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ARTICLE

FROM 'NO BAILOUT' TO THE EUROPEAN STABILITY MECHANISM

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INTRODUCTION

This article traces the history of the fiscal "stability" features of the Eurozone, following the European Union's movement from a firm 'no bailout' policy, through the eventual financial rescue of several troubled Eurozone member states during the Euro crisis,[1] and then on to the 2012 establishment of the European Stability Mechanism ("ESM").[2]

It will also describe the parallel history of the European Union's Stability and Growth Pact ("SGP"), [3] from its origins in the

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1. For an overview of the Euro crisis, see generally Philip R. Lane, *The European Sovereign Debt Crisis*, 26(3) J. ECON. PERSPECTIVES 49 (2012).

2. The European Stability Mechanism, established in 2012 in the aftermath of the Euro crisis, is a permanent facility for financial assistance to Eurozone members.

3. For an overview of the history of the Stability and Growth Pact through its 2005 reforms, as well as an argument that economic growth concerns should be given more primacy, see generally Roger J. Goebel, *Economic Governance in the European Union:*

convergence criteria stipulated by the Maastricht Treaty[4] in the run-up to the launch of the Euro, to the first generation of the SGP through its breakdown and subsequent 2005 reforms, and onto the post-crisis Treaty on Stability, Coordination, and Governance ("Fiscal Compact").[5]

These two lines of development represent the European Union's fiscal stability apparatus. The SGP, as reformed and enhanced by the Fiscal Compact, continues to address fiscal stability in ordinary times, which includes both the times of economic expansion and the periods of contraction that are experienced through the business cycle. The SGP system operates both *ex ante*, in reviewing member state proposed budgets, and *ex post*, where it creates the possibility of the imposition of sanctions on member states that persistently run excessive budgetary deficits.

The European Stability Mechanism has been set up to address a return of member state fiscal catastrophe. The ESM will serve to bailout an imperiled Eurozone member state, notwithstanding the continued presence of a 'no bailout' provision in the Treaty on the Functioning of the European Union ("TFEU").[6] An intergovernmental treaty among the Eurozone member states formally established the ESM.[7] Participation by the Eurozone member states in this treaty, in turn, was authorized by an amendment to the TFEU[8] that had been

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Should Fiscal Stability Outweigh Economic Growth in the Stability and Growth Pact?, 31 FORDHAM INT'L L. J. 1266 (2008) [hereinafter Goebel*, Should Fiscal Stability Outweigh Economic Growth*].

4. *See* Treaty on European Union (Maastricht text), July 29, 1992, 1992 O.J. C. 191/1 [hereinafter Maastricht TEU]. The Treaty set out four convergence criteria for member states to qualify to adopt the Euro: low inflation rate, low long-term interest rates, stable exchange rates, and avoidance of excessive budget deficits. *See generally* Roger J. Goebel, *European Economic and Monetary Union: Will the EMU Ever Fly?,* 4 COLUM. J. EUR. L. 249 (1998).

5. *See generally See* European Commission Press Release D/12/2, Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Feb. 1, 2012, http://europa.eu/rapid/press-release_DOC-12-2_en.htm [hereinafter Treaty on Stability, Coordination, and Governance].

6. *See* Consolidated Version of the Treaty on the Functioning of the European Union art. 125, 2012 O.J. C. 326/47 [hereinafter *TFEU*]. The provision provides that neither the EU nor any member state "shall be liable for or assume the commitments of . . . any member state . . . ."

7. *See generally* Treaty Establishing the European Stability Mechanism, Feb. 2, 2012, Eur. Comm'n DOC/12/3.

8. *See id.* at art. 136(3). TFEU Article 136(3) now provides: "The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the eruo area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."

adopted through the 'simplified revision procedure.'[9] The ESM is intended to act as a "firewall" for the Eurozone.

The establishment of the ESM in the aftermath of the Euro crisis represents the delayed recognition that a Eurozone member state may indeed fail - and that the common interest of the Eurozone (if not that of the entire European Union) may justify financial intervention. Effectively, the ESM is a vehicle for a bailout. Like many "crisis" facilities,[10] the ESM may never be called on. The ESM's presence may simply serve to calm financial markets. Still, recent experience has demonstrated that easy access to Euro borrowings might tempt Eurozone member states into fiscal irresponsibility and trap them into economic straits from which they could not emerge on their own power, thereby threatening the entire Eurozone project.

The very presence of the ESM, even should it never be drawn on, admits the possibility of a future bailout. Maintaining the ESM in the meantime is costly, though to a varying degree beneficial to certain member states – if for no other reason than driving down their Euro-denominated borrowing costs. The ESM more than mutualizes sovereign default risk; it effects a present transfer from certain states to others. It is, functionally, an element of fiscal policy at the intra-EU level.

This brief history of the ESM will be, in design, a backward look, as essentially most histories are. The story will end, for the moment, with the 2012 establishment of the ESM and the lingering workout of the Euro crisis that had been ignited by the 2009 post-election revelations of the massive understatement of Greece's budgetary shortfalls.[11] It will proceed chronologically, beginning with the stipulation of the convergence criteria that had to be satisfied before a member state could be admitted to Stage III of the Economic and Monetary Union ("EMU") called for by the Treaty of Maastricht.[12] Maastricht addressed the 'deficit bias' that had been observable in several EU member states embarking on the Euro launch; it imposed a convergence criterion for annual budget deficits

9. See *id.* at Part III. The "simplified revision procedure" is made available for amendments to Part Three of the TFEU.

10. For a discussion of 'crisis containment' international financial law, see generally Anna Gelpern, *Financial Crisis Containment*, 41 CONN. L. REV. 1051 (2009).

11. *See* Tayyab Mahmud, *Is it Greek or déjà vu all over again?: Neoliberalism and Winners and Losers of International Debt Crises*, 42 LOY. U. CHI. L. J. 629, 639 (2010-11).

12. *See supra* note 4.

of a maximum of 3% of GDP. Overall national indebtedness was to be reduced so as to approach 60% of GDP as a condition for admission to the Euro.

