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PHOENIX OUT OF ASHES?
THE EURO BETWEEN ECONOMIC-POLITICAL PRESSURES AND NEW OPTIMISM

DRAFT

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New Optimism

The sovereign debt crises of Eurozone economies brutally uncovered the many inadequacies of the economic and political underpinnings of the Eurozone. Even though not only members of the Eurozone were running into severe debt problems, and also it needs to be noted that not all economies outside the Eurozone managed the implications of the financial crisis from 2008 better then Eurozone members did, it was the Eurozone that run into an existential crisis. Despite all the gloom over the last few years it is undisputable that in the last couple of months the economic news coming from the southern periphery of the common currency area has changed to the better, and thus as a result financial markets rewarded those economies with substantial reductions of risk preemie. Ireland exited the Troika programs, and may be shortly joined by Portugal. Financial markets with an oversubscription of 5-year government bonds early in 2014 rewarded the bad boy Greece, and Eurostat announced a first primary surplus of Greece since years. At the same time the exchange rate of the Euro went down, i.e. the Euro appreciated strongly. Does this mean the Eurozone is out of trouble? I will argue that the new wave of optimism that sweeps through financial as well as political markets misses the picture and paints over the actual situation. In my further I try to prepare the ground for a more cautious analytical view that argues that we are at the start of a secular stagnation of the Eurozone rather then moving to a new path of stability. Low growth in the near future not only poses economic and social problems for many Eurozone economies but also changes the political case for the common currency in serious ways.

Analytical skepticism should not be confounded with wishful thinking. The dissolution of the Eurozone would create substantial costs for the member economies as well as for the global economy; moreover, it would open a venue for depreciation races that eventually undermine the stability of the European economic space. Yet, following a business-as-usual strategy will not help correcting the governance deficits. From the very outset the debate about the economic and political rational of the common currency of the EU was highly divided. Political proponents of the Euro jumped on the transaction cost argument provided by economic theory, and the public at large was more then happy to enjoy the advantages of a handy currency that allowed them to move easily between different national territories that shared the one and same currency. The more sophisticated proponents made the point that the common currency space soon will benefit from the advantages of a optimum currency area, and thus disconnect its members from undesired destabilizing processes that may happen to smaller economic units. This optimism was justified with the argument that dynamic convergence processes would come into being after the launch of the new currency. More skeptical voices made the point that such an economic project can't work without a flanking political union. Only latter would provide an encompassing set of mechanisms in order to contain given differences of national accumulation regimes and thus to provide unified political-economic space. Others made the point that the restrictive mandate of the newly established European Central Bank (ECB) is a recipe for disaster, as the mandatory one-size-fits-all approach would only strengthen given historical differences in terms of inflation acceptance and thus generate a highly uneven inflation environment.

Most recently one of the most prolific economic historians, Kevin O'Rourke, who engaged early on in the Euro debates nicely summarized the skepticism:

> The euro is a bad idea, which was pointed out two decades ago when the currency was being devised. The currency area is too large and diverse and given the need for periodic real exchange rate adjustments, the anti-inflation mandate of the European Central Bank (ECB) is too restrictive. Labor mobility between member countries is too limited to make migration from bust to boom regions a viable adjustment option. And there are virtually no fiscal mechanisms to transfer resources across regions in the event of shocks that hit parts of the currency area harder than others. (http://www.imf.org/external/pubs/ft/fandd/2014/03/orourke.htm).

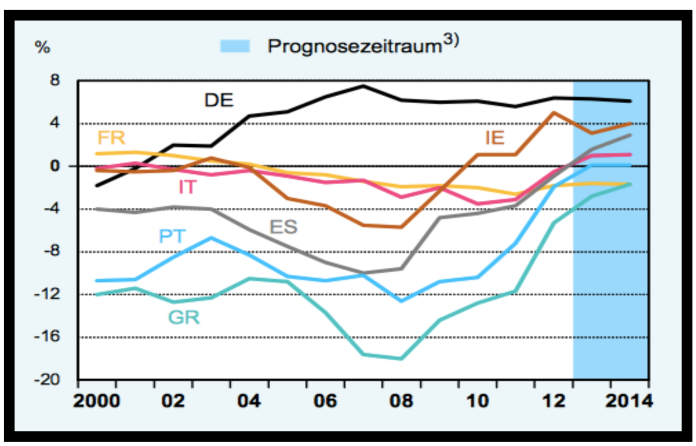
The first ten years of the Euro were widely seen as a success story, and it seemed that the critics were proven wrong. Not few academic supporters of the Euro commentators stuck to such a positive assessment even at a point in time when the first signs of fundamentals problems emerged. However, also many of the initial critical arguments against the common currency were discredited by the developing Eurozone crisis. Rather then plagued by a galloping inflation the Eurozone experienced a strong polarization of current accounts and the rise of a creditor-debtor regime. Latter was driven by the liberalization of the banking and finance industry that could act in an under-regulated political environment. In brief, market forces overwhelmed the architecture of the Eurozone. The last five years or so were characterized by changes in the economic governance of the Eurozone as well as by the launch of austerity regimes in troubled member economies. Many of those changes were driven and actually forced by the panic of financial markets that even put the existence of the Eurozone in jeopardy. Since Mario Draghi's 'whatever it takes'-announcement in summer 2012 the waves of panic receded and made room for a new wave of optimism. This time is different seems to reign the day, and politicians as conservative economists join into a mutual back patting.

