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The Institutional Design of EMU: A Democratic Deficit?[1]

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ABSTRACT

The introduction of the euro is accompanied by an independent European Central Bank (ECB) which is solely responsible for monetary policy in the euro zone. No European institution will be introduced to flank the ECB. This particular institutional design is problematic. This article argues that Economic and Monetary Union (EMU) suffers moderately from a democratic deficit. However, the case of Germany illustrates that it is not the independence of the ECB that should be cause for concern, but the absence of specific domestic features and a government. It is unclear which political authority will be held responsible if EMU leads to an uneven distribution of costs and benefits across the euro zone. Economic literature suggests that under EMU distortions could well occur and that a different design could deal better with these imperfections. The historical process leading to EMU explains the reasons for its particular design. Although imperfect, EMU is an improvement over the pre-EMU status quo in which Germany *de facto* dominated monetary policy. Nevertheless, the design of EMU remains suboptimal.

The prospect of creating an Economic and Monetary Union (EMU) in the European Union (EU) has left academics, citizens and politicians of the Member States wondering whether democratic accountability will be sacrificed. In particular the fact that a politically independent European Central Bank (ECB) has been established, with the sole mandate of safeguarding price stability, has led to considerable concern. This feeling of apprehension towards the creation of this new institution and new type of policy-making in the European Union has, of course, been more widespread in those countries with a tradition of central bank accountability to the national parliament, such as the

United Kingdom, and much less widespread in countries with politically independent central banks, such as Germany and the Netherlands.

Apart from the specific national unease with central bank independence, general concern remains for four reasons. First, the ECB is even more independent than the most independent European national central bank – the German Bundesbank. The German central bank is embedded in a system of political checks and balances. Moreover, the German parliament has the power to change the statutes of the Bundesbank. For changes to the ECB, a Treaty change would be required. Such a change is only possible if it is unanimously accepted by all EU Member States. A second general concern is the fact that the aim of price stability is incorporated in the Maastricht Treaty.[2] Again it provides a stronger legal commitment to price stability than is the case in Germany where such a provision is not incorporated in the German constitution but in the statute of the Bundesbank (Kenen 1995). Again, the EU price stability mandate is more difficult to change than that of the Bundesbank. Third, the so-called 'policy mix' of national monetary and fiscal policy-making will be disrupted as a result of the transfer of monetary policy-making to the ECB while budgetary and fiscal policy-making will remain the responsibility of the national governments of the Member States (see Johnson 1994). This policy mix could be further disrupted as Member States will have to obey strict rules on budgetary deficits or be fined.[3] Fourth, contrary to what is the case in mature federations, the progress towards EMU will not coincide with a significant transfer of funding to the European level and subsequent redistribution. According to the body of literature referred to as 'fiscal federalism', these federal transfers would be necessary to enable distribution of the costs and benefits of EMU (Banting, Brown and Courchene 1994; Biehl and Winter 1990; Commission of the EC 1977; Radaelli 1996; Tondl 1999; Van Rompuy et al., 1991; Wyplosz 1991). However, as there is no political support for a further expansion of the EU budget, or the transfer of sovereignty over budgetary and fiscal policies, no such transfers will accompany EMU in the short term (cf. Biehl 1990; 1994; European Commission 1993a; 1993b).

Notwithstanding these reasons for concern, it is still very understandable that the Maastricht Treaty featured a politically independent ECB. EMU was only acceptable if a single monetary policy was conducted by an independent central bank. This institutional design was crucial for attracting general support for EMU from the monetary authorities of the twelve EC Member States, in particular the German government. The reasoning was that politically dependent central banks could not at all times safeguard low inflation. Especially because some countries had experienced higher inflation in the recent past, it was considered absolutely crucial to abandon all possible doubt regarding the central aim of European monetary policy, i.e. price stability, and make the future European central bank independent in order to secure the safeguarding of this mandate.

This focus on low inflation as the core aim of monetary policy had become widely accepted in economic literature, since the early 1980s (cf. Canzoneri, Grilli, and Masson 1992). Many monetary authorities throughout the world, encouraged by the authoritative International Monetary Fund (IMF), have since those years stressed the need to contain inflation. Furthermore, as the ECB is a *new* institution, it is necessary to gain credibility in the absence of a track record. Economic studies have shown that inflation and interest rates are strongly related to the *expectations* of operators in the financial markets (cf. Gros and Thygesen 1998; Woolley 1992). Yet, central bank independence alone is an insufficient measure for securing price stability (Lohmann 1996, Sturm 1995, Winkler 1996). Moreover, as the ECB *de facto* replaces the German Bundesbank, it was politically necessary to model it closely on the German institutional arrangements. Finally, it was believed that it would be impossible to have EMU become fully operational in an environment where economic convergence between the potential participants of EMU would still be insufficiently guaranteed. Therefore, some kind of constraint was deemed necessary; the independent ECB and its mandate to secure price stability would provide such a constraint.

The EU Member States have accepted as its next step in the European integration process a particular kind of economic and monetary integration. First, a transfer of sovereignty over monetary policy-making to the European level. Second, a transfer of sovereignty over monetary policy-making to an *independent* central bank. Third, the absence of flanking policies at the European level, i.e. no transfer of sovereignty to the European level of fiscal, budgetary, and other macroeconomic policy-making. These adjacent areas of policy-making remain at the national level, albeit subject to overall restrictions conforming to the so-called stability pact. There will only be an informal advisory council, the Euro-X or Euro-11 Council, to deal with issues of possible macro-economic policy coordination[4]. Fourth, the absence of regional or fiscal transfers to accompany EMU.