The Maastricht convergence criteria were given a kind of permanency in the first Stability and Growth Pact adopted in 1997.[13] The 3% annual budget deficit and 60% overall debt targets were carried over from the Maastricht convergence test.[14] Eurozone member states were subjected to fairly rigid budgetary constraints on a continuing basis. Such strong fiscal discipline, given the retention of fiscal competence by the Eurozone member states, was thought to be necessary to enhance the credibility of the single monetary policy.[15]

The initial Stability and Growth Pact proved unworkable[16] and provoked a political (and constitutional) crisis;[17] it was reformed in 2005.[18] A relatively stable few years followed,[19] before Europe was drawn into the 2007/2008 global financial crisis. But it was the October 2009 Greek revelation that suddenly brought the risk of a Eurozone member state sovereign default to the forefront of the

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13. The Council adopted two regulations in June 1997 in order to implement the SGP: the Multilateral Surveillance Regulation and the Excessive Debt Regulation. *See* Roger Goebel, *Should Fiscal Stability Outweigh Economic Growth, supra* note 3 at 1269. *See also* Council Regulation No. 1466/97, O.J. C 236/1 (Aug. 2, 1997); Council Regulation No. 1467/97, O.J. C 236/3 (Aug. 2, 1997).

14. There was no stipulation of the targets for aggregate budget deficits or aggregate sovereign debt. As these are likely less volatile than the constituent national statistics, and as they cannot be directly controlled, there may be little technical advantage that these be established.

15. *See* Marco Buti & Bertrand Martinot, *Open Issues on the Implementation of the Stability and Growth Pact*, 174 NAT'L INST. ECON. REV. 92 (2000) ("The SGP is probably the most stringent 'commitment technology' ever adopted by a group of governments in an attempt to establish and maintain sound public finances.")

16. Economic conditions in Europe began to decline in 2002, and unemployment grew to over 10%. *See* Goebel, *Should Fiscal Stability Outweigh Economic Growth*, *supra* note 3, at 1319-20.

17. Both France and Germany were projected to run budget deficits exceeding the 3 percent SGP limits in 2003. *See* Goebel, *Should Fiscal Stability Outweigh Economic Growth, supra* note 3, at 1320-1323. The Commission had recommended the initiation of sanctions, but France and Germany were able to wield political support in the Council to block the process. The Commission sued the Council, seeking to annul its decision not to adopt the recommendations of the Commission. *See* Commission v. Council, Case C-27/04, [2004] E.C.R. I-6649. *See generally* Goebel, *Should Fiscal Stability Outweigh Economic Growth, supra* note 3, at 1329-1340.

18. *See* R. Morris, H. Ongena and L. Schuknecht, *The Reform and Implementation of the Stability and Growth Pact*, EUROPEAN CENTRAL BANK OCCASIONAL PAPER NO. 47, June 2006.

19. *See generally* Goebel, *Should Fiscal Stability Outweigh Economic Growth*, *supra* note 3, at 1318-1319.

awareness of the financial markets.[20] This jangling of the nerves of the financial markets played out on top of an already challenged economic picture in many Eurozone member states, as bust seemed to have replaced boom for the long haul.

The very real confrontation with the prospect of a sovereign default within the Eurozone demonstrated that the prophylactic approach relying on the budgetary limits set out in both the initial and reformed Stability and Growth Pacts had failed. The SGP did not prevent Greece and other Eurozone member states from approaching the brink of default. Moreover, once the prospect of a Eurozone member state default arose, there was little to no assurance of a credible rescue. Working without a net - the 'no bailout' principle - demonstrated to have generated more collective harm than good.

The various Eurozone bailouts were built on a series of ad hoc undertakings. They were, so it now seems, adequate to rescue the afflicted member states. The ESM has now made a Eurozone bailout facility a permanent feature of the Economic and Monetary Union. Collective Eurozone intervention in response to a prospective sovereign default has moved from the unimaginable to the anticipated.

It has been frequently remarked that the Economic and Monetary Union is misnamed.[21] The EMU does, of course, establish a monetary union among the participating Eurozone member states – and a supreme, independent European Central Bank is charged with the conduct of Eurozone monetary policy.[22] But a true economic union remains far from realization; notwithstanding the considerable progress achieved toward commercial integration within the European Union, fiscal policies (taxation, spending, pensions, and the like) continue to be jealously guarded sovereign prerogatives. Indeed, there are only minimal efforts at harmonization of these fiscal policies,

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20. *See* Mahmud, *supra* note 11.

21. Roger Goebel admits the existence of the monetary union, but writes "the so-called economic union is not really a union." Goebel, *Should Fiscal Stability Outweigh Economic Growth*, *supra* note 3, at 1272.

22. Formally, the establishment of the EMU constitutes a transfer of monetary authority from the Eurozone member states to the ECB. *See id.* at 1267. It should be remembered that the adoption of the Euro followed a long period of exchange rate coordination, where functionally most EU member states ceded monetary control to Germany's Bundesbank. See GOEBEL, FOX, BERMANN, ATIK, EMMERT & GERARD, EUROPEAN UNION LAW 4TH (2015) at 1223-1232.

such as the budgetary and overall debt strictures of the Stability and Growth Pact.

It is awkward, to put it mildly, to have a common currency throughout a zone where disparate national macroeconomic policies are in play. And the simple fact remains that real economic convergence is a far-off scenario in the Eurozone; there are wild differences in productivity, employment, and workplace demographics among the member states. As it seems clear now, the original EMU design was destined to shake itself apart sooner or later.

The structural disparities among the Eurozone member states are profound. Greece demonstrated some of the wildest political expectations, which inflamed German sensibilities. A heady mix of vast public employment, early retirement ages, and a demonstrable inability (or unwillingness) to collect taxes as due seemed to make budget shortfalls inevitable. Were Greece running the drachma, the result of such profligacy (and I use this term ironically) would have been domestic inflation and a loss of exchange value. But Greece now had the Euro as its domestic currency, so these automatic adjustments did not take place. And while it is true that the Euro is a commonly shared domestic currency, it is, from the budget perspective of any particular Eurozone member state, an external currency. The necessity of budget balance cannot be escaped in the long run, absent default or other form of, shall we say, external involuntary transfer. Spain, Ireland, Portugal, Italy - all have significant fiscal structures that cannot, as a political reality, be easily changed. And having to meet domestic social obligations with hard Euros is a considerable hardship.

What then were the designers of the EMU thinking? They clearly understood that imposing a common currency on a mix of countries following very different macroeconomic courses was unstable at best. They may have simply ignored the problem, hoping (as optimists) that deeper fiscal integration would follow before a crisis would erupt. Or - more darkly - they may have recognized that it would take a crisis, an inevitable crisis, to goad the Eurozone into the deeper fiscal integration they viewed as necessary to complete the European project. It is hard to imagine that any serious economic (or political) thinker would have believed the simple-minded, somewhat arbitrary, and one-sized budgetary and indebtedness undertakings set out in the Stability and Growth Pact would, by themselves, be adequate to effectively coordinate Eurozone member state fiscal policies in a way that would support a strong and stable Euro - without the periodic and continuing need for large compensating transfer payments from some member states to others.

