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The Politics of Fiscal Burden Sharing in Eurozone Reforms and Next Generation EU: Policy-Making Power, Differentiated Integration, and Democratic Legitimacy

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Introduction

The crisis of the Eurozone started in late 2009 and led to several reforms of the Economic and Monetary Union (EMU), which were enacted step-wise between 2010 and 2015. Triggered by the financial crisis, the stability of the Eurozone was severely challenged, even to the point where some economists speculated about a breakdown of the common currency. Several economic scholars have analysed the flaws of the common monetary system (Alesina and Wacziarg, 1999; Sinn, 2014; Stiglitz, 2016; Schelkle, 2017). The perspective of economists on the Eurozone is strongly influenced by concerns that the EMU is not an optimal currency area, mainly because asymmetries in macro-economic conditions are not sufficiently equalized with automatic stabilizers such as labour mobility or fiscal transfers (Mundell, 1961; Obstfeld et al., 1997). This economic analysis points to the risks of a monetary union – and highlights the institutional deficiency of the Eurozone in respect to the missing fiscal stabilizers (Feldstein, 2012; Krugman, 2013).

Along these lines, a large literature on fiscal federalism explores which institutional settings and fiscal stabilizers could make the EMU more resilient. One proposal is the adoption of an unemployment insurance on the European level, which would automatically provide transfers to economically weaker regions and thus equalize the differences in economic conditions across the Eurozone (Dolls et al., 2018). Also prominent are studies that draw lessons from the fiscal and monetary integration history of the United States (Sala-i-Martin and Sachs, 1991; Bordo et al., 2013). This literature is relevant because at the core of the Eurozone crisis were accumulating imbalances among Eurozone members in current account surpluses and deficits, which then turned into a balance-of-payments and debt crisis (Copelovitch et al., 2016; Frieden and Walter, 2017).

However, besides the study of deficiencies and potential improvements of the institutional framework of the EMU, we also need to understand better how the institutional framework of the EMU came about, how it was reformed during the Eurozone crisis, what type of political conflicts shape and dominate the policy making of the EMU, and how it has been recently extended in reaction to the COVID-19 pandemic. Abundant political science research provides important insights by identifying and analysing the dominant political conflicts among member states, which are observable since the Euro was introduced with the Maastricht Treaty about 30 years ago. Already at the Maastricht summit, the EU leaders discussed the need for a deeper political union, which was supposed to complement the monetary union with shared fiscal authority and capacity. However, the heads of state and government could not agree on a common approach for deeper political and fiscal integration, and this discussion remained conflictual ever since (Woolley, 1994; Wasserfallen, 2014).

The main regulatory framework of the EMU includes the no-bailout clause and the deficit and debt rules of the Stability and Growth Pact. Building on this institutional legacy, the reforms enacted during the Eurozone crisis between 2010 and 2015 addressed some institutional deficiencies by further deepening the monetary union. As often in European integration, a crisis led to more integration, not disintegration (Ioannou et al., 2015; Jones et al., 2021). In essence, member states agreed on a further strengthening of the fiscal discipline criteria with the legislation of the Two- and Six-Pack, and they created rescue funds in the form of the European Stability Mechanism. A further key element of the reforms were the banking regulations, such as the Single Supervisory Mechanism and the Single Resolution Fund (Howarth and Quaglia, 2016; Wasserfallen et al., 2019). Not on the negotiation table was the common financing of debts through some sort of Eurobonds, which would have been a more explicit step in the direction of a fiscal federal set-up of the EMU.

All the mentioned Eurozone reforms were negotiated under the context of highly conflictual policy making. Political science research sheds light on the political conflicts and power constellations in the reform of the EMU. Four broader findings stand out: (a) the dominance of intergovernmental conflicts in EMU negotiations among rather stable coalitions of member states, often simplified as the North-South divide (Brunnermeier et al., 2016; Armingeon and Cranmer, 2018; Lehner and Wasserfallen, 2019); (b) the importance of the French-German tandem in accommodating this intergovernmental conflict with compromises, particularly in the agenda-setting stage, where the potential options for reform are prepared (Schild 2013;

Bulmer 2014; Degner and Leuffen, 2019); (c) the important role of smaller coalitions of member states at the polarized ends of the spectrum (Morlino and Sottilotta, 2019; Armingeon et al., 2021); and (d) the influence of the Commission in both the shaping of policies and the final bargaining stage (Carstensen and Schmidt, 2021; Kudrna and Wasserfallen, 2021; Lundgren et al., 2021).

