Ian Lovering (King's College, London) ian.lovering@kcl.ac.uk

Inga Rademacher (King's College, London) inga.rademacher@kcl.ac.uk

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All about institutions? How the ECB enabled the deepening of fiscal austerity during the Eurozone Crisis through strategic interaction with the economic sphere

Abstract: Fiscal responses of Eurozone economies after the Global Financial Crisis (GFC) differed considerably from responses outside of the EMU. While Anglo-Saxon governments had greater fiscal space following a quick response with new unconventional monetary instruments, the ECB first implemented interest-rate hikes and was then slow and indecisive in its implementation of unconventional monetary tools like QE. The result has been divergent patterns of economic growth between Anglo-Saxon economies and the Eurozone. Explanations of fiscal austerity have focused on the role of market pressures, ideas, and institutions. But those three factors are not well equipped to explain an increasing deepening of austerity in the EMU over time, especially during the crisis. This article, therefore, explores how a power struggle between fiscal and monetary actors and strategic use of economic conditions during the crisis by the ECB shaped crisis responses after the Global Financial Crisis of 2008 and the Eurozone Crisis of 2010. Adopting a theory-building process-tracing approach which analyses ECB interests and behaviour vis-à-vis domestic fiscal actors based on a document analysis and semi-structured expert interviews, we find that austerity in the Eurozone was fundamentally shaped by the ECB's ability to use the emergent economic constraints in global financial markets as a tool to push for austerity in a high-stakes and contested game over domestic fiscal decisions. We conclude that institutionalism needs to think in greater depths about how individual governing institutions, like central banks, are able to use the world around them to achieve institutional goals.

1. Introduction

The crisis responses in the EMU and the Anglo-Saxon world have differed considerably and have driven a further wedge between a Eurozone model stressing austerity and a more expansive British-American-model of post-Fordist economies. While the UK and the US implemented large-scale unconventional monetary policy quickly at emergence of the Global Financial Crisis (GFC), EMU policies were focused on institutionalisation of fiscal discipline for individual member states and a slow (and at first, countercyclical) response on the monetary side. Large loans were offered by European institutions and the IMF, however, these were only offered in exchange for structural reforms, cuts in governments spending and the imposition of new plans to achieve balanced budgets instead of forcing private creditors to write off debt from crisis countries (Henning 2017, 4). Instead of implementing nonstandard monetary policy to create space for expansive fiscal measures, European authorities implemented them cautiously and raised interest rates briefly in the midst of the crisis. This stands in stark contrast with responses in countries outside of the EMU, including the US in which the Fed responses to offer instant lender-of-last-resort assistance, cutting interest rates to the zero lower bound and offering quantitative easing on a large scale to recapitalise banks and offer a fiscal stimulus (Blyth 2013; Pisani-Ferry 2014). As a result, spending to GDP has contracted significantly more sharply in EMU countries compared to non-EMU countries after the Eurozone Crisis (see Table 1).

It is surprising that restrictive responses in the Eurozone were implemented with such rigour and consistency due to the economic and electoral risks attached to such reforms. When, as a result of the pressures of the Troika and the ECB, governments in the PIIGS economies implemented massive budget cuts, this did not only lead to the shrinking of their domestic economies (Blyth 2013, 4), but also to the subsequent stagnation of the Eurozone economy as a whole (Stockhammer 2016; Stockhammer, Qazizada, and Gechert 2019). Moreover, by emphasising market forces and demands of supranational organisation, representative democratic institutions were sidestepped with detrimental effects on the trust and stability of future elected democratic governments. The pressure to implement internal devaluation made responsiveness to electoral demands impossible, especially, in the less wealthy economies, and removed the fiscal sphere, just as previously the monetary sphere, from the reach of the national demos (Bohle 2010). Responsiveness to domestic voters became increasingly replaced by responsibility of domestic governments towards international obligations (Mair 2013; Streeck 2014).

