European Integration (Theory) in Times of Crisis
A comparison of the Euro and Schengen crises

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Abstract
The European Union has gone through major crises of its two flagship projects of the 1990s: the Euro and Schengen. Both crises had structurally similar causes and beginnings: exogenous shocks exposed the functional shortcomings of both integration projects and produced sharp distributional conflict among governments as well as an unprecedented politicization of European integration in member state societies. Yet they have resulted in significantly different outcomes: whereas the Euro crisis has brought about a major deepening of integration, the Schengen crisis has not. I put forward a neofunctionalist explanation of these different outcomes, which emphasizes variation in transnational interdependence and supranational capacity across the two policy areas.

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Introduction
The European Union (EU) has come to operate in crisis mode permanently. When the Treaty of Lisbon entered into force in December 2009, the EU finally appeared to have achieved institutional consolidation after the failure of the Constitutional Treaty. Around the same time, however, the mounting Greek balance-of-payment problem signaled the start of the Euro crisis. As soon as “Grexit” was averted in dramatic negotiations in July 2015, the migration flow across the Aegean Sea spiraled out of control, triggering a crisis of the Schengen regime of free movement across internal EU borders. Both crises affected core policies of the EU and the flagship projects of European integration of the 1990s. These crises pose a major challenge not only for European policy-makers but also for students of European integration. In the 1990s and early 2000s, theories of European integration focused on explaining progress in integration. Theoretical debates dealt with the conditions and mechanisms of “more integration” (e.g. Moravcsik 1998; Sandholtz and Stone Sweet 1997; Schimmelfennig 2003). It is only recently that regional integration theory has shifted to Euroskepticism, differentiated integration, or even disintegration (e.g. Hooghe and Marks 2009; Leuffen et al. 2013; Webber 2014).

Crises are open decision-making situations. In the context of integration, they present a manifest threat and a perceived significant probability of disintegration but may also trigger reform activities leading to more integration. Following an institutional concept of integration, I define disintegration
and integration as a decrease or increase in the level of centralization, the functional scope, or the membership of the EU. Both from a theoretical and practical perspective, it is important to understand the conditions under which crises bring about one or the other outcome.

To further this understanding, I examine the Euro and Schengen crises, which not only threatened core EU policies, but also lend themselves to comparative analysis. On the one hand, both crises are similar cases in many respects. Both the Euro and Schengen came under pressure due to exogenous shocks. These shocks exposed major deficiencies of integration, produced severe intergovernmental conflict about sharing the crisis burdens, and led to high domestic politicization. On the other hand, however, the crisis outcomes have been markedly different. In the Euro crisis, governments preserved the key public good of the policy regime, the common currency, and agreed on a major leap in supranational integration and mutual financial commitments: the creation of a permanent rescue fund, the banking union, and enhanced macroeconomic and budgetary supervision of the member states. By contrast, member states have not only retaken control of the open borders, the key public good provided by the Schengen regime, but also failed to agree on substantial integration progress. The difference in crisis outcomes in spite of similar causes and beginnings is the puzzle this paper addresses.

I argue that variation in the two main factors of institutional path-dependence stipulated by neofunctionalist integration theory – transnational interdependence and supranational capacity – best explains the variation in outcomes. Transnational actors and linkages were strong in the Euro crisis. Financial market interdependence had increased considerably after the introduction of the Euro; the actions of financial market actors threatened the highly indebted Eurozone countries with sovereign default; and these countries were unable to withstand financial market pressure on their own. Exit costs from the Eurozone were prohibitive for all member states. By contrast, transnational interdependence was weak in the Schengen crisis. Migrants are weak transnational actors, and even the most affected and weakest countries on the refugee routes were capable of staving off migration pressure by unilateral means. Exit costs from Schengen pale in comparison with exit costs from the Eurozone. In addition, the Eurozone benefited from the ECB, a powerful supranational organization, which had both the autonomy and the resources to preserve and expand supranational integration, whereas the European organizations in the Schengen regime, Frontex and the European Asylum Support Office (EASO) lacked the capacity to make an independent impact on crisis management.

Finally, I contend that neofunctionalism provides a more convincing explanation than major theoretical alternatives. Postfunctionalism attributes variation in crisis outcomes to variation in politicization. Intergovernmentalism explains integration outcomes by the constellation of national interests and state bargaining power. Yet the constellations of politicization and intergovernmental distributional conflict in the two crises were too similar to explain the markedly different outcomes. Rather, institutional and material path-dependencies resulting from earlier integration decisions shaped the transnational interdependence, the supranational capacities and the interest in the preservation and consolidation of integration that overrode domestic politicization and intergovernmental conflict in the Euro crisis, but not in the Schengen crisis.

The crises of European integration are spurring a fast-growing theory-oriented literature, including several papers that compare the Euro and Schengen crises. Genschel and Jachtenfuchs (2017) also highlight the similarities of the two crises, which they attribute to the particularities of European integration in the domain of core state powers. In contrast to this paper, they do not see substantial differences in the crisis outcomes. In line with this paper, Börzel and Risse (2017) as well as Rittberger et al. (2017) focus on explaining the variation in outcomes. Yet Börzel and Risse (2017) put forward a modified postfunctionalist argument about the nature and sequence of politicization.
Rittberger et al. (2017) provide an intergovernmentalist analysis of state preferences and bargaining constellations, which I share. However, their paper is limited by the general “snapshot” view of intergovernmentalist analyses of European integration, which fail to take into account the endogenous institutional and social effects of earlier integration decisions (Pierson 1996: 127).

