in their assessment of the outcomes of 'Austerity in 2009–2013' they omit the Eurozone's most critical cases, Greece and Cyprus 'because the data required to include these countries in the panel used to estimate the model were not available—and if they were, as could be the case of Greece, such data have since been extensively revised' (Alesina 2014: 8).

have served the Eurozone better and at much lower costs for taxpayers (Eichengreen 2009). To that aim, German economist Clemens Fuest has been proposing a state insolvency procedure for the Eurozone (Fuest 2014). Critics of the first Greek bailout in May 2010 and of the 2012 Greek debt restructuring noted that these choices were more in the self-interest of the other Eurozone governments than drawing a line under the Greek euro-crisis (CEPR June 2015a).

Also, the Eurozone leaders—led by the German chancellor—have been accused for their approach to rescue-programs. Not willing to develop the ESM into a genuine European Monetary Fund, they continue bringing the IMF on board as a creditor and institutional supervisor into any of their rescue agreements. In relation to its Eurozone engagement, the IMF has admitted more easily failures than it has implemented corrections (cf. Strauss-Kahn 2015). For instance the IMF issued a call for Greek debt sustainability only after the conclusion of the 'Agreekment' (the agreement with the Greek government, laid down in the Euro Summit Statement of July 12th 2015) and including only a vague reference to debt. The IMF did not forcefully press this issue during the five months of negotiations between the Eurogroup and the Syriza led government, for which debt relief was a top priority. On occasion of the G7 finance minister summit hosted by Germany in Dresden in 2015, leading economists and policy advisors have disputed with the German Finance Minister's and the Eurozone's approach to handling the Greek sovereign crisis, noting that it was too rigid and lacked the necessary pragmatism for successfully stabilizing the Euro.[14] Although the first two Greek programmes proved obsolete in practice, also the most recent 2015 Greek bailout programme was designed according to rigid rules-based calculations of fiscal austerity, aimed at export-led internal devaluation programs, and to be implemented under micro-surveillance. In a devastating self-criticism, former IMF director Dominique Strauss-Kahn characterised this established governance approach as 'antagonistic conditionality' (Strauss-Kahn 2015). Unfeasible ideas that are written into EMU reforms and conditionality

[14] The Eurozone leaders were presented with criticisms by leading economists, including Nouriel Roubini and Larry Summers, on occasion of the G7 finance ministers' meeting at Dresden (28/9. 5. 2015).

programmes function as obstinate obstacles against policy-learning on the part of the Eurogroup lenders, on the one hand, and obstruct the effective Greek recovery, on the other. Constrained by its institutional rules at the current state of play, the EMU does not have incentives to foster collective learning and will formation aimed at a more legitimate and effective way to end the Eurozone's Greek crisis.

Finally, a fatal case to illustrate the ill-advised consequences of the hard-line narrative on rules-based governance has been the fiction created by some Eurogroup leaders that to heal the crisis and re-establish the integrity of the Eurozone required Greece's departure from the Eurozone. This narrative twist has backfired, as it was too obviously based on misleading ideas with dangerous consequences:

First, the Grexit storyline misread the 'no' vote in the Greek bailout referendum 2015[15] as a statement in favour of exit which was factually wrong. The Greek government (2015) made clear to its people and to its Eurozone partners that it did not pursue an anti-Eurozone course but instead wanted to negotiate the terms of Greek membership, namely, the dysfunctional austerity conditionality that over five years had been working against economic and labour market recovery.

Second, the misreading of the Greek vote was dangerous, as it would go decisively too far in forcing the will of a few lender governments (without a formal say by their constituencies) on that of Greece (debtor government and citizens), which could lead to the worst outcome: the disorderly exit of Greece from the Eurozone, in the terms of 'Graccident'. The power asymmetry between smaller and larger states in the Eurogroup and the Euro-Summit and the lack of direct accountability of both organs would hamper the legitimacy of the EMU, especially in economically hard times.

Third, from a geopolitical perspective, the economic, social and financial costs of a potential 'Graccident'—an accidental exit of Greece from the Eurozone—for the various constituencies of the Eurozone and beyond could further undermine the democratic life in, and legitimacy

[15] This referendum was called for by the Syriza led Greek government to decide whether Greece was to accept the bailout conditions proposed by the European Commission, the IMF and the European Central Bank to take place on 5 July 2015. Following the Government's No-campaign, 61 % rejected the bailout conditions; see https://en.wikipedia.org/wiki/Greek_bailout_referendum,_2015

of, the EU and would likely harm the community of destiny that always more interdependent European member states have gone a long way to construct.

Obsolete but Obstinate: TINA's Resilience

All these informed criticisms notwithstanding, the TINA narrative of austerity has demonstrated a remarkable resilience (Schäuble 2015). Apparently, it has prevailed over the anti-austerity stances of the Syriza-led Government after the Greek 25 January elections, let alone the nearly two thirds of the Greek electorate that voted against the austerity program of the Euro-Institutions in the Referendum of 5 July 2015. As the most recent 'Euro Summit Agreement' (July 12th 2015) indicates, the 'cash for austerity and reforms' conditionality is alive as ever, ignoring expert advice, mass public anti-austerity protests and government opposition. On the contrary, the austerity narrative has further institutionalised and apparently become more immune against policy failures in the intractable Eurozone debt crisis. In fact, Eurozone leaders succeeded in writing the austerity conditionality—that is the core principles of fiscal discipline—into successive EMU reforms, namely the 2010 European Semester, the 2011 Fiscal Compact, and the 2011 ESM.

This could be achieved since core Eurogroup leaders take for granted that their 'rescue strategy' has proven generally right. Their prominent claim is that it has worked in cases such as Ireland, Spain and Portugal where rescue programmes have been concluded and access to financial markets regained (but economic recovery is weak and mass unemployment and emigration persistent). Greece is portrayed as an exceptional case where external reform pressures did not work because of political and societal resistance against unpopular reforms. The facts speak against the persistent myths that Greece had done nothing. On the contrary, Greece has undergone huge adjustments of its fiscal and external positions, including a primary fiscal balance tightened by 12 % of gross domestic product during 2009–2014; a structural fiscal deficit by 20 % of GDP, and a current account balance by 12 % of GDP. From January 2008 to April 2013, its real spending fell by 34 %, its GDP by 27 %, while

its unemployment rose to 28 % of the labour force (Wolf, in FT 21.4. 2013). But EMU is institutionally well insulated against public grievances provoked by distributional impacts of Eurozone governance that are perceived as unfair. To quote an exemplary rebuttal of debt restructuring for Greece from a German perspective:

> It seems to be fashionable and convenient to accuse Germany of bullying these days. You might have a legal point but your conclusion is simply wrong. Germany has 2000 billion state debt, has undertaken harsh reforms in the last decade and has been for decades the largest contributor to the European Union and its transfers. Germany bailed out Portugal, Ireland, Spain and Greece now for the third time. German taxpayers had no say in the policies and financial legislation of these countries; however, they jumped in to help. Greece committed fraud when it joined the EURO, it paid ridiculous wages, civil servant bonuses, handed out free airplane tickets, paid pensions for people who were already dead and last but not least the government did not tax, not the church nor the rich. After using the credit limit of the Eurozone for 10 years and openly breaking agreements made to further financial aid, all that is left in the public debate is 'The Germans are bullies'. There is a famous quote 'no taxation without representation' German tax payers have not been represented in any of the governments decisions in Southern Europe—yet they will pay for them. (Schroeder 2015)

The mainly technocratic and only indirectly partially accountable set-up of ESM decision-making serves as a firewall against excessive political influence.[16] The Eurogroup and the Euro Summit have been constructed to operate in splendid isolation from the European Parliament. If the Eurozone political leaders were not only responsible to their national constituencies but also had to account regularly and in public to the European Parliament, they would have more incentives (or pressures) for learning from and correct past policy failures. At present, the Eurozone's organs are institutionally over-constrained by fragmented domestic mass publics and the conflicting narratives that they are not able to reconcile. Narrative differences along national lines have degenerated into hostile

[16] However, the finance ministers and the elected members of national parliaments will take the final decision on financial assistance packages for crisis countries.

frictions between governments, locking the Eurogroup into a vicious circle that has been undermining the very effectiveness and legitimacy of the EMU.

