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Freedom as Non-Domination in the Eurozone- a Republican assesment of the Eurozone Sudden-stop Crisis

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Abstract:

By bringing together macroeconomics and republican political theory, the paper explores the possibility that the conception of freedom as non-domination can be meaningfully applied to evaluate, from the point of view of justice, the Eurozone sovereign debt crisis. The analysis will highlight how member States' capacity to autonomously determine how to weather the impact of the crisis has been unjustly curtailed by the dominating power of financial markets. The coexistence of national frameworks for banking resolution, the no-bailout rule and the prohibition of monetary financing has led investors to question the capacity of member states to finance their debts. The self-fulfilling sudden-stop crisis that ensued as a consequence of such uncertainty has unjustly reduced the capacity of Eurozone states to exercise effective sovereignty. In line with the republican idea that people are truly free only if they live in a state that is not dominated by external institutions and forces, it is then argued that Eurozone members have an obligations to establish institutions that increase private and public channels of risk-sharing.

Keywords: Eurozone crisis, Republicanism, Sudden-stop crisis, Non-domination, Sovereign debt.

Introduction

I intend to explore the possibility that the republican conception of freedom as non-domination can be meaningfully applied to understand what was problematic, from the point of view of republican justice, about the sovereign debt crisis witnessed in the Eurozone between 2010 and 2012. In particular, I will focus on the so-called sudden-stop crisis that exposed the fragilities of an incomplete currency union.

The over-arching research question can thus be summarised as: has Member States' (MS) capacity to autonomously choose how to weather the crisis been unjustly diminished? If so, who limited their sovereignty and how?

I aim to show that the Eurozone crisis led to the emergence of a new dysfunctional trinity, much like the one between fixed exchange rates, free capital flows and independent monetary policies that led policy-makers to embark on the Euro-project. The trinity is composed of the prohibition of monetary financing by the ECB, the no-bail-out rule and national banking systems (Pisani-Ferry, 2012). These elements uncomfortably coexist in the current monetary arrangements, since they gave rise to self-fulfilling run on weaker countries' public debt. I contend that the these phenomena are problematic from the point of view of republican justice as they represent a source of arbitrary power that unduly limits Eurozone countries' autonomy. After projecting the responsibility for such limitations of sovereignty on the set of rules that govern the Economic and Monetary Union (EMU), I will claim that there is a level of co-responsibility for the consequences of these sudden-stop crisis that is not met by appropriate institutional duties. Eurozone countries thus have a political obligation to create new institutions that ease the constraints imposed by the logic of the uncomfortable trinity.

The paper is organised as follows. In part Part 1 I will explain how sudden-stop or balance-of-payment crisis manifest themselves in a monetary union and, with the help of the literature on the topic, will show that some Eurozone countries were caught up in a self-fulfilling run on their debt as a consequence of the emergence of such phenomena. I will then show (Section 1.2) that countries suffering the drying up of liquidity are left with few unappealing options, because of the peculiar institutional set-up of the single currency. In Section 1.3 I argue that the lack a lender of last resort in the government bond markets, of a single supervisory authority in the banking industry and the no-co-responsibility for public debt make Eurozone countries susceptible to financial markets' overreaction. Section 2 begins with a description of the normative benchmark used to evaluate the sudden-stop crisis and then identifies three phenomena that are problematic from the point of view of republican justice (Section 2.2.1 and 2.2.2). Using Valentini's definition of systemic coercion, I then claim that Eurozone members are responsible for upholding the set of rules that ensured the emergence of these financial imbalances (Section 2.3). I conclude by highlighting the kind of political obligations that follow from this argument and that should motivate Eurozone states to create new risk-sharing institutions.

1.1 The Economic Problem: Sudden-stop Crisis With a Monetary Union Flavor

A sudden-stop crisis is a reversal of capital flows toward a country, which is generally preceded by a period of rapid credit expansion and related accumulation of current account deficits. The withdrawal of private capital from

the economy can lead to a balance-sheet recession, as the outflow depresses asset prices and threaten the solvency of private households and financial intermediaries.

The economic literature on sudden-stops has mostly focused on the problems faced by emerging market economies in the late 80' and 90', which -after easing capital controls- have seen a constant flow of foreign capital funding their domestic investments (Calvo et al. 2004). Despite the many institutional differences Eurozone MS share one peculiar feature with emerging economies: both groups of countries borrow on international capital markets in a currency over which they have no control. Indeed according to Article 123 of the Treaty on the Functioning of the European Union the ECB cannot finance government's spending and can intervene in sovereign bond market only under specific circumstances. Much like the central banks' of emerging economies do not have enough international reserve to assure investors that the exchange rate will be stable, Eurozone MS cannot give an ironclad assurance to investors that liquidity will be available when their bond reach maturity.