This particular institutional design may lead to concerns over democratic accountability, legitimacy, responsive and responsible government and redistributive justice. It is already an unprecedented step to have so many countries remove monetary policy-making out of the hands of national governments into the hands of a European body. In addition, monetary policy will be different when a ECB takes as its

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domain of policy-making the area of eleven countries instead of the traditional domestic economic area. Moreover, the EMU institutional design will not mirror the policy-mix of domestic policy-making. Macroeconomic policy-making will not be transferred as well. One can wonder what political body can be held accountable for any imperfections once EMU is fully operational. It also leads to the question who will be approachable and responsible if EMU leads to an unfair spread of costs and benefits across the regions, the Member States or even the various industrial sectors. Once it is clear what body is responsible it begs the question what measures can be taken to correct the imbalance. Obviously, as long as the ECB is fulfilling its mandate, i.e. is securing price stability, *that* body should *not* be held responsible for correcting any of these possible distortions. Thus, if Member States are unhappy with the results of those policies, another European body should respond and be held responsible. The institutional design of EMU does not make clear what body would be responsible, and what policy instruments and measures it could use to correct these imperfections. Hence, this institutional design of EMU causes some concern.

This article explores these issues. Five central questions are posed: first, does EMU and the independent ECB indeed cause a democratic deficit problem? Second, what can be learnt from examining non-majoritarian forms of policy-making for understanding these democratic concerns? Third, which lessons can be learnt from the existing arrangements in Germany regarding the role of an independent central bank, and concerns over democratic accountability? Fourth, how do economic theories, such as optimum currency areas and fiscal federalism, inform us about the possible proper institutional design of EMU? Fifth, why was an economic government absent from the EMU project? Finally, are the concerns about democratic accountability and the EMU institutional design justified?

1 Democratic deficit and accountability

The discussion on the 'democratic deficit' in the EU has taken off in recent years. Its literature is vast and discusses various aspects of democratic accountability and principles (see *inter alia* Boyce 1993; Chryssochoou 1998, Featherstone 1994; Lodge 1994; Scharpf 1997; V. Schmidt 1997; Williams 1991). When discussing the 'democratic deficit' scholars may be referring to the lack of democratic control of the national and European parliaments over the decision-making process in the European Council and the EU Council of Ministers (see Verdun 1999a). Often a criticism is heard about the fact that the European

Commission, the policy initiator, is not sufficiently democratically controlled (Boyce 1993; Chryssochoou 1995; Williams 1991).

The ECB will also not be accountable to either national or the European Parliament. The statute of the European System of Central Banks (ESCB) which comprises the ECB and the national central banks of the Member States participating in EMU ensures that it will be completely independent in its conduct of monetary policy-making (Teivanen, 1997). Politicians may not even *seek* to influence the ECB. Article 107 of the Maastricht Treaty states the exact degree of political independence:

'When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any Government of a Member States or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.' (Treaty on European Union, Art 107).

In addition to the provisions of independence, the ESCB will also operate in secrecy. The proceedings of the Governing Council of the ESCB[5] will be confidential. It will, however, publish a quarterly bulletin and an annual report. The latter will be presented to the European Council and the EP by the president of the ECB.

In addition to the lack of formal parliamentary control over the decision-making process, another aspect of the process has led to considerable concerns about democratic accountability: the aspect of secrecy, technocracy and lack of transparency in the EU policy-making process. Kevin Featherstone criticizes the technocratic and elitist mode of policy-making in the EC, and in particular the role of the European Commission in the integration process. Featherstone takes his definition of the democratic deficit in the EC from the 1988 Toussaint Report:

'the combination of two phenomena: (i) the transfer of powers from the Member States to the EC; (ii) the exercise of these powers at Community level by institutions other than the European Parliament, even though, before the transfer, the national parliaments held power to pass laws in the areas concerned.' (Featherstone 1994: 150).

A somewhat different analysis of this dimension of the democratic deficit problem is adopted by Juliet Lodge (1994). Lodge focuses in particular on the lack of transparency, the lack of provisions for citizen participation, and the relatively underdeveloped inter-institutional cooperation. She advocates a wider debate on these issues and larger information flow to the general public in order to close at least the 'information gap', which she considers as part of the cause of the democratic deficit.

For economic and monetary policy-making in the EU these dimensions of the democratic deficit problem could also be considered applicable. Many of the decisions agreed on by the Ecofin Council (the Council of Ministers of Economic and Financial Affairs), have been prepared in total secrecy in the Monetary Committee of the European Union. The Monetary Committee consists of top officials of the Member States' central banks and Ministries of Finance. It meets once a month behind closed doors. No minutes are taken. This influential committee has closely monitored the economic developments in the Member States since 1960 (cf. Kees 1987; Rosenthal 1975; Verdun 1999c).

In other words, the 'normal' concerns for democratic accountability which have been noted with regard to various aspects of EU policy-making could well be argued to be also at the core of the establishment of EMU.

This article is not the first to link the democratic deficit to EMU. Lisa Martin (1993) has argued that EMU is subject to fears of lack of accountability because it is linked to other EC issues, about which these concerns exist. In addition, legal scholar Laurence Gormley and the economist Jakob de Haan (1996) argued that compared to the existing independent central banks in Germany, the Netherlands and New Zealand, there exists a democratic deficit problem with the ECB. Although they welcome the fact that the objective of monetary policy would be price stability, they propose that the EP should be responsible for the legal framework:

> 'In other words, the "rules of the game" (i.e. the objective of monetary policy) are decided upon according to normal democratic procedures, but the "game" (monetary policy) is delegated to the European Central Bank. Since national parliaments can alter this legislation, the Central Bank remains under the ultimate control of those parliaments.' (Gormley and de Haan 1996: 112).

Following the analogy with the national situation, they add that in the EU the ECB thus ought to be controlled by the European Parliament.

