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European Economic Governance

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Today's question for our workshop is posed in the right terms: Inside the European Union, we are dealing only with a European Economic Governance – and not or not yet with a European Economic Government. And that's the problem.

At its root, the problem is of political and not so much economic nature. With the Euro crisis we are not only confronted with a lack of efficiency of the Stability and Growth Pact and all the other rules made for EU economic policy. But at the same time we are confronted to an obvious lack of legitimacy.

Tightening the rules for better economic governance might be reasonable and arguably necessary. But even the most comprehensive reform discussed today avoids assessing the question of legitimacy. Since 2002 when Germany and France decided to waive the SGP rules unilaterally we have observed governments acting beyond democratic control. No constituency has ever sanctioned any of the decisions taken behind closed doors at the Justus Lipsius building in Brussels; no parliament has ever overthrown a government for having taken part in these decisions.

We are beginning to realize that this lack of efficiency, transparency and legitimacy has its price – it's a growing sentiment of disenchantment towards the EU as a whole.

But let me argue this point by point.

The first point is **efficiency**.

The Euro has been a consequence and a logical tool of the Single market. If you read the Delors report submitted in April 1989, you will soon discover that globalisation or international monetary reasons are not what led to the creation of a single currency. The integration of European markets has created millions of jobs over the last ten years. And the financial crisis of 2008 has shown the merits and advantages of the Euro in a globalized financial crisis. The Euro is an economic success. But it is a success despite the SGP, not because of it.

The mantra for the SGP is as follows: The Stability and Growth Pact ought to ensure that Member States maintain budget discipline in order to avoid excessive deficits. It therefore contributes to monetary stability. Member States coordinate their economic policies at the European level. Every member state keeps its own in order, and at the end of the day we get what German philosopher Leibniz once described as “pre-established harmony”.

Well, we have not got this harmony yet. And this is not so much due to permanent disregard for the SGP rules as for a much too narrow view of the multitude of elements which can have de-stabilizing and growth-endangering effects.

The vast majority of Euro members and of the EU *tout court* are breaking the rules – the annual budget deficit are higher than 3 % of the GDP, and the annual public debt is higher than 60 % of the GDP. The Council of Ministers failed to apply sanctions against France and Germany after 2002, despite punitive proceedings having been initiated. when dealing with Portugal (2002) and Greece (2005), though fines

were never applied in their case. Even before the Greek crisis of 2010 one could have known about Athens infringing the rules.

One should have known - this is today's echo to yesterday's mantra. One should have known that Spain and Ireland with marvellous GDP figures and best-of-class deficit levels, but high current account deficits were in danger even before the Big Crisis hit hard, fuelling private debt through dithering banks into public debt.

One should have known that Latvia, not yet a Euro member, but a member in the European Exchange Rate Mechanism ERM II, with high net imports and extensive private borrowing, was a candidate for a sudden and painful end of a un-sustainable boom even before the crisis hit – the consequence being riots in the street, a collapsing government, a formal bail-out by the IMF and the European Union, an internal devaluation and sharply rising unemployment.

We all have learned during this crisis – which contains different types of crises – that the SGP is perfectly blind on the eye watching private sector debt. As Belgian economist Paul de Grauwe showed recently, "the fundamental cause of the debt crisis in the euro zone is to be found in the unsustainable expansion of private debt prior to the crisis. The strong expansion of government debt levels started after the financial crisis erupted".

Nor does the SGP take into consideration broader imbalances between EU member economies like import/export ratios or differentials in labour costs.

Reform of the Euro system has not started end of September with the Commission's proposals but between April and June with the Greek

emergency plan (an unsatisfying start in the eyes of financial markets), followed by the more satisfying European Financial Stability Facility allowed to raise money on the market by issuing bonds by a 120 % guarantee of each Member State's pro rata share in the ECB. Who really believes that this innovation is due to die after three years in 2013? This is the first big step in renovating the Euro building. The second is the Commission's proposal from the end of September 2010.

The European Commission's proposals try to tackle these deficits in the rules by sharpening the SGP in the right direction. All measures proposed are in my view promising, reasonable, and rigorous, from monitoring public finances to the medium-term objective, from preventing or correcting macroeconomic imbalances to compliance and sanctions rules. But all these measures are nonetheless problematic, too.

France is not the only country already asking to water down the proposal. German research institutes on economics this week also opposed the Commission's proposals as too much inspired by the idea of "central state coordination" - which sounds not only to German ears like "communist-inspired".

We'll see the outcome. Tim is short. As the FT put it rightly this week, "whether at EU or national level or both, however, action i essential. Relative economic and geopolitical decline apprears likelihood unless Europe improves growth rates."

National governments know about this. But national governments don't like at all being controlled and sanctioned by international markets – but

they literally hate the idea of being controlled and sanctioned by their peers, or worse, by the European Commission.

However, reform stays strictly inside the existing system, trying simply to improve surveillance, control and sanctions. We won't need a new treaty or a new Pact.

The European Commission's September package of six regulatory legislative proposals probably contains the most comprehensive reinforcement of economic governance in the EU and the euro area since the launch of the Economic and Monetary Union. Broader and enhanced surveillance of fiscal policies, but also macroeconomic policies and structural reforms are proposed in the light of the shortcomings of the existing legislation.

