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ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES  
Global Governance Programme

THE DEMOCRATIC GOVERNANCE OF THE EURO

Organized by Miguel Poiares Maduro, Bruno De Witte and Mattias Kumm



**EUROPEAN UNIVERSITY INSTITUTE, FLORENCE**  
**ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES**  
**GLOBAL GOVERNANCE PROGRAMME**

*The Democratic Governance of the Euro*

**ORGANIZED BY**  
**MIGUEL POIARES MADURO, BRUNO DE WITTE AND MATTIAS KUMM**

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## Table of Contents

<i>Introductory Remarks</i> Miguel Poiares Maduro .....	1
<i>The Euro Crisis and the Democratic Governance of the Euro: Legal and Political Issues of a Fiscal Crisis</i> Miguel Poiares Maduro, Bruno De Witte and Mattias Kumm.....	3
<i>Democratic Governance of the Euro: Shortcomings and proposals for reform (rev/16.4. 2012)</i> Roland Bieber.....	13
<i>The Democratic Governance of the Euro: some proposals</i> Carlos Closa Montero.....	21
<i>Lessons for the Euro and its Governance from History</i> Harold James .....	33
<i>The European Economic Constitution in Crisis: Between 'State of Exception' and 'Constitutional Moment'</i> Christian Joerges .....	39
<i>The European Stability Mechanism: a constitutional authority in disguise</i> Giulio Napolitano .....	45





## Introductory Remarks

Miguel Poiares Maduro\*

This policy paper includes some of the contributions for a group set up at the EUI to address the crisis of the Euro area with a focus on its democratic dimensions. The perspectives included in here are diverse and not necessarily unanimous in the solutions they propose to address the crisis. They also go from the more general issues (what is needed to save the common currency and how to legitimate it) to more concrete questions regarding particular aspects of the new governance regime that the EU has slowly been setting up for the Euro. Common to them, as mentioned, is the democratic question. What democratic challenges does this crisis raises and how to address them?

The democratic question is crucial to understand the present crisis and decide how best to address it. Many of the financial problems at the origin of the crisis can be represented as democratic problems, either as failures of the political processes or as market failures that the democratic processes of the states are not able to correct. The Euro might help to address some of those democratic failures. But it may also aggravate them by increasing interdependence and the spill over effects of the fiscal policies of some states in other states. The key issue then is how to develop a model of governance for the Euro area that can maximize its potential in correcting the democratic failures of states and markets instead of aggravating them. The contributions in this paper assume that this is possible and try to put forward proposals on how to do it. The EU should not be constructed as a challenge to national democracy but, instead, as offering democracy and social justice where States can no longer offer them. But there are also different visions on the extent to which that is possible and how to achieve it.

Other contributions focus, instead, in what the Union has already done to change the governance mechanisms of the Euro. The emerging governance of the Euro raises, itself, a variety of democratic challenges that need to be addressed: from the accountability of some of its new “institutions” (such as the ESM) to the coordination between what is to be done within the EU legal system and what is being done outside it.

A final theme is the relationship between national democracy and EU democracy. Here, the views are not the same. Some believe that the democratic legitimacy of the new powers gained (or to be gained) by the EU passes by an even stronger involvement of national democracies (in particular in the form of national parliaments participation) in the EU decision-making process. Others, as myself, believe that the Union cannot continue to fundamentally depend on a permanent “negotiation” with national politics and needs to develop its own political space, even if this ought not to replace national politics but to complement them.

Ultimately, the proposals put forward in this paper aim at contributing to a constructive debate not only on how to save the Euro but also on its merits and demerits. This is a necessary discussion to be had. If further integration will be necessary to solve the current crisis this ought not to be presented to citizens simply as a logical necessity on which they no longer have a choice. It is necessary to make a case for the Euro and not only to make a case on how to save it. These essays contribute to that.

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## **The Euro Crisis and the Democratic Governance of the Euro: Legal and Political Issues of a Fiscal Crisis**

Miguel Poiares Maduro, Bruno De Witte and Mattias Kumm\*

The European financial crisis is not going to be fixed by Council agreements or technical fixes. Instead it also raises profound political questions that affect the future of the European Union as a whole. A first part of the Memo will briefly describe how the fiscal crisis raises fundamental political questions relating to the democratic legitimacy of practices of national as well as European institutions (I). A second part will analyze different ways in which the democratic legitimacy of European institutions can be enhanced within the parameters of the existing institutional framework. In practice, we suggest a constitutional changes but without Treaty amendments (II). A third part discusses in greater detail a number of specific suggestions that concern the implementation of the ESM, the Fiscal pact and the Six-Pack (III).

### **I. The Euro Governance and the Democratic Question**

We need to discuss not only the governance of the Euro but also the *democratic quality of that governance*. The latter must be at the centre stage of the reforms that are being put in place. First, because many of the problems at the origin of the crisis correspond to democratic failures of the states that the EU needs to help correct. Second, because whatever institutional answers are being proposed at the European level, they will have to be democratically legitimate themselves. In this respect, a fundamental challenge for the future reform will be to overturn the presumption, shared by many that these issues can only be democratically addressed at the national level or, if addressed at the European level, would necessarily have to reproduce the democratic model of the State. Ideally, the governance of the Euro might be used to finally develop a new approach to the democratic challenges of European integration.

The fiscal crisis has highlighted a political gap: the scope and level of politics has not followed the scope and level of political problems in Europe. This is our most important democratic deficit. First, we have not internalized the degree and democratic consequences of the interdependence generated by integration. The financial troubles of a few States - the unintended consequences of seizing opportunities provided by the integrated market - became a problem for all. An immigration influx into Italy spills over into all other States. A wrong assessment by German authorities on the health risk of a particular vegetable leads to high losses for farmers all over the Europe. In all these areas, national policies have important external effects in other Member States. These are European issues but they are in good part still governed at national level and, when governed at EU level, still largely dependent on national politics.

At the same time, the EU is both a source of wealth creation, through market integration, and of redistributive effects, by competition in that market and the increased majoritarian character of its decisions. This requires for democracy to be extended as far as the problems and the interests they affect do. But it also requires some democratic notion of distributive fairness to legitimate the impact of what is done and decided in common.

European integration generates therefore a deep interdependence between national policies that has never translated itself into European politics. But if national politics is not able to incorporate the existing European interdependence on certain issues then it cannot, itself, provide appropriate and legitimate democratic solutions to those issues.

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\* (with the contributions of Roland Bieber, Carlos Closa Montero, Filippo Donati, Sergio Fabbrini, Harold James, Christian Joerges and Giulio Napolitano)

A credible solution to the current crisis depends on addressing this democratic deficit but also provides an opportunity to do so. The crisis started because of a democratic problem: the fiscal policies adopted by some states had an impact on all other European states and there was no effective mechanism of governance, at the Union level, to hold them accountable for that. Solving that democratic problem requires developing instruments of governance to prevent those externalities and, if necessary, impose particular economic and financial policies on some States. We have taken some necessary steps in that direction. But this, in turn, also needs to be democratically legitimated. Once the EU binds, for example, the financial assistance being given to some states to the adoption of certain policies, a claim emerges for it to be accountable also for the outcome of those policies.

## **II. A Constitutional Change Without Treaty Amendments**

So how can the democratic legitimacy of European institutions be enhanced within the parameters of the existing institutional framework?

The first concerns the politics of European elections. It is important to make the elections for the European Parliament genuine European elections for the choice of the President of the European executive. For this, it would be sufficient for the different European political groups to present competing candidates before the next election. If the election campaign would focus on this, the European Council would, in practice, have to appoint the winning candidate. Of course there are obvious risks with this approach. The politicization of the Commission is bound to affect its perceived neutrality and the authority it derives from being conceived as a semi-technocratic body. Some in the group were understandably deeply concerned with this risk. But we believe that such a shift is important for a wide range of reasons. First, it is already the case that the position of President of the Council is limiting the influence of the Commission as an honest broker between Member States, while simultaneously the Commission has to engage with an increasingly assertive European Parliament. In this context, the Commission needs to acquire new political capital in order to preserve (and perhaps strengthen) its position in the EU institutional system. But more importantly, and somehow paradoxically, under the Fiscal Treaty and other fiscal crisis related legislation like the six-pack the Commission gains considerable powers to intervene in the budgetary processes of Member States, once they have shown themselves unable to meet the strict budgetary requirements imposed on them. For those powers and the discretion that comes with these powers to be exercised effectively and legitimately, the Commission must be able to rely on the kind of legitimacy that comes with direct link to the outcome of European elections. Budgetary questions were at the heart of the historical parliamentary struggles for control over a democratically unaccountable executive – they are the inner sanctum of parliamentary prerogatives - and it is unlikely that national Parliaments will give much weight to a Commission that is seen as the instrument of the collective executives of Member States.

The effects of such a shift would be profound: In a democratic Europe we should not be surprised to see that European citizens disagree about the kind of policy measures that are the best response to the financial crisis and other political issues that the EU rightly addresses through legislation. It is a mistake to insist, as national politicians invariably do, when they defend the measures taken at late night Council meetings, that there is no alternative to the decision they have made. For many citizens that is the reason why they turn their back on Europe: They do not like the policy choices generated on the European level, and there is no alternative personnel and menu of policy options present to engage with on the European level, so they associate Europe with those policy choices they deem undesirable. If faced with a genuine choice in personnel, programmes and policies, disgruntled citizens would be able to articulate their dissent not by turning away from Europe and seeking refuge in populist recipes. They might instead, as European citizens, vote or mobilize for an alternative Europe, personified in a different President, committed to different policies. It is revealing, the extent to which European citizens from different Member States increasingly feel engaged in national elections in other Member States, particularly those understood as playing a key role in EU policies. This signals the extent to which European citizens perceive the EU as shaping their lives and need to believe that they have

options as to what determines those lives. But it also highlights the increase risk that they will see those lives being determined by national politics in which they have no voice. The only viable alternative is to offer such politics at European level. Tying the outcome of the European elections to the determination who will be the next Commission President will lead not only to a surge of interest in European parliamentary elections and allow the Commission to more effectively fulfil the functions assigned to it, it is also likely to be the best antidote to the spread of nationalist populism and Euroscepticism.

On a second level the European Union can increase its democratic legitimacy by more closely aligning its policy priorities to the problems that, given the ineffectiveness of Member State solutions, it should address. The European Union is widely believed to be an institution that enables Member States collectively to reap the benefits of greater market integration, both on the European and global level, while at the same time ensuring political control over markets to ensure through appropriate regulation that mobile market actors can't exploit the freedoms offered by transnational markets to undermine public goods.

The financial crisis is a case in point. It illustrates clearly that financial institutions have not been regulated sufficiently to ensure that the highly dynamic global financial markets effectively serve as the infrastructure of an efficient market economy. To the extent the crisis in Europe is described as a sovereign debt crisis, this is, in large part, of a result of states bailing out financial institutions, fearing the contagion effects of financial institutions failure. To a good extent the sovereign debt crisis is just a knock-on crisis to the 2008 financial crisis, as the example of Ireland and Spain illustrate. Meanwhile financial institutions, often invoke global competition and exit options in globalized financial markets to oppose regulations that burden or restrict financial transactions, . This is the type of blackmail that challenges the European Union to prove that it can actually do what it has promised: To make use of Europe's considerable regulatory capacities and market clout to tame the forces empowered by otherwise unfettered global markets. There is no reason why Europe should not follow through on this: The enhanced cooperation procedure can be used to overcome the lack of consensus among Member States and an aggressive interpretation of the jurisdiction of the EU can ensure that exit options are effectively closed or minimalized. The EU is becoming a victim of the crisis when it should be perceived as the solution for the crisis. We understand well the difficulties of articulating and making concrete such message. But it is precisely because of these difficulties that it is even more important to structure a series of initiatives around this narrative. A narrative that presents the Union as protecting the European model of social markets both by being a reformer of the States but also by protecting and empowering them at the global level.

Our point here is not theoretical or communicational. It requires restructuring key European policies in light of this European narrative and the need for European politics. This narrative should be mainstreamed into different policy proposals. Let us exemplify with a couple of proposals that could be pushed for in the context of the upcoming debate on the financial perspectives post-2014.

Let us start by noting that this debate should be used as an opportunity to democratize EU politics along another dimension: The Union should be made accountable not only for what it spends but also for the wealth it generates. It must distribute 'its' money and not that of the States. The democratic argument requires a clear connection of the Union's financial resources with the wealth it generates and with the economic activities of a state that have important externalities for other states. The recent Commission proposals for EU own resources are a step in the right direction. But it is important to clearly highlight the link between own resources and either economic activity that is made possible by the EU or economic activities with substantial cross-border externalities. Both VAT and a financial transactions tax are susceptible of being presented as such. Of the two, the financial transaction tax may be the one more susceptible of success. In this respect, though this has not been discussed between all of us, some believe it is possible to introduce a EU financial transactions tax through enhanced cooperation.

There is nothing in the enhanced cooperation provisions themselves that prevents a group of states to adopt a common tax to fund their contributions to the EU budget. This is how such a proposal could be conceived to be compatible with the existing EU Treaties. Naturally, nothing in the enhanced cooperation regime may affect the rights and obligations of non-participating Member States (Article 327 TFEU). Furthermore, such a new tax would have to respect the Council Decision on own resources that can only be amended by unanimity (Article 311). What needs to be done then is for participating states to adopt a new own resource under enhanced cooperation that will be, at the same time, compatible with the Decision on own resources and the rights and obligations of non-participating states under the Treaty and that Decision. There is a way to do this: The new common tax could be used to pay for the GNI contribution of participating Member States. So long as there would be a clause stating that those States would commit themselves to transfer, if necessary, any part of their GNI contribution not covered by the new European tax, this tax would not affect the rights and obligations of other Member States under the Treaties and the Decision on own resources. In effect, it would basically be a new way for some member States to comply with their obligations within the existing own resources Decision. One may question why not leave that to the Member States. But the advantages and reasons to move to such a system are several. First, it would be a first step towards genuine EU own resources (if there can be no taxation without representation it is arguable that there also cannot be any representation without taxation since any democratic system requires some principle of distributive justice). Second, it would be a first link between the Union's resources and its role as a regional regulator of cross-border externalities, in particular, in this case, those generated by mobile financial institutions. Third, it would relieve the national budgets of participating States (from their GNI contributions) and, in this way, it would also put pressure on non-participating Member States to adhere to the system (it would, in fact, become difficult for these States to justify to their citizens why they would still have to transfer funds from their national budgets when other States are relying on a EU tax). Fourth, it will also be a first step in detaching the EU budget from national contributions, a step that we consider fundamental to later be able to have a more constructive discussion on the EU budget itself.