To explain the curious deepening of fiscal austerity in the Eurozone, the literature has so far emphasised the role of markets, ideas, and the institutional infrastructure in the EMU, with an emphasis on the European central bank mandate. These factors certainly played an important role in the emergence of Eurozone austerity, however, they are not well equipped to explain the deepening response in midst of a crisis. Crises tend to be moments in which existing ideas are most contested (Hall 1993), in which market pressures are most likely rebuffed by electorates and political actors (Limberg 2019), and in which institutional change is most likely to follow a pattern of radical change in a new policy direction (Capoccia 2016). This paper explores how we can make better sense of the deepening of the austerity model in the midst of the Eurozone crisis.

This study builds on existing institutionalist accounts, but also develops a novel approach by extending them. So far, institutionalism has emphasised resilience or incremental change of institutions with an emphasis on endogenous factors *or* radical institutional change during a crisis driven by external factors. The stability-focused approach cannot explain deepening as austerity in the EMU became considerably more pronounced within the crisis. The critical juncture approach expects a crisis to place policy development on a new path pointing in a different direction – which, at least during the Eurozone Crisis, was not the case. What is missing in the literature is an analysis of the conditions in which a model or regime becomes a purer version of itself, when it deepens, before it potentially collapses under the pressure of turning into an exaggerated model of themselves. To make sense of this, we are emphasising the role of the expansion of power of the ECB within the larger macroeconomic infrastructure within the EMU and how it came about. We find that the ECB was able to use the pressures of the markets as a tool to achieve its own policy goals of more coordinated fiscal and monetary policies.

Table 1) Averages of general government expenditure as a share of GDP

EMU	2000-2009	2000-2014	2014-2019	***Non-EMU***	2000-2009	2000-2014	2014-2019
Austria	51.32	51.81	49.56	UK	40.13	44.87	40.90
Germany	46.60	45.51	44.35	US	37.46	40.43	38.12
Ireland	35.51	46.62	26.88	Korea	27.94	30.27	31.20
Luxembourg	40.57	41.43	41.34	Denmark	52.30	56.42	51.52
Netherlands	43.49	46.73	42.96	Norway	44.00	44.71	50.33
Portugal	45.42	50.49	44.83	Sweden	52.05	50.71	49.44
Spain	39.72	46.36	42.26	Poland	44.35	43.74	41.46
Belgium	50.37	55.48	52.58	Australia	36.83	38.22	39.79
France	53.16	56.94	56.18	Switzerland	31.88	32.57	33.01
Greece	47.51	55.61	49.58	Japan	36.17	40.09	38.60

Finland	48.78	55.42	54.51				
Italy	47.54	50.30	49.01				
Slovakia	41.82	42.23	42.84				
Estonia	35.18	40.24	39.08				
Slovenia	46.70	52.30	45.15				
Average	**44.91**	**49.17**	**45.41**	***average***	**40.77**	**42.20**	**41.44**

Source: own calculations from OECD (2022)

The contribution of this article is threefold. Empirically, we explore the role of the ECB in austerity policies within the EMU and trace in great detail the interests and strategies deployed by the ECB to achieve austerity in EMU countries. Theoretically, we knit together institutionalism with approaches based on the Regulation School – the growth model literature and the macroeconomic regimes approach. This allows us to explore the mutually reinforcing dynamics between institutions and external economic developments which may lead to an "entraining" of different institutional sets. And we finally demonstrate that it is useful to add a causal mechanism which links the economic conditions of the crisis with the outcome of deepened fiscal austerity which explores the power relations between the fiscal and the monetary sphere, as well as how powerful actors like central banks are able to extend their powers through specific conditions in a crisis.

The article is structured as follows: In the next section we delve into limits of the existing institutionalist literature and show what accounts based on the Regulation School have to offer theoretically. This is followed by a methodology section which describes the process-tracing rationale behind the paper as well as the data used. In section four, we analyse chronologically the interests of the ECB in domestic austerity, the fears that were attached to fiscal dominance in the crisis, as well as how officials over time deepen their institutional power within the EMU by using the features of the deepening economic crisis. In the final section we draw conclusions about the larger theoretical implications for the evolution of paradigms.