I will argue that this optimism is unfounded and not at all covered by economic facts. Early in 2014, many of the initial crisis indicators turned to the better but only to worsen other critical economic factors. Overall economic growth of they Eurozone is sub-par and unemployment rates are extraordinarily high. Then there is an increasing probability that the Eurozone slips into a deflationary trap, with the implication that debt-ridden economies will run into deeper problems in regard to their ability to serve their debts. Divisions inside the executive committee of the ECB threaten vivid and timely monetary policy actions, not to forget the potentially political-legal constraints for unorthodox measures that may be handed out by the European Court of Justice and/or the German *Bundesverfassungsgericht*. Not to talk about the inadequacy of the banking union that may get tested as soon as we know about the outcome of the stress test organized and executed by the ECB. Rather the supporting subdued economic growth it seems to me that the strong appreciation of the exchange rate of the Euro in the first half of 2014 contributes to the brewing economic troubles.

The Eurozone is on its way into a 'low inflation/deflation - high unemployment - positive current account regime' that aggravates the economic and political costs of the currency union. In political terms a lot of valuable time has been missed over the last few months to come up with coherent economic governance for the Eurozone. Change has happened but - in line with the overall policy approach - the steps have been too small too slow, and mostly took the wrong direction. Rather then having solved the crisis the Eurozone moved into a new zone of economic and political fragility where already small events potentially trigger a new crisis. The main reason for skepticism is the lack of economic growth that ultimately is suppressed by the newly established economic governance. Despite quite some policy turns in the past it can be doubted whether the ECB will be able and willing to step up to the challenge.

Persistence and Change in Divergence

It is a truism that a functioning common currency zone needs either a minimum of convergence or alternatively working adjustment mechanisms that deal with disequilibria. Hence, the commitment to generate strong economic convergence processes was widely underwritten from the very start of the Euro project. Already the *Maastricht Criteria* and then the *Stability and Growth Pact* oriented politics as well as markets towards efforts to create to some degree a leveled playing field. Consequently, much ado was made about budget deficits, inflation rates, and interest rate developments in the member economies. The sole focus on monetary indicators and the quite obnoxious attention directed towards public debt prepared the ground for a alleged success narrative during the first decade of the 2000s that was used by politicians and business representatives alike – that dramatically failed to even recognize the build-up of substantial frictions and



Graph 1 Current Account, 2000 - 2014, selected Eurozone economies

Source: SVR 2013

contradictions. Financial market actors were so much convinced of the success of the Euro, and deliberately appeased by their claim that the non-bail out clause eventually would be a lost promise. As a result they lost all risk averseness in regards to traditionally weaker member economies. Risk premiums converged with extraordinary speed to a very low level, and fuelled debt-driven accumulation processes in the periphery. The increasing growth rates of GDP then were interpreted as successful catch-up processes that fed the optimism of markets and states. Given the still existing differences in national inflation rates and the one-size-fits-all interest rate policy of the ECB real interest rates diverged, however. Traditionally inflation-prone economies enjoyed negative real rates whereas inflation-hawks had to live with rates that were too high in relation to their economic junctures. We know in the meantime that the risk optimism of financial markets was unfounded. Moreover and also critical, the differing economic developments within the Eurozone that resulted in quite substantial differences of inflation rates had also implications for the price competitiveness of national economies. All this was represented in a strong polarization of current accounts within the Eurozone, where a significant number of member economies moved into deep deficit positions and a small number of economies into surplus positions (see graph 1). Experts and politicians alike simmered down this polarization with the calming argument that national spaces do no longer matter in a currency union.

The importance of country risks came to the foreground when at the time the newly incoming Greek government declared that the recently officially reported budget deficit needed to be corrected big time. Out of sudden financial markets woke up, and responded to the emerging situation with immediate and huge increases of risk premiums for sovereign debt. Financial market actors realized that banks in economies like Ireland, Spain, and Portugal and other economies were far overstretched. Consequently, sovereign debt crises of Eurozone economies started, and put the overall Euro on risk. The story is well known: Rather then acting as 'watch dogs' financial markets acted as a rat pack, and actually generated a crisis sentiment that led to deeply flawed negative expectations, and thus to the establishment of a 'bad equilibrium' in the Eurozone.

