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Abstract

The Eurozone crisis and the refugee crisis are showcases of the problems associated with the EU's shift from market integration to the integration of core state powers. The integration of core state powers responds to similar functional demand factors as market integration (interdependence, externalities and spill-over) but its supply is more tightly constrained by a high propensity for zero-sum conflict, a functional requirement for centralized fiscal, coercive and administrative capacities, and high political salience. We show how these constraints structured the initial design of EMU and Schengen, made them vulnerable to crisis, and shaped policy options during the crises: they made horizontal differentiation unattractive, re-regulation ineffective, centralized risk and burden sharing unfeasible and the externalization of adjustment burden to non-EU actors necessary by default. In conclusion, we explore possible escape routes from the trap.

Keywords

Eurozone crisis, refugee crisis, neofunctionalism, liberal intergovernmentalism, core state powers

1. What's new?

Moments of extremity allegedly reveal 'the essence of a situation' (Gerring 2001). What does the extremity of first the Eurozone and then the refugee crisis reveal about the essential situation of the EU? The answer suggested by most political science analysis is: nothing that we do not already know. Crisis management is presented as European business as usual, if only at a very high-pitch. Neofunctionalists duly report evidence of spill-over dynamics, supranational agency, endogenous preference change, and a functional upgrading of EU institutions (e.g. Niemann and Ioannou 2015; Niemann and Speyer, this volume; Schimmelfennig 2014). Liberal intergovernmentalists find ample proof of asymmetric interdependencies, issue-specific distributive conflict, power-based bargaining, and institutional designs enhancing commitment to unpopular European policies (e.g. Schimmelfennig 2015; Zaun, this volume). All this is true as far as it goes but relegates much of what appears new and distinctive about the crises to the unexplained boundary conditions of the analysis. Puzzling questions remain unaddressed:

- Why was the level of domestic politicization so high? It is now common to assert that the years of permissive consensus are over in which insulated political elites could cut deals on integration. Political leaders increasingly have to 'look over their shoulder when negotiating European issues' to secure mass support (Hooghe and Marks 2008: 5; Grande and Kriesi 2016). Why did this development come to a head during the two crises?
- Why were the distributive implications of the crises so intractable? Distributive conflict is ubiquitous. The EU has developed a broad range of techniques for dealing with it (see Falkner 2011 for a recent catalogue). Still, it was unable to settle the conflict over risk and burden sharing at the heart of both crises. Why?
- Why didn't we see more differentiated integration? Scholars and policy makers consider the (self-)exclusion of unwilling member states as a prime tool for managing an increasingly heterogeneous Union (e.g. European Commission 2017; Leuffen *et al.* 2013). Why then was the exit of individual member states more often seen as a threat than as a solution during the crises?
- Why did the EU rely so extensively on outside help? Standard theories of integration assume that all EU business is transacted by EU-actors. Yet, non-EU actors including the International Monetary Fund (IMF) and Turkey played a prominent role during the Eurozone and the refugee crises. Why this strong reliance on the kindness of strangers?

We claim that the key to answering these questions and to understanding the novelty of both crises is the distinction between market integration and the integration of core state powers. Market integration is the EU's traditional rationale. Yet most integration activities since the 1990s concern the integration of core resources of sovereign government (money and fiscal affairs, defense and diplomacy, border control and internal security). The Eurozone crisis and the refugee crisis highlight the specific problems associated with this new field of integration: a strong functional demand for integration coupled with tight political constraints on supply. Policy options that work in market integration are unattainable or dysfunctional in the integration of core state powers. Intergovernmentalism and neofunctionalism do not help much to understand this difference because they focus on variance in the institutional mechanisms of integration (supranational vs. intergovernmental) but neglect variance in the integration field. The purpose of this paper is to show how the general features of a particular integration field, core state powers, shaped the European choice of policy options during the Eurozone and the refugee crises. These general features explain why the basic policy choices were surprisingly similar despite obvious differences between the crises, and why they differed in distinct ways from the patterns known form, and theorized for, market integration.

As we argue in section 2, the integration of core state powers responds to similar functional demand factors as market integration (interdependence, externalities and spill-over) but its political supply is more constrained by a high propensity for zero-sum conflict, high political salience, and a functional requirement for centralized EU capacities. In section 3, we show how these three factors shaped the original institutional design of the European Monetary Union and the Schengen[1] regime. This design made both regimes vulnerable to crisis, as we demonstrate in section 4. The following sections analyze how the functional demand for integration and the specific difficulties of supply conditioned the choice of policy options for crisis management. We focus on four options in particular: horizontal differentiation (section 5), re-regulation or centralized risk and burden sharing (section 6) and the externalization of adjustment burdens to non-EU actors (section 7). We conclude by a scenario analysis of the future of the EU.

2. Market integration vs. integration of core state powers

Neofunctionalism and liberal intergovernmentalism are usually treated as rival theories of integration. Yet, the apparent ease with which both theories can claim the Eurozone and the refugee crises as supporting evidence warns against overdramatizing conceptual differences (Hooghe and Marks 2008: 3–5). Indeed, both theories share three important assumptions.

First, interdependence creates a functional demand for integration (Moravcsik and Schimmelfennig 2009; Sandholtz and Stone Sweet 2012): sector-specific interdependencies between states cause externalities and spill-over effects; externalities and spill-over effects in turn imply collective benefits from supranational policy coordination; these benefits are then reaped through integration. Integration proceeds if, and to the extent that, it increases efficiency and collective welfare. It is the institutional means of collective problem-solving under conditions of complex interdependence (cf. Keohane 1984).

