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European economic integration in times of crisis: a case of neofunctionalism?

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Abstract

This contribution analyses the relevance of neofunctionalist theory and the various spillover mechanisms for explaining the management of the crisis and the drive towards a more complete Economic and Monetary Union (EMU). The management of the crisis resulted in integrative outcomes due to significant functional dissonances that arose from the incomplete EMU architecture created at Maastricht. These functional rationales were reinforced by integrative pressures exercised by supranational institutions, transnational organised interests, and markets. The paper concludes that despite shortcomings, neofunctionalism provides important insights for understanding the integrative steps taken during the crisis.

Introduction

In a special issue that investigates the development of European (economic) integration (in times of crisis) from different theoretical perspectives, neofunctionalism is arguably one of the more obvious choices for analysis. First, as pointed out in the introduction to this volume, we have witnessed quite a number of integrative steps in the area of EMU over the past few years relating to crisis management mechanisms such as the European Financial Stability Facility (EFSF) and European Stability Mechanism (ESM), the streamlining and tightening of fiscal and economic policy coordination such as the two-pack, or the creation of the banking union with single supervision and resolution. Neofunctionalism, with its particular focus on explaining policy-making outcomes (Wiener and Diez 2009) and its core competence with regard to the dynamics of European integration, should be apt to account for these changes. Second, and closely related, many observers agree that one of the
insights gained from the crisis is that the introduction of the euro cannot be taken as the endpoint in the process of economic integration. Although EMU solved some of the economic dilemmas of an integrated single market with liberalised capital movements, variable exchange rates and national monetary policies, it also laid the ground for new ones, for example stemming from the mismatch between centralised monetary and decentralised fiscal and financial policies. This seems to be a fertile breeding ground for neofunctionalist spillover pressures. Third, although neofunctionalism is one of the most widely criticised theories of European integration, it has remained relevant in the academic discourse over the years (Niemann and Schmitter 2009).

In view of these aspects, it appears rather astonishing that there is relatively little research on the crisis that (explicitly) draws on neofunctionalism. Interestingly, economic integration during the crisis arguably constitutes a crucial (hard) case for neofunctionalism, mainly because it is an area of ‘high politics’, i.e. close to the heart of national sovereignty and substantially politicised (Hobolt and Wratil 2015), while it has often been assumed that the neofunctionalist logic only works in a depoliticised environment (Hoffmann 1966). This paper tries to address this gap by posing the following research question: to what extent is neofunctionalism (still) relevant for explaining the management of the crisis and the drive towards a more complete EMU, i.e. to what degree are neofunctionalist propositions supported by empirical findings?

We proceed as follows: section one specifies the neofunctionalist tenets and the concept of spillover. In section two, we briefly elaborate our dependent variable (the degree of European economic integration in response to the crisis). Sections three, four, and five analyse the extent to which the concepts of functional, political and cultivated spillover contribute to explaining the integrative steps taken to resolve the crisis. Finally, we draw some conclusions from our analysis.
1. Neofunctionalism and the concept of spillover

The basic neofunctionalist assumptions can be summarised as follows: (1) integration is understood as a process. Implicit in the notion of process is the assumption that integration processes evolve over time and take on their own dynamic. (2) Regional integration is assumed to be characterised by multiple, diverse and changing actors who also build transnational coalitions (Haas 1964: 68ff). (3) Decisions are taken by rational actors, who nevertheless have the capacity to learn from their experiences in co-operative decision-making (Haas 1958: 291). (4) Incremental decision-making is given primacy over grand designs, where seemingly marginal adjustments are often driven by the unintended consequences of previous decisions as most political actors tend to be incapable of long-range purposive behaviour since decisions on integration are normally taken with very imperfect knowledge of their consequences and frequently under the pressure of deadlines (Haas 2004: xxiv). (5) Neofunctionalists pointed out that interaction in the Community setting is often characterised by positive sum-games and a supranational style of decision-making where participants seek to attain agreement by means of compromises upgrading common interests (Haas 1964: 66).

The neofunctionalist conception of change is succinctly encapsulated in the notion of ‘spillover’. Three types of spillover have generally been identified: functional, political and cultivated spillover (Tranholm-Mikkelsen 1991).

*Functional spillover*

Functional spillover pressures come about when an original objective can be assured only by taking further integrative actions (Lindberg 1963: 10). The basis for the development of these pressures is the interdependence of policy sectors and issue areas. Individual sectors
and issues tend to be so interdependent in modern polities and economies that it is difficult to isolate them from the rest (Haas 1958: 297). Functional pressures thus encompass the various endogenous interdependencies, i.e. the tensions and contradictions arising from within, or which are closely related to, the European integration project, which induce policy-makers to take additional integrative steps in order to achieve their original goals. Due to such ‘inherent linkages of tasks’ (Nye 1970: 804), ‘actors discover that they cannot [satisfactorily] do A […] without also doing B and perhaps C’ (Lindberg and Scheingold 1970: 117).

