South European Society and Politics

ISSN: 1360-8746 (Print) 1743-9612 (Online) Journal homepage: https://www.tandfonline.com/loi/fses20

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To cite this article: Leonardo Morlino & Cecilia Emma Sottilotta (2019) Southern Europe and the Eurozone Crisis Negotiations: Preference Formation and Contested Issues, South European Society and Politics, 24:1, 1-28, DOI: 10.1080/13608746.2019.1603697

To link to this article: https://doi.org/10.1080/13608746.2019.1603697

Published online: 25 Apr 2019.

SOUTH EUROPEAN SOCIETY AND POLITICS
2019, VOL. 24, NO. 1, 1–28
https://doi.org/10.1080/13608746.2019.1603697

Routledge
Taylor & Francis Group

Southern Europe and the Eurozone Crisis Negotiations: Preference Formation and Contested Issues

Leonardo Morlino and Cecilia Emma Sottilotta

ABSTRACT
South European countries were severely hit by the eurozone crisis. Adopting the theoretical framework of prospect theory, this article conducts an empirical analysis of the interpretation of the situation by the South European political leaders in terms of gains and losses. After discussing the stances of South European countries *vis-à-vis* a number of contested issues which emerged during the 2010–2013 negotiations, the article goes on to provide a comparative account of the determinants of national preference formation with respect to the eurozone crisis reforms in Cyprus, Greece, Italy, Malta, Portugal and Spain, paying special attention to the relationship between governments and parliaments.

KEYWORDS
Greek bailout; European stability mechanism; fiscal compact; prospect theory; Portugal; Spain; Malta; Italy; Greece; Cyprus

With the exception of Malta, South European countries were severely hit by the Great Recession, i.e the financial and economic crisis that started in 2008 and brought about profound consequences such as the emergence of protest parties (Morlino & Raniolo 2017), the growth of Euroscepticism (Verney 2017), unprecedented levels of political instability (Bosco & Verney 2012, 2016), a shrinking of welfare states (e.g Wulfgramm, Bieber & Leibfried 2016), and higher socio-economic inequality (Dolvik & Martin 2015). As further explained in Section 4 below, a number of measures including financial assistance schemes and a strengthening of the Stability and Growth Pact (SGP) rules were introduced at the EU level in response to the crisis over the 2011–13 period. It is important to notice that such relevant reforms were negotiated and approved in a relatively short time span.

Moreover, although they imposed budget constraints bound to seriously impair their ability to respond to voters' demands, South European governments voted in favour of those reforms. The question arising from these circumstances is: considering the negative consequences those reforms would predictably produce, why did those governments agree to introduce and implement them? In other words, why did they decide to be unresponsive to their public opinion while other eurozone governments were much more responsive (on this point, see for instance The Economist 2012; Degner &

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Leuffen 2018)? In the relevant literature, such question is usually framed in terms of national preference formation, which according to liberal intergovernmentalist theory are the product of a process of domestic deliberation, mainly shaped by national economic interests (Moravcsik 1998). In this sense, the puzzle we aim to solve can be rephrased in these terms: what were the determinants of preference formation for South European countries during the euro crisis negotiations?

In addition to the now classic analyses of foreign policy (e.g Hill 2003), the limitations of the rational choice approach have been exposed by scholars emphasising the role of misperceptions in international politics (Jervis 1976), or that of psychological factors in national preference formation (McDermott 2004). Taking stock of these limitations, which also apply to more sophisticated versions of the rational choice approach as applied to international relations (see Kydd 2008; Snidal 2012), we aim to test the suitability of the so-called 'prospect theory' for explaining eurozone crisis decision making in Southern Europe.

In order to do so, we focus on three contested issues which emerged during the negotiations, that is the decision on whether or not to support Greece, the introduction and the lending capacity of the European Stability Mechanism (ESM), and the constitutionalisation of a balanced budget as requested by the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) also referred to as the 'Fiscal Compact'. Although these are not the only issues which surfaced during the negotiations, they nonetheless are among the most salient ones as they epitomise the member states' preferences on fundamental questions which are still debated today. While comparative analyses of the crisis in the sub-region usually focus on the largest South European countries only (see e.g Hassel 2014; Matthijs 2014; Morlino & Raniolo 2017), this article also includes Malta and Cyprus, therefore providing a complete and more nuanced picture of the responses to the crisis.

The second section illustrates the theory and method used to tackle our research question. The third section contains a synthetic account of the unfolding of the crisis in the countries considered. The fourth section provides a short overview of the reforms to EMU governance introduced in the wake of the financial-turned-sovereign debt crisis. The fifth one shows that, with the exception of Malta, decision making in South European countries was mostly characterised by a low level of involvement of the parliaments and, consequently, the decisions were taken by a limited number of individuals, with a very low level of engagement of the parliamentary opposition. The subsequent sections discuss national preference formation in the countries considered *vis-à-vis* three case studies which emerged during the negotiations. In the concluding section the relevance of prospect theory in explaining convergence and divergence in the positions adopted in response to the crisis by South European member states is restated.

Theory and method

According to prospect theory, when a decision has to be made under risk, as is the case with any complex decision characterised by uncertainty, 'behaviour is based not on the individual predispositions of a particular leader, but evolves out of a cognitive response to a situation that constrains the way options are interpreted and choice is made' (McDermott 1998, 4). A key element of this empirical theory as originally developed by Kahneman and Tversky (1979) is that individuals tend to be risk-averse in the domain of gains, meaning that when things are going well, people tend to be cautious as they do not want to risk losing what they already have for uncertain gain. On the other hand, they tend to be risk-seeking in the domain of losses, namely when they anticipate losses in case they do not act. In other words, when individuals feel their situation is desperate, they are more likely to take big chances in the attempt to recoup their losses (McDermott 2009).

Consequently, the decision-maker's interpretation of the situation is pivotal both in terms of preference formation and in terms of negotiating tactics. At the same time, the framing of the decision is also crucial for the assessment of the situation and especially for the definition of available options. As far as our research question is concerned, it must be stressed that a key framing role is played by EU institutions: as Puetter (2014) and Csehi and Puetter (2017) put it, governments' preferences are inherently tied to their EU-level interactions rather than being the result of a purely domestic deliberation process. Therefore, keeping in mind prospect theory (Kahneman & Tversky 1979) and its former applications (e.g McDermott 1992, 1998) we can specify our research question by looking at the interpretation of the situation by the South European political leaders in terms of gains and losses in the context of their interactions with other governments in the EU arena.

To this end, we also need to mention a feature that for obvious reasons both Kahneman and Tversky and later on McDermott overlooked, but that deserves special attention here with regard to the decisions made and the individuals involved. That is, we need to consider 'shortermism', or the simple fact that when assuming their stances, elected politicians typically have a temporal horizon that is delimited by the next elections. Consequently, the analysis of gains or losses is usually done within a very short time horizon: if losses (for instance, possible electoral punishment) may emerge later, but gains (for instance, avoiding uncontrolled financial default) are expected to materialise soon, then we are within the domain of losses and risk seeking, rather than gains and risk aversion.