A similar plea has been made by the prominent economist Peter Kenen (1995). Notwithstanding the fact that he welcomes the independence of the ECB and its mandate to secure price stability, his basic criticism is that 'the European Central Bank will be even more independent than any existing bank – even the German central bank – and thus less accountable' (Kenen 1995: 42). Whereas national legislators have the competence to amend the laws and statute of the national central banks, any amendments to the ESCB statute would require a unanimous European Council decision and ratification of the amendment in all Member States. Hence, Kenen spurs the European Union to 'do more to close the democratic deficit' and suggests that the EP be given the right 'to initiate amendments to the ESCB Statute and even the right to enact them'. (Kenen 1995: ibid).

Finally, political science scholars who have written widely on EMU, have also recognized an inherent democratic deficit problem in the EMU process. Kenneth Dyson, Kevin Featherstone and George Michalopoulos (1995) state two reasons. First, the democratic deficit problem occurs because of what they call, the 'insularity' of the EMU process, i.e. a minor role played by interest groups and business elites compared to the one played by national governments in the 1991 Intergovernmental Conference negotiations on EMU. Second, the problem worsens because further development towards political union to flank EMU lags behind. They see the latter as a problem mainly because the ECB will be independent and no provisions are made for linkage with fiscal responsibilities (Dyson *et al.* 1995a: 35). This argument of the absence of fiscal federalism or political integration is at the heart of a comparison between the existing central bank arrangements in existing nation states. Elsewhere I have argued that EMU displays a basic asymmetry due to the lack of parallelism between 'economic' and 'monetary' integration (Verdun 1996). This asymmetrical process of integration in combination with the absence of further macroeconomic and political integration has enlarged the democratic deficit problem (cf. Verdun 1999a).

Summarizing, related to EMU the democratic deficit can be identified as occurring, firstly, as a result of the absence of parliamentary accountability. Secondly, it results from the lack of transparency in the decision-making process, and thirdly the asymmetrical development of the monetary integration process compared to the political or budgetary and fiscal integration process. Yet, one can wonder whether the these concerns about central bank independence and the EMU institutional structure more generally should really be viewed from this 'democratic deficit' perspective. Recently scholars have discussed the legitimacy of having independent regulatory agencies and non-majoritarian ruling as a form of governance.

2 *Non-majoritarian Modes of Governance*

Whether or not a mode of governance is democratic depends on whether it is subject to control. '*Modern Political Democracy* is a regime or system of governance in which rulers are held accountable for their actions in the public realm by citizens, acting indirectly through the competition and cooperation of their representatives.' (Karl and Schmitter 1991: 76).

The first type of democratic control that comes to mind is that by individuals who are directly accountable to the electorate. This parliamentary accountability is often perceived as the 'normal' democratic mode of governance. However, non-majoritarian modes of governance (court rulings, policies made by independent regulatory agencies, as well as decision-making by supranational institutions) can be just as acceptable as a majoritarian mode of governance, provided they are in one way or another accountable (Dehousse 1997; Kreher 1996; Majone 1997a, 1997b; Shapiro 1997). When properly accountable, non-majoritarian modes of government can be fully legitimate (Verdun and Christiansen 1999; Patomäki 1997). This is particularly true when it concerns long-term policies. Various scholars have noted that the European integration process has typically been legitimised through economic output and not through participation (see Kohler-Koch and Eising 1999; Jachtenfuchs, Diez and Jung 1998). When the need to create policy credibility is at stake, a non-majoritarian mode of governance is in fact the most likely way to achieve the desired policy outcome (Majone 1996: 2, 1997a, 1997b; cf. Wincott 1992). For many years, the question at stake with regard to monetary policy has been whether national governments should maintain the capacity to set their policy objectives in response to day-to-day economic and monetary conditions or whether they should direct their policies towards fixed targets, such as inflation or exchange rate targets. In recent years it has become conventional wisdom to accept that monetary policies will be more successful, in terms of policy outcome, if they are pre-announced and taken out of the hands of national politicians. This explains the recent worldwide popularity of the idea of creating independent central banks. Even in those countries where central bank independence for the longest time was inconceivable, such as the United Kingdom, the Bank has gained more autonomy in meeting a pre-announced inflation target.

In this regard Majone has pointed to the difference between 'efficient' and 'redistributive' policies. Drawing on the work of Knut Wicksell, Majone stresses the need to settle both types of policies through separate decision-making processes:

> 'Efficient policies attempt to increase aggregate welfare, that is, to improve the conditions of all, or almost all, individuals and groups in society, while the objective of redistributive policies is to improve the conditions of one group at the expense of the other' (Majone 1996: 16).

According to Majone there should be no problem with a non-majoritarian mode of governance if it concerns efficient policies.

Hence, the fact that the institutional design of EMU is based on a non-majoritarian mode of governance should not *per se* trigger concerns over democratic accountability, provided that its creation will be compatible with a good example of 'responsive' and 'responsible' government – i.e. that a given body of government will respond to changing circumstances and will safeguard the principles and objectives that it set out to protect (see also Teivainen 1997). It would also need to be accountable to the national and/or European political body, in that it showed that it was fulfilling its mandate (see also Verdun 1998b).

Suppose that economic and monetary policies conducted in EMU could be regarded as efficient policies (i.e. would benefit everyone participating in EMU). In order to satisfy our notion of responsive and responsible government, two central principles and objective could be identified. First, EMU needs to safeguard its primary objective, price stability. The ECB has decided this means not more than two per cent inflation. Second, EMU needs to be compatible with the 'principles' of the European Community as stated in Article 2:

> 'The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing the common policies or activities (. . .), to promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and the quality of life, and economic and social cohesion and solidarity among the Member States' (Treaty on European Union, Title II, Article 2).