In the subsequent academic debate it has been suggested that the strength of functional spillover logics does not only depend on the degree of interdependence between policy areas. Two aspects influence when, and the extent to which, functional tensions impact on actors. First, when functional dissonances are not balanced or offset through further integrative steps, this may foster shocks or crises that may in the process of their management/mastery generate amplified functional pressures, which are likely to prompt the ‘necessary’ integrational steps. Second, functional structures do not determine actors’ behaviour in a mechanical or predictable manner. Actors must regard functional logics as plausible or compelling in order for them to unfold their potential (cf. Niemann 2006: 31). In other words: functional logics are only as strong as they are perceived by (relevant/important) actors. The development of the political discourse can be suggested as an indicator for the persuasiveness of functional logics on decision-makers. When arguments along the lines of functional spillover rationales are substantially taken up by decision-makers, and especially when they become part of the dominant discourse, they also tend to find expression in political decisions (Niemann 2006: ch. 4). Through such modifications and extensions of the concept we should be able to better specify when and how functional pressures impact on the policy process.
Political spillover

Political spillover encapsulates the process whereby (national) elites come to perceive that problems of substantial interest cannot be effectively addressed at the domestic level. This should lead to a gradual learning process whereby elites shift their expectations, political activities and – according to Haas – even loyalties to a new European centre. Consequently, national elites would come to promote further integration, thus adding a political stimulus to the process. Haas (1958: chs. 9-10) in particular focused on the pressures exerted by non-governmental elites, especially trade associations and trade unions, while second-generation neofunctionalists tended to refer to a broader range of interest groups (e.g. Schmitter 1971: 257). Interest groups were thought to expose functional interdependencies between policy areas and organise increasingly at the European level (Haas: 1958: ch. 9; Nye 1970: 806ff). Lindberg (1963: chs. I+IV) attributed greater significance to the role of governmental elites and socialisation processes, which tended to foster consensus formation among member governments and would eventually lead to more integrative outcomes.

Cultivated spillover

This pressure concerns the role of supranational institutions that, concerned with increasing their own powers, become agents of integration, because they are likely to benefit from the progression of this process. Once established, they tend to take on a life of their own and are difficult to control by those who created them. Supranational institutions may foster the integration process, for example, by acting as policy entrepreneurs, through

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1 In his second edition of “The Uniting of Europe” Haas pointed out that elites are more likely to follow economic advantages pragmatically rather than developing a deeper concern for European integration, thus no longer banking on their longer-term integrative support.
2 This indicated that the various types of spillover are closely interlinked and cannot be clearly separated from each other (Niemann 2006: 50-51).
3 While Haas emphasised the role of the High Authority/ Commission, later on neofunctionalism was often interpreted as viewing the role of supranational institutions, more generally, as an integrative dynamic.
promotional brokerage, lifting agreements beyond the lowest common denominator (e.g. Haas 1964: 75ff; Lindberg 1963: ch. 3), or through positions of centrality and authority in the Community’s political system, capable of directing the dynamics of relations with various types of actors (Nye 1970: 809; Lindberg and Scheingold 1970: ch. 3).

2. European economic integration in response to the crisis

As regards the dependent variable, i.e. the degree of European economic integration, the pre-crisis institutional framework considerably advanced under all main policy areas of EMU. The integrative steps followed a chronological order that reflected the nature of the crisis (and thereby the rise in pressures due to functional dissonances) as well as the fact that in some cases more than one iteration was necessary to reach a point where functional pressures had adequately subsided.

Thus, the first integrative steps in the area of crisis-related firewalls were of an emergency nature and included in May 2010 first bilateral loans to Greece and the agreement to establish the European Financial Stability Mechanism (EFSM) and European Financial Stability Facility (EFSF) in combination with macroeconomic conditionality in the form of European Union (EU) Economic Adjustment Programmes for the worst hit crisis countries. The EFSF developed into the more permanent ESM in March 2011 which took over new financing of programmes from the EFSF in July 2013 and, despite its intergovernmental nature, was also linked to the Treaty through an addition to Article 136.

In parallel, and in terms of fiscal and macroeconomic surveillance, the so-called “six-pack” of legislative measures was adopted, with the intention of strengthening the fiscal rules of the Stability and Growth Pact (SGP) and the national fiscal frameworks, and setting up a framework to tackle macroeconomic imbalances. The six-pack was then further
supplemented by the so-called two-pack and the Fiscal Compact increasing the coordination of fiscal and budgetary policy (Begg 2013).

In the financial sphere, the original reaction to the crisis in 2009 was in the form of elevating the committees responsible for coordinating micro-prudential supervision and regulation to authorities with greater autonomy and powers. These were also complemented by the new European Systemic Risk Board (ESRB) for macro-prudential policy. However, when functional dissonances escalated further through the coupling of public and private over indebtedness into the bank-sovereign nexus, the response in the financial sphere went a step further with the creation of the Banking Union, i.e. the creation of centralised banking supervision at the European Central Bank (ECB) and its resolution counterpart, the Single Resolution Mechanism (SRM) with a Single Resolution Fund (SRF) at the Commission. All these steps deepened to a remarkable degree European economic integration within a relatively very short period of time (also cf. special issue introduction). Some observers have suggested that banking union in particular represents the most important integrative step since the inception of the euro at Maastricht (Merler 2014).