Using Calvo's (2004) methodology, Merler and Pisani-Ferry (2012) identify three sudden-stop episodes that hit four MS during the Eurozone crisis. At the start of the global financial crisis, between March 2008 and March 2009, Ireland and Greece saw an abrupt outflow of capital that quickly translated into pressures in the bond market (Baldwin et. al 2015). The spring of 2010 marked the beginning of a second episode, following the agreement between the EU and the IMF on the Greek programme. Greece and Ireland were caught up in the spiral again and market panic spread to Portugal showing how the fate of Euro-area MS is inexorably linked in times of crisis. At the end of 2011, it was Spain and Italy's turn to witness the power of a change in market sentiments in the third and final episode.

While the loss of a country's private sector capacity to finance itself on international capital markets does not necessarily translate into doubts about the solvency of the state, this may happen if a large number of domestic banks lack sufficient liquidity to fund their cash-flows.

In the Eurozone this additional calamity materialised very quickly. Without a European resolution framework, MS remain the ultimate lender-of-last-resort for their national banks, which implies that any turbulence in the banking industry will raise doubts about the sovereign's capacity to service its debt after a bail-out. This relationship is a two-way street though. The same troubled national banks are also the main buyers of government bonds, which are the most common instrument for interbank lending in Repo transactions. This means that any uncertainty in the creditworthiness of the government, as shown by increasing spreads, may threaten banks' solvency as well (Pisany-Ferry, 2013; for an empirical analysis see De Bruyckere et al. 2013). This is a truly "deadly embrace", in the sense that a heightened risk perception in either the banking sector or the bond market casts serious doubts on the liquidity of both government and banks (see for instance Mody et al. 2012, Acharya et al. 2014, Alter et al. 2014 for an overview and empirical test of the so-called "sovereign-bank nexus").

On top of this, the self-fulfilling nature of sudden-stop crisis adds an element of unpredictability to an already unstable monetary system. As investors in the sovereign bond market start questioning the capacity of the MS government to service its debt, some will start selling government bonds in order to avoid future losses. In turn, this pushes interest rates further up making it harder for the government to rollover its stock of debt at the new rates. Noticing such funding problems, investors demand even higher interest rates and the vicious loop repeats itself. What may start as a liquidity crisis, can quickly turn into a solvency crisis. Market participants' expectations play a key role here. Holding the size of the initial shock constant, if market participants are confident about the future, they will not expect the government to default on its debt and will thus ask for a normal return on its treasury bills, which will allow

the country to weather the shock. However, if investors are pessimist they will ask for a higher return and a "bad" equilibrium will arise, in which investor's initial expectations become reality (Baldwin et al. 2015).

In short, it is the self-fulfilling nature of expectations (for a formal model of the dynamic see Obstfeld, 1986; Flood et al. 1996; Calvo 1998, Gros 2011 and Corsetti et al. 2011) driven by market sentiments, not fundamentals, that determines whether a state will be able to weather the crisis or whether it will be pushed into illiquidity and possibly insolvency (Arghyrou et al. 2012). De Grauwe et al. (2013), Favero and Missale (2012) and Bocola et. al (2016) have shown how a major share of the Eurozone bond spreads cannot be explained by changes in fundamental variables as the debt-to-GDP level, fiscal space and current account position. Instead, a significant part of bond prices' movements appears to be time-dependent and thus related to market's "animal spirits". In a similar econometric estimation, Aizeman et al. (2011) have "matched" Eurozone periphery countries with five middle-income countries outside Europe displaying similar fundamentals and concluded that sovereign default risk has been priced much higher in the EMU during the crisis.

1.2 The Crisis-management Problem

Ultimately Eurozone countries being singled out by financial markets and facing rising cost of borrowing are left with few, unappealing options. MS cannot devalue or inflate within the common currency, so they could, in principle, leave the euro and regain monetary sovereignty. Looking at the experience of developing countries one should expect the new currency to depreciate and inflation to pick up very rapidly (Calvo et al 2004). However, leaving the euro in times of market panic and scarce liquidity is an incredibly painful process that could have long term and unexpected economic and political costs.