More recently, a further crisis, the COVID-19 pandemic, led again to deeper fiscal integration of the EU in the form of the Next Generation EU (NGEU) programme. From a fiscal point of view, the remarkable aspects of the NGEU are that it extends the fiscal capacity of the EU remarkably by adding 806 billion EUR to the regular budget of 1074 billion EUR, which is known as the multiannual financial framework (of 2021-2027), and that the member states jointly finance the NGEU by issuing bonds on the financial market (European Commission, 2021). Overall, we find both continuity and change from the EMU reforms to the politics of the NGEU programme. Both reforms were triggered by crises, and, in both cases, we find a similar divide between fiscally more hawkish countries and proponents of more fiscal burden sharing. Germany, however, took a more accommodating stance in the case of the NGEU, which made it possible to move in the direction of fiscal burden sharing. The remarkable novelty of the NGEU is that the Commission borrows, on a large scale, on behalf of the EU on the capital markets for the financing of the NGEU (Armingeon et al., 2021; Schelkle, 2021).

In that respect, we observe a clear development towards deeper fiscal integration from EMU reforms to the NGEU. However, the conditionality of this step was that the NGEU programme is supposed to be exceptional – and thus not foreseen to become a regular tool of fiscal policy making. A final important aspect is that NGEU is designed for the EU-27, not the EMU. This substantial fiscal integration step has thus been taken for the EU-27, not the Eurozone – and this step is a reaction to the economic and social consequences of a pandemic, not to the institutional deficiencies of the EMU, which were in the spotlight of the Eurozone crisis triggered by the financial crisis. This observation points to a general challenge of fiscal burden sharing in the EU, namely, the different extents to which the EU member states are fiscally integrated. The political science literature on differentiated integration investigates precisely these varying degrees of integration across policies and member states (Leuffen et al., 2013; Schimmelfennig and Winzen, 2020).

Studies on differentiated integration are particularly relevant in the economic and fiscal arena because the institutional deficiencies of the EMU should be addressed within this smaller sub-set of EU member states. There is, however, no clear demarcation line between the EMU and EU-27, as some reforms and policies include all EU member states (like NGEU) or only the members of the EMU (like parts of the fiscal compact) – and some are legislated according to the ordinary or special legislative procedure of the EU (like the banking regulations) and others as intergovernmental agreements (like the fiscal compact). Overall, the structure of fiscal and economic policy making in the EU remains somewhat ambiguous on the question of which type of fiscal burden sharing ought to be a policy of the EMU or the EU-27. Some researchers emphasize the potential of deeper integration among a sub-set of member states, such as the Eurozone countries, which would call for deeper fiscal integration within the EMU – and not for further fiscal burden sharing among the EU-27 (De Vries, 2018; Fabbrini 2019).

A final key question is the extent to which authority transfers to the EU level in fiscal burden sharing and fiscal discipline measures are democratically anchored and legitimized. The literature on the so-called democratic deficit of the EU is abundant (Majone, 1998; Moravcsik, 2002; Follesdal and Hix, 2006; Hix, 2008). One concern in that context is the power shift from parliaments to the national executives, which is particularly striking in the area of fiscal and economic policy making, where national governments play the central role. On the EU level, there is a limited involvement of the European Parliament and, on the domestic level, member state governments only marginally integrate their national parliaments in the formation of positions (Târlea et al., 2021). As a consequence, the national executives take up a dominant role in the legislation of fiscal transfer and discipline measures. This legislative power interferes directly with the prerogative of national parliaments, namely the legislative authority in taxation and spending (Genschel and Jachtenfuchs, 2018). This power shift to the national executives may raise concerns that fiscal policy making on the EU level lacks democratic anchoring and legitimacy – not least because there has not been any revision of the EU Treaties since the Treaty of Lisbon from 2007, which would update and clarify the basic framework of fiscal and economic integration with the EU and EMU.

