Smoke with Fire: Financial Crises, Institutional Reform, and the Future of EU Democracy

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The handling of the sovereign debt crisis in the European Union (EU) has raised fears that decision making in fiscal policy and related matters has become less democratic and that an unholy coalition of European Central Bank mandarins and government officials now calls the shots in Europe. This article confronts this pessimistic speculation of a gradual drain of authority from parliaments to "Brussels" with systematic evidence of the institutional consequences of past financial crises. We advance an adapted modernization argument and expect in contrast to the renewed debate over the "Democratic deficit" of the EU that severe economic crises have typically strengthened democratic decision making and also increased the level of independence of the national central bank. Panel regression models support the double conjecture that both democratic and technocratic decision making should be a consequence of severe economic crises. We qualify in light of these findings the widespread pessimism that the EMU crisis has depleted the power of the European legislatures. Our assessment of the reform potential of the EU boils down to the contention that treaty amendments need to rectify the potential for supranational agenda setting that that the Treaty of Lisbon has created and that the Fiscal Compact Treaty has further strengthened.

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There's no smoke without fire,
Baby, baby you're a liar
Duffy*, Smoke without Fire*

Introduction

The political economy literature still disagrees over the conditions under which a country introduces political reforms following a severe economic and social crisis. The functionalist literature originally advanced the position that no government would launch policy reforms without the pressure from a severe crisis. Rodrik (1996: 27) pointed out that this thesis borders on a tautology, arguing "That policy reform should follow crisis, then, is no more surprising than smoke following fire." Others have, however, uncovered the considerable delay in which many countries implement urgent reforms (Alesina and Drazen 1991), thus invoking at least for a certain period of time the possibility of "smoke-free fire" and thus crises that do not lead to any real reforms. Indeed, Greek decision makers provoked in the beginning of the seemingly unending European sovereign debt crisis several wars of nerves until they reluctantly accepted some of the austerity measures designed by the European Union and the International Monetary Fund.

The frequency with which the Greek and other member state governments have broken deadlines and postponed decisions on key austerity measures has reinvigorated the fear (or, for some, hope) that the European Union has reached its nadir, having fallen victim to a final and deadly bout of what Giersch (1985) had described as "Eurosclerosis". As the inertia supposedly prevents the organization from introducing institutional reforms that would enable it to deal with the crises effectively, the end of the integration project seemed closer than ever before in the history of the supranational organization. A renewed debate over the alleged "democratic deficit" of the organization accompanied the pessimistic view that the supranational organization is unable to confront the historical challenges successfully. Leading European intellectual like Jürgen Habermas and Anthony Giddens have complained *in unison* that the handling of the European sovereign debt crises undermines European democracy, identifying a trend towards technocratic and autocratic decision making. "What about the fate of democracy in all this? Those who have assumed the mantle of the saviors of the EU – Angela Merkel and Nicolas Sarkozy, together with the "technocrats" in Greece and Italy – are largely bypassing the decision-making agencies of the union" (Giddens 2012). Fearing the "real possibility of a failure of the European project", Habermas (2011:97, own translation) advanced the hope that the crisis has a cathartic effect and that the EU will establish a "transnational democracy".

Addressing the question whether smoke follows fires in a new context, this article examines in light of these concerns the institutional consequences of banking, currency, and sovereign debt crises theoretically and empirically. We argue based on the modernization literature that both states and a supranational organization like the EU can introduce in the wake of a severe financial crisis changes along two dimensions of institutional reform. The first dimension deals with the extent to which the (supra)-national parliament, the population or both are able to ratify or amend executive decisions. The second choice is about the degree to which a government is forced to delegate decision making power to autonomous agencies. While changes along the first dimension alter the legitimacy of a decision, a choice about the allocation of decision making power affects its efficiency.

We therefore expect against the fears of a depletion of EU democracy that severe economic crises have in the past affected the *reform capacity* along these two dimensions positively and that, more precisely, crises *have increased the level of democracy and strengthened the autonomy of the central bank*. Both conjectures are grounded in the modernization literature (Lipset 1959, Prezeworski and Limongi 1997, Acemoglu et al. 2008) and recent research on the fate of political leaders (e. g. Bueno de Mesquita et al. 2003) that voters hold the governments that was at the helm in the beginning of the crisis responsible for the economic turmoil. As this government or a possible successor face the demand for institutional changes that lower the risk of a new crisis, they will respond through the introduction of reforms that strengthen democratic control over their activities and that increase the autonomy of the central bank. Panel regression results support this double hypothesis. We find for the period from 1950 to 2007 that countries which have experienced banking or currency crises or which had in the past five years a cumulatively high debt-to-GDP ratio have increased the autonomy of the central bank. We also establish with recourse to the Polity data set that past debt crises have increased the chance for democratization. We discuss the implications of these findings for the debates over the future of the European Monetary Union (EMU) and the European Union based on an analysis of the relevant rules that were introduced through the Lisbon Treaty. Our main expectation is that future intergovernmental treaties will have to rectify the biased unanimity decision making setup that this last change in the institutional structure of the EU has brought about and which was strengthened through the introduction of the Fiscal Compact Treaty (officially, the “Treaty on Stability, Coordination and Governance in the Economic and Monetary Union”).

Financial Crises, Democracy, and Delegation

The New Debate on the “Democratic Deficit:” One of the key features in the history of the European Union has been the stop-and-go nature in which the organization has institutionally evolved over time (Schneider and Cederman 1994). Observers have frequently described the periods in which attempts to widen and deepen the process of European integration largely failed as crises which might herald the end of the integration process altogether. The inability of the European Council - and thus the intergovernmental forum of the Heads of States and Prime Ministers - to deal with the sovereign debt crisis in a timely and effective manner has reinvigorated such fears. Several European leaders have taken up the doomsday rhetoric of earlier periods of stagnation and tried to convince their electorates that a failure to resolve the debt crisis would result in an irreparable breakdown of the European institutions and the escalation towards a situation in which the specter of a European war would loom large.