I. NO BAILOUTS AND THE STABILITY AND GROWTH PACT

It is true, of course, that a 'no bailout' principle has been incorporated into EU law from the Maastricht Treaty. This language was scrutinized in the CJEU's 2012 *Pringle* decision, which challenged the compatibility of the ESM with EU norms.[23] Yet a 'no bailout' obligation cannot be said to have any demonstrable effect until a crisis comes along to test it. Indeed, the 'no bailout' principle failed to warn off the financial markets from underappreciating the real possibility of sovereign default, where the terms of Euro-denominated debt largely converged without regard to the marked difference in credit-worthiness of the various Eurozone member states.[24]

To some degree, the declared 'no bailout' policy was an EMU afterthought, a piece of window dressing to allay worst-case concerns. While Europe had experienced devaluations during its post-World War II experience, it had not suffered a sovereign default. But the Euro introduced the possibility of a new kind of sovereign default - one involving a country's official currency, yet a currency the debtor state does not and cannot control. In typical sovereign default scenarios, the debtor is unable to service its external debt, expressed in a harder currency it cannot control. Internal borrowings create less of an obstacle, as the borrowing state can simply monetize the internal debt through issuance of additional units of national currency.

For budgetary purposes, the Euro functions as an external currency for each Eurozone member state. They no longer maintain the possibility of running the printing press or engaging in a devaluation. Sooner or later, member state budgets must balance. But

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23. *See Pringle v. Ireland*, Case C-370/12, [2012] ECR I (2012). In *Pringle*, the CJEU characterized TFEU Article 125 as "essentially preventive," whereas the ESM would operate in "the management of financial crises which, notwithstanding such preventive action as might have been taken, might nonetheless arise." *Id.* ¶59. The Court does not seem to appreciate that 'no bailout' is negative action.

24. *See* Jay Shambaugh, *The Euro's Three Crises,* BROOKINGS PAPERS ON ECONOMIC ACTIVITY, Spring 2012. See also Christian Odendahl, *Insight*, *The Eurozone's Real Interest Rate Problem,* CENTRE FOR EUROPEAN REFORM, July 8, 2014, http://www.cer.org.uk/insights/eurozones-real-interest-rate-problem.

linked to this hard reality was the new possibility to borrow Euros at rates comparable to those offered to Germany. The markets, for whatever reason, were eager to make Euro-denominated loans. Easy money presented the temptation to finance budget losses that proved irresistible to several Eurozone member states.

The markets viewed Spain like the Netherlands, Greece like Germany - at least in terms of the interest rate charged for sovereign debt. How could the markets be so wrong? It may have been, of course, that the budgetary divergence among Eurozone member states did not in and of itself represent any meaningful risk of default given the bullish launch of the Euro.

Nor were member states unappreciative of the loss of macroeconomic tools joining the EMU entailed. For this and other reasons, they clutched to their retained sovereignty in fiscal affairs. And ultimately, each Eurozone member was left to its own devices. 'No bailout' goes hand in hand with the retention of sovereign fiscal discretion. The EMU formed on the smashing success of the reunification of Germany - and the substitution of the hard Deutschmark for its East German counterpart.[25] The German experience may have led the founders to an underappreciation of new risks introduced by the EMU experiment.

In all events, the prospect of sovereign default must have seemed distant at the time of the Euro launch. Certainly, there was little perceived need for a coordinated response to a Eurozone member state default. A concern for introducing moral hazard discouraged any hint of tolerance for the kind of troubles that came to visit the Eurozone from 2009. The policy of no bailouts is a policy attempting to contain moral hazard - but there are practical limits to eliminating moral hazard. So long as there is a collective interest in play, any single member state is exposed to moral hazard, notwithstanding solemn declarations (such as TFEU Article 125) to the contrary. For all intents and purposes the policy approach adopted by the Eurozone was one of prevention, as opposed to a post-bailout mop up.

The convergence criteria had already been applied to the prospective Eurozone member states as they approached Stage III. Their overall indebtedness of prospective Euro adopters was to be reduced below 60% of GDP and their annual budgets were not to

25. *See* Peter Bofinger, *The German Monetary Unification (GMU): Converting Marks to D-Marks*, Federal Reserve Bank of St. Louis, July/August 1990.

exceed 3% of GDP. It is important to note that these criteria were originally convergence criteria, and not (at least in their first incarnation) intended to serve as ongoing fiscal targets. And the choice of the 60% and 3% targets were conceded to be arbitrary.[26] The fiscal discipline these numerical criteria exerted was given a permanent, post-convergence role by the Stability and Growth Pact.

It is hard to imagine that a member state that scrupulously followed the criteria laid down in the Stability and Growth Pact could ever find itself at risk of default and in need of a bailout. Indeed, under certain growth assumptions, maintaining budget deficits below 3% would eliminate overall indebtedness in fairly short order, which might neither be appropriate nor desirable.[27] Yet not all Eurozone member states proved to be so scrupulous. For complex reasons, it was the larger member states, including Germany, which appeared to have the greatest difficulties in applying budgetary discipline.[28]

II. 2005 STABILITY AND GROWTH PACT REFORMS

The run-up to the launch of the Euro involved no little disregard for the convergence criteria that had to be met by each prospective Euro member state.[29] Rather than confining the Euro to the strongest economies - those countries whose political climate and structural characteristics best fit the sought after 'hard' macroeconomic policies - the Euro was intended to reach the greater part of the European Union as it then existed[30] (the United Kingdom and Denmark were permitted to opt out,[31] and Sweden's unilateral decision to stay away from the Euro has never been challenged).[32] In the end, all but one of

26. *See* Goebel, *Should Fiscal Stability Outweigh Economic Growth*, *supra* note 3, at 1279-80 ("[T]he leading Belgian economist Paul de Grawe flatly states that using the 3% figure as a limit for the budget deficits 'has no valid scientific basis.'").

27. *See* Paul De Grauwe, *The Stability and Growth Pact in Need of Reform,* (University of Leuven, Working Paper, 2003).

28. *See A very European crisis: The sorry state of Greece's public finances is a test not only for the country's policymakers but also for Europe's,* THE ECONOMIST, Feb. 4, 2010.

29. *See* Paul De Grauwe, *The Politics of the Maastricht convergence criteria,* in VOX – CEPR'S POLICY PORTAL, Apr. 15, 2009.

