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On the Efficiency-Legitimacy trade-off in EMU

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Abstract

This paper addresses the question whether the process of European monetary integration implies efficiency-legitimacy trade-off. The paper considers that the process of monetary policy delegation to the European Central Bank (ECB), ratified by all European Union (EU) parliaments, was a non-zero-sum game, increasing both the efficiency and the legitimacy of monetary policy in the eurozone. There was however a change in the nature of delegation: the initial principal (EU national governments and/or parliaments) delegated to the agent (the ECB) control over its behaviour in regard to monetary policy. The paper distinguishes two types of constraints for monetary policy: credibility constraints and political constraints. The change in the nature of delegation of monetary policy (tying the hands of the principal) was a means of dealing with credibility constraints. The paper goes on investigating whether, and if so to what extent, the European Parliament (EP) is fit to function as a principal of the ECB as a means of dealing with political constraints. Thus, the paper analyses the European Parliament's increased involvement in overseeing the Central Bank's activities, aiming at understanding whether and how that new and special role (an informal institution of dialogue) could affect the trade-off between efficiency and legitimacy in the conduct of monetary policy in the eurozone.

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1. Introduction

The so-called Community method of integration is said[2] to face an efficiency-legitimacy trade-off. It is not possible to increase the legitimacy of the EC system without decreasing its efficiency and vice versa. In other words, there is a trade-off between democracy and the European Union's problem-solving capacity. Höreth (1999) suggests that the quest for more legitimacy of EU governance is a zero-sum game. Reinforcing the input legitimacy could well reduce its efficiency.

From a normative perspective it can be argued that legitimacy cannot be reduced only to performance. Notwithstanding such normative objections, some output legitimisation, for example through a well-functioning Economic and Monetary Union (EMU), can contribute to and benefit from input legitimisation. Increased input legitimisation smoothes the processes of agreeing on and implementing common policies, thus facilitating delivering.[3] The two processes are then cumulative in enhancing the democratic quality and effectiveness of governance in the EU. It is with that approach to input and output legitimisation that this paper discusses the trade-off between democracy/legitimacy[4] and efficiency in the European monetary integration process.

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[2] See for instance Scharpf (2001) and Héritier (2002).
[3] To that extent the way in which the term effectiveness is used is somehow more demanding than just the relation between input and output of a given existing system.
[4] The concepts of democracy and legitimacy are generally used in an interchangeable way without a proper distinction and/or as communicating vessels, as put by Gustavsson (2002). Good examples are the official Nice and Laeken Summit declarations, the first talking about "the need to improve and to monitor the democratic legitimacy and transparency of the Union" and the other saying that "The EU derives its legitimacy from the democratic values it projects" (see Gustavsson 2002). Yet we know that a process can be democratic but not legitimate and vice versa. This paper recognises the importance of legitimacy insofar as delegations of power are concerned but it focuses on democracy – how transparent and accountable governance is in the EU.

Most authors dealing with the legitimacy problem, the democratic deficit and the efficiency[5] of the decision-making process in the European Union (EU) defend that the EU would have to opt to be either a federal political union, with one government and one parliament, or a confederation of sovereign states, without majority-voting. In most of these analyses, the present role of the European Parliament (EP) has been somehow neglected. Most of the time, the EP's role is only analysed as a potential conventional parliament in a future federal political union. For a considerable part of this literature and also for many EU observers and national politicians, the European Parliament has "an inferior representative quality" and therefore it is argued that a parliamentarisation of the European Community (EC) system would not improve its democratic quality.

This paper centres on the example of EMU, the making of its rules and the overseeing of the European Central Bank's (ECB) conduct of monetary policy. It examines whether there is indeed a trade-off between efficiency on the one hand and transparency and accountability (and participation and deliberation) on the other hand in the process of European monetary integration.

While supranational regulation in the EU may be subject to the above referred trade-off, one has to acknowledge that the building-up of EMU could well have enhanced different forms of participation, namely, by national parliaments and European citizens. It also represented an accountable and relatively transparent power delegation of executive authority (from the European Council and the EU Council of Ministers to the ECB). If that is the case, and if there is no evidence of decreased efficiency in that process, one has to look elsewhere for that trade-off. Moreover, monetary policy may well have been beyond the reach of the democratic political system before centralisation (EMU) --

[5] Throughout the paper the concepts of efficiency and effectiveness are used in an almost interchangeable way but the former refers more to the processes that create institutions and the latter to the institutions that deliver policies.

abandoning the intergovernmental mode of governance would not even have been subject to the legitimacy-efficiency trade-off (a non-zero-sum game).

In that case, "elsewhere" is in the steady-state of supranational regulation of monetary policy, that is, the system since 1999. In fact, it was in 1999 that EMU's third phase began. Consequently, EMU has to be analysed in terms of its contribution to increased transparency and accountability (and also participation and deliberation) of the implementation of monetary policy by the ECB.