The second proposal is to use such opportunity to restructure and represent the nature of EU policies. One possible lesson of the current crisis is the failure of the foundations supporting the political and social contract underpinning the European Union. Poorer countries would open their markets and in return would get funds and cheaper credits in the expectation that such money would reform their economies. It does not seem to have worked this way and the main reason may have to be found in the lack of capacity of EU policies to provide incentives for reform. This is another of the structural unbalances affecting the nature of the EU relationship with the Member States. On the one hand it has a growing number of regulatory and "disciplinary" powers upon the States. On other hand, its purse power is not only limited but moreover, apparently, largely ineffective in reforming the states. The Union financial arm, no matter how limited, should be much better used for reform purposes in the States. More than being concerned with goals, EU funds should be concerned with institutional change at the level of the States. On example, to make this more concrete: In the area of education and research, instead of defining themes of research for which the Union will provide funds to national institutions, the EU should fund institutional changes in those higher education and research centres. In other words, it should make the award of those funds conditional on certain institutional criteria to be fulfilled, determined in light of what can promote systemic change at national level (such as, in this case, mobility, internationalisation of faculty and student bodies etc. etc.).

In this respect, one may also envision to clearly differentiate the funds awarding conditions and priorities between Member States so as to link them to the structural reforms needed in each Member State (again, funding of projects should be largely complemented or even replaced by funding of institutional changes, including in national administrations). One may even imagine that a sort of structural reform contract could be entered into with some states for the use of certain funds. This would be particularly important in the case of states that are currently subject to adjustment programs

or others to be subject to sanctions in the future. May be a contract For the mechanisms of Euro governance to be democratically legitimate it is important for the intervention of EU institutions to take not only the form of sanctions but also the form of incentives.

### **III. Improving the Democratic Quality of Economic Governance**

We will now, in the reminder of this paper, move to a more specific consideration of the way in which macro-economic governance currently works in the European Union, and the ways in which this poses the question of democratic accountability. In our search for ‘more democracy’, we consider the various dimensions of the democratic ideal: strengthening parliamentary control of governments and independent agencies; improving transparency of decision-making; creating channels of accountability and financial and judicial control; promoting the direct involvement of citizens and responsiveness to civil society. We emphasize that most of the improvements suggested below (like those already suggested above) do not require a formal revision of the European Treaties, which, in the current political circumstances, would be a very hazardous enterprise.

#### ***A Fragmented Institutional Landscape of Economic Governance***

As a result of the many political initiatives and legal reforms that have been adopted in the past years, both inside and outside the institutional framework of the European Union, we are faced with a very fragmented institutional landscape where the macro-economic governance of Europe is concerned. A reflection on the improvement of the democratic quality of decision-making must, therefore, take account of the great diversity of institutional sites within which that reflection must take place, both at the national level and at the European level.

At the *national level*, those questions will arise during the parliamentary debates on the approval of the ‘stability amendment’ of the TFEU (approved by all 27 governments in 2011), the ratification of the European Stability Mechanism treaty (signed by 17 states) and of the Fiscal Compact (signed by 25 states). They will also arise during the debates on how to implement in national (possibly constitutional) law the ‘golden rule’ and other requirements imposed by the Fiscal Compact and the ESM treaty. Finally, macro-economic and budgetary policies and procedures of the EU member states must be adapted to the new requirements of the EU legislation (‘six-pack’) adopted in 2011.

At the *European level*, there are many different institutional sites within which democratic challenges can and must be addressed:

- The application by the EU institutions of the EU’s revised legislative framework on excessive deficits and macro-economic imbalances, as resulting from the adoption of the ‘six-pack’ in 2011.
- The functioning of the financial services supervision system introduced in 2010 (although this is not macro-economic governance strictly speaking, it is of course closely related to it)
- The common governance of the extra-EU stability mechanisms (EFSF today; ESM in the future, once it enters into force)
- The common governance under the Fiscal Compact, once it enters into force
- The co-decision procedure in which the additional economic governance proposals of the Commission (the ‘second package’ of November 2011) are being discussed
- The follow-up of the Euro Plus Pact by the European Council
- The debate about launching new EU policies and measures (Eurobonds, financial transaction tax, new European social model, reformed cohesion policy, etc.)

This is not a complete picture of all the macro-economic governance sites, and it leaves aside the ‘no go areas’ for democratic control constituted by the activities of the ECB and the central banks of the

non-euro countries, as well as the international sites of monetary and economic governance such as the IMF.

Identification of the various elements of democracy and of the different institutional sites allows for the development of targeted reforms, which aim at strengthening the democratic character of each of those institutional sites in accordance with its own characteristics. In addition to the overall “constitutional” reforms discussed above, we also *targeted improvements* that take account of the nature of the democracy deficit of each site, and the feasibility of the proposed remedies. For example: whereas parliamentary control is present in the discussion of the Commission’s ‘second package’, because of the fact that it must be approved through the EU’s ordinary legislative procedure, the governance of the EFSF and future ESM is mainly in the hands of the participating governments and (national) parliaments will have difficulties in exercising their control powers.

At the same time, the institutional landscape is characterised by a large degree of overlap (for example: between the obligations under the Fiscal Compact and the obligations under existing EU legislation), and a great degree of confusion on ‘who does what and within which institutional framework’. Therefore, reconstituting democratic governance should not only aim at proposing targeted responses for each of the existing institutional sites but should also try to counteract this fragmentation and help in the emergence of a *comprehensive* democratic discussion on the future of macro-economic governance, both at the national and at the European level.

One practical way in which the European Commission could stimulate this is by creating an independent *Euro Governance Forum* which could:

- Combat confusion and improve transparency by collecting and presenting legal and economic data and political opinions in a rigorous and objective manner; at present, there is no single (web) site that provides a reliable gate to the whole Euro governance landscape.
- Promote deliberation by organising regular debates in which the main governance actors would confront their views with members of European national parliaments and representatives of civil society. Those debates could deal with the overall direction of euro governance, but also with particular questions within that overall debate, such as: the introduction of Eurobonds, the recourse to enhanced cooperation for the creation of a financial transaction tax, the performance of the financial services supervisors, etc.
- A more ambitious version of the latter would be the organisation, in each national parliament, of a debate on the state of the State in the Union, in parallel with the EP debate on the state of the Union. This debate should count with the presence of at least a European Commissioner presenting an overall view of the different reports, recommendations and assessments that the Unions is now supposed to produce for each State. It would be an opportunity for the Commission to be responsive to national politics in the exercise of that role but also for that role to shape national political debates.

### ***Improving the Operation of the Reformed Economic Surveillance Regime***

We are currently in the first year of effective application of the reformed economic surveillance regime that was introduced by five EU Regulations and one EU Directive commonly known as the Six-Pack. The reforms were primarily inspired by the wish to make the existing surveillance mechanism – as introduced, in its basic features, by the Maastricht Treaty – more effective in preventing and addressing macro-economic imbalances that may destabilize the euro area and the Union as a whole. As those reforms were made under the ‘Community method’, with a crucial input from both the Commission and the European Parliament in addition to that of the national governments represented in the Council, the regime which was put in place also seeks to respect the democratic achievements of the European Union and to make economic governance a policy area which is ‘as democratic’ as other areas of EU policy, whilst acknowledging, of course, the particular



and independent role played by the ECB in the monetary domain. Nevertheless, we think that further improvements are needed to enhance the democratic quality of this governance mechanism, if anything because this will improve the acceptance, by national politics and public opinion, of the 'bitter pills' that the new regime will ask the member states to swallow from time to time.

Art. 121 TFEU sets forth a procedure for the coordination of the economic policies of the Member States, which is based on a Council recommendation, setting out broad guidelines for the economic policies of the Member States and of the Union, on the basis of the conclusions of the European Council. No role in the broad guidelines decision-making process is provided for the European Parliament, which is merely informed of the Council recommendation adopting the broad guidelines. The Council, on the basis of reports submitted by the Commission, carries out surveillance on the consistency of the implementation of economic policies of Member States with the broad guidelines. In case of inadequate performance, recommendations may be addressed to the Member State concerned by the Council, on the basis of a recommendation by the Commission. The European Parliament is simply informed of the results of multilateral surveillance. The Regulation n. 1175/2011 of the European Parliament and of the Council has now introduced an 'economic dialogue', whereby the competent committee of the European Parliament may invite the President of the Council, the Commission and, where appropriate, the President of the European Council or the President of the Euro Summit to appear before the committee to discuss measures adopted for the coordination of the economic policies of the member States. The economic dialogue, anyhow, provides no duty of the Commission and of the Council to report to the European Parliament. In addition, Parliament has not been granted any effective involvement in the adoption of the measures within the process of multilateral surveillance under Article 121 TFEU. In addition, the national parliaments do not participate in that dialogue despite the fact that they are the ones that will eventually decide how to comply with the European recommendations. Some suggestions put forward in our group include:

- Integrate the specialized committees of the national parliaments in the economic dialogue established by Regulation n. 1175/2011.
- Establish a public debate in the Council before the adoption of the "broad guidelines" (Article 121, 3<sup>rd</sup> subparagraph). This can be introduced by an amendment to Article 8 of the Council's Rules of Procedure.
- Before the discussion in the European Council, the "conclusion" (Article 121 (2), subparagraph 2 TFEU), could be transmitted to the European Parliament for debate by analogy with voluntary consultation.
- The draft « conclusion » on the broad guidelines should be transmitted to national parliaments by analogy to the procedure laid down in Article 2, Protocol n° 1 TEU.
- The "broad guidelines" should be formally presented to the national parliaments (preferably by a Member of the Commission). This could, in fact, be part of the debate of the state of the State in the Union mentioned above.

### ***The Entrenchment of National Budget Discipline by the Fiscal Compact: How to Preserve Democratic Decision-Making?***

The short period in which the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (commonly nicknamed as 'Fiscal Compact') was negotiated and concluded left little time for the participation of national and European Parliaments, a circumstance that may render its effective implementation more difficult.

This Treaty intends to reinforce the financial stability of the Euro Area through an enhanced coordination of the Member States' budget policies, the provision of benchmarks for structural deficit and debt-to-GDP ratio, as well as an enforcement mechanism for non-compliance to such benchmarks.

There was, arguably, no strict need to adopt a new *treaty* to implement what is contained in its final text. Certainly, most of what it contains in terms of economic governance at the European level could have been adopted through enhanced cooperation within the EU or by means of a modification of Protocol No. 12 on the excessive deficit procedure. The treaty confirms the creation of the Euro Summit and also provides for a new body, the Meeting of the Heads of State or Government of the Contracting Parties, whose membership will reflect the number of states that will eventually ratify the Fiscal Compact, but whose role is limited to loosely monitor the implementation of the Fiscal Compact. Those bodies will operate in an informal manner. No new hard governance mechanisms are introduced at the European level, and therefore there also arises no additional need to improve democratic accountability at the European level beyond what is written in Article 13, namely the creation of a conference of members of the EP and of the national parliaments of the Fiscal Compact countries to discuss together the issues arising from the implementation of the treaty. However, to the extent that the coordination mechanism of the Fiscal compact builds upon the existing EU economic coordination regime, the misgivings about the latter's democratic quality – noted in the previous section - indirectly apply here as well.

### ***The European Stability Mechanism: A New Public Authority Lacking Constitutional Quality***

The establishment of the European Stability Mechanism, by means of a treaty signed on 1 February 2012 between the 17 euro area states, represents an important step in the European integration process. Its permanent nature transforms the Union into a community of risks, not only of benefits. As a collective insurance device against future damages that could affect a country or a people, it is a properly constitutional mechanism.

The legal status and some fundamental rules of the ESM, unfortunately, seem unable to meet the challenges raised by such an ambitious program. Transparency and accountability needs are not satisfied. And the day by day effectiveness of the Mechanism could be seriously undermined by failings in its institutional design. Indeed, this Treaty – in contrast with the Fiscal Compact – does create its own institutional regime in the margin of the ‘mainstream’ institutional framework of the European Union, and the question of its democratic quality is therefore of prime importance.

The Treaty defines the ESM as an ‘international financial institution’. The term ‘international’ is correct in so far as the Mechanism is established by means of a separate international agreement; it is not an agency of the European Union, but a separate organization under public international law, even though its operation is, of course, narrowly linked to the EU's economic governance regime. The term ‘financial’ might be misleading in conveying the impression that this is a commercial entity. In reality, however, its subscribers are member states of the Union. The governance is in the hands of ministries of finances. Its purpose is to give aid to member states, not to earn money or raise revenues. The definition as an international financial institution may therefore hide the fact that the Mechanism will be a European public institution which should, because of its nature, be subject to norms of transparency and accountability that are similar to those applying to the functioning of the EU institutions.

The procedures to grant financial assistance, under the ESM Treaty, are ill conceived. On the one hand, they are complicated and slow. On the other hand, they depend on the request for help by an ESM member state. But if the state concerned does not make the request – for internal political reasons – the financial stability of all the Eurozone could be threatened. This is why it would be important to introduce a third-party trigger of ESM support: the power to start the procedure should be conferred also to a qualified number of other member states, or perhaps to the European Systemic Risk Board, even though this is an EU agency and not a specific ESM body.

In the decision-making system of the ESM, too much discretion is given to the Board of Governors (composed of the ministers of finance of the ESM member states). The Board has been vested with the power to grant support to a member state. In order to foster the efficiency of the financial assistance, it

can also allow the states to allot the subsidy to the re-capitalisation of a financial institution. Finally, it can decide to purchase bonds of a member state both on the primary and the secondary market. While adopting such measures, the Board of Governors seems to enjoy a broad discretion, as suggested by the fact that it ‘*may decide*’ to adopt the measures mentioned above. Indeed, the Treaty does not set any general goal or set of objectives that would constrain the exercise of those powers. Although the appraisal by the Commission shall be taken into account, it is not binding on the Board and the Board does not have a duty to state its reasons. It seems that such a duty to give reasons (which is imposed on all *EU institutions* under Article 296 TFEU) should be introduced, especially for all those cases in which the Board sets aside the advice of a European institution.

The dispute resolution mechanism of the ESM violates the principle of *nemo iudex in causa propria*. Indeed, the Treaty entrusts the Board of Governors itself with the settlement of disputes arising on the interpretation and application of the ESM Treaty between the ESM and one of its member states. The creation of an independent Board of Appeal – like those foreseen for some European Union agencies – would be more appropriate.

