Chapter on the Political Dimension of the Economic Union for the

Cambridge Handbook on European Monetary, Economic, and Financial Market Integration

Edited by Dariusz Adamski, Fabian Amtenbrink, and Jakob de Haan

The Politics of Fiscal Integration in Eurozone Reforms and Next Generation EU

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May 2022

Introduction

The introduction of the Economic and Monetary Union (EMU) with the Euro as a common currency is the deepest form of integration among EU Member States. From the beginning, the institutional setting of the common currency area was contested – not least because the basic goal of the EMU was controversial: for some, the Euro was a rather technical and incremental extension of economic integration, while others saw in the common currency a big step towards a closer political union. To date, the key question remains how strongly the members of the Eurozone, who gave up national authority in monetary policy, have to pool fiscal and economic policymaking on the European level. At the 1991 Maastricht summit, the EU leaders discussed the need for a deeper political union with pooled fiscal and economic authority, which was supposed to complement the monetary union. Eventually, the heads of state and government created in Maastricht the EMU, but they could not agree on a common approach for deeper political and fiscal integration—and this discussion has remained conflictual ever since (Woolley, 1994; Wasserfallen, 2014).

Stepwise, the EMU's institutional setting was introduced and extended, for example, with the deficit and debt criteria and the Stability and Growth Pact (SGP). The approach to governing the Eurozone with fiscal rules remains controversial, and the non-sanctioning of Germany and France, which violated the deficit criteria in 2003, weakened the pact's credibility. The institutional framework of fiscal integration is still a work in progress, whereas the crises of the Eurozone and COVID-19 triggered multiple fiscal integration steps. This contribution seeks to analyse the recent trends and remaining challenges of fiscal integration by asking the following guiding questions: Who is in conflict with whom over what? Why and how did the EU Member States agree to deepen fiscal integration further? What are the key challenges of fiscal integration? To provide some answers to these questions, the following analysis draws on political science research and investigates how the EMU's institutional framework was established and how it was updated in the last few years during the Eurozone crisis and in reaction to the COVID-19 pandemic. The focus lies on the political conflicts, which shape the EMU's governance structure. Building on this analysis of political conflict, this chapter also addresses the more general questions of democratic legitimacy and the varying degrees to which EU Member States are fiscally integrated.

The EMU's fiscal cornerstones are the no-bailout clause and sustainable fiscal policy. Building on this institutional legacy, the reforms enacted during the Eurozone crisis between 2010 and 2015 further deepened the monetary union. As often in European integration, a crisis opened the window of opportunity for accomplishing more integration among EU Member States (Ioannou et al., 2015; Jones et al., 2021). In essence, the EU Member States agreed on further strengthening the fiscal discipline criteria with the Two- and Six-Pack legislation, and they created rescue funds in the form of the European Stability Mechanism. A further key element of the reforms was the Banking Union comprising the Single Supervisory Mechanism and the Single Resolution Mechanism (Howarth and Quaglia, 2016; Wasserfallen et al., 2019). Not on the negotiation table was the common financing of debts through Eurobonds, which would have been a more explicit step in the direction of a fiscal federal EMU set-up.

All the mentioned reforms were negotiated under the context of highly conflictual politics. Political science research sheds light on the political conflicts and power constellations in the EMU's reform negotiations. Four broader findings stand out: (a) the dominance of intergovernmental conflicts 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 preparatory stage, where the potential options for reform are defined (Schild, 2013; Bulmer, 2014; Degner and Leuffen, 2019); (c) the important role of smaller coalitions of Member States at the spectrum's polarised ends (Morlino and Sottilotta, 2019; Armingeon et al., 2021); and (d) the Commission's influence in policy preparation and the final bargaining stage (Carstensen and Schmidt, 2021; Kudrna and Wasserfallen, 2021; Lundgren et al., 2022).

The COVID-19 pandemic led again to deeper fiscal integration in the form of the Next Generation EU (NGEU) programme. From a fiscal point of view, the NGEU programme is remarkable because it extends the EU's fiscal capacity by adding 806 billion EUR to the regular budget of 1074 billion EUR, known as the multiannual financial framework of 2021–2027.

