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**EMU and EU Governance**

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# EMU and EU Governance<sup>1</sup>

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## Abstract

This paper argues that a shift from an intergovernmental form of governance to a supranational regulation form of governance, as is the case of EMU, may not only do away with the efficiency-legitimacy trade-off but also enhance the democratic quality and effectiveness of European governance in the monetary sphere. The emerging role of the European Parliament in enhancing the democratic accountability of decision-making in supranational regulation (monetary policy) may prove quite powerful with respect to avoiding such a trade-off and indeed improving efficiency, transparency and accountability in European governance. It is argued that the democratic accountability of governance in the EU increased very much as the direct result of the making of EMU, that is, of the democratic delegation of executive powers to the ECB by the European Council and the EU Council of Ministers. That democratic accountability has also been substantially enhanced thanks to the emerging (and still evolving) role of the European Parliament as a principal of the European Central Bank (ECB). That new role of the EP materialised because of the change in the nature of delegation, i.e. the initial principal (the Council) delegated to an agent (the ECB) in order for the agent to control its behaviour in regard to monetary policy. That led to a change in the assignment between agents and principals. The new principal (still in the making one could argue) 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.

**Keywords:** Governance; supranational regulation; monetary policy effectiveness; accountability; delegation; principal-agent relations.

Comments welcome

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## 1. Introduction

Most authors dealing with the legitimacy problem, the democratic deficit and the efficiency 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.

By the same token (see for instance Fritz Scharpf, 2001, and Adrienne Héritier, 2002), the so-called Community method of integration is said 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. According to Höreth (1999), the quest for more legitimacy of EU governance appears to be a zero-sum game and reinforcing the input legitimacy of such a process could well reduce its efficiency.

On the other hand, although other authors stress the fact that legitimacy in the European Union can also be obtained through delivering (see again Scharpf, 1999), from a normative perspective it can be argued that legitimacy cannot be reduced only to performance. Notwithstanding such normative objection, some output legitimisation, one has to acknowledge, namely reforms such as Economic and Monetary Union, can contribute to and benefit from input legitimisation<sup>2</sup>.

Increased input legitimisation - transparency and accountability - smoothes the processes of agreeing on and implementing common policies, facilitating delivering. (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). 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 legitimisation and output legitimisation that the paper goes on discussing the well-established view that there is a trade-off between democracy/legitimacy<sup>3</sup> and efficiency in the European integration process.

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<sup>2</sup> The transformation of EU challenges into national political objectives, as in the case of EMU, are also supported on some input legitimisation that involve, through a mandate and/or national representatives, transparency and accountability and deliberation (public argument and reasoning).

<sup>3</sup> 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

## 1.1 Aim and scope of the paper

This paper aims at analysing how exactly European policy constraints and goals contribute to increase the democratic quality and effectiveness of governance in the European Union. In that perspective it discusses how processes (i.e. their democratic quality) and the system's effectiveness in terms of outcomes (formulation and implementation of policies) evolve in a political system such as the European Union.

For that purpose it looks at how the democratic quality of governance in the EU may enhance the effectiveness of the European integration process and/or of the policy-making process in the EU. In other words: how the joining-in of domestic and European factors in the process of coping with new challenges and of transforming them into new EU policy constraints and even objectives might bring about a change in will and/or attitudes, both at the European level and at the national level, that generate durable reforms. Conversely, it is also important to understand whether and how such challenges, policy constraints and European and/or national objectives as well as the new modes of governance they generate contribute to enhance the democratic quality, and legitimacy, of the European integration process.

With that objective in mind the paper centres on the example of EMU, the making of its rules and the overseeing of the ECB's conduct of monetary policy to see whether there is a trade-off between efficiency on the one hand and transparency and accountability (and participation and deliberation, one can add) on the other hand in the process of European monetary integration.

While that example of supranational regulation 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.

The paper also investigates whether some of the characteristics of the process of European integration can be seen as solutions both for the increased complexity and individualisation of modern societies and for the on-going process of globalisation. This is because monetary policy may well have been beyond the reach of the democratic political system before centralisation (EMU). If that was the case, we depart from a non-zero-sum game: abandoning the intergovernmental mode of governance was then not even subjected to the legitimacy-efficiency trade-off.

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

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derives its legitimacy from the democratic values it projects" (see Gustavsson, 2002). And 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.

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 as to whether and to what extent the European Parliament is fit to function in a (democratic) EU polity (in the making). Therefore the paper investigates the nature of the more important (and for some authors, politicians and policy-makers still disputable) role of the European Parliament as a principal of the ECB. That is to say 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 its 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. Moreover, the paper tries to shed light on the extent to which the EP can divert political pressure by the various interest groups away from the monetary authorities towards itself.

While the chief aim of this paper is to contribute to our analytical understanding, some policy conclusions are also drawn. That is the case of the importance of representative institutions, in particular the European Parliament, for the democratic quality of the European integration process and for the effectiveness of its governance, i.e. its state, likely future developments and desirable outcomes.

## **1.2 Structure of the paper**

In order to analyse the efficiency-democracy trade-off in the process of European monetary integration and to analyse the democratic quality and effectiveness of Governance in the European Union, drawing on the example of EMU, this paper is structured as follows:

The subsequent section examines the issue of increased centralisation of policies and of political structures in modern societies in general and in the EU in particular. It also discusses the growing felt need for democracy in the EU and how its political structures, namely the European Parliament in its role of principal, may respond in the light of a balance between the criteria of efficiency, on the one hand, and transparency and participation, on the other hand.

Section 3 discusses the importance of enhanced accountability as a way of improving the quality and effectiveness of European monetary integration. Enhanced accountability permits dealing with what is called below credibility and political constraints without reducing the legitimacy of the European integration process and/or putting at stake the efficiency of its processes and the effectiveness of its institutions<sup>4</sup> and policies but increasing its democratic quality, that is, without

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<sup>4</sup> Throughout the paper the concepts of efficiency and effectiveness are used in an almost

incurring into any trade-off between efficiency and democracy (transparency and accountability) and participation. A sub-section is dedicated to the new emerging (and evolving) role of the European Parliament. The argument is that the European Parliament is instrumental for making institutions such as the ECB more accountable and the process of policy-making more transparent and participated (by citizens, non-governmental organisations, national parliaments, etc.), and indeed also more deliberative, while guaranteeing a balance between processes and outcomes.

