Downsizing the Eurozone into an OCA or Entry into a Fiscal Transfer Union

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Last chance to stabilize the eurozone

Since May 2010, three member states of the eurozone have already been supported by the EU rescue measures due to their indebtedness: Greece since May 2010, Ireland since November 2010 and Portugal since May 2011. The most critical candidate is Greece. While the situation in Ireland and Portugal appears to be stabilizing after the implementation of austerity measures, the Greek drama is continuing. The worsening of the economic and political situation in Greece during 2011 forced the partner countries of the eurozone (shortly after the July 2011 package was announced) to strengthen the rescue measures at two consecutive Euro Summits (in October and December) in the hope of making the preliminary 'last' attempt to fix the eurozone crisis. Although Greece was the target of prime importance, the danger of contagion to other EU periphery countries (e.g. Italy) was increasingly a case that deserved attention.[1]

When talking about the current crisis, one should be aware of the fact that there is no 'euro crisis' but a sovereign debt crisis in some of the periphery eurozone countries, in particular in Greece. The recession of 2009 triggered the debt crisis. Since the outbreak of the crisis in early 2010, the euro-dollar exchange rate has remained relatively stable in a band of 1.30 to 1.50.[2] One reason can be seen in the fact that the euro has increasingly gained power and established itself asthe second world currency. In the last ten years, the euro increased its share in global foreign exchange reserves from 18 to 27 percent. Inversely, the share of the US dollar shrank from 72 to 60 percent. Further diversification of Chinas' huge foreign reserves and hence a shift from dollars to the euro could further support the value of the euro in spite of the current financial turbulences (see Breuss, Roeger and in't Veld 2009).

At the December Euro Summit (see Euro Summit 2011B), the Heads of State or Government (HoSG) of the euro area made a 'final' attempt to combat the sovereign debt crisis by agreeing measures to move towards a genuine *'fiscal stability union'* (or an embryonic 'fiscal union') in the euro area (see also below). Besides these longer-term reforms aimed at enhancing economic policy coordination in the EU, some immediate strategies to strengthen the stabilisation tools were also announced at the earlier October Euro Summit as short-term actions to address the current financial market tensions (see Euro Summit 2011A). These include:

- *Increase the firepower of the European Financial Stability Facility (EFSF).*[3] An optimisation (leveraging) of the resources of the extended EFSF, without expanding the guarantees underpinning the facility to have a credit capacity of 440 billion euros (by October 2011 approved by all parliaments of the 17 euro member states). The leverage effect should be up to 4 or 5, which is expected to yield around 1 trillion euros. The terms and conditions of the two concrete 'leverage' options (insurance solution with 20–30 percent insurance quotas and establishing a special purpose vehicle fund) were worked out in detail by the EFSF and had been agreed by the Eurogroup on 29 November

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[1] According to simulations with the IMF Global Projections Model (GPM), the macroeconomic impact on Europe in case of an 'earthquake' scenario would be considerable. A large financial shock that spreads to the entire eurozone and a policy response that falls short, would lead to large financial losses in the periphery which, in turn, would result in banking problems throughout the eurozone. Consequently, eurozone growth would fall by 2.5 percentage points relative to the baseline, while global growth would fall by about 1 percent over 2011–12 (see IMF 2011).

[2] Presently only 17 EU member states are members of the eurozone. Nevertheless, due to a tight tie to the euro (either *via* currency boards or voluntarily), the eurozone has at least four 'shadow members': Bulgaria, Denmark, Latvia and Lithuania. This implies an extended eurozone of 21 member states, leaving out six countries: the Czech Republic, Hungary, Poland, Romania, Sweden and the United Kingdom. These countries are more or less floating their currencies *vis-à-vis* the euro.

[3] The EFSF and from 2012the permanent ESM are new institutional arrangements outside the EU Treaty (in case of the ESM, Art. 136 TFEU was amended). The EFSF is (and the ESM will be) a Luxembourg-registered company owned by eurozone member states according to British Law.

2011. Whether the planned Co-Investment Fund (CIF, which would allow the combination of public and private funding, will get enough response by big international investors (Brazil, China, Japan, Norway, etc.) is an open question. The ECB is ready to act as an agent for the EFSF in its market operations. The EFSF (see Euro Summit 2011B) will remain active parallel to the ESM (European Stabilisation Mechanism) which is to enter into force in July 2012 (instead of July 2013), thus doubling the firepower (440 billion euros plus 500 billion euros).