Moreover, the Member States jointly finance the NGEU by issuing bonds on the financial market (European Commission, 2021). Overall, we find continuity and change from the EMU reforms politics to the NGEU programme. On the one hand, 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 transfers. On the other hand, Germany took a more accommodating stance in the case of NGEU, which made it possible to move in the direction of joint financial responsibility. NGEU's remarkable novelty is that the Commission borrows on a large scale, on the EU's behalf within the capital markets for the programme's financing, which is a strong development towards new financing mechanisms from EMU reforms to NGEU (Armingeon et al., 2021; Schelkle, 2021).

Among other reasons, this step towards substantial joint borrowing was politically feasible because the NGEU programme is supposed to be exceptional and thus not anticipated to become a regular tool of fiscal policymaking. It remains to be seen whether that will be the case. A key challenge of fiscal integration is the demarcation between the EMU and EU-27. The NGEU programme is designed for the EU-27, not the Eurozone with its 19 members, and was a reaction to the economic and social consequences of the COVID-19 pandemic. On a more general level, the comparison between the Eurozone reforms and NGEU illustrates that the EU Member States are fiscally integrated to varying extents.

The scholarship on differentiated integration investigates precisely these varying degrees of integration across policies and Member States (Leuffen et al., 2013; Schimmelfennig and Winzen, 2020). This literature is particularly relevant in the fiscal, financial, and economic fields, where some reforms include all EU Member States (e.g., NGEU) and others include only the EMU members (e.g., European Stability Mechanism). Some policies are legislated according to the EU's ordinary or special legislative procedure (e.g., the banking regulations) and others as intergovernmental agreements (e.g., the fiscal compact). Against this backdrop of large integration heterogeneity, some researchers advocate deeper integration among a subset of Member States within the EMU (De Vries, 2018; Fabbrini, 2019).

Another key challenge is the extent to which authority transfers to the EU level are democratically anchored and legitimised. The literature on the EU's so-called democratic deficit is abundant (Majone, 1998; Moravcsik, 2002; Follesdal and Hix, 2006; Hix, 2008). One concern is the substantial power shift from parliaments to the national executives. In the area of fiscal and economic policymaking, there is limited involvement of the European Parliament and, on the domestic level, Member State governments only marginally integrate their national parliaments in EU fiscal politics (Târlea et al., 2021). Consequently, the national executives take up a dominant role on the EU level and interfere 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 raises concerns that fiscal policymaking on the EU level lacks democratic anchoring and legitimacy.

Within this broader context of recent reforms and the remaining key challenges of fiscal integration, this chapter discusses the politics of fiscal integration in four parts. The first part identifies the main political conflicts, with a focus on the EMU reforms enacted as a reaction to the Eurozone crisis. The second part investigates the NGEU programme, highlighting similarities and changes compared to EMU politics. Based on the EMU and NGEU analyses, the third part identifies the scope conditions for fiscal reforms, as well as the general power structure of fiscal integration politics. The final section highlights two remaining key challenges, namely the difficulty of integration in a highly differentiated area with unclear demarcation lines between the EU-27 and Eurozone, as well as the limits of democratic legitimacy in fiscal politics.

The Politics of the Eurozone Reforms

More than 30 years ago, when the EMU was founded in Maastricht, the heads of state and government were in conflict with one another over the scope and scale of fiscal integration, which was required to complement and stabilise a common currency area. At the Maastricht summit, the EU leaders could not agree on a common approach for deeper political and fiscal integration but, nevertheless, created the EMU (Woolley, 1994). A main building block of EMU governance in the fiscal realm became the 1997 SGP, with its attempt to operationalize the fiscal deficit and debt rules. In 2003, the SGP framework was severely undermined when no sanctions were enacted against Germany and France, which violated the deficit criteria. A rather fundamental critique of the SGP was that, instead of building on fiscal discipline, a system of burden-sharing and automatic fiscal transfers within the Eurozone was required to stabilise the common currency area.

Triggered by the financial crisis, the Eurozone's stability was then severely challenged starting in late 2009, even to the point where some economists speculated about a breakdown of the common currency. With the benefit of hindsight, this gloom and doom scenario was exaggerated, but the Eurozone crisis showed that the EMU's institutional framework was not resilient enough to absorb imbalances and shocks (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 macroeconomic conditions are not sufficiently equalised with automatic stabilisers, 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 Eurozone's institutional deficiency with respect to missing fiscal stabilisers (Feldstein, 2012; Krugman, 2013; de Haan and Gootjes, 2022).