3. Functional spillover

The concept of functional spillover will be operationalised by probing several indicators and mechanisms including: (1) the salience of the original goal, which determines the strength of the functional pressure for further action. (2) The existence of functional interdependence between issue A (original objective) and issue B (requiring further action). To what extent do changes/tensions in issue area A (EMU) have significant consequences for issue area B, thus requiring more collective action? (3) The availability of functional solutions. Is further action in a particular issue area necessary to achieve the initial objective, or are there alternative
solutions? If the original goal cannot be reached by other means, the functional connection is likely to be a strong one. (4) Functional dynamics are only as strong as they are perceived by (key) actors. If important policy-makers have used the functional argument(s) in political discourse repeatedly, this strengthens the functional rationale.

The salience of the original goal(s)

A significant and/or urgent original policy objective is required to let functional pressures develop. With regard to the integrative measures taken since the crisis, there has been one prime original objective: (financial) stability of EMU/safeguarding the Euro. This fundamental objective was endorsed by a vast majority of, if not all, member governments and the EU institutions (Schimmelfennig 2012: 403). This objective is inextricably linked to an even more elementary one, that of protecting the Single European Market (SEM), as cited by several key policy-makers (Schäuble in Der Spiegel 2012a; Rajoy 2012). In addition, it has been argued that EMU and the SEM constitute policy goals crucial for the entire EU project, epitomised by Chancellor Merkel’s statement “Europe fails if the euro fails” (Merkel 2012). In sum, the original goals have been (considered) very salient indeed.

Functional interdependencies

Functional interdependencies between policy areas explain why the desire to achieve an original integrative objective may lead to further integration in a related area. In this case the developments towards deeper economic integration can be explained as steps taken in order to alleviate functional pressures arising from an incomplete architecture created at Maastricht.

Such functional interdependencies are based on the multitude of policy areas that are conducted in parallel and interconnected over different time horizons. Key in this
interaction is that policy, which would normally take place at the same level of governance, has been allocated at different levels of government under the EMU design of the Maastricht Treaty. While monetary and exchange rate policy is an exclusive EU competence, fiscal policies are largely determined at national level. Financial sector regulation is determined at European and national level, while financial sector supervision and structural policies (beyond the single market) were loosely coordinated at EU level but legislated at national level.

Three functional dissonances can be identified, which brought about substantial integrative pressures during the crisis. First, a functional dissonance manifested itself between supranational monetary policy and intergovernmental budgetary, fiscal and structural policy, resulting in negative externalities. While these externalities were meant to be contained by the SGP and the non-bailout clause of the Treaty as well as loosely coordinated structural policies, this framework proved inadequate and provided incentives for free riding behaviour. At the same time, member states with severe imbalances found their policy options restricted when their sovereign debt came under pressure in financial markets, as they no longer had the possibility to counter such pressures through, for example, nominal exchange rate adjustment (Schimmelfennig 2012; Leuffen et al. 2013: 173). The creation of crisis management tools such as the ESM and concomitant conditionality, and a tighter fiscal and economic framework, sought to alleviate the functional dissonances between a stable single currency and the “no-bailout” clause and decentralised national policies leading to public over-indebtedness.

Second, monetary union relied on the adequate supervision by national authorities of nationally based credit institutions within the single financial market, even though a number of them were exposing their balance sheets across national borders and/or were systemically important. More broadly, the degree of financial market integration increased
substantially with the introduction of the euro (ECB 2005). Yet, while cross-border activity in the EU banking sector and financial markets prospered, supervision remained largely inward looking at national level and without (sufficient) institutional adaptations. In other words, the limited institutional framework and financial public policy at European level did not match the extensive Europeanisation of the banking system and single financial market. A financial trilemma emerged between financial integration, national financial policies and financial stability, which became untenable (Schoenmaker 2011). The establishment of the banking union reflects steps taken to reduce the functional dissonances emanating from European financial stability and integration on the one hand, and a banking system that was functioning under essentially national policy allowing private over indebtedness on the other hand.

The third dissonance manifested itself through the interaction of the first two in what became known as the bank-sovereign nexus (European Council 2012a). Fragile public and private debt developments became intertwined at national level, either because domestic banks were overexposed to failing domestic sovereign debt, or because the sovereign had to rescue the systemically important credit institutions. A close correlation thus arose between sovereign and bank debt with European-wide financial instability implications, simultaneously interrupting the smooth transmission of monetary policy by the banking system. The nexus thus endangered EU and euro area wide public goods such as financial stability and the single currency, and required emergency measures involving both the national and European level. A combination of fiscal backstops like the ESM (and the possibility of bank recapitalisation), together with a centralised supervisory and resolution framework, sought to alleviate the additional functional pressures emerging as the crisis mutated into the bank-sovereign nexus.

*The crisis: the result of existing, and amplifier of subsequent, functional pressures*
If functional pressures are not resolved through further integrative steps, this can promote crises which in turn cause further functional pressures during the process of crisis management, thereby eventually triggering the necessary steps of integration. We can observe this process following the introduction of the single currency in 1999. During the time of broadly positive economic developments in the early years of monetary union, existing functional logics went largely unnoticed and did not give rise to sufficient integrative pressures. However, the functional dissonances described above allowed for the disrespect of the SGP’s fiscal rules (already in 2003), the build-up of financial imbalances, and the loss of competitiveness in a number of economies failing to pursue sound fiscal, wage and structural policies in line with the single monetary and exchange rate policy. Thus, at least some of the elements of the crisis can be attributed to the first two functional dissonances described above (Schmidt 2012: 76).

