

Fiscal Policy-Making in EMU

Empirical question and approach

The thesis seeks to analyse the emergence and the functioning of the mechanisms for fiscal policy-making in the European Monetary Union with regard to the question, how the actors preferences are formed and how they are pushed through in the multi-level system of EU policy-making. The analysis follows an actor-centred approach (as outlined e.g. by Moravcsik 1997) inspired by rational choice theory, yet puts a strong emphasis on the impact of institutions and the way interests are formed and realised in the systemic context of the EU. A conclusion from the analysis of the way preferences are formed and then met or violated could be an assessment of the potential for change inherent in the current set-up

Political relevance and policy significance

EMU is unique in the way it combines a single monetary policy with national economic and fiscal policies. Strong interdependencies among monetary and fiscal policies (as e.g. von Hagen/Mundschenk 2001 argue) have led to some degree of policy co-ordination. Yet, national hesitation to surrender further parts of national sovereignty to the EU-level has produced an outcome which does not correspond to the economic policy-making setting in nation states: The single monetary policy is neither matched by a unitary economic or fiscal policy, nor are there transfer mechanisms as exist in other monetary unions. This has led to criticism both from economists and political scientists, who see the danger of sub-optimal outcomes in economic terms, the danger of defection in times of crises, or deficits as far as legitimisation, transparency and efficiency are concerned (for an overview see Mooslechner 1999).

For fiscal policy-making, the start of EMU can be considered as a regime shift: From 1993 to

the assessment of the convergence criteria in May 1998, the sanctioning of excessive deficits was two-fold: 1) The political sanction was the exclusion from EMU due to not meeting the convergence criteria. 2) The market sanction were higher interest rates on public debt due to risk primes when the debtor was not considered credible, which again was relevant for the convergence assessment.

With the launch of the Euro, this setting has changed. While there still is the a theoretical possibility of applying sanctions by means of the Stability and Growth Pact (SGP), the current set-up can better be described as one in which policy-co-ordination occurs (if it does) through soft law and peer pressure. Market sanctions still apply: Risk primes are now even more clearly related to the countries fiscal policies, as the compensation for risks caused by exchange rate variations and inflation in a monetary union do not apply any more on an individual basis.

Member states have lost inflation and the exchange rate as adaptation instruments, while greater pressure is on wages. Fiscal policy remains the only instrument for the state to adapt to shocks etc. given the absence of a eurozone-wide transfer system. This setting is an argument to maintain the highest possible degree of autonomy in fiscal policy making. Yet, three years into EMU, the following puzzle emerges: Within the various procedures of EU economic policy-making, comments, recommendations and agreements on fiscal policy-making have developed to a stronger degree that might have been presumed beforehand. Examples are: comments on the quality of state finances in the broad economic guidelines, attempts to coordinate within the eurogroup e.g. on fiscal compensation of the high oil price, recommendations on deficits going beyond the SGP as in the case of Ireland. So what - if at first sight autonomy is best - drives the actors to take these decisions and how fragile are they?

Theoretical background and relevance

Economists have profoundly analysed the interdependence of monetary and fiscal policy (see e.g. Weale 1999) and also wage policies (Calmfors 1998). These findings by economists will be acknowledged in the thesis by explaining the arguments for the reasons for a certain degree of policy co-ordination. Yet, while some economists tend to see policy-making as a technical exercise in welfare maximisation, this study sees macro-economic policy-making as government action to achieve various conflicting aims, many of which have more to do with domestic politics than with international policy co-ordination.

The EU integration process is thus understood as a series of rational decisions by which member states try to optimise the pursuit of their targets. For the study of fiscal policy-making, this allows to describe goal-oriented decisions by states and social actors within the existing framework, rather than attributing (in the functionalist view) exaggerated weight to non-intended dynamics triggered by spill-overs.

The study presumes that the EU member states define their interests in view of domestic constraints and institutional limits. Yet, as macro-economic policy-making is strongly influenced by schools of economic thought, consider e.g. the strong role for economic beliefs in creating the current set-up, attention will also be paid to the role and relevance of economic ideas in fiscal policy-coordination in EMU. In this respect, the research undertaken will dwell upon the literature on preference formation, and before this background, build a model for preference formation in fiscal policy making in EMU.

Fiscal policy in EMU is a very "young" field of investigation. For this research, this has two implications, the positive being that not much has been written on the policy processes that have emerged; the negative being that working on an emerging phenomenon may mean the

target of analysis is a moving one and also turn out as a problem for the availability of empirical data. Two consequences are drawn in view of this constraint: 1) Attention is paid to the regime shift in 1999, asking why it occurred in the way it has, what has changed for the relevant actors and what they have made of this since the start of EMU. 2) A stronger emphasis may be put on the theoretical dimension of policy-making in EMU. This includes – apart from preference formation – the questions of learning and evolving systems, in this case of soft-coordination, for which fiscal policy-making in EMU is considered an example.

Research design

1. A first step will be to develop a choice-theoretical framework for the analysis of preference formation as well as a framework for preference realisation in the multi-level system of EMU (study of literature)
2. Secondly, the choice for the initial set-up for fiscal policy at the start of EMU will be explained (Excessive Deficit Procedure EDP, Maastricht 1992, and Stability and Growth Pact SGP Council Resolution 1997) (literature and interviews)
3. Then, the nature of fiscal policy making in EMU will be analysed, i.e. the functioning of the EDP and SCG, the Broad Economic Guidelines, the dialogue in the eurogroup etc. (interviews, analysis of sources such as EU documents and press)
4. These decision-making processes and especially their practical developments two years into EMU will then be assessed with regard to two questions 1) preference formation (e.g. the impact of domestic politics, economic ideas, institutional constraints) and 2) realisation in the EU system, e.g. soft vs. hard coordination, competence shifts/agency slippage, preference shifts, the logic of bargaining vs. consensus building etc. Explanations for these observations will be given with reference to how institutions shape actors preferences/cognitive processes, the impact of externalities or domestic events etc. (model building)

5. The study ideally concludes, in how far the current set-up may be problematic from a preference point of view with regard to the question in how far national actors preferences are met, violated or have changed. The objective is to add a political scientist's critique to the predominantly economic assessments of the current set-up (to be defined e.g. likelihood of defection, legitimacy of outcome). This could give an indication to answering the question how sustainable the current set-up is, and in which direction institutions could develop.

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