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Abstract

This paper describes and assesses the functioning of differentiated integration arrangements in the field of Economic and Monetary Union (EMU). In detail, we describe and study how differentiated institutions work in key EMU policy areas: monetary policy, fiscal surveillance (the Stability and Growth Pact, the Fiscal Compact), financial assistance (the European Stability Mechanism) and policy coordination (including the Macroeconomic Imbalance Procedure and the European Semester). We start by presenting the regulatory and organisational dimensions of differentiation as well as their respective accountability mechanisms and procedures. The paper then assesses whether the deeper differentiated integration resulting from the early 2010s EMU reforms has strengthened the functioning of the EMU, as well as the implication for the Union's political unity. We find that the EMU emerged less vulnerable to shocks, and better equipped to tackle future challenges, although some limitations remain, and political unity has weakened.

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Executive summary

The Economic and Monetary Union (EMU) is the most prominent example of differentiated integration in the European Union. It involves several differentiated institutions that make its structure complex. These arrangements belong to the areas of monetary policy, fiscal surveillance, financial assistance and policy coordination. This study explores how member states engage in a differentiated manner with these arrangements.

With the financial and sovereign debt crises came the realisation that the EMU structure and governance was incomplete and vulnerable. In the early 2010s, far-reaching reforms and new instruments were adopted that have led to a much deeper integration of EMU members, and inevitably also to more differentiation with non-EMU members. The EMU framework changed in many directions. Monetary policy operated unconventional purchases of public assets, reducing tensions in the sovereign debt markets. Fiscal surveillance was strengthened, leading to more compliance with fiscal rules but also restrictions on countercyclical polices. A financial assistance instrument was created to provide support to countries that lost market access. Economic policies have been strictly monitored with the aim of reducing macroeconomic imbalances, although enforceability is weak.

While these modifications have not yet been tested in a similar crisis, they have made the EMU structure more complete, equipping it with some of the tools necessary for a currency union. In making the EMU less vulnerable, the euro area members have become more deeply integrated, widening the difference with non-EMU countries. EU political unity emerged scarred from the process of deepening differentiated integration. Non-EMU member states have been excluded from some institutions and sidelined in the decision-making processes. Some countries have become more reluctant to join the common currency. Even within the euro area, political divisions emerged because of different political preferences and backlash against some EU polices.

To smooth these frictions some options should be considered. First, include non-EMU countries as much as possible in the Eurogroup and Euro Summit discussions, especially those relevant for the Union as a whole or for the euro architecture. Second, avoid resorting to intergovernmentalism, which creates complexity and increases fragmentation. Third, strengthen political work towards overcoming old narratives pitching member states against each other.

As a result of the crisis, EMU differentiated integration was reinforced, because the survival of the monetary union needed deeper integration among its members. We find that the EMU has emerged less vulnerable to shocks, and better equipped to tackle future crisis, although this remains to be tested and significant faults remain. While more differentiation led to political fragmentation, a change of approach has emerged in the response to the COVID-19-related health and economic crisis, potentially paving the way towards more integration.

Introduction: The Economic and Monetary Union as differentiated integration

The Economic and Monetary Union was designed as a form of differentiated integration. The economic justification for differentiated integration was that only economically convergent countries would be allowed to join the common currency. For the monetary union to function properly, its economies had to be similar and balanced.[1] The differentiation between EMU members and non-participating members was conceived to be temporary, as all EU member states are required to join the euro once they fulfil the requirements, although political will also plays a role. Only two countries, the United Kingdom (UK) and Denmark, negotiated an opt-out. The opt-out was considered the only way to overcome a potential veto over further integration.

The EMU is an interesting case study of differentiated integration. While it is itself a form of radical differentiation, i.e., some countries do not belong to the EMU, it also includes a large variety of differentiated arrangements. For example, some of its policies are based on the community method while others are intergovernmental, and they may apply to different combinations of countries.

The financial and sovereign debt crises revealed some flaws of the original EMU setup established with the Maastricht Treaty. In this paper, we focus on the differentiated arrangements that were introduced and/or reformed in the early 2010s, during or in the aftermath of the crisis. From these reforms, even if often formally addressed to the EU27, EMU differentiated integration emerged strengthened, setting members and non-members further apart (Schimmelfennig 2014). We explore whether deeper differentiated integration has improved the functioning and the effectiveness of the EMU, as well as its effects on the EU's political unity.

This paper is structured as follows. Section 1 investigates differentiated integration in the main areas of EMU competence, that is monetary policy, fiscal surveillance, financial assistance and policy coordination. Section 2 describes the accountability mechanisms of the differentiated arrangements. Section 3 assesses whether the EMU arrangements that deepened differentiated integration have been effective in strengthening the EMU's functioning. In section 4 we explore the effects of EMU differentiation from a political unity perspective. Lastly, we draw some conclusions and recommendations.

1 A set of economic requirements was created, enshrined for the first time in the Maastricht Treaty. These requirements are known as "convergence criteria" or "Maastricht criteria". The criteria are laid out in article 140 of the Treaty on the Functioning of the European Union (TFEU) and further explained in Protocol 13 of the same treaty.

1. Differentiated institutions in the EMU

The first decade of the euro was characterised by stabilised inflation, convergent interest rates, the elimination of exchange rate risks, growing interdependencies and financial markets integration. Nonetheless, business cycles were not aligned, and macroeconomic and fiscal asymmetries persisted.

These imbalances however were not matched by an adequate EMU governance, which instead had focused on monetary institutions only. The cornerstones of the original EMU setup were fiscal prudence and the prohibition against the EU and of the European Central Bank (ECB) taking over member states' liabilities. The "two crises" of 2008–2009 and 2010–2012 revealed the limitations of this framework. In efforts to keep the EMU together when it was put under pressure, new instruments and rules were introduced. These included stronger surveillance of fiscal and macroeconomic imbalances, mechanisms for financial assistance, the Banking Union[2] and stronger coordination of economic and budgetary policy.

This section analyses differentiated integration in these policy areas: monetary policy, fiscal surveillance, financial assistance and policy coordination. We follow the analytical framework developed by Lavenex and Križić (2019) to map the differentiated arrangements in these policy fields. For each arrangement, the Annex presents a detailed analytical grid on the regulatory and organisational dimensions of differentiated integration, with references to the relevant legal documents.

1.1 Monetary policy

Monetary policy is the most differentiated EU policy, since it does not concern member states that have not joined the single currency. Euro area member states commit to the European Central Bank's exclusive right to conduct the EMU monetary policy and to issue the euro banknotes and coins. The ECB is an independent institution, thus all influence by national authorities is prohibited. National Central Banks, which are all represented in the Governing Council, remain central in the implementation of monetary policy but follow the instructions of the ECB.

Member states that do not have the euro are "with derogation" and maintain sovereignty over their monetary policies, although they commit to some coordination and cooperation with the ECB and the European System of Central Banks (ESCB). National central bankers of non-EMU countries are represented in the General Council of the ECB and contribute to the collection of the necessary statistical information for the undertaking of ECB tasks. The General Council carries out all the necessary preparations for irrevocably fixing the exchange rate of the currency of the member state joining the euro.

2 The Banking Union will be the subject of a EU IDEA Policy Paper on the financial sector.

Furthermore, as underlined by Hayo and Méon (2012), the General Council is a discussion forum between EMU and non-EMU members on monetary policy issues and exchange rate relations. Indeed, albeit heterogeneously, non-EMU countries coordinate their monetary policies with the ECB. Because of the full capital mobility provided by the single market, monetary policy autonomy is limited if a country wants to avoid large exchange rate fluctuations (Plümper and Troeger 2006). Despite the opt-out, Denmark has belonged to the European Exchange Rate Mechanism (ERM II) system since 1999. Bulgaria has already pegged its currency to the euro through a currency board, abandoning de facto monetary policy autonomy (Tokarski and Funk 2019). The Czech Republic, Croatia, Poland, Hungary and Romania have in place a "managed floating exchange rate" approach aimed to avoid large fluctuations, whereas Sweden has a free-floating exchange rate regime, without constraints.

Lastly, some micro-states use the euro as their currency thanks to an explicit bilateral agreement with the European Union. This is the case, for example, for the Principalities of Monaco and Andorra, the Vatican City State and the Republic of San Marino. These countries are subject to the monetary policy of the ECB. Kosovo and Montenegro also use the euro as their currency, but the adoption was a unilateral decision without a formal agreement with the EU.

1.2 Policy coordination

In the early 2010s, a stronger framework for reform and macroeconomic coordination was put in place to improve transparency about national policies and to take preventive and corrective action against potential asymmetries and imbalances. For this purpose, economic policy coordination, necessary to guarantee economic convergence, is framed in the European Semester. This latter allows the Commission to survey the compliance of fiscal policies with respect to *the rules of the Stability and Growth Pact (SGP) and to detect and correct the emergence of macroeconomic imbalances. To coordinate national structural reform agendas, countries submit reform plans and the Commission issues Country Specific Recommendations (CSRs). Non-euro-area member states participate in the common coordination framework but are subject to looser monitoring.