Section 4 deals with the question of the qualitative change in the process of continuously evolving governance in the EU against the background of the growing individualisation of society and the complexity of issues at stake. It is argued that despite the inexistence of a European constitution and a European government, EU governance is not hindering European democracy but rather extending it by bringing in more transparency and increased participation of citizens in the formulation of its policies. This fact in turn facilitates the implementation of common policies, that is, their effectiveness.

Section 5 centres on the example of EMU from the perspective of being able of bringing into account uncontrolled forces through a process of multi-level political negotiation capable of creating credible, long-lasting institutions. It also discusses how the transformation of EU challenges into national political objectives in the case of EMU triggered a sustained change in political attitudes and in policy stances and hence led to enhance the democratic quality and effectiveness of monetary policy and macroeconomic policy in general in most EU countries.

Last, section 6 concludes on how the interaction between representative institutions at different levels allows for more participated and transparent modes of governance and how a shift from the intergovernmental to these modes of governance may enhance the democratic quality and effectiveness of governance in the EU, its state, likely future evolution and outcomes. It also concludes that in the case of EMU (supranational regulation) the democratic accountability of governance in the EU has been substantially enhanced thanks to the emerging and evolving role of the European Parliament as a Principal of the ECB.

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

Modern societies have become more complex in nature. As a result of this increased complexity but also in the face of a growingly individualised society and the process of globalisation, the traditional mechanisms of a parliamentary democracy seem not to be so satisfactory.

At the level of the state, but as well at the EU level, the parliamentary system has to live up to a two-fold challenge, namely to be effective in the light of the growing intervention needs of the state in a complex, permanently modernising

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interchangeable way but the former refers more to the processes that create institutions and the latter to the institutions that deliver policies.

industrial society and to be democratically legitimated, serving as an instrument in the political opinion- and decision-making processes. The fact and consequences of in particular bureaucratisation and oligarchisation are then at the centre-stage of the democracy discussion, due to the concentration of decision-making and power in the social and political system within ever larger organisational structures.

According to Neumann (1950), in a given context, any political system can be analysed in the light of some formal criteria.<sup>5</sup> Let us bear in mind throughout the paper the three most relevant criteria. They are: efficiency, transparency and participation. Efficiency is the relation between benefits and costs (technical-rational economic performance: higher benefits for the same costs or vice versa); transparency is the degree of disclosure, important for control and indeed accountability; and participation refers to participatory observation, counselling and co-decision.

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 (see Elgie, 2000, for a brief review of those reasons), the agent's actions may differ from the principal's preferences. For that reason, transparency, in conjunction with accountability, is critical to ensure that agents comply as mandated.

## **2.1 The issues of efficiency, transparency and participation at the EU level**

As far as transparency is concerned, one can argue, on the basis of the various examples given in subsequent sections of this paper, that monetary reform is already leading to greater transparency. Such enhanced transparency (and indeed effectiveness) of European monetary policy, improves the democratic quality of the European integration process.<sup>6</sup>

In the case of Economic and Monetary Union, there was already an increased (compared with the previous situation and in all EU countries with the exception of Germany) degree of transparency, accountability and indeed participation (through referenda on the Maastricht Treaty or through public discussions at the occasion of several national and European election campaigns) in the making of its rules. One can say that in the case of EMU the 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 preferences by means of enhanced transparency and accountability as well as, one could add, through some kind of deliberative processes among

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<sup>5</sup> These criteria are obviously to be analysed in a multi-dimensional perspective.

<sup>6</sup> This aspect is specifically dealt with in sub-section 5.2.

monetary policy experts with different perspectives on what should be the conduct of monetary policy.<sup>7</sup>

For agents to be held accountable, though, there is the need not only for transparency (which comprises the access to the necessary information) but also for enforcement mechanisms (see Kehoane and Nye, 2003, for a discussion of these issues).<sup>8</sup> This is particularly relevant for the case of the ECB in its relation with the European Parliament.

In fact, although the European Parliament's oversight of the ECB's activities lacks enforcement mechanisms – as it cannot pass any laws which define the goals and tasks of the ECB (as the German Bundestag could do) – it has been able (as put forward below; see also Elgie, 2000) to develop an informal (sometimes at the ECB's own initiative to ensure broad political support, one can argue) but to some extent effective role in overseeing the ECB. The litmus test for that capacity (a serious crisis or conflict) has however not taken place yet.<sup>9</sup>

The process of globalisation made the tension between increasing complexity and the growing felt need for democracy in modern societies more acute. In fact, with globalisation, concentrated decision-making and larger organisational structures are well beyond the sphere of democratic influence of national social and political systems. 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).

On the other hand, governments of different countries by getting together can only partly deal with such type of transnational problems, incurring in additional costs. This is because at the intergovernmental level the process of reaching decisions is obviously more complicated: there are thus (very concrete) additional costs in terms of efficiency (concerning all the difficulties to reach agreement among governments, to get then the approval of their respective parliaments, etc.) and citizens may feel even more acutely the need for more democracy, given the lack of transparency and/or the insufficient participation in that type of decisions.<sup>10</sup> In fact, one can argue that the inter-governmental level alone, while necessary for carrying on the European integration process both in terms of processes and outcomes, is

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<sup>7</sup> See Schürz (2002) for a discussion of the issue of democratic legitimacy with deliberative institutions for the case of the ECB.

<sup>8</sup> As discussed in Torres (1996) 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.

<sup>9</sup> Regarding 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).

<sup>10</sup> For Beate Kohler-Koch (1999) for instance, 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, therefore upsetting the balance between the three Neumann criteria. Note that this presupposes, however, that the state still had *de facto* sovereignty in the first place. By pooling sovereignty in the EU some Member States might at least influence some decisions that they could not affect before.

neither an efficient nor a transparent or a participatory way of governance in the European Union.

In the European Union, where regional, national, inter-governmental and federal structures overlap, the tension between increasing complexity and the growing felt need for democracy in modern societies is thus even more evident than at the national level. In the EU there is an on-going evolution in terms of sharing sovereignty that should raise efficiency. Stable forms of political cooperation among the EU Member States are hence (quite an important) part of the solution as a way of improving efficiency (and therefore output legitimisation) but also part of the problem in terms of transparency and accountability as well as participation and deliberative processes (input legitimisation). Given that in the EU responsibility is much more diffuse than in national systems, it becomes even more difficult to bring the various institutions that formulate policies and/or take decisions at different levels into account.