An additional but rather central question (subject to efficiency considerations) that the paper tries to answer is whether, and if so to what extent, the European Parliament is fit to function in a EU polity. Therefore the paper investigates the nature of the increasingly important (though usually disputed) role of the European Parliament as a principal of the ECB. Thus, it analyses the European Parliament's increased involvement in overseeing the Central Bank's activities, aiming at understanding whether and how that new role has significantly affected the above referred trade-off (in the steady-state of supranational regulation of monetary policy). For that purpose it is necessary to understand whether the European Parliament can develop a role of principal (overseeing the activity) of the ECB without putting at risk the credibility (and consequently, effectiveness) of the European monetary authorities in the financial markets. Furthermore, the paper seeks to clarify how the EP diverts political pressure by various interest groups away from the monetary authorities towards itself.

2. Increased centralisation versus the growing need for democracy in the EU

Concentration of decision-making in some institutions in modern democracies mirrors situations in which legitimate principals have delegated power to agents for the sake of efficiency. The process of delegation itself may, as for instance one can argue for the case of Economic and Monetary Union, meet transparency and accountability requirements. However, those legitimate principals expect agents to carry out policies that are consistent with their initial preferences. Nevertheless, for different reasons[6] the agent's actions may differ from the principal's preferences. Transparency, in conjunction with accountability, is critical to ensure that agents comply as mandated.

2.1. The issues of efficiency, accountability and responsiveness at the monetary level

Enhanced transparency of European monetary policy, improves the democratic quality of the European integration process.[7] In the case of EMU, compared with the previous situation (with the exception of Germany), there was already an increased degree of transparency, accountability and indeed participation. This increase occurred through referenda on the Maastricht Treaty, through public discussions during national and European election campaigns and when making its rules. The EMU process of delegation met some accountability and transparency requirements.

However, it is possible to improve the democratic quality of monetary policy decisions by making sure that the agent's actions do not differ from the principal's initial preferences (objectives). It could be improved by means of enhanced transparency and accountability as well as through informal institutions (such as the interaction between the ECB and the EP) and deliberative processes among monetary policy experts that have different perspectives on the conduct of monetary policy (that might lead to more responsive EMU governance).[8]

[6] For a brief review of these reasons, see Elgie (2000).
[7] This aspect is specifically dealt with in section 3.5.
[8] Stefano Bartolini (2006) defends that no governance can, *strictu sensu*, be accountable so that the term responsivess is more adequate in the context of governance. See also Schürz (2002) for a discussion of the issue of democratic legitimacy with deliberative institutions for the case of the ECB.

To hold agents accountable one needs not only transparency but also enforcement mechanisms.[9] These provisions are particularly relevant for the relationship between the ECB and the European Parliament. In fact, although the EP's oversight of the ECB's activities lacks enforcement mechanisms -- as it cannot pass any laws that define the goals and tasks of the ECB -- it has been able to develop an informal role in overseeing the ECB. The litmus test for that capacity, i.e. a serious crisis or conflict, has not taken place yet.[10]

The process of globalisation made the tension between increasing complexity and the growing perceived need for further developed democratic mechanisms in modern societies more acute. Moreover, many of the various problems that modern societies face cannot be dealt with successfully by national political systems -- let us think of monetary and financial instability, just to stick to our example (EMU).

Governments of different countries can only partly deal with such types of transnational problems by collaborating. Collaboration comes at a higher cost because at the intergovernmental level the process of reaching decisions is more complicated. There are thus (very concrete) additional costs in terms of efficiency. Examples are the difficulties to reach agreement among governments, to get then the approval of their respective parliaments, etc. Citizens may feel even more acutely the need for enhancing democratic mechanisms given the lack of transparency and/or the insufficient participation in that type of decisions.[11] The inter-governmental level alone, while

[9] See Keohane and Nye (2003) for a discussion of these issues. As discussed in Torres (1996a) and in section 3 (3.2) the *ex-ante* specification of the rules of the game (EMU) was not part of the Treaty of Maastricht that focused on entry requirement rather than on working rules.

[10] See below and also Elgie (2000). With respect to some EU common policies, such as environmental policy, there is already a much more important level of participation than in the case of monetary policy and also an increasing level of transparency due to the European co-decision procedure, see Torres (2003).

[11] For instance, for Kohler-Koch (1999) majority voting, although increasing the effectiveness of decisions in the EU at the intergovernmental level, infringes the sovereign right of the Member States to ultimately decide what is and what is not acceptable to their national constituencies. Note that this presupposes that the state still had *de facto* sovereignty. By pooling sovereignty in the EU some Member States might at least influence some decisions that they could not affect before.

necessary for carrying on the European integration process both in terms of processes and outcomes, is neither an efficient nor a transparent way of governance in the European Union.

Where regional, national, inter-governmental and federal structures overlap, the tensions between increasing complexity and the growing felt need for democracy in modern societies is even more evident than at the national level. In the EU there is an on-going evolution in terms of sharing sovereignty that should increase efficiency. Stable forms of political cooperation among the EU Member States are hence part of the solution as a way of improving efficiency. At the same time they are also part of the problem in terms of transparency and accountability as well as participatory and deliberative processes. Given that in the EU responsibility is much more diffuse than in national systems, it becomes even more difficult to make the various institutions that formulate policies and/or take decisions at different levels accountable.

