Eurozone Governance: Deflation, Grexit 2.0 and the Second Coming of Jean-Claude Juncker

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Introduction

The global financial crisis continues to cast a long shadow over the eurozone and, in spite of an occasional break in the clouds, blue skies remain a distant prospect. As discussed in last year's review (Hodson, 2014), the eurozone's exit in 2013 from its double dip recession provided some grounds for optimism, as did the emergence of Ireland and Spain from their loan agreements with the European Union (EU) and, in the case of the former, the International Monetary Fund (IMF). The eurozone economy continued to recover in 2014 but its recovery was beset by economic and political problems. The principal economic problem was a sharp deceleration in the rate of inflation, driven mainly by falling oil prices, which left the eurozone on the cusp of deflation. The ECB stopped short of fully fledged quantitative easing in its response to falling prices – giving credence to the view that it has been behind the curve in dealing with the euro crisis (De Grauwe, 2011) – but it stepped up its purchases of asset-backed securities and experimented with negative interest rates. If this deflationary scare served as a quiet reminder that the euro crisis was not over, the fall of the Greek government in December 2014 shouted this message from the rooftops. By the year's end, Greece's Coalition of the Radical Left, Syriza, were on the verge of winning power on an anti-austerity platform. Syriza won plaudits at home for promising to put an end to the painful reforms undertaken by Greece in exchange for financial support from the EU and IMF, but its policies cast doubt on Greece's commitment to its international creditors and its fate in the eurozone. This was a dramatic turn of events for Greece, which saw long-term interest rates fall in the first half of 2015 to their lowest levels since 2009, only to see them spike in the second half of the year as the risk of Grexit (Greece's departure from the eurozone) returned (Alcidi et al., 2012; Panagiotarou, 2013).

It was against the backdrop of these turbulent events that Jean-Claude Juncker succeeded José Manuel Barroso as president of the European Commission in November 2014.¹ This was an inauspicious year to change the EU's policy-making guard, but Juncker arrived at the Berlaymont with a wealth of experience after nine years as Eurogroup president and twice as long as Luxembourg Prime Minister. Yet Juncker also had a reputation as a prickly customer, with a particular view of eurozone governance and strained relations with some players in EU policy-making. He also introduced radical reform to the internal governance of the European Commission, which raised questions over its ongoing role in managing the euro crisis.

This contribution takes stock of these and other developments in eurozone governance in 2014. Section I gives an update on the euro crisis, focusing on the reemergence of concerns over Grexit. Section II looks at the economic outlook in 2014 and the factors driving deflation in the eurozone.² Section III explores key developments in eurozone
monetary policy, including the ECB's experiment with negative interest rates. Section IV focuses on financial surveillance in the eurozone and the emerging relationship between the ECB Governing Council and the new Single Supervisory Mechanism. Section V turns to economic policy co-ordination and reviews the Six-Pack's third year in operation. Section VI offers tentative thoughts on what we might expect from Juncker's tenure as Commission president based on his past, and at times problematic, performance as Eurogroup president.

I The Euro Crisis in 2014: Grexit 2.0

The year 2013 provided some breathing space for the eurozone after three years of fiscal turmoil. Mario Draghi's commitment ‘to do whatever it takes’ (Draghi, 2012) to save the euro remained untested but still credible, as evidenced by falling long-term interest rates for Member States at the epicentre of the crisis (see Figure 1). Long-term interest rates, as measured by the yield on ten-year government bonds, provide a proxy for the risk of sovereign default. Since the start of the euro crisis, financial market analysts have treated bond yields of 7 per cent as the dividing line between sustainable and unsustainable debt. Seen in these terms, the fact that yields fell below 3 per cent in Spain, Italy, Ireland and Portugal by the end of 2014 can be seen as a vote of confidence in these countries and the eurozone more generally.

- Figure 1 here -

That Portugal was included on this list was a major achievement for this country, which turned to the EU and IMF in May 2011 after its deficit reduction plans were blown off course by the global financial crisis (see Hodson, 2012). In May 2014, Portugal exited its €78 billion rescue package, leaving it reliant once again on financial markets to service existing debt obligations and raise new loans. Like Ireland in December 2013, Portugal did so without obtaining a precautionary line of credit, which would have provided the country with access to additional loans should the need arise. With government debt in Portugal at 128.9 per cent in 2014, unemployment at 14.2 per cent and real GDP (gross domestic product) growth at 1.0 per cent, this was an economic gamble (Wolff et al., 2014). Yet the domestic political costs of doing otherwise were too high. A precautionary line of credit would have required the government to sign up to certain economic policies with its creditors and Lisbon, like Dublin, preferred the semblance of independence that came with a clean break from its EU–IMF programme to the safety net of further financial support.