The question then is how to address the identified democratic deficit in terms of democratic accountability and transparency (and participatory and deliberative processes one might add) in the EU. Gallagher, Laver and Mair (2001), discussing different ways of making policy-decisions in the EU more accountable and responsive to European citizens, 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 national (different) practices (and traditions). More importantly, the growing complexity of political structures, especially acute in the case of the EU, sits uneasily with yes or no referenda (as was the case for Denmark, France and Sweden and it will be the case for the UK) and/or simple extensions of national practices beyond the nation state.

According to Neumann (1950), the only criterion for the democratic character of an administration is the full political responsibility (accountability) of the top of the administration, not towards single interests but to the whole of the voters, by means of responsible representatives (see Steffani, 1973). In that perspective, it would be the European Parliament, or a possible European congress<sup>11</sup>, 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.<sup>12</sup> The EP is the only supranational EU body that represents the whole of the voters.

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<sup>11</sup> Habermas (2001, p. 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." Also the Economist's proposal for a constitution for the European Union of October 28th, 2000, provides for a new chamber of representatives of national parliaments, the Council of Nations.

<sup>12</sup> 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

However, one has to bear in mind that such a change has to go hand-in-hand with both the principle of subsidiarity (enshrined in the Treaty on European Union) that also reflects proximity to the citizens (and *a priori* should facilitate transparency and participation), and the democratic legitimacy of the EU vis-à-vis the different national governments, in the eyes of the European citizens.<sup>13</sup>

One of the most important forms of political action in a democracy is however the free election of the representatives. This presupposes that social structures (such as unions or parties) remain independent from the state and are open and accessible to pressures from below and that voters can get together to spontaneously solve difficult problems when they arise. At the EU level, there are no political parties (yet) capable of fulfilling that role. However, the collaboration of national organisations, such as non-governmental organisations and even national parliaments, with European institutions, such as the European Commission and the European Parliament, may partially fulfil that function. In this context let us consider whether the European Parliament could be a principal, along the lines of responsible representation.

## 2.2 A role of principal for the European Parliament

In this paper the European Parliament is chosen to illustrate the point that it is the European institution that comes closest to fulfilling the functions of responsible representation and of principal for different other EU-supranational bodies.

In fact, the European Parliament is the representative institution at the EU level, directly chosen by the people. Thus, one can argue that not only in the case of EU-supranational bodies' decisions but also in the case of qualified majority voting (QMV) where national governments may be outvoted in the Council, and therefore cannot be held accountable to national parliaments, the European Parliament can be seen as an alternative (to a certain extent, and under a particular perspective, complementary to national parliaments) for democratic accountability.<sup>14</sup>

By its very nature<sup>15</sup>, the EP is also relatively open and accessible to pressures from below (and to lobbying, one might add), allowing for instance for citizens'

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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.

<sup>13</sup> In a way, that primacy of democratic decision-making in the conduct of global governance at the EU level may also provide the conditions for the development of other forms of democratic innovations put forward by different authors. See for instance Michael Saward (2001) for some examples of new forms of democracy: cosmopolitan, deliberative, politics of "presence" and "difference", ecological redefinitions, associative and party-based direct models.

<sup>14</sup> According to opinion polls (see Eurobarometer, 56 and 57), in the EU the European Parliament is the institution, among the main EU institutions and agencies, which people tend to trust most on average; exceptions are Germany, Denmark, Finland, Sweden, Austria, the Netherlands and Luxembourg where the 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 life of the EU (Eurobarometer 56, fig. 3.6).

<sup>15</sup> Different MEPs and Staff tend to listen and receive all kind of different experts and organised and non-organised interests as a way of negotiating and advancing their own proposals and reports. They

petitions and questioning; it also somehow 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.

Moreover, the European Parliament, again as a representative institution, has a unique role in an overlapping political structure such as the European Union: it interacts more and more with the various national parliaments<sup>16</sup>, bridging the gap between national and European representation; it is recognisably 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, permitting in that way to enhance the accountability of other European institutions, such as the European Commission and the European Central Bank, otherwise difficult to assure.

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. Also according to De Haan, Amtenbrink and Eijffinger (1998) the trade-off between central bank independence and accountability does not exist in the longer run.

In fact, a central bank, continuously conducting a policy which lacks broad political support, will sooner or later be overridden. As discussed in section 3, politicians will tend to put the blame for the crisis onto the institutions that escape their control. Therefore, it is possible to conclude that not only it was 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 that it is necessary to assure the proper (or at least some kind of effective and evolving) oversight of the ECB by an institution that is representative of the European population. Public opinion cannot play such a role because it lacks democratic legitimacy and 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.

In the case of monetary policy (and even more in other cases, corresponding to other modes of governance, such as environmental policy), the European Parliament may well increase the efficiency of governance at the European level by smoothing out various resistances to the acceptance of some common policies. 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 for the European Parliament has been somehow neglected in the literature. Most authors dealing with the legitimacy problem, the democratic deficit and the effectiveness problem of the European Union, defend that it would have to

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are also quite open (to citizens, the media, researchers, etc.) regarding their political and policy options.

<sup>16</sup> The European Parliament holds regular meetings with members of the relevant national parliaments' committees on a wide range of issues: EMU and hearings of the ECB's President, the BEPG, the IGCs, EU enlargement, etc., not to mention the COSAC - Conference of European Affairs Committees of the EU (and applicant countries) National Parliaments and the European Parliament - and the European Convention.

opt to be either a federal political union, with one government and one parliament, or a confederation of sovereign states, without majority-voting. Some authors, such as Beate Kohler-Koch (1999, p. 17), argue that the European Parliament has “an inferior representative quality” and claim that there is a broad consensus in the scientific community that a parliamentarisation of the European Community (EC) system would not improve its democratic quality.<sup>17</sup>

Without entering into more normative type of arguments, one can argue, however, that the representative quality (of the European population) of the European Parliament is also evolving. It is argued in the next section and throughout the paper that the European Parliament has been assigned new roles in the Treaty Establishing the European Communities by the Maastricht and Amsterdam treaties and that this fact is certainly perceived by the European public opinion or the different Member States’ public opinions, as shown by the polls referred above.<sup>18</sup> That fact was certainly perceived by all national parliaments that ratified those treaties.