- *Adjustments to the ESM Treaty:* the decisions taken at the October Euro Summit (see Euro Summit 2011A) concerning Greek debt (a 'haircut' of 50 percent on notional Greek debt held by private investors – primarily banks – should secure the decline of the Greek debt to GDP ratio to 120 percent by 2020, down from presently 186 percent) are unique and exceptional. This is because this 'voluntary measure' proved to be a big mistake because it unsettled the sovereign bond market in Europe. Instead, standardised and identical Collective Action Clauses (CAC) will be included in the ESM. The voting rules in the ESM will be changed to allow a qualified majority of 85 percent in order to include an emergency procedure.
- *Additional financial resources:* euro area member states will consider additional resources for the IMF of up to 200 billion euros in the form of bilateral loans by the national central banks. However, the US government may not support this programme.
- *The latest Greek rescue package:* besides the agreement of a haircut of Greek debt, the eurozone leaders decided at the October Euro Summit that a new EFSF-EU-IMF multiannual programme, financing up to 100 billion euros, will be put in place by the end of 2011, conditional on structural reforms (see Euro Summit 2011A). This package will replace those of July 2011, totalling 159 billion euros (109 billion euros from EFS/IMF and 50 billion euros resulting from the haircut by bank participation). Overall, the new Greek rescue package amounts to 230 billion euros (euro area member states will contribute up to 30 billion euros to the Private Sector Involvement (PSI) package; the haircut amounts up to 100 billion euros; the EFSF-EU-IMF programme amounts to 100 billion euros).
- *Banking rescue packages*: at the October Euro Summit the eurozone leaders also agreed a comprehensive set of measures to raise confidence in the banking sector by (i) facilitating access to term-funding through a coordinated approach at EU level and (ii) an increase in the capital position of banks to 9 percent of core tier 1 by the end of June 2012 (Euro Summit 2011A). National supervisors must ensure that the banks' recapitalisation plans do not lead to excess deleveraging (to avoid a 'credit squeeze').

Following the proposals by Merkel and Sarkozy, the leaders of the Eurogroup decided to embark on a 'fiscal stability union' by more strongly centralising fiscal policy *via* a new 'fiscal compact' (see below). Due to the absence of unanimity among the EU member states (Britain vetoed the new measures), the new rules cannot be implemented by primary legislation (reform of the EU Treaties) but must be implemented by an 'international agreement' to be signed in March 2012, again an intergovernmental action (see also Euro Summit 2011B).

By these steps, the hitherto asymmetric economic policy design of EMU (centralized monetary policy combined with a decentralized fiscal policy, coordinated by the Stability and Growth Pact – SGP) is going to become more symmetric. That means that the gap between the philosophy of 'one market, one money' – the basis of EMU – and the normal formula of a functioning monetary union – 'one country, one money' – will be filled in gradually by the newly planned 'fiscal stability union'. Nevertheless, the final goal of a really functioning monetary union, which – on the EU level – would imply a Political Union, still lies far in the future.

A new fiscal compact aims at establishing a new *fiscal rule,* containing the following elements (see Euro Summit 2011B):

- The general government budget shall be balanced or in surplus (like in the SGP); this principle shall be deemed respected if the annual structural deficit does not exceed 0.5 percent of nominal GDP.
- Such a rule ('debt brake') will be implemented in the EU member states' national legal systems at constitutional or equivalent level. The rule will contain an automatic correction mechanism that shall be triggered in the event of deviation.
- The Court of Justice shall verify the implementation of this rule at national level.
- The EU member states shall converge towards their specific reference level according to a calendar proposed by the Commission.

- The EU member states shall report *ex ante* their national debt issuance plans.
- If the Commission recognises that a member state breaches the 3 percent ceiling, there will be automatic consequences unless a qualified majority of euro area member states is opposed.[4] Steps and sanctions will be ruled by reversed majority voting according to the new Sixpack rules of the SGP-III that entered into force on 13 December 2011. In addition, a numerical benchmark for debt reduction (1/20 rule) for member states with a government debt in excess of 60 percent needs to be enshrined in the new provisions.
- The eurozone leaders will examine the new rules (directives) proposed by the Commission on 23 November 2011 on (i) monitoring and assessment of draft budgetary plans and the correction of excessive deficits in euro area member states and (ii) the strengthening of economic and budgetary surveillance of member states experiencing or threatened by serious difficulties with respect to their financial stability in the euro area (presently the three countries under the rescue umbrella – Greece, Ireland and Portugal; maybe also Italy).
- Euro area governance will be reinforced as agreed at the Euro Summit of 26 October 2011. In particular, regular Euro Summits will be held at least twice a year.