Cyprus and Greece are outliers here. The former had yet to regain the confidence of financial markets after entering an EU–IMF programme in 2013 and so its bond yields remained higher in 2014 than for other peripheral eurozone members. Greece's problems were, in the short term at least, of its own political making. Greek bond yields fell below 7 per cent in March 2014 for the first time in four years but they returned to 8.4 per cent by the year's end. The turning point here occurred in May 2014 when Syriza, the Greek Coalition of the Radical Left, won 26.5 per cent of Greek votes in the European Parliament elections, more than any other party. The European Parliament has not been a first-order player in the euro crisis, but this result was significant because it sent a clear signal that Syriza could, and probably would, form the next Greek government.
In September 2014, Syriza's leader Alexis Tsipras put forward a €13.5 billion programme of economic policies that included further haircuts on Greek debt, tax cuts, a minimum wage, subsidized electricity for individuals and improved social security benefits. These proposals proved understandably popular with an electorate that had seen the Greek economy contract by an astonishing 25 per cent between 2008 and 2013. Financial markets, however, were less sympathetic. The problem here was that Tsipras simply failed to convince that a Syriza government could pay for such economic measures, meet its obligations to its international creditors and keep Greece in the euro. Grexit, in other words, was back on the cards.

Questions over Greece's fate in the eurozone ceased to be hypothetical when, in December 2014, Greek Prime Minister Antonis Samaras brought forward by two months a parliamentary vote for a new president of the Hellenic Republic. Why Samaras did not wait here is unclear, but the move triggered a general election when Stavros Dimas – a former European commissioner and the governing coalition's candidate for president – failed to win the required super-majority in the Greek Parliament. It seems doubtful that Samaras’ government could have hung on for its full term, which was due to expire in 2016, but its mishandling of the presidential election was badly timed. Having begun 2014 with falling bond yields amid talk of exiting its EU–IMF programme or negotiating a third but smaller financial support package, Greece found itself facing rising bond yields and a general election by the year's end. Syriza emerged as the largest party in the January 2015 election and by the time it had formed a governing coalition with the Independent Greeks, a populist right-wing party, Greek bond yields had reached double digits once again. In consequence, the euro crisis entered a new and deeply worrying phase in which the future of the single currency was once again in doubt.

II The Economic Outlook: Recovering Slowly but Unsurely

The eurozone's economic recovery continued in 2014, albeit tentatively (see Figure 2). Real GDP in the eurozone increased by 0.8 per cent in 2014, which was an improvement on the −0.5 per cent growth rate recorded in 2013, but still disappointing. The United States, in contrast, saw real GDP rise by 2.4 per cent in 2014. A key difference between the two economies (see Figures 2 and 3) was domestic demand, which increased by just 0.8 per cent in the eurozone in 2014 compared to 2.5 per cent in the United States. Looking at some of the components of domestic demand, the eurozone lagged behind the United States in terms of private rather than public consumption, which is illustrative of weaker consumer confidence and higher unemployment in Europe. A puzzle for the eurozone is why external demand, which was so vital to its recovery from the great recession of 2009, is declining. In 2012, net exports of goods and services to eurozone growth contributed 1.4 percentage points to real GDP growth. In 2014, this figure had fallen to 0.1 percentage point. This reversal is linked to a cyclical slowdown in the world economy since 2010, although longer-term structural shifts might be at play. One such shift is that China is now importing fewer parts and components as part of its production of goods to be exported to the rest of the world, which suggests that the Chinese economy is no longer the same turbo-charged engine of global trade that it once was (see European Commission, 2015; Mattoo and Ruta, 2015).
As always, the economic performance of eurozone members varied (see Figure 4). Real GDP in France and Germany increased by 0.4 per cent and 1.5 per cent respectively in 2014. For France, weak domestic demand and a negative contribution from net exports underlined president François Hollande's failure to boost growth in spite of his turn towards ‘supply-side socialism’ in 2014. Germany's recovery in 2014 was primarily built on domestic demand, which was out of character for a country that has long relied on export-led growth (Hall, 2012). A falling savings rate, perhaps in anticipation of rising wages, appears to have been a key factor here.