Functional pressures were amplified during the crisis because the institutional framework did not include crisis management tools. This lead to the third dissonance described above whereby the support of illiquid banks to ensure financial stability became difficult for over-indebted national governments (Dyson 2013: 216). In the European context, the crisis uncovered among other things ‘that European authorities had no means to stop the spiral of the European sovereign debt crisis. In particular, no pan-European fiscal mechanism to face the global crisis [was] available’ (Bordo et al. 2011: 1). Eventually, both crisis management and broader institutional integrational steps took place to alleviate these functional pressures, including the pooling of resources to manage the crisis and ensure economic and financial stability, the adjustment of the fiscal and economic coordination rules especially in the euro area, together with rules governing the regulation, supervision, and resolution of banking institutions.

*Alternative solutions?*
If the original goal – here the stability of EMU and safeguarding the euro – cannot be (adequately) reached by means other than further integration, the functional spillover logic is likely to be strong. Several other scenarios could be imagined, such as retaining the status quo, a break-up of the euro area and a return to national currencies, or several intermediate scenarios, such as dividing EMU into a north and south euro, the establishment of a core EMU, etc. (Schmidt 2012: 165-192). We argue that these alternative solutions were considered politically and economically far too costly and/or risky by euro area policy-makers and that path dependencies point in a different direction.

First, the crisis convincingly demonstrated that the status quo was untenable. Second, spillback scenarios were (considered) highly undesirable. The change to the euro and a supranational monetary policy came to imply very significant ‘sunk costs’ for states and firms. In addition, as pointed out above, EMU reinforced the integration of capital markets and thus interdependencies between the euro area member states. Consequently, a break-up of EMU and/or the exit of a member state would have posed very considerable costs and risks. Therefore, euro area governments across the board strongly supported the maintenance of the entire euro area (Schimmelfennig 2012: 404). Where dissenting views were expressed in national politics – such as sporadically by representatives of the Christian Social Union and the Free Democratic Party in Germany – these were met by heavy criticism (Handelsblatt 2011). Overall, top Eurozone policy-makers clearly dismissed such alternatives.

*Increased shaping of the political discourse through functional logic*

As described in section one, actors also have to consider functional logics as plausible or urgent in order for them to substantially unfold. The crisis, as a result and amplifier of functional pressures, has apparently fostered learning effects and thus decisively reinforced
the functional spillover logic. Although the functional spillover dynamic emanating from EMU had been (sporadically) articulated since the late 1980s (Delors Committee 1989), it found little traction in political discourse until the crisis.

Through the crisis, functional spillover argumentation became the dominant political discourse relatively quickly. This discourse is evident throughout nearly all national governments and EU institutions. The functional link between the Single European Market and the single currency was referred to repeatedly during the crisis. According to German Finance Minister Schäuble, “[t]here is certainly the risk that, in the event of a collapse of the euro -- which, by the way, I don't believe is going to happen -- much of what we have achieved and become fond of would be called into question, from the common market to freedom of travel in Europe” (Der Spiegel 2012a). Spanish Prime Minister Rajoy argued similarly: “The euro is on a path of no return, and its connection with the entire European project, starting with the common market, is undissolvable” (Rajoy 2012).

As for the functional consequences emanating from the common currency, politicians in Europe also increasingly make use of functional spillover logic. Chancellor Merkel for example suggested that “a renewed EMU requires a common fiscal and economic policy” (Der Spiegel 2012b; authors’ translation). Commission President Barroso likewise argued: “It was an illusion to think that we could have a common currency and a single market with national approaches to economic and budgetary policy” (Barroso 2011: 4). Similar arguments were expounded, for instance, in the four Presidents report (Van Rompuy et al. 2012: 3).

Subsequently, the functional link between EMU and an often ill-defined but much broader political union was cited by a multitude of decision-makers at national and
European level. Apart from Chancellor Merkel and the four Presidents, French President Hollande also followed this logic: “This Eurozone must take a political dimension [...] but political union comes afterwards. It is the step that follows the fiscal union, the banking union, the social union” (Le Monde 2012). Political union as a necessary result of the single currency was also seen as uncontroversial, less surprisingly of course, in wide sections of the European Parliament and the European Commission. For example, Commissioner Almunia declared:

It’s legitimate to pursue national interests. But, at the end of the day, individual nations need to do what is necessary in order to save Europe as a whole. This also means that Germans are right to push for a political union after having achieved the economic and monetary union. (Spiegel Online 2012)

Steps towards a European financial market union are mostly constructed as a logical result of functional constraints in the political discourse. Even politicians of governments follow this logic, whom one would expect rather to advocate the importance of national sovereignty. As suggested by the British Finance Minister Osborne: “We've always said a banking union was a necessary part of a more stable single currency for the Eurozone [...]” (The Guardian 2012).

The above indicates that functional logic found increased acceptance in the political discourse of senior policy-makers in the EU and its member states during the crisis. This seems to imply that functional pressures were, during the crisis’ development, increasingly perceived convincing by political elites in the EU. Since discourses tend to restrict decision-makers’ freedom of action in the political process (Jachtenfuchs 1997: 47), one can

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4 Functional spillover logic within EMU is also evident in legal EU texts, such as the “fiscal compact” (European Council 2012b: 7).