A second option for MS facing liquidity (and eventually solvency) problems, would then be to remain in the euro, but default on their debt. This would still be uncharted territory for policy-makers, since the Eurozone lacks a legally and politically recognised framework to deal with a sovereign bankruptcy. While in theory this option may sound more appealing than leaving the currency union, the lesson from the crisis has been so far that there are significant spill-overs between countries (see for instance Candelon et al. 2011). Developments in one sovereign-bond market can affect the whole Eurozone as the domino-effect initiated by the Greek crisis has already shown.

The last option is to obtain a loan from other MS the ECB and the IMF. These loans come with the much-discussed and criticized memorandum of understanding, in which national sovereignty is de-facto suspended and debtor countries have to implement the economic reforms suggested by creditors. Despite the EMU institutional framework' inexperience with sovereign bailouts, this was the option chosen by five Eurozone countries.

But even before being faced with such scenarios, governments caught up in a self-fulfilling sudden-stop crisis are forced by financial markets to give up an important tool at their disposal to smooth the business cycle, namely automatic spending (DeGrauwe et al. 2013b). As panic pushes spreads higher, policy-makers cut spending and reduce automatic stabilizers that could make the budget deficit increase further. Arguably, there are elements of a Keynesian beauty contest behind such policies (Keynes, 1936). The idea is that in order to regain market confidence the country must convince investors through the signalling effect of budget cuts, that the average valuation of the market of such move will be positive, regardless of its effect on fundamentals. However, the immediate result of reducing public

spending when the private sector is also deleveraging is lower growth. This worsens the fundamentals on which bond pricing is based (De Grauwe and Ji 2013b) and reinforces the vicious circle of higher debt, higher interest rates, higher probability of default. On this point Cottarelli (2014) shows that, contrary to economic theory, in 2011 government bond spreads were significantly affected by the short term (instead of long-term) growth prospect of each country. This short-terminism implied that a fiscal tightening, while reducing the primary balance, can lead to a further increase in spreads and the risk of default.

1.3 An Uncomfortable Trinity

Three institutional characteristics make the Eurozone architecture prone to such balance-of-payment crisis, namely: the lack of a lender-of-last-resort in the sovereign bond markets, the no-co-responsibility for public debt and the lack of a banking union.

The prohibition of monetary financing (i.e. the buying of government bonds by a central bank) codified in the ECB's DNA (Article 123(1) TFEU) meant that a self-fulfilling run on sovereign debt could not be prevented. Simply put, investors knew that no one was there to foot the bill if the situation worsened.

Crucially, liquidity constraints in the bond market do not materialize in countries with their own currency. First of all, stand-alone countries can rely on the automatic adjustment an outflow of capital spurs on the exchange rate. As investors sell the proceeds of the sovereign bond sale following uncertainties on the stand-alone country's solvency, the national currency depreciates and marginally improves the country's price-competitiveness.

Secondly, the existence of a lender of last resort in the sovereign bond market prevents the self-fulfilling prophecy from happening in the first place. The UK, the US, Japan, Denmark, Poland (to name a few) have all seen their fundamentals deteriorate as a result of bail-outs or the impact of automatic stabilizers on their budget, but none saw its spread meaningfully increase during that time (De Grauwe and Ji, 2013). De Grauwe and Ji (2013) have thus concluded that " (...) financial market do not punish stand-alone countries for public debt accumulation that appear to be equally unsustainable as in the Eurozone countries" (ibid, p.31). Countries with their own central bank cannot be pushed from a liquidity crisis to a solvency crisis, simply because the cash will always be there for investors, as their debt is denominated in their own currency.

The second institutional feature that makes Eurozone countries supsceptible to sudden-stop crisis and impairs their management is the no-co-responsibility for national public debt. Strict adherence to the so-called no-bail out rule (Art 125 TFEU) implied that, before the crisis, there was no established procedure for Eurozone countries to come to the rescue of their neighbors that lost market access. There was also no EU institution in place to grant loan to countries in need, as Article 143, which allows EU members to make use of the medium-term financial assistance facility, applies only to those outside of the single currency (Marzinotto et al. 2010). Ultimately, such lack of collective risk-sharing mechanisms contributed to the perceived risk of instability in financial markets.

Finally, lack of both a centralised authority for banking supervision and a common framework for the resolution of banking crisis implied that investors saw national legislation and the singular MS as the ultimate bearers of responsibility. As banks in one country started experiencing problems, the prospect of them being bailed-out by the government increased doubts about the future solvency of the latter (Pisani-Ferry, 2012). In other terms, the advent of the euro for the banking industry represented an increase of interdependence and cross-border exposure rather than risk-sharing through equity holdings and cross-border bank-to-real sector flows (Schelke, 2017; Hoffman et. al. 2018).