Amazingly, rather then putting the ‘efficient market hypothesis' to rest academia and much more so public institutions like the EU Commissions Economic and Financial DG and the German Supreme Court, or for that matter the Nobel Prize Committee, resurrected this concept, and again financial markets became the lighting rod for policy-making at the beginning of the crises. In order to avoid *moral hazard* creditor governments and international organizations alike rejected any plans to bailout national financial systems or debtor governments. The soon established *Troika* made harsh austerity policies conditional for crises economies, and as a result the Eurozone moved to a significantly lower growth plateau. The ECB’s promise to do whatever it takes to keep the Eurozone intact calmed down financial markets, and risk premiums came down to acceptable levels. However, neither austerity policies nor the accommodating monetary policies have solved the fundamental problems of those economies. Admittedly, the austerity recipe kick-started an impressive convergence of current accounts and unit wage costs. More so, the Eurozone is moving into a current account surplus position, not least but not only due to the drastically reduced imports of some economies. However, the rise in unemployment and the simultaneous cuts in public budgets, not least in the area of social assistance and pensions as well as public servants, resulted in reductions of effective demand that put downward pressure on nominal wages. Simultaneous deleveraging of the private business sector as well as the financial industry made the situation worse. Low rates of economic growth and high unemployment became the new poster feature of the Eurozone. As a result, unit nominal wages in crises economies decreased. The strong reduction of effective demand also had a hampering effect on imports, which helped to shrink trade deficits. Simultaneously, the crises economies were able to make use of the improved price competitiveness and could increase their exports.

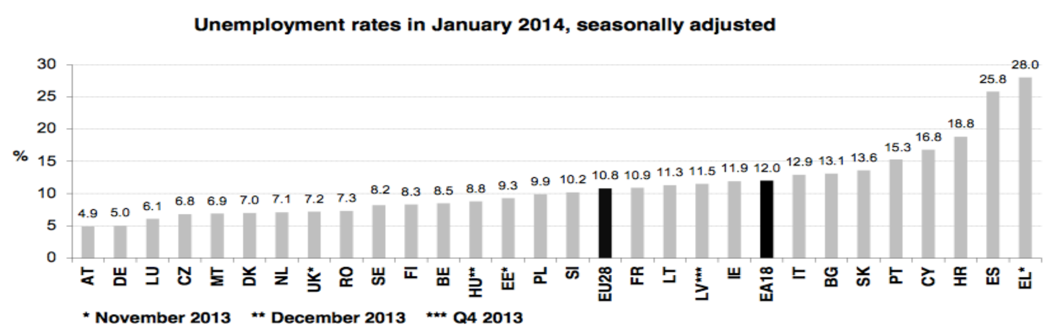
Graph 1 documents the convergence of current accounts that started in 2009, which was mainly driven by improvements on the side of the crises economies and thus not the result of symmetrical adjustments. A closer inspection would show that the improvements made by Ireland, Spain and to some degree also by Portugal are to some degree export-driven but also the simple effect of shrinking imports. Oddly enough, it seems that the improvement on the side of the crises economies goes hand in hand with a stable surplus in the German current account. Even though the Commission in its Macroeconomic Imbalances report from March 2014 is not urging to punish German's continuously high current account surplus, it’s analysis nevertheless makes clear that Germany's external position is disturbing. As analyzed elsewhere (Hübner 2014) Germany's surplus should be seen in a zero sum- perspective as the deficit of its Eurozone partners. As a matter of fact, the share of the Eurozone crises economies in Germany's overall surplus is shrinking. The real problem is that Germany makes an under-usage of its resources and potentials, and thus accepts much too low domestic growth. Rather then acting as the growth locomotive in the Eurozone the German export model holds back potential exports of other economies.

The price for this type of convergence is high. The Eurozone’s output gap is not closing but is on the rise. The IMF among others calculates the output gap with about – 3.5% for the overall Eurozone. This average covers relative small gaps like in the case of Germany and very large ones like in Greece and Portugal. Even though the calculation of output gaps comes with quite some methodological problems it is fair to assume that a relatively large output gap indicates a serious lack of overall effective demand. In other words, the Eurozone is far away from a socially acceptable and economically satisfying growth path.

Given that currently the headline inflation in the Eurozone is less then 1 %, and thus far below the mid-term objective of the ECB that is close to 2 %, there is now a serious probability for the Eurozone to move into a deflationary trap (see below). Low growth in combination with slowly growing or even shrinking prices will make it even more complicated to orderly serve debts. Slow growth will also not help dealing with the unemployment problem that badgers so many member economies. In other words, the convergence of current accounts comes with implications, intended or not, that changes the underlying growth models and contributes to further troubles, economic as well as political.

Unemployment Clusters

In 2014, four years after the sovereign debt crises started, about 20 million people are unemployed across the Eurozone. This is roughly a one-and-a-half time larger number of unemployed then before the start of the crises. Such an aggregated perspective disguises stark differences inside the Eurozone, however, as unemployment is rather unequal distributed across the Eurozone and overall across the EU-28. Whereas economies like Austria and Germany enjoy very low levels of unemployment the situation differs for economies of the southern periphery and also of Eastern Europe (see graph 2). The already high average unemployment rate of 10.8% for the EU-28 is even higher for the Eurozone, and some member states of the currency union show rather uncomfortable rates.