Second, integration is mostly supplied by pooling regulatory sovereignty, i.e. by harmonizing national rules and regulations at the EU level. Delegation to supranational agencies is limited, serving mainly to support regulatory integration through centralized monitoring, enforcement, and adjudication. Institutions such as the Commission and the Court of Justice (CJEU) fill in the details of, and provide credible commitment for, the EU's incomplete regulatory contracts (see Hooghe and Marks 2015 on pooling and delegation). They enjoy extensive regulatory but limited material power: the EU is not a positive but a regulatory state (Majone 1997).

Third, the political supply of integration is not automatic mainly because distributive conflict between governments impedes agreement on common European rules. Yet, to the extent that a joint interest in managing interdependence exists, both approaches are quite optimistic about the prospects of conflict resolution. Neofunctionalism highlights conflict management by an 'upgrading of common interests' (Haas 1964): the Commission talks governments into compatible visions of their national interests (Jabko 2006) or mobilizes transnational interest groups to break national resistance (Sandholtz and Stone Sweet 2012); the Court overcomes decision-blockades by unilateral hierarchical decisions (Burley and Mattli 1993). An important precondition is insulation from mass politics. Elite-centered decision-making facilitates the socialization of decision-makers into an integration-minded, problem-solving attitude and denies self-perceived victims of integration a political platform for obstructionism (Haas 1964: 81). This allows for significant advances of integration even under conditions of a constraining dissensus (Niemann and Ioannou 2015; Niemann and Speyer, this volume; Schimmelfennig 2014).

Liberal intergovernmentalism emphasizes conflict solution by power-based distributive bargaining (Moravcsik 1998). Conflicting interests cannot simply be redefined or forgotten but have to be accommodated. Yet, as long as the common interest in integration dominates, the probability of

[1] For lack of a better term, this is how we refer to the policies related to the abolition of internal border controls, common external borders, asylum and migration policies.

compromise is high. Differentiated integration, i.e. the self-exclusion of preference outliers who are unwilling to integrate, or the exclusion of member states with capability deficits who are unable to contribute to integration (Leuffen *et al.* 2013) may facilitate agreement. If disagreement prevails nevertheless, this is not because the member states were unable to overcome it but simply because the prospective joint gain was too small to make it worth their while. In a slightly Panglossian way, what EU member states can agree on substantively is interpreted as what they need functionally to strive and survive under conditions of interdependence (Moravcsik 2002).

In sum then, neofunctionalism and liberal intergovernmentalism share a remarkable functional optimism regarding the supply of integration. This optimism reflects the area of integration that both theories were originally calibrated to explain: market integration. Market integration is associated with distributive conflicts, modes of integration and mass politics conducive to smooth extension and development. The distributive conflicts involved are often limited and dominated by joint gains from trade. Under a broad range of assumptions, trade liberalization benefits all participating states (even if not always to the same extent). Disagreement over the shape of market regulations can be settled on the basis of the largest common multiple, i.e. by aggregating contradictory policy preferences into 'endless lists' (De Muth cited in Majone 1996: 64) of regulatory requirements imposed on market actors. This facilitates conflict resolution by both the upgrading of common interest and by power-based distributive bargaining.

Also, market integration proceeds mainly in the mode of regulatory unification: trade-impeding national regulations are harmonized by EU legislation, by CJEU case law or by regulatory competition. No major delegation of administrative, fiscal or coercive capacities is required. The EU can operate on a small budget, with a lean central administration and without any coercive powers of its own. This keeps integration low key and comparatively unintrusive. This, finally, helps to sustain a permissive consensus on integration: mass publics are largely disinterested because market integration does not affect their distributive interests or identity in any direct and dramatic way.

The functional optimism of neofunctionalism and liberal intergovernmentalism appears less plausible with respect to core state powers. Core state powers refer to the action resources deriving from the state's monopoly of legitimate coercion and taxation: military force, police power, border control, public revenue, administrative might (Genschel and Jachtenfuchs 2014)[2]. Since these resources are essentially limited, the distributive conflicts involved in the integration of core state powers tend to be more pronounced than in market integration: every Euro of public revenue can only be spent once; every border guard can only be at one place at a time; every administrator can only be assigned so many tasks. This increases the likelihood of zero-sum conflicts, leaves little room for agreement on the largest common multiple, and, hence, decreases the likelihood of conflict solution by an upgrading of common interests or by power-based distributive bargaining.

Also, regulation is a less effective tool of integration in core state powers than in market integration because compliance costs fall squarely on the member states rather than on market actors. Playing by the European rules can require a substantial investment of fiscal, administrative or coercive capacities. If national capacities are scarce, even willing member states cannot comply. Hence, to a higher extent than in market integration, compliance is a matter of ability rather than willingness. This ability may be impaired by integration itself, for instance, because it magnifies exogenous shocks or amplifies asymmetric interdependencies that raise the risk of country-specific shocks. Hence, the regulatory integration of core state powers needs to be backed up by European level capacities for burden sharing to insure member states against the risk of excessively high compliance costs (Schelkle 2017). The regulatory state is not enough for the integration of core state powers. Their integration requires a modicum of a positive state, i.e. the creation of centralized fiscal, administrative and coercive

[2] Incidentally, the focus on state resources is what distinguishes our concept of core state powers most clearly from the concept of 'high politics' which focuses on a particular subset of state policies (e.g. Hoffmann 1966).

capacities at the EU level. Yet, their creation is likely to fuel distributive conflict among the member states: who pays for and who benefits from the joint resources?