If the TINA narrative of the euro-crisis is too limited to solve it, what then are the alternatives?

Counter-narratives of the Euro-crisis

Anti-austerity protesters across Europe have been in search of alternatives since the international financial crisis broke in 2008 (Pianta and Gerbaudo 2014). TINA criticism provided the social science research agenda with new questions, including topics such as: How to conceptualize 'the market as a Res Publica', in ways to 'take back the economy' (Pettit 2013); or how to 'civilize the capitalist market economy' (Ulrich 2016)? When the Greek radical party Syriza rose to government power on 25 January 2015, its longstanding anti-austerity platform confronted EMU leaders with TINA's most severe challenge to date. In the euro-crisis management from 2010 onwards European policy makers had rarely heeded critical comments by heterodox economists. A contest of narratives could not happen as long as the arenas in which they were performed did not overlap. This changed when alternative ideas critical of TINA appeared on Syriza's electoral platform and translated into Greek government policy after February 2015. In light of the deep differences among the established and the counter-narratives—and given that Eurozone decision-making is premised on the principle of unanimity—the clash of narratives was programmed and would inevitably lead to troubles.

Alternative Stories of the Crisis Origins

Joseph Stiglitz's account of 'The euro-crisis, causes and remedies' presented in the Italian Chamber of Deputies (23.9.2014) has gained political following, if less in Northern Europe, all the more so in Southern Europe. According to his story of the crisis, lack of budget discipline neither caused the last financial crisis nor will fiscal disci-

pline prevent the next one (Stiglitz 2014). Instead of governments' overspending, there are three flaws that supposedly better account for the crisis: misconceived economic models, flawed EMU design, and misleading euro crisis policies. In his account of austerity as 'a dangerous idea', Mark Blyth has shed light on another origin of the Eurozone crisis that the austerity narrative serves to conceal: the international financial and banking crisis after 2007 (Blyth 2013). All four were systemic flaws that contributed to the lack of foresight to prevent the euro-crisis in the first place and the failure to settle it after it broke.

Innovative Policy Ideas: Structural-reform-indexed Loans

Alternatives to TINA's agenda of fiscal austerity and structural adjustment programmes aim first and foremost at true economic recovery through pro-growth policies. At the level of principles, they foreground core values, principles and objectives that are written into the EU treaties and the Charter of Fundamental Rights: solidarity, social cohesion, gender equality, high level of employment and social protection, and social progress. The German Arbeitsgruppe Alternative Wirtschaftspolitik in its yearly Memoranda has been advocating in favour of 'social-ecological regulation instead of austerity policy and tax dumping' (2010), 'solidaristic integration instead of German austerity dictates' (2012). At the same time, Joseph Stiglitz has vocally supported the anti-austerity claims: 'Even though the 2008 crisis originated in the US, the gap (in GDP between the US and Europe) is as big, and on trend it will be worse; the Euro and the policy responses to the euro-crisis are a key reason'.[17] Following Stiglitz, by the end of 2014 the euro-crisis has mutated into an intractable economic depression in several Eurozone countries. In countries that went through a banking crisis in 2007–2009,[18] five years later real GDP per working population and per capita incomes is lower than it was before the crisis. The GDP gap between

[17] https://www0.gsb.columbia.edu/faculty/jstiglitz/download/speeches/2014_Rome_euro_ppt.pdf last accessed on 23 September 2015.

[18] The banking crisis took off in 2007 in the USA and had particularly adverse effects on Iceland, Ireland, Spain, Greece, Portugal, Italy, Germany, France and the UK.

the USA and Europe has been increasing. The Eurozone–19 is affected by higher unemployment—and even much higher youth unemployment than the USA or Japan. After having already lost half a decade with economic stagnation, the Southern euro-members—in particular Italy, Greece, Spain, Portugal and France—face the threat of losing another decade or even a quarter century to come. Given the lowering of future potential growth as a result of persistent unemployment, the long-term costs of the crisis—and of the Eurozone's failure to establish effective counter-policies—are mounting. Due to the Ukraine crisis and the depression in the Southern Eurozone, Germany's role model performance would likely decline, as well (Stiglitz 2014). While neoliberal economists advocate 'fiscal discipline' and 'structural economic reforms' to enable states in sovereign debt crisis to gain access again to the financial markets in no more than a few years time, non-orthodox economists point to the recessionary impacts of these measures and, therefore, prioritize 'investment' or 'stimulus' for the economy to return to a growth path.

Sharing the thrust of this diagnosis, Yanis Varoufakis, Greek Finance Minister from February to 6 July 2015, retells this story in a theoretically sophisticated way (Varoufakis 2011; 2015; Varoufakis et al. 2015). In 'The Global Minotaur: America, Europe and the Future of the Global Economy', his version is critical of Germany for having constructed the Eurozone as a system of fixed exchange rates without any means of recycling surpluses towards deficit countries, such as Greece. As Germany refuses the role of a benign European hegemon, it dominates the European economy and secures its own surplus by not fighting stagnation outside its borders. However, without stimulating demand by investing across the Eurozone, the crisis of the Eurozone will inevitably continue. To quote but one of the quality presses, such as the *Financial Times*, that supported Varoufakis' counter-narrative:

> Varoufakis' dismissal of structural solutions does Greece no favours. But the savagery of the German approach, akin to dragging a collapsed marathon runner back to the race, looks like an economic surplus used as a weapon of coercion. (Wilkes, FT 19. July 2015)

The short-lived Greek Finance Minister's policy priority has been debt relief for Greece: While granting to serve interest payments on loans received from creditors such as the IMF he proposes prolonging loan maturities by linking them to Greek growth. Growth indexed debt relief would establish a new kind of positive conditionality aimed at providing the Greek economy with breathing air. Along this line, other economists develop this claim into an alternative approach to 'antagonistic conditionality' based on positive incentives. Barry Eichengreen, in 'Escaping the Greek Debt Trap', elaborates the idea of gross-domestic-product-indexed bonds to propose still another way for squaring the circle, namely linking debt relief to structural reform implementation: 'Greece and the EU should contractually link changes in the terms of the country's EU loans to milestones in structural reform. Think of the result as structural-reform-indexed (SRI) loans' (Eichengreen 2015, Barber 2015).

Blind Spots Curbing Alternative Proposals for Solving the Greek Crisis

Shortly after Syriza had risen to the ruling party, German ordoliberal economists anticipated the July 13th agreement that some depicted as 'a new Versailles Treaty' as destiny: 'Greece: No escape from the inevitable' (Feld et al. 20.2.2015). The subsequent five months of negotiations between the Greek government and the Eurogroup would showcase on which policy-issues the anti-austerity narrative by the Greek government would challenge the dominant crisis storyline of the Eurozone leaders and why it had ultimately to surrender:

First, the anti-austerity narrative takes its starting point in the multiple financial, economic, social and political crises exacerbated by the international financial system and the misguided Euro-crisis policies, but it tends to ignore the problem of fiscal overspending. Also, the anti-austerity narrative takes issue with TINA by prioritizing debt sustainability for one country over fiscal austerity but overlooks the reactions that this claim will have in other member states, thus requiring a common solution.