Graph 2 *Unemployment Rates in the EU*

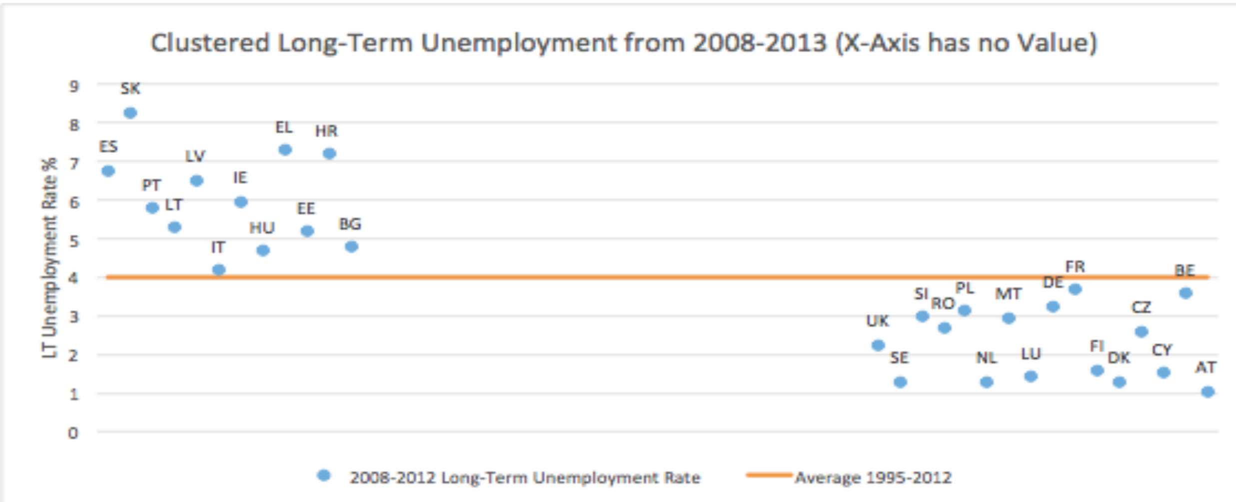
This snapshot indicates that economies in similar economic situations differ in labor market outcomes. The UK, for example, suffered from a severe banking crisis and a strong downturn as well as from negative effects of austerity policies, and still managed to keep its unemployment rate at a level significantly below the EU-28 average. Labor market institutions can help explaining such differences. Overall, however, the distribution seems to roughly confirm the well-known relation between economic growth and unemployment (‘Okun’s Law’): The weaker macroeconomic growth the higher unemployment.

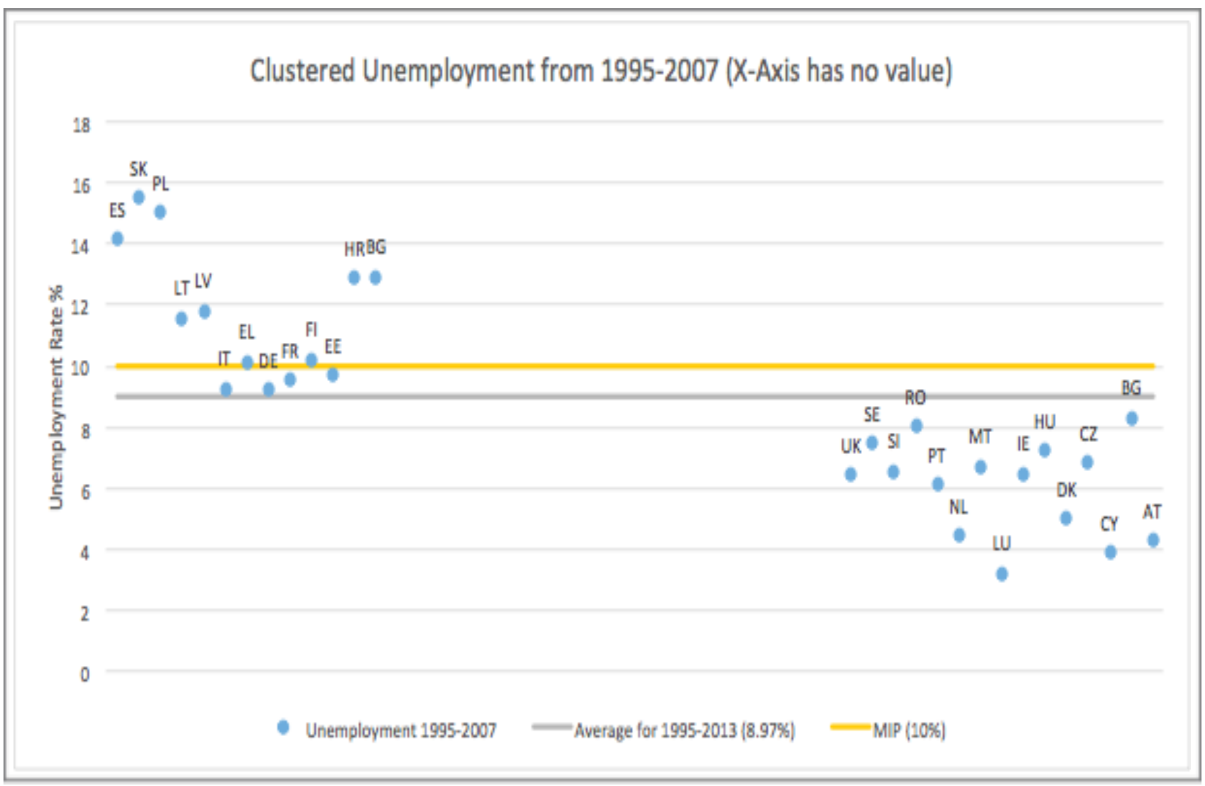
The changes in labor market outcomes are even more pronounced if we take a longer perspective. Graph 3 shows the clusters of unemployment for the periods 1995-2007 and 2008-2013. The green line shows the average unemployment rate for the EU27, and the purple line indicates the tolerable rate according to the MIP (Macroeconomic Imbalance Procedure). The blue dots show average unemployment rates for individual economies for this period. It is no surprise that some economies of Eastern Europe were not doing very well during this period. It is also no surprise that Germany shows a devastating labor market outcome, given its adjustment problems to its unification. And to some degree it is no surprise that Italy did not well during this period, either.