1.2.1 Macroeconomic imbalance procedure

Applied within the framework of the European Semester, the Macroeconomic Imbalances Procedure (MIP) was introduced with the "Six Pack" legislation (Reg. 1176/2011). Its purpose is to monitor and address the presence of potential asymmetries, especially within the euro area. The MIP monitors a set of economic indicators including the current account, house prices, private debt and labour costs.[3] These indicators are framed in a scoreboard with different thresholds, which

3 The full list of indicators is accessible in the European Commission website: *Scoreboard*, https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/macroeconomic-imbalance-procedure/scoreboard_en.

are stricter for euro area member states than for the others.[4] If any member state breaches the threshold, the Commission may issue a country report in which it assesses macroeconomic imbalances and suggests policy measures. The procedure foresees a preventive and a corrective arm including, in the latter, sanctions only for euro area countries. As in the corrective arm of the SGP, non-euro-area countries do not vote on sanctions for euro area member states.[5]

1.3 Fiscal surveillance and financial assistance

While fiscal policy remains a responsibility of member states, the EU provides a fiscal surveillance framework. Introduced in the 1990s, fiscal rules were significantly strengthened during the financial and sovereign debt crises, through the revision of the Stability and Growth Pact and the introduction of the Fiscal Compact. Since 2013, the EU also provides last resort financial assistance to euro area sovereigns in crisis, through the European Stability Mechanism. The introduction of new rules and mechanisms was considered necessary to strengthen the functioning of the EMU and resulted in deeper differentiated integration.

1.3.1 The Stability and Growth Pact

For all EU member states, the SGP reaffirms the reference thresholds of government deficit (3 per cent) and public debt (60 per cent of GDP) and comprises rules to ensure compliance. All member states commit to reduce excessive debt and to adjust their fiscal policies towards meeting their medium-term budgetary objectives (MTOs). To show how they intend to accomplish this goal, euro area member states submit their policy plans every year to the Commission as part of the European Semester process. The preventive arm of the SGP monitors the soundness of national budgetary policies, while the corrective arm aims at reducing excessive debts and deficits. Non-euro-area countries are subject to looser monitoring, for example they do not submit draft budgetary plans to be assessed by the Commission. While all member states can be subject to an excessive deficit procedure (EDP), only euro area member states are subject to additional monitoring and reporting requirements, including the presentation of an Economic Partnership Programme.

In the SGP, the main forms of differentiated integration concern sanctions and decision-making. While euro area member states can be subject to monetary sanctions, other member states can only be subject to a suspension of the European Structural and Investment Funds. This applies to both the preventive and corrective arms. The decision-making process is differentiated. All measures and sanctions are decided by the Council, based on a Commission proposal. However, voting rights of non-euro-area member states are suspended for the adoption of certain decisions

4 For instance, the reference threshold for unit labour cost increase is +9 per cent for euro area member states, while it is +12 per cent for the rest of the EU. The real exchange rate threshold is +/- 5 per cent for euro area countries and +/-11 per cent for the others.

5 Reg. 1176/2011 and Reg. 1174/2011.

concerning a euro area member state.[6]

1.3.2 The Fiscal Compact

The Fiscal Compact belongs to an intergovernmental treaty, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG). To strengthen budgetary discipline, the Fiscal Compact was adopted in 2012 to enshrine the rule of a balanced budget in national legislation. While all 27 EU member states are now contracting parties of the Treaty, only 22 member states are bound by the Fiscal Compact: the 19 euro area countries alongside Bulgaria, Denmark and Romania. All 22 member states are fully committed to the rules of the Fiscal Compact on ensuring a balanced budget, but the three non-euro-area member states do not vote on recommendations concerning a euro area country and are not subject to enhanced surveillance.

The intergovernmental approach was taken following the British veto to an amendment to EU primary law. The openness of the TSCG to non-euro-area member states signalled the willingness to include those members. Nonetheless, in practice, the Treaty increased differentiated integration in an even more complex form, given that some non-euro-area countries are signatories of the Fiscal Compact (Ondarza 2013, Pisani-Ferry et al. 2012).

The TSCG also established the Euro Summit, from which all non-euro-area member states are excluded, with some exceptions.[7] For example, non-euro-member states are included in discussions concerning the future of the euro area and its fundamental rules. It was only after the pressure exerted by some non-euro-area countries that their inclusion in the Euro Summit, at least once a year, was enshrined in the Treaty (Ondarza 2013).

1.3.3 The European Stability Mechanism

As some member states lost market access during the sovereign debt crisis, EU leaders agreed on creating a common institution to provide loans to sovereigns under market pressure. It was realised that a monetary union, characterised by strong financial integration, was prone to negative spillovers and "contagion" of financial instability among countries. After its temporary predecessors, the Greek Loan Facility and the European Financial Stability Facility, the European Stability Mechanism (ESM)

6 Non-euro-area member states do not vote on recommendations made to euro area member states in the framework of multilateral surveillance, including on stability programmes and warnings. They also do not vote on measures related to excessive deficits of euro area member states, including coercive means of remedying (art 139 (4) TFEU).

7 Article 12(3) TSCG : Member states whose currency is not the euro, which have ratified the Treaty "shall participate in discussions of Euro Summit meetings concerning competitiveness for the Contracting Parties, the modification of the global architecture of the euro area and the fundamental rules that will apply to it in the future, as well as, when appropriate and at least once a year, in discussions on specific issues of implementation of this Treaty on Stability, Coordination and Governance in the Economic and Monetary Union".

was established in 2012 by an intergovernmental treaty among euro area member states. They can access financial assistance under strict conditionalities on fiscal discipline and reform. These conditionalities have been temporarily relaxed in the context of the COVID-19 crisis.[8]

Non-euro-area member states are fully excluded from the ESM, which is guaranteed by capital contributions of the euro area countries. The differentiation of non-members is stark, as they can only rely on the International Monetary Fund (IMF) or on the EU's Balance of Payments Facility should they lose market access.

This section has presented the main EMU arrangements in which EU member states engage in a differentiated manner, resulting in a complex governance. The grids in the Annex provide a detailed description of the differentiated forms of engagement. In sections 3 and 4 we will assess these instruments.

2. Accountability mechanisms of the EMU differentiated arrangements

In the EMU differentiated arrangements described in the previous section, executive and enforcement powers are attributed to the European Commission, the Council and the European Central Bank. Accountability mechanisms involve the European Parliament (EP) and more rarely national parliaments.

2.1 Monetary policy

The European Central Bank is an independent institution whose policy decisions cannot be influenced by governments and other actors. It informs the European Parliament on an annual basis, by presenting the Annual Report during a plenary debate. Furthermore, the ECB reports its activities at least quarterly and members of the Executive Board may be heard by the competent committees of the European Parliament.[9]

2.2 Policy coordination

In the context of the European Semester, the European Parliament is involved through the economic dialogue. The competent EP committee may invite the President of the Council, the Commission, the President of the European Council or the President of

8 The ESM Pandemic Crisis Support has been introduced as a response to the COVID-19 crisis. This targeted credit line allows member states to access favourable loans on the sole condition that the finance is used to "support domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID-19 crisis" (Eurogroup 2020).

9 Art. 284 TFEU and Art. 15 Protocol No. 4, Statute of the European System of Central Banks and of the European Central Bank.

the Eurogroup to discuss guidelines, orientations and conclusions of the Council and of the European Council on the multilateral surveillance.[10] Moreover, the European Parliament drafts a resolution on the Annual Growth Survey (AGS) that is approved in February. In May/June, an economic dialogue between the European Parliament and the Commission is set up on CSRs. Lastly, in October, in the ECON committee, a dialogue on the AGS is held with the participation of representatives from national parliaments. This latter also has scrutiny power on the content of CSRs (Delivorias and Scheinert 2019).

The powers of the European Parliament in the context of the Macroeconomic Imbalance Procedure resemble those of the SGP. The European Parliament is kept informed on the application of the MIP and can organise exchanges of views with the member state concerned. Additionally, the competent committee may invite the President of the Council, the Commission, the President of the European Council or the President of the Eurogroup to discuss decisions taken in the corrective arm (including imposition of sanctions). Lastly, the Commission, during surveillance missions in countries under the corrective arm, establishes a dialogue with social partners and other national relevant stakeholders.[11]

2.3 Fiscal surveillance and financial assistance

In both the preventive and corrective arms of the Stability and Growth Pact, the Council and the Commission must inform the European Parliament of the application of the related regulations.[12] In addition, the EP competent committee may invite for discussion, at different steps of the preventive and corrective procedures, the President of the Council, the Commission, the President of the European Council or the President of the Eurogroup. The discussions can concern the Council recommendation in case of a deviation towards the MTO and the Council recommendations issued during the excessive deficit procedure. The member states subject to these recommendations can be invited by the same competent committee to participate in an exchange of views.[13]

For euro area member states under an EDP, the European Commission adopts delegated acts to define the content and the extent of additional reporting requirements. The European Parliament and the Council delegate to the Commission the power to adopt such acts but retain the power to revoke this delegation and to veto the entry into force of the delegated acts.[14] Additionally, the national parliament of a member state under an EDP can ask the Commission to present and explain the recommendation urging the country to correct the excessive deficit.