Even with an “inferior” representative quality, in the view of different authors and observers of the EU, the European Parliament’s overseeing of EU institutions, such as the ECB, clearly contributes to an increased transparency and accountability of the system. Moreover, the interaction and collaboration between the European Parliament and national parliaments in the EU may allow for increased participation and of enhancing its representative quality.

### **3. Enhanced accountability as a way of improving the democratic quality and effectiveness of monetary policy**

Let us consider why is it important to enhance the role of a representative institution (even though for some authors with still an inferior representative quality) as principal of other institutions in the EU. One can say that it is important to enhance the role of a representative institution for the simple reason that, as referred above, the full political responsibility of the top of the administration, not towards single interests but to the whole of the voters, by means of responsible representatives, is if not the only (as defended by Neumann, 1959), nevertheless an important criterion for the democratic character of an administration. In that perspective, 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.

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<sup>17</sup> 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).

<sup>18</sup> Regarding knowledge about the EP, how it is perceived to play the most important role in EU life and how it is the institution which on average people tend to trust most in the EU (Eurobarometer, 56).

The European Parliament, as it does not necessarily follow the changing views of the initial principal, i.e. the European Council, may be particularly suited, and still enjoy the legitimacy (conferred by the treaties signed by the various EU national governments and ratified by all EU national parliaments), 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, extended to the EU Council of Ministers, and, on the other hand, the need to assure and enhance if not the proper at least some accountability and transparency of procedures of the ECB’s administration, allowing at the same time for some form of deliberation.

According to Jonathan Bradbury (1996, p. 1) in the Oxford Concise Dictionary of Politics, accountability is: “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. 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, to specific groups, etc. Keohane and Nye (2003) distinguish between several categories of accountability: electoral, hierarchical, legal, reputational and market accountability.

### **3.1 Credibility and political constraints**

Let us now introduce what it is an important distinction in order to characterise the importance of accountability in general and of the European institutions in particular. Accountability is necessary to achieve agreement on the design and establishment of lasting institutions. In fact, if institutions are not accountable one might well solve a short-term problem of creating independent institutions but not the longer-term problem of their sustainability.

Elected politicians will only defend independent institutions, namely the ECB, in the case of crisis, say an economic recession in the Euro zone, if they can at least oversee their functioning. Paul De Grauwe (De 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”. 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 (see the examples provided by the EMS, German Monetary Unification and EMU). Politicians will tend to put the blame for the crisis onto the institutions that escape their control and these will have to resist (if they can) alone all 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.

The distinction I want to introduce is based on the literature of a new theory of economic policy that became popular in the late 1980s / early 1990s – see Torres, 1992, for a discussion. That distinction is 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.<sup>19</sup>

Governments, besides being subject to the constraint of their lack of knowledge about the functioning of the economy, face as well 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, 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 (which in general parallel rules versus discretion) to changes in government colour and organization (elections, simple majority, multi-party coalitions, etc.) 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”.<sup>20</sup> 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.

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. In the EU, that happened already in the case of the creation of Economic and Monetary Union and the ECB, through nation-wide referenda, several national and European elections where discussions about EMU were a major issue in the electoral campaigns, and many public debates on the matter. The process of making the rules of EMU (that also govern the ECB) was subject to democratic accountability, as argued above.

With that clarification between credibility and political constraints made, one can perhaps better understand the importance of enhancing the accountability of the European institutions, in particular the accountability of the ECB. The European Council wanted to “tie its hands” and make Europe's central bank independent from

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<sup>19</sup> 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).

<sup>20</sup> 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) and Torres (1987, 1989).

any political influences. This was a way of dealing with credibility constraints and the problem of time-consistency (see Torres, 1989).

However, avoiding excessive politicisation of agencies (in order to avoid that policy outcomes are determined by vested interests) removes them from direct political control (they may become “fiefs of their own” not responsive to any principal, or develop a cosy relationship with those whom they are to regulate, Caporaso, 2003: 13; see also Gustavsson, 2002, for a discussion). That is why the European Union has also to deal with political constraints, that is, it has to assure that its institutions, namely its central bank, are accountable. This need for the accountability of EU institutions involves in the case of the European monetary authorities three dimensions put forward by De Haan, Amtenbrink and Eijffinger (1998), namely: decisions about the ultimate objectives of monetary policy; transparency of actual monetary policy; and who bears final responsibility with respect to monetary policy.

One question is then how 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 (and is already improving, one can argue) the efficiency of common EU policies and the democratic quality of the process of European integration. Again, democratic quality meaning here 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**

It is true that with the ECB, the act of delegation of power was undertaken by the heads of state and government in the constitution of an Intergovernmental Conference (IGC) on behalf of the Member States. Yet, as put by De Haan et al. (1998), this one-time act of legitimisation cannot replace mechanisms of democratic accountability. As a matter of fact, from a normative viewpoint, such a delegation of powers to unelected officials may only be acceptable in a democratic society if central banks are one way or another accountable to democratically elected institutions.

Moreover, one can say that the European Parliament does lie, although somehow ambiguously, along the chain of delegation between the European Council and the ECB (so it was established in the TEU). In fact, one can argue that the European Parliament may act as a principal under implicit delegation from popular sovereignty (i.e. moving beyond the initial chain of delegation referred above and building up a new one). On the other hand, it is possible to argue that the Member States have not only intentionally chosen to give autonomy to the monetary authorities (in order to deal with credibility constraints) but that they have also delegated authority to the European Parliament to act on their behalf as principal in relation to the European Central Bank (in order to deal with political constraints).

In fact, the Treaty of Maastricht that established the European monetary constitution and which was ratified by all national parliaments gave the European Parliament significant competencies. According to the Treaty establishing the European Community (TEC), Article 113 (3) of the Amsterdam Treaty, the ECB's president should present the annual report to the European Parliament. Moreover, the Parliament could hold a general debate on that basis and the ECB Executive Board could also be requested and/or take the initiative to be heard by the competent committees. Finally, the European Parliament has to be consulted by the European Council upon the nomination of the entire Executive Board (TEC, Article 112(2b)).

