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An economic government for the Eurozone?

Numerous suggestions have been made to improve the institutional structure of the Eurozone, with reforms of its various constituent elements being put forward. One proposal has received high-profile endorsement and therefore stands out in the public debate: French politicians and commentators have repeatedly called for more economic co-ordination in form of a *gouvernement économique* – an economic government for the Eurozone.

By virtue of being an often-used catchphrase the idea rallies both fervent support and outright rejection, though politicians often mean different things when they endorse or reject an 'economic government'. It can best be defined as a collective, identifiable body that is designed to cover the decision-making process of issues explicitly relating to euro-area economies. Such an institution would assess the economic situation in the Eurozone, discuss policy options and adopt major economic-policy strategies both as immediate response to macroeconomic shocks and with regards to underlying structural issues. Beyond this strategic function, some commentators have suggested vesting the body with legislative power.

What are the advantages of institutionalising economic co-ordination in the Eurozone? What are the problems attached with it? This Brief will assess the issues at stake and the historical development of the informal Eurogroup up to date. Its preliminary conclusion is that there are economic and political reasons for vesting a collective body with such a strategic task – though it has to be acknowledged that the current political climate in the EU will make it difficult for such reforms to be carried out in the near future.

The benefits of a unified institution

EMU was, as a matter of conscious decision, created without a formal collective political body at its centre. The European single currency would have a single monetary authority, the European Central Bank (ECB). But it would have no political equivalent as a centralised economic decision-making body. This structure was based on both political and economic considerations. Many European governments were politically reluctant to reinforce the sovereignty-pooling inherent in the European single currency by setting up a central body to govern the currency's workings. Equally, many of the governments engaged in structuring the Eurozone's governance were inclined to believe that a rule-based structure for the new system would produce better economic results than one with a central European economic government, acting at its own economic and political discretion.

The case for economic co-ordination

Over the past fifteen years, however, a number of voices have been raised, urging that a European level of economic governance is necessary for the Eurozone to run more smoothly than it has until now and to improve the lacklustre overall economic performance of the Eurozone. A number of related arguments have been put forward in this connection.

It is common ground that a single currency creates strong interdependence between national economies and national economic policies through a common foreign exchange rate and a single monetary stance. On the face of it, it seems to critics paradoxical that this interdependence should be so clearly recognised in the institution of the European Central Bank but find no equivalent political expression at the level of European economic/political governance. Whatever the precise relationship between national central banks and national governments before EMU, it was rarely denied that national governments were and should be significant economic actors, whose decisions made an enormous difference, for good or ill, in the economic sphere. That the Eurozone system, itself manifestly a transnational system, has no transnational political pendant to its highly centralised monetary arrangements constrains, it is argued, the optimal working of the single currency area. Economic decisions taken on a purely national basis by national politicians interact in the current Eurozone with monetary decisions taken on a Euro-wide basis by the European Central Bank. This 'mis-match' is seen as both theoretically incoherent by its opponents and responsible (in the view of some) for a 'deflationary bias' in the working of the Eurozone, derived from an over-powerful European Central Bank.

Advocates of a European 'economic government' see at least three specific advantages of such a political institution. They believe it would be more flexible than the current rule-based structure. They believe it would be more legitimate. They believe it would be more effective. All these arguments bear further examination.

Those who see a 'deflationary bias' in the workings of the Eurozone often associate their critique with the claim that the Growth and Stability Pact (at least in its original unreformed version) has been an undesirably inflexible basis on which to conduct economic policy. This claim underlay Mr. Prodi’s controversial observation that the Pact had been 'stupidly' applied. An 'economic government' might have been able, working with the Commission and the European Central Bank, to achieve more quickly a more sophisticated working of the Pact, which in its turn might have given more room for manoeuvre to the Central Bank. Particularly in its early years, the Bank clearly felt itself as needing through its interest rate policies to compensate for the inadequacies of national governments. A continuing dialogue between the Bank and the 'economic government' might have ensured a better and less potentially confrontational relationship. There might well be occasions in the future where the fullest possible understanding will be necessary between the ECB and the European Union’s political decision-makers, in times for instance of economic crisis or political instability. The absence of a political partner for the ECB is seen by some as a clear lacuna in the Eurozone’s governance system.

