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## **EUROPEAN ECONOMIC GOVERNANCE THROUGH FISCAL RULES**

*The European Union has been one of the most enthusiastic proponents of fiscal rules. Following the European sovereign debt crisis, the EU did not embark on a wide-scale governance reform with the aim of creating a fiscal union; rather, it started to cement the original architecture that had been built upon fiscal rules. By applying the conceptual framework of liberal intergovernmentalism, the article argues that the choice between stronger rules on the one hand and deeper fiscal integration on the other hand has been basically determined by German preferences. With the help of the simple model of war-of-attrition, the article shows that core countries managed to strengthen the rules-based economic policy framework of the EU to the extreme.*

### **INTRODUCTION**

The European Union has always been amongst the most enthusiastic proponents of fiscal rules. From the time of signing the Maastricht Treaty, several supranational and national fiscal rules have been introduced in the member countries of the EU. In fact, the EU has been possibly the most vehement proponent of fiscal rules right after the crisis. The European Commission called for stricter rules at the time of the Greek sovereign debt crisis (European Commission 2010a, b), which resulted in the adoption of the Six-pack in the first round. But the EU did not stop there; a year later, in 2012, euro-zone members agreed on the adoption of the so-called Fiscal Compact, which was supposed to endorse fiscal discipline at the cost of national sovereignty and which caused a dramatic increase in the number of fiscal rules used at the national level. In fact, the adoption of rules has become the norm in the EU, while discussions on a fiscal union have simply evaporated.<sup>2</sup>

This study focuses on the European Union and its member states and raises the question why there has been a seemingly constant interest in adopting newer and stricter fiscal rules following the debt crisis on both the supranational and especially the national level? Why has the crisis triggered a renewed interest in imposing a numerical constraint on discretionary fiscal policy? The answer to such questions might not be trivial. Explanations for fiscal rules derived from economics do not shed light on the striking difference in the number of adopted rules before and after the crisis. In fact, the pre-crisis and the post-crisis periods have not been different in the sense that countries and their politicians might have not become more short-sighted in the post-crisis era that would call for stricter fiscal frameworks and rules. Also, time-inconsistency, deficit bias and the common pool problem have been nothing new to European economies; such phenomena were solidly part of their history well before the crisis as well. Why did then such a relentless interest emerge in fiscal rules in basically every single country in the European Union *following* the crisis?

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<sup>2</sup> On fiscal union in the EU, see Csaba (2013), Kutasi (2017).

The paper argues that while the typical textbook-style economic causes for fiscal profligacy such as time inconsistency have certainly not evaporated in the post-crisis era and these can explain at least partly the increased interest in adopting fiscal rules, the real cause for such an extraordinary multiplication of rules was driven by German interest. Germany was ready to engage in sovereign bail-outs on the one hand and in supporting the creation of a permanent rescue mechanism, i.e., the European Stability Mechanism, on the other hand, only at the expense of imposing strong conditionalities on debt-ridden countries. Such conditionalities, however, went well beyond the typical measures of fiscal austerity and/or structural reforms; they also required member countries to introduce stricter than ever numerical limits on public spending. Since domestic politics has turned out to be hostile to sovereign bail-outs (and especially the Greek bailout), German policy makers and Angela Merkel in particular, tried to convincingly demonstrate that German taxpayers' money was given away not for nothing (Emmanouilidis and Möller, 2010).

In order to give teeth to the argument, the article applies the conceptual framework of liberal intergovernmentalism (LI), one of the most well-known (economic) integration theories.<sup>3</sup> By identifying the converging preferences (stability of the euro-zone) and diverging preferences (costs of preserving the single currency) of the member states and by applying the simple model of war-of-attrition, the paper argues that Germany (along with other core countries) managed to strengthen the rules-based economic policy framework of the EU to the extreme.

