MASTER THESIS

Deeper fiscal integration as a result of the European sovereign debt crisis?

Analyzing fiscal implications of economic measures taken within the EU's institutional framework during the crisis

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List of Abbreviations

CSR	Country Specific Recommendation
EA	Euro Area
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EDP	Excessive Debt Procedure
EFSF	European Financial Stability Facility
EFSM	European Financial Stability Mechanism
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
ESFS	European System of Financial Supervisors
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
ESRB	European Systematic Risk Boars
EU	European Union
GDP	Gross Domestic Product
IMF	International Monetary Fund
LTRO	Longer-Term Refinancing Operations
MIP	Macroeconomic Imbalance Procedure
MTO	Medium Term Objective
OMC	Open Method of Coordination
OMT	Outright Monetary Transactions
QMV	Qualified Majority Voting
RQMV	Reversed Qualified Majority Voting
SGP	Stability and Growth Pact
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
TSCG	Treaty on Stability, Coordination and Governance in the Economic and Monetary Union
US	United States

INTRODUCTION

The European sovereign debt crisis has showed us that the Euro area is suffering from significant institutional framework and governance deficiencies. Moreover, many rules have been established to keep the Eurozone stable and sustainable through debt level limitations, but the experience has showed us that these rules have been breached regularly and without any sanctions. Completely solving the existing European sovereign debt crisis and preventing the emergence of future crises is possible through solutions which are available, but their implementation and full efficiency would depend on a strong political will. Both the reforms in member states individually, but also on the level of the Economic and Monetary Union (EMU) of the European Union are needed. EMU is characterized with the heterogeneity of its states while at the same time Eurozone has a homogeneous monetary policy based on a single currency. Consequently, European Central Bank (ECB) was unable to act efficiently during the crisis, as there were no fiscal policy instruments, i.e. no supranational fiscal counterpart to the ECB that could be used to fight the facing crisis and complement the monetary actions on the EU level (Martin & Ross, 2004). In a heterogeneous monetary union, the central bank cannot respond to a purely country-specific shocks because the members of such currency union are refrained from pursuing their own monetary or foreign exchange rate policy, while at the same time an individual member is left only with fiscal policy as a direct instrument to use and react when the idiosyncratic shocks occur. Unlike monetary policy, the responsibility for fiscal policy in the Eurozone remains reserved for national governments.

This paper will examine if the European sovereign debt crisis has influenced further fiscal integration in the EU through measures that had to be undertaken to ensure the existence of the EU and even more of the Eurozone. Question is if the specific changes in the EU's institutional framework and decision-making that happened during the crisis have led us to a deeper fiscal integration and if yes, how did they do so. The relevance of this research question stems from the fact that the improved economic measures, both monetary and fiscal, are necessary to reduce the severity of future crises, but also to ensure the sustainability of the single currency area. It is important to see if the implemented measures did lead to a fiscal integration and even more if they have led to the improvement in the fiscal governance of the EMU because well created measures will also lead to a better fiscal discipline and consequently strengthen the EMU. The thesis will be contributing to the existing debate on what kind of measures are being taken in the Eurozone as a consequence of the crisis and what measures and institutional architecture

changes are still needed. The specificity of the paper will be its particular focus on the fiscal policy i.e. measures already taken and future ones leading towards fiscal unification through analysis of the EU legislation and its reports, as well as existing research from the academia.

Regarding the organization of the paper, *Chapter 1.* will provide necessary background on the fiscal policy-making while analyzing both EU and national levels. The dependence of historical developments in monetary and fiscal policy-making will be explained together with the analysis of the problematics stemming from the unsynchronized monetary and fiscal policies in the EU.

Ever since the crisis has spread to the European soil, first as a financial crisis and later emerging into a sovereign debt one, EU has been working hard to address the occurring problems and problematic gaps revealed in the EU's institutional and governance framework. *Chapter 2.* will thus be addressing these actions and reforms aimed not only at solving the emergency situations, but also at making the EU strong and its existence sustainable. The aim of the paper is to analyze if these measures have influenced further fiscal integration in the EU. Several reforms are directly correlated to ensuring the fiscal discipline in the EU such as Six-pack, Two-Pack and Fiscal Compact, but many more have been implemented that could indirectly help in reaching the necessary fiscal stability and prudent decision-making in that field.

Finally, the question on what is the right path for the EU's future development remains open. Deeper integration in the EMU has been called for in the reports such as "*A blueprint for a deep and genuine economic and monetary union Launching a European Debate*" by the European Commission and "*Towards a genuine economic and monetary union*" by the President of the European Council Herman Van Rompuy in collaboration with the President of the Commission, the President of the Eurogroup and the President of the European Central Bank, both published in 2012. *Chapter 3.* explains what such integration would mean in terms of even more fiscal integration. Moreover, it touches upon the fiscal union which is a logical partner to the monetary one, but still a very far and ambitious project needing way more political support. (Maystadt, 2015)

1. CHAPTER - General overview of fiscal policy-making in the EU

This chapter will examine how the fiscal policy has been developing together with various occurrences in economy and with changes in monetary policy-making in the EU. Economic and Monetary Union of the European Union (EMU) is characterized with the heterogeneity of its states and at the same time Eurozone has a homogeneous monetary policy based on a single currency. This makes it crucial to explain the characteristics and segments of fiscal policy-making in the European Union which has been left as a national competence. What will follow is the problematics in coordination of the monetary and fiscal policy-making in the EU, such a specific organization in the world where it is hard to apply any standard theories of policy mix that usually describe their functioning in sovereign nation states or federations. EU does not belong to any of these categorizations and thus has to be analyzed separately. Furthermore, this chapter will be giving a short overview of the historical developments in monetary integration in the EU, combined with the overview of developments in fiscal-policy making. It will be visible how fiscal policy developments have definitely been very much interconnected and dependent on monetary integration in the EU. The background given in *Chapter 1.* will later be of crucial importance for understanding the developments of fiscal policy-making in the EU which took place after the global financial and economic crisis occurred in 2007/08.

1.1. Characteristics of fiscal policy-making in the EU

European Union (EU) and especially Eurozone member states are unique in the world when it comes to the organization of monetary and fiscal policy of their member states, i.e. with the combination of centralized monetary policy while leaving other macroeconomics and structural policies decentralized, especially when it comes to the fiscal policy. Fiscal policy in the EU has been developing as a consequence of further developments in economic and later monetary integration and in the function of the preservation of stability of the single European currency - Euro. Strengthened supranational fiscal governance that member states are facing today is a consequence of global financial and economic crisis and EU fiscal governance reforms that were necessary primarily for the Eurozone member states, which will be elaborated on in *Chapter 2.* Even though fiscal policy is left to be managed at the national level, some integration had to be done throughout the history of the EU integration as a spillover effect from integration in other policy fields.

We can see that the fiscal policy-making has been left in the hands of the member states meaning that, at the moment of monetary union creation, states were not ready to transfer this powers to the EU level. EU is strongly integrated in political, judicial and economic terms which is coupled with central budget, harmonization of taxes and policy coordination. It would thus be very useful to have a more active and powerful role of fiscal policy-making on a central level, but such development are blocked by political unwillingness or extremely slow process of integration characteristic for the EU. (Cangiano & Mottu, 1998) Fiscal system of the EU can be observed through its 3 segments: EU budget, taxation harmonization and coordination on of fiscal policies. Budget is the only instrument which is completely managed from the supranational level and is used mainly for financing of common EU policies. Its macroeconomic meaning thus is not like in usual nation state budgets, as its usage is different and its size is small. The rest of the fiscal system can be seen as a set of rules and arrangements through which member states harmonize and coordinate other segments of fiscal policies, i.e. through taxation harmonization and coordination of fiscal policies through Maastricht criteria and the SGP. (Šimović, 2005)

With this approach to the monetary and fiscal policy-making, European Central Bank (ECB) was unable to act efficiently during the Eurozone crisis, as there were no fiscal policy instruments that could be used to fight the facing crisis. In a heterogeneous monetary union the central bank cannot respond to a purely country-specific shocks because the members of a currency union are refrained from pursuing their own monetary or foreign exchange rate policy, while at the same time an individual member is also only left with fiscal policy as a direct instrument with which to react to idiosyncratic shocks. Unlike monetary policy, the responsibility for fiscal policy in the Eurozone remains reserved for national governments as there is no supranational fiscal counterpart to the ECB.

In theories of public finance, economic roles of different levels of governments are being observed in fiscal federalism area. As a subfield of public finance, fiscal federalism addresses the vertical structure of the public sector and the roles of different level of government. Fiscal federalism thus tries to estimate which competencies should be allocated to which level of centralized or decentralized level of government. (Oates,1999) Even though EU is often connected with the term multi-level governance, its organization is still too special to be settled in these theoretical approaches as its foundations are 28 sovereign nation states managing 28 fiscal policies on national level, whereas EU is left only with the right to exercise those competencies that were given and agreed upon with Treaties. (Oates, 2002) The current debate

thus argues which model of fiscal integration the EU should choose. Current state could be explained with the surveillance model where member stated exercise all the power in fiscal policy and EU only manages the fiscal discipline. On the other hand, one of the options often proposed for the future developments is the classic fiscal model where EU would get all of the powers that are currently belonging to the member states and as such would be able to manage fiscal policy on EU level gaining full fiscal autonomy and authority. (Hinarejos, 2013) These choices should be based on the optimal degree of fiscal decentralization on different levels of government, which is currently harmonized in the EU through coordination of all fiscal policies of EU member states and on harmonized taxation. *Chapter 2.* will be explaining what was happening throughout crisis period and how the EU was moving from the surveillance model towards the state of more fiscal power, but not yet being close to the proposed classical fiscal model.

1.2. The entanglement of developments in monetary and fiscal policy in the EU throughout history

Fiscal policy in the European Union has been developing as a consequence of developments in monetary integration and in the function of the preservation of stability of the single European currency - Euro. The main idea behind the European integration at first was never to allow such widespread devastation as occurred in the two World Wars, which later turned in the process of deep economic integration with its single market and one currency. Integration in the area of fiscal policies came as a consequence of further economic and later monetary integration. Even though fiscal policy stays to be managed at the national level, some integration had to be done during the history of the EU integration as a spillover effect from integration in other policy fields. This part will shortly explain the historical developments of monetary integration in the EU and make it easier to realize how interconnected monetary integration is with a fiscal one. It will also be useful as a background for better understanding of further monetary and fiscal integration which occurred as a result of crisis, but also in understanding of fiscal policy developments of EU member states and on the EU level itself.

