Who is reforming Europe's Economic Governance?

Stefan Collignon on 03.08.2010 • Categorized as Columns, European Union, Governance • 3 Comments

After the crisis, European policy makers are now crafting reforms to strengthen the Union's economic governance. It is an opportunity to make Europe more democratic. Instead, conservatives increase the democratic deficit under the pretext of closing budget deficits. This will not work.

The European Commission has proposed measures to enhance economic policy coordination. ECB President Trichet sees the "need for a quantum leap in the Euro Area's governance" and has suggested setting up an independent agency, housed within the European Commission, with powers to hand down a broad range of sanctions on countries whose budgetary and macroeconomic policies would lead to a sharp loss of competitiveness.

Even Chancellor Merkel has joined President Sarkozy in calling for an economic government and Council President van Rompuy has set up a task force for economic governance reform that is to report later this year. All these efforts by Europe's conservative establishment have one purpose in common: make Europe more efficient, but avoid giving citizens a bigger say.

The euro was intended to become a stable currency, but stability requires more than an independent central bank and the Stability and Growth Pact. Europe's economic crisis of 2010 has shown that the intergovernmental mode of governing Europe has become counterproductive. This is evident in three major economic policy areas.

First, with respect to financial supervision, member states cannot agree on a unified authority for the financial market of the single currency area, because each government seeks to protect its "own" banks (which are often not even nationalized!). Stress tests are supposed to reassure investors, but everyone knows that they are manipulated to avoid banks having to raise their capital reserves in order to remain "competitive". Thus, partial interests are blocking the pursuit of the common good.

With respect to competitive distortions, focus is on current account deficits in Europe's south but talking about Germany's surplus is taboo. The fact is, however, that in a monetary union current account imbalances are irrelevant as a policy constraint, because banks allocate the savings of the whole Euro Area to wherever they find profitable investment opportunities. Hence a current account deficit may signal the inflow of capital to profitable investment, and a surplus the lack of such opportunities and the outflow of savings.

Alternatively, a current account deficit can also be caused by the loss of competitiveness, which is compensated by government borrowing that props up local demand, while a surplus can reflect cost advantages and lack of domestic demand. Notice, however, that in the single market uncoordinated national stimuli are dispersed across the Union, while national debt accumulates in the fiscally active member state alone. Hence, focusing on current account imbalances within the Euro Area is a red herring. Far more important are relative levels of unit labour costs, i.e. the levels of nominal wages relative to productivity. But hardly anybody talks about this because wages are negotiated nationally, as if the wage settlement in one country had no consequences in the rest of the monetary union. It is time we understand that money determines what is an economic country and not the legal boundaries of jurisdictions. The Euro Area needs a unified policy-making authority, an economic government.

Finally, with respect to budget policies, Europe's policy establishment is swept by a wave of consolidation hysteria that has little foundation. The case has been made convincingly by J. Bradford DeLong (30.07.2010) and Robert Skidelsky (20.07.2010) in their columns in Social Europe. However, misconceived ideas by policy makers do not mean that we can continue with the old fiscal policy rules in Europe. Quite to the contrary.

First, there is a need to ensure that public debt remains sustainable. The Greek drama has shown that sovereign debt cannot be confined to nation states. Problems in one member state of the same currency area inevitably become problems for all member states. Policies by one government affect citizens in the whole Union, even if they had no possibility to approve or disapprove, i.e. to vote for them. Hence, public debt in the Euro Area is a public good, but we have no mechanisms for making democratic choices regarding policies that affect all owners of these European public goods.

Second, to this day, no one has been able to prove that the Hellenic Republic is insolvent, i.e. that its debt is unsustainable. What is clear is that financial markets have become unwilling to provide funds to the Greek government, but this does not necessarily imply that Greek debt cannot be repaid by future tax revenue. The crisis is about liquidity, not solvency. The European Council in May this year was therefore correct to follow the leadership of the ECB and provide a €750bn facility for governments that have difficulties to access markets at reasonable conditions. However, there is widespread uncertainty, how this ad hoc policy innovation can ensure fair access to liquidity for governments that need it in the future.[1]

The conservative pretense, whereby every member state is out there on its own, can no longer be defended after what has happened this year. In its place, a mechanism is needed to make policy decisions in the interest of all European citizens, rather than of European governments and their clients. By definition, member states in the Council can only represent a small faction of citizens, not the common interest. Hence one should not expect democratic reforms coming from the European Council.

Third, economic reforms have the potential to improve the welfare of European citizens. The Lisbon Strategy of 2000 was the attempt, driven by social democratic governments, to set up such reforms. It has by and large failed. This failure is not simply because conservative governments have gained the majority in the Council. More importantly, political economy theories teach us, that in large groups there is a temptation to free-ride on others and minimize one's own efforts towards producing the common good. In such circumstances, systemic coordination failure becomes inevitable and prevents the implementation of policies in the interest of the vast majority of citizens. Policy making therefore needs to be centralized under one authority, but this is only possible if the European Union becomes more democratic.

This is Europe's problem. Our common public goods and general welfare are only sustainable if we administrate them jointly, but nation state governments play the identity game whereby they alone can represent the interest of "their" people. As the kings in ancient regimes, they claim sovereignty, while everyone knows that in a modern world, it is citizens who are sovereign. Sovereign citizens appoint governments as their agents to administer their common public goods. They have different agents for different goods. Some are local, some regional or national; but Europe's citizens are denied the right to appoint an economic government that administers their common European public goods. Only a democratic European government can efficiently solve Europe's economic problems without widening the democratic deficit. It would give citizens the opportunity to debate the broad orientations of policies that serve their interests, rather than being at the mercy of the German Chancellor, the French President or the British Prime Minister. It would allow them to appoint representatives to execute their general will, rather than being subjected to the mainstream orthodoxy of "independent" experts and faceless bureaucrats.

Democracy is the key to reforming Europe's governance. Conservative "realists", who lack the creativity to imagine a world where citizens decide on the orientation of their interests despite differences in histories and cultures, will become the grave diggers of European integration, because in the medium to long run, citizens will not accept that fiscal policies are made without representation. Compromised politicking does not satisfy anybody. Policy rules cannot replace the will of the people. What Europe needs is that the Commission proposes policies that are approved by the European Parliament, because Parliament alone has the legitimacy to speak in the name of all citizens. The Commission, not the odd Merkel-Sarkozy couple, must be the economic government. This government needs to draw its legitimacy from the Parliament, where controversial policy debates between the Left and the Right, between Social Europe and Neo-liberalism, offer real choices to voters at European elections. None of this requires changes in the Lisbon Treaty. It only requires taking the general legislative procedure (art. 294) seriously and extending it to all issues of economic policy making.

However, such reform does require political will. It is now left to the Left and other progressive forces to oppose the conservative agenda of reforms that widen the democratic deficit and delegitimize policy making in the Union; it is the mission of Europe's Social Democracy to engage and articulate citizens' political will, in short to "dare more democracy" (Willy Brandt) in Europe. Who else would do so?

1. My proposal of issuing Union Bonds would be one solution by creating a fully integrated European Bond market for low risk government debt. See:http://www.stefancollignon.de/PDF/Greece%20and%20Union%20Bonds.pdf ↩

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