Bradbury (1996: 1) sees accountability as "the requirement for representatives to answer to the represented on the disposal of their powers and duties, act upon criticisms or requirements made of them, and accept (some) responsibility for failure, incompetence or deceit". The concept thus requires sanctions or enforcement mechanisms as already mentioned above and discussed below for the case of the lacking *ex-ante* specifications (working rules) of EMU.

The question then is how to address the identified democratic deficit in terms of democratic accountability in the EU. Gallagher, Laver and Mair (2001), discuss different ways of making policy-decisions in the EU more accountable and responsive to European citizens. They identify three major possibilities: EU-wide referenda; direct elections for the president of the European Commission; and to operate more in accordance with the subsidiarity principle. While the latter is already enshrined in the Treaty on

European Union (TEU), the two other solutions may suffer from being a too straightforward extension to the EU level of different national practices and traditions. More importantly, the growing complexity of political structures, especially acute in the case of the EU, sits uneasily with yes/no referenda (as was the case for Denmark, France and Sweden in the case of EMU) and/or simple extensions of national practices beyond the nation state.

The EP is the only supranational EU body that represents the European population. Thus, it would be the European Parliament, or a possible European congress[12], rather than an inter-governmental body such as the European Council and/or the Council of Ministers of the EU that would act as the sole principal for the ECB and the European Commission.[13] However, one has to consider that such a change has to go hand-in-hand with both the principle of subsidiarity that also reflects proximity to the citizens and the democratic legitimacy of the EU vis-à-vis the different national governments.

In the case of monetary policies, this paper departs from the perspective, explained below and shared by other authors (see De Grauwe et al. 1998), that too informal an accountability may not guarantee lasting institutions.[14] Moreover, as argued by De Haan, Amtenbrink and Eijffinger (1998), the trade-off between central bank

[12] Habermas (2001: 99) sees a European congress, representative of both the European population and the EU member states, as a necessity: "...in a European Federation the second chamber of government representatives would have to hold a stronger position than the directly elected parliament of popular representatives, because the elements of negotiation and multilateral agreements (...) cannot disappear (...) even for a Union under a political constitution.".

[13] In fact, an economic government, defended by several politicians, could interfere with the statutory independence of the ECB and it would not by itself add more legitimacy to the EU institutions in the eyes of the European citizens precisely because of its intergovernmental character. This is not to say, however, that more democratic bodies could not engage in power politics.

[14] Note that there are other notions of accountability that do not necessarily require democratic accountability. An agency can be accountable to the markets (investors), to a dictator, or to specific groups. Keohane and Nye (2003) distinguish between several categories of accountability: electoral, hierarchical, legal, reputational and market accountability. Bovens (2006) distinguishes three different perspectives with respect to the assessment of accountability relations: democratic, constitutional and cybernetic. Zilioli (2003) defends that an economic rather than a "formalistic" notion of accountability should be applied to independent central banks.

independence and accountability does not exist in the longer run. A central bank that continuously conducts policies that lack broad political support will sooner or later be overridden. As discussed in section 3, politicians will put the blame for the crisis onto the institutions that escape their control. Therefore, it was not only necessary to assure a broad and long discussion about the objectives of EMU and the aims of the ECB prior to the launching of its third phase but also to assure the proper oversight of the ECB by an institution that is representative of the European population.[15] Public opinion cannot play such a role because it lacks democratic legitimacy and lacks institutional structures. Other institutions such as the European Council and/or the Council of Ministers of the European Union have deliberately chosen not to control the ECB to avoid any misperceptions and/or any temptation of conflicting views over the implementation of monetary policy.

2.2. A role of principal for the European Parliament

The European Parliament is the European institution that comes closest to fulfilling the functions of responsible representation and that of principal for different other EU-supranational bodies. It is the only representative institution at the EU level that is directly chosen by the people. The European Parliament can be seen as an alternative (though from a particular perspective, complementary to national parliaments) for democratic accountability, one can argue, not only in the case of EU-supranational bodies' decisions but also in the case of qualified majority voting (QMV). In the case of the latter national governments may be outvoted in the Council and therefore cannot be held accountable to national parliaments.[16] By its very nature, the EP is also relatively

[15] See Zilioli (2006) for a different perspective.
[16] Europeans trust the EP more than other EU institutions and agencies (see Eurobarometer, 56 and 57); exceptions are Germany, Denmark, Finland, Sweden, Austria, the Netherlands and Luxembourg where the

open and accessible to pressures from below allowing for instance for citizens' petitions and questioning; it also facilitates the development of other emerging social structures, such as European parties or party families, independent from the national states, the Commission and the European Council.[17]

Moreover, as a representative institution, the European Parliament has a unique role in the overlapping EU political structure: it increasingly interacts with the various national parliaments[18], bridging the gap between national and European representation; it is more open and accessible than any other European institution to pressures from below, allowing for an increased participation of European citizens in the Community's life; and it provides more transparency to the process of decision-making in the EU, which enhances the accountability of other European institutions, such as the European Commission and the European Central Bank.