Elsewhere in the eurozone, 2014 was the year in which Greece, Portugal and Spain resumed growth after protracted recessions. Spain's growth performance was particularly striking, with falling prices encouraging greater consumption in spite of very high rates of unemployment. Two eurozone economies saw real GDP contract in 2014: Cyprus, where fiscal consolidation continues to take its toll, and Italy, which saw its comparatively strong export performance offset by a sharp contraction in domestic demand. Latvia, which became the 18th EU Member State to join the eurozone in January 2014, saw real GDP growth slow from 4.2 per cent to 2.6 per cent, due, in part, to the country's exposure to a sharp depreciation in the Russian rouble (European Commission, 2015, p. 88).

Unemployment remains a defining problem for the eurozone. In the eurozone as a whole, the unemployment rate fell from 12.0 per cent to 11.6 per cent, a modest fall but the first in six years (see Figure 5). Within the eurozone, nine members recorded unemployment rates in excess of 10 per cent in 2014 and, of these, two saw rates in excess of 24 per cent. The Member States in question, Greece and Spain, saw their unemployment rates fall in 2014. The resumption of growth in 2014 in these countries undoubtedly helped. Spain's performance in dealing with this labour market crisis is the more impressive of the two. A set of labour market reforms adopted in 2012 which make it cheaper for firms to dismiss workers on permanent contracts while promoting a more decentralized approach to collective wage bargaining won high praise from the Organization for Economic Cooperation Development (2014) for promoting greater flexibility, as well as criticism for their wider economic and social consequences (Navarro, 2014).

Perhaps the most worrying economic development in 2014 was the sharp fall in the inflation rate, from 1.4 per cent to 0.4 per cent (Figure 6). Falling energy prices were the key driver of this downward adjustment, with the cost of a barrel of Brent crude oil falling from around $111 in December 2013 to around $62 a year later. Falling prices reflect the slowdown in the world economy but they cannot be explained by demand-side factors alone. On the supply side, the effect of geopolitical instability in Libya and Iraq on oil production was much less than anticipated. Important too is Saudi Arabia's refusal to cut oil production, a decision that is seen by more conspiratorially minded commentators as an attempt to destabilize Iran and scupper shale gas production in the United States (Bazzi, 2014). Whatever the reasons behind falling oil prices, they brought the eurozone close to deflation in 2014. A sustained fall in price levels has some benefits, of course, but it means higher real interest rates
and hence is a scenario to be avoided for those eurozone Member States that are already struggling to pay down government debt.

- Figure 6 -

In the eurozone as a whole, the budget deficit as a percentage of GDP fell from 2.9 per cent to 2.6 per cent and government debt increased from 93.1 per cent to 94.3 per cent (see Table 1). Of 18 eurozone members, 11 found themselves with government borrowing below the excessive deficit procedure's 3 per cent of GDP threshold, although government debt as a percentage of GDP was in excess of 60 per cent in 13 countries. Fiscal consolidation was most severe in Greece, which saw its budget deficit fall from 12.2 per cent in 2013 to 2.5 per cent in 2014. In spite of this fact, Greek government borrowing increased from 174.9 per cent to 176.3 per cent in this period. Posting a positive primary balance (i.e. a measure of government borrowing that excludes interest repayments) is a conventional indicator of a country's ability to reduce its government debt. In 2013, Greece, Ireland, Portugal and Cyprus all posted primary surpluses for the first time since the sovereign debt crisis hit. This fact is testament to the considerable fiscal consolidation undertaken by these countries, even if these efforts were not sufficient to convince markets that the euro crisis is over (see Section I).

- Table 1 -

### III Monetary Policy: All eyes on the ECB (Again)

Faced with sharp falls in price levels and forecasts of deflation, the ECB came under considerable pressure in 2014 to go further in its response to the euro crisis. Conventional monetary policy had little room for manoeuvre here, the ECB Governing Council having cut the interest rate on its main deposit facility nine times since the global financial crisis struck in 2007. As a result of these cuts, the interest rate on the main deposit facility reached zero in November 2013. In spite of historically low nominal interest rates, the European Commission's monetary conditions index for the euro area tightened in 2013 and the early months of 2014 (Figure 7). This index is a weighted average of real interest rates and the real effective exchange rate. The real interest rate is defined here as the nominal interest rate minus anticipated consumer price inflation and the real effective exchange rate measures changes in euro area unit labour costs relative to key trading partners. The monetary conditions index fell (i.e. tightened) between July 2012 and February 2014, chiefly because the euro-area real effective exchange rate experienced sustained appreciation over this period. If a rise in the euro exchange rate thus countered the effects of low nominal interest rates, the risk of deflation threatened to make matters worse by causing real interest rates to rise too. It was against this backdrop that the ECB Governing Council decided in June 2014 to cut the interest rates on its main deposit facility to −0.1 per cent, followed by a further cut to −0.2 per cent three months later.  