2. Continuity, change and "deepened regimes"

Institutionalism of the past thirty years has placed a strong emphasis on the stability of institutions and on endogenous factors driving this stasis. Only the critical juncture approaches, which have received less attention, stress the role of exogenous factors. However, neither of these two approaches to institutional development is equipped to explain how specific institutional configurations, or regimes, becoming purer versions of themselves over time, or how they become "deepened", before they may fall apart.

Most accounts of recent institutionalism have placed an emphasis on continuity, stressing the role of institutions themselves as critical ingredients for this stasis. There are approaches which highlight the differences between countries – most prominently among them is the VoC approach which distinguishes different political economy regimes within which firms and other actors may solve coordination problems within a relatively fixed institutional regime that surrounds them (Hall and Soskice 2001). Scholars have also emphasised the role of feedback effects in institutional development, which stress the manifold obstacles and political risk entailed in reform as some institutions, most notably welfare state institutions create their own constituencies which will fight the change in these institutions (Pierson 1996; 2000).

And while more recently, accounts have highlighted incremental change (Streeck and Thelen 2005a), here too endogenous factors are critical for institutional change. This literature accounts for minor policy changes which add up over time to transformative institutional change. Change can come about through the quest of rational actors using gaps between the types of institutions that exist and the ideal patterns of institutions, i.e. loopholes, or ambiguity in institutional settings, which can be exploited by

actors for their own purposes. Transformative change results from the endogenous behaviour of an institution itself as actors contest the functions of institutions. Thinking about institutional change in this way does not lend itself to explaining the deepening of a regime, which is likely accompanied by rising crisis indicators, hardships for large sections of society and contestants for a new, possibly emerging, regime. In such a high-stakes scenario, it seems unlikely that change actors can exploit gaps in the institutional sphere without disruption. In short, the approach does not take seriously enough the conflicts and contests over policy development between different governing actors which arise in a moment of crisis (Kingdon 2002; Haffert and Mehrtens 2015).

We, therefore, build on a literature which places a strong emphasis on factors external to institutions to explain change (Madariaga 2016). The growth-model literature, for example, examines the links between institutions and the economic sphere by exploring how regime with a distinct set of institutions emerge in line with corresponding political coalitions and how these together shape political outcomes and reproduction of a model (Baccaro and Pontusson 2016; Haffert and Mertens 2019). This has also been extended to the field of ideas which can enrich the link between institutions and growth models (Bremer and McDaniel 2020).

Building on this literature, we follow Blyth and Matthijs (2017) who build a conceptual framework of macroeconomic regimes. The two authors try to make sense of the deepening or entraining of capitalist modes of accumulation. They follow the Regulation School to demonstrate that a shift took place from the period of Fordism to post-Fordism. Fordism lasted from the 1950s to the 1970s and was based on a post-war compromise which ensured mass production, mass consumption and a powerful welfare state. In the late 1970s, this regime was replaced by Post-Fordism or neoliberalism which became increasingly based on global production and financialisation as a means to ensure compromise in the capitalist society (Boyer 2000; 2012). Blyth and Matthijs describe an acceleration of policy development, an increasing institutional focus on prescribed policy remedies, bringing policy regimes to eventual collapse. Macroeconomic regimes are organised around a target variable – employment, and inflation, respectively - and they over time become institutionally more synchronised around this variable. One reason for the increased entraining is that each paradigm privileges specific institutions over others and thereby privileges certain societal groups. For example, full employment is dependent upon constrained capital mobility and a strong tax state with the ability to shift capital into productive spaces of the economy. While price stability is dependent upon low bargaining power of workers, accompanied by capital mobility as well as central bank independence. Over time, and particularly in the increasingly mounting crises, macroeconomic regimes become more tightly coupled and entrained, they become more focused on the target variable, and emphasise the same remedies until they eventually collapse.