Second, the anti-austerity narrative proposes creating economic growth and developing social policies to fight poverty and foster domestic demand. However, financing counts on EU resources and private investments coming from abroad while refuting to tap into domestic fiscal resources, private savings or the privatisation of state property.

Third, the anti-austerity narrative pursues an agenda of responsiveness towards citizens' needs by encouraging their direct democratic participation in EMU decision-making. But it disregards the potentially disruptive effects that the proliferation of national referenda in Euro countries must be expected to have.

Fourth, the anti-austerity narrative suffered from the difficulties of the newcomer, the contending Greek government party, incapable of building political alliances within the complex setting of the EU. It did not sufficiently weigh the costs of loose negotiations and of unwelcome outcomes for Greece, such as the three-week bank closure and capital controls in July 2015. Ultimately, it nearly defeated itself by moving Greece closer than ever before to exit from the Eurozone.

Fifth, the anti-austerity narrative puts EMU reforms centre stage but snubs the needs for Greek state capacity building, including the fight against corruption and tax evasion and the necessity of implementing effective domestic reforms. Elias Papaioannou, Richard Portes and Lucrezia Reichlin, professors of economics at the London Business School, in their policy paper 'Greece, a way forward', assess both the Greek government reform proposal and the institutional draft agreement for Greece quite critically:

> While Greece should not revert to the era of deficits and while establishing a sustainable social security system is needed, it is disappointing that there is not much discussion on the major structural deficiencies of the Greek economy. The new program should focus on opening-up closed and oligopolistic product markets, removing barriers to entry and expansion, reducing red tape, and tackling tax evasion. The new program should also focus on public administration reform and on building institutional capacity. It is time to tackle the deep issues rather than myopically focusing on fiscal measures. (Papaioannou et al. 4. 6. 2015)

Struggles About Political Space for Euro-crisis Policy Alternatives

The newly introduced mechanisms for governing the Euro-crisis have deeply transformed the democratic politics of the member states under programs. These are now required to consent to sovereignty transfer to the 'institutions' (ECB, COM, IMF) and, in practice, to the informal Euro group. In the Euro-area, Europeanisation has prompted the marginalization of national parliaments, albeit in some cases—given the German veto position in the ESM—much less than in others. In an attempt to reverse these de-democratising dynamics, the Greek government called for a referendum on the austerity programme proposed by the Euro group. The referendum of 5 July 2015 was an unprecedented instance of a plebiscite on Eurozone bailout-conditions. The Eurozone leaders had no choice but to acknowledge it as a legitimate means of democracy. Greek voters turned out in unexpectedly high numbers and forcefully spoke their will. Yet, the mixed message of the Greek electorate—nearly two thirds voting against austerity but for staying in the Euro—failed to penetrate TINA and, therefore, did not make any difference. On the Eurozone side, dismissing the referendum outcome, leaders forgot that governance of an economic and monetary union is part of the EU of states and citizens, founded on common values such as 'respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities' (Art. 2 TEU). In the framework of EU fundamental values, the Greek population of 11 million ought to be acknowledged as minority among the nineteen Eurozone states comprising some 300 million citizens, a minority that is deeply divided over the burdens which Eurozone rules require them to bear for the sake of the euro's stability.

Unfortunately, on the Greek part, misleading ideas were brought into play. Oversimplifying the answers to the complex challenges facing the Eurozone members, Greek citizens were made to believe in the Government referendum campaign that their 'no' could end austerity in Greece any time soon.[19] Also, they were persuaded to trust the ill-con-

[19] In any case, the preparation of the 3rd Memorandum immediately after the referendum left all but optimism among Greek citizens regarding the end of austerity any time soon.

ceived claim that national referendums will pave the way to democratising the technocratic supranational EMU regime. Yet, normatively speaking, in exceptional cases referendums can, and should, be used to allow a minority to make its otherwise weak voice better heard by a European political class dominated by national majority concerns. And in practical terms, the effective management of the referendum and the unexpectedly high turnout should have convinced also Greece's most sceptical Eurozone partners that, if the Greek people stand behind their government, there is actually a good potential in Greece for taking political ownership of a meaningful, long-term programme for successfully modernising state, economy and society. This potential for constructive ownership was not taken advantage of. Instead, Eurogroup leaders used the threat of 'Grexit' for forcing Greek Prime Minister Tsipras to agree with the 3rd Memorandum. Designed after TINA, it offers little scope for paradigm change and more constructive outcomes than in the past. With limited resources pledged by the Commission to stimulate economic growth, the Greek government and citizens will hardly believe in the 3rd Memorandum to bring a decisive upswing to the Greek economy and society. In the absence of a credible perspective for debt sustainability and a common European fiscal policy, the chances for successful recovery in Greece will be hard to materialize.

Paradigm Change? How Alternative Narratives of the Euro Crisis Matter

The present analysis suggests reading the Eurozone's sovereign crisis as a story about a series of events that have been framed and told differently within the framework of contentious crisis narratives. After its contentious take-off amidst a wave of Euro-scepticism (Liebert 2001), during its first decade the EMU has successfully defied a number of critical claims (Verdun 2010). The single currency has been praised for being conducive to price stability with average inflation rates close to 2 %, relative fiscal discipline[20], cross-border trade due to protection of the Single Market

[20] The aggregate fiscal deficit of the Eurozone was at 0.6 % of GDP, compared to close to 3 % of USA, UK and Japan in 2007.

against exchange rate volatility, thereby to GDP growth and, ultimately, to establishing the second most important world currency. Even after the outbreak of the Euro debt crisis, the EMU seemed to be better positioned than other currency areas, given its lower fiscal imbalances compared to those of the USA and Japan (IMF April 2011, Table A8). After all, following the international financial crisis Iceland was interested in joining the EU as a precondition to adopt the euro. And despite its debt crisis the Eurozone enlarged, taking in Estonia (2011), Latvia (2014) and Lithuania (2015).

The advent of the sovereign debt crisis in the Eurozone in late 2009 to 2010 was the crucial event that broke the established rules of the game and created divisions on how to develop new ones. Challenged by the crisis, the previously de-politicised state of play has given way to a new confrontational style of politics. The new struggles are about seemingly irreconcilable scripts. On the one hand, there is the TINA—narrative of 'there is no escape from the inevitable' (Feld et al. 2015) claiming that irrespective of humanitarian values, social justice and risks of humiliation, deep and long-term fiscal austerity for debt servicing to be the condition for financial solidarity provided to fellow member in a sovereign debt crisis, allegedly conducive to promoting competitiveness and economic growth. On the other hand, there is the storyline of the sovereign crisis proclaiming that 'austerity has failed' (Darvas and Tschekassin 2015; Fundacion Alternatives 2012), scapegoating the EU, the IMF or the creditors for it, but not prepared to embrace the necessary domestic reforms. Thus, none of both narratives is capable of breaking through the vicious circle of corruption and tax evasion, of recession and unemployment, of the lack of social and political trust. Handicapped by their respective blind spots, the dominant TINA narrative clashes with contentious alternatives on a range of issues regarding the root causes of the crisis, policy ideas and alternative visions regarding the politics of EMU rules. Five years after the break of the Greek sovereign crisis, these narrative clashes have cast the Euro-Union into political turmoil, pitting founding member states against each other. If these differences prevail, they will lock the EU in a lasting institutional crisis. Arguably, the current clash of crisis-narratives matters for the EMU in a variety of ways, depending on what kind of differences are at stake:

Contentious narratives matter economically and politically depending on how the austerity dogma is linked to solid interests at the root of the narrative conflicts—such as the conflicts about debt-relief or debt sustainability among the debtor and the creditors—and whether or not these can be reconciled in the framework of a win-win arrangement. Narratives do matter, because they can help reconcile or polarise hard interests: 'The Greek crisis…provides a vivid illustration of how conflicting narratives can lead us close to a lose-lose result' (Gros 2015). If contentious narratives can be reframed in conciliatory terms, they will support a paradigm change of EMU towards new modes of political economic governance, including shared risk arrangements, a joint debt redemption fund, a fiscal union, the strengthening of a common supranational budget and a social dimension of EMU. If not, confrontational narratives pitting national sovereignty against supranational pooling of capacities will inevitably help trigger the dismantling of EMU.