## **LIBERAL INTERGOVERNMENTALISM AND THE SOVEREIGN BAIL-OUTS**

Liberal intergovernmentalism has become a reference point in integration theories due to its theoretical coherence and robust, empirics-based relevance. LI, as a theoretical synthesis or framework, is acclaiming the status of a general social theory, which is not merely a theory of European regional integration (Moravcsik and Schimmelfennig 2009). Liberal intergovernmentalism is an unrelenting contender of other major explanations on European integration. It contests the realist claim that European integration would be the ultimate consequence of geopolitics (Waltz 1979, Mearscheimer 1990). It also dismisses the federalist view that a unifying Europe would wind up nationalism (Pinder 1986). LI does not find the explanation of Milward (1992) too convincing either, as it claims that the integration project was not simply an attempt to save European nation states. Most importantly, it refuses the neofunctionalist understanding of European integration (Haas 1958), which concentrates on the intimate relationship between high politics and low politics and emphasizes the (almost sole) importance of supranational elites.

The unit of analysis is the (nation) state and not the EU *per se*. States, however, do not act in a vacuum; they try to articulate their interests through different means, especially interstate bargaining. In European integration, states are the ultimate masters of the treaty. States, being rational, utility-maximiser actors, base all their decisions on a strict cost-benefit analysis and choose amongst different alternatives accordingly (i.e. cooperating with others or not). Any international agreement or institution is ultimately the output of substantive interstate bargaining (Moravcsik 1998).

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<sup>3</sup> On LI versus neofunctionalism, see amongst others Vigvári (2017).

Liberal intergovernmentalism has not yet exhaustively reacted to the European sovereign debt crisis. There has been one solid exception, though, to this trend. Schimmelfennig (2015) framed a typical intergovernmentalist problem: converging national preferences on the most-preferred outcome (i.e., preserving the single currency and the EMU itself) on the one hand and diverging preferences with regard to the distribution of costs of the Pareto-optimal solution on the other hand. In consequence, while each member state, including the crisis-hit economies, agreed on the maintenance of EMU and disfavoured the option of the fall apart of the euro-zone, the asymmetric nature of interdependence amongst EMU member counties has given birth to such an institutional design and burden-sharing which exclusively reflected German (and its allies') preferences. The situation is described by Schimmelfennig (2015) as a "chicken game", referring to hard interstate negotiations and brinkmanship.

The typical preference-ordering of a chicken game is the following:

$DC > CC > CD > DD$ ,

where D refers to defection and C to cooperation (and the first letter refers to the preference of the first actor, while the second letter refers to the second actor's preference).

The chicken game is similar to the prisoner's dilemma (PD), as the Pareto optimal outcome (mutual cooperation, CC) is not the equilibrium in any of the two games; yet, CC is strictly preferred to mutual defection (DD).<sup>4</sup> In contrast to the PD, however, the chicken game has multiple equilibria and, in turn, it does not have a dominant strategy.<sup>5</sup> The chicken game is often used in the context of conflictual and violent situations like the Iranian nuclear programme (Sadjadpour 2007) or the invasion of Iraq by the US or Russia's aggression against the Ukraine. Some of the trade negotiations, especially when one party has to take unilateral concessions, can be described by a chicken game, too (Aggarwal and Dupont 2008).

Schimmelfennig (2015) provided a couple of points for demonstrating the rightness of the chicken game analogy. First, each and every country tried to avoid the worst outcome, i.e., the disintegration of the EMU (DD). Keeping the single currency alive and introducing reforms (CC) was strictly preferred to the collapse of EMU, because each participant could only gain with the euro. Second, the chicken game – in harmony with LI – has a distributional conflict, too: actors must agree on how the burdens of crisis management are distributed. The highest payoffs (DC) come only if one actor can force the other one to take the costs. The other one loses but is still alive; that is, it can remain in the EMU (CD). Third, the chicken game is also adequately descriptive with regard to actors' irrationality, which Schimmelfennig addressed as brinkmanship. That is, actors try to send signals that they lost control over events in order to deter others.

While the chicken game could be a good starting point in explaining crisis management by revealing diverging preferences on outcome, it might not be the most appropriate choice for understanding the actions, and more importantly the lack of actions, of member states in the post-

<sup>4</sup> Preference ordering of the PD:

$DC > CC > DD > CD$

<sup>5</sup> The Nash equilibrium of PD is DD.

crisis situation. It is argued in this article, instead, that national governments have been steadily engaged in a game of “war-of-attrition”.