Finally, mass publics tend to be highly attentive to the integration of core state powers. Their distributive interests are directly affected if the EU draws on their tax money, their security services or their border guards for creating EU capacities and achieving EU policy goals. The likely result is to pit national publics against each other. Also citizens' sense of identity is directly affected. The state monopoly of force and taxation is at the heart of the national social contract: tax duties, welfare entitlements, military or other public service obligations, immigration rules and naturalization laws define who belongs to the national community and who doesn't and what community members owe to each other. The integration of core state powers thus raises salient issues of European statehood, national community and democratic self-determination. This facilitates political mobilization, boosts the audience costs of integration and increases the probability of a constraining dissensus.

Importantly, just because the supply of integration is difficult does not mean that there is no functional demand for it. As the following case studies show, the EU is propelled into the integration of core state powers by similar interdependencies, externalities and spill-over dynamics as in market integration. Yet, unlike in market integration, the demand is met by inadequate supply both pre-crisis and during the crisis.

3. The pre-crisis status quo: regulatory integration and horizontal differentiation

After the spectacular failure of the European Defense Community in 1954, the EU refrained from core state powers and focused on market integration instead. Yet, the completion of the Single Market in the early 1990s created spillovers, real and imagined, that finally thrust the EU into core state powers nevertheless: one market allegedly required one money plus supporting fiscal and economic policy integration (European Commission 1990); the elimination of internal frontiers required a common border management regime for the external border. Mindful of their inner core, the member states refused to integrate these policies by European state-making. A unified EU government with extensive fiscal powers and coercive control over European borders was not in the cards. Instead, the EU opted for integration by regulation and by horizontal differentiation.

Integration is regulatory in the sense that the EMU and Schengen regimes leave debts, taxes, border checks, and asylum procedures entirely in national hands but submit their exercise to common European rules. To be sure, EMU started with a dramatic act of capacity building: the creation of the new European Central Bank (ECB). Yet, the Treaties tightly constrained the ECB's powers in order to prevent any supranational encroachment on national budgets and economic policies: Art. 123 TFEU prohibits the monetary financing of public debts; Art. 125 bans fiscal burden sharing among member states or with EU institutions ('no bail out'); Art. 127 essentially restricts the ECB's mandate to the maintenance of price stability. In effect, these articles deny the ECB the power for which central banks have historically been invented: the power to act as a lender of last resort to government. In order to curb fiscal externalities and preempt fiscal crises that could trigger demand for a lender of last resort, EMU submits national budgets, debts and deficits to tight European surveillance under the Stability and Growth Pact (SGP).

Also Schengen leaves it to each individual member state to control access to the EU territory and to handle issues of immigration, refugee protection and asylum provision. It just provides a regulatory framework for policy coordination: The 'Dublin Regulation' (604/2013) assigns responsibility for processing asylum claims to the member state of the asylum seeker's first entry into the Schengen area in order to prevent buck passing; Art. 67 TFEU provides for the harmonization of national practices in asylum, immigration and border control in order to prevent a downward spiral in national standards and venue shopping by immigrants, refugees and other claimants. In marked contrast to the ECB, the

Schengen agencies (Frontex, the European Asylum Support Office (EASO) and the Asylum, Migration and Integration Fund) are fairly small, weak and intergovernmental in structure.

EMU and Schengen are both based on horizontal differentiation (Leuffen *et al.* 2013; Winzen 2016). Not all member states participate: some because they are *unwilling* such as Denmark, Sweden and the UK in EMU, or Ireland and the UK in Schengen, others because they are *unable*. EMU membership is premised on the fulfillment of 'convergence criteria' in order to prevent member states with unsustainable fiscal policies from joining prematurely. For the same reason, applicants to Schengen have to undergo a 'Schengen evaluation'.

4. System Failure in EMU and Schengen

EMU and Schengen were built on regulatory integration and horizontal differentiation. This was politically convenient for getting integration started (Genschel and Jachtenfuchs 2014: 252; Genschel and Jachtenfuchs 2016: 49–50). The (self-)exclusion of unwilling or unable member states reduced the distributive conflicts involved. The focus on regulation dampened domestic politicization by keeping the façade of national authority over fiscal policy and border control intact, and by providing formal fairness among the member states (the same EU rules apply to all). Yet, regulatory integration failed to ensure effective policy coordination and to contain harmful externalities, leaving both systems fragile and vulnerable to shock. We highlight three sources of failure: low compliance, regulatory gaps, and insufficient European risk and burden sharing.

Whereas compliance is remarkably high in market integration, some see *low compliance* in core state powers as a main cause of the two crises (e.g. Börzel 2016). Half of the Eurozone was in 'excessive deficit', i.e. did not comply with SGP requirements (Eyraud *et al.* 2017: 18; Hallerberg 2014: 93) even before the Eurozone crisis started. Likewise in Schengen, low compliance with the Dublin regulation (requiring Schengen states of first entry to process asylum applications) predated the crisis. As the Commission complained: 'the track record of implementation of EU law in the field of asylum is poor' (COM(2016)270: 4). Why?

