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European Monetary Union: Restriction or Loss of Monetary Sovereignty

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I. Regional Integration and (Monetary) Sovereignty

Regional integration through a supranational organization like the European Union entails the granting of competences to the supranational organization and its institutions. With respect to Germany's membership in the European Union the German constitution (Basic Law/GG) speaks of a "transfer of sovereign powers." As a consequence of such transfers of sovereign powers to the European Union, the member state governments either lose their competence in the respective policy field entirely (if the organization has been granted an exclusive competence) or they have to share its exercise with the organization's institutions. According to Art. 3:1 (c) of the Treaty on the Functioning of the European Union (TFEU) monetary policy falls within the exclusive competence of the European Union for the member states whose currency is the euro. In the terminology of the German constitution: member states have transferred their sovereign powers with respect to monetary policy to the European Union.

It does not seem farfetched to conclude that as a consequence they have given up monetary sovereignty entirely. There exists a different view, however, which interprets the transfer of monetary powers to the EU not as giving up monetary sovereignty, but rather as its effective exercise.[1] This interpretation is based on the argument that monetary union allows members of the euro area to "*secure a maximum of monetary and financial stability under the evolving constraints of an ever more independent global economy*."[2] This argument is reminiscent of longstanding discussions on the democratic deficit or legitimation of the exercise of authority by EU institutions. Here it is a frequent argument that a loss of democratic legitimation at the EU level is outweighed by a greater effectiveness of EU governance as compared to national government.[3]

In this paper I intend to raise a number of questions concerning the relationship between monetary integration in the EU and monetary sovereignty. I will attempt to inquire what exactly is being lost when the competence of monetary policy is being transferred to the European Union, whether it is even useful to conceptualize monetary integration as a transfer of sovereign powers and which consequences arise from the strict separation of monetary policy from "other" economic policy, including fiscal policy, a separation which appears as a foundational norm of European Economic and Monetary Union.

II. What is Lost With the "Transfer of Sovereign Powers"

The Maastricht Treaty which entered into force in 1993 paved the way for European Economic and Monetary Union.[4] It provided for a number of different stages through which, *inter alia*, the internal market was to be completed, a European System of Central Bank was to be created and member states were to meet a number of economic convergence criteria concerning inflation, interest rates, budget deficits and sovereign debt. The process was to culminate in the issuance of a single currency to be managed by the European System of Central Banks.[5]

The distinction between "monetary policy" and "economic policy" is a defining feature of European Economic and Monetary Union and from its inception has been a point of contention. The distinction

[1] C. D. Zimmermann, A Contemporary Concept of Monetary Sovereignty, 2013.

[2] *Ibid*., p. 144.

[3] See only F. Scharpf, Governing in Europe: Effective and Democratic?, 1999.

[4] It should be noted that while the treaties postulate that "[t]he Union shall establish an economic and monetary union" (today: Art. 3:4 Treaty on European Union (TEU)) it would be more correct to just speak of monetary union as member states have not fully transferred their economic policy powers to the European Union.

[5] On the history of the monetary union: B. Eichengreen, Globalizing Capital, 2008, ch. 5; on the constitutional framework: K. Tuori/K. Tuori, The Eurozone Crisis. A Constitutional Analysis, 2014, pp. 1-60.