2. What Would Republicans Say?

What is wrong about the dynamics just described? In what follows I shall argue that the dynamics of the sudden-stop crisis revealed how MS autonomy has been unjustly curtailed during the eurozone crisis and that such infringement occurred in part because they are members of an incomplete monetary union. In turn, this poses a challenge to the rules governing the single currency that allowed these self-fulfilling crisis from happening in the first place.

At the same time, pointing at an infringement on a country's autonomy logically forces us to also recognise the responsibilities for the handling of the crisis that are attributable to each single country. I will thus claim that if we want to uphold the republican value of self-determination, we have to make MS responsible for the bad fundamentals with which they entered the crisis. Even if we factor in this important consideration, there still seems to be a level of collective responsibility for the consequences of the sovereign debt crisis that is not adequately transposed into institutional duties or implied by institutional structures.

Before spelling out more clearly what seems unjust about the sovereign debt crisis, it is necessary to briefly sketch the normative benchmark that will be used to evaluate these phenomena and the institutional characteristics of the monetary union, namely: republican political theory.

2.1 Republicanism and Global Justice

Republican political theory distances itself from liberalism by contesting the idea that freedom is the absence of interference. Instead, Pettit's theory equates unfreedom with domination, which is defined as the dependence on arbitrary power. The difference between the two conceptions is made clear by the oft-cited example of the slave and the master. A liberal would not define a slave, who has a benevolent master, as unfree, since the master would never interfere with his choices. Republicans would instead argue that the master still has the capacity to arbitrarily interfere with the slave as he sees fit, thus making him unfree (Pettit, 1999, 165). In turn, arbitrary power is defined as one that fails to track the interests of those subject to it (Pettit, 1999). Democratic structures that embed deliberative processes allow people to define what is in their collective interest qua citizens, so that the laws devised through democratic institutions become the epitome of non-arbitrary and thus legitimate interference.

But domination, being it republicans' "supreme political value" (Pettit, 1997, 80), does not only describe what unfreedom is, but also grounds a conception of justice (Laborde et. al. 2016). Indeed, a just society and a just state should aim at minimising domination as a matter of right (Lovett, 2010). In other terms, the republican state should seek to minimize, through the rule of law, citizens' exercise of arbitrary power against other citizens, but also, its own use of power.

When this normative framework is transposed to the international realm, the two-dimensional view of non-domination is enlarged; using Pettit's slogan: "the state ought to be internationally undominated, domestically undominating defender of its citizens' freedom as non-domination" (Pettit, 2012, 19). This three-dimensional picture thus has at its core the concern for individual freedom, which can only be secured by a free state. In turn, a free state requires, not only instituttitutions that are non-dominating towards their citizens, but that are themselves not dominated by external

actors, such as other more powerful states, transnational corporations, but also global monetary and trade institutions. The unconstrained forces of globalization can thus be seen as undercutting democratic self-rule when they force states to change the laws and arrangements that citizens, through their representatives, have given themselves. On this point, Laborde and Ronzoni (2016) argue that "institutionalised non-arbitrary interference -the subjection to supranational rules and institutions- is necessary to secure the joint and reciprocal non-domination of states" (ibid. p.281).

Assuming that what the state should minimise is people's subjection to the arbitrary will of others and that, in order to do this, it must itself not be dominated (Laborde and Ronzoni, 2016), how should we evaluate the sudden-stop crisis described in the previous section?

2.2 Domination in the Eurozone Crisis

I believe there are three interrelated phenomena that are particularly troubling from a republican justice standpoint. Firstly, the self-fulfilling nature of the run on government's debt represents a case of uncontrolled and arbitrary power in the hands of financial market that requires regulation. Secondly, the consequence of financial markets' overreaction has been that those governments that were on the verge of losing market access had to modify their spending plans with the aim of signalling their goodwill to investors. This, I contend, has curtailed their capacity to autonomously choose how to weather the impact of the crisis. Finally, the sovereignty of those countries that lost market access was further compromised as soon as they obtained loans from the Troika of lenders. The institutions that were created to offer financial assistance exercised a form of unchecked power over debtors and in so doing they failed to recognize those polities and their citizens as equal members of the same european community.

Taken together, these three elements make clear that there has been an unjust curtailment of some MS autonomy during the Eurozone crisis. In the following two subsections I will explain in more details why this is the case.