One cause contributing to low regulatory compliance in core state powers is that compliance costs fall squarely on member state governments, and not, as in market regulation, on market participants. Governments are more sensitive to the cost implications of regulation and more willing to consider non-compliance to avoid them. Also third party enforcement is weaker than in market integration. In core state powers, there is no functional equivalent to exporters suing national governments in national courts for non-compliance with Single Market rules (Stone Sweet 2004). Refugees lack incentives to sue governments for not enforcing EU regulations that would limit their own freedom of movement. Tax payers lack the means to sue governments for non-compliance with the SGP because enforcement lies with the Council, not the CJEU. Bond markets were initially hoped to enforce SGP compliance through higher risk premia for fiscally profligate member states, yet failed to do so, as indicated by the general convergence of sovereign bond rates across the Eurozone until shortly before the crisis (Scharpf 2016: 35). Finally, the unequal distribution of compliance burdens also contributed to low compliance. Obviously, the Dublin regulation is much cheaper to implement for landlocked states than for states exposed to large numbers of incoming refugees (Heijer *et al.* 2016: 613). Likewise, Northern 'export-led' economies are better placed to implement the SGP than Southern 'demand-led' economies because fiscal restraint is part of the former's growth model while the latter rely on occasional macroeconomic expansion to sustain growth and employment (Iversen *et al.* 2016; Johnston and Regan 2016; Scharpf 2016). The obvious unfairness made it difficult to insist on full compliance by all.

Yet, even full compliance would not have ensured policy consistency because *regulatory gaps* in the SGP and the Common European Asylum System (CEAS) left many important interdependencies unregulated. The SGP's exclusive focus on fiscal imbalances and its ignorance of imbalances in the rest of the economy is now often seen as a contributing cause to the debt crisis (e.g. de Grauwe and Ji 2014; Eichengreen 2012; Scharpf 2016). Apart from Greece, the problem in the Eurozone periphery was not public but private overindebtedness, fueled by cheap credit and massive capital inflows facilitated by EMU: 'Financial problems created the fiscal imbalances, rather than the fiscal imbalances creating financial problems as was assumed by the architects of the Stability and Growth Pact' (de Grauwe 2013: 161–162; Eichengreen 2012: 128). The CEAS's focus on harmonized minimum standards for the identification, reception, protection and recognition of asylum seekers stopped a long way short of creating a level playing field for asylum seekers in the Schengen area (Heijer *et al.* 2016; Slominski and Trauner, this volume). Perhaps most importantly, it failed to address any of the socio-economic conditions affecting asylum seekers' locational preference, including the size and composition of pre-existing refugee communities, national income levels, employment rates, wages, welfare institutions and education systems.

A final cause of regulatory failure in EMU and Schengen was *insufficient burden and risk sharing*. Neither scheme planed for member states being unable, rather than unwilling, to comply. The SGP sanctions intentional non-compliance but fails to provide insurance for cases in which member states face a crisis of confidence in bond markets because they do not fully control the currency in which their national debt is denominated, i.e. the Euro. During the Eurozone crisis, this has driven member states towards default in a self-fulfilling manner, as risk-averse investors shift their Euro-denominated assets out of perceived high-risk and into low-risk Eurozone states. As discussed in section 3, this lack of mutual insurance was fully intended in order to curb moral hazard and incentivize fiscal rectitude. Yet, the Greek crisis broke nevertheless and the Eurozone lacked readymade instruments to contain it. Likewise, Schengen lacked a robust insurance mechanism against the risk that sudden increases in refugee numbers overwhelmed the capacity of border states to process and protect, or the willingness of popular host states to accept asylum seekers. When refugee numbers rapidly increased in 2015, there was no mechanism for spreading the burden from the directly affected border and host states to the more fortunate rest of the Schengen area.

EMU and Schengen failed for systemic reasons: Due to low compliance and regulatory gaps, they failed to prevent the outbreak of crisis; due to insufficient risk and burden sharing, they failed to facilitate crisis management. Differentiated integration hardly helped. While it kept *unwilling* member states securely out, neither the 'convergence criteria' nor the 'Schengen evaluation' stopped the accession of member states which subsequently proved *unable* to comply with the rules and policy requirements of EMU and Schengen, including, most prominently, Greece.

In sum, EMU and Schengen were 'fair weather systems'. When the Eurozone crisis and the refugee crisis broke, the EU was unprepared and had to develop coping strategies on the go. In principle, it had the choice of four distinct options. First, further horizontal differentiation: EU member states could cut their losses and either exit from EMU or Schengen or force others to exit. Second, regulatory tightening: EU member states could improve regulatory compliance and close regulatory gaps in order to finally achieve the policy coordination already intended by the SGP and the CEAS. Third, European capacity building: member states could create European risk and burden sharing arrangements in order to provide the collective insurance mechanisms ex post that EMU and Schengen failed to provide ex ante. Finally, externalization of crisis management: EU member states could tap into the capacities of non-EU actors to externalize part of the adjustment burden and bypass internal decision blockades.