In a nutshell, we argue that in the context of the Euro crisis negotiations, South European decision makers were operating in the domain of (short term) losses. Consequently, they were willing to take the risk of being unresponsive to their voters. Of course, although Southern Europe is often presented as a relatively homogeneous group of debt-ridden countries (Hall 2012; Schild 2013; Schimmelfennig 2015; Copelovitch, Frieden & Walter 2016), we cannot expect decision makers from each and every country to have assessed the situation in the exact same way. Nevertheless, for the reasons outlined above, it is reasonable to assume that the individuals involved in decision making on behalf of the countries considered were operating within a domain of short-term losses.

To empirically check the hypotheses that stem from this theoretical frame we need to know how South European incumbent elites interpreted the situation in which they were involved. For this purpose, we rely on official documents as well as research conducted in the framework of the Horizon 2020 Project 'The Choice For Europe since Maastricht' (EMU Choices), [1] based on 34 in-depth elite interviews with former negotiators and policy-makers such as ministers of finance, high-ranking officials from finance ministries, central bank governors, Members of Parliament, ministers of European and/or foreign affairs from the countries considered. The names and exact positions of the interviewees are subject to strict confidentiality as stipulated in the Data management Policy and Ethics Clearance of the EMU Choices Project.

The interviews used for this study are a subset of a larger data set, EMU Formation (EMUf), created by the EMU Choices research consortium and relying on 141 structured interviews conducted in the 28 EU member states between May 2016 and March 2017. The dataset includes influence scores for 23 different domestic and external actors that were potentially involved in the formation of national preferences *vis-à-vis* reforms in fiscal and economic governance of the EMU that were debated during the 2010–2015 period. The codes used for citing interviews in this article (e.g 'ITA1') are a simplified version of those used by the EMU Formation data set created by the EMU Choices consortium.[2] An important premise is that the theoretical framework adopted would be particularly appropriate (and the salience of the empirical results higher) if we could show that the number of individuals involved in the decisions was low, which is partially in contrast with what was suggested by other theories of European integration, in particular liberal intergovernmentalism, which theorises national preference formation as a process involving a plurality of actors and interests. Consequently, this aspect will also be taken into account in our empirical analysis.

The unfolding of the crisis: six different stories

To better illustrate the background against which the decisions under scrutiny were made, it is useful quickly to recall how the crisis unfolded in each of the countries considered. Figure 1 provides a visual representation of the different evolution of the crisis in Southern Europe as reflected in the spread between Germany's 10-year government bonds' yields and those of the countries considered, highlighting the dramatic reaction of financial markets to economic and political developments in all South European countries, again with the exception of Malta. Table 1 instead provides a synthetic overview of the most immediate causes for the crisis in each country, emphasising each country's key vulnerabilities.

Table 1. A comparative overview of the causes of the crisis in Southern Europe.

Country	Vulnerability
Greece	• Loose budgetary policy • Excessive borrowing • Poor accounting practices
Portugal	• Economic stagnation • Low productivity in the decade prior to the crisis
Spain	• Construction bubble fed by easy credit and subsequent shock • Inadequate banking sector regulation
Italy	• Economic stagnation • High public debt • Low productivity in the decade prior to the crisis • Poor quality of regulation
Cyprus	• Sluggish growth since 2008 • High levels of government spending since 2008 • Hypertrophic banking sector • Overexposure of the banking system to Greek financial institutions
Malta	• Not affected by the crisis

Sources: Authors' elaboration. See also Reis (2015) for Portugal; Ortega and Peñalosa (2012) for Spain.

As for Greece, a tradition of poor accounting practices combined with excessive government borrowing created the conditions for the 'perfect debt storm' to happen in the second half of 2009, once the financial crisis which started in the US spread to European markets. Accordingly, the Greek crisis is the only one genuinely linked to budgetary policy (Stein 2011).[3] Facing bankruptcy and the risk of a forced 'Grexit', as reflected in skyrocketing government bond yields (see Figure 1), the socialist government led by George Papandreou sought and obtained a first bailout worth 110 billion euros in May 2010; a new short-lived three-party coalition led by technocrat Lucas Papademos took over in November 2011 and finalised the negotiation of a second bailout package in February 2012; then political instability led to new elections in May and June 2012, resulting in a new coalition government led by centre-right leader Antonis Samaras. In spite of their divergences in terms of ideological orientation, all three Greek cabinets proved willing to commit the country to painful structural reforms to avert the risk of an imminent 'Grexit'.

After Greece and Ireland, Portugal became the third eurozone country to apply for a bailout. In the face of increasing pressure from financial markets and the looming risk of a default, in September 2010 the Portuguese government announced the introduction of austerity measures, including a freeze on state pensions, cuts in public sector wages and a rise in value-added tax (Wise 2010). On 23 March 2011, the Portuguese parliament rejected a further government-sponsored austerity package, a move that triggered the resignation of the prime minister and paved the way for a snap election the following June. Amid political turbulence and after losing access to financial markets, in April 2011 Portugal applied for a bailout. In May a memorandum of understanding (MoU) listing the conditions for disbursement of financial support was signed by the Portuguese government and the so-called 'Troika' of international lenders (the European Commission, the European Central Bank, and the International Monetary Fund). The need to minimise the risk of a forced withdrawal from the eurozone prompted the Portuguese executive to completely align with the Troika's requests in terms of policies of structural adjustment (POR5, POR6), to the point of appearing 'more German than the Germans' (Lisi & Ramalhete 2018).

Also for Spain, the enabling conditions for the crisis cannot be directly found in the lack of fiscal discipline. Unlike Greece and Italy, in the years before 2008 Spain did not engage in excessive borrowing. Moreover, unlike Portugal, its GDP growth rate in the five years before the crisis hit was between three and four per cent, and consequently the public debt was on a negative trend (World Bank 2015). The distinctive feature of the Spanish case is the construction bubble fed by easy credit. When the bubble burst in 2011, the shock spread to the rest of the economy through virtually all existing channels: tightening financial conditions slowed down demand for housing, which pushed down house prices and had a negative impact on employment and on the banking sector (especially the regional *cajas*). These circumstances led to the June 2012 decision by the Spanish government, led by Mariano Rajoy, to accept (up to) 100 billion euros as a 'loan' by the ESM to recapitalise the country's ailing banks. A formal MoU was avoided, nonetheless in order to receive financial support and contain the risk of a financial meltdown the Spanish government accepted harsh conditions, with nationalised banks cutting jobs and imposing losses on their creditor bondholders.