5 i.e.: European Council President van Rompuy, Commission President Barroso, Eurogroup President Juncker and ECB President Draghi.
tentatively deduce that this discourse should also be evident in consequent political decisions.

4. Political spillover

Due to the limited scope of this paper, our analysis of political spillover – i.e. the integrative role that elites play due to their awareness of the benefits of supranational solutions – focuses only on non-governmental elites. First, we discuss the role of interest groups before we turn to that of financial markets.⁶

The role of interest groups

In this section the concept of political spillover will be probed by (1) examining the extent to which supranational solutions have been regarded beneficial by interest groups⁷, (2) analysing the degree to which interest group representation and articulation has taken place through Brussels-based umbrella organisations and/or in a co-ordinated fashion transnationally, rather than nationally, and (3) approximating the impact of organised interests on decision-makers.

First, we look at the degree to which supranational solutions are/have been regarded beneficial for solving the crisis. Generally speaking, business leaders have strongly favoured European solutions in this regard. Grant Thornton survey data suggest that 78 percent of Eurozone business leaders are positive about the overall impact of joining the Euro, 94 percent support the survival of the Euro, and 89 percent favour further economic integration (Grant Thornton International Business Report 2013). The position papers,

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⁶ The section on political spillover as well as those on the Commission and the EP partly draws on Koch (2013), whose MA thesis one of the authors supervised.
⁷ In this paper we have focused on business interest groups as the largest and best documented segment of organized interests in this sector.
reports and statements of business interest groups further corroborate their interest in supranational solutions (e.g. BusinessEurope 2011; ERT 2011, 2012). Especially those economic interest groups representing businesses substantially involved in intra-currency union trade tend to favour the euro due to reduced transaction costs resulting from the eradication of exchange rate risks (Jäger 2013: 120).

Second, as neofunctionalism suggests, much of the corporate interest representation and articulation has taken place through Brussels-based umbrella organisations and/or in a co-ordinated fashion transnationally during the crisis. For example, in the run-up to the European Council summit of June 2011, a coalition of 51 German and French top representatives from major corporations, such as Air France, BASF, Deutsche Bank, Michelin and Siemens, launched a newspaper campaign entitled “The euro is necessary” calling for further financial aid for the highly indebted countries (Büschemann 2011; Jäger 2013). In addition, the euro area’s three largest national business interest groups, the Bundesverband der Deutschen Industrie (BDI), Le Mouvement des entreprises de France (MEDEF), and Confederazione Generale dell’Industria Italia (Confindustria) issued a joint statement in 2011. They demanded safeguarding the euro and deeper European economic integration (BDI, Confindustria and MEDEF 2011). Furthermore, the European Roundtable of Industrialists (ERT) – which brings together some 50 CEOs of major European corporations – got significantly involved in the business campaign for stabilising the euro by advocating measures reinforcing and deepening the entire Eurozone architecture (ERT 2011, 2012). In addition, BusinessEurope (2010a,b,c), the largest European umbrella business association, has continuously and unequivocally pushed for such objectives, and also did so jointly with other European industrial and financial umbrella organisations (BusinessEurope et al. 2010).

Thirdly, the precise impact of organized interests on decision-makers is difficult to ascertain, as can be seen from other works on the role of EU corporate groups (Green
Cowles 1995). Nonetheless, it seems that the above-mentioned interest groups have had direct access to key decision-makers. Cromme of Thyssen-Krupp, the initiator of the Franco-German newspaper campaign described above, together with Diekmann of Allianz and Todenhöfer of Bosch, went to meet Chancellor Merkel on 10 May 2011 to report their concerns with regard to “the ailing euro” (Büschemann 2011). Furthermore, in the autumn of 2011 ERT representatives met with Chancellor Merkel in Berlin, with Council President Thorning-Schmidt in Copenhagen, and with French President Sarkozy in Paris to draw their attention to the ERT crisis management proposals for deepening the euro area architecture (Embassy of France in London 2011; Corporate Europe Observatory 2012a).

In more tangible terms, the influence of organised interests can be discerned on the various legislative dossiers leading to further integration such as the so-called “six-pack” that aims at strengthening the procedures to reduce public deficits and address macroeconomic imbalances. Evidence suggests that BusinessEurope acted as a policy entrepreneur during the six-pack (pre-)negotiations. On important issues that ended up in the legislation, BusinessEurope was the first group/entity to argue for their inclusion. For example, BusinessEurope argued for stricter binding sanctions – both in terms of greater automatism and a transfer of fines to a crisis resolution fund – before this was taken up by the Commission or Task force. There is no evidence that the Commission and Task Force included certain provisions in the legislation because of the efforts undertaken by BusinessEurope. However, the similarity of content, the timing of the proposals and the intensive contacts cultivated by BusinessEurope with representatives from the Commission and Parliament, along with four letters directly addressed to Van Rompuy (e.g. BusinessEurope 2011), suggest that BusinessEurope’s lobbying efforts have at least been conducive (Knedelhans 2014).

In addition, BusinessEurope contently concluded that it was ‘glad to see a large number of [their] recommendations reflected in the legislative package’ for example in terms of the exceptions for meeting the envisaged budgetary targets (BusinessEurope 2010c: 2; cf. Official Journal 23/11/2011: 17), which is a telling statement because interest groups tend to understate their influence (Dür 2008).