In the case of monetary policy, the European Parliament may well increase the efficiency of governance at the European level by smoothing out various resistances to the acceptance of the ECB's monetary stance. But it increases efficiency as a consequence of more transparency and participation and not at the cost of driving political decision-making further away from citizens. This role of the European Parliament has been somehow neglected in the literature. Kohler-Koch (1999: 17) argues that the European Parliament has "an inferior representative quality" and claims that there

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Court of Justice and/or the ECB tend to score higher. The EP is also the best known EU institution (Eurobarometer 56, fig. 7.10) and it is perceived to play the most important role in the EU (Eurobarometer 56, fig. 3.6).

[17] Different MEPs and staff tend to listen and receive all kinds of different experts and organised and non-organised interests as a way of negotiating and advancing their own proposals and reports. They are also open to citizens, the media, and researchers, regarding their political and policy options.

[18] The EP holds regular meetings with members of the relevant national parliaments' committees on a wide range of issues such as EMU and hearings of the ECB's President, the BEPG, the IGCs, EU enlargement and European constitutional matters.

is a broad consensus in the scientific community that a parliamentarisation of the European Community (EC) system would not improve its democratic quality.[19]

Without entering into more normative type of arguments, one can argue, that the representative quality of the European Parliament is also evolving. As will be argued in more detail in the next section the European Parliament has been assigned new roles in the Maastricht and Amsterdam treaties and European public opinion has picked up on that change.[20]

3. Central bank independence in the long run

The European Parliament rather than an inter-governmental body such as the European Council and/or the Council of Ministers of the European Union should act as principal for EU-wide institutions, such as the European Central Bank and the European Commission. The EP may be particularly suited, and still enjoy the legitimacy to oversee the activities of the ECB. The European Parliament might indeed provide a good balance between, on the one hand, the "tying of its own hands" by the European Council (national governments), extended to the EU Council of Ministers, and, on the other hand, the need to assure if not a traditional form of accountability increased transparency of procedures and responsiveness of the ECB.

If institutions are not responsive and somehow accountable one could solve short-term problems of creating independent institutions but not the longer-term problem of their sustainability. Elected politicians will only defend independent institutions, such as the ECB, in the case of crisis if they can oversee their functioning. Paul De Grauwe (De

[19] This "inferior representative quality" of the European Parliament is in general attributed on the basis of the "inferior quality" of European elections (disputed not on European but on domestic political grounds and with very low turnouts and different national voting rules and party lists) and of the lack of clear political and ideological cleavages (MEPs remain rather technocratic). See Follesdal and Hix (2005) for a discussion.

[20] Regarding knowledge about the EP, how it is perceived to play the most important role in EU life and how it is the institution that on average people tend to trust most in the EU (Eurobarometer, 56).

Grauwe et al. 1998) goes even further in saying that "politicians will be willing to defend the independence of the central bank only if they know that they have the ultimate power to control the central bank". Politicians will tend to put the blame for the crisis onto the institutions that escape their control and these will have to resist the pressures for a change of their policy stance. Only by becoming accountable, independent central bankers will ensure the political support that they will need for their long-term survival. If that is not the case a disruption might well occur because "ultimately politics rules".

Even in the very special case of Germany -- where the monetary authorities enjoyed broad support -- one can argue that the Bundesbank could not follow its way at very (indeed the most) important occasions of post-war German monetary history (examples are the European Monetary System, German Monetary Unification and EMU).

3.1. Credibility and political constraints

Based on the theory of economic policy that became popular in the late 1980s / early 1990s (see Torres 1992) one needs to make a distinction between two types of constraints faced by policy-makers: credibility constraints and political constraints. Credibility constraints concern the temptation of policy-makers to deviate from their initial plans, without any disagreements over the ultimate goals of policy. Political constraints regard conflicts of interest over those goals.[21]

Governments face explicit credibility and political constraints. As a result, policies are the outcome of the government's optimization problem: the maximization of a well-specified objective subject to those binding constraints. This approach translates,

[21] The idea of binding political constraints stems from the political business cycle literature, where governments have opportunistic incentives to adopt certain policies (for instance, in order to be re-elected), and from the theory of public choice, where there are conflicting policy preferences among different interest groups (because politicians and bureaucrats maximise their welfare rather than pursuing public interest) and/or the so-called agency and/or principal drift in principal-agent problems (Elgie and Jones 2000).

in the literature, into a number of positive models of economic policy in alternative institutional settings. These different environments vary from monetary and/or fiscal regimes and reforms to changes in government colour and organisation and determine the credibility and political constraints that policy-makers face. In the case of monetary policy the European Union already deals with the credibility constraints that national and European policy-makers face by "tying their hands".[22] Therefore, the functioning of European monetary institutions should be free of political interference in the sense that they should be granted autonomy, as is the case of the ECB. That is however only a way of dealing with credibility constraints and not with political constraints.

Given that political constraints regard conflicts of interest over the ultimate goals of policy, the creation of European institutions should also take into account those possibilities of disagreement. As argued above, in the EU discussions already took place during the creation of EMU and the ECB, through nation-wide referenda, several national and European elections and public debates. The process of making the rules of EMU was subject to democratic accountability.