The whole set of new rules in this new 'fiscal compact' outside the EU Treaty raises many legal questions (e.g. are automatic sanctions legally binding; which competence is given to the Court of Justice to intervene in national budgets; which role does the Commission play) that should be clarified by the European Commission by March 2012.

Here for the more medium and long-term reorganization of economic governance (sometimes called 'EU government' in EMU), a number of measures are already in force or in the pipeline (see Breuss 2011; Buti 2011). This enhanced governance should foster fiscal discipline (by the enhanced SGP within the legal measures in the Sixpack; the European Semester; the intergovernmental agreement of the HoSG in the Euro Plus Pact) and deeper integration in the internal market as well as stronger growth (by the agenda of Europe 2020), enhanced competitiveness (two new regulations concerning the surveillance and correction of macroeconomic imbalances in the Sixpack) and social cohesion (new targets in the structural policy). Additionally, a European System of Financial Supervisory (ESFS) with three new European Supervisory Authorities (ESAs: EBA, London, EIOPA, Frankfurt, ESMA, Paris[5]) – already in place since January 2011 – should secure better governance of the financial sector in Europe.

The question arises whether all these heterogeneous measures and initiatives on EU level or outside the EU Treaty really meet the needs to cure the causes of the current crisis in Europe. In the following we shall try to confront the causes and cures of the euro crisis in a theoretical framework based on earlier ideas of the 'optimum currency area' (OCA) theory.

From an economically optimal to a politically suboptimal EMU

Two major causes – partly interrelated – of the present crisis in the eurozone can be identified:

- *Diverging competitiveness:* competitiveness, measured by relative unit labour costs (ULC) of eurozone countries to the eurozone average, drifted apart in the last decade. Germany and Austria steadily improved the countries' cost competitiveness since the inception of EMU, whereas in the periphery countries Portugal, Ireland, Italy, Greece and Spain (PIIGS the competitive position) deteriorated.
- *Indebtedness*: public debt increased dramatically in the PIIGS countries, in particular in Greece. When countries surpass the benchmark of 'sustainability' spreads on newly issued government bonds (also followed by a downgrading by rating agencies), they are in danger of potential default. In this case only bail-out mechanism by the eurozone partners can avoid default.

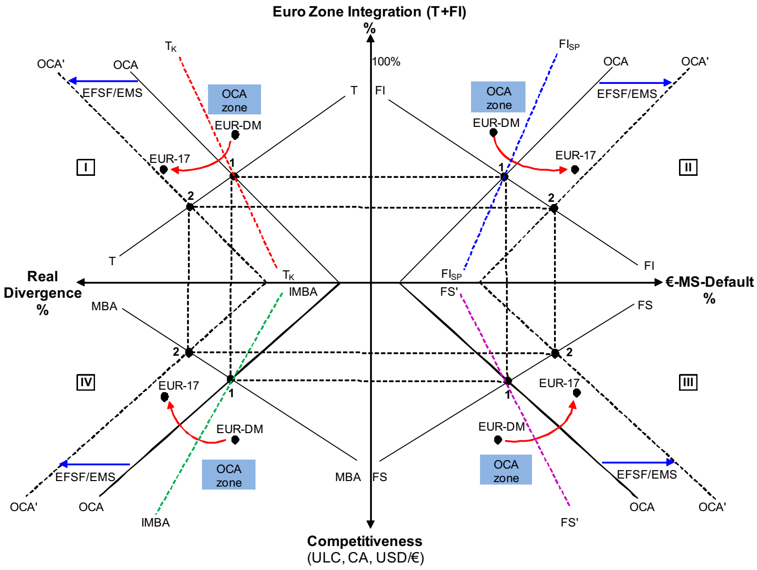
The implications of these two causes of the present eurozone crisis may be discussed with the help of Figure 1, a generalization of the usual graphical treatment of the traditional and/or endogenous OCA theory (see Breuss 2006). The generalized OCA theory of Figure 1 consists of four quadrants with interrelated states of integration in an economic OCA and its deviations due to the shocks of the present crisis in the eurozone. The combination of

[4] The 'automatic' sanctions would, however, require a change of Article 126 TFEU that determines the excessive deficit procedure. If a eurozone member state breaches the rules, sanctions could have no legal basis.