BusinessEurope also appears to have played an active role in advocating economic governance reform eventually codified in the fiscal compact. Already in its 2010 ‘European Action Plan’, it proposed, binding fiscal rules and stronger institutions to ensure long-run budgetary discipline (BusinessEurope 2010a). The crisis provided a good opportunity for business interests to promote the strengthening of EU economic governance (Mandate 2012). Before the EU summit of December 2011, three major changes were advocated: strengthened voting rules to make it tougher for the Council to overrule the Commission’s recommendations regarding deficits; greater ambition and commitment from Member States in their national reform programmes; making ESM lending conditional on member states accepting the fiscal compact (BusinessEurope 2011a: 2-3). The final version of the fiscal compact, signed in March 2012, appears to be modelled rather closely on BusinessEurope’s demands (Corporate Europe Observatory 2012b; cf. Council 2011: 15-16).

The role of the financial markets

While the previous sub-section analysed the role of actors in the ‘real’ economy, this part examines the role of financial markets.9 Although financial markets may be treated simply as arenas in which actors play out their individual strategies and respond to each other

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9 To include financial markets within the notion of political spillover may be contested as it is doubtful whether they undergo (deeper) learning processes, an assumption that was dropped however during the first revisions of the theory in the late 1960s (cf. footnote 3). In that spirit, the inclusion of financial markets as actors seems justified. In addition, their very high degree of autonomous acting fits core neofunctionalist maxims.
(Overbeek 2012: 40), a majority of authors have viewed them (mostly implicitly) as actors during the crisis (e.g. Yiangou et al. 2013: 16ff; Schimmelfennig 2012: 396).

Overall, we argue that financial markets acted both directly and indirectly during the crisis to promote integration, and with a particularly high level of autonomy (Schmidt 2012: 24). They may not have been organised as a unitary actor but due to the high uncertainty and herd like behaviour observed during the crisis (Dyson 2013:220), their actions appeared unitary vis-à-vis EU policy makers and influenced substantially the EU’s crisis management towards the adoption of integrative measures (Schimmelfennig 2012:396). In particular, they bluntly revealed the functional dissonances of the original EMU design and became a serious threat to the euro area through the radical reassessment of a variety of economic and credit risks. Arghyrou and Kontonikas (2012: 672) have argued that, on several occasions, financial markets understood policy-makers’ hesitation as a withdrawal of previously perceived fiscal guarantees, which furthered the notion of a significant default risk. Substantial funding pressures emerged in several euro area sovereign debt markets, translating into augmented borrowing rates. The sharp increase in interest rates for new issues of sovereign debt securities, especially for the highly indebted countries, created additional costs for governments and put further pressure on budget deficits (van Scherpenberg 2012: 369). This, together with an on-going downgrading of several euro area members’ creditworthiness triggered a vicious circle of increasing debt and interest rates, pushing some euro area states to the edge of insolvency (De Grauwe 2011: 1).

At that time, European decision-makers had to act given the magnitude of the negative consequences of a Eurozone member’s bankruptcy. When EU Heads of State and Government met for an emergency summit on 7 May 2010, they started to realise the immense risks and necessity for swift action. The amount of market pressure was reportedly dramatic and all-pervading during negotiations (Ludlow 2013). When the President of
Cyprus, Christofias, asked for some days of reconsideration regarding the decision on a new European bailout facility, Merkel refused, urging that a decision before the reopening of markets after the weekend (Ehrlich 2010). Late in the night before 10 May, a decision to establish a European stabilisation mechanism was taken by the Economic and Financial Affairs Council. This decision represented the first of several integrative measures taken in response to very substantial market pressures during the crisis. Nevertheless, while the measures taken in May 2010 were certainly important for reducing the risk of a deep pan-European financial crisis in the short run, they quickly proved inadequate to prevent speculative attacks on sovereign bonds of some euro area members (Panico and Purificato 2012: 13). Pressure thus continued and even sharpened after the adoption of early crisis management mechanisms, which eventually compelled policy-makers to consider deeper institutional reforms to address the flaws in the EMU design. During numerous “historic” summits, where decision-makers attempted to persuade the markets of their ability to solve the problems, original positions gradually subsided to the pressure of financial markets, which led to more sustainable measures such as the six-pack, Fiscal Compact and Banking Union (Vilpišauskas 2013: 372).

Characteristic in this regard was the case of the Fiscal Compact: by late autumn 2011 it was clear the adopted measures were insufficient to arrest deteriorating market conditions. When Greek government yields reached a new peak and overnight borrowing from the ECB hit its highest level in December 2011, the tone between the participants at the European Council summit became sharper. Head of the EFSF, Regling, talked to investors on the eve of the summit and reported that they aimed to decrease their exposure in the euro area. This raised the pressure on the summiteers to persuade investors that the agreed measures were indeed appropriate to shield the euro area (Spiegel Online 2011). ‘The market needs to see a road map of the process by which the Europeans will get to a fiscal-integration situation, not just a statement of intentions. Without it, you get the Euroquake scenario:
runs on European banks, forced nationalization of European banks. (...) With a healing plan for fiscal union, the markets will feel much more relaxed. If they don't have one, the markets will freak out again’ (Wood, in Norton 2011).