Now that the difference between credibility and political constraints is clarified one can better understand the importance of enhancing the accountability of the European institutions, in particular that of the ECB. The European Council wanted to "tie its hands" and make Europe's central bank independent from any political influences. Independence was a way of dealing with credibility constraints and the problem of time-consistency (see Torres 1989).

However, avoiding excessive politicisation of agencies removes them from direct political control (Caporaso 2003: 13; Gustavsson 2002). To ensure central bank

[22] For the classical example of tying hands as a solution to the time-consistency problem, see Homer's Odyssey: Ulysses asking to be tied to the ship's mast in order to be able to listen to the sirens while resisting to the temptation to try to join them. See Elster (1984), Giavazzi and Pagano (1998), perhaps the most influential academic contribution to the convergence of ideas (and epistemic communities) in favour of EMU, and Torres (1987, 1989).

accountability De Haan, Amtenbrink and Eijffinger (1998), put forward three dimensions: decisions about the ultimate objectives of monetary policy; transparency of actual monetary policy; and who bears final responsibility with respect to monetary policy.

How is one to improve the ECB's accountability without undermining its credibility in the financial markets? The answer developed below is that the European Parliament should have an enhanced role as principal of the ECB. Similarly, an enhanced role of the European Parliament in the formulation of policy decisions and/or at the EU legislative process may well improve the efficiency of common EU policies and the democratic quality of the process of European integration. Again, democratic quality here refers to the degree of accountability and the level of transparency and participation at different levels of government in the decision-making process.

3.2. The emerging role of the European Parliament

With the creation of the ECB, the heads of state and government delegated power to a new supranational institution. Yet, as put by De Haan et al. (1998), this one-time act of legitimisation cannot replace mechanisms of democratic accountability. From a normative viewpoint, such a delegation of powers to unelected officials may only be acceptable in a democratic society if central banks are in one way or another accountable to democratically elected institutions.[23] Yet, it is possible to argue that the Member States have not only intentionally chosen to give autonomy to the monetary authorities but also have delegated authority to the European Parliament to act on behalf of their long-term objectives as principal in relation to the European Central Bank.

[23] Moreover, the EP lies somewhat ambiguously along the chain of delegation between the European Council and the ECB. The EP may act as a principal under implicit delegation from popular sovereignty.

In fact, the Treaty of Maastricht gave the European Parliament significant competencies. According to Article 113 (3) of the Amsterdam Treaty – formerly Article 109-B (3) of the Treaty establishing the European Community (TEC) -- the ECB's president has to present the annual report to the European Parliament. Moreover, the EP is entitled to hold a general debate on that basis and the ECB Executive Board can also be requested (and/or take the initiative) to be heard by the competent committees. Finally, the EP has to be consulted by the European Council upon the nomination of the entire Executive Board (TEC, Article 112(2b), formerly Article 109(2b)).

Besides having managed to obtain the ECB's Board of Director's agreement on the presence of its President four times a year in the appropriate committee (the Committee on Economic and Monetary Affairs), the EP also holds meetings both with members of the relevant committees of the national parliaments and with experts to prepare those hearings.[24]

The intention of delegating power to an independent central bank in the EU went hand-in-hand with the very idea of assigning a new role to the European Parliament. The delegation of power to unelected officials (central bankers) by an act of Parliament (by a treaty ratified by national parliaments in the case of the ECB) does not by itself lack democratic legitimacy. Therefore, the idea that the European Parliament was assigned a new role regarding the overseeing of the ECB goes without contesting the legitimacy of the European Council (and the fact that it can act on behalf of popular sovereignty). Without contesting the proximity of the European Council as the initial principal of the ECB, it is possible to indicate ways of improving democracy and efficiency in the EU that are already partly taking place.

[24] The first of those meetings -- proposed by a national Member of Parliament and a Member of the European Parliament at the May 1998 London COSAC, one of the bi-annual meetings of the Conference of European Affairs Committees of the EU National Parliaments and the European Parliament -- took place in Brussels on November 3, 1998.

Let us follow what might have been the reasoning of the builders of EMU. One can then say that in order to deal with the credibility constraints faced by monetary authorities that do not enjoy yet a solid reputation of sticking to their announced goals, the principal (the European Council together with the EU Council of Ministers) delegated to an agent (the new European monetary authority) control over its behaviour in regard to monetary policy. Such a change in the nature of delegation -- a principal tying its own hands -- implied a new role for the EP, which in fact implied a change in the assignment of agents and principals. From a normative point of view, it would have been undemocratic if the agent (the ECB) had remained in control of the behaviour of future principals (the European Council and/or the EU Council of Ministers).[25] That is why leading politicians and national governments in the EU have defended an economic government as a counterweight to the ECB.[26]

The initial principal (the European Council) did delegate to an agent but also established new (potential) mechanisms of democratic *ex post* control, namely monitoring and oversight, which can raise the quality of the democratic process in the EU without affecting the credibility of monetary policy in the financial markets and among economic agents in general. The initial principal tied its own hands and that of the Council of Ministers but assigned a new role to a new principal: the European Parliament.[27]

[25] This claim parallels the normative claim referred to by Elgie and Jones (2000) that the preferences of both the principal and the agent should remain in line. The positive claim, which is also underlying agency drifting, that their preferences are bound to diverge points to the need for some form of oversight.
[26] The sub-optimality of the ECB's accountability has been recognised by several authors; see for instance Torres (1996b: 76/77), De Haan et al. (1998), De Grauwe et al. (1998), Verdun (1998) and Harrison (2001). This latter author concludes however that, because of the relatively high degree of transparency of the ECB and the strength of its commitment technology, that sub-optimality should not impact on "its effective framework for success".
[27] Clear *ex-ante* specification of the rules of Economic and Monetary Union was not part of the Treaty of Maastricht and/or Amsterdam. See Torres (1996) for a discussion of possible ex-ante specifications of EMU rules concerning, among other things, enforcement mechanisms.

