Evolution of European economic integration

Does the past define future?

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I am grateful to have my parents as inspiration. They have worked tirelessly to raise me as a person who is proud to ask questions, and taught me to never back down in the face of challenges. Thanks to their guidance, I learned not to take anything for granted and always do my best, no matter the circumstances. Thank you for the decades of support.
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Foreword

The research paper at hand is written as completion to the master studies in Public policy and Management, at the Corvinus University of Budapest. The programme focuses on structures, mechanisms, incentives and reforms in the public sector and the interplay between economics and the public sector. The subject of this thesis is to explore what impulses drove economic integration in the European Union, and what effects these imply for the future. Furthermore, the influence of the global economic crisis and the European sovereign debt crisis on the institutional setup of the Economic and Monetary Union will be touched upon. I decided to apply an economics-centered approach to the issue, as the future development of the EMU will to a great extent be the result of interplay between economics and politics. Institutional design and various mechanisms are subject to agreements and compromises as politics and economics continue to significantly impact the EMU and each other in the process.

The main reason behind the choice of topic for this paper is that recent developments, political and economic difficulties and their solution will greatly influence and shape the future of the European Union and will therefore have an impact on our daily lives as well.
1. Introduction

Even before starting my university studies, I was fascinated by the concept of the European Union. As I delved deeper into the subject, it became clearer step by step how much effort was concentrated into the current architecture. During the economic difficulties of the past years, I shared the concern of many other Europeans who worried what would happen if this achievement and guarantee of peace and prosperity fell apart. Fortunately, this did not come to be. However, in the process, I realized the number of underlying tensions and design flaws affecting the system and the inner mechanisms. Gradually, I started to explore the tendencies and historical events that guided the European integration process, with particular interest for economic issues. After spending copious amounts of time researching the topic, I managed to identify three main factors that shaped the European Union profoundly.
1.1. Methodology and approach

Since its conception, authors worldwide have constantly scrutinized the European Union. In the past decades of academic debate, many discussions have surfaced as economic integration became ever more accentuated in Europe. With the onset of financial troubles in 2008, discussions about the European Union reemerged, complete with new arguments and theories, ranging from speculations about a Eurozone exit of certain member states to calls for a genuine and complete federation. These debates have spawned large amounts of literature. For this research, I acquainted myself with a large amount of secondary sources, as the nature of the topic calls for a qualitative analysis over an extended timespan without personal bias. Nevertheless, I have made attempts to integrate reliable data and conference proceedings, reports and presentations as much as possible, in order to gain a deeper understanding of the topic.

The sources used in this paper mostly stem from acknowledged academic authors or articles published in renowned political and economic reviews and journals. I also managed to incorporate the knowledge I gained from my years at the Corvinus University of Budapest and the Katholieke Universiteit Leuven. Although the quality of the sources I used was of paramount importance, the nationality rarely mattered, as internal and external views on the topic both provided me with valuable insight. Apart from the use of written sources, I attended numerous conferences, presentations and lectures where leading officials of EU institutions and academics presented their views.
1.2. Research question and objectives

During my research, I have come across numerous theories that attempted to conceptualize why the European Union evolved into the structure it is today. Without doubt, political bargaining had a serious effect on the development of the region, but what about the ideas fuelling the debates? What states, ideological or technical features have had the most influence on the institutional, political and economic setup of the European Union as we know it?

My first thoughts behind these issues pointed back to some of my memories regarding the Greek debt crisis and the heated political debates surrounding the issue. The notion of Germany strong-arming another member state seemed too obvious and much too political as an explanation. There must be some reason behind the behavior of certain states and institutions, including the European Commission. Then again, the people who make up these institutions come from all across the EU. Is there a single, or perhaps multiple key influencing ideas that have entrenched themselves in these institutions recently? Is it a collective bias with accidentally everyone acting the same way, or is there a deeper institutional culture that never before came to the forefront? Maybe history can offer some answers to these questions?

The idea behind the hypothesis is to seek out the reasons behind the current situation of the European Union. Therefore, the question is: are there ideologies, states or integration concepts that defined the European Union at its base with effects reaching from the beginnings until today and possibly into the future?

After formulating the question, the objective of my research was to find the links through which the supposed influence of the aforementioned became tangible. These linkages were provided in large part by historical events, as developments in recent times build upon the pre-existing leanings. This paper aims to evaluate the effects and consequences of these linkages in light of recent events.
2. Overview

The European Union faces a period of transformation and development as the financial difficulties experienced since 2008 have gradually shed light on the shortcomings of the original design of the economic, political and institutional structure of the community. These design flaws have resulted in heated debates on the desirable future of the Union, as it tries to bundle the interests of 28 states to form joint objectives and a coherent set of policies for internal governance and external relations.

In its current state, the European Union is a community that is unique, as it stands halfway between a supranational federation and an intergovernmental organization. (Issing, 2015) As such, it has been the longest running monetary union without a complete political union, which justifies its treatment as a sui generis entity. The institutional design mirrors this peculiar situation. The underlying paradox is partly attributable to the fact that the introduction of the common currency was a political project with serious economic implications. (D. Bordo, Jonung, & Markiewicz, 2013)

As the economic setup developed over time, it became obvious that political leadership was driving integration at a fast pace, but this speed was not matched by the setup of necessary coordination mechanisms for political reasons. Economic incentives pointed towards the feasibility of a single market with a common currency, and political incentives were provided throughout nearly two decades between the introduction of the first stage of the EMU and the onset of the global economic crisis in 2008.

The era of euro-optimism yielded an economic system in which monetary policy was gradually centralized and conducted by the newly established European Central Bank. At the same time, fiscal policy competences remained in the hands of national governments. Originally, this small flaw was considered unimportant, as seemingly enough safeguards were introduced in the Treaty of Maastricht, encompassing a number of convergence criteria. The requirements were later expanded in subsequent treaties and their modifications. One of the key issues frequently evoked regarding the
Maastricht criteria is that member states, once they adopted the common currency successfully, did not keep the requirements set forth by the Treaty over the following years. Not respecting these rules induced a deviation from tight fiscal discipline, leading to expanding debt and deficit in several countries. This provided a foundation for later economic troubles as member state budgets and economies started diverging.

Another point of importance is that the Maastricht Treaty expressly stated that member states could not assume the debt obligations of other states. This “no-bailout” clause was violated several times throughout the European sovereign debt crisis. The two cases mentioned imply that the initial structure of the EMU was not designed well, as the first major crisis since the introduction of the common currency brought attention to the fact that several critical elements were missing, while many that were in place were not effective.

The post-crisis deadlock was first alleviated with immediate intermediary solutions, which included several intergovernmental agreements and the establishment of bailout funds as well as the involvement of international actors such as the International Monetary Fund. Although the immediate threat has been mitigated, the economic and political processes underpinning the Union have not changed significantly.

While the economy of the EU has recovered slightly, its overall situation still indicates a period of low growth, high unemployment and considerable social tensions, especially in the states most involved in the European sovereign debt crisis. Assuming that no state considers an exit from the European Union or the Eurozone and they all want to avoid future financial difficulties, developing the Economic and Monetary Union remains the solution. This development must include a new approach to institutional design. It is no longer acceptable to take decisions based on the current political or economic climate or general mood. That is exactly why euro-optimism failed to anticipate future economic and political tensions. If these tensions were realized at the time, it is an equally great irresponsibility to have left these problems unsolved.
While euro-optimism certainly should not be the guiding principle, we must refrain from euro-pessimism as well as that would also distort our perception of reality. Keeping a cold head and a balanced attitude based on facts is of enormous importance when we try to design and circumscribe processes that influence the coming decades of the wealthiest region of the entire planet.
2.1. Historical evolution of European economic integration

The history of the European Union starts shortly after World War II, when the French foreign minister, Robert Schuman, delivered his famous speech calling for two countries to place their coal and steel production under a common High Authority. Together with Jean Monnet, a political and economic advisor who also contributed to the proposal, they launched the modern-day European integration project. The speech, delivered on 9 May 1950 originally aimed at safeguarding peace on the continent by essentially making war impossible between the two old enemies; France and Germany. Therefore, the main idea driving integration in the first years was pacification.

While this seems like a logical step after years of war, it did not originally start out as an easy cooperation. Directly after the war, the Monnet plan originally aimed to position France as an economically superior county to Germany. (French Government, 1945) In this competition, the French have gained control over the Saarland and have made steps to also absorb the industrial region in the Ruhr. Germany protested these moves, but as a defeated enemy, it did not have enough political strength to act against the French advances. The push for resources was only halted when the International Authority for the Ruhr was established in 1949.

External players also had interests in the fate of the region. As Europe was split in two in the post-war period, the Western and the Eastern bloc fell into the sphere of influence of the United States and the Soviet Union, respectively. It was in this political climate that the speech by Robert Schuman was delivered. In an attempt to counterbalance the newly formed Eastern bloc, the United States actively supported the European integration project through several channels including political and diplomatic support, financial aid and economic incentives. The most notable step in this process was the establishment of the Organisation for European Economic Co-operation in 1948, which was meant to coordinate the Marshall Plan.

While the French actively strived to gain a leading role in Europe, the primary objective for the United States was to rebuild Western Germany as part of the Western Alliance and keep the country dedicated to the idea of peace and prosperity.
within the framework of a supranational coordination in Europe. After the speech made by Schuman, German chancellor Konrad Adenauer had welcomed the initiative and started active cooperation with France and the other four founding countries, namely Belgium, the Netherlands, Luxembourg and Italy. The European Coal and Steel Community (ECSC) created by the Treaty of Paris, on April 18, 1951 thus became the first institutionalized community aiming for European integration. The reason for choosing coal and steel as the basis of the newly founded community was that these two resources were considered essential in war efforts, and therefore were to be held under joint control. While the Council of Europe was already established in 1949, it encompassed a much wider group of countries, and remains formally independent from the European Union even today and has somewhat different objectives altogether. Notably, the United Kingdom did not participate in the ECSC, as it rejected the idea of a supranational authority.

The ECSC already introduced many of the institutions, which are still cornerstones of the European Union. The originally created High Authority evolved into the European Commission, serving as the Community’s executive branch and representing community interests. The governments were represented in the Council of Ministers, and the Presidency rotated between the different governments, at that time every three months.

