LECTURE 21: THE DEMOCRATIC TRILEMMA OF THE EUROZONE

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Tutorial discussion…

- “*The central issue is simple: democracy and the public authorities must be enabled to regain control of and effectively regulate 21st century globalized financial capitalism. A single currency with 19 different public debts on which the markets can freely speculate, and 19 tax and benefit systems in unbridled rivalry with each other, is not working, and will never work. The Eurozone countries have chosen to share their monetary sovereignty, and hence to give up the weapon of unilateral devaluation, but without developing new common economic, fiscal and budgetary instruments. This no man's land is the worst of all worlds*”…… Thomas Piketty (writing in the Guardian)

Introduction

- The *proximate* cause of the Euro crisis is a banking collapse.
- The *ultimate* cause, however, can be traced to structural imbalances that emerged form joining together distinct national models of capitalism into a single currency, without a fiscal state or a banking union.
- To understand the policy response to the Euro crisis it is useful to consider the interactive effect of interests, institutions and ideas.
- The banking crisis in Europe has cost almost $4 trillion. By the end of 2009 German banks, alone, had lent $720 billion to Greece, Ireland, Italy, Portugal and Spain . French banks had lent $493 billion.
- Collectively, Eurozone banks were exposed to $727 billion in Spain, $402 billion in Ireland, and $206 billion in Greece.

Explaining the response

- Why then has the policy response to the Euro-financial crisis almost entirely focused on budget deficits?

- To answer this question we need to examine how the institutional decision-making process of the EMU interacts with the domestic ideational and material interests of its member-states.

- In political economy, comparative responses to international crises are usually attributed to variation in domestic producer group coalitions.

- National governments negotiate international treaties in the interest of those sectors of the economy that give them comparative advantage.

- We can think about how to explain the policy response to the Euro crisis in terms of ideas (epistemic elites) and interests (political coalitions).

Economic ideas

- Economic ideas are not just instruction sheets for what governments should do. They are a power resource that enshrine very different conceptions of how the burden of adjustment should be distributed.
- They are never purely technical decisions.
- Initially, when the financial crisis hit, the governing 'neoliberal idea' of free efficient self-correcting financial markets was discredited. Policymakers in most countries pursued an immediate Keynesian response.
- Brazil, China, USA, and Spain lined up to stimulate their economies. But this Keynesian reprieve barely lasted 12 months. Why?
- In the Euro area, and at international summits, Germany led the charge against stimulus and called for a return to fiscal austerity and structural reform as a policy solution to the crisis.
- The new idea was 'growth enhancing fiscal consolidation'.

Where does the idea come from?

- The German ordoliberal idea is built around an instruction sheet that suggests the job of government is not to correct market failures but to set and enforce rules.
- Nation-states provide safety nets, ensure that cartels do not develop, limit unproductive speculation, impose strong budgetary discipline, and ensure a politics of order and stability.
- Policy failures by government not markets make crises.
- The policy response to the Euro assumes that if all Euro countries follow a Northern european economic instruction sheet (government stability, fiscal austerity and structural reform of the labour market) they will converge.
- The problem is that peripheral and southern Europe states do not have the domestic institutions to make this export-led instruction sheet work.
- A varieties of capitalism framework suggests that countries will increasingly diverge from one another.

Austerity

- At the G20 summit in 2010 the international ideational climate radically changed. Jean Claude Trichet, the then President of the ECB wrote in the Financial Times:
- Stimulate no more - it is now time for all to tighten
- Soon afterwards, the German finance minister Wolfgang Schäuble published an opinion piece in the FT where he outlined what would become the Euro strategic discourse until today:
- Europe needs expansionary fiscal consolidation
- The ECB followed with their June 2010 monthly bulletin, and called for:
- Growth friendly fiscal consolidation

Meanwhile

- In 2010 - Greece received European financial assistance (110 billion) in return for a 20 percent cut in public sector pay, pension cuts and structural reform. In 2011, an additional 110 billion was provided with a 20 percent cut in spending required in return.

- In 2010- Ireland received European financial assistance (60 billion) in return for a 24 percent cut in public spending.

- In 2011 - Portugal received financial assistance (78 billion) in return for a 25 percent cut in public spending + structural reforms.

