# Slovakia and the Economic Governance of the European Union at the Times of the Crisis

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Submitted to

Central European University

Department of Political Science

In partial fulfillment of the requirements for the degree of Master of Arts

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Budapest, Hungary

2012

## Abstract

The thesis discusses the 'hot' issue of the current crisis in the European Union. The theoretical explanations of the role of the Economic and Monetary Union and its institutional setting in the transformation of a local liquidity problem of several peripheral countries of the Union into a full-blown crisis of the European unification are presented in the opening chapter. In addition to that, the issue is evaluated using the concept of economic governance. This theoretical introduction is followed by an analysis of the efforts to address the crisis by the European Union's institutions and member states. Finally, a question of the impact of these changes on Slovakia is being discussed with the aim of discovering the upsides and downsides of the changes of the *status quo* from the prospective of Slovakia. The thesis concludes by stating, that Slovakia benefits from the changes politically and economically, but they also create risks by potentially undermining the identification of Slovaks with the Euro.

# Acknowledgements

I would like to thank my supervisor Attila Folsz for patiently reading my draft, despite their varying level of quality and offering useful advice and to Bela Greskovits for his kind assistance with gathering useful literature. My thanks also go to Anil Duman, Levente Littvay and Tamas Rudas for helping me to prepare for the life beyond the academia (although why there needs to be such a thing remains a mystery to me). Also, kudos to (in no special order) Robin, Edward, Mina, Maja, Samo, Marton, Balazs, Andrej, Valentin, Zoltan, Stela, Mom, Dad, my lil'sis Bernadette and everyone else who has been there for me, each in their own way. I feel indebted to Mr. Soros for his generosity that made it possible for me to study at this great institution.

Dedicated to Klara.

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## Introduction

This thesis examines the ongoing changes that the Economic and Monetary Union (EMU, Eurozone, Euro Area) is currently[1] going through and attempts to develop an understanding of what this means for Slovakia. Namely, it addresses two key questions: How can the change of the *status quo* benefit Slovakia? And how can it, on the contrary, pose a threat to the country? I will try to show that the current developments in the economic governance of the European Union (EU) are of major concern for Slovakia, even though it is not yet clear, whether they also represent a major shift in the power balance between the member states and the European institutions in the Union. Nevertheless, it is clear that the changes deepen the existing differences between the levels of economic integration in the Eurozone member states on the one hand and the EU members, who have not (yet) entered the Eurozone on the other.

The differences are nothing new in the history of European integration. There have always opt-outs and two EU member states – the United Kingdom and Denmark - have even a permanent opt-out from participation in the EMU. A case has been made in the literature, that this internal diversity benefits and is indeed crucial for functioning of the EU. (Majone 1997, p. 21). However, now with the strict European Compact in place, along with the permanent European Stability Mechanism, and the budgetary policies of the Eurozone countries being put under surveillance by the reform of the preventive and corrective mechanisms of the EMU, it seems that the gap between the EMU members and the EU countries remaining outside of the Eurozone is growing bigger. Their right to make sovereign decisions has not been pooled on the European level, yet the Eurozone governments are finding themselves in need of making costly



[1] As of May 24 2012

political decisions. Therefore, I believe it is meaningful to try to analyze these developments from the perspective of their impact on an EMU member state.

It used to be a common wisdom that the commitments by democratic politicians were not credible (Ioannou, Stracca 2011, pp. 8, 9). This is why the supranational institutions were created in the first place; quoting Majone again, “independent agencies are a response to the credibility problems of democratic politicians: they can provide greater policy continuity and consistency than cabinets …” (Majone 1997, p. 8). Yet, this time around it is actually the states represented by democratic politicians, who are committing themselves through treaties to abandon the myopic, populist policies in favor of the often politically very costly solutions designed to save the EMU. As I will try to show, this is an exciting new development in the history of European integration. No longer are the politicians allowed to pursue short-sighted fiscal policies closely correlated with the election periods (Ioannou, Stracca 2011, p. 9), while maintaining their credibility through pooling some less politically salient competences, such as monetary policy, on the level of supranational European institutions and gaining political capital by scapegoating the EU as a tyrant forcing the sovereign nations to submit to their whims (Guibernau 2011, p. 36). This system has failed, the lack of fiscal prudence and the failure of the EU to act in solidarity with its members in trouble have devastated the trust in such an arrangement having any future.

In this thesis, I discuss what environment is being forged by the major actions of the European states and institutions in the response to the crisis. Based on this, I will evaluate the repercussions of Slovakia as the only Eurozone member in the Visegrád 4 (V4) group. I make no pretense about being able to qualify cost and benefits of Slovakia being in the Eurozone vis-à-vis its neighbors who stayed out of the monetary union, either by necessity or by choice. The developments that I discuss are still in flux and it would be a task for a futurologist to tell how things will look when the storm of the crisis has passed, which is why I only examine developments that took place up to May 2012. Nevertheless, I feel it would be interesting to see what changes in the opportunity structures and what threats and opportunities such major changes represent in a country that is still a relative newcomer to the world of European politics, having joined the EU only in 2004 and the Eurozone on the brisk of the crisis.

Formally, the thesis is divided into three chapters that are constructed to provide an interconnected narrative. The first is dedicated to developing an understanding of the changes in economic governance of the EU that have been taking place as a result of the ongoing sovereign debt crisis plaguing the Eurozone, through introducing concepts of the leading authors in the field, including de Grauwe, Majone and Hodson. The middle part aims to present an analysis of the changes to the economic governance of the European Union, both relevant to the whole EU, as well as the specific provisions for the Euro area. Finally, I will try to evaluate the impact of these changes on Slovakia in terms of new threats and opportunities arising.

## 1. The Rise and Fall of the Euro

The economic and monetary union is perhaps the most ambitious project of the European integration since 1993, when 12 countries that constituted the European Community adopted the Maastricht Treaty that founded the European Union. From the ashes of the Exchange Rates Mechanism arose a phoenix, in the form of a currency, tying 17 European countries together more tightly than it has ever been witnessed in the history of European integration by introducing a common European currency. As noted by Robert Jones, the project has an unprecedented potential to fuel further integration and move it significantly forward, but can also seriously damage the integration as such, if it turns out unsuccessful (Jones 2001, p. 288).

However, it seems that the project has not turned out exactly according to original visions of its creators. As I will try to show in this thesis, this was a systemic failure of both supranational and intergovernmental institutions governing the Eurozone. Indeed, the initial reaction to the sovereign debt crisis that started in Greece in 2009 could be easily compared to that of a deer that suddenly finds itself in the headlights of an oncoming car. The Polish foreign minister, Radoslaw Sikorski, explained it quite bluntly: "I will probably be the first Polish foreign minister in history to say so, but here it is: I fear German power less than I am beginning to fear German inactivity" (der Spiegel 2011). This sentiment was echoed by Majone, who also argued that the Union is a 'fair-weather construction' – a construction — large and ornate, but not robust enough to protect its dwellers against major external shocks" (Majone 2009, p. 31).

In short, the Eurozone, which was designed as a major milestone in the European integration process has turned into a major problem for European unity. In my thesis, I will analyze this extraordinary phenomenon from the perspective of governance. After a short discussion of the meaning of the term 'governance' in the context of my thesis, I will continue by summarizing the main approaches to understanding the change present in the literature that has been written on the issue in the short time since the outbreak of the crisis. I will finish the chapter by discussing the initial state of the economic governance in the EU along with the political economy aspects of the crisis as a catalyst for change.

## 1.1. What is Meant by Governance

George Frederickson, in his paper entitled "Governance, Governance Everywhere" discusses in detail how the term evolved from being a synonym of the term "Public Administration" to a broader term encompassing also aspects of governing private entities such as large corporations (corporate governance), the division of labor between states and subnational (and lately also supranational, like the EU) actors and contractual involvement of other entities, including private ones[2] and also to the ideational base of public administration – the beliefs, norms and established "ways of doing things" (Frederickson 2004, pp. 3-26). The modern understanding of the term governance can be expressed through the following definition of the term used by the World Bank, according to which governance is a set of traditions and institutions that influence the exercise of authority (Kaufmann et al. date). In my own inquiry, I will be interested specifically in how the governance works in the European Union.

Just like the national states, the European Union is a political system. However, the difference is that unlike the subnational units in the national states, which are clearly subordinate to the national government, the EU operates through a multi-level system in which the states, the central institutions and even the regional units form an interwoven network, in which the decision-making powers are diluted between the actors. The exact governance framework then



[2] Through public-private partnerships, for example in construction of infrastructure.

depends on the particular policy area; for example the matters relevant to functioning of the common market,[3] are governed through the process known as 'pooling of sovereignty', in which the states functioning as principals delegate part of their sovereign decision-making power to the agents in the form of the European institutions. In other policy areas, the European institutions only assist in coordination of policies created at the level of member states (Wallace 2005, pp. 25-29). The dynamics of power between the states and the European institutions will be therefore of major importance for my thesis.

The economic governance of the EU in particular has historically developed in a rather peculiar way: While the monetary part of it has reached the final point of full monetary integration, with an independent European Central Bank, the fiscal coordination has been largely unaffected by communitarization (George 1995, p. 206). As noted by Amtenbrink and de Haan, this is a reflection of a view going back to the initiatives of the Delors commission in the 1980s, which introduced the concept of common currency, that while there is a need for economic governance on the European level, based on a common framework respected by all member states in their sovereign economic policies, rather than having pan-European economic policies (Amtenbrink, de Haan 2003, p. 1078). In short, the EMU consists of a centralized monetary system, which is however decoupled from the fiscal policies of the individual member states, which retain full control over their economic policy, but have completely surrendered their independence in terms of monetary policy. The apparent crisis of this framework is one of the major points discussed in the thesis.



[3] Before the Lisbon treaty amendment of the EU primary law, these areas used to form the 'first pillar' of European governance, while the more intergovernmentally governed areas such as Common Foreign and Security Policy and the cooperation in the domain of interior affairs and justice formed the second and the third pillar respectively.

## 1.2. The Main Approaches Present in the Literature

Long before the crisis of the system became apparent, the EMU was facing major criticism aimed at the way it was constructed. The criticism can be summarized in the following three points.

1. The EU is not a so-called ‘optimum currency area’, hence it does not make sense for it to have a common currency. This argument is centered on the notion that the existing level of convergence of business cycles and of living standards at the moment of the birth of the common currency was not sufficient (Angeloni & Dedola, (1999), Krugman & Obstfeld (2000), De Grauwe, (2003). This was claimed despite the fact that the EMU is not the only currency area with a high degree of internal diversity in terms of economic developments between different units. Wynne and Koo found a similar level of dissimilarity in the United States (Wynne, Koo 2000, p. 349).
2. A monetary union can not exist without simultaneously being a fiscal union. A major stream in the literature has been questioning the wisdom of establishing a monetary union without incorporation of some sort of mechanism of effective and credible coordination of fiscal and economic matters (Collignon et al. 1994: xvii). I believe an important aspect of this is that it that while monetary policy has been delegated to independent national banks across Europe, based on the assumption that in order for a commitment to be credible, the agent should enjoy guarantees of independence from political pressures (Majone 1997, p. 104), the fiscal policy is a matter of national sovereignty. After all, as Reuters writer Edward Hadas stated in his blog: “A government is not really autonomous unless it can raise its own taxes, borrow on its own account and allocate its own expenses” (Hadas 2011 page).

