



The Political Endgame for the Euro-Crisis

Charles Goodhart, LSE and Dirk Schoenmaker, Duisenberg school of finance

Summary

Any complete solution to the euro crisis needs to be political. A strong Euro Commissioner with budgetary and banking powers is wanted. This policy brief sketches the democratic setting for such a Euro Minister of Finance. A technocratic solution will not do; an elected president of the European Commission and a two chamber parliament representing EU citizens and EU member states is crucial. This policy brief also discusses the implications of the British veto for the Internal Market on Financial Services.

Introduction

The euro has a supranational monetary policy framework, while the fiscal side is still national/intergovernmental. We have a central bank president for the euro zone, but no finance minister. But if countries are going to cede sovereignty over some aspects of fiscal policy, can, or should, this be done to them without democratic legitimacy? We need to fix the political dimension, before we can finally solve the financial side of the sovereign and banking crisis. It is not sufficient to elevate the current Commissioner for Economic and Monetary Affairs to Finance Minister status. A full democratic setting, including an elected president of the European Commission, is necessary to complete political union.

Political legitimacy for the EC president is needed for two reasons:

1. To enforce budget discipline on participating members, to restrict the impact of fiscal spending on the wider euro-zone; and
2. To oversee euro-zone banking supervision and resolution, to foster the stability of the euro-zone banking system.

Political union

The Treaty of Lisbon has created a Union of democratic states. The European Union itself also forms a democracy, albeit an incomplete one with the European Parliament as its main democratic element. The question is how the EU democracy can be further advanced with an elected Executive.

The political framework starts with a much-needed Euro Minister of Finance, as suggested by Trichet (2011). There have been suggestions about the powers of such a newly elevated Euro Commissioner (e.g. Marzinotto, Sapir and Woff, 2011). But a strong, technocratic, finance

minister is not sufficient by itself. Proper mechanisms for election and accountability are needed to have the Euro Finance Minister work in a democratic setting.

National experience shows that the success of any finance minister crucially depends on strong support from the Prime Minister (and vice versa). Thinking about a democratic political union therefore starts with a President of the European Commission, elected by the citizens of the European Union (Goodhart, 2011). Angela Merkel has now made preparations for such a political endgame. At the recent Parteitag, the CDU (2011) endorsed a resolution proposing an elected President of the European Commission. The European Commission President can then after election form a team, including his or her Commissioner for Economic and Monetary Affairs. The Commissioners will need to be approved in hearings by the European Parliament.

The CDU resolution also suggests reforms to the parliamentary side of political union. It proposes a two chamber system. The current European Parliament would continue to be chosen by European citizens, and form the equivalent of the Bundestag, House of Commons, Tweede Kamer or House of Representatives in the respective national countries. But a new chamber comprising the Council of Ministers would be created and form the equivalent of the Bundesrat, House of Lords, Eerste Kamer or Senate. The central idea of such a two chamber system is that the political discussion would be initially held in the main chamber representing the full electorate, and that a separate "chambre de réflexion" would then represent the interests of the separate member countries.

Powers of the European Minister of Finance

The idea of a European minister of finance has its *raison d'être* in the need for enforcement of the Stability and Growth Pact (Trichet, 2011). The intergovernmental approach has clearly failed, as EcoFin ministers followed the principle of non-intervention: ministers would not interfere with each other on the understanding that each of them would not be touched when they ran into problems. The Euro Commissioner would have full supranational powers to impose sanctions if a country transgresses the fiscal deficit rules. Nevertheless the concept of sanctions needs much further thought. Imposing pecuniary fines on a country already in fiscal difficulties does not make much sense. An alternative is to give the Euro Commissioner supranational powers to block budgetary expenditures, or to require prior approval by the Euro Commissioner of expenditures by transgressing countries.

The Euro Commissioner would thus be the counterpart for the ECB president. In any country, the Minister of Finance and the Central Bank President are *de facto* choosing the appropriate monetary-fiscal policy mix. When the central bank is operating on an independent basis, the appropriate mix can emerge tacitly.