- Figure 7 here -

Monetary Conditions Index, Eurozone, January 1999–December 2015. The ECB is not alone in embracing negative interest rates in the wake of the global financial crisis – Denmark, Sweden, and Switzerland have taken similar steps – but
this is an experimental move nonetheless (Ilgmann and Menner, 2011). Practically speaking, it means that commercial banks holding deposits at the European Central Bank will be charged for this service rather than receiving an interest payment. The rationale for this switch is to encourage commercial banks to lend to individuals and businesses rather than keeping their money in central banks and to incentivize consumption and investment by individuals and businesses. Negative interest rates can also serve as a spur for exchange rate depreciation as investors sell domestic for foreign currency in search of higher rates of return on their investment. The gains from negative interest rates are by no means guaranteed and an additional concern here is that they could harm the profitability of banks, especially those that are heavily dependent on deposits to finance loans. It is too soon to judge the effects of negative interest rates in the euro area but it may have encouraged a depreciation of the euro real effective exchange rate in the second half of 2014 and, hence, a loosening of monetary conditions. Negative interest rates certainly proved to be unpopular with Germany's public banks, the Sparkassen, which criticized the ECB and put pressure on the German government to support savers (Ross and Jones, 2014).

Negative interest rates are an interesting experiment but they are most certainly not a panacea for the eurozone. For one thing, there are limits to how far into negative territory interest rates can go, even though economists disagree on what the true lower bound on interest rates actually is. Furthermore, negative interest rates are just one of several unconventional monetary policies considered by the ECB in 2014. Others include a four-year targeted long-term operation (TLTRO) launched in June 2014 and designed to provide over €400 billion in additional liquidity support to euro-area banks. A policy response that was much debated in 2014, but not realized until early 2015, was quantitative easing: the large-scale purchase of public and private bonds by the central bank, financed through the expansion of its balance sheet. ECB president Mario Draghi dropped a strong hint that the bank was moving in this direction in his speech at the Annual Central Bank Symposium in Jackson Hole in August 2014. In this intervention, Draghi expressed concerns over rising real interest rates and announced that ‘The Governing Council will acknowledge these developments and within its mandate will use all the available instruments needed to ensure price stability over the medium term’ (Draghi, 2014).

In September 2014, the ECB Governing Council put forward new instruments in the form of its Asset Backed Securities Purchase Programme (ABSPP) and an Expanded Covered Bond Purchase Programme (CBPP3). Under these programmes, the ECB agreed to buy a wider range of private bonds over a two-year period in order to ‘facilitate credit provision to the euro-area economy, generate positive spill-overs to other markets and, as a result, ease the ECB's monetary policy stance’ with the overarching aim being ‘a return of inflation rates to levels closer to 2 per cent’. This statement is an interesting one for ECB watchers since it recalls discussions in the early days of Economic and Monetary Union (EMU) about the existence of a deflationary bias in euro-area monetary policy (Arestis and Sawyer, 2001). In October 1998, the fledgling ECB Governing Council agreed on a quantitative definition of price stability as ‘a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2 per cent’ (ECB Governing Council, 1998). The ECB Governing Council provided further guidance here in June 2003 when it announced that it would seek to maintain inflation rates ‘below, but close to, 2 per cent over the medium term’ (ECB, 2003). This clarification was, in one sense, a fudge
that satisfied the hawks on the ECB Governing Council by keeping the original asymmetric definition of inflation while offering a more symmetric clarification to the doves. Providing greater clarity at this juncture might have cleared the way for quantitative easing by the ECB, which arrived only in January 2015 when the ECB Governing Council unveiled its Expanded Asset Purchase Programme. Under this scheme, the ECB finally agreed to the large-scale purchase of bonds issued by euro-area governments, agencies and institutions, some seven years after the US Federal Reserve had embarked on a similar course of action.

IV Financial Supervision: The Strange Case of the Single Supervisory Mechanism

The year 2014 was another high-stakes one for eurozone financial supervisors. In October 2014, the ECB published the results of its so-called comprehensive assessment of the eurozone's biggest 130 banks (ECB, 2014). The first part of this assessment involved an asset quality review to determine whether these banks were sufficiently capitalized. Twenty-five banks failed this test. Twelve of these institutions had already taken sufficient steps to increase their capital, the ECB concluded, but 13 others from Italy, Greece, Belgium and Slovenia were required to take immediate remedial action. The second part of the assessment was a stress test that sought to establish whether the eurozone's banks could withstand unfavourable economic shocks. Here the ECB, working with national authorities and the European Banking Authority, concluded that such a scenario would deplete banks’ so-called common equity tier 1 capital – a key proxy for the financial strength of an institution – by not more than minimum requirements. Euro-area banks, in other words, were adjudged to be in a position to withstand hard economic times. The comprehensive assessment was not the game-changer that the United States government's stress test in 2009 seems to have been (see Geithner, 2014, for an insider account). For some commentators, the ECB erred by failing to consider a large deflationary shock as part of its stress tests, but the exercise was otherwise deemed credible (Arnold et al., 2014). The ECB certainly did a better job here than the EU's Committee of European Banking Supervisors. In 2010, the latter, which was later transformed into the European Banking Authority, conducted a euro-wide stress test that provided a clean bill of health to Allied Irish Bank just months before Ireland's second largest financial institution required recapitalization by the government.