currently is reflected in Title VIII of the TFEU "Economic and Monetary Policy". As was indicated above, those member states which have completed the final stage of monetary integration and form part of the euroarea have transferred their monetary policy powers to the European Union. Monetary policy for these states is the exclusive competence of the European Union, to be exercised by the European System of Central Banks (ECSB). The ECSB consists of the European Central Bank (ECB) and the national central banks (Art. 282:1 TFEU). The European System of Central Banks itself does not have legal personalities or any organs; it is governed by the decision-making bodies of the ECB (Art. 8 Statute of the ESCB and the ECB) with the central banks of the euroarea states acting as the ECB's operating arms (Art. 12.1, 14.3 Statute). Art. 127:2 TFEU lists the basic tasks of the ESCB which are: to define and implement the monetary policy of the Union, to conduct foreign-exchange operations, to hold and manage the official foreign reserves of the Member States and to promote the smooth operation of the payments system. In exercising these tasks the ECB and the national central banks must as their primary objective pursue the maintenance of price stability (Art. 127:1 TFEU). A number of provisions seek to secure the independence of the ECB and national central banks: according to Art. 130 TFEU they shall not seek or take instructions from EU institutions or Member State governments; Art. 282:3 obliges the ECB to independently exercise its powers and manage its finances (Art 282:3 TFEU).
While the member states whose currency is the euro do not retain any powers in monetary matters, the EU competences in the realm of economic policy are more limited: Members shall regard their economic policies as a matter of common concern and shall coordinate them within the Council (Art 121:1 TFEU). Furthermore EU law intends to impose fiscal discipline on member states, in particular through the so called Stability and Growth Pact which obliges member states to avoid excessive deficits (Art. 126 TFEU)[6] and provides for procedures for the enforcement of this obligation, the prohibition of monetary financing (Art. 123 TFEU) and the so-called no-bailout clause which prohibits the European Union or member states from assuming commitments of governments or other public authorities (Art. 125 TFEU).
Two main critiques have been voiced against this "design" of Economic and Monetary Union; the first holds that monetary union violates the principle of democracy. Not only has monetary policy been removed from the power of national governments entirely, but monetary policy in the European Union is conducted by a democratically unaccountable body – the European Central Bank. The second critique argues that monetary union deprives EU member states of important policy instruments to address economic imbalances or asymmetric shocks which are likely to persist as monetary union has not been complemented with an economic or political union. While these are important and persistent critiques they appear to accept a predominant set of monetary institutions as well as the distinction between monetary and economic policies which is fundamental for the construction of monetary union in the EU. They thus conceal a more radical critique which questions the predominant legal framework for monetary policy and public finance. Consequently, when asked what is lost with the transfer of monetary policy powers to the European Union we may need to depart from the way critique is currently framed in terms of democratic self-government and functionally in terms of effective economic governance. This will require us to rethink the relationship between money, public finance and democracy.

1. Critique I: Loss of Capacity for Democratic Self-Government

When the constitutionality of the Maastricht Treaty was challenged before the Federal Constitutional Court of Germany, the Court had to address the question whether the transfer of powers to issue a common currency and conduct monetary policy to an independent European Central Bank violated the principle of democracy of the German constitution. The Court formulated the challenge posed by European Monetary Union to democratic self-government as follows:

[6] The reference values are 3% of GDB for government budget deficits and 60% of GDP for government debt.

> *"A substantial political sphere which supports individual liberty by maintaining the value of the currency, and influences public finances and those areas of politics dependent on them by controlling the money supply, has been withdrawn from the authority of the holders of sovereign rights and (without an amendment of the Treaty) from legislative control over functions and procedures."*[7]

This statement is as vague as it is influenced by the German 'style' of Bundesbank monetary policy. It assumes that the primary objective of monetary policy is monetary stability ('maintaining the value of the currency') and that the way to achieve this objective is by controlling the money supply. Given this particular conception of the affected 'political sphere' then provides the springboard for the Court to rebut the challenge that the principle of democracy is unduly impaired. Transferring competence to an independent European Central Bank which is to give priority to monetary stability was justified according to the Court:

> *"because it takes account of the special factor, established in the German system and also <u>scientifically proven</u>, that an independent central bank is more likely to protect monetary value, and therefore the general economic basis for national budget policy and private planning and disposition, while maintaining economic liberty than are sovereign governmental institutions."*[8]