Along these lines, a large literature on fiscal federalism explores which institutional settings and fiscal stabilisers 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, equalise the differences in economic conditions across the Eurozone (Dolls et al., 2018). Another policy option is a permanent EU-wide stabilisation facility (Beetsma and Kopits, 2022). This literature serves as a relevant point of orientation for understanding the Eurozone's struggles because the core reason for the crisis was that Eurozone members accumulated imbalances, which turned into a balance-of-payments and debt crisis (Copelovitch et al., 2016; Frieden and Walter, 2017). A further strand of studies draws lessons from the United States' fiscal and monetary integration history (Sala-i-Martin and Sachs, 1991; Bordo et al., 2013).

For EMU leaders, the key political question in the reaction to the crisis was the same as 20 years before in the Maastricht summit: namely, how much emphasis should they put on fiscal discipline and what type of fiscal transfers are needed to make the common currency area more resilient? The EU Member States agreed on a large set of reforms from 2010 to 2015. One part of these reforms further strengthened the EMU's fiscal discipline side with the legislation of the Two-Pack, Six-Pack, and Fiscal Compact. In addition, the fiscal transfers of the EMU architecture expanded with rescue funds in the form of the European Financial Stability Facility, the European Stability Mechanism, and assistance packages to Greece. The final key elements of the EMU reforms brought about the Banking Union (i.e., the Single Supervisory Mechanism and the Single Resolution Mechanism and Fund; see Wasserfallen et al., 2019; Kudrna and Puntscher Riekmann, 2021).[1] All of these EMU reforms were negotiated in the context of highly conflictual policymaking. The research of political scientists points to four broader characteristics that define and explain the fiscal politics of EMU reforms.

First, the politics of EMU reforms were *dominated by intergovernmental conflicts* with Member States' governments as central actors. Although 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 policymaking of the EMU reforms involved several institutional procedures, from intergovernmental treaties to legislation according to the ordinary legislative procedure, as well as involving the Commission and partly the European Parliament. Overall, however, the reforms generally were decided in intergovernmental negotiations.

Second, the conflict among Member States is often simplified as the *North–South divide* (Brunnermeier et al., 2016; Armingeon and Cranmer, 2018; Lehner and Wasserfallen, 2019).

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

On one side are the Northern countries of the Eurozone, including Germany and the frugal four (i.e., Austria, Denmark, the Netherlands, and Sweden), which emphasise the need for strict fiscal discipline rules. On the other side are the Mediterranean countries, such as Greece, Italy, France, Spain, and Portugal, which demand greater fiscal burden-sharing and fiscal equalisation in the form of transfers. This conflictual structure between the two groups of Member States advocating two fundamentally different approaches to the Eurozone's institutional governance is a rather stable setting for EMU politics. Overall, neither side of this political divide dominated the bargaining of the recent EMU reforms. The reform outcomes between 2010 and 2015 accommodated the core demands of both sides. Accordingly, the analysis of the intergovernmental bargaining shows that the bargaining outcomes were the result of compromises and reciprocity between these two opposing camps of Member States (Lundgren et al., 2019).

Third, the *Franco–German tandem,* which is well-known as the European integration engine, played a key role in the pre-bargaining stage, that is, the agenda-setting of policymaking (Degner and Leuffen, 2019). Agenda-setting refers to the pre-negotiation stage, during which decision-makers define the options to be negotiated among all EU Member States. An important power in this stage is the blockage of certain proposals (Bachrach and Baratz, 1962). France and Germany, as Northern and Southern coalition representatives, could broker compromises in advance and keep certain proposals off the agenda. For example, the Germans blocked the proposal for Eurobonds. The joint agenda-setting power of France and Germany, however, did not translate into the final bargaining among all EU Member States—neither of the two was remarkably successful, compared to the other EU Member States, in influencing the final bargaining outcome (Lundgren et al., 2019). This summarizes the broader picture. Depending on the context and specific initiatives, we also observe additional coalitions and cooperation among countries that go beyond this stylized and general pattern.

