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End of previous Forum article

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On the Relation of Monetary and Political Union

During the recent financial crisis, rescue packages and extraordinary assistance programmes for a number of countries prevented the euro area from falling apart. Thus, one could argue that crisis management in the eurozone has been successful so far, although the situation in Greece is still anything but satisfactory. However, the experience of the past several years has triggered a discussion on the architecture of the European Economic and Monetary Union (EMU) that goes beyond current problems.

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The euro has always been a political project, as was reaffirmed in the recent Five Presidents' Report:

> Europe's Economic and Monetary Union today is like a house that was built over decades but only partially finished. When the storm hit, its walls and roof had to be stabilised quickly. It is now high time to reinforce its foundations and turn it into what EMU was meant to be: a place for prosperity based on balanced economic growth and price stability, a competitive social market economy, aiming at full employment and social progress.[1]

1 J.-C. Juncker, D. Tusk, J. Dijsselbloem, M. Draghi, M. Schulz: Completing Europe's Economic and Monetary Union, Brussels 2015, European Commission, p. 4.

Political ideas at the start

At the end of WWII, European integration – to be more precise, Western European integration – was motivated by the idea of drawing an everlasting lesson from the devastating experience of two world wars on the continent. Reconciliation between France and Germany was the central point of this ambitious goal. Robert Schuman, then the French foreign minister, made it clear when explaining in 1950 the reasoning behind the proposal for the European Coal and Steel Community (ECSC):

> The pooling of coal and steel production should immediately provide for the setting up of common foundations for economic development as a first step in the federation of Europe, and will change the destinies of those regions which have long been devoted to the manufacture of munitions of war, of which they have been the most constant victims. The solidarity in production thus established will make it plain that any war between France and Germany becomes not merely unthinkable, but materially impossible.[2]

This was apparently first and foremost a political project that was in a short time followed by a proposal for a Treaty on the establishment of a European Defence Community among the six members of the ECSC. However, in the summer of 1954, the French National Assembly did not ratify the treaty.[3] This failure brought an end to the plan of creating a European Political Community and with it the idea of establishing this group of six as a new kind of political entity. It had become obvious that even with the best intentions it was, to say the least, difficult in principle and certainly premature to bring countries – with their deep-seated histories, cultures, political systems and peculiarities – so closely together.[4] The escape from this impasse was found in the concentration on economic integration which started with the European Economic Union and led finally to the Single Market and a European Union with 28 member countries.

Why did political integration fail and economic integration succeed? Economic integration is a kind of "functional" approach. It started with reducing intra-area tariffs and continued by gradually removing all barriers to economic activities between member countries. Stronger trade relations and a more competitive environment would bring welfare gains for all members. The implicit loss of national sovereignty was limited to the field of economic activities by creating a level playing field. The core issues comprising national sovereignty, like public finance, were not touched by these developments. The success of this approach combined with limited intrusion into national political sovereignty attracted first other Western European countries, like the UK, and later, after the fall of the Iron Curtain, a large number of former communist countries.

EMU – a watershed

The Single Market guarantees the "four freedoms", i.e. the free movements of goods, services, capital and, last but not least, people. With the removal of all barriers – a project that has not yet been fully accomplished – this kind of functional integration reaches its peak. Sharing a common currency eliminates the exchange rate risk for intra-area transactions and in this respect completes the single market. This marks, so to speak, the end of the contribution of economics to integration. It is the other side of the introduction of the common currency which brings further integration via institutional change. Establishing a common central bank represents an element of statehood, and transferring national competences to the European level is a sign of giving up national sovereignty in a field as fundamental as monetary (and exchange rate) policy.

However, this kind of implicit political integration is not what leading politicians primarily had in mind when they discussed the concept of EMU. Their ambition went much further in the direction of a political union in its own right. As former German chancellor Helmut Kohl made fully clear when he addressed the German Federal Parliament on 6 November 1991:

> It cannot be repeated often enough: Political union is the indispensable counterpart to economic and monetary union. Recent history, and not just that of Germany, teaches us that the idea of sustaining an economic and monetary union over time without political union is a fallacy.[5]

The conviction that political union should come first and monetary union thereafter was dominant in Germany at the time. The "economist" view claimed that introducing a common currency should be the final step, the coronation of a continuous and sustainable process of integration. In contrast, the "monetarists" – a term which has nothing to do with Milton Friedman and which was most popular in France – were convinced that fixing exchange rates irrevocably, and especially introducing a common currency, would enforce a process of further integration

2 R. Schuman: Déclaration du 9 mai 1950.
3 M. Gehler: Europa, Munich 2010, Olzog Verlag.
4 O. Issing: Economic and Monetary Union in Europe: political priority versus economic integration?, in: I. Barens, V. Caspari, B. Schefold et al.: Political Events and Economic Ideas, Cheltenham 2004, Edward Elgar Publishing, pp. 37-54.

