EUROPA briefing

Economic government: What kind of coordination for the Eurozone?

How are decisions made in the euro area? And how democratic are they? These questions moved to the centre of the debate during the euro crisis. Under tremendous time pressure, solutions had to be found for stabilising the euro. New institutions and rules were created such as the European Stability Mechanism, the Banking Union and the Fiscal Compact. Who makes the decisions in the Eurozone today? Is there a democratic deficit? Does the currency union need better control mechanisms – or are the old ones good enough?

JACQUES DELORS INSTITUT BERLIN | BertelsmannStiftung

Who decides upon economic policy in the Eurozone?

The responsibility for budgetary and economic policy in the Eurozone is largely in the hands of the member states. Responsibility for the common monetary policy was handed over to the European Central Bank (ECB), however. As a result, there has been a monetary union, but no economic union as yet since the Maastricht Treaty.

The budgetary policies of the euro-area countries are subject to European rules. The members of the Eurozone must comply with an agreed set of ➔ **fiscal rules** that are designed to keep their budgets in check and protect against excessive debt. The European Commission monitors compliance and can impose fines in the event of any breaches.

Collective economic policy decisions are primarily made in the ➔ Eurogroup where the finance ministers of the Eurozone countries meet. Since 2011, national economic policies have also been coordinated in the European Semester. The focus of coordination here is on budgetary policy, national structural reforms and the avoidance of excessive macroeconomic imbalances. Eurozone countries can theoretically be sanctioned for not complying with the rules. In practice, however, threats of punishment have proven to be toothless.

A majority of Europeans support the euro, but many do not accept the way the EU handles economic issues. According to a Eurobarometer survey in April 2017, almost three-quarters of the Eurozone population support the common currency. At the same time, many have doubted since the crisis that the euro can achieve its original stability and growth promises. A survey published by the Pew Research Centre in June 2017 showed that over half of the surveyed EU citizens are dissatisfied with economic policy management in Europe. The approval ratings in Greece, Italy and France are especially low.

➔

Fiscal rules
A package of European rules that sets the maximum levels for new debt and accumulated debt in Eurozone countries. The package includes the Stability and Growth Pact as well as the Fiscal Compact and the two legislative initiatives Six-Pack and Two-Pack, which further strengthened the original rules during the crisis.

Eurogroup
The finance ministers of the Eurozone countries discuss questions related to the common currency here. Their most important task is to ensure close coordination of economic policy in the euro area. Despite its informal character, the group made essentially all the important decisions on crisis management and on the rescue of individual countries during the crisis.

“Do we need something like an economic government [for the Eurozone]? I am quite in favour of this. A European finance minister? In principle, I also agree with this. […] If there is a common legal foundation, I can also imagine many other things.”

Angela Merkel, German Chancellor
in an interview with Die Zeit on 6 July 2017

“I have an ‘impossibility theorem’ for the global economy that is like that. It says that democracy, national sovereignty and global economic integration are mutually incompatible: we can combine any two of the three, but never have all three simultaneously and in full.”

Dani Rodrik, Economist at Harvard University
in his weblog on 27 June 2007

Does the Eurozone suffer from a lack of democracy?

During the crisis, a web of interwoven, partially contradictory sources of legitimacy emerged in the Eurozone. Before the crisis, policy for the euro was mainly legitimised through the member-state governments. The changes to the euro area's architecture during the crisis mean that this is no longer adequate as a democratic basis.

First, the Eurozone countries have further reduced their national decision-making authority. In the crisis, many collective decisions were made and new institutions created, going far beyond the loose pre-crisis coordination. This includes the European Stability Mechanism (ESM), whose reform programmes entail deep cuts for the affected crisis countries. What's more, the rules for handling ailing banks or the strengthening of budgetary controls through the Fiscal Compact have further reduced the autonomy of Eurozone countries.

Second, parliaments remain largely left out of the process. Without direct control by the European Parliament, for example, the Troika consisting of representatives from the European Commission, the ECB and the International Monetary Fund reached decisions with far-reaching consequences in crisis countries.