The assumptions underlying the EMU institutional design are: an independent ECB will lead to price stability. This achievement, in turn, will lead to harmonious and balanced development of activities, a high degree of convergence and employment. However, if these targets clash, i.e. if price stability proves not at all times to be compatible with balanced economic growth throughout the EU, it will have to be decided which of the two objectives would have priority. The independent ECB is likely to favour safeguarding price stability. Hence, if a clash of the two targets occurs, i.e. if low inflation in EMU countries results in uneven levels of economic growth and levels of employment, a situation would have been reached where in fact EMU policies would be considered in Majone's terms 'redistributive' policies. In this case it would be necessary, according to the principles set out above, to demand that majoritarian rule be introduced, that is, to hold a public authority responsible. However, the institutional design of EMU has not envisaged this kind of governance. What will be necessary in such an event is that the European Council or another majoritarian body,

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is responsible for resolving the redistributive issues which occur. It is this concern over the unequal spread of costs and benefits of EMU and the possible lack of political authority to be held responsible that is at the heart of the general concern about the EMU project.

In part these concerns arise from its construction: it was modelled after the German Bundesbank without appreciating the specific German domestic context. As we shall see in the next section, in the German case there are no major concerns about whether central bank independence endangers democratic principles. What however will become clear is that the Bundesbank is embedded in a domestic framework which is quite different from the one found in the EU as a whole.

3 Lessons from Germany's central bank independence

What lessons can be drawn from the German 'model' regarding the role of an independent central bank? Does it pose problems of democratic accountability? Is the Bundesbank as independent as is often claimed? How is responsive and responsible government ensured in Germany?

The German Bundesbank not only has price stability as its overriding mandate but also the task of supporting the economic policies of the national government, in ways that do not threaten the objective of price stability. Moreover, the German national government is responsible for exchange rate policies, and the Bundesbank has only an advisory role – the government is not obliged to seek the Bundesbank's advice. The Bundesbank's independence is further constrained by the fact that the government appoints the central bank president as in the case of the EU, where the European Council appoints the President of the ECB (Kennedy 1991; Louis 1989).

Sturm (1995) has argued that these legal foundations are insufficient to safeguard central bank independence. The appointments of political allies of Chancellor Kohl as the central bank governor, Hans Tietmeyer, and the vice-president, Johann Gaddum, illustrate this concern.[6] Indeed, the German government has still quite a strong position to conduct monetary policies independent from the Bundesbank, and has in recent years demonstrated the political will to take decisions which the Bundesbank opposed. The two often quoted examples are German reunification including the decision to lock the exchange rates of the Ost- and D-Mark at an economically overvalued rate. The second famous example is the fact that the Bundesbank was against the fixing of a timetable on EMU, because it estimated that economic convergence could not be achieved in the proposed time period, but the government of Chancellor Helmut Kohl went ahead and signed the Maastricht Treaty anyway (Henning 1994; Marsh 1992; Sturm 1995). A third interesting example is found in the creation of the EMS in the late 1970s. As is told anecdotally in Helmut Schmidt's memoirs, he and Giscard d'Estaing met to discuss the EMS explicitly behind the back of the Bundesbank as Schmidt was convinced that the Bundesbank would oppose the EMS initiative (H. Schmidt 1990).

Hence, formal central bank independence in Germany has not meant a fully rigid regime in which there is no role for politics and politicians. Whether or not this fact plays any role of importance in German attitudes to central bank independence is not known. The fact is that German citizens and the German parliament have never objected to the political independence of the Bundesbank. Central bank independence has not led to concerns about democratic accountability; German citizens have accepted that low inflation can only be guaranteed by having an independent central bank.

The reasons for the historical acceptance in Germany of central bank independence, and its mandate of price stability, are found in the country's history; in particular the 1923 hyperinflation and the need for a new start after the Second World War (Goodman 1992; Marsh 1992; Verdun 1999b). Moreover, the German experience of the two World Wars meant that an institutional solution to a political problem was much welcomed. Determining that low inflation was a 'good' policy objective, and giving an independent central bank the mandate to safeguard this objective, meant that the Germans could be certain of the policy result independent of who governed the country. The D-Mark is part of the German national identity (see Risse *et al.* 1997; Verdun 1999b). Recently, German citizens have strongly opposed the rush into EMU if it means that the countries joining EMU will not completely fulfil the convergence criteria of the Maastricht Treaty. They are concerned that the new European currency – the euro – will not be as strong as the D-Mark.[7] Protestors have marched the streets opposing the cuts in government spending, but no calls were heard of problems with central bank independence or indeed its mandate of price stability. In other words, the German public has not been concerned about the official independence of the Bundesbank. They have accepted it as a necessary condition for price stability.

The fact that the German federal government *de facto* has an influence over certain important decisions in the realm of monetary policy gives it a stronger position when it is necessary to have a majoritarian decision taken. When necessary it can take over the function of being a responsive and responsible government. In this respect, the German system is quite distinct from what can be expected from the creation of EMU in the EU. In the EU the German institutional design has been adopted. However, there seems to have been little attention given to the *de facto* responsible and responsive role played by the German government, whereby the decisions of the central bank are occasionally overruled.

This leads us to a next related question, does central bank independence actually mean being able to safeguard low inflation, convincingly? John Goodman (1992) has noted that during the 1970s inflation in Germany went up as a result of high wage demands. McNamara and Jones (1996) emphasise the importance of domestic institutions, and the understanding of German trade unions and employers' organisations to keep wages and price increases under control. The 1989 Delors Report, the central bankers' blueprint to create EMU, has also stressed the need to have wages and prices geared towards price stability – a conviction echoed by authors such as Hall (1994) and Kaufmann (1995). It is, in fact, this insecurity about whether price stability can be maintained simply by having a statutory independent central bank that has been an important reason for making the ECB as independent as possible. The adoption of the Stability Pact has been another reaction to this concern over price stability under EMU (Artis and Winkler 1997; Lohmann 1996). In addition, according to a study of the Federal Reserve in the United States, some role for fiscal transfers may be necessary to counterbalance the ECB (Canzonieri, Grilli and Masson 1992; Eichengreen 1995). These issues are addressed in the next section.