Finally, the ESM Treaty does not provide any of the accountability tools that are usually made available in the structure of European Union agencies. There are no consultation procedures with either general stakeholders or specialized parties, such as institutional investors and creditors. There are no transparency duties, nor are there rules about access to information. The Board of Governors does not have to report to the European Parliament, and there are no procedures to assess the ESM’s operation. Only the financial administration of ESM is subject to a specific set of rules. Every four months, the member states shall receive a report on financial administration. The Treaty also provides for two levels of audit, internal and external. In this view, the Board of Governors also appoints a Board of Auditors, which, nonetheless, shall be independent. The only document released by the Board of Auditors is its annual report. The latter is submitted to the Board of Governors, which makes it accessible to the national parliaments and supreme audit institutions of the member states, as well as to the European Court of Auditors. Oddly enough, the report does not have to be made available to the European Parliament.

Finally, we must realize that the ministers of finance who compose the Board of Governors remain, each of them, accountable to their national parliaments. In some cases, they will need the prior approval of their parliaments for their decisions. The German Constitutional Court, in its judgment of 7 September 2011, held that the budgetary responsibility of the Bundestag is an essential constitutional principle. The Bundestag must ‘retain control of fundamental budgetary decisions even in a system of intergovernmental administration’. The same approach may be adopted by the constitutional courts of other ESM countries, or their national parliaments may simply insist on a prior consent to funding decisions taken by their country’s representative in the Board of Governors.

We conclude that, in order to increase the legitimacy and the accountability of the ESM, it is highly recommendable to set up a regular consultation process, to increase transparency, to allow access to data and records, to introduce reporting obligations towards the European Parliament, and to agree on a common approach for all national parliaments. Those reforms could provisionally be introduced by means of a memorandum of understanding between the ESM member states, but should subsequently be introduced in the Treaty by means of its amendment. It must be noted, in this respect, that the ESM Treaty has no special revision clause, so that its future amendment will be subject to the general rules of public international law, that is, amendments will have to be approved by means of a new treaty between all the ESM member states.<sup>1</sup>

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<sup>1</sup> In principle, all 17 euro states should become parties to the ESM Treaty, but Article 48 provides that it will already enter into force upon ratification by signatory states representing at least 90% of the total subscriptions; thus, the non-ratification by (a number of) smaller countries would not prevent the start of the ESM. The number of ESM member states can also fluctuate upwards by accession of EU Member States other than the current Euro area countries (Article 44).



# Democratic Governance of the Euro: Shortcomings and proposals for reform (rev/16.4. 2012)

Roland Bieber\*

## I.

This paper discusses some shortcomings in the democratic foundation of economic governance within the European Union and among its Member states and presents some proposals for reform.

The paper comprises five sections:

- A. Terminology and Criteria
- B. The rules on the **ordinary functioning of EMU** – shortcomings and proposals with regard to democratic principles
- C. The rules on governance in EMU in **extra – ordinary situations** – shortcomings and proposals with regard to democratic principles
- D. The **Treaty on Stability, Coordination and Governance in the EU (TSCG)**
- E. The **Treaty establishing the European Stability Mechanism (ESM)**

## II.

### A. Terminology and Criteria

- “Economic Governance” refers to measures, adopted by the European Union and/or its Member States, which aim at the establishment and the functioning of the economic and monetary union provided for by Article 3 (4) TEU. Acts adopted on the basis of the TSCG and ESM are considered as part of economic governance.

“Governance” comprises two sets of measures, those, which concern the ordinary functioning of EMU and those which relate to extra – ordinary situations (e.g. non – compliance).

-“Democratic Principles” are understood here to include *transparency*, *participation* (of individuals and groups), *accountability* of actors, *efficacy* of institutions, procedures and instruments, the *Rule of Law* and *solidarity*.

B. The rules on the ordinary functioning of EMU - shortcomings and proposals for reform with regard to democratic principles

#### 1. *Transparency*

a) Shortcomings

- The **ambiguity of Articles 5 and 121 TFEU** in general and of Article 121 (1) TFEU in particular (who, Member States or the Union and which of their institutions, are responsible for economic policy decisions?);

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- The **ambiguity of the legal implications of the recommendations**, adopted pursuant to Article 121 (2) TFEU (by definition not binding, but sanctioned, if not followed);
- The “recommendations” for the broad guidelines to be submitted by the Commission to the Council do not fall within the scope of Articles 1 or 2 of Protocol n° 1 (national parliaments) and **are therefore not formally transmitted to the national parliaments**;
- The **lack of transparency of political choices** made in the implementation of the **ESM** (Articles 13, 14).

#### b) Proposals

- **Establish a public debate in the Council before the adoption** of the “broad guidelines” (Article 121, 3<sup>rd</sup> subparagraph). This can be introduced by an amendment to Article 8 of the Council’s Rules of Procedure.
- Before the discussion in the European Council, the “conclusion” (Article 121 (2), subparagraph 2 TFEU), could be **transmitted to the European Parliament** for debate by analogy with voluntary consultation.
- The “**broad guidelines**” **should be drafted in greater detail**, setting out more specifically the measures, which each Member State is supposed to adopt. In this way the gap could be closed between the “broad” guidelines and the extremely detailed “measures”, adopted with regard to Member States with an excessive deficit (Article 126 (9) TFEU, cf. Decision n° 2010/320, OJ 2010, L 145, p. 6, as amended by Decision 2010/486, OJ 2010, L 241, p.1 = Greece).
- The draft « conclusion » on the broad guidelines should be transmitted to national parliaments by analogy to the procedure laid down in Article 2, Protocol n° 1 TEU.
- The “broad guidelines” should be **formally presented to the national parliaments** (preferably by a Member of the Commission).

## 2. Participation

#### a) Shortcomings

- The recommendations setting out the broad guidelines are adopted outside of the ordinary legislative procedure without any participation of the European Parliament and are not based on a proposal from the Commission within the legal meaning of Article 293 TFEU.
- The EP is informed by the Commission of its recommendation, which leads to the adoption of the draft guidelines. Although the EP may discuss the recommendation in plenary (cf. Article 114 EP Rules of Procedure), no follow – up is envisaged for the further procedure. Only an “economic dialogue” has recently been established (Article 2 a),b) of Regulation 1466/97 (as amended by Regulation 1175/2011). The dialogue involves the competent committee of the EP, the President of the Council and of the Commission but does not lead to any right of the EP to effective participation in the decision - making.
- Equally, assistance, which is granted by the Union to a Member State pursuant Article 122 TFEU, does not require any consultation or co - decision by the European Parliament. It is decided by the Council alone. Parliament is informed ex - post facto only.
- National Parliaments are not involved either.
- No participation of the European Parliament in decisions taken under the TSCG is provided. Article 13 TSCG provides only for a right of the EP and of national Parliaments “to discuss” policies and “other issues”.

b) Proposals

- Since the “broad guidelines” touch upon fundamental economic and social choices, a serious public debate and decisions by elected institutions are of fundamental importance for their legitimacy.
- Hence the European Parliament should be given a **right to participate in the adoption of the broad guidelines**. Various improvements can be envisaged to this end:
- as has been mentioned above (1.b), **voluntary consultation** of the EP (with the possibility of a debate and a vote in Plenary) could be introduced without amending the Treaties.
- A more consequential solution for this democratic lacuna would be a Treaty amendment in order to replace the decision-making procedures provided for in Articles 121, 122 (and 126(9), (11), *cf. infra C. 8*) TFEU by the ordinary legislative procedure, adding in particular a **right of co-decision** on the part of the European Parliament.
- The **EP should be consulted** by the Commission on its proposal of « common principles » for the correction mechanism foreseen in Article 3 (2) TSCG. The existing inter – institutional agreement (EP/Commission) could be amended to this end.

### **3. Accountability**

a) Shortcomings

- The Council is not accountable to the EP for its decisions under Article 121 (2) TFEU. Only an ex – post information of the competent EP – committee has been introduced (*cf. supra, 2 a*)). Multilateral surveillance results (Article 121 (3) TFEU) are, however, reported to the EP (Article 121 (5)).
- No reporting obligations to the EP are foreseen on the activity of the Commission in the operation of the ESM (Article 13 ESM).

b) Proposal

- Establish coherence between Paragraphs 5 and 2 of Article 121 TFEU by “**Upgrading**” the “**economic dialogue**” (*cf. supra 2 a*) to a formal duty of reporting.
- Provide for **reporting of the Commission** to the competent EP – committee on its activities provided for in Article 13 ESM.

### **4. Efficacy of institutions, procedures and instruments**

a) Shortcomings

- The most important single shortcoming is the absence of “positive” measures, which establish minimum rules for economic policy in the form of binding directives for the economic policies of the Member States and which have been adopted according to a democratic decision - making procedure.
- Until 2011 the recommendations adopted pursuant Article 121 (2) TFEU had been drafted in very general terms, which did not stimulate a dynamic in the Member States for their implementation.
- Although Regulations 223/2009 and 479/2009 have established a framework for common statistical data and for the transmission of budgetary data, the Commission (Eurostat) has still no

systematic direct access to all accounting and budgetary information of public budgets in the Member States.

- Certain economic data, which normally do not figure in national budgets (e.g. future payments for pensions, long – term contracts with the private sector, public undertakings) are not available to Eurostat.

#### b) Proposals

- The focus of Union action should be brought forward so as to obviate ex post facto intervention in the form of sanctions. One way of achieving this would be to enable the “**broad guidelines**” referred to in Article 121(2) TFEU, instead of being adopted in the form of non-binding recommendations, **to be adopted as binding directives**. Member States, while remaining free to select the means to be used, would then nonetheless be committed to the achievement of the stated aims. It would, in addition, be possible to lay down time-limits.
- It would also serve the same aim of constructive policy-formulation if, following the example of EU social policy rules (Article 153(2)(b) TFEU), a number of areas of economic policy were designated in which the EU is empowered to lay down **mandatory minimum requirements** by means of directives.

### 5. Rule of Law

#### a) Shortcomings

- The Rule of Law principle, on which the Union is founded, would require a consistent use of legally binding instruments for the achievement of the Union’s objectives, including EMU. The uncoordinated co – existence of non – binding recommendations and sanctions for the achievement of a single policy (Article 121 and 126 TFEU) generates confusion among national actors and citizens about the nature and size of obligations resulting from the EU Treaty. The various regulations, adopted in November 2011 (“six – pack”) establish a closer legal link between the commitments resulting from the EU – Treaties and internal policies. The regulations are, however, still too strongly influenced by a “carrot and stick” approach (cf. *infra* B).
- Also the overlap of various instruments for economic governance establishes a threat to the rule of law.

#### b) Proposal

- It is suggested to bring economic policy entirely within the realm of “**shared competences**” (Article 4 TFEU). This would allow a more consistent operation of the powers of both the Union and the Member States. It would furthermore allow to reduce the sharp contrast between “soft law” and sanctions in this area.
- Equally a more consistent system of legal instruments, which is applicable within the Union for the economic governance, should be aimed for. To this end, a **framework agreement** should be concluded, which sets out the relationship between the various instruments.

### 6. Solidarity

#### a) Shortcomings

In the European context, solidarity suffers from a particular problem. It is not perceived by the citizens as a genuine European value. It is rather considered in a horizontal manner between states or people.



In matters of economic policy the Treaty provides only for solidarity by the Union and only in exceptional circumstances (Article 122 TFEU). The budget of the Union is, however, too small to allow measures of a substantial financial impact by the Union. On the other hand, solidarity among Member States but within the context of the Union is not envisaged. As a result various ad – hoc agreements (ESM, Fiscal Compact) have been concluded between Member States. Their close link with the Union creates again confusion among citizens about responsibility and accountability.

#### b) Proposal

In parallel to a transfer of economic policy competences to the Union as mentioned above (*supra* 4 b) and 5 b)), a “**solidarity mechanism**” should be established for the purpose of assisting Member States in budgetary difficulties. This fund would be financed and administered outside the EU – budget but **within the Treaty framework**. Inspiration for this concept could be found in the rules on the financing of the CFSP (Article 41 (2), (3) TEU). Such a mechanism could raise consciousness of the added value of European solidarity, which would not suffer from national bias.

### **C. The rules on governance in EMU in extra – ordinary situations - shortcomings with regard to democratic principles and proposals for reform**

Extra – ordinary situations may arise from lacking consistency of the economic policy of a Member State with the broad guidelines (Article 121 (4) TFEU); from an excessive government deficit (Article 126 TFEU) and from “severe difficulties” in a Member State (Article 122 TFEU).

## **7. Transparency**

#### a) Shortcomings

- The most important shortcoming with regard to economic policy measures in extra – ordinary situations is related to the request by the Council for the adoption of “measures” by a Member State, which has failed to put into practice recommendations in the excessive deficit procedure (Article 126 (9) TFEU):
- Recent practice has shown, that the Council has used this instrument for imposing extremely detailed and far reaching legislative and administrative requirements (e.g. Decision 2010/320 (Greece)) which contrast sharply with the ordinary EU competences in economic policy matters. Neither the Treaty nor implementing legislation (Regulation n° 1467/97 (as amended by Regulation 1177/2011) contains any definition of the “measures”, which may be requested. Hence, transparency as to the possible instruments used by the Council is absent.
- Information about divergences between the guidelines and national policies are scarcely made publicly available (Article 121 (4) subparagraph 1 TFEU).
- Similarly findings and recommendations in the excessive deficit procedure are not systematically accessible for the public (Article 126 (7) TFEU).
- With regard to assistance in cases of “severe difficulties” it is not specified in Article 122 (2), what kind of “conditions” could be imposed on a Member State, which receives assistance.

#### b) Proposals

- Regulation 1467/97 should be amended in order to insert an **exhaustive catalogue of measures**, which may be requested under Article 126 (9).

- Measures, which the Council wants to be adopted by a Member State (Article 126 (9)), should be transmitted prior to the adoption of the respective decision of the Council to the EP.
- Information in **cases of Articles 121 (4) and 126(7) TFEU** should, as a general rule, be **made publicly available**, unless a prevailing interest for confidentiality can be proven.
- Implementing legislation for Article **122 TFEU (financial assistance)** should be adopted, establishing **details of the conditions**, which may be imposed when assistance is granted.

## **8. Participation**

### a) Shortcomings

- No parliamentary participation is provided for in the cases of Article 126 (9) (decision by the Council addressed to a Member State and requesting the adoption of certain “measures”) and of Article 126 (11) (sanctions). Only the latter provides for an ex – post information of the EP.
- In the light of the far reaching consequences for the people of the relevant Member State this situation is absolutely not acceptable from a perspective of democratic decision – making.
- Moreover, the adoption of implementing legislation to Article 126 provides only for the outdated consultation procedure of the European Parliament (Article 126 (14) TFEU).
- The EP is not involved in the adoption of decisions on assistance pursuant to Article 122 TFEU.