The next section presents a theoretical framework of integration under conditions of crisis and outlines the theoretical arguments. The empirical part of the paper starts with the similarities of the two crises and then describes the differences in their outcomes. Subsequently, I compare transnational interdependence and supranational capacity in both crises and their effects on the crisis process. The conclusions summarize the theoretical and practical lessons of the analysis.

**Theory: crisis and integration**

Theories of European integration have developed implicit or explicit alternative perspectives on the causes, process, and outcomes of integration crises (Schimmelfennig 2017). Adapting a synthetic model presented in Leuffen et al. (2013: 259-267), I integrate them into a single theoretical framework. It starts from a baseline liberal-intergovernmentalist (LI) explanation of integration as the outcome of international interdependence and intergovernmental constellations of preferences and bargaining power (cf. Rittberger et al. 2017). In a crisis triggered by a shock and a failure of the existing integration regime, member state governments revert to intergovernmental conflict about distributing the burdens of the crisis and hard bargaining, in which asymmetries of interdependence and bargaining power determine the integration outcome. By contrast, both neofunctionalism and postfunctionalism assume that prior integration is subject to feedback processes that kick in when the regime fails. Whereas neofunctionalism focuses on positive feedback processes of spillover and path-dependence that produce more integration than intergovernmentalism would expect, postfunctionalism emphasizes backlash driven by the mass politicization of integration and resulting in less integration than the baseline. Figure 1 illustrates the framework.

![Figure 1: Theoretical framework](image-url)
Intergovernmentalism: the baseline
LI does not have a specific theory of integration crises. In both crisis and ‘normal’ times, national preferences mirror the (predominantly economic) interests of powerful domestic groups; substantive agreements reflect the relative bargaining power of states in a situation of asymmetrical interdependence; and the design of European institutions reflects the need to establish credible intergovernmental commitments (Moravcsik 1998: 3).

LI does not have a theory of unintended effects or feedback on national preferences and bargaining power either. Yet unintended effects (such as crises) do not contradict LI. Given its assumption of minimal state rationality (Moravcsik 1993: 481), LI does not claim that governments are able to foresee or prevent crises that may affect, or emanate from, the integrated policy regimes on which they agreed.

Integration crises are characterized by heightened interdependence, i.e. pronounced (negative) international policy externalities that create particularly strong demand for policy coordination (Moravcsik 1993: 485) and intense preferences related to the severe costs and losses incurred during crises. Yet interdependence is often asymmetrical: crises affect some social groups and states heavily, while others are much less vulnerable. The national interest results from how strongly and adversely the state is affected by the crisis.

Crises commonly have significant distributional implications. Even if governments can agree on a joint response to the crisis that benefits all, the burdens of adjustment are likely to be unequally distributed (Moravcsik 1993: 486-487). Asymmetrical interdependence and the unequal international distribution of the costs and benefits of integration give rise to intergovernmental bargaining, in which states negotiate to achieve the integration outcome that maximizes their national interest. Those states that are hardest hit by the crisis and require most support by the other member states, and those that stand to gain most from (more) integration or stand to lose most from disintegration, find themselves in a weak bargaining position and most willing to compromise. By contrast, the states that are least affected by the crisis and most satisfied with the status quo, are best able to achieve their preferred policy and extract concessions (Moravcsik 1993: 497-507).

Finally, governments pool decision-making and delegate competences to supranational institutions to maximize the benefits of integration. The higher they value their substantive bargains and the more uncertain they are about the future commitment of domestic actors in their home states and in other member states, the more power they are willing to invest in EU institutions to stabilize these bargains and prevent potential losers from revising the policy (Moravcsik 1993: 510; 1998: 9, 486-487). In sum, intergovernmentalism explains the difference in the integration outcomes by differences in the intergovernmental constellation of preferences and bargaining power and in the severity of commitment problems.

Neofunctionalism: path-dependence
In spite of their otherwise considerable theoretical diversity, neofunctionalist approaches have preserved a stable theoretical core informed by historical institutionalism (Leuffen et al. 2013: 62-72). Neofunctionalism theorizes a progressive integration dynamic driven by spillovers and path-dependencies of initial integration. Initial integration steps are often deficient, incomplete, and unstable because they tend to reflect the lowest-common denominator of national preferences rather than functional requirements (Moravcsik 1993). However, they produce various types of spillover (Niemann 2006; Tranholm-Mikkelsen 1991), processes of supranational institutionalization (Stone Sweet and Sandholtz 1997), and transnational linkage.
Successive crises are an integral part of the integration dynamic (Schmitter 1970). They are predominantly endogenous, i.e. “produced by the very functioning of the integration process...” (Lefkofridi and Schmitter 2015: 10), and tend to reproduce and strengthen integration thanks to institutionalization (Stone Sweet and Sandholtz 1997) and path-dependence (Pierson 1996). For path-dependence to work reliably in favour of integration stability and progress, disintegration must become increasingly unattractive – even if integration develops in unintended ways, becomes inefficient or contradicts the preferences of major member states. Several factors contribute to path-dependence in the integration process: high sunk and exit costs, endogenous interdependence, the autonomy of supranational actors, and decision-making hurdles (Pierson 1996).