The integration movement did not stop with pooling and jointly controlling coal and steel capacities, as further proposals were handed in for discussion. The two new communities to be established would have been the European Defence Community (EDC) and the European Political Community (EPC). However, while the treaty for the EPC was being drawn up, the French Parliament rejected the idea of the EDC. As a result of this opposition, Jean Monnet decided to resign from the High Authority and began work on other types of communities.

Political integration therefore suffered a significant setback, and the integration effort was refocused on economic and nuclear issues. (Mikesell, 1958) What followed then was two additional communities, each tasked with specific issues. Paul-Henri Spaak was dealing with the European Economic Community (EEC), while Louis Armand was in charge of creating a community dedicated to supervise nuclear capacities. The
reason behind this separation into three different communities was the differing interests. After the Suez crisis in 1956, the Common Assembly of the ECSC proposed an extension of its powers to cover other energy sources, including gas, electricity and nuclear power, as many countries came to realize the limits of their individual political actions. Jean Monnet, who started to organize the creation of two new communities, each covering different issues, opposed the extension. The separate community for nuclear energy was named European Atomic Energy Community (EAEC or Euratom). As for the EEC, the project was strongly advocated by the Benelux countries and Germany, but was going against the French protectionism, as it promoted a full customs union between members. In some respect, this could be seen as the first clash behind the underlying political ideas fueling French and German politics in particular. While France actively pursued interventionist policies, Germany came under the influence of ordoliberalism, as can be seen later. It also seemed to pinpoint the first major fight for dominance of the communities.

Ultimately, a compromise was reached and both the EEC and Euratom were incorporated into the Treaty of Rome, signed on March 25, 1957. The three communities shared the same assembly, now renamed Parliamentary Assembly. The two new communities had Commissions instead of High Authorities, as France opposed further expansion of supranational powers. Another political condition that was changed was that the Council would now have to agree to the key decisions. This modification foreshadowed the outlines of future top-level EU decision-making procedures. (Centre Virtuel de la Connaissance sur l'Europe, 2012)

The three communities together became the first of the three “pillars” of the European Communities.

Based on the political objectives of France and Germany at the time, it is worth mentioning that France mainly pursued political objectives by means of integration efforts, while Germany consistently took initiative in the field of economic cooperation. This struggle between two objectives carries through to structural problems still present today.

Due to their size, economic and political impact, France and Germany led the efforts to create the European Communities. What happened to Italy? The third ‘large’
member of the original six, Italy remained favorable to closer integration. Its role is important in terms of facilitation and providing important locations for negotiations and treaty signatures, but its political influence on the entirety of the bloc remains smaller than that of the other two big players. While its economic weight was second only to Germany, constant political instability, poor policy coordination and an inherent weakness of administrative structures had a notable negative impact on the effect of Italian politics on the European integration effort. Nevertheless, both the public and the political class were supporters of the project. (Daniels, 1998)

The years following the Treaty of Rome were characterized by the early realization for many European countries that cooperation was beneficial, as all participating states of the European Communities enjoyed a healthy period of stable growth. Political and economic situations were quite different in many European countries at the time. The existence of the EEC attracted interest from several states, although there was an alternative free trade area under construction, established in 1960. It was created by states that were either unwilling or unable to join the EEC.

The European Free Trade Area aimed to liberalize and expand trade between its member states and the outside world, which meant a less ambitious cooperation project than that of the EEC. The area’s members were often referred to as the “Outer Seven” in contrast to the “Inner Six” of the EEC. Many of these countries eventually left ETFA in order to participate in the EEC. In 1961, four new countries (Denmark, Ireland, Norway, United Kingdom) decided to apply for membership in the community. In order to successfully evaluate the importance of this event, we need analyze the context in which the situation occurred.

There were two notable political difficulties at hand, which undermined the accession process of the United Kingdom in particular. First, there was an understanding that the British would be opposed to a participation in any kind of supranational entity, although the ultimate goal of economic cooperation was to enhance further initiatives leading ultimately to a political union in the future. Although setbacks happened (especially with the failure of the EPC and EDC), political consolidation was not lost as an objective, merely pushed back in time. At the other side of the Channel, then President of France Charles de Gaulle viewed a British membership as a “Trojan
horse” of the American interests in Europe. Therefore, he consecutively denied membership, as he was convinced that American interference through the United Kingdom’s “special relationship” would undermine the possibility of developing an independent European foreign policy. He also feared a loss of French leadership in the case of a UK accession, as France in fact dominated the early years of European integration. Additionally, he was not convinced about the commitment of the United Kingdom to the European integration project. (Sweeney, 2014) As a result of the famous “Non”, the applications of all four countries were suspended. Charles De Gaulle repeated the veto threat once again in 1967. (BBC) The deadlock was solved when Georges Pompidou succeeded De Gaulle as President from 1969. Subsequently, the veto was lifted and negotiations were opened. The talks proved particularly tough in relation to the Common Agricultural Policy, which remains a cornerstone of debates to this day. At the end of the process, Denmark, Ireland and the United Kingdom joined the EEC. In Norway, the accession was rejected at a referendum in 1972.

The accessions in 1973 transformed the EEC in an unforeseen manner, as according to the treaties, the Parliament was to be elected. The first elections took place in 1979. With the first enlargement and the new Parliament setup, the structural power of France decreased significantly in the community. Ironically, De Gaulle viewed supranational institutions as a threat to French interests, just as much as the British thought the same. The evolution of the European Council is in great part attributable to this resentment. For the first decades it was merely an informal group consisting of heads of state to counterbalance the structural power of the Parliament and the High Authority, which later became the Commission.

At the same time, the German economy was experiencing historical growth. The post-war period bloom (“Wirtschaftswunder”) carried on from the early 1950’s until the early 1990’s, with the oil crises (1973 and 1979). The period of unprecedented wealth increase was in great part attributable to the economic policies of Ludwig Erhard, who held ordoliberal views. His influence on German policies was considerable first as Minister of Economics first under Chancellor Konrad Adenauer and later as Chancellor himself. (Mészáros, 2010) Stable politics supported the German participation in the EEC, the effect of which was also positive on the country.
The reason for the influence of ordoliberalism is that it was present early on at the establishment of the most important economic institutions of Germany in the post-war era, including the Bank Deutscher Länder, which later developed into the German Bundesbank in 1957. Ordoliberal policies defined German attitude to inflation, economic governance and macroeconomic questions and thus had an impact reaching beyond Germany, especially as other states accommodated to German economic and monetary policies, as it will be detailed later. It follows therefore, that the influence of these ideas is more significant than it seems at first glance, but quite subtle at the same time. These events underline the earlier observation about what characterized the politics of each country as regards integration; France was preoccupied with its own protectionism and was striving for political leadership, Germany kept developing its economy and German politics accommodated itself to this objective while the British finally managed to join the community after a long struggle and heated debates that left much of the country disillusioned. It was in this climate that the 1973 enlargement was developing, albeit slowly, through more than a decade.

The global economic situation was volatile during this period, as the Bretton Woods system collapsed in 1971. As a consequence, the EEC decided to go ahead with the introduction of the European Monetary System (EMS), which aimed to limit large fluctuations of European currencies relative to each other. Up until the formal creation of the system, an agreement was in place to keep exchange rate fluctuations under 2.25%, colloquially dubbed the “European currency snake”. Essentially, the currency snake was the first attempt made to enhance European monetary cooperation. The European Monetary System and as an integral part of it, the European Exchange Rate Mechanism was launched in 1979 in order to safeguard monetary stability, reduce exchange rate volatility and provide the grounds to adequately prepare for the eventual introduction of a common currency in the future. While the EMS had no predesigned anchor currency, due to the policies of the German Bundesbank, the Deutschmark started emerging as a central currency.

With the 1979 elections to the European Parliament, elected representatives took upon themselves to further the cause of European integration by using more democratic means. The project gained impetus once again and further membership applications
followed as a result of democratization processes, first in Greece and not much later in Spain and Portugal. Greece eventually joined the community in 1981, with Spain and Portugal both following in 1986. Turkey also submitted its application in 1987, which launched the longest application process of the community and has still not finished. The enlargements and the prospect of further membership applications coupled with the need to reorganize the institutional structure gave an incentive for decision-makers to start negotiations on the next treaties, encompassing radical changes. Therefore, the Single European Act, the first major revision of the Treaty of Rome was accepted in 1986. It introduced several new elements of policy, which quickly became cornerstones of the integration process. Apart from procedural solutions such as voting mechanisms, the changes in economic policy issues were of great impact. The focal points in the new treaty were the harmonization of rules and policies, increasing competitiveness and the explicit goal of establishing the Single Market until 1992.

The next historical milestone was indirectly related to the community, but nevertheless meant an expansion without enlargement; the German reunification. The formerly divided West Germany and East Germany reunited after decades of different historical pathways, economic governance and political systems. The German Chancellor at time was Helmut Kohl, who pressed the agenda of reunification to be completed as soon as possible. The developments came surprisingly fast for other major players in Europe, in particular to Britain, France and the Soviet Union. The latter’s policies are beyond the scope of this paper, thus a closer analysis will concentrate on British and French reactions and policies. The United States supported German reunification, and thus left the British wondering about their “special relationship”. They feared Germans would take their place as primary and preferred partner of the United States. American interests tipped towards keeping NATO stable and intact, thus a reunited Germany’s membership was pivotal.

The main issue for the United Kingdom and France was the change in the previously existent balance of power. Beyond the fears of German expansionism, it was agreed that both the British and the French would work towards “containing” Germany, advocating therefore using the mechanisms of the European Community to keep the country in check. This was to be done in order to ensure that Germany doesn’t
develop a foreign policy and political ambitions independent of the previous power structures, which could have possibly harmed British and French interests. (Los Angeles Times, 1990) The European Community acted as a security valve, through which German influence could be somewhat steered, or at least curbed. Amid the fear of political issues, European nations were preoccupied with economic issues just as much, as the reunified Germany was to be the largest European nation in terms of population, and with close to unmatchable economic power, which could potentially be translated into political power at a certain point. In fact, German reunification became closely intertwined with the process of European integration, as the latter has been considered to be the safest and best way to ‘tame’ Germany. (The Telegraph, 2009) (Financial Times, 2009) (Der Spiegel, 2010)

With regard to European integration, two consequences were to be considered. First, the newly unified German state meant that the path towards the Economic and Monetary Union would be accelerated, which was already underway while German reunification was in the making. Second, it solidified the impression that post-communist countries could become integral parts of the community, giving Eastern European countries the objective to actively pursue membership. (Kühnhardt, 2009) Furthermore, the true achievement of integration would be to encompass Eastern Europe just as much as Western Europe, transcending borders previously thought to be next to impermeable and thereby truly uniting Europe. As the issue of the Economic and Monetary Union is central to the paper at hand, a deeper analysis of the situation in relation to German economic issues and the EMU is needed and will be provided in detail later in this study.