### b) Proposals

- Since the adoption of measures under Article **126 (9) and (11) TFEU** requires the broadest possible legitimacy on the level of the Union, the **European Parliament should have a power of co – decision**. The ordinary legislative procedure should therefore be made applicable to those cases by way of an amendment to the TFEU.
- Before such an amendment could come into effect, the Council should agree to **voluntary consultation** of the EP.
- Article **126 (14)** should be amended in order to substitute the **ordinary legislative procedure** to the presently applicable consultation procedure.
- For the granting of assistance (**Article 122 TFEU**) the **ordinary legislative procedure** should be introduced. Also in this case as a first step, **voluntary consultation** of the EP should be agreed by the Council.

## **9. Accountability**

### a) Shortcomings

- Considering the potential heavy impact of interventions according to Article 126(9) and of sanctions (Article 126 (11) TFEU), the mechanism for accountability is weak. The Council is not at all accountable to Parliament for decisions taken under Article 126 (9) and has to inform the EP only *ex post* about sanctions, which had been imposed (Article 126 (11)).
- No reporting is provided for on the implementation and on effects of assistance (Article 122 TFEU).

b) Proposals

- The Council should not impose a measure, which it envisages to request from a Member State in accordance with Article 126 (9), **if the European Parliament has objected to it by a qualified majority**. (This requires, by definition, prior information of the EP (cf. proposal 7. b)).
- A similar mechanism could be applied to **sanctions** (Article 126 (11)).
- As far as assistance (Article 122) is concerned, an implementing regulation should lay down precise **reporting obligations** for the Commission on the effects of the assistance and on the compliance with the conditions, on which it was granted.

**10. Efficacy of institutions, procedures and instruments**

a) Shortcomings

The entire mechanism for the coordination of national economic policies and for the prevention of excessive deficits has proven to be ineffective.

It is built on the assumption that economic and budgetary policies in a multi – layered democracy can be brought to convergence by a combination of non binding acts, prohibitions and sanctions. As a matter of principle, sanctions are a poor instrument for the achievement of lasting results in any context. They intervene only *ex post facto*, they react to results but do not prevent causes. They are particularly inappropriate, when it comes to public deficits, which normally result from multiple causes over a longer period of time and where those, who feel the sanctions, are not necessarily identical with those who have collected the benefits.

b) Proposal

The chapter “**economic policy**” (Articles 120 – 126 TFEU) should be **re – considered**. A substantially revised approach should first and foremost be based on a new attribution of competences (“shared”), which would allow the Union to adopt “positive“ measures in matters of economic policy and which could replace the unbalanced system of sanctions.

**11. Rule of Law**

a) Shortcomings

The power of the Council to request the adoption of “measures” (Article 126 (9)) is worded in too general terms. Its use cannot be anticipated, hence legal security is threatened. It risks to be used in a way which is contrary to Article 13 (2) TEU and which was not intended by the authors of the Treaty.

b) Proposal

Article 126(9) should be given a more precise wording or a definition in implementing legislation (cf. proposal n° 7 b)).

## **12. Solidarity**

### a) Shortcomings

In their present wording, the provisions concerning exceptional situations consider economic and budgetary crisis in Member States as an internal problem of those states. Except for the mechanism of Article 122, the action of the Union is essentially punitive. Since economic or budgetary crises normally have their origin in the policy of a Member State, which was democratically founded when adopted, any punitive action is not likely to be perceived by the people concerned as an act of solidarity by the Union, but rather as an intervention in the internal political process.

### b) Proposal

The Union should **assume responsibility for economic crises** within EMU. In return, its competences for the adoption of binding acts have to be increased and its budget for assistance to Member States in difficulties would have to be increased.

An alternative would consist of creating within the Union a system of horizontal solidarities among Member States, consisting, among others, of funds to be provided under certain circumstances (= ESM). This latter system is however, not transparent to the citizens in its origin and in its functioning. It is therefore unlikely to generate a sense of solidarity between the peoples of the Union.

## The Democratic Governance of the Euro: some proposals

Carlos Closa Montero\*

### A. How to improve the democratic quality of the existing euro governance instruments?

Proposals concentrate both on the in force instruments (i.e. the TEU, the RFEU, the Six Pack) and new treaties pending ratification (chiefly, the TSCG).

- **Improving accountability: democratic oversight on the Commission in EDP and EIP.** The Commission role has been greatly reinforced both in the Six Pack and the TSCG. Commission recommendations in both the EDP (Excessive deficit procedure) and Excessive Imbalance Procedure (EIP) become quasi automatically adopted since they trigger sanctions if not rejected by “reversed” qualified majority (a qualified majority of Member States vote against). Greater democratic scrutiny on the Commission will improve the legitimacy of the reinforced EDP. This could happen at two different levels:
  - Whenever the Commission proposes a sanction for a Member State, the President/Commissioner may have a hearing in plenary session with the Parliament of the Member State concerned. This will enhance debate, deliberation and transparency and will contribute to better present to national public opinion the infractor position and the Commission recommendation. It will also temper the tune of Commissioners and will bring closer to the citizen decisions taken in Brussels.
  - The Commission should present to the EP any sanctioning recommendations.
- **Improving accountability: the President of the Euro Summits.** Whenever the TSCG enters into force, the President of the Euro Summit should make himself available to attend plenary sessions with national parliaments in order to discuss euro summit matters.
- **Improving the representativeness and legitimacy of the President of the Euro Summits.** Appointment should involve the EP which could, at minimum, hold a hearing with the candidate(s).
- **Reinforcing the institutional connection with the Union.** The implicit assumption of the TSCG seems to be the merger between the posts of President of the European Council and President of the Euro Summit. If or whilst this does not happen, the President of the European Council should be included into the euro summits.
- **Improving the working of the Euro-summits.** A better clarification of the role of the Budget/Fiscal/Economy ministers under the form of a Council could make euro governance more robust institutionally and continued through time. This is more required given the exigencies of coordination stemming from the new TSCG.
- **Democratic constitution-making on euro-governance.** Merging of the TSCG and the TEU/TFEU as foreseen in article 16 of the former should proceed through the ordinary revision procedure (article 48) hence involving national parliaments and the EP through a Convention.
  - Merging both Treaties should also provide an opportunity for revising unanimity as the general revision requirement, given the framework for imposing externalities that the rule offers.
- **Democratic implementation of the TSCG at domestic level.** Commission must report on the implementation of article 3(2) TSCG. This includes, *inter alia*, the obligation of creating *provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and anchored through the national budgetary process.* Commission Report could examine the democratic quality of the domestic processes of

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constitutional reform or law making leading to the implementation of this provision. Likewise, the Euro summit with the support of the Commission could launch processes of debate as they were organised after the failure of the 2005 constitutional treaty. Naturally, nothing guarantees that democratic debate leads to the sought result.

## **B. What are the consequences in democratic terms for the Union?**

The new Treaty raises at the level of *primary legislation* rules related to fiscal and macroeconomic governance. The 2005 reforms show that the regulation of the SGP through secondary legislation allows for rapid change to adapt to circumstances. Also, during the Convention, the Working Group on Economic Governance rejected the *constitutionalization* of the Stability Pact. The new Treaty grants the Pact rules the kind of rigidity associated with primary legislation. They become protected by constitutional rigidity and, hence, they only can be changed by means of a process of “constitutional revision”. Moreover, if the TSCG is ever included into the TEU, unanimity will add further constitutional rigidity to these rules.

One of the cornerstones of democracy is that majorities (defined by means of any given rule) may decide on policy options within the framework set by existing constitutional rules. As far as the discretionary preferences of majority do not contradict constitutional rules, they may be legitimately transformed into policies and, hence, the values attached to these policies may orientate a given community.

This basic relation between secondary norms (as a proxy of democratic process), and primary legislation (i.e. constitutionalism) applies to any domain in general. I argue that in fiscal governance within the Euro there has been a non linear movement linear towards an increased constitutionalization of the norms in detriment of (democratic) governance. I also argue that the decision in favour of a certain model of fiscal policy tilts the balance in definitive way not only towards specific ideological preferences but also against “democracy”.

Last but not least, the democratic quality of the TSCG is dubious: a treaty drafted behind closed doors, in a situation of emergency and with a clear outcome determined by the preferences of certain players. In parallel, some of the processes of domestic constitutionalisation (i.e. Spain) present the same lack of democratic quality: rushed through parliament without deliberation under the feeling that action was required due to ECB/EU Commission requirements.

Democracy has a lot do with asking to citizens and it seems to me that frustration, aloofness and dissatisfaction increasingly describe the perception of at least a substantive part of European citizenship. It may be the case that the very tight requirements of the TSCG implemented in dramatic conditions with little margin of flexibility may be perceived (and rightly so) as a strong attack on the social contract that seems to be the backbone of postwar European democracies. It could be argued that national governments are the primary responsible for this, which is the same of saying that citizens are responsible. Whether this is right or not, it may seem that a requirement for TSCG and EU legitimacy may increasingly pass through policies that help a reconstruction of the social contract.

**Working Group on the Democratic Governance of the Euro**  
**Proposals for reform**  
**(In order to enhance the role of Parliaments in the governance of the Euro)**

Filippo Donati\*

**1.-** Democracy is one of the founding values of the European Union (Art. 2 TEU). The functioning of the Union is based on the principle of representative democracy (art. 10.1 TEU), implemented through the European Parliament, where citizens are directly represented at the Union level (art. 10.2 TEU), and the National Parliaments, where citizens are directly represented at the member State level (art. 12 TEU).

**2.-** The European Monetary Union (EMU) requires economic policy cohesion among the Eurozone States. The 2011 debt crisis, which jeopardized the stability of the entire euro system, has its origins in the unsound financial policies of certain member states. The depth of the debt crisis clearly indicated the need for a higher degree of economic and fiscal coordination and convergence in the Eurozone. In order to achieve this goal, a set of measures have been recently adopted, including reinforcement of the stability and growth pact (SGP) through the Six Pack legislative package, the institution of the European Stability Mechanism (ESM), the amendment of art. 136 TFEU and, finally, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (Fiscal Compact).

The Fiscal Compact, whose content in part simply confirms existing rules, is intended to reinforce the financial stability of the Euro Area through an enhanced coordination of the Member States' budget policies, the provision of benchmarks for structural deficit and debt-to-GDP ratio, as well as an enforcement mechanism for non-compliance to such benchmarks. The Fiscal Compact is based on a commitment by each Contracting Party to a balanced government budget and on the provision, in the event of significant deviations, of an automatic correction mechanism to be implemented at the national level. Informal Euro Summit meetings shall take place when necessary, and at least twice a year, in order to strengthen convergence in the Euro Area.

Although the Fiscal Compact is an intergovernmental agreement formally separate from the EU legal framework, the Contracting Parties clearly indicate their intention to take all necessary steps in order to incorporate the substance of the agreement into the EU Treaties.

**3.-** The Euro governance system raises important issues with respect to the democratic principles enshrined in the Union Law.

Art. 121 TFEU sets forth a procedure for the coordination of the economic policies of the member States, which is based on a Council recommendation, setting out broad guidelines of the economic policies of the Member States and of the Union, on the basis of the conclusions of the European Council. No role in the broad guidelines decision-making process is provided for the European Parliament, which is merely informed of the Council recommendation adopting the broad guidelines. The Council, on the basis of reports submitted by the Commission, carries out surveillance on the consistency of the implementation of economic policies of Member States with the broad guidelines. In case of inadequate performance, recommendations may be addressed to the Member State concerned by the Council, on the basis of a recommendation by the Commission. The European Parliament is simply informed of the results of multilateral surveillance. The Council regulation (EC) n. 1444/97, on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (as amended by Regulation (EU) n. 1175/2011 of the European Parliament and of the Council), has introduced an "economic dialogue", whereby the competent committee of the European Parliament may invite the President of the Council, the Commission and,

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where appropriate, the President of the European Council or the President of the Euro Summit to appear before the committee to discuss measures adopted for the coordination of the economic policies of the member States. The economic dialogue, anyhow, provides no duty of the Commission and of the Council to report to the European Parliament. In addition, Parliament has not been granted any effective involvement in the adoption of the measures within the process of multi-lateral surveillance under Article 121 TFEU.

Furthermore, the European Parliament is not involved at all in the provision of financial assistance to the Member State (Art. 122 TFEU), that requires only a decision adopted by the Council, on a proposal from the Commission.

Under Fiscal Compact, the governance of the Euro Area will be based on orientations defined by the Heads of State or Government whose currency is the euro in the Euro Summit meetings, without any direct involvement of the European Parliament. Specifically, the Fiscal Compact provides that Euro summit meetings shall be convened in order to discuss core issues concerning the governance of the Euro Area and the rules that apply to it, and to furnish strategic economic policies to increase convergence in the Euro Area. The Euro Summits (with participation of Heads of State or Governments of all Member States) will further discuss the modification of the global architecture of the Euro Area, the fundamental rules that will apply to it in the future and the implementation of the Fiscal Compact. Whilst the President of the European Central Bank participates in the Euro Summit meetings, the President of the European Parliament may participate only if invited. No participation at all is provided for the President of the European Commission.

The accountability of Heads of States and Government toward their national Parliament is not sufficient to give democratic legitimacy to the governance of the Euro Area. The invitation of the President of the European Parliament to be heard at Euro Summit meetings, as well as the reporting requirement after each Euro Summit meeting, are not sufficient to grant democratic legitimacy to Euro governance.

**4.-** Also the excessive deficit procedure, as designed by Art. 126 TFEU and further specified by the Fiscal Compact, allows insufficient involvement of Parliaments.

According to Art. 126 TFEU, the Council may request the adoption of measures for deficit reduction by the relevant Member State and may impose sanctions against a Member State that has taken no effective action for the correction of its excessive deficit. The European Parliament is merely informed of the Council sanctioning decisions.

The Fiscal Compact has introduced new rules designed to make the procedure more effective, by providing, in case of deviation from the objectives defined in the revised SGP, an automatically triggered correction mechanism. The Fiscal Compact provides that such correction mechanism shall fully respect the prerogatives of National Parliaments. Notwithstanding this (quite vague) provision, the nature, size and time-frame of the corrective action to be undertaken will be subject to common principles decided by the European Commission, with no participation of the European Parliament or of the National Parliaments.

A contracting party subject to an excessive deficit procedure is now required to put in place a budgetary and economic partnership programme including a detailed description of the structural reforms necessary for an effective and durable correction of its excessive deficit. The Fiscal Compact sets forth that the content and format of such programmes “shall be defined in European Law”, most probably in a Council decision according to Art. 126(9) TFEU. No involvement of the concerned National Parliament or of the European Parliament is foreseen.