Economic and monetary union (EMU) is one of the most innovative accomplishments of the European integration, in monetary and political terms, but also when it comes to significantly strengthened cooperation and solidarity. EMU was created in 1999 together with the ECB, but the Euro was physically introduced in 2002, leading this process to truly supranational monetary policy-making we have today. (Wallace, Wallace, & Pollack, 2005) The idea of further

integration in direction of EMU could be traced back in 1970 with the Werner Report (named after the Luxembourg's Prime Minister and Finance Minister at the time) and a three-stage approach to EMU, but which did not come to life then due to the unfavorable economic conditions. In 1978 The European Monetary System (EMS) is launched, consisting of an Exchange Rate Mechanism (ERM) and the European currency unit (ECU). In 1989 The Delors Report (named after the then Commission President Jacques Delors) sketches EMU creation in three stages which will be implemented in 1990, 1994 and 1999. (European Commission, 2009)

First stage of the EMU creation could be followed from the 1993 Maastricht Treaty, characterized by closer economic policy coordination and liberalization of capital movements, but was also when the convergence criteria was set which states will have to fulfill to join the EMU. Second stage was the creation of European Monetary Institute (EMI), institution that preceded the ECB and which overlooked the creation of EMU together with the convergence criteria on inflation, interest rates, government deficit and debt and exchange rate stability states had to fulfill. Third stage of the EMU creation is the introduction of the single currency named Euro and the three year period of transition from the introduction of the new currency in 1999 and the launch of euro cash in 2002. Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland were the countries that met the required criteria and were set to adopt the euro as a single currency. The main characteristics of the EMU when it was created were that the monetary policy will be managed by a strictly independent ECB who will keep the price stable. Moreover, fiscal policy will remain in the hands of member states, but they will have to respect rules set in the Maastricht Treaty. Macroeconomic and financial policies (e.g. bank supervision) will also stay member states' responsibility. (de Haan, Hessel, & Gilbert, 2014)

The foundations of fiscal integration in the EU have been set during the 1990is, together with the preparations for the implementation of single currency. Stability of this currency depends significantly on fiscal discipline of member states of EMU so many regulations have been implemented controlling the public finances of the Eurozone member states in order to avoid possible negative spillover effects throughout the whole Eurozone. Financial mismanagement in a country could reduce market confidence and lead to higher borrowing rates for all countries.

For that reason, fiscal discipline meant that EMU members had to balance their budgets in middle term and that they had to obey set reference values for budget deficit and public debt. EMU takes the EU one step further in its process of economic integration, which started in 1957 when it was founded, but this time also one step further in fiscal integration. In 1992, the

Maastricht Treaty thus states that fiscal policy will be national competence, but limited by strict rules on public deficit and public debt limits i.e. restricting public deficit to no more than 3% of GDP and the public debt to no more than 60% of GDP. Moreover, fiscal policies will be coordinated on the Council level, while the no-bail-out clause has also been implemented forbidding the monetary financing of public deficits by the ECB. (Ferreiro Aparicio, 2008)

The next step in fiscal integration was in 1997 with the Treaty of Amsterdam and the Stability and Growth Pact which had the goal to ensure that member states maintain budgetary discipline in the EMU. EU Member States agreed to strengthen the surveillance and coordination of national fiscal and economic policies to enforce the Maastricht rules. (European Commission, 2015) SGP at that moment had a preventive mechanism which assumed budgetary balance as a medium term goal, but allowing some discretion in handling fiscal policy when a less favorable economic evolution occurs. (EUR-Lex, 2005) Its corrective mechanism established in a more concrete way the mode of operation for Excessive Deficit Procedure (EDP), i.e. specific sanctions in case states maintain excessive deficits and do not act as it was recommended by the Council. (Alfonso & Alves, 2011) SGP thus satisfied the need for better fiscal discipline, making the budgetary surplus as the main goal, suiting both prudent fiscal governance and price stability required by the ECB.

SGP was later amended with preventive and corrective measures used if some of the member states were not keeping up to the agreed values for budget deficit and public debt. Preventive measures enabled common fiscal control which should act in case of excess budget deficit in some of the member states of Eurozone. Corrective measures represent mechanism which should automatically activate if member state would not remove the excess budget deficit in certain agreed time span. Major reforms of the SGP included longer deadlines for the correction of the excessive deficits, greater attention to the evolution of the structural deficit and the weight of public debt on the GDP as central elements of fiscal sustainability in the medium and long run and inclusion of various factors that could ease situation and not be counted towards the excessive public deficit. (Alfonso & Alves, 2011) Such reforms ended the era of uniform rules where all states had to obey same ones, but inserted more flexibility and consideration for the specificities of each country cases. Even though it was reformed, SGP was often criticized, both before and after the reforms, as it did not manage to keep the countries from breaching the rules from the Treaty, i.e. levels of public deficits and debts were constantly growing in many states and such behavior was not sanctioned.

1.3. Problematics of unsynchronized monetary and fiscal policies

The simplest way to describe what fiscal policy is would be as changes in government spending and taxes designed to affect overall spending. Expansionary fiscal policy is done through an increase in government purchases of goods and services, a cut in taxes and as an increase in government transfers. Restrictive fiscal policy on the other hand is implemented through a reduction in government purchases of goods and services, as an increase in taxes and as a reduction in government transfers. Monetary policy are changes in the quantity of money in circulation where the quantity of money could be used to change the interest rates and spending in a country. Expansionary monetary policy is done through purchases of government securities in the open market, lowering the reserve requirements of banks and lowering the discount rate (Krugman & Wells, 2012). On the other hand, restrictive monetary policy will be done through opposite measures. All these monetary instruments are now in the hands of the ECB in the EU.

While it is easy to apply these definitions to describe functioning of a classical nation state and their management of fiscal and monetary policies, it makes it much harder to apply it to a sui generis organization which EU definitely is. Fiscal policies play a crucial role when it comes to the influence on economic growth and managing all kinds of macroeconomic instabilities and misbalances, but to do so control over budget i.e. expenditures and revenues is necessary, implying also control over the debt that a country is creating. Exactly there we encounter problems when talking about overall control over EU's stability as it is a monetary union, but fiscal discipline is left to be exercised by governments on a national, sovereign state level. When turmoil in economy does occur, member states of the EU do not have the ability to respond with monetary policy as it has been transferred to the EU level, but can use fiscal policy measures and for that reason it is crucial to exercise responsible and well standing fiscal discipline, as country-specific shocks do not necessarily harm the state alone anymore, but spillover the effects of a crisis to other euro zone members.

While monetary policy-making is highly centralized, fiscal and macroeconomic policy-making remains largely national, as does political representation. The challenge for the EMU therefore, is how to be successful and sustainable despite the incomplete nature of its political integration. The long lasting monetary integration is still not finished, but just the opposite - open for further challenges. This implies further integration in the fiscal area as well as the gap between single currency operated from the supranational level and economic governance from a national one has to be lowered. We can see how intertangled the developments of the monetary and fiscal policy integration were. Member states have lost the authority over the monetary policy, while

fiscal one is restricted under various fiscal rules of the SGP needed for stopping the potential negative effects of country-specific problems and shocks. Such spillovers could lead to the possible increase in interest rate of the EMU, put pressures on the ECB to lead expansionary policy and consequently lead to inflation. Thus, we can conclude that fiscal policy rules and more coordination is needed to keep the aim of the monetary policy as well, i.e. price stability.

2. CHAPTER - Overcoming the Euro crisis through the fiscal integration?

After *Chapter 1.* gave us a short overview of fiscal policy-making in the EU and complexities arising from the distribution of competencies over monetary and fiscal policy-making on supranational and national levels, the following chapter will finally tackle the crisis times i.e. period from 2008 till today. An analysis of measures taken during the Eurozone crisis will be given, focusing on their fiscal implications i.e. answering the question if these measures did and if yes, how did they influence further fiscal integration in the European Union. Chapter is starting with a short description of the crisis evolution followed by the main gaps which the crisis has exposed, as that will be helpful for better understanding of measures taken and their implications on policy-making in the EU. Only after these foundations have been given, it is possible to move on to the specific measures taken within EU institutional framework and observe how they influenced the changes in the economic policy coordination within the EMU. Such analysis will allow to tackle the research question of this thesis i.e. did they and if yes, how did these measures influence further fiscal integration in the EU. For that reason, every set of measures will be explained and analyzed in terms of fiscal integration. Chapter will finish with the general, macro overview of the development in terms of policy-making after several years of crisis management.

2.1. Multifaceted crisis of the European Union

When talking about the crisis in the European Union we are mainly referring to the debt crisis which occurred in some of the euro zone member states (notably Greece, Ireland, Portugal, Spain, Italy) and which later worsened as a consequence of weak financial system whose financial actors realized that the current debt situation in these member states is unsustainable and thus stopped financing new debts. (Geeroms, Idee, & Naert, 2014) But European crisis can also be described as indeed multilayered phenomena which started out as a financial crisis transferred from the one with its epicenter in the US mortgage market and which later turned into a debt crisis combined with the severe political and institutional crisis.

Global crisis started in 2007 at the US mortgage market thus initially representing only a small part of the US banking sector, but after the burst of the housing bubble caused by low interest rates, securitization and inadequate measures of risk it has spread further. In 2008 the mortgage crisis firstly transferred to the financial markets and real sector (especially building sector) as a result of massive securitization of mortgage debt. Consequence of a collapse of Lehman

Brothers in 2008, the fourth-largest U.S. investment bank at the time of its collapse that heavily invested in the securities tied to the US sub-prime mortgage market and the largest bankruptcy filing in the U.S. history, were huge shock and negative signals were sent across the global financial market (Wiggins & Metrick, 2014). And just as the Lehman's operations were carried out across the world, banking and in general financial market today are global and huge, operating under similar risk calculations and they thus soon felt consequences of such an enormous failure. Trust was eroded within the banking system and consequently made banks unwilling to lend money to other banks which froze the credit markets. Crisis thus quickly spilled over to the European continent, leading to grand problems in the European banking sector and becoming the start of the first phase of the European crisis - financial crisis. Such quick reaction came as a consequence of greatly interconnected financial sector where U.S. banks are undertaking great part of their operations in Europe and vice versa. Second phase of the crisis - European sovereign debt crisis came to life at the end of 2009, and became even more severe in the following years, especially 2010 and 2011, as certain Euro zone member states accumulated unsustainable public debt and deficits, while financial crisis significantly decreased their liquidity and revealed those unfeasible situations, starting with Greece and followed by Ireland and Portugal (Alessi & McBride, 2015).