Within this broader context, this book chapter analyses the politics of EMU reforms and the NGEU to develop a better understanding of the politics of fiscal integration by answering the following questions: who is in conflict with whom over what, and which member states and institutions shape the politics of fiscal integration in the EMU? The final part of the chapter discusses the promises and pitfalls of further differentiated integration, which focuses on the demarcation of fiscal and economic integration between the EMU and EU-27, and discusses, more broadly, the democratic anchoring and legitimacy of fiscal integration.

The Politics of the Eurozone Reforms

As a consequence of the Eurozone crisis, the EU member states agreed from 2010 to 2015 on a large set of reforms. One part of these reforms further strengthened the fiscal discipline side of the EMU with the legislation of the Two-Pack, Six-Pack, and Fiscal Compact. In addition, the fiscal transfer side of the EMU architecture also expanded with rescue funds in the form of the European Financial Stability Facility, the European Stability Mechanism, and the assistance packages to Greece. The final key elements of the EMU reforms were the banking regulations, that is, the Single Supervisory Mechanism and the Single Resolution

Mechanism and Fund (Wasserfallen et al., 2019; Kudrna et al., 2021).[1] All of these EMU reforms were negotiated in the context of highly conflictual policy making. The lines of conflict among member states were not new for EMU politics, but they came to the spotlight during the negotiations of these reforms. The research of political scientists investigates these conflicts and points to four broader findings.

First, the politics of EMU reforms were dominated by intergovernmental conflicts with member states governments as central actors. While there are interesting nuances in respect to the involvement of domestic national actors and national legal constraints across member states (Kassim et al., 2020; Griller and Lentsch, 2021), the dominant role of national executives in EU decision making is a striking feature of EMU politics (Târlea et al., 2021). This dominant role of governments was amplified by the intergovernmental nature of the reform politics (Csehi and Puetter, 2021). The policy making of the EMU reforms involved several institutional procedures, from intergovernmental treaties to legislation according to the ordinary legislative procedure, but, by and large, the reforms were decided in intergovernmental negotiations.

Second, the conflict among member states is often simplified as North-South divide (Brunnermeier et al., 2016; Armingeon and Cranmer, 2018; Lehner and Wasserfallen, 2019). On one side are the Northern countries of the Eurozone, including Germany and the frugal four (Austria, Denmark, the Netherlands, and Sweden), who emphasize the need for strict fiscal discipline rules. On the other side are the Mediterranean countries, such as Greece, Italy, France, Spain, and Portugal, who demand more fiscal burden sharing and fiscal equalization in the form of transfers. This conflictual structure between two groups of member states, advocating two fundamentally different approaches to the institutional governance of the Eurozone (i.e., fiscal discipline versus transfers), is quite a stable setting. Already in the negotiations of the Maastricht Treaty of 1992 proponents of both approaches had to find compromises to create the EMU (Woolley, 1994). Overall, neither side of this political divide dominated the bargaining of the most recent EMU reforms. The reform outcomes between 2010 and 2015 accommodated core demands of both sides. Accordingly, the analysis of the intergovernmental bargaining shows that the reforms are the result of compromise and reciprocity between these two opposing camps of member states (Lundgren et al., 2019).

Third, the Franco-German tandem, which is well-known as European integration engine, played a key role in the pre bargaining stage, that is, the agenda-setting (Degner and Leuffen, 2019). Agenda-setting refers to the pre-negotiation stage, when decision makers define which options will eventually be negotiated among all EU member states. An important

[1] Besides the political reforms of the EMU, which are at the focus of this book chapter, the role and actions of the European Central Bank (ECB) in addressing the Eurozone crisis stand out. The ECB takes a central role in the banking regulations and took decisive monetary actions, for example, with the outright monetary transactions.

power in this stage is the blockage of certain proposals (Bachrach and Baratz, 1962). France and Germany, as representatives of the northern and southern coalition, could broker compromises in advance and keep certain proposals off the agenda. The joint power of France and Germany, however, did not translate into the final bargaining among all EU member states – neither of the two turned out to be remarkably successful, in comparison to other EU member states, in influencing the final bargaining outcome (Lundgren et al., 2019).