Third, the crisis led to a sharing of risk without any fundamental changes in the way decisions are democratically controlled in the Eurozone. The ECB played a key role here: By buying government bonds and coming from the signal given by its president, Mario Draghi, that it would do "whatever it takes" to save the euro, the ECB defused the crisis in individual countries. Furthermore, the ESM effectively meant the end of the no-bailout clause in the Eurozone: A member state can now be helped with direct payments that are provided or guaranteed by other euro-area countries.

The euro crisis showed that the Eurozone must improve its governance. Although additional steps towards integration and the EU Treaty amendments required to achieve this are difficult, the conditions for institutional reforms in the euro area after the latest national elections are probably better than they have been for a long time.

Sharing of risk
This refers to the sharing of liability risks or burdens among Eurozone countries, for example in the area of public finance. Risks can be shared indirectly through the capital markets or ECB policy and the prices for government bonds or directly through payments between countries.

No-bailout clause
A provision in the European Treaties that rules out any liability of the EU and all member states for the debts of individual EU countries. The rule was created in order to motivate euro-area countries to show budgetary discipline. They should not harbour hopes that they would receive backing later in the event of imprudent fiscal policy.

"Democracy deserved a boost in euro-related matters. We just delivered it. Let the people decide."

Yanis Varoufakis, Finance Minister of Greece
prior to the Greek referendum on the euro bailout package via Twitter on 26 June 2015

"In order to invest more than today, we want a budget for the Eurozone, passed by a Eurozone parliament and implemented by an economics and finance minister for the Eurozone."

Emmanuel Macron, President of the Republic of France
in his election programme "En Marche!" 2017

ECONOMIC GOVERNMENT

A look ahead

SCENARIO 1

Expansion of the European Stability Mechanism

In this first scenario, Eurozone institutions that are founded on intergovernmental agreements are strengthened. This includes the expansion of the European Stability Mechanism (ESM). It could receive additional competencies such as economic analysis of member states, monitoring of national budgetary and economic policies or penalty options in the event of non-implementation of rules and required reforms. Should countries experience economic difficulties, the same automatic mechanisms are always activated. The ESM would become a kind of early warning system for the Eurozone in the hands of member state governments, which would have to account for their actions, as before, to their national parliaments.

In this scenario, the reforms aim at enhancing proper implementation of common euro-area policies. However, there are doubts as to whether the rules monitored on an intergovernmental basis can really be implemented: The budgetary rules in the Stability and Growth Pact were often breached without – theoretically available – sanctions being imposed. Experience has also shown that a strict rule book leaves less leeway for action in the event of unanticipated economic shocks. A further strengthening of intergovernmental controls also entails a weakening of the European Commission and the European Parliament.

SCENARIO 2

A federal Eurozone

The second scenario is based on an extensive sharing of risk and sovereignty in the euro area where the competencies for economic policy are anchored more at EU level. This includes turning the ESM into a European Treasury that coordinates and monitors not just bailout packages, but also the fiscal and economic policies of euro-area countries. As opposed to the first scenario, the Treasury would be under EU management, for example under a European finance minister representing the interests of the Eurozone as a whole. Such an office could also be given its own investment budget in order to compensate for shocks and to reward reforms. This scenario would come with a substantial strengthening of democratic control by the European Parliament.

The "federal quantum leap", which this scenario requires, appears to be unlikely for now despite increasing public support within the monetary union. Hardly any member state is ready to accept a further shift of competencies to the European level and to deal with the ratification process required for treaty amendments, including by a referendum vote in some countries.