Second, narrative conflicts also originate in different disciplinary backgrounds. They matter cognitively depending on how lawyers and orthodox economists succeed in isolating their models against empirically informed social and political analyses. In this sense, conflicting narratives are about the economics vs. the politics and sociology of the Euro-crisis:

> Tsipras' volte-face demonstrates that the economists who call for Grexit might have their economics right (a devaluation could potentially benefit the country) but they have their politics and sociology awfully wrong. There is a reason why 70 per cent of Greeks want to stay in the euro. They know their country well. This is why they have accepted Tsipras' capitulation in Brussels and encouraged their Parliament to vote, for the first time with an overwhelming majority, in favour of this harsh third rescue package. (Otero Iglesias 2015)

Given disciplinary constraints, crisis narratives will be inevitably biased towards some premises and causal links while ignoring others that only a multidisciplinary account will account for.

Third, narrative differences regarding austerity also have impacts that will be missed if we do not take democratic legitimacies and collective

identities into account. The Greek crisis is not about a clash of ideologies but rather a clash of democracies, as Raoul Ruparel argues:

> You now have one democratic government who has a mandate to impose huge losses and reap huge changes on other democratically elected governments, who do not have a mandate to accept such changes. Direct transfers would have required a fundamental rewriting of the Eurozone and EU treaties. Furthermore, it also requires referenda in many member states including probably the UK and Germany—where there would need to be a fundamental change to the basic law and the German constitution. This would have to be done in a democratic fashion. (Ruparel 2015)

From a normative democratic perspective, the (technocratic) TINA narrative inevitably undermines existing political identities, representative institutions and other channels where citizens and civil society have a say.

TINA will have won out over its alternatives if EU leaders succeed to legally strengthen the rules and firewalls for a shock-proof EMU regime to make it the only game in town. In case this does not happen, and if the TINA narrative on austerity continues to provoke counter-narratives that generate political trouble, a paradigm change of EMU will become more likely. The contentious narratives provide suggestions as to which changes EMU needs to implement to reform TINA and, hence, how a future EMU paradigm change might look like:

First of all, policy alternatives to the current programmes (fiscal consolidation, competitiveness-oriented structural economic reform) will aim at socially fairer distributional consequences. Seeking a compromise between Europe's social and humanitarian values and the economic governance of its single currency, redistributional policy reforms will move EMU some way towards a 'Transfer Union' but not necessarily pitting economic interests of creditor nations against those of the debtors.

Moreover, theoretical alternatives have to cope with both dominant economic models—the currently operating EMU that is fraught by the structural divergence of a non-optimum currency area, and the economic orthodox advocacy for Grexit as a device for redesigning a more homogeneous core Eurozone. They adopt heterodox approaches to develop economic

theorizing on the impacts of economic and social imbalances on monetary stability, in search of 'a better understanding of what Europe needs to be a dynamic economic and monetary union' (Marimon 2014).

Finally, democratic alternatives to the established technocratic EMU regime propose institutional reforms below or above treaty reform. In the best case, the confrontation of TINA with alternatives could lead to more political scope to gradually transform the technocratic nature of the current EMU paradigm. It could lead to paradigm change by empowering the European Parliament with national parliaments to hold executive agencies such as the Troika, ESM and the Eurogroup democratically accountable. Depending on party political power relations, this could even bring a social democratic euro-union about. In the worst case, however, the legalistic-technocratic mode of governance as well as policy-changes will be rejected. As a consequence, the Eurozone will either disintegrate, if constituencies do not any more accept pressures for adjusting national democratic practices to global market imperatives. Useless narrative conflict will again help ordoliberal alternatives prevail, lead to the shrinking, and even trigger a process that might spell the collapse of the EMU. This worst case scenario could be avoided only if political leaders committed to European values of egalitarian democracy will negotiate a more solidaristic and inclusive political pillar for EMU. This would upgrade real existing democratic institutions, enabling them to better perform complex conflict articulation and intermediation in the multi-layered system of representation that the Euro-Union needs to further develop (Schmitter 2012; Evas et al. 2012).

Conclusions

This chapter has explored the Greek case to revisit the dominant austerity narrative that is rooted in the paradigm of monetary stability in light of two major contentious alternatives: the anti-austerity narrative on the one hand, and post-Grexit core-EMU on the other. My analysis seeks to contribute to a more nuanced understanding of the contentious politics of austerity by developing a number of claims. First, I show that TINA did not emerge with Syriza's rise to power in the Greek elections of 25

January 2015 but rather dates back to early 2010, when this narrative was introduced by the German government at the wake of the Greek sovereign crisis, deflecting the focus of public attention from the systemic banking crisis (and tax funded bank bailouts) and EMU design flaws to the responsibility of national governments. Successive EMU governance reforms have armed TINA with quasi-constitutional rules, making it possible for public contention to challenge ill-fated social consequences and economic failures but offering no institutional channels for articulating grievances and translating them into political will formation and decision-making on EMU. The second section exploring the counter-narratives shows that they involve more than anti-austerity ideas and claims for debt-forgiveness, namely, they provide for non-orthodox explanations of sovereign debt crises. Moreover, these multidisciplinary narratives link EMU to ideas of the political, of 'social justice', democratic legitimacy, and political integration of Europe. The third section has discussed the questions of whether and how conflicting narratives matter in the politics of EMU, suggesting to differentiate policy interests, disciplinary divisions and democratic identities. The last section pondered the potentials for partial EMU paradigm change by analysing the multiple impacts of the narrative struggles among TINA and its competitors.

Regarding the future EMU paradigm between continuity and transformation, it amounts to a catch-22 for EU leaders on how to settle the Greek precedence: a case for keeping a Member State in the Eurozone and ensuring debt-sustainability but without forcing it into much more fiscal austerity, whilst strengthening the integrity and stability of the common currency regime. For this purpose, the fundamental rules of EMU governance will need to further develop. To strengthen the Eurozone's capacity to learn from past failures for the sake of better coping with intractable crises in the future, its current rules-based regime requires a stronger institutional backing and cross-checking. Arguably, it needs institutions capable of settling conflicting narratives intertwined with hard interest by performing deliberations that are transparent to European publics. Such a representative-participatory-political pillar is required if the Euro-Union is to regain new political trust that recent antagonistic Eurogroup and Euro-summit meetings behind closed doors have shattered. Not a new, but timely plea

against 'façade democracy' and in favour of a paradigm change for Europe: 'Not banks but citizens must decide over Europe' (Habermas 2015b).