10 Reg. 1466/97 (Art. 2-ab).
11 Reg. 1776/2011 and Reg. 1774/2011.
12 Reg. 1466/97 (Art. 2-ab (4)) and regulation 1467/97 (Art. 2a (2) and Art. 3).
13 Reg. 1466/97, Reg. 1467/97 and Reg. 473/2013.
14 Reg. 473/2013.

The accountability procedures of the TSCG are fairly limited. First, the President of the European Parliament may be invited to be heard at the Euro Summit. Second, the President of the Euro Summit must present a report to the European Parliament after every Euro Summit meeting. Third, the President of the Euro Summit must inform non-euro-area member states of the preparation and outcome of the Euro Summit meetings. Lastly, the European Parliament and the national parliaments can organise a conference of representatives of the relevant committees to discuss budgetary policies and other issues covered by the TSCG.

The ESM Treaty provides limited accountability measures. The ESM is audited by an independent Board of Auditors, which includes the national audit institutions and the EU Court of Auditors. The annual audit report to the Board of Governors must be made available to national parliaments. Regulation 472/2013 foresees a broader participation of the European and national parliaments. For instance, the ESM Board of Governors is composed of euro area finance ministers who are held accountable by national parliaments. Depending on domestic procedures, in some cases national parliaments may act as "veto players" over negotiations on financial assistance packages (Kreilinger 2019). Regulation 472/2013 states the accountability mechanisms for countries under enhanced surveillance. First, the Commission informs the parliament of the member state under enhanced surveillance and the EP relevant committee of the measures the country must take to tackle the sources of financial instability. Second, throughout the process, the competent committees of the European or national parliament may invite representatives of the Commission, the ECB and the IMF to participate in an economic dialogue. In case the Council recommends further measures, the European Parliament is informed, and it may offer the opportunity to the member state concerned and to the Commission to participate in an exchange of views.

It emerges that the main actors in charge of decision-making and implementation are the member states and the Commission. Accountability and scrutiny powers of national or European parliaments are relatively weak, and mainly consist of audits, exchange of views and a right to information. The European Parliament exercises a veto power only on delegated acts concerning reporting requirements for EMU countries under EDP.

3. Assessing the effect of differentiated integration arrangements on the effectiveness of EU policy making

The EMU reforms adopted during and in the aftermath of the financial and sovereign debt crisis significantly deepened differentiated integration in the EU, as euro area members created new (monetary, fiscal, financial) instruments and strengthened the surveillance of national policies. The new, more complex governance widened the differences between EMU members and non-members, who have been excluded from some decision-making processes. Following the analytical framework designed by Lavenex and Križić (2019), we assess whether this increased differentiation has improved the effectiveness of EU policy making. Being aware that it is sometimes difficult to clearly isolate one policy area from the other, we analyse effectiveness by exploring the extent to which the introduction and/or reform of these differentiated arrangements has strengthened the functioning of the EMU and/or reduced its vulnerabilities. The analysis of the effects on political unity belongs to section 4.

3.1 Monetary policy

The monetary policy of the European Central Bank began on 1 January 1999. The setting up of the common currency led to stabilisation of inflation rates and elimination of the exchange rate risk and transaction costs related to different currencies. This favoured trade and financial integration. For example, the money market became immediately integrated, in particular the unsecured segment, which is crucial for a common monetary policy. While the government bonds market had already started to converge in the run-up to the EMU, the introduction of the euro brought an alignment of yields (ECB 2007).

The original setup enshrined in the Maastricht Treaty rested on the budgetary prudence and market discipline pillars, meaning that markets would assess member states' budgetary prudence. Consequently, the Eurosystem is forbidden to provide facilities and/or purchase directly sovereign debt (art. 123 TFEU). Countries would have to face the consequences of their inability to finance themselves on the markets (Van den Bogaert and Borger 2017).

The financial and sovereign debt crises triggered a reshaping of the initial EMU. In 2009–2010, panic in the sovereign debt markets drastically reduced the borrowing capacity of Greece, Spain, Portugal, Italy and Ireland. To avoid sovereign defaults and to safeguard the transmission mechanism of monetary policy, the ECB gradually put in place nonconventional instruments addressed to the secondary market of government bonds (given the prohibition in art. 123). From May 2010, under the Securities Market Programme, the ECB started to buy government bonds of distressed euro area countries (Manganelli 2012).

Another breakthrough was the 2012 decision, following Mario Draghi's "whatever it takes" speech (Draghi 2012), to introduce a new scheme: the Outright Monetary Transactions, which signalled the potentially unlimited bond-buying capacity of the ECB (Cour-Thimann and Winkler 2013). Lastly, in 2015 the ECB introduced a comprehensive Quantitative Easing (QE), also to counteract the deflationary dynamics in the eurozone. Quantitative Easing, which is carried out mostly through the Public Sector Purchase Programme, was reduced in intensity from 2017 onwards but was recently accompanied by another assets purchase programme to tackle the COVID-19 crisis: the Pandemic Emergency Purchase Programme. Both of these programmes are linked to the ECB capital key benchmark, which means that the total amount of country-specific assets the ECB can buy is proportional to the country's shares in the ECB capital (Micossi 2015). However, the ECB has interpreted this constraint with flexibility and the same approach will be followed for the Pandemic Emergency Purchase Programme (ECB 2020). The ECB's flexible approach has been challenged by some, as we discuss in section 4.2.

Non-EMU countries responded differently to the crisis. The autonomy of monetary policy made it possible to independently cut rates over time, but not all countries with a derogation could exploit the exchange rate instrument to face the shock. Nominal exchange rate depreciations were large in Poland and Romania. The Czech Republic, Hungary and Sweden devalued their currencies as well (Höpner 2017). Bulgaria's currency is pegged to the euro and therefore the country was not able to stabilise the economy through the exchange rate. For that reason, demand contraction was worse in Bulgaria than in other non-euro countries especially in 2008–2009 (Gabrisch and Kämpfe 2013, IMF 2015). Similarly, Denmark has had to respect the bands of ERM II mechanism, so its monetary policy was closely coordinated with the decisions of the European Central Bank.

Given the constraints of the original EMU setup and the lack of political consensus among countries,[15] the initial ECB reaction to the crisis was gradual and slow. As member states realised that more action was necessary, the ECB had more political space to carry out unconventional policies that were decisive to preserve the transmission mechanism of monetary policy and to avoid the breakup of the common currency. The steps taken by the European Central Bank during the crisis overcame the original framework and, today, allowed for a prompter and effective reaction in relation to the COVID-19 crisis.

3.2 Policy coordination

Even after the introduction of the euro, member states experienced different macroeconomic developments. For example, Ireland and Spain relied too much on real estate investments to spur economic growth, which were fuelled by cheap and large credit flows, resulting in heavy current account deficits financed by intra-EMU capital flows (Messori 2015). The crisis led to "a sudden stop" of capital flows forcing an adjustment mainly through internal devaluation (resulting in lower wages

15 The ECB started the Securities Market Programme after EMU countries agreed on the European Financial Stability Facility.

and higher unemployment). In addition, the banking exposure to the house market demanded public intervention, resulting in higher deficit and debt levels (Gros and Alcidi 2013, Gros 2015). The financial and debt crises showed that in a monetary union macroeconomic convergence is as needed as sound fiscal policy. For that purpose, the Six Pack introduced the Macroeconomic Imbalance Procedure.

Since 2011, compliance with MIP rules is framed within the European Semester, which guarantees a stronger policy coordination than before. Although the new instruments of macroeconomic coordination (MIP and European Semester) have helped countries in the rebalancing process,[16] thereby representing new tools for a better functioning EMU, some other considerations must be added. First, the adjustment was also forced by the economic recession that led to a drop in domestic demand, prices and wages, thus improving competitiveness. Second, Spain, Ireland, Portugal and Greece[17] keep registering high stocks of public, external and to a lesser extent private debt. Third, the rebalancing has not been symmetric within the euro area as some countries, e.g., Germany and the Netherlands, still run large current account surpluses (European Commission 2019). Fourth, the European Semester has had limited success in ensuring that the member states implement the Commission's recommendations. Lastly, the sanctioning mechanism does not involve the preventive arm, thus risking providing little incentive to member states to comply with the rules (ECB 2011b).

Despite these limitations, the MIP is another piece of the EMU post-crisis governance reform and it has an important impact on differentiated integration. While the procedure addresses all 27 member states, macroeconomic coordination is far more crucial for countries using the same currency. Consequently, EMU and non-EMU members are involved differently in the steps of the MIP. Even if it's only about tighter coordination, the MIP has contributed to widening the gap between euro area and non-euro-area countries. Indeed, stronger and more binding rules for the euro area, together with a more differentiated governance, imply a wider legal and integration gap (Pisani-Ferry et al. 2012).