Finally, two supranational institutions, the European Central Bank and the Commission, played a key role in further deepening the Eurozone with the EMU reforms. The decisive actions by the ECB with, for example, the outright monetary transactions, which followed the famous dictum of Mario Draghi that the ECB will do "whatever it takes" to preserve the Euro, have been broadly discussed.[2] Less emphasis has been put on the role of the Commission, not least because the EMU reforms have been mostly analysed through the lens of the intergovernmental conflicts among member states, as mentioned above. The Commission, however, was an influential actor during the EMU reforms. For starters, the Commission carefully prepared the ground for new reforms, waiting for the political window of opportunity to open (Kudrna and Puntscher Riekmann, 2021). In addition, the Commission was remarkably successful in influencing the final bargaining in the intergovernmental negotiations among the member states. The Commission could pull the negotiation outcome to its preferred option by exerting influence on member states, which were less exposed to the policies of the EMU reforms, were less integrated in intergovernmental politics, and attached lower salience on the negotiated policies (Lundgren et al., 2021). This indicates that the Commission strategically and successfully exploited its power resources in intergovernmental bargaining among member states.

Breaking New Ground with the Next Generation EU (NGEU)

If we extend the analysis from EMU reforms to the NGEU, which is a financial programme set up in reaction to the COVID-19 pandemic, we observe both a continuation of EMU politics, but also remarkable shifts. The COVID-19 pandemic led to a substantial economic contraction in several EU member states. To address this economic hardship, the NGEU package was negotiated as a supplement to the new EU budget (i.e., the multiannual financial framework). The NGEU programme extends the EU budget very substantially, and breaks new ground in respect to both the financing and spending side.

In terms of the fiscal size, the volume of NGEU is about 806 billion EUR for the period 2021-2026, which is very large if we compare it to the regular budget of 1074 billion EUR from 2021-

[2] Mario Draghi, the President of the ECB, held the speech with this announcement on July 26, 2012, at the Global Investment Conference in London.

2027. All EU member states are entitled to receive 386 billion EUR in loans, 407.5 billion EUR in grants, and 12.5 billion EUR will be allocated through competitive programmes (European Commission, 2021). The spending mechanism of the NGEU is that every member state has a certain proportion of the programme assigned and submits investment plans, which are supposed to rebuild the economies of the EU countries after the COVID-19 pandemic with a specific emphasis on programmes fostering green and digital transitions.

Even more remarkable than the spending side is that the NGEU is funded through jointly raised capital on the financial markets. The EU has issued bonds on the financial markets since the 1970s, but never at the scale of the NGEU (European Commission, 2021). For example, the EU raised 75 billion EUR in 2020 for the temporary support to mitigate unemployment risks caused by the COVID-19 pandemic (SURE). The SURE programme was designed as a temporary labour market stabilizer, allowing the financing of a crisis emloyment insurance scheme with low-interest rate loans (Schelkle, 2021). Thus, while the EU has issued bonds before with other programmes, the case of the NGEU is different and unique because of the substantial size of this fiscal intervention.

The Commission has a wide range of funding instruments and techniques at its disposal to borrow for the NGEU on behalf of the EU on the capital markets, using the EU budget as security. That the EU member states together raise capital on the financial markets at this scale is a new level of fiscal burden sharing. Borrowing this volume for the financing of NGEU to stabilize and develop the EU economy by issuing long-term bonds on the capital markets is a type of reform element, which was, in this form, out of reach in the EMU reform discussions, where eurobonds did not even make it to the negotiation table.

A striking similarity between the EMU reforms and NGEU politics is that both fiscal integration steps were triggered by economic crises. Thus, the updating and advancing of the institutional architecture in fiscal and economic policy-making is strongly reactive to crises. In addition, the lines of conflict between EMU and NGEU politics were very similar with the frugal four (i.e., Austria, Denmark, the Netherlands, and Sweden) forming the most sceptical group of EU member states (Armingeon et al., 2021). The heads of state and government of these countries asked for a downsizing of the NGEU programme, with fewer fiscal burden sharing in the form of common financing, and strict conditionalities for the spending. A major change in NGEU negotiations, as compared to EMU politics, was that Germany supported the joint raising of capital at this scale, which made this form of fiscal burden sharing feasible in the NGEU programme. This accommodative stance of Germany substantially weakened the Northern coalition of member states and isolated the frugal four, which then could successfully negotiate some concessions on the size of the NGEU programme, but could not block the basic design of this new fiscal integration step.