30. *See* European Commission, Economic and Financial Affairs, *One Currency For One Europe: The Road to the Euro* (2015), http://ec.europa.eu/economy_finance/publications/general/pdf/the_road_to_euro_en.pdf.

31. *See* European Commission, Economic and Financial Affairs, *The Euro: Who Can Join and When*?, (May 15,2015), http://ec.europa.eu/economy_finance/euro/adoption/who_can_join/index_en.htm.

32. *See id.*

the then EU member states seeking to adopt the Euro were deemed to have met the convergence criteria. Only Greece failed to qualify - and it too joined the Eurozone merely one year later.[33]

In fact, the desired convergence, as measured by the 60% of GDP upper limit on debt and the 3% budget deficit cap, had not been obtained by several member states. For some, nominal compliance with the convergence criteria resulted from a combination of accounting tricks and outright looking away.[34]

To some degree, achievement of fiscal convergence was accepted as a matter *à faire*. After all, the very same targets were hardwired into the Stability and Growth Pact. So long as the Eurozone member states were approaching the targets at the time of the Euro launch, it might not be far-fetched to imagine that they would meet and maintain the target convergence in short order.

And so the Euro was launched, with the Stability and Growth Pact functioning as the central mechanism for fiscal coordination. The early experience was favorable.[35] The Stability and Growth Pact featured an elaborate compliance mechanism. All EU member states - not simply the Eurozone states - were to subject national budgeting to review by the Commission.[36] Failure to make the targets triggered intense review and the possibility of Council-approved financial penalties for non-compliance.[37] It was thought that national governments would not stray far from the Stability and Growth Pact targets because - given the prospect of discipline - it would simply be too expensive to do so.[38]

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33. *See* Jennifer Rankin, *Greece in Europe: A Short History*, GUARDIAN, July 3, 2015. Greece has been a Eurozone member since January 1, 2001. European Commission, Economic and Financial Affairs, *Greece and the Euro* (May 4, 2009).

34. *See* Allan Little, *How 'Magic' Made Greek Debt Disappear Before it Joined the Euro,* BBC NEWS, Feb. 3, 2012.

35. *See* Goebel, *Should Fiscal Stability Outweigh Economic Growth, supra* note 3 at 1286-89.

36. *See* European Commission Press Release MEMO/15/6071, European Commission – Fact Sheet: The EU's Economic Governance Explained, (Nov. 26, 2015), http://europa.eu/rapid/press-release_MEMO-15-6071_en.htm.

37. *See id.*

38. In fact, the early perception of favorable operation of the Stability and Growth Pact may have been due to the happenstance of benign economic times when, for most Eurozone member states, achieving the targets came easily. In retrospect, there was likely an underappreciation of the pro-cyclical nature of the system. That is, Eurozone member states failed to use 'good times' to make structural reforms and/or aggressively reduce indebtedness.

All this broke down dramatically in 2004 as both France and Germany veered into recession.[39] In both cases, the national government engaged in deficit spending beyond the margin permitted by the Stability and Growth Pact. The Commission took action to sanction France[40] and Germany[41] - but France and Germany used their seats on the Council to block the imposition of the enforcement phase of the Stability and Growth Pact.[42]

The Commission brought the Council before the Court of Justice for its failure to act.[43] In a "Solomonic" judgment,[44] the Court upheld the inherently discretionary role the Council exercised under the Stability and Growth Pact (and thus acquitted the Council for its actions in this instance). The Court did, however, suggest that there might be situations where a failure to act by the Council might be actionable.[45]

As a political matter, the Stability and Growth Pact was a dead letter. If it failed to check Germany - a state with a long-standing tradition of hard currency policy - in times of economic stress, it was hard to imagine that it could be fairly applied to any other member State. In the words of Commission President Prodi, the Stability and Growth Pact was "stupid."[46] The position of the affected member states was that the budget criterion - the 3% deficit cap - was too inflexible.[47]

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39. *See* Goebel, *Should Fiscal Stability Outweigh Economic Growth, supra* note 3, at 1289.

40. The Commission recommended on October 21, 2003 that the Council should sanction France for its failure to take effective action to reduce its deficits. *See* European Commission, Recommendation for a Council Decision giving notice to France, Oct. 21, 2003.

41. The Commission recommended on November 18, 2003 that the Council should sanction Greece for its failure to take effective action to reduce its deficits. *See* European Commission, Recommendation for a Council Decision giving notice to Germany, Nov. 18, 2003.

42. At its November 25, 2003 meeting, France and Germany blocked Ecofin Council action that would have endorsed the Commission's findings. *See* Goebel, *Should Fiscal Stability Outweigh Economic Growth*, *supra* note 3, at 1325-29.

43. *See id*. at 1329-30.

44. According to Roger Goebel, the Court's judgment was "Solomonic" as it permitted both the Commission and the Council to claim a victory on certain issues. *Id*., at 1336.

45. *See* Commission v. Council (Stability and Growth Pact), Case C-27/04, [2004] E.C.R. I-6649. *See also* Goebel, *Should Fiscal Stability Outweigh Economic Growth*, *supra* note 3, at 1329-40.

46. Elaine Sciolino, *An Italian Official's Blunt Words Set Off Euro-Mayhem*, N.Y. TIMES, Oct. 19, 2002.

47. European Commission, Economic and Financial Affairs, Policy and surveillance, *The corrective arm,* http://ec.europa.eu/economy_finance/economic_governance/sgp/

In the aftermath of the CJEU's decision, the Commission adopted a conciliatory attitude, proposing a series of reforms to the Stability and Growth Pact.[48] These involved introducing the missing flexibility by expanding the situations where the budget deficit cap could be relaxed.[49]

In 2005, the Stability and Growth Pact was "reformed" through amendments of the Multilateral Surveillance Regulation and the Excessive Deficit Regulation. The Stability and Growth Pact as reformed retained the 3% and 60% targets, however. The European Union remained committed to fiscal coordination; arguably its resolve was ever stronger given the newly engineered flexibility. The statistical capacity of both the national budget offices and the Commission in conducting oversight was increased.[50]

It would turn out, however, that the reforms to the SGP and enhanced oversight of Eurozone member state budgeting were not sufficient to prevent Greece's massive understatement of the budget deficit. Greece smashed through the SGP's budgetary and accumulated debt ceilings in such a surprising manner (the surprise of course a result of the expectation induced by the presence of the reformed Stability and Growth Pact), that the financial markets were shaken. And so things proceeded from bad to worse, as Greece saw its funding costs escalate, its access to borrowing decline, and its real economy tumble away.