Sunk costs are the irredeemable investments states and other actors make to adapt their institutions and strategies to an integrated policy; exit costs refer to the relative losses that states incur when leaving the EU or an integrated policy area. Both costs make actors reluctant to embark on a new course. Endogenous interdependence, i.e. the further deepening of interdependence produced by previous integration steps, increases the costs of exit and the resistance of actors that benefit from integration. Supranational organizations such as the Court of Justice or the ECB have a stake in the preservation and expansion of integration. Their autonomy, competences, and resources strengthen resistance against disintegration. Finally, decision-making procedures such as unanimity make it hard to muster support for disintegration.

Yet path-dependence only works reliably if these factors surpass critical thresholds. Governments seek to stick to their original bargain and to remain in control of the integration process; they are reluctant to give up autonomy and enter into new commitments. Governments only agree to more integration out of necessity – if the costs of stagnation or disintegration appear unbearable. Conversely, integrated policies run a high risk of disintegration in the event of crisis if they have remained at low levels of transnational interdependence and supranational capacity (Lefkofridi and Schmitter 2015: 7). Neofunctionalism, then, explains the difference in the integration outcomes of crises by variation in transnational interdependence and supranational capacity.

Postfunctionalism

In the postfunctionalist perspective, integration crises are characterized by politicization, i.e. the growing salience of European politics, the broadening of actors and audiences involved, and the polarisation of their attitudes and opinions on European integration (De Wilde 2011). To be sure, an increase in politicization as such does not imply either integration or disintegration effects. Early neofunctionalism also hypothesized a politicization effect of progressive integration (Schmitter 1969) but expected it to work in favour of transcending the nation-state and promoting political integration. By contrast, postfunctionalism expects politicization to mobilize Euro-sceptic citizens around national identities, empower Euro-sceptic parties, and undermine support for European integration. Hooghe and Marks “expect to see downward pressure on the level and scope of integration” (2009: 21) and domestic constraints on governments’ room to manoeuvre (2009: 22).

Whether and to what extent this happens, depends on the extent of mass politicization. If politicization is weak, the likelihood of integration is higher, ceteris paribus, because intergovernmental negotiations, transnational pressures, and supranational institutions can operate unimpeded by Euro-sceptic opposition and referendum threats. Conversely, strong politicization constrains the room of manoeuvre for international political and economic elites. Postfunctionalism, then, explains the difference in integration outcomes of crises is explained by variation in domestic mass politicization.
Similar conditions: shock, failure, distributional conflict, and politicization

In line with the theoretical framework and the comparative design, I first discuss the similarities of the Euro and Schengen crises: the shocks to the existing integration regimes, their deficiencies leading to regime failure, the ensuing intergovernmental distributional conflict, and the strong domestic politicization.

Exogenous shocks

Both crises originated in an exogenous shock to the European integration regimes. The Euro crisis can be traced back to the US subprime mortgage crisis, which was caused by the bursting of the US housing and credit bubble in 2007 and triggered a deep financial crisis and economic recession. Due to their participation in and linkages with the US financial market, major European banks became engulfed in the crisis and had to be bailed out by governments. The economically weaker Eurozone countries, which had been able to borrow at low cost after the introduction of the Euro, lost confidence of the bond markets. Together, the bank bailouts and the credit squeeze brought these countries to the verge of sovereign default.

The Schengen crisis was triggered by turmoil beyond the borders of the EU, too. Armed conflict and political repression in the Middle East were the most important push factors, above all the civil wars in Syria, Iraq, and Afghanistan. Difficult and worsening conditions in the countries of first refuge such as Lebanon or Turkey increased the migration pressure on the EU. Whereas the number of migrants across the Mediterranean had already been increasing for several years, in 2015 migration flows shifted from the Central Mediterranean to the less dangerous Eastern Mediterranean routes, and the number of asylum-seekers in the EU doubled to close to 1.3 million in comparison with the year before.¹

Endogenous deficiencies

Whereas the shocks were exogenous in origin, they exposed home-made weaknesses and deficiencies of the EMU and the Schengen regimes for border control and asylum policy. Economic and Monetary Union (EMU) resulted from an intergovernmental compromise about limited macroeconomic integration. It was designed to liberalize capital markets in the EU and to delegate monetary policy to an independent central bank with a primary mandate to ensure price stability. By contrast, national governments kept fiscal resources and fiscal policy as well as the oversight of banks under national control. The Stability and Growth Pact (SGP) established to commit member states to fiscal discipline in 1997 had already proven malleable and ultimately toothless ahead of the financial crisis. The EMU lacked effective European rules and mechanisms for the rescue or resolution of systemically relevant banks and for the rescue or orderly insolvency of member states in severe balance-of-payment crises. Any intergovernmental or supranational bailout and deficit financing was prohibited under EMU rules (Copelovitch et al. 2016).