[5] EBA = European Banking Authority; EIOPA = European Insurance and Occupational Pensions Authority; ESMA = European Securities and Markets Authority.

Figure 1

EUROZONE – FROM AN OCA TO A FISCAL TRANSFER UNION



Source: Author's conception.

the numbers 1 in the four quadrants defines equilibrium of an economic OCA. Those of the numbers 2 describe a situation of the present politically created eurozone which can only survive by embarking on a fiscal transfer union.

Quadrant I (upper left side) represents the relationships between real divergence (or alternatively, the increasing failure to form a 'European business cycle' because the economies of the eurozone member states become more and more heterogeneous) and trade integration (T) in the eurozone.

(i) First we have the *European Commission's optimistic view of EMU.* There is a downward sloping line (TT) because as trade integration (T) increases, the degree of economic divergence between the eurozone countries declines. The upward sloping line (OCA) says that more divergence makes EMU more costly (or the costs surpass the benefits). More trade integration reduces these costs. Thus, an increase in real divergence must be compensated by more trade integration to make benefits surpass the costs of EMU. Points on the OCA line are combinations of divergence and integration for which EMU has zero net gains. In the upper area of quadrant I we find countries that, in economic terms, would be sustainable candidates for EMU (the OCA zone). In hindsight, one must confess that only a small group of countries would belong to the OCA zone. The fact that the EU had, for political reasons, created a large EMU instead of an economically sustainable OCA was emphasized by several studies before 1999. The small OCA would have consisted of the countries belonging to the former DM bloc (EUR-DM: Austria, Belgium, France, Germany, Luxembourg and the Netherlands) and eventually also Finland. In any case, the present composition of the eurozone with 17 member states (EUR17) does not form an OCA. Many members of the politically formed EMU were not able to adapt to the new situation of a single currency by increasing their ULC. They could not compensate for the loss of the instrument of currency depreciation, formerly used often to improve competitiveness. In Figure 1, EUR17 therefore lies outside the OCA zone. In this context, one must also state that the forecasts made by the so-called endogenous OCA theory seem to be falsified by the eurozone performance of the last decade. The hope has been disappointed that membership in the eurozone and the promise of increased intra-eurozone trade would automatically lead to less heterogeneity and hence to an urgently needed 'European business cycle'.

(ii) Second, *Krugman's pessimistic view of EMU* could have dominated the most recent performance of EMU. This view is represented by the upward sloping T_K line. According to Krugman (derived from experience in some regions of the United States), more trade integration could lead to more specialization and hence to increasingly removing countries from the OCA zone. Besides the lack of adjustment, this argument could somehow explain the drifting apart of competitiveness in the eurozone. Empirical evidence is scarce, however. Indirect evidence may be found in most recent regional studies (see EU 2011A and 2011B), which identify the periphery countries of the EU as extremely vulnerable concerning globalisation as they are supplying products in international trade with RCA values concentrated in agricultural products and low-tech categories.

Quadrant II (upper right side) represents the relationship between potential default of eurozone countries

(€-MS default) and financial integration (FI) in the eurozone. This quadrant represents the second cause of the present eurozone crisis.

(i) First there is the *optimistic view of EMU.* The line (FI) is downward sloping because, as financial market integration (FI) increases, the probability of eurozone countries' sovereign defaults declines. The upward sloping line (OCA) says that the more eurozone countries are moving towards default, the more the costs of EMU surpass the benefits. An increase in the number of eurozone countries being in sovereign default must be compensated by increased financial integration. In the upper area of quadrant II we find countries that, in financial and fiscal terms, are sustainable candidates for EMU (the OCA zone). Again, the former DM bloc (EUR-DM) countries would belong to this area, whereas the present EUR17 group lies outside the OCA zone. One reason may be that the low interest rates after entering EMU has led to a misallocation of funds and to debt-financed spending in the private and public sectors. Due to lax control by EU institutions and hence the disregard of SGP rules, some eurozone member states have accumulated debt-to-GDP ratios far above the sustainability level – not least Greece.