The situation changed for our second period, 2008 to 2013. Now a larger number of economies show unemployment rates far above our first period and a smaller amount of economies shows values below the MIP- threshold. Overall, the composition of the clusters did not change fundamentally. Still, debt crises-shaken economies like Greece, Spain, and Portugal who had to run serious austerity programs moved high up in the unemployment scale, whereas Germany, the most prominent example, moved from the high unemployment to the low unemployment cluster. Even though differences in labor market institutions and also in chosen economic policies very much influence unemployment developments it is a safe bet to argue that differences in growth dynamics of national economies explain the better part of unemployment. In other words, labor market outcomes are very much determined by macroeconomic factors. In this regard the crises of Eurozone economies had strong negative effects on a number of Eurozone economies. The negative fiscal multiplier effects of public austerity policies and the de-leveraging efforts of the private sector led to a shrinking of effective demand and thus to mostly negative growth rates of GDP for the periphery.

Low growth tends to generate high unemployment, at least if the output per worked hour (labor productivity) does not act as a compensating mechanism, i.e. does not shrink stronger then output. Latter constellation is the case for the UK during our second period where the dismal growth performance has not been translated in a parallel increase of unemployment. The German case shows in another way the relevance of economic growth for labor market outcomes. Over the whole first period Germany had a relatively high ratio of long-term unemployed. This changes during the second period, and as a result Germany moved from the high long-term unemployment cluster to the low long-term unemployment cluster. Again, labor market institutions can help to understand this performance but it is the particular set-up of the German growth model that makes the critical difference (Hübner 2014). Long-term unemployment is a crucial issue, in economic, social as well as in political terms. Long-term unemployed fall victim to labor market hysteresis dynamics that makes them, the longer they are off regular jobs, more and more unemployable. In times of low economic growth the private sector is shedding jobs as well as limiting the intake of new workers. This holds in particular for young people who are experiencing string exclusion effect.

Graph 3 Clusters of Long-Term Unemployment





If we use the average long-term unemployment rate for all EU members for the period 1995-2012 as benchmark then graph 4 shows that overall twelve economies rank above this average over the period 2008-2013. Long-term unemployment has become a huge problem in those economies that results in economic losses as well as in social deprivation. A return to socially acceptable unemployment rates will be difficult for those economies, at least without a strong positive external shock.

The distribution also indicates that labor market institutions very well can play an accommodating and thus softening role but also can be easily overstretched by the challenges arising from low or negative economic growth. Even the most accommodating labor market institutions cannot generate sustainable jobs without sustainable economic growth. A more recent ECB- study of structural effects in the framework of the Philips Curve for the Eurozone came to the result that significant shares off the overall unemployment are not of a cyclical nature and thus will stay with the affected economies unless the current low growth-regime makes place for a truly strong growth regime (ECB 2014). This stance is supported by the contrasting cases of Spain and Germany where the so-called 'non-accelerating wage rate of unemployment' (NAWRU) that covers the non-cyclical element of unemployment differ significantly. Since 2008 the rate in Spain increased and the one in Germany decreased. The report explains the lower NAWRU for Germany as the product of relative stronger economic growth and 'economic policy shocks', and thus tries to stick to its supply side-approach. Looking at the Eurozone as a whole, however, makes clear that NAWRU is closely related to the growth performance of the economies. Returning to economic growth becomes a necessary condition for improved labor market outcomes but in light of hysteresis effects this is not a sufficient condition. The longer unemployment rates stick at a high level the more existing skills will get devaluated.