“War-of-attrition” is often called the “game of timing”, as it has two major defining characteristics: (1) the winner’s payoff is greater than the loser’s payoff; and more importantly, (2) payoffs do deteriorate as time passes. While the first characteristic is obvious, the second one underlines that actors choose to wait instead of acting even if their reluctance to act implies a significant decline in net payoffs. Waiting (insisting on the status quo) is basically the consequence of informational asymmetry amongst partners: actors are well-informed about their own stakes but are unaware of other parties’ payoffs. If actors opt to wait, the question is how long it is worth waiting for (and thus foregoing the benefits of an immediate action) in order to win the game and force the other party to take all the costs. This approach is therefore rather useful in cases where the challenge is to reveal different bargaining strategies over time when the status quo deteriorates.<sup>6</sup>

In the war-of-attrition amongst the members of the European Union, two distinct groups could be identified. The crisis-hit economies, often called the periphery or the PIIGS, referring to Portugal, Ireland, Italy, Greece and Spain on the one hand and the Northern or core economies (e.g., Germany, the Netherlands, Luxembourg, Finland) on the other hand. Both the periphery and the core agreed on the priority of maintaining the stability of the euro-zone as the Pareto-optimal outcome (Moravcsik 2012, Schimmelfennig 2015) but the two groups definitely did not manage to agree on the distribution of adjustment costs.

At the periphery, countries tried to minimize the cost of crisis management and to shift as much of the burden of crisis management as possible onto the core. Practically they wanted two things: 1) the core taxpayers to pay the bill, and 2) to commit themselves to as soft reforms as possible due to the associated political and social consequences of any consolidation that would imply a change in the prevailing *status quo*. At first glance, it might be trivial to assume that the troubled nations did not have too much to offer for the others; therefore, the core could easily enforce its terms and conditions on the crisis-hit economies. But this was not necessarily the case. Troubled nations can always threaten others with exit or default (the worst-case outcome, DD, that both groups though wanted to avoid since  $CC > DD$ ), thereby destabilizing the whole euro-zone.

The crisis-hit economies never really wanted to abandon the single currency and return to their national currencies. An exit would have practically resulted in a devastating effect on the troubled nations, since the public debt would have (still) been denominated in euro, whereas all (future) income would have been accrued in national currencies (Eichengreen 2007). In fact, any country that decides to leave the EMU should, in principle, decline its EU-membership, too, which makes such a scenario rather unlikely. Nevertheless, exit and especially the threat of an exit can substantially strengthen the bargaining position of the periphery, because an exit can significantly endanger the stability of the euro-zone. Default has never been a desired option either, as it always entails a huge economic and social burden. Also, a default may undermine the stability of the whole currency area, as other countries may also become the target of speculative attacks of international financial markets. Yet, default is once again a valid option for threatening

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<sup>6</sup> One of the most widely known applications of the war-of-attrition model is Alesina and Drazen (1991) in the economics literature. The authors showed that coalition governments react only slowly or not at all to fiscal shocks, so stabilisation is delayed, thereby placing extra burden/costs on society.

the core and enforcing them to surrender (in technical terms, surrendering in a war-of-attrition game means that the marginal cost of extra waiting equals its marginal benefit).

Furthermore, strict conditionalities attached to financial rescue can always be softened by referring to “unexpected circumstances”. Implementing only partial reforms is always a possible and rational strategy in a waiting game. The core might have wanted the periphery to get engaged in taking as much fiscal consolidation as possible, but Germany and its allies had to be rather cautious about their demands with regard to fiscal, financial and structural reforms. If the cost of reform was politically and economically untenable, thereby alienating the periphery, the whole situation could have eventually deteriorated into default or a total abandonment of EMU membership. In this sense, partial reforms are always better than no reforms at all and much better than a country’s collapse or a possible collapse of the whole euro-zone.

