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Monetary Union, economic coordination and democratic legitimacy

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Policy implications

Since the outbreak of the financial, economic and budgetary crisis, we have been witnessing a potentially radical change in the mode of governance of the euro zone. Amid the state of emergency decreed by the financial markets, a series of innovations – institutional, political, procedural, etc. – have been implemented by the European and national political actors. In view of the urgency of the situation, the question of the democratic legitimacy of these measures has not yet been raised. And yet this question will determine their acceptability among European populations and the long-term sustainability of the answers proposed for dealing with the crisis. In strengthening the governance of the euro zone, it is therefore not possible to turn a blind eye to the democratic legitimacy of the measures selected for this purpose.

Introduction¹

The deep crisis experienced by the euro zone since 2009 forces awareness of the absence of institutions appropriate for fostering progress towards a harmonious and lasting form of economic and monetary integration. In no sense is this actually surprising, for most of the political and academic debates conducted back in the early 1990s drew attention to the incomplete and unbalanced nature of the arrangement devised at Maastricht (a single currency, but as many different economic and social policies as there are member states sharing the currency).

But today, in the context of crisis, and faced with the need for urgent action, we are seeing the emergence of innovations in terms not only of rules (adoption of new regulations for the stability and growth pact) and procedures (*ex ante* analysis of national budgetary policies, 'European semester', etc.), but also of practices (purchase by the European Central Bank – ECB – of

bonds on the secondary market) and of institutions (creation of the European Financial Stabilization Facility)². This set of innovations is far from having achieved any stable consistency, and it is even appropriate to raise doubts about the long-term relevance of these answers to the questions posed by the crisis of monetary integration. The member states, carried along by Germany and France, as well as the ECB, have been the main drivers of these changes, with the European Commission – and even the European Parliament – playing only a secondary role. Yet it is, paradoxically, the financial markets and rating agencies that have undoubtedly shown themselves to be the real cause of this increased recourse to economic and political integration. Given the urgency of the crisis, analysis has focused essentially on the short-term answers. How is monetary union to be saved? How are contagion and domino effects to be avoided right now and in the immediate future?

¹ We would like to thank Sotiria Theodoropoulou, Maria Jepsen and Kurt Vandaele for their astute and helpful comments.

² This *Policy Brief* focuses on the governance of the euro zone and the countries belonging to it. We do not here consider the broader aspects of this debate (what is entailed for those countries that remain outside the euro zone, whether or not they belong to the Euro Plus Pact, etc.)

The long-term sustainability of the arrangement that attempts are being made to consolidate has become a secondary issue. The urgency can of course be understood, but it is important to remember that it is the initial construction faults that contributed to making the current crisis so threatening.

No currency without political integration

Underneath the debates on monetary union runs the idea that there can be no lasting currency – even less so in the absence of an optimum currency area – without some form of State. History has provided examples that serve to confirm this link (the failure of projects such as the *Zollverein* or, more recently, of the dollarization of Argentina in 2001-2002). But then it is really a matter of knowing what is to be understood by 'State'.

In Europe it is quite obvious that the emergence of a European state along the lines of the national states is not a credible scenario in the short and medium term. Two aspects at least, however, are required for European monetary integration:

- On the one hand, a form of collective and supranational action that enjoys sufficiently strong legitimacy to impose political choices at the national level (thereby setting limits on national sovereignty);
- On the other hand, instruments of solidarity and redistribution that can be used to stabilise the monetary area in the event of asymmetric shock. This can be achieved either by increasing the European budget (see the Mac Dougall report of 1977 which advocated a European budget of between 5 and 7% of GDP in order to exert stabilizing effects) or by a form of unemployment insurance in the crisis-hit regions or countries (for an overall account see Pochet *et al.*, 1999).

According to an approach popularized by Fritz Scharpf, it is a question of strengthening the legitimacy of the inputs (formal democratic rules) but also of the outputs (policy outcomes in terms of increased wellbeing for all, which requires at least a feeling that there exists a balanced set of policies)(see also Scharpf, 2011).

a) Political integration

At the end of the 1980s and beginning of the 1990s, when preparations were being made for economic and monetary union (EMU), this debate failed to lead to any change in the EMU architecture as it was adopted in the Maastricht Treaty in 1992. This architecture is founded on a form of legitimacy that is essentially technocratic – independence of the ECB, growth and stability pact, broad economic policy guidelines – and on a (naïve) belief in a spontaneous convergence of the real economies as a result of the adoption of a limited number of formal public deficit/debt and inflation criteria, in conjunction with completion of the internal market (Collignon, 2010). We know today that the spontaneous nature of this process is an illusion. This is an aspect that is very much worth emphasising: over and above the dramatic current events, it is the lack of genuine convergence that is undermining the EMU, and to this situation a structural solution has to be found.