The events described above provide a framing necessary to understand the importance of the role played by the German Bundesbank and the Deutschmark in the prologue to the establishment of the euro. Political and economic considerations strongly pointed towards the necessity of keeping Germany within the European Community. This translated into a relatively high bargaining power for Germany, thus resulting in a comparatively bigger influence in the future structure of the Economic and Monetary Union in particular. To set this into context it must be stated that West Germany highly valued its currency, the legendarily stable Deutschmark. The reason for its
performance and the support behind it will be detailed later on, the key point to be noted here is the wide support the currency enjoyed.

In light of the German reunification, taking place at the same time as the negotiations preparing the EMU, the most influential states saw the monetary union as a political tool with which they could bind Germany into the European construct. It can be observed that the issues of European monetary integration and German reunification were connected, to say the least. Although it is a simplification, the basis of agreement was that Germany would accept to become an integral part of the European community and abide by the common rules in exchange for the establishment of the European Monetary Union. At the time, the Bundesbank already dominated the Exchange Rate Mechanism, as evidenced by an oft-cited remark reportedly made by officials at the Elysée palace: “We may have the nuclear bomb, but the Germans have the Deutsche Mark.” (Der Spiegel, 2010) (Cline, 1994)

While the question of German reunification was being debated, other influencing factors have also come into play during the same years. With the end of the cold war, military strength and security policy gave way to economic issues, which gradually became the epicenter of discussions throughout the region. Once again, the French were standing to lose, as Germany regained full sovereignty and reasserted its status as the largest state of Europe, both economically and population-wise. (Staal, 1999) German civilian power and economic performance would soon cast a shadow over the French nuclear state. In the arguments for binding Germany to the European Community, there were two opposing positions, one held by France and the other by the United Kingdom.

According to the French, the integration structure would ensure that Germany could be kept at bay, as the Germans could easily dominate a simple trading bloc. Therefore, supranational integration was preferable based on this viewpoint. On the other hand, the British had argued for a looser union with a rapid expansion towards the East, which would satisfy the British demands for a looser confederation. Additionally, the British opposed the French position by underlining that in fact it was a tightly integrated structure, which would be more easily dominated by Germany. Germans saw deeper integration as being compatible with its national policies, and
support of the position was wide. (Die Zeit, 1988) (Baun, 1995) The economic and political compromises and their implications were subsequently enshrined in the Maastricht Treaty and the development of the EMU.

After the Delors Report in 1989, the first steps towards the construction of the Economic and Monetary Union were also taken in 1990, as capital controls were lifted in the EEC, thereby liberalizing capital movements. As foreseen, the upcoming treaty had to incorporate the EMU as an objective, and further refine requirements and institutions necessary for the operation of the entity. Unsurprisingly, during the negotiations participants accepted the predicament that the new monetary institution would be modeled after the German central bank, both in institutional distance from the government and in policies. (Marcussen, 1999)

The growing need for a consolidation of the many institutions, communities and entities resulted in negotiations that set out to create order and logic in the increasingly chaotic structure of European integration.

With its introduction, the Maastricht Treaty, signed in 1992, brought about the pillar structure, created the European Union as an entity and paved the way for the future introduction of the euro. Existing previous communities, such as the EEC, ECSC and Euratom have been absorbed into the pillar structure as well. Additionally it is worth mentioning that the other two pillars were the European Political Cooperation, which became the Common Foreign and Security Policy, and Justice and Home affairs, which was transformed into Police and Judicial Cooperation in Criminal Matters. In terms of economic structure, the Treaty imposed new rules upon member states including limits for inflation rates, debt, annual deficit, exchange rate and long-term interest rates. As such, it was the first treaty in the European Union or its predecessors to explicitly regulate government finances and therefore provide guidelines on economic policies.

Complementing the integration process, the European Economic Area was established in 1992. As per The EEA agreement, signatory states were allowed access to the single market and have a say in shaping future decisions relating to the it. The EEA currently encompasses all of the European Union’s member states plus Iceland,
Liechtenstein and Norway. Switzerland also has access to the single market by way of bilateral agreements, but is not a member of the EEA.

The 1990’s brought several key events in terms of integration history. The second stage of the EMU was initiated with the creation of the European Monetary Institute (EMI), the precursor to the future European Central Bank. The name for the new common currency (Euro) was also decided upon in 1995. From the viewpoint of economic integration, the Stability and Growth Pact is considered one of the most important agreements. By accepting the agreement in 1997, budgetary discipline was to be ensured and the ERM II mechanism was set up to safeguard economic trajectories after the creation of the euro. After twenty years of monetary policy coordination, the euro became a real currency and the single monetary policy was introduced by the ECB in 1999. After a three-year transition period, euro banknotes and coins were introduced in 2002.

Negotiations were also close to completion with three new states, signaling once again an enlargement of the European Union. Austria, Finland and Sweden ultimately joined together on January 1, 1995. The Schengen Agreement became effective in 1996, which allowed for a quasi-borderless area. Immediately after the Treaty of Maastricht it became apparent that the inner consolidation was not complete yet, the European Union had to face the simultaneous accession of numerous new member states and events in the Balkans called for a change in defense policies. For this reason, the Treaty of Amsterdam was negotiated and signed in 1997.

Since the treaty failed to ensure the institutional transformation necessary for the expansion of the EU towards Eastern states, another treaty had to be proposed once again. This time, it was the Treaty of Nice, signed in 2001. It changed numerous mechanisms in the decision-making processes and bodies of the EU, while also providing for many shortcomings of previous negotiations. Most importantly though, the Treaty of Nice maintained the pillar structure agreed upon earlier in the Treaty of Maastricht. Yet again, the subsequent criticisms included that the agreement had failed to fulfill its purpose. In 2004, the largest single expansion took place with ten new member states joining the European Union. Legal, institutional and democratic debates continued however, while the economy produced stable growth across the
continent. The accumulating treaties have produced a desire to adopt a “European Constitution”, the preparations for which were started soon after the Treaty of Nice.

According to the new developments, earlier treaties would all have to be repealed and replaced by the new document. The adoption of the constitution failed however, at referendums held in France and in the Netherlands in 2005. After some confusion following the decisions, member states resolved to keep the existing treaties intact and amend them once more, including many ideas that originally were to be part of the constitution. The new ‘reform’ treaty became the Treaty of Lisbon, signed in 2007, with the objective of enhancing the efficiency, democratic legitimacy and coherence of EU actions. It also named the euro as the official currency of the EU, and gave official status to the ECB, among other provisions. This time, the pillar structure was unified, thereby making the EU a single legal entity with a legal personality. The same year also saw the accession of two additional member states, Romania and Bulgaria. In order to provide some clarification, the two original and main treaties that form the basis of the European Union are the Treaty of Rome and the Treaty of Maastricht. Subsequent treaties are meant as amendments for the aforementioned ones.

The following period was characterized by economic turmoil with the advent of the 2008 global economic crisis, which shed light on many remaining shortcomings of EU institutions, with particular problems highlighted in the economic governance system and the half-complete EMU. Apart from the accession of Croatia in 2013, recent developments regarding the consequences of the events of 2008 and the problems in structure will be presented in a detailed manner in the following sections.
2.2. Instruments and mechanisms of European monetary integration

For several decades at the beginning of European integration, the Bretton Woods system was the prevailing framework in which Western countries conducted their policies. In 1971, the United States unilaterally terminated the agreement by rendering the US dollar a fiat currency, as it was no longer possible to directly convert it into gold. At the time, Europe was not prepared for the event, and in order to avoid future shocks to exchange rates, an alternative solution was designed in the following years. The first attempt at avoiding large fluctuations was the “snake in the tunnel” approach, whereby countries mutually agreed to limit their exchange rate fluctuations against the dollar and each other. The mechanism proved to be unsustainable, with countries joining and withdrawing as they wished. Only some countries remained true to the agreement, which resulted in the emergence of a certain type of Deutschmark zone, effectively dominated by German policy. Participating countries included Germany, Denmark, the Netherlands, Belgium and Luxembourg. A new solution was therefore proposed.

Although the IMF introduced the Special Drawing Rights (SDR), the European Community decided not to adopt it as a common unit of accounting, instead creating its own basket of currencies and avoiding the dollar. One of the reasons cited for an independent, new basket is that it would underpin the development of the Community’s monetary identity. It has been emphasized however, that the European Unit of Account (EUA) would have nothing to do with an eventual common European currency, as its creation implied policy changes and had specific political and economic requirements. (Commission of the European Communities, 1975)

After introducing and refining the EUA, then-President of the Commission Roy Jenkins proposed the idea of a European Monetary System. The new mechanism was implemented in 1979, when the European Currency Unit (ECU) replaced the EUA. At the start however, the United Kingdom’s currency, the pound sterling has not joined the EMS. The new key feature of the EMS was a first-ever pooling of monetary sovereignty, as only mutual agreement between member states and the Commission could change the exchange rates.
It is generally considered that the EMS worked well, even though it generated important debates in the first months of its existence. Once again, German policies were at the epicenter of discussions, as the Bundesbank continually raised interest rates in order to continue its traditional anti-inflationary policy, which resulted in capital flight and the drop of the Belgian franc and the Danish krone until they reached the bottom of the parity grid. After some negotiations, the issue was resolved with a compromise, but it foreshadowed the types of problems a monetary union would eventually have to face. (Cohen, 1981) The EMS was deemed successful, as it resulted in a reduction of short-term interest rates, inflation tendencies started converging and policy management was more coordinated at the Community level. (European Commission, 2007)
2.3. **German monetary policy in charge of the EMS**

The role of German monetary policy deserves attention to detail, as it determined the political and monetary framework of the European Community to a great extent. Initially, the Germans feared that the EMS would bring a pro-inflationary bias. Instead, the Deutschmark gradually became the anchor currency of the EMS, bringing disinflationary environment. The reasons for this are threefold. First, the burden of adjustment mostly weighs on countries with a current account deficit. Second, internal stability was mainly due to increased monetary cooperation and seldom changing exchange rates, while global financial interdependence grew and capital mobility increased. Third, interest rates started to move in parallel patterns, although nominal and real interest rate divergences were present, even though inflation rates converged throughout the EMS. The benefits of low exchange rate volatility reached some non-EMS states as well, as their currencies were pegged to the Deutschmark. In particular, Austria and Switzerland are good examples.