Last but not least, PIIGS have had an immense interest in allying with the European Commission in its attempt to mutualize public debt. The common issuance of sovereign bonds could have been a clear supranational solution of crisis management, proposed by the European Commission (2011) and backed by France under Sarkozy; yet Germany never gave credit to a euro-bond due to the assumed endorsement of moral hazard. Nevertheless, the very idea of debt mutualization, a much-refuted option by the Germans was (or could have been) a card in the hands of the periphery.

Core countries also tried to minimize (their) costs during crisis management. The core had to solve a puzzle, though. A financial rescue is an explicit violation of the so-called no-bail-out-clause of TFEU (Article 125 (1)), which says that no member state or the EU itself can rescue another country. The no-bail-out clause was placed in the Treaty for a very good reason. It was rightly assumed that financial rescue could strengthen moral hazard in a currency union, making countries less reluctant to claim special status at times of difficulties. Abandoning the article had certain costs in terms of weakened credibility (a point that the core has always tried to avoid). The solution to such a dilemma was to grant the first Greek bailout package upon the assumption of “extraordinary circumstances” that were beyond the control of the Greek authorities (Council regulation 96/06/2010).

In the chicken game, the winner takes it all (DC). In a waiting game, both the winner’s and the loser’s payoff deteriorate over time. This is exactly what happened in the first Greek rescue negotiations. On the one hand, Greece tried to demonstrate its ability to cope with the crisis and to avoid default or leaving the euro-zone. It took almost half a year for the Papandreaou government to officially ask for (and accept) the financial assistance of the EU and the IMF (Benczes and Benczes 2018). Right from the beginning, it was clear to Greek politicians that any official rescue would be granted on a conditional basis only, making the agreement politically risky. They turned to the EU/IMF at the point where the cost of additional waiting would have been unacceptable, because in that case Greece would have found itself in a disorderly default, which was the worst case scenario.

On the other hand, the EU, dominated by Germany, was obviously aware of the Greek situation, but it did not want to commit itself to an early rescue with soft conditionalities. At that point, waiting was still less costly than striking a deal. By delaying the agreement and playing tough with Greece, Germany managed to lock Greece in an agreement with strict conditionalities that met the preferences of the German public. Germany’s concern was not Greece itself but the stability of the euro-zone and the integrity of the single market. Germany decided to sign

the agreement only when the conditions deteriorated considerably throughout the euro-zone, following the downgrading of Greek sovereign bonds to junk status in late April. By that point it became evident that it was not rational to wait any longer.

Generally speaking, with the application of strict conditionalities, core countries wanted to strongly commit crisis-hit economies to crisis management. By strict conditionalities the core, and especially Germany did not mean solely fiscal austerity of competitiveness-enhancing structural reforms. They also wanted the periphery and the whole euro-zone, in fact, to engage in the adoption of extremely strict numerical fiscal rules where the sanctioning of non-compliance would happen automatically in the future. The means to this end was the adoption of the Fiscal Compact, an intergovernmental treaty of the euro-zone members which were joined by some other non-euro-zone economies, too.

## FISCAL RULES AND GERMAN INTERESTS

Germany has evidently taken the leadership position in EU crisis management. It was rather clear since day one of the eruption of the European sovereign debt crisis that Germany was to play a major role in overcoming the crisis. But Germany was willing to agree to use its own taxpayers' money to bail out failing states, and thereby go against the no bailout clause, under strict conditions only such as the ones enshrined in the Fiscal Compact.

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (aka the Fiscal Compact) was adopted in March 2012 and came into force on January 1, 2013. As a reform of the Stability and Growth Pact, the EU enacted the so-called Six-pack in 2011; but Germany was not fully content with the new rules of the Six-pack; it wanted to stop fiscal profligacy in euro-zone member countries once and for all. The Fiscal Compact initiated significant changes in at least three respects. It enforced member countries of the euro-zone to adopt stronger than ever fiscal rules at the national level targeting balanced budgets.<sup>7</sup> The compact also asked countries to transpose the new rules into high-level national legislation, most preferably into constitution.<sup>8</sup> It also authorised the Court of Justice of the European Union to step in in case of non-compliance.<sup>9</sup>

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<sup>7</sup> "The budgetary position of the general government of a Contracting Party shall be balanced or in surplus" (Art. 3 (1a), Fiscal Compact). "The rule under point (a) shall be deemed to be respected if the annual structural balance of the general government is at its country-specific medium-term objective, as defined in the revised Stability and Growth Pact, with a lower limit of a structural deficit of 0.5 % of the gross domestic product at market prices" (Art 3 (1b)).