Secular Stagnation Hypothesis

Often it needs a prominent voice to push items on the public agenda that have been in the public domain for quite a while. This general observation was recently confirmed when Lawrence Summers used a talk at the IMF Forum to present his 'secular stagnation hypothesis'. The core of his argument argues that the financial crisis of 2008 with its post-crisis deleveraging effects and the negative price trend for capital goods, mainly the result of IT-related productivity gains, have driven down the demand for private investment, and as a result of both processes generated low real interest rates. This then creates a situation for central banks ('lower zero bound') where traditional monetary policy comes to its limits. Rather then exiting forms of quantitative easing central banks may need to stick to variants of this approach for quite a while. In a situation where the self-regulating forces of markets are constrained it needs accommodating fiscal policies to jump-start a strong growth process. However, such an accommodation will likely not happen, mainly due to political limits for moving towards an active fiscal policy. 'Secular stagnation' does not mean zero growth of GDP. Growth can happen but growth will be, on average, lower then in previous economic periods. More important, the hypothesis suggests that a return to full employment with financial stability will only happen if successful active demand policy is put in place because self-restoring market forces are not working properly in a stagnation situation. Monetary easing is a necessary but not sufficient condition to return to acceptable economic growth. Summer's take on the current situation reminds on Alvin Hansen's dark vision for capitalist growth, published in 1939 in *American Economic Review*, argues that with all the drivers of economic growth (innovation, population growth) gone it would be up to fiscal policy to save the day. We know, that this vision was highly misleading and rather then stagnation Western capitalism experienced a 'golden age' of capitalist growth that only came to a halt in the 1970s. Still, a new version of secular stagnation may be relevant to understand the conundrum of today's Western capitalism.

The aftermath of the financial crisis of 2008 led to changes in the macroeconomic constellation on a global scale. Cleaning up private balance sheets is a much more protracting process then many anticipated that needs close accommodation by monetary policy in order to avoid a credit crunch. Low or even negative real interest rates are the preferred instrument; but such rates tend to increase the systemic financial risk because individual investors are more and more willing to accept risks in order to receive expected yields. At the same time, given the global abundance of savings, it gets easier for governments to take up new debt, respectively to refinance existing debt to lower rates. Both those implications can go hand in hand as, for example, the return of Greece to financial markets in April 2014 has demonstrated. Financial market actors take the carry trade route and even with a drastically reduced spread can earn a considerable profit – assumed that Greece stays solvent with the support of the Troika.

In a low growth environment the demand for capital goods does only to a smaller part depend on the real interest rate. Expectations about effective national and global demand are more crucial. In a deflationary situation, to take the extreme case, economic actors postpone consumption and investment and thus increase savings. Rather then financing domestic investments critical parts of those savings are channeled towards financial market activities, and tend to increase liquidity of financial markets rather then financing private or public investments. In a world of globally open financial systems negative interest rates in one economy do not automatically generate an overall investment push, at least not in case of demand-constrained economies. Given that private investments depend not only from the real interest rate but also from the internal rate of return of a given investment as well as from expectations about future effective demand it seems that constraints in current and future effective demand suppress any positive impact of negative real rates. In other words, returning to economic growth may need an accommodating monetary policy but mainly rests fiscal policies. If latter is restrictive even negative interest rates will not result in higher economic growth. Rather, such rates may encourage forms of carry trade that increase the overall financial risk.

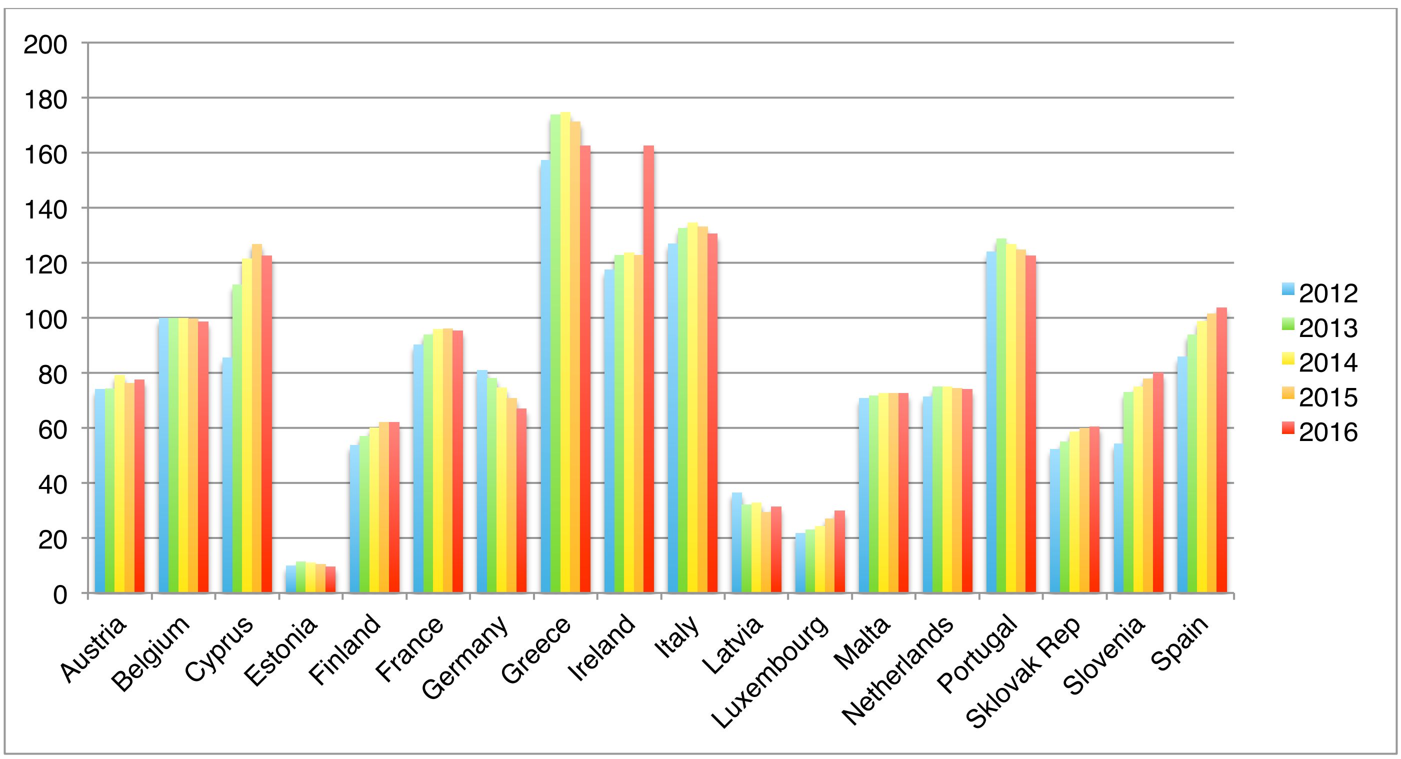
The constraints in demand come from three ankles. The first ankle is fiscal policy where the political turn towards fiscal conservatism and austerity led to a severe under-demand for public investments. Drastic cuts in public employment, wages as well as in social assistance and pension payments added to the downward pressure on wages of the private sector, and generated strong negative impulses for effective demand. The second ankle has to do with the implications of financial and banking crises where highly indebted actors are forced to de-leverage, and thus to save rather then to spend. What makes sense for individual actors creates problems for the macro economy, however. The third ankle comes from deflation or *'lowflation'* in core economies that makes private economic actors reluctant to spend now given the chance that spending tomorrow saves money. This classical self-fulfilling prophecy leads to shrinking economic growth.