3.3 Fiscal surveillance and financial assistance

The EU framework of fiscal rules was introduced with the Maastricht Treaty and later operationalised in the Stability and Growth Pact, which entered into force in 1997–1998. Even if the framework envisaged strict rules, compliance was loose in the early 2000s and applicability of the excessive deficit procedure was weak.

In the aftermath of the crisis, the SGP reforms of 2011–2012 (the "Six Pack" and the adoption of the Fiscal Compact) increased the powers of the EU and the Council on national fiscal policies and strengthened fiscal surveillance. The reforms demanded a

16 For example, some euro area periphery countries (especially Spain and Ireland) managed to reduce current account deficits and to improve their price and labour cost competitiveness (European Commission 2020b).

17 Among periphery countries, Italy's main challenge is a high debt to GDP ratio, but private and external debt are limited.

larger transfer of sovereignty in fiscal policy towards the EU level, where sanctions are decided by reverse qualified majority (Leuffen et al. 2013). This stronger integration concerns only euro area member states, as the others are not subject to sanctions. The resulting EU governance is significantly more differentiated.

Although a clear causal relationship is impossible to establish, the strengthening of fiscal rules in 2011–2012 led to improved compliance. The euro area average fiscal deficit declined significantly from 4.2 per cent in 2011 to 0.6 per cent in 2019 (Eurostat 2020). In the period 1998–2007, compliance with the structural balance rule was 44 per cent. This increased to 63 per cent in the 2011–2018 period (European Fiscal Board 2019). The number of countries meeting their MTO has increased steadily since 2011 and deviations from the required adjustment have reduced significantly (European Fiscal Board 2019, Leiner-Killinger and Nerlich 2019). Although debt levels remain high in many countries, these may be resulting from the global financial and sovereign debt crisis, and progress in adjustment has been made.

The deeper differentiated integration in fiscal policy has led to a reduction of imbalances and the formulation of more sound fiscal policies, as shown by the increased compliance with the rules. Less heterogeneity improves the functioning of the EMU, which becomes less vulnerable to shocks, and leads to a more effective single monetary policy. At the same time however, the stricter application of rules aimed at improving national fiscal positions reduced the fiscal space that some countries needed for effective countercyclical stabilisation during the crisis.

In the early 2010s, the EU also was confronted with member states losing market access and risking a default on their sovereign debt. As the costs of exit from the EMU were too high, financial assistance mechanisms were put in place. Non-euro-area member states can access the assistance of the Balance of Payments facility, which is guaranteed by the EU budget and thus is relatively small. The European Stability Mechanism is instead guaranteed by capital contributions, allowing for a much higher lending capacity. Unlike its predecessors,[18] the ESM is a permanent mechanism and is open to all and only euro area countries. The permanent character of the ESM and its larger bond-buying powers improved the EU's capacity to provide financial assistance to member states (Gocaj and Meunier 2013). With the establishment of a permanent mechanism for financial assistance, the EU communicated that its commitment to help member states in financial distress is reliable, stable and not subject to political preferences. Compared to a temporary mechanism, the ESM creates stability in the system and reduces the risk that markets may see in some member states. These effects, however, concern only euro area member states since the others are effectively excluded from the mechanism. Nonetheless, this form of deeper differentiated integration has improved the functioning of the EMU by providing a safety net for its members, thereby reducing the EMU's vulnerability to shocks (Hafner and Jager 2013).

18 The Greek Loan Facility and the European Financial Stability Facility.

4. Assessment of the effect of differentiated integration on EU political unity

Following the realisation that the EMU framework was suboptimal, the deeper differentiated integration resulting from the early 2010s reforms has reduced the EMU's vulnerability by equipping it with stronger tools for effective single monetary policy, preventive policy coordination, last-resort financial assistance, and monitoring and correction of imbalances. In this section we evaluate the effect of deeper differentiation on the EU's political unity. There is a recognition that the developments and political narratives during the economic and sovereign debt crisis have shaken the EU's political unity, which could have been permanently scarred by the exit of Greece from the euro area. Nonetheless, the deeper differentiated integration resulting from the early 2010s reforms has not posed an existential threat to EU political unity (Tekin et al. 2019, Tekin 2017). In this section we explore in more detail the effects of the differentiated arrangement on political unity.

4.1 Political unity between euro area members and non-members

During the past decade, with respect to the EMU, the EU has experienced both centripetal (greater integration) and centrifugal (fragmentation) dynamics (Cini and Verdun 2018). On the one hand, euro membership has steadily increased since its inception. The fact that some countries joined during and in the aftermath of the sovereign debt crisis shows that the EMU has maintained its appeal to outsiders.[19] At the same, some countries of Central Eastern Europe have been increasingly reluctant towards joining the single currency.[20] The sovereign debt crisis and its suboptimal management, as well as the larger implied transfer of sovereignty, reduced the interest of some countries in rapidly joining the euro (Adler-Nissen 2016).

On the other hand, the deeper differentiation resulting from the EMU reforms of the early 2010s widened the difference between the euro area and non-EMU members. The arrangements created institutions from which non-euro members are deliberately excluded, such as the ESM. The Eurogroup meetings denied participation to non-EMU countries, which had to fight for including in the TSGC their once-a-year participation in Euro Summits (Ondarza 2013). Even if legally informal, the Eurogroup had a strong decision-making power during the years of the crisis, de-facto excluding non-euro-area members from the political process (Kurri 2013). At the same time however, it was because of the reluctance of a non-EMU member, the UK, that the other member states took an intergovernmental approach (the TSGC), leading to

19 Estonia joined in 2011, Latvia in 2014 and Lithuania in 2015. Some countries remain interested in joining the single currency, e.g., Romania hopes to join in 2024 (Blesse et al. 2020) and Bulgaria is making progress with the reforms needed to join the EMU (Gotev 2020).

20 For example, Poland (Florkiewicz and Charlish 2019). Sweden does not have the intention to join the single currency, also due to a negative referendum result on the question in 2003.

more fragmentation. Additionally, the reforms have created processes that pay more attention to the euro area, e.g., the frameworks for fiscal and macroeconomic surveillance.

Additionally, the exit of the UK from the EU affected the balance between the EMU and non-euro-area member states. As the largest non-EMU member left the Union, non-EMU countries lost relative influence in decision-making. The effect of Brexit is not yet clear. On the one hand, it could result in further separation and differentiation between the two groups (centrifugal effect). On the other, the relative loss of influence could push non-euro-area members to join the EMU more quickly than previously intended (centripetal effect).

While integration in the EMU has continued to strengthen and more members have joined, deeper differentiated integration resulting from the financial and sovereign debt crisis has negatively impacted political unity between the euro area and differentiated members. Although this damage is neither drastic nor existential, it is visible. First, some countries became more reluctant to join the euro. Second, the differentiated arrangements have exacerbated the differences between the two groups of countries, resulting in the exclusion of differentiated members from decision-making processes and some institutions.

4.2 Political unity among euro area members

During the crisis, some believed that EMU reform efforts would lead to differentiated integration within the euro area and to the emergence of a more integrated "core" of countries. In the context of the current COVID-19 crisis, the idea of a "stronger core" has re-emerged, for example through full debt mutualisation. These developments, however, did not materialise and thus remain beyond the scope of this paper. Nonetheless, the introduction of new arrangements during the early 2010s impacted the political unity within the euro area.

The ECB unconventional monetary policies were considered not appropriate by some countries, resulting in diverging political preferences among states. In Germany, a case against the ECB asset purchase programmes was first brought to the Constitutional Court in 2015 (Jones 2019), and culminated in a May 2020 ruling that the asset purchase programme would be illegal government financing beyond the ECB mandate, unless a formal justification is provided (Karnitschnig 2020). A group of countries, including Germany, have experienced a public opinion backlash against the ECB's policies, which are seen as disproportionally in favour of more fiscally profligate countries (Arnold 2019).[21]

The differences in political preferences regarding fiscal policy have not been reduced by the strengthening of fiscal rules (revised SGP, Fiscal Compact). On the one hand, a group of countries are in favour of a strict application of the rules, and criticise

21 At the same time, however, by reducing debt financing costs, these policies have allowed countries to improve their fiscal position.

that, for example, there is reluctance to initiate excessive deficit procedures.[22] On the other hand, some member states support a more flexible application of the rules allowing for more exceptions.

Lastly, the creation of mechanisms for financial assistance, including the ESM, has resulted in political backlash in some countries receiving assistance. The heavy reform conditions imposed in exchange for assistance were considered too intrusive and restrictive by the receiving country, where the image of the EU and of the ESM was consequently scarred. In Italy for example, even if the country has never had an ESM programme, the ESM has the negative reputation of imposing austerity and the public opinion is wary of the Greek experience with the ESM and the Troika (Rossi and Mingardi 2020).