The situation of Italy when the crisis erupted was yet different from that of the other South European countries. For most of its recent history, Italy has been characterised by high public debt. Nonetheless, the country has also always had a good reputation in terms of debt management. Italy's Achilles heel was (and to a large extent still is) to be found in the poor quality of regulation, a business climate that discourages foreign and domestic investment, low labour productivity, corruption, all factors that account for 'two lost decades' in terms of economic growth in the country, as the IMF recently put it (Miglierini 2016).

Just as in Greece, the crisis in Italy had a relevant political fallout in terms of governmental instability. As fear of contagion – epitomised by skyrocketing 10-years bond yields – soared at the end of 2011,[4] the government led by Silvio Berlusconi was replaced by a technocratic cabinet led by former EU commissioner Mario Monti. Italy is the only country which managed to avoid any direct involvement of the Troika, although this can be explained as the effect of an 'internalisation' of a 'Troika-type' oversight via the installation of Monti's technocratic cabinet (Sacchi 2015; Moschella 2017; Morlino & Sottilotta 2017). The perceived risk of a possible default and a humiliating 'Italexit' from the 'euro club' produced a substantial alignment of all domestic actors in supporting government-sponsored austerity measures whose possible long-term fallout in terms of unresponsiveness was essentially overlooked by decision makers.

While until 2007 the fiscal position of Cyprus was quite sound, by May 2011 the situation of the country had changed dramatically. The roots of Cyprus' financial difficulties can be found in sluggish growth since the beginning of the financial crisis in 2008 and increases in government spending after the Cypriot Communist party took over in the same year, complemented by the overexposure of the Cypriot banking system to Greek financial institutions. On 26 October 2011, the European Council agreed to '…a significantly higher capital ratio of nine per cent of the highest quality capital and after accounting for market valuation of sovereign debt exposures, both as of 30 September 2011, to create a temporary buffer… to be attained by 30 June 2012' (European Council 2011a). At that point, a feedback loop in Cyprus was unavoidable: while it was extremely hard for Cypriot banks to raise the necessary capital, it would have been equally difficult if not impossible for the government to bail in the banks.

Unwilling to initiate a structural adjustment programme under the aegis of the Troika, in the second half of 2011 the Cypriot government bought itself some time by securing a 2.5 billion euros emergency loan from Russia, which was nonetheless only meant to offer support for the country's budget deficit and excluded any recapitalisation of the country's banking sector (Katsourides 2014, p. 52). In June 2012, a downgrade of the Cypriot sovereign by all of the 'Big Three' credit rating agencies made government debt not eligible as a collateral for borrowing from the euro system. As the risk of exiting the eurozone materialised, the government finally asked for assistance for its banking system (The Economist 2013). In March 2013 the newly elected conservative president agreed to a bailout deal worth ten billion euros and envisaging a haircut to bank deposits under the threat that the ECB would stop providing liquidity to the Cypriot banking system (The Economist 2013). A MoU between Cyprus and the Troika was finally signed in April 2013.

Unlike the other five South European countries, and in spite of the relevant role played by financial services in the economy, Malta was virtually untouched by the eurozone sovereign debt crisis (see also Figure 1 and Table 1 above) due to generally good levels of capitalisation, the relatively low level of external exposure of domestic banks (Azzopardi 2009, p. 105) and an overall economic stability. During the 2013 Maltese general elections issues of competence and credibility of the rival parties were dominant, while the eurozone crisis did not play a relevant role (Fenech 2013).

Negotiating the crisis: a mosaic of responses

In September 2008 US financial behemoth Lehman Brothers collapsed, with the ensuing credit crunch marking the start of a financial crisis which soon

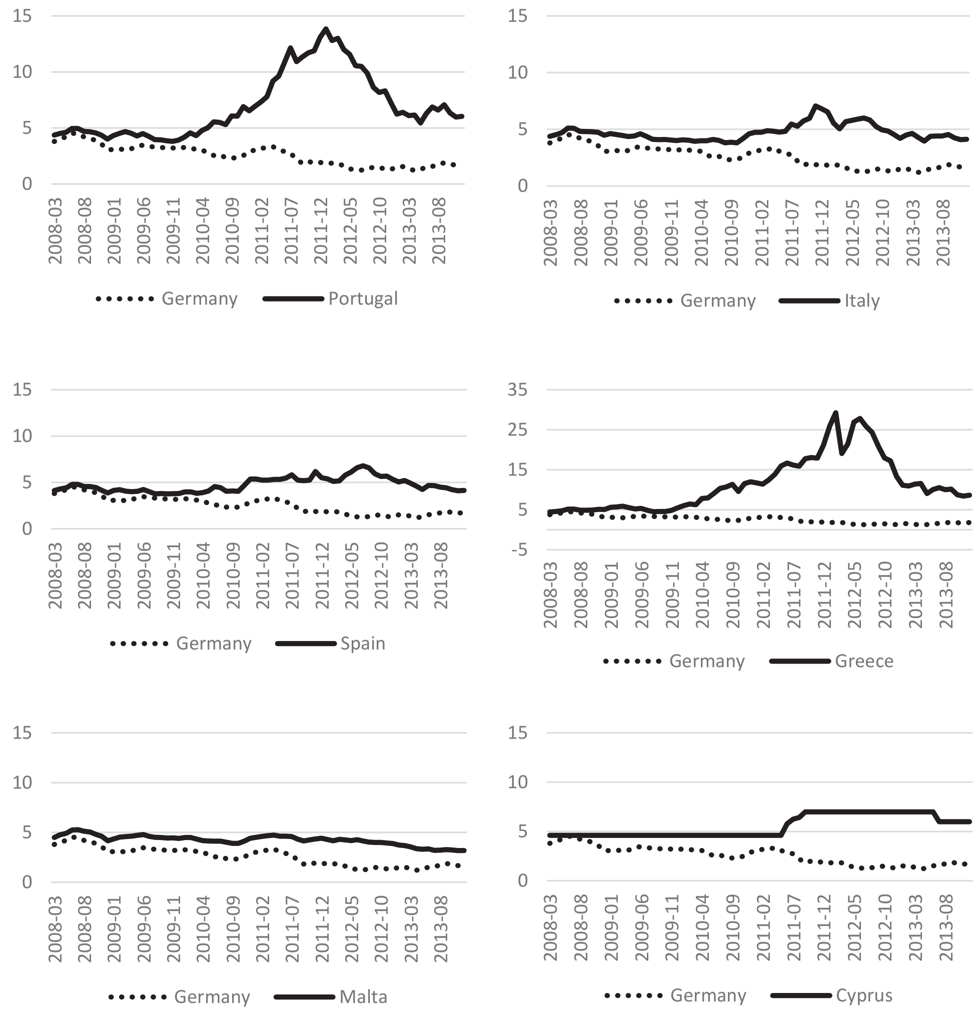

Figure 1. Long term interest rates (%) on government debt 2008–2013. Southern Europe vs. Germany.