The Single Supervisory Mechanism (SSM) began operating in November 2014, 12 months after EU finance ministers and the European Parliament agreed on the legislation underpinning the bank's new role in EU financial supervision. As discussed in last year's review, the Single Supervisory Mechanism entails a significant transfer of powers to the ECB when it comes to the supervision of financial institutions. As of November 2014, the ECB assumed responsibility for ‘contributing to the safety and soundness of credit institutions and the stability of the financial system within the EU and each Member State’. This means, in practice, that the ECB will be responsible for licensing financial institutions, enforcing prudential standards and carrying out supervisory reviews. And yet, in spite of – or, more accurately, because of – the wide-ranging scope of these powers, the ECB's control over the Single Supervisory Mechanism has been heavily constrained by national governments.
For students of EU governance (see Wallace et al., 2014), the Single Supervisory Mechanism is a curious exhibit. Situated within the ECB's decision-making structures, the Single Supervisory Mechanism also operates at one remove from the bank. A Supervisory Board is responsible for the day-to-day functioning of the Single Supervisory Mechanism and for preparing decisions to be approved by the ECB Governing Council. The Supervisory Board's right of initiative here is powerful; the ECB Governing Council is able to object to, but not modify, draft decisions by the Supervisory Board and – under the so-called principle of non-objection – the ECB Governing Council has no more than ten days to register objections before draft decisions by the Supervisory Board take effect.

If this approach limits the ECB's authority over the Single Supervisory Mechanism, then so too do the procedures for appointing members to the Supervisory Board. The chair is not an internal appointment made by the ECB Governing Council. Instead it falls to the ECB Governing Council to propose a candidate on the basis of an open procedure who is then approved by the European Parliament and confirmed by the Council of the European Union. The Vice Chair of the Supervisory Board is chosen from the members of the ECB Executive Board but the chair cannot be a member of either the ECB Executive Board or the ECB Governing Council. The other members of the Supervisory Board include four representatives of the ECB and a representative from each national financial supervisor, this being the national central bank in some cases or a government agency in others. As such, national representatives exercise an even stronger grip on the ECB Supervisory Board than is the case with the ECB Governing Council.

The ECB's control over the Single Supervisory Mechanism is also limited by a strict division of labour between European and national authorities over the direct supervision of financial institutions. The Single Supervisory Mechanism has overall responsibility for the supervision of around 4700 financial institutions but it is directly responsible for the supervision of only around 1200 significant entities. Significance is determined by a set of criteria that covers: credit institutions with total assets exceeding €30 billion; those with assets below €5 billion but which account for 20 per cent of national GDP; the three most significant credit institutions in a Member State irrespective of these criteria; those institutions that are being directly supported by the European Stability Mechanism; and those with significant cross-border assets and liabilities. Those credit institutions that do not fall within this category are supervised directly by national supervisors, albeit under the gaze of the ECB.

A final way in which the ECB's powers over the Single Supervisory Mechanism are constrained concerns the conduct of supervisory missions. Day-to-day supervision is carried out by so-called Joint Supervisory Teams, which include officials from both the ECB and national supervisors. Each team will be led by an ECB official and their work will be supported by the bank's newly created Directorate General for Micro-Prudential Supervision IV. In spite of such support, it is clear that national supervisors will play a decisive role in the supervision of even significant financial institutions in their own countries.
V Economic Policy Co-ordination: Softly Goes the Six-Pack

For Scharpf (2013, p. 12), who has been as a vocal critic of EU economic governance, it can be ‘treated as given … that the Fiscal Pact and the Six-Pack and Two-Pack regulations have strengthened, rather than relaxed, the rules preventing the use of expansionary fiscal policies at the national level’. As discussed in recent reviews (Hodson, 2011a, 2012, 2013, 2014), the track record of EU economic surveillance following these reforms calls for a closer look at this issue. Member States have been subject to no shortage of peer pressure but none have faced financial penalties since the reforms took effect, and most countries have been given a margin of flexibility to get government borrowing under control. The interim conclusion, then is that the Six-Pack, Fiscal Compact and Two-Pack are softer than they look. It is important to note, however, that ‘softer’ does not mean ‘weaker’ here, since a system relying on peer pressure and flexible interpretations of compliance can be more credible than harder forms of co-ordination. A recurring problem for the latter is that pecuniary sanctions impose costs on the sender as well as the target, and they can also lead more easily to a breakdown in co-operation between the parties involved (Hodson and Maher, 2004).