New enforcement mechanisms are foreseen for non-compliant Member States. The "European semester" will help checking national budgets. A new surveillance process could help indeed to get a comprehensive and effective economic policy framework. National budgets will be submitted to EU scrutiny; henceforth the legal procedure will start in Brussels' Commission offices before coming to the parliaments as representations of the citizens. From London to Berlin, from Paris to Warsaw the first answer is the same: No way, we won't skip our parliament's prerogative.

This brings me to my second point, **transparency**. With regard to efficiency and transparency the Commission's proposals move into the right direction. But enforcement of these new rules will come in a quasi automatic way. Once again, we'll have to do with mechanisms, not politics. We are going to apply the same treatment, somehow intensified and in bigger doses, for the same illness – which is a growing diversity,

economically as well as socially, inside the EU and the EU zone. Like it or not, but better financial supervision implies the idea of a certain homogeneity of the Union. Macroeconomic imbalances' should be corrected, and with regard to financial markets, this correction can only go in one direction, i.e. follow the best.

Please don't misunderstand my proposal. If the proper EU financial supervision doesn't bring all sinners back on the track of virtue, the job will be done by the hard-boiled and ruthless markets. Let's assume for a moment the EU Commission's proposals become reality, and the Commission with the help of Eurostat and the ECB are becoming the European rating agency we are missing.

Their work will affect not only fiscal policy, public spending and borrowing of member governments, but will monitor private consumption, wage developments, unit labour costs and competitiveness of every single member state. National budgets as well as wages and private spending and consumption are henceforth part of the larger picture. We are going to Europeanize by and large any national economic governance and governments. But we don't say it clearly and openly.

Let us take an example. Countries like Spain or Ireland enjoyed as we have learned through the crisis a strong decline in their real interest rates when they joined the Euro. This opened a comfortable pathway towards consumption and created a bubble in the housing markets. Prices and wage costs were pushed up, the economy heated up.

What would the EU Commission's reaction and action be if a similar boom would happen again? Would Brussels invite the ECB or the now created European Systemic Risk Board to restrict bank credit in Spain or pushing Spanish banks increasing their mortgage rates? Pushing Spanish or Irish government to increase taxation on housing and real estate - and risking the next elections?

Any of these possible, reasonable, necessary measures would be seen as what they are – as a centralised intervention of a power not legitimized by general elections. To put it more bluntly, the Euro system allows a non-elected body of civil servants to give orders to an elected government.

Dominique Strauss-Kahn, the IMF's managing director, was right when he warned last month in a Brussels speech: "Of course I recognise that such a delegation of fiscal powers to the centre could meet political resistance in some countries, where the appetite for ceding further control to Brussels is already weak".

With the laudable and reasonable reform of the SGP we, members of the EU or at least of the Euro zone, become all highly transparent. But this happens to us inside a mechanistic political body not legitimized by fully-fledged democratic procedures.

Under the comprehensive body of legislation following the Treaty of Lisbon we are standing on the threshold of a kind of federal system. The body of rules and regulations foreseen by the reform of the SGP pushes us further in this direction.

To be clear, I won't complain about the Europeanization of economic governance, and I am not afraid of the F-word either. The EU is already a kind of federal system, unique in its form as well as its substance. And this European Union is not in danger of becoming a super-state today or even tomorrow. But this federal system does refuse to see its face in the mirror. The Union is not ready to admit its political nature of being a federated political body, nor is it ready to admit its lack of democratic legitimacy.

This brings me to my third and final point, **legitimacy**.

By sharpening economic surveillance and by shaping a new form of economic governance the Euro zone and the European Union are making a significant step towards a federated political entity. Sure, there are still some loopholes in the system but this is not the main issue. We are transforming economic governance into an economic government without having this government institutionalized or personalized.

Let me quote here two opinions which are on opposing sides of the political spectrum.

It was billionaire George Soros who in February 2010 complained about the Euro's misconstruction. According to Soros we need both, a central bank as well as a European ministry for Finance. Soros shapes his argument in a purely functional way; legitimacy is not his purpose, efficiency is.

Scholar Stefan Collignon, rather a Social democrat, justifies his "Republican Approach to Euroland's Governance" with an enlarged

range of European public goods like inflation rate, interest rate, exchange rate, fiscal policy. I'd extend his argument in the light of the Commission's proposal towards private consumption, wage developments, unit labour costs and competitiveness. Collignon calls for a European government in the name and interest of common European public goods (and to be precise, he refuses the previously mentioned federal character of the Union "insofar, that it does not seek to integrate autonomous nation states into a single federation of states").

Let me conclude.

By enhancing economic governance of the Union we are not so much confronted with the question of an Economic government for the Union but with the quintessential question of the democratic nature of this European Union. The subtleties between governance and government disappear in this perspective.

I am not naive; I can't see any national head of state or head of government working in light of this. On the contrary they all know too well that democracy being the winner, national governments would be the looser in this process. They can completely agree with the call for more efficiency, they can even live with the call for more transparency. But they will avoid as long as possible the L-question, the call for legitimacy of far-reaching decision-making, in the name of the EU and for the sake of us all.

Hence the problem is neither fiscal nor even economic, but political. And the price could be increasing frustration about an Europeanization out of citizen's range.