Source: Authors' elaboration based on data by the OECD and the European Central Bank (2018) reached Europe. By the end of 2010, what had started as a quintessentially financial crisis had turned into a full-fledged sovereign debt crisis. As hinted at in the previous section, fear of contagion started to spread in October 2009 after Greek finance minister Papacostantinou disclosed that the country's deficit in that year would soar to 12.5 per cent of GDP, a much higher figure compared to that originally estimated by the former conservative government (Barber 2009). In May 2010 Greece lost access to capital markets.

A Greek Loan Facility (GLF) was initially created but it became soon clear that a broader approach to the problem was needed. Two lending facilities were then established to support eurozone countries experiencing fiscal difficulties: a European Financial Stabilisation Mechanism (EFSM) was ceated in May 2010 and placed under the rcontrol of the European Commission, with a relatively small lending capacity (60 billion euros), and the European Financial Stability Facility (EFSF) was set up in June 2010 as a temporary 'special purpose vehicle' managed by the European Investment Bank, with a lending capacity of 440 billion euros supplemented with a 250 billion euros commitment by the International Monetary Fund (IMF). Nonetheless, as the spread between Germany's 10-year government bonds interest rate and those of Greece, Ireland, Italy, Portugal, and Spain kept soaring (see Figure 1), it became apparent that the EFSF and EFSM, also due to their temporary nature, were far from being a panacea for financial turbulence in the euro area (Sibert 2010, p.4).

In July 2011 the need for a permanent financial assistance mechanism pushed the eurozone member states to sign an intergovernmental treaty establishing the European Stability Mechanism (ESM), whose lending capacity was set at 500 billion euros. Its payments – crucially subject to conditionality – were meant to operate as a 'liquidity bridge' (Kapp 2014) to support countries until they reacquired capital market access. In order to address the shortcomings of the institutional framework underpinning the process of financial integration within the EU (Jones 2015), after the introduction of the ESM further steps were also taken toward the creation of a European banking union. More specifically, the second half of 2012 was characterised by an intense discussion on how to complete the EMU by introducing a common system governing the regulation, supervision, and resolution of financial intermediaries (Howarth & Quaglia 2013). Parallel to the negotiation of financial support schemes, important fiscal integration steps were taken by EU member states. Since its inception, the Stability and Growth Pact had lacked effective enforcement mechanisms, apart from 'peer pressure', 'moral suasion' and a no-bail out clause which was generally deemed an adequate disincentive to discourage fiscally irresponsible behaviours (Larch, van Den Noord & Jonung 2010).[5]

The so-called Six Pack was introduced in December 2010 with the aim of addressing public deficits and macroeconomic imbalances by reinforcing economic and fiscal surveillance in the EU. Its provisions also introduced a comprehensive framework for the coordination and monitoring of fiscal policies across member states with standardised deadlines throughout the year (the so-called 'European Semester'). On 9 December 2011, while taking stock of the new rules contained in the Six Pack, the European Council recognised that not all the necessary measures could be introduced via secondary law. More specifically, some member states were reluctant to introduce further solidarity measures in absence of a parallel increase in common, credible, constraints on national expenditure (Mortensen 2013, p.14). At the same time, as the UK had overtly rejected the hypothesis of incorporating them into the EU treaties (Spiegel et al. 2011), the only viable solution left was the conclusion of an international agreement to be signed by March 2012 (European Council 2011b).

This led to the negotiation of the Fiscal Compact, eventually signed in March 2012. Among the other things, the signatories of the treaty committed to enshrining a 'debt-brake' rule into their own constitutions, following the analogous principle – the so-called *Schuldenbremse* – already introduced into the German constitution in 2009. The signatories also accepted to be subject to the jurisdiction of the EU Court of Justice, which oversees the transposition of such rule at the national level. Moreover, as explicitly stated in the preamble to the Fiscal Compact, the granting of financial assistance under the umbrella of the ESM is conditional on the ratification of the Fiscal Compact itself. In March 2013 the Two Pack regulations were approved and they granted to the Commission the power of examining and issuing an opinion on the draft budget for the following year, which each euro area country had to submit every year by 15 October. In case of patent misalignment of a member state's budgetary plan *vis-à-vis* the obligations deriving from the SGP, the Commission can ask the member state to revise the plan and resubmit it.

South European choices: who were the decision makers?

In light of the rapid unfolding of events during the most acute phase of the crisis (2010–2013) and of the limited amount of financial resources available to the EU, it is not surprising that in general, the member states' governments played a central role even after the activation of EU mechanisms. Especially at the height of the crisis, an intergovernmental logic prevailed, with member states pursuing their national interest through bargaining and deliberation within the Council of the EU (Bickerton, Hodson & Puetter 2015), while the Commission and the European Parliament were effectively marginalised (see e.g Fabbrini 2013).

As illustrated in the next section, the South European countries reacted differently to the contested issues that emerged during the euro crisis negotiations, but one common aspect was the concentration of decision making in the hands of the executive, typically the prime minister and the minister of finance. In the case of the first contested issue discussed in the next section, for instance, Italy and Spain were respectively the third and the fourth largest contributors to the bailout after Germany and France. Nonetheless, in both cases the disbursement was authorised via governmental decree, entailing much less room for debate than ordinary law.

For our purposes, it is important to consider the relative influence exerted by domestic actors involved in the processes of deliberation and national preference formation. The case of Greece is once again emblematic. Since its inception (1974), the Third Greek Republic has typically been characterised by a dominant role of the prime minister, which can be ascribed to institutional factors, such as the strong agenda-setting power of the government and the fact that the ratification of the budget follows a procedure whereby MPs are not allowed to propose amendments (Alexopoulos 2015). In this vein, as stressed by Sotiropoulos (2015), the poor record of the Greek Parliamentary committee on European Affairs is one of the factors explaining the lack of elaborated positions on policy issues arising in the EU public sphere. It is therefore unsurprising that parliament's involvement in the formation of preferences during the euro crisis negotiations was marginal, to the point that crucial policy documents, such as the May 2010 MoU, were 'presented to the Greek Parliament as a piece of information rather than an issue to be debated in the Parliament's plenum' (Sotiropoulos 2018b).

Matters of institutional architecture also explain a similar pattern of executive dominance in Portugal. Here, a process of 'governmentalisation' of mainstream parties took place whereby the ministerial selection of experts and non-partisan members of the professional elites reinforced leaders' power over the cabinet (Lisi 2015, pp. 59–60). Such asymmetry is all the more evident when it comes to parliamentary control over the government on European issues. In particular, in the context of the implementation of Portugal's MoU, after the June 2011 general election, the centrality of the government was underpinned by new prime minister Passos Coelho's decision to appoint technocratic, non-partisan ministers to key austerity-stricken portfolios, namely the economy, healthcare, and education. This move was dictated by Passos Coelho's preference for ministers displaying ideological proximity with his own views and substantial alignment with the preferences expressed by Germany on EU matters (Moury & Standring 2017). It *de facto* enhanced the new ministers' accountability to the prime minister (Lisi & Ramalhete 2018).