While some saw such developments as a welcome chance to reduce the integration project to the core function of a free-trade area, leading European intellectuals rather believed that more formalized cooperation is needed to tackle the problems of the integration process. Habermas (2011) most vigorously voiced the latter position, complaining that one institutional consequence of the crises, the strengthening of “executive federalism”, has led to an intergovernmentalist hollowing out of democracy in Europe and a destruction of the ambition to establish transnational cosmopolitanism through the integration project. In Habermas´ (2011: 37-38, own translation) vision, the EU „can be understood as a decisive step on the way to politically constitutionalized world society.”

The claim that the financial crises of several EU member states has undermined the legitimacy of decision making in the supranational institutions and its member states has re-launched the

discussion over the so-called democratic deficit and the measures that could be taken to resolve it.[1] Although we do not want to rehash here the rich discussion over this continuing challenge, we need to briefly identify the key dimensions of disagreement. Moravcsik (2002) and Majone (1996, 1998) contend, to begin with the most controversial position, that there is no real deficit as the ambition of the integration project is a more technocratic one. The EU, in other words, is a highly efficient bureaucratic machine that produces efficient technical solutions in less politicized arenas and that a lack of democracy is, therefore not really a problem for the organization. Føllesdal and Hix (2006), by contrast, contend that the decision making power of the European Union have reached beyond far beyond a level where only technocratic expertise is required and that decisions over these issues are done by government delegates who cannot base their position on a clear popular mandate. Hix (2008) has therefore called for a strengthening of the European Parliament as a key means to address the democratic deficit.

We believe that these diverging positions are irreconcilable as they are based on diverging understanding of what the EU should do and whether the integration project is dominated by technocratic or legislative and quasi-legislative decision making. Empirically, however, we agree with Hix (2008) that some decisions of the organization have severe redistributive consequences that require democratic control and transparency. One can obviously advance the position that some of the pet ideas advanced in the discussion on the democratic deficit – like the creation of a European public sphere or the introduction of EU-wide referenda – would be appropriate means to legitimize EU decision making. However, the realization of such projects is not imminent so that we need to examine how decisions on the financial crisis are made and whether there is room to increase the legitimacy of these choices. We contend that the European Union is still a predominantly intergovernmentalist institution which decides on the fiscal crises through negotiations between the heads of state or government and through a largely independent agency like the European Central Bank (ECB). Our discussion of the institutional consequences of the financial crisis of the European Union will consequently focus on the two interrelated questions of how much external scrutiny the intergovernmental decision making should receive and how independent the European Central Bank shall be.

Institutional Effects of Crises: Although the political ramifications of the Eurozone crisis go far beyond the borders of a single country, other polities have faced a comparable constitutional dilemma in the aftermath of economic shocks. We will therefore in the following examine the institutional responses to severe financial crises. To start with, the modernization literature lets us expect that the prospects of democratization grow with economic development. Some tests of this thesis, originally advanced by Lipset (1959), have, however, led to inconclusive results (Prezeworski and Limongi 1997, Prezeworski et al. 2000, Epstein et al. 2006, Acemoglu et al. 2008). A comprehensive review of the literature shows in line with Prezeworski and his co-authors that only some of the socio-economic drivers of modernization consistently improve the chance of a democratic consolidation. While development does not increase the chance of democratic transitions, it helps at least and in line with Prezeworski and Limongi (1997) to consolidate it (Alemán and Yang 2011). A further result is that the democratizing effect of inequality and thus the wish for redistribution (Aecmoglu and Robinson 2006) is "predicated on the presence of political mobilization" (p. 1139), while this form of economic

[1] These concerns have also led to a plethora of subsequent contributions such as the "Manifesto for re-building Europe from the bottom-up" which called for "A European Year of Volunteering for Everyone" (http://manifest-europa.eu/?lang=en, 13/9/2012)

disparities does not affect the risk of an authoritarian transition. Ulfelder (2009:28) shows, in a careful evaluation of 43 transitions, that economic shocks rather than development are a key driver of political liberalization: "In most instances, poor economic growth produced declines in living standards that spurred popular rebellion. Threatened by these uprisings and often hobbled by an accompanying fiscal crisis that also undermined the loyalty of key elites, dictators sometimes responded with political liberalization."

As financial crises often precede periods of economic stagnation, we will in this application focus on the effects of sovereign debt, banking and currency crises on the chance of democratization. We generally expect that citizens who had to endure the negative effects of financial turmoil will try to punish their leaders for the hardship that they had to endure. Bueno de Mesquita et al. (2003) provide solid evidence that leaders who have not been economically successful face a higher chance of being outvoted or overthrown in a revolt and that authoritarian turns are more likely when governments are not threatened. Bueno de Mesquita and Smith (2010) show furthermore that the negative effect of GDP growth on government turnover is especially pronounced in autocracies or, to use their parlance, where the size of the winning coalition is small.[2] Note, however, that citizens will not automatically punish government leaders for economic hardship. Without being able to directly account for the originator of the economic troubles, Alesina et al. (2011) show for the OECD countries that the electoral consequences of severe austerity measures are smaller than is often suggested. We nevertheless maintain that the chance of democratic transitions grows after a country went through a financial crisis.

Government leaders often try to shield themselves against public protest during periods of economic stress by pointing out that the source of the troubles is located outside the country or by pointing their fingers at their colleagues in the finance ministries or the central bank. Frankel (2005) shows for a sample of developing countries that the risk that a central banker or finance minister loses her job after a currency crises is over 60 per cent higher in the year after the economic shock in comparison to a less turbulent year. However, firing the underlings does not completely banish the danger for the government leader to be forced out of office. According to Frankel´s calculation, this risk is more than 30 percent higher following the devaluation in the preceding year compared to a normal year. Sacking the allegedly responsible policy makers is, however, only a short-term response to an economic crisis. A more long-term response would consist of institutional changes that reduce the risk of future financial crises. The European Union and most industrialized states has unsurprisingly reacted with new banking regulations to the crisis in this industry and with sharper fiscal rules in response to the sovereign debt troubles that affected some of its member states profoundly. The introduction of unorthodox policy measures have also strengthened the role of the ECB considerably, which had already enjoyed the same level of independence that the German Bundesbank had possessed since the 1980s.