The differentiated arrangements introduced during the crisis had preserving unity as the ultimate goal. They were meant to keep the common currency together, and they succeeded. At the same time however, the fiscal consolidation policies undertaken at the height of the crisis may have been counterproductive in some countries and led to opposite economic trajectories within the euro area. Additionally, the new differentiated arrangements brought to the surface the differences among member states and resulted in political backlash in some countries. The political unity of euro area member states thus emerged weakened.

Conclusions

The EMU was intentionally designed as temporary differentiated integration in order to allow only convergent countries to join the euro area (with the exclusion of opt-out countries, which was allowed to overcome political blockage). At the same time, the EMU is itself composed of several differentiated arrangements, which increase complexity. Deeper differentiated integration was deemed necessary to ensure the survival of the EMU through the financial and sovereign debt crises, even if it widened the gap with non-EMU member states. Monetary policy moved away from its original framework and operated unconventional instruments, even raising doubts on its accordance with the Treaties. A strengthened surveillance framework improved compliance with the common fiscal rules and the soundness of national fiscal policies but on some occasions did not allow enough space for fiscal stimulus at the national level. National economic policies are better coordinated and monitored, although large asymmetries remain, and recommendations are not easily enforceable. A new financial assistance mechanism has been put in place to support euro area member states.

Even with some limitations, the deeper differentiated integration has ensured the survival of the EMU, reducing its vulnerability to shocks and equipping it with necessary tools. However, the new EMU governance has yet to be tested in another

22 See, for example, the Dutch criticism to the European Commission's decision not to initiate an excessive deficit procedure against Italy in 2019 (Khan 2019, Akkermans and Dendrinou 2019).

financial or sovereign debt crisis, so an assessment on the correct functioning of the reformed EMU will be possible only in the future.[23]

At the same time, EMU deeper differentiation has undermined political unity within the EU. Non-euro-area member states could feel confined to the sidelines of the decision-making process with limited potential to influence decisions (Piekutowska and Kużelewska 2015), and some countries have lost appetite to join the single currency.

Within the euro area, the new instruments and policy decisions that brought members closer together also led to political fragmentation. Different political preferences among groups of countries came to the surface. The introduction of policy novelties led to political backlash in some countries, e.g., against unconventional monetary policy, fiscal constraints and conditions on financial assistance. Political cohesion and economic coordination are threatened still today by aftershocks/long-term effects of the crisis. Proposals for further economic integration, for example on harmonised taxation, a joint fiscal capacity and debt mutualisation, have failed to find political consensus.

Under the construction of the EMU, some member states are not yet part of the monetary union. Given the interdependencies and financial and economic ties among EU (and especially EMU) countries, deeper integration would make the Union less vulnerable to future crises and more effective in its policy making. Thus, if more differentiated integration leads to a better functioning of the EMU, it should be welcomed. At the same time, a few points should be considered to smooth the frictions emerging from differentiation.

First, the Eurogroup and the Euro Summits should always be held in an inclusive format, allowing non-EMU countries to participate as observers with speaking rights, while maintaining their exclusion from voting rights. The Eurogroup has been accepted as a de-facto decision-making body, but its relevance in non-crisis situations can be questioned. The inclusion of non-EMU members, which will one day adopt the euro, should be especially the case when the discussion and decisions are relevant for the Union as a whole and for the future of the euro.

Second, the intergovernmental approach to the creation of new instruments should be avoided, as it increases the complexity of procedures and legal actors, and weakens accountability to the European Parliament. On occasions where unanimity is politically impossible to find, an approach of "constructive abstention" or the creation of opt-outs should be preferred. This would avoid integration being blocked by non-willing member states, while remaining within the known EU legal framework and reducing fragmentation.

Lastly, there needs to be a change of narrative. Within the EMU, memories of the last economic crisis are still vivid, and old narratives pitching countries against each other

23 Given that this paper focuses on differentiated integration, considerations on how to improve the design of EMU instruments and policies are beyond its scope.

have yet to be fully overcome. In the Council, there needs to be political work towards adopting new perspectives. The COVID-19 crisis offers an opportunity for this, and a change in approach can be perceived in discussions on tackling the economic and health crisis related to COVID-19, although sometimes old narratives resurface.

The European Commission has put forward a proposal, "Next Generation EU", for the EU to raise funding on the financial markets by issuing EU common debt. This breakthrough instrument has the backing of many EU member states, including Germany, and could be approved in the course of 2020. The recovery package would be channelled through EU budget programmes and EU-wide initiatives. This is a promising approach to avoid creating more differences between the EMU and non-euro-area members. Nonetheless, future work will have to explore the potential impact of this new instrument on differentiated integration.

To conclude, as underlined by Emmanouilidis (2017), despite the recent reforms, the euro is not fully shielded from future storms and its construction remains incomplete. The integration of all EU members in the single currency will not happen in the short to medium term. Any kind of deeper integration within the EMU will inevitably lead to more differentiation of non-members, creating challenges for political unity. EMU differentiated integration will remain an open issue in the EU.

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Annex: Analytical grids of differentiated arrangements

Grid 1 | Monetary policy

Definition of the policy studied	**Members** ("Normal" level of integration between EU members without differentiation) (Euro area member states)	**Differentiated members** (Differentiated level of integration of EU members beyond or below the "normal" level) (Non-euro-area member states)	**Differentiated non-members** (Level of integration by non-EU members) (Non-EU countries using the euro as official currency)
Regulatory dimension: Commitment to			
Regulatory scope - Full - Partial - Punctual - None	**Full commitment** - ECB's exclusive right to authorise the issue of euro banknotes within the Union. - Common monetary policy implemented by the Eurosystem with the aim of price stability (TFEU: art 119, Title VIII Chapter II, art 127. Protocol No. 4 on the statute of the European System of Central Banks and of the European Central Bank). The ECB's Governing Council in 1998 adopted a quantitative definition of price stability as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2 per cent. - Prohibition of credit facilities to public bodies and direct purchase of public debt instruments by the ECB and national central banks (art 123 TFEU). - Political independence of the ECB and of national central bank (art 130 TFEU). - ECB Governing Council is composed of the members of the ECB executive board and the governors of the national central banks of euro area member states (Protocol 4 TFEU, art 10).	**Punctual commitment** - Member states with derogation maintain their powers in the field of monetary policy (art 139 TFEU). - Join the single currency once the necessary conditions are fulfilled (art 119 TFEU). - Make progress towards fulfilling the obligations, i.e., convergence criteria (art 140 TFEU) and joining the ERM II for at least two years (fixed exchange rate). - Prohibition of credit facilities to public bodies and direct purchase of public debt instruments by the ECB and national central banks (art 123 TFEU). - Treat its exchange rate as a matter of common interest (art 142 TFEU). - ECB General Council is composed of the ECB president and vice-president and the governors of the national central banks of all EU member states (Protocol 4 TFEU, art 44). - Coordination between ECB and national central banks of member states with derogation (cooperation, coordination of monetary policies, holding consultations (art 141 TFEU)). **Denmark** - Opt-out from joining the monetary union. Denmark is the only member state that is not required to join the euro (Protocol 16 TFEU).	**Partial commitment** The Principality of Monaco, the Republic of San Marino, the Vatican City State and the Principality of Andorra have concluded monetary agreements with the EU. They can produce limited quantities of euro coins, but they cannot issue euro banknotes. **Partial commitment** Some French overseas territories, not part of the European Union, have signed agreements with the EU to use euro but without issuing their own coins: Saint-Pierre-et-Miquelon islands and Island of Saint-Barthélemy. **Partial commitment** Kosovo and Montenegro use the euro as their currency, but without the agreement of the EU.