Crisis in Greece emerged from the prolonged deficit spending, economic mismanagement, government misreporting and tax evasion. Ireland felt consequences from the housing crisis in 2008 as Ireland's bank had many resources invested in problematic assets connected to the mortgage assets. Government tried to help the financial system in trouble, but was later forced to ask for funds from the EU and IMF while experiencing severe recession. Spain's case could be compared to the Ireland's one. Portugal's problem stemmed from the high foreign debt-financed deficit and due to which country was unable to finance itself once the investors left the country. (Alessi & McBride, 2015) Just like in Ireland's case, rescue package was needed in exchange for austerity measures as the recession hit hard. In Italy, crisis hit later in 2011 when the crisis moved to bigger countries for whose huge public debt there were no bailing out options. Cyprus, whose huge financial sector was deeply interlinked with the one of Greece, accumulated significant amount of Greek loans and sovereign debt. The whole banking sector collapsed in 2013 after it became completely insolvent. (European Commission, 2014)

It is important to note here that irresponsible public policy-making dates back to the introduction of Euro as a common currency. Joining such a monetary union required certain

criteria fulfilled[1], but weak surveillance of these rules existed even before countries joined the Eurozone and continued with even nonexistent sanctions after the creation of the Eurozone. It is thus clear that such unsustainable situation in public finances just waited to explode and that is exactly what happened with the financial crisis. (Benić, 2012) For the full understanding of the rest of the paper, it is also crucial to understand the vicious circle occurring between banks and sovereigns. Banks in Europe are holding a very big amount of government debt and that is the main reason why governments will always be keen on bailing out banks. European governments often encouraged their banks to finance growing public debt piles because many simply do not have enough alternative buyers after an exodus of foreign investors (European Stability Mechanism, 2015). Otherwise, consequences could be terrifying for the economy, causing chain reaction in bank bankruptcies and bankrupt state.

Figure 1. Breakdown of government debt by holding sectors (% of total), selected countries, mid-2011

	Domestic banks	Central bank	ECB	Other public institutions	Other residents	Non-residents (excl. ECB)
Greece	19.4	2.6	22.9	10.1	6.5	38.5
Ireland	16.9	n/a	16.1	0.9	2.43	63.8
Portugal	22.4	0.8	11.2	-	13.5	52.1
Italy	27.3	4.0	5.3	-	26.7	36.7
Spain	28.3	3.5	4.8	-	30.2	33.2
Germany	22.9	0.3	-	0.0	14.1	62.7
France	14.0	n/a	-	-	29.0	57.0
Netherlands	10.7	n/a	-	1.1	21.4	66.8
UK	10.7	19.4	-	0.1	39.5	30.2
US	2.0	11.3	-	35.5	19.9	31.4

Source: Bruegel. Note: The variable considered is central government marketable debt for Greece (2011Q2); central government long-term bonds for Ireland (2011Q2); general government debt for Portugal (2010Q4); general government debt for Italy (2011Q2); general government debt for Spain (2011Q2); central, state and local government debt for Germany (2011Q1); OATs for France (2011Q2); federal government treasury securities for the US (2011Q2) and central government gilts for the UK (2011Q1). For Ireland, holdings by the National Central Bank are included in 'domestic banks' and not in 'public institutions', due to data availability.

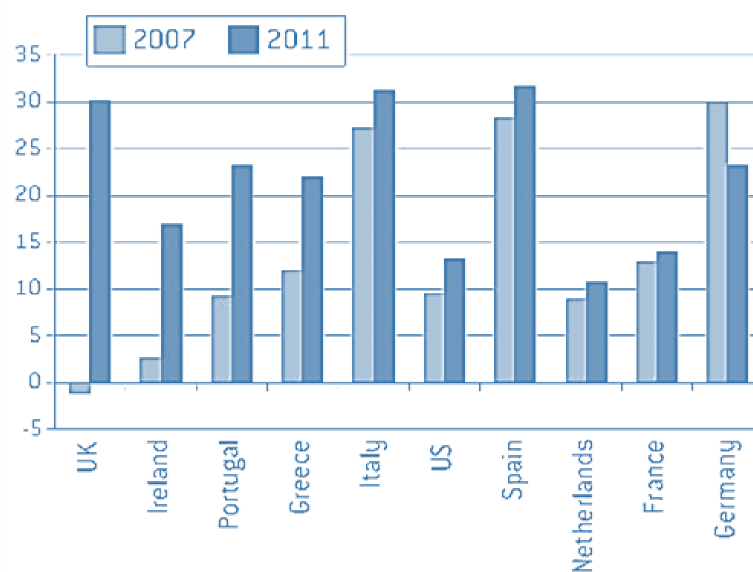
Source: Bruegel

During the financial crisis in EU, some countries decided to financially stimulate their banks, being aware of the amount of sovereign debt in these banks. It would not be risky for banks to hold government debts, but when their holding are so undiversified and oriented towards the sovereign debt, it does become a problem (Figure 1.). In 2007, about 25% of the bonds issued by the state were in possession of domestic banks in Germany, Italy, Spain and Portugal and

[1] Under the Maastricht convergence criteria, states joining the euro must have their economic houses in order, and the 1997 Stability and Growth Pact requires ongoing fiscal compliance.

just a bit less in France, the Netherlands and Greece (Figure 2.). (Pisani-Ferry, The Euro crisis and the new impossible trinity, 2012) On the other hand, such financial stimuli increased the sovereign debt of these countries drastically and resulted in loss of faith of the financial actors who linked the fate of governments with the solvency of the banking system and vice versa. (Geeroms, Idee, & Naert, 2014)

Figure 2. Share of domestic banks in total holdings of government debt, selected countries, 2007 and mid-2011



Source: Bruegel

Today, reasons such as parallel and reinforcing existence of financial and sovereign debt crisis coupled with their longevity and hesitative and slow reaction from the EU side, accumulated and lead to the new form of crisis which could be called political and institutional crisis of the European Union. Such crisis consists of crisis of democracy, crisis of European identity and the rise of Euroscepticism. Primary financial crisis spilled over and showed many structural problems in the EU, including high unemployment, weak banking systems, huge debt and rigid labor markets, is facing with which even more were emphasized in the times of severe crisis. European institutional framework had to be reformed immediately and resolutely in order to fix currently existing deficiencies and reduce the probability of new crisis. (Gabrisch & Staehr, 2014)

2.2. Revealed gaps in the EU governance framework

Complex and multilayered crisis still occurring in the European union clearly showed that not only structural reforms in the member states were urgent, but also that the EU is facing serious institutional shortcomings together with the huge need for some kind of competency over the fiscal policies in the Eurozone member states. More than a decade has been since the EU has become monetary union and its members are still very much economically and structurally heterogeneous with great imbalances. Under these conditions, it is the role of the ECB to maintaining strong monetary policy that has to fit all of its member states which becomes inefficient and almost impossible if the asymmetric shocks do occur. At the same time, individual member states with idiosyncratic shocks possess only fiscal policy, together with the limitations enshrined in the SGP, to deal with their situations which showed to be very dangerous for crisis resolution. (Steinbach, 2014)

Many gaps were exposed during the crisis, including institutional, governance and political ones and calling for an immediate response. Firstly, it has been argued that focus of measures for fiscal policy-making limitations should be on the level of the government debt instead of on budget deficits because it has been showed that government debt is a more significant indicator of fiscal troubles than mere deficit because many countries that were following EU rules on low deficits had problems during crisis as their public debt were too big. Secondly, macroeconomic imbalances[2], i.e. risky macroeconomic developments, had to be better overlooked as they are the ones that lead to serious problems such as distress on financial markets and unsustainable debt accumulation. Moreover, even if the problems were spotted, EU's governance structures and institutions failed to act as they were only giving weak enforcement after a very slow decision-making process which did not give immediate results when necessary. After all of these mechanism failed, financial help was needed to the Eurozone member states but clear and automated mechanism that would work quickly was nonexistent. This resulted not only in catastrophic consequences for the country in urgent need for funding, but also in spillover to the other Eurozone member states as their markets are so interconnected today, and making the whole situation doomed (European Commission, 2014). The euro has been positively influencing countries of the Eurozone, inflation was kept low together with the low interest

[2] *"Imbalances means any trend giving rise to macroeconomic developments which are adversely affecting, or have the potential adversely to affect, the proper functioning of the economy of a Member State or of the economic and monetary union, or of the Union as a whole. Excessive imbalances means severe imbalances, including imbalances that jeopardize or risks jeopardizing the proper functioning of the economic and monetary union."* (Official Journal of the European Union , 2011)

rates for all of them, which later proved to be problematic, for example in the case of Greece and its sovereign debt problem as a result of excessive and uncontrolled borrowing. Greater integration also came with greater spillover effects and the crisis itself easily spilled over in the Eurozone, as a result of bigger financial market interconnectedness, strong trade relations and over-borders asset ownerships.

Under the umbrella of Eurozone, its members can still be characterized with the big structural differences and non-convergence in growth rates, all of which was expected to disappear after the introduction of the common currency. Labor mobility stayed low and fiscal policies imprudent. This means that various economic problems occurring in these countries will be particular for them and having many different problems in different member states cannot be solved with single monetary policy. On the other side, irresponsible and unsustainable behavior of some member states in terms of fiscal policy, paired with the weak surveillance and monitoring activities on the EU level with no sanctioning measures, caused the crisis to become even more severe and harder to solve. Financial markets, on the other hand, got very much interconnected while banks kept a lot of the government debt in their balance sheets. Financial crisis emergence caused distress both for banks and sovereigns whose debt was in these banks which can be explained as complex relationship where one distress reinforced another and was leading to a collapse of financial systems in Europe. (Allard, et al., 2013)

The crisis has thus encouraged plenty of governance changes, often regarding the fiscal discipline. Surveillance has been reformed together with the strengthening of the fiscal framework by intensified EU involvement in national budgetary affairs. Moreover, new mechanism for spotting and correcting economic and financial imbalances have been introduced as they could easily spillover to other Eurozone member states. Also, financial backstops have been introduces to break the risky link between sovereigns and banks, as well as to avoid the risk of moral hazard. On a national level, fiscal consolidation and structural reforms have been planned and implemented. (Buti & Carnot, 2012)

2.3. Implications of measures taken during the Eurozone crisis on fiscal policy-making and fiscal integration in the European Union

Transformation of the global financial crisis into a sovereign debt crisis in the Euro area started from Greece in autumn 2009, where the crisis has prompted European policy makers to take extraordinary measures aiming to limit the crisis fall-out on the affected countries and prevent

its further spreading. (Arghyroua & Kontonikas, 2012) Many plans, guidelines and ideas have been published regarding the crisis and the ways forward including the Report by President of the European Council Herman Van Rompuy "*Towards a Genuine Economic and Monetary Union*" and "*A blueprint for a deep and genuine economic and monetary union - Launching a European Debate*" by the European Commission. These documents finally addressed the deficiencies and problems EU is dealing with, calling for stronger supervision, better enforcement and competitiveness incentivisation. Very important for this thesis is that they called for enhanced economic and budgetary policy integration and steps towards a proper fiscal capacity and discipline. (Van Rompuy, 2012) A lot has been accomplished in a very small time span as the general fear of more crisis, deeper crisis and eternal crisis prevailed while the EU's sustainability and existence was severely questioned. As many of the deficiencies and reasons behind the prolonged crisis were in the fiscal policy coordination, the following pages will review the impact of the measures taken during the crisis and their fiscal implications as it is still an existing challenge on how much of fiscal decision can be considered for a transfer to a supranational level. (Schuknecht, Moutot, Rother, & Stark, 2011)

2.3.1. Six-Pack - fiscal and macroeconomic surveillance through reinforced SGP

Until 2011 the Stability and Growth Pact was a coordination instrument limited exclusively to the fiscal policy metric of government debt i.e. limiting deficits, which was shown to be its major deficiency and a source of huge criticism as it did not manage to secure fiscal discipline and effectiveness, both due to its scope and other institutional weaknesses and as explained in *Chapter 1*. As the sovereign debt crisis emerged and spread in the EU, it has been shown that such limited scope of the SGP competence was not enough to deal efficiently with weak positions of Eurozone member states which stemmed not only from their large public debts, but also from multiple other structural reasons. (Schuknecht, Moutot, Rother, & Stark, 2011) Moreover, institutional and economic framework was not formed in a way which would incentivize reaching good budgetary position during economic times of prosperity. Instead, revenues were spent inadequately and violations of deficit criteria were slowly corrected, i.e. efforts for reaching sustainable budgetary positions were minimal as the SGP was characterized with weak enforcement rules and non-automatism, without ever imposed financial sanctions. (European Central Bank, 2012) All these reasons led to the so needed reforms and new measures when the crisis hit, namely the implementation of the Six-pack.