Events in 2014 confirmed this ‘soft’ interpretation of EU economic governance in the light of the global financial crisis. Out of the 11 eurozone members that found themselves with excessive deficits at the beginning of the year, four – Belgium, the Netherlands, Austria and Slovakia – saw disciplinary proceedings brought to a close after the Commission and ECOFIN Council agreed that government borrowing in these countries had fallen below 3 per cent of GDP. Six of the remaining states – Cyprus, Spain, Greece, Ireland, Portugal and Malta – faced no additional sanctions, EU authorities being content that these Member States had taken sufficient action in response to earlier calls for corrective action. The only problematic case in 2014 was France, which the Commission adjudged to be at ‘significant risk of non-compliance with the recommended fiscal effort [by EU finance ministers] both in 2013 and 2014’ (European Commission, 2014, p. 3). The French government was duly invited to come forward with additional measures designed to get government borrowing under control in its stability programme, which it presented to the Commission in May 2014. Acting on the recommendation from the Commission, the ECOFIN Council concluded in June that France's ‘stability programme broadly responded to the Commission recommendation’.

VI The Future of Euro-Area Governance: The Return of Jean-Claude Juncker

In November 2014, Jean-Claude Juncker took office as the 12th president of the European Commission, having served as Prime Minister of Luxembourg from 1995 to 2013. Juncker's appointment signified change and continuity in the selection procedure for Commission presidents. It was novel insofar as Juncker was first put forward by the European People's Party as a candidate for the Commission presidency as part of the Spitzenkandidaten process (Hobolt, 2014) rather than emerging as a compromise candidate after negotiations between EU heads of state or government.
Juncker's appointment was also a conservative move that resulted, yet again, in the Commission president being chosen from the (recent) ranks of the European Council. Between 1958 and 1994, only one out of eight Commission presidents had previously served as a head of state or government, although all had held senior positions in government. Since 1995, all four Commission presidents have served as Prime Minister of their country before coming to Brussels. This tendency may reflect the increased complexity of leading the Commission in the post-Maastricht period, but only partly so. It can also be seen as an attempt by the members of the European Council to appoint ‘one of their own’ to the Berlaymont rather than an unknown quantity. Martin Schulz, the Socialists and Democrats' candidate for the Commission president and someone who rose through the ranks of local politics before becoming a member of the European Parliament, would have been a much more controversial choice here – so much so, in fact, that the heads of state or government might not have agreed to his appointment had the Socialists and Democrats come top in the European Parliament elections.

Juncker is not only an alumnus of the European Council; he also has a close personal connection to eurozone governance from his time as the Eurogroup's first ‘permanent’ president (2004–13). What, in the light of this turbulent time in this role (see Hodson, 2011b), can we expect from Juncker's presidency of the Commission in relation to EMU? First, and perhaps most fundamentally, Juncker has a track record of flexibility in relation to the enforcement of the EU's fiscal rules. One of his first major contributions as Eurogroup president was to chair talks between euro-area finance ministers over the reform of the stability and growth pact following the ECOFIN Council's de-facto suspension of disciplinary measures against France and Germany in 2003. Juncker played a critical and pragmatic role in these negotiations by convincing France and Germany to recommit to the effective and timely enforcement of the excessive deficit procedure by giving Member States more time to get government borrowing under control and by ensuring that financial penalties would be used only in extremis. While this compromise has been judged harshly in the light of the euro crisis, such criticism forgets that most Member States had reduced government borrowing below 3 per cent of GDP by the time that the global financial crisis struck.