Finally, two *supranational institutions,* the European Central Bank (ECB) and the Commission, played a key role in further deepening the Eurozone. The ECB's decisive actions, such as the outright monetary transactions that 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 Commission's role, not least because the EMU reforms have been analysed primarily through the lens of intergovernmental conflicts among the Member States, as mentioned above. The Commission, however, was an influential actor during the legislation of EMU reforms, such as the Two- and Six-Pack. 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 negotiations among the

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

Member States. The Commission pulled the negotiation outcomes to its preferred option by exerting influence on Member States, which were less exposed to the EMU policy reforms, less integrated in intergovernmental politics, and attached lower salience to the negotiated policies (Lundgren et al., 2022).

Breaking New Ground with Next Generation EU

If we extend the analysis from EMU reforms to NGEU, which is a financial programme set up in reaction to the COVID-19 pandemic, we observe a continuation of EMU politics, as well as 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 substantially extends the EU budget and breaks new ground in respect to both the financing and spending.

In terms of its size, the NGEU's volume is approximately 806 billion EUR for the period 2021–2026 (compared to the regular budget of 1074 billion EUR for 2021–2027). All EU Member States together are entitled to receive 386 billion EUR in loans, 407.5 billion EUR in grants, and 12.5 billion EUR for the allocation through competitive programmes (European Commission, 2021). The NGEU's spending mechanism is that every Member State has a certain proportion of the programme assigned and submits investment plans, which are supposed to rebuild the EU countries' economies 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 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 NGEU (European Commission, 2021). For example, the EU raised 75 billion EUR in 2020 for temporary support to mitigate unemployment risks caused by the COVID-19 pandemic (SURE). The SURE programme was designed as a labour market stabiliser, allowing for the financing of a crisis unemployment insurance scheme with low-interest rate loans (Schelkle, 2021). Thus, although the EU has issued bonds with other programmes, the case of NGEU is different and unique because of its substantial financing capacity size. The Commission has a wide range of funding instruments and techniques at its disposal to borrow for the NGEU on the EU's behalf on capital markets, using the EU budget as security. That the EU Member States jointly raise capital on the financial markets at this scale is a new level of joint financial responsibility, which makes capital for some member available at better conditions. Stabilising and developing the EU economy by issuing together long-term bonds on the capital markets is a policy instrument which was, in this form and scale, out of reach in the EMU reform discussions, during which 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 policymaking are highly reactive to crises. In addition, the lines of conflict in EMU and NGEU politics were similar, with the frugal four forming the most sceptical group of EU Member States (i.e., Austria, Denmark, the Netherlands, and Sweden; see Armingeon et al., 2021). The heads of state and government of these countries asked for a downsizing of NGEU programmes, opposing the joint financing of public spending and asking for strict spending conditionality. A major change in NGEU negotiations, compared to EMU politics, was that Germany supported the joint raising of capital at this scale, which made the collective sharing of financial responsibility possible in the NGEU programme. Germany's accommodative stance substantially weakened the Northern coalition of Member States and isolated the frugal four, which then could successfully negotiate concessions on the size of the NGEU programme, but they could not block the basic design of this new financing instrument.

Why, then, was this deeper form of collective financing possible in NGEU but not in EMU politics? The major difference between EMU and NGEU was the framing of the causes of the two crises. In NGEU, the asymmetric shock that the pandemic exerted across EU Member States was seen as completely exogenous. Thus, the heavy exposure of some countries to the COVID-19 pandemic was not perceived as a self-inflicted problem. This stands in strong contrast to the narrative in EMU politics, where politicians in fiscally hawkish Member States argued that the countries in need of financial assistance were responsible for their crisis conditions (Matthijs and McNamara, 2015).

This difference in interpretation of the crisis matters. In the case of the Eurozone crisis, the narrative of self-inflicted problems laid the ground for strong conditionality and blocked burden-sharing in the form of Eurobonds. An opposing narrative focused on the systemic elements of the crisis. The argument from this perspective is that the EMU's institutional deficiency led to an accumulation of imbalances within the Eurozone and exposed the Eurozone's less competitive countries to the shocks of the financial crisis (Frieden and Walter, 2017). Following this persuasive analysis, the crisis conditions of some Eurozone countries were not primarily self-inflicted. Rather, they were largely a function of the EMU's institutional deficiency.