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11

From One-directional to Multi-directional Paradigm Shift

Pablo Iglesias-Rodríguez, Anna Triandafyllidou, and Ruby Gropas

Beyond One-dimensional Understandings

In the existing literature, the concept of paradigm has traditionally been interpreted as a one-dimensional phenomenon with a potential impact on other dimensions which are not intrinsic to the paradigm. For example, in the view of Kuhn (2012: xIii) paradigms are 'universally recognized scientific achievements that for a time provide model problems and solutions to a community of practitioners'.

The traditional perceptions about the phenomenon of paradigm shift have been highly influenced by the prevailing one-dimensional

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conceptions of paradigms. In this respect, changes in paradigm have predominantly been analyzed as one-directional, top-down processes in which paradigms originate in scientific or public policy arenas and are then progressively embraced by actors and forums in other dimensions.

The emergence and consolidation of the Efficient Market Paradigm constitutes an example of such a one-directional, top-down process of change in paradigm. In effect, the Efficient Market Paradigm can be traced to a scientific theory—the Efficient Market Hypothesis (EMH)—that was developed and formalized by Eugene A. Fama in the year 1965. The EMH soon expanded its influence beyond the academic field, and was encompassed by policy-makers of several jurisdictions—notably in the USA—through measures that involved, *inter alia*, the adoption of a *laissez-faire* approach towards the financial services industry and the propitiation of industry self-regulation.

> In this new scenario, regulatory structures were confined to an increasingly limited area. Innovation seeks—and in many cases manages—to evade regulatory controls. If to that you add a booming pro-market ideology into the mix, it is not hard to understand how we arrived at 'light-touch regulation', where the idea of self-regulation by the very market agents themselves reigned supreme. In this vision, the market processes are clearly superior for monitoring, anticipating and measuring risk. (Arias and Costas 2015: 71)

The EMH was ultimately embraced by investors in their financial decisions.

But when does a paradigm shift occur? How does it occur? And can we say that the current crisis led to an incomplete paradigm shift as change has taken place but at different speeds and in different levels of the legal, civic and institutional framework.

Indeed, a paradigm shift is the result of patterns of interaction between social innovation by citizens and organized groups, system innovation by regulators and through law or institutional creation/change, and in interaction with macro-development factors that function as 'game changers'. These different elements may contribute to creating narratives of (radical)

change. Individual actors or networks contribute through different forms of action, including social learning, resourcing and monitoring governance to these shifts (Haxeltine et al. 2013).

Haxeltine et al. (2013) have convincingly argued that this crisis involved a number of perspectives. It has been considered to have had socio-economic, socio-ecological, socio-technical, socio-political and socio-cultural implications. It has been perceived to have magnified inequalities, poverty and alienation with negative consequences on efforts towards sustainability, technological innovation, the quality of democracy and on values. The crisis has been considered to have had profound impact on society leading actually to 'narratives of change'.

These narratives of change relate to what Murray et al. (2010) have referred to as 'generative paradigms' or, in other words, ideas and goals that drive and motivate social innovation. These narratives of change—policy narratives, counter-narratives, meta-narratives—may co-evolve with new paradigms such as those concerning the regulation of the financial sector or the role of the market.

Counter narratives develop expressing loss of trust in the growth and governance models that existed prior to the crisis and proposing alternative visions of growth, livelihood, interaction and governance. The models that are proposed as alternative paradigms are not necessarily 'new'. In fact, in most cases they have existed for substantial periods of time. It is the way they are perceived that is important because they are considered, to return to Haxeltine's proposed terminology, as 'game-changers'. Thus, narratives, practices, considerations and modes of interaction and governance that also existed prior to the crisis, are considered forward-looking responses to contemporary and future challenges (Castells 2010; Rifkin 2014).

This book has examined these responses to the crisis, at different levels, notably in governance and regulation, the economy, the political scene and in civil society asking whether along with narratives of change, actual change has occurred, whether the change amounts to a shift in paradigm, and if so, whether we may speak of a complete or, indeed, as we argue, incomplete paradigm shift, that actually develops in different directions, thus requiring us to reconsider our understandings of how paradigms work.

The Determinants of an Incomplete Paradigm Shift

Incompleteness of the Post-crisis Social Sciences Theoretical Framework

As has been referred in Chap. 1, a shift in paradigm may often source from the formulation, dissemination and acceptance at various spheres of more or less developed theories challenging former ideas and providing a new cognitive framework where to analyse social phenomena. If and when actors and forums in various social dimensions encompass these theories, they may in turn trigger a shift of paradigm.

Even in those instances in which a process of shift in paradigm originates in a non-scientific dimension, the consolidation of such change requires that, at some stage, a theoretical framework embraces the ideas underlying such a paradigm. In other words, the scientific dimension of a paradigm constitutes a necessary condition for its survival over time or for a process of paradigm shift being complete.

One of the facts evidenced by the various chapters in this volume is that the post-crisis developments in the social, economic and legal arenas have not yet been embraced and supported by strong theoretical frameworks. For example, in the economic arena, the prevailing pre-crisis financial paradigm, namely the Efficient Market Paradigm, has been challenged but scholars have not yet been able to provide a theory that offers an alternative and comprehensive explanation of the mechanisms driving the functioning of the financial markets and their actors.

Whereas scholars have been trying to craft new theories, the post-crisis conceptual developments in the scholarly arena suffer from various weaknesses. In the first place, they tend to be mono-disciplinary and are based on the observation of events affecting specific economies/jurisdictions. They are, hence, unable to capture and embrace the true nature of paradigms, which have a multidimensional and global nature.

Second, rather than offering new theories, the work of scholars to date generally provides a reconceptualization of ideas and/or paradigms that existed before the crisis. For example, the prevailing counter-narratives of the euro-crisis examined by Ulrike Liebert in Chap. 10 reflect to a

large degree Keynesian ideas and old policy discussions. In this respect it is more adequate to speak of a development of ideas and theories in the Kuhnian sense of 'normal science' rather than new theories embraced by the idea of 'revolutionary science'.

One the main reasons for the absence of an all-encompassing theoretical framework that initiates and/or explains and supports post-crisis processes of paradigm shift lies in the fact that we are still in the early aftermath of the post-Global Financial Crisis. The development of a new theory in the social sciences that explains and potentially embraces the post-crisis paradigms initiated in the economic, political, legal and social arenas requires a careful and long-run observation and examination of the operation of those processes in practice.

Vested Interests

A paradigm and its various dimensions may have an overall positive or negative welfare effect on society as a whole. The prevalence and persistence of a paradigm over time is not necessarily and positively correlated to those welfare effects. For instance, the EMH paradigm discussed in Chap. 2 ultimately contributed to, *inter alia*, European Union (EU) citizens experiencing in different ways the dramatic effects of the financial, economic and political crises triggered by the 2007 meltdown and, despite this, such paradigm has long since been and, to a certain degree still is encompassed by policy-makers (Iglesias-Rodríguez, Chap. 2).

The awareness of an actor/forum about the merits of a new paradigm for society as a whole does not necessarily mean that that very same actor/forum will support, with actual actions, changes that embrace such paradigm and the shift towards it. In this respect, Bradley (Chap. 3) refers to a gap between post-crisis policy statements, on the one side, and post-crisis policy actions, on the other—the latter not necessarily encompassing a shift in paradigm. Hemerijk (Chap. 6) highlights the contrast between the role of the Commission as a 'social investment cheerleader', on the one side, and as 'fiscal austerity headmaster', on the other.