A second power is in the area of European banking. The Internal Market legislation enables banking on a European scale, while supervision and resolution is primarily done at national level with some loose coordination. The home country principle of the Internal Market does not suffice for the current large cross-border banks in Europe. During the 2008-2009 financial crisis, it was clear that all authorities (both home and host) followed a national rather than a European agenda. To get out of the current setting dominated by national interests, banking supervision and resolution should be put on a European footing (Schoenmaker, 2011; Veron, 2011). While the chairs of the European banking and resolution authorities can be accountable to the European Parliament, these chairs need a political counterpart in the setting of banking policies and overall accountability. Moreover, the European minister of finance needs to decide, if needed, on tax-payer's money for bank resolution.

Two speed Europe

The Euro Minister of Finance will need its budgetary oversight powers only for the euro-zone members. It is therefore likely to start overseeing euro-zone banking supervision. But the ultimate goal should be to operate at the EU level since the Internal Market for Banking

operates EU-wide. The statement by the Euro Area Heads of State or Government at 9 December 2011 provides for a variable geometry (European Council, 2011). The new legal framework will encompass the 17 euro-zone members and up to 9 non euro-zone members. The UK Prime Minister has exercised its veto and decided not to join.

Nevertheless, financial services policy is as important for the UK (with the City as the premier financial centre for Europe and beyond) as agricultural policy for France. France has informal leadership on agricultural policy. It is difficult to outvote France on agricultural matters. Such a political arrangement could only work for financial services, if the UK would be prepared to play the collaborative game (and not to demand unanimity in particular financial services domains as it did at the December Summit).

The aim of our proposal is to keep the Internal Market on Financial Services. The financial system can then continue to support the real economy in an efficient way and thus foster economic growth. By contrast, an *Alleingang* of the euro-area in financial services would force a split in the EU's financial system. This may end up in an internationally competitive financial centre outside the "European" framework and a more traditional financial system inside the "European" framework. This is clearly a lose-lose situation: London may lose some business from its European neighbours, while the remaining European countries face a less dynamic financial system.

Fiscal and legal imbedding

A minister of finance without money is like an emperor without clothes. There are proposals to have tax capacity capable of funding a budget of about 2% of European GDP (Marzinotto et al, 2011; Goodhart, 2011). While this 2% budget could cover most eventualities, including effective stabilisation policies, there may be exceptional circumstances, e.g. relating to banking resolution where more is needed (the deep pockets of government). Examples are the fiscal backstop to a new European Deposit Insurance Corporation (EDIC) and the resolution of one or more large cross-border banks. In that case, the European minister of finance should be able to share the burden amongst participating members based on an *ex ante* burden sharing arrangement (Goodhart and Schoenmaker, 2009).

In addition to fiscal powers, a minister of finance would need appropriate legal powers. The coordination of budget policies is based on Article 5 of the TFEU (Treaty on the Functioning of the European Union) and the rules governing the Excessive Deficit Procedure on Article 126 of the TFEU. After the decision at the December Summit to adopt a variable geometry (European Council, 2011), the new legal framework will start outside the EU treaties. This is similar to the Schengen Arrangement (creating Europe's borderless Schengen Area), which is a treaty signed in 1985 between five of the ten member states of the European Community. The Schengen Agreements and the rules adopted under them were, for the EU members of the Agreement, entirely separate from the EU structures until the 1997 Amsterdam Treaty, which incorporated them into the mainstream of EU law. The Council and the Commission are invited to prepare the new legal framework by March 2012.

The new banking supervision and resolution powers could be introduced by Regulations (Schoenmaker, 2011). The new European System of Financial Supervision allows specific powers to be transferred to the European Supervisory Authorities (ESAs). The European Securities and Markets Authority (ESMA) has, for example, received the power to supervise directly credit rating agencies. Similarly, banking directives and regulations could transfer the supervision of large cross-border banks from the national banking authorities to the EBA. In addition, a new European Resolution Authority could be established by a regulation. Finally, a special resolution regime laid down in a EU regulation would ensure application to the European-wide operations of a bank. Such a Regulation would provide a European mandate and override national legislation. This European mandate is crucial to overcome national interests. The Maastricht Treaty assigns, for example, the ECB with the task of monitoring price

stability of the euro area (instead of the inflation in the participating members). This ensures that both the ECB president (and executive directors) and the national central bank governors focus on euro area inflation.

Conclusions

Any complete solution to the euro crisis needs to be political. A strong Euro Commissioner with budgetary and banking powers is wanted. This column sketches the democratic setting for such a Euro Minister of Finance. A technocratic solution will not do; an elected president of the European Commission and a two chamber parliament representing EU citizens and EU member states is crucial.

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