5. Temporary differentiation

While horizontal differentiation had been an important means to get EMU and Schengen started, it was not very important for coping with the Eurozone or the refugee crisis. To be sure, Cyprus and Greece introduced capital controls in 2013 and 2015 respectively in order to stem impending bank runs. Austria, Belgium, Denmark, France, Germany, Hungary, Slovenia and Sweden reintroduced internal border controls to reduce refugee inflows in 2015. Yet, all these measures were temporary.

Proposals for a permanent exit from the Eurozone or Schengen failed to gain traction even though ideas to kick, alternatively, Greece or Germany out of the Euro, or to shrink Schengen to a hard core of countries around Germany were well covered in the press.

On the face of it, the disregard of horizontal differentiation as a crisis management tool is surprising. Exit from the Eurozone and Schengen promised benefits for both the exiting and the remaining states. The former would gain enhanced policy autonomy and freedom from troublesome cross-border interdependencies, the latter would benefit from facilitated agreement on common policy measures and a lighter overall problem burden. Yet, these benefits were associated with considerable costs (Eichengreen 2010; Schimmelfennig 2014; Niemann and Speyer, this volume).

First, national exit devalued the *sunk costs* tied to EMU and Schengen: Private parties stood to lose to the extent that their savings, investments, logistics and life plans were premised on the Euro and the absence of internal border checks; governmental elites risked a loss to the extent that their income, reputation and career prospects derived from their role in running either EMU or Schengen. Actors in exiting member state would suffer most. But actors in remaining member states would also lose because the benefits of integration (increased price transparency and financial deepening in the case of EMU; increased cross-border mobility and transnational value chains in the case of Schengen) would be restricted to a smaller geographical area.

Second, differentiated integration was associated with substantial *economic risks*. The exit from, or breakup of the Eurozone threatened Northern export-led economies like Germany with currency appreciation and declining exports while Southern demand-led economies such as Italy would face higher interest rates reflecting the return of devaluation risks (e.g. Eichengreen 2010). Even the Euro-exit of small Greece and tiny Cyprus was considered a huge economic threat because of anticipated knock-on effects on much larger Southern member state such as Italy or Spain, and on big Northern banks heavily exposed to Southern debt. The breakup of Schengen was associated with the risk of reduced trade, travel and economic growth (Bertelsmann Stiftung 2016) even though the sense of impending economic catastrophe was more muted (European Council on Foreign Relations 2016).

Finally, there were *political risks* to consider. Given its causal and symbolical significance, even a partial disintegration of the Eurozone would have left the European project badly bruised: ‘If the Euro falls, Europe falls’ (Angela Merkel). Large popular majorities in all Eurozone member states (including Greece) preferred keeping the Euro despite the sobering experience of the debt crisis (Eurobarometer 85 2016: 32). The breakup of Schengen threatened another palpable achievement of European integration (travel without border controls): ‘the end of Europe’ (François Hollande cited in Niemann and Speyer, this volume). Despite widespread complaints about the ‘surge’ in refugee numbers, a common European policy on migration continued to receive strong popular support (Eurobarometer 85 2016: 35).

In conclusion, all member states, debtors and creditors, border and host states, shared an endogenous interest in preserving the Eurozone and the Schengen area intact (Schimmelfennig 2014: 328–329). Governments were loath to write off the sunk costs tied to integration and to sacrifice the known advantages and problems of integration for the unknown benefits and risks of disintegration. While horizontal differentiation can facilitate integration *ex ante* by excluding problematic member states (unable or unwilling), it hardly helps with the handling of integration-induced crises *ex post*. Disentangling oneself (or others) from existing integration schemes is simply much more difficult and costly than never joining in the first place.

6. Re-regulation vs. capacity building

A joint interest in the preservation of integration does not guarantee a consensus on how to preserve it. In both crises, intergovernmental agreement on common coping strategies was hampered by a stark distributive conflict between two fairly consolidated camps, one favoring the creation of European capacities for risk and burden sharing, the other favoring tight regulations. The latter had more bargaining power but the former had the functional requirements of integration on its side. The result of this standoff was a mix of extensive, but not necessarily effective, re-regulation and insufficient capacity building.

The first camp consisted of the *unfortunate* governments directly and immediately hit by the crisis (i.e. governments of debtor countries, states with exposed borders, overrun host states). They viewed crisis management as a common responsibility of all Eurozone or Schengen states, and objected to having to bear a disproportionate share of the joint adjustment burden. The second camp included the *fortunate* governments, one step removed from the brunt of the crisis (i.e. governments of creditor states, and of Schengen states with few refugee arrivals). In their view, the main cause of the crises was policy failure in the directly hit states, i.e. lack of economic and fiscal discipline, lax monitoring of external borders, and irresponsible largesse by host countries attracting even more refugees to come. In general, the fortunates refused to share the costs of what they saw as others' mistakes. In their view, crisis management required primarily policy reforms in directly hit countries and improved compliance with EU rules.

Each camp had a clear policy preference. The unfortunates called for European burden sharing, either through intergovernmental transfers (e.g. bilateral debt forgiveness, multilateral emergency funds, joint relocation mechanisms for refugees, administrative assistance) or, preferably, through the creation of genuinely supranational capacities (e.g. Eurobonds, Eurotaxes, a European border and coast guard). These new burden sharing capacities would provide the mutual insurance mechanism ex post that was missing in the original EMU and Schengen frameworks ex ante. The fortunates opposed joint capacity building and burden sharing because it would subsidize the policy failures of directly hit states (moral hazard) and prevent correction. Instead, they advocated stronger European regulations forcing member states to reform policy failures, and reduce harmful externalities for others. More and better monitoring and enforcement would enhance compliance; more and better rules would close regulatory gaps (e.g. macroeconomic imbalances (EMU); safe countries of origin (Schengen)).