There are numerous other reasons behind German dominance in the EMS. Other members of the EMS welcomed the ‘imported’ price stability and downward pressure on inflationary tendencies, which was, however, coupled with higher unemployment. Other positive effects of ‘shadowing’ German monetary policy included increasing price competitiveness, contributing to higher exports and growth. Apart from the credibility originating from the track record of its central bank, the German economy also benefited from high competitiveness stemming from its technological superiority and a high trade balance surplus vis-à-vis other countries in the European Community. Germany also produced 40% of the manufacturing output of the European Community at the time.

High inflation countries had to deal with several detrimental effects. Sustained high inflation eroded competitiveness, had serious negative effects on growth and revenues, while low inflation rates reduced risk for the private sector and contributed to raising average maturities in capital markets. The latter considerably helped the realization of productivity-augmenting long-term investment and innovation projects. This increased pressure on other EC countries to reduce inflation rates, made available by accommodating to German monetary policy. Political incentives also

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played a part in the aforementioned practice, since devaluations were considered to be politically embarrassing. Additionally, devaluations of national currencies ran the risk of raising real interest rates in countries which relied most on foreign borrowing, mainly Italy and France. Therefore, all EMS countries attempted to avoid parity changes and follow the course of monetary stability set by the Bundesbank. However, the list goes on. Falling in line with German monetary policy was also incentivized by the desire to avoid speculative attacks, which was to be done by importing the credibility of the Bundesbank. Existing short-term interest rate linkages also essentially ran from Germany to other states. Finally, the low-inflation policy of the Bundesbank furthered the leading position of Germany in the European Community as regards trade and investment, providing political and economic resistance against high inflation in the community. (Welfens, 1991)

As European states continued to strive for stable currencies, it became obvious that the next question to be tackled would be inflation, as it often endangered the functioning of the EMS by eliciting individual response from national central banks. The need for the common currency however was clear, especially with the creation of the single market, where the existence of several currencies and changing exchange rate would hinder economic activities through high business costs. National monetary autonomy proved contradictory to the common goals of the community. In 1990, the United Kingdom joined the EMS.

Soon after, German monetary policy had to respond to rising inflationary pressures due to the expenses brought about by German reunification and a weakening of the US dollar. The financial situation of the UK was also considered weak by 1992, and on September 16th, partly due to speculative moves by investors and the general view that UK membership in the EMS was unsustainable, the UK government decided to leave the EMS. The day of exit later became known as ‘Black Wednesday’. In the aftermath, the Italian lira also had to leave the EMS, while the margin of fluctuation was raised to 15% from the earlier level of 2,25% (6% for the Italian lira), in order to prevent further speculative attacks on other currencies, including the French franc.

Following the turbulences in the early 1990s, the European Monetary Institute has been set up as the predecessor to the European Central Bank. The seat of the
The institution became Frankfurt am Main, with Germany arguing strongly in favor with the view that German public had to be reassured that post-war stability would not be lost with the introduction of the euro and the disappearance of the Deutschmark. (Ungerer, 1997) The location of the EMI (later ECB) was important in several respects; German monetary traditions would still strongly influence the future common monetary policy and reassert institutional credibility and independence from governments in line with ordoliberal convictions. As the ERM was an asymmetric construct, it was headed by Germany. Implicitly, this would not change with the introduction of the euro.
2.4. *Why is the EMU central to the European Union?*

The EMU encompasses all members of the European Union. Its members have all agreed to the obligation of introducing the euro as a currency at some point sooner or later. The requirement of adoption was included in the treaties, only two members states have been allowed to opt-out; Denmark and the United Kingdom have both negotiated to be exempted from the compulsory adoption of the euro set forth by the Treaty of Maastricht. At the time of writing, the structure of the EMU is the following. There are 19 European Union member states in the Eurozone, 7 member states not in ERM II, but obliged by the Treaty of Maastricht to join, 1 member state with an opt-out participating in the ERM II alone and 1 member state with an opt-out not in ERM II. It follows therefore, that if we exclude the countries with an opt-out, the prospective total possible membership of the common currency include two groups of countries; members of the Eurozone with completely centralized monetary policy and a set of countries under obligation to join, which do not currently fulfill the criteria to adopt the common currency.

One of the most prominent objectives of the European Union is set out in the Treaty of Maastricht. The treaty enshrines the idea that the EU should strive to create and maintain an internal single market, guaranteeing the four basic freedoms that make its existence possible. These freedoms include, but are not limited to the free movement of goods, freedom of movement for workers, the right of establishment and freedom to provide services and the free movement of capital. The EU seeks to maintain these freedoms with a set of tools, which include positive and negative integration. In this context, negative integration means the elimination of barriers, which restrict these freedoms, while positive integration entails exercising common sovereignty over shared competences, through means of harmonizing, modifying or creating institutions and mechanisms.

The Treaty of Maastricht aimed to strengthen the single market by introducing a common currency, effectively paving the way for the creation of a monetary union. The incorporation of a monetary union in the treaty was significantly influenced by political ideas. Economic objections and possible future issues were partly dismissed
as unimportant or pessimistic. The view that political integration requires monetary integration prevailed in the decades leading up to the introduction of the common currency. Under the rules of the Treaty of Maastricht, member states give up their right to issue their own currency forever. Irreversibility implies that devolution of central banking is no longer possible for states that join the common currency. This is the main reason why the EMU is of crucial importance to the existence of the European Union.
2.5. Optimum Currency Area Theory

The Optimum Currency Area Theory, originally developed as a comprehensive framework, lists four indispensable criteria that every currency area would need to fulfill in order to operate effectively and minimize risk. The first factor to be considered is labor mobility. Second, the criterion of capital mobility and price and wage flexibility must be taken into account. After the two factors accounting for flexibility, the area must be tested against the third criterion of risk sharing or, in other words, fiscal transfers. Fourth, in an ideal currency union, external shocks have the same effect on all member states. (Mundell, 1961)

While the both the Eurozone and the European Union are making progress in terms of integration, the Eurozone is, as it stands, far from an optimum currency area. Fiscal transfers among member states are infrequent, impacting community-wide shock absorption capacities. Labor mobility is traditionally low, stemming at least in part from the unchangeable fundamental characteristic of the entire European Union, namely that it is an association of individual states with separate cultural traditions and languages, with a limited history for mobility as opposed to other currency unions. External shocks find members of the Eurozone at different stages of the business cycle, which is not harmonized across the zone and the overall flexibility of the currency area is debatable, although some improvement can be seen in recent years. (Nemes, 2013) Currently the only criterion that can be judged as at least partially complete, is the requirement of capital mobility coupled with price and wage flexibility with the gradual development of the single market.
2.6. The necessity of common fiscal governance

The existence of the Economic and Monetary Union implies that a variety of instruments are used in order to safeguard its stability. The necessity of common governance and collective supervision mechanisms has been underlined by the developments of the last decade. As the crises have shown, there exists a significant interdependence among EMU, and particularly Eurozone countries. This interdependence translates into the possibility of spillover effects every time a member state introduces a new element into their economic policy. (De Grauwe, 2011) Members of the EMU cannot be viewed as isolated states, as they form a heavily integrated group. Since monetary integration is already centralized at the supranational level and safeguarded by the ECB, fiscal policy remains the instrument of choice for governments. However, disregarding the interests and situation of other member states in the group would be irresponsible, for reasons mentioned earlier. The fundamental idea behind the stability of the Eurozone is arguably trust. Individual states pool part of their sovereignty, and exercise the remaining part with caution towards others. Provided that monetary policy is centralized, fiscal policy becomes central to this interstate trust.

It is reasonable to assume that the centralization of monetary policy and the single currency will persist (European Central Bank, 2012) for many years to come, the pressures to coordinate fiscal policies will therefore not cease to exist. In fact, these pressures will likely increase as economies become more interlinked by the gradual integration process. Fiscal integration is bound to become the main issue of the Economic and Monetary Union for the next decade. The development will not be swift, as it causes strong political tensions between and within member states and several stakeholders. Yet, if we take the words of Mario Draghi seriously, a rollback of the monetary union will not happen, which leaves the Eurozone and in the long run, the EMU without alternatives to fiscal integration. (Draghi, 2012)

The underlying stress in the system is reinforced by the mechanism connecting states within the Eurozone and the policy-making of the ECB. The single interest rate set by the ECB affects several economies, which differ in their characteristics on a wide
range. The impact of interest rate can therefore hinder or support economic tendencies in any given country. As long as the Eurozone persists without political and fiscal union, the holes must be filled with policy initiatives. High-deficit countries run the risk of breaking up the entire monetary union unless their policies fall in line with basic requirements. Several crises in the past decade have proven that some kind of supervision is necessary, as the fiscal irresponsibility of certain countries can undermine the stability of the entire monetary union.

Mutual coordination of policies remains a central issue in the EU, its traces extending back into the first days of integration. A proposal presented by a former President of the ECB, Jean-Claude Trichet outlined a possible future scenario for common governance, in which the EU’s federal powers would only be activated once the policy setting of a country threaten the entire union. (Reuters, 2012) The mismatch underpinning the debate is the one between political territory and economic territory. While political territory is defined by the capacity of a state to impose rules and regulations, economic territory is defined by money and can therefore be of different nature.

The primary concern for Europe at the moment is this dissonance, as the degree of integration differs in the economic and the political sphere. (Collignon, 2001) The missing objective of the European Union is therefore to internalize externalities that currently exist at the member-state level. The Stability and Growth Pact was a step in this direction, but did not deal with giving guidance on a coherent policy mix. The question of common fiscal governance remains a political issue, as national governments reflect the consensus of their electorate, and federal-type solutions often capsize on the opinion of national public attention.
2.7. Attempts at creating common fiscal rules

In this section, a broad overview of fiscal coordination attempts will be presented, focusing on the years following the Treaty of Maastricht. The Delors report, published in 1989 stated that an economic union and a monetary union would have to be implemented in parallel, as they form two integral parts of the same whole and can not be treated separately. Although the Commission was conscious of this important detail, it did not receive enough recognition in subsequent actions.