Why, then, was this deeper form of fiscal burden sharing possible in the NGEU, but not in EMU politics? The major difference in the politics of the NGEU was that the asymmetric shock that the pandemic exerted across EU member states was seen as completely exogenous. The heavy exposure of some countries to the Covid-19 pandemic was not perceived as a self-inflicted problem, but as an exogenous shock. This stands in contrast to the strong narrative in EMU politics, where politicians in fiscally hawkish member states argued that the countries in need of financial assistance were to a large extent themselves responsible for their crisis condition (Maathijs and McNamara, 2015).

This difference in interpretation of the crisis matters. It is by no means evident why in the case of the Eurozone crisis this narrative of self-inflicted problems, which laid the ground for strong conditionalities and blocked burden sharing in the form of eurobonds, was so strong in the reform politics of the EMU. Actually, the argument that the institutional deficiency of the EMU led to an accumulation of imbalances within the Eurozone and exposed the less competitive countries in the Euro area to the shocks of the financial crisis is persuasive (Frieden and Walter, 2017). Following this logic, the crisis conditions of some Eurozone countries exposed were not primarily self-inflicted, but to a large extent a function of the institutional deficiency of the EMU.

This discussion highlights that the interpretation of how exogenous or self-inflicted an economic crisis is for an EU member state influences the extent to which the other member states are willing to agree to fiscal solidarity in the form of fiscal transfers and common debts. A further important element in the discourse about COVID-19 is that this crisis is regarded as exceptional – and the NGEU programme accordingly designed as a one-time fiscal intervention. Therefore, a big question is whether the NGEU instrument of jointly raising credits on the financial markets at this scale becomes a new blueprint in EU fiscal and economic policy-making in the direction of fiscal federalism – or whether this instrument will indeed remain a one-time exception. Also, more broadly speaking, it remains to be seen how strictly the deficit and debt criteria, which are currently suspended because of the pandemic, will be re-enforced in the years ahead.

Scope Conditions, Power, and Influence in Fiscal and Economic Policy Making

The analysis of the EMU reforms and NGEU politics highlight the potential, limits, and scope conditions of fiscal burden sharing in the E(M)U. Overall, in the last decade, the two crises have substantially deepened fiscal integration in the EU. The experience suggests that an economic crisis is a necessary condition for deeper fiscal and economic integration. While the conflict constellation among member states in the politics of the EMU and NGEU were rather stable, we also observe remarkable shifts, mostly on the part of Germany's willingness to agree to the new financing instrument in the NGEU, which is a substantial development, compared to the politics of the EMU reforms.

Besides the rather stable conflict constellations among EU member states in fiscal and economic politics, it matters how a crisis is framed, particularly regarding the questions of whether the hardship of exposed countries is perceived to be self-inflicted and whether a crisis is treated as exceptional. Apart from the analysis of the scope conditions and differences in the narratives of the two fiscal integration steps, inquiry into the two cases also improves our understanding of who is most powerful and influential at each stage of E(M)U fiscal and economic policy making. In respect to power and influence, we can draw five key lessons.

First, the politics of fiscal transfers and discipline in the EU are structurally shaped by a rather *stable conflict* between predominantly Northern and Southern member states on both sides. This divide stems from profound differences among the two groups of countries in economic interests and ideational paradigms of economic and fiscal policy-making (Brunnermeier et al., 2016; Hall, 2018). Of course, there are interesting nuances across member states to explore, but this broader divide defines the structure of political conflict among member states in fiscal integration. Second, the *Franco-German integration tandem* plays a key role in how this structural conflict among member states translates into policy making. Both countries together have a very influential role in defining the policy options that are eventually negotiated (and dropped from the choice set); and they both can change the power balance, when they take an accommodating stance in the direction of the other side, as Germany did in the case of the NGEU. Third, *smaller coalitions*, like the frugal four, can reduce the scope of fiscal integration programmes, if they coordinate among one another, but they cannot block the basic design and direction of a fiscal integration step. Fourth, the *Commission* plays both in the preparation and the final bargaining stage an influential role, even when the negotiations are predominantly intergovernmental among member states.