We transfer this idea of entraining from the global to the regional sphere by exploring why the EMU become more austere over time. To further explore the mechanism behind entraining, we investigate the role of the distribution of power between governing bodies and how powerful governing bodies expand power in moments of crisis. Against traditional institutionalist accounts which stress the role of existing institutional power of actors and feedback effects, or crisis and choice on the other, our conjecture about deepened regime elements is that powerful institutional actors are able to *expand* their power. Delving deeper causally, we suspect that plain enforcement rights or veto powers (Streeck and Thelen 2005b, 10) are not sufficient to explain deepening of the regime. Change in a deepening fashion requires change in the power resources available to state actors. If institutions don't change, actors will have to gather these power resources outside of the existing power structure to achieve policy goals. This is where regimes can be a helpful heuristic as they allude to the interaction of institutions and the economy. We show that state actors which have been institutionally privileged within the infrastructure of the state may use market developments to further expand their power position and thereby drive the entraining of institutions. This gives greater depth to the underlying mechanism of entraining, the power relations within the economy and the power relations within the state move in tandem and reinforce power relations of particular actors over others. At the same time, it adds a component to institutionalism, it is not just the sphere of the state, but how state actors use the market sphere around them to achieve institutional goals.

In the case of the ECB this allows us to explore the successive expansion of power of a powerful institutional actor within a macroeconomic system. Powerful actors, like the ECB, can build on existing power resources to expand into new areas of power. However, it is not just institutional power which allows actors to get what they want, they also need to mobilise a dynamic power resource, which sits outside of their own institutional toolkit to move beyond existing structures. Therefore, what actors do with their power and how they use it in specific economic contexts, is just as important as institutional power itself. Actors have to wait for that opening which allows them to expand power.

3. Data and Methods

We use theory-building process-tracing after Beach and Pedersen (2013) to explore how the ECB has contributed to the rise of austerity within the Eurozone Crisis. While most case-study methods try to establish correlation between variables, the analytical goal of process-tracing is to establish whether a causal mechanism connects x and Y. Theory-building process-tracing specifically is most fruitful in a setting in which researchers are still largely in the dark about the mechanism that links x and Y. It allows us to build a theory about the causal mechanism that sits between x and Y explored in a single case but aiming at a theory of a causal mechanism that is applicable beyond the case. In our case, x is a crisis and Y is austerity.

Theory-building process-tracing can be used as a method of x-Y-centric theory building if we already know from the existing literature that there is a correlation between x and Y, but we have yet to establish what the mechanism between these two is. Case selection is important to identify a plausible causal mechanism which subsequent studies can test empirically in other cases (Gerring 2016), and has to be based on a typical case which is a member of the set of x and Y and scope conditions for the mechanism to operate are present. Scope conditions are an institutional setting of a monetary union, an independent central bank, pressure of markets on individual domestic economies (Beach and Pedersen 2013).

We are using data which displays the interaction of central bank officials and domestic and EU-level fiscal officials from a document analysis as well as from expert interviews which are both analysed with Nvivo a text coding programme that allows us to code the interests of fiscal and monetary actors before and within the crisis, as well as the actions of both actors to achieve desirable fiscal outcomes. It also allows us to track over time change of interests and strategies of these actors.

4. The European Central Bank: Strategic enforcement of austerity

In this section we trace the evolution of fiscal conditionality in the EMU back to a fundamental conflict of the ECB and domestic fiscal actors which had lingered since the emergence of the ECB within the institutional foundations of the EMU. This conflict became aggravated during the crisis, as central bankers feared that with expansive fiscal bailout packages monetary operational capacity would be curtailed, and that fiscal actors may use the opportunity of the crisis to rise to a higher power position and hence curtail the power of the central bank within the larger macroeconomic sphere. While the ECB held (power) resources, including liquidity, which became critical for member states during the crisis, it had to wait for an emergency placing members states into a situation of dependency on the central bank to instigate large scale fiscal reform. We conclude from this that the deepening of the austerity model within the EMU was not just a function of the previous distribution of power to an independent central bank, but that it required the crisis for the ECB to rise to the height of its power. Accordingly, it is not just institutional powers which determine deepening of a regime, but how powerful actors use the economic world around them to push for change.