<sup>8</sup> "The rules set out in paragraph 1 shall take effect in the national law of the Contracting Parties at the latest one year after the entry into force of this Treaty through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes" (Art. 3 (2), Fiscal Compact).

<sup>9</sup> According to Art. 8 of the Fiscal Compact, any member state can take another contracting party to the Court of Justice of the European Union if the latter happened to ignore the claim of transposing the balanced budget rule along with the correction mechanism into national law, possibly into the constitution. The decision of the Court of Justice is binding. The Court may impose a penalty on the non-complying country which shall not exceed 0.1 per cent of GDP.

The Fiscal Compact caters to German needs by introducing strict rules in a way that any later bailout is contingent on the party having joined the pact (only those failing member states can get ESM funding who have ratified the compact too). Germany itself sacrificed its own widely acclaimed fiscal rule (the German golden rule) it had been using for nearly four decades in order to first implement what it later required the other members to put into effect in the whole EU. The German debt brake of 2009, which is practically equivalent to the budget balance rule of the Fiscal Compact, limited the room of manoeuvre of German fiscal policy – with two thirds majority political support – following a thorough and comprehensive constitutional process. The German constitutional court had called on German parties repeatedly to change the earlier golden rule, as well as some provisions of the fiscal constitution, as they had caused legal disputes more and more frequently.<sup>10</sup> In Germany the reason for a comprehensive constitutional reform was thus not just overspending on the regional level and the consequent request of particular states for bailout funds from the federal government, but also the risk of such behaviour becoming the accepted norm in the country and the moral hazard it would bring about (Feld and Baskaran, 2010).

It was the crisis hitting Europe in 2008 that brought a sweeping change in the protracted constitutional process. Germany committed itself to deficit financing, but by laying down the new rule in the constitution it sent the clear signal to financial markets that its extravagancy is only temporary. Combining crisis resolution with the introduction of the new rule laid down in 2009 was to demonstrate that Germany did have an exit strategy.<sup>11</sup>

Germany wanted to transplant its own mechanism onto other member states of the European Union as well. By 2011, the steadily increasing Spanish, Portuguese and Irish risk premia were threatening the stability of the whole eurozone. The creation of the temporary bailout mechanisms such as the EFSF did not convince international financial markets. In turn, by early 2011, Germany no longer objected to setting up a permanent bailout mechanism (Beach, 2013). The question was, however, how to sell such an idea to domestic voters and how to ensure that a permanent bailout mechanism did not help embed moral hazard in the euro-zone. The Fiscal Compact seemed to be the right means to do this job as it has connected two pillars that have been considered to be important for economic governance in the eyes of Germany. The compact has introduced strict rules, and afforded the opportunity to lay down the foundations of transfer mechanisms. It is beyond doubt that the compact is about the tightening up of fiscal rules, but from a German perspective it was just as important to make sure that only countries that join the Fiscal Compact should be made eligible for financial assistance from the European Stability

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<sup>10</sup> Several German states especially Saarland, Bremen, and the capital city of Berlin were hoping to get bailout funds from federal sources. In these legal disputes it was the constitutional court that had to decide which federal land could get fiscal transfer and which could not.

<sup>11</sup> The German debt brake limits the structural deficit at 0.35 percent at federal level – as opposed to 0.5 percent in the Fiscal Compact. Originally, the new German rule was not supposed to be applied to the individual federal states. However, due to the crisis it was also extended to them as well (requiring them to have a balanced budget). Nevertheless, while at federal level the starting date is 2016, at state level the new rule is to be applied from 2020 only.