One can then argue that the intention of delegating power to an independent central bank in the EU went hand-in-hand with the very idea of assigning to the European Parliament a new (and evolving) role. This is true even if the delegation of power to unelected officials (central bankers) in general does not lack by itself democratic legitimacy that can be found in the legal status of central banks by an act of Parliament (by a treaty ratified by national parliaments in the case of the ECB).

Therefore, the idea that the European Parliament was assigned a new (evolving) role regarding the overseeing of the ECB goes without contesting the legitimacy of the European Council and/or the EU Council of Ministers and the fact that it can act on behalf of popular sovereignty. Without contesting the proximity of the European Council (heads of state and government, as representatives of Member States governments and peoples) as the initial principal of the ECB, it is possible to indicate ways of improving democracy and indeed efficiency in the EU, that in fact are already at least partly taking place.

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 that monetary authorities that do not enjoy yet a solid reputation of sticking to their announced goals (the above-mentioned time-consistency problems) face, the principal (the European Council together with the EU Council of Ministers) delegated to an agent (the new European monetary authority) in order for the agent to control its behaviour with regard to monetary policy.

Such a change in the nature of delegation, however, one can put forward, implied a new role for the European Parliament, in fact a change in the assignment of agents and principals. From a normative point of view, one can also argue that 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).<sup>21</sup> That is why leading politicians and national governments in the EU have defended an economic government as a counterweight to the ECB.<sup>22</sup>

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<sup>21</sup> 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, that is also underlying to agency drifting, that their preferences are bound to diverge stresses the need for some form of oversight.

<sup>22</sup> The sub-optimality of the ECB's accountability has been recognised by several authors. See for instance De Haan et al. (1998), De Grauwe et al. (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".

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. As a matter of fact, one can argue that the initial principal tied its own hands (and the hands of the Council of Ministers) but assigned a new role to a new principal (the European Parliament).

This is all the more relevant given that clear *ex-ante* specification of the rules of Economic and Monetary Union was not part of the Treaty of Maastricht and/or Amsterdam. The stability pact is an intergovernmental solution to strengthen the enforcement mechanism of the excessive deficit procedure (EDP). Alternative rules concerning the allocation of resources and voting mechanisms within the ECB, the re-design of the System of European Central Banks in an attempt to make it more stable, and even the enforcement of a mechanism that would allow for the removal of the ECB's Board of Directors should it fail to maintain price stability are neither defined in the treaties nor at the intergovernmental level (see Torres, 1996).

It is in this perspective without a clear *ex ante* specification of the rules of the game – namely without an enforcement mechanism (whose inexistence was already discussed above) –, that the European Parliament may well oversee the activity of the ECB. That role of oversight does not endanger the credibility of the European monetary authorities because there is no need for a treaty change.<sup>23</sup> Furthermore, EMU can indeed work more effectively and smoothly 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 - to which, among other European bodies, the ECB already reports<sup>24</sup> - 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 (not in the least place because of less immediate electoral concerns), 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.<sup>25</sup>

In fact, the European Parliament cannot be so directly influenced by the electoral concerns of one or two governments in the EU. This is because the opposition to those governments is also represented in the EP and may well have different (if not opposing) views on the issue under discussion and because even

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<sup>23</sup> 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.

<sup>24</sup> See article 109b of the Maastricht Treaty, now Article 113 of the TEC after the Amsterdam Treaty was ratified by all national parliaments.

<sup>25</sup> One could point out several examples of that nature concerning for instance the excessive deficit procedure.

larger countries cannot influence the EP to the extent that they do influence the European Council or the Council of Ministers.<sup>26</sup>

The role of principal of such an institution as the European Parliament 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 European Parliament, as it 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 European Parliament in the oversight of the ECB's activities has already been quite substantial. 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 European Parliament also holds meetings both with members of the relevant committees of the national parliaments and with experts to prepare those hearings.<sup>27</sup>

According to Elgie (2000), there is also evidence that the European Parliament has managed to "encourage" the ECB to not exclusively focus 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).<sup>28</sup> This may also be seen as a way of influencing EU policy constraints by the European Parliament.

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<sup>26</sup> In fact, a study by Simon Hix (2001) for the first year of the 1999-2004 European Parliament concluded that transnational party group affiliation was more important than national affiliation for determining how MEPs vote. In that perspective, it is not to be expected that say the German or Portuguese opposition would come to rescue their respective countries from an early warning.

<sup>27</sup> 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.

<sup>28</sup> That may well show, in the terminology of Farrell and Héritier (2002), the importance of the effects of an informal institution on the interaction between the European Parliament 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) and also between the European Parliament and national parliaments with respect to EMU (regular informal meetings in the EP and COSAC).

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

The process of European integration is a good example of how different challenges posed by an evolving (“ever closer”) political co-operation may contribute to achieve a model of sustainable development that is compatible with the other objectives enshrined in the treaties.<sup>29</sup> The concept of sustainability implies that development is bound by some limits that, if surpassed, may cause its reversal. One can also argue, on the basis of the arguments put forward in the previous section, that a development process may be reversed if based upon non-democratic (and/or unaccountable) institutions.

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 (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.

More recently (since the Amsterdam Treaty), even intergovernmental conferences (IGCs), convened to revise the treaties, are increasingly characterised by multi-level political negotiations. In fact, these intergovernmental conferences include representatives of the European Parliament that is regularly briefed by the negotiators and can give its views on the issues under discussion. Moreover, the European Parliament’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)<sup>30</sup> 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

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<sup>29</sup> The objective of sustainable development was enshrined in the Treaty on European Union, Article 2, by the Amsterdam Treaty.

<sup>30</sup> It is rather frequent that national parliaments (European Affairs Committees) invite members of other national governments for hearings on the Inter-Governmental Conference (IGC) in order to discuss their points of view. These invitations are in general accepted. Several national governments (represented by their foreign affairs ministers and/or European affairs ministers), and not only the government of the country holding the EU Council Presidency, visit several or all of their counterparts and respective parliaments for an “exchange of views”.

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<sup>31</sup> that the objective of the realisation of Economic and Monetary Union in Europe was instrumental for creating the necessary consensus to overcome specific interests in the pursuit of social welfare. This was not just economic orthodoxy (as perceived by some authors - see for instance Robert Cox, 1997) – in fact politicians (Delors, together with Kohl, Mitterrand and Gonzalez, among others) pushed for it -, but rather institution-building as an answer to the challenges of globalisation.