Legal quality - Community method (supranational hard law) - Intergovernmentalism (intergovernmental hard law) - Transgovernmentalism (soft law)	Community method TFEU	Community method TFEU	Intergovernmentalism Monetary Agreements between the EU and: the Principality of Andorra, the Principality of Monaco, the Republic of San Marino, the Vatican City State. Monetary Agreement between the European Union and the French Republic on keeping the euro in Saint-Barthélemy. Council decision concerning the monetary arrangements in the French territorial communities of Saint-Pierre-et-Miquelon and Mayotte.
Extent of legal commitment - Harmonisation - Approximation - Information	Harmonisation	Approximation	Harmonisation
Organisational dimension: Participation in			
Agenda setting - Full - Partial - Punctual - None	**Partial** The Governing Council adopts the agenda for each meeting. A provisional agenda is drawn up by the Executive Board. An item can be removed from the agenda at the request of at least three of the members of the Governing Council if the related documents were not submitted to the members of the Governing Council in due time (art 5(1), Decision of the European Central Bank adopting the Rules of Procedure of the European Central Bank).	**None**	**None**
Policy formulation - Full - Partial - Punctual - None	**Full** The Governing Council shall formulate the monetary policy of the Union including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the ESCB (Protocol 4 TFEU, art 12).	**None**	**None**
Decision taking - Full - Partial - Punctual - None	**Full** Each member of Governing Council has one vote (rotating vote system since there are more than 15 governors). The Governing Council proceeds by simple majority (Protocol 4 TFEU, art 10). In practice, monetary policy decisions have generally been taken by "consensus" (ECB 2011a: 20).	**None**	**None**

Policy implementation - Full - Partial - Punctual - None	**Punctual** - The Executive Board implements monetary policy in accordance with the guidelines and decisions taken by the Governing Council (Protocol 4 TFEU, art 12). - The national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB (Protocol 4 TFEU, art 14).	**None**	**None**
Policy enforcement - Full - Partial - Punctual - None	**Punctual** The Court of Justice of the European Union has jurisdiction on disputes concerning the fulfilment by national central banks of the obligations of the Treaties and the Statute of the European System of Central Banks and of the European Central Bank. In this regard the Governing Council, if it considers that a member state has failed to fulfil an obligation under the Treaties, delivers a reasoned opinion and can, at a later stage, bring the matter before the Court of Justice of the European Union (art 271 TFEU).	**None**	**None**
Policy evaluation - Full - Partial - Punctual - None	**Partial** - Political independence of the ECB and of national central bank (art 130 TFEU). - Monetary policy review. In 2003 the governing Council confirmed the quantitative objective for inflation rate (close to but below 2 per cent year on year HIPC). In January 2020 a new strategy review was launched, encompassing quantitative formulation of price stability, monetary policy toolkit, economic and monetary analyses and communication practices.	**None**	**None**

Grid 2 | Fiscal policy – The Stability and Growth Pact

Definition of the policy studied	**Members** ("Normal" level of integration between EU members without differentiation) (Euro area member states)	**Differentiated members** (Differentiated level of integration of EU members beyond or below the "normal" level) (Non-euro-area member states)
Regulatory dimension: Commitment to		
Regulatory scope - Full - Partial - Punctual - None	**Full commitment** - Reference thresholds deficit: 3 per cent, debt: 60 per cent (Protocol 12 TFEU and then reaffirmed in the SGP). - Medium Term Objectives (MTOs) and debt reduction (Reg.1466/97 and 1467/97). Preventive arm: - Multilateral surveillance including "Stability Programmes". - Sanctions if deviation from MTOs (art 121 TFEU, Reg.1466/97, Reg.1173/2011). Corrective arm: - Excessive Deficit Procedure (EDP). Possibility of sanctions: 0.2 per cent of GDP non-interest bearing deposit (Art.126 TFEU and Reg.1467/97, Reg.1173/2011, SGP Code of Conduct). - Additional monitoring and reporting requirements for member states under EDP (Reg.473/2013). - Member states under EDP must present an Economic Partnership Programme (Reg.473/2013).	**Punctual commitment** - Reference thresholds deficit: 3 per cent, debt: 60 per cent (Protocol 12 TFEU and then reaffirmed in the SGP). - Medium Term Objectives (MTOs) and debt reduction (Reg.1466/97 and 1467/97). Preventive arm: - Multilateral surveillance including "Convergence Programmes" (art 121 TFEU, Reg.1477/97). - No monetary sanctions (art 139(2) TFEU), but possible full or partial suspension of European Structural and Investments funds payments. Corrective arm: - Excessive Deficit Procedure (EDP) (Art.126 TFEU, Reg.1467/97). - No monetary sanctions (art 139(2) TFEU), but possible full or partial suspension of ESI fund payments.
Legal quality - Community method (supranational hard law) - Intergovernmentalism (intergovernmental hard law) - Transgovernmentalism (soft law)	Community method (supranational hard law)	Community method (supranational hard law)
Extent of legal commitment - Harmonisation - Approximation - Information	Harmonisation	Harmonisation
Organisational dimension: Participation in		
Agenda setting - Full - Partial - Punctual - None	Preventive arm: **None**. The European Commission addresses an early warning to the member state which significantly deviates from the path towards the MTO (art 121(4) TFEU). Corrective arm: **None**. The European Commission examines compliance with the reference values and prepares a report if there is risk of excessive deficit.	Preventive arm: **None**. The European Commission addresses an early warning to the member state which significantly deviates from the path towards the MTO (art 121(4) TFEU). Corrective arm: **None**. The European Commission examines compliance with the reference values and prepares a report if there is risk of excessive deficit.

Policy formulation - Full - Partial - Punctual - None	Preventive arm: **None**. The European Commission proposes necessary measures, deadlines and sanctions for the Council to decide upon (art 121(4), 136 TFEU). Corrective arm: **None**. The European Commission proposes that an excessive deficit exists (art 126(6) TFEU).	Preventive arm: **None**. The European Commission proposes necessary measures, deadlines and sanctions for the Council to decide upon (art 121(4), 136 TFEU). Corrective arm: **None**. The European Commission proposes that an excessive deficit exists.
Decision taking - Full - Partial - Punctual - None	Preventive arm: **Full**. The Council decides on the recommendations by the European Commission (art 121(4) TFEU). Corrective arm: **Full**. The Council decides, on a European Commission proposal, if an excessive deficit exists. The Council can impose additional measures, sanctions and fines (art 126(6), 126(9), 126(11) TFEU).	Preventive arm: **Partial**. The voting rights of non-euro-area member states are suspended for the adoption of certain decisions concerning euro area member states (art 139(4) TFEU). (*) Corrective arm: **Punctual**. The voting rights of non-euro-area member states are suspended if the decision concerns euro area member states (art 139(4) TFEU).
Policy implementation - Full - Partial - Punctual - None	Preventive arm: **Full**. The member state concerned must take effective action to implement Council decisions/recommendations. Corrective arm: **Full**: The member state under EDP is responsible for implementing the Council recommendations.	Preventive arm: **Full**. The member state concerned must take effective action to implement Council decisions/recommendations. Corrective arm: **Full**: The member state under EDP is responsible for implementing the Council recommendations.
Policy enforcement - Full - Partial - Punctual - None	Preventive arm: **Partial**. The Council can adopt the recommendations by the European Commission stating that no effective action has been taken, that other measures are necessary, that a sanction should be imposed (art 121(4) TFEU). Corrective arm: **Full**. As long as a member state fails to comply with the recommendations, the Council may decide to apply additional measures including fines (art 126(9), 126(11) TFEU). The Council shall abrogate some or all of its decisions or recommendations to the extent that the excessive deficit in the member state concerned has, in the view of the Council, been corrected (art 126(12) TFEU).	Preventive arm: **Partial**. The voting rights of non-euro-area member states are suspended on some occasions if the decision concerns euro area member states (art 139(4) TFEU). Corrective arm: **Punctual**. The voting rights of non-euro-area member states are suspended if the decision concerns euro area member states (art 139(4) TFEU). Additional measures including fines and sanctions are not applied to non-euro-area member states (art 139(2) TFEU).
Policy evaluation - Full - Partial - Punctual - None	**Punctual** - The European Commission publishes communications reviewing the application of the SGP (See for example European Commission 2018a). - The European Fiscal Board (EFB) is an independent advisory body of the European Commission in charge of evaluating the implementation of the Union fiscal framework and suggesting its future evolution. - The European Commission is currently conducting a review of the EU economic governance, including the SGP, which is open to a variety of stakeholders including national authorities (European Commission 2020c).	**Punctual** - The European Commission publishes communications reviewing the application of the SGP. - The European Fiscal Board (EFB) is an independent advisory body of the European Commission in charge of evaluating the implementation of the Union fiscal framework and suggesting its future evolution. - The European Commission is currently conducting a review of the EU economic governance, including the SGP, which is open to a variety of stakeholders including national authorities.

Note: (*) The voting rights of non-euro-area member states are suspended in the following instances: recommendations made to those member states whose currency is the euro in the framework of multilateral surveillance, including on stability programmes and warnings (Article 121(4)); measures relating to excessive deficits concerning those member states whose currency is the euro (Article 126(6), (7), (8), (12) and (13)); and measures related to the articles listed in paragraph 2 of art 139 TFEU.