The argument can be restated as follows: Mandating a central bank which is insulated from parliamentary politics with the conduct of monetary policy to be aimed at monetary stability, rather than encroaching upon democratic self-government in fact protects the very bases of democracy – individual liberty as well as material security. It may be observed that this argumentation must be read and understood in the particular German constitutional context. Yet, three things should be noted here which may indicate the significance of this treatment of the 'democracy critique' beyond the particular context of German constitutional law. First, independence of the Bundesbank had not previous to European Monetary Union been a constitutional principle in Germany, but was enshrined in simple parliamentary legislation.[9] Thus while the Bundesbank acted as a largely independent expert body, this practice could have been changed. By contrast, the European Central Bank's independence from the other EU institutions is enshrined in the treaties which rank above member states' constitutions and can only be changed by following the amendment procedure. Insulation from the EU's political organs is greater than the Bundesbank's insulation from government ever was.[10]

Second, the Federal Constitutional Court presented its conclusion as a matter of scientific truth – only through independence may monetary stability be safeguarded and without monetary stability democracy will be endangered. The court thus itself decontextualizes the issue of how monetary policy should be conducted, something we observe in many discussions not only among economists, but also lawyers discussing monetary policy. Indeed we may notice adherence to what Roberto Unger termed the thesis of convergence: A particular set of political and economic institutions is presented as the only one capable of reconciling economic prosperity with political freedom and social security, thus foreclosing any imagination of institutional alternatives.[11]

Third, while the Court stresses the importance of a stable currency for democratic politics it nowhere in its judgment recognizes the particular dangers which the predominant model of monetary institutions poses for democracy and which are potentially exacerbated in the context of Monetary Union with the unprecedented 'independence' it attributes to the ESCB. These dangers are explained

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[7] Decision of the German Federal Constitutional Court of October 12, 1993, in Re Maastricht, available at: http://www.judicialstudies.unr.edu/JS_Summer09/JSP_Week_1/German%20ConstCourt%20Maastricht.pdf, p. 30.

[8] *Ibid*., p. 31 (emphasis added).

[9] The Bundesbankgesetz.

[10] C. Zioli/M. Selmayr, The Law of the European Central Bank, 2001, pp. 32-35.

[11] R. M. Unger, What Should Legal Analysis Become, 1996, p. 8.

by the interrelation of public finance and monetary policy. Whereas the Court points to one dimension of this relationship – that public just as private finance benefits from monetary policy that ensures stability – it does not acknowledge another, namely that according to the predominant model monetary power may not constitute a source of public finance. States cannot may not 'print money' if tax revenue or revenue from levies do not suffice to cover public expenditures nor may central banks extend credit to governments. Instead governments need to revert to the capital markets and private finance through the issuance of sovereign bonds. In accordance with this model the Treaty on the Functioning of the European Union attributes to the European Central Bank the exclusive right to authorize the issuance of euro currency and determines that only euro notes shall have the status of legal tender within the euro area (Art. 128 TFEU). Art. 123 TFEU, as was already noted, prohibits the ECB and national central banks to grant credit to or to purchase sovereign bonds directly from governments. If governments, however, depend on private credit – and given the difficulties to raise revenue through taxation due to international tax competition, tax evasion and tax avoidance increasingly so – they cannot only be held accountable by their citizens, but also by private creditors. This development then calls into questions fundamental conceptions of constitutional democracy. Under these conceptions public authority is derived from the citizens *inter alia* through elections and as it is the citizens who finance public spending through tax payments they also have an incentive to hold governments to account in periodic elections.[12] In reality, with governments increasingly indebted to private capital, citizens compete with these creditors to hold governments accountable. The competition is an unequal one and the latter -- given their economic power – are likely to be more successful in getting governments to cater to their (special) interests.[13] Finally, it should be noted in this context that sovereign bonds play a crucial role in today's banking systems as they provide banks with an investment at low risk that they can offer to the central banks as collateral to receive credit for further investments.[14] Thus, the privatization of public finance not only leads to an attenuation between the accountability links between citizenry and government, but also grants a special advantage to the finance industry.