Therefore when the crisis in the Eurozone broke out, it could be seen as a result of these inherent problems. However, there was no obvious solution. Yet the project could not be simply abandoned because the costs of that happening would be so enormous that they provide major incentives for the countries to adopt measures that would have otherwise been thought sunthinkable (Eichengreen 2010, p. 12, 13). But even when the incentives were there, the countries failed to act collectively against the crisis. There are several viewpoints presented in the literature as to why this might have happened.

De Grauwe blames the intense disagreements between Eurozone states concerning the appropriate solutions for the crisis (de Grauwe 2010, p.2). Meanwhile, Hodson argues that the EMU cannot be understood merely as an international regime, but there is a need to recognize some crucial aspects of the old communitarian method of governance present in the Eurozone, more precisely the existence of a strong supranational institution, namely the ECB (Hodson 2011, p. 3). Finally, a third camp present in the debate likes to argue that the agency of states is limited by the path dependency dynamics and that, consequentially, "the institutions matter" in explaining the response (or lack of it) of the EU to the sovereign debt crisis (Salines et al. 2011, pp. 8-9). Before discussing them, however, I will present a short overview of how the EMU works.



## 1.3. The Initial Setup of the Economic Coordination in the Eurozone and the Impact of the Crisis

At the beginning of the EMU, there were two main instruments designed for the EU to govern economic matters: The convergence criteria and the Stability and growth pact (SGP). Both are based on  articles 120-126 through articles 120-126 of the Treaty on the Functioning of the European Union, amended by the Lisbon Treaty. The main provisions are as follows: The Council may formulate a draft for the Broad Economic Guidelines (BEPGs), that are however not binding for the states in any way (Article 121), the states might help each other in the case of “severe difficulties caused by natural disasters or exceptional occurrences beyond its control” (Article 122), but every member state is responsible for their own debt (Article 125). Furthermore, the Council may, based on the assessment by the Commission, punish a EU member state that is not doing a good enough job in avoiding excessive deficit using a range of penalties from requiring the state to publish additional information to levying fees “of appropriate size” (Article 126).

The convergence criteria are a set of rules that a country has to comply with in order to be admitted into the Eurozone. They are based on Protocol number 13 attached to the TFEU. In total there are 4 criteria: shown in Table 1.

Table 1: Admission Criteria for the membership in the EMU defined by TFEU

| Criterion | Set Target |
|---|---|
| Inflation rates | No more than 1.5 percentage points higher than the average of the three best performing member states of the EU. |
| Government finance | Annual deficit not more than 3% of GFP (or at least reach a level close to 3%). Must be sustainable in the long run. Debt level no larger than 60% of GDP, |
| Exchange rate | Be a member of the ERM II[4] at least for the period of two years |
| Long-term interest rates | No more than 2 percentage points higher than in the three lowest inflation member states. |

[4] Exchange rate mechanism, the idea is to tie the national currency to the Euro and ensure the conversion rate remains stable at least over the period of two years.

The two government finance targets form the base for the SGP, which governs the economic part of the EMU. The SGP is legally based upon council regulations numbered 1466/97 and 1467/97. The former document defined the two conditions (deficit below 3%, debt below 60%[5]), while the latter introduced the mechanism to ensue surveillance over budgetary procedures in the EU member states and prevent and sanction irresponsible behavior in the Eurozone. The surveillance was designed to be executed through the Convergence Reports prepared annually by the non-Eurozone EU members and Stabilization Reports submitted by the Euro area countries. The reports are evaluated by the Commission, which singles out countries that do not have realistic plans to maintain a low budget deficit. Based on the evaluation, the Council then decides on the time that countries in breach of the SGP have to rectify the situation and, in the case no significant progress is reached during the given time period, applies sanctions of about 0,2% of the GDP, which can be increased up to 0,5% in the case that the state continues to fail to comply with the Pact (Council 1467/97, p. 7).

However, all this is largely theoretical, because the Council never really applied sanctions. Even worse, nothing happened when it was discovered that Greece kept misleading the European Union by simply reporting fabricated numbers. Overall, empirical inquiries have concluded that the SGP was a failure, as it did not have any significant effect on fiscal discipline of the Eurozone countries (Ioannou, Stracca 2011, p. 7). Therefore, it could be concluded that the economic governance of the Eurozone had failed to prevent the Euro area states from engaging in irresponsible, myopic spending. The states (including the major economies Germany, France and Italy) did not live up to their promises and behaved irresponsibly after becoming members of the EMU, no effective reform was enacted, despite the fact that main actors (both European



[5] The Pact was reformed in 2005 to allow for a greater flexibility in evaluating the size of the deficit for countries facing economic stagnation.

institutions and the states) knew that the SGP is not working and the institutions failed to do anything about it, in fact the rules were even relaxed in 2005.

The arrival of the crisis in 2008 upset the established equilibrium and caused a mushrooming of reforms. This was not unexpected. The question how such crisis situations influence reforms has been in the centre of focus of theoretical political economy research at least since the 1980s. Ranis and Mahmood argue that “resistance (to) vested interests can be overcome only when the system has no other way of avoiding the required adjustment” (Ranis and Mahmood 1992, quoted in Rodrik 1996: 26).

However, the proposed relationship between reforms and crisis, no matter how logical it sounds, is not without its problems. Rodrik argues that the claim that reforms are enacted when there is a crisis is very close to a tautology. It goes without saying that new policies are introduced when the old are not working and not when they are working just fine (Rodrik 1996: 26-27). Could it be perhaps that there was a perceived shift in the payoffs for the main actors, who were panicked by the reaction of the markets to Greek problems and therefore started to see the existing equilibrium as unsustainable? The relative long period of passivity following the breakout of the crisis in the Eurozone can be seen as evidence that it was perhaps the fear of the impending implosion of the whole system, rather than the existence of the crisis alone, that made the reforms possible.



## 1.4. Explanations of Dynamics in the Euro Area

Seemingly, there is a paradox; on the one an extraordinary situation in form of the crisis opened a window of  opportunity for the EU actors to address the main problems of the EMU. Yet, as I discussed in the beginning of the chapter, the first reaction to the crisis was simply inactivity. Clearly, there is a need to look at the dynamics of interaction between individual players relevant to the economic governance in the EU.

### 1.4.1. The State-Based Approaches

As I have mentioned in the previous section, there exists an influential string in the literature that attributes this unusual institutional setting to different interests between countries. From the start there have been substantial differences inside the traditional 'German-French engine' of the European integration to a point that these two countries can be seen as rivals in the fight for the shape of the European monetary integration. For France, the monetary unification was about increasing its own prominence in the EU and decreasing the hegemony of the dollar on the global capital markets (Howarth 2002, p. 147-148). In addition to that, the Euro was useful for France as a convenient reason to enact much-needed reforms ending the period of competitive disinflation, when the country was only able to maintain price stability at the cost of increasing unemployment and budget deficits (Donelly 2005, p. 962). However, it is important to note that these were the strategic interests recognized by the elites across the political spectrum, but not necessarily by society at large. The French citizenry lacked the internalized historical event similar to the hyperinflation in interwar Germany and was largely socialized in the environment, where growth had traditionally been a much more salient concern than fiscal and monetary discipline. Therefore, France could not simply commit to the same prudent policy preferred by Germany and some the other Northerners and instead made quite an effort to include as many Southern countries into the Eurozone as possible to balance the interests of fiscally traditionally responsible countries like Germany (ibid).

Germany, on the contrary, enjoyed a traditionally strong mark, which dominated the original Exchange Rates Mechanism (ERM) and therefore, it could be argued, that Germans did not need the Euro as much as the French did. In addition to that, Germany had another ‘big project’ undergoing since the beginning of the 1990s in the form of reunification of the country, which obviously consumed a large portion of resources available to the country. Furthermore, Germany was suspicious of its Southern EU partners led by France and did not deem their commitments to sound fiscal policy as credible. Therefore it was Germany that insisted on the creation of mechanisms of economic governance on the European level that would be capable of applying pressure on the Southern governments to honor their commitments (Dyson 2002, p. 178).

In game theory terms, the situation can be (and has been, for example Beetsma et al. 2001) described as a simple two-players game, not very different from the famous “Prisoner’s Dilemma”. Neither of the players could have hoped for many payoffs in the case of failure to cooperate. However, taking a leap of faith was just as risky, because France could not know if pooling sovereignty in the economic areas would not lead to an increase in the pressure to abandon its model of society if Germany and its ‘allies’ were to get their way, and Germany was justifiably afraid that France along with Southern countries would lead the common currency away from the tradition of the stable Mark. One interesting aspect to this is that the polarization was obvious even in the sphere of public perception. Most people in Germany and in the Netherlands were opposed to the common currency, while the idea was rather popular in France and especially in the Southern countries: Spain, Portugal and Italy (Boyer 2000, p. 28). Therefore, it could be argued that under such circumstances, the effective cooperation would be too costly and non-cooperation can actually be the Nash equilibrium outcome of the game (Beetsma et al. 2001, p. 68).

The game is, however, more complicated than this in reality because there are more than two players. First and foremost there is the United Kingdom, an undisputedly major player in the European unification, which however historically had the tendency to be 'with' Europe, rather than a 'part of' Europe. Another specific group of actors are the Scandinavian countries, which also had a history of being rather 'reluctant' Europeans. Finally, even though it might be meaningful to imagine the division of Europe between the French block containing Spain, Portugal and Italy and the German block encompassing Austria and the Netherlands, with the rest of the countries being *ad hoc* associated with one of the blocks at any given point in time, it is perhaps necessary to realize that these countries can and do sometimes act independently, following their own particular interests. Furthermore, the EU has undergone two additional rounds of enlargement since the Euro as a currency came to existence, which increased the number of relevant countries from 15 to 27.

Nevertheless, the intergovernmental aspects of the problem cannot be ignored. As noted by Hodson, the breakout of the debt crisis in Greece also empowered the French president, Nicolas Sarkozy, to promote the traditional Gaullist vision of Europe governed by the head of member states (Hodson 2011, p. 38). The popular media images of the 'Merkozy' duo leading Europe into the fight against the crisis, while clearly exaggerated, are therefore not entirely without substance and the national states definitely need to be taken into consideration in the analysis.



### 1.4.2. The New Governance Approaches

Hodson's contribution goes way beyond connecting the traditional structure of European international environment to the economic governance of the Eurozone in the crisis. What he has shown is that there is a sort of interplay between national governments on the one hand, and supranational bodies, such as the ECB, on the other. The Central Bank has shown a certain degree of willingness to support the further development of economic governance in the Eurozone, for example through supporting the German plan for a European monetary fund (Hodson 2011, p. 30).