SCENARIO 3

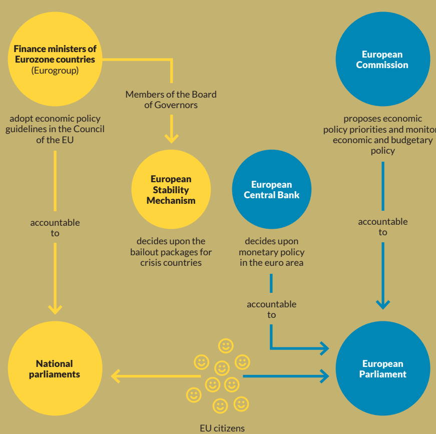
Simplification prior to expansion of the euro architecture

Improving the governance of the Eurozone here implies making the current decision-making structures and democratic control mechanisms more transparent as a first step. Only then would any additional steps towards integration be negotiated. Inter alia, the position of president of the Eurogroup could be assumed by a full-time official chair conducting any negotiations on aid programmes. The ESM could be built up financially and be brought into the European legal framework. Furthermore, existing rules on budgetary policy could be simplified and country-specific recommendations in the European Semester reduced. The advantage of this scenario is that no amendments to the European Treaties would be necessary initially.

In the medium term, the ESM's role could be expanded to that of lender of last resort if member states are ready for this politically. A European finance minister could occupy the position of president and double up as commissioner and president of the Eurogroup. This individual could answer to a joint committee of delegates from the European Parliament and national parliaments that could veto any ESM decisions via a qualified majority vote.

FACT #1

Governance in the Eurozone today: Who decides and who controls what?

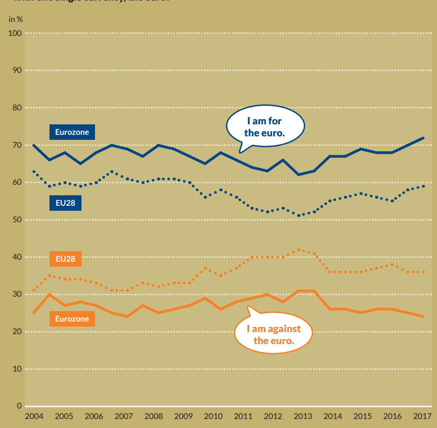


Source: European Commission 2017, author's chart.

FACT #2

A majority of Europeans support the euro

What is your opinion on the European economic and monetary union with one single currency, the euro?



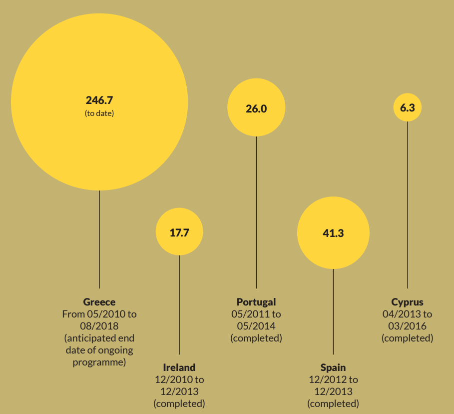
59 percent of Europeans support the euro, which is the highest level since autumn 2009. In the Eurozone, approval of the common currency is even higher at 72 percent.

Source: Eurobarometer, April 2017.

FACT #3

Bailout programmes in the Eurozone

Loans paid out to crisis countries (in billion euro)



Since 2010, Eurozone countries with payment difficulties have received loans from the European Stability Mechanism (ESM) and its predecessor, the EFSF. Ireland, Portugal, Spain and Cyprus have left the ESM in the meantime. Only Greece still has an ongoing programme – now the third.

Source: ESM.

"Understandably, the countries in the Eurozone want to be able to decide upon their economic policy autonomously. In a monetary union, however, a certain degree of steering is necessary to shape policy coherently and to achieve compliance with rules. Therefore, the gradual strengthening of European institutions is important to improve the governance of the Eurozone – even if it is difficult."

Dr. Katharina Gnath
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www.strengthentheeuro.eu
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EUROPA briefing

In the publication series "Europa briefing", the Bertelsmann Stiftung and the Jacques Delors Institut – Berlin cover key topics of European politics and present possible scenarios: What is the problem? What might happen next? And what can politics do now?

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Translation
ETC Europe scrl, Brussels

Edit
David Gow, Edinburgh

Design
ressourcenmangel
an der Panke GmbH, Berlin

Production
druck.haus rihn gmbh, Blomberg

Persons responsible according to
the German Press Law
Prof. Dr. Henrik Enderlein,
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