III. GREEK DEBACLE TO EURO CRISIS

The scale of the hidden Greek deficits shocked market and Eurozone political leaders to the core.[51] More importantly, the member state established in the public's mind (particularly in the German public's mind) an image of a wasteful, irresponsible Greece, enjoying the good life managed by favored Euro-borrowings. To

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corrective_arm/index_en.htm. *See also* European Parliament, Debates, Stability and Growth Pact, Sept. 15, 2004, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+CRE+20040915+ITEM-006+DOC+XML+V0//EN.

48. *See* Amy Filpek & Till Schreiber, *The Stability and Growth Pact: Past Performance and Future Reforms,* (College of William and Mary Department of Economics, Working Paper No. 97, 2010).

49. *See id.*

50. *See* Goebel, *Should Fiscal Stability Outweigh Economic Growth, supra* note 3, at 1347-50.

51. The revised 2009 Greek budget anticipated a deficit of 12.7% of GDP; the prior forecast had been 6.0%. *See* Lane, *The European Sovereign Debt Crisis, supra* note 1, at 36.

some degree, there were grounds for this belief that Greece was living beyond its means. Its pensions, it became known, were extremely liberal (a public employee could retire to full pension at the age of sixty-one).[52] And Greece was notoriously derelict in collecting taxes;[53] in fact, the Greek state may have been complicit in the widespread tax evasion that pushed its budget deeply into the red. That said, the root cause of the deficits in Greece and the other peripheral Eurozone member states may have had systematic causes beyond the control of their respective governments.[54]

The budget deficit was run up by one Greek government; its existence was revealed by the successor government led by George A. Papandreou.[55] There was, no doubt, some internal political scorekeeping. But the turn of government did seem to restore at least some possibility of Greece's return to fiscal prudence.

From the perspective of Greece's Eurozone partners, its behavior was doubly reprehensible: running up the deficit itself, followed by the deliberate effort of keeping it hidden. But the budget deficit may have been a thoroughly understandable response to irresistible internal forces. Greece was engaged in democratic government; in running up the deficits, the Greek government was responding to domestic political pressures. It may well have been that the democratic 'cost' of adopting the Euro had been understated. The subsequent Greek revulsion to the austerity program imposed as a condition of the Greek bailout suggests that the expectations of the Greek people of their government may have exceeded what the Stability and Growth Pact permitted.

Greece, like other Eurozone member states, faced structural obligations that were resistant to budgetary cuts. Again, Greek public pensions were quite generous (and tellingly more generous than their German counterparts).[56] Greece also has a heritage of extremely high

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52. *See* Kate Connolly, *Greek debt crisis: the view from Germany,* GUARDIAN, Feb. 11, 2010.

53. *See* Adea Guillot, *Greece struggles to address its tax evasion problem,* GUARDIAN, Feb. 24, 2015; *see also* Mike Bird, *This is the real reason Greece has a massive tax-evasion problem,* BUSINESS INSIDER, Feb. 25, 2015.

54. According to Lane, the "political narrative of the crisis . . . laid the primary blame on the fiscal irresponsibility of the peripheral nations, even though the underlying financial and macroeconomic imbalances were more important factors." Lane, *The European Sovereign Debt Crisis, supra* note 1, at 56.

55. *See* Mahmud, *supra* note 11, at 639.

56. *See What makes Germans so very cross about Greece?- Greece's Generous Pensions,* ECONOMIST, Feb. 23, 2010.

military expenditure as part of its frontline NATO role during the Cold War.[57] And Greece faced some dismal demographics: an aging population, high levels of unemployment, and outward migration of the young and ambitious.[58] That Greece was out of compliance was an open secret for many years - and here the EU oversight (or lack thereof) might be described as enabling. Turning a blind eye to Greek noncompliance was important to maintaining the overall perception that all was well in the Eurozone.

The convergence of interest rates prior to the Greek revelations suggested that the financial markets viewed all Eurozone member state obligations as posing substantially the same risk. Interest rate convergence in itself does not establish that the market had perceived all Eurozone sovereign debt to have the same level of primary risk; rather, there seems to have been a widely shared perception that, notwithstanding the presence of TFEU Article 125 (the 'no bailout' provision), the Eurozone would intervene to prevent the occurrence of any credit event. It was not the existence of the deficits that shocked the markets upon their revelation, but their magnitude. Things were bad enough to quickly present the possibility of default - something that had simply not been imagined.

The ECB[59] and the German political leadership,[60] by word and by inaction, quickly educated the financial market that this would not be the case, and huge gaps developed between the borrowing costs facing Greece and certain other Eurozone states and the German benchmark.[61]

The painfully long period of non-response by EU and Eurozone officialdom brought two scenarios to the forefront. The first was the possibility of a sovereign default, which was easy enough to imagine in the case of Greece. The second was the exit of Greece from the Eurozone. Presumably this would involve an awkward reintroduction of the drachma - with the result that Greek sovereign obligations that

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57. *See* Marina Skordeli, *The Way Forward: Sixty years from the accession of Greece and Turkey to NATO,* NATO REVIEW MAGAZINE, http://www.nato.int/docu/review/2012/turkey-greece/greece-turkey-60-years-nato/en/index.htm.

58. *See* Nikos Konstandaras, *Greece's Dismal Demographics*, N.Y. TIMES, Dec. 9, 2013.

59. *See* Mahmud, *supra* note 11, at 640 ("The ECB reiterated its no special-treatment posture and reminded Greece that 'it ha[d] to catch up on its homework'" (citing *Europe Markets Rise Amid Rumors on Deals*, N.Y. TIMES (Jan. 19, 2010))).

60. *See* Mahmud, *supra* note 11, at 642.

61. *See id.* at 640.

were originally expressed in Euros would become payable in the newly re-established, greatly devalued, domestic currency.

It is the second scenario - exit from the Euro - that likely created the greater amount of contagion. If Greece could leave the Euro, so could any other Eurozone member state grasping to devalue its Euro-denominated indebtedness. Investors holding Euro-denominated bonds could imagine them converted to pesetas or Irish pounds or lire - and that would be a financial horror. In fact, a Greek exit might well have led to a total collapse of the Euro. The very idea of this 'created' shadow national currencies, with shadow interest rates reflecting the variance in risk.

A mix of contagion (justified or not) and objective economic weakness plunged other Eurozone member states into crisis. Portugal, Italy, Ireland, and Spain joined Greece in facing large spikes in interest rates, a drying up of liquidity, and a resultant fall of their real economies into crisis.