Economic coordination and fiscal rules therefore had to be agreed after the implementation of the monetary union had started. This lag was partly attributable to the fact that monetary sovereignty was a less politicized debate. In the following years, several attempts were made to rectify the error of an incomplete EMU.

As it happened so often at earlier stages of integration, the first attempt after the Treaty of Maastricht to clarify rules and procedures relating to economic governance came from Germany. The Stability and Growth Pact (SGP), adopted in 1997, was originally designed to ensure that member states would keep in line with requirements necessary to sustain the monetary union even after they were admitted into the Eurozone. It was a framework that tried to bind together independent and sovereign fiscal policies effectively to provide financial stability throughout the Eurozone. The Pact contained two main branches. First, the preventive branch obliged EMU states to submit annual financial plans, evaluated by the European Commission and the European Council. The branch closely monitored government debt level as a percentage of GDP and government budget deficits as a percentage of GDP, both included in the Treaty of Maastricht. If a member state was judged to deviate from the targets, the Council could issue an early warning to prevent a buildup of excessive deficit, and provide policy recommendations to counteract the problems. Second, the dissuasive branch was conceived as a means to ensure compliance to the budget rule. Above the threshold of a budget deficit surpassing 3% of GDP the Council may issue recommendations to be implemented within a timeframe, which means the launch of an excessive deficit procedure. Failure to do abide by the recommendation would trigger the possibility of penalties imposed on the member state.
The SGP was revised in 2005 after a dispute between Germany and the European Commission, when Germany could not comply with the expectations due to cyclical deficits.

The credibility crisis following the question of enforcement led to the revision incorporating the possibility of revision and timeline extension for the Commission recommendations, especially in the case of negative macroeconomic events. Additionally, clarifications were made for the cases of structural reforms including pension reform. Some other minor improvements were also added in order to detail requirements on short-term and medium-term budget management and rooting out pro-cyclical fiscal tools, but the revision failed to account for an early warning mechanism or significant macroeconomic shocks outside the regular cycle.

Medium-term budgetary objectives were also modified to better reflect the situations of individual member states instead of a common requirement of a structural balance of 0%. While it improved flexibility, the credibility of the SGP remains weak. Offences regarding its rules are rampant in the EMU, with many countries failing to implement its recommendations or intentionally trying to circumvent its rules. For most indicators, a majority of EMU member states is in an almost constant breach. The SGP is important as it advocates a push towards stability and growth, but it does not provide sufficient incentives for EMU countries to effectively conduct responsible fiscal policies.

The SGP is complemented by two other agreements, the first of which came in 2011. The agreement is known as ‘Six-pack’, as it consists of five regulations and one directive. The Six-pack introduces a strengthening of the fiscal rule by adding quantitative evaluation of the fulfillment of the criteria set forth by the SGP. The agreement makes it possible to launch an excessive deficit procedure in case the debt ratio is not converging to the limit of 60% at a satisfactory pace, and finally, it foreshadows the use of financial sanctions, which can now be passed more easily with a reverse qualified majority voting procedure.

The so-called ‘Two-pack’, also adopted in 2011, is the second complementary agreement. Although it does not impose new policy requirements, it sets stricter rules
and timelines for monitoring processes, including additional surveillance of budgetary procedures.

In the same year, the Euro Plus Pact was also adopted by member states, except Croatia, Czech Republic, Hungary, Sweden and the United Kingdom. The framework agreement intended to enhance competitiveness and employment while safeguarding financial stability and fiscal strength of participating countries. It was to be the next step in strengthening the EMU and aimed to encourage participating states to implement structural reforms while committing to a transposal of the SGP requirements in their respective economic policies. The agreement tiptoed around the possibility of asking for tax policy coordination, but no requirements were set.

In the meantime, the Lisbon Treaty formalized the existence of a previously informal group known as the ‘Eurogroup’, which was made up by the finance ministers of Eurozone countries. Initially, Germany opposed the appointment of a permanent president for the group, as it viewed that it could lead to a violation of the independence of the ECB by creating a competing, more political position. The Lisbon Treaty explicitly states that the president of the Eurogroup is appointed for a period of two and a half years. Eventually, the French President Sarkozy and German Chancellor Merkel introduced a plan intended to reinforce common economic governance, but it was based on the intergovernmental method and merely included more frequent meetings between Eurozone leaders and the proposed that states should incorporate the obligation of a balanced budget in their constitution.

French politicians pushed the agenda of common European economic governance further, but their German counterparts met that with resistance. The French arguments included that governance is equal to politics, and politicians should take the leading role, instead of unelected technical experts, the latter being a reference to the ECB. In the aftermath of the crisis, the ECB decided to buy Greek, Italian and Spanish government bonds, which led to high tension in the EU and resulted in the resignation of two German central bankers; the President of the Bundesbank and a member of the ECB executive board. The decision led to harsh critique by the German political and financial elite. What made it even more delicate is that the decision of the ECB to buy these bonds was actively supported by the French. This conflict was partly a result of
the fact that while France and Germany are part of the same institutional structure in the EMU, their ingrained attitudes diverge on many issues, including central bank independence. (van Esch & de Jong, 2011)

The next agreement, adopted in 2012, is referred to as the ‘Fiscal Compact’ (Treaty for stability, coordination and governance, TSCG), encompassing all member states except for the UK, the Czech Republic and Croatia but it is only binding for euro area member states. It was drawn up in order to further encourage coordination between member states, particularly in the areas of fiscal policy coordination, economic reform plans and governance.

The new provisions of this agreement include a new balanced budget rule, expectations regarding convergence speed for the debt brake rule and an automatic correction mechanism, which implies setting up institutions independent from the government that scrutinize fiscal trajectories and have a say in policy-setting. This means that deviations are immediately corrected, unless they are the result of an external macroeconomic shock.

Debt issuance coordination is an important new feature of the agreement. By accepting this provision, signatory states will be required to pass along all information regarding capital borrowing plans through the European Commission so that it can synchronize bond issuance timing. Furthermore, the agreement links signatory states to the newly established European Stability Mechanism, which participants are obliged to support. For this reason, only signatory states can withdraw funds from the ESM. (Steurtewagen, 2013)

The agreements listed above serve as the basis of cooperation from which the European Fiscal Union can eventually develop. Although the crises of 2008 and 2010 influenced the course of action taken by decision-makers, in some respects economic turmoil made it possible to advance at a greater pace towards fiscal integration. Reform ideas continually appeared in the years since, and the possibility of designing a new treaty is looming.
2.8. Debt pooling & bailout options

In response to the crisis in 2010, the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM) were set up. The EFSF acts as a common pool of funds financed by members, from which any member can withdraw the needed amount in order to safeguard their financial stability, but it is only available to Eurozone countries. The fund was authorized to borrow as much as 440 billion euros. In case an intervention is necessary, a programme must be negotiated and designed between the requestor countries, the European Commission and the IMF, subject to unanimous acceptance by the Eurogroup. Lending is only allowed if the requestor state can no longer finance itself from financial markets at ‘acceptable’ rates.

The lending capacity of the EFSF was extended to 780 billion euros in 2011, as a result of a shortage of funds and the need to calm financial markets. The EFSF was complemented by the European Financial Stabilisation Mechanism (EFSM), which had the objective to raise funds from financial markets. It is guaranteed by the European Commission, which uses the budget of the European Union as a collateral. The EFSM was authorized to handle as much as 60 billion euros and may assist every EU member state. With the use of these two instruments, the European Commission, the European Central Bank and the International Monetary Fund were able to contain the sovereign debt crisis and save several Eurozone countries from defaulting on their debt.

As the EFSF and the EFSM were drawn up in haste, they constitute temporary solutions, partly due to the fact that it was unclear whether the two instruments violated the Treaties, stipulating that no member state could assume the debt of another member state, effectively prohibiting cross-state lending and bailouts. (Olivares-Caminal, 2011) The construction of loans and bailouts can accurately be described by the word ‘mess’. The complicated structure of institutions, bilateral and intergovernmental agreements, treaty circumventions and other issues led to a situation in which it became an absolute necessity to consolidate the existing architecture. In order to solve the issue, the French and German governments
proposed a plan, which would require a new treaty to formalize a permanent lending mechanism, replacing the earlier temporary measures. After the approval of both the European Council and the European Parliament, the European Stability Mechanism (ESM) was created by means of an intergovernmental treaty, absorbing the EFSF in the process, as it would no longer handle new bailouts. The 700 billion euro framework of the ESM is financed from two sources, the first being a ‘bail-in’ fund, amounting to 80 billion euros with the remaining 620 billion euros raised from the capital markets by issuing ESM obligations.

Although it was designed to counteract crises, its permanence elicited criticism from numerous political and economic actors. From the European Union’s point of view, this can be evaluated as a welcome step in further fiscal integration and another effective tool safeguarding financial stability, thereby solidifying the construct of the monetary union. However, circumventing the treaties is not an option in the long run, dodging the issue of designing a new treaty can thus not be postponed eternally. Eventually, wide political support for the use of these mechanisms is to be achieved, until then, the issue of a legitimacy deficit persists with regard to these new agreements.
2.9. EMU reform plans

Major reform plans for the functioning of the EMU have been debated for several years, as stakeholders realized the risks associated with a half-complete EMU. Two major documents by the heads of EU institutions provided guidelines for the future architecture of the EMU. The first of these is the so-called ‘Four-Presidents’ Report’, presented in 2012. It was written in reaction to the events of the sovereign debt crisis, which highlighted many shortcomings in the structure of the EMU. The report proposes three stages of stronger integration. The first stage set out to achieve stronger common fiscal governance through ex ante coordination of major policy reforms, a Single Supervisory Mechanism for the banking sector, a deposit guarantee framework and the setup of the ESM. This stage was designed to end by 2013. Arguably, the plans were completed. According to the report, 2014 would see the implementation of an integrated financial framework, a common resolution authority and the setup of stronger mechanisms, which aim to foster coordination convergence and enforcement of structural policies in the form of contractual agreements between member states and EU institutions, subject to possible financial support.