Finally, the *power of ideas and narratives* is critical for understanding the politics of fiscal integration (McNamara, 1998; Brunnermeier et al., 2016). Crises may be necessary for further integration, but how the nature of an economic crisis is framed is decisive in respect to how much fiscal solidarity and burden sharing is part of the new fiscal integration step. The main question in that respect is whether the exposure to an economic shock is perceived to be self-inflicted or not. If not, the odds are much better that the fiscal response of the EU puts more emphasis on burden sharing and transfers and is not dominated by the principles of fiscal discipline and conditionality.

Generally speaking, since the creation of the EMU in Maastricht in 1992, two models of integration compete with one another: one is built on fiscal discipline and the other on fiscal transfers and joint debts. Simplifying the politics of fiscal integration, the Northern coalition of member states advocates the former model, the Southern coalition the latter. New fiscal reforms and programmes, developed as reactions to crises, build to varying degrees on the two competing models. By putting more or less emphasis on the former or latter model, these new elements change the fiscal architecture of the EU. However, every reform also builds on institutional and political legacies (i.e., is path dependent). Besides the discussed shifts and changes in NGEU and EMU politics, the larger picture points to very strong continuity since Maastricht. In sum, the experience of the last decade suggests that crises lead to deeper integration – not disintegration, as some may fear – but how the fiscal and economic reform programmes incrementally advance the fiscal architecture of the EU and EMU is heavily dependent on the interpretation of the crisis to which they are designed as reaction.

Differentiated Integration and Democratic Legitimacy

The Eurozone reforms and NGEU further deepened fiscal integration and added new layers of complexity to the extent to which member states are integrated in the fiscal and economic structure of the EU-27 and EMU. An abundance of literature on differentiated integration studies the phenomenon that EU member states are to varying extents integrated in the EU (Leuffen et al. 2013; Schimmelfennig et al., 2015; Hobolt, 2016; Schimmelfennig and Winzen, 2020). The Eurozone with its 19 EU member states is a crucial case in point. Denmark has opted-out, and Sweden does not want to adopt the Euro either. At the same time, several Central and Eastern European member states wait for the next steps in the Euro accession process.

Overall, the field of fiscal and economic integration is highly fragmented, which complicates reforms. As discussed above, the NGEU is designed as a fiscal reaction for the EU-27 to the pandemic – and as a complement to the EU budget. In that sense, the NGEU is not connected to challenges of the EMU, although the fiscal programme of the NGEU includes – with the joint raising of credits – a tool of fiscal solidarity, which is, as a policy instrument, highly relevant for the challenges of the EMU. Also, on the spending side, the investment programmes of the NGEU address a core challenge of the Eurozone, as they are supposed to increase the competitiveness of EU member states. The imbalances in competitiveness across the Eurozone countries are a main source of instability within the EMU (Frieden and Walter, 2017). The broader point is that the existing fiscal and economic programmes of the EU and EMU do not define clear demarcation lines between the policies and competences of the Eurozone and EU-27.

Zooming into the governance structure of the Eurozone, we also observe a high level of differentiation and complexity. The territorial coverage of fiscal and economic policies varies and many different decision-making processes apply – from legislation according to the ordinary or special legislative procedure (like the banking regulations) to intergovernmental agreements (like the fiscal compact). The example of the fiscal compact illustrates the extent of differentiated integration. The fiscal compact was signed in 2012 as an intergovernmental treaty by all EU member states except the Czech Republic and the United Kingdom (Smeets and Beach, 2021). The intergovernmental treaty was signed outside the EU legal framework and some parts are only binding for Eurozone member states. The banking regulations (that is, the Single Supervisory Mechanism and the Single Resolution Mechanism and Fund) are examples of the opposite institutional structure: these policies were adopted according to the special and ordinary legislative procedure, also involving the European Parliament in decision making, and they cover all EU countries (Howarth and Quaglia, 2016).

Taken together, this analysis and examples illustrate that fiscal, economic, and financial policies apply to different compositions of member states and follow different decision-making procedures. As an additional level of heterogeneity, we observe variation in compliance across countries (e.g., as far as the adherence to the fiscal debt and deficit criteria is concerned). The broader point is that the levels of integration across member states and policy fields as well as the governance structure are highly differentiated. This institutional structure becomes even more complex, when we add the involvement of the different institutions, such as the ECB, the Commission, the European Parliament – or more specialized bodies, such as the board of the European Stability Mechanism, which conducts the operational task of providing financial assistance to Eurozone countries in need.