For Spain, a high level of centralisation in decision making could also be observed, and in parallel, the number of actors involved in the process was strikingly small. This is epitomised, for instance, by the fact that the constitutionalisation of the debt brake, which required the amendment of article 135 of the Spanish Constitution, was not publicly debated, but rather agreed upon behind closed doors by the ruling PSOE (Partido Socialista Obrero Español-

Spanish Socialist Workers' Party) and the main opposition party, the centre-right PP (Partido Popular – Popular Party), and then submitted to parliament, resorting to a swift procedure and without a confirmatory referendum (Gutiérrez Calvo & Muñoz 2011). A low level of involvement by parliament and other relevant social and political actors also characterised the negotiation by the PP-led government of the MoU for the financial support Spain received (avoiding a formal bailout under Troika supervision). The Spanish MoU was kept secret until its existence was disclosed during a Dutch parliamentary debate on the Spanish bailout (Navarro 2012). This secrecy engendered strong criticism *vis-à-vis* the Spanish government when it became clear that financial support was conditional on relevant reforms in the Spanish banking system (Coller Porta & Ramírez de Luis 2018).

Italy is another case in which parliament was essentially marginalised throughout the whole phase of the euro crisis negotiations. On the one hand, in the period considered, Italy was struggling to regain credibility in the eyes of international markets and of the other EU countries, Germany in particular. Such a situation of 'national emergency' explains why, as mentioned above, there was very little debate about – and virtually no opposition to – the constitutionalisation of the debt brake. Meanwhile, austerity measures, such as a reform of the pension system promoted by Monti's technocratic government, were approved by parliament with a comfortable majority (Pogliotti & Rota Porta 2012). On the other hand, it should also be noticed that, as one interviewee put it, 'the engagement of the parliament … [was] very much dependent on the level of competence of MPs, which was not necessarily high, especially considering the technical nature of the issues discussed during the negotiations' (ITA.00). Unsurprisingly, the flow of information between government and parliament before the relevant meetings at the EU level was also typically poor.

The pattern of decision making was very different in Malta, where a long and intense debate took place in parliament throughout the eurozone crisis. Such parliamentary involvement is epitomised by the fact that the debate on the Fiscal Compact lasted more than nine sittings over two legislatures, thanks to the role played by the opposition which insisted that the parliament retain control and have the final word on every measure adopted during the negotiations.

Issues of national sovereignty were key also to Cyprus, which shares with Malta both the status of small state and the British colonial legacy (Faustmann 2008). Nevertheless, compared to Malta, the management of the euro crisis negotiations was much more concentrated in the hands of the executive. While this concentration of power was partially due to institutional factors, bearing in mind the country's presidential system, the low capability of parliament to scrutinise the activity of the government was due to a lack of resources and know-how on both EU-related and budgetary issues (Katsourides 2018). This resonates with the thesis that the Cypriot elites' failure to foresee possible negative developments for Cyprus and the overexposed banking system was symptomatic of the dominance of local politics over sound economic policy making in the response to the crisis (Orphanides 2014, p.15).

Based on the analysis conducted so far, it is possible to conclude that euro crisis decision making in Southern Europe was crucially influenced by a limited number of individuals belonging to a small governmental elite. As anticipated above, this reinforces our argument in favour of prospect theory as a suitable theoretical framework for our analysis. Moreover, it should be stressed that our results are in line with those obtained by other researchers working on similar issues. Based on the EMU positions (EMUp) data set developed by the EMU Choices consortium (see Wasserfallen et al. 2018),[6] Tarlea et al. (2019) conducted a quantitative analysis of a larger number of contested issues, including those we analyse here. In explaining preference formation during the euro crisis negotiations, these authors emphasise the lack of correlation between public opinion and governments' negotiating positions, thereby confirming that the decisions were actually made by a relatively small group of individuals as suggested above. Moreover, they show that governmental preferences were mainly influenced by the conditions of the domestic financial sector: in the presence of a highly exposed financial sector, the government is more willing to accept an expansion of the prerogatives of European institutions.

As already mentioned, it is important to keep in mind that in broader terms none of the governments of the six South European members states had the intention of leaving the monetary union. It is well known the status quo was largely preferred to any 'exit' scenario as the eurozone was recognised as a necessary shield against market speculations. In terms of prospect theory, the dreaded eventuality of being 'kicked out' of the eurozone clearly placed decision makers in all South European countries in a domain of losses. Even in the case of Malta, whose own membership in the eurozone was not directly at stake, the prospect of a systemic crisis engendered by the uncontrolled default of one of the larger South European member states was perceived as a serious threat.

This preference for the *status quo*, complemented by the fear of market punishment, also implied that no leader could openly express benign interest in the problems that were afflicting other South European countries. This explains why a 'Southern' coalition never materialised and any leader's initiatives in that sense were bound to be dismissed by other leaders. The unsuccessful bid by Italian prime minister Romano Prodi in September 1996 to convince Spanish prime minister Aznar to coalesce with him to soften the Maastricht parameters for admission to the eurozone, stands as the last attempt to create a South European coalition on these issues.

In order to allow for the next explanatory step, it is necessary to analyse the assessment of the situation by domestic decision makers to see what short-term gains (or losses) they expected to incur as a consequence of supporting or opposing the EMU reforms considered. In other words, it is necessary to look at some of the contested issues that emerged during the euro crisis negotiations and to unpack the positions adopted by the countries considered. As explained above, we decided to focus on the decisions on whether or not to support Greece, the introduction and lending capacity of the European Stability Mechanism, and the constitutionalisation of a balanced budget as requested by the Fiscal Compact.

The first Greek bailout

The discussion on whether or not to support Greece, one of the first issues to spur debate among EU member states during the euro crisis, took place before the Greek government decided to formally ask for support in May 2010 (see Table 2 for a summary of country positions). In fact, the Eurogroup had decided to offer support on 15 March 2010 (European Commission 2010).

Greece

From the standpoint of Greece, according to the results of our investigation the catastrophic implications of the country's predicament and the costs of structural adjustment were clearer to the government than to any other domestic actor. As the first Greek rescue package accompanied by the first MoU was rushed through parliament, the wider public remained substantially uninformed of the actual extent of the problems ahead. Meanwhile, most of the Greek mass media hoped that the reversal of the traditional Keynesian policies of PASOK (Πανελλήνιο Σοσιαλιστικό Κίνημα-Panhellenic Socialist Movement) would be temporary (Sotiropoulos 2018b).

Table 2. Preferences of South European Member-States on First Greek Bailout.