5 H. Kohl: Protocol of the Deutsche Bundestag, 6 November 1991.

in all fields. This opinion is reflected, for example, in the argument that the conditions stipulated by the theory of an optimal currency area, if not fulfilled before entry in a monetary union, would be accomplished in a kind of endogenous process by the necessities stemming from the single currency.[6]

EMU without political union?

When EMU started on 1 January 1999, no progress in the direction of political union had been achieved – indeed, it had not even been attempted. Therefore, from the beginning the euro was confronted with a kind of sword of Damocles: can monetary union survive without political union?

The historical evidence here seemed clear. All previous monetary unions that were not embedded in a political union had collapsed. However, such a comparison with the past is misleading. Apart from the totally different monetary regime, e.g. in the Latin Monetary Union, euro area countries already shared a number of essential elements of a political union. A central bank does not make a state, but it is an important component of statehood. In fact, the European Central Bank and the euro currency are increasingly at the centre of controversies about future political integration. In addition, member countries have already transferred competences from the national to the European level for exchange rate policy, trade policy and most recently banking supervision. European institutions include also the Commission, the Parliament and the Court of Justice. This creates a complex system of joint and mixed competences that is still a long way from being a fully fledged political union. Seen from this perspective, EMU is still an unfinished house.

Completing EMU?

The crisis has triggered numerous proposals to improve cooperation and strengthen the institutional framework. Prominent politicians like French president François Hollande have suggested establishing a European Finance Minister. The "Five Presidents" recently presented the comprehensive report "Completing Europe's Economic and Monetary Union", which comprises most, if not all, the suggestions which are presently on the table.[7]

The presidents call for a "deep, genuine and fair" European Monetary Union:

> Progress must happen on four fronts: first, towards a *genuine Economic Union* that ensures each economy has the structural features to prosper within the Monetary Union. Second, towards a *Financial Union* that guarantees the integrity of our currency across the Monetary Union and increases risk-sharing with the private sector. This means completing the Banking Union and accelerating the Capital Market Union. Third, towards a *Fiscal Union* that delivers both fiscal sustainability and fiscal stabilisation. And finally, towards a *Political Union* that provides the foundations for all of the above through genuine democratic accountability, legitimacy and institutional strengthening.[8]

The suggestions on economic union comprise more or less structural reforms to make the euro area better prepared for global competition – the necessity of such reforms has long been well known. Whether the establishment of new "competitive authorities" is necessary or even conducive to achieve this goal or just a new layer of red tape can be left open here. Overall, this part of the report can in principle be interpreted as an extension of functional integration. The boundary to institutional integration is transgressed when competences for enforcing structural reforms are transferred to the European level.

The same interpretation holds true for the concept of financial union, with its two components, a banking union and a capital market union. The establishment of a Single Supervisory Mechanism is, as already mentioned, an element of institutional and therefore political integration. The extent to which this interpretation also applies to the other two elements of a banking union, namely bank resolution and deposit insurance, will depend on the final arrangement. On the other hand, creating a capital market union via more integrated bond and equity markets can be seen as a final step of functional integration. The political element does not play a major role. This can also be seen from the recommendation that all 28 EU member countries should join this arrangement.

The Five Presidents' Report can be seen as a kind of summary of ideas developed over many years in numerous sources. They all deal with the complex nature of EMU as a very special institutional arrangement based on a single market combined with substantial political elements. The presidents ask for progress towards a political union.[9] The interpretation of this wording points in two directions. On the one hand, political union seems to be the final goal,

6 O. Issing, op. cit.

7 The Five Presidents are the presidents of the European Commission, European Council, Eurogroup, European Central Bank and European Parliament. See J.-C. Juncker et al., op. cit.

