How Member States Cope with the Eurozone Crisis:

Perceptions, Preferences, Negotiations, and Reform Outcomes

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November 2018

Abstract

This book is part of the larger research project *EMU Choices*, funded by the Horizon 2020 research programme. The project investigates the politics of the reforms enacted during the Eurozone crisis from 2010 to 2015, which, taken together, mark the most significant deepening of European integration since the Maastricht Treaties. The project's publications study national preference formation and the negotiations on the European stage. By elaborating in-depth insights on southern European countries, this book makes an important contribution to the literature. Our chapter summarises some of the findings of the *EMU Choices* research and situates the book within this larger research programme.

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Introduction

The Eurozone crisis unfolding post-2008 and engulfing a number of member states, first, in the financial sector and, second, as a sovereign debt challenge, was of a different kind compared to previous crises in European integration. Some European leaders considered it as a possibly lethal threat not only to the single currency, the centre-piece of the Treaty of Maastricht, but to the European Union as a whole. However well founded this perception may have been, it is generally regarded as triggering the member states' willingness to agree on rescue measures and new preventive and corrective provisions to offset the danger that had hitherto appeared impossible. At the same time, the crisis also unleashed a variety of interpretations about causes and consequences, the non-abiding by the rules established in the Stability and Growth Pact (SGP) becoming the most important case in point.

While rescue operations were carried out through credits and loans disbursed to member states in difficulties to recapitalise their debt on financial markets, SGP rules were reinforced by a number of regulations and one directive to ensure better compliance. They were, however, not considered sufficient. The EFSF/ESM Treaties came with another innovation, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG or 'Fiscal Compact'), as the precondition for disbursement of credits. As both are intergovernmental treaties – thus adding to the hybridity of the EU's institutional setup – they inspire an intergovernmental reading of crisis resolution mechanisms.

These developments in turn raise the question of member states' preferences and positions in the pertinent negotiations as investigated in the Horizon 2020 project *EMU Choices*. The project empirically assesses those preferences, positions and negotiation strategies in the period of 2010 to 2015,with a comprehensive document analysis and expert interviews in Brussels and all 28 member states on national preference formation and policymaking on the European stage regarding specific contested issues, such as the rescue packages for Greece, the size of the ESM, the introduction of a debt brake in national (constitutional) law and the reversed QMV on the Commission's recommendations for sanctioning of fiscal misbehaviour (see Wasserfallen et al. 2019 for a more detailed discussion of the data and the data collection).

The overall goal of the project is to analyse if and how member states' negotiators heed their given national political economy, make concessions and thus compromise on diverse positions. A first important finding on the overall politics of EMU reforms is that the conflict among member states was structured over all reforms on a one-dimensional conflict scale on which supporters of fiscal transfer-opposed countries advocating fiscal discipline. The southern countries and Belgium advocated for more fiscal transfers, whereas the fiscal discipline group includes northern, central, and east European countries, with the Netherlands and Finland as the most extreme counties (Lehner and Wasserfallen, 2019).

This broader picture, derived from a comparative analysis of all EU member states, is explored in further detail herein by examining the politics of the southern European countries, highlighting interesting nuances and differences among this set of member states and contributing important facts to the larger debate. For example, where the ideological controversy between the north and the south from different views on fiscal discipline and growth models dominated much of the public discourse, Southern member states were, with the exception of Greece, quite swiftly prepared to implement measures that did not mirror these ideological differences (Morlino and Sottilotta 2018, Coller and Ramirez de Luis 2018, Lisi and Ramalhete 2018, Katsourides 2018), yet the Greek government formed by the far-left SYRIZA eventually submitted to the harsh conditions imposed by the Troika in return for the loans; such a move was seen as lacking an alternative (Sotiropoulos 2018). As for Malta, it is considered to be an 'exceptional case': first, because Malta owing to its regulations could by and large avoid the crisis of its banking system, and second, because there was consensus among political parties on the need to save the euro (Pace 2018).