The third stage, planned after 2014, sets out to present the view that, aside from establishing new capacities for absorbing external shocks, the European Union should move towards common decision-making on national budgets. Effectively, this is a clear step towards a future Fiscal Union, as it takes budget oversight to the supranational level, with the involvement of all member states and EU institutions. Complete with the coordination of national economic policies, this would be the next stage in deepening integration. (Van Rompuy, Barroso, Juncker, & Draghi, 2012)

Many elements of the Four Presidents’ Report can be found in the next document drawing up comprehensive reform plans, which was dubbed the ‘Five Presidents’ Report’. The plan presents a similar roadmap to the one seen before, albeit it is more comprehensive and its goal is to fully complete the EMU by 2025. The first stage until 2017 would see member states building upon existing instruments to deepen integration, with stage two envisioning the completion of the EMU through means of binding common rules, procedures and benchmarks. With the full economic and institutional structure, the EMU would practically be operating as it was originally
intended to, with all the legal, political and economic criteria fulfilled. The adherence to the common rules would be a condition necessary for participation in the Eurozone’s shock absorption mechanism. The third stage would be reached if all previous steps are completed, and provide a stable and prosperous environment. (Juncker, Tusk, Dijsselbloem, Draghi, & Schulz, 2015)

The existence of these two reports is a testament to the existence of the integration forces that persist. Leaders of EU institutions continue to advocate the idea of gradual federalization, which ultimately relies on the public opinion and political elites of the member states.
2.10. *The many unions of Europe*

We cannot understand the architecture of the EMU without examining how different sets of policies or ‘unions’ relate to each other. The clarification and taxonomy of unions determines how we can analyze the topic. Throughout this paper, a total of eleven different unions are used to describe particular policy areas. Some are standalone and coequal, while others are subordinate and may be subsets. The primary, all-encompassing expression is the European Union. This idea includes all countries and related policies. The second level includes the Economic and Monetary Union, as it is a subset of the European Union. Although the members of the two are the same, the EMU circumscribe a more specific policy area. The third level includes four unions, namely the Monetary Union, the Economic Union, the Financial Union and the Fiscal Union. The fourth level has five unions, as the Banking Union and the Capital markets Union are a subset of the Financial Union, the Budgetary Union is a subset of Fiscal Union, the Currency Union is a subset of Monetary Union and the Customs Union is a subset of the Economic Union. For the sake of simplicity, non-members of the European Union are not include in the discussion of the unions, but they would for example be part of the customs union, while not being members of the European Union. Thus this taxonomy deals exclusively with member states of the EU.

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<th>European Union</th>
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<td>Economic and Monetary Union</td>
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<td>Monetary Union</td>
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<td>Currency Union</td>
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*Figure 1 - Taxonomy of the unions*
It is clear from this quick look into the underlying structure that the European Union is a ‘union of unions’, which often overlap, but serve different purposes. Many of the concepts integrated in this figure are not dealt with separately, as the paper focuses on the macro-level institutional setup and developments, rarely reaching below parts of the third level.
3. Context

In order to gain a comprehensive view of the current situation, it is imperative to go into detail on the complexities of some major topics defining the environment surrounding the European Union. Looking at international examples, recent dilemmas and ongoing processes only provides a limited view. For a more advanced grasp on several key issues, the network of ideas impacting European integration must be analyzed to a deeper extent. The setting in which the European Union exists may very well be the most complex one history has witnessed.

The intricate system of internal balances between cultures, economies, politics and other aspects of nationalities are put to test in the global competitiveness race and a geopolitical environment. Governance resembles no other structure known before, as the European Union develops gradually while retaining its status as an entity halfway between a supranational federation, a unitary state and an intergovernmental organization. Therefore it would be a mistake to exclusively concentrate on its internals, as external impulses continue to design and test the integration process just as much as internal dilemmas and decisions.
3.1. International examples of economic and monetary unions

Among the numerous types and variants of different unions created mainly for economic reasons, comparability remains an issue. Cultural backgrounds, economic history, political and administrative systems all influence unions in many ways. In the case of the Eurozone, the first criterion necessary for a comparative evaluation is the size of the union, as the Eurozone (and by proxy, the European Union) remains one of the largest voluntarily created associative unions in history.

Currently, this quasi-federative system is taking steps towards further unification, but lacks much of the institutional structure and political conditions necessary for the successful establishment of a functional setup. Worldwide, at the time of writing there is only one system, which can be perceived as a potential role model due to its size and development. This role model is the United States of America. Full comparability is of course not possible as mentioned earlier, but in terms of institutional structure and operational mechanisms, European countries may learn valuable lessons by examining the current setup in the United States.

The differences can be grouped together into three main categories, each subject to smaller subsets of issues. (Butzen, Cheliout, & Geeroms, 2014) The main questions revolve around the topics of the fulfillment of conditions for the Optimum Currency Area Theory, the Banking Union and the Fiscal Union. These provide the framework for identifying key differences between the American and the European structures. As it can be seen, the European system lacks some main characteristics necessary for tighter economic integration.

As soon as it was created, the Eurozone was politically biased in favor of integration, while associated risks were consistently downplayed. This resulted in the oft-cited half-legged system providing the root of problems even today. Contrary to expectations, financial markets did not apply differential pricing to individual countries, and treated the Eurozone as a single block from the outside, while on the inside, structural differences between countries in terms of economic health and various indicators were obviously high. Centralized economic coordination was dropped in favor of light and non-binding rules. Combined with converging low
interest rates and inadequate adjustment mechanisms, this resulted in major growth of
debt levels in several member states of the Eurozone, which culminated in the
sovereign debt crisis, as soon as the system came under serious pressure for the first
time since its inception. The sovereign debt crisis then evolved into a dangerous
feedback loop between governments and banks, with significant negative effects on
growth even in 2016.

At the same time on the other side of the Atlantic, the federal system evolved as a
much more close-knit union. While it is widely assumed that the American economy
is more homogenous than the Eurozone, a closer look tells us that regional differences
are largely comparable to those in Europe. The most important indicator supporting
this viewpoint is the synchronicity of growth, which measures the correlation between
the growth of the constituent states and their respective macro-entities (Eurozone,
USA). This indicator expresses that economic cycles and convergence are in fact
comparable in the two regions. This refutes the argument that economic heterogeneity
is a main cause for the unsatisfactory performance of the economy of the Eurozone.

Another key difference between the United States and the Eurozone is the role of the
banking sector. Financial fragmentation contributed significantly to the escalation of
economic problems in Europe. Specifically, two indicators point out that the systemic
importance of banks is much higher in the Eurozone. First, the relative size of bank
assets; in the US this number is 72% of GDP, while in the Eurozone total assets reach
266% of GDP. The second indicator is financing roles. While the US relies on banks
for corporate and household financing as much as 25%, the same number for the
Eurozone exceeds 60%.

The financing roles of banks are attributable to two underlying factors; size of capital
markets and the scale of “shadow banking”. Both of these systems are fundamentally
better established and more developed in the United States. Furthermore, as the
Eurozone is an association of sovereign states, they were more exposed to risks in the
national banking systems, which holds true especially for weaker countries aided by
bailout or debt relief programs, such as Ireland, Greece or Spain. The federal level,
which would be able to bear the associated risks in the Eurozone is simply absent,
thus the refinancing and bailout needs fall back on national governments, even though the size of banks in these countries make a national bailout all but impossible.

A smaller, nearby monetary union can also be considered for analysis. Based on its size, it is of course no match for the Eurozone, but historical experiences can provide some food for thought. The United Kingdom, which is a fiscal, monetary and political union, recently experienced debates regarding the independence of one of its constituents. Although the referendum resulted in Scotland remaining a part of the union, fiscal devolution remains an influential idea.

The British hope that fiscal devolution may lessen the popularity of full-fledged independence may be supported by politics, but in terms of economics, it could lead to similar problems as the Eurozone faces today, as taxing and spending (i.e. fiscal policy) would be decoupled from monetary policy. This move would undermine the functioning of the monetary union by incentivizing separate fiscal policy-making and a loosening of coordination, ultimately leading to monetary policy becoming less effective depending on the economic situation of the region, as the interest rate set by the Bank of England would no longer be equally appropriate for all members of the monetary union. The divergence of economies could effectively wreck the smaller constituent, as the common pool of funds would no longer support it. The decoupling of fiscal and monetary policies in this case is once again a matter of political debate.
3.2. Current political and economic situation

The European Union and the Economic and Monetary Union are both undergoing reforms at the time of writing. The use of the word reform is intentional here, and is used separately from the concepts of evolution and integration. The reforms underway are intentional, and are a direct result of the deliberation of the European citizens, politicians and institutions, as all three groups believe that certain changes are necessary. One of the most important political reforms in in the EU is the newly established system of “Spitzenkandidaten”, meaning that the President of the European Commission is now a nominee of a political group in the European Parliament.

For earlier Commission presidents, the European Parliament merely disposed of consent right. In connection with this development, a vision of the reforms planned for the EMU are set forth by the Five Presidents’ Report, which shows a strong commitment of the five most important institutions and their leaders to reforming the current architecture of the EMU. The reform initiatives mentioned are direct results of several events and public sentiment. The problems regarding the democratic legitimacy of certain European leaders and institutions prompted a wide section of citizens to demand that the community rethink the setup and mechanisms it operates with. This was the main cause for changing the election process of the Commission president.

The will to reform the EMU is attributable to a series of economic events and crises, starting with the global economic crisis of 2008. Continuing through 2010 with the European sovereign debt crisis and the resulting political and economic hardships in several member states, it became evident that the supervision mechanisms and the half-complete EMU could not withstand large external shocks without dangerous tensions. After the immediate threat of the breakup of the Eurozone was averted, it became the dominant view that in its current state, the EMU is unsustainable and its architecture is in need of a revision.
Political tensions between many member states continue to persist, and the unity of the European Union in terms of political stance is called into question more frequently in recent years. Internal disagreements have existed in the community since its inception, but global issues now present the EU with new types of challenges. In many cases, lacking the necessary institutions and common standpoints, the community failed to respond to some crises as an integrated group, diminishing thereby its own influence on global matters.