It is in this perspective without a clear *ex ante* specification of the rules of the game; namely, without any enforcement mechanism, that the European Parliament may well oversee the activity of the ECB.[28] Furthermore, EMU can indeed work more effectively if political pressure from the various interest groups is directed away from the European Central Bank (ECB) towards an institution that represents the entire European population. As defended in Torres (1996), the easiest way to secure that goal while preserving the ECB's independence seems to be to recognise and enhance the role of the European Parliament in overseeing the ECB's activity.

In fact, an institution that is representative of the European population and attaches more weight to long-term objectives safeguarding the well-being of all Europeans could better fulfil the role of a principal on whose behalf the ECB should conduct its policies than the European Council that is also driven by short-term (electoral cycle) considerations. In fact, the European Parliament cannot be so directly influenced by the electoral concerns of one or two governments in the EU. The opposition to those governments is also represented in the EP and may well have different views on the issue under discussion.[29]

The role of principal of such an institution as the EP is consistent with a principal-centred perspective (principal drift) of principal-agent problems (Elgie and Jones 2000) that is indeed particularly adequate to analyse situations that involve credibility constraints or time-consistency problems as in the case of monetary policy. It is also consistent with an approach that takes into account the possibility of a simultaneous drift by the agency (the ECB) and the initial principal (the European Council). The EP, as it

[28] As put by Elgie (2000), in the case of the ECB, any renegotiation of the set of *ex-ante* controls is unrealistic and even if the Treaty could be reformed that would undermine its very credibility.
[29] Hix (2001) concluded that for the first year of the 1999-2004 European Parliament transnational party group affiliation was more important than national affiliation for determining how MEPs vote. It follows that it is not to be expected that say the German or Portuguese opposition would come to rescue their respective countries from an early warning concerning the excessive deficit procedure.

does not necessarily share the potentially drifting views of the initial principal, the European Council, is particularly suited to oversee the activities of the ECB. The increased involvement of the EP in the oversight of the ECB's activities has already been quite substantial. Elgie (2000) finds evidence that the EP has managed to "encourage" the ECB to not focus exclusively on its primary objective, price stability, but also pay more attention to its secondary objective: to support the objectives of the EU as stipulated in the Treaties (Article 2 of the TEU and of the TEC), namely sustainable development and employment (i.e. growth).[30]

4. The on-going qualitative change in the nature of governance in the EU

Evolving political co-operation has been increasingly subject to a multi-level political negotiation process in the EU. That process comprises, among others, co-decision and all ensuing EU directives and legislation in general, the discussion and approval of the Broad Economic Policy Guidelines (BEPGs) (an increasingly important tool of soft policy coordination in EMU, supporting a more deliberative way of governance), the new open method of coordination (OMC), the new European Council Spring meetings, all sorts of European and national recommendations and parliament resolutions, the adoption of summit agendas and conclusions and of European strategies and white papers and, quite importantly, the domestic and European debate that takes place.

Since the Amsterdam Treaty even intergovernmental conferences (IGCs), convened to revise the treaties, are increasingly characterised by multi-level political negotiations. These intergovernmental conferences include representatives of the EP

[30] In the terminology of Farrell and Héritier (2002), this fact supports the importance of the effects of an informal institution on the interaction between the EP and the ECB. While these authors refer to empirical evidence indicating that such informal institutions have an important effect on interactions between the European Parliament, the European Commission and the Council of Ministers, I focus here on the importance of the effects of such informal institutions on interactions between the European Parliament and the European Central Bank (see Elgie 2000, for evidence).

regularly briefed by the negotiators who can give their views on all issues under discussion. The EP's views on the IGCs are increasingly important in shaping the European public opinion on these matters and therefore the inter-governmental negotiation process.

National parliaments, too, participate in that process. Not least, they retain the ultimate power of ratifying the treaties. Moreover, they also participate in the process through regular hearings with national (and other) IGC negotiators, through bilateral and multilateral meetings with the European Parliament's Constitutional Committee and through internal and open discussions (increasingly with representatives of the Civil Society) and resolutions. The European Convention of 2002/03 was the maximum exponent of the (multi-level) involvement/participation of many parties in such a process. It is through such a process that those EU policy constraints transform into European and national political objectives.

Such a multi-level political negotiation process in the EU allows for a continuous discussion of processes and outcomes. That permanent discussion in turn permits increased transparency of and participation in the entire process of European integration. Moreover, that multi-level political negotiation process has also repeatedly allowed for the creation of a national and European consensus for reform at the EU level.