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 as well transparency and even participation and, one might add, effectiveness, to the extent that new challenges were brought under more democratic control.<sup>32</sup> 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.

Previously, when monetary policy was basically set out by the German Central Bank for the entire 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 European Monetary System.

The challenge of EMU, one has to acknowledge, may have started as the importing of “bottom-up pressures”, meaning the ideas of some elites, epistemic communities, reflected by the European Commission, central bankers and monetary economists (also according to Jones, 2000, such influences reflected epistemological rather than distributive considerations) embraced only by a leading fraction but without the participation of most of the national populations. 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 European Union is currently in a process of transition towards a wider political union in Europe together with an increasingly important role of representative institutions. In such a situation, European institution-building,

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<sup>31</sup> See for instance Jones, Frieden and Torres (1998) for the case of some Small Member States.

<sup>32</sup> See Erik Jones (2002) for a similar conclusion in regard to efficiency and transparency.

with more efficient and transparent bodies and even transnational political parties may be a way of reinforcing the democratic quality (and its reach) 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.

EMU was a good example of a process of a continuous multi-level negotiation during both the discussion of its very rules inscribed in the Maastricht treaty and its convergence phase. That phase included the implementation of the various national convergence programmes, the adoption of the Stability and Growth Pact (SGP) and other changes in domestic policy throughout several national, local and European elections. That meant a permanent discussion and a negotiation at different levels of government. One can also argue that the different referenda that have been held on that subject (yes or no political campaigns and debates and voting alternatives), by conditioning the project of EMU for some countries and, in the case of the first Danish and French referenda on the Treaty of Maastricht, its calendar for the entire European Union, have also triggered wide-spread political discussions.

On the other hand, 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 European integration challenges such as Economic and Monetary Union have worked not only as mechanisms for economic stabilisation but also, and perhaps more importantly, as pre-requisites for structural reform and long-term development.

The responses to European integration challenges provide good examples of evolving governance in the EU because they go together with the more clearly perceived need for democratic control of its new institutions. In addition, they also allow for an increased participation of representative institutions and the civil society in the discussions that take place before the approval of treaty changes and their ratification about the goals of the envisaged reforms, i.e. on the type of model of society envisaged.

Despite the fact that Europe does neither have (yet) a constitution nor a government and that it suffers the impact of globalisation on national political systems (that are unable to deal with new global problems without sharing sovereignty), one may argue that such conditions may also be leading to an improvement of the democratic quality of EU governance.

In fact, the European Union has been experiencing a permanent re-drafting of its treaties, necessary to accommodate important institutional changes (such as the Internal Market, EMU, Schengen and the communitarisation of other matters of justice and internal affairs) that involve an explicit transfer of national sovereignty to the Union level. At the time of each constitutional change the question of democracy is discussed both Europe-wide and at the level of each Member State, in some cases

in conjunction with a referendum and, especially in traditionally more centralised states, it is also focused on that very transfer of sovereignty.<sup>33</sup>

Moreover, with on the one hand a growing individualisation of society and the resulting loss in terms of the aggregation of interests and on the other hand the increased complexity of issues at stake (namely risks, one could say, using Ulrich Beck's terminology), multi-level political negotiation involving many different actors is a rather important mechanism for democracy which referenda cannot deliver.<sup>34</sup>

In fact, apparently nation- and/or union-wide referenda provide an opportunity for citizens' increased participation and even transparency in the process of decision-making. However, the necessarily simple or simplistic nature of the questions, generally yes or no questions, does not really allow for more participation when complex issues are at stake. They may give the citizens the last word on some issue but *per se* they do not guarantee the quality of their increased participation and obviously they may affect negatively the efficiency (outcomes) of the process.

On the contrary, a continuous process of negotiation at different levels of government might allow for a permanent (and more transparent) discussion (and other forms of participation), even through various national and European elections (as mentioned above for the case of EMU). On the other hand, clear-cut decisions over clear-cut issues may be decided very efficiently through a referendum. The same is not valid though 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 (for all and at the various levels of government) 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 bringing in some new important features, such as new forms of participation, through the interaction of different institutions and citizens in that multi-level political negotiation process. The role of national and European representative (parliamentarian) institutions and also their interaction further enhances the transparency and effectiveness of EU governance.

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<sup>33</sup> That transfer of sovereignty only does not involve its external affairs aspect because other sources of power (such as the United Nations, NATO or simply the United States) superior to that of the EU and its territory do exist and both European citizens and member states recognise that. Recent world events illustrate this point well.

<sup>34</sup> As Ulrich Beck (1992, p. 36) put it: poverty is hierarchic, smog is democratic. In other words, as in a modern (risk) society social differences are more relative, there is a loss in terms of aggregation of interests.

## 5. Bringing into account previously uncontrolled forces

In this section, I discuss the case of EMU from the perspective of creating credible monetary institutions, namely the European Central Bank (ECB) and the European System of Central Banks (ESCB) and a credible monetary constitution, also through a process of multi-level political negotiation.

The case of EMU illustrates how EU policy constraints, to which a Member State could normally adapt rather slowly, may gradually (quite quickly sometimes) be transforming into political objectives. The adoption of national convergence programmes was indeed a way of transforming EU policy constraints into common European and national objectives. This obviously increases policy effectiveness but it also allows for increased participation of national citizens in a European common project that internalises at the European level some externalities that arose from uncoordinated (and probably not perceived as such before the discussion of new common objectives) national policies.

### 5.1 Adopting a credible monetary constitution

Joining a monetary union based on institutions that deliver price stability<sup>35</sup> 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. Actually, fixed exchange rates, unlike other policy targets, are easily observable by the public but also easily implemented by the authorities.<sup>36</sup>

In such a regime, the authorities raise the political costs of inflation because the public can constantly monitor their anti-inflation commitment and any different behaviour would imply a loss of competitiveness for the tradables sector. One should not forget, however, that exchange rate flexibility can only have a transitory impact and hence does not dispense the need for long-run real adjustment of a country's economic structure (Torres, 1996). Besides, nominal exchange rate devaluations are totally ineffective if they cannot affect the relative price of domestic and foreign goods (the real exchange rate, a relative price).