There is some evidence that countries under economic stress have in the past increased the discretion of their central banks in the wake of economic crises. The central justification for granting independence to these agencies is the belief that such a self-imposed drain of governmental authority helps the political system to overcome the time consistency problem of day-to-day policy

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[2] Some historical evidence on the linkage between debt and institutional chance is offered in Stasavage´s (2011) sweeping analysis. He shows that "the development of public credit did indeed tend to accompany the development of representative institutions, but this phenomenon happened almost exclusively within city-states".

making. The increased independence of central bank should translate, in this view, into lower inflation rates. Recent evidence shows that the assumed relationship is, however, more involved than previously thought. Hielscher and Markwardt (2012) for instance demonstrate that only significant steps towards further independence lower inflation and that the leeway granted to the central banks reforms has to be embedded into a political system with high quality institutions to make the reforms effective. Moser (1999) shows in this vein that central bank independence is more likely in states with "check and balances." We nevertheless believe that citizens who have experienced a financial crisis hold primarily the government accountable for the economic turmoil. Besides demanding more democracy, they will also ask for institutional reforms that limit the interference of the government in economic affairs.

In sum, we contend that electorates will demand institutional changes in the wake of a severe financial crisis. They will ask especially for further controls on the executive and for a reduction in the government´s discretion over the central bank. To put it differently, we should expect a move for more democracy rather than autocracy and reforms through which central banks gain independence after crises that the citizens largely attribute to policy failures by the government which was in charge during the economic troubles. More democracy and increased technocratic decision making are thus, in a nutshell, the average response to the economic stagnation financial crises create.

Research Design

We will test our hypotheses on the nexus between financial crises, central bank independence and democratization through a longitudinal research design and then discuss how the current economic turmoil might affect the institutional setup of the EU in the medium term. The quantitative tests are the basis for our discussion of what these results imply for the future institutional architecture of the European Union. The time span for the statistical examination is from 1950 and 2007. We use longitudinal fixed effect OLS (change in central bank independence) and logit (democratization, autocratization) models to test the hypotheses. We detail the Hausman tests that demonstrate the appropriateness of these models plus extensive robustness checks in the online appendix.

Operationalization:
Dependent variables: We examine the influence of financial crises on three indicators of institutional reform. *Change in central bank independence*, the first outcome variable, is adapted from Sadeh´s (2010) update of the classic Cukierman et al. (1992, see also and Cukierman, Miller and Neyapti) measure. Note that we integrated information from Jácome & Vázquez (2005) on the historical independence of Latin American banks as well as Guthmann´s (2011) extension of the Sadeh update. We have multiplied the CBI measure with its range between 0 and 1 with the factor 100 so that the score goes from perfect dependence (0) to perfect independence (100). As we examine the change in independence from one year to another one, we calculated this indicator's lag for the rate of change of central bank independence. We then magnified it so to have a theoretical range going from -100 (complete loss of central bank independence) to +100 (complete gain of central bank independence). *Democratization* and *autocratization* refer to the change in the Polity score from the previous to the current year. Based on the combined scores of the Polity IV dataset, we created two binary variables where the value 1 stands changes on this indicator above a value of 3 (democratization) and below -3 (autocratization), respectively. The online appendix reports similar results with alternative thresholds.

Explanatory variables: As we are agnostic about the timing of institutional reforms following an economic shock, we observe whether a financial crisis occurred during a half decade. We employed two IMF sources to account for the presence of a financial crisis, distinguishing between banking crises, currency and sovereign debt crises. Based on the Laeven and Valencia (2008, 2012) dataset, two dummy variables, *banking crisis* and *currency crisis,* assign a value of 1 to the case if at least this type of crisis occurred at least once throughout the past five years. A banking crisis can be observed, according to Laeven and Valencia (2012:4), through significant "financial distress in the banking system (as indicated by significant bank runs, losses in the banking system, and/or bank liquidations)" and "banking policy intervention measures in response to significant losses in the banking system". Laeven and Valencia (2012:11) follow standard practice and define a currency crisis as a "nominal depreciation of the currency vis-à-vis the U.S. dollar of at least 30 percent that is also at least 10 percentage points higher than the rate of depreciation in the year before" (ibid.: 11). Note that we also conducted the analysis through count variables that number the times a particular sort of crisis occurred within five years. The results with these variables are included in the Webappendix. *Cumulated debt to GDP* comes from the public debt database by Abbas et al (2011). We obtained our indicator by summing the values of the lags for five years of debt. As we are interested mainly in the "surplus" of debt rather than the lack thereof, we assign a zero for all cases where debt is not recorded. Note that we also included the binary sovereign debt default and restructuring indicator of Laeven and Valencia (2008, 2012) for descriptive purposes in some parts of the analysis.

Finally, the dataset also includes *GDP per capita* as well as *GDP growth,* taken from the Penn World Table (2012), and the *inflation rate*, which we drew from the IMF World Economic Outlook dataset. Note that the multivariate tests reported below only refer to the impact of the crises indicators and not the effect of these economic factors on institutional changes. The online appendix, however, provides tests that account for the endogeneity of the economic variables following the financial crises. The robustness checks in which we use the indicators of the financial crises as instruments confirm that there is a direct link between the economic shocks and the institutional changes.