When talking about Six-pack we are basically referring to a renewed Stability and Growth Pact through five regulations and one directive listed below:

1. Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies
2. Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure
3. REGULATION (EU) No 1173/2011 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area
4. COUNCIL DIRECTIVE 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States
5. Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances
6. Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area (European Union, 2015)

Six-pack is in force since 2011 and represents one of the most significant moves related to the economic governance in the EU since the launch of the EMU which was almost two decades ago, while applying to all EU member states (European Commission, 2011). Six-pack is bringing more efficient and effective legislation and mechanisms for both coordination of fiscal policies in the EU member states and for the surveillance of these policies.

Out of many measures and new legislation brought in the light of the crisis, Six-pack is bringing the most regarding the fiscal discipline among member states and consequently regarding the stabilization of the EU economy. The Six-pack does not only cover fiscal surveillance, but also macroeconomic surveillance under the new Macroeconomic Imbalance Procedure which should be warning member states in case of excess imbalances in their economy. The only directive in the Six-pack sets out minimum requirements for the design and operation of domestic budgetary frameworks. Six-pack regulates i.e. changes preventive and corrective arms of the SGP, creates more options for possible state sanctioning and punishing in case of nonobeyance of rules listed in the SGP. This significantly helps in changing the existing

regulations of the SGP which completely failed as the government debts continuously rose, even in good economic times budget were not properly balanced.

In the fiscal field, the six-pack strengthens the Stability and Growth Pact (SGP). Countries should still respect the usual 3% of GDP ratio for the deficit and 60% of GDP ratio for the debt, but in the medium term they should go towards their set medium term objectives which are budgetary targets that take into account current market conditions and economic cycles. Moreover, the Six-pack adds more to the Excessive Deficit Procedure (EDP) for those countries who did not manage to stay within the fiscal rules set in the SGP, while taking into account current situation if it could not be controlled by the member state. Moreover, under the EDP a country could be sanctioned if its debt and/or deficit is not diminishing at a satisfactory pace and this pace has now been quantified as the significant deviation from the MTO. Sanctions are financial and their amount is getting bigger as the country breached more rules during a longer period, eventually reaching 0,5% of the GDP. Reversed qualified majority voting (RQMV) is another novelty in the Six-pack for the sanction imposture, meaning that a qualified majority of member states will now be needed to reject the sanctions proposed by Commission, thus making them less likely to be rejected. (European Commission, 2013)

In terms of fiscal implications it can be seen that Six-pack has done much in ***fixing the design failures of the SGP*** through stricter and more automated rules as these failures were stressed even more in the times of crisis. Six-pack is bringing more efficient and effective legislation and mechanisms for both coordination of fiscal policies in the EU member states and for the surveillance of these policies. Moreover, the consequence of Six-pack is that more ***rules will have to be respected at the national level, but those rules will be coming from the EU level*** and such trend can be connected to the term of centralized enforcement. There are now three key focal points for sanctions: the existence of an excessive deficit in a Member State, significant deviation from a Member State's MTO and the existence of an excessive macroeconomic imbalance in a Member State. (European Commission, 2014) With these regulations, there is the extension of the capacities for sanctioning Member States for breaches of the fiscal constraints set at the EU level.

Just as the whole process of the EU integration, ***integration in the fiscal fields can be described as slow and gradual***. The EU has addressed the sovereign debt crisis in the euro area by taking measures with one small step being taken each time. Each time financial markets were not convinced and it was soon realized that the measures announced were not enough and more needed to be done. This situation reflects the fact that there is little appetite among member

states for more integration in fiscal policy making. Member states do not want more centralization in this policy area. One may thus conclude that perhaps only such a gradual process of integration was feasible, with member states not willing to accept more fiscal integration than the minimum necessary to address the crisis. Such slow fiscal integration can also be paired with the paradoxical situation where countries **are reluctant for further integration, but the integration is necessary and happening**. The member states are not willing to go for a full fiscal union, but we are now closer than ever to this stage. A fiscal union, whatever its form, implies some loss of national sovereignty in fiscal policy. This is being implemented gradually in the EU, with the first step being made in the Six-Pack and developed further in the economic governance reforms that followed.

2.3.2. Two-Pack - strengthened budgetary surveillance for the euro area

As the crisis escalated even more, Two-pack was added to the Six-pack in May 2013, being binding only for Eurozone members as they very more influenced by the occurring crisis and as such needed additional measures together with the Six-pack. Two-pack consists of the following regulations:

1. Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area
2. Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (European Commission, 2014)

Measures are focused on domestic arena and the budgetary decision-making processes occurring at that stage. They brought more transparency to the decision-making process related to budget as well as more cooperation within the Euro area. (European Commission, 2013) Two-pack thus complements already existing budgetary surveillance and consequently improves policy-making in the EU as further measures after Six-pack were still needed and it is obvious that economic policies, including those regarding budget, pursued in euro area have evident spillover effects elsewhere in the common currency area. (European Commission, 2013)

Two-pack can be seen as ***adding more to the EU law together with previously explained Six-pack.*** And while Six-pack was mainly focused on fiscal reforms and new rules in budgetary policy, Two-pack are new regulations added to bring more coordination. Crisis showed the need for more action in budgetary coordination and more surveillance, especially in the Euro zone as the countries are much more interlinked and dependent. This lead to two new regulations covering budgetary surveillance and coordination together with the strengthening of the total economic stability. (European Commission, 2013) The use of new, additional EU instruments to amplify obligations under EU law caused piling up of the EU legislation and rise in complexity as it risks creation of conflicting interpretation of various laws dealing with similar areas and with different sources of normativity. The Two-pack regulations apply to the Euro zone member states and this could be pointed out as another specificity of crisis measures where we have a creation of ***legislation binding only for certain groups of member states.*** Not just that it stresses the fact that member states belonging to the Euro zone need more measures which will make their policy-making more coordinated, but it also shows that deeper integration in fiscal terms might be crucial for the survival of the Euro zone. Such integration does not have to be necessarily be in form of supranationalism, but also could come from better institutional framework with right mechanisms.

2.3.3. Treaty on Stability, Coordination and Governance and the Fiscal Compact

Fiscal compact is part of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), signed in 2012 and in force as of 2014, is another change in the European economic surveillance framework. It is a treaty which indeed is mostly concerned with the budget policy, providing more automatic sanctions and stricter surveillance. The aim of the TSCG is by adopting a set of rules intended to foster budgetary discipline through a fiscal compact, to strengthen the coordination of their economic policies and to improve the governance of the euro area. (European Commission, 2012) Main elements of Fiscal compact are balanced budget rule including an automatic correction mechanism to be implemented in national law, strengthening of the excessive deficit procedure, numerical benchmark for debt reduction for Member States with government debt exceeding 60% of GDP and ex ante reporting on public debt issuance plans. (European Central Bank, 2012) At its core, the Fiscal Compact requires commitment to reach for a budgetary position that is balanced or in surplus, thus fostering fiscal discipline. This is supported through the imposition of two binding fiscal rules, alongside a requirement for a nationally-legislated ‘correction mechanism’ to ensure

compliance with these rules. (Weymes & Bermingham, 2012) Fiscal Compact is thus bringing two new rules where the Balanced Budget Rule required that the countries are reaching their MTOs at a satisfactory pace, setting the limit at -0,5% of GDP. Debt rule requires lowering of the public debt to GDP ratio of at least 1/20th per year. (Weymes & Bermingham, 2012)

When comparing the Fiscal compact with before explained Six-pack and Two-pack, it is easily noticeable that almost no new measures have been introduced that are different from these in packs. Only few new, relatively small measures have been introduced and are influencing budget policy of signatory states. And while fiscal compact does ***address certain remaining shortcomings*** in the fiscal policy-making area, Commission still has the main say when it comes to fiscal policy surveillance and its implementation with only very limited use of political discretion by the Council. For that reason we can note that the complexity of the overall fiscal framework has not been reduced, since the fiscal compact basically ***adds an additional layer to the existing rules of the SGP and thus adds complexity***. There appears to be a consensus that in substance the Fiscal Compact does not add very much to the governance of the Euro zone: it is primarily a political document that restates much of what had already been in place under the Six-Pack rules in Union law. (Azoulai, et al., 2012) Fiscal compact bring mandatory implementation of the balanced budget rule and automatically triggered correction mechanism at the national level. These measures should increase the sustainability of public finances and the commitment of member states to this goal. Moreover, if these measures will be implemented as planned and enforced as written in regulations, they would perfectly complement and reinforce the rules of the Stability and Growth Pact. As a result, both would be leading to the sound and prudent fiscal policy-making, i.e. ***stronger rule-based fiscal governance framework.***

So far we could see that not many things are new in the Fiscal Compact, but that Fiscal Compact mostly brings measures already mentioned in the Six-pack or other legislation. What can definitely be stressed as special is the fact that the ***national ownership of the fiscal discipline has increased***. Fiscal compact inserts its objectives in the national constitutions of the member states or similar law, making the commitment of the signatories to implement the debt rules in their national law even more concrete. The signatories of the Fiscal Compact have decided to adopt ***same and permanently valid rules in the national law*** concerning the debt brakes. Member states can chose a way of how to implement these rules, but these debt rules are viewed as the right way towards the sustainable fiscal policy-making which will result in no negative spill-overs. Problem stemming from this kind of legislation is already known and seen with the SGP. Member states can introduce these rules in their national law, but even that will not

guarantee that these rules will be completely respected, making us question if the legal or constitutional norm is really binding without true political will. To insure this rules will be respected, main idea would be to set up an independent body in charge of surveillance and monitoring and The Fiscal Compact's regulation require that adherence to the debt brakes be enforced by an independent body.