Vested interest may help to explain instances of incomplete paradigm shift. At the micro level, a single paradigm may have a different impact on different societal groups. For example, an 'austerity paradigm' may

bring about benefits to the owners of sovereign debt of the state that applies austerity measures, but at the same time result in extremely harmful consequences for most societal actors in the country concerned; the latter may happen if and when the government applies budgetary cuts—as those referred by Ulrike Liebert in Chap. 10—that limit access to or lower the quality of essential public services. When the private welfare of certain social groups is threatened by a potential shift in paradigm, those groups may react by trying to prevent such a shift in paradigm.

One strategy consists of attempts to discredit new theories supporting paradigm shift or theories and movements that challenge the validity of old paradigms. Post-crisis social movements have often been the target of attacks by political and financial powers that might be dramatically affected by new policy-paradigms. For instance, in 2015, Francisco González—the head of Banco Bilbao Vizcaya Argentaria (BBVA), one of the biggest Spanish Banks—warned about the 'road to nowhere' represented by certain political alternatives in Spain (El Confidencial 2015), in implicit reference to new social/political movements that challenged the ideas represented by the moderate left/moderate right prevailing pattern of political alternation in Spanish politics since the transition period. Interestingly, the political parties that embody the aforementioned alternation pattern, namely the Partido Popular and the Partido Socialista, had close connections and, often, questionable relationships with the banking industry. In such relationship both sides engaged in actions and behaviours that were beneficial to each other but that did not necessarily improved general welfare.

An example of banks' decisions that benefited political parties in Spain was the remission of the latters' debt with the former (El Confidencial 2011). Also, a recent scandal in Spanish politics regarded the remission of various loans that Rodrígo Rato Figueredo—former Vice-President and Minister of Economy of Spain, and former Head of the International Monetary Fund (IMF)—had with the BBVA; the remission took place during the tenure of Francisco González, who had been appointed as head of BBVA's predecessor—Argentaria—by Rodrígo Rato Figueredo (OK Diario 2015).

Second, whenever vested interest are endogenous to policy-making infrastructures or have the ability to effectively influence policy-making processes they may contribute to the adoption of policy actions that hinder the process of shift in paradigm. For example, policy arenas captured

by vested interest may take decisions that enhance the powers of those vested interests in policy processes (Iglesias-Rodríguez, Chap. 2).

The presence of vested interests may, indeed, offer an explanation of the contrast between policy statements and policy actions. On the one side, policy-makers use policy statements that support certain processes of shift in paradigm in order to build and maintain their legitimacy towards an important part of the electorate and stakeholders. On the other side, those very same policy-makers may adopt policies that do not fully encompass such a shift because they have an interest in that shift not taking place.

Social Resilience and Collective Action Problems

The crisis has accentuated the differences between social groups. Whereas high income actors have maintained or even increased their welfare since the beginning of the crisis, low income actors have generally worsened their position (see for example The Fiscal Times 2013). Citizens and civil society groups have sought to deal with the crisis both through developing alternative narratives of change and contesting the dominant economic mantras of the EMH and the austerity recipes. They have, thus, at times challenged the state's ability to provide for maintaining social cohesion and have activated bottom up forms of social protection and solidarity, seeking to bypass actually the state and, thus, further undermine its legitimacy from below (see Gropas, Chap. 7). These actions and these new narratives certainly point towards a direction of paradigm shift, and the crisis can be seen as a catalyst of change in this realm.

This shift is evident also among civil society groups active in Brussels such as those investigated by Woodward in Chap. 8. There, too, we discern revolutionary tactics on both the right and left. However a more careful look shows that the change stops short of producing new narratives of what society and civil society in particular is and how we should go about organizing social action and achieving social cohesion. They rather adopt strategies of survival, they change their tactics not their strategies or their *raison d'être*. The new tactics of course carry with them seeds of a paradigm shift as they produce new networks and new

forms of participation and voice as both Gropas and Woodward highlight in Chap. 7 and Chap. 8, respectively. The role of IT here and of digital networking across borders is important. However, the response from European institutions to the Brussels-based transnational umbrella organisations seems to aim at neutralizing their efforts seeking to establish a new status quo but without a real paradigm shift, while in the medium run the organisations see their capacity weaken by the cutting of relevant funds (particularly at national but also at EU level) that supported their actions (Woodward, Chap. 8).

Indeed, the results also highlighted by Lorenzini et al. in Chap. 9 concerning the limited change experienced in the political party scenes in the countries that suffered little (Germany, Austria) or less in any case (France) from the crisis shows that the democratic, grassroots shift in the paradigm of economic and fiscal orthodoxy has a geographical gravity centre. It is to be found in the countries that have been hit hardest by the crisis. In addition the contribution of Ulrike Liebert and her analysis of the 'there is no alternative' (TINA) narratives shows that while subversive narratives have matured through the crisis contesting the orthodox accounts of the crisis' origins as well as the 'cures' imposed on countries, these narratives have hit an institutional ceiling. TINA methods have been vested with a quasi-constitutional framework making it nearly impossible for counter-narratives to effect change.

The Tensions Between the Global Nature of Paradigms and the Local Drivers of Paradigm Shift as an Explanation of Incomplete Paradigm Shift

The Global Financial Crisis (GFC) has impacted economies and people all over the world. Even countries where the crisis did not have a direct effect have experienced, in some way, the negative externalities resulting from the financial downturn—for example, through a decrease of exports (Shelburne 2010). Despite such a global reach, the GFC and the subsequent economic and debt crises have had—and are having—a very dissimilar impact on economies and societies around the world.

In some countries, such as Greece or Spain, the crisis has hit hard at all levels, both macro- and microeconomic. This has resulted in important

changes in the patterns of political behaviour, the emergence of new social movements as well as of alternative forms of social organization—such as those referred by Gropas in Chap. 7. The post-crisis regulatory overhaul in the EU and the greater public intervention in the financial markets analyzed by Iglesias-Rodríguez, in Chap. 2, constitute policy reactions to the overall effects of the crisis in the EU.

However, in other countries the effects of the crisis have been more limited. This is, for instance, the case of most central European states that did not experience a major economic downturn or high unemployment rates, as was the case with their southern counterparts. In these countries the demands for a shift of paradigm at economic, legal and political levels have been more limited. This would, for instance, partly explain the results of Lorenzini et al. (Chap. 9), which indicate that in Austria, France and Germany there was not a major transformation of political spaces after the crisis.

The consequence of the asymmetrical effects of the crisis across territorial and functional levels is that the forces and pressures that may contribute to actual shifts of paradigm after the crisis are not global but rather local. This poses certain problems. Notably, there is a tension between the all-encompassing nature of paradigms and the non-global drivers of paradigm shift that the analysis of this volume has evidenced. This divergence may cause processes of paradigm shift being incomplete.

For instance, a change of policy-paradigm in pan-national policy settings, such as the EU, requires certain consensus among the actors with the power to encompass such process in policy arenas, namely the EU member states as well as stakeholders affected by a potential shift of paradigm. If there is no coordination and/or agreement among these actors and forums across the EU then the probability of a process of paradigm shift initiated in an EU member state being complete—that is successfully expanding to other member states and social arenas—is low.

Concluding Remarks

In this volume, we explored the changes and shifts that have or have not taken place in different sectors. We have attempted to highlight some of the dynamics that have triggered changes and transformation in smaller or greater extent, and in more 'progressive' or 'regressive' dimensions.

At the present phase of the crisis or post-crisis conjuncture that we find ourselves in Europe, what is most interesting to observe now going forward is how the interactions between these emergent changes will play out, and whether they may lead to a complete paradigm shift and socio-economic transformation. In some areas, there exists a degree of maturity and increasing support and legitimacy for seeking alternative approaches and methods (civil society, politics) but not in all countries.