In this context, one might argue (Torres 1994, Jones, Frieden and Torres 1998, Verdun 2000a) that the objective of the realisation of EMU was instrumental for creating the necessary consensus to overcome specific interests in the pursuit of social welfare. This objective was not just economic orthodoxy (as Cox 1997 claims); EMU was an institution-building response to the challenges of European integration and globalisation (Torres 1996, Verdun 2000a).

In fact, it is possible to say that the EMU process has not only increased the economic sustainability of the European integration process by avoiding the undesirable consequences of uncoordinated macroeconomic policies, but has also raised the quality of its democracy; not only in terms of efficiency, but also transparency and participation and, one might add, effectiveness, to the extent that new challenges were brought under more democratic control.[31] This is because it has allowed for some new forms of political negotiation in establishing new goals and it is bringing into account a new common institution, the ECB.

The challenge of EMU may have started as the importing of ideas of some elites, and epistemic communities, reflected by the European Commission, central bankers and monetary economists and were initially embraced only by a leading fraction without the participation of most of the national populations.[32] However, having involved a prolonged period of multi-level political negotiation, the design and implementation of EMU allowed for increased participation of the European population.

Furthermore, the EU is in a process of transition towards a wider political union in Europe together with an increasingly important role of representative institutions. The process of integration and decision-making in the European Union is probably the only case of sovereignty-sharing that has proceeded steadily up to a point where some multi-level governance can be already regarded as a polity. European institution building, with more efficient and transparent bodies and even transnational political parties, may be a way of reinforcing the democratic quality of the European integration process, namely the link between participation and "responsible representation" of the voters and the guarantee that the existing social structures remain open and accessible to pressures from below.

[31] See Erik Jones (2002) for a similar conclusion in regard to efficiency and transparency.
[32] Jones (2000), points out that such influences reflected epistemological rather than distributive considerations.

EMU is a good example of a process of a continuous multi-level negotiation during the discussion of its very rules inscribed in the Maastricht treaty, its convergence phase and current follow up arrangements. The process includes the implementation of the various national convergence programmes, the adoption and implementation of the Stability and Growth Pact (SGP) and other changes in domestic policy throughout several national, local and European elections. These arrangements require a permanent discussion and a negotiation at different levels of government.

Clear-cut decisions over clear-cut issues may be decided very efficiently through a referendum but the same does not hold for more complex issues that cut across national interests: the probability of a continuous deadlock would be very high. Again, a multi-level political negotiation process may render policy-making more efficient by allowing for a continuous confrontation of positions at various levels of government, making it possible and easier to converge to an acceptable common position.

It follows that national parliaments, the European Parliament and European citizens in general may have all become more aware of the need for more democratic control of new European institutions but also of the need of regaining democratic control over national governments and institutions that have become more unaccountable through the process of globalisation. Therefore, despite the inexistence of a European constitution (as yet) and a European government, EU governance may not be hindering European democracy but rather extending it. The role of national and European representative (parliamentarian) institutions and also their interaction further enhances the transparency and effectiveness of EU governance.

5. From monetary and financial external constraints to a common monetary constitution

Previously, when monetary policy was basically set out by the German Central Bank for the entire European Monetary System (EMS) zone, national monetary authorities could not be held accountable for the implementation of monetary policy, devised and implemented in the system's anchor country, Germany. National governments (with the exception of Germany) could only be held accountable for having taken the decision (and sticking to it) of joining the Exchange Rate Mechanism (ERM) of the EMS.

EMU was a clear case in point of extending the democratic reach to areas so far beyond the national control by bringing into account at the EU level policies so far uncontrolled (exchange rate and monetary, and indeed macroeconomic, policies) at the national level (arguably less so in the case of Germany). In most EU countries EMU has also worked not only as mechanism for economic stabilisation but also as prerequisite for structural reform and long-term development.

Joining a monetary union based on institutions that deliver price stability[33] is, as stressed by the modern political economy literature, probably the best way to implement a solid strategy of sustained economic development. The reason is that this option, besides precluding many of the transition costs (economically speaking, the output losses of a disinflation strategy) of such a regime change, is also more transparent in terms of policy objectives.[34] In such a regime, the authorities raise the political costs of inflation because the public can constantly monitor their anti-inflation commitment. Any different behaviour would imply a loss of competitiveness for the tradables sector.

In the case of the EU, such a project was also a way of insulating all of the European economies that had embarked on the EMU project from foreign exchange

[33] Fixed exchange rates, unlike other policy targets, are easily observable by the public (see Torres 1990).
[34] Institutions that deliver price stability encompass here not only the European Central Bank but also the monetary constitution of the EU (the ECB's status) and other macroeconomic rules, such as the Stability and Growth Pact, etc., its *ordnungspolitische Grundsätze*, one may say. In that sense and according to Douglass North (1990: 3), "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction".

speculation, exchange rate volatility and serious currency misalignments. Those could not only affect the macroeconomic stability of weaker currency countries and the competitiveness of stronger currency countries, thereby giving rise to protectionist claims and/or retaliations, but also put at stake the functioning of the Internal Market and indeed the entire European integration project.