2.3.4. EURO plus pact

Euro Plus Pact[3] (EPP), subtitled Stronger economic policy coordination for competitiveness and convergence, calls mainly for the cost competitiveness. EPP is an intergovernmental agreement from 2011 and among 23 EU member states, including all Euro zone states[4]. These countries have committed themselves to the Open Method of Coordination, i.e. a procedure from reform implementation where the Commission evaluates the progress of countries while the countries should include their commitments to their National Reform Programmes. EPP is focused on competitiveness of the EU member states through cost reduction which should result in reduction of financial and economic imbalances as they indeed could be a consequence of lower competitiveness on the global market. (European Political Strategy Centre, 2015)

EPP called for national debt brakes to coordinate fiscal policy, and demanded their implementation by member states for the first time. In the Pact, the Eurozone states committed themselves to put EU fiscal rules from the SGP into national law while keeping the freedom to choose the way of how will the translation of that legislation be done. This range of quantitative targets is used to achieve stronger competitiveness and reducing economic imbalance (Gabrisch & Staehr, 2014). The Euro-Plus pact (EPP) is a political control instrument that, unlike other coordination forms, has an intergovernmental character while touching upon many areas of economic policy. Member states are responsible for its implementation that should result in strengthened economic pillars of the EMU which would be impossible without stable economic environment, thus stressing the importance of strong competitiveness, healthy public finances and financial stability.

[3] The Plus reflects the fact that the deal applies not only to the Eurozone states
[4] without Czech Republic, Hungary, Sweden, United Kingdom and Croatia

EPP objectives are the following:

- Foster competitiveness: The Pact provides 'Progress will be assessed on the basis of wage and productivity developments and competitiveness adjustment needs.
- Foster employment: The Pact provides 'A well-functioning labor market is key for the competitiveness of the euro area. Progress will be assessed on the basis of the following indicators: long term and youth unemployment rates, and labor participation rates
- Contribute further to the sustainability of public finances: The Pact provides that in order to secure the full implementation of the SGP, the 'highest attention' will be paid to the 'sustainability of pensions, healthcare and social benefits'.
- Reinforce financial stability: This covers maters such as putting in place national legislation for banking resolution, strict bank stress tests and monitoring macro-financial stability and macroeconomic developments in the euro area. (Gabrisch & Staehr, 2014)

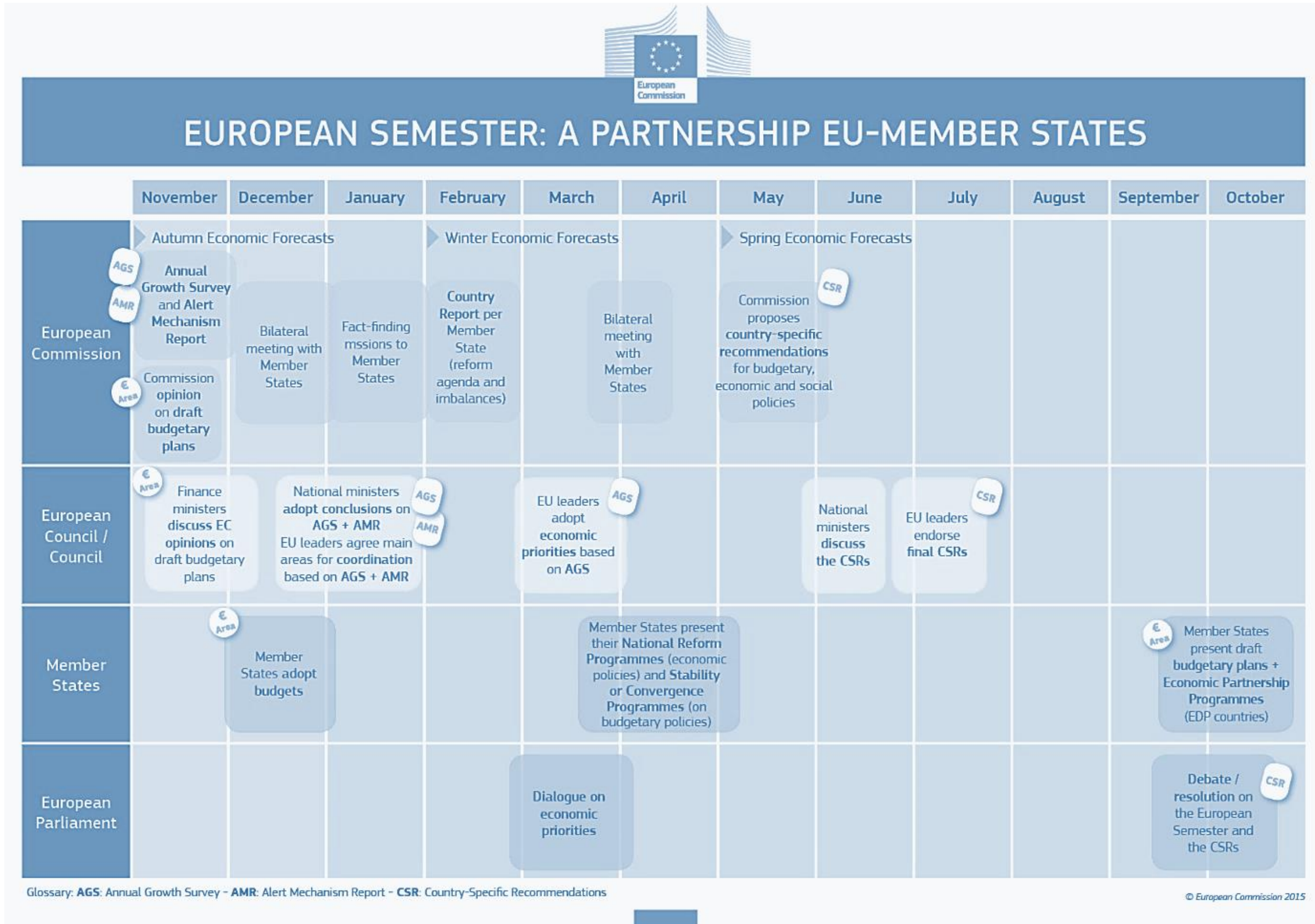
In terms of fiscal implications, it can be argued that EPP ***does not add any additional value*** to the existing measures as its implementation will could end up being very weak due to its intergovernmental and non-binding character. Its value also disperses as it covers many economic policy areas, not concentrating on a few with clear and effective measures. Moreover, it does not have sanctioning mechanism which makes it even harder to enforce than other measures implemented during crisis. In fiscal field it overlaps with the SGP, which already contains measures ensuring the sustainability of public finances. It stays only a nice political touch, without true impact. Furthermore, the ***pact calls for a partial harmonization of fiscal policy***. Under the pact, participants will meet once a year to agree on common targets that will be implemented at the national level. The Pact concerns policy areas that fall under national competences, such as wage policy, pension reforms and tax policy coordination, and hence could constitute an important development in the improvement of economic policy coordination amongst the countries concerned. However, its enforceability may be weak because it involves national policy commitments, which are monitored politically and such systems based on peer pressure usually do not end up as a big success.

2.3.5. European Semester within Europe 2020 context

European semester, as the annual cycle of economic policy guidance and surveillance, represents the implementation of rules, measures and policies set at the EU level and aimed at

EU member states. After a throughout analysis of the member states in terms of fiscal governance and required structural reforms, EU gives its recommendations in order to improve the situation in these countries. Member states then have to implement policies on which they have agreed upon and the process starts all over again the following year (Figure 3.). (European Commission, 2015) European Semester stems from the Europe 2020 strategy and the goals set in it, since they can only be achieved if all of the member states join forces and work hard together, but while acting locally, i.e. on a national level. European Semester represents the expansion of scope of the economic policy coordination and links the implementation of the Europe 2020 aims and the fiscal rules enshrined in the SGP, thus mixing both economic and social policy recommendations with the fiscal policy ones. European Semester thus came as result of the Europe 2020 strategy and the necessary reforms of the SGP, but is today integrated in the Six-pack where it is used to better impact national implementation of necessary law and rules coming from the EU level for the cause of better economic coordination and sustainability. (Steinbach, 2014) It has been seen that the influence of the European Semester and the Country-Specific Recommendations (CSR) has been different for different states. Those with more severe situations and usually smaller countries are taking these CSR more serious, together with their implementation. These states are thus trying to reach the positions recommended by the EU and here we can see the influence and power which the EU has today, even in the fields of economic and fiscal policy-making where it does not officially possess competencies.

Figure 3. European Semester - Annual Plan



Source: European Commission

European Semester ***widens the economic policy coordination*** in the EU. It created a link between the Europe 2020 aims and fiscal policy requirements as the EU is giving recommendations for all of these fields to achieve maximum possible coordination and efficiency of member states' efforts. Among all of these economic policy recommendations, taxing and public finances are also included. While requiring major or even structural reforms of the fiscal governance, EU is contributing to the smoother functioning and more prudent fiscal policy-making on a national level. Consolidation, synchronization and ***expansion of existing forms of cooperation and coordination*** is a clear aim of the European Semester with the main goal of policy alignment among member state i.e. putting an end to the chaos of uncoordinated economic and fiscal policies. It is important to note that the recommendations stemming from the European Semester are not binding, but usually are implemented due to the political pressure. Furthermore, European Semester should increase coordination between budgetary and structural policies as these are now presented and assessed concurrently. Finally, it can be stated that European semester does strengthen the EU level of policy-making by recommending rules, even though they are officially non-binding, and by strongly influencing national level of policy-making which is under obvious pressure to adopt EU level proposals regarding economic policy with fiscal policy included.