The Institutional Correlates of Financial Crises and their Implications for EU Decision Making

This section examines the institutional consequences of financial crises. The descriptive analysis of the period from 1950 to 2007 quickly evinces that financial crises often live up to the dire prediction of the German proverb that bad luck rarely comes alone. Of the 9551 country half-decades included in the data set, 68 stand according to the Laeven and Valencia (2008, 2012) dataset for triple crises shocks. 276 country half-decades include both a currency and a banking crises, 164 cases stand for the co-occurrence of for debt and currency crises, and there are 82 overlaps of banking and debt crises. Of course, not all of these crises are genuine crises. The period covers 63 starting years for a debt, 123 beginnings of severe banking and 206 commencements of currency crises.

The temporal order between the crises is not always clear. For instance, in eight cases a currency crisis started in the year before a sovereign debt default and restructuring occurred, while four sovereign debt crises escalated in the year prior to a currency crisis. There is, however, a clear temporal link between some crises exist if we regress the occurrence of one type of crisis within the past five years onto the risk that another form of crisis occurs in the current year. The odds that a country will experience a banking crisis in the current year is 3.9 (with 2.6 and 5.7 being the upper and lower estimate in the 95% confidence interval) in the presence of a currency crisis in the past five

years, as a bivariate random effect longitudinal logit model evinces. The analogous figures for the relationship between a sovereign debt default and the occurrence of a currency crisis respectively a banking crisis are 2.8 (1.6; 5.0) and 2.4 (1.2; 5.0).

While economic crises come seldom not alone, it is unclear what form of political repercussions they have. Table 1 examines the impact that the three forms of financial crisis included in our analysis have on central bank independence. In line with our modernization argument, we expect that citizens will demand less government interference following situations of grave financial stress.

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Table 1 about here
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The empirical analysis clearly shows that financial crises in the past have institutional consequences and increase the power of technocrats vis-à-vis their political masters. This is most pronounced for countries that have experienced a banking crisis in the past five years. Different models show that there was an average increase between 1 and 2% in the level of central bank interdependence following this type of crisis. For example, the 1991 banking crisis in Georgia, which led the new independent government to join the World Bank the year after, resulted in a stark increase of central bank independence in 1995. Similarly, the financial credit problems recorded In Armenia' and Estonia's banking sector in the early 1990s influenced the increase in independence to the central bank as well as the democratic institutional increment registered in 1994 and 1998, respectively. The effect of sovereign debt crisis is much more modest, but shows in some models in the same direction, while currency crisis do not have a clear impact. According with these general trends, there is no country with a cumulated debt of more than 500% of the GDP which decreased the leeway of the central bank, while Bulgaria (1998), Chile (1990) and Italy (1994) increased the independence of this government agent in sovereign debt crises of a similar magnitude.

Figure 1 nevertheless unravels that these relationship are often more involved and that the positive relationship between the cumulated debt indicator and the central bank independence measure only holds for the countries which are in a strong, but not yet extreme sovereign debt crisis where the cumulated debt of five years approaches or surpasses 1000% of the GDP. A similar relationship holds, as Figure 1B reveals, for the interaction between debt and banking crisis.

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Figure 1 about here
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We examine in the following also whether financial crises foster the level of democracy. Table 2 reports for cases whether the three types of economic shock considered in this paper influence the chance of democratization or the risk of autocratization. Note that such institutional changes are rare events. Among all the cases covered in the subsequent analysis, there were only 161 instances of democratization and 98 autocratizations.

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The results presented in Table 2 strongly support our expectation that financial crises only increase the chance of democratization and not the risk of autocratization. On the contrary, if financial crisis

are related in any systematic way, they reduce the probability of an authoritarian translation as the as model 4 and 7 marginally demonstrate in Table 2B. This double result supports similar findings by Ulfelder (2009) who in contrast to the original modernization argument reports a strong link between economic shocks and democratic transitions. Our study particularly shows that sovereign debt and currency crisis increase the chance of democratization. Interestingly, there is not a single case of a country which became more autocratic after experiencing five years in which the cumulated debt through GDP was above a value of 500. There are, however, five countries which underwent a political liberalization under the same condition (Chile, 1990; Guyana, 1992; Haiti, 1994; Hungary, 1990; Nicaragua, 1984; Sierra Leone, 1996).

Figure 2 illustrates that different types of financial crisis can jointly increase the chance that a country democratizes further. The upper Figure shows the marginal effects of past banking crises as the level of the cumulative debt increases. The corresponding effect for autocratization, shown in Figure 2B, is much smaller.

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Figure 2 about here
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The Sovereign Debt Crisis and the Future of Democracy in the EU

The double finding that financial crises strengthen democracy and increase the independence of central banks does not directly address the concerns raised in the renewed debate over the democratic deficit in the European Union. To offer some forecasts about the possible institutional consequences of the crisis, we need to analyse the conditions under which the key intergovernmental actor, the European Council, agrees on an institutional reform. The original debate on the feasibility of reforms started out with the pessimistic speculation by Scharpf (1989, 2006) that the European Union finds itself in a "joint decision making trap". In his view, there are always governments which profit from the current status quo which renders it impossible to change the rules of the game. The prediction is, however, based on the rather restrictive assumption that the status quo is located inside the core and thus the set of outcomes that, depending on the threshold used, cannot be beaten by either a qualified majority or a unanimous alternative (Schneider 1997).

As the EU has in many instances been able to reform itself and even in situations when the electorates back home were highly sceptical, we need to inquire how far the reform potential is (Schneider and Cederman 1994, Finke et al. 2012). Figure 3 illustrates based on Veen´s (2011) collection of Euromanifesto data the positions of the member state governments on the European Monetary Union and the further shift of competencies to "Brussels". While the EMU dimension is based on two categories (Positive or negative mentions of the ECB (4087; 4086) as well as the corresponding assessments of EMU and the Euro (3151; 3141), respectively), the delegation dimension comprises government attitudes to three topics (European Community/Union (110; 108); Transfer of Power to the EC/EC (3011; 3021); Competencies of the European Parliament (307; 306).