Member State	National preference
Cyprus	The government was strongly in favour of assisting Greece, supported by parliament and public opinion (CYP2, CYP3, CYP4, CYP5).
Greece	The government was in favour of the bailout deal, with resistance from the centre-right official opposition and the radical left (HEL2).
Italy	The government was in favour of assisting Greece, acting as quickly as possible to avoid contagion (ITA1).
Malta	The government was in favour of assisting Greece, mainly to defend the monetary union (MLT2, MLT3), but embraced the concept that Greece had to be held accountable for fiscal mismanagement (MLT5, MLT5), without substantial objections by the opposition.
Portugal	The government was in favour of assisting Greece, supported by the main parties on both sides of the political spectrum (POR1, POR2, POR3, POR4, POR6, POR7, POR8).
Spain	The government was in favour of assisting Greece within a broader vision of EU integration, supported by parliament and public opinion (ESP3, ESP4).

Source: Authors' elaboration based on the EMUf dataset.

With the spectre of bankruptcy looming over the country, there was neither room for manoeuvre nor enough time for other domestic actors such as private banks or independent authorities to discuss or resist the government's application for external support. However, labour unions disapproved of the austerity-based rescue package and began to mobilise, triggering a process of disengagement from the main parties and subverting the traditional pattern of authoritarian corporatism typical of Greek state-labour relations (Sotiropoulos 2018a). Violent popular resistance to austerity erupted in early May 2010 and went on until May 2012, with other forms of resistance continuing until January 2015, when the radical left SYRIZA (Συνασπισμός της Ριζοσπαστικής Αριστεράς – Coalition of the Radical Left) won the general election. But Greece's negotiating positions were not influenced by the protests, with Greece's policy making process remaining closed to systematic and coordinated consultation of non-governmental actors, a pattern which was already present before the outburst of the crisis (Valinakis 2012). The stance of the other South European countries *vis-à-vis* the first Greek bailout was one of general support, but with different nuances.

Spain

At the time of the first bailout negotiation, the socialist government led by José Luis Rodríguez Zapatero lent its support to Greece, ostensibly because of the prime minister's Europeanist vision and the belief that multilateral mechanisms are preferable to bilateral ones when it comes to consolidating the EMU. As Zapatero stated in parliament, the euro's strength 'will depend on our will to stand together against the crisis and our determination to pursue the needed reforms in the economic governance of the EU' (Congreso de los Diputados 2010, 5). Nevertheless, at least three other elements modulated this general stance: 1) the risk of contagion, as the Spanish economy was quickly deteriorating with growing unemployment, an increasing public deficit and unusually high household debt; at the same time, there was a general feeling that supporting Greece would calm financial markets and reduce the uncertainty surrounding the future of the eurozone; 2) a perceived lack of political alternatives, considering the credit exposure of French and German banks to Greece; 3) ideological affinity between the Socialist government in Spain and PASOK in Greece (Coller Porta & Ramírez de Luis 2018).

Portugal

At the time of the negotiation of the Greek bailout, Portugal was mainly focused on domestic politics: the government budget for 2010 was presented only in January 2010 and a higher-than-expected budget deficit of 9.3 per cent of gross domestic product was reported for 2009 (Lewis & House 2010), while the European Commission recommended that a process of fiscal consolidation be initiated as soon as possible. On 16 March, after the Eurogroup 'reaffirmed the commitment by euro area Member States to take determined and coordinated action, if needed' to support Greece (European Commission 2010), Portuguese Finance Minister Teixeira dos Santos publicly declared that Portugal was itself in a delicate position, due to which it could hardly support an increase in public debt to assist Greece. Nevertheless, within a few weeks, as the systemic dimension of the crisis and the urgent need for a European-wide response became undeniable, the position of the Portuguese government switched from such a recalcitrant attitude *vis-à-vis* the perspective of participating in a bailout to full and unconditional support for Greece (Lisi & Ramalhete 2018).

Italy

During the negotiation of the Greek bailout package, Italy's government was not excessively alarmed, in view of the fact that the Italian banking system was much less exposed to Greece than its German and French counterparts. Nonetheless, considering Italy's worryingly high level of public debt, from the very beginning the Italian government was in favour of a timely intervention to support Greece for fear of contagion.

Malta and Cyprus

A comparison between the positions adopted with respect to the Greek bailout by the two smaller South European states, i.e Malta and Cyprus, exposes interesting divergences. While a primary concern of both countries throughout the negotiation was to maintain a certain degree of autonomy and to avoid being marginalised and relegated to a subordinate position *vis-à-vis* the larger member states, their attitudes towards Greece were very different. All of the policy makers interviewed indicated that Cyprus was unequivocally in favour of assisting Greece at any cost. This was for several reasons, including the fact that at the time Cyprus' economy was faring relatively well, at least in the perception of the public. A central role was also played by the special relationship between Greece and Cyprus and the widespread sentiment of fraternity between the populations of the two countries (Katsourides 2018). On the other hand, Malta's position was heavily influenced by concerns about the consequences of a potential collapse of the EMU. In line with the government's position, the Maltese Parliament advocated in favour of strong conditionality to be attached to any lending to Greece. Maltese policy-makers shared the view that Greece was by and large responsible for its predicament, and therefore they wished to receive guarantees that any lending to the Greek government would be conditional on the implementation of structural reforms and improvements in fiscal and economic governance (Pace 2018).

In a nutshell, our analysis lends further support to the hypothesis tested by Tarlea et al. (2019). However, in order better to clarify the specific determinants of South European leaders' decision making on this issue, special attention should be devoted to the assessment of the situation as one where avoiding the risk of contagion was imperative and there was a perceived lack of political alternatives. This of course does not mean that all other factors should be completely excluded from the analysis. For instance, to add further complexity to the picture, it is important to consider 'ideological' proximity between governments based on either partisanship (Socialist leaders both in Spain and in Greece) or traditional 'special relationships' (Greece and Cyprus).

The creation and size of the ESM

Another key measure negotiated during the crisis was the introduction of a permanent facility devoted to financial stability, that is the ESM, to replace the pre-existing temporary schemes (see Table 3). During the negotiation, an important issue emerged with regard to the possibility of endowing the ESM with firepower greater than 500 billion euros, a figure that was considered adequate by some member states such as Germany, Austria, and Finland. Looking at the preferences expressed by the South European countries, it is possible once again to notice that while (although with different nuances) there was an overall preference for the ESM to be larger, the six South European member states did not coalesce and eventually accepted the 500 billion euros figure. The European Council decided to establish the ESM in March 2011.

Greece

Although the Greek government would have preferred the ESM to have been larger, at that point Greece was already under the yoke of the first MoU. This meant that it was relegated to the role of a policy-taker and had no other

Table 3. Preferences of South European Member-states on Creation and Size of the ESM.