Overall, this complex and differentiated set-up complicates the search for reforms aiming at clarifying integration in the fiscal and economic area. Such a clarification should be done by a Treaty revision, but we have not seen any updating of the Treaty since the Lisbon amendment was signed in 2007. The structure of fiscal and economic policy making in the EU thus remains somewhat ambiguous on the question of which type of fiscal coordination and fiscal burden sharing ought to be organized on the EMU or EU-27 level. The differentiated nature of this policy area raises questions on the desirability of fragmentation and on the democratic legitimacy of fiscal policy making on the EU level.

Several scholars identify the need for deeper fiscal and economic integration (De Grauwe and Ji, 2014; Genschel and Jachtenfuchs, 2018). Contested, however, is the approach towards deeper integration. Some analyses identify more differentiated integration as a path forward because this allows those member states who are willing and capable of further integration, to move ahead. The argument for this integration model is that more flexibility in the composition of member states helps overcome conflicts, and is thus conducive to achieving deeper integration among a subset of member states (De Vries, 2018; Fabbrini, 2019). Accordingly, more differentiation with deeper integration within the EMU is supposed to make the institutional framework of the Eurozone more distinct and resilient. The European Commission, however, is critical of more differentiation (although the White Paper of the Commission from 2017 mentions this as a possible scenario; see the European Commission, 2017). Also critical are EU member states who want to adopt the Euro, but are not yet members of the Eurozone. They fear that more differentiation and flexibility will make it more difficult for them to enter the Eurozone.

A final – and related – key challenge of fiscal integration is the democratic anchoring of decision making on the European level. An abundant literature in political science analyses the so-called democratic deficit of the EU (Majone, 1998; Moravcsik, 2002; Follesdal and Hix, 2006; Hix, 2008). In the case of fiscal and economic integration, three dimensions are particularly relevant: (a) the substantial power shift to national governments already discussed above, (b) the vertical separation of authority between the national and European level, and (c) the extent to which decision making is democratically anchored by the mechanisms of input and output legitimacy (Scharpf, 2011).

A defining characteristic of fiscal and economic policy making in the EU is that national governments take a very central role. National governments are in the Council and European Council key actors (Smeets and Beach, 2021; Târlea et al., 2021). They formulate policies to which they are then held accountable. This elevates the national executives to legislators on the European level and, as a consequence, limits the room of national parliaments to manoeuvre in fiscal policy making (Scharpf, 2011). The substantial shift of power from national parliaments to national governments is particularly sensitive in the area of fiscal policy making because the power to tax and spend is an area of core state power and, as such, a prerogative of national parliaments in parliamentary democracies. The policy authority on the European level recalibrates this separation of power between executives and legislators on the national level. One way to address this is the systematic involvement of national parliaments in EU fiscal and economic policy making (Beukers, 2013; Puntscher Riekmann and Wydra, 2013; Winzen, 2021).

Another critique is that economic and fiscal policies of the EU, most notably the conditionality policies of the Eurozone reforms, confront "national democratic choice" (Featherstone, 2016, 2) and may lead to "a crisis of democratic legitimacy" (Scharpf, 2011, 2). The basic concern is that EMU governance puts constraints on national policy options and lacks democratic mechanisms for managing crisis politics. As a consequence, citizens may become detached from national and EU democracy. Several studies observe this phenomenon in countries that were exposed to the Eurozone crisis (Armingeon et al. 2016, Matthijs, 2017), while others identify this effect as a temporary crisis problem, rather than a systemic threat to the legitimacy of democratic governance (Schraff and Schimmelfennig, 2019). This empirical literature shows how the separation of authority between the national and European level in the fiscal and economic policy area impacts foundational issues on democratic processes.