(ii) Second, we can also interpret the present crisis with a *pessimistic view of EMU.* In the aftermath of the recession of 2009 and after the declaration that Greece had faked its fiscal statistics (for the second time), the spreads of government bonds (*vis-à-vis* German 10-year bonds) exploded and – simultaneously – Greek bonds were downgraded by the rating agencies. The process started with Greece and was followed by the other PIIGS countries. Whereas during the 'fair-weather' period of EMU (from 1999 to 2007) the government bonds of all euro area countries exhibited near-zero spreads, they started to diverge in 2008, implying different default risks. Before the start of EMU, the spreads of the PIIGS had also diverged considerably, mainly due to exchange rate risks. The situation of a weakly integrated financial market (in particular concerning government bonds) is represented by the upward sloping FISP line. In the so-called 'fair-weather' phase of EMU, banks financed budget deficits of eurozone member states under the pretext that all government bonds (those of Greece and Germany alike) would have the same risk. These financing activities were reinforced by the fact that under Basel II (and also under Basel III) rules, government bonds must not be secured with core tier 1 capital.

The eurozone crisis has brought to light the fact that the present composition of the EUR17 group is (at least economically) not an OCA. In order to come to grips with this situation one can follow two options: (i) either the eurozone is re-dimensioned, i.e. some of the problem countries temporarily leave the eurozone[6] or (ii) a fiscal transfer union is started. In the first case, eurozone members will re-introduce their national currencies and improve their competitiveness by depreciation. After having reformed their economies and having reduced their public debt, they could re-join EMU. In the second case, the EUR17 zone becomes a permanent fiscal transfer union, which was not intended in the Maastricht Treaty, manifested in the 'no-bail out' clause of Article 125 TFEU. The several rescue plans for Greece (not to forget those for Ireland and Portugal) indicate that politically the most likely outcome is the fiscal transfer union.[7] Initial steps in this direction were made by the announcement of creating a 'fiscal stability union' (see Euro Summit 2011B). In Figure 1, the bail-out actions of the eurozone member states *via* EFSF/ESM would shift the OCA line towards the left (in quadrant I) and to the right (in quadrant II) to the new OCA' line. If that were the political intention, the present EUR17 group would also belong to the OCA zone.

Quadrant III (lower right side) represents the relationship between potential default of eurozone countries (€-MS default) and competitiveness. An improvement of the latter may come about by reducing unit labour costs (ULC) and hence improving the current account (CA) and/or by depreciating the euro against the US dollar or other currencies.

(i) First we deal with the *optimistic view of EMU.* There is a downward sloping fiscal stability line (FS), i.e. the situation where eurozone member states would follow the SGP rules. Sovereign default can be mitigated or overcome by increasing competitiveness and hence stimulating economic

[6] For the time being, the Lisbon Treaty (Article 50 TFEU) only allows an exit from the EU and hence also from the eurozone but not an exit solely from the eurozone. Therefore we would need a new Article 50a TFEU which allows the temporary exit only of the eurozone.

[7] In a future 'new EU' with a revised EU Treaty one could also think of a 'fiscal transfer union' consisting of the ESM (which could be transformed into a European Monetary Fund – EMF) to intervene temporarily in acute debt problems and a permanent 'fiscal federalism' *à la* the United States and Canada which automatically balances budgetary disequilibria between eurozone member states during the business cycle.

growth. The upward sloping line (OCA) says that the more eurozone countries are moving towards default the more the costs of EMU will surpass their benefits. Increasing competitiveness can compensate fiscal unsustainability. In the lower area of quadrant III there are countries that would be, in competitiveness and fiscal terms, sustainable candidates for EMU (the OCA zone). Again we see a switch from the former DM bloc countries (EUR-DM) belonging to the OCA zone to the present EUR17 country group which is outside the OCA zone with a high potential of default (the outlier is Greece) combined with low competitiveness.