2.3.6. European Central Bank as a quasi-fiscal actor

Central banking system of the European Union is characterized by its supranationality where member states have transferred their competencies in monetary policy making to the independent European Central Bank (ECB) with the main goal of keeping the stability of the common currency and unallowed to directly financially support governments of the Euro area. Effective economic policy-making proved to be very hard with the monetary policy on the EU level and insufficient coordination of fiscal policies whose decision-making belongs to the national levels. As certain countries kept large budget deficits throughout history, huge burden was put on the monetary policy and the ECB. (Scheller, 2004)

Financial and sovereign debt crisis in the EU was a big challenge for the ECB which had to keep the financial markets stable and return the trust in them, but also deal with the countries on the verge of bankruptcy. The quasi-fiscal role of the ECB in the crisis could be interpreted through the following actions: Outright Monetary Transactions (OMT) and Long Term Refinancing Operation (LTRO). OMT basically represents the actions of the ECB on the

secondary sovereign bond markets where it purchases the government bonds belonging to the Eurozone states, which could be easily seen as the lender of last resort action. Secondly, LTRO is a way of financing of the European banks which in its essence had an aim to keep the banks liquid by providing them with the cheap loans and avoiding possible collapse of the whole banking system, but later could be seen as an instrument to keep the banks able to buy sovereign debt as they kept on buying government bond from the states in troubles. (Woźniakowski, 2014) The ECB's interventions during the financial crisis have shown that the ECB has recognized a need to engage in monetary policy that has fiscal implications and as such has stepped out of the traditional monetary policy approach and actions. (Steinbach, 2014)

ECB relied first on standard monetary policy measures to manage liquidity. This quickly led to the ECB to give up control of the monetary supply in order to provide banks with unlimited liquidity. Yet, even more serious from a fiscal policy view was that the ECB had to weaken its usual safety mechanism in order to expand the liquidity available to banks. Among other moves, it lowered the credit quality threshold for its main refinancing operations from A- to BBB-. This was especially important for stabilizing the banking sector in Eurozone nations such as Greece, Italy, Spain, Portugal and Ireland. All of these countries had suffered bond rating downgrades, and largely financed their sovereign debt through the domestic banking sector. (Steinbach, 2014)

ECB is not allowed to directly bail-out countries on primary markets, i.e. while buying their debt. On the other hand, nothing is written in EU law about ECB acting on the secondary market so that is exactly how ECB decided to act when using OMTs. Through OMTs, ECB was buying sovereign bonds on the secondary market and thus gave thumbs up to the banks to buy these kind of risky instrument, which they usually would not buy. (Woźniakowski, 2014) Consequently, this course of action has led to ***the occurrence of moral hazard*** simply because it has led governments to believe that they can always count on the ECB and its funds and rescue measures in case of big distress and thus it has created discentives to act properly in the times to come. (Steinbach, 2014) Quasi-fiscal role of easing government finances by purchasing their debt thus has severe consequences for the future fiscal-policy making in these states making their actions risker and relaxed. Some of the attempts to reduce the occurrences of moral hazard were through the conditionally for the participation in the ESM and EFSF, forcing the countries to undertake necessary reforms and keep their public finances sounds and prudent.

Quasi-fiscal role of the central bank strongly influences the power given to the fiscal authorities, i.e. legislative branch of the government. It means going against the divide of the monetary and

fiscal policy powers enshrined not only in laws, but also constitutions. (Buiter, 2009) Of course, to make a clear-cut separation between fiscal and monetary policy is often close to impossible in a certain economy, but the better the economy is managed, the more these two policies are separated. As such, they are acting towards goals which are they field and in which they more efficient. (Tanzi, Bléjer, & Ter-Minassian, 1997) Quasi-fiscal role of the central bank most often though does stems from weak fiscal institutions when they are for example unable to collect necessary revenue. (Tanzi, Policies, Institutions and the Dark Side of Economics, 2010) All monetary policies which deal risky with money which comes from the taxpayers could be called quasi-fiscal policies i.e. investing government funds in risky assets. Moreover, this means that officials working for the ECB, who are experts but at the same time unelected, will be deciding and influencing policies which citizens think belong to the elected government thus ***blurring the lines between fiscal and monetary policies.*** One can interpret it by saying that ECB never got the power of redistribution assigned to it and for that reason, acting in a quasi-fiscal way, could be seen as a breach of democracy and democratic order. Main role of the ECB is price stability and other mandates could violate its independence as the use of taxpayers' money necessary requires political responsibility.

2.3.7. European Banking Union

Banking union is as a set of mechanisms whose aim is supervision and resolution of the EU banking system which should lead to the financial stability and later on growth in the Euro area while being one of the biggest economic policy measures introduced in the last few decades. (European Commission, 2014) Banking regulation and supervision are key elements that have to be tackled in order to resolve the current situation that Eurozone is facing and whose implementation should lead to the dislinkage of sovereigns and banks. (Viral, et al., 2012, p. 7) All participating countries will be under the supervision coming from the ECB and on these countries measures will be taken by a Single Resolution Board in case of bank failures which will be financed by banks themselves and not from the taxpayers money. This will lead to a safe financial sector for the EU's single market as legislation will be on EU level for all the participating member states. The single market and the banking union are thus mutually reinforcing processes. (European Commission, 2012) The single market for financial services is based on common rules which ensure that banks and other financial institutions which under the Treaty enjoy rights of free establishment and free provision of services are subject to equivalent rules and proper supervision across the EU. The creation of the banking union must

not compromise the unity and integrity of the single market which remains one of the greatest achievements of European integration. (European Commission, 2012)

Banking union main elements are Single rulebook, Single Supervisory Mechanism and a Single Resolution Mechanism. Single Rulebook is its foundation with the aim of complete legislation harmonization across the Union. As such, it represents all the legal rules, as well as administrative standards, which will be used and applied in order to achieve proper regulation and supervision of the financial sector in order to achieve efficient governance in all EU countries. Single Rulebook is to ensure the consistent application of the regulatory banking framework across the EU, but at the same time to allow new regulatory framework that has to be shaped in such a way to leave a certain degree of national flexibility, as credit and economic cycles are not synchronized across the EU. (European Banking Authority, 2014) Two mechanisms are also added to the whole story, based on the European Commission roadmap for the creation of the Banking Union, namely Single Supervisory Mechanism and a Single Resolution Mechanism.

The Single Supervisory Mechanism (SSM) represents banking supervision which should be independent and supranational while ensuring sustainable functioning of the monetary union. (European Central Bank, 2014) Constant and strong supervision will, together with other implemented measures, restore the confidence of all parties engaged in the EU banking sector. SSM is complementing the Single Resolution mechanism which must ensure that, even with fierce supervision, banks that do face serious difficulties could go through a resolution offered by the SRM. Such resolution has to be managed efficiently which entails minimal costs for taxpayers and the real economy through Single Resolution Board and a Single Resolution Fund, financed by the banking sector. (Official Journal of the European Union, 2014) In other words, in a rare case when a bank fails or is at risk of failing, the SRM will come into play and make sure that the problem is solved in a way which ensures best option for all stakeholders including taxpayers, banks, deposit-holders, where the best option equals to the financial and economic stability of the entire Union. The Single Resolution Board will contribute to re-establishing a safe and sound financial market putting in force reliable resolution planning and by removing obstacles to resolution. (Single Resolution Board, 2014)

Creation of a meaningful banking union has far reaching consequences for resolution policies and fiscal policy, a strong system needs to be put in place. Clear decision-making power is crucial here so that decisions about bank resolution and about distribution of costs are taken

quickly and effectively. Also, the democratic legitimacy of those decisions needs to be strengthened significantly. (Pisani-Ferry & Wolff, The fiscal implications of a Banking Union, 2012) Banking union is important in fiscal terms as it is going to ***reduce possibly large fiscal costs.*** Banking union's purpose is making the risk of banks getting into situations requiring crisis management tools much lower and making EU better prepared if crisis do occur. This Union will help to restore financial stability and confidence in Europe and its banks. Consequently, this will help create the right conditions for the financial sector to lend to the real economy, spurring growth and job creation as Europe's number one priority today. Even though European banking union has been discussed before, it came to an agenda only after the crisis has hit the European Union hard, especially those interconnected member states belonging to the Euro zone. It has been seen how easily banking crisis could cause large fiscal costs and seriously endanger sovereigns and their budgets leading to sovereign debt crisis resulting from the deficiencies of governance structures and political constraints in the EU.

The banking union is aiming at ***disconnecting banks and sovereigns i.e. their risks*** which were so far very interlinked. EU is aiming at creating a fierce banking system, resilient to any occurring shocks. Stricter prudential supervision, certain levels of capital reserves and of required liquidity ratios are put in place and will disable the occurrence of bank failings. In case such scenario does occur, these banks will be resolved with financial means coming from banks themselves, and thus keeping the taxpayers safe, as well as governments. Banking union is a part of a larger reform package addressing sovereign fragility and the entanglement of banks with sovereigns, but also another brick in the foundations of the EMU. As such, banking union is not only a measure for the current crisis, but carefully designed system that will significantly influence in the prevention of any future crisis. Moreover, it represents a measure that leads to a further integration during the times when unsustainable policies had to be immediately changed. Sustainable currency union will be attainable only with ***further integration*** by creating an "ever closer union" among the peoples of Europe as it is stressed in Article 1 of the Lisbon Treaty, including both monetary and fiscal integration.

2.3.8. From temporary European Financial Stability Facility (EFSF) to the European Stability Mechanism (ESM)

The European Financial Stability Facility (EFSF) is a company which was agreed on by the countries that share the Euro in 2010 and whose objective is to preserve financial stability of Europe's monetary union by providing temporary financial assistance to Euro area member

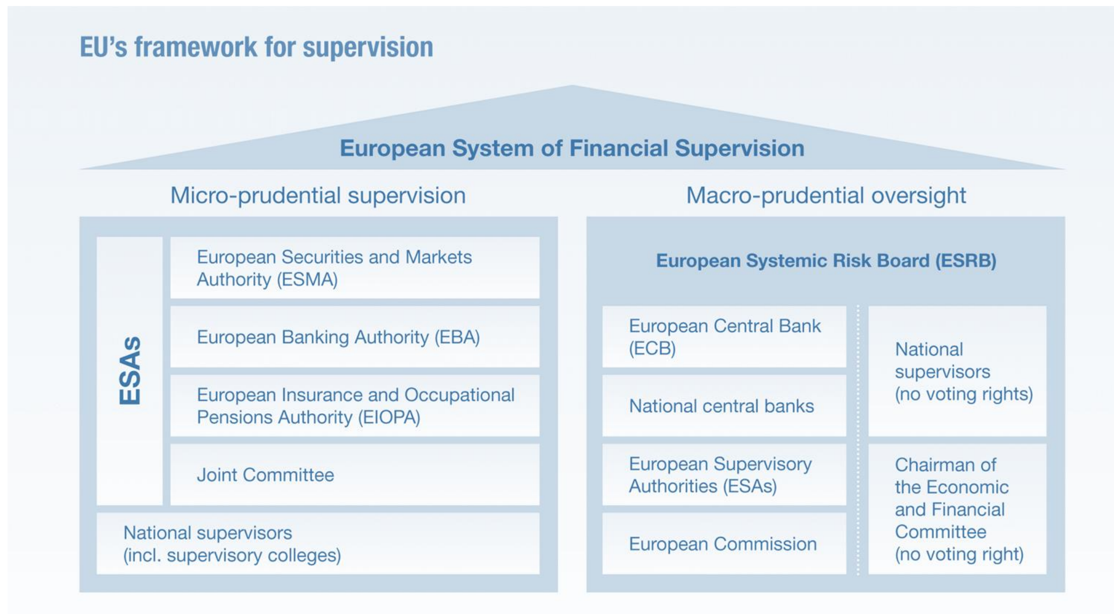
states if needed. The European Stability Mechanism is the permanent crisis resolution mechanism for the countries of the euro area. The ESM issues debt instruments in order to finance loans and other forms of financial assistance to euro area Member States. As of 1 July 2013, the EFSF may no longer engage in new financing programs or enter into new loan facility agreements. From that date, the European Stability Mechanism is the sole and permanent mechanism for responding to new requests for financial assistance by euro area Member States. The EFSF will remain active in financing the ongoing programs. The EFSF will be dissolved and liquidated when all financial assistance provided to euro area Member States and all funding instruments issued by the EFSF have been repaid in full. European stability mechanism (ESM) is an intergovernmental institution and a permanent crisis resolution mechanism for the euro area providing financial assistance to euro area Member States experiencing or threatened by financing difficulties, but under strict conditionality. ESM has the capacity and resources; with €80 billion of paid-in capital and a maximum lending capacity of €500 billion, of act as a financial backstop and apply a lending instrument that will stabilize the financing needs of that country through bonds issuing, intervention in primary and secondary debt markets, financial recapitalization of financial institutions through loan to governments. (European Stability Mechanism, 2014)