The broader point for the purpose of this analysis is 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 the pandemic is regarded as exceptional, and the NGEU programme was accordingly designed as a one-time fiscal intervention. The big question is, thus, whether the NGEU instrument of jointly raising credits on the financial markets at this scale becomes a new blueprint in EU fiscal integration in the direction of fiscal federalism or whether this instrument will remain a one-time exception. More broadly speaking, it remains to be seen how fiscal discipline with the SGP, which was suspended because of the pandemic, will be modified in the years ahead.

Scope Conditions and Power Structure in Fiscal Integration

The analysis of the EMU reforms and NGEU politics highlights the potential, limits, and scope conditions of fiscal integration in the EU and the Eurozone. In the last decade, the two crises have led to various fiscal, financial, and economic reforms with new collective financing mechanisms. The two cases suggest that an economic crisis is a necessary condition for deeper fiscal and economic integration. Although the conflict constellation among EU Member States in the politics of the EMU and NGEU was rather stable, we also observe remarkable shifts, especially regarding Germany's willingness to agree to the new financing instrument in NGEU, which is a substantial development compared to EMU reform politics between 2010 and 2015.

Besides the stable conflict constellations among EU Member States in fiscal integration, it matters how a crisis is framed, particularly whether a crisis is treated as exceptional or the hardship of exposed countries is perceived to be self-inflicted. So far, we have focused on the analysis of the scope conditions and differences in the narratives of the two fiscal integration steps. Another question is who was most powerful and influential in EMU and NGEU politics. In respect to power and influence in fiscal integration politics, we can draw five key conclusions.

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 in economic interests and ideational paradigms of economic and fiscal policymaking (Brunnermeier et al., 2016; Hall, 2018). Of course, there are important nuances across Member States, but this broader divide defines the structure of political conflict among EU Member States. Second, the Franco–German integration tandem plays a key role in how this structural conflict among Member States translates into policymaking. Both countries play an influential role in defining the policy options that are eventually negotiated (and blocked from the policy choice set), and they both can change the power balance when they take an accommodating stance in the other side's direction, as Germany did in the case of NGEU. Third, smaller coalitions, such as the frugal four, can shape 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 an influential role in the preparation and the final bargaining stage, 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 the way the nature of an economic crisis is framed is decisive in respect to how much fiscal solidarity and burden-sharing are part of a new fiscal integration step. The main question in that respect is whether the exposure to an economic shock is perceived to be self-inflicted. 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.

Summing up these key findings, we find a large continuity since the EMU's 1992 creation in Maastricht. Essentially, 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, are built to varying degrees on the two competing models, while the problems of enforceability and the suspension of fiscal discipline criteria have shown the limits of the fiscal discipline approach. By putting more or less emphasis on the former or the latter model, the new elements of fiscal integration change the fiscal architecture of the EU. Besides the discussed shifts and changes in NGEU and EMU politics, the larger picture, however, points to a remarkably stable political setting since Maastricht. The experience of the last decade also 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 a reaction.

Differentiated Integration and Democratic Legitimacy

The NGEU and EMU reforms deepened fiscal integration, and they added new layers of complexity to the model of how Member States are integrated in the fiscal and economic structures 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; Schimmelfennig and Winzen, 2020). Fiscal, monetary, and financial integration is a crucial case in point. For example, the Eurozone includes 19 EU Member States. Denmark has opted out after the Maastricht Treaty was rejected in a referendum, and Sweden does not want to adopt the Euro either. At the same time, some Central and Eastern European Member States are waiting for the next steps in the Euro accession process, while others have no such plans.

Overall, integration in EU fiscal policy is highly fragmented, which complicates reforms. As previously discussed, 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, NGEU is not connected to the challenges of EMU, although the fiscal programme of 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 Eurozone. Moreover, regarding the spending side, the investment programmes of 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 currency area (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, which complicates the targeted improvement of the fiscal architecture in the monetary union and the full EU-27.