Grid 3 | Fiscal policy – The European Stability Mechanism

Definition of the policy studied	**Members** ("Normal" level of integration between EU members without differentiation) (Euro area member states)	**Differentiated members** (Differentiated level of integration of EU members beyond or below the "normal" level) (Non-euro-area member states)
Regulatory dimension: Commitment to		
Regulatory scope - Full - Partial - Punctual - None	**Full commitment** to the ESM's provision of financial assistance (e.g., direct loans, primary market purchases, loans for bank recapitalisation). - Contribution to capital stock (ESM Treaty art 8). - Possibility to request stability support (ESM Treaty art 13). - Strict conditionalities: Memorandum of Understanding (ESM Treaty art 13) and macroeconomic adjustment programme (Regulation 472/2013 Art. 7 (1)). - Ratification of the TSCG (Fiscal Compact) (ESM Treaty, preamble point 5).	**No commitment** Only euro area member states are members of the ESM. "Membership in the ESM shall be open to the other member states of the European Union as from the entry into force of the decision of the Council of the European Union taken in accordance with Article 140(2) TFEU to abrogate their derogation from adopting the euro" (ESM Treaty art 2).
Legal quality - Community method (supranational hard law) - Intergovernmentalism (intergovernmental hard law) - Transgovernmentalism (soft law)	Intergovernmentalism ESM Treaty	
Extent of legal commitment - Harmonisation - Approximation - Information	Harmonisation	
Organisational dimension: Participation in		
Agenda setting - Full - Partial - Punctual - None	**Full** In the Board of Governors, "Additional subjects may be placed on the agenda by any Governor" (ESM by laws art 3(5)).	**None** Non-euro-area member states are not ESM members. Non-euro-area member states may be invited to participate, on an ad hoc basis, as observers, in the meetings of the Board of Governors and Board of Directors (art 5 and 6 ESM Treaty).
Policy formulation - Full - Partial - Punctual - None	**Full** All ESM members can ask for assistance (art 13 ESM Treaty).	**None**
Decision taking - Full - Partial - Punctual - None	**Full** Each ESM member has voting rights, but according to its share (art 4 ESM Treaty).	**None**

Policy implementation - Full - Partial - Punctual - None	**Full** All ESM members are on the Board of Governors, which decides if/how to provide financial assistance. The Board of Governors entrusts the European Commission to negotiate the memorandum of understanding (art 13.3 ESM Treaty).	**None**
Policy enforcement - Full - Partial - Punctual - None	**Partial** "The European Commission – in liaison with the ECB and, wherever possible, together with the IMF – shall be entrusted with monitoring compliance with the conditionality attached to the financial assistance facility" (Art 13(7) ESM Treaty). After the first tranche of support, the Board of Directors (representatives of all members) decides whether the credit line continues to be adequate or whether another form of financial assistance is needed (art 14(6) ESM Treaty).	**None**
Policy evaluation - Full - Partial - Punctual - None	**Partial** The ESM has an independent Board of Auditors which verifies that the operational accounts and the balance sheet are in order. Each year, it reports to the Board of Governors audit findings, conclusions and recommendations (art 30 ESM Treaty). Member states evaluate the functioning of the ESM and can propose changes to the Treaty (e.g., current discussion to transform the ESM into a European Monetary Fund, or create new credit lines).	**None**

Grid 4 | Fiscal policy – The Fiscal Compact

Definition of the policy studied	**Members** (“Normal” level of integration between EU members without differentiation) (Euro area member states)	**Differentiated members** (Differentiated level of integration of EU members beyond or below the “normal” level) (Non-euro-area member states)
Regulatory dimension: Commitment to		
Regulatory scope - Full - Partial - Punctual - None	**Full commitment** - General government budget must be balanced or in surplus. - All rules, including MTOs, must be introduced in national law. - Automatic correction mechanism if deviations from the MTO occur. - Economic partnership programmes (for countries under EDP). - Report ex-ante on their public debt issuance plans. - Vote on European Commission recommendation if a euro area member state has breached deficit rules. Recommendations are adopted by reverse qualified majority voting (RQMV) - Euro Summits must be held twice a year. - Enhanced surveillance for euro area member states with fiscal sustainability issues.	**Bulgaria, Denmark, Romania: Partial commitment** - General government budget must be balanced or in surplus. - All rules, including MTOs, must be introduced in national law. - Automatic correction mechanism if deviations from the MTO occur. - Economic partnership programmes (for countries under EDP). - Report ex-ante on their public debt issuance plans. - Participate in the Euro Summit meetings concerning competitiveness for the contracting parties, the modification of the global architecture of the euro area and the fundamental rules that will apply to it in the future, as well as on specific issues of implementation of the TSCG in the Economic and Monetary Union (art 12(3) TSCG). **Czech Republic, Croatia, Hungary, Poland, Sweden: Punctual commitment** - Participate in the Euro Summits on some occasions (art 12(3) TSCG).
Legal quality - Community method (supranational hard law) - Intergovernmentalism (intergovernmental hard law) - Transgovernmentalism (soft law)	Intergovernmentalism Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)	Intergovernmentalism Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)
Extent of legal commitment - Harmonisation - Approximation - Information	Harmonisation	Harmonisation
Organisational dimension: Participation in		
Agenda setting - Full - Partial - Punctual - None	**Full** The Eurogroup examines and discusses the agenda of the Euro Summit. The agenda must be agreed in the Euro summit by simple majority (Rules for the Organisation of the Proceedings of the Euro Summits, point 3).	**Punctual** Contracting parties whose currency is not the euro shall participate in Euro Summits to discuss: - competitiveness for the contracting parties, - the modification of the global architecture of the euro area and the fundamental rules that will apply to it in the future, - specific issues of implementation of the TSCG (art 12(3) TSCG).

Policy formulation - Full - Partial - Punctual - None	**None** The time frame for convergence to MTOs is proposed by the European Commission. Correction mechanisms are put in place by the member states, based on principles proposed by the European Commission (art 3 TSCG).	**Bulgaria, Denmark, Romania: None** The time-frame for convergence to MTOs is proposed by the European Commission. Correction mechanisms are put in place by the member states, based on principles proposed by the European Commission (art 3 TSCG). **Czech Republic, Croatia, Hungary, Poland, Sweden: None** They are not bound by the Fiscal Compact.
Decision taking - Full - Partial - Punctual - None	**Full** The contracting parties whose currency is the euro approve or reject with RQMV the European Commission's recommendations in the context of an EDP for a euro area country (art 7 TSCG).	**Bulgaria, Denmark, Romania, Czech Republic, Croatia, Hungary, Poland, Sweden: None**
Policy implementation - Full - Partial - Punctual - None	**Full** The member states have to comply with the rules, e.g., put in place correction mechanisms and ensure compliance with reference values.	**Bulgaria, Denmark, Romania: Full** The member states have to comply with the rules, e.g., put in place correction mechanisms and ensure compliance with reference values. **Czech Republic, Croatia, Hungary, Poland, Sweden: None** They are not bound by the Fiscal Compact.
Policy enforcement - Full - Partial - Punctual - None	**Partial** The contracting party can bring a case to the European Court of Justice if it considers that a country has failed to comply with the rules (art 8 TSCG).	**Bulgaria, Denmark, Romania: Partial** The contracting party can bring a case to the European Court of Justice if it considers that a country has failed to comply with the rules (art 8 TSCG). **Czech Republic, Croatia, Hungary, Poland, Sweden: None** They are not bound by the Fiscal Compact.
Policy evaluation - Full - Partial - Punctual - None	**Full** The European Fiscal Board (EFB) is an independent advisory body of the European Commission in charge of evaluating the implementation of the Union fiscal framework and suggesting its future evolution. As an intergovernmental treaty, contracting parties can evaluate the outcomes and decide on changes.	**Bulgaria, Denmark, Romania: Full** The European Fiscal Board (EFB) is an independent advisory body of the European Commission in charge of evaluating the implementation of the Union fiscal framework and suggesting its future evolution. As an intergovernmental treaty, contracting parties can evaluate the outcomes and decide on changes. **Czech Republic, Croatia, Hungary, Poland, Sweden: None**

Grid 5 | Macroeconomic coordination – The European Semester

Definition of the policy studied	**Members** ("Normal" level of integration between EU members without differentiation) (Euro area member states)	**Differentiated members** (Differentiated level of integration of EU members beyond or below the "normal" level) (Non-euro-area member states)
Regulatory dimension: Commitment to		
Regulatory scope - Full - Partial - Punctual - None	**Full commitment** System of macroeconomic coordination timeline: November: the European Commission presents Annual Growth Survey (AGS), Alert Mechanism Report (AMR), recommendations for the euro area and opinions on draft budgetary plans. December/January: euro area ministers in the Council adopt euro area recommendations. Ecofin adopts conclusions on AGS and AMR. Euro area member states adopt budgets. February: the European Commission publishes Country Reports for all member states (including in-depth reviews). April: all member states submit national reform plans and euro area member states present stability programmes. May: the European Commission proposes Country Specific Recommendations (CSRs) which are then discussed by the Council and approved by the European Council. October: Euro area member states provide draft budgetary plans and Economic Partnership Programme (if under EDP) (Art.119, 121 and 136 of TFUE, Reg.473/2013 and Reg.1466/97).	**Partial commitment** Non-euro-area member states have the following exceptions: - No commitment to the recommendations for the euro area. - Exemption from presenting draft budgetary plans. - Different thresholds for the scoreboard of the AMR. - In April, presentation of national reform plans and convergence programmes. - Non-euro-area member states do not vote on adopting euro area recommendations (Art.119 and 121 Reg.1466/97 and 1176/2011).
Legal quality - Community method (supranational hard law) - Intergovernmentalism (intergovernmental hard law) - Transgovernmentalism (soft law)	Community method	Community method
Extent of legal commitment - Harmonisation - Approximation - Information	Harmonisation	Harmonisation
Organisational dimension: Participation in		
Agenda setting - Full - Partial - Punctual - None	**None** In Annual Growth Surveys the European Commission sets out economic priorities for the EU and gives member states policy guidance for the following year. In AMR the European Commission identifies countries to which an in-depth review will be addressed.	**None** In Annual Growth Surveys the European Commission sets out economic priorities for the EU and gives member states policy guidance for the following year. In AMR the European Commission identifies countries to which an in-depth review will be addressed.