Furthermore, as noted by de Grauwe, the ECB has been a central player in the crisis, being basically the only actor with the ability to 'pay the bill' at the end of the day, by deciding whether it would accept the bonds of troubled countries as collateral or not and thus act as a lender of last resort or not (de Grauwe 2009, p. 2). Of course, this can be understood as a matter of fiscal policy as part of the effort to maintain price stability, but there is also an easily observable spillover into the realm of economic governance, because it is the ECB that has the power to decide which framework of economic governance it deems to be credible enough to warrant provision of the much-needed liquidity.

In addition to the ECB, Hodson also discusses the Eurogroup as a body which has been very active in its effort to establish itself as a formal body responsible for the economic governance of the Eurozone. The argument goes as follows: The Eurogroup had the potential to make the economic governance more standardized and active by serving as an expert (non-majoritarian in Majone's terms) institutions responsible for the economic governance of the euro area, akin to the role the ECB plays in the area of monetary policy. However, due to its rapid formalization and subsequent politization, it lost this ability, because in the political area it had little added value over the national states (Hodson 2011, p. 48, 49).

What is, however, important is that both the ECB and Eurogroup, their mutual interaction along with their interaction with member states, can serve as a basis for the new method of governance – the so called ‘deliberative intergovernmentalism’. In this system, the decision making is neither in the hands of political bodies, nor governed by supranational ‘expert’ institutions, but takes place through a complex system of informal bargaining between different actors, which results in a product that combines political agency with the practices of supranational institutions (Puetter 2006).

In my analysis, I will try to show how, despite the failure of the Eurogroup, the cooperation between the states and the European institutions is becoming the way in which the EMU area governs its attempts to solve the EMU crisis.

### 1.4.3. Institutional Explanations

It is important to note that there are certain limits to the cooperation between states and the European institutions. One important barrier to smooth functioning of such cooperation is certain rigidity of the institutions. This is less a matter of the particular institutional design and more a matter of essence of international institutions. Firstly, there is the issue of credibility of commitments. As noted by Salines et al., “the EU, as a ‘community of law’ resting on the principle of ‘mutual sincere cooperation’ between its institutions (Art. 13.2 TEU), was fundamentally ill-equipped to countenance the possibility of an outright defiance of common rules, e.g. in the form of persistent fraudulent accounting and intentionally defective statistics that violated agreed standards” (Salines et al. 2011, p. 5, reference present in the original). As I will try to show, the question whether the Commission, the Council or other European institutional bodies can effectively function in an environment where states seem to be able to defy their decisions intentionally, whether there is a way to reform them in a way that their commitments to maintain macroeconomic stability in the environment, where sovereign states exercise complete control over their respective fiscal policies, is of major importance.

The second legacy that is complicating the smooth governance of the Eurozone is based on the initial assumption present, at the time when the EMU was designed, that all EU countries will use the Euro as their national currency. That is why the Euro area shares institutions with the EU itself, which were created to serve the whole community. Now it is clear that this is not something that will happen, not even in the medium term (Ferry et al. 2012, p. 2). Therefore, all reforms of the economic governance in the EU have to cope with the issue of the special position of the countries connected by the same currency.

An evaluation of the dynamics between members and non-members in the Eurozone are, therefore, a prominent issue in understanding the changes in European economic governance.

## 1.5. Summary of Findings

The underlining points of the debate can be summarized as follows:

1. The EMU is a key part of the European integration. In the governance arena, however, it represents something new; while the monetary part is governed by a supranational institution, the ECB, the macroeconomic policies are fully in the hands of the member states. At the same time, the member states represent very different economic, social and societal traditions. For these reasons, there were doubts from the beginning, whether a monetary union consisting of such a high number of diverse countries and without central fiscal authority can survive.
2. In reality, the EMU saw a continuation of divergence of interest and economic conditions between the member states and to these days, there are huge differences in policies and ideas perceived as effective in the governance of economic matters in different member states of the EMU. In addition to that, the SGP turned out to be inefficient as a tool to ensure, that the member states of the Euro Area behave

responsibly, due to the reluctance of member states to punish other member states even for obvious breaches of the treaty. Hence, the Eurozone is in a major crisis.

3. The crisis itself set in motion pressure for reforms, but the system turned out to be quite rigid, because of the pervasive disagreements between states, politicization of nascent Eurozone institutions, like the Eurogroup and failure of traditional European institutions to adopt. Yet, the action eventually came and the Eurozone is changing. However, the changes appear to be only made possible by necessity, due to the enormous costs of letting the Eurozone collapse.

# 2. Changes in European Economic Governance Since the Outbreak of the Crisis

Having established that the economic governance of the Eurozone has been deeply flawed and that the crisis made continuation of the existing setting of economic governance unfeasible, I will now turn my attention to discussing the most important new initiatives that have mushroomed with the aim address some of its critical points.

The initiatives can be divided into two main streams according to the approach they take to addressing the sovereign debt crisis. The first group consists of initiatives that address the immediate liquidity needs of EMU member states, that find themselves unable to finance their debt on the markets due to the crisis . The relation of these to the issue of economic governance is indirect; through establishment of redistribution channels between the center of the EMU, which has retained the ability to borrow on the markets and the peripheral countries, which are faced with declining rankings and sharply increasing premiums they have to pay in order to secure funding for their public expenditure. The second groups consists of initiatives that address the problem from the point of developing a framework for the future of the monetary union. Addressing the imbalance between centralized monetary policy and decentralized economic policy, these initiatives are in the business of developing solutions for the needs of the EMU, that go beyond the immediate liquidity concerns of some EMU members and devising policies to prevent future crises.

I will discuss all the major initiatives introduced since the outbreak of the crisis from the perspective of economic governance, trying to explain how these initiatives change the existing framework of the EMU. At the end of this chapter I present a summary of my findings, trying to construct a synopsis for the subsequent analysis of the opportunities and threats that these changes pose for Slovakia.

## 2.1. Friends in Need – How the European Institutions and Member states Addressed the Fiscal Crisis

As has been noted in the previous chapter, the EU had found itself in a schizophrenic state in 2009, when it became clear that European integration could not survive without solidarity, yet lacking any tools for actual realization of money transfers. It, therefore, comes without surprise that the initial EU authorities' actions came with a great degree of suspicion and mostly took the form of *ad hoc* solutions addressing immediate issues of liquidity, rather than more sophisticated solution for the more broader issues of macroeconomic imbalances.

### 2.1.1. Outbreak of the crisis in the East and in Greece – the time of bailouts.

**The Outbreak of the Crisis in Eastern Europe**

The evidence supporting the narrative above is easily traceable in the history of the crisis. First of all, the problem was localized to Eastern Europe, where several countries, including EU member states Hungary, Latvia and Romania, were forced to apply for a credit line mostly from the IMF with a contribution of the EU (Gray 2010, p. 3). However, this assistance was completely different from the so-called 'bailouts', provided by authorities globally to banks and companies, because it came with serious conditionality attached, was rather small in size[6] and dealt with situations that did not seem to threaten the stability of financial systems beyond the troubled countries. Therefore it came as little surprise that the EU chose to stay in the background and let the IMF do the main work in setting conditions for the bailout.

[6]The credit allowance amounted to $ 10.5 billion for Latvia, $ 25 billion for Hungary and $ 30 billion for Romania. However, the liquidity was provided in trenches and drawn only upon request of a country that it was intended for. (Gray 2010, p. 5)

There was, however, one aspect in which the EU was very active. As Vivien Schmidt argues the EU diverged from IMF suggestion that approached the problem from a complex financial balance perspective, encouraging the countries to devaluate their currencies to increase their competitiveness vis-à-vis the Euro area. Instead, the EU insisted on treating the problem as a liquidity problem solvable by means of imposing austerity measures on spending (Schmidt 2010, p. 202).

**The Crisis Spreads to the Eurozone – the Case of Greece**

The real need for intervention only arose when the wave of rising interest rates hit Greece[7], as a result of the deadly combination of spiraling government deficits and high levels of legacy debt. The amount needed was much greater than it was in the case of the Eastern European countries[8] and the cost of non-involvement on the part of the EU was thought to be much greater. The reason for this was that there was a suspicion that markets might be implicitly considering the debt of peripheral countries of the Eurozone guaranteed by the rich states, most prominently Germany, despite the existing explicit claim to the contrary in the European primary law. The Treaty on the Functioning of the European Union (TFEU), amended by the Lisbon Treaty, contains the so called 'no-bailout clause', according to which the Union and its member states shall not be "liable for or assume the commitments of the debt of other member states (TFEU, Article 125). If, however, this provision was not credible for the markets and if this belief was disproven by a default of Euro area country, the fiscal situation of a huge number of Euro area countries would be immediately jeopardized (Valiante 2011, p. 10).



[7] It would be a mistake, however, to assume a clear line of crisis spreading from Central Europe to Greece. In fact, it was Ireland, that faced spiraling deficits even before Greece, due to its decision to guarantee all deposits in Irish banks. A timeline of the crisis can be found online http://www.t-wm.com/Workshops/Eurocrisis%20Timeline_Sept%2708-Dec%2711.pdf (5/25/2012).

[8] The size of the rescue package eventually granted on May 2012 reached € 110 billion (Schmidt 2010, p. 199)

Therefore Article 143 of the TFEU which allows for the provision of assistance to an Euro area state if it "is in difficulties or seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control" and to a non-Eurozone state, which is facing similar troubles and when its problems cause a systemic risk to the community (TFEU, Article 122), was used to provide large emergency bailout for Greece. It is, of course, questionable to what extent it is feasible to attribute the problems faced by Greece to "natural disasters or exceptional occurrences beyond its control", especially in light of the Greek tendency to report false numbers in its effort to portray the country as fiscally sounder than it really was (BBC 2010).

The incentives to take Barry Eichengreen called 'Europe's Historic Gamble' and bail out Greece were therefore higher than ever (Eichengreen 2010). The time was also a pressing concern, because the crisis started to spread to other peripheral Euro area countries, which were soon labeled by the press as the PIIGS group.[9] Therefore, a collective action was ultimately taken on purely intergovernmental grounds, collecting financial contributions from all Eurozone countries (sans Slovakia[10]) for a conditional loan to Greece (Alloway 2010). In exchange for the loan, Greece promised to enact measures, including privatization, liberalization and austerity.

However, Greece was not the only problem. As the Figure 1 shows, there was a fast growing gap between the costs of borrowing of the PIIGS countries on the one hand, and that of core countries, like Germany, on the other. Suddenly, the problem was no longer isolated to Greece.