A second observation is that Juncker is likely to be a much less emollient figure than his predecessor as Commission president, José Manuel Barroso. Aside from a high-profile spat with French president Jacques Chirac over the European Constitution, Barroso developed a reasonable working relationship with key players in EU politics during his ten years in the Berlaymont. As Eurogroup president, Juncker had run-ins with several key players. One was with ECB president Jean-Claude Trichet, who bristled at Juncker's willingness to speak out against interest rate increases in late 2005 and the Eurogroup president's attempts to foster a closer dialogue between euro-area finance ministers and the bank (Hodson, 2011b, chapter 3). Juncker also clashed with French president Nicolas Sarkozy over France's budget plans, and on the more fundamental question of who should speak for the eurozone; such tensions may explain Sarkozy's decision to block Juncker's appointment to the position of European Council president in 2009. Relations between Juncker and Angela Merkel, meanwhile, got off to a bad start when the former reportedly failed to brief the then German opposition leader about his plans in 2003 for an integrated defence policy between Belgium, France, Luxembourg and Germany. Certainly, Merkel seems to
have been a late convert to Juncker's candidacy for Commission president, with the German Chancellor refusing to endorse the former Luxembourg Prime Minister even in the immediate aftermath of the European Parliament elections in May 2014. It is tempting to put these spats down to personality – and Juncker's sarcastic style wins friends as well as foes – but they stem from the Luxembourger's attempt to show leadership on the European stage rather than, as Barroso so often did, to follow the lead of others.

Third, Juncker has a track record of seeking to enhance the euro area's role on the international stage. One of his more successful initiatives as Eurogroup president was his monetary diplomacy towards China (Hodson, 2011b, chapter 7). In November 2007, the Eurogroup dispatched Juncker to Beijing for talks with Chinese officials on the persistent depreciation of the renminbi against the euro after China ended its peg with the dollar to years earlier. The results of these talks were inconclusive, but they provided an instance in which euro-area members showed themselves to be capable of speaking with one voice on international issues. Diplomatic initiatives of this sort are more difficult in multilateral settings, where EU Member States are over- rather than under-represented and supranational actors struggle to gain traction. Juncker learned this first-hand in 2010 when he was not invited to attend the landmark leaders’ summit of the Group of Twenty (G-20) summit in London, the EU delegation being led by the president of the European Council. Juncker was an advocate of a more unified approach to the external representation of the euro area even before this snub. In July 2009, he tried but failed to convince euro-area finance ministers to support the idea of creating a single chair on the IMF Executive Board.

Seen in this historical context, the five priorities adopted by Juncker in April 2014 – in what was, in effect, a manifesto for his Commission presidency – read like a list of leftover business from his time as Eurogroup president. They include proposals to ‘re-balance the relationship between elected politicians and the European Central Bank’, the creation of a ‘full-time’ presidency for the Eurogroup, a concern for social impact alongside fiscal sustainability and moves to strengthen the eurozone's voice in the IMF. Commission presidents do not make the political weather of course and it remains to be seen whether Member States will support Juncker's plans to reform euro-area governance.

Juncker's presidency of the Commission – like those of his predecessors – hinge on whether his political aims for euro-area governance are aligned with those of the large Member States. Important too will be his management style within the European Commission. On the first of these points, the Juncker presidency began with a radical change to the internal structures of the European Commission. Like Barroso, Juncker has sought to exercise a high degree of control from the centre via the president's cabinet and strong secretariat, but the latter has also sought to use vice-presidents to constrain his other commissioners. The appointment of Pierre Moscovici as European Commissioner for Economic and Financial Affairs, Taxation and Customs was a controversial move given the French finance minister's mixed track record of compliance with the stability and growth pact. Significant, however, was the decision to appoint former Latvian Prime Minister Valdis Dombrovskis as Vice President for Economic and Monetary Affairs and the Euro. Moscovici finds himself tightly constrained by this arrangement; decisions for the College relating to EU economic co-ordination and surveillance – including any disciplinary measures against France –
must now be jointly presented with Dombrovskis. A key question for the Juncker presidency is whether such constraints will slow decision-making in the Commission and whether the new vice-presidential veto players will allow Juncker to make his own mark on EMU and other policy issues.

A final issue to consider here when looking at Juncker's role in euro-area governance concerns his relations with Donald Tusk, who succeeded Herman Van Rompuy as president of both the European Council and the Euro Summit in December 2014. Van Rompuy played a key role in euro-area governance following the global financial crisis, helping to broker a deal over the involvement of the EU and IMF in providing emergency loans to Greece and leading on negotiations over the Six-Pack, the creation of European banking union and wider reforms of euro-area governance. Institutional tensions between Van Rompuy and Barroso arose from time to time but they formed an effective working relationship. On paper, there is a potential imbalance between Tusk, a former Prime Minister of a non-euro area member, with Juncker, a self-styled founding father of the euro area and veteran of the European Council. That said, euro-area heads of state or government did not have to choose Tusk and the fact that they did may, as Puetter (2014) argues, be a calculated effort to build a bridge between euro and non-euro area members. Tusk also brings credibility by virtue of his successful stewardship of Poland's economy in recent years and his close working relationship with Angela Merkel and, as a politician from Central and Eastern Europe, brings more bite to the EU's dealings with Russia at a time of ongoing tension over the conflict in Ukraine. Key political decisions on the future of euro-area governance will, in any event, flow through the European Council and here Tusk will be at a distinct institutional advantage over Juncker.