Consequently, a dynamic sovereign–bank nexus developed when the financial crisis hit. Governments undertook bailouts of their domestic banks; these bailouts increased sovereign credit risk, which in turn increased the vulnerability of banks invested in sovereign bonds and the interest governments had to pay for continued access to credits (Acharya et al. 2011). Faced with mounting balance-of-payment problems, Eurozone countries could neither take recourse to currency devaluation nor count on assistance through bailouts or fiscal transfers from the Eurozone. In the absence of

adequate policy instruments, there was a high risk that deficit countries would default and abandon the Euro.

Neither was the Schengen regime prepared to deal with a massive influx of refugees. The Schengen agreements abolished internal border controls and established a common external border of the Schengen area. Yet the policing of the external borders and the handling of asylum requests remained under the authority of individual member states. The so-called Dublin rules normally allocate responsibility to the country where the asylum-seeker first applies for asylum, i.e. in most cases the country of arrival to the Schengen area. Registered asylum-seekers who try to apply elsewhere can be returned. The regime follows the principle of mutual recognition. Asylum-seekers can only apply for asylum in a single Schengen country whose decision all other Schengen countries will recognize. Yet in spite of several difficult attempts to harmonize asylum rules across the Schengen area, conditions of the reception of asylum-seekers, the asylum procedures and the granting of refugee states still differ vastly across the Schengen area. These unequal standards are not only a problem from a human rights perspective; they also encourage “asylum shopping” and “secondary movement” of refugees away from the countries of first arrival. In both EMU and Schengen, governments were aware that they had to agree on common rules to ensure the working of the integration regime. Ultimately, however, they sought to keep core state powers and capacities – taxation and redistribution in EMU and border and migration policies in Schengen – under national control (Genschel and Jachtenfuchs 2017; Thym 2016).

Because of the Dublin rules, the migration flows from Northern Africa and the Middle East affected the Mediterranean member states almost exclusively – and at a time when they were already hard hit by the financial crisis of the Eurozone. In the migrant surge of 2015, they – and Greece in particular – were overwhelmed. They were neither capable of blocking unauthorized migration at the external Schengen border nor did they possess the infrastructure to handle such a high number of asylum-seekers. Yet the Schengen area did not have a system of burden-sharing among member states or supranational organizations that could have effectively supported the border countries. As a result, the Mediterranean border countries stopped registering numerous migrants, failed to conduct their asylum procedures, and turned a blind eye to migrants disappearing into illegality or other Schengen countries (Trauner 2016: 315).

Intergovernmental distributional conflict

As the EMU and Schengen regimes faltered, governments entered into hard intergovernmental bargaining on how the burdens of the crisis and the costs of policy reform would be distributed among them. In the Euro crisis, governments held conflicting views on the means of saving and consolidating EMU that were essentially in line with their fundamentally different fiscal and economic positions (Schimmelfennig 2015: 182-183). The “northern” coalition of Germany together with Austria, Finland, and the Netherlands shared a favourable balance-of-payments and fiscal position and sought to minimize their financial liabilities and assistance. They were initially reluctant to bail out Greece. Rather than mutualizing debt through euro bonds or other instruments, they demanded that crisis countries adjust through austerity policies. They also insisted on stricter fiscal discipline and supervision. In the case of banking regulation, Germany initially opposed the direct recapitalization of banks through the rescue funds and a Europe-wide resolution fund and deposit insurance scheme. By contrast, the “South” was in a worse economic and fiscal position: less wealthy, more highly indebted, and under pressure from the financial market. Accordingly, it pushed for the mutualisation of sovereign debt and soft adjustment policies. Led by France, the southern countries demanded, among others, the establishment and expansion of rescue funds, unlimited bond purchases by the ECB, the direct European recapitalization of banks, a European bank
resolution fund and the introduction of Eurobonds – but opposed rigid austerity conditions and automatic sanctions (Schild 2013).

In the Schengen crisis, intergovernmental conflict resulted likewise from differential affectedness. State interests resulted mainly from their geographical and partly from their policy positions. We can distinguish frontline, destination, transit, and by-stander states. Because of their geography, frontline states like Greece and Italy were most immediately affected by the migrant flows but did not offer attractive asylum conditions. Destination states like Germany and Sweden, prosperous countries with a comparatively liberal asylum regime, were strongly affected by secondary migrant movement owing to attractive conditions. Transit countries such as Hungary and Slovenia lay on the migration routes from the frontline to the destination states. By-stander countries were located off-route and therefore not directly affected. As in the Euro crisis, each member state engaged in burden-minimizing. The heavily affected frontline and destination states pushed for the redistribution of refugees across the EU, whereas transit and by-stander countries opposed relocation (Rittberger et al. 2017).

The intergovernmental distributional conflicts that developed in the face of regime failure are in line with LI expectations. Governments calculated the national material consequences of the crisis and the national costs of alternative adjustment options, and they oriented their policy positions towards the least costly option. Member states with a similar structural position formed coalitions, and coalitions with opposite policy positions entered into negotiations characterized by hard intergovernmental bargaining. The distributional conflicts left little room for agreement. Neither the Eurozone nor Schengen had centralized capacities to support the most affected states. Any support would have to be based on direct intergovernmental transfers – of money from the creditor to the debtor countries in the Euro crisis, and of people from the destination to the by-stander countries in the Schengen crisis – and any transfer would make the less affected states worse off. Because the less affected countries were also close to the institutional status quo, the expected outcome would be “no (further) integration”. This commonality of the two crises, however, cannot explain the variation in outcomes. We need to examine further, which factors pushed the Euro crisis negotiations towards more integration and the Schengen crisis negotiations towards integration failure.