Bargaining between both camps was complicated by the zero sum perception of the conflict and by high domestic politicization. In the short run, at least, the conflict seemed to concern the distribution of finite resources: '[F]or every European who would profit' from debt forgiveness or joint Eurobonds, 'there is a German who would lose' (Marsh 2013: 11); for every refugee relocated out of one member state, there is a refugee more in another member state. Zero sum conflicts are difficult to solve under the best of circumstances. Domestic politicization made agreement more difficult still. Governments in Southern debtor countries faced opposition from populist left-wing parties scandalizing the national 'enslavement'[3] by Northern creditors. In the North, governments faced right wing populists opposed 'to pay for all of Europe' (in the words of *Bild*, the German tabloid).[4] Governments in border and host states with high refugee arrivals were pressed by public opinion to extract more solidarity from the rest of Schengen. In Eastern member states, by contrast, public opinion cringed at the notion of sharing the costs of Western multicultural sentimentality.

To be sure, distributive conflict and domestic politicization did not stop collective decision making: the Eurozone and the Refugee crises both triggered an outburst of joint decision making (Börzel 2016). Regulatory decision making was facilitated by the power advantage of the fortunate camp. Its bargaining power generally exceeded that of the unfortunate camp because its policy preference for tighter EU regulation was closer to the status quo of regulatory integration than its opponent's preference for more European solidarity and capacity building. Yet, to the extent the crisis was caused

3 https://yanisvaroufakis.eu/2015/08/18/bailout-deal-allows-greek-oligarchs-to-maintain-grip-the-guardian/, accessed January 2017.

4 http://www.bild.de/politik/wirtschaft/muessen-wir-am-ende-fuer-ganz-europa-zahlen-14762122.bild.html, accessed January 2017.

by the inability, rather than just the unwillingness, of unfortunate member states to abide by the rules and avoid harmful externalities, tighter regulation was not a very effective crisis management tool. Decisions on capacity building and burden sharing were potentially more effective but less likely politically, given the power disadvantage of the unfortunate camp. Such decisions prevailed only at the most extreme moments of crisis when the survival of integration seemed to depend on manifest solidarity between the member states.

The regulatory response to the Eurozone crisis was particularly pronounced. Under the so-called six-pack (2011), the fiscal compact (2012) and the two-pack (2013), the member states agreed on various measures to improve the monitoring of member state compliance, strengthen enforcement and extend the scope of EU regulation to 'macroeconomic imbalances' (external accounts, net investment shares, private debt, housing prices, unemployment rates, etc.). The regulatory response to the refugee crisis is comparatively more modest but also more recent. In autumn 2015, the Commission started a large number of infringement procedures to strengthen the enforcement of existing CEAS regulations. It also tabled a 'European Agenda for Migration' (COM(2015)240) listing various proposals for reforming, extending and better implementing Schengen's regulatory framework. Proposals include a new monitoring system for the CEAS, a strengthening of the returns directive, the expansion of the safe country of origin directive, the reform of the Blue card directive on regular migration and the implementation of common standards for border management.

The effectiveness of these diverse regulatory measures was limited. They did not reduce the collective adjustment burden but simply shifted it to unfortunate member states directly exposed to market speculation or high refugee inflows. For instance, the fiscal regulations adopted in the wake of the Eurozone crisis trapped the debtor countries of the Eurozone in a bad equilibrium in which high interest rates, deep budget cuts, severe economic depression, failure to meet regulatory targets and lack of market confidence fed on each other. The creditors, by contrast, profited from liquidity inflows from the debtors which in turn lowered interest rates, boosted growth, facilitated balanced budgets and increased investor confidence (e.g. de Grauwe 2013). Instead of solving the crises, the tightening of regulatory integration increased asymmetry within the EU (Chalmers *et al.* 2016).

Only at rare, very dramatic moments, when burden sharing seemed inevitable to prevent the impending breakdown of unfortunate member states and the unintended unravelling of integration, did fortunate member states agree to joint capacity building. But even then they insisted on regulatory strings and conditionalities. Agreement was generally slow, contested and limited to the bare minimum. Grand designs for solving the Eurozone crisis by Eurobonds, a Euro Treasury, or by a special Eurozone budget were dismissed out of hand. Instead the member states stumbled from one intergovernmental risk pooling stop gap to the next. Main steps included the first Greek rescue package of May 2010, the temporary European Financial Stability Facility (EFSF) of June 2010, and the permanent European Stability Mechanism (ESM) replacing it in 2012 (Gocaj and Meunier 2013). While the institutional framework became more robust and the lending capacity expanded with each step, it failed to stop the market panic (de Grauwe and Ji 2014). The ESM's lending capacity was high (500 billion Euros) but strictly capped leaving markets with something to speculate against.