All three factors play out in case of the Eurozone. The emergence of sovereign debt crises provoked rather far-reaching changes of economic governance in the EU and the Eurozone by establishing a form of fiscal conservatism that restricts government spending in various manners. Eurozone governments today act under severe restrictions that demand a balancing of public budgets and comes 2016 also a step-by-step reduction of public debt to the 60%-level of the Maastricht Treaty. In other words, governments are on a de-leveraging trajectory that restricts growth policies to the supply side. Banking crises may not be any longer on the agenda but they may come back, soon depending on the quality and rigorousness of the stress test organized by the ECB. Estimations vary but it seems to be a good ball figure to assume a additional capital need between 240 and 670 billion Euro in order to overcome the balance sheet crisis of Eurozone banks (Acharya/Steffen 2014). The planned resolution mechanism of the Banking Union is a far cry away from providing such funds. The third mechanism for the constrained demand-regime of the Eurozone works via deflation, respectively *'lowflation'*. Widespread self-feeding price declines are not yet a reality in the Eurozone. Still, for quite a while Greece and Spain entered the deflation zone and others, including Germany, are close to the critical negative boundary (see graph 7). The executive committee of the ECB so far has not officially recognized that deflation has arrived but it seems that the Bank is starting to get armored for such a situation.

Negative inflation rates are poison for debtors as it increases the real value of existing debts, and thus makes debt service more difficult. Low or negative real interest rates can help dealing with that problem by allowing refinancing to lower rates. This is currently happening in Spain, Portugal and also Greece where risk-willing investors enter bond purchases to relatively low risk premiums. Moreover, in so far as economic actors start anticipating lower prices in the future they postpone (long-term) consumption and investments, and thus create a self-feeding process that results in further slow down of economic growth. Monetary policy enters difficult terrain in times of deflation. At the one side it needs to turn towards large versions of quantitative easing in order to lift inflation expectations. On the other side we know that such a policy potentially drives financial bubbles. Fiscal policy, then, would be the way to go but this avenue is restricted, either due to the predominance of fiscal conservatism or due to legal limits that require governments to stay on the sideline. The result may be not *stagnation pure* but a longer period of depressed economic growth, and thus a prolongation of unemployment on a socially unacceptable level.

This may be the most likeable scenario for the periphery of the Eurozone. Even though those economies enjoyed in 2014 drastic reduction in their risk premia that helps them to escape conditional credit programs of the Troika they still carry high debt ratios. Looking into the near future is risky but if we follow through with such an exercise we receive a pretty bleak picture (graph 4). Gross government debt to GDP will increase over the next few years for a majority of Eurozone economies, and the ratios will be extremely high for Cyprus, Greece, Ireland, Italy, Portugal, and Spain with debt ratios above 120 % for the next years. Those debts need to be serviced. Even with shrinking interest rates governments will have to make tough choices in order to generate positive primary fiscal budgets. Over the last few years the annual interest bills for those governments were already high and difficult to finance, given that in a negative or low growth situation tax receipts are getting smaller.