[9] The acronym consists of the first letters of the names of the five Eurozone peripheral countries that were most affected by the fiscal crisis: Portugal, Italy, Ireland, Greece and Spain (sometimes also spelled PIGS omitting Ireland or Italy). The association with the domestic animal has been perceived as insulting and therefore the use of acronym was restricted by a number of outlets, including the Financial Times. (Mackintosh, 2010)

[10] Slovakia initially opted to participate in the bailout but the country's national parliament failed to pass the notion releasing the € 800 million worth of guarantees that Slovaks were supposed to contribute. (Tomek 2010)

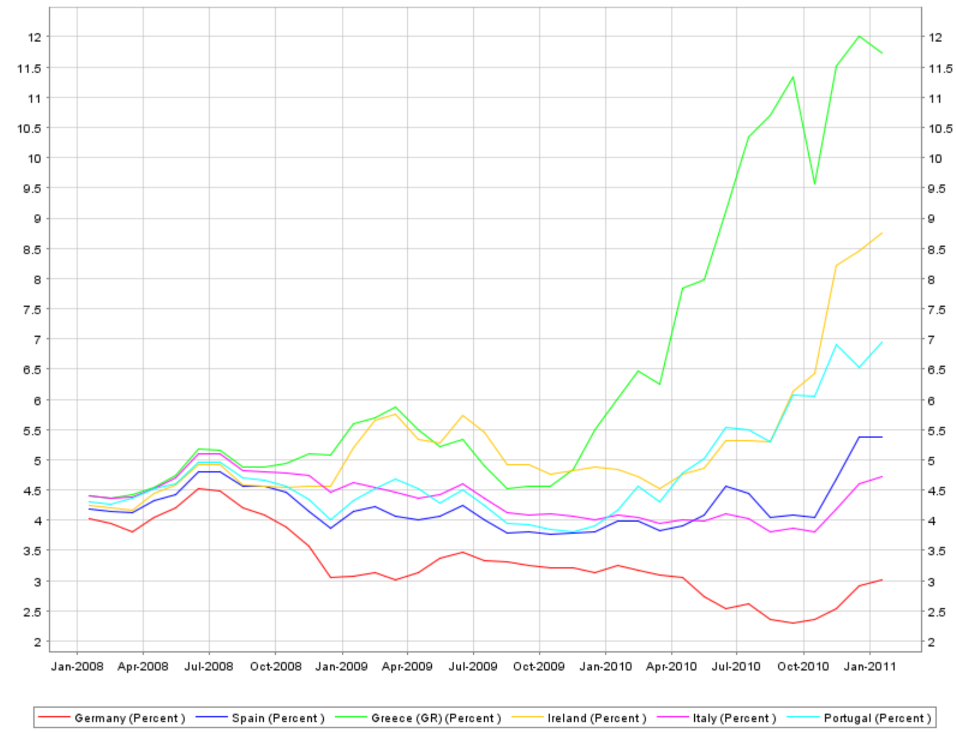


Figure 1: Long-term interest rates of the PIIGS countries and Germany. (Source: ECB)

### 2.1.2. First Attempts at Institutional Solution

To address the issue of sovereign debt crisis spreading deeper into the Euro Area, the European institutions moved on to create a new institution. Legally, it was based on the same grounds as the *ad hoc* relief for Greece, however the governance approach has shifted from a coordinated action of states to the classical Commission method of governance. A new institution was created on May 11, just a couple of days after the aid for Greece was finalized, by a regulation of the Council[11] no. 407/2010 under the name European Financial Stability Mechanism (EFSM).

The key role in EFSM is played by the Commission, which has been empowered to obtain loans for capital markets against the European budget (Article 2) and give conditional (Article 3) loans to the EU member states, based on Article 122 of TFEU.



[11] Based on a Commission proposal.

Given the high cost of enforcing collective actions of the member states,[12] the supranational-based Community method of governance might seem to be the preferred way of dealing with the issues of providing liquidity for the PIIGS. However, the main limitation of this approach is painfully obvious; the common European budget is relatively tiny, limited by the 1.24 per cent of the Gross National Product (COM(2001) 801), which places strict limits on how much funds the Commission can obtain. The consequence of this is that the whole ESFM is worth only € 60 billion – a sum much lower that the amount that was needed to bail out Greece alone (ESFS 2012, p. 3).

Therefore, it is hard to imagine how such an underfinanced instrument can ever do anything to provide a credible backing for the governments of Portugal or Ireland, not to mention Spain or Italy. Therefore, the ESFM could only work as part of a wider framework financed by the member states that are able to provide sufficient funding for the endeavor.

Two things can be concluded from the narrative presented above: 1. An *ad hoc* action to help Greece was insufficient to stop the contagion from spreading to the rest of the PIIGS and 2. The Community method of governance has been only of limited usability, because of the relative small financial power of the European supranational bodies. The Council gathered on May 9 in the ECOFIN configuration (states represented by ministers of finance) to deliberate on the manner. (Council 2010) The solution resulting from the deliberation was in line with the 'new old method of governance'. A new institution was created on a strictly intergovernmental basis as a limited liability company in Luxemburg owned by the Euro Area countries, with a debt guarantee



[12] The example of Slovakia not contributing to the loan for Greece in 2010 illustrates how especially smaller member states can get lucrative payoffs (at least from the political point of view) by not contributing to the common effort.

worth € 780 billion[13] by the member countries, with additional resources obtained from the IMF and by inclusion of the EFSM. The table below shows the contributions of each member state[14]

Table 2: Contribution of the Eurozone members to EFSF as of October 18 2001 (Source: (ESFS 2012, p. 2)

| | New EFSF Guarantee Committments (€m) | New EFSF contribution key (%) | EFSF Amended Guarantee Committments* (€m) | EFSF amended contribution key* (%) |
|---|---|---|---|---|
| Austria | 21,639 | 2.78 | 21,639 | 2.99 |
| Belgium | 27,032 | 3.47 | 27,032 | 3.72 |
| Cyprus | 1,526 | 0.20 | 1,526 | 0.21 |
| Estonia | 1,995 | 0.26 | 1,995 | 0.27 |
| Finland | 13,974 | 1.79 | 13,974 | 1.92 |
| France | 158,488 | 20.31 | 158,488 | 21.83 |
| Germany | 211,046 | 27.06 | 211,046 | 29.07 |
| Greece | 21,898 | 2.81 | - | 0.00 |
| Ireland | 12,378 | 1.59 | - | 0.00 |
| Italy | 139,268 | 17.86 | 139,268 | 19.18 |
| Luxembourg | 1,947 | 0.25 | 1,947 | 0.27 |
| Malta | 704 | 0.09 | 704 | 0.10 |
| Netherlands | 44,446 | 5.70 | 44,446 | 6.12 |
| Portugal | 19,507 | 2.50 | - | 0.00 |
| Slovakia | 7,728 | 0.99 | 7,728 | 1.06 |
| Slovenia | 3,664 | 0.47 | 3,664 | 0.51 |
| Spain | 92,544 | 11.87 | 92,544 | 12.75 |
| **Total** | **779,783** | **100** | **726,000** | **100** |

The EFSF serves only the members of the Euro Area (ESFS 2012, p. 8). Additionally, the EFSF is a strictly temporary institution and will stop giving new loans after June 2013. (ibid, p. 6) So far, the EFSF has provided funding for Portugal, Ireland and the second bailout for Greece. Initially, the EFSF was rated with the highest mark by all three major rating agencies, however S&P has downgraded it following a downgrade of several key contributor countries, including France. (BBC2012a)

The EFSF has had both economic and political consequences. The economic consequences have been, strictly speaking, rather simple: It managed to stabilize interest rates in the PIIGS in a short term perspective, however in the medium term it has had a rather mixed



[13] Originally € 440 billion, increased in October 2011, bringing about a collapse of Slovak government. (ESFS 2012, p. 1)

[14] The amended percentage shows contributions of countries excluding Greece, Ireland and Portugal, which do not contribute anything, because they are the recipients of the aid.

record of being able to prepare the countries for return on the financial markets (World Finance 2012).

Politically, the evaluation is more difficult. On the one hand, the project has gained the support of all the Eurozone countries and showed their ability to commit to an action to save the currency union (as well as perhaps the EU itself) despite its high costs. However, as pointed out by a group of prominent German economists published in *Frankfurter Allgemeine Zeitung*, the solution might very well just delay the solution of the real problems of the PIIGS, which go beyond simple liquidity crisis and are connected to the wider financial imbalances inside the Euro Area. On top of that, the EFSF has a potential to create a whole deal of moral hazard, because the countries might be incentivized to continue with irresponsible spending once the immediate threat of default is avoided (Nuti).

It is definitely too early to judge whether fears of the German economists are justified. The fact, that Greece has largely failed to live up to its promises, at least as far as privatization of its state-owned industrial companies is concerned (Cordes 2012), is definitely a warning sign. So is the electoral I of populist leaders rallying against austerity in Greece and even France in May 2012. A great deal of uncertainty over whether the PIIGS are able to ever start living inside their means without having to be forced to default is definitely present. Furthermore it is not clear whether austerity can even help solve the problem by itself. The empirical evidence presented by a trio of Cambridge economists shows that the austerity measures have been so far unsuccessful in significantly lowering the government debt in not just the PIIGS, but globally. (see Figure 2) However, it is also true that some empirical studies focusing on the long run actually do confirm, that austerity can be effective and even growth enhancing. (Rohac 2012)

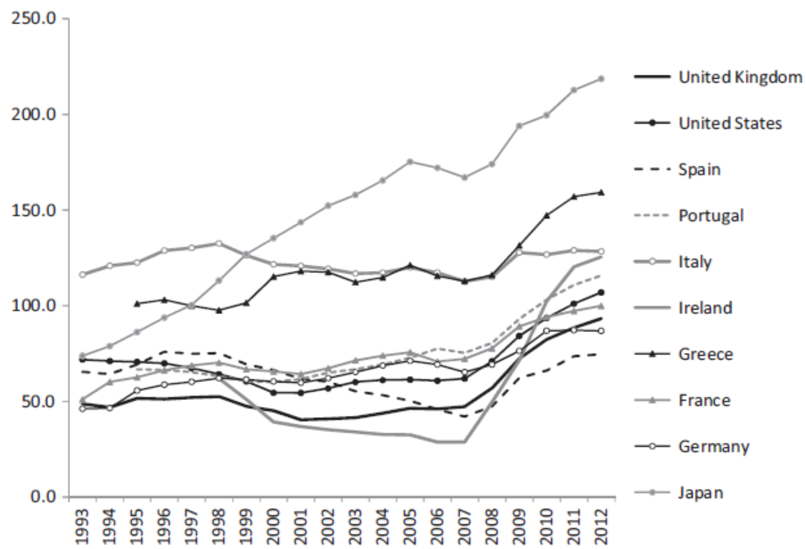


Figure 2: Trends in general government gross debt, as percentage of GDP, selected countries, 1993–2012 based on OECD data (Source: Kitson, Martin, Tyler 2011, p. 292)

It is clearly outside my capacity to evaluate the ability of political systems in the PIIGS countries to deal with protracted austerity programs in the next years or even decades to avoid the doom of a disorderly default and the capacity of political systems in the center of the EMU to sustain money gigantic money transfers to the periphery, which, according to Anders Aslund, must be much greater in the future to work, when reasonable doubts exist that it is just sinking money into an endless black hole (Aslund 2011).