Whilst Art. 126(13) TFEU requires a qualified majority for the Council to impose sanctions on a Member State, under the new Fiscal Compact rules the Council can stop the sanctions proposed or recommended by the European Commission only by a “reverse majority” voting, e.g. when a qualified majority, calculated without taking the vote of the Member State concerned, is opposed to the



proposed or recommended sanction. Again, no provision allows any involvement of the concerned National Parliament or of the European Parliament.

National Parliaments and European Parliament are merely called to organize and promote a conference of the relevant committees representatives in order to discuss budgetary policies and other issues concerning the Euro Area. This provision is clearly not sufficient to counter-balance the loss of democratic control by Parliaments over the content of the correction mechanism to be implemented at a national level.

Ratification of the Fiscal Compact, expected to take place in 2012, may turn out to be problematic in certain Member States. In any case, notwithstanding ratification, the absence of sufficient democratic legitimacy in the Euro Area governance system may in the future enhance euro-scepticism and critics at the National level against the Euro.

**5.-** In light of the situation briefly described above, I would like to propose some minimal suggestions for improving the democratic quality of Euro governance. In particular, the following minimal suggestions are directed at enhancing the role of parliaments and increasing the transparency of the decision-making process with respect to: (i) the coordination of the Member States' economies, and (ii) the excessive deficit procedure.

**6.-** With respect to the co-ordination of the economic policies of the Member States, the following measures may be opportune:

- a) Granting the European Parliament a voice in the definition of the governance of the Euro Area.

To this extent, prior distribution to the European Parliament should be granted for: (i) the draft for the broad guidelines of the economic policies of the Member States and of the Union formulated by the Council and submitted to the European Council pursuant to art. 121 TFEU, (ii) the agenda and preparatory materials concerning each Euro Summit meeting to be convened in accordance with the Fiscal Compact, and (iii) the Commission's proposal to the Council for the granting of financial assistance to States facing severe difficulties.

This prior distribution would enhance the transparency of the decision-making process and would allow the European Parliament to have a voice in the definition of the measures intended to ensure budgetary discipline. No amendment of the Treaties would be necessary to this respect.

In addition, the European Parliament should be granted a co-decision power with respect to the fundamental decisions concerning the governance of the Euro Area. To this extent, however, a Treaty amendment would be necessary.

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- b) Involvement of the European Parliament in the appointment of the President of the euro summit. To this extent, at least a hearing before the Parliaments for the candidates to the presidency of the Euro Summit should be provided.

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- c) Participation in euro summits by the President of the European Parliament should not be subject to a specific invitation by the Council. Participation of the President of the European Commission should be granted.

**7.-** With respect to the excessive deficit procedure, the following measures may be opportune:

- a) Granting the European parliament a voice in the main decisions regarding the excessive deficit procedure.

To this extent, prior distribution to the European Parliament should be provided for: (i) recommendations addressed by the Council to the Member State pursuant Art. 122(7) TFEU, (ii) measures for the deficit reduction imposed by the Council pursuant Art. 122(9) TFEU, (iii) sanctions imposed by the Council pursuant to Art. 122(9) TFEU, (iv) decision on the time-frame for the convergence towards the medium-term budgetary objectives, adopted by the Commission pursuant to Art. 3.1 b) of the Fiscal Compact, (v) common principles for the correction mechanism to be put in place at national level, established by the Commission according to Art. 3.2 of the Fiscal Compact, (vi) endorsement and monitoring activity carried out by the Council and by the Commission with respect to the budgetary and economic partnership program for the correction of its excessive deficit, pursuant to Art. 5 of the Fiscal Compact, (vii) sanctioning proposals or recommendations made by the Commission according to Art. 7 of the Fiscal Compact.

This prior distribution would enhance the transparency of the decision-making process regarding the fundamental measures intended to ensure budgetary discipline, and would allow the European Parliament to have a voice in these matters. No amendment of the Treaties would be necessary to this respect.

In addition, the European Parliament should be granted a co-decision power with respect to the fundamental measures intended to ensure budgetary discipline in the governance of the Euro Area. To this extent, however, a Treaty amendment would be necessary.

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- b) Commission's sanctioning proposals or recommendations should be presented to the National parliament of the concerned contracting State. The hearing of the President of the European Commission (or of a Commissioner representing the Commission) before the National Parliament would allow a public parliamentary debate at the national level and would allow national Parliaments to have a voice in the sanctioning procedure.

# The Democratic Governance of the Euro

Comments by Sergio Fabbrini\*

## Premise

The financial crisis of the euro has shown the inadequacy of the intergovernmental method, formalized in the Lisbon Treaty, for dealing with economic and social issues. A crisis in the outskirts of the EU has become a systemic crisis of the EU. The decision-making mechanisms did not operate as required by the situation. The intergovernmental decisions of the European Council arrived *too late* and were not sufficient to calm the markets. Strategic divisions for dealing with the crisis between the larger member states of the euro-area and radical divergences in the domestic electoral interests of the incumbent governments made the decision-making process within the European Council particularly burdensome. Indeed, the European Council was pressured to meet continuously, between 2010 and 2011, hoping each meeting was the ‘last one’. But it was not. None came out as decisive. Certainly, in those meetings of the European Council were taken decisions that have thus radically transformed the economic governance regime of the EU. Some of those decisions remained within the supranational logic of the EU as the *Six Pack* which was approved mainly through the ordinary legislative procedure. However, with the deepening of the crisis and the difficulty to find an unanimous agreement within the European Council on the measures to be taken, the pressure to go beyond the supranational EU brought to the setting up of two new organizations for economic governance *outside* the Lisbon Treaty. First, the European Stability Mechanism (ESM), establishing a new treaty among the euro-area member states, with its own institutions, “as an intergovernmental organisation under public international law, justified by an amendment proposal to TFEU, Art. 136. And second, the so called Fiscal Compact Treaty, with its own governance structure signed by all the 17 euro-area member states plus those non-euro area states (all of them, apart from the UK and the Czech Republic) interested in participating in the treaty. Thus, two years after the approval of the Lisbon Treaty, the latter was considered *de facto* and *de jure* out of date. Why this outcome? Is this outcome satisfactory from the perspective of *democratic legitimacy*? I will organize my answer to each question in the form of a sequence of arguments.

## Why? The meagre balance of intergovernmentalism

### *First argument: the institutional dilemma*

Intergovernmentalism as a decision-making method based on voluntary policy coordination did not work because it was unable to solve the basic dilemmas of collective action in conditions of existential crisis (as is the euro crisis). In particular it could not resolve three dilemmas. The *first* is the *institutional dilemma*: how to neutralize veto positions in a decision-making process requiring intergovernmental consent? This dilemma accompanied the entire evolution of the euro crisis. For neutralizing the British veto on the fiscal compact, it was necessary to move outside of the Lisbon Treaty itself. Or, to avoid jeopardizing the entire project by the possible rejection of one or another intergovernmental treaty by few of their contracting parties, the Fiscal Compact Treaty (Title VI, Art. 14.2) states that it “shall enter to force on 1 January 2013, provided that twelve Contracting Parties whose currency is the euro have deposited their instrument of ratification”. If this decision has eliminated unanimity as a barrier to activating the new treaty (a very important step forward in the EU institutional history), it will nevertheless reveal more new problems than it solves old ones. What will the consequences be for the euro area as a coherent monetary system if some euro area member states

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approve the treaty and other euro area member states will not? Will those that approved the treaty continue in their fiscal integration while those that did not play a free-riding role? Indeed, anticipating plausible rejection of the Fiscal Compact Treaty, the ESM Treaty states (Point 5) that “the granting of financial assistance...will be conditional, as of 1 March 2013, on the ratification of Fiscal Compact Treaty by the ESM Member concerned”. Will this threat be sufficient to cool the euro-sceptical mood of Irish voters or the anti-European mood of Greek voters? At the same time, majority voting is extended even in the ESM (Art. 6.5). However, it may be impracticable to recur to majority voting in a treaty justified by international public law. And, above all, the establishment of new treaties to solve the contradictions of an old one will probably be the source of legal, technical and political problems that might constrain the proper functioning of each.

### ***Second argument: the non-compliance dilemma***

The *second* dilemma is the *non-compliance dilemma*: how to guarantee the respect of rules decided voluntarily by contracting governments when that respect no longer fits their interests? This dilemma exploded when it became apparent that Greece cheated the other member states’ governments (manipulating its statistical data regarding public deficit and debt) to enter and then remain in the euro-area. However, the same dilemma emerged in 2003, when France and Germany were saved from sanctions by a decision of the ECOFIN (and in contrast to a Commission’s recommendation) notwithstanding their disrespect for the SGP’s parameters. The Fiscal Compact Treaty tries to deal with the non-compliance possibility providing for a binding intervention of the ECJ upon those contracting parties that do not respect the agreed rules. This also applies when the Commission issues a report on a contracting party failing to comply with the rules established by the Treaty. In the latter case, in order to neutralize a recommendation of the Commission to intervene against a member state breaching a deficit criteria, “a qualified majority of the member states (should be) opposed to the decision proposed or recommended” (Art. 17).

However, these solutions of the non-compliance dilemma seems problematic. It is problematic, in fact, that a new organization (set up by the Fiscal Compact Treaty or ESM Treaty) might use an institution (such as the ECJ) of another organization (the EU set up by the Lisbon Treaty) to bind its own member states. This may also apply to the technical expertise of the Commission or ECB, upon which both treaties rely. Certainly, the intervention of the ECJ is justified by TFEU, Art. 273, that states: “the Court of Justice shall have jurisdiction in any dispute between Member States which relates to the subject matter of the Treaties if the dispute is submitted to it under a special agreement between the parties”. However, it is also certain that the ECJ or the Commission are institutions also composed by the contribution of countries (such as the UK and the Czech Republic) that did not sign the Fiscal Compact Treaty that utilizes them. Which are the political implications of this discrepancy? Moreover, it also seems problematic to assume that the procedure of a reversed qualified majority will finally neutralize discretionary decisions of the Council. In fact, it remains to be seen whether it is so difficult to build a qualified majority when the member state to save is a large one with its persuasive resources for affecting the choices of the other small and medium sized member states.

### ***Third argument: the legitimacy dilemma***

The *third* is the *legitimacy dilemma*: how to guarantee legitimacy to decisions reached by national executives in the European Council that were never discussed by the institution representing the European citizens (the EP)? Indeed, this dilemma became evident as the crisis deepened and the citizens of the indebted member states had to pay high costs for making the structural adjustment of their country possible. Not only did they have to abide by decisions imposed by impersonal financial markets, but also by the national executives of the larger member states within the European Council (and the Council) they never voted. The legitimacy of the intergovernmental decisions cannot be guaranteed by the ECJ’s involvement in the Fiscal Compact Treaty framework. The intergovernmental

framework cannot identify a satisfactory solution to this dilemma because it assumes, theoretically and politically, that the legitimacy of the EU derives from the legitimacy of its member states' governments. However, as shown by the protests in the streets of many European capitals, the legitimacy of decisions taken on behalf of the EU cannot be a derivative of the legitimacy enjoyed by the governments of its member states. Decisions made at the EU level require a legitimizing mechanism at that level, not at the level of its member states. Without proper involvement of the EP in those decisions, the latter will lack the justification sufficient to be accepted by the European citizens affected by those decisions.

The new treaties, for solving the first two dilemmas, have reduced the discretion of the Council (in particular if compared with the rules concerning the SGP institutionalized in the intergovernmental side of the Lisbon Treaty), recognizing the need to rely on third actors (the ECJ or the Commission) for keeping the contracting parties aligned with the agreed aims of the treaty. Even the ESM Treaty states that, in case of a dispute between an ESM Member and the ESM (Art. 37.2), "the dispute shall be submitted to the Court of Justice of the European Union. The judgement of the Court of Justice of the European Union shall be binding on the parties in the procedure, which shall take the necessary measures to comply with the judgement within a period to be decided by said Court" (Art. 37.3). However, those treaties are structurally unable to deal with the legitimacy's dilemma, which implies necessarily a stronger role for the European Parliament (EP).

## **How? The need to increase the legitimacy of the economic governance regime**

### ***First argument: developments towards separation of powers***

The Lisbon Treaty has brought to maturity a long process of distinction between the executive and the legislative branches. Celebrating the codecision procedure as "the ordinary legislative procedure" (TFEU, Art. 289), the Treaty has institutionalised a two-chamber legislative branch, consisting of a lower chamber representing the European electorate (the EP) and an upper chamber representing the governments of the member states (the Council). The Treaty has thus celebrated the growing role acquired by the EP since its direct election in 1979. The EP has finally become an institution of equal standing with the Council representing (in its various ministerial formations) the ministers of the EU member states' governments. The inter-institutional balance between the EP and the Council has given legitimacy to the law making process of the EU. At the same time, by recognising the European Council as the body responsible for setting the general political guidelines and priorities of the EU, the Treaty has transformed it into a political executive of the Union, while confirming the Commission in its role of technical executive of the latter. The Lisbon Treaty has therefore built a four-sided institutional framework for governing the EU policies (on the single market), with a bicameral legislature and a dual executive branch. This quadrilateral raises two problems: first, how do we reconcile the European Council's decision-making role with the decision-making independence of the Commission, given that both institutions exercise executive functions? Second, because through its irresistible institutionalization the EP has become a legislature of a separation of powers system rather than a parliament of a fusion of powers system, which role might it play for checking the dual executive?

### ***Second argument: the euro crisis has strengthened the role of the European Council***

It is not sufficient to bring the new treaties back to the Lisbon Treaty. In fact, the latter has formalized that economic and monetary policies (and the Economic and Monetary Union or EMU in particular) should be organized according to new modes of governance. Indeed, since the 1990s, scholars and practitioners alike have celebrated the virtues of this new approach to policy-making based on 'open method of coordination' (OMC): benchmarking, mainstreaming, peer review and, more generally,

*intergovernmental coordination* In economic and financial policy the Lisbon Treaty has formalized a model of integration through *growing coordination* between member states' governments. In this approach, policy entrepreneurship from some national capitals and the active involvement of the European Council set the overall direction of policy. It is the European Council which monopolizes, with the Council, the decision-making process.