This book on southern countries is a central stand-alone aspect of the overall *EMU Choices* project, which generates insights on various aspects of domestic preference formation and negotiations on the European level, studying all 28 member states with quantitative analysis of two comparative datasets and qualitative analysis of about 165 expert interviews. As specialists on southern Europe, the authors of this book have conducted interviews on positions and preference formation in the countries analysed this book. They can thus draw on rich and detailed empirical material.

As such, this book adds to the *EMU Choices* research with further in-depth analyses of six southern countries, of which several were hard hit by the EMU crisis. In this sense, the contributions of this book both further investigate the Southern block as a central player in European negotiations and highlight the area of the Eurozone that was, and still is, facing the most far-reaching social, economic, and political challenges. The focus on southern Europe thus sheds light on an understudied but important aspect of the EMU's challenges.

Drawing on findings about past decisions, the *EMU Choices* project also aims to deliver plausible, if tentative answers to questions about the future prospects of deepening European Monetary and Economic Union as spelled out by the European Commission, the Five Presidents' Reports and other actors. In this regard, the project also scrutinizes which reform proposals or parts thereof may be feasible in the light of member states' visions for the future of the Eurozone and the Union.

Here, a caveat is important: as we are dealing with a moving target due to government changes in important member states, our conjectures are speculative. Unless another 'wicked' crisis occurs, our basic assumption is the following: While major ideological cleavages will still be about risk-sharing versus risk-reduction, redistribution versus fiscal discipline and supranationalism versus intergovernmentalism, concrete solutions are more likely to be pragmatic piecemeal reforms that accommodate some of these diverging interests rather than a major overhaul of the Eurozone's institutional setup based on one dominating ideological stance.

This chapter first sets out to describe the nature of the Eurozone's fiscal and financial crisis and its members' capacity to act; second, it shows in greater detail how member states actually operated, as well as who the drivers were and who the followers in selected examples; third, it will point to possible future controversies about deepening economic and fiscal integration, maintaining the status quo or enhancing differentiation in the Eurozone.

Crisis perceptions, ideological cleavages and compromise

If crises are moments of truth, the question is, what and whose is the truth? Who decides that problems have turned into a serious crisis in which 'existing paradigms, policies, institutional roles and rules' are challenged? When a whole political system may be 'tested and contested', traditional modes of problem-solving no longer work and new ones are yet to be found (Laffan 2016, 916). To what extent is economic integration complemented by political integration (Wasserfallen 2014)? How and how fast do political and economic elites recognize that 'simple' problems have become 'wicked' and that new tools and rules are needed to resolve them (Rittel and Webber 1973)? Who and what frames the cognitive approach to the problem? And last but not least: which interests prevail and which succumb (Puntscher Riekmann 2018)?

A key hypothesis of our project is that national political economy shapes member state preferences and positions, but it also frames the interpretation of given problems and eventually of crises. This was very much so in the case at hand. While financial markets defined the truth at the onset of the crisis, they simply seemed to unveil a much older truth—i.e. that the Eurozone consisted of very diverse (political) economies that had hardly converged since Maastricht, despite the pledges enshrined in that Treaty as well as in the Stability and Growth Pact (SGP) (Hall 2018). While the lack of stabilization mechanisms to compensate for macro-economic imbalances between members states and the risk of asymmetric shocks had been criticized by a number of economists at the single currency's inception (Obstfeld 1999), the builders of the euro thought they may ignore such warnings because the common currency is based on clear rules about debt, deficit and inflation, including the no bail-out clause of the Treaty (Article 125 TFEU) that was to prevent the mutualisation of debt.

Once the crisis became really 'wicked' and this position untenable, several truths came to the fore that were, however, morally weaponized in national political discourse and the media (Dyson 2014). The first truth was that if the Euro was to be saved, the fiscal 'saints' could not wash their hands of responsibility and had to find considerable resources to support the 'sinners' regardless of the gravity of the sin; the second truth was that fiscal sinners would only be granted aid on the condition of passing structural reforms in economic and fiscal policy, and that such truth is to be enshrined in a Memorandum of Understanding and enforced by the Troika, a novel institution formed by the Commission, the ECB and the IMF. The third and at a certain point most decisive truth was that despite its restrictive mandate, the ECB could announce outright monetary transactions and quantitative easing programs to stabilise the single currency. Last but not least, financial regulation was further Europeanised with the so-called banking union.