Therefore, I presume that the continuation of the vital fiscal transfers from the center and periphery will become a center point of the European integration process in the foreseeable future. While it seems that the provision of liquidity on a much greater scale compared to the current levels is necessary to maintain stability of the common currency, it is also true that the fiscal transfers can breed resentment and decrease the legitimacy of the European integration as such in the eyes of the public.

### 2.1.3. European Stability Mechanism

The European Stability Mechanism (ESM) can be understood as a permanent institutionalization of the EFSF and EFSM. It exists through an international treaty between the Euro area member states, called the Treaty Establishing European Stability Mechanism**.**(TEESM)**[15]** The planned time, when the ESM is set to be put into effect is mid-2013, when all participating countries will have provided capital required for its functioning (DG Economic and Financial Affairs 2011).

Legally, the ESM is a very interesting instrument because it is based on an amendment of the EU primary law that the Council passed in December 2010, using the new instrument defined by the Lisbon treaty[16] that allows the Council to amend the primary law without the need for renegotiation of the treaties, as long as the change does not widen the competences of the institutions of the Union. From the point of European governance, however, not much has changed. The ESM is a purely intergovernmental organization, which will be run by a board of governors composed of ministers of finance of the Eurozone countries (TEESM, Article 5).

However, the actual mandate of the ESM reflects the experience from the ESFS failure to solve the crisis through providing emergency credit lines to the PIIGS. Recognizing the complexity of the financial imbalances, the ESM will also be allowed to provide capital for re-capitalization of financial institutions of the Euro Area member state (Article 15) and directly purchase bonds issued by the state on the primary market (Article 17), in addition to providing a credit line (Article 14) or a loan (Article 16). The fund will have € 500 billion worth of lending capacity at its disposal, provided by states partly directly, and partly through a promise to provide

[15] Formally, two treaties were signed under that name. One in July 2011 and the other in February 2012. The two versions are largely similar, the main reasons for the amendment include streamlining of financing tools and pricing and making the treaty compatible with the late 2011 developments, most notably with the fiscal compact. (European Council 2012, p.1)
[16] See Article 48 of the TFEU

money when needed. The ESM also comes with a new mechanism called the ‘collective action clauses, which conditions the assistance from the mechanism on the private owners of bonds accepting a loss of portion of their investment, effectively defaulting on part of the debt.

All EU countries may choose to participate in the operations of the mechanism, but only the Eurozone countries are eligible for receiving assistance through the program and automatically become contributing members. Just like in the case of EFSF, the loans are given conditionally based on commitments to austerity. Additionally, eligibility for loans is conditional on ratification of the Fiscal Compact. The chart below summarizes the contributions of all Eurozone countries.


Figure 3: Size and share of contribution of all EMU member states to ESM (Source: http://actuary-info.blogspot.com/2012/03/eu-risk-management-alert.html)

From the perspective of addressing the manifestation of the fiscal crisis in the form of growing interest rates, the EFM may very well be more effective than its predecessors. Following the argumentation of Paul de Grauwe, a long term guarantee is needed, because the monetary union by its nature limits the possibility of the state to cope with a liquidity crisis by the standard monetary and fiscal tools available to countries outside of the Eurozone. What he means by that is that the situation of the Euro area countries facing spiraling interest rates, like Spain, is very similar to that of the Eastern European countries that have to issue debt in foreign currency; because they are unable to print the money to repay debts, a bad equilibrium is established, with markets constantly betting on default sharply causing the interest rates to rise sharply, turning a liquidity crisis into a solvency crisis (de Grauwe 2011, pp.8-10). It is not possible to solve the situation by simply increasing the money supply and thus decrease the cost of debt management and thereby effectively 'inflate the fiscal troubles away', which is an option for countries that posses their own strong currency, like the USA or the UK.

Therefore, a permanent institution is needed to persuade the markets that the PIIGS will not default. However, it is necessary to note that the EFM is also quite small in comparison with its ambitious goals, its lending power being only half a billion EUR, clearly far below the needs of giants like Italy or Spain. I read this as an indicator of the prevailing mindset in the central Eurozone countries, which, despite acknowledging the fact that the problem can not be solved without establishing a long term mechanism for transfer of funds to the countries facing difficulties to finance their debt, are nevertheless quite sensitive about the issues described by the German economists and refuse to put greater weight behind the effort of saving the Eurozone. Even though this is undoubtedly a sign of failure of solidarity between the member states, in my opinion the reluctance also signals that the main actors simply lack desire to deepen the European integration more than it is necessary.

Therefore, it is wrong to interpret the establishment of ESF as the beginning of a "Fiscal Union", as the Czech president Vaclav Klaus referred to these efforts. (Phillips 2011) However, I am also in agreement with de Grauwe's estimation, that the ESF could be a very good step in that direction (de Grauwe 2011, p. 17). The ESF provides a framework, that allows – in theory - the Eurozone countries to credibly assure the markets that they will not accept a default of any member state of the MMU, without the need for pooling sovereignty and empowering supranational institutions. It however also carries significant risk of being ineffective, due to the failure of politicians to commit enough funds to calm the markets and the failure of leaders of the recipient countries to live up to their promises and get the fiscal situation in their countries under control. Therefore, it could be argued, that the problem of fiscal transfers is a problem of lack of confidence among the European leaders in their peers.

## 2.2. Building Trust Inside of the Union

If the transfers of funds inside the Eurozone rise and fall on the credibility of the commitments to responsible fiscal policy, then it is quite easy to assume the reasons behind the reluctance to commit to the existing debt relief schemes, that have been established since the outbreak of the crisis. Namely, the issue has something to do with the lack of faith in the ability or willingness of at least some Euro area member states to conduct responsible fiscal policy.

### 2.2.1. Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

Traditionally, fiscal policy has been in the domain of the states and only coordinated through the Stability and Growth Pact, which required all the Euro area countries to keep their budgets close to being balanced and made it formally possible to punish a country running deficits above 3 per cent of its GDP to be punished, however the penalties were subject to the consent of the Council (Schuknecht et al. 2011, p. 11). The conditionality of penalties turned out to be a problem. The Council, as an intergovernmental organization, selectively opted for not punishing countries breaching the Pact, even when they failed to uphold it repeatedly. Greece, Portugal, Italy and even France and Germany had breached the 3 per cent limit over the 2000s without any punishment.  (ibid). Therefore, it is easy to see why the assurances of the PIIGS, that they will behave responsibly, were not considered credible and why there was a need for reform in that area.

The Treaty on Stability, Coordination and Governance (Fiscal Compact)  addresses the main problems of the SGP. The Treaty was signed on March 2, 2012 by all EU member countries, except for the United Kingdom (UK)  and the Czech Republic and it is expected to enter into force from the beginning of 2013, provided that at least 12 countries have ratified it by then, or if not, it will become valid after being ratified by 12 countries. (Fiscal Compact, Article 14) It introduces automatic sanctions for the countries which run excessive deficits.[17] The definition of an 'excessive deficit' is much stricter in comparison with the SGP, the countries are allowed to only run deficits of 1 % of GDP and it is even stronger for the countries that already have a debt of over 60 % of GPD – these have to cope with a 0.5 % limit. (Article 3) Breaching this rule results in a sanction up to 0.1 % of their GDP, which does not require consent of any intergovernmental organization. The Commission plays a central role in this process, bringing the matter in front of the Court of Justice, which would set a period of time that the state has to rectify its problem and can apply the penalty if the state fails to consolidate its budget in the given time window (Article 8). To increase the credibility of the Pact even further, the Eurozone countries are required to incorporate the deficit limitation into their legal systems, "through provisions of binding force and permanent character, preferably constitutional " (Article 3).

While it is clearly true that the introduction of an automatic sanction addresses a real issue of the SGP, it is doubtful how such a low fine can  have a profound effect on the policy makers committed to short term benefits of irresponsible fiscal policies (Gros 2012, p.2). However, this

[17] This part is valid only for the Eurozone countries.. (Article 1) The sanctions can be only blocked by a qualified majority in the Council voting against them, no positive votes are required.

issue is quite elegantly addressed in the preamble, which stresses the conditionality of being eligible for help from the ESM by upholding the rules of the Fiscal Compact.

Only time will show whether this system will be effective in reality. However, one thing is clear: Just like the ESF does not represent an establishment of redistribution on the European level, the Fiscal Compact is as far from representing a substantive change in the way how fiscal matters are governed in the EMU. As noted by Daniel Gros, the main significance of the Compact is that it represents a political commitment to austerity and balanced budgets (Gros 2012, p.2).

Such commitments, however, are nothing new. Germany has led by example by enacting an austerity program back in 2010 (Pop 2010). So did other countries, among them the United Kingdom and France, as well as the PIIGS, even though in their case its hard to tell how much their decision was influenced by the conditionality of support from the ESFS. (BBC 2012b) It seems therefore, that the Fiscal Pact is only one piece of the puzzle, that together gives a picture of states' behavior in times of crisis, along with other factors (such as perhaps the impact of the markets and rating agencies and internal political developments).

### 2.2.2. Europe 2020, a general overview

So far I have discussed the solutions that were presented for the debt crisis at the EU level and the tool devised to ensure effective coordination of fiscal policy. These things are without a doubt very important, but as I have previously noted, it is not clear that austerity by itself can solve the debt problem. On the European level, there is a recognition of a need for "financial stability and economic growth – one and the other." (Barosso 2012)

On March 3, 2010 the European Commission proposed a 10-year plan entitled 'Europe 2020: A strategy for smart, sustainable and inclusive growth' to address this goal. Europe 2020 is a framework for an exit strategy that is meant to follow the undergoing period of bailouts and austerity. It is a policy document that is meant to recognize that while credible commitments to sound fiscal policy are meaningful – and necessary – in the short run, austerity itself cannot be an answer to the challenge of ensuring stability and growth in the more long term perspective.

The document proposes three general directions for starting significant growth to help overcome the crisis in the medium run, namely (1) intelligent growth based on education and innovation, (2) sustainable growth achievable through application of 'green' solutions with highly effective use of energy, (3) inclusion as a priority for lowering unemployment and boosting cohesion of European societies. (Commission 2010, p. 5) To fulfill the goal, a set of quantitative indicators were defined in line with the targets defined by the predecessor of Europe 2000, the Lisbon Strategy. The indicators are as follows: Spending on science and education in all member countries was prescribed to reach at least 3 per cent of GDP, 75 per cent of working age Europeans were to be employed, the '20/20/20' goal[18] for green energy usage was confirmed, the number of students who drop out of the education system was to decrease below 10 per cent with at least 40 per cent of the young generation obtaining a tertiary level education and the number of people living in poverty in the EU was to decrease below the 20 million mark (ibid).