Zooming into the Eurozone's governance structure, we observe high levels of differentiation and complexity. Fiscal and economic policies apply to varying sets of member states and are to different extents implemented. Also, the decision-making processes vary, from legislation according to the ordinary or special legislative procedure (e.g., banking regulations) to intergovernmental agreements (e.g., fiscal compact). One example of differentiated integration is the fiscal compact, which 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 institutional architecture of the banking regulations stands in contrast to the fiscal compact. The banking union policies (i.e., the Single Supervisory Mechanism and the Single Resolution Mechanism and Fund) were adopted according to the community method of special and ordinary legislative procedure, which involves the European Parliament in decision-making, and the policies cover all EU countries (Howarth and Quaglia, 2016).

These 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 also observe variation in compliance across countries (e.g., as far as the adherence to the fiscal debt and deficit criteria is concerned; see de Haan and Gootjes in this volume). In sum, the levels of fiscal integration across Member States and policy fields, as well as the governance structure, are highly differentiated. This institutional structure becomes even more complex when including the involvement of the different institutions, such as the ECB, the Commission, and the European Parliament, or more specialised bodies, such as the Boards of Governors and Directors of the European Stability Mechanism, which conducts the task of providing conditional financial assistance to Eurozone countries in need.

Overall, this complex and differentiated set-up complicates the search for reforms aiming to clarify integration in the fiscal and economic area. Such a clarification should be done by a

Treaty revision, but there has been no Treaty update since the Lisbon amendment was signed in 2007. Thus, the structure of fiscal and economic policymaking in the EU remains somewhat ambiguous on the question of which type of fiscal coordination and fiscal burden-sharing ought to be organised on the level of the EMU or EU-27. The differentiated nature of the fiscal policy area eventually raises questions about the desirability of fragmentation and on the democratic legitimacy of EU fiscal policymaking.

Several scholars have identified the need for deeper fiscal and economic integration (De Grauwe and Ji, 2014; Genschel and Jachtenfuchs, 2018). The approach towards deeper integration, however, is contested. Some analyses have identified more differentiated integration as a path forward because this allows the Member States that are willing and capable of further fiscal 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 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 resilient. The Commission, however, is critical towards more differentiation (although the White Paper of the Commission from 2017 mentions this as a possible scenario; see European Commission, 2017). Moreover, the EU Member States that want to adopt the Euro, but are not yet members of the Eurozone, are critical as well. They fear that more flexibility will eventually 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 has analysed 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 in this debate: (a) the substantial power shift to national governments discussed above, (b) the vertical separation of authority between the national and European levels, and (c) the extent to which decision-making is democratically legitimised (Scharpf, 2011).

A defining characteristic of fiscal integration in the EU is that national governments take a central role. The Council and European Council, composed of representatives of national governments, are the key institutions (Smeets and Beach, 2021; Târlea et al., 2021). In these institutions, the governments formulate policies to which they are then held accountable. This elevates the national executives to legislators on the European level and, consequently, limits the room of national parliaments to manoeuvre in fiscal policymaking (Scharpf, 2011). One remedy to this problem is the empowerment of the European Parliament, which, however, also raises questions in respect to authority transfers to the European level and the capacity of the European Parliament to provide this democratic anchoring within the institutional structure of the EU.

In any case, the shift of power from national parliaments to national governments is particularly sensitive in the area of fiscal integration because the power to tax and spend is a core state power. As such, fiscal policy making is a prerogative of national parliaments in parliamentary democracies, which makes it difficult to transfer authority in this field to the EU level. 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 problem is the systematic involvement of national parliaments in EU fiscal and economic policymaking (Beukers, 2013; Puntscher Riekmann and Wydra, 2013; Winzen, 2021).

A related critique is that the EU's economic and fiscal policies, most notably the conditionality policies of the Eurozone reforms, confront "national democratic choice" (Featherstone, 2016, 48) and may lead to "a crisis of democratic legitimacy" (Scharpf, 2011, 165). The basic concern is that EMU governance puts constraints on national policy options and lacks democratic mechanisms for managing crisis politics. Consequently, citizens may become detached from national and EU democracy. Several studies have observed this phenomenon in countries that were exposed to the Eurozone crisis (Armingeon et al., 2016; Matthijs, 2017), while others have identified this effect as a temporary problem rather than as a systemic threat to the legitimacy of democratic governance (Schraff and Schimmelfennig, 2019).