**Politicization**

According to the most common indicators, the Euro and the Schengen crises were highly politicized. First, monetary and fiscal policy as well as interior and border policies belong to the areas of “high politics” (Hoffmann 1966) or “core state powers” (Genschel and Jachtenfuchs 2014), which tend to produce highly politicized integration politics in general.

Second, both crises exhibited extremely high political salience. At their height, they topped the political agenda of the EU and its member states. Eurobarometer data show not only that citizens regarded the economic situation and unemployment as the two most important issues facing their country during the Euro crisis. More strikingly, immigration moved to the top of the list in the autumn of 2015 (Debomy 2016: 42-43). In both cases, apparently remote EU policies have gained a directly attributable, visible and mostly negatively perceived effect on people’s lives. This was true of the austerity measures imposed on citizens in the highly indebted Eurozone countries and of the migrants arriving in high numbers in many European countries.

Third, political contestation was high during both crises. According to Eurobarometer, public opinion (the trust in and the image of the EU) plunged toward historic lows at the height of the Eurozone crisis and, after a brief recovery in 2014 and early 2015, again during the peak of the Schengen crisis in the second half of 2015 (Debomy 2016: 15-16). During the crises, the financial issues of the
Eurozone and the migration issue became the dominant issues of contestation in domestic politics and national elections – especially in the countries hit hardest by the crises. Polarization ran high – within and between the member states of the EU. Eurosceptic parties thrived on their opposition against bailouts in the North and against austerity in the South during the Eurozone crisis. In the Schengen crisis, they mobilized successfully against immigration and Islam.

In both crises, domestic politicization reinforced the intergovernmental distributional conflict between the member states. Under pressure from voters and Eurosceptic parties, governments were reluctant to accommodate their European partners and agree to compromises that would be hard to sell at home. This is in line with postfunctionalist expectations. Yet, the Euro crisis resulted in a major leap in integration, whereas the Schengen crisis did not.

**Divergent outcomes**

**Deepened Integration in the Euro crisis**

The reforms agreed during the Euro crisis have deepened both fiscal and financial integration, while keeping monetary integration intact. First, no government exited the Eurozone. Second, the strict no-bailout policy was replaced with institutions and practices providing deficit countries with sufficient public credit to keep them afloat. An ad hoc emergency credit to Greece in April 2010 was followed by the European Financial Stability Facility (EFSF) in May 2010, a private company that issued bonds guaranteed by the highly solvent Euro countries and offered the proceeds to indebted countries under the condition of fiscal and financial consolidation measures. The EFSF was superseded in September 2012 by the European Stability Mechanism (ESM), a permanent international financing institution with a capital stock of 80 billion euro from the Eurozone countries and a lending capacity of 700 billion euro. Even though the ESM is formally an intergovernmental institution, it creates a massive and permanent financial commitment of the Eurozone countries. In addition to these formal steps, the ECB has adopted several instruments to provide relief to deficit countries and banks. In the course of the crisis, it has bought bonds from highly indebted Eurozone countries and provided banks with long-term cheap credit. Whereas the mandate of the ECB has not been formally revised, these measures have made the ECB more similar to a “lender of last resort”.

Third, fiscal regulation and supervision have been strengthened in a series of legislative acts (most notably the “Six-Pack” and “Two-Pack” legislation) and in the Treaty on Stability, Coordination and Governance in the EMU (aka the Fiscal Compact) signed in March 2012. Fiscal surveillance now starts with ex-ante control of national budgets. Member states are obliged to establish a national balanced budget rule and procedure in addition to EU-level rules and monitoring. The ESM and the ECB only assist countries financially that commit to such a procedure.

Finally, the EU has engaged in building a “banking union” with three pillars. The Single Supervisory Mechanism assigns supervision of systemically significant banks to a new supranational authority at the ECB. The Single Resolution Mechanism applies to the resolution of failing banks supervised by the ECB and can draw on a Single Resolution Fund, which is being built up by the European banking sector over a period of eight years (starting in 2016). Finally, the Commission proposed a European Deposit Insurance System in November 2015, which, however, still meets with resistance, mainly by the German government.

In sum, the Eurozone has been preserved and consolidated through a major leap in integration. Its member states reacted to the crisis by introducing unprecedented collective financial liabilities.
through the ESM and the ECB programs, reducing state autonomy in budgetary policy, and centralizing financial market regulation and supervision.

No substantial deepening in the Schengen crisis

As in the Euro crisis, the revealed flaws of the European border and asylum regime have triggered a series of policy and institutional reform initiatives. Yet they have failed to consolidate the regime. Whereas two years after the start of the euro crisis, the major building blocks of reform were in place or agreed on, two years after the outbreak of the Schengen crisis, a significant shift towards more pooling and delegation has not materialized. Rather, member states continue to suspend the Schengen regime.