Even though the strategy was defined for the whole European Union, the Eurozone was assigned a key role in this agenda. A reform of the SGP has also been proposed to increase the economic coordination inside the Eurozone. The so called 'European semesters' have been introduced that greatly increase the oversight of the national budget by the Commission. The semesters represent, in my opinion, a milestone in the development of

[18] 20% increase in energy efficiency, 20% reduction of CO2 emissions, and 20% renewables by 2020

European economic governance, which is why the entire next chapter has been devoted to examining them in detail.

As noted by Salines and his colleagues, Europa 2020 can be understood as an attempt to solve the problem by streamlining the existing institutional setting, without a change in the underlining philosophy of the institutional framework governing economic matters on the Union level. (Salines 2011, p. 17) While the document potentially strengthens the supranational governance of the economic affairs through increasing the Commission's surveillance powers, it does not substantively shift the power away from the national states.

In fact, Europe 2020 represents a continuation of the so-called 'open-method of coordination (OCM). The OCM represents what literature refers to as the 'new' or 'soft' method of governance, when instead of formalized institutional framework being put in place, states are encouraged to engage in benchmarking their performance against that of their peers to determine the best practices through the so called broad economic policy guidelines (BEPGs) (Hodson 2011, p. 3). The BEPGs are expected to produce peer pressure through non-binding resolutions asking an infringing Eurozone country to adjusts its policy in a certain way (ibid, p. 78).

A big advantage of the BEPGs is that they allow to answer the problem of broader fiscal imbalances without the need for an international institution that would command states to commit to certain fiscal policies, beyond stabilizing their budgets. Having touched upon how much resentment towards the European integration project and common currency is created even by imposing austerity upon countries in need of financial aid, it is hard to imagine that the institutions of the EMU or EU will ever get directly involved in developing policies for addressing systematic economic imbalances in the Eurozone.

Therefore, once again it can be concluded that Agenda 2020 does not entail a radical change of the economic governance in Eurozone. The Commission envisions a Europe as we know it, in which it acts as a 'engine' of the integration, while accepting constraints from the side of the Council as well as the EP, coordinating the efforts essentially[19] determined on the state level, not on the level of the European institution (Salinas 2011, p. 18). It reflects a belief that the Union does not need to fundamentally change to survive, it only needs to get its priorities straight and increase the effectiveness of the procedures already in place.

### 2.2.3. The European Semester

The Semester is the first practical example of what the Commission meant by streamlining and increasing effectiveness of the existing instruments. Both the Commision, as well as a special task force set up by the Council under the leadership of its president, Herman Van Rumpuy, worked to propose solutions for increasing the effectiveness of economic governance in the EU in accordance with the Europe 2020 framework. A concrete weak point was identified inside the structure of economic governance; the system was deemed to lack effective tools for macroeconomic surveillance.

The European Semester was approved by the council in September 2010 and creates a six-month annual cycle of evaluation of the financial imbalances as well as economic and fiscal policies of the member states. At the beginning of each year, the Commission prepares reports covering the whole EU and the member states individually, in which it will analyze the main macroeconomic developments. Based on the evaluation by the Commission, the Council and the European Parliament create proposals for each EU country identifying major challenges and proposing policy solutions for them. Taking these into account, all countries have to submit

[19] As long as the state is not affected by conditions attached to a bailout.

policy proposals relevant to the issues of economic policy and financial balance by April. Subsequently, the Commission has the right to propose frameworks for the countries that do not come up with a credible plan of addressing the identified shortcomings and imbalances for the following year (Council 2010, p. 5). The following chart shows the six-month cycle graphically.

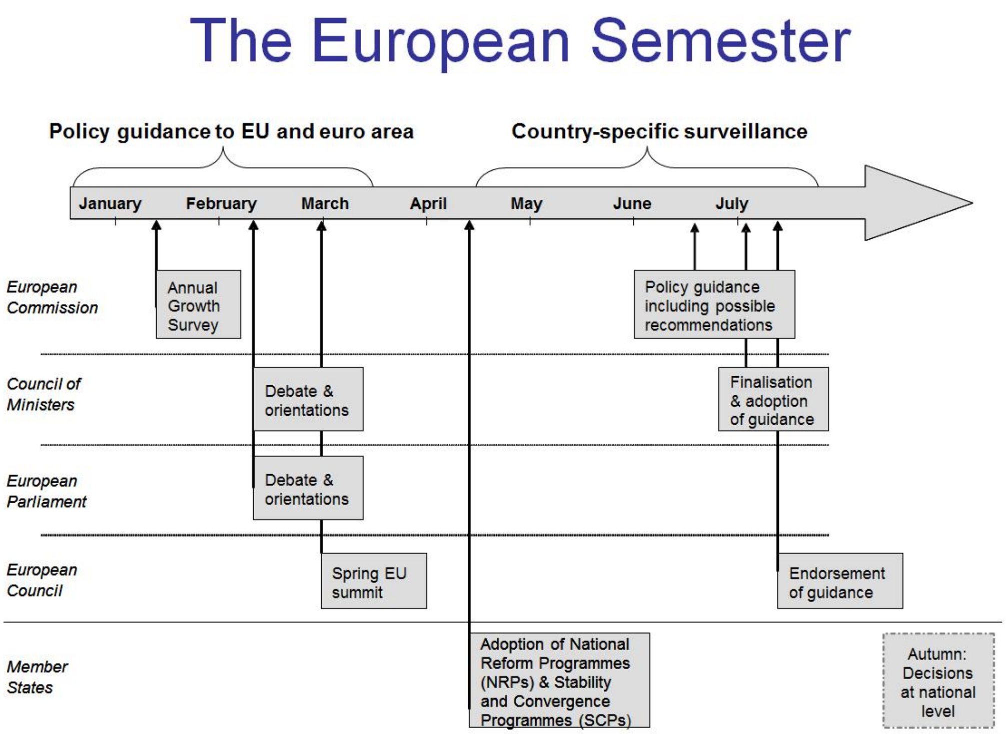


Figure 4: The six-month cycle according to the European Semesters (Source: Council 2012a)

In this the Commission went beyond simply dwelling on the known issue of Greek authorities effectively sending misleading data to the Eurostat[20] and instead framed the problem through the lens of addressing the broader economic imbalances inside the system, essentially making the case for enhanced economic surveillance relevant to three broad issues. Firstly, it was the budgetary discipline itself, secondly the broader financial stability, including such issues as stabilizing the long-term redistribution commitments of the member states and thirdly the issues

[20] See COM 2010/1 for a detailed analysis of irregularities concerning reporting of data by the Greek authorities.

of other macroeconomic imbalances, most prominently the lack of competitiveness in some periphery countries (Fierry 2010, p. 6).

The European semesters aim to remedy the situation by involving the Commission and the Council in the process of preparation of budgetary and reform documents at the level of national states, which will receive expert evaluations of their economic policies and will be asked to provide their own frameworks for medium term economic policy and budget-relevant to be evaluated by the institutions at the European level. That policies themselves will stay on the national level (hence it is not possible to speak about a revolutionary change or additional communitarization of economic governance in the EU), but will bethesubject of extensive surveillance and ex ante evaluation by the Council and the Commission.

What is very interesting from the governance perspective is how it is actually the Commission that is seemingly acting against its 'natural' preference for increasing its own power (compare Hodson 2011, p. 35) and seems satisfied with its role of expert body ascribed by the open method of cooperation. In my opinion, this is a symptom of a conscious political decision, showing that the Commission does have a vision of distribution of power among the different levels of the European political system. Following the principle of *subsidiary,*[21] it attempts to establish a *modus Vivendi* in which power is shared between the European institutions and the member states, rather than pursuing a 'European superstate'.

The purpose of the European semesters is simply not to gain control over the budgetary procedures in the member states (even though such fears apparently exist, as notable in the British decision to stay out of the initiative), but simply to allow for the already existing bodies to fulfill their role more effectively, to broaden the number of participating countries to encompass

[21] Issues are being solved on the lowest possible level, where they can be effectively solved.

the states that are yet outside of the Eurozone and to broaden the scope of the goals in the 'spotlight' of the Community beyond mere financial stability to include the issues of broader economic imbalances as well.

### 2.2.4. "The Sixpack"

In addition to the European semesters, several additional reforms of the existing institutional setting have been proposed by the Commission with the intent to strengthen the economic governance in the EU. In total, there are five regulations and one directive, all entering into force in December 2011 (Council 2012b):

- Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area
- Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area
- Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies
- Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances
- Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure
- Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States

It is not possible to provide a detailed analysis of all these proposals within the scope of this paper. In addition to that, it would not be particularly meaningful for a piece of writing that focuses on the changes in economic governance in the EU. However, the proverbial devil is in the details, which is why it is meaningful to look at the major changes brought about by these documents. The purpose of the six-pack is twofold: To enable a stronger preventive and corrective action to ensure fiscal responsibility in the EMU and to reduce wider macroeconomic imbalances, again through corrective and preventive action (Council 2012 b).

The fiscal responsibility has been reinforced by limiting expenditure growth by tying it to economic growth in a country, thus effectively prohibiting governments from quickly raising expenditure in the good times to unsustainable levels. In addition to this, the Excessive Deficit Procedure, that has been already established as a punishment mechanism for the Eurozone member states that are found infringing upon the SGP. The six pact made it possible to enforce punishment for the Eurozone countries based on the debt level criterion, in addition to the original deficit criterion and made the sanctions (0.2 % of GDP deposit to the ESF) more automatic by conditioning it by a majority of other Eurozone countries not voting against it (negative simple majority). Originally, states were required to vote in favor of the sanctions. Finally, all EU member states are required to increase transparency of their internal budgetary procedures through producing standardized 'national budgetary frameworks' from 2013 onwards.[22] To achieve the second objective, a scoreboard has been created evaluating the performance of the member states in addressing macroeconomic imbalances. A new Excessive Imbalance Procedure has been brought into existence with an associated fee of 0.1 % of GDP, however again only for EMU members (MEMO/11/364).

The new legislative has been in effect only for a few months, providing close to non opportunity to evaluate its impact in praxis. However, it can be said that it addresses the main weak points of the SGP: The sanctions have been made more automatic and the technical benchmarks for evaluating performance of the individual countries have been developed to

[22] The deadline is 2012 for the EMU members.

encompass the issues of the debt levels and overall macroeconomic imbalances, in addition to the traditional deficit criterion. However, it is impossible to predict the future behavior of state representatives in the Council; only time will tell whether they will be more willing to enforce penalties over states in breach of reformed SGP due to the reformed procedures.

From the perspective of European economic governance, the ‘six pack’ brings sticks to the ‘streamlining without major changes’ formula of the Europe 2020 framework. There is no radical departure from the *status quo,* in which the national states control the budgets and the European institutions only provide oversight and consultancy, having only minor penalty-inflicting mechanisms in their arsenals to address potential breaches of the agreed rules. Following the argument of Buti and Padoan, it is questionable whether the Commission has effectively taken advantage of the *window of opportunity* for fundamental reform created by the crisis, or whether there was a need to go further in increasing the communitarization of the fiscal and economic policies in the Eurozone and beyond (Buti, Padoan 2012, p. 5).