Mechanism.<sup>12</sup> The German type of brakes laid down in the constitutions also helped to make it easier to sell future bailouts more easily to the German public politically. This way the message of the compact could be more in accordance with German intentions, i.e., that any bailout or the possibility thereof could not under any circumstances carry the moral hazard of becoming inherent. And as Table 1 demonstrates, EU countries have been indeed busy with adopting new rules following the crisis – most of these changes came right after (or together with) the ratification processes of the Fiscal Compact in 2012.

**Table 1. Fiscal rules in use in the euro-zone (year of introduction)**

	Balanced-budget rule	Debt rule	Expenditure rule	Revenue rule
Austria	2015		2015	
Belgium	2003, 2014		2016	
Cyprus	2014	2015		
Germany	1990, 2013			
Estonia	2014	2014		
Greece	2014			
Spain	2014	2014	2014	
Finland	2013, 2014	2014	1999	
France	2013		2009	
Ireland	2013	2015	2013	
Italy	2001, 2010, 2014	2014	2014, 2016	
Lithuania	2015, 2016	2012	2015	2015
Luxembourg	2014, 2015			
Latvia	2016	2014	2016	
Netherlands	2014	2014	2015	1998, 2016
Portugal	2014, 2015, 2016	2013		
Slovenia	2015, 2016		2010	
Slovakia	2014	2012	2016	
Malta	2014	2014		

Source: own compilation based on European Commission (2018).

Note: Rules adopted at the federal or state (regional) level plus in the social security system.

<sup>12</sup> In fact, many countries such as Germany itself ratified the ESM Treaty and the Fiscal Compact at the same time (de Witte 2011).

## LAMENTING ON THE FISCAL COMPACT

It is often claimed that the Fiscal Compact has simply been the reinforcement of existing rules; it only restated the ones adopted by the Six-pack – enough to mention the balanced budget rule, the focus on debt sustainability or the escape clauses attached to the treaty (ECB 2012). Others, however, argue that because the intergovernmental treaty was much tougher than the previous EU framework, the current rules will arrange themselves in a clear hierarchy. Supremacy is given to the new structural balance rule of the Fiscal Compact, and the EU rules (the Lisbon Treaty and the Six-pack in particular) would provide a sort of safety net to the balanced budget rule (Blizkovsky 2012, Verhelst 2012).

Table 2. Order of likelihood of activation of fiscal instruments

Order	Legal basis	Instrument	Parameter	Sanction	Decision on sanction	Participating member states
1	TSCG	Balanced budget rule	Structural deficit below 0.5% of GDP	Penalty up to 0.1% of GDP	European Court of Justice	25 (does not include CZ and UK)
2*	TSCG	Debt rule	1/20th annual reduction of debt above 60% of GDP	N/A	N/A	25 (does not include CZ and UK)
3	EU secondary legislation	6-pack,	Adjustment to medium-term objective and excessive structural deficit over 0.5% of GDO	From an interest-bearing deposit of 0.2% to a fine of 0.2% of GDP	Council (reverse qualified majority voting)	27, sanctions to 17 (EMU members) only
4	EU primary legislation	TFEU Article 126, Protocol 12	Annual deficit below 3% of GDP	Up to a fine of an appropriate size	Council (qualified majority voting)	27, sanctions to 17 (EMU members) only

Note: \* a similar debt rule is part of the 6 pack rules.

Source: Blizkovsky (2012).

Originally, the EU was built around a “dual constitution, supranational in the single market’s policies and intergovernmental in (among others) economic and financial policies” (Fabbrini 2013: 1003). Accordingly, policies related to the single market have been conducted with the robust involvement of supranational institutions such as the European Commission and the Court of Justice of the European Union. In the case of financial and economic policies, however, an intergovernmental mentality has prevailed since the signing of the Maastricht Treaty. In con-

sequence, the Council and the European Council in particular have been solidly involved in both crisis management and crisis prevention, i.e., laying down the foundations of the future economic governance of the EU. There is no surprise therefore that the Fiscal Compact has been, in fact, the result of intergovernmental mentality, strongly backed by the EU's largest economy.