4 Optimum Currency Areas and Fiscal Federalism

A problem which has been frequently discussed with regard to the creation of a currency union, is to determine when individual countries are sufficiently interdependent, and their economies sufficiently converging, for them to be in the position to give up the exchange rate instrument (McKinnon 1963; De Grauwe 1997). These questions have been addressed among others by a body of literature referred to as the optimum currency area (OCA) literature (Kenen 1969; cf. De Grauwe 1997; Gros and Thygesen 1998; Sachs and Sala-i-Martin 1992; Taylor 1995). This economic literature explains under what conditions it would make sense, economically, for countries to adopt a common currency. Unfortunately, the OCA 'theory' suffers from weak predictive features as most existing federations and monetary unions usually do not fully meet the criteria (see also Taylor 1995; Winkler 1996).

Yet, in mature federations, such as Germany or the United States, adverse effects of a single currency and a single monetary policy are in part offset by the existence of automatic fiscal stabilisers. The extent of these stabilising fiscal transfers has been calculated by Eichengreen

(1990; 1993) and Sachs and Sala-i-Martin (1992) who found that the transfers were significant. The question has been asked to what extent the EC/EU should embark on fiscal transfers.

In 1977 a first major EC Commission report was dedicated to examining the role of public finance in the Community to deal with regional problems. It concluded that a substantial central budget was needed. (Commission of the EC 1977: 12). At the same time it noted that:

> 'an essential characteristic would be that the supply of social and welfare services would nearly all remain at the national level. Such an arrangement could provide sufficient geographical equalisation of productivity, living standards and cushioning of temporary fluctuations to support a monetary union.' (Commission of the EC 1977).

However, as it was recognised that little support existed for extending the EC budget, the report's conclusions were that the Community's budget needed to be expanded by a mere 2 to 2.5 percent of Community GDP in the short run, and eventually account for 5 to 7 percent if a monetary union were created.

In 1991 the Commission embarked on a new major study on public finance 'Stable Money – Sound Finances' (European Commission 1993b, see also European Commission 1993a). When it came out in 1993 it had very cautious recommendations. It did not suggest the need for any major increase in Community spending if EMU was to go ahead. Instead, it was argued, national governments were adequately equipped to handle any occurring country-specific, regional, or sectoral shock, by using national resources. Interestingly, the study was completed in early 1992 but only published in late 1993, as the Commission President Jacques Delors put an embargo on its publication[8] due to the difficulties surrounding the Danish and French referendums on the ratification of the Maastricht Treaty and subsequent problems with the EMS that year.

Ideally the European single currency would be introduced in an optimum currency area (OCA) and would be accompanied by fiscal transfers and some sort of supranational institution ('government') would monitor the entire economic and monetary area. The institutional design of EMU deviates from this ideal type in three ways. First, EMU will by far not represent an optimum currency area. A core group of countries, i.e. Austria, the Benelux countries and Germany, could possibly form an OCA. But certainly countries such as Ireland, Italy, Portugal, Spain and the UK would not form an OCA with the core group nor with each other. Second, there will not be an EU economic government which will determine macro-economic policies for the countries participating in EMU. These policies will remain the full competence of Member State governments, even though they will have to accept limits on their budgetary debts and deficits according to the stability pact. Third, there will be no European centralised fiscal transfers of significance. Given their large public spending ratio of Gross Domestic Product, Member State governments in fact *do* have a significant budget to redistribute in the domestic economy, but of course not across the EMU zone.

5 Why did EMU develop this way?

Let us now briefly examine why there was no 'economic government' envisaged in the Maastricht Treaty to flank the ECB. In the first EMU blueprint, the Werner Report drafted in 1970, there was a provision for a European 'Centre of Decision for Economic Policy' (CDEP). This supranational body was meant to flank the ECB, and the CDEP would be accountable to the European Parliament. Its main task was to coordinate economic policies of the Member States. Though the Werner Report was adopted by the European Council in 1971, this first EMU initiative failed for a number of reasons due to international and domestic political changes.

The relaunch of EMU came with the publication of the Delors Report in 1989. This time there was no mentioning of an equivalent to the CDEP. One can ask why no role was deemed necessary for an economic supervisory board? The answer has to be found in the changing trends in beliefs about monetary policy-making and governance (Marcussen 1997; McNamara 1998). What had happened was that the monetary authorities of the EC Member States had changed their 'belief system' – 'their shared assumptions about causal effects and legitimate objectives' (Kohler-Koch 1996: 372). Whereas in the early 1970s Keynesianism was the driving force behind economic governance in all the EC Member States, anti-inflationary policies became the doctrine of the 1980s, though some countries were more successful than others.

Let us recapture here what the context was in which the Delors Committee came up with its EMU-blueprint. The EMS had been operational since 1979 and had surprised most observers with its relative success after the turmoil of the early 1980s. In 1988 exchange rates had been relatively stable, and the monetary authorities of the EMS countries were pursuing policies which made stable exchange rates sustainable.