The multidimensional scaling analysis of these government positions evinces that the potential of reform is restricted to the EMU countries (without Finland) and to one dimension only. There are only four countries in the upper right quadrant and thus in the area where the assessment of both

dimensions is positive. We could therefore expect that the institutional response of the EU to its sovereign debt crisis is either restricted to a subset of its member countries – as it is the case with the European Fiscal compact – or that the reforms either curtail the powers of the European Central Bank or increase the power of either the European Parliament or the national legislatures in fiscal policy making.

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However, such conjectures about the institutional reforms of the EU in light of the current crisis remain largely speculatory as the composition of the European Council can quickly change. To assess the reform potential, we need therefore a more theoretical analysis of the impact that the rules governing the interactions within the European Council have. The deliberations of the member states in this intergovernmental setting are still based on unanimity voting. This lends the most conservative country veto power in case that the all other member states wish to change the prevailing status quo, but this laggard government is against any kind of reform. If this maverick only wants a minimal change, a modest reform or a more fare reaching policy change without the consent of the recalcitrant are possible outcomes (Schneider and Cederman 1994). As Colomer´s (1999) general analysis of the unanimity rule shows, the implications of this decision making procedure reach, however, beyond the expectation that the members which are closest to the status quo are able to dictate decision making. This is especially the case for the European Union since the Lisbon Treaty which has brought a supranationalist twist to the intergovernmental negotiations. As Article 9B of the Treaty of Lisbon makes clear, the President does not depend on the laggard members of the organization: "The European Council shall elect its President, by a qualified majority, for a term of two and a half years, renewable once." This increases the chance that a President pursues interests that are not in line with the most nationalist member states, but rather opts for policy outcomes which the member states with supranationalist leanings like.

Obviously, our expectation that the introduction of a Council Presidency has introduced a decision making bias in favour of the group of countries supporting the President rests on the assumption that the Presidency and the countries supporting it have an informational advantage over the less integration inclined members of the organization. If such an asymmetry really exists, supranational agenda setting, delimited by the unanimity rule, is feasible. Note in this context that unanimity or (qualified) majority agenda setting are not the same. While the latter form of exploiting the agenda is independent of the location of the status quo, the reform potential in a unanimity setting depends on this fallback position of the committee members. [3]

Colomer (1999) makes usage of the so-called preferred-to-set concept (the policy outcomes an actor prefers over the status quo) and visualizes the preferences as circular indifference curves around the ideal points, implicitly assuming that the two considered dimensions are equally important for the actors. The intersection of the preferred-to-sets is the unanimity winset, while socially optimal choices are located within the Pareto optimum set which is, given Eucledian preferences, the

[3] This difference casts a doubt on Tseblis´(2012:59, see also Yataganas and Tsebelis 2005) analysis that Valéry Giscard d´ Estaing and the Praesidium of the European Convention were successful agenda setters and led the delegates to the Convention for a constitutional treaty "to an outcome that simplified the previous treaties, was internally consistent, and produced institutions that could function in an enlarged EU".

minimal convex set containing all ideal points. The outome within the Pareto optimum set that minimizes the committee members´ distance from the ideal points represents what Colomer calls the "social utility optimum point" (ibid.: 546).

The configuration of the Pareto optimum and the unanimity set depend considerably on the location of the status quo. In Colomer´s (1999: 548) words, "a large distance from the status quo to the actors' ideal points offer many possibilities for choice to the decision-makers and may make the decision relatively open and uncertain" (Colomer 1999:. 548). This indeterminacy offers a potential for biased decision making if the reform potential is limited and thus if status quo is relatively close to the unanimity winset. To illustrate this, Colomer introduces the Uncertainty set and thus "the set of points which are farther away from each ideal point than the most distant ideal point from it" (ibid.) A committee can according to his analysis only reach a socially optimal outcome if the status quo is located within the uncertainty set. This leaves a part of the decision making space open for biased decision making and thus changes of the status quo which are not socially optimal. Such outcomes are located within the Bias set which contains all outcome not located neither in the Uncertainty set or the Pareto set. Colomer (1999: 551-552, italics in original) calculates that the Bias set is at least eight times larger than the Pareto set and concludes that only "from a status quo placed outside this very large area is it possible to reach *any* point inside the Pareto optimum-set".

The "paradox" of unanimous decision making uncovered by Colomer implies the imposition of outcomes which are not socially optimal for all member states as long as the member states are not sufficiently dissatisfied with the current state of affairs. The introduction of the Presidency through the Lisbon Treaty guarantees that these biased outcomes will reflect the interest of those EU actors who are able to influence the position of the President of the European Council. As the Commission and the European Central Bank possess an informational advantage over the intergovernmental institution, it seems possible to conclude that the lack of representativeness of EU decision making during the sovereign debt crisis has to do with the imbalance the Lisbon Treaty has brought about in EU affairs. Ironically, this last intergovernmental treaty which has been ratified by all 27 member states was initially described as a success of the member states. Kurpas´ (2007:3) for instance believes that: "…those who see the Union as another tool in the box of the nation state have clearly won the case, which is unlikely to be without consequence for the prospect of future integration". Dougan (2008, p. :698) moreover maintains that "a relative resurgence in intergovernmental influence within the functioning of the Union" is possible. As we have shown, these observations are, however, only partially correct as the introduction of a new actor who can be elected against the wishes of some member states has introduced the possibility of supranational agenda setting. The possibility to move the outcomes closer to the ideal points of EU agents like the ECB adds to the frustration of those who generally believe that the organization suffers from a democratic deficit and that increased legitimization of its policy outcomes is mandatory in times of crisis and crisis decision making.