Member State	National preference
Cyprus	The government was in favour of the creation of the ESM with as big firepower as possible (CYP04, CYP05).
Greece	The government wanted the ESM to be larger than 500 billion Euro (HEL1, HEL2, HEL4).
Italy	The government wanted the ESM to be larger than 500 billion Euro (ITA1).
Malta	The government wanted the ESM to be as large as necessary (MLT4, MLT5).
Portugal	The government wanted the ESM to be as large as possible, but knew that a size greater than 500 billion Euros would be difficult to achieve (POR2, POR4, POR5).
Spain	The government wanted the ESM to be as large as necessary (ESP5, ESP6).

Source: Authors' elaboration based on the EMUf dataset.

option than to support the establishment of a new institution which in the future would be at the disposal of eurozone countries facing major economic difficulties (Sotiropoulos 2018b).

Spain

The socialist government led by Zapatero was very much in favour of the introduction of an ESM whose lending capacity which would be as large as possible. This was based on the belief that the introduction of a European mechanism would be a first step in the direction of fixing the incomplete architecture of the eurozone. It should also be recalled that the financial situation of Spain was rapidly deteriorating, therefore the Spanish government participated in the ESM negotiation knowing that it might possibly need to resort to it in the near future.

Portugal

The government maintained a low profile with respect to this issue. Its preference with regard to the size of the ESM was that the higher the amount available for lending, the better (Lisi & Ramalhete 2018). Nonetheless, the Socialist cabinet in power never expressed this preference openly, for fear of creating a perception, in the financial markets and the other EU member states, of an imminent Portuguese default. This was essentially one of the reasons why most countries, especially those in a situation of vulnerability, ended up bandwagoning with the larger EU member states instead of promoting the creation of a 'peripheral' coalition to advance an alternative agenda.

Italy

The issue of the size of the ESM was not discussed publicly. However, all of the institutional actors involved, including the Bank of Italy, would have preferred a larger lending capacity. They were well aware of the fact that 500 billion euros would perhaps have been enough to bail out a smaller member state but was certainly an inadequate amount to rescue larger member states such as Italy and Spain. As in the Portuguese case, what shaped the Italian government's position was the risk of creating the perception of an imminent default. The medium-to-long-term costs of the ESM were overlooked in the face of the short-term need to reassure the markets about Italy's creditworthiness.

Malta and Cyprus

As already stressed, Malta was not experiencing financial turbulence at the time that the ESM was negotiated. Therefore, unsurprisingly, the domestic debate hinged on the necessity of providing the EU with a powerful tool to settle uncertainty and calm down financial markets. The introduction of the ESM was essentially perceived by all political actors like a 'nasty medicine which you would have to swallow', as a former Maltese policy maker put it (MLT3), to mitigate systemic risks. In Cyprus, there was virtually no domestic debate. The government immediately lent its support for the creation of the ESM with the highest possible lending capacity: this measure was perceived as an indispensable tool to support Greece and other troubled EU member states (Katsourides 2018).

Going back to prospect theory, it can be said that the key reason behind the preferences expressed by the six countries considered was an assessment of their situation within the domain of possible short-term losses. Supporting EMU reforms would have brought about immediate gains in terms of reducing uncertainty and restoring market stability, while the potentially problematic implementation of those reforms and the predictably negative reactions by voters would have materialised later, if ever. The apparently more neutral position of Portugal is also very revealing insomuch as it lends further support to our explanation of why a 'Southern' coalition did not emerge. As stated above, the government's top priority was to avoid being seen in a situation of forthcoming financial default.

The constitutionalisation of the 'debt brake'

Another important issue that emerged during the negotiation of the Fiscal Compact, was whether and how to institutionalise the commitment of member states to budgetary discipline by incorporating a debt brake into the domestic legal systems (see Table 4). In the first two drafts of the treaty, reference was made to 'national binding provisions of a constitutional or equivalent nature', a vision that embodied the German preference, while the final text (approved on 2 March 2012) included a 'softened' version of the original formula, referring to 'provisions of binding force and permanent character, preferably constitutional, that are guaranteed to be respected throughout the national budgetary processes' (Kreilinger 2012, p. 4). This issue was particularly sensitive, not only because of its symbolic value but also because procedures of constitutional reform varied greatly across EU countries.

Greece

The Greek constitution is rigid, requiring a complex and lengthy procedure in order to amend it. Moreover, enshrining the balanced budget rule into the constitution would have meant giving it high visibility at a time of social conflict and high political risk for the government. At the same time, due to its predicament it was virtually impossible for Greece not to commit to the balanced budget rule, and the choice for the government was once again

Table 4. Preferences of South European Member-states on constitutionalisation of the 'debt brake'.

Member State	National preference
Cyprus	The government opposed the constitutionalisation of the 'debt brake' and it was introduced via ordinary legislation (CYP2).
Greece	The government's position was constrained by constitutional impediments which did not allow it to pass anything more than an ordinary law (HEL1, HEL2, HEL3, HEL4). A constitutional reform would have also been politically difficult to achieve (HEL5).
Italy	The government strongly supported the constitutionalisation of the 'debt brake' as a way to show commitment *vis-à-vis* austerity (ITA0, ITA4).
Malta	The government was in favour of binding legislation but not necessarily constitutional in nature (MLT1, MLT3, MLT4, MLT5).
Portugal	The government was in favour of binding legislation but not necessarily constitutional in nature (POR1, POR3, POR4).
Spain	The government strongly supported the constitutionalisation of the 'debt brake' as a way to calm down financial markets (ESP1, ESP5).

Source: Authors' elaboration based on the EMUf dataset.

whether to secure immediate gains in terms of continued financial support or to risk a 'Grexit'. For these reasons, and also to preserve its sovereignty in matters of fiscal policy, Greece quickly ratified the treaty on 10 May 2012, but opted for an ordinary law without amending its constitution.

Spain

The positions adopted by Spain and Italy with regard to this issue were quite similar and went in the direction of a swift incorporation of the balanced budgets rule in the constitution. Both countries were in a very delicate situation as they desperately needed to reassure financial markets about their creditworthiness. In Spain, the incorporation of the debt brake rule into the constitution was decided within a week, without extensive debate and with the sole opposition of socialist party leader Alfredo Pérez Rubalcaba (Coller Porta & Ramírez de Luis 2018).

Italy

The technocratic cabinet led by Mario Monti had been voted into office in November 2011 with the precise intention of re-establishing Italy's credibility and avoiding direct intervention by the Troika (Morlino & Sottilotta 2017). Therefore, and ironically for a country which before joining the monetary union had typically relied upon high deficits and competitive devaluations, in Italy there was virtually no opposition to the constitutionalisation of the debt brake, with the exception of two small opposition parties, the LN (Lega Nord -Northern League) and IdV (Italia dei Valori – Italy of Values) (see e.g Camera dei Deputati 2012). The debt brake was incorporated in the constitution in an exceptionally short time,[7] with the last vote taking place on 17 April 2012. Moreover, constitutional law 1/2012 containing the provision was passed swiftly by both chambers of parliament with a two-thirds majority, which avoided the need for a confirmatory referendum.