2.2.1 Market Power and Sovereignty

The self-fulfilling nature of the crisis casts casts doubts on the capacity of financial markets to not only deliver welfare-enhancing solutions, but also impose the right kind of discipline over countries. In contrast with the standard models of competitive financial markets (see for instance Arrow, 1986), in a self-fulfilling liquidity crisis two equilibrium interest rates exist and it is not necessarily the case that the "good one", in which a low interest is demanded and the country can finance itself, will necessarily arise. Investors' coordination of beliefs around specific information can lead instead to the second equilibrium, in which pessimism drives up spreads and can lead to the state's ex-ante unjustified (but ex-post justified) insolvency. Both government and investors would be better-off in the other equilibrium, but coordination problems prevents them from reaching it. Using republican terminology, we can say that these market forces fail to "track the interests" of those affected (Pettit, 1997, 56), i.e. of both government and investors and thus represent an arbitrary source of power.

In broader terms, what periphery countries have witnessed during the crisis (but admittedly even before) are the consequences of the "discipline" imposed by imperfectly competitive markets; plagued with problems of incomplete

information that push it further away from the full competitive model of general equilibrium, which instead includes markets for future goods and all future contingencies (Arrow, 1986). The sudden stop episode thus confirms Delor's assertion that "market perceptions do not necessarily provide strong and compelling signals.... The constraints imposed by market forces might either be too slow and weak or too sudden and disruptive" (Delors Committee 1989, p. 2). Under these circumstances, market forces represent Pettit's antipower in a procedural sense, as participants (i.e. investors and the government) do not have "the capacity to interfere with impunity and at will" (Pettit, 1996, 578) with the actions of others, but not in a substantive sense, because the sudden-stop can lead to a situation in which welfare is lower for all, so that market forces are not actually tracking the interests of those affected.

It should also be clear that the idea of submitting governments to the discipline of markets is premised on the assumption that investors react to what the government does and is thus responsible for. Instead, in a self-fulfilling crisis part of the higher spread cannot be explained by the country's fiscal stance or capacity to reform, but by investor's collective fear. Market discipline loses its normative appeal if the "judgment" (i.e. the bond price) does not depend on the relevant features on which the government has control.

Higher spreads, over and above what can be explained by the fundamentals of each country, pose a second, albeit related problem from the point of view of justice: they make governments responsive to and dependent on the development of a panic-driven financial market, rather than on their citizens' interests.

As governments are pushed from illiquidity to insolvency by the self-fulfilling run on their debt, the only thing that seems reasonable to do is to signal investors that the cash will be there at maturity by raising taxes and cutting spending (De Grauwe et al. 2013; Baldwin et. al. 2015). In 2010 the market panic created by the coexistence of the three institutional features described in Section 1 spread to the world of policy-making where it was interpreted as a clear message that the will of the market was austerity. In their attempt to gain investors' favour, governments of periphery countries were thus forced to shut down automatic stabilizers precisely when those were most needed.

What is problematic from a normative perspective is instead that MS fiscal sovereignty was temporarily suspended. Governments caught up in the liquidity crisis were not responsive to their citizens' needs but to investors' and rating agencies' reactions. In times of panic financial markets in Eurozone enjoy the sort of "editorial control" described by Pettit (2006), in the sense that governments' reform and spending plans are drafted with an eye to what investors, rather than citizens, will think. This undermines the value and function of political institutions as citizens are governed without justification. Citizens' public autonomy and, in particular, the country's right to fiscal self-determination has been eroded.

2.2.2 Autonomous if Solvent

The Eurozone crisis has not only revealed how anonymous market forces can unjustly limit a country's capacity to self-rule, but also how similar restrictions on MS sovereignty can be imposed by new EU institutions, whose design is the outcome of a conscious collective decision. In 2010, as the situation in Greece worsened, further threatening the financial stability of the whole Euro area, heads of state decided that it was time to act together and to do so quickly. Between 2010 and 2013 three different institutions were created in order to lend money to Greece, Portugal, Ireland, Spain and later Cyprus. The European Financial Stabilization Mechanism, the European Financial Stability Facility and the European Stability Mechanism make up the so-called rescue umbrella for financially distressed MS, who received in total around 400 billion euros in the form of loans and other debt instruments. All rescue packages came

with a Memorandum of Understanding signed by the receiving country and designed by the Troika of lenders, which specified the macroeconomic adjustment program to be followed. This conditionality is meant insure taxpayers in creditor countries against the possibility that debtors will just take the money and not reform adequately, yet even if we factor in the legitimate concern toward debtor's moral hazard, there seem to be many characteristics of these institutional arrangements that, when assessed against the benchmark of republican justice, seem problematic.