Such processes revealed functional dissonances, which encouraged institutional reforms to replace ‘governance through markets’ with ‘governance through governments’, and hence establish mechanisms to guarantee stable outcomes for the monetary union (Yiangou et al. 2013: 239). From a neofunctionalist perspective, financial markets became a ‘revealer’ of, and barometer for, the degree to which functional dissonances were addressed: when significant crisis management and integrative measures were taken, markets generally reacted positively, reducing pressure on sovereign bonds. By contrast, investors withdrew rapidly from these markets when they saw policy-making inactivity and hesitation in terms of finding durable institutional solutions.

5. Cultivated spillover

As for the potentially integrative role of supranational institutions, the most directly relevant supranational institutions, the Commission, the European Parliament, and the European Central Bank shared a clear preference for substantial action towards further integration. The overall process towards further integration during the crisis would not have taken place to the same extent without their involvement.

The European Commission

The Commission seems to have played a relatively limited role in cultivating spillover pressures during the crisis. According to Hodson (2013), it appeared little determined to mobilise ideas in support of, and push for, further integration, especially in the initial years of the crisis. This may have been because crisis management solutions such as the EFSF and
the ESM were strongly intergovernmental, limiting the Commission’s right of initiative. In the talks on the Fiscal Compact, the Commission managed to position itself on the ‘winning side’, but whenever its interests diverged from that of the ‘coalition’ headed by Germany, it failed to (fully) realise its preferences. However, the Commission did add impetus towards integrative solutions by emphasising functional spillover rationales (e.g. Commission 2013: 3; Barroso 2011: 4). It also played a more proactive role once the Heads of State broadly agreed to move ahead with further integration, for example, by putting forward ambitious legislative proposals in particular for the two main pillars of the banking union, the Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM), despite strong scepticism for its proposals by some member states (Commission 2009; cf. Hasselbach 2012). In the end the Commission gained new competencies with the implementation in particular of virtually all new surveillance procedures under the six-pack, two-pack and the Fiscal Compact, together with its role in the SRM, which increased its potential for autonomous action.

The European Parliament (EP)

The European Parliament contributed substantially to the integrative impetus, sometimes playing a notable role even in those areas where it lacked significant powers. As with the Commission, on the negotiations of the EFSF, the ESM and the Fiscal Compact, Parliament was side-lined because Heads of State or Government decided to conclude intergovernmental contracts. Nevertheless, of every such step taken outside the Community framework, the Parliament was very critical (cf. EP 2012). Consequently, and under the pressure from Parliament in particular, it was agreed that the ESM was linked to the Treaty through a simplified revision procedure and that the Fiscal Compact would eventually be brought into the Treaties (Ludlow 2013). Moreover, on the negotiations of the six-pack, the EP managed to assert itself and forced the Council into tough negotiations and largely
prevented the supranational dimension of the legislation from being watered down (e.g. as regards the role of the Commission; a higher degree of automaticity in the procedures and thus more restricted role of member states). Although the EP had co-decision rights for only four out of the six legislative proposals, MEPs were able to ‘sell this to the Council as a package’ obliging the Council to negotiate with the EP on the package as a whole (Chang 2013: 263). Parliament ensured the same approach was taken with the SSM by gaining de facto co-decision with the Council on the SSM Regulation assigning supervisory tasks to the ECB by treating it as a package with the parallel European Banking Authority (EBA) Regulation. Finally, Parliament did not only seek to strengthen the supranational institutions’ competencies (e.g. the Commission in the economic and fiscal area; the ECB for supervision) but it also sought to gain a commensurate role in the accountability of the new institutional solutions.

The European Central Bank

The EU institution that attracted most attention during the crisis was the European Central Bank. A key challenge for the ECB during the crisis was to maintain price stability for the euro area while the transmission of its monetary policy was becoming impaired. In this context, its actions also had to eliminate fears about the reversibility of the euro and the preservation of financial stability. The ECB’s standard and non-standard monetary policy measures included the rapid reduction of its key interest rates; changes to its collateral policy and Long Term Refinancing Operations (LTROs); the adoption of three Covered Bond Purchases Programmes (2009, 2011, 2014), the Securities Markets Programme (SMP) in 2010 and the announcement of Outright Monetary Transactions (OMT) in 2012 both with the aim of enhancing the transmission of monetary policy through purchases, under
different conditions, of securities in secondary markets.\textsuperscript{10} As regards the non-standard measures, while Sinn and Wollmershäuser (2012) claimed that the use of the ECB’s balance sheet exceeded its competences, others, such as de Grauwe (2011), criticised it for doing too little, claiming for example that it had failed to act as lender of last resort.

Beyond these monetary policy measures, the ECB was an early advocate of integrative deepening to buttress EMU. It did so in the Van Rompuy Task Force of 2010, in its legal opinions on EMU-relevant legislation, and through its interaction with the fiscal authorities in fora such as the Eurogroup and the European Council. It also provided input to the four Presidents report (Van Rompuy \textit{et al.} 2012). Moreover, given the strong interconnection between the different policy domains under EMU, it also played an advisory role in assisting the authorities in shaping the EU-financed economic adjustment programmes and monitoring them.