In other areas, we have not discerned dynamics of notable change, or rather the path-dependent constraints of the pre-existing realities appear to be stronger than the forces of change. The overall picture is patchy, diverse, even fragmented in the different sectors of social, economic and political life and in the different countries.

We have discerned trends towards a partial or incomplete paradigm shift, and we have also identified strong elements of continuity and of practices and methods that remain legitimate in spite of the crisis. What will be interesting in the years ahead will be to see how the old and the new will interact, how the underlying dimensions of persistence and continuity will interface with quests for alternatives and contestation. It will be interesting to observe whether these interactions will lead to an accelerated desire for transformative innovation or whether there will be a strong preference for retention of the current dynamics and power relations. The intertwining of these are playing out in fascinating ways leading to both anxiety and trepidation of change, and also to a sense of urgency and enthusiasm for the social innovations and paradigm shifts that may be in the making.

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Index

A

Accord Implementation Group, 83
accounting standards, 80
active labour market policies (ALMP), 155, 160–1, 166, 168, 188, 192, 195, 199
adverse selection, 159, 181
agenda-setting, 31, 199
AIG, 83, 83n5, 92
alternative economic practices, 219–24, 232, 234
Alternative for Germany (AfD), 277, 278, 288, 295, 297
Alternative Solidarity Network, 235
altruistic practices, 224
American leadership, 109
Ancien régime, 110
anti-capitalist movements, 248
anti-globalist, 248
asset bubbles, 78
atenistas, 227, 228, 231, 232
ATTACK, 257
austerity measures, 3, 77, 82, 96, 231, 234, 241, 244, 245, 247, 248, 251, 253, 254, 257, 340

B

banking regulation, 76, 87
banking secrecy, 80
Banking Union, 27, 52, 199
Bank of England, 88, 89, 94, 97, 200
barter exchanges, 225
Basel Committee on Banking Supervision (BCBS), 76, 83, 86, 87, 91
Basel II, 82, 83
Basel III, 83

Note: Page number followed by “n” refers to footnotes.

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P. Iglesias-Rodríguez et al. (eds.), *After the Financial Crisis*,
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Baumol cost disease, 184, 191
Bretton Woods, 114, 121–3, 128, 131, 180
Brexit, 175
budgetary rigor, 275, 289
BZÖ, 278, 289

C

Capital Markets Union, 29, 57
CDU, 277, 288, 294
centre-left parties, 274
citizen interests, 242
civic responsibility, 220, 228, 229, 232
clearing and settlement, 25
collective action, 65, 341–2
Commission Expert groups, 31, 35, 60, 61, 63–4
Committee of European Banking Supervisors (CEBS), 32
Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), 32
Committee of European Securities Regulators (CESR), 32
Commodity Futures Trading Commission (CFTC), 2
competitiveness recovery, 140, 151–2
compulsory insurance, 159
consultation process, 33, 35, 64
consumer cooperatives, 222
cosmopolitan democracy, 130
credit boom, 78, 187
credit crunch, 2, 186, 187, 198
credit default swaps, 6, 92
credit rating agencies, 25, 31, 80, 84
credit risk, 76, 77, 87, 91, 92
crowd funding, 252, 257
cultural liberalism, 280, 282, 285, 286, 288–9, 292, 294
currency depreciation, 149–50

D

DG for Employment and Social Affairs, 254
DG for Justice, 254
die Linke, 277, 295
disequilibria, 146
disobedience, 216
draft technical standards, 30

E

ecological crisis, 109
economic and monetary union, 113, 174, 203, 310, 324
economic disparities, 174
economic liberalism, 111, 279, 285, 286, 289, 290, 294–7
economic paradigm, 131
economic paradigms, 140
economic shocks, 140
Efficient Market Hypothesis (EMH), 5, 7, 23–9, 34, 44, 64, 197, 336, 339, 341
electoral campaign, 270–2, 274, 276–8, 281, 282, 285, 286, 290, 292, 293, 295, 296
employers federations, 155, 169
employment protection legislation (EPL), 153, 156–60, 166–7
employment rates, 153, 182, 192, 193
employment relationships, 54, 153, 156, 168
employment subsidies, 151, 166

engagement of citizens, 257, 258
equilibrium paradigm, 24, 32
ethical banking, 222
ethnic minorities, 251
EU Council, 151, 154
EU funding, 253
Euro crisis, 15, 141, 169, 270, 281, 288, 295, 296, 305–29, 338
Euromarkets, 90
European Central Bank, 52–6, 80, 89, 125, 150, 175, 183, 309, 316n15
European civil society, 238, 242–4, 246, 247, 249, 259
European Coal and Steel Community (ECSC), 111, 115–17, 120
European Commission Expert Groups (Expert Groups), 29, 31, 35, 60
European Court of Justice (ECJ), 112, 121, 176
European Defence Community (EDC), 117–18
European democratic deficit, 128
European Economic and Social Committee (EESC), 30, 242, 244, 246n1, 247, 311
European Economic Recovery Plan, 140, 150–1
European Federation, 112, 115
European integration, 112–18, 120, 126, 128–30, 173–5, 179, 271, 273, 275, 282, 290, 292, 297
European Monetary System (EMS), 121, 124, 127
European Network Against Racism, 244, 256
European Payment Union (EPU), 122–3
European Securities Markets Expert Group (ESME), 31
European Social Platform, 255, 256
European Supervisory Authorities (ESAs), 26, 32, 35–9, 47–52, 55, 56, 60
European System of Financial Supervision (ESFS), 26, 36, 61, 308
European Trade Union, 250, 255
European Union politics, 178, 244, 260
Europe 2020 Strategy, 151, 152, 310
euro-scepticism, 128, 325
EU-Wide Fiscal Policy, 150
externalities, 93, 162, 181, 198, 342

F

far-left anarchist, 228
Federal Reserve, 2, 131, 150, 200
financial conglomerates, 86, 87
Financial Crisis, 2, 12, 44, 46, 76–81, 84–95, 97, 109, 126, 130, 132, 169, 185–7, 191, 245, 246, 249–51, 269, 279n3, 305, 307, 319
financial instruments, 6, 24, 78, 336
financial meltdown, 6, 11
financial regulation, 5, 12, 29, 33, 37, 44, 64, 75–6, 78–83, 87–90, 92, 95–8, 185, 187, 199
Financial Sector Assessment Program (FSAP), 79, 82, 84–5
financial services industry, 6, 24, 25, 28, 30, 32–4, 37, 44, 45, 56–9, 64, 336

financial shocks, 147
financial stability, 75, 79–81, 88, 89, 92, 93, 97, 109, 150, 200
Financial Stability Board, 76, 79, 82, 93
Financial Stability Forum, 76, 79
fiscal austerity, 140, 178, 191, 304, 312, 315, 320, 322, 326, 330
fiscal consolidation, 167, 178, 185, 199, 308, 313
fiscal retrenchment, 151–2, 314
fiscal stimulus, 151
flexicurity, 152, 154, 155, 166–9
FPÖ, 278, 289, 295
free market, 2, 110
free movement, 120, 122
free trade, 110, 111, 120, 178
Front de Gauche, 277
functional representation, 31, 35, 243