First of all, creditors have the capacity to arbitrarily interfere with debtors decisions and even to dictate specific policies, without taking into account the political preferences expressed through national democratic procedures. Indeed, the Memorandum of Understanding of Greece, Portugal and Spain detailed, for instance, how labor markets and health care should be reformed, what the appropriate minimum wage is together with the right pension expenditures. This was possible because the ESM (which now replaces the other two institutions) lacks procedures and transparent regulations regarding the scope and content of the adjustment programs. This allowed the Troika to have ample room for discretion in writing the Memorandum of Understanding. In addition, national parliaments were effectively left with the only options of either defaulting or accepting the Memorandum of Understanding agreed upon between the government and the creditors (European Parliament, 2014), as no procedure was in place to guarantee that people's representatives could review the text (Alcidi et al., 2014, Crum, 2013).

Secondly, those decisions were arbitrary in the republican sense, as those who formulated them could not be held to account afterwards. The Eurogroup, which created all three institutions and devolved its power to negotiate to the Commission, is an informal organisation that acts beyond the Treaty framework and is thus disanchored from any form of EU-level democratic accountability, yet it de facto performed executive functions. This also means that top-level decisions affecting the lives of millions of citizens were reached according to the logic of international power, without any procedure to ensure that wealthier creditors do not abuse their position.

Finally, the institutional set-up of the assistance facilities, assigned roles and responsibilities to different agencies that were not consistent with their mandate. The ECB, for instance, was given the task to supervise and negotiate with the beneficiary-- together with the Commission and the IMF-- the adjustment program. However, its mandate as by Treaties is limited to the supervision of monetary policies and financial stability and it surely does not include the budgetary policies described in the Memorandum of Understanding (European Parliament, 2014). The same holds for the Commission, which is given a mandate by the Eurogroup that little has to do with its usual task of protecting the EU interest and ensuring the implementation of EU rules within the limits established by the Treaties.

Overall it seems like debtor's sovereignty was lost with their capacity to finance themselves on financial markets. Such strong intrusion in MS internal affairs must be motivated by the belief -- which is in line with the moral hazard narrative-- that the political choices of debtor countries are not appropriate; that supranational institutions know better than national politicians; and that, if left with the freedom to choose how to use these loans, debtors would choose policies that impose costs on other member states. Mistrust in the debtors' capacity and willingness to reform, must itself be premised on the idea that losing market access was fundamentally debtor countries' own fault. This seems in stark contrast with the functioning of the only institution created within the EU Treaty architecture, namely the EFSM. Article 1 of Council Regulation 407/2010, which establishes the scope of the EFSM, states that assistance may be granted to a MS threatened with a severe "economic or financial disturbance caused by exceptional occurrences beyond its control".

2.3 Systemic Coercion and the Question of Responsibility

The next question that seems reasonable to pose is: who is responsible for what I have claimed to be some unjust curtailments on MS sovereignty?

In the case of the third problem described above, namely the lack of democratic checks on the functioning of the new institutions created during the crisis, the identification seems more straightforward: the heads of state that created the institutions in charge of financial assistance are the ultimate bearer of responsibility even if they they entrusted the Commission to monitor and coordinate the assistance programmes.

Understanding who is the agent responsible for the use of arbitrary power over periphery countries during the sudden stop crisis is instead more complex. While it is clear that the self-fulfilling run on a country's debt is caused by (and consists of) investors fire-selling government bonds, it is not them that seem to be morally responsible for the constraint placed on governments actions. They are risking their own resources by signing a debt contract with a country's government that allows them to sell the bond as they see fit. Moreover, once the run on the asset has started, it is even rational, from the point of view of the singular investors to sell, so as to avoid future losses.

Going back to Pettit's definition of arbitrary force we can see that its core idea, namely that any form of coercion requires justification, to evaluate more complex situations, in which the restrictions on agents' freedom cannot be traced back to the action of an individual. Indeed, if it is true that the republican idea of non-domination is clearly agential, as it refers to relationships between people, it's normative appeal would be greatly reduced if it could only be employed to analyse personal interactions. This is because nowadays people, but also states, find themselves immersed in largely impersonal socioeconomic relations and norms of behavior that can still, through their effect on agents' incentives and actions, reduce freedom in arbitrary ways (Laborde et al., 2016).
Valentini's (2011) definition of what she calls "systemic coercion" can help us analyze more precisely these cases. She argues that "*a system of rules S is coercive if it foreseeably and avoidably places nontrivial constraints on some agents' freedom, compared to their freedom in the absence of that system*" (ibid. p.212). The institutional structure of the single currency fits this definition quite well.