For example, regarding excessive deficit procedures of the euro-area member states (annexed as a Protocol n. 12 to the Lisbon Treaty, the SGP, as regulated by TFEU, Art. 126) in particular, the Council monopolizes the policy's decision, although the latter is generally based on reports or recommendations of the Commission. As stated in TFEU, Art. 126.14, "the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the European Central Bank, adopt the appropriate provisions" for implementing agreed-upon economic guidelines. According to the special legislative procedure, the Council, acting either unanimously or by a qualified majority depending on the issue concerned, can adopt legislation based on a proposal by the Commission after consulting the EP. However, while being required to consult the EP on legislative proposals concerning economic and monetary policy, the Council is not bound by latter's position. Indeed, the Council took frequently decisions without even waiting for the EP's opinion. The Council (in its configuration as Council on Economic and Financial Affairs generally known as ECOFIN) is supported in its activities by an Economic and Financial Committee whose task (TFEU, Art. 134) is to supervise the economic and financial situations of the member states. It is an advisory body to ECOFIN, to which "the Member states, the Commission and the European Central Bank shall each appoint no more than two members" (TFEU, Art. 134.2). In sum, either through recommendations or special legislative procedure, the ECOFIN is the institution with the power of making decisions concerning the economic and financial policies of the Union. More in general, the Lisbon Treaty has given a strategic role to the European Council, which is now the real political head of the Union. Thus, to assume that bringing the new treaties back to Lisbon is sufficient for giving them democratic legitimacy is not appropriate. It might, indeed, create false illusions.

### ***Third argument: to democratize the European Council***

The political dynamics induced by the euro crisis have had both institutional and structural consequences. Institutionally, the European Council has emerged as the main decision-making body of the EU and its President as a more influential actor than the Commission's President. Because the Commission's President should pass through the approval of the EP for entering in the office, and being no prohibitions in this respect in the Lisbon Treaty, the legitimacy's breaches of intergovernmentalism might eventually be reduced through a re-composition of the two presidencies in a single person. However, it is equally plausible to assume that the two presidencies will remain distinct, with the President of the Commission playing a technical role and the President of the European Council a political function. Path dependency has its own logic. If the dual executive will remain, then it is necessary to increase the legitimacy of the European Council, transforming it into a proper *European Presidency* of a separated system bound to account to the other separated institutions of the EU, the EP in particular. If that is the case, then specific measures might follow. First, it is necessary that the President of the European Council be supported by the administrative structure of the Commission and no longer by that of the Council' Secretary General, thus separating properly the executive and the legislative functions. Second, it is necessary to increase the democratic legitimacy of the role of the European Council's President. It is implausible to assume that the legitimacy of the latter should derive from the legitimacy of the heads of government and state electing him or her. One might think to an electoral process organized according to the Electoral College's logic: the heads of state and government of the European Council will select two candidates for the presidency (the first two voted candidates); an electoral college constituted by representatives of the national parliaments will thus vote for one or the other of the candidates, the candidate getting the majority of electoral college's votes will become the President of the European Council. At the same time, the President of

the Commission and the commissioners would still be appointed by the European Council, with the advice and consent of the two-chamber legislative branch. This would also apply to the High Representative, who should become an official of the executive and lose his or her role as chair of a legislative committee as Foreign Affairs Council. Coherently separating the powers is a condition for making them, not only more effective but also and more accountable, thus more legitimate.

## **Conclusion**

The new treaties have created (for the very first time) an inner Europe constituted by those member states adopting the euro currency plus those member states aiming to coordinate their currency with the euro and an outer Europe constituted by those member states (the UK, the Czech Republic and probably other few member states) willing to maintain their own domestic sovereignty in monetary affairs and also to regain that sovereignty in other previously Europeanized policy fields. This distinction might have two different outcomes. It might reciprocally paralyze the two Europe or might be helpful in defining two different institutional containers for divergent perspectives on the integration process. The first outcome would probably lead to the decline of the EU or in any case to a permanent dissatisfaction of the citizens towards its behaviour (dissatisfaction coming from both those who think it does too much and those who would like it to do more). The second outcome would recognize that the two Europe can no longer go along together on all policy issues. Indeed, the inner Europe might operate according to the logic of reinforced cooperation in a growing number of policy fields (from fiscal to foreign policy), while the outer Europe might operate according to the intergovernmental logic of market coordination. The point is that the strategy of reinforced cooperation does not answer to the question of how to increase effectiveness and legitimacy of the polity emerging from that cooperation. The latter is justifiable only if it is able to institutionalize a system of separation of powers *across all the policies* it will deal with. The logic of separation of powers should favour a clear distinction between the executive and legislative roles, so that the former can become more effective and the latter can strengthen its checking and balancing functions so to increase the accountability of the system. In sum, a discussion on how to democratize the EU should start again.





## Lessons for the Euro and its Governance from History

Harold James\*

The makers of the Euro, and almost every analyst and commentator, assume that the creation of the single European currency was a major and novel experiment in building a non-national money, and thus that there were few if any lessons to be derived from any more remote historical experience.<sup>1</sup> That deduction is not really valid, and there are some important lessons that may be drawn from the vast laboratory of historical experience, especially in regard to the need for rules, but also of flexibility in the implementation of monetary policy.

EMU, as discussed in the 1970s and 1980s, stood for Economic and Monetary Union. But the technical aspects went ahead of the political initiatives on European integration, with the result that there was imperfect agreement on crucial aspects of the monetary union, in particular fiscal rules and banking supervision and regulation. Both these issue areas raised political concerns about loss of national sovereignty and about the redistributive consequences of Europeanizing a fundamental part of economic policy-making. In consequence, the makers of the settlement looked back on a task that was only half accomplished. As former EU Commission President Jacques Delors put it in a recent interview, “the finance ministers did not want to see anything disagreeable which they would be forced to deal with.”<sup>2</sup>

The institutional framework for the single European currency was designed by central bankers, who tried to isolate themselves from political pressures. They gave a great deal of attention to central bank design, but other elements that would have been needed for the successful and enduring operation of a durable monetary union were neglected. In the first draft of the European Central Bank statute produced by the central bankers, Article 2 on the objectives of the European System of Central Banks stated that it should “support the general economic policy of the Community.” But on the grounds that there was a multiplicity of national economic policies, at a late stage in the Intergovernmental Conference that culminated in the Treaty of Maastricht, the Dutch presidency of the Community substituted the phrase “support the general economic policies in the Community.” In other words, there was to be no mechanism for making an economic policy to go alongside the new monetary regime.

There is now a powerful pressure to demand more “democratic accountability” of the ECB, but it is not at all clear how that accountability would work in practice. The problems arise purely out of the exceptional crisis measures – that are parallel to those adopted by other central banks – and that represent a temporary diversion from the central responsibility of the bank in ensuring price stability. After the crisis is over, there is a legitimate expectation that the central bank should return to that objective; measures to regulate or supervise the choice of crisis instruments would be fundamentally superfluous. *The often articulated political demand for changes to the ECB’s governance structure should thus be very firmly resisted.*

There are two parallel reasons for concern about the Euro: one is the imperfect realization of the fiscal concomitants (including the fiscal implications of bank resolution) attached to monetary union; the second, however, is excessive trust in the integration of the capital market and as a consequence

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<sup>1</sup> There are some exceptions, drawing on the history of monetary unions: Michael D. Bordo and Lars Jonung, *The Future of EMU: What Does the History of Monetary Unions Tell Us?* NBER Working Paper No. 7365, September 1999; Michael D. Bordo and Harold James, *A Long Term Perspective on the Euro*, NBER Working Paper No. 13815, February 2008.

<sup>2</sup> <http://www.telegraph.co.uk/finance/financialcrisis/8932640/Jacques-Delors-interview-Euro-would-still-be-strong-if-it-had-been-built-to-my-plan.html> (December 2, 2011)

inadequate flexibility in monetary policy. For both cases, history offers a rich laboratory of potential solutions.

## Fiscal Rules

European interest in American precedents for federal finance has been whetted in the aftermath of Europe's debt crisis. In particular, Alexander Hamilton has become the hero of contemporary Europe. Specifically Alexander Hamilton's 1790 negotiation of a federal assumption of the high levels of state debt in the aftermath of the War of Independence looks like a tempting model for European states groaning under unbearable debt burdens. It has been cited as a precedent in Thomas Sargent's Nobel Prize Acceptance speech.<sup>3</sup> The states had not been responsible for the poor fiscal performance: that was a consequence of the external circumstances of the war of independence. At least it might be argued that some of the European debt problems are also not the consequence of bad policies but of a global financial crisis.

Hamilton argued – against James Madison and Thomas Jefferson - that the war debt accumulated by the states in the War of Independence should be assumed by the federation. There were two sides to his case, one practical, the other philosophical. Initially the most appealing argument was that this was an exercise in providing greater security and thus reducing interest rates, from the 6 percent at which the states funded their debt to 4 percent. The historical case looks like an attractive precedent for the Europeans of today. Hamilton emphasized the importance of a commitment to sound finance as a prerequisite to public economy. “When the credit of a country is in any degree questionable, it never fails to give an extravagant premium upon all the loans it has occasion to make.” Hamilton also insisted on a stronger reason for following good principles than merely the pursuit of expediency. There existed, he stated, “an intimate connection between public virtue and public happiness.” That virtue considered in honoring commitments. Extended in a political body, it would build solidarity. Those principles made the fiscal union what he called “the powerful cement of our union.”<sup>4</sup>

The condition for success in the American case was that the Union raised its own revenue, initially mostly through federally administered customs houses. The logic of a need for specific revenue applies also in modern Europe, where a reformed fiscal system might include a common administration of customs or of value added tax (with the additional benefit in both cases of eliminating a great deal of cross-border fraud).

In the American case, however, the Union was bought at a price. The exposure to the common liability of Virginia, the most politically powerful state in the union, was limited with a ceiling. Only this inducement moved Madison to drop his opposition and agree to the proposal. (The compromise, which also led to the capital being moved to the new site of Washington, on the border of Virginia and Maryland, may be a precedent for limiting German liabilities in the case of the creation of a common European bond or Eurobond.) And some states, such as Georgia, opted out of the assumption.

The U.S. experiment in federalized finance was not immediately successful. Two important parts of Hamilton's financial architecture were not realized, or only realized imperfectly. He proposed a model of joint stock banking on a national scale, which ran into immediate opposition, and which curiously was much more influential in Canada than in the U.S. Secondly, the proposal for a national central bank was eventually blocked by political opposition. The charter of the First Bank of the United States was allowed to lapse in 1811; then, one generation later, the charter of the Second Bank of the United States was successfully opposed by Andrew Jackson in 1836.

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<sup>3</sup> Thomas J. Sargent, “United States Then, Europe Now,” December 8, 2011 Nobel Prize speech: [http://www.nobelprize.org/nobel\\_prizes/economics/laureates/2011/sargent-lecture.html](http://www.nobelprize.org/nobel_prizes/economics/laureates/2011/sargent-lecture.html).

<sup>4</sup> Alexander Hamilton, Report on Public Credit, January 9, 1790; available as: [http://press-pubs.uchicago.edu/founders/documents/a1\\_8\\_2s5.html](http://press-pubs.uchicago.edu/founders/documents/a1_8_2s5.html).

Neither did the Hamiltonian scheme of federal finance guarantee a peaceful commonwealth. In fact the fiscal union proved to be explosive rather than cement. As international capital markets developed in the early nineteenth century, American states used their new reputation to borrow on a large scale, and promptly ruined their creditor status. In the late 1830s there was a wave of state defaults. In this case, as in that of for instance contemporary Greece, the problems stemmed from misguided policies, and cannot be blamed on external circumstance, war or global crisis. One generation later, in the 1860s, the country was torn by Civil War as a result of what was in large part a dispute about states' rights and about the character of financial burdens. In attempting to end the immoral practice of slavery, Abraham Lincoln originally proposed that the slaveowners should be compensated by the public purse. But that was unacceptably expensive. So in the end, the Virginians (and the rest of the South) were expropriated by the Union – at least that is the way they saw things.

The Hamiltonian assumption was not and could not be on its own a guarantor of political order. The perspective that debt required a common foundation of morality was central to Hamilton's approach; but it foundered on the differences between the different states' conception of morality.

Europeans today have caught onto the practical side of the argument, that this might be a means to cheaper credit; but they have not worked out the political institutions that would be needed to give reality to the union. The consequences of the extended and politicized debate about debt restructuring – what is termed kicking the can down the road – have been harmful, and have made a Hamiltonian solution more difficult. The fact is that the credit of the countries has become questionable.

An obvious starting point for a Hamiltonian Europe would be to set some standard limit up to which national debt would be federalized – perhaps the notorious 60 per cent of GDP from the Maastricht convergence criteria, perhaps a lower limit. Debt exceeding that amount would be left to the responsibility of the national states. What can the Europe of tomorrow learn from the American past? A collective European burden-sharing responsibility is in the long run the only non-catastrophic way out of the current crisis. Such generalized European burden-sharing requires a substantially greater dimension of political accountability and control on a European level.

## **Monetary Flexibility**

A common criticism of monetary union is that it requires a single monetary policy, that thus becomes “one size fits all” and deprives policy-makers of a policy tool in responding to particular national or regional circumstances. When the EC Committee of Central Bank Governors began to draft the ECB statute, it took two principles as given: price stability as the primary objective of the central bank; and the indivisibility and centralization of monetary policy. This would not be “in contradiction with the principles of federalism and subsidiarity.” But in fact the second assumption was not really justified either historically or in terms of economic fundamentals.

Think first of the gold standard. Many critics of EMU maintain that looks a lot like the pre-1913 gold standard, which imposed fixed exchange rates on extremely diverse economies. But is that resemblance as bad as it sounds, or as the euro's critics insist? The critics should take the gold-standard analogy more seriously. Like any system in the real world, it was more complex, more interesting, and also filled with more real policy possibilities than textbook caricatures suggest.

First, there was no automatic deflationary pressure following from some alleged peculiarity of the adjustment mechanism. The question of overall deflationary – or inflationary – impact depended (and still depends) on the total quantity of money. Thus, in periods after large new gold discoveries – for example, following the California Gold Rush of 1849, and again in the 1890's, when new mining techniques opened up South African, Alaskan, and Australian reserves – the classical gold standard had a mild inflationary bias. In an era of paper money, however, the link to a physical stock of some precious metal – or, indeed, some other commodity – does not exist, and there should be no reason

why a central bank cannot aim at an overall inflation rate. In fact, almost all modern central banks, including the European Central Bank, do precisely that.

The second lesson to be learned from the gold standard concerns the extent and limits of capital-market integration. In the early 1990's, policymakers, market participants, and economists alike simply assumed that the European Community's "1992 program" – the legislative framework for the single market, and thus for a single capital market – would create a new reality, within which the single currency would work its magic. From this followed an official obligation to treat all types of risk in the monetary union – bank risk or government risk – as identical.

But the history of the gold standard, and of other large common-currency areas, was more complex. Despite the theoretical possibility of capital being sent over vast distances to other parts of the world, much capital remained local. Creditors and banks often preferred to do business with known borrowers, and where local jurisdictions could settle any disputes.