The Lisbon Treaty, along with the Stability and Growth Pact, were evidently lacking real rigour and sanctioning. When the foundations of the EMU were laid down in the early nineties, no actor involved in the negotiations wanted to restrict sovereignty beyond the surrendering of monetary policy. The Maastricht Treaty, back in 1992, was a sort of compromise therefore. The Court of Justice of the EU for instance did not have a role at all in the excessive deficit procedure. Even the role of the European Commission was substantially limited in the process (TFEU 126). The consequence was the total negligence of the Stability Pact as early as 2003. The Fiscal Compact, therefore, intended to sign the end of that particular era. It called for the active and effective involvement of both the European Commission and the Court of Justice. Strangely enough, it was an intergovernmental treaty which managed to restore the authority of these two supranational institutions in the field of fiscal policy.

It has been noticed long ago in the scholarly works on political economy that rational politicians are reluctant to delegate authority over issues which can redistribute rents to their constituencies (Drazen 2000). Since direct access to distributional resources makes the government capable of organising a winning coalition in election times, no rational incumbent has the incentive to weaken its own sovereignty. Alesina and Tabellini (2007) have demonstrated that politicians delegate only those tasks to bureaucrats and (supranational) institutions which require technical knowledge on the hand and provide little direct benefit to incumbents on the other hand. Monetary policy has become an ideal policy area for delegation, since it assumes special skills and it is difficult to communicate its direct benefits. The situation is rather different, however, with regard to fiscal policy: both taxation and spending can provide ample room for politically motivated actions, which are easy to target and communicate.

While European politicians agreed on the establishing of an independent central bank, they have remained very reluctant to give up national authority over fiscal policy. Member states have not shown too much interest in authorising the Commission to act on behalf of member states in times of an economic crisis, either. Heads of state and government have anxiously tried to keep their hands on every single detail of crisis management, thereby reflecting a strong inclination toward intergovernmentalism. Though the Fiscal Compact is, in fact, an intergovernmental treaty, it did make a strong leap forward to a more supranational supervision of economic policies of member states. The compact is about acknowledging that neither the ECOFIN, nor the European Council, possesses the capacity and skills to enforce compliance to fiscal rules. In turn, the preamble of the treaty calls for the integration of the compact into EU legislation as soon as possible.

As a non-EU text, the treaty authorises the contracting parties (their governments) to act as the main decision-makers. The European Commission is, therefore, in a rather strange situation. On the one hand, it cannot have a decisive role in implementing the treaty. On the other hand, neither the Council, nor the European Council has the capacity and the skill to monitor the compliance of rules by national governments. Therefore, the intergovernmental treaty calls for the substantial involvement of the European Commission in the implementation of the procedures of the treaty. Such a schizophrenic situation, however, can easily culminate in non-transpa-

rent and non-accountable activities and decisions. The further increase of democratic deficit will not make the treaty attractive for many, and may even be the target of harsh criticism later on, undermining overall its credibility.

The single most important problem with the Fiscal Compact could be though the fact that the crisis itself was not triggered by the lack of discipline of incumbents. It is well-known by now that except for Greece, EU countries did refrain from fiscal laxity before the crisis; they did not accumulate huge deficits or debts. Ireland had a debt-to-GDP ratio less than half of that of the 60% limit. But Spain and Portugal also managed to keep their debt dynamics within constraints. Fiscal deficits in these countries jumped to unlikely high levels only as a consequence of cleaning off commercial banks' balance sheets. The contagious effect of the banking crisis was transmitted onto the sovereigns, ending up in public debt crisis. De Grauwe (2013) referred to the intimate relationship between banks and sovereigns as "the deadly embrace".

Bailing out banks was officially left to the national government after the decision of the European Council in October 2008, just one month after the collapse of Lehmann Brothers. However, the banking sector had grown incredibly large, thanks to the success of the single market project. At the extreme, total banking assets were eight times that of the GDP in Ireland. The ratio was four in Austria and France, three in Spain and two and a half in Portugal (ECB 2014.) Recapitalising the banks meant a huge burden on taxpayers in the crisis-hit economies. Consequently, the debt-to-GDP ratio was elevated by ca. 100% of the GDP in Ireland. What is now called as the European debt crisis, therefore, emerged not as a result of the mismanagement of public finances. It was an unintended consequence of tackling the first wave of the 2008 global *financial* crisis. It was the private sector, and not the public sector, which triggered the crisis. Consequently, it is highly unlikely that a treaty like the Fiscal Compact could have prevented the eruption of the crisis of 2008. Since the roots of the crisis stemmed not from the public sector, the Fiscal Compact cannot provide a real shelter from skyrocketing deficit and debt ratios.