The longer it took the member states to produce a viable intergovernmental solution to calm markets, the more hopes turned to the ECB. Already in 2010, France, Portugal and Italy had called upon then ECB President Trichet to unfreeze capital markets by buying government bonds of distressed Eurozone member states. Trichet refused, reminding them that under the TFEU fiscal policy was their responsibility, not his (Barber 2010). Yet, when the inability of the member states to create a credible fiscal back up for EMU led to a new banking crisis in 2011, the pressure on the ECB mounted to provide lender of last resort support regardless of its formal mandate. Eventually, Mario Draghi made his famous 'whatever it takes' speech in June 2012, heralding the Outright Market Transactions (OMT) program that finally quelled the market panic and reduced rate spreads in the Eurozone. EMU was rescued but not by an explicit intergovernmental agreement of the member states to create the requisite fiscal capacity but by the ECB reluctantly providing this capacity through the monetary backdoor, claiming a lender of last resort authority if officially didn't have (Lombardi and Moschella 2016; Schelkle 2014). The political and legal opposition to this move[5] raises doubts about its long-term sustainability. In late 2016 bond spreads in the Eurozone started to climb again, reaching critical level in some exposed debtor countries including Greece, Italy and Portugal.[6]

Burden sharing has also been the main issue during the refugee crisis. In principle there were three options. Border states and popular host states could be supported financially through transfer payments, administratively through operational assistance in border protection, asylum registration, and the hosting of refugees, and physically by relocating refugees to other states (Thielemann and Dewan 2006). Financial and operational burden sharing was largely uncontroversial but remained very modest (Thielemann, this volume: 17): The Asylum, Migration, and Integration Fund (AMIF) provided 2.4 billion Euros over six years (2014-2020) to help member states manage migration flows; Frontex deployed 165 experts to Italy and Greece in 2015 to assist with the creation of hotspots for the registration of refugees (Börzel 2016: 20); in September 2016, the Council decided to transform Frontex into a new European Border and Coast Guard (Regulation(EU) 2016/1624) and increase staff numbers from 400 in 2016 to 1000 in 2020. Compared to national resource commitments, these are very low numbers. In 2016 alone, Germany spent 20 billion Euros on refugees and increased the staff of its Office for Migration and Refugees from 2800 to 4500.

Physical burden sharing was more controversial, most notably the proposal on a temporary (2015-2017) scheme to relocate 120.000 refugees from Greece and Italy to other Schengen states. The proposal had solid support from Italy, which hoped to offload part of its refugee burden, from Germany, which hoped to incentivize Greece and Italy to crack down more effectively on outward secondary movements, and from France, which saw a welcome opportunity to curry favor with Germany. It was formally adopted by majority vote in September 2015 but remained factually irrelevant. Outvoted Eastern European countries continued to resist it.[7] The Hungarian and Slovak governments challenged its legality before the CJEU. Implementation was dismal across Schengen. By September 2016 only 5651 refugees had been relocated.[8] Plans for a permanent relocation system to replace the temporary scheme were quietly shelved (Frankfurter Allgemeine Zeitung, 3 May 2016).

In conclusion then, despite strong functional demand, severe distributive conflicts between the member states, and high levels of constraining dissensus within them, prevented an adequate supply of European burden sharing capacities. Whatever was agreed was either too little, or too late, or too poorly implemented to stop the crisis. During the debt crisis, the ECB filled the capacity gap, at least temporarily. No such convenience was available during the refugee crisis.

7. Externalizing crisis management

Given the problems of internal capacity building, the EU relied extensively on the capacities of non-EU actors for crisis management. The IMF provided substantial funds and technical expertise for European rescue packages during the Eurozone crisis (Hodson 2015). UNHCR operated refugee

5 See prominently the 2016 'OMT ruling' of the German Constitutional Court, http://www.bverfg.de/e/rs20160621_2bvr272813en.html, accessed April 2017.

6 Interview with Mervyn King in http://corriere.it/digital-edition/CORRIEREFC_NAZIONALE_WEB/2017/03/14/5/londra-se-la-cavera-il-vero-grande-rischio-e-la-fine-delleurozona_U432901009175269OUE.shtml, accessed April 2017.

7 Victor Orban said that the 'concept of "someone letting immigrants into their country" and then "distributing" them among the other member states is a mad and unfair idea'; cited in http://www.theguardian.com/world/2015/may/10/european-commission-migrant-quota-plan-mediterranean-crisis, accessed January 2017

8 https://ec.europa.eu/home-affairs/sites/homeaffairs/files/what-we-do/policies/european-agenda-migration/background-information/docs/20160928/factsheet_relocation_and_resettlement_-_state_of_play_en.pdf, accessed January 2017.

camps on Greek islands. NATO provided reconnaissance, monitoring and surveillance of illegal crossings in the Aegean. Turkey stemmed the refugee flow by stepping up maritime interception in the Aegean, by blocking the land border with Greece and Bulgaria, by cracking down on smuggling networks, and by accelerating readmission procedures for returned migrants (Heijer *et al.* 2016).

Orchestrating third party capabilities has obvious advantages over creating genuine EU capacities (Abbott *et al.* 2015; Abbott *et al.* 2016): It is faster, cheaper and requires fewer resource commitments; it sidesteps distributive conflict and preempts domestic politicization; it deflects blame from EU governments and institutions, and buys time to defer or completely avoid EU capacity building. Yet, there are also disadvantages.