IV. 2012 GREEK BAILOUT AND THE ESTABLISHMENT OF THE EFSF & EFSM

There was a long period between the initial recognition of the dire straits Greece found itself in and the May 2012 bailout. On the part of the Eurozone member states - and the larger European Union as well - the initial response was to hope the Greek problem would go away. This was not a simple matter of indifference. There was no ready-made political constituency supporting a bailout. A Greek bailout would violate the clear 'no bailout' principle enshrined in the Treaty. Article 125 may never have been intended to serve as a real legal check on member state action, but it did express a political undertaking that was sold to the European people, especially the German people who abandoned their revered Deutschmark for the unknowns of the Euro.

And the Greeks did little to engender sympathy during this period. Revelations of abuses (of a kind that likely could be found in many states) drove moralizing responses: the Greeks, it seemed to right-thinking Germans, deserved to be left to their fates.[62]

62. At one point, German politicians suggested that Greece might close their budget deficits by "selling off some of their lovely islands." *Id.* at 645.

The Greeks resisted, both before and after the May 2012 bailout, the imposition of austerity terms.[63] An initial bailout was precluded when the Greek government unexpectedly scheduled a referendum to approve its terms, including acceptance of the required conditionality.[64] At no point did Greece appear penitent for its non-compliance with the Stability and Growth Pact. This reciprocal aversion to addressing the problem further enhanced the perception that Greece would have to leave the Euro.[65] And this increased the contagion now afflicting other Eurozone member states.

In the end, a "troika" comprising the IMF, the European Union, and the European Central Bank put together an ad hoc and quite complex bailout package that Greece was willing to accept. The bailout included "private sector involvement,"[66] also known as haircuts, where private investors of Greek obligations would exchange these for new obligations of much less value. Ironically, a considerable amount of Greek debt was held by foreign private creditors;[67] any bailout funded in part by Germany would flow into and out of Greece's hands to partially satisfy these creditors. The awareness that any bailout would benefit private debt holders drove the insistence on the inclusion of severe haircuts in the bailout. Notwithstanding the haircuts, the bailout did not reduce the overall indebtedness of Greece, although it did effectively shift the mix of debt from what had been largely private in character to one in which most debt would be held by public institutions.[68]

Moreover, the bailout imposed conditionality on Greek management of its economy.[69] This in turn led to popular resistance in Greece and elsewhere in the European Union as austerity policies were applied in response to the Euro crisis. Austerity was viewed as

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63. Three people died in May 2010 during violent protests in Athens. *See id.* at 649.

64. *See* Daniel Harari, Briefing Paper 7114, *Greek debt crisis: background and developments in 2015*, HOUSE OF COMMONS, Oct. 13, 2015.

65. Chancellor Merkel raised the possibility that Greece might be excluded from the Eurozone. *See* Mahmud, *supra* note 11, at 645.

66. Nouriel Roubini, *Greece's Private Creditors are the Lucky Ones*, FINANCIAL TIMES (Mar. 7, 2012), http://www.ft.com/cms/s/0/f0f0708e-679d-11e1-b6a1-00144feabdc0.html#axzz46WIvkgbF.

67. *See* Mahmud, *supra* note 11, at 651.

68. *See* CONG. RESEARCH SERV., THE EUROZONE CRISIS: OVERVIEW AND ISSUES FOR CONGRESS (2012).

69. *See Greece's Debt Crisis Explained*, NY TIMES, (Nov. 9, 2015), http://www.nytimes.com/interactive/2015/business/international/greece-debt-crisis-euro.html?_r=0.

both antidemocratic and punitive.[70] As such, conditionality touched off a renewed debate about the proper role of the state in providing needed social services.

The Greek bailout provided a historical demonstration of what the response of the Eurozone to a financial crisis of one of its member states would entail. It put to rest the notion that a rigorous 'no bailout' policy would be applied in such event. Rather, bailout (and further bailout) appeared to be the appropriate prescription.

The Greek bailout (and on-going support), as well as the financial assistance provided to Ireland and Spain, have reduced concerns of any particular member state leaving the Eurozone. The once-predicted collapse of the Euro[71] has been postponed. The markets seem to have swallowed this; once again, interest rates applied to various Eurozone member states on the sovereign borrowings have converged.

The ad hoc Greek bailout was followed by the establishment of two 'temporary' facilities to provide assistance to struggling Eurozone member states: the European Financial Stability Facility ("EFSF")[72] and the European Financial Stability Mechanism ("EFSM".)[73] While both of these facilities have been drawn on, their establishment was not tied to any particular bailout. Together, they operated to bolster creditor confidence beyond the specific member states' beneficiaries of their financial assistance.

The two facilities were backed by guarantees from the participating Eurozone member states.[74] They were able to access

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70. *See* Christina Schweiger, *Progressive Politics: Permanent Austerity Stranglehold?*, SOCIAL EUROPE, May 29, 2015, https://www.socialeurope.eu/2015/05/progressive-politics-permanent-austerity-stranglehold/.

71. Famously, Paul Krugman, Nobel laureate and columnist of the *New York Times*, warned of the collapse of the Euro. *See* Paul Krugman, *Euro Zone Death Trip,* NY TIMES, (Sept. 25, 2011), http://www.nytimes.com/2011/09/26/opinion/euro-zone-death-trip.html.

72. *See* European Financial Stability Facility, *About EFSF* (2016), http://www.efsf.europa.eu/about/index.htm.

73. The EFSM was created on June 7, 2010. It was engaged on November 28, 2010 to provide €85 billion of assistance to Ireland and on May 17, 2011 to provide €78 billion to Portugal. The EFSM provided €139.9 billion of follow up financial assistance to Greece in 2012. European Stability Mechanism, European Financial Stability Facility & European Stability Mechanism, May 2014. *See also* Boris Ryvkin, *Saving the Euro: Tensions with European Treaty Law in the European Union's Efforts to Protect the Common Currency,* 45 CORNELL INT'L L.J. 227 (2012) at 240-45.

74. Cyprus, Greece, Ireland, and Portugal, all recipients of bailout funds, withdrew their respective guarantees from the EFSM. *See* European Stability Mechanism, European Financial Stability Facility & European Stability Mechanism, May 2014.

funds from the capital markets. While they have been replaced in some sense by the 'permanent' European Stability Mechanism, the EFSF at least will be with us for a long time,[75] as it services outstanding loans.