In order to understand which fiscal policy changes were implemented during the Eurozone Crisis we first have to take stock of the pre-crisis fiscal institutions in the EMU. The Stability and Growth Pact (SGP) is an agreement of 1997 based on the Treaty on the Functioning of the European Union, or the

Maastricht Treaty, which originally mandated that domestic government deficits should be no higher than 3 percent of GDP and sovereign debt only reach 60 percent of GDP for each EMU member country. A fiscal surveillance mechanism was also included within which governments had to go through annual budget peer review and could receive fines within the Excessive Deficit Procedure (Schelkle 2012, 36). Surveillance takes place within the self-regulated ECOFIN Council which is comprised of economic and finance ministers of the Euro area and the Commission. The Directorate General of Economic and Financial Affairs (DG Ecfin) evaluates the Stability and Convergence Programmes can find a breach of the Maastricht Treaty and trigger the EDP (Savage 2005).

The issue of credibility of central bank policy has been a long-standing concern of European central bankers and is deeply interlinked with developments in the fiscal realm. Most young central banks are vulnerable to concerns of credibility as market actors are still deciding on the level of trust granted into the new currency. However, for the ECB this issue was even more salient because the coordination with the fiscal sphere is more complicated in the EMU compared to domestic central banks as the ECB lacks the usual counterpart of a fiscal actor with whom policy coordination can be agreed (Schlosser 2019, 48). As a result, uncoordinated fiscal policy can be an important factor which shapes monetary policy outcomes. While the SGP was supposed to support trust in the currency, several breaches of the pact in the 2000s, including by Germany and France, cast doubt on the ability to develop a strong Euro. When between the late 1990s and mid-2000s the value of the Euro faltered, analysts ascribed this to the often-changing messages and confusion about the ECB’s two-pillar strategy to achieve price stability. The strategy is comprised of the announcement of a quantitative target for the growth rate of a broad monetary aggregate (M3) and a measure of predicted price developments in the Eurozone which the potential impact of deficits on price developments in the medium term. ECB officials worried that government borrowing would lead to a crowing out effect of private borrowing and higher interest rates necessary to achieve price stability (Howarth and Loedel 2004).

Due to these issues of credibility, the European Central Bank became a vigilant supporter of the Stability and Growth Pact as it “ensure[d] that the country surveillance is taking place” and central bankers “strongly supported the European Commission in implementing and enforcing all [the attached] rules” (interview 1). Our interviewees confirmed that the central bank has in its general toolkit three key communication channels to “voice” concerns over excessive spending: direct communication with governments and finance ministers by attending Council meetings and meetings of the Euro group, communicating with the public, although this is not a preferred measure of communication because it is difficult to take back things that are being said, and finally, there is hidden communication through rating agencies. All three communication channels were used extensively before and during the first years of the crisis to make clear that spending levels had to be brought back to a level bringing a balanced budget into reach in a few years.

The preferred instrument chosen before the crisis was the communication channel through rating agencies which the ECB enabled through a policy change in 2005. Central banks carry out monetary policy by lending against collateral, often government bonds, to shield themselves from financial losses. This entangles the fate of government finances and banking sector stability. If the financial sector holds large volumes of government bonds this affects the yields paid by governments and government bonds become critical instruments for banks’ solvency. Starting in 2005, the ECB made collateral market-based by linking its value to private credit ratings and mechanically adjusting policies to changes in ratings (Gabor and Ban 2016). This made the value of sovereign bonds sensitive to downgrades because in repo transactions higher haircuts are enacted on bonds with lower ratings. In 2008, the ECB lowered the minimum credit rating requirement to support sovereign bonds through an extended eligibility of collateral. However, when credit ratings of member states went down, the risk of losing eligibility increased and values of bonds deteriorated (ECB 2018; van ’t Klooster 2022). While the Bank of England’s haircuts did not increase in this period – because it does not base them on credit ratings, the minimum credit requirements forced member governments into fiscal austerity in the middle of the crisis (Ban 2016). In our interviews ECB officials explained that this was a hidden mechanism to communicate to governments when they would have to return to balanced-budget policies: “maybe one example, kind of arcane, you know, central bank policies, we have our

collateral framework". "We don't accept any government bond" but use private ratings. We "could of course, use our own rating because we have the expertise in house. But what we do and have been doing and I've also insisted to do it we use the rating agencies for that, we use Standard and Poor's, Moody's, Fitch Ratings for that, simply because we do not want to go out and make public that we wait, country ABC is […] super trustworthy, or medium trustworthy or less trustworthy" (interview 1). The links created between the fiscal sphere and credit rating agencies has been widely interpreted as triggering the bond market panic after the Global Financial Crisis 2007-2008 and thereby contributing to the outbreak of the Eurozone Crisis in 2010-12 (De Grauwe and Ji 2015; Gabor and Ban 2016).