And so we see that, from the outset, formal criteria and technocratic processes were substituted for a supranational form of political legitimacy and instruments of solidarity – which could have enabled the development of a process of real convergence.

It is true that the debate on ways of strengthening the EU's democratic legitimacy continued around the turn of the millennium (with the work of the European Convention on the one hand and, on the other, the proclamation at Nice of the Charter of Fundamental Social Rights) but these met with failure at the same time as the draft constitutional treaty. In any classic vision of European federalism, political integration would quite naturally entail, among other things, a strengthening of the European Commission as a preliminary draft form of a European government for defence of the general interest. Yet, from an institutional standpoint, it is the European Council (with its now stable presidency) and European Parliament that, with adoption of the Lisbon Treaty in 2009, saw an increase in their powers, to the detriment of the Commission. This latter body is moving increasingly away from any notion of government of the EU and would appear to be turning into something more resembling a secretariat for the Council. This trend is further strengthened by the proliferation of working groups, for example on governance of the euro.

b) Choice of economic and social policies

Alongside these debates on political legitimacy, little progress has been seen in the efficient conduct and outcome of economic and social policies. The rules of the stability and growth pact were disregarded as from 2003, but the debates on the EU social dimension and on more elaborate forms of solidarity vanished into thin air quite soon after the turn of the millennium, in the context, in particular, of the EU enlargement to take in the countries of central and eastern Europe.

Economic and social policies have been focused, for the most part, on market solutions. They have been more compatible with a negative form of integration – in other words, less rules and more competition – than with positive integration – in the form of common European rules. Left-wing criticism of the constitutional treaty focused, in particular, on this underlying economic model which would have been strengthened by the new rules of the game – 'set in stone' in the European constitution – that would no longer have allowed free and open choice of economic and social policy options.

Meanwhile, since the crisis, the national austerity plans and those imposed by the EU and IMF have focused more on a reduction of expenditure than an increase in resources (Theodoropoulou and Watt, 2011). The demand for massive privatization programmes in Greece and elsewhere has come to appear normal, even though the European Treaties adopt a stance of neutrality as regards ownership regimes in the member states. Meanwhile, proposals that would offer alternatives to the automatic reduction of public expenditure are accorded scant attention: thus a proposal put forward by two members of the German Economic Council was to agree on a European consolidation pact designed to establish balanced national public finances by means of an automatic increase in taxes in the event of a deficit out of line with the approved schedule (Bofinger and Ried, 2011).

Ultimately, the current failure of the process of political integration and of the essentially negative form of integration opened up the way to alternative scenarios in which the question of the democratic legitimacy of the EU, and, in particular of the economic governance of the euro zone, is raised in a more complex manner (Barber, 2011; Bohle, 2011).

What is the legitimacy of a European 'economic government'?

The Franco-German proposal from Angela Merkel and Nicolas Sarkozy to create what they themselves described as a real form of 'European economic government' represents an innovation in institutional terms. According to this proposal, the European Council would become the government of the euro zone, in accordance with new national constitutional provisions (the insertion into the member states' fundamental texts of the 'golden rule', namely, the aim of balancing their national budget)³.

Because the amendments to the fundamental texts have to be adopted on the basis of special majorities in most member states, this could be seen as a strengthening of democratic legitimacy, insofar as it would require open debates to be conducted in all the member states of the euro zone (see example of Spain in August/September 2011, but also the national debates in Italy, Austria, Poland, etc.). This proposal also constitutes a reply to those who assert that it is less a question of strengthening European democracy than of not emptying national democracy of its substance (Schelkle, 2011).

And yet, one cannot help wondering whether such a constitutionalisation of the rules for balancing budgets really is the result of a national democratic debate and not rather of a balance of power with the rating agencies, or even of a particular historical moment at which Germany happens to be in a position to impose its own rules on all the others, by threatening to limit, reduce or discontinue its financial support.