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) based on a complex chain of delegation and representation in the EU's multilevel structure. Output legitimacy (i.e., the governance for the people) refers to the requirement of providing welfare and prosperity to EU citizens. The Eurozone crisis has shown that output legitimacy is lacking when citizens in countries exposed to economic hardship, such as 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 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. From a long-term perspective, the politics of fiscal integration are characterised by a strong continuity in the basic set-up since the EMU's creation in Maastricht approximately 30 years ago. The core political conflict is between predominantly Northern and Southern Member States, and the basic conflict is between those who emphasise fiscal discipline measures versus those who advocate a system of fiscal transfers to make the Eurozone more stable (Brunnermeier et al., 2016; Lehner and Wasserfallen, 2019). This conflict constellation is conducive to a standstill and gridlock, but the recent crises of the Eurozone and the COVID-19 pandemic have also led to several fiscal, financial, and economic reforms in the last years. Overall, both crises were addressed with a deepening of fiscal integration. Whereas the banking union stands out in the case of the EMU as a reform achievement, the NGEU programme introduced an investment programme that is financed through joint borrowing on the capital markets (Howarth and Quaglia, 2016; Armingeon et al., 2021; Schelkle, 2021).

Besides the integration progress, this reactive mode of crisis-induced fiscal integration has further increased the complexity of the EU's fiscal architecture. As a result, fiscal policy is a textbook case of differentiated integration in the EU: different fiscal and economic policies apply to different compositions of Member States, which are shaped and administered by different decision-making procedures and institutions and implemented to varying extents by Member States. On a more general level, the demarcation line between fiscal policies of the EU-27 and the EMU is ambiguous. 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 Eurozone is a promise or peril for the future of European integration. While this approach may have clear advantages, as willing and capable Member States could move ahead, proposals in that direction meet strong resistance, questioning the political feasibility of such initiatives.

Given the ad-hoc and crisis-induced extension of fiscal integration and the high level of differentiation, clarifications about the approach to fiscal integration and the institutional responsibilities would be a reasonable next ambition. Instead of adding new layers of complexity to the fiscal architecture, a basic reform should clarify the model of fiscal integration. Ideally, such a constitutional reform would (a) define the balance between the principles of fiscal discipline and transfer, (b) distinguish between the fiscal policies of the Eurozone and EU-27, and (c) separate authority between the national and EU levels. Only such a reform, which requires a Treaty change, can address concerns about the democratic legitimacy of fiscal policymaking in the EU (Auer and Scicluna, 2021). The governments of EU Member States have been too powerful in the fiscal politics of crisis management during the last decade. From a democratic point of view, this executive dominance should be better balanced by either domestic parliaments or the European Parliament. A constitutional reform in this direction would eventually foster the democratic anchoring of fiscal integration.

This may all be desirable, but the unanimity requirement of Treaty amendments makes such constitutional reforms unlikely when there is a high level of political contestation about basic principles, as is the case with fiscal integration. Thus, more realistic is further crisis-induced and incremental reform with a central role played by the Franco–German tandem in the basic conflict constellation between Northern and Southern Member States (Kudrna and Puntscher Riekmann, 2021). In the short term, the newly elected leaderships in Germany and France may use this window of opportunity of a new government term in both countries to go beyond the incremental approach of deepening fiscal integration when an economic crisis hits the EU. However, the reality is that the EU has to tackle one crisis after another and that the next fiscal conflict is already on the agenda. Because of the COVID-19 pandemic, the fiscal deficit and debt rules have been suspended and will most likely be modified. Several Member States have already called for an easing of the fiscal rules, and Germany reacted sceptically but signalled some flexibility.[3] Thus, the basic conflict among advocates of fiscal discipline and supporters of more fiscal transfers will continue, and time will tell whether the EU Member States will recalibrate fiscal integration by designing a more distinct and stable model. The alternative is that ad-hoc and crisis-induced reactions will continue to add new layers of complexity to the EU fiscal architecture.

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[3] See, for example, the reporting by Matei Rosca and Bjarke Smith-Meyer for POLITICO, February 10, 2022, (latest access, February 24, 2022): https://www.politico.eu/article/berlin-very-skeptical-over-easing-eu-debt-rules-for-green-spending-scholz-adviser/

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