That argument was not trivial even for Germany since it hinged exactly on the idea of protecting the internal market from currency misalignments. Thygesen (1996) further develops that idea claiming that protectionist demands, arising from a fragmented currency system, would include industrial subsidies in the strong-currency countries.

Adopting a credible monetary constitution that delivers price stability[35] was also a means of cancelling out the primacy of monetary policy over other more important concerns facing society, which was in particular the case in countries with less developed fiscal and monetary institutions like Greece, Portugal, Spain and even Italy (and now all new EU members). In those cases, EMU was a means of getting rid of national currencies and, consequently, the typical excuses that technocrats find to cling to power and implement all kinds of mercantilist policies in the name of short-term real convergence.[36]

Not surprisingly, in the case of some EU (laggard) countries, those very policies, which have been pursued until now[37], implied a sharp deterioration of social cohesion and the quality of life, undermining the long-term (sustainable) real convergence with the most developed regions of Europe. In other words, what at the first glance could have

[35] Such an institution internalises both the costs of excessive inflation and exchange rate instability (see Torres 1996). Eichengreen and Ghironi (1996) provide other arguments for the case of low inflation countries in the context of EMU.

[36] What, at a first glance, could be branded as a mere "new constitutionalism" approach in the interpretation of Hewson and Sinclair (1999) -- that is ring-fencing central banks from political interference with mandates to combat inflation -- goes much further than that in the case of a common European monetary institution. In fact, the new monetary constitution of Europe, EMU, may be a way of avoiding the ring-fencing of many national authorities on monetary and financial external constraints and of creating the necessity -- and the conditions -- for increased transparency and accountability.

[37] For instance, cohesion countries, namely Greece, Portugal and Spain, and also the UK and Ireland, tend to opt for derogations on matters such as energy costs (giving wrong economic incentives through lower energy costs to pollute more) in the name of short-term competitiveness.

been seen as top-down (EU Commission and "statesmanship") pressures were indeed a way through which some Member States were able to bring into account at the EU level uncontrolled transnational forces, such as the permanent threat of speculation against weaker currencies within the EU, avoiding serious currency misalignments that would endanger the entire European project. On the other hand, European citizens in those Member States got rid of many ills associated with political short-term considerations that implied a sacrifice in terms of social welfare.

What the example of EMU demonstrates is that EU challenges and governance at the EU level, by transforming into national political objectives, make reform possible and more effective.[38] At the same time the process in which such challenges are raised to national political objectives becomes more transparent.

6. Concluding remarks

The challenges posed by the European integration process determine a continuously evolving system of governance in the EU because of the more clearly perceived need for democratic control of its new institutions and of the way in which policies are formulated. However, the effectiveness of EU policies and the quality of democracy in the process of European integration can be enhanced if the intergovernmental mode of governance gives way to the interaction of representative institutions at different levels and with the civil society.

As shown in the paper, using the example of EMU (the making of its rules and the conduct of monetary policy), that interaction can allow for more transparent and responsive modes of governance. Besides the intergovernmental mode of governance and

[38] The transformation of EU challenges into national political objectives, as in the case of EMU, are also supported by some input legitimisation that involves, through a mandate and/or national representatives, transparency and accountability and deliberation (public argument and reasoning).

in addition to supranational regulation, these new modes of governance include: joint decision-making, as is the case in the Single Market, and policy coordination, as is the case of the open method of coordination of economic affairs (BEPG; EES).

This paper did not elaborate on these new modes of governance and policy instruments. Rather, it explored issues related to the democratic deficit and challenged the common wisdom on this matter and on the efficiency-legitimacy trade-off in EMU governance. It tried to show that even a shift from an intergovernmental form of governance to a supranational regulation (EMU) form of governance not only does away with such a trade-off but rather enhances the democratic quality and effectiveness of European governance. This finding is mainly due to the yet very much neglected phenomenon of the interaction between representative institutions at different levels in the European Union and participatory and deliberative processes (in this case the building-up of EMU) that have characterised supranational regulation.

The emerging role of the EP in enhancing the responsiveness of decision-making in supranational regulation (monetary policy) has proved quite powerful at avoiding such a trade-off and indeed at improving efficiency (allowing for the internalisation at the Union level of different externalities) and democracy in European governance. The responsiveness of governance in the EU has actually increased as the direct result of the making of EMU (democratic delegation of executive powers by the European Council and the EU Council of Ministers to the ECB). That responsiveness has however been also substantially enhanced thanks to the emerging and still evolving role of the European Parliament as a principal in regard to the European Central Bank.

The new role of the EP materialised because of the change in nature of delegation, i.e. the initial principal (the Council) delegated to an agent (the ECB) control over its behaviour in regard to monetary policy. The new principal in the making (the EP) has also allowed for increased participation in and deliberation on the discussions about the conduct of monetary policy by the ECB, contributing in this way to its greater transparency. These discussions have involved monetary policy experts and economists with different perspectives as well as national parliaments. National MPs can in turn better understand and discuss the appropriate policy mix in their own countries, with both national central bank governors and members of the national government that is accountable to them.

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