The Heads of States and Governments at the European Council meeting in Hannover in 1988 asked a committee of twelve central bank governors and three independent experts to "propose concrete stages" which would lead towards Economic and Monetary Union. Commission

President Jacques Delors was asked to preside over the Committee. Given the composition of the committee, the central bankers' line of reasoning obviously resonated in the report (Verdun, 1999d). The monetary experts had been meeting on a regular basis in two committees during the previous decades: in the Monetary Committee and in the Committee of Central Bank Governors. They had experienced the change in attitude to monetary policy and had been discussing the conduct of monetary policy among themselves in the preceding years, even decades. It was therefore relatively easy to come to a conclusion which was based on their common understanding of the role of monetary policy.[9]

By asking a group of monetary experts, in particular central bank governors, to draft a blueprint for EMU, the European governments could expect to receive a blueprint that would be based on a European Central Bank, modelled after the Bundesbank. At this stage the full political commitment to EMU was still shaky as in particular the British Prime Minister Margaret Thatcher was much against EMU, and any transfer of sovereignty. But the argument was that it was as yet not a political decision, but rather a 'possible blueprint' to EMU. Other national governments had fully understood the fact that any next step to monetary integration would incorporate to a large extent the 'German model', as that was *de facto* what was happening within the context of the EMS.

In 1989 most of the central bank presidents were still accountable to their national parliaments. The central bank presidents were much in favour of gaining political independence from their governments as it was believed that independence would strengthen the central bank capacity to safeguard low inflation. Hence, the Delors Committee proposed in its report published in April 1989 that the EMU plan would include an independent central bank. The committee members strongly felt that they were not in the position to make any suggestions regarding the political arrangements, which they considered to be the responsibility of elected politicians. Hence, the central bankers were surprised when it became clear that the EMU provisions in the Maastricht Treaty resembled so much the original Delors Report.

During the intergovernmental conferences leading up to the Maastricht Treaty a number of details that were left open in the Delors Report were specified, such as the official statutes of the ESCB, the convergence criteria (the criteria for participation in the EMU), the transition to the final stage and the 'opt out' for the UK. Other decisions regarding EMU were taken even in the post-IGC period: such as the stability pact, the name of the single currency, the data of the introduction of the single currency, the decision to set up the Euro-X

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Council, etc. However, the basic structure and ingredients of EMU, remained as they had been specified in the Delors Report.

There seem to be four reasons why there were not more political ingredients incorporated in the EMU provisions. First, reaching agreement on the monetary provisions of EMU already was a major achievement in itself. Cooperation of those monetary authorities with a different attitude towards the conduct of monetary policy was mainly based on the fact that in the exchange rate mechanism of the EMS there already existed a dominance of West Germany which the countries were *de facto* confronted with. In particular the British government was still very much against EMU, and would never have agreed to anything more than a minimal package. The British government opposed anything which remotely resembled a federal arrangement.

Secondly, in the early 1990s, in parallel to the IGC on EMU, a second IGC on political union was held. However, the IGC on political union never really focused on the creation of fiscal federalism in the Community nor the establishment of an economic authority to flank the monetary authority. The French government proposed in the EMU-IGC that there was to be a 'gouvernement économique' which would be set up in parallel to the ECB, much along the lines of the CEDP proposed in 1970. However, German negotiators failed to support this initiative, with the result that it was not incorporated in the Treaty (Italianer 1993; Thiel 1995). It seemed that by discussing foreign and security matters under the heading of 'political union' the whole issue of political integration had been seriously neglected (Wallace 1993).

Third, there was strong difference of opinion as to whether EMU would really require fiscal harmonisation. Some authors argued that EMU would require more rather than less flexibility regarding fiscal policy-making (cf. Goodhart 1990). But even if agreement could have been reached about its usefulness, the fiscal systems in the Member States were still very divergent. In addition there was no common understanding about how much, and which, taxes would have to be harmonized, or indeed levied, at the Community level, or about who would be responsible for it, who would pay for it, and benefit from it. Fiscal policy harmonisation was just simply one step too far; there was no support for transfer of sovereignty over these matters to the European level.

Finally, due to the policy interdependence, capital liberalisation, the success of the EMS, the near completion of the Internal Market, the increasing international trade and the continuing competition from non-European firms, policy independence had actually become an empty shell. Hence, it was widely felt that monetary policy-making increasingly was influenced by external factors and by the policies in the dominant country: Germany. The anxiety about the *de facto* loss of room for manoeuvre in monetary policy-making created a strong drive to make the IGCs come to a productive conclusion. As a result the leaders of the Member States wanted to agree to a package deal on EMU even if it was incomplete. Hence, the Treaty on European Union, a multi-facetted compromise, was agreed to at the Dutch town of Maastricht in December 1991 (cf. Artis 1992; Bini-Smaghi et al., 1994; Dyson 1994; Henning 1994; Sandholtz 1993).

6 Coping with the democratic deficit of EMU

The EMU provision in the Maastricht Treaty had particular institutional design due to its specific historical background. Under different conditions the creation of EMU *could theoretically* have coincided with greater transfer of political responsibility to the European level and could have been accompanied by greater redistribution through federal fiscal transfers. However, given the development of economic, monetary and political integration in the EC such a development was highly unlikely.

The above synoptic historical account indeed substantiates the existence of the democratic deficit of EMU as defined earlier in this article. This democratic deficit of EMU results from a lack of parliamentary accountability, lack of transparency, an asymmetrical development of monetary integration on the one hand, and lack of budgetary, fiscal and political integration on the other hand. Let us now return to the question whether the democratic deficit of EMU should be a real concern to us.

EMU developed as a monetaristic project as a result of the presence of widespread agreement on monetary policy objectives (i.e. price stability, and stable exchange rates) and the need for solid institutional provisions for the independent monitoring of monetary policies. There was no support for the establishment of a European 'economic government' which would be responsible for the conduct of macro-economic policies. In fact, even if an attempt had been made to formulate macro-economic policies at the European level, it is highly unlikely that policies could have been formulated which all EU Member States would support. Hence, part of the reason for the asymmetry between the role of monetary policy and macro-economic policy is the fact that there exists strong consensus regarding the former, and much less consensus regarding the latter area of policy-making.