2. Critique II: Loss of Policy Instruments to Address Economic Imbalances

The separation of monetary policy from economic policy is also at the heart of the second critique of monetary union voiced mainly by economists. Sceptics of the success of monetary integration in the EU such as Barry Eichengreen have long warned that giving up monetary autonomy would deprive member states of the European Union of important policy instruments in case of economic imbalances in the euroarea. Such economic imbalances or asymmetric shocks were likely to persist and could not be absorbed by full labour mobility, wage flexibility or fiscal transfers – the characteristics usually required for 'optimum currency areas' to exist but not in place in the European Union. Governments in the euroarea may no longer use monetary policy instruments – e.g. the lowering of interest rates to stimulate investment – in order to counter such economic shocks.[15]

The question whether it would be sustainable in the long run to allocate the power for monetary policy at the supranational level while member states remain largely responsible for economic policy was also put before the German Federal Constitutional Court in the Maastricht proceeding. The complainants voiced fears that monetary union would introduce economic union 'through the backdoor'. In response the Court acknowledged that

> *"[t]here may be justifiable grounds for suggesting that, in political terms, the monetary union may be implemented practically only if it is supplemented immediately by an economic union*

[12] Under German constitutional law public finance shall generally be generated through taxation; the Federal Constitutional Court speaks of the principle of the tax state (Prinzip des Steuerstaats), cf. BVerfGE 82, 159/178; 93, 319/342; 101, 141/147.

[13] W. Streeck, Gekaufte Zeit: Die vertagte Krise des Demokratischen Kapitalismus, 2013.

[14] T. Mayer, Die Neue Ordnung des Geldes. Warum wir eine Geldreform brauchen, 2014.

[15] B. Eichengreen, J. Frieden, the Political Economy of European Monetary Unification: An Analytical Introduction, 5 Economics and Politics (1993), 85.

> *which exceeds simple coordination of the economic policies of the Member States and the Community."*[16]

Moreover it referenced the Bundesbank Chairman's view that a monetary union among states with active economic and social policies could only be realized within a political union with all "essential functions of public finance".[17] Whilst registering the doubts with respect to the feasibility of monetary union without economic and political union the Court stated that to go ahead with monetary union alone was a political decision "for which the relevant governmental institutions must assume political responsibility".[18] Were monetary union to fail, the treaty would need to be amended either to reverse monetary union or to complement it with economic and political union.

What we are currently observing in the European Union seems to be proving the sceptics right. Instead of convergence of the economies of the euroarea members we see increasing disparities between center and periphery. Yet, the assumption of political responsibility by either reversing monetary union or complementing it with economic and political union is not in sight. Rather the solution is sought in increased fiscal discipline. Moreover, and possibly even more worrying from the perspective of democratic governance (as due to intransparency even further removed from public contestation), is the fact that the ECB is placed in the position of acting as "policy-maker of last resort".[19] Thus while the separation between monetary and economic policy is formally maintained the ECB is pursuing with so-called 'unconventional monetary policy instruments' economic policy goals beyond (and potentially in conflict with) its primary objective of price stability.

3. Critique III: Loss of Institutional Imagination

Both critiques discussed above appear to coincide in the view that there exist distinct realms of economic policy on the one hand and monetary policy on the other hand. This view corresponds to the image employed by the German constitution that the sovereign has a number of powers at her disposal which she can keep for herself or transfer (within the limits of constitutional law) to a supranational organization. Euroarea members have accordingly transferred all powers of monetary policy to the EU and have kept some of their powers with respect to economic, including fiscal, policies. Within the EU then the distinction between monetary policy and economic policy is kept up as a matter of law and institutions. Monetary policy is clearly separated from economic policy, it is attributed its own objective -- price stability -- the pursuit of which is being entrusted to experts insulated from democratic politics.