The euro "system of rules" is built on the international treaties that describe the functioning of the EU and, at the same time, assign duties and responsibilities to the MS and the different supranational institutions.
Looking then at the last part of Valentini's definition, it can be argued that if such system of rules was not in place, the crisis would have been less severe for periphery countries. Indeed the characteristics of this system inform investor's decisions and expectations about the future, which -- as noted in section 1.1-- play a fundamental role in triggering a sudden-stop crisis. The uncomfortable coexistence of the three institutional feature described in section 1 helped in spreading market panic and one could also add the lack of appropriate procedures to deal with the loss of market access as an additional factor that justified investor's negative expectations.

Counterfactual scenarios should be handled with care though. Despite the evidence presented by De Grauwe at al. (2013), one cannot be sure that if the ECB acted as a lender of last resort from the beginning, no turbulence on financial market would have arisen. This is because countries' fundamentals still matter a great deal for the pricing

behavior of investors. A country like Greece (but to some extent also Italy) that showed endemic problems in raising sufficient taxes to fund its expenditures may not be able to avoid paying high interest rates even in times of crisis.

Nevertheless, what can be concluded from the evidence presented in section 1 is that the institutional structure of the single currency, by informing investor's expectations, *increased the probability* of financial markets dominating countries with weaker fundamentals. We can thus say that the euro-system imposes, in times of crisis, "non-trivial constraints" on the actions of government. I argued above that these constraints are not just "non-trivial", but also problematic from a republican perspective as they expose countries to the uncontrolled power of financial markets.

It could be objected that, even if we project moral responsibility on those political actors that sustained the system of rules of the single currency, it still seems like Member States entered this currency arrangements in a non-dominated way. If the decision to join the euro and to create *those* kind of institutions and procedures is a free choice, then the whole claim that the power exercised by financial market is arbitrary seems misplaced. After all, nobody forced periphery countries to give up their monetary sovereignty, to accept the no-bailout rule and the prohibition of monetary financing.

From an economic perspective, this argument suggests that MS knew and understood the consequences of structuring the single currency as they did on sovereign bond markets. However, the point of the no-bailout rules decided by the architects of the euro was to limit as much as possible the moral hazard and externalities that stems from accessing a common pool of liquidity (Shelke, 2017). Since in a currency union of fiscally autonomous countries part of the cost -- in terms of higher interest rates -- of borrowing one euro more is shifted on to other members, there is a need to ensure that governments do not overspend. The Maastricht "deal" was thus meant to limit the inter-state domination, which arises from the externalities and moral hazard of public debt accumulation. Financial markets were instead assumed to be stable and provide consumption-smoothing benefits to all individual borrowers. A sudden stop crisis, was thus among the "unknown unknowns" that emerged as a consequence of monetary integration (Pisany-Ferry, 2013). On a philosophical level, it seems wrong to argue, as this counterargument implicitly does, that justice claims, like the demand to not be arbitrarily interfered with by financial markets, cannot find their place in voluntary associations. Sangiovanni (2012) thus argued that "acceding Member States consent to be governed by the framework of treaties constituting and regulating the EU, but they do not consent to waive any justice-based entitlements that they may have upon entering" (ibid. 20).

Projecting responsibility for the injustices on the rules of the common currency leads us to the question their role and function with respect to MS sovereignty. What should we do to fix them? What kind of duties do MS have as members of the common currency?

2.4 Co-responsibility Against Arbitrary Interference

Before tackling these questions, there is one powerful, as much as divisive, economic counterargument to the case presented thus far that is useful to address. If periphery countries' government overspending and over-regulated labor markets caused the sovereign debt crisis, by reducing the countries export competitiveness, then a limitation of their autonomy is the price to pay for fiscal profligacy and wrong policies (see for instance Dadush, 2010; Chen et al. 2012; Sinn, 2011). Moreover, excessive government spending in the form of deficits among the GIIPS is a negative

externality as it raises interest rates for all other Eurozone Members, so why should irresponsible governments, who misuse the common good (i.e. a hard currency) and impose costs on others be bailed out or helped in any way?

This objection is factually wrong in its claim that the culprit of the crisis is periphery's fiscal profligacy. The only country that fits this diagnose is Greece, whose government misreported its liabilities becoming the epitome of moral hazard.