The ECB’s role in advancing integration was perhaps most evident in the development of the banking union. This was in line with its proactive stance towards fostering financial integration (ECB 2005:3) and closely linked to the efficient transmission of monetary policy through the banking system. The ECB thus strongly supported the establishment of the SSM and took on the role of single supervisor, even if this may not have been the only solution in principle (Angeloni and Ioannou 2013). Furthermore, the ECB also strongly supported the establishment of the Single Resolution Mechanism seeing the possibility of further functional dissonances emerging if supervision were not to be coupled with an effective European-wide resolution.

According to Traynor (2012), the ECB’s calls to strengthen and integrate the institutional architecture of EMU were justified within its remit to secure the single currency. Some observers have also argued that this stance was partly due to the policy paralysis caused by

\textsuperscript{10} For a timeline of the measures taken by euro area, EU and global authorities during the crisis, see: \url{https://www.ecb.europa.eu/ecb/html/crisis.en.html}
the prohibition of monetary financing and the no-bail-out clauses of the Treaty (Menz and Smith 2013: 197) as well as poor political leadership (Dyson 2013; Torres 2013). In 2012, the Economist also claimed that ‘the slow moving response of European leaders to the crisis created a vacuum that has forced the ECB, the only institution in the euro area capable of intervening promptly and decisively, into territory far outside its custom and practice’ (quoted in Alessi 2012). Menz and Smith (2013: 203) even go as far as to suggest that the ECB was a ‘decisive, at times even shrewd actor in pursuing its favoured strategy. In fact, much of the empirical story reads like one of quiet, yet powerful, mission creep.’ They further claim that ECB “officials [were] dedicated to not only salvaging the euro at any cost, but also pushing for fiscal union”.

Ultimately, the Central Bank’s advocacy to adjust and deepen the EMU framework need to be understood, in neofunctionalist terminology, as resolving functional dissonances between the different policy domains under EMU that jeopardised the ECB’s independence and its ability to shield the euro and deliver price stability. Pressures on its independence came as soon as the sovereign debt crisis erupted in May 2010. When French President Sarkozy demanded from ECB President Trichet what essentially amounted to a bailout, Trichet reportedly reacted very strongly, warning that the ECB Governing Council would react very negatively to such pressure with potentially “catastrophic consequences” (Ehrlich 2010; Ludlow 2010).

Some observers saw the ECB’s attitude as ‘business as usual’ (Schmieding 2012: 182), or even ‘inaction’ (Dyson 2013: 217), which may itself have induced further integrative steps (Glöckler et al. 2013: 224). Schmieding (2012:183) has suggested that the ECB was willing to ‘tolerate significant economic and financial stress, as such stress gives politicians a strong reason to fortify their economies through fiscal repair and structural reforms’. Referring to the creation of the EFSF and ESM, de Grauwe (2011: 4) has suggested that this approach
“has forced the euro zone members to create [these] surrogate institutions’. That the ECB’s proportional monetary policy actions (ECB 2012:7) and ‘encouragement’ to deepen EMU were key in this process therefore appears plausible.

**Conclusion**

Neofunctionalism – as a framework for analysing EU economic integration during the crisis – has substantially contributed to our understanding of that process. In particular, it identified crucial driving forces and mechanisms of change. From a neofunctionalist perspective, the management of the crisis resulted in integrative outcomes due to three significant functional dissonances that arose from the incomplete EMU architecture created at Maastricht, based on salient original policy objectives (mainly related to the stability of EMU and safeguarding the euro). The functional dissonances (at least partly) triggered the crisis, which in turn amplified these dissonances. In the absence of credible and sensible alternative solutions, the functional spillover dynamic was reinforced considerably and increasingly shaped the political discourse. In addition to functional pressures, supranational institutions exerted important additional integrative pressure – for example due to skilful policy entrepreneurship by the EP during the six-pack negotiations, as well as the ECB’s insistence on integrative solutions for managing the crisis and dealing with the fiscal and economic governance shortcomings of EMU. Interest groups, which largely advocated further economic integration as a means of solving the crisis, provided further significant integrative impetus by lobbying mainly through Brussels-based umbrella organisations and/or in a co-ordinated fashion transnationally. Still more important was the role of markets, in their own search for economic advantage, uncovered functional dissonances and sanctioned policy-making inactivity and hesitation in terms of finding durable institutional solutions.
The above analysis also makes an important limitation of neofunctionalist theory apparent. Neofunctionalism – in its conventional version that predominantly focuses on the dynamics of integration – struggles to account for the limits of European (economic) integration. For example, that decision-makers have not yet agreed on a fully-fledged fiscal union by now cannot be adequately explained by (mainstream) neofunctionalist theory because it lacks an account of countervailing or disintegrative pressures.\footnote{But see Niemann (2006) for such a revised neofunctionalist framework.}

The seeming continued utility of neofunctionalist theory, the existing potential for further spillover in view of remaining functional dissonances\footnote{For example, a number of elements identified in the Four Presidents’ Report (Van Rompuy 2012) have yet to be dealt with suggesting that the updated EMU architecture still entails potentially significant functional dissonances.}, the tentativeness of parts of the preceding analysis, and the limitations of neofunctionalism to explain certain aspects of economic integration during the crisis suggest that there is considerable scope for further research emanating from this article.

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