(ii) Second, we can interpret the present crisis situation with a *pessimistic or realistic view of EMU.* In spite of the implementation of the SGP in 1997 and its first reform in 2005, there were always some countries (in 2003–2004 France and Germany did not comply with the SGP rules) that did not fulfil the rules of the SGP. In the 'fair weather' period of EMU (1999–2007) this did not very much hamper the eurozone because the rates on government bonds of all eurozone member states were pretty much the same. Only since the recession of 2009 has public debt exploded and hence also the spreads of government bonds – in particular in the PIIGS. The usual suspects with debt-to-GDP ratios far above the 60 percent benchmark were always Belgium, Greece and Italy. Belgium was able to reduce its ratio from 114 percent in 1999 to 84 percent in 2007. After the crisis it increased again to an expected 99 percent in 2012. In Italy, the debt-to-GDP ratio was 114 percent in 1999 and was then reduced to 103 percent in 2007. After the crisis it increased again to an expected 120 percent in 2012. Greece entered EMU in 2001 with faked fiscal figures and a debt-to-GDP ratio of 104 percent. Whereas other countries reduced their levels during the 'fair weather' period of EMU, in Greece the debt-to-GDP ratio increased to 107 percent in 2007. Since then it has exploded und will reach 199 percent in 2012/2013. The violation of the SGP rules in eurozone member states over time is represented by an upward sloping fiscal non-sustainability line (FS'). Even improvements in competitiveness are associated with an increased probability of debt levels that are not sustainable.[8]

[8] After the recession of 2009 in 23 EU member states, excessive deficit procedures (EDP) were initiated by the European Commission (Greece was excluded as a special case); only in four countries – Estonia, Finland, Luxembourg and Sweden – no EDP was necessary. In 22 out of the 23 EU countries the EDPs were stopped temporarily because of the present crisis.

Quadrant IV (lower left side) closes the general picture of the extended OCA theory. It represents the relationship between real divergence and competitiveness.

(i) First we start with the *optimistic or natural view of EMU.* There is a downward sloping macroeconomic (international) balance line (MBA), i.e. all combinations of real divergence and competiveness which lead to a balanced current account. Real divergence can be overcome and/or improvements towards a 'European business cycle' can be realised by increasing competitiveness. The upward sloping line (OCA) says that the more economies of the eurozone countries drift away from what would be a 'European business cycle', the more the costs of EMU surpass the benefits. Increasing competitiveness can offset real divergencies. In the lower area of quadrant IV we have countries which would ideally form an EMU because their economies move together and they are competitive (OCA zone). Again we see a switch from the former DM bloc countries (EUR-DM) belonging to the OCA zone to the present group of EUR17 countries which lies outside the OCA zone.

(ii) Second, there is again the *pessimistic or realistic view of EMU* if the years since the recession of 2009 are considered. In some countries the real divergence cannot be overcome even through increasing competitiveness (due to the Krugman effect of specialization). This is represented by the upward sloping macroeconomic (international) imbalances line (IMBA). Two new directives of the Sixpack are targeting the imbalance problems in the eurozone. Macroeconomic imbalances have been neglected so far, although they are the second major reason – besides indebtedness – of the current eurozone crisis.

As already discussed in the context of quadrants I and II, we are confronted with the basic question: do we go back to the roots of (economic) OCA criteria that would involve a re-dimensioning or downsizing of the eurozone or must we come to live in a fiscal transfer union in the future? The present rescue activities speak a clear language: the second option is the most probable. In Figure 1 the bail-out actions of the eurozone member states *via* EFSF/ESM shift the OCA line towards the right (in quadrant III) and to the left (in quadrant IV) to the new OCA' lines. By this political will the present EUR17 group would also belong to the OCA zone, artificially and politically but not economically.

Europe *à deux vitesses* due to the eurozone crisis

The 'Greek crisis' is a superb example of the validity of the 'butterfly effect' in the chaos theory: the indebtedness of a small country (the flap of a butterfly's wing on the Acropolis) holds the whole eurozone hostage (sets off a Tornado in Europe). Although the economic weight of Greece, measured by its share of eurozone GDP (2.5 percent) and by its intra-eurozone trade potential (1.5 percent) is negligible, the debt crisis in this country has profound implications for the eurozone. Firstly, because European banks financed the Greek public debt and secondly, the financial (bond) market integration poses the risk of contagion by other PIIGS countries. Ireland (due to its banking problems after the Lehman disaster) and Portugal had already to be rescued by assistance of EFSF, EU and IMF. Italy and Spain have problems in financing their public debt because of increasing spreads for their bonds and because now the rating agencies are taking a keener view on the fiscal performance of these countries.

In addition to its economic and financial implications in Europe, the debt crisis in the eurozone has had already considerable political collateral damage. In six eurozone countries (Greece, Ireland, Italy, Portugal, Spain and Slovakia) either the national parliaments were dissolved and/or the heads of state (prime ministers) had to resign. In Greece and Italy overwhelmed politicians have been replaced by technocrats. Academic economists have become prime ministers.