Regardless of the economic debate, which is still open, on the role of periphery countries' cost competitiveness in the accumulation of imbalances, there is one crucial point that this objection misses. By shifting the focus to the clear weaknesses of some periphery economies, this argument fails to duly recognise that the rules of the common currency and, in particular, the presence of the uncomfortable trinity (see section 1), has imposed costs on periphery member states over and above what can be explained by their less competitive economic model.

The sudden-stop crisis is ultimately a crisis of confidence in the capacity of periphery countries to finance their public and private debt. Since the standard macroeconomic policy tools are not available in currency union, this confidence depends, in part (but not entirely) on the kind of risk-sharing institutions present at the supranational level and on the responsibilities for financial supervision that fall on MS. Unfortunately, in 2010 the EMU architecture was not equipped to deal with a financial crisis, as no formal supranational risk-sharing institution was in place and states had to deal with the crisis on their own. The reduction in MS autonomy thus comes from a lack of co-responsibility.

What does this imply from the point of view of the duties Eurozone MS have toward each other? The three-dimensional picture republicanism offers us, namely that citizens are free only if their state is externally free as well, points toward the need to regulate the sources of arbitrary power that constrain democratic-self rule.
Much like the republican state is meant to maximise citizens' freedom as non-domination, so should a supranational institution shield countries from the external sources of domination. As we have seen, domination can be exercised by other powerful states, by the supranational institution itself and by market forces, which are not properly regulated. In other terms, the goal of making states free from domination imposes certain duties on the supranational structure in which they are embedded.

More precisely, avoiding self-fulfilling sudden-stop crisis in the future requires escaping the uncomfortable trinity by providing a supranational level of insurance either in the private sector -through a common back stop in the banking sector- or in the public one - through public debt mutualization. These measures increase the level of co-responsibility among Eurozone members and signal to investors that states are not alone when facing asymmetric shock to their economies.
While the lack of collective risk-sharing mechanisms has usually been motivated by the potentially deleterious consequences of moral hazard, the crisis has demonstrated that some level of collective insurance is needed for at least two reasons. The first, more practical, is that some countries needed financial assistance, despite their compliance with with the rules of the Stability and Growth Pact against moral hazard. Without the loans from the Troika the financial stability of the Euro area was at risk. The second is that escaping the logic of the uncomfortable trinity by pooling risks would prevent the unjust dilution of MS autonomy described in this section.

These duties to create risk-sharing institutions do not arise because of an injustice inflicted by one country on another. These are duties of solidarity generated by the countries' membership in the Euro area and thus respond to the

demands of a political concept of justice. Political obligations are different from legal and moral duties, in that they require us to create new institutions and to fix the ones we have (Eriksen, 2017). Nowhere in the EU Treaties is it written that a more extensive form of co-responsibility between states is needed as a matter of right, yet in virtue of our membership in the Euro area, we should recognize that our common rules have had consequences on the autonomy and standing of periphery countries vis-a-vis other members. In turn, this realisation grounds a duty to change some rules and create new institutions, in order to restore a norm of effective equal membership.

Simply put, there is a shared responsibility in upholding common rules that requires us to fix what is wrong about them. Using Young's words: "The point is not to blame, punish, or seek redress from those who did it, but rather to enjoin those who participate by their actions in the process of collective action to change it" (Young, 2006, 122).

3. Conclusion

Instead of making states more autonomous in the face of globalization, the EMU has amplified financial markets' imperfections. The coexistence of national frameworks for banking resolution, the no-bailout rule and the prohibition of monetary financing has led investors to question the capacity of member states to finance their debts. The self-fulfilling sudden-stop crisis that ensued as a consequence of such uncertainty has greatly reduced the capacity of Eurozone states to exercise effective sovereignty. In line with the republican idea that people are truly free only if they live in a state that is not dominated by external institutions and forces, it was argued that Eurozone members have an obligations to establish institutions that increase private and public channels of risk-sharing.

The existence of this duty is justified by the fact that the characteristics of the pre-crisis monetary union are causally linked to the emergence of an injustice. This shouldn't be mistaken for a call to share the gains of the monetary integration process between winners and losers, justified by the ex-post realisation that the former fared better than the latter from the same economic regime. The fact of sharing a currency does not ground by itself the duty to redistribute resources. What justifies the call for the creation of new institutions is the fact that some member states have seen their autonomy curtailed, because they were part of a common monetary arrangement. Moreover, these infringements with member countries' sovereignty were not instrumental to the preservation of hard and stable currency.

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