In some countries of the Union at least the apparently predominant role of the ECB in the Eurozone’s governance structure is seen as undermining the whole legitimacy of the Eurozone’s structure. Many of those advocating a European 'economic government' believe that this possible gap in legitimacy would be filled by the recognition of the EU’s citizens that economic decisions affecting their lives and well-being were not simply being taken at the European level by unelected bankers, but that elected politicians played a substantial role in this process as well. If they did participate in a real European level of economic decision-making, national politicians would then, moreover, be forced to explain and justify to their electors the sometimes painful choices needing to be made. A number of European politicians have sometimes found it convenient, explicitly or implicitly, to blame the ECB for problems to which it had only marginally contributed, if at all. The political legitimacy of independent national central banks has not been generally transferred to the European Central Bank. An 'economic government' for the European Union might make the Eurozone’s system of governance generally more palatable to the European public, without necessarily trespassing upon the specific competences of the ECB.

Finally, a European economic government would arguably have within its grasp possibilities for a common economic analysis and common political decision-making which would be more coherent and effective than the present arrangements allow. Beyond their varyingly serious attempts to conform with the Growth and Stability Pact, the European Union’s politicians have little that could seriously be described as a 'European' economic policy. French Prime Minister Dominique de Villepin has suggested that finance ministers of the Eurozone should open a 'dialogue' with the ECB about how to deal with low growth and high unemployment by defining a common economic stance and achieving an appropriate policy mix. Such a dialogue would be difficult to envisage under present institutional arrangements for the Eurozone. A mechanism for central economic decision-making within the single currency area would provide both the partner in dialogue for the ECB and the guarantee that any agreed fiscal or economic stance would be effectively executed.

From theory into practice: the rise of the Eurogroup?

Having established the advantages of such a collective economic body, how would such an institution look in practice? And, more to the point, why cannot ECOFIN fulfil this role, given that it already has political authority in certain areas of European economic policy (such as the intervention in foreign exchange markets and the decision-making power over the 'excessive deficit procedure')? One obvious answer is that ECOFIN deals with the economy of the European Union as a whole – an explicit body for the Eurozone would however recognise that the territory of the Eurozone and the EU will be incongruent for some time, especially after the latest enlargement round. Moreover, in an EU of 25 (or possibly 30), Eurozone problems are qualitatively different to pan-European concerns, with its members having a much higher economic and political stake in co-ordinating their policies than countries that have not joined the common currency.

One initiative that has gained attention is the suggestion to transform the already-existing 'Eurogroup' into an 'economic government[1]. Formerly known as Euro-X (or, in the process of admitting more countries to adopt the common currency, Euro-XI), this informal group of Eurozone finance minister was created at the request of the French government. Designed as a forum for policy co-ordination and consultation with regards to specific Eurozone matters, it meets in advance of regular ECOFIN sessions. It is said that vital decisions concerning the Eurozone are now discussed and informally decided in this caucus-like configuration. In addition, there have been calls over the past years for 'euro summits' dealing specifically with problems specific to the Eurozone.

Conclusion: the future of an economic government

The economic working group of the European convention officially acknowledged the informal meeting of ministers from countries having adopted the common currency and thus reinforced the Eurogroup as playing an important role in facilitating discussion. It further proposed the creation of a president for the Eurozone – a ‘Mr. Euro’ who would chair meetings for two years and provide a political face – much like the EU’s foreign policy representative. Yet with the Constitutional Treaty being put on hold, those plans have moved further to the back of the European Union’s agenda.

It now takes a renewed effort and political will by the member states to continue with the institutionalisation of economic governance in the Eurozone. Whether that is likely is questionable in the current political climate. The very term 'government' will without much doubt spark resistance beyond the actual influence of such a body, whose powers depend very much on what is agreed by the member states.

Luxembourg’s Prime Minister Jean-Claude Juncker has said that he fears that Europe is not ripe for substantial changes in its economic governance at the moment – despite the merits that such an economic government would have for the Eurozone. His Belgian colleague, Mr. Verhofstadt, seems more optimistic in his recent pamphlet 'The United States of Europe', although his proposal of a European economic government in which the European Commission would play a leading role might be unacceptable to more intergovernmentalist member states. If over the coming years the Eurozone does decide to go down the route of an 'economic government,' it will probably do so by a series of small steps in that direction rather than a spectacular moment of creation. The frequency and coherence of such steps will say much about the evolution of the European Union over the coming decade.

[1] The idea has been put forward most prominently by P Jacquet and J Pisani-Ferry, 'Economic policy co-ordination in the euro-zone', 2001 and by R Boyer, 'Le gouvernment économique de la zone euro', 1999.