In fact, a small open economy tends to lose less (gain more) than a larger closed economy by giving up its monetary autonomy and joining in a monetary union with its trading partners. Foreign exchange transaction costs and exchange rate uncertainty tend to affect mainly small open economies. This is because a relatively

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<sup>35</sup> By institutions that deliver price stability it is meant 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, p. 3, opening statement of Chapter I), "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction".

<sup>36</sup> See Torres (1990).

important fraction of their trade is done with other countries and therefore they face large (and potentially unstable) foreign exchange markets. As the degree of openness increases, the benefits of adopting a common currency increase and the costs of relinquishing control over an autonomous exchange rate policy diminish. This is because a devaluation has a much stronger impact on the price level of a relatively open economy than on the price level of a relatively closed economy.

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 speculation, exchange rate volatility and serious currency misalignments. Those in turn 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. Niels 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.

Furthermore, one could argue that, as a tendency, high inflation countries tend to gain more than low inflation countries from sharing their monetary autonomy in a common monetary institution. Eliminating inflation through the sharing of monetary sovereignty in a common credible (and upon its creation with expectations, and realistic chances, of becoming more accountable) institution such as the ECB and the abolition of different currencies, does away with the need to waste resources on hedging against exchange risks (and financial speculation). A common monetary institution that delivers price stability is therefore a two-fold welfare improving mechanism.<sup>37</sup>

Adopting a credible monetary constitution was also a means of cancelling out the primacy of monetary policy over other more important concerns facing society. This was especially true for countries with less developed fiscal and monetary institutions like Greece, Portugal, Spain and even Italy (and in the future all new EU members). In that case, EMU was a means of getting rid of national currencies and all the economic jargon that goes with them 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.<sup>38</sup>

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<sup>37</sup> The reason is that it internalises both the costs of excessive inflation and exchange rate instability. See Torres (1996) for a discussion. Eichengreen and Ghironi (1996) provide other arguments for the case of low inflation countries in the context of EMU.

<sup>38</sup> What, at a first glance, could be branded as a mere “new constitutionalism” approach in the interpretation of Martin Hewson and Timothy 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.

Not surprisingly, in the case of some EU (laggard) countries, those very policies, which have been pursued until now<sup>39</sup>, 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 could have been seen at the first glance as top-down (EU Commission and “statesmanship”) pressures were indeed a way through which some Member States regained some political control over monetary policy at the European level.

In fact, in that way, those EU countries 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, in that way, 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.

## **5.2 From EU-level constraints to national (and common) political objectives**

During the entire convergence period, however, few people presented EMU as a desirable political reform instead of an external constraint. For a long time, most politicians, bureaucrats and even economists just referred to it, initially, as an objective rather unlikely to be realised and, later on, as an unavoidable development within the European Union.<sup>40</sup> Presented in this way, EMU could have been (and as a matter of fact was at different periods) easily blamed for all the policy errors made by national governments, monetary authorities and other national or European institutions.

In many instances, the EMU project was regarded as an unavoidable external constraint that went together with an exogenous political objective to which their political leaders had converged. Good examples of that perspective can be found in the reactions of some policy-makers, politicians and economists (such as the Group of 155) in Germany expressing their reluctance concerning the Bundesbank’s integration into “less solid” European monetary institutions or the cross-party political resistance in Portugal, on the basis of the defence of national sovereignty, regarding the proposal to enshrine the objective of price stability in the Portuguese Constitution.<sup>41</sup>

The root of one of the chief misunderstandings about the entire process of monetary unification was in fact that many people tended to see it as a technocratic

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<sup>39</sup> 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.

<sup>40</sup> Depending on the perspective, the only way of tying Germany into the European Union, of achieving more political integration or, simply, of maintaining access to EU structural funds.

<sup>41</sup> In 1997, all political parties refused, on the grounds of national sovereignty, to enshrine in the Portuguese Constitution the objectives of EMU in the article concerning the central bank. At the same time, however (mind the contradiction!), they accepted to comply with whatever international rules (external constraints) Portugal would accept in the future.

obsession and/or an ideological defence of the market. At the same time, some of the forceful opponents of EMU happened to be technocrats (sometimes diplomats, central bank employees and even Eurocrats) or ideological free-marketeters (as for example some economic advisers, conservatives in some countries (e.g., the UK), Keynesian-leftist in others (for instance France and Portugal) and independent economists in Germany as well as in other European countries.

Instead, one can defend the idea that adopting a credible monetary constitution is a means to do away with the primacy of monetary policy over more important concerns to society. However, in the event few people did present EMU as a desirable political reform instead of an external constraint.

The decisive argument turned out to be of economic nature (by definition less relevant for countries such as Denmark, the UK and Sweden). It was that, in a multi-speed EMU, it would have been more difficult for the catching-up countries to converge, in the sense that by being left out of EMU's third phase they risked to become more exposed (and indeed vulnerable) in the international financial markets. Note, however, that this reasoning already implicitly enshrines the idea of bringing into account previously uncontrolled economic forces such as speculation against weaker currencies within the EU.

There was also the perception - which may have constituted a decisive (political) argument - that it was important to qualify for accession to EMU right away since the core members could have become reluctant to enlarge the initial club (composed of *Euroland* founding members) both in the monetary sphere and in other domains of European integration.

With EMU, the new European co-decision process, the forthcoming enlargement process and the prospect of a closer political union for a limited number of countries within the EU, it became more difficult - or politically much less attractive - for EU countries in general and cohesion countries in particular to follow the old rule of asking for derogations on EU directives and/or for postponing any decisions concerning the future of common European institutions and policies.

Experience suggests that the European integration process - and in particular the need to perform sufficiently well to be part of the inner political core, especially at the time of each country's presidency - provides member countries with a good incentive to leap forward and embark on a more proactive policy stance. This is especially the case for countries for which European integration is at the core of their development strategy. In this context it is illustrative that it was during the Portuguese presidency of the EU in 1992 that the national currency, the *escudo*, joined the Exchange Rate Mechanism (ERM) of the EMS and that domestic capital controls were completely liberalised. The same had happened in the case of the Spanish presidency of the EU in 1989, when the *peseta* joined the ERM just a few days before the European Council of Madrid accepted the Delors Report on EMU.