Under the terms of the Franco-German proposal, this national level of constitutionalisation would be accompanied by a second (indirect) level, namely, decisions taken by the heads of state and government – and not only the economics ministers – along the lines of the Lisbon Strategy model which, in 2000, had given policy-steering responsibility to the European Council – and not the Finance ministers, this being an indication that the steering

would not be limited to economic policy matters but would extend to all forms of policy.

However this may be, this Franco-German proposal is thus founded on the need to come back to the national debates on the (national and European) conditions that have to be met to achieve the long-term stabilization of this hybrid and multi-level construction constituted by economic and monetary union. It is, what is more, this same type of debate that took place in most of the member states in relation to the changes to be made for entry to the euro (most often by means of social pacts, Fajertag and Pochet, 2001; Pochet *et al.*, 2010).

Yet this proposal prompts at least two criticisms. The first criticism, institutional in nature, is that the choice of the European Council has the effect of strengthening the role of the large states, France and Germany in particular. These are likely to seek to impose their views on the smaller ones, and hence to meet with systematic resistance from them. And this would mean that the democratic deficit would not be reduced but merely shifted: it would no longer stem from the powers accorded to a supranational body versus the national authorities but from the strength of the big countries versus the small ones. The decisions could well come to be regarded as not being the outcome of a European democratic debate but as having been imposed by the strongest. If one is a citizen of a country other than France or Germany (where new governments can be elected) what remaining power does one have to influence the decisions imposed by these two countries? It is important too to consider what the role of the European Parliament – whose powers were strengthened in the Lisbon Treaty – would become in this new set-up. Will it become the institution before which the 'European economic government' (of the countries of the euro zone alone) will be required to justify and take responsibility for its actions?

The second criticism is a matter of substance: the incorporation of the 'golden rule'⁴ into the fundamental national texts is tantamount to constitutionalizing rules that are, if not absurd, at least controversial, and which, what is more, have already proved highly contentious among professional economists. Should we not be reminded that, before the crisis, Spain and Ireland remained respectful of the convergence criteria of the Maastricht Treaty? In 2005, 2006 and 2007 Spain was already, in a certain manner, abiding by the golden rule – of budgetary surplus – until it went under in 2008 – as a result of the crisis and not because it could be faulted on the score of budgetary virtue. Ireland before the crisis, meanwhile, had had, even better, a budgetary surplus since 1997, with a single year of deficit in 2002 (-0.4% of GDP). In 2010 it had a deficit amounting to -32.4% of GDP.

Is it also necessary to be reminded that the EU member states reduced their public deficits as from 2000 (De Grauwe, 2011)? With the exception of the Greek case, there was no general drift away from required standards that might perhaps have been such as to justify the inclusion of the famous golden rule (there is a need

3 The other components of the Franco-German proposal are a tax on financial transactions and a harmonisation of corporate taxation. It is to be noted that, on these two subjects, there already exist Commission proposals currently under discussion (the Commission was to present 'after the summer' a formal proposal for the introduction of a tax on financial transactions in the EU – France and Germany made their proposal in August (!); meanwhile, the Commission proposal on establishing a common tax base for corporate taxation in the EU is dated 16 March 2011). Does this reflect an institutional shift towards intergovernmentalism? However this may be, these two proposals indicate that we are witnessing a definite shift in political priorities. This could equally well serve to foster a greater acceptance of a strengthening of European integration. While this is extremely important, it is not the main subject of this *Policy Brief*; it is a subject to which we will return in a forthcoming issue.

4 It should be pointed out that, in principle, the true 'golden rule' (of economists) is that deficit may be equal to investment. In Franco-German parlance, the expression is used to mean a balancing of budgets.

to distinguish developments attributable to the problem specific to Greece from those attributable to the architectural defects of the EMU; see, on this subject, Featherstone, 2011). But there was some degree of political will to balance the deficit reduction by heeding the social and societal (and electoral) repercussions and the need for social cohesion.

Such considerations indicate that constitutionalisation of the golden rule would have been quite useless in the current crisis; and not only that, for it is equally unlikely to constitute a remedy in the future. It is quite obvious that when the crisis is over, the main new challenge will be climate change, and this is a challenge requiring massive infrastructural investment. What will be people's attitude to the golden rule under those conditions? We can be pretty sure that there are countries where it will be regarded as quite devoid of legitimacy.