V. ESTABLISHMENT OF THE ESM

The EFSF and EFSM served their purposes, providing needed funding to Greece, Portugal, Ireland, Spain, and Cyprus.[76] Moreover, their very presence assured holders of sovereign obligations issued by other troubled Eurozone member states. But they were designed to be, and were limited to, the particular financial crisis that inspired their creation. They were, frankly, of some constitutional dubiousness, given the presence of Article 125, the 'no bailout' clause, and the possible impermissible delegation of exclusive EU powers.

The decision was taken to construct a permanent facility, the European Stability Mechanism, to be built on a fairly firm constitutional foundation,[77] and to increase investor confidence in the performance of Eurozone member states going forward.

The permanent European Stability Mechanism was established following the October 28-29, 2010 meeting of the European Council.[78] The ESM replaced the ad hoc Greek bailout facility, as well as the temporary (though more general purpose) EFSM and EFSF. Soon after launch, the ESM provided EU€41.3 billion in financial assistance to Spain to provide for the recapitalization of the Spanish banking sector[79] and provided EU€4.75 billion in assistance to Cyprus in 2013.[80]

Establishing the ESM required an amendment to the TFEU authorizing the Eurozone member states to enter into a stand-alone

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75. *See* European Stability Mechanism: Synopsis from the European Commission, http://ec.europa.eu/economy_finance/eu_borrower/efsm/index_en.htm.

76. *See supra* note 72 and accompanying text.

77. *See generally* EUROPEAN CENTRAL BANK, THE EUROPEAN STABILITY MECHANISM, (2011), https://www.ecb.europa.eu/pub/pdf/other/art2_mb201107en_pp71-84en.pdf.

78. *See id.*

79. *See* European Stability Mechanism, *Spain (concluded),* http://www.esm.europa.eu/assistance/spain/index.htm.

80. *See* European Stability Mechanism, *Cyprus (concluded),* http://www.esm.europa.eu/assistance/cyprus/.

treaty.[81] The European Council anticipated resort to the simplified revision procedure[82] in order to add a new provision to TFEU Article 136. Whether use of the revision procedure had been appropriate was tested in the *Pringle* case,[83] a challenge brought by an Irish parliamentarian who opposed the ESM. The CJEU upheld the use of the simplified procedure, stressing that resorting to the ESM did not constitute an improper delegation of monetary authority, given that the ESM would only be activated to safeguard the stability of the Eurozone as a whole and that financial assistance would be subject to strict conditionality.[84] These two limits - the necessary presence of a threat to wider Eurozone stability and application of strict conditionality - are set out in the revised TFEU Article 136.[85]

The European Stability Mechanism entered into force on July 1, 2013.[86] The ESM is directed by a Board of Governors comprising the finance ministers of the Eurozone member states.[87] The President of the European Central Bank and the EU Commissioner for Economic and Monetary Affairs have observer status.[88] Major decisions of the ESM - including the grant of financial assistance - are to be taken by "mutual agreement," which is defined as unanimity of those member states voting.[89]

Both the ECB and the IMF will liaise with the ESM to determine the existence of a threat to the financial stability of the Eurozone as a

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81. *See* ARTICLE 136 TFEU, ESM, FISCAL STABILITY TREATY – RATIFICATION REQUIREMENTS AND PRESENT SITUATION IN MEMBER STATES, EUR. PARL. DOC. (2013), http://www.europarl.europa.eu/meetdocs/2009_2014/documents/afco/dv/2013-06-12_pe462455-v16_/2013-06-12_pe462455-v16_en.pdf [hereinafter ARTICLE 136 TFEU RATIFICATION REQUIREMENTS].

82. The simplified revision procedure is provided by Article 48(6) of the Treaty on European Union. The Council used this procedure to amend TFEU Article 136. *See* European Council Decision of March 25, 2011 (2011/199/EU).

83. *See Pringle v. Ireland*, Case C-370/12 (27 November 2012).

84. The Court held that the ESM did not fall within the exclusive competence of the EU over monetary policy and that the conferral of tasks on the Commission and the ECB were compatible with their competencies. *Pringle v. Ireland*, Case C-370/12 (27 November 2012) at ¶ 95. *See generally* Jonathan Tomkin, *Contradiction, Circumvention and Conceptual Gymnastics: The Impact of the Adoption of the ESM Treaty on the State of European Democracy,* 14 GERMAN L. J. 169.

85. *See* ARTICLE 136 TFEU RATIFICATION REQUIREMENTS, *supra* note 81.

86. EUROPEAN CENTRAL BANK, THE EUROPEAN STABILITY MECHANISM, (2011), https://www.ecb.europa.eu/pub/pdf/other/art2_mb201107en_pp71-84en.pdf.

87. *See id.*

88. *See id.*

89. *See id.*

whole.[90] This mechanism will operate to temper the political discretion to dismiss what is intended to be a significant check on the ESM's bailout capacity - and so should reduce moral hazard concerns. The ECB and the IMF will likely contribute to the stipulation of financial adjustment policies needed to satisfy the conditionality of any assistance to a troubled member state.[91]

The terms of eventual financial assistance will be tailored to the situation at hand with regard to loan maturity and whether interest will be fixed or variable.[92] Pricing will start at 200 basis points, increasing by an additional 100 basis points for any amounts outstanding after three years.[93] The pricing is said to be non-concessionary; that is, sufficiently adverse to discourage any permanent recourse by a troubled member state.[94] The ample margins are also intended to compensate the risk undertaken by the ultimate providers of the ESM's funding.

The ESM will also have the power to intervene in the secondary market for bonds issued by the troubled Eurozone member state.[95] Exercise of this capacity would relieve the ECB from undertaking similar actions.[96]

The twin requirements - threat to Eurozone stability and application of strict conditionality - imply that a Eurozone member state may find itself in dire straits without meaningful access to ESM assistance (and by implication, to assistance of any other kind). One assumes that the Greece scenario would satisfy the threat to the stability of the Eurozone as a whole test, but one cannot be sure. Greece is a very small economy, but, as events demonstrated, its default generated contagion and challenged structural notions about the solidarity of the Euro compact. Still, an extremely irresponsible member state (which might fit Greece) floundering in what otherwise might be healthy times for the Eurozone as a whole might find itself with no hope of rescue. But perhaps this is precisely the dose of worst-case consideration that operates to reduce moral hazard.