First, starting with Germany in September 2015, several Schengen states (Austria, Denmark, France, Norway, and Sweden) have reintroduced controls at some of their internal Schengen borders. Whereas these measures are covered by the Schengen Borders Code and have been authorized by the EU, they have already been prolonged several times – apparently without a demonstrable threat to public order and security\(^2\) – and thus amount to a major and long-term restriction of the earlier state of integration. By contrast, there have been no temporary exits from the euro – only capital controls were reintroduced in Cyprus (for a short time) and Greece (still in place).

Second, the EU has failed to replace or complement the Dublin rules with a system of shared responsibility or reallocation. Member states have only agreed to a \textit{one-time} reallocation of up to 160’000 refugees in May and September 2015, and even this ad hoc measure has been opposed and legally challenged by several Eastern member states. It also has a poor record of implementation: only one eighth of the envisaged relocations had taken place by June 2017 – three months before the end of the agreed relocation period.\(^3\) A Commission proposal for a permanent quota system for the allocation of asylum seekers was rejected not only by the Eastern member states but also by Western member states such as France and Spain – all of them countries at the margins of the 2015 migration routes (Rittberger et al. 2017). As of May 2017, the member states still failed to reach agreement on a reform of the Dublin system.

The two EU agencies active in the border and asylum regime of the EU – the European Asylum Support Organization and Frontex – have seen a major expansion of their budget and personnel but have not acquired supranational competencies. The competences of EASO continue to be limited to supporting and coordinating member state authorities in the implementation of EU asylum rules. It can promote but not enforce uniform asylum decisions across Europe. In the case of Frontex (now the European Border and Coast Guard Agency), the Commission proposal had contained supranational competences: the right to return rejected migrants and to deploy guards to the borders of EU states without the consent of the government. These proposals did not pass the Council and the Parliament, however. Instead, the new Regulation allows member states to reintroduce border controls at their internal borders if a member state fails to cooperate with Frontex or protect its external Schengen borders effectively. This is renationalization rather than supranational enforcement.

In sum, the Schengen crisis has brought about an ongoing (partial) suspension of the Schengen regime rather than an adaptation of its basic rules. It has also led to a quantitative expansion rather than qualitative deepening of the activities of EU agencies. Instead, the EU has focused on externalization to overcome the Schengen crisis. As member states have failed to agree on

strengthening the capacity of the EU for the orderly reception of a large number of migrants, they have concentrated their activities on preventing migrants from reaching EU borders in the first place. These measures include the March 2016 agreement with Turkey as well as the migration partnerships and the Khartoum process with African countries. At their core, these agreements promise EU financial and technical assistance in return for partner countries’ efforts to restrict migration.

Explaining variation in crisis outcomes
I have now set up the puzzle of this paper: Why has the EU agreed on more integration in the Euro crisis but not in the Schengen crisis, although both crises revealed the deficiencies of existing integration regimes in response to exogenous shocks and triggered major intergovernmental and domestic conflict? To solve the puzzle, I propose a neofunctionalist explanation based on differences in transnational interdependence and supranational capacity in the two crises. Whereas high transnational interdependence and supranational capacity produced sufficient path-dependence in the Euro crisis to push member states reluctantly towards more integration, weak interdependence and capacity in the Schengen area enabled states to manage the crisis through unilateral measures and failed to generate positive feedback.

Transnational interdependence
Both EMU and Schengen have increased transnational interdependence— but to highly different degrees. In the Euro crisis, governments had to cope with powerful non-state actors: banks and other financial actors. The two-way sovereign-bank interdependence in the EU (Merler and Pisany-Ferry 2012) meant that governments were not only highly indebted to their domestic banks but also responsible for saving them. Because bank failures would potentially drag down state finances and the entire economy with them, Eurozone governments had little choice but to come to their rescue. Yet interdependence was not only national. EMU has significantly reinforced transnational financial market interdependence in the Eurozone. It brought together countries pursuing different growth strategies: an export-led growth strategy based on wage restraint, productivity and competitiveness in Germany and the north of the Eurozone, and a demand-led growth strategy based on fiscal expansion and wage inflation in the south (Hall 2012: 358–9). Thanks to their membership in the Eurozone, the financial market considered the southern member states safe. Consequently, balance-of-payment surpluses in the north generated massive financial flows to the south. The threat of sovereign default in the south thus left northern banks heavily exposed. Put briefly, had states like France and Germany refused to bail out the deficit countries, they would have had to bail out their banks.

In the crisis, financial market actors continuously drove governments to action. In the distributional conflict of the Euro crisis, the surplus countries had an incentive to avoid bailing out the deficit countries, and the debtor countries were interested in delaying austerity measures for as long as possible. It was only the growing mistrust and disengagement of financial markets, indicated by increasingly unsustainable interest rates for government bonds, that forced both sides to cooperate reluctantly and undertake the necessary steps to prevent the Eurozone from disintegrating (Schimmelfennig 2015: 185-187).