### 2.3. Summary of Findings

I believe there are several major conclusions that can be made from the discussion presented above.

1. There have been significant changes to the structure of the Eurozone as well as the EU as a whole since the advent of the crisis; yet it is unclear as of yet, whether the scope of the changes was sufficient.

2. The first group of major changes involves the establishment and institutionalization of fiscal transfers to the PIIGS countries. There are a few notable facts relevant to this: The EU only got involved on a larger scale when the fiscal crisis reached the borders of the

Eurozone; it remained rather passive vis-à-vis fiscal problems in Hungary and Romania. Furthermore, the core countries were reluctant to provide the needed assistance and therefore the size of the bailout packages and funds created to address the liquidity problem remains rather small. There is no redistributive union.

3. The help was provided under the condition of austerity being enacted in the PIIGS countries. Despite the recession, growth was given lower priority in comparison with demands for slashed spending.
4. The second group of initiatives addresses the shortcomings of the SGP, through increasing surveillance and transparency and polishing the punishment mechanism for countries in a breach of the fiscal commitments set by the Pact. Again, this is mostly a Eurozone issue, because the punishments are only in effect for the EMU countries. There have not been a significant shift away from the current *status quo* of power distribution inside the European political system – budgeting essentially remains in the domain of the states. No 'European super state' is on the horizon.
5. Yet, there is an important innovation being introduced through the European semesters as well as the measures included in the 'six pack'. The states are now required to consult their budgetary policies and medium-term plans with the European initiatives, thus effectively being subjugated to an ex-ante control.
6. Lastly, there have been efforts to address the issues beyond the immediate problems plaguing the EU, such as restoration of growth and addressing wider financial imbalances in the system, represented mainly by the Europe 2020 framework. An interesting aspect to this is that the Commission did not aggressively push forward to gain more ground in the power structure of the European economic governance and instead chose to rely on the new method of governance to shape the future of the economic coordination inside the EMU.

## 3. Impact on Slovakia

Since getting rid of the semi-authoritarian regime of Vladimír Mečiar in 1998, Slovakia has been a country characterized by high degree of devotion to the ideals of European unity. Citizens of no other country expressed such a universal support to the EU as Slovaks upon their accession to the Union. More than 93 per cent of Slovaks, who attended the 2003 referendum deciding on the EU accession, voted yes.[23] As noted by Taggart and Szczerbiak back in 2001, Slovakia is also an exception in the sense that there are no relevant parties in Slovakia representing principled opposition to the European Union (Taggart, Szczerbiak 2001, p. 16). This is still true, there is no Slovak equivalent of the UK Independence party or Hungarian Jobbik. To promote the idea of EU membership, Slovak leaders even organized a rather awkward promotion event with each and every remotely relevant political figure in Slovakia participating. The reformists, the socialists, the conservatives, even the communists and Mečiar himself, participated in a common stroll through the streets of Bratislava approaching people with

But it would be a mistake to assume that the fondness that Slovaks hold in their hearts for the European Unity is unconditional. The public support for the common currency has fallen by almost ten percentage points since the outbreak of the crisis (Roth et al. 2012, p. 14). Furthermore, opposition to the common currency has established itself as a viable political platform in the country. This development was manifested for the first time with the bailout for Greece. Fico's left-wing government did support the loan in the Council, however remained passive when it came to actually approving the funds. The argument presented by the Slovak prime minister at that time, who is now back in power, Robert Fico was as follows: "I don't trust

[23] However, the turnout was just 52 per cent, even though this number is still the highest turnover in the history of Slovak referendums.

the Greeks. The approval by the [Greek] government is not enough. We want to see laws approved by the parliament leading to cuts in salaries, pensions and social benefits. Until then the Slovak cabinet will not authorize its loan"  (Goldirova 2010).

In the end, however, it was Fico's center-right political opponents who adopted his reservations and channeled them as a political issue in the 2010 government election. As soon as they took power, they outright refused to contribute to the rescue package for Greece, pointing to the relative poverty and difference in living standards between Slovaks and Greece (New York Times 2010). However, this was not necessarily formulated as a rebellion against EU involvement in the rescue of the PIIGS. Nor did Slovakia started to play the role of 'troublemaker' in the European community. Indeed, Slovakia has agreed with the establishment of the EFSF, the Fiscal Compact and even the permanent EFM. Only when Slovaks were asked to provide funding for an increase of the size of the EFSF, the ruling coalition split into two[24] over the issue of whether it is 'a loan for the fat Greek' (Eastern Approaches 2011) or not. This resulted in a preliminary election, greatly strengthening Fico's left wing camp, while weakening the center-right forces as a whole.

The moral of the story is that the EU has had a long, profound influence on Slovak politics and society. For the most part, the European integration project (with the common currency) played the role of a role model creating opportunities for progressive forces in Slovak society to challenge the *status quo* as a way of securing Slovak membership in the EU and in the EMU. In the following, I will make a case for the claim that the Slovak confidence in the integration project was not misplaced and Slovakia has actually benefited from the opportunities,

[24] Resulting in the failure to pass the resolution in the parliament when it was first proposed and indirectly in the fall of the ruling coalition.

that would not have appeared if it had chosen a different path. Furthermore, I will show how the developments discussed previously in this thesis represent an opportunity for Slovakia to benefit even further.

However, I do not intend to present the ongoing changes as unproblematic. As I have mentioned in the opening of this chapter, there is evidence of a turn towards redefinition of Slovak attitudes towards the European Unity – a development, that  in my opinion, creates a threat to the future of the Slovak social and economic model. I will try to develop a framework for understanding why Slovakia might be driven away from its traditional pro-European focus by the developments in the economic governance of the EU.

## 3.1. Risks Created by the EMU Reforms

Slovakia as a country has changed significantly since its 2004 accession to the EU. The country has implemented comprehensive 'second generation' reforms of its economy and greatly increased its economic performance. Figure 5 below shows the impressive level of convergence of the Slovak economy with the economies of the 'Western' EU members, in comparison with convergence in other V4 countries, which have progressed at much slower pace.

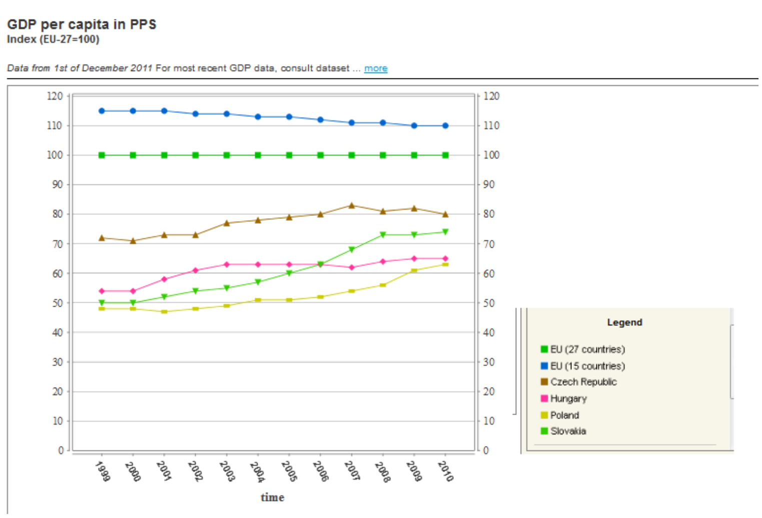


Figure 5: GDP per capita in PPS comparison of V4 countries (Source: Eurostat)

It is important to note that the fast economic progress took place at the time when the country not only implemented the one-of-the-kind reforms, that have been the major reason behind the Slovak success (O'Dwyer, Kovalcik 2007, p. 3,4), while also striving to join the Eurozone. This meant that throughout the time when Slovakia experienced fast growth, it also had to fulfill the accession criteria and therefore had to retain responsible monetary and fiscal policies. As concluded by Christoph Rosenberg in his IMF paper, these two issues are even interconnected, because even though Slovakia also benefited from positive global economic trends, the preparation for the Euro entails redoubling the Euro efforts (Rosenberg 2008, p. 2).

Meanwhile, the other countries in the region experienced comparatively slower growth, were not as successful in reforming their economies and remained outside of the Eurozone. Of course, this does not necessarily mean that Slovakia would not be successful if it chose to remain committed to its national currency, but it does suggest that the European economic framework provides an opportunity for leaders to commit to responsible macroeconomic policies, while retaining absolute sovereignty over their economies. Ultimately, this allows them to pursue their own way of managing society and the economy.

However, the hard evidence shows that the main benefits of the Slovak integration efforts came only after the country's 2009 Eurozone entry. An analysis published in the Financial Times confirms, by joining the EMU Slovakia avoided having to deal with high levels of currency fluctuation, that plagued all other countries in the region[25] (see Figure 6 below). Due to having a



[25] Most notably, even the Czech Republic, which is a country that is very similar to Slovakia in economic terms and has the most developed economy in the region suffered from significant levels of instability of its currency, the Czech crown.

stable currency, Slovakia maintained a relatively predictable environment for investors, which led to surpluses in trade balance and faster industrial growth (Cienski 2012).

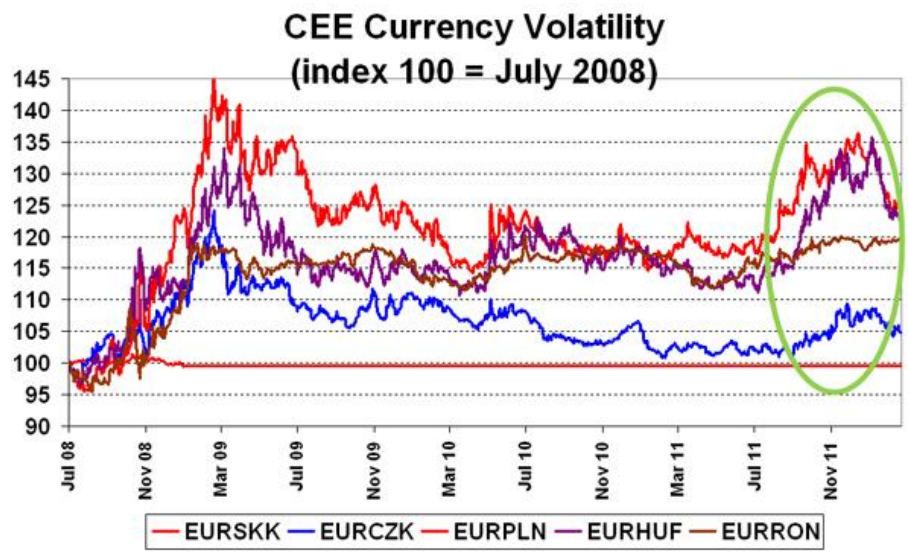


Figure 6: Currency volatility in the V4 region (Source: Financial Times 2012).