Politics in hard times

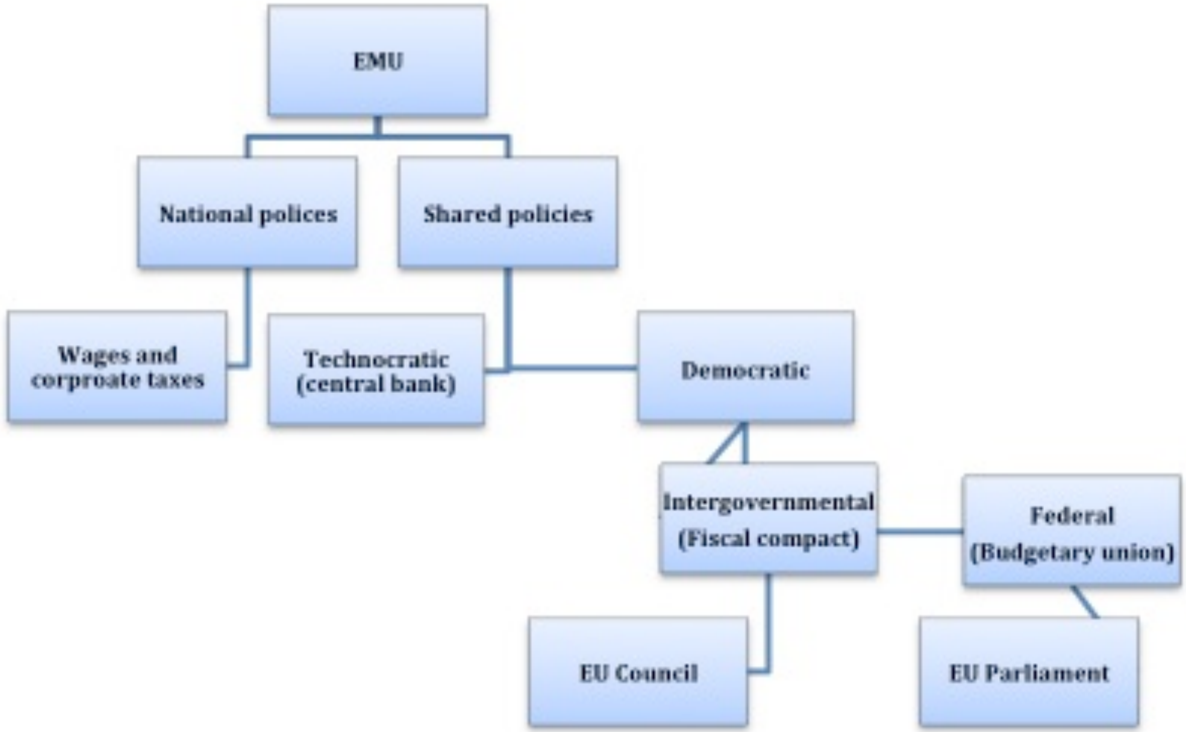
- Fiscal adjustments in the Euro periphery have been shaped by both international constraints (EMU) and domestic politics. But the near convergence on the policy of 'austerity' is a puzzle.

- At the European level the policy response is negotiated through the EU Council.

- The response has not been to build common fiscal institutions as a complement to monetary union. The response is to impose stricter fiscal rules on each member-state.

- Democratic choices have been constrained in favor of maintaining the nation-state and preserving the single currency.

The Euro trilemma



The Euro trilemma

- The first choice facing national governments in the context of increased European integration is between prioritizing *nat*ional policies or *shared* polices.

- Where policies are *nationally* determined (as is the case for wages, social welfare, pensions, and taxation) there is the risk that one nation-state can impose a cost another nation-state.

- Alternatively policies can be jointly coordinated between member-states. Policies are '*Europeanized*' (as is the case in agriculture and monetary policy).

Legitimacy

- If we accept more European integration is necessary to preserve the currency then member-states face the dilemma as to how to legitimize their economic decisions.

- Economic policies can be delegated to non-political technocratic institutions such as the central bank and the EU Commission.

- If this leads to welfare enhancing outcomes (stronger growth and employment) then such decision-making can legitimized on the basis of 'outputs'.

- Alternatively, economic decision-making can be delegated to democratically elected representatives who are accountable to their national electorates.

- In some cases, it makes economic sense to delegate decision-making to technocratic institutions with non-negotiable rules. For example, banking regulations in the Euro area.

Democracy

- But the electorate in most national jurisdictions want to hold their national executives to account for decisions (and shared policies) taken at the European level i.e. input legitimacy.
- Member-states (and electorates) then face a choice whether economic policy and political decision-making should be determined by intergovernmental means or federal procedures.
- If the intergovernmental process prevails, then the EU Council gets priority. This means decisions will be shaped by the bargained interests of national executives in the Council.
- If the federal process prevails, then the EU parliament (or the creation of a Euro budgetary parliament) would determine economic policies, as suggested by the Lisbon treaty.
- Presently the Euro area is stuck somewhere between these two modes of governance. Decisions are taken in the Eurogroup, which has no formal legislative legitimacy.

Conclusion

- European integration is legitimated and accountable to public opinion through national executives (via the EU Council), which tends to give priority to the interests of larger member-states.

- The implication is that national policy discourses (Germany versus Greece) rather than European wide policy discourses tend to prevail.

- Ask yourself is decision-making in the European council, the Euro group and Eurozone summits sufficient to legitimate the present trajectory of European economic integration?

- Thomas Piketty suggests that this is not sustainable and has called for a new European manifesto that includes a Eurozone budgetary parliament. Do you agree?