Financial market actors were able to force the Eurozone countries into more integration because exit costs were prohibitively high. For the highly indebted countries, abandoning the euro would have meant sovereign default, a likely breakdown of the monetary and financial system, hyperinflation
and being cut off from external capital. Moreover, contagion effects were widely expected. Whereas the other euro countries may probably have been able to cope with a default and exit of Greece alone, there was reason to fear that financial markets would lose trust in the euro more generally, withdraw from further debt countries and force the Eurozone to back countries (such as Spain and Italy) that were too big to rescue. For Germany and the north, a breakdown of the euro would have resulted in a steep appreciation of its currency, a concurrent slump in exports, and deep and long-lasting recession. In 2011, UBS, a major Swiss bank, estimated the immediate costs of exit from the Eurozone at 40-50 percent of GDP in the first year for the economically weaker euro countries and at 20-25 percent for an economically strong country like Germany.⁴ Even though costs would decrease in the following years, a Bertelsmann/Prognos study put the cumulative loss of GDP (until 2020) of an exit of the southern European countries (Greece, Italy, Portugal, and Spain) from the Eurozone at 69 percent for Germany and 154 percent for France.⁵ In comparison, bailout costs and risks (such as ESM capital contributions and ECB TARGET liabilities) look small.

These common negative externalities of a Eurozone breakdown generated a common interest in preserving the euro and rescuing the Eurozone among all member states. This common interest turned the intergovernmental distributional conflict into a mixed-motive (“chicken”) bargaining game (Schimmelfennig 2015: 184-185). On the one hand, governments have been united in their commitment to the survival and defense of the euro (zone), and this position was underpinned by a strong sense of negative interdependence and prohibitive costs. No Eurozone government intended to give up the euro. Throughout the crisis, heads of government vowed to do everything to defend the euro (Schimmelfennig 2015: 181-182). Whereas governments have continuously tried to shift as much of the rescue burden away from themselves, they put the survival of the Eurozone first whenever a member state was threatened by immediate default. Germany and the northern countries agreed to the necessary bailouts, and southern countries consented to the austerity attached to them.

By contrast, governments were confronted with weak transnational actors in the Schengen crisis. The only “pressure” refugees could put on EU governments derived from international human rights obligations under the UN Refugee Convention and informal moral commitments. Initially, news and images of refugees drowning in the Mediterranean created such pressures. In Germany in particular, the Merkel government’s decision of September 2015 to accept Syrian refugees stuck on the Balkan route is best attributed to a humanitarian impulse. When, however, public support waned under the impact of the surge in migrant inflows, governments were able to block or divert the migrant flow by introducing border controls, building fences, or assisting their transit across the country. Whereas the most affected states in the Euro crisis could not have extricated themselves from sovereign default, even small and weak countries on the Balkan migration route were able to help themselves without international cooperation.

National self-help produced a chain reaction of beggar-thy-neighbour policies, which ultimately led to the closing of the Balkan route from Austria to Macedonia and left the biggest burden with the destination countries and with Greece whose coastline was impossible to seal off. Yet, whereas Eurozone capitals feared a Greek default in the Euro crisis for its risk of contagion, no comparable incentive to support Greece existed in the Schengen crisis. This has to do with the vastly different costs of breakdown in the Eurozone and Schengen. Even according to the most pessimistic scenarios of several studies that have appeared during the Schengen crisis, the annual “costs of no Schengen”

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⁵ [https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Presse/imported/downloads/xcms_bst_dms_36656__2.pdf](https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Presse/imported/downloads/xcms_bst_dms_36656__2.pdf)
would not have amounted to more than 0.13 (European Commission), 0.18 (Bertelsmann/Prognos), or 0.2 (Stanley Morgan) per cent of GDP. Even in the most optimistic scenario for a euro breakdown, the costs would have been at least a hundred times higher.

In the absence of a strong common interest in cooperation, the bargaining structure of the Schengen crisis resembled a “Rambo” (Zürn 1992) or “suasion game” situation (Martin 1992), in which one player has the dominant strategy to defect (play “deadlock”), leaving the other player dissatisfied. This was the bargaining position of the by-stander and transit countries who did not have an incentive to alleviate the frontline and destination countries of their burdens and agree to a European relocation scheme. This situation contrasts strongly with the chicken game constellation of the Euro crisis, in which even the least affected countries would have suffered severely from a breakdown of the regime (Rittberger et al. 2017). Even a generally powerful destination country like Germany had to resort to negotiating an externalized solution with a non-member state (the so-called “Turkey deal”) because it could not attain effective relocation among the member states.

**Supranational capacity**

Variation in transnational interdependence, and variation in exit costs in particular, constitutes the main condition for the difference in integration bargaining and outcomes in the two crises. Variation in supranational capacity played a contributing role. The integrative outcome of the Eurozone crisis benefited from the fact that member states had already engaged in supranational integration before the crisis and created a powerful supranational organization: the ECB.

Supranational monetary integration in the EMU not only created considerable sunk costs, it also made the suspension of integration or the renationalization of Europeanized powers extremely difficult. EMU was designed to be permanent – there is no exit or suspension procedure apart from exit from the EU itself.