Conclusion

The financial crisis in the Eurozone has led to considerable disenchantment and the anger that the decision making by the EU and its member states will destroy the very vision on which the integration project is built. We have examined this claim through a historical examination of the institutional effects that banking, currency and sovereign debt crises had in the past and through a

institutionalist analysis of the reform potential of the supranational organization. The statistical evidence that we have assembled clearly shows that severe economic distortions do not only result in policy changes, but that they also have institutional consequences. As crises were rather followed by an increase in central bank independence and by democratization instead of autocratization, we have some reason for the optimist conclusion that the hollowing out of parliaments from the crisis decision making processes in the Eurozone was an episode. We nevertheless conclude from an analysis of the decision making rules introduced by the Lisbon Treaty that the introduction of the Presidency of the European Council has increased the potential for biased decision making in the European Uníon. While key decision still follow the unanimity rule, outcomes benefit some member states more than others. In our view, the Union can only rectify this imbalance through the decision to delegate the drafting of the next intergovernmental conference to institutions and actors which have not profited from the most recent institutional reforms to a disproportional extent. In other words, national parliaments and delegates from all member states should develop the ideas how the drift of executive power to “Brussels” can be curtailed and how a European fiscal policy can be democratically legitimized.

Such a scenario obviously assumes that the EU-skeptical shift in the public preferences we are witnessing since more than a decade does not dramatically accelerate. A growing heterogeneity of the preferences would indeed make any kind of institutional reform in the European Union unfeasible.

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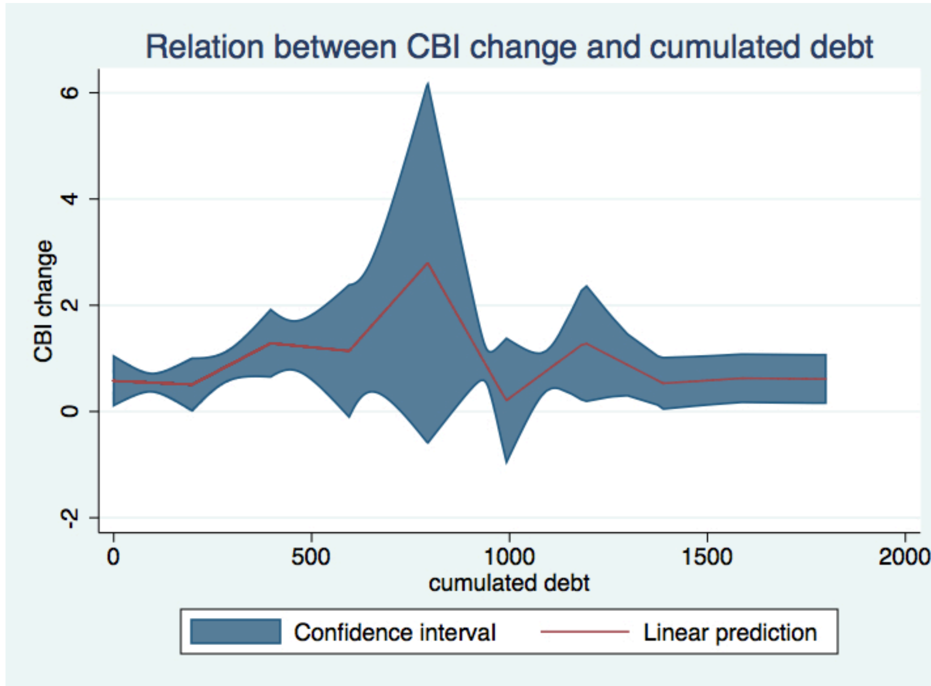
Tables and Figures

Figure 1: The effect of cumulated debt (1A) and of the interaction between banking crisis and cumulated debt (1B) on change in central bank independence

1A:



1B:

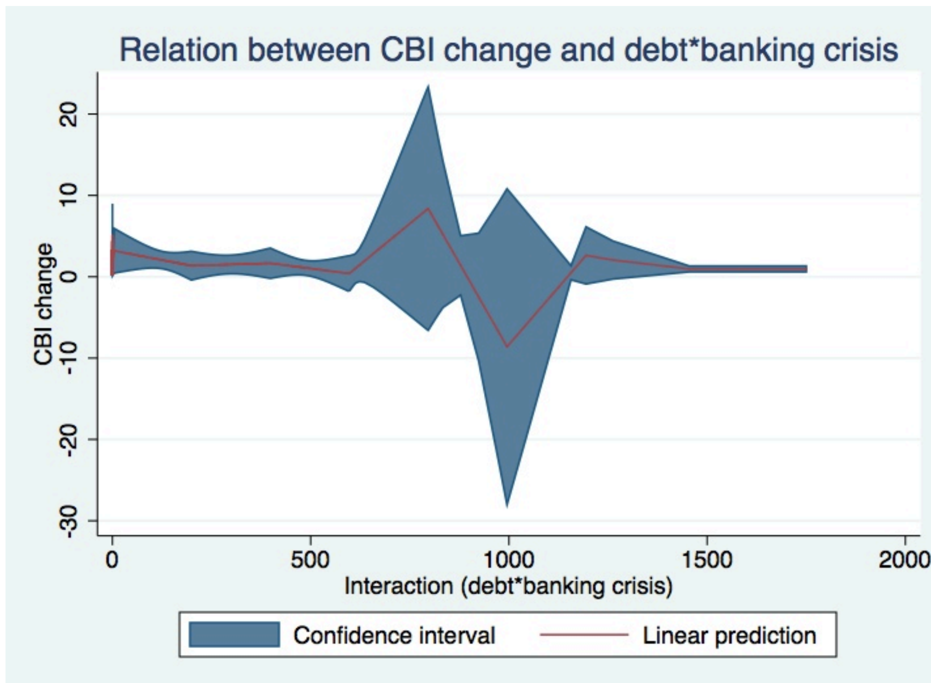
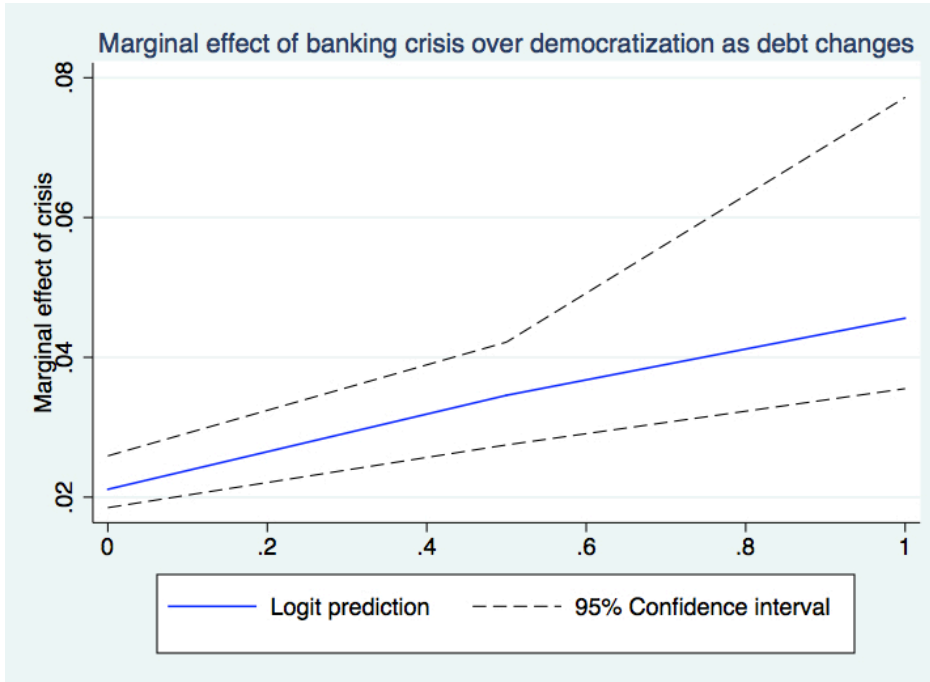
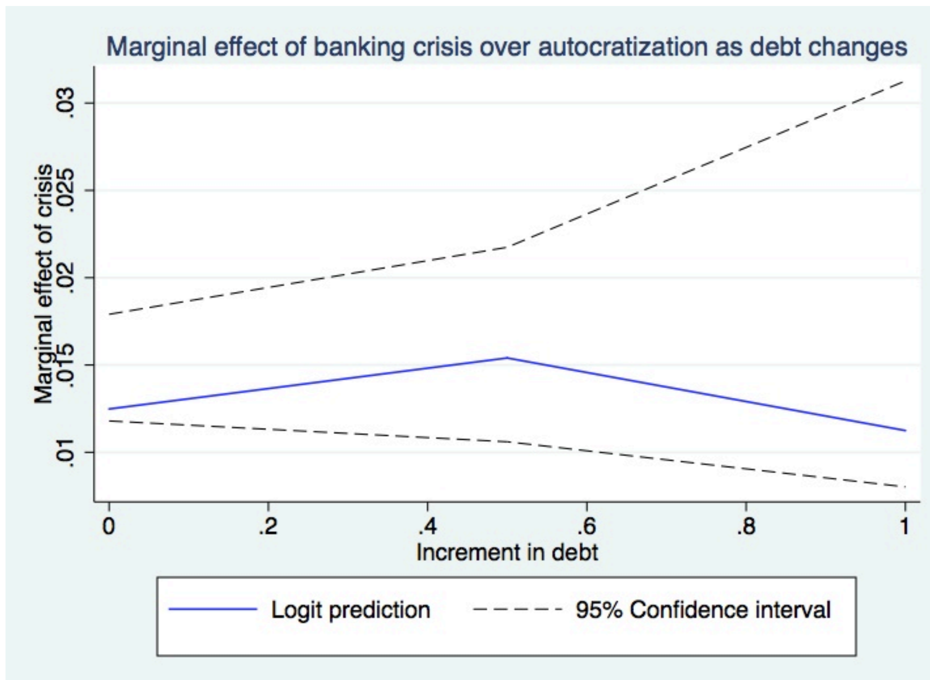


Figure 2: The impact of economic crises on the risk of democratization (2A) and autocratization (2B)

2A:



2B:



<u>Figure 3:</u> The preferences of the EU and EMU member states over central bank independence and the strengthening of democracy in the EU (without Bulgaria and Romania)