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90. *See id.*
91. *See id.*
92. *See id.*
93. *See id.*
94. *See id.*
95. *See id.*
96. *See id.*

The ESM includes EU€700 billion of paid in and callable capital drawn from the Eurozone member states, which is thought to be adequate to provide for EU€500 billion of lending capacity.[97] The ESM is also authorized to raise funds on the capital markets by issuing its own securities.[98] The mix of paid in and callable capital is designed to operate as a further brake on the offer of financial assistance; sponsoring Eurozone member states might well hesitate to approve a bailout if it has the consequence of drawing resources during a time of general financial stress.[99] Of course, this is precisely the scenario where financial assistance is likely to be needed. It remains to be seen how the markets will view debt issued by the ESM. The ESM is a European institution with a distinct legal personality; as such, its commitments do not involve any commitment from the Eurozone member states that stand behind it.

The Stability and Growth Pact received a substantial reworking in the aftermath of the Euro crisis. A new intergovernmental treaty among participating EU member states, the Treaty on Stability, Coordination and Governance, known as the Fiscal Compact, was signed on March 2, 2012, and came into effect for the initial sixteen member states completing ratification on January 1, 2013.[100] Certain obligations of the Fiscal Compact apply to certain EU member states outside the Eurozone. Article 3(2) of the Fiscal Compact imposes the obligation on signatory states to transpose the balanced budget rules into national legislation within one year of its entry into force.[101]

CONCLUSION

The Maastricht design for monetary union was bold, if not reckless. It had not been lost on many political and economic

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97. *See European Stability Mechanism to be launched*, DIE BUNDESREGIERUNG, (Mar. 13, 2012), https://www.bundesregierung.de/Content/EN/Artikel/2012/03/2012-03-14-esm-gesetze.html.

98. *See* CREDIT SUISSE, ESM: AN IN-DEPTH ANALYSIS IN EUROPEAN SSAS – EXPLORER, FIXED INCOME RESEARCH (2012), https://doc.research-and-analytics.csfb.com/docView?language=ENG&format=PDF&source=em&document_id=1002045321&serialid=YiV93D198UryyTOfk5ytJk5BlEQZtjoMMyHxl6%2fHtqo%3d.

99. *See* CONG. RESEARCH SERV., THE EUROZONE CRISIS: OVERVIEW AND ISSUES FOR CONGRESS (Sep. 26, 2013), https://www.fas.org/sgp/crs/row/R42377.pdf.

100. The Fiscal Compact has now been ratified by all 25 signatory states (all EU member states but Croatia, the Czech Republic and the United Kingdom). *See* Article 136 TFEU, *supra* note 81.

101. *See* Treaty on Stability, Coordination and Governance, *supra* note 5.

observers, if not the creators of the European Economic and Monetary Union, that the design was incomplete. Yes, there would be monetary union for most EU member states, a new common currency would be adopted, and monetary policy would be transferred to a central authority (what has become the European Central Bank). But left incomplete was any transfer of fiscal sovereignty by any member state. Taxation and social benefits were (and continue to be) matters of national determination; the decisions when and how member state budgets would run into deficits were only loosely coordinated. The Euro experiment has tested whether a group of countries could operate a monetary union without fiscal union. There was enough hope that a felicitous combination of growth and economic convergence would make the plan work. In retrospect, they and we should have known better.

The post-Maastricht treaty imposed certain budgetary expectations: budgets should balance in the medium term and there would be no bailouts of a member state. In other words, there wasn't much structure to inhibit a Greece (or an Ireland or a Portugal) from getting into the trouble they later encountered.

One wonders: were the EMU designers simply irresponsibly optimistic (the Naive Theory) or did they engineer a structure they realized was prone to collapse in the belief that inevitable crisis would force deeper fiscal integration (the Cynical Theory)?

The first Stability and Growth Pact was an afterthought - implemented as the greater number of EU member states approached Stage III of the monetary union. It provided both *ex ante* and *ex post* controls on Eurozone member states' budgets. The elaborate vetting of national budgetary plans by EU institutions, and the attendant transparency, contributes to budgetary discipline; it cannot, however, prevent the occurrence of deficits in the event that assumptions are not realized. The *ex post* controls stipulated by the First Stability and Growth Pact broke down: the Council's reluctance to impose sanctions on Germany and France, which had excessive deficits during a period of economic slowdown, led to the effective death of the First SGP and the follow-on reforms. But it had never been clear what was gained by imposing a financial penalty on a country that was already running a budget deficit.

The reformed Stability and Growth Pact created more discretion to manage economic stress, at least with regard to *ex post* sanctions, but it is not clear if this was much of an improvement over the initial

SGP. In any event, the reformed Stability and Growth Pact did little to prevent the series of catastrophes that characterized the Euro crisis. The collapse of Greece, the follow-on contagion to other weakened member states, the unravelling of the market's expectation of Eurozone solidarity, and the property crashes in Ireland, Spain, and Portugal were more than the monetary union could sustain. A bailout, of course, is a one-off fiscal transfer; to have a bailout program, either unstated or institutionalized (as is now the case under the European Stability Mechanism) is to have at least a residual Eurozone fiscal policy.

The ESM may still be a stop-gap, in that deeper, formal fiscal integration may be needed to save the Euro (and perhaps the European Union). At this writing, it is difficult to see the next steps. The EU is currently threatened with the impending withdrawal of the United Kingdom, following the June 2016 Brexit referendum.[102] The UK departure might create conditions for greater fiscal coordination among the remaining EU membership. Or it might push the European Union into a broader collapse. The European Union as a single market was a remarkably stable enterprise; the Eurozone as a monetary union has been far less so. The Cynical Theory might be right: crisis and demonstrated dysfunction might create the political conditions, years after the launch of the Euro, for the fiscal coordination needed to sustain a common currency.

In any event, the European Stability Mechanism is at work - even if it has never been called on to provide financial assistance. There remains a sizable stock of Eurozone indebtedness owed to the EFSF; it is still too early to declare the Euro crisis behind us. But now and going forward, the financial markets can read the presence of the ESM as some level guarantee for Euro-denominated debt issued by Eurozone member states. The markets can also rest assured that the strict 'no bailout' policy has been abandoned (although of course Article 125 remains in the TFEU).

The Euro crisis has exposed the fact that in broad parts of Europe there is no consensus that budget deficits should not be tolerated. Indeed, the German antipathy to budget deficits (rooted in German experience) is not widely shared. Post-crisis austerity triggered hostile opposition. Many Europeans prefer their familiar

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102. *See* Brian Wheeler & Alex Hunt, *Brexit: All you need to know about the UK leaving the* EU, BBC NEWS (July 21, 2016), http://www.bbc.com/news/uk-politics-32810887.

safety nets, and will support deficits to keep them in place. Attitudinal (that is, political) convergence is more difficult to achieve – given the absence of consensus among national leaders (let alone Commission technocrats) on the degree of budgetary discipline needed to maintain the Euro.