Although much of the discussion centred on the question of fiscal responsibility and public debts, the main empirical finding of the literature studying the economic causes of the EMU crisis does not point to increasing debts and reckless spending. Instead, increasing imbalances in competitiveness and exports led to accumulated, massive balance-of-payments transfers from the south to the north, which in turn destabilised the Eurozone (Johnston et al. 2014, Copelovitch et al. 2016). Accumulating imbalances drove this massive transfer of money. This analysis of the causes of the Eurozone crisis highlights the problem discussed above—namely that, if anything, the economic structures of the different Eurozone countries became even more distinct after the introduction of the Euro. Rather than leading to a convergence of political economies, the common monetary union has further amplified existing differences. Notwithstanding this quite well-established empirical analysis, the narrative of reckless spending in southern countries as the cause of the crisis is persistent and prominent.

The story of the Eurozone crisis is but another instance of actors shifting truths under pressure. This general wisdom notwithstanding, it is difficult to foresee when actors are capable of such shifts, as these are hard to reconcile with previously held fiscal truths and to communicate to the electorate; in the Eurocrisis, it took almost three years from recognising the problem in late 2009 to Draghi's announcement of 'Whatever it takes' mid-2012. Much depends on whether an integrative or disintegrative framing of crisis interpretation prevails (Falkner 2016, 965) and whether actors have a common purpose (e.g. saving the euro) or at least sufficiently overlapping interests (e.g. the failure of the euro may be detrimental for the whole Eurozone). Finally, it remains to be seen whether this changed mind set is irreversible once the crisis has subsided.

Crisis actions, power and bargaining success

In any case, European leaders did take action based on a mix of truths: aid was granted despite ideological cleavages, but was combined with the older truth of fiscal discipline to be imposed by the Six- and the Two-Pack, including the European semester and, in case of programme countries, by a new institution of disputed legitimacy - the Troika -, whereas opposition to the ECB non-standard measures withered in the light of the Court of Justice of the European Union (CJEU) interpretation of its mandate (Saurugger and Fontan 2017). Moreover, negotiations on the urgently needed Banking Union gathered momentum and were rapidly concluded, even if national 'options and discretions' still exist and a potent backstop remains wanting. EMU was significantly deepened by all these measures.

However, this deepening did not solely serve the interests of the Eurozone's northern core. This is quite surprising, given the widespread belief that the crisis provoked a power shift towards the northern group of Eurozone with Germany at its helm. However, Lundgren et al. (2019) challenge this conventional wisdom with their analysis of the data collected in the *EMU*

Choices project. The empirical findings show the following: first, the negotiations produced no clear winners and losers; in particular, Germany was one of the countries that had to give the most ground to other member states. Second, states' power resources were of limited importance for bargaining success, with more salient factors related to preferences and coalitions. Member states with less extreme and intense preferences were more successful in achieving their preferred outcomes, as were states sharing a coalition with the Commission. Third, the negotiations involved a considerable amount of compromise and reciprocity, with member states trading gains and concessions within and across issues, as they exchanged wins and losses within larger reform packages.

The results of Lehner and Wasserfallen (2019) further suggest that France and Germany, as the leaders of the two opposing coalitions on the question of fiscal transfer versus fiscal discipline, are critical for the negotiation of package deals based on the principles of compromise and reciprocity. In that sense, despite the differences in opinion among southern member states and important nuances discussed in several chapters of this book, they have to form a somewhat cohesive coalition in this larger political environment structured by diverging interests and variations in power. The southern countries also have to build on the power of France as their de facto leader and close negotiation partner of Germany (the leader of the opposing coalition of fiscal discipline advocates). Degner and Leuffen (2019) analyse in more detail the Franco-German integration axis, showing that France and Germany's power is particularly strong in the agenda-setting stage, where policy alternatives are selected to negotiate on the European level (and other solutions blocked).