**Conclusion: One Step Forward, Two Steps Back**

A student was late for class one icy day and, when asked by the teacher to explain himself, replied: ‘It was so slippery that every time I took one step forward, I slid two steps back’. ‘Then how did you get here?’ asked the teacher. ‘I tried to go home’, said the student. As in this story, the eurozone took one step forward in its recovery in 2014 only to take two steps back towards crisis. On the positive side, the eurozone economy grew in spite of lacklustre external demand thanks to a tentative pick up in domestic demand. Welcome too was a sense of renewed financial market confidence in Portugal, which exited its EU–IMF programme, and Ireland and Spain, which continued to recuperate from their sovereign debt difficulties. On the down side, falling oil prices pushed the eurozone closer to deflation. Deeply worrying for the single currency too was the fall of the Samaras government in Greece in December 2014. This paved the way for Syriza's general election victory in January 2015 on an anti-austerity platform, a result that brought hope to some and fear to others, and fuelled concerns over Grexit for all.

Eurozone authorities responded to these challenges with a combination of ingenuity and conservatism. The ECB rarely sits still during crises, but nor does it move quickly. True to form, then, was the ECB Governing Council's decision in 2014 to embrace negative interest rates alongside more ambitious private bond buying schemes while stopping short of government bond purchases. Fully fledged quantitative easing – of the kind witnessed in the United States in 2008 – would come to the eurozone only in January 2015. The ECB, meanwhile, carried out its new
responsibilities for eurozone financial supervision through its stress tests of eurozone banks, which were credible without being conclusive, and with the launch of the Single Supervisory Mechanism. On the fiscal side, events in 2014 lend weight to the hypothesis that the EU’s fiscal rules are softer than they look, as evidenced by the leeway given to France in getting government borrowing under control.

The year 2014, finally, saw José Manuel Barroso make way for Jean-Claude Juncker as president of the European Commission. Barroso was a consensus candidate and a consensus-seeker who worked with the heads of state or government rather than seeking to forge a particular path for the eurozone following the global financial crisis. Juncker is an altogether more divisive figure. His presidency owes more to the Spitzenkandidaten process rather than the usual smoke and mirrors of EU summits and, as such, his relationship with the heads of state or government is more than usually complicated. How Juncker will adjust to this new role remains to be seen. He brings to the Berlaymont significant experience of eurozone governance from his time as Eurogroup president but also political baggage from his sometimes difficult dealings with other leaders. The former Luxembourg Prime Minister has already made his mark on the Commission through controversial reforms to the College that are likely to affect the EU executive's role in euro-area governance.

Footnotes

1. See Dinan's contribution to this volume.
2. On developments in the European economy as a whole see Benczes and Szent-Ivanyi's contribution to this volume.
5. Between June and September 2014, the ECB also cut the interest rates on its main refinancing operations and marginal lending facility to 0.05 per cent and 0.30 per cent respectively.
9. See Dinan's contribution to this volume.

References


Figure 1: Bond Yields for Selected Eurozone Members, 2007-2014

Note: 10 Year Government Benchmark Bond Yields

Source: ECB Statistical Warehouse

Figure 2: Real GDP Growth and Selected Components, Eurozone 2007-2014

Source: European Commission AMECO database
Figure 3: Real GDP Growth and Selected Components, United States 2007-2014

Source: European Commission AMECO database

Figure 5: Real GDP Growth, Eurozone and its Members 2013 and 2014
Figure 6: Inflation Rate for the Eurozone and its Members 2013 and 2014

Note: Annual change in Harmonized Index of Consumer Prices

Source: European Commission AMECO database
Figure 5: Unemployment Rate in the Eurozone and its Members 2013 and 2014

Note: Unemployment as a percentage of the civilian labour force.
Source: European Commission AMECO database

Figure 6: Monetary Conditions Index, Eurozone, January 1999 - December 2015

Note: Real interest rates (RIR), Real Effective Exchange Rate (RIR) and Monetary Conditions Index (MCI)
Source: European Commission
Table 2: Governing Borrowing in the Eurozone and its Members as % of GDP, 2014

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<th>Net Lending</th>
<th>Government Debt</th>
<th>Primary balance</th>
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Source: European Commission AMECO database.