It is important to note that the ESM is ***very much interconnected with the Fiscal Compact***. Financial assistance from the ESM can reach the member state requesting it only under the condition that the Fiscal Compact has been ratified in that state. The beneficiary state should also show that it has no other ways of financing its debts, for example through private sector. ECB will only purchase government debt on secondary markets if the country has applied to the ESM. This move of the ECB transferred it from the exclusively monetary actor taking care of the inflation to an actor which will interfere in the affairs of national public finances while strongly linking the ECB activities and ESM functioning. This means that ***the strong divide between what monetary and what fiscal authorities has been blurred*** and the enhanced cooperation between them occurred as the ECB will now have to be consulted for all of the fiscal packages given to the countries in economic distress in close cooperation with the ESM. (Steinbach, 2014)

2.3.9. European System of Financial Supervision: European Systematic Risk Board and European Supervisory Authorities

European System of Financial Supervision (ESFS) is a result of process of reformation of a European financial supervision system which took place between 2009 and 2011, consisting of the European Systemic Risk Board (ESRB) and three European Supervisory Authorities (ESAs): European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA). (European Commission, 2014) The need for the deep reformation of the financial system occurred in the light of the crisis, calling for urgent changes in both microprudential and macroprudential controls. ESRB today is contributing to the stronger and more sustainable functioning of the financial sector on the macro level, while ESAs are in charge for the microprudential supervision. ESFS functions with ESRB providing timely warnings of system-wide risks together with possible steps to make in a process of risk resolution, thus addressing one of the major weak points of very much interconnected and complex financial system of the EU. Moreover, ESAs will be dealing with individual financial institutions in close collaboration with national supervisory authorities, while deriving power from the option of creation of binding decisions and rules. Main goals of these reforms and new institutions were, together with other adopted legislation in terms of financial regulation, to create safer and sounder financial system in Europe. (European Commission, 2010) ESFS has been established and imagined well but it does need a stronger foundation, i.e. stronger decision-making and more consistency, as it will not have any effects without harmonized and consistent usage throughout the whole EU. (Demarigny, McMahon, & Robert, 2013) Even though ESFS has performed well in general, it will be regularly reviewed and corrections will be made if needed and until its full effectiveness does not take place.

Figure 4. European System of Financial Supervision



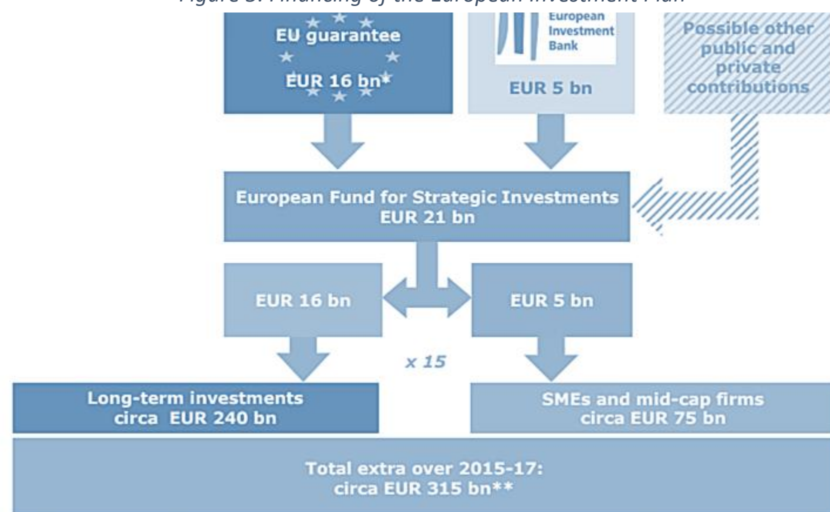
Source: European Commission

Seen from this last crisis, banking crisis can easily turn into a sovereign debt one where governments and consequently taxpayers are covering the loss of the collapse on the financial market. ***Fiscal policy-making and decision in the time of crisis as well as financial supervision are very much interconnected***, crucial in crisis resolution and reaching a stable position. (Goodhart & Schoenmaker, 2006) For those reasons European System of Financial Supervision is being described here, even though it is not directly related to the fiscal-policy making, but then again it is crucial in lowering or even completely diminishing fiscal costs stemming from the financial crisis which can be so large to cause transformation of crisis to the sovereign debt crisis and even state bankruptcy. Financial and banking groupations are operating in all EU countries in today's globalized business world, thus potentially causing great fiscal costs in times of crisis, as the spilling-over effect is even easier and especially dangerous for smaller countries with lower budget capacity. To sum up, it is of the utmost importance to nurture both the sound fiscal policy-making and proper risk management in the financial sector because the cross-border fiscal costs in times of financial crisis would be too big for some countries to cover.

2.3.10. European Investment Plan 2015 vs. European Economic Recovery Plan 2008

European Investment Plan (EIP)[5] is a major new initiative created to deal with the investment gap EU is facing ever since the investment peak at 2007 and fall of around 15% ever since. Investment plan, which should deliver more than €300 billion of additional investments in the following three years, consists of three key parts: smart mobilization of private and public resources for financing without creation of new public debt, viable projects provided with the necessary technical assistance and removal of sector specific and other financial barriers for the improvement of financing conditions. This plan is trying to put together structural reforms, fiscal responsibility and investments at national and EU level, all of them being crucial factors for the economic recovery in the EU. (European Commission, 2015) This investment mechanism will function through the European Fund for Strategic Investments (EFSI) where €21 billion of initial funding is EU funding consisting of the €16 billion guarantee and €5 billion of European Investment Bank's (EIB) own resources.

Figure 5. Financing of the European Investment Plan



Source: European Commission

Similar plan was put into action in 2008 under the name European Economic Recovery Plan with main aim to boost demand and restore confidence in the European economy, mostly orienting on a short-term measures, but also mentioning long-term sustainability, both achieved with the counter-cyclical macro-economic measures. (European Commission, 2008) Plan was criticized for lacking the true will and impetus for the structural reforms and smart investments,

[5] often called the „Juncker Plan“

but it did contain important notions of dealing with the fiscal sustainability and protection of the Single market. Even though the Plan has achieved some positive stimulus, long-term prospect was not sufficient in the rough crisis that followed. (Zuleeg & Martens, 2009)

Investment Plan uses public funds to create more private investment, thanks to its public fund guarantee. In a critical fiscal situation Europe is in, this is a ***good way of managing limited public funds*** in order to create an investment boom and multiply the invested public money since other ways to raise more funds for investment do not exist. (Zuleeg, 2014) Many are doubting if this plan will add any or sufficient additional value for Europe that surely does need to finance necessary reforms and to restore fiscal credibility. Moreover, it is argued that this plan bring together all element EU would need to transform itself into a fiscal union without really calling it that way. (Mahony, 2014) Here it is important to note that with the predicted amount of invested public funds, even if the expected leverage is not fully achieved, at least some of the project will succeed i.e. some amount of new investment in the private sector will be created. On the other hand, if the situation turns out completely opposite and there are more profitable projects than initially predicted, it will be easy to add more funding to the EFSI and help in creating an opportunity to stimulate growth, but also in conducting of structural reforms and further efforts for reaching needed fiscal discipline.

EIP is often represented as a new start based on investment, growth and jobs for Europe. With the rise of debt levels from 60% of the GDP to 90% in just few years, it is clear that public funds have to be used to unlock investment instead of debt repayments or no recovery will follow. (Juncker , 2014) Member states have been trying hard in the process of reaching greatly needed fiscal discipline, while following many measures brought by the EU throughout the crisis times. One has to be aware that without fiscal stability and renewed trust in the EU member states public finances, processes of further growth and increase in competitiveness will also not reach required levels for the economic recovery. This ***plan is shifting the attention of reforms from the crucial fiscal field, on which EU has been working ever since the crisis occurred, to the fields of investments***. Many will argue that EU without doubt needs investment and growth, but will be able to achieve so only in combination with other reforms whose importance cannot be denied. Fiscal governance still has to stay a top priority, as it was throughout the last few years. On the other hand, reforms in the fiscal arena can support the EIP through its promotion in the European Semester, reforming the EU Budget while orienting on EIP focused investments or of course, through proper EU wide national structural reforms which will create proper conditions allowing the biggest possible multiplying effect to take

place while EIP is being done. It is clear that focusing only on fiscal reforms did not bring much during the last couple of years and measures in terms of optimistic-looking economic recovery and orienting on fiscal measures together with concentration on such investments which promote growth and increase demands, definitely is what Europe need more than anything. With the use of monetary policy only not much will be accomplished, but the right balance of fiscal reforms and actions through an investment strategy which combines national and supranational expertise might do the job. (Schneider, 2015)

EIP is getting its funding from the voluntary contributions from the states, while not adding these contributions to the required 3% government budget deficit calculations, thus ***bringing crucial flexibility and balance between needed fiscal consolidation and economic growth***. It can be noticed then that this Investment Plan still applied the rules of the SGP, but in a looser fashion thus trying to once again help to the member states in economic distress and give another opportunity for growth and reformation. Completing fiscal responsibility and structural reform with innovative investment plans and instruments with a ground-breaking investment plan which will mobilize all levels of government. Full recovery needs restored fiscal discipline, together with drastic structural reforms and finally - investments. (Juncker, 2014) Current President of the European Commission stresses the importance of this plan because it is the first time to combine all of these crucial components together. ***Giving more flexibility in the interpretation of the SGP fiscal rules*** or by giving more importance to the public investment in the European Semester, especially to the member states with better fiscal position, gives more opportunity for the profitable public investment which later can stimulate private ones. Another point here is the paradoxical situation where states with better fiscal situation are unenthusiastic about more spending and investing, while those that are in dying need are very much limited by multiple fiscal rules. Further loosening of these rules might stimulate quality public investment with high multipliers and returns on capital. (Schneider, 2015)