In short, Slovakia benefits from the strength of the Euro as a currency and from the associated economic coordination mechanisms, which provide an incentive for politicians to conduct responsible fiscal policy, while leaving enough space for Slovaks to follow their own approach to the economy. Therefore, I conclude that any action that serves to the benefit of the Eurozone also benefits Slovakia. Evaluating whether the bailout mechanism for the PIIGS is, in fact, the best tool to strengthen the Eurozone is beyond the scope of this thesis, even though I have touched upon some of the potential sources of problems, like their limited size and perhaps unbalanced focus on austerity to the expense of growth. However, I believe it is important to note that a stable Eurozone is also vital for Slovakia and not just a matter of saving the PIIGS.

Lastly, there is the matter of increased surveillance over national budgets. This effort is consistent with Slovak policy of increasing credibility of its commitments to responsible fiscal policy as evidenced by the amendment to the Slovak constitution passed on December 2011 with the votes of 147 out of 150 members of the Slovak legislative body, the National Council of Slovak Republic. The amendment introduces automatic sanctions activated when the debt of the country exceeds 50% of its GDP (Onuferova 2011). Additionally, there is empirical evidence suggesting that there might have been a decline in fiscal responsibility on the part of Slovakia after being admitted to the Eurozone. Figure 7 below shows that Slovakia performed worse than the average of both the EU and the Eurozone, and much worse vis-à-vis its neighbor, the Czech Republic. Therefore, the streamlined SGP might offer an opportunity for Slovakia to avoid facing liquidity problems in the future.

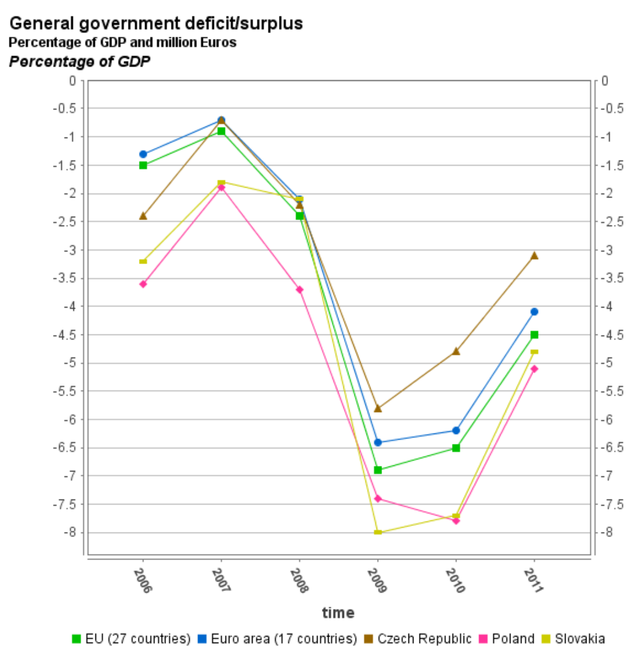


Figure 7: General government deficit in the EU and in the V4 countries[26] (Source: Eurostat)

[26] Hungary is not shown because its budget followed a distinctive path due to the actions of the Orban government.

## 3.2. Slovak EMU Membership as a Threat

Slovakia benefits from being in the Eurozone and the undergoing changes in the economic governance of the EU are good for the country, because its economy receives a boost from predictability and stability provided by a stable currency and the fiscal rules help Slovakia to remain on the path of fiscal prudency. Nevertheless, I would like to make a case for the claim that there is also a significant risk associated with the current developments. As argued by Andrea Pechova, it is not possible to evaluate the membership in Slovakia through purely rationalist arguments. Instead, she proclaims, it is necessary to include "historical and ideational aspects of national identity" (Pechova 2012, p. 9). Also Bela Greskovits argues that for Slovaks the Euro is a matter of identity, more precisely it is about establishing Slovakia as a worthy member of a club of developed countries (Greskovits 2011, p. 274).

This 'non-materialistic' approach to the common currency has an obvious downside. Because Slovaks understand the Euro Area through the discourse of national identity and pride, as a reward for fulfilling the harsh admission criteria, any assistance for the PIIGS can be potentially seen as unfair to Slovaks. This opened a window of opportunity for politicians, such as Richard Sulik, who served as the speaker of the Slovak parliament to gain political capital by resisting what he frames as 'unfair preference' for the PIIGS countries. Mr. Sulik formulated this argument quite explicitly:

> *From the Slovak perspective, helping the Greeks is utterly absurd. Slovakia is the poorest country in the eurozone. Our average monthly income is 780 euros, or 1050 euros when the employer's payroll contributions are include. Average pension is less than 400 euros per month. We have a GDP of 70 billion euros and collect 30 percent of the GDP in taxes. The average wage in Greece is twice as high as that in Slovakia. The average pension is three times as high…*
>
> *…But, Slovak politicians have, in spite of my party's opposition, agreed to join the temporary European Financial Stability Facility. As a consequence, Slovakia has agreed to guarantee loans worth some 7.7 billion euros. Moreover, Slovak politicians have agreed to join the permanent European Stability Mechanism. As such, Slovakia will have to guarantee further 5*

*billion euros - and transfer 650 million euros up front as cash…We cannot afford to be this generous. We do not have a highway between Slovakia two largest cities; we have a sub-standard education and healthcare; we have the lowest wages and pensions. Yet, nobody seems to care. What is important to our political elite is that we appear to be "good Europeans"* (Sulik 2012, pp.7,8).

Hence a paradox arises: Even though Slovakia benefits from the efforts to solve the crisis in the Eurozone, all actions taken to that effect can be used politically to steer Slovakia into the position of a barrier to the reform in the Eurozone. There are at least two examples of this happening: First when Slovakia refused to contribute to the bailout for Greece and second when the Slovak parliament failed to pass an increase of funding for the EFSF at the first attempt. From this point of view, any future demands for financial transfers can be framed as a direct challenge to the Slovak pro-European tradition. The fact that the reforms of the economic governance create new requirements almost exclusively for the Eurozone countries and that it is the Eurozone countries who have to bear the weight of the bailouts just adds insult to injury. If the European integration once represented such values as stability, responsibility and good policy values and then morphed into an unstable club that includes extremely irresponsible members and the resulting problems are not being addressed effectively, then a case can be easily made for the Slovak public that the prudent course would be, in fact, to be outside of the EMU.

Such a realization, if internalized by the population, represent what Greskovits calls 'turning points' in the history of a nation, which represent a radical reorientation of the policies pursued by the political system of a country in question (Greskovits 2011, p. 280). If my analysis is correct and the current direction represents an opportunity and not a threat to Slovakia, then this can be seen as a worrying development.

### 3.3. Summary of Findings

Even though the developments are still in progress, it is possible to say a few things about the impact of Slovakia being in the Eurozone during the times of the crisis.

1. Slovakia has benefited from its membership in the Eurozone, despite the crisis. That is because, unlike its neighbors, that have retained national currencies  it did not have to cope with currency fluctuations, creating much more stable environment for the investors. Furthermore, evidence suggests, that Slovakia benefits from responsible fiscal policies, that it implemented before the crisis to satisfy EMU entry requirements.

2. Slovakia was admitted to the Eurozone, while at the same time implement liberal economic reforms. Slovakia benefited from this development, because it led to a fast growth, without creating unsustainable deficits. Current changes to the economic governance of the EU increase the ex-ante and ex-post control over national budgets, while leaving the economic policy decision-making power on the national level.

3. Yet, it is important to note, that for Slovaks, the European integration is not simply about rationalist calculation, but also about identity, as argued by Bela Greskovits. Therefore, there might yet be political dangers to the current developments, because the changes can be (and has been) used by the Slovak populist as a weapon in the local politics.

## Conclusion

In this thesis, I tried to argue that the sovereign debt crisis in the Eurozone has shown a major failure of the economic governance, due to the imbalance between the centrally governed monetary aim of the EMU and the decentralized coordination of fiscal policies, which remain in the domain of the member states. Worse yet, the coordination mechanisms did not work effectively; the threat of sanctions just was not credible, because it was conditioned by agreement of ministers in the Council to punish one of them and the preventive function was paralyzed by insufficient oversight over budgetary procedures in the member states.

Another important shortcoming of the European economic governance became obvious when the crisis started: The Euro Area just was not capable of an effective action. I tried to show that there were three reasons for this: The intergovernmental nature of the non-monetary part of the project resulted in a need to address the issues through a costly collective action, the intergovernmental European institutions were prone to politicization, preventing them from effectively functioning as credible expert bodies and the supranational institutions did not show enough flexibility to be able to provide effective leadership. Therefore, I argue, it was only due to the rapid intensification of the crisis, which increased the opportunity cost of not doing anything, that the system started to change.

Firstly, a system of liquidity assistance was slowly developed, from an *ad hoc* bailout for Greece to a permanent rescue mechanism, with defined strict conditions, that are there to make sure, that the country receiving assistance will be able to restore macroeconomic balance. It is unclear as of yet if the size of the assistance is going to be sufficient, because it is very hard to predict to which countries will the contagion spread in the future and it is equally hard to evaluate the capacity of the PIIGS to cope with their fiscal situation. Furthermore, it is also questionable, whether it is optimal to focus so much on the budget cuts in the conditions attached to the assistance. Nevertheless, the size of the rescue mechanisms is definitely not big enough to justify claiming that the EU is establishing a redistribution platform. This is simply not what is happening, the support does not go beyond emergency assistance.

In addition to the assistance, the EU is also actively working to reform the SGP, both in terms of budgetary surveillance and in regards to sanctions, which have been made less dependent on the decisions of the member states and more encompassing to address financial imbalances beyond the issues of fiscal deficits. Despite the fact, that the Commission played a major role in designing these measures, there is no significant change in the distribution of power between the member states and the European institutions. Instead, the focus is placed on making the existing framework of economic governance more effective.

I argued that Slovakia benefits from these changes, because it has an interest in preserving the EMU and because these changes actually make its commitments to responsible fiscal policy more credible, without scarifying Slovak ability to follow its own approach to governing economic matters locally. I argued that the ability of Slovakia to pass a comprehensive reform program, while being subjected to the accession requirements to join to Eurozone shows, that there is no inherent contradiction between adhering to the rules of the Eurozone memberships and enjoying high economic growth.

However, I also pointed out, that for Slovaks the Eurozone membership is a matter of identity discourse, not just an issue of rational choice. Therefore, it is important that the assistance for the PIIGS is done in such a way, that it does not reward irresponsible behavior and that the economic coordination efforts leave no doubt, that Slovakia will not be forced to abandon its own economic policies. It is important, that Slovaks maintain their faith in the common currency as a well-run club of developed, responsible nations, because otherwise the Slovak populist might push the country down the way, which would jeopardize all the gains that Slovakia has, through heavy sacrifices, gained since the fall of Meciarism in 1998.

As a follow up to my thesis, I think there are several ways to pursue in order to develop the presented arguments further. Firstly, it would be interesting to reevaluate the situation in the future, perhaps in a couple of months. The situation is still in the flux and it might turn change dramatically rather quickly. Secondly, it might be interesting to explore the behavior of not just Slovakia but also other small EMU and non-EMU countries in the EU, to enrich the debate by discussing other perspectives than just those of the main actors.

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