Orchestration may offer a quick fix for filling immediate capacity gaps but is quite unreliable in the long term. This is, most importantly, because the EU lacks hard controls over the third parties it utilizes: Third parties cooperate in EU crisis management only if, and to the extent that, this serves their own goals. Sometimes goal alignment is spontaneous and relatively unproblematic: the IMF was eager to assist the EU in managing the debt crisis in order to preserve global financial stability (Barber 2010); the UNHCR helped in Greece because caring for refugees is its essential mandate. Sometimes, the EU incentivizes goal alignment through ideational and material rewards: Under the terms of the EU-Turkey 'Joint Action Plan' the EU promised Turkey up to 6 billion Euros, visa liberalization and a reinvigoration of the accession talks in return for its assistance in guarding EU borders from irregular migration (Ruhrmann and FitzGerald 2016). In any event, goal alignment is subject to change. Third parties may change their mind and defect on the EU before the crisis management job is done. The cooperation between the IMF and the EU has always been strenuous. For instance, the IMF long insisted on restructuring the Greek debt as a matter of policy while the EU member states wanted to avoid such restructuring as a matter of legal principle. The IMF has also been accused by developing countries and rising powers of lending too much to Eurozone countries and of enforcing its policy conditions too weakly. This put IMF participation in the third Greek bail out at risk (Elliott *et al.* 2016). If anything, the EU's cooperation with Turkey has been even more difficult with President Erdoğan constantly threatening to withdraw Turkish cooperation if the EU fails to comply with his demands. The UNHCR, in turn, has threatened to withdraw cooperation because the EU-Turkey deal infringes migrants' rights under international law (Slominski and Trauner, this volume).

In short, by relying on the assistance of third parties, the EU becomes vulnerable to the whims of these parties. At the same time, it undermines its output legitimacy by exposing its inability to solve home-made problems without outside help.

8. The Future of Europe

Neofunctional and liberal intergovernmental theories conceive of integration as an efficient collective response to common European problems. The founders of EMU and Schengen clearly thought of their creations as responses of that type. Yet, the Eurozone crisis and the refugee crisis suggest that these responses have been neither efficient nor truly collective: EMU and Schengen bred distributive conflict where there hadn't been conflict before; they created new fiscal and migratory risks without providing insurance cover against them; they undermined the permissive consensus and fueled domestic politicization. In short, they created at least as many problems as they solved. What can the EU do to improve this state of affairs? What are the policy options for regaining problem-solving capacity? The Commission's recent 'White Paper on the Future of Europe' discusses four 'scenarios'.[9] We review them in light of our analysis.

The first scenario is to simply 'carry on': 'problems are tackled as they arise' in a basically unreformed EU (European Commission 2017: 16). In a benign policy environment, this may work as

[9] We disregard the implausible scenario 5 'Doing much more together'.

the pre-crisis histories of EMU and Schengen testify. In a less benign environment, the distributive conflicts and domestic protests which impaired crisis management and burden sharing during the Eurozone and the Refugee crises would quickly reemerge. A lot then depends on the willingness and ability of external actors to relieve the EU from adjustment burdens it cannot absorb internally.

The second scenario calls for 'nothing but the Single Market' (p. 18): The EU abandons its ill-fated experiment with the integration of core state powers and retreats to market integration. Yet, simply because the EMU and Schengen regimes are risky, costly, and unpopular, their disintegration will not be cheap, risk-free and popular: Even the hardest hit member states never seriously considered leaving EMU or Schengen. Incidentally, one prominent fear deterring exit was spill-over to market disintegration.

The third scenario envisions more horizontal differentiation: closer integration among those member states 'who want more' (p. 20). While the formation of 'coalitions of the willing' would certainly help to carry integration into new, contested policy fields, it is unclear how it would improve problem-solving in existing fields of integration. It would certainly not solve the conflict over the creation of European burden sharing capacity that impeded crisis management during the Eurozone and the refugee crisis. What was lacking was not the freedom of the *willing* to move on minilaterally, but the unwillingness of the *able* to show multilateral solidarity.

Scenario four suggests 'doing less more efficiently' (p. 22): The EU should focus on a few policy areas that really matter and renationalize the rest, partly or completely. What matters, according to the White Paper, is the integration of core state powers. Here the EU should tool up: 'The European Border and Coast Guard fully takes over the management of external borders. All asylum claims are processed by a single European Asylum Agency. Joint defense capacities are established' (p. 22). In EMU, the EU would finally create a European 'fiscal capacity to improve the absorption of country-specific shocks, through an insurance system set up at the central level' as recommended by the 'Four Presidents' Report (van Rompuy *et al.* 2012: 5). The White Paper's prime candidates for renationalization, by contrast, are areas of market regulation including state aid, consumer and environmental protection, health and safety at work, and social regulation.

In view of this selection of policy fields, the Commission could have also labeled scenario four 'From the regulatory to the positive state'. That it refrained from doing so is politically understandable but also shows the dilemma. On the one hand, the EU is deeply involved in the integration of core state powers, deeper in fact than with the benefit of hindsight it might have wished. On the other hand, it can only turn this involvement into a success if it develops some capacity in core state powers of its own. Unlike in market integration, common regulation is not enough. Yet, the idea of ceding coercive and fiscal resources to Brussels raises all the tough distributive conflicts and toxic domestic debates that even the Eurozone and the refugee crises were too weak to overcome. The history of coming-together federations tells us that the creation of central capacities is a very long and conflictual process with periods of stagnation and disintegration (Kelemen 2014). The EU still has a long way to 'fail forward' (Jones *et al.* 2016).

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