8 Ibid., pp. 4-5.

9 For an overall assessment of the report, see O. Issing: Completing the Unfinished House: Towards a Genuine Economic and Monetary Union?, in: International Finance, Vol. 18, No. 3, 2015, pp. 361-372.

the famous *finalité* of European integration. On the other hand, their proposal marking the way towards political union is seen as necessary to stabilise EMU.

The concept of a fiscal union – whatever the concrete aspects – is implicitly a political project. The proposal for a European Fiscal Board, which would consist of independent experts providing assessments of all national budgets and their execution in line with the objectives and recommendations set out in the EU fiscal governance framework, may be seen as rather uncontroversial. However, when this is seen as the basis for interfering in national sovereignty on budgetary issues, the political aspect becomes dominant. Another proposal, a macroeconomic stabilisation function, has to be financed and may function as an initial step towards a larger European budget.

The proposal to integrate the European Stability Mechanism (ESM) into the EU treaties indicates a preference for centralised authority over national sovereignty. It is true that the ESM's intergovernmental structure, governance and decision-making process are all cumbersome. However, taxpayer money is at stake, and therefore national parliaments must agree upon its use. National sovereignty cannot just be bypassed in a cavalier manner.

This is even truer for the proposal to establish a euro area treasury to enable the "joint decision-making on fiscal policy" required in a fiscal union.[10] The presidents make clear that this partial transfer of national fiscal sovereignty needs arrangements for democratic accountability, legitimacy and institutional strengthening. To achieve this goal, they present a number of arrangements, especially involving closer cooperation among the European Parliament, national parliaments and the European Commission.

These are all moves in the direction of political union. However, this combination of a limited transfer of fiscal sovereignty from the national to the European level and limited democratic legitimacy raises a fundamental constitutional problem:

> [...] anything less than a comprehensive shift of sovereignty would fall short of what is required. This holds true regardless of whether we move to a common euro-area treasury with its own budget, or to a system allowing interventions in existing national budgets.[11]

The competence of the national government to decide on taxes and public expenditure is a core element of a democratic state. Transferring this right to the European level would require changes to the constitutions of member states. There is no legal way to undermine this key element of national sovereignty through the backdoor of complex and complicated arrangements.

Monetary union – political union?

There is a strange line of argument connecting monetary and political union. On the one hand, we have the notion that a common currency should work as a pacemaker towards political union. The shortest version of this view is Jacques Rueff's dictum from 1950: *"L'Europe se fera par la monnaie, ou ne se fera pas."* This idea was revived in the context of the introduction of the euro.[12] As the optimism that the euro would strengthen identification of people with "Europe" has been bitterly dashed – the opposite seems to have happened – the argument is now turned upside down: steps in the direction of political union have to be taken to prevent a collapse of the euro area.

These are proposals without any consideration of the preferences of the people in Europe. In the beginning, European integration was a project driven by exceptional personalities in a special historical environment. This "top-down approach" continues today. Habermas is one of many who deplore this "elitist approach" and would require popular support.[13] However, what politician would dare call for a referendum in member states on support for the project of political union? This has in all likelihood long been an "elitist illusion", but in the context of recent developments – take only the refugee problem – such an approach is just unrealistic.

If the political union remains at best a vision for the distant future, all proposals implying moves in this direction will not only have lost their anchor but will magnify the risk of setting governments and the people in even greater opposition to each other. As a consequence, such proposals also increase the risk that even the status quo is in danger.

It is high time to remember what EMU at present still is – and will remain for the foreseeable future: namely, a union of in principle sovereign states which share a number of common institutions but which will not abandon their full sovereignty – especially, though not exclusively, on fis-

10 J.-C. Juncker et al., op. cit., p. 18.
11 J. Weidmann: At the crossroads – the euro area between sovereignty and solidarity, Deutsche Bundesbank, Auszüge aus Presseartikeln, No. 48, 18 November 2015.
12 O. Issing: The Birth of the Euro, Cambridge 2008, Cambridge University Press.
13 J. Habermas: Europe – The Faltering Project, Malden, MA 2009, Polity Press.

cal policy. This conclusion leads back to the perception that EMU is based on treaties which have to be respected again, and responsibility for national policies has to be taken by national states. To refer to a major element of the treaties, the no-bailout clause should be sufficient to demonstrate how urgent and challenging this task is.