It was in 2008, with the implementation of a first set of bailout programmes that the ECB actors developed concrete interests in fiscal constraint within an emergent crisis context, against the general EU push for fiscal expansion. On the surface these interests were tied to its operational steering capacity, however, the crisis also triggered more deep-seated concerns about central bank independence indicating that interests in fiscal policy change were not just caused by the immediate crisis conditions but also by a power struggle that had been lingering since the formation of the EU. ECB officials became concerned when, in response to the downturn ensuing from the Global Financial Crisis, a set of initial bailout programmes were implemented, including a Euro 200 billion European Economic Recovery Plan (EERP) in December 2008 which allowed individual member countries to use discretionary packages with an emphasis on infrastructure, social safety, environmentally friendly technology (Schelkle 2012, 43). Following these programmes, budget restraint became a critical topic in the central bank because the crisis instigated spill over effects from the fiscal to the banking sphere leading to "banks losing credibility" (interview 1). The ECB perceived the support programmes as a threat to its own steering capacity and, effectively as a threat to its independence. As a practical implication of the crisis, officials feared that member states would be inclined to implement a central fiscal authority which would join fiscal forces in a EU-level body (Hodson 2011). On the operational level, ECB officials worried that the crisis and the consecutive bailout packages would instigate a loss of steering capacity for central bankers. As one of our interviewees put it: "our prime goal on the fiscal side is that we want to ensure smooth functioning of the EMU. That is kind of the mantra" and for that to happen "we need sound fiscal policies, because if pockets were to perceive the […] fragmentation risk that one or more Euro area governments were not sound, then of course […] the transmission of our policy tools will not work anymore […] if investors move out of Spanish bonds, or what have you, then our monetary policy transmission will simply not work" (interview 1). However, underlying operational concerns were fundamental fears of losing independence through what the central bankers called "fiscal dominance". In one of our interviews the expert explained that "fiscal dominance" is a scenario in which "governments are highly indebted [and] central banks simply have no choice but to conduct policies that stabilise the fiscal side." With the beginning of bailout programmes the concern was that through excessive spending expansion "we [would] become the department of the finance ministries […] and all we would do is to ensure smooth fiscal policies". This would mean the "end of independence" (interview 1). These sentiments imply that the crisis offered an opportunity to bring fundamental issues of fiscal-monetary conflict.

Between the first bailout programmes in 2008 and the beginning of the Eurozone Crisis in April 2010, the ECB adopted a strategy of "voice" to influence Eurozone member states as well as the European Commission and European Parliament to reinforce member state commitment to balanced budgets. In April 2010, credit rating agencies downgraded Greek bonds to junk status putting the country at risk of sovereign default, and another set of bailout programmes was implemented with the European Financial Stability Facility (EFSF) and successor European Stability Mechanism (ESM). Throughout the implementation of these programmes, ECB officials including former president Trichet pushed publicly to uphold the budget rules that member countries had agreed to in the Stability and Growth Pact (SGP). Trichet gave addresses to the European Parliament pushing for faster fiscal consolidation and the implementation of quasi-automatic sanctions in the midst of the crisis (Blyth 2013; Ban 2016). Throughout the first years of the crisis, the German government and ECB officials promoted the implementation of a new fiscal compact voicing concerns about moral hazard arising in the EFSF and the EFSM. The German government pushed for the implementation of a debt ceiling in the

Lisbon Treaty and automatic sanctions and quantitative targets inscribed into primary law. Mario Draghi, appointed as the new president of the ECB in November 2011, repeatedly promoted the need for a stronger EMU surveillance framework within a "New Fiscal Compact" (Schelkle 2013, 114; Schlosser 2019, 58). Voice entailed speeches to the European Parliament, the participation of the ECB president and the board members in the Euro group meetings - informal meetings of finance ministers of the Eurozone - including the negotiations over the Stability Pact reforms, making statements to the public, the President talking to individual finance ministers (interview 2).