Very few people had expected that Portugal and Spain, not to mention Italy, could meet the Maastricht criteria on time to join EMU from its very inception.<sup>42</sup>

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<sup>42</sup> Greece also managed to join EMU in 2001 two years after the beginning of its third phase but still one year before the replacement of all national currencies by euro coins and bills.

One, if not the main, reason for this disbelief had to do with the so-called systemic deficiencies of their political and administrative institutions. Those deficiencies, which did exist, were partly overcome thanks to importance of the challenge that the European integration process, in particular the objective of EMU, constituted (especially) for (catching-up) member countries and to which their policies had to live up.

What I have tried to demonstrate by means of the example of EMU is that EU challenges and governance at the EU level, by transforming into national political objectives, make reform possible and more effective. At the same time the process in which such challenges are raised to national political objectives becomes more transparent, allowing for increased participation of citizens, non-governmental organisations and other actors.

European integration challenges such as Economic and Monetary Union condition then the process of EU governance because they foster a clearer perception of the need for democratic control of its new institutions. Additionally, they allow for a new role of representative (parliamentary) institutions and the civil society in the discussions that take place before the approval of treaty changes and their ratification about the goals of the model of society envisaged at both the European and the national levels.

## **10. Concluding remarks**

The challenges posed by European integration process determine a continuously evolving 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 overseeing of the ECB's conduct of monetary policy), that interaction can indeed allow for more participated and transparent modes of governance. Besides the intergovernmental mode of governance and in addition to supranational regulation, these new modes of governance include: joint decision-making, as is the case of the Single Market, and policy coordination, as is the case of the open method of coordination of economic affairs (BEPG) or employment policy (EES).

Recently, especially since the Lisbon European Council of 2000 that gave rise to the open method of coordination, there has been an increasing interest in this latter new mode of governance (policy coordination) aimed at improving the problem-solving capability of the European Union through policy coordination without binding rules. For some authors, as for instance Scharpf (2001), the development of these new instruments of policy coordination such as the OMC are a

pragmatic but credible alternative to the Community method of integration (see also Héri-tier, 2002) that does not face any efficiency-legitimacy trade-off.

This paper did not take up that popular and interesting line of research. Rather, it explores a much less popular line of research, challenging the common wisdom on the democratic deficit of the European Union and on the efficiency-legitimacy trade-off. It tried to show that even a shift from an intergovernmental form of governance to supranational regulation (Economic and Monetary Union) form of governance not only does away with such a trade-off but rather enhances the democratic quality and effectiveness of European governance.

This is mainly due to the yet very much neglected phenomenon of the interaction between representative institutions at different levels in the European Union and also to the better studied participatory and deliberative processes (in this case the building-up of EMU) that have characterised supranational regulation.

The emerging role of the European Parliament in enhancing the democratic accountability of the 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 (transparency and accountability) in European governance.

The democratic accountability of governance in the EU increased very much 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 democratic accountability 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.

That 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) in order for the agent to control its behaviour with regard to monetary policy. That led to a change in the assignment between agents and principals. The new principal (still in the making one could argue) 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.

But the interest of looking at the European model lies also in the fact that it is reinventing itself continuously as the process of European integration deepens - it is not a mere transposition of the domestic democracy to the Union level. That is why it is possible to enhance the democratic quality of governance through the evolving process of multi-level political negotiation that has emerged in the EU.

The European integration process is responding to the globalisation process and also to the growing individualisation and complexity of society through the development of these new multi-level negotiation mechanisms, namely the interaction of the different national European parliaments with each other and with

the European Parliament, the respective governments, the European Commission and other European institutions and civil society. In fact, today, representative institutions (parliaments) might be unable to control international governance but they may be in the process of regaining some control over European governance.<sup>43</sup>

As a matter of fact, representative institutions, and especially the European Parliament by its very nature, are instrumental for making institutions such as the ECB more accountable and the process of policy-making more transparent and participated, while guaranteeing a balance between processes and outcomes. The European Parliament is indeed in the best position to fulfil the role of a principal that the European Council and/or the Council of Ministers, as intergovernmental bodies, can difficultly exercise.

The European Parliament's overseeing of EU institutions, such as the ECB, clearly contributes to an increased transparency and accountability of the system. Moreover, the interaction and collaboration between the European Parliament and national parliaments in the EU is a way of allowing for increased participation and of enhancing its representative quality.

By enhancing the accountability of EU institutions, common policies, namely monetary policy, become more effective (smooth) in the long run. By allowing for an increased participation of representative institutions (national parliaments and the European Parliament) in the formulation of other common policies, such as environmental policies, national vested interests can be more easily overcome and a common position (internalising some externalities) has a better chance to be reached in the EU.

Let me take up an argument put forward by Anthony McGrew (2000) that a world government is not politically attainable and/or desirable (under the present conditions, one might add). In that case, a possible solution for the incapacity of national democratic institutions to regulate globalisation is to pool sovereignty in a way that goes beyond the notion of a mere set of pluralistic arrangements that characterise global governance. The EU already pools sovereignty clearly beyond such a set of pluralistic arrangements, as stated by Article 1 of the TEU (as revised by the Amsterdam Treaty): "This Treaty marks a new stage in the process of creating an ever closer union among the peoples of Europe, in which decisions are taken as openly as possible and as closely as possible to the citizen". On the other hand, sovereignty-sharing in the European Union can only involve a more powerful notion of legal authority, provided that Member States also share some common political values. That is also the case for the EU, as stated in Article 6 of the TEU (as revised by the Amsterdam Treaty): "The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms and the rule of law, principles which are common to the Member States"

In fact, the process of integration and decision-making in the European Union is probably the only case of sovereignty-sharing that has proceeded steadily

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<sup>43</sup> Take the case of the reluctant but inevitable and quite predictable acceptance by governments and political parties alike of the model of the convention of 2003/04, already used before for drafting the Charter of Fundamental Rights. That may also reflect the fact that the European co-decision procedure is in practice reinforcing the role of national parliaments and indeed democracy in the EU.

up to a point where some multi-level governance can be already regarded as a polity. The on-going qualitative change of governance in the EU, i.e. the building-up of new European institutions and the development of new policy instruments devised at the European level, can be seen as a way of extending (and enhancing) democracy beyond the nation state.

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