Graph 4 Gross Government Debt As Share of GDP



Political Pressures and Divisions

Eurobarometer survey data published in March 2014 on 'The Future of Europe 'show that unemployment ranks at the very top of concerns of EU citizens, with 52 % across the EU mentioning this problem as key for the future of the EU. Social inequality (32%) and insufficient economic growth (22%) were also of strong concern. Such a flashlight of public sentiment indicates that the EU and in particular the common currency is more and more seen as a project that does not deliver socially preferred outcomes. The mood is in particular dark in societies that deal since years with the effects of sovereign debt overhangs, and had to install harsh austerity policies in order to get EU-support. One can argue that such concerns disappear as soon as the economic situation changes to the better. The analysis above, though, is not supportive for such an optimistic perspective. The outcomes in terms of employment and economic growth will stay meager for a substantial number of Eurozone economies. This supports the hypothesis that output-founded legitimacy of the EU and the Eurozone is on a downward slope.

The Eurozone crisis uncovered quite substantial mal-designs of the political and economic governance of the EU and the Eurozone that demanded quick changes. In hindsight one can make the argument that the period 2008 to 2014 was one of unprecedented changes. At the same time one can argue that those changes came mostly too late and followed a deeply flawed economic paradigm (Hübner 2013). This alleged contradiction is explained by the swift dynamics of the crises on the one side and the dominating economic policy pattern on the other side. When due to the pressures of financial markets action was overdue, the EU Commission and more so key members of the EU, in particular Germany, the Netherlands, and Finland, eventually got ready their acts they followed their national interests as well as their conservative economic instincts. The result was a rigid policy regime of austerity that simultaneously guided the institutional renewal of the Eurozone and the EU.

This new economic governance not only institutionalized a European version of fiscal conservatism but also gave room for a policy lacking serious democratic control. Recently Scharpf (2014) made the point that this governance regime lacks input-founded legitimacy, and also is very ambivalent in its output-founded legitimacy. The members of the European Council are accountable to their own parliaments and electorates but they make decisions for member economies for which they are not accountable at all. Even though all rescue programs were executed by the *Troika* it stands that the European Council predetermined the conditionality of the programs, and the finance ministers and heads of state did so in overstepping their democratic accountability. When the crises started with Greece's declaration of missed deficit objectives a hectic crisis management was put in place, with the European Council and the ECOFIN council at its core. The more the crises deepened the more the crisis management turned into an intergovernmental affair. Debtor members and creditor members are no longer unison in their policy preferences. At the same time the new treaties like the ESM and the Fiscal Compact could only be initiated by dissolving the regular unanimity principle. Decisions within those treaties now need no longer a unanimous voting outcome of all members of the Eurozone rather then a unanimous decision by a qualified limited number of members. Not only is this new procedure a break of one of the most deeply entrenched principles of the EU but it is also a procedure that defeats input-founded legitimacy.

The situation is somehow different for the ECB. It is only a slight exaggeration to make the point that the Eurozone would have been dismantled without the actions of the ECB. In a situation where governments and the Commission were entangled in their austerity webs it was the ECB that turned away from its orthodoxy and started to imitate actions of other central banks. Still, the turn was in no way complete as the Bank insisted on austerity programs in troubled economies in exchange for quantitative easing and bond purchases. Nevertheless, its actions calmed down financial markets and gave politics on all levels some breathing room. This increase in output legitimacy goes hand in hand with a steep decline in input legitimacy. Never before have policies of the ECB been as critical for the existence and direction of the Eurozone, and yet the ECB is beyond a sufficient democratic control. None of the members of its executive committee has been elected or is in any meaningful way accountable to national parliaments or the European Parliament. Notwithstanding its critical role to dampen the open crisis of the Eurozone and to avoid its break-up it is also necessary to stress that the ECB became an agency that defines and co-controls the access to emergency funding of troubled debtors. In regards to its monetary policy the ECB does not act differently then other modern central banks; however, given its initial limited mandate one can argue that the ECB has undergone a far-reaching transformation, and makes use of its extended mandate on the go.

Particularly in Germany this new role of the ECB is seen as highly suspicious, and various plaintiffs took their concerns to the Constitutional Court that will have to decide about the constitutionality of ECB's actions. It is well-documented that the fiercest critique of the ECB heads the German *Bundesbank* who strongly believes that many of the more recent ECB decisions are close on the fringes of legality. It is only on the first sight paradox that the German government, on the other hand, willingly accepted the new functions of the ECB. In a situation of pro-cyclical fiscal policy and deep mistrust on the side of financial markets governments needed to rely on the ECB. Widely seen as technocratic and boring institutions, central banks in general and the ECB in particular have become key crisis manager that influence the growth paths of economies. This role will probably continue for quite a while. Input legitimacy may become a concern, also because the mandate of the ECB is getting larger with resuming the supervisory role for the banking industry.

Whether a policy of pragmatic muddling through will be sufficient to successfully deal with all those problems seems to be seen. Chances are that the Eurozone will return into its crisis zone, and politicians may be urged to do what has been seen so far as unthinkable.