In particular, a critical part of the gold standard was that individual national central banks set their own interest rates, with the aim of influencing the direction of capital movements. This became the central feature of the gold-standard world: a country that was losing gold reserves would tighten interest rates in order to attract money. Central bank discount rates (the policy rate) in France and Great Britain, major capital exporters, were constantly lower than in Germany, which had no major current account surplus, even though there was never any market expectation of a parity alteration. France and Britain in practice placed a floor under rates, and their choices affected other countries because of the possibility of arbitrage. Italy, where there were expectations of parity changes in the 1870s and 1880s, needed much higher rates. The gold-standard rules look very different from the modern practice of monetary union, which relies on a single uniform interest rate. That one-size-fits-all approach meant that interest rates in southern European countries were too low before 2009, and too high in northern Europe. A gold-standard rule would have produced higher rates for the southern European borrowers, which would have attracted funds to where capital might be productively used, and at the same time acted as a deterrent against purely speculative capital flows.

We can see the same differentiation of interest rates in the early history of the Federal Reserve System. Individual Reserve Banks set their own discount rates. Under Section 14(b) of the 1913 Federal Reserve Act, these rates were "subject to review and determination of the Federal Reserve Board." The Board also (section 13) had the "the right to determine or define the character of the paper thus eligible for discount." The individual Reserve Banks had different collateral requirements and accepted differing kinds of securities. In smooth or normal times, the rates tended to converge. But in times of shocks, they could move apart. In the summer of 1929, at the height of the credit boom, New York tightened, while the other banks left rates unchanged; in 1932, New York went much faster and further in lowering rates than other banks. There was thus a space for big policy conflicts. In 1919 the Attorney General ruled that the Board could change rates for a Bank; and in 1929 there was an acute conflict when the Board voted 4:3 to impose a reduction on the Chicago Bank.<sup>5</sup> By the late 1930s, the rate differences were disappearing, but they only vanished completely during the Second World War, for the simple reason that operating with Federal bills (a single instrument) rather than a multiplicity of differently valued private securities became the primary tool of U.S. monetary policy. The makers of the ECB took the practice of the postwar Federal Reserve, and simply assumed that the debt instruments of different member states could fill the monetary policy role of Federal debt in the case of the Federal Reserve's open market policy.

Is modern Europe a single capital market in a deeper sense than that of the nineteenth century, when there were also no formal capital controls between European countries? One guide is the extent to which securities markets are primarily national. Many countries in the nineteenth century issued

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<sup>5</sup> See Lester Chandler, *Benjamin Strong, Central Banker*, Washington D.C.: Brookings, 1958, p. 444; Allan H. Meltzer, *A History of the Federal Reserve I: 1913-1951*, Chicago: University of Chicago Press, 2003, pp. 221-223.

bonds that were mostly held abroad. Since the 2008 financial crisis erupted, there has been something of a renationalization of financial behavior in Europe. Up to the late 1990's and the advent of monetary union, most European Union sovereign debt was domestically held: in 1998, the overall ratio of foreign-held debt was only one-fifth. That ratio climbed rapidly in the aftermath of the euro's introduction.

In 2008, on the eve of the crisis, three-quarters of Portuguese debt, one-half of Spanish and Greek debt, and more than two-fifths of Italian debt was held by foreigners, with foreign banks holding a significant proportion, especially in the case of Greece, Portugal, and Italy. One consequence of the ECB's large-scale long-term refinancing operation (LTRO) has been that Italian banks are once again buying Italian government bonds, and Spanish banks are buying Spanish bonds.

German Economics Minister Philipp Rösler has made the fascinating suggestion that members of the European System of Central Banks should set their own interest rates (though, interestingly, he made this suggestion explicitly as a party politician, not as a government minister). Autonomous interest-rate determination would penalize banks that have borrowed in southern Europe from their national central banks. Meanwhile, the German Bundesbank would have lower rates, but southern European banks would be unlikely to have access to that credit for use in their own markets. There are also signs that individual central banks are using the leeway that they have within the existing framework in order to carry out important policy shifts. The Bundesbank has stated that it will no longer accept bank securities as collateral from banks that have undergone a government recapitalization.

The new collateral requirements, together with tentative talk of autonomous interest rates, represents a remarkable incipient innovation. In the aftermath of the crisis, some policymakers are beginning to see that a monetary union is not necessarily identical with unfettered capital mobility. Recognition of diverse credit quality is a step back into the nineteenth-century world, and at the same time forward to a more market-oriented and less distorting currency policy. Different interest rates in different countries might open the door to a more stable eurozone.

### **Even greater monetary flexibility**

Europeans can also look to other past episodes, when previous crises produced innovative solutions. The history of the immediate aftermath of the Maastricht Treaty holds out some lessons. The European Monetary System (EMS) crises between September 1992 and July 1993 looked as if they would blow up the whole course of European integration. What was at first seen as a one country problem (then it was Italy) toppled other currency regimes like dominos: Britain, Spain, Portugal, and by July 1993 even France was vulnerable. Then as now the future of Europe was at stake.

The solution adopted in frantic late night negotiations at a meeting of the EC Monetary Committee on July 31, 1993, in Brussels at first sight looked counterproductive. The massive widening of the EMS bands to 15 percent either way of the central rates initially made a single currency seem much further off. But it also took away the one way bet character of speculative attacks on the vulnerable currency, and thus removed the fundamental driver of instability. The French franc initially fell sharply against the Deutschemark (but within the new band), largely recovered by the beginning of 1994, had another bout of weakness around the contested and uncertain presidential election of 1995, and then rose to a stronger position than in 1992-3 on the eve of the introduction of the single currency.

The modern equivalent to the band widening of 1993 would be keeping the Euro for all members of the Eurozone but also allowing some of them (in principle all of them) to issue – if they needed it – national currencies. The countries that did that would find that their new currencies immediately trading at what would probably be a heavy discount. California recently adopted a similar approach, issuing IOUs when faced by the impossibility of access to funding. The success of stabilization efforts

could then be read off from the price of the new currency. If the objectives were met, and fiscal stabilization occurred and growth resumed, the discount would disappear. In the same way, after 1993, in a good policy setting, the French franc initially diverged from its old level the band but then converged back within the band. Such a course would not require the redenomination of bank assets or liabilities, and hence would not be subject to the multiple legal challenges that a more radical alternative would encounter. There would also be the possibility that the convergence did not occur. The two parallel currencies could then coexist for a very much longer time period. This is not a novel thought. It was one of the possibilities that was raised in the discussions on monetary union in the early 1990s, that there might be a common currency but not necessarily a single currency.

Such a state of affairs is not just a theoretical construct in fringe debates in the early 1990s, but a real historical alternative. There is in fact a rather surprising parallel for such a stable coexistence of two currencies over a surprisingly long period of time. Before the victory of the gold standard in the 1870s, Europe operated with a bimetallic standard for centuries, not only gold but also silver. Each metal had its different coinage. One trick that made this regime so successful was that the coins were used for different purposes. High value gold coins were used as a reference for large value transactions and for international business. Low value silver coins were used for small day to day transactions, for the payment of modest wages and rents. Silver was what Shakespeare termed the “pale and common drudge ‘tween man and man.” A depreciation of silver relative to gold in this system would bring down real wages and improve competitiveness. Early modern Italian textile workers would find their pay in silver reduced, while their products still commanded a gold price on an international market for luxuries.<sup>6</sup> Larry Neal describes the operation of the Bank of Amsterdam in the seventeenth century as providing a flexible exchange rate its management between the bank guilder and the coin guilder, and thus offering a “shock absorber” for the domestic economy.<sup>7</sup> This is one of the reasons why theorists such as Milton Friedman considered a bimetallic standard inherently more stable than a mono-metallic (i. e. gold standard) regime.<sup>8</sup>

In the modern setting, the equivalent of the adjustment mechanism in the early modern world of bimetallicism would be a fall in Greek (or other crisis country) wage costs as the wages were paid in the national currency, as long as it was traded at a discount. These would be the equivalent of silver currencies. Meanwhile, the Euro would be the equivalent of the gold standard. It would be kept stable by the institutions which already exist today, the ECB and the ECSB of those national central banks who have no new alternative. In this sense the core countries would be the equivalent of eighteenth and early nineteenth century Britain, which also had no bimetallic standard but simply a gold standard regime. Adjustment would be an internal matter in countries which would have a greater flexibility as to domestic wages; and much of the burden would be taken off the central currency mechanism. Now as then a choice of currencies in a national as well as an international setting seems odd and counterintuitive: but it can satisfy a demand for stability.

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<sup>6</sup> Richard A. Goldthwaite, *The economy of Renaissance Florence*, Baltimore : Johns Hopkins University Press, 2008; Tim Parks, *Medici money : banking, metaphysics, and art in fifteenth-century Florence* , New York : W. W. Norton & Co., 2005.

<sup>7</sup> Larry Neal, “How it all began: the monetary and financial architecture of Europe during the first global capital markets, 1648–1815,” *Financial History Review* 7 (2000), pp. 117–140.

<sup>8</sup> Milton Friedman, *Money mischief : episodes in monetary history*, New York : Harcourt Brace Jovanovich, 1992.

# **The European Economic Constitution in Crisis: Between ‘State of Exception’ and ‘Constitutional Moment’**

Christian Joerges\*

No task is more urgent for the students of European law than the search for a way out of the present crisis. It is nevertheless also important, to be aware of the complexities of such efforts. This note is a reflection on the nature of the difficulties we face. The argument will proceed in three sections. The first section addresses the responses to the crisis in the interpretation of the Treaty and subsequent measures (I.1) and those in the judgment of the German constitutional Court of 7 September 2011 on the aid granted to Greece and the euro rescue package (I.2). The second section will reflect upon the state of the law in controversial theoretical perspectives, namely the positions of Jürgen Habermas on the one hand (II.2) and his intimate enemy Carl Schmitt on the other (II.1). On that background section III will sketch out alternatives.

## **I. Europe’s Economic Constitution in Crisis**

Primary law, secondary law and other measure are developing in unprecedented modes. This note cannot attempt to document these developments and their by now enormously intensive discussion in European law scholarship in any systematic way and to evaluate the relative merits of more affirmative and more critical comments. All that is intended here is to point to three groups of particularly controversial issues (1). How difficult it is to find convincing answers to these queries will be so-to-speak confirmed by a look at the German judgment (2)

### ***I.1 Critical legal developments***

The critical state of the economic constitution becomes apparent in the extensive interpretation of primary law, daring provisions in the recent secondary legislation and in the Fiscal Pact.

#### **a) Primary law**

Articles 122 (2) TFEU talks about difficulties “caused by natural disasters or exceptional occurrences beyond” the control of the affected state – it is not evident that the accumulation of sovereign debts fit into that provision.

Article 125 (1) TFEU provides that the Union shall not be liable for or assume the commitments of central governments...and that a Member State shall not be liable for or assume such commitments. – Who would have questioned that the no-bail-out-clause was meant to discipline the Member States? At the beginning of the crisis the objectives of that provision were hardly controversial and informed the understanding of the non-bail-out-clause.

#### **b) Secondary law**

Suffice it here to single out from the Six Pack of November 2011 Regulation 1174/2011, which empowers the Council to sanction with the help of the Commission non-compliance of a state with recommendations concerning macro-economic imbalances. This is very difficult to reconcile with the European order of competences.

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c) The Fiscal Pact as it was signed on 2 March 2012:

Controversies abound. Two issues deserve particular importance. One concerns the constitutional importance of budgetary powers which are the basis for political choices. A second one is the empowerment of the European Council and the Commission to define the corrective measures that have to be taken in case of budgetary imbalances.

### ***1.2 The judgment of the Bundesverfassungsgericht of 7 September 2011***

So far Germany's Federal Constitutional Court (FCT) is the only judicial forum in which the crisis has been examined. The Court was confronted with complaints by a group of 5 professors against the aid granted to Greece and of Dr Gauweiler, Member of the Bundestag, against the euro rescue package. The technicalities cannot be discussed here. The principles, however, which the Court has established are instructive – and so are the limits of these principles, which the court indicated in the yes-but-structure of the judgement.

Principle 1: The budgetary responsibility of the Bundestag is a constitutional essential. The Bundestag must “retain control of fundamental budgetary decisions even in a system of intergovernmental administration (p. 48).

But: “The FCT must restrict itself to manifest violations... it must respect a latitude of assessment” of parliament ( p. 51).

Principle 2: Germany will not comply with European legislative act where the order of competences was not respected (*‘ausbrechende Rechtsakte’*); the pertinent pages from the Maastricht judgment are referred to (p. 50). The bail-out clause (Article 125) is binding and needs to be respected. Was it respected? The FCT does not examine that query, let alone refer it to the ECJ (p. 50).

Principle 3 is the most challenging: Can the governments operate outside the Treaty framework in intergovernmental mode characterised by the German Chancellor as ‘Union Method’.

- a) The Basic Law protects the citizens against “a less of substance of their power to rule by far-reaching ...transfers of duties and powers of the Bundestag to supranational institutions.
- b) The same applies to comparable commitments entered into by treaties (p. 39).

But: The application of these principles remains then somewhat enigmatic:

- a) The FCT controls German legislative bodies. Whether they complied with their integration responsibility is left undecided because the complaints did not substantiate such violations (p 43, para. 109).
- b) Decisions taken in intergovernmental meetings are not acts of German state authority which may be challenged –‘notwithstanding other possibilities of review’.

How poor is that reasoning? Is there a kernel of truth in Joseph Weiler's remark on ‘the dog that barks and then never bites?’ One may conclude that the court avoid a discussion of queries it is not prepared to answer. Or is precisely this apparent inability to hand down a conclusive judgement revealing and instructive? The Court simply could not comply with the letter of the law because that law is misconceived; the German Court also acknowledges that it is not the guardian of the whole of Europe. If this is so, Karlsruhe was even well advised not to refer the matter to the ECJ. It seems inconceivable that the ECJ could hand down a judgment of the whole of Europe's economic constitution.

What, then, are the law's options? My provisional conclusion: The controversies generated by the crisis are beyond the law's limits. At that point I turn to Jürgen Habermas and his favourite enemy – in a chronological order for reasons that will become apparent.



## II. State of Exception or Constitutional Moment? Carl Schmitt v. Jürgen Habermas

### 1. Carl Schmitt

Carl Schmitt has famously and with good reasons been called the crown jurist of the Third Reich. He was thereafter neither exposed to criminal prosecution and his past may even have contributed to the fascination with his work, even or in particular among Anglo-Saxon theorists.