To return to the example of Spain, this proposal to constitutionalise the golden rule, even though it is supported by the two major national political parties, seems to be more of a sop to the financial markets than a legitimate choice resulting from an open and public debate: at the time of writing, a petition demanding a referendum on the golden rule appears to be encountering great success among the population. This gives rise to the paradoxical situation in which a country that has respected the Maastricht criteria to the letter ever since the launch of the single currency now finds itself having to deal with social unrest in opposition to a constitutionalisation, with a demand that it be preceded by a referendum, even while the socialist and conservative majority parties are opposed to such a referendum.

This brings us to ask a few questions about the legitimacy of the measures virtually imposed in the context of the crisis, without any prior opportunity having been given for them to receive a democratic political airing. Indeed, one of the reasons for which the stability and growth pact was, from the outset, not respected in its spirit (nor even its letter, particularly in 2003 by France and Germany) is, precisely, the absence of national-level legitimacy of the measures that it contained. To this absence should be added the absence of legitimacy of the Commission and its EcFin DG when it comes to imposing their view in relation to failure to respect the pact. And it is also a defect in the Commission's argumentation that, for example, led Ireland, during the same period, to refuse to take account of the European recommendations on the overheating of its economy. Here there existed, already, a twofold challenge over legitimacy: who decides and on the basis of what type of rationale?

Conclusion: the need for complex and open debates

We would appear to be witnessing, since the outbreak of the crisis, a potentially radical change in the mode of governance of the euro zone. This change results from the observation that the arrangement put in place at Maastricht is not such as to be able to resist the knockdown blows inflicted by financial markets and rating agencies. The arrangement was already known to be fragile (De Grauwe, 2011) and now it has come up against a twofold

crisis: in relation to the formal convergence criteria, principally illustrated by the Greek case; and in relation to the absence of real convergence (justifying the inclusion of new criteria in the new stability pact package). The former crisis calls for short-term action, the latter for action in the medium or long term. Accordingly, all the questions on the governance of the euro that have been more or less repressed since Maastricht are emerging once more, but this time in acute fashion.

We will here mention just two such questions:

- The measures adopted as matters of urgency entail, and will continue to entail, deep social and democratic consequences in many countries. This is particularly true, what is more, in those areas where the EU has no formal powers (pay formation), or very few competencies (social protection), or even in fields that are expressly excluded from the European sphere (while the Treaties expressly abstain from laying down provisions that would require a specific form of ownership, the plan to rescue Greece explicitly provides for the sale – privatisation – of state assets). The consequences will be all the more serious in that, in the absence of a classic federalist architecture (which would require a genuine European budget of between 5 and 7% of GDP and the Commission as a sort of government subject to control by the Parliament), there is a need to devise rules and procedures such that a similar direction will be taken at each national level, and this will necessarily entail increased controls and less national autonomy. The routes taken by the European actors to rescue the economic and monetary union thus pose, in a complex manner, the question of the democratic legitimacy of this newly emerging (multi-) governance of the euro zone, and of its social policy consequences.
- Will these new rules serve to prevent another crisis? As Paul De Grauwe has astutely pointed out, it is not because fire-prevention standards have been put in place that we can afford to dispense with firemen. The existence of fire prevention standards does not mean that fires do not break out, for the actors may themselves fail to comply with the rules (this is frequently the case if they have not been involved, or if they consider the rules to be absurd, or think that they should not apply to them). What is more, these rules cannot foresee all instances that may arise. For the rules to be accepted and implemented, it is thus important that they should be judged legitimate and balanced (rather than being seen to incorporate a 'winner-takes-all' bias, cf. Hacker and Pierson 2010). For this reason, it is necessary to go back to the idea of a compromise in which all can see their concessions offset by gains, and to the idea of political alternatives, for there is a need for political choices to be subject to change in accordance with changing political majorities. When all possibility of an alternative is blocked, the risk is – as shown by the movement of the 'indignants' – one of anger, social explosion or a disintegration of cohesion.

The debate on rules and the respect of formal criteria will thus not change the governance of the euro unless it is framed within open public discussion of the economic and social policy choices, and within a perspective of policy integration (Fitoussi *et al.*, 2010). The surveillance and solidarity measures adopted at European level need to be accompanied by national debates about how

to manage the constraints of monetary union, and how to build real convergence. Such debates took place in the 1990s in the run-up to entry to the euro zone. It is on this condition alone that the governance of the euro zone will encounter legitimacy and that the risk of new crises will be able to be reduced. This is a far-reaching programme indeed. But in the absence of this legitimacy, and in the presence of permanent crises, the risk is that the people of Europe will rise up against Europe.

Translation from the French by Kathleen Llanwarne

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