While voice had accompanied the discussions over bailouts since the beginning of the crisis, the ECB used it most extensively when EU leaders agreed on a reform of the SGP to stabilise market expectations and negotiations over the Six Pack commenced. In these negotiations, the ECB held an advisory role in the Task Force Van Rompuy next to the finance ministers of the Euro area governments, with the European Commission supporting the process as a mediator allowing the ECB to place interests squarely into the negotiation process (Schlosser 2019, 49–50). This set-up allowed for "a more formal way of coordination" between member states and ECB interests (interview 2). However, despite having a seat at the table, the attempts of the central bank to influence the reforms only yielded partial successes. President of the ECB Trichet demanded the most rigorous rules in the six sessions of the Task Force including the implementation of quasi-automatic rules "with less discretion over outcomes" and better support for the SGP which would revive the credibility of monetary policy (Trichet 2010). In November 2011, the new ECB president Mario Draghi carried that message further when one of his first speeches in front of the European Parliament called for restored "credibility" through decisive fiscal action in the Six Pack negotiations in front of the European Parliament (Draghi 2011). However, as one of our interviewees confirmed, the voice strategy was a continuous, but also eventually futile activity to achieve rigorous fiscal goals. ECB officials had used all kinds of tools of "public communication […] to strengthen [the SPG] to ensure that the country surveillance is taking place, the countries are bound to their commitments", however, in the end fiscal policy was a domestic domain and there was no way that the council was going to implement effective new rules (interview 1). While the Six Pack strengthened European-level monitoring of fiscal decisions and coordination of fiscal policies, it did not achieve a full-fledged security for budget discipline. In the area of surveillance, the European Semester was the most decisive reform element which centralised all surveillance procedures in one cycle and introduced a top-down procedure into domestic budget making. The only element with enforcement capacity were the Medium Term Budgetary Objectives (MTO) which allowed member states to implement financial sanctions of interest-bearing deposits of 0.2 percent of GDP and the introduction of the Reverse Qualified Majority Voting in the Council to allow sanctions to make it harder for member state coalitions to block fines, but still a considerable number of member states would have to agree to punish their peers which was an unlikely scenario (Schlosser 2019, 52–53).

The ECB had to wait until the year of 2011, when in a moment of acute economic emergency, a window of opportunity opened for the central bank to use its institutional power to pressure fiscal actors into policy change. This implies that institutional power as such is not enough to win in a high-stakes situation in which economic approaches are contested. Instead, powerful governing institutions can use developments in the world around them to expand their position of power. In 2011, the outcome of this conflict over policy development was that conditionality was introduced into the existing government bond buying scheme within the Securities Market Programme (SMP). The economic emergency allowed central bank actors to use the institutional powers they had previously acquired to achieve policy change. It allowed them to "bargaining" with domestic governments over further extensions of liquidity in exchange for fiscal austerity. Since the Maastricht Treaty prohibited direct ECB-financing of member-state debt, the SMP was announced on 10 May 2010 by the Governing Council as an alternative way to restore liquidity in debt securities markets. It was a Euro 750 billion rescue program to combat disruptions in the monetary policy transmission mechanism in which the Eurosystem bought government and corporate debt securities on the secondary market especially from May to July 2010 (bought Euro 60 billion) and August 2011-January 2012 (Euro 140 billion); this was the first bond-buying scheme for the Eurozone carried out on the secondary market (ECB 2010; Henning 1994, 92–93). In the first few years of the crisis, the Troika had decided on the