The external issues that prove to be most difficult are questions of trade and economics, with the additional dilemma of competitiveness and the transformation into a knowledge-based economy. Although still considered the wealthiest region on the planet, the European Union faces numerous disfunctionalities in its own structure and is repeatedly trying to induce more economic growth. At the same time, the new political situation brought about by an increasingly threatening Russian foreign policy doctrine tests the ability of the community of responding jointly and diverting attacks on a diplomatic, political and security level. With regard to the limits of this paper, a deep analysis of external factors will unfortunately have to be omitted. However, further studies on modern foreign policy on economic integration provide ample grounds for research.
3.2.1. The debt problem

During and after the crisis, a tendency of member states to build up an increasing amount of debt could be observed. General government gross debt, measured as a percentage of GDP shows a consistently increasing trend over the past decade. This trend is not limited to Eurozone countries, as the averages of the entire Union show the same developments. (Eurostat, 2016) Although the distribution of the debt based on individual countries may show variance, if we examine the EMU as a single entity, the data is unequivocal. Merely 13 member states currently fulfill the Maastricht requirement, which set the tolerable maximum value of this indicator at 60%.

High state debt correlates with more difficult access to liquidity on financial markets, particularly in times of economic problems. The overexposure of some member states to external shocks and the effect of risk-premiums on financing instruments of these countries provide a point of tension and jeopardize the stability of the EMU. (European Commission, 2014) Potential contagion effects enhance the pressure financial markets can impose on the EMU, as it is widely regarded as a closely interlinked economic entity. This provides another incentive to creating and enhancing common mechanisms for dealing with fiscal policy. Furthermore, the impact of excessive state debt levels has an impact on budgeting, as debt financing eventually translates into financing needs, which draws away resources from national central budgets.
3.2.2. Bank bailouts

It has become commonplace to refer to banks as symbols of globalization and increasing economic integration, both in a regional settings and worldwide. This also holds true for the EMU, as Eurozone countries larger banks often pursue activities in other Eurozone member states (and states outside the EMU) as well. In times of good business, this is not necessarily a problem, although some issues regarding supervision might arise.

As with state debt levels, bank solvency and liquidity comes under pressure when there is an economic downturn. In extreme cases, there might be a danger of bankruptcy. Banks of large size and systemic importance are therefore often saved or bailed-out by their respective national governments. However, because of their interstate operations, the amount of liquidity needed to keep these institutions from failing may exceed the financing capacity of national governments. This link between large banks and national governments was one of the reasons why the crisis hit so hard, as the unaddressed shortcomings of managing interconnected national economies without sufficient coordination exacerbated the already existing economic problems.
3.3. Key political and economic ideas influencing integration

Having assessed several characteristics and origins of the situation at hand, it is beneficial to take a look at what patterns of influence can be identified in the European Union with respect to policies, traditions and main stakeholders. As the system is based on a linkage of politics and economics, elements of differing nature have to be considered. States, ideologies, concepts have all come into play, and the next step of evaluation would be to circumscribe what factors have had an impact on the integration process, and in what way. The three main points follow here, as I judge the fourth one, namely monetarism, to be of relatively small importance, mainly existing as a certain type of byproduct of ordoliberalism. Nevertheless, a small subsection is dedicated to this train of thought as well.
In the pursuit to formulate a better understanding of what exactly we have to deal with, it would be a mistake to overlook the ideological background of the past decade as a function of crisis resolution and integration. Structural dominance is very difficult to define according to a strictly theoretical analysis of the institutional setup of the European Union. Based on the experience of the years since the European sovereign debt crisis however, the informal dominance of Germany in the European Union and in particular the Eurozone became apparent. (The Economist, 2013) If we consider that a country can become dominant, then the ideas and beliefs of that country are likely to permeate the institutions and processes over which the aforementioned country exercises most of its informal influence. (Young, 2014) This is exactly what happened with the European Central Bank.

The case for proving the German Dominance Hypothesis was made several times over the past decades, but only limited empirical research has been conducted on this topic. However, a comprehensive empirical research initiative proposes that many European states have already abandoned their autonomous monetary policy even before the establishment of the EMU, as they aligned their policies to the Bundesbank. (Camarero & Ordóñez, 1999)

The key information here is that by establishing the EMU, Germany was the only member state that effectively ceded monetary policy sovereignty to the community. (Reade & Volz, 2009) What follows therefore, is that economic and monetary policy setting in Germany before the existence of the EMU already had a significant impact on other countries’ policies. It is reasonable to assume then, that the political ideas fueling German policies in these decades have also had an indirect influence on the future structure of the Eurozone and the European Union.

Following the possibility that German influence on the integration process is substantial, the analysis implies a strong effect of political ideas, but also a transposition of governance models to some extent. In the context of the current analysis, only German administrative tradition will be analyzed to a deeper extent, for reason of determining the possible effect it might have had on European governance
structures, specifically the European Commission. The origins of modern German statehood involve many elements of the Weberian state concept, but changes in the past decades point towards the assumption that that Germany is developing into a Neo-Weberian state as a response to global and domestic challenges in administrative culture. The main characteristics of this culture outline a strong steering and regulating presence for the state, which is in line with fundamental ordoliberal ideas.

The German approach to public sector reform is incrementalism. Therefore reforms of fundamental impact have not been implemented. The focus has largely been on gradual development of the system, as smaller changes have made it possible to constantly redirect the development trajectory of governance to a certain extent without uprooting the foundations. (Pollitt & Bouckaert, 2011) Although the comparability of the European Commission to national governance is difficult, the main mechanisms and procedures in the EC stem from the French and German administrative traditions. With regard to the latter, Weberian and Neo-Weberian ideas in particular have been shaping the EC for decades. The defining features of the EC, such as a career system for civil servants, their motivation and identity satisfy criteria for a labeling including Weberian and Neo-Weberian ideas. (Drechsler, 2009) Although the influences of French public service traditions ought not to be neglected, German influence becomes clearly tangible upon closer inspection.

Besides the administrative traditions, cultural aspects have also been transferred into the architecture of European integration. A more detailed view on one specific aspect proved to be interesting. From among the many dimensions of national cultural attitude, power distance gives the best insight into the interplay of German and European institutional mechanisms. Power distance impacts the general attitude towards political systems on many levels, but in this specific case the concentration of power on an institutional level is concentrated on. (Hofstede, 2001)

In this respect, it is observable that the two key players defining European integration rank quite differently on the power distance index, as Germany and France stand at the opposing ends of the scale. Germany scores low on the index, meaning that Germans do not accept the idea of high degree centralization. This translates into a preference for a network of smaller, autonomous institutions. By proxy, this also
means that the idea of an independent central bank is more acceptable. For the French, who score high on the power distance index, central bank independence is less important. This was reflected in the pre-EMU structure as well, with the French central bank seeing more direct influence from the government.

Both countries entered the same structure following the establishment of the monetary union, which is, in terms of institutional culture, more dominated by Germany than any other nation by itself. It is known that the independence of the ECB was effectively copied from the German structure, meaning that there is a fundamental mismatch between French cultural attitudes and the institutional setup of the European Union, at least in this respect. Plausibly, this is not the only point of stress, and the argument applies for many more countries.

The existence of common institutions by default brings along controversy and difficulties, but in the case of the European Union, very different cultural attitudes must conform to the same system, resulting in an underlying mismatch that leaves a mark on all negotiations, agreements and plans.

Provided we accept the idea that German cultural attitudes had a defining impact on the European construct, it is quickly understandable how the difficulties of the past decades and in fact, the dilemmas of recent years have taken shape. The types of mismatches mentioned so far shine light on the difficulties of such an integration process. The efficiency of an entity such as the European Union handling adverse situations clearly depends on the ability and will of the people and cultures of member states to be tolerant of each other’s views and attitudes. As these characteristics change rather slowly over time, the European Union must also strive to accommodate all kinds of various views in order to successfully tackle the challenges it constantly faces.

The developments of most recent years however, show that the existing institutional trajectories define the entire entity’s common attitude, leading to stress in the system. The most widely publicized argument that the mismatch has led to was the debate that emerged between Germany and Greece, with assistance from several European institutions. Although it is a subjective evaluation, I found that European institutions
sided with German views more often than not, confirming my earlier beliefs that Germany did in fact have an outsized impact on European policy-making. This was part of my motivation for delving into the current research project.

As the European Union moves forward, it is likely that ongoing integration will present it with many more situations in which the aforementioned aspects will come into play and must be considered while conducting debates. Although German influence on the European Union is controversial and many see it as a threat, I found no evidence of it being a thought-out, willingly conducted strategy or a conscious decision to take over decided policies or institutions. Besides, this would prove difficult with twenty-seven other member states keeping a close eye on policy and acting as counterweight. Nevertheless, a perhaps unconscious, indirect transfer of cultural, institutional and political attitudes and convictions can be observed.
3.3.2. *Ordoliberalism*

The political school of ordoliberalism developed as a reaction to the crises following the 1920s. Its predicaments include the idea that the market cannot be left to organize itself automatically, as that would result in unmanageable inequalities and would bring about intolerable social conditions. The ordoliberal school of thought viewed both laissez-faire liberalism and collectivist political economy as harmful and inefficient. Therefore, the ideology that developed can be classified as a ‘third way’ beyond political right and left.

The developments of the early 20th century changed the foundations of modern societies as new challenges appeared with the era of mass democracies and the development of large-scale economic entities. Competing ideals of efficiency, competitiveness and social welfare and protection began to emerge as central problems. Ordoliberals theorized that a strong state would have to enforce strict rules in order to ensure the efficient and just functioning of a market economy. In other words, supporting the orderly functioning of a free economy is governance by itself, meaning that this defines tasks for the government and its administration.

Although ordoliberalism is treated as a consistent set of ideas, it must be noted that it exists predominantly in fragments and excerpts of studies and critiques. A systematic classification of ordoliberal arguments is therefore hard to come by. (Bonefeld, 2012)

In the post-war period, Walter Eucken and Franz Böhm developed ordoliberalism extensively. The political ideas had a profound impact on the convictions of Ludwig Erhard in particular, who was one of the most influential figures in post-war German politics and economic policy setting. Through this link, ordoliberal ideas were transferred directly into the new architecture of the West German state, and thereby also into the entire process of European integration.