Finally, Scharpf (2011) approaches the democratic challenge of fiscal integration with the conceptual distinction between input and output legitimacy. His analysis elucidates the limits and challenges of input legitimacy (i.e., the governance by the people) on the basis of a complex chain of delegation and representation in the multilevel structure of the EU. Output legitimacy (i.e., the governance for the people) refers to the requirement of providing welfare and prosperity to the citizens of the EU. The Eurozone crisis has shown that output legitimacy is lacking when citizens in countries exposed to economic hardship, like Greece or Italy, do not experience the Euro as a source of welfare and prosperity, particularly when EMU fiscal policies involve austerity (Franchino and Segatti, 2019; Jurado et al., 2020; Baccaro et al., 2021). Without output legitimacy, the governance of the Eurozone becomes very challenging because the EMU institutional framework lacks a strong foundation on the principle of input legitimacy.

Conclusion

Building on the political science scholarship, this contribution has analysed the politics of fiscal integration in the Eurozone reforms and the more recent NGEU programme. The basic conflict between member states is over how much emphasis fiscal reforms should put on fiscal discipline measures or fiscal transfers and burden sharing (Brunnermeier et al., 2016). Contested is the extent to which the fiscal architecture of the EU should move in the direction of a fiscal federal set-up. The politics of fiscal integration are characterized by strong continuity and path-dependency since the creation of the EMU in Maastricht about 30 years ago. However, the crises of the Eurozone and the COVID-19 pandemic have also led to remarkable shifts. Both crises were addressed with a series of fiscal reforms on the EU level. While the deeper financial integration with the banking union stands out in the case of the Eurozone, the NGEU programme took fiscal integration to new levels with a large-scale investment programme that is financed by joint borrowing on the capital markets (Howarth and Quaglia, 2016; Armingeon et al., 2021; Schelkle, 2021).

The analysis of fiscal integration points to the importance of intergovernmental politics, which are structured by a conflict between predominantly Northern and Southern member states (Lehner and Wasserfallen, 2019). In this conflict constellation, the Franco-German tandem and smaller coalitions of member states, such as the frugal four, have important roles (Degner and Leuffen, 2019). Also, supranational institutions such as the Commission and the ECB are influential actors in the politics of fiscal integration (Lundgren et al., 2021). Finally, ideas and the framing of crises shape fiscal politics (McNamara, 1998; Matthijs and McNamara, 2015). The extent to which burden sharing in the direction of a fiscal federal union is politically feasible depends on whether the economic challenges, which are triggered by crises, are perceived as a common European or as a self-inflicted problem by the countries that are hard hit by these crises. The common interpretation of the crises shapes the form of the fiscal reaction to them.

This mode of more fiscal integration in reaction to economic crises has also increased the complexity of the fiscal architecture of the EU. Fiscal and economic policy is a textbook case of differentiated integration in the EU: different policies apply to different compositions of member states, are shaped and administered by different decision-making procedures and institutions, and are implemented to varying extents by member states. Already on a very general level the demarcation line is ambiguous between fiscal policies of the EU-27 and the EMU. Against this backdrop, a key question is whether a more distinct differentiation in the form of deeper fiscal integration among a core group of member states in the EMU is a promise of peril for the future of European integration.

Taken together, the Eurozone reforms and NGEU have added new fiscal elements to the toolkit and have thus advanced fiscal integration substantially. However, these programmes were designed in reaction to crises. The basic institutional model of fiscal integration in the EU is still highly contested. For example, it remains unclear whether the large-scale joint borrowing of NGEU is going to be exceptional – or a mechanism that is regularly used –, and the extent to which fiscal discipline measures will be reinforced again in the future remains to be seen. As a next step in fiscal integration, a systematic institutional reform, ideally with a revision of the Treaty, could address these basic questions (Auer and Scicluna, 2021).

Instead of adding new layers of complexity to the fiscal architecture of the EU in reaction to a crisis, such a reform should seek to reduce complexity by defining the EU model of fiscal integration on a more general level – and on the basis of the substantial fiscal integration measures that have been taken in the last 10 years. Ideally, such a reform would strike a balance between the principles of fiscal discipline and fiscal burden sharing and clarify the distinction between the fiscal policies of the EMU and EU-27. This type of reform could also help in addressing concerns about the democratic legitimacy of fiscal policy making in the EU. The governments of member states have been too powerful in the politics of fiscal integration by crises management of the last decade. A more distinct separation of authority between the member states and the EU level and the clarification of institutional responsibility between the European and domestic level would foster the democratic anchoring of European fiscal policy making.

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