size and the conditionality of loans. However, when a lack of trust of markets in the credibility of the Italian Berlusconi government and the Spanish Zapatero governments emerged in the summer of 2011 driving sovereign spreads apart, the ECB started its own programme outside of the Troika agreements. In this summer, despite existing support programmes, markets perceived Italy lacked credibility and Italian and German long-term bond spreads diverged considerably. Berlusconi had been unable to find a clear path to austerity as its coalition partner, the Northern League, refused to accept pension reforms. In August of that year, the ECB devised a plan to purchase Italian and Spanish government bonds in the secondary market at a large scale in exchange for austerity measures. The ECB President and the Governor of the Bank of Italy sent the government an informal letter which offered buying government bonds in exchange for a balanced budget by 2013. In Spain, the ECB President wrote a letter with the Governor of the Bank of Spain arguing that the SMP would only be extended if more rigorous fiscal discipline would be implemented. As a result, an Italian emergency package was passed and Berlusconi implemented a deep fiscal consolidation package. In Spain, the Prime Minister announced a reform of the Spanish constitution with a balanced budget rule preceding similar demands within the Fiscal Compact (Badell et al. 2019, 1319–20).

With the success of "bargaining", the ECB repurposed this strategy as a means to extend pressure on governments to implement budget rules into constitutions within the Fiscal Compact. Bargaining power was particularly high due to a window of opportunity which allowed it to place particular pressures on domestic governments. The Fiscal Compact was discussed outside of the Community method framework which excluded the European Parliament and the Commission from the negotiation process and thereby preventing fiscal interests to move into the equation. Bargaining power was also distributed to the ECB by the fact that domestic governments were particularly dependent on support by the ECB at the point of negotiation. On the one hand, Spanish and Italian bond yields were at very high levels of around 6 percent. On the other hand, other sources of new financial assistance were unlikely to emerge as the European Council disagreed about further extending existing support. These political and economic dependencies of governments allowed the ECB to use increased liquidity for banks as a lever to get them to sign the Fiscal Compact. It offered to increase the liquidity for banks through an extension of the Long Term Refinancing Obligations (LTRO) from one to three years (Schimmelfennig 2014, 330; Wyplosz 2012).

The Fiscal Compact was implemented on March 2, 2012 as part of the Treaty on Stability, Coordination and Governance (TSCG) which attached fiscal rules to unconventional monetary instruments and made interventions dependent on a macroeconomic support programme which could only be accessed by signing and implementing the TSCG (Schelkle 2013). Article 2 of the TSCG includes the desired balanced budget rule that sovereign budgets shall be balanced or in a surplus. It established a balanced budget rule and an automatic mechanism for corrections. By making governments inscribe fiscal issues into their constitutions genuine changes were enforced at the domestic level. Domestic governments implemented domestic watch dog institutions including the AIREF created in 2014 in Spain enshrined into the "organic law" which is the law directly secondary to the Constitution, which makes their mandate enshrined into the law, with more reporting and databased analysis in the six pack negotiations but which was eventually enshrined through the fiscal compact to analyse the macroeconomic environment and make suggestions to the government about fiscal stances with harsh expenditure cuts. Many of the rules implemented were called "marketing effect" for the markets, to show "we're going to be disciplined, and we're going to convince the markets that we're going to be so austere […] and the Germans tell us that we have to do this" by the Spanish officials but "now we have these targets at a constitutional level, it's impossible to change" (interview 3). Even the Italian Mario Monti government, which came to office in 2011, and attempted to be the "good pupil" of reforms among the crisis economies, and implemented considerable pension and labour market reforms, struggled under the enhanced enforcement mechanisms of the SGP and the predetermined schedule of debt reduction for high debt economies and persistently attempted to achieve a flexibilization of the rules on EU level (Stolfi 2013, 175). While several letters had been sent to the Italian government over the years demanding fiscal restrictiveness, it was Fiscal Compact which enforced radical reforms. The Monti government implemented a balanced budget principle into the Italian constitution in April 2012, adopted a reinforcement law which spelled out the corrective

mechanisms for the case in which the budget deviated significantly from the fiscal targets in December 2012 and established an independent parliamentary budget office which monitors budgetary developments in relation to EU fiscal rules (Badell et al. 2019, 1319; Moschella 2017).

5. Conclusions

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6. References

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Appendix 1

Interview 1: Expert interview on fiscal policy during the crisis at the ECB

Interview 2: Expert interview on monetary policy during the crisis at the ECB

Interview 3: Experts on fiscal decisions in the Bank of Spain