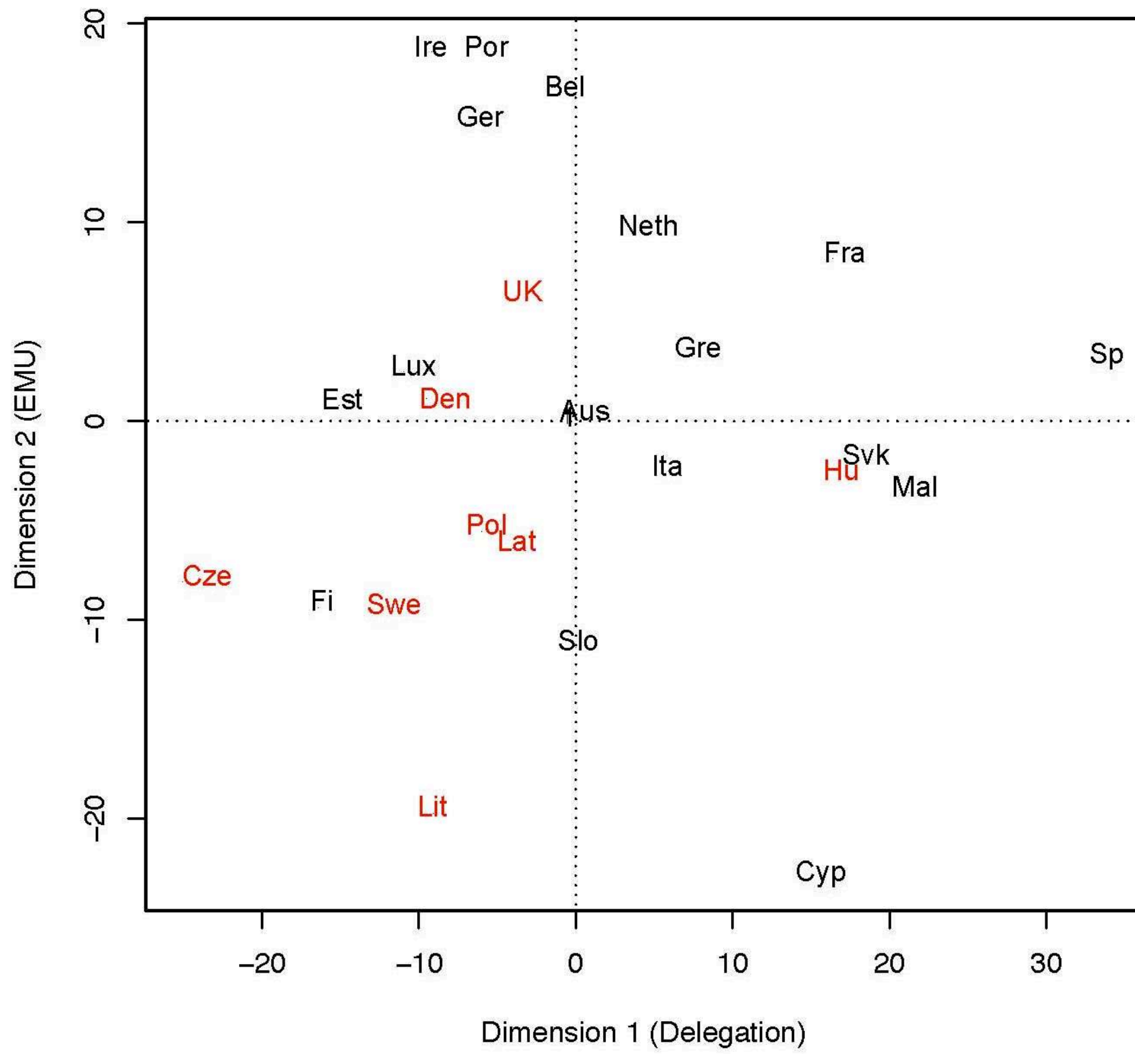


Table 1: Effect of three types of financial crises on changes in central bank independence (fixed effect longitudinal linear regression models)

Variable/Model	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Cumulated	0.001*			0.001*	0.001**		0.0009
Debt	(0.0006)			(0.0006)	(0.0006)		(0.0006)
Banking crisis		1.47***		2.08***		1.12**	1.63***
		(0.32)		(0.45)		(0.43)	(0.37)
Currency crisis			0.18		0.55	-0.53	-0.19
			(0.31)		(0.44)	(0.37)	(0.34)
Interaction debt and				-0.003**			
banking crisis				(0.001)			
Interaction debt					-0.002		
and currency crisis					(0.001)		
Interaction currency						1.06	
and banking crises						(0.70)	
Threeway crises							-0.001
interaction							(0.001)
Constant	0.53***	0.56***	0.72***	0.30*	0.44*	0.63*	0.40*
	(0.16)	(0.11)	(0.12)	(0.17)	(0.18)	(0.12)	(0.17)
R^2 within (between)	0.001 (0.10)	0.008 (0.08)	0.0001 (0.012)	0.01 (0.03)	0.002 (0.07)	0.009 (0.08)	0.009 (0.01)
R^2 overall	0.000	0.009	0.0006	0.01	0.0004	0.01	0.008
F-Statistic	3.07*	20.58***	0.35	8.84***	1.65	7.86***	5.93***
N (countries)	2781 (93)	2781 (93)	2781 (93)	2781 (93)	2781 (93)	2781 (93)	2781 (93)

Note: Standard errors in parentheses. * Significant at 10 per cent; ** significant at 5 per cent; *** significant at 1 per cent.

Table 2: Effect of three types of financial crises on changes in the level of democracy (fixed effect longitudinal logit models)

Variable/Model	(1)	(2)	(3)	(4)	(5)	(6)	(7)
A: Democratization							
Cumulated Debt	0.0008** (0.0003)			0.001*** (0.0003)	0.001*** (0.0003)		0.0009*** (0.0003)
Banking crisis		0.68 (0.22)		0.85*** (0.22)		0. .96*** (0.28)	0.62*** (0.24)
Currency crisis			0.38* (0.20)		0.48* (0.24)	0.46* (0.24)	0.22 (0.22)
Interaction debt and banking crisis				-0.0009* (0.0004)			
Interaction debt and currency crisis					-0.0007 (0.0004)		
Interaction currency and banking crises						-0.94** (0.48)	
Threeway crises interaction							-0.0009* (0.0005)
Log likelihood	-526.13	-526.44	-528.90	-521.17	-523.93	-523.95	-521.17
LR chi^2	8.87***	8.26**	3.34*	18.80***	13.27***	13.25***	18.72***
N (countries)	3522 (80)	3522 (80)	3522 (80)	3522 (80)	3522 (80)	3522 (80)	3522 (80)
B: Autocratization							
Variable/Model	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Cumulated Debt	-0.0007 (0.0004)			-0.0009* (0.0005)	-0.0007 (0.0005)		-0.0009* (0.0005)
Banking crisis		-0.11 (0.35)		-0.22 (0.42)		-0.41 (0.60)	-0.25 (0.41)
Currency crisis			0.46 (0.26)		0.16 (0.34)	0.009 (0.30)	0.11 (0.29)
Interaction debt and banking crisis				0.0008 (0.0007)			
Interaction debt and currency crisis					-0.0002 (0.0009)		
Interaction currency and banking crises						.47 (0.78)	
Threeway crises interaction							0.001 (0.0007)
Log likelihood	-334.82	-336.05	-336.08	-334.36	-334.70	-335.81	-333.77
LR chi^2 l	2.55	0.10	0.03	3.47	2.79	0.56	4.65
N (countries)	2740 (62)	2740 (62)	2740 (62)	2740 (62)	2740 (62)	2740 (62)	2740 (62)

Note: Standard errors in parentheses. * Significant at 10 per cent; ** significant at 5 per cent; *** significant at 1 per cent.