Policy formulation - Full - Partial - Punctual - None	**None** The European Commission presents Euro Area Recommendations. The European Commission proposes CSRs.	**None** The European Commission proposes CSRs.
Decision taking - Full - Partial - Punctual - None	**Full** December/January: Ministers of euro area in the Council adopt Euro Area Recommendations. Ecofin adopts conclusions on AGS and AMR. March: the European Council adopts economic priorities based on AGS. June/July: the European Council endorses CSRs proposed by the Commission.	**Partial** December/January: Ecofin adopts conclusions on AGS and AMR. March: the European Council adopts economic priorities based on AGS. June/July: the European Council endorses CSRs proposed by the Commission.
Policy implementation - Full - Partial - Punctual - None	**Full** Member states present stability programmes to show how they will comply with CSRs, the priorities set by the European Council, and fiscal rules (MTOs). In October, euro area member states present the Draft Budgetary Plans, which must be consistent with SGP and CSRs (Reg.473/2013 and Reg.1466/97).	**Full** Member states present convergence programmes to show how they will comply with CSRs, the priorities set by the European Council, and fiscal rules (MTOs) (Reg.1466/97).
Policy enforcement - Full - Partial - Punctual - None	**Punctual** The European Commission issues an opinion on draft budgetary plans by 30 November. If the Commission identifies a serious non-compliance with Stability and Growth Pact rules, it requests a revised draft budgetary plan to be submitted as soon as possible by the member state concerned (Reg.473/2013). The European Commission and the Council examine stability programmes. The Council may issue an opinion to strengthen the objective and the content of a member state's stability programme (Reg.1466/97). See the grids on the Stability and Growth Pact and on the Macroeconomic Imbalance Procedure for more details on policy enforcement.	**Punctual** The European Commission and the Council examine convergence programmes. The Council may issue an opinion to strengthen the objective and the content of a member state's convergence programme (Reg.1466/97). See the grids on the Stability and Growth Pact and on the Macroeconomic Imbalance Procedure for more details on policy enforcement.
Policy evaluation - Full - Partial - Punctual - None	**Punctual** The European Commission is currently conducting a review of the EU economic governance, including the European Semester, which is open to a variety of stakeholders including national authorities (European Commission 2020c).	**Punctual** The European Commission is currently conducting a review of the EU economic governance, including the European Semester, which is open to a variety of stakeholders including national authorities (European Commission 2020c).

Grid 6 | Macroeconomic coordination – The Macroeconomic Imbalance Procedure

Definition of the policy studied	**Members** ("Normal" level of integration between EU members without differentiation) (Euro area member states)	**Differentiated members** (Differentiated level of integration of EU members beyond or below the "normal" level) (Non-euro-area member states)
Regulatory dimension: Commitment to		
Regulatory scope - Full - Partial - Punctual - None	**Full** Economic coordination. The Council monitors the consistency of national economic policies with the objectives of the EU (art 121 TFEU). Preventive arm: - Alert Mechanism Report and scoreboard, in-depth reviews (IDRs), MIP country specific recommendations and specific monitoring for countries experiencing imbalances (Reg.1176/2011). Corrective arm: - Excessive imbalance procedure (EIP) can be triggered by the Council. - The member state with excessive imbalances presents Corrective Action Plan (CAP). - Sanctions may be imposed if the member state presents an inadequate CAP (for two consecutive times) or if it does not take actions to address the imbalances (Reg.1176/2011 and Reg.1174/2011).	**Partial** Economic coordination. The Council monitors the consistency of national economic policies with the objectives of the EU (art 121 TFEU). Preventive arm: - Alert Mechanism Report and scoreboard, in-depth reviews (IDRs), MIP country specific recommendations and specific monitoring for countries experiencing imbalances (Reg.1176/2011). Corrective arm: - Excessive imbalance procedure (EIP) can be triggered by the Council. - The member state with excessive imbalances presents Corrective Action Plan (CAP). - No sanctions applied (Reg.1176/2011).
Legal quality - Community method (supranational hard law) - Intergovernmentalism (intergovernmental hard law) - Transgovernmentalism (soft law)	Community method	Community method
Extent of legal commitment - Harmonisation - Approximation - Information	Harmonisation	Harmonisation
Organisational dimension: Participation in		
Agenda setting - Full - Partial - Punctual - None	Preventive arm: **None**. The European Commission, through the AMR, decides which countries will be subject to IDR and which countries experience imbalances (Reg.1176/2011). Corrective arm: **None**. The Commission recommends to the Council to start an Excessive Imbalance Procedure (Reg.1176/2011).	Preventive arm: **None**. The European Commission, through the AMR, decides which countries will be subject to IDR and which countries experience imbalances (Reg.1176/2011). Corrective arm: **None**. The Commission recommends to the Council to start an Excessive Imbalance Procedure (Reg.1176/2011).

Policy formulation - Full - Partial - Punctual - None	Preventive arm: **None**. The Commission proposes to the Council a recommendation for MIP-related CSRs (Reg.1176/2011). Corrective arm: **None**. Recommendation of the Commission for a Council recommendation establishing the existence of an excessive imbalance, policy recommendations, deadlines for the presentation of the CAP and sanctions (Reg.1176/2011 and Reg.1174/2011).	Preventive arm: **None**. The Commission proposes to the Council a recommendation for MIP-related CSRs (Reg.1176/2011). Corrective arm: **None**. Recommendation of the Commission to the Council establishing policy recommendations, deadlines. Non-euro-area countries do not participate concerning sanctions (Reg.1176/2011).
Decision taking - Full - Partial - Punctual - None	**Full** Council decides Country Specific Recommendations (QMV). Council decides recommendations establishing the existence of an excessive imbalance, policy measures, deadlines for the presentation of the CAP, adequacy of CAP (corrective arm). Council adopts the Commission's recommendation that no corrective action has been taken and can impose sanctions (RQMV) (Reg.1176/2011 and Reg.1174/2011).	**Partial** Council decides Country Specific Recommendations (QMV). Council decides recommendations establishing the existence of an excessive imbalance, policy measures, deadlines for the presentation of the CAP, adequacy of CAP (corrective arm). Non-euro area countries do not vote on sanctions on euro area countries (Reg.1176/2011).
Policy implementation - Full - Partial - Punctual - None	**Full** The concerned member state experiencing imbalances presents a Corrective Action Plan with policy actions it implements to address imbalances (Reg.1176/2011).	**Full** The concerned member state experiencing imbalances presents a Corrective Action Plan with policy actions it implements to address imbalances (Reg.1176/2011).
Policy enforcement - Full - Partial - Punctual - None	**Full** By reverse qualified majority the Council imposes sanctions if two consecutive CAPs are considered insufficient or no action has been taken (Reg.1174/2011).	**Partial** Non-euro-area member states vote on the recommendations, but not on sanctions.
Policy evaluation - Full - Partial - Punctual - None	**None** The Commission each year issues a Communication to assess progress on structural reforms and the functioning of the MIP's preventive and corrective arms (European Commission 2020a).	**None** None. The Commission each year issues a Communication to assess progress on structural reforms and the functioning of the MIP's preventive and corrective arms.

EU Integration and Differentiation
for Effectiveness and Accountability

Differentiation has become the new normal in the European Union (EU) and one of the most crucial matters in defining its future. A certain degree of differentiation has always been part of the European integration project since its early days. The Eurozone and the Schengen area have further consolidated this trend into long-term projects of differentiated integration among EU Member States.

A number of unprecedented internal and external challenges to the EU, however, including the financial and economic crisis, the migration phenomenon, renewed geopolitical tensions and Brexit, have reinforced today the belief that **more flexibility is needed within the complex EU machinery**. A Permanent Structured Cooperation, for example, has been launched in the field of defence, enabling groups of willing and able Member States to join forces through new, flexible arrangements. Differentiation could offer a way forward also in many other key policy fields within the Union, where uniformity is undesirable or unattainable, as well as in the design of EU external action within an increasingly unstable global environment, offering manifold models of cooperation between the EU and candidate countries, potential accession countries and associated third countries.

EU IDEA's key goal is to address **whether, how much and what form of differentiation is not only compatible with, but is also conducive to a more effective, cohesive and democratic EU**. The basic claim of the project is that differentiation is not only necessary to address current challenges more effectively, by making the Union more resilient and responsive to citizens. Differentiation is also desirable as long as such flexibility is compatible with the core principles of the EU's constitutionalism and identity, sustainable in terms of governance, and acceptable to EU citizens, Member States and affected third partners.

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