The underlying statement is that through German dominance in several key decision-making processes, institutions and situations, there is an observable influence of ideas closely linked to ordoliberalism. (Nedergaard, 2013) The specific connection to German-dominated monetary policy is evidenced by the fact that price stability,
central bank independence and the avoidance of large public deficits are influential tenets of ordoliberalism. The strong defense of these three core policy elements has continued after the establishment of the European Central Bank and often characterizes German political standpoints in high-tension environments, such as the aftermath of the sovereign debt crisis. The ECB, and the European Commission often echo these views throughout debates.

It is reasonable to postulate that institutional designs matter and have an effect on monetary policy outcomes, and in this respect ordoliberalism had an influence on a global scale. Germany was one of the world’s first countries to establish a central bank, which operates independently from the government. Even at the time when the Maastricht Treaty was signed in 1992, many signatory countries still have not given independence to their respective central banks. (Beyer, Gaspar, Gerberding, & Issing, 2009) Since then, the practice of central bank independence has spread well beyond Europe.

The fact that ordoliberalism is willingly accepted by the European Union is also evidenced by the Treaty of Lisbon, where it is stated that “The Union shall […] work for the sustainable development of Europe based on […] a highly competitive social market economy, aiming at full employment and social progress […]”.

Further examples testify the influence of ordoliberalism not only in the realm of economics as regards the EMU, but also from a perspective of interpretation in general. The rule-based character of the Treaty of Maastricht and other documents of regulative nature continue to have a strong impact on decision-making in the European Union, particularly in times of crises.

The strict rule-based approach to a wide range of problems produced situations that have been widely contested, as extreme situations, such as financial crises, would demand more flexibility than these ordoliberal ideas would permit, some arguments say. The counterarguments include the observation that consistency in this case yields more benefits in the long run than accommodating a variety of different courses of action. The constant long-term view is also part of this picture, as it is the only way to ensure stability and thereby credibly encourage long-term investments.
Ordoliberalism approaches moral hazard and excessive risk-taking from the perspective of expectations. Considering that market actors expect an intervention, for the sake of example, a bailout, they are less likely to continue implementing sound fiscal policies. This eventually leads to the realization of the moral hazard problem, which often appeared in crisis resolution discussions.

While the ordoliberal sanctity of rules is strongly enforced as we can see, not only by Germany, but also by the European Union, the possible beneficial effects of changes in policy are somewhat downplayed, resulting in controversies regarding crisis mitigation and tailored resolution mechanisms. (Woodruff, 2014)

Evidence from multiple sources thus points towards affirming that ordoliberal views have in fact had a seldom-realized impact on the evolution of the European Union. (The Economist, 2015)
3.3.3. Monetarism

Hand-in-hand with the ideational influence of ordoliberalism, monetarism emerged as one of the defining economic theories behind the actions and the motivation of the European Central Bank, thus propelling itself to the forefront of economic integration. The policies of the ECB are broadly in line with monetarist principles, as its main objective is to achieve price stability, set forth by the Treaty of Lisbon. Concentrating on the supply of money in the economy has been at the epicenter of German monetary policy since 1975. (European Parliament, 2015) These views were carried through to the ECB when it was established.

Current policies of European institutions of course take into account a multitude of analyses and reports, thus the ideas presented here are not exclusively dominant in European policy-making. A more pragmatic approach tolerates deviations from time to time. I do wish to emphasize however, that the effects of the schools of thought mentioned above have wide-ranging effects even to this day in European economic governance and politics.
3.3.4. **Fiscal integration**

One of the most contentious issues throughout the entire process of European economic integration is the idea of fiscal integration. As it impacts national sovereignty, member states and European institutions all treat it as a sensitive topic, even though its existence has been in the minds of many Europeans in the past decades. The possibility of tight fiscal integration floated time and time again, but the first opportunity for effective action presented itself at the moment of the introduction of the monetary union, as the two are inextricably linked conceptually. (Cangiano & Mottu, 1998)

The reasons for the continually stressful discussions surrounding the issue are numerous, but one of the problems is that while central banking and monetary policy evolved into a model where political independence is widely respected, fiscal policies continue to remain at the center of highly politicized debates.

This politicization often invokes the phenomenon of long-term interests being subdued by short-term considerations, often of political nature aiming to maximize votes among the electorate. These short-term processes not only harm sound fiscal policies and effective cooperation between member states, but can also undermine the idea of integration by transforming it into the subject of day-to-day political debates.

While discussion on integration of course should not be exempt from public discourse, short-term political incentives often result in untrue but popular statements regarding European integration, downplaying its benefits and magnifying the existing shortcomings. These political debates and incentives have defined the boundaries of discussion in which fiscal integration develops.

The entire history of the European Union, using some simplification, hinges on this concept. As long as this area of integration is not completed, the European Union will have to face external shocks in an unprepared manner, even with important corrections enacted in recent years, that merely serve to fill the gaps in the institutional structure until the fiscal union seems viable. (Horațiu, 2014) Currently, existing plans call for completing fiscal integration in order to avoid this handicap.
from becoming a critical flaw in the event of future difficulties. It is no question that
the eventual completion of a fiscal union will be a historical step, as it is ultimately
one of the ideas upon which European integration has been founded. If the European
Union and its currency, the euro, are to persist, there can be no question that this
institutional gap will need to be closed and a fiscal union must be established, else the
status quo might result in disastrous consequences.
4. Conclusion

In this paper, I have attempted to present a variety of arguments underpinning the assumption that there were three main influential factors in the process of European integration that determine the path of the European Union to this day. Historical accounts informed us about the dilemmas experienced by decision-makers at early stages of post-war consolidation.

The reestablishment of economic order after the war took different turns in all countries, but the security policy, foreign pressure and economic considerations all pointed towards the desirability of some form of coordination and cooperation at a European level. The attitudes towards this idea of creating a common interest group were not constant throughout time and space. Some countries were never truly enthusiastic about binding together, while others feared the new construct. The personalities and experiences of top-level political leaders heavily weighed upon foreign policy doctrines and negotiations, tilting the balance of agreements one way or another.

After the rules of the game were more or less set, European countries gradually accommodated themselves to the idea that European integration yielded benefits for all participants. The special status of Germany, divided in the first decades of integration made sure of a complicated process. Its economic weight and technological development made partner countries grow wary of its political goals. The outcome of decades of bargaining and negotiations eventually led to the setup of the European Union, in which Germany had considerable influence, given its position at the epicenter of European economic integration for several decades.

Through this influence, German political ideas, ordoliberalism in particular, were also disseminated in the institutions of the European Union. The original goal of economic integration dragged along a lagging political integration as well, a process that carries on to this day. As monetary integration was the first to be completed and German ideas had considerable impact upon it, the remaining areas of integration would have to be tailored in light of this relationship. This effectively translates into the assumption that in order for the entire European Union to work well, sooner or later it
has to adopt more elements of institutional structure pioneered earlier by Germany. One of the reasons why Germany outranks other players in the current system is that it is essentially part of Germany that was exported throughout the continent to some extent, knowledge of the system and its weaknesses are therefore deepest in Germany. The effect of other key countries and ideologies is not to be belittled of course, but this paper is merely a glimpse into the complexities of the system.

Following the identification of a state (Germany) and an ideology (ordoliberalism), accompanied by monetarist ideas, that had considerable impact on the European Union, we are left with the last element of the puzzle, that is, the concrete concept of economic integration.

The monetary union is complete, but still has to be complemented by the fiscal union, which continually proves to be much more difficult as national governments often oppose the idea of pooling their sovereignty, as it has been for the past decades. Therefore, the third building block is identified as being fiscal integration, the desire for which periodically appeared since the earliest days of the integration process. Where does this take us?

Until recently, economic integration was progressing much faster than the pace of institutional evolution as economic development cast a shadow over design flaws. Nevertheless, economic integration remains central to the core values and ideals of the European community. The task for the European Union at hand now is to design the institutions by means of which this unprecedented economic integration process can be supervised and steered.

Great emphasis must be placed on further studies in the subject of cultural development and mutual accommodation, as stronger integration will inevitably place strains on intercultural relationships, particularly in high-tension circumstances, such as a crisis and high-stakes discussions, such as national sovereignty and economic policies. The questions on the development of the European Union must be faced with a cold head and a clear mind, even though this approach has already come under pressure several times in recent years.
The ability to coordinate has brought the community enormous benefits so far, a move backwards could therefore be disastrous. The often-referred domino effect also comes into play here. As soon as any member of the community would be left behind, the entire idea of integration would take a very hard hit.

While the possibility of such events has diminished after much discussion and continuing economic, and therefore political hardships for many countries, it is imperative that political leaders throughout the community stay vigilant and ready for compromise within the jointly agreed rules of the game if need be. Present developments indicate further moves towards completing the fiscal union, with political union fading into the distant future.

Much depends on the public opinion of the member states and their capacity to gauge the importance and the consequences of their decisions. The remaining issues that often float are questions of sovereignty, democratic deficit and budgeting. Most of the opposing factors that limit the integration process are once again, as in the past, of political nature.

While the relevance of these questions is undisputable and there are no clear-cut answers, the responsibility of national policy-makers is clear. Are they willing to take the necessary steps to support deeper integration of the European Union, or will they be arguing in favor of a devolution or a status quo, both of which bring the European construct into peril?

Further studies in the topic should be conducted in order to fully reveal the cause-effect relationships between political and economic considerations in the European integration process. The special, and perhaps least researched, link that exists between ordoliberalism and European institutions merits much more detailed inspection. The main reason for this is that while the effects of individual ideas might gradually decrease over time, the architectures designed under their influence will define European integration far into the future.
If we fail to connect the dots and do not adequately explore these relationships, we risk misunderstanding European integration and thereby endanger the project’s future by mishandling its shortcomings.

Germany, ordoliberalism and fiscal union. The three factors that have defined much of the first sixty years of European integration continue to have an impact on our daily lives through the political and economic system we live in and the institutions we have to deal with. The identification of the roots of influencing factors brings us closer to an understanding of the difficulties of crisis management and intergovernmental conflicts in Europe that are now luckily taking place at a table instead of the battlefield.

The European integration project is an experiment of historical proportions; its guidelines therefore merit more research and analysis. I sincerely hope that the contents of this paper can bring people, especially European citizens closer to understanding the entity that keeps redefining and influencing global politics and economics.
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