It is always true in an open economy that

$$(X-M) = (S-I) + (T-G) \quad (1)$$

where X stands for export, M is import, S and I are the savings and investment of the private sector, whereas T denotes taxes and G governmental spending.

Equation (1) demonstrates that the external balance can deteriorate even if the public sector is in balance ( $T=G$ ). Investment exceeding savings culminates in trade deficit – as was the case in countries at the periphery. If both the external position and the general government are in balance (or close to balance), the private sector will be in a balanced position too, and no domestic savings would be exceeded by private investments. But is it reasonable to assume that both the public and the private sectors are in balanced positions at the same time? In federal states (or in a common currency union) it is not rare at all that certain regions (states) have very different positions due to both cyclical and structural factors, the latter including economic development, competitiveness, etc. In turn, the EMU can either accept that disequilibria cannot be prevented to emerge and creates a permanent transfer mechanism in order to reduce the likeliness of the occurrence of a crisis, or it institutionalises such mechanisms that can guarantee the balanced position of each of the three parts of equation (1). In the current circumstances, the fiscal com-

pact can be successful only if it is supplemented by another pact that focuses on the stability of the private sector. Mody (2013) for instance urged the adoption of a banking and a competitiveness pact besides the Fiscal Compact.

## CONCLUSION

Following the German unification, Germany became the strongest player in the European arena. Nevertheless, it never really acted (or even imitated to act) as a hegemon. Germany remained the strongest supporter of integration in the post-Maastricht era, always ready to pay the bill of deepening or enlarging the EU. Yet it always let France and/or the European Commission to take the leading role in the design of the integration process. The crisis, however, has brought about significant changes to the European landscape. France has become weak both in economic and political terms following the crisis and especially under the presidency of Hollande. The UK, having not been part of the euro-zone, soon maintained its distance from crisis management and started to concentrate solely on its own economic troubles. In 2016, it decided to leave the EU eventually. The European Commission under Barroso did not seem to be willing to become the agenda setter either (Wyplosz 2012).

Applying the vocabulary of LI, the asymmetric nature of interdependence has dramatically increased in the EU, finding Germany in a rather new and unusual position of a “reluctant” hegemon, a position that was more rather the consequence of circumstances than intention (Bulmer and Paterson 2013). Paradoxically, Germany should have provided stability financed by German resources when domestic politics shifted away from unconditional support to European integration. National preferences in Germany, by and large, have become seriously anti-bail out or even anti-Greek (Schweiger 2015).

What is considered by many commentators as the lack of solidarity and simply as a failed policy (Jones 2010, Summers 2015), or as a series of rational and calculated decisions (Beck 2014), has a rather different reading in the eyes of German policymakers. For the latter, the strict position of the German cabinet has been interpreted as the clearest effort to stabilise the euro-zone; all these decisions were considered as the right steps toward rescuing the single currency. Accordingly, Angela Merkel’s main duty has been to enforce all those rules and procedures that the successful European integration was based upon (Janning and Möller 2016). As the EU is not a sovereign like the USA, its member states’ activities have to be coordinated by mutually respected rules, procedures, and formal and informal institutions. From such a perspective, the Greek or whatever bail-out is simply the violation of the Lisbon Treaty. Or more generally: the undermining of the norms of the union. Strict conditionalities are accordingly not part of the wishful thinking of Germany, but constitute rather the interest of the EU itself. What critics interpret as reluctance or lack of solidarity is, in fact, the firm position of Germany on defending European values. In turn, Germany’s *Europapolitik* might not necessarily be inconsistent, and might not be lacking of strategic orientation at all.

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