All of these findings of the *EMU Choices* project add to larger literature on bargaining dynamics and success in EU decision making (Bailer 2004; Arregui and Thomson 2009; Thomson 2011; Golub 2012; Cross 2013; Arregui 2016), providing detailed and systematic results on the dynamics and power constellations in the politics of EMU reforms. While the Eurozone core's (and hence Germany's) willingness to compromise is in line with a tradition of reciprocity and solidarity, one should not forget that 'saving the euro' was a powerful motif that served their interest as much as that of southern states to remain in the Euro. Thus, 'while for sure, the economic woes of the crisis were highly unevenly distributed, the steps taken to resolve the crisis reflected a balancing of gains and concessions leaving no states an unequivocal winners or losers' (Lundgren et al. 2019, XX).

Based on all these findings, we may thus draw some preliminary conclusions: the division between northern and southern member states also implies that reform packages are more likely to garner support if they balance the 'dislikes' of both sets of countries and build on common concern for Eurozone stability and long-term success. Their design is likely to be similar to that of the banking union, which demonstrated that the 'Southern' group can – despite initial opposition – accept deepening supranational governance (introduction of the Single Supervisory Mechanism) if the reform also provides some element that eases fiscal pressures under at least some circumstances (such as the Single Resolution Fund in case of a large bank's failure). The package deal on the banking union was construed as a combination of both aspects that facilitated a compromise based on mutual concessions.

Future Perspectives: What are the chances for EMU reform?

Do *EMU Choices* results allow for predictions about the future development of EMU? The situation in 2018 is not the same as at the apex of the crisis: despite prophecies of doom (e.g. Stiglitz 2016), the Euro and the Eurozone appear to have stabilised, with former programme countries such as Spain, Portugal and Ireland again growing and capable of recapitalising their debt on international financial markets, and Greece hoping to return to normal soon; on the other hand, EMU deepening projects (e.g. transformation of the ESM into an EMF, introducing EDIS in the Banking Union) are still languishing in the Commission's drawers and waiting for member states' willingness to make bolder commitments. The elephant in the room is Italy, in which some large banks still seem to hoard significant amounts of non-performing loans and whose per capita purchasing power is said to potentially undercut that of Spain in the foreseeable future.

At the same time, in 2017, Germany and France's national elections have produced quite divergent outcomes: French elected president Emmanuel Macron who ever since has advocated deeper integration of EMU with a number of far-reaching proposals, whereas Angela Merkel won again the German chancellery but, due to vote losses, finds herself in a weakened position within her party and in the grand coalition with the Social Democrats. Also, at the time of this writing in late October of 2018, she has initiated her retreat from politics by announcing that she will not seek re-election as party leader of the CDU after her party's weak election results in Hessen and Bavaria. The newly elected chair of the CDU will be a major power factor with which Merkel has to coordinate German positions on the European stage. Merkel's response to Macron so far was a call for wait and see, despite the strong commitment to Europe and EMU reforms in the coalition pact.

In early 2018, Italy held an election that yielded a relative majority of the Five Star Movement that formed a government with the Northern League: with some nuances, both parties profess euro-sceptic positions, particularly with regard to fiscal policy. In the fall of 2018, this was epitomised by the row between the Italian government and the European Commission on the Italian budget proposal. The deficit of 2.4% of GDP envisaged therein greatly surpassed the threshold of 0.5% stipulated in the Fiscal Compact and foreseen for countries with large state debt. Finally, Brexit has changed the game, not least by altering negotiations of the EU Multiannual Financial Framework (MFF), as net-payers required to fill the gap upon the departure of the UK and recipient states (particularly CEE members) show no willingness to take cuts in cohesion funds.

The finance ministers of the Nordic and Baltic member states, as well as Ireland and the Netherlands, have formed a common position about EMU. They first claim that discussions about the future of EMU have to be inclusive of Eurozone insiders and outsiders; second, that a 'stronger EMU requires first and foremost decisive action at the national level and full compliance with our common rules', and by building up fiscal buffers in national budgets; third, that initiatives must have public support in member states, whereas the European debate should focus on 'need to haves' instead of 'nice to haves'; fourth, completion of the Banking Union should be given priority and aim at realizing the elements spelled out in the Council Roadmap of 2016; fifth, the ESM should be strengthened and possibly developed into a European Monetary Fund in which 'decision-making should remain firmly in the hands of Member States'; and sixth, the signatories to the document conceive of a post-2020 MFF that helps foster sustainable growth but is aligned with the implementation of structural reforms in which responsibility and ownership lies with member states (Warren et al. 2018).