Should we be concerned about this asymmetrical development? To judge this fact one needs to reflect on the case of 'non-EMU', or 'the pre-EMU status quo'. If EMU had not happened, the Member States

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that had closely participated in the ERM would have remained being dominated by the Bundesbank policies. As most of them had chosen to peg their currencies to the D-Mark, and hence closely follow the German monetary policies, they would have been in a situation similar to EMU as far as monetary policy is concerned. (The situation is different for those countries, such as the UK and Sweden, who have chosen *not* to peg their currency to the D-mark.) The price they had to pay for shadowing German monetary policies was to have limited capability to make independent policy choices, the reason being that a deviation from the German monetary policy would occur at considerable economic cost. Financial markets would 'punish' any such deviation by charging higher premia for that currency. The effectiveness of devaluations is also limited; even 'surprise' (competitive) devaluations are only more or less successful once every so many years. If they occur too frequently the 'benefits' will not outweigh 'costs' of imported inflation and the subsequent premium that market actors will impose on the currency. So, even though national monetary authorities formally exert sovereignty over monetary policy in the current situation, it cannot be exercised without paying a high price (Gros 1996).

A second significant cost of the pre-EMU status quo was that national monetary authorities in the various Member States had no influence whatsoever over German monetary policy. At first sight this may not seem to be a cost. But as could be observed from the situation in France and the Benelux countries in the aftermath of German reunification, it can severely disrupt the relationship between monetary policies and economic fundamentals. In that period France and the Benelux countries, that had followed German monetary policies and hence the high German interest rates, were conducting monetary policies which were not supported by their domestic 'economic fundamentals'. At the time the French and Benelux economies were going into recession, and there was no fear of inflation. Hence lower interest rates would have been more appropriate in those countries. By creating the ESCB "Member States" have influence over the formulation of European monetary policy, i.e. national central bank governors and other prominent individuals appointed to the Governing Council of the ECB have a say over monetary policy – albeit as formally politically independent officials.

Third, as was illustrated by the discussion of non-majoritarian modes of government, the notion of central bank independence, provided it receives full support in the Member States and is properly accountable, does not indicate the real problem. Problems with independent central banks occur also outside EMU. However, the particularly serious problem is that it is unclear who will be responsible and held accountable if costs and benefits of EMU are unevenly spread, and if EMU requires

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redistributive policies. The main difference between being outside EMU and having an independent national central bank compared to being in EMU is that in the last case there is an independent ECB which conducts a single monetary policy for the whole of the currency union, whereas national governments retain the power over their domestic economy. Moreover, as was argued above, the ECB is a more independent central bank than the Bundesbank – the most independent central bank in Europe. In addition, there will be no European coordination of macro-economic policies by a European institution. Even though it can be argued that in the absence of EMU *de facto* sovereignty over monetary policy is also strongly reduced, and hence policy effectiveness would also not be secured, this does not necessarily mean that there are no democratic concerns arising from the mode of governance under EMU. For example, what if the support for price stability vanishes in parts of the EU? As it will be very difficult to make any changes to the Treaty support for European integration might decline. Thus, the problems are not directly related to central bank independence as such. Rather, the problems seem to occur because it is unclear what government would be responsive and responsible to deal with imperfections, and what measures they could take to offset these imperfections.

What are the political and economic costs of the type of governance chosen with regard to EMU? Obviously, Member States government which have put in so much effort to fulfil the convergence criteria for entering EMU, consider a single currency and low inflation to be in their national interests. But what if these governments' estimates are wrong or change over time? How can citizens and parliaments ensure that their national economy is governed properly under EMU? Will the EU have enough points of access for dissatisfied citizens, national politicians and others? The answer so far is, 'No, *not likely*'. The institutional design of EMU so far implies that it will be up to the national governments to settle the distributive effects of joining EMU by using national policy instruments. If citizens become disenchanted with the monetary provisions, one of the ways to influence the policy-making process is to ensure changes to the statute of the ECB. This can be achieved if all Member States agree and ratify a change to the Maastricht Treaty. In the last instance citizens could persuade their national government to drop out of EMU. However, if the reason for the desired change were the unequal spread of costs and benefits of EMU across regions and social class, citizens may not feel that national governments are the appropriate level of governance to appeal for change. They could try to put on the European agenda the need for a greater role for the European institutions for *redistributing* the costs and benefits

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of EMU. This is possibly a better way to solve those problems, as it is unlikely that a change to the independent status of the ECB would be unanimously accepted by the fifteen Member States. Dropping out of EMU is also improbable as it could well incur great political and economic costs.

7 *Conclusion*

The democratic deficit of EMU has come about as a result of various factors: firstly, as a result of the absence of a parliamentary accountability; secondly, it results from the lack of transparency in the decision-making process; and thirdly, from the asymmetrical development of the monetary integration process compared to the political or budgetary and fiscal integration process.

Having stated all this, monetary policy might well be the type of policy which is best conducted by a non-majoritarian mode of governance. This type of governance chosen reflects the ever increasing political support for the establishment of national independent central banks geared towards price stability. The German case has shown that the German public has not put into question the existence of an independent central bank with as its overriding motive the need to safeguard price stability. Nevertheless, some concern may remain regarding the fact that compared to the German situation, it will be much more difficult in the EU to change the independence of the European Central Bank and its mandate to safeguard price stability above all. Furthermore, the case of Germany showed that the system is embedded in a social-political framework, which is absent in the EU.