In addition, the member states had created an independent central bank with exclusive competencies in monetary policy. The ECB not only had a vital self-interest in the preservation and consolidation of the euro, it also had the autonomy and the resources to make and implement its own policies. Consequently, the ECB played a major and probably indispensable role in saving the Euro and strengthening the integration of the Eurozone. Rather than the establishment of the ESM, it was the declaration of ECB President Draghi in July 2012 to do “whatever it takes” that calmed the financial markets durably. Financial market actors generally regarded the ECB as more credible than governments, and took its announcement more seriously (Bølstad and Elhardt 2015). Moreover, the existence of the ECB presumably facilitated the establishment of a supranational supervisory and recovery mechanism in the banking union.

Even though the Schengen regime has been progressively “Communitarized” since its intergovernmental beginnings in the 1990s, it is nowhere near the depth of monetary integration. Rather than transferring executive powers to EU institutions, it mainly follows the internal market pattern of negative integration (abolishing national restrictions to free travel within the EU) and regulatory policy-making (approximation of national asylum rules), while leaving implementation and operational administrative capacity with the member states. In this context, it was much easier for the member states to restore border controls and revise their asylum rules and procedures than it

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would have been in the case of supranational centralization along the EMU model. Moreover, the Schengen Border Code offered legal possibilities for a temporary suspension of the Schengen regime. In a 2013 regulation, member states had agreed on a period of up to two years for the reintroduction of border controls in case of serious deficiencies of external border control and serious threats to the public order and security. Governments could invoke this exception in the Schengen crisis without formally violating the Schengen regime.

Finally, Frontex and EASO, the agencies of the Schengen regime, had neither the competences nor the resources to compensate the lack of administrative capacity in some member states or to overcome the opposition to the integration regime in others. Nor could they follow the ECB in informally elaborating the existing rules and practices towards more supranational integration.

To conclude, transnational interdependence and supranational capacity differed significantly between the Euro and the Schengen regime. In particular, their dependence on the financial sector and the massive prospective exit costs pushed governments towards cooperation and more integration in the Euro crisis; high supranational capacity supported path-dependence additionally. By contrast, weak migrants, low exit costs, and high national capacity were unable to overcome the resistance of governments against burden-sharing and sovereignty transfers in the Schengen crisis.

Conclusions

Jean Monnet, a founding father of European integration and an inspiration for neofunctionalist theorizing, claimed in his Memoirs that he had “always believed that Europe would be built through crises, and that it would be the sum of their solutions” (Monnet 1978: 417). Monnet attributed the integration effects of crisis to a mix of self-interest, practical constraints, and institutional autonomy. Commenting on the Community’s first crisis in the 1960s, he wrote that “intergovernmental discord, human ill-temper, and material confusion” could not stop the momentum of European integration. For one, “self-interest, in moments of crisis, made up for any lack of European team-spirit” (Monnet 1978: 469). Moreover, “people only accept change when they are faced with necessity, and only recognize necessity when a crisis is upon them” (Monnet 1978: 109). In addition, he put faith in “institutions” having “their own strength, which is greater than the will of men” (Monnet 1978: 469).

This paper demonstrates the continued relevance of Monnet’s thinking about European crises. Neofunctionalism regards incremental European integration as both prone to crisis and capable of progressing through crisis. Yet neofunctionalism is not unconditionally optimistic. Whereas integration crises can indeed build the momentum for major leaps in integration, such momentum depends on the effects of prior integration on transnational interdependence and supranational institutional capacity. Path-dependency only obtains if transnational interdependence and supranational capacity cross “critical” thresholds. The comparative analysis suggests that critical transnational interdependence consists in prohibitive costs of stagnation or disintegration and a lack of nation-state capacity for unilateral action. Critical supranational capacity requires both autonomous decision-making powers of the supranational organizations and the resources to mitigate intergovernmental distributional conflict and transnational pressure. In addition, ideational mechanisms also theorized by neofunctionalism such as actor socialization and institutional norms have not been decisive when compared to interdependence and organizational capacity. Otherwise, we should have seen much less preference heterogeneity and hard bargaining.

This paper has attempted to show that neofunctionalism explains the variation in crisis outcomes better than its major theoretical alternatives. Whereas there is nothing wrong with LI, it lacks explanatory depth. LI accounts for the state preferences, the distributional conflict, and the bargaining game in both crises, and it predicts the outcomes correctly (Moravcsik and
Schimmelfennig forthcoming; Rittberger et al. 2017). Yet it fails to embed intergovernmental bargaining into the historical dynamics of integration. Whereas LI has to take the overriding interest of Eurozone governments in avoiding cooperation failure as exogenously given, neofunctionalism accounts for the emergence of this preference as an endogenous result of earlier integration, which boosted financial interdependence, created prohibitive exit costs, reduced national crisis management capacities, and endowed the Eurozone with a powerful supranational organization.

Neofunctionalism also explains Börzel’s and Risse’s (2017: 2-3) observation that European elites sought to depoliticize the Euro crisis by supranational delegation but failed to do so in the Schengen crisis. According to their modified postfunctionalist argument, governments could not agree on integration in the Schengen crisis because right-wing populist parties politicized “identification patterns with regard to Community membership” (Börzel and Risse 2017: 5). In a neofunctionalist perspective, it is rather that the member states did not need supranational delegation to cope with the migration pressures at a reasonable cost.

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