Reasons abound. In the present context a whole range of his notions are worth to be revisited: His understanding of the state of exception as a constitutional concept; his critique of parliamentary democracy; the theory of commissarial dictatorship, his diagnosis of the rise of the executive. Most pertinent, however, seems his theory of the European *Großraum*.

a) In the spring of 1939, *i.e.*, after the *Anschluss* of Austria and the invasion of Bohemia and Moravia, but before the war against Poland, the '*Reichsgruppe Hochschullehrer des Nationalsozialistischen Rechtswahrer-Bundes*' [Reich section of professors in the National Socialist Association of Lawyers] met in Kiel. This was the setting in which Carl Schmitt presented his new theory of international 'law': the '*Großraum* order in international law, with a ban on intervention for spatially foreign powers. A contribution on the concept of the *Reich* in international law.'

The core argument of his key: The *jus publicum europaeum*, which had made the sovereign state its central concept, was no longer in line with the *de facto* spatial order of Europe. A specific 'sphere/space' (the *Raum*) had to become the conceptual basis for international law, with the *Reich* constituting the order of that space. Schmitt underlined that his notion of *Großraum* was a 'concrete, historical and politically contemporary concept' [*konkreten geschichtlich-politischen Gegenwartsbegriff*] rooted 'essentially *not in the state but in the technical, industrial and economic sphere*' (my italics). In a later edition of his Kiel speech, Schmitt referred to debates and theorems on the erosion of the territorial state as the harbingers of the necessity to adapt international law to the factual re-structuring of international relations and the replacement of classical international law by norm systems which one would call governance structures today. He underlined specifically two phenomena, namely, the economic inter-dependencies beyond state frontiers [an emerging '*Großraum* economy'] and the valueless rationality of technology-driven developments, which further the dictatorship of 'technicity' [*Technizität*].<sup>1</sup>

b) Beyond these pronouncements, Schmitt remained silent about the inner ordering of the European *Großraum*. And indeed there was not much to say at the turning point of the war beyond the claim for German leadership. However, Schmitt's remarks are quite instructive when read together with his references to his pre-1933 theory of dictatorship and the quest for commissarial powers in the state of emergency and also a post-1933 essay on 'legislative delegations' which was published only shortly before the Kiel conference. In that comparative analysis, Schmitt observes a blurring of the demarcations between legislative and executive powers in all of the leading democratic states and an apparently irresistible resort to 'simplified' legislative techniques. Legislation, so he concludes, has become essentially a governmental activity.

c) What should all this have to do with the present state of the European Union. Ernst-Wolfgang Böckenförde, formerly a renowned judge of the *Bundesverfassungsgericht* and a great *connaisseur* of Schmitt's oeuvre, was among the first to characterise the crisis of the Euro and of Monetary Union as an '*Ausnahmezustand*' ('state of emergency') which would suspend the rule of law.<sup>2</sup> This was by no means meant as a complacent acceptance of the crisis management on which Böckenförde commented in the spring of 2010, let alone of the disregard of the bail-out clause and the provisions on the

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<sup>1</sup> I leave aside here what he added in a later edition of his essay about German leadership and what may be simply opportunistic concessions to his Schmitt's opponents in the Nazi party

mandate of the ECB or of the more euphemistic readings prevailing in pertinent comments. The implicit, albeit clear, references to Schmitt, in Böckenförde, have in the meanwhile been more widely noted.

d) Who governs in the state of exception? Schmitt discussed this query famously from 1921 onwards. ‘Commissarial Dictatorship’ was the notion he came up with when suggesting that the state of exception is not one of permanent disorder. The commissarial dictator is empowered to restore order and in that sense committed to constitutionalism. On the road to that restoration, however, there are no legal constraints, no objections against ‘*Maßnahmen*’ -- actions or arrangements necessary to overcome the circumstances at hand.

The topicality of the substance of Schmittian notions is intensive and alarming. It seems all the more important to listen to Jürgen Habermas.

## 2. Jürgen Habermas

One cannot be more passionately committed to the European project than Jürgen Habermas. His writing on Europe started shortly before the publication in 1992 of his *magnum opus* on the ‘Discourse Theory of Law and Democracy’ – and there is coherence between his constitutional theory of the nation state and his work on the postnational, European and extra-European constellation. In all of his writing the European project is presented as an indispensable prerequisite for the survival of democracy and social justice. His quest for ‘more Europe’ was never simply affirmative. The tone of his interventions, however is getting ever more intense, and shifting in its emphasis from institutional deficits to the failure of the institutional personal and politicians: He sees Europe on the road to ‘executive federalism’ driven by a ‘technological (mis-)management’, which is threatening democracy, the rule of law and the legitimacy of the European project.

Habermas the political citizen, however, is always accompanied and supervised by Habermas the theoretical analyst and political philosopher. The crisis has provoked both the citizen and the theorist. The citizen complains: What the rulers of Europe envisage is in essence an intergovernmental form of cooperation, that is, a politically inconspicuous step toward further integration of the states, not of the citizens. The heads of state of the seventeen euro countries assembled in the European Council are supposed to remain firmly in control. In pursuing this course, however, they would be equipped with competences of economic governance that annul the budgetary prerogative of the national parliaments. We would then have to reckon with a post-democratic empowerment of the executive on an unprecedented scale. The unavoidable protest of the parliaments stripped of their powers will at least reveal a legitimacy gap in that can be closed only through democratic reform of the interplay among the EU bodies.

The theorist continues his search for the proper constitutional framing of a democratic Union. In a recent essay which will be available in English very soon, Habermas re-defines his perspectives. Nation states, so the argument goes, are no longer in a position to accomplish what their constituencies expect from democratic rule. The erosion of their power is due to both growing inter-dependence and the dynamics of globalisation. Both aspects are compelling reasons to co-operate transnationally and to transfer competences to supranational institutions. As long as this transfer does not damage democratic procedures, it can operate to rescue democratic constitutionalism. The Union represents this potential. The European project can then be re-constructed as a rescue of democratic constitutionalism which is respectful of the democratic credentials of its Member States while, at the same time, institutionalising supranational rule. The peoples of Europe are supposed to understand this supranationalism as a democratic command because it would enable them to accomplish what their nation states are unable to achieve. Once more, Habermas operates with the construct of co-originality in order to reconcile what is usually understood as a dichotomy or antagonism. In his vision, we are citizens of the Union *and* of the respective Member States. The Union is therefore neither a state nor a federation, but a *Verfassungsverbund*. The construction is certainly fascinating, in particular, because

it provides good reasons for a bond of solidarity among the peoples of Europe. It also provides critical yardsticks. Habermas not only criticises a broad range of practices and omissions passionately but, in addition, identifies design defects in the European institutional architecture. His prime target is the establishment of a monetary union which lacks the powers to govern the economy effectively.

I am impressed as I always was ever since I attended for the first time a Habermas seminar back in the late 1960s. However, I am not really convinced, neither by the theorist nor by the political citizen. The parallel or analogy between the Janus-faced national and European citizen and Habermas' co-originality theory of private and public autonomy in constitutional democracies seems to underestimate the non-formal prerequisites of the functioning of democracies, the weight of historical experience, and the social embeddedness of institutions. European governance cannot substitute these conditions in the foreseeable future.

These reserves affect the plausibility of Habermas political hopes, which I share. What is so difficult to see is the potential for the organisation of such a democratic turn, and sensitivity for steadily increasing socio-economic diversity of the Union, the differences of interests and political orientations and the political readiness of European leaders and European citizens to exercise solidarity?

### **III. Is the Alternative really '*alternativos*'**

In the shadow of the sketched-out scenarios, it may appear naïve indeed to reflect upon alternatives to the nightmares of commissarial dictatorship on the one hand and the somewhat desperate hope for a bold democratisation move. And yet, it would seem somewhat irresponsible *not* to do precisely that. At that point I should finally engage with our assignment.

This, however, I cannot do outside the perspectives on which I have been working for quite some time now – and I would have to discuss how the crisis affects them. A few remarks must suffice here:

- a) I believe that we have to depart from some of our fundamental premises in two important respects:
  - We have to re-consider the integration project in the light of Europe's ever growing diversity.
  - We should hence re-orient Europe's agenda from harmonisation and unity to the management of complex conflict constellations.
- b) 'Conflicts-law constitutionalism' is my perhaps not so fortunate title of such efforts. Two of its core messages seem worth to be defended in principle:
  - European law should derive its legitimacy from its potential to correct democracy deficits of nation states, in particular their failure to include those affected by their policies into their decision-making processes.
  - European law should also organise a co-operative solution of problems which the member States cannot resolve autonomously.
- c) 'Conflicts-law constitutionalism' as a critical exercise
  - My claim until recently was that conflicts-law-constitutionalism is to a large degree a reconstructive project, a re-interpretation and re-conceptualisation of really existing European law: European law does compensate external effects of parochial policy-making; it does organise cooperative regulation and governance.
  - After the crisis the gap between my normative suggestions and the operation of European politics is widening, not just in the strive for economic governance or government, but also in fields which seemed well consolidated.

I refrain from any generalisation and even more so from any predictions. What I cannot imagine is even under the impact of a deepening crisis, that we will experience all-encompassing comprehensive transformations. 'Executive federalism' is not to be equated with Schmitt's commissarial dictatorship.

The management of the crisis is unfortunate but will not re-vitalise the hostility of the past. The European machinery continues to function well in numerous fields. Pragmatic, patient and fair conflict management is a source of European legitimacy – and a more cautious and modest Europe may indeed be a sustainable vision.

## The European Stability Mechanism: a constitutional authority in disguise

Giulio Napolitano\*

The establishment of the European Stability Mechanism represents a turning point in European integration process. Its permanent nature transforms the Union into a community of risks, not only of benefits. As a collective insurance device against future damages that could affect a country or a people, it assumes an intimate constitutional nature.

The legal status and some fundamental rules of the Esm, unfortunately, seem unable to meet the challenges raised by such an ambitious program. Transparency and accountability needs are not satisfied. And the day by day effectiveness of the Mechanism could be seriously undermined by compromises, ambiguities and perhaps mistakes in the institutional design.

Firstly, the Treaty defines the Esm an “international financial institution”. Such a definition doesn’t fit its authentic nature. On one side, it’s not truly international. Even if established by a specific Treaty, its birth is covered by an amendment to the Treaty on the functioning of the European Union. Its dimension is European and its tasks are complementary to the European economic governance. On the other side, the Mechanism is not merely a financial institution, like a commercial bank. Its subscribers are Member States of the Union. The governance is in the hands of ministries of finances. Its purpose is to give aid to Member States, not to earn money or raise revenues. The definition as an international financial institution is not only misleading. It also produces undue legal effects, creating an obstacle to the proper application of general rules on transparency and accountability referred to E.U. public institutions.

Secondly, procedures to grant financial assistance are ill conceived. On one side, they are too much complicated and long lasting. On the other side, they depend on the request advanced by a needing Member State. But if it doesn’t issue the request – for internal political reasons – the financial stability of all the Eurozone could be threatened. That’s why it could be extremely useful to introduce a third party kick off. The power to start the procedure should be conferred also to a qualified number of other Member States, or to the European Systemic Risk Board.

Thirdly, too much discretion is given to the Board of Governors. The Board has been vested with the power to grant support to a member State. In order to foster the efficiency of the financial assistance, it can also allow Member States to allot the subsidy to the re-capitalisation of a financial institution. Finally, it can decide to purchase bonds of a Member State both on the primary and the secondary market. While adopting such measures, the Board of Governors seems to enjoy a broad discretion, as suggested by the fact that it “*may* decide” to adopt the measures mentioned above. Indeed, the Treaty does not set any general goal or primary interest for exercising such powers. Although the appraisal by the Commission shall be taken into account, it is not binding on the Board. The problem is that the Board is not even compelled to give reasons. It seems, however, that a motivation would be utterly necessary, especially whenever the Board sets aside the advice of a European institution. It is highly recommendable also the introduction of the dissenting opinion: representatives of Member States exercising *de facto* a veto power should be obliged to give reasons, from the perspective of the European interest and not only of the national one.

Fourthly, the rules on dispute resolution violate the principle of “*nemo iudex in causa propria*”. In fact, the Treaty entrusts the Board of Governors itself with the settlement of disputes arising on the interpretation and application of the Ems Treaty between the Ems and an Ems member State. Thus, dispute resolution is mainly “political”, as it belongs to the same body that leads the Ems and represents national Governments, with the non negligible effect of rendering the Board of Governors a

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sort of *iudex in causa propria*. In this regard, the set up of an independent Board of Appeal – like those of some European agencies – would be more appropriate.

Fifthly, the Treaty does not envisage any of the accountability tools that are usually made available towards European agencies. There are no consultation procedures, neither with general stakeholders, nor with “qualified” parties, such as institutional investors and creditors. There are no transparency duties, nor is it possible to have access to the files. Moreover, the Board of Governors does not report to the European Parliament and there are no procedures to assess Esm's efficiency. Only the financial administration of Esm is subject to a specific set of rules. Every four months, the Member States shall receive a report on financial administration. Moreover, the Treaty provides for two levels of audit, internal and external. In this view, the Board of Governors also appoints a Board of Auditors, which, nonetheless, shall be independent. The only document released by the Board of Auditors is its annual report. The latter is submitted to the Board of Governors, that makes it accessible to the national parliaments and supreme audit institutions of the members States, as well as to the European Court of Auditors. Oddly enough, the report is not accessible to the European Parliament. In order to increase the legitimacy and the accountability of the Esm, it's highly recommendable to set up a regular consultation process, to increase transparency, allowing access to data and records, to introduce reporting obligations in favor of the European Parliament.

Notwithstanding the complex legal and institutional frame of the Esm, for the very first time the European Union has accepted to set up a common fund in order to support ailing member States and citizens in need. As matter of fact, the European Union is getting a constitutional feature under the dress of facing the emergency of financial and sovereign debt crises.

Apparently, it may look curious that such an extraordinary step towards European integration leans on the tools international law and that it is not endorsed by all member States. However, the whole history of monetary integration has been characterized by the relationship between further integration and further differentiation, so that there is no surprise if the same happens while building the stairway for fiscal union and co-insurance among the member States.

Nevertheless, the possible outcomes of this constitutional process are still unclear. In fact, on the one hand, the Fiscal Compact Treaty deeply affects national political-institutional balance. Therefore, its ratification process will have to overcome several oppositions, especially if it will be faced to national political changes and unpopular referendums. On the other hand, the destiny of Esm will also depend on other unforeseeable events: in case of an ease of the sovereign debt crisis (e.g., because of a slack in financial speculation or thanks to the proper functioning of the new public finance provisions), the Mechanism will remain “dormant” in the backstage. However, further speculative attacks against sovereign debt could require an immediate intervention in order to prevent contagion. It will then be necessary to foster Esm, by increasing the resources at its disposal and by solving the institutional problems of its legal framework.