In light of the feeble and instable political environment in Greece and Italy after the collapse of the governments, the future of the eurozone is gloomy. It appears that there are only two extreme options:

(i) *A breakdown of the eurozone:* this scenario could materialize if a large founding member state like Italy were penalized by the financial markets by excessively high interest rates on government bonds which would make it impossible to refinance the public debt. In this case even the leveraged EFSF would be too weak to bailout Italy. If Italy falls, the eurozone in its present composition is dead. A reduction to the EUR-DM zone would become plausible.

(ii) *Two-speed Europe or two Europes:* this scenario is most likely and a consequence of the numerous bail-out activities starting with the Greek crisis, then continuing with the rescue measures in case of Ireland and Portugal. Due to the urgency, many actions of the eurozone partner countries were *ad hoc* and outside the EU Treaty, some are designed within the EU Treaty and will improve economic governance of the EU in the future.

In any case, the future strengthening of European integration will now take place within the eurozone, widening the gap between ins and outs. The eurozone crisis made it necessary to act quickly (intergovernmental) and *ad hoc,* and to break many legal taboos. Because the crisis affected one of the eurozone member states, the rescue measures were taken and financed only by the eurozone member states:[9]

- *Bail-outs*: the bail-out activities of EFSF/ESM are and will be executed outside the EU Treaty (only ESM will be sanctioned by an amendment to Art. 136 TFEU). Both bodies are companies organized by British law in Luxembourg. The contracting parties and hence financiers are only eurozone member states.
- *Euro-Plus Pact (EPP):* the same is true of the Euro-Plus Pact activities of the HoSG of the eurozone. This pact is organized by a gentlemen agreement in a purely intergovernmental way. Members of the EPP are 17 eurozone member states plus six non-eurozone countries.
- *'Euro economic government':* due to the absence of unanimity (because of Britain's veto) at the December Euro Summit (Euro Summit 2011B), the reform of the EU Treaty had to be circumvented by an 'international agreement' among the 17 eurozone member states which may also be followed by non-euro member states. After this intergovernmental interregnum, the eurozone leaders hope to be able to implement the new rules into primary legislation (a new EU Treaty) later. Again the leaders of the eurozone are starting with a new 'fiscal compact' that should lead to a 'fiscal stability union' with new fiscal rules ('debt brake') implemented in national constitutions, surveillance by the Court of Justice and the right to intervene in national budgetary sovereignty and (quasi)-automatic sanctions. Some elements of this new fiscal pact are already implemented in the reformed SGP within the Sixpack which became effective on 13 December 2011. Also within the budgetary surveillance procedure of the 'European Semester', the direct budget control by EU institutions has already been executed and in some of the PIIGS

[9] The only forward strategy encompassing all EU-27 member states is 'Europe 2020', a strategy for smart, sustainable and inclusive growth. This medium-term strategy should not least also foster competitiveness in the periphery countries of the eurozone.

the budgetary sovereignty has been reduced even further. In the three eurozone countries under the rescue umbrella – Greece, Ireland and Portugal – the 'Troika' (experts of the European Commission, the ECB and the IMF) is monitoring regularly (each quarter) their budgetary plans. That means that these countries are already suffering a loss in their budgetary sovereignty (weakening of the 'king's right' of national parliaments as the Germans like to say). After the G20 summit in Cannes (3–4 November 2011) Italy also stands (preventatively) under the budgetary supervision of the European Commission and the IMF.

Whereas the above mentioned measures are changing the economic governance of the eurozone outside the EU Treaty, hence intergovernmental, the other initiatives in the wake of the Greek crisis target a redesign and strengthening of economic governance (better co-ordination) or sometimes named 'EU economic government' by the reform steps in the Sixpack, Europe 2020 and financial supervisions. These activities are covered by the EU Treaty and therefore cover all 27 EU member states. This is the usual Community method. Whether the approach to deal with the current crisis is intergovernmental (this is adequate in the short term because it allows a faster response to the fast acting financial markets) or by the Community method (which is more democratically founded but takes more time to be implemented, all new EU or eurozone activities aim at avoiding a new Greek catastrophe in the future. The price might be a division of the EU into a 'two-speed Europe'. But in any case, after this crisis we will have a new EU.

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