Thus, talks about the future of EMU have to be analysed against this backdrop. In this regard, EMU Choices data collected in 2016 and 2017 in the 28 member states show two important findings: first, a prevailing preference for the institutional status quo, particularly for working within the existing Treaties, with a European federal vision definitely a minority position (though some sympathy for stronger differentiation); second, with regard to economic and fiscal policy, classical state-led policy is ruled out by almost all interviewees (including states with a long tradition in this respect). A significant majority advocate national public investment to foster growth and employment as well as an ECB monetary policy taking into account growth and employment data beyond price stability.

Reading the two findings together and interpreting them in the current situation, we believe that it is likely that member states will bring about changes to complete the Banking Union but shirk the crucial issue of European Deposit Insurance Scheme (EDIS), and initiate the transformation of the European Stability Mechanism (ESM) into a European Monetary Fund (EMF) but maintain the intergovernmental structure. They are also likely to avoid the more far-reaching ambition of Macron to establish a European Finance Minister who commands greater own resources to foster growth and employment. Thus, on the basis of our data and more recent evidence collected by a new series of interviews in the Permanent Representations, we have reason to conclude that more delegation of powers to the supranational level is unlikely, let alone a concept that would give credit to Macron's vision of European sovereignty.

Most of the articles of the *EMU Choices* research consortium discussed in this book chapter build on liberal intergovernmentalism as 'baseline theory' of integration (Moravcsik 1998, 2018); they apply and extend this 'baseline theory' of EU decision-making with analyses of the project's comprehensive quantitative and qualitative data. Overall, the rich findings of this research program support the notion that liberal intergovernmentalism offers a fruitful starting point for analysing the politics of EMU reform. In contrast, other scholars of the *EMU Choices* research consortium explicitly deviate from liberal intergovernmentalism. This is most evident in the contribution of Csehi and Puetter (2017), who point to the importance of the supranational arena in shaping and reshaping national preferences and also argue that member states might enter supranational deliberations without (strong) national preferences due to a lack of preference articulation, difficulties in preference aggregation and interrupted feedback loops between societal interests and government decision-making.

Conclusions

Our exploration of the data collected through document analyses and expert interviews in the framework of the Horizon 2020 project *EMU Choices* yields a number of interesting results. While the Eurozone crisis finally pushed northern member states to rescue southern member states by installing the EFSF/ESM and to stabilise the Euro by allowing the ECB to set non-standard measures, they complemented these steps by reiterating and sharpening mechanisms to ensure fiscal discipline in secondary legislation with the Six- and the Two-Pack, as well as the intergovernmental Fiscal Compact and its focus on the debt braking rule. Moreover, the so-called programme countries, including southern members and Ireland, had to face policy prescription and close monitoring of implementation by the Troika.

Thus, solidarity came at the price of encroachment on national fiscal, economic and social policy. Both sides were driven by their interests to save the euro and to stay in the Eurozone, whereas financial sector exposure was of significantly higher relevance as political or ideological positions (Tarlea et al. 2019). Measures were a mix of supranational and intergovernmental provisions showing that member states leaped to further deepen EMU, but at the same time reassert their decision-making power in particular with regard to financial aid. As a result, the debates on the following questions are ongoing and will gain salience as soon as some Eurozone members again face economic turmoil: are the enacted crisis measures that recently allowed some hard-hit southern Eurozone members to return to financial normalcy the blueprint for addressing upcoming cries? Can this approach reduce the north and south's economic imbalances, which had not been overcome by the creation of the Euro and were exacerbated in the crisis? Despite all the progress with the substantial reforms enacted during the Eurozone crisis, they will not be sufficient for a sustainable stabilisation of the Eurozone. We should thus expect new crisis politics in the not-so-distant future.

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