3. CHAPTER - Further developments in terms of fiscal integration

"It remains necessary, for citizens and markets alike, to develop a long-term perspective on how the framework of EMU should develop, where it could be considered complete, and where further work will be necessary to develop stronger common governance. […] The euro area has not recovered from the crisis in the same way as the U.S., which might point to the fact that an incomplete monetary union adjusts much slower than one with a more complete institutional setup in place." (Juncker, Tusk, Dijsselbloem, & Draghi, 2015)

Above quoted sentences perfectly reflect on what is necessary for the future of the EU and where are their leaders taking it. Many quick and resolute measures were taken during the crisis, but now it is time to think about the future influence of these measures and turn them into a long-lasting and democratically legitimate base for future integration. Conditions in which states found themselves during the crisis where truly extraordinary, but they should continue to act decisively on a way to the stronger EMU. (Juncker, Tusk, Dijsselbloem, Draghi, & Schulz, 2015) The question of further developments in the EU in terms of fiscal integration will mainly depend on the willingness of member states to accept significant transfer of national competencies to the European level paired with the need of giving more political legitimacy to the EU and its institutions. It would be impossible to transfer fiscal policy-making on the EU level where we would have independent and technocratic decision-making processes as is the case of the ECB, thus higher political representation should accompany the process of fiscal integration. Countries are ready to transfer some competencies, but still excluding those having the highest political sensitivity such as taxation.

Short term future will probably be marked with the usage of legislation and institutional framework we have established until today for boosting competitiveness and structural convergence, completing the Financial Union, achieving and maintaining responsible fiscal policies at national and Eurozone level and enhancing democratic accountability. On the other hand, after some time the foundations for bigger change will be created, namely in way for fiscal union as it has been proved that fiscal policies are vital part of the EMU functioning and that they can harm price stability and cause negative spillover effects and distress in financial markets. Even if Eurozone member states continue to decide on fiscal policies, i.e. taxation and budgetary expenditure based on national interests, with the evolution of the EMU pooling of sovereignty will become a necessity as it will not remain sustainable without common decisions and common path of development. More integration would make the occurrence of future crisis

less possible and less significant, as well as easier to manage. Transfer of even some powers in benefit of centralized fiscal policy would make the idiosyncratic shocks less likely and protected with various mechanisms and backstops on a supranational level. Of course, all this comes under the assumption that the future EU governance system, both monetary and fiscal, would be designed to function efficiently and prudently.

The euro area is now at crossroads, going either towards more fiscal integration which would imply certain loss of national sovereignty in that field, or could go for a decentralized solution where fiscal policy-making stays national but under a strict condition without bail-out option (Sapir & Wolff, 2015) The newest report by J.C. Juncker for the EMU choses the first solution:

"*…need to shift from a system of rules and guidelines for national economic policy-making to a system of further sovereignty sharing within common institutions, most of which already exist and can progressively fulfil this task, In practice, this would require member states to accept increasingly joint decision-making on elements of their respective national budgets and economic policies*." (Juncker, Tusk, Dijsselbloem, Draghi, & Schulz, 2015)

This is just a continuation of what has been discussed during the whole period of crisis namely in the reports "*Towards a Genuine Economic and Monetary Union*", '*Blueprint for a Deep and Genuine EMU*' of 2012 and the Analytical Note '*Preparing for Next Steps on Better Economic Governance in the Euro Area*' of 12th February 2015. All these reports stress the crucial importance of the integrated financial, budgetary and economic policy framework paired with the strengthened democratic legitimacy and accountability. Today, we do have improved fiscal policy-making with better surveillance and coordination, but they do still remain largely nationally owned. Making the changes addressed in the above mentioned reports will be though as the nation states' political will for integration which would include the loss of sovereignty does not grow.

Development towards fiscal union could happen in various ways and shapes as well, as it will be a consequence of many political and economic environmental factors. But it is clear that it has to address fiscal policy-making integration to indeed stop and make the future crisis less severe. In the short term, EMU should be strengthened through the current governance. Latest suggestions coming from the President of the European Commission call for the creation of the European Fiscal Board, which would coordinate and complement the national fiscal councils that have been set up in the context of the EU Directive on budgetary frameworks, thus clearly acting on EU level and leading to the better respect of the EU fiscal rules and better coordination

of fiscal policies. Moreover, more mechanisms for dealing with the country-specific shocks are necessary as the way to the fiscal union must be ensured from big macroeconomic imbalances. (Juncker, Tusk, Dijsselbloem, Draghi, & Schulz, 2015)

Minimum requirements for a fiscal union would entail a common set of fiscal rules, mechanisms for crisis intervention, fiscal equalization and transfer mechanisms between countries and a common budget. (Vetter, 2013) We can easily recognize that the first two elements, namely fiscal rules and mechanism for crisis intervention, have already been put in force, especially during the crisis. SGP was amended with even stronger rules with Six-pack, while banking union, EFSF and ESM have been introduced to create safer environment for the financial markets. On the other hand, fiscal equalization and proper common budget are still not a reality. In any case, with or without fiscal union, simplifying the fiscal governance framework, while making the enforcement more serious and automatized is crucial step forward. In other words, no matter how do we call future developments in fiscal policy-making, the aim is just to reach stability and sustainability of the European Union, after it has recovered from the crisis.

We are very far from a proper fiscal union with central budget, supranational taxes, commonly issued debt (e.g., Eurobonds) and fiscal transfers between member states. (Ioannou, Leblond, & Niemann, 2015) On the other hand, we are moving step-by-step toward more integrated Europe, including the fiscal integration.

CONCLUSION

The crisis in the European Union which emerged from a financial one to an even more dangerous sovereign debt crisis, has showed us that the EU has severe institutional deficiencies which came to light during the crisis. The crisis thus exposed structural problems such as unsustainable debt levels in some EU member states stemming from inappropriate fiscal discipline, but also how interconnected the EU states are and how quickly negative spillovers can endanger the whole Eurozone. The root cause of all these problems could be tracked back to the creation of a single monetary policy accompanied with nationally managed fiscal policies, restricted only by rules coming from the very much criticized Stability and Growth Pact. Under the Pact these rules were frequently not followed and not sanctioned if breached. In other words, heterogeneous member states were united under the umbrella of a single currency, i.e. homogenous monetary policy while states faced the challenge of great economic turmoil. This thesis thus argued that the states were overcoming the crisis through fiscal integration, even though they were reluctant to give more of their sovereignty to the supranational level of the EU.

During the crisis, the EU faced a situation where new solutions in both the financial sector and in fiscal regulation were necessary and urgent. These solutions unfortunately came very slowly, in a classical EU step-by-step fashion and with careful integration where states were cautiously weighing where to give up their sovereignty and where not. Results were strengthened through fiscal and macroeconomic policies on the EU level, which mitigated some impacts of the crisis and hopefully will be helpful in any future crisis as well. But to really be able to cope with interdependent global markets and harsh crises, deeper fiscal integration is necessary, implying deeper political integration as well.

Much has been done regarding the fiscal discipline in the EU as of 2008, mostly as a consequence of the failed Stability and Growth Pact which did not manage to achieve that goal. In terms of fiscal policy-making i.e. through surveillance and coordination, the most prominent moves were the introduction of the Six-Pack, Two-Pack and the Treaty on Stability, Coordination and Governance -- also known as the Fiscal Compact. Measures touched upon budgetary and fiscal rules while reforming the SGP and hopefully will lead to better results than the SGP in its original form, both in times of recession and expansion. Moreover, measures have been taken slowly as the member states did not want to rush into them, being afraid of too much integration and loss of sovereignty. Resistance towards centralization is resistance

towards more integration and, while only some integration was allowed by the states, such behavior showed the unwillingness of the member states for more integration. We did see though that integration still happened, despite the hesitancy of the member states, as it was truly unavoidable.

It is clear that some parts of the fiscal policy-making are being transferred or strengthened at the EU level. EU institutions have been getting more power during crisis times, controlling and restraining member states' budgets. Both the European Commission and the European Central Bank got out of this crisis as bigger players, having more powers over the member states and some aspects of their fiscal policies. Such power was gained by gradual implementation of more and more legislation, mechanisms and processes, as the member states did not want more fiscal integration than really necessary. It can also be seen that the unstable economic conditions necessitated further integration and made it indispensable, no matter what the member states' wishes were.

Moreover, many new bodies and mechanisms have been set up at a central level now, as it has been seen that they are crucial in ensuring the smooth functioning of the whole European Union and reducing the risk of new or more sovereign debt crises. Such mechanisms are complemented with stricter fiscal rules, also coming from the EU level and are to be implemented on a national level, even though the biggest part is of course still on a national level. We can sum up by saying that national sovereignty in fiscal policy-making was touched, but the situation is not even close to a full transfer of fiscal powers to a supranational level even though economic policy coordination was improved, including fiscal policy-making. Politically sensitive issues connected to state sovereignty are still off the table when it comes to the institutional reforms of the EU necessary for the better coordination of fiscal and monetary policies. Such a situation could bring problems regarding the further implementation of measures brought forward during the crisis i.e. it could result in similar disregard of rules which caused the failure of the SGP.

Several points should thus be pointed out as main outcomes of the crisis. First of all, integration in the fiscal field happened, but it was slow and gradual. This means that member states are reluctant for further integration, but as integration is absolutely necessary in some fields of fiscal decision-making it is thus happening, even though states are unwilling to lose even more sovereignty. All of the legislation resulting from the measures that were necessary to cope with the crisis, added more complexity and layers to the existing EU legislation, possibly creating increasingly complicated situations and interpretations of the law. Moreover, it has been seen

that fiscal policy-making has to be prudent, but also paired with the smooth functioning of the financial sector due to their high level of interconnectedness. Failures in the financial sector could easily cause huge fiscal costs and for that reason it is crucial to add reliable measures to both sides.

Future development in the EU will definitely be challenging as the high levels of debt remain a reality, paired with the unsatisfactory will of member states for further fiscal integration. Moreover, the biggest problems in the EU such as high unemployment and insufficient economic growth require efficient governance whose reformation is happening in a slow, step-by-step style and cannot be done in a short time span, and as such requires patience and strong dedication to the future integration. The sustainability of the Eurozone as well as its advancement require fiscal and structural coordination. To achieve such goals more supranational decision-making will be needed to be able to answer to all of the country-specific shocks as well as global challenges.

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