Studies of fiscal federalism have shown that in mature federations a single currency zone is paralleled with fiscal transfers. The absence of a significantly large EU budget may cause some concern over redistributive justice of EMU once it is fully operational as planned. Still, EMU's history and the way economic and monetary integration has been institutionalised in the EC/EU leaves little doubt as to why EMU has its current structure; EMU is the result of a gradual move towards integration basically founded on convergence in ideas, and policy practice concerning monetary policy-making. Regarding macro-economic and fiscal policies, sovereignty has remained in the domain of Member States. Similarly there has not been sufficient support to transfer more political sovereignty to the EU. Hence, the EMU project reflected this process.

When evaluating whether this specific democratic deficit of EMU should cause concern it is necessary to reflect on the 'pre-EMU status quo'. The analysis presented here suggests that the 'pre-EMU status

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quo' – i.e. with Germany dominating monetary policies in Europe, increasing economic interdependence, and integrated financial markets – implies that in the case of non-EMU many of the Member States *de facto* find that they have very limited influence over monetary policies. However, even though at first sight the democratic deficit of EMU appears to be not much worse than that in the 'pre-EMU status quo', democratic accountability and legitimacy could become highly problematic if the majority of European citizens failed to support the chosen policies. The Maastricht Treaty leaves insufficient possibilities for changes in the conduct of monetary policies. But, most importantly, there are few mechanisms dealing with problems of uneven spread of costs and benefits of EMU. Or, to use Majone's terminology, who will deal with redistributive matters if EMU turns out to move beyond pure 'efficiency' oriented policy matters? It is unclear which political body should be responsible to correct any possible imbalances. If policy change is difficult to achieve, when a large group of citizens and politicians find it necessary, they may well become disillusioned with the integration process at large.

The European integration process is full of incomplete package deals. Throughout history we have seen Member States wait and see what problems occur before they make the 'next step' in the integration process. Yet, it is to be hoped that sooner rather than later the mode of governance in the EU will be transformed once again, in order to address some of the problems discussed here.

NOTES

1. An earlier version was presented in two workshops in January 1997; at the workshop on the 'Transformation of Governance' at University of Mannheim and in the European Forum at the European University Institute. The author would like to thank their participants for useful comments. These and other scholars have provided insightful suggestions on earlier versions. Special thanks goes to Michael Artis, Thomas Christiansen, William Coleman, Thomas Diez, Kevin Featherstone, Thomas Hüglin, Peter B. Kenen, Beate Kohler-Koch, Georges Pagoulatos, Vivien Schmidt, Philippe Schmitter, Paul Schure, Stelios Stavridis, Albert Weale and three anonymous referees of JPP. Financial support from the European University Institute's European Forum and the European Union's Human Capital Mobility programme are gratefully acknowledged.
2. Article 105 of the Treaty on European Union states: 'The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the community . . .'. 'The basic tasks to be carried out through the ESCB shall be to define and implement the monetary policy of the community . . .'.
3. The rules on fines in the event of excessive deficits are set out in the 'stability pact', which was first launched in November 1995 ('Stabilitätspakt für Europa', *Auszüge aus Presseartikeln,* No 75, 7 November 1995). The stability pact was discussed at great length in the monetary committee of the EU and in the Ecofin Council during 1996. In October the European Commission adopted two proposals for Council Regulations which together constituted the

stability pact. The pact, renamed 'stability and growth pact', was finally approved by the Heads of States and Governments at the European Council in Dublin in December 1996.

4. The Euro-X Council (or now Euro-11 Council) is envisaged to serve as an informal body to the Ecofin Council and the European Council to discuss issues related to EMU. It consists of two members from each Member State participating in EMU and two members from the European Commission. To date it has discussed the compatibility of statistical data. The decision to have the Euro-X Council was made during the Luxembourg Summit in December 1996.
5. The Governing Council of the ECB shall comprise the members of the Executive Board of the ECB (four persons, a vice president and a president) and the Governors of the national central banks. The members of the Executive Board shall be appointed for a period of eight years, their term of office will be nonrenewable (TEU, Article 109a).
6. John T. Woolley (1994) has made a similar argument with regard to the political appointment of the President of the Federal Reserve Board. In May 1998, it became clear that the appointment of the ECB President can become equally political. At the European Council meeting President Chirac was willing to veto the appointment of Willem Duisenberg if he were to stay on for the full eight years. In the end a messy compromise was reached after Duisenberg so-called 'voluntarily' announced that he would opt for early retirement after four years in office, thereby making room for a Frenchman to take over that position thereafter (see also Verdun 1998a).
7. Though recent opinion polls (Eurobarometer 49) show an increasing support for EMU among the German population, the recent past was characterised by opposition. A public opinion poll conducted in May 1996, showed that 58 per cent of the German general population was opposed to the euro replacing the D-Mark against 20 per cent in favour. The opinion of German organised interests (Führungskräfte) was diametrically opposed: 83 per cent was in favour and 15 per cent was opposed to the euro replacing the D-Mark, according to the Allensbacher Archiv, Capital-Elite Panel of June 1996. Among the German elites (Führungskräfte) interviewed in January 1996, there was considerable doubt whether the ECB would be just as independent as the Bundesbank: 41 per cent had doubts about 'economic independence', whereas 57 per cent thought the ECB would be as 'economically independent' as the Bundesbank. As regards 'political independence' there was more confidence in the future ECB: 72 per cent thought the ECB would be politically independent, against 23 per cent in doubt (Allensbacher Archiv, Capital-Elite-Panel, January 1996).
8. DG II official, interview with the author (1992).
9. Official of the Monetary Committee, interview with the author, Brussels, October 1996 (Verdun 1999d). Similar findings are reported in also Dyson, Featherstone and Michalopoulos (1995b) and Thygesen (1994).

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