Portugal

In this case, the situation was more complex. Centre-right prime minister Passos Coelho was clearly in favour of constitutionalising the debt brake, a position strongly supported also by the Minister of Finance. Nonetheless, contrary positions were expressed by members of the official opposition socialist party. Eventually, on the eve of the European Council meeting that approved the final text of the Fiscal Compact, the government realised that it would be impossible to achieve the two-thirds majority needed to enact a constitutional reform to incorporate the debt brake. This resulted in a compromise solution that is the incorporation of such a rule on 20 December 2012 via the amendment of the Budgetary Framework Law, which is a law of reinforced value *vis-à-vis* ordinary legislation.

Malta and Cyprus

As had happened for the other reforms, the Fiscal Compact was subject to intense debate in Malta. The treaty was submitted to Parliament on 5 March 2012 and approved 15 months later – when it had already come into effect following its ratification by 12 Euro-zone member states. As one interviewee noticed, the distinctive feature of the debate was that Malta's government and MPs conducted it assuming that whatever was decided would one day apply to Malta. In contrast, in Cyprus, the debate over the Fiscal Compact took place mostly with reference to Greece, while little if any attention was given to the hypothesis that Cyprus might find itself in a difficult position. The treaty was ratified on 26 July 2012 and the debt brake rule was introduced via ordinary legislation (Katsourides 2018).

What clearly emerges in the two largest countries, Spain and Italy, is that the respective governments were once again operating in the domain of losses. For this reason, they showed a strong preference for the preservation of the *status quo* which was under threat in the short term, and a willingness to take the risk of being unresponsive to voters in the medium-long term. Consequently, the strategy adopted was an immediate constitutionalisation of the fiscal brake. In the other four countries, the same assessment was constrained by domestic factors and produced a cautious avoidance of deeper internal conflicts. Consequently, the debt brake was approved through ordinary legislation (Greece, Cyprus, Malta) or a law of reinforced value (Portugal).

Conclusions

The positions of South European countries during the euro crisis negotiations did not reflect the long-term preferences of the wider public. In other words, the decisions made by South European countries against the backdrop of the eurozone crisis were essentially unresponsive: less popular, austerity-oriented views prevailed in the short term. To explain why and how this was the case, this article delves into the determinants of domestic preference formation during the euro crisis negotiations in Cyprus, Greece, Italy, Malta, Portugal and Spain. Keeping in mind the results of complementary research (see Tarlea et al. 2019), Table 5 summarises the main factors shaping the way in which the decisions under scrutiny were made. What emerges from our empirical analysis is that, within the framework of uncertainty and urgency generated by the crisis, in the countries considered there was a low level of parliamentary involvement, with the sole exception of Malta which was essentially immune from the crisis. Moreover, in all cases, including Malta, decisions were essentially taken by small governmental elites.

Prospect theory provides useful guidelines to answer the puzzle we aimed to solve, that is why did decision makers choose to be unresponsive to public opinion despite the differences in their interests and assessments of the situation? As McDermott (2009, p. 87) put it, 'Prospect [t]heory can provide a comprehensive explanatory framework for understanding the motivation behind seemingly irrational actions and behaviours in decision making under conditions of risk, including those relevant to bargaining and negotiation'. In the broader framework of the euro crisis, the only viable alternative for decision makers was doing whatever was perceived as necessary to remain in the eurozone. This broader objective was underpinned by an underlying preference for the *status quo*, and therefore a willingness to risk electoral punishment in the medium-long term in order to avoid severe losses in the short term.

In order to study this preference in more detail, we decided to focus on a limited number of contested issues. Although with different nuances, we found that South

Table 5. The specific determinants of preference formation on eurozone crisis decisions in Southern Europe.

Contested Issue	Determinants of preferences
First Greek bailout	• Perceived need to avoid the risk of contagion • Perceived lack of political alternatives • Closeness between governments on ideological (Socialist leaders both in Spain and in Greece) or traditional (Greece and Cyprus) grounds
Creation and size of the ESM	• Expected immediate gain *vis-à-vis* market stability
Constitutionalisation of the debt brake	• Perceived need to maintain *status quo* in the two largest countries (constitutionalisation in Italy and Spain) • Perceived need to maintain *status quo*, influenced by domestic constraints and need to avoid deeper internal conflicts (ordinary bill in the case of Cyprus, Greece, Malta and Portugal)

European decision makers assessed the situation in terms of likely short-term losses, hence their tendency to commit to long-term austerity policies to avert the imminent risk of an exit from the eurozone. While it may be inaccurate to state that the decisions made by small governmental elites were totally unresponsive to public opinion, it is certainly possible to conclude that underneath a surface of apparent unresponsiveness lay a complex mix of loss aversion, anticipated short-term gains, as well as domestic specificities linked to potential conflict that prospect theory is overall able to account for when applied to our data.

Notes

1. The grant agreement (European Union's Horizon 2020 research and innovation programme) is no. 649,532.
2. In the original data set the coding was slightly different, e.g ITA01.ITA, where the first part of the code 'ITA' refers to the country, the number i.e '01.' identifies the interviewee, and the final part of the code, i.e '.ITA' referes to the research team which carried out the interviews. To maximise readability, we maintained the first and the second part of the code. The EMU Choices project data sets and codebooks are available at www.EMUchoices.eu/data .
3. It can be recalled that in 2004 Greece had already received a warning by the European Commission for under-reporting budget deficit data (Saragosa 2004).
4. As shown in Figure 1, in November 2011, the Italian 10-years government bond yields almost reached seven per cent, with a spread of over five per cent *vis-à-vis* the German Bund.
5. As well known, in the framework of the Stability and Growth Pact (SGP), member states wishing to join the monetary union committed to a path of convergence entailing a limit of three per cent of GDP for the budget deficit and 60 per cent of GDP for government debt. Failure to comply with these requirements triggered the excessive deficit procedure which could eventually lead to the imposition of sanctions.
6. While the EMUf dataset we use for this article focuses on preference formation and is based on in-depth structured interviews with former policy-makers, the EMUp data set covers member states' preferences on contested policy issues related to EMU reforms between 2010 and 2015, mapping 47 issues related to EFSF, ESM, Six/Two Packs, Fiscal Compact and the banking union legislation.
7. The first draft of the constitutional law had been approved on 30 November 2011 (Il Sole 24 Ore, 2012).

Acknowledgments

We would like to warmly thank the two Editors of *South European Society and Politics* and the anonymous referees for their generous comments and criticisms that substantially improved this article.

Disclosure statement

No potential conflict of interest was reported by the authors.

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