G

G20, 75, 77–84
GDP growth, 143
gender equality, 173, 176, 191, 256, 320
German reunification, 125, 148, 163
global competition, 7, 200
global financial crisis (GFC), 1, 2, 23–9, 31–4, 44, 59, 63, 76, 95, 186, 197, 312, 342
global inequality, 132
globalization, 7–9, 110, 119, 204, 271, 275
Great Depression, 139, 178–80
Great Recession, 139–41, 144, 151, 158, 166–8, 176, 193, 269–71, 273, 279n3, 298, 299
Greens, 277, 278
Grexit, 304, 313, 325

H

Herstatt, 90
The High Authority, 116
hysteresis, 180, 181

I

IMF, 2, 77–80, 82, 84, 86, 87, 123, 132, 175, 176, 182, 187, 275, 309, 310, 313–15, 322, 324, 326
income inequalities, 143–5, 164
incomplete paradigm shift, 5, 13, 59, 64, 111, 113, 129, 130, 221, 259–60, 336, 338–44
Indignados, 9, 225, 237, 257
industry associations, 32
input-legitimacy, 25, 34
interest groups, 4, 11, 60, 111, 243, 245, 255
interest rates, 90, 94, 145, 146, 185–7, 198, 201, 252
inter-generational solidarity, 173
International Association of Insurance Supervisors (IAIS), 81
internationalism, 114
International Organisation of Securities Commissions (IOSCO), 79n1, 81, 83–4, 86, 93, 97
International Political Economy (IPE), 112, 129
international security, 109, 119

J

job insecurity, 216
joint-decision trap, 200, 203
Joint Forum, 76, 86–7, 92

K

Keynesianism, 183
knowledge-based economies, 140

L

labour market institutions, 140, 149n4, 153, 157, 167, 168
labour market policies, 139–70
laissez-faire, 24, 336
Lamfalussy Committees, 31–2
Lehman Brothers, 8, 90, 279n3
liberal democracy, 2, 10, 178
Lisbon Strategy, 151, 154–5, 191
Lisbon Treaty, 176, 178, 204, 307
lobbying platforms, 32

M

Maastricht Treaty, 125, 128
macroeconomic governance, 176, 197–204, 311–28
macroeconomic policies, 167, 169
macro-prudential risk, 80, 88, 91, 94, 95
market bubble, 89, 90n, 139
market democracies, 6
market inequalities, 144
Market Participants Consultative Panels (MPCPs), 31–2
material markets, 147
meta-platforms, 249
microprudential policy, 89
micro-prudential risk, 80, 91, 95
mobilization, 9, 11, 192, 243, 258
monetarism, 182
monetary policy, 52, 80, 88, 89, 94, 95, 124, 127, 130, 131, 150, 176, 183, 203
money market funds, 93
Monnet, Jean, 114, 115
moral hazard, 77, 127, 155, 159, 160, 181, 308–9
Mouvement Démocrate, 277
Movimento Cinque Stelle, 298
Movimento Federalista Europeo, 117
multiculturalism, 275
multipolar world, 109, 129, 131

N

national identities, 275
neo-conservatism, 181
neo-liberal capitalism, 8
neo-Nazi militias, 228
NEOS, 278
Network of Exchange and Solidarity, 233
new left, 9
NGO-isation, 245, 258
non-discrimination, 121

O

Occupy movement, 78
Organization for European Economic Cooperation (OEEC), 120, 122
output legitimacy, 25, 34, 63
Outright Monetary Transactions (OMT), 199
over-the counter derivatives, 2, 24, 25
ÖVP, 278, 288, 295

P

party politics, 270, 298
philanthropy, 252, 253
PIGS, 142, 143
piqueteros, 235
political actors, 217, 269, 279
political agendas, 269
political conflict, 8, 9, 216, 271, 274, 296, 298
political cynicism, 270
political environment, 251
political parties, 4, 9, 11, 113, 115, 204, 225, 226, 236, 271, 272, 274, 275, 277, 278, 284, 297, 298, 340
political tensions, 109
population ageing, 154, 188
populism, 128, 174, 204
pound sterling, 150
precarity, 216
privatization, 182, 275
protest, 5, 9–11, 13–14, 216, 218, 220, 221, 226, 228, 248, 249, 257, 270
PS, 277
public consultations, 30
public regulation, 2, 6, 25, 58
public services, 182, 184, 216, 340
purchasing power, 149, 269

R

radicalization, 13
Rational Expectations Hypothesis, 23, 24, 34
Regulatory Consistency Assessment Program, 83
rent-seeking, 182, 235
repo transactions, 92
revolving doors, 26, 27, 41–58, 62, 96
Rome Treaty, 120, 123

S

Schuman, Robert, 114
scientific revolution, 4, 110
scientific theories, 3, 336
Securities and Exchange Commission (SEC), 2
securities lending, 92
securitisation, 88, 92n10
self-regulation, 2, 6, 7, 24–5, 32, 58, 59, 336
self-sufficiency, 219
significant financial institutions (SIFIs), 92, 93
Single European Act, 120
Single European Market, 113, 182
social behaviour, 8, 12
social benefits, 151
social collective actors, 242
social currency, 222, 234
social exclusion, 151
social insurance, 176, 179, 188, 190, 191
Social Investment Package, 178, 197
social justice, 8, 14, 219, 254, 326, 330
social movements, 9, 204, 220, 245, 247–9, 257–9, 340, 343
social networks, 10, 216
social partners, 155–6, 169, 242, 243
social progress, 173, 174, 320
social protection, 4, 7, 173, 175, 176, 178, 179, 191, 192, 199, 204, 275, 320, 341
social rights, 7, 178, 182
society mobilisation, 216

sovereign debt crisis, 77, 126, 128, 139–41, 146, 151, 185, 198, 199, 306–8, 310, 321, 326
SPD, 277, 288, 295
Special Drawing Rights (SDR), 132
speculation, 90, 90n8
speculative bubbles, 89
SPÖ, 278, 288, 295
stagflation, 180, 181, 183, 187
stakeholder groups, 30, 33–9
stakeholder participation, 29–34
standard setters, 81, 83, 86, 87, 90
Standards Implementation Group, 83
state funding, 245
structural reforms, 151, 154, 183, 304, 306, 308, 310n7
supervision, 56
supranational political economy, 112, 129–36
supranational political order, 130
supranational public goods, 113, 119, 126, 130
sustainable development, 132, 134, 135
Syntagma square, 225
Syriza, 271, 298, 309, 315, 319, 322, 329
systemic risk, 75–98

T

tariff barriers, 120, 122
tax cuts, 164
technological innovations, 153
TEM, 225, 233–4
there is no alternative (TINA), 303–31, 342
trade unions, 155, 162, 163, 169, 181, 188, 243, 248, 255, 258
Treaty on European Union (TEU), 29, 324
Treaty on the Functioning of the European Union (TFEU), 29, 50, 173, 312
Tripartite Group, 86
Troika, 175, 187, 228, 231, 304, 308, 309, 314, 329

U

UMP, 277, 286
UN, 132–6, 242
underemployment, 216
unemployment insurance (UI), 140, 153, 156, 158–60, 166–8, 182, 201
unemployment insurance scheme, 140, 201
US Financial Stability Oversight Council, 93

V

vested interests, 2, 60, 339–41
voluntarism, 225, 231

W

wage moderation, 188
wage-setting institutions, 161–4
Wall Street, 78, 176
Washington Consensus, 182
Wassenaar Agreement, 155, 169
welfare state, 7, 8, 174–84, 189, 190, 192, 198, 204, 226, 274, 276, 282, 288
World Bank, 2, 79, 82, 84, 182
World Tax Authority (WTA), 135
World Trade Organization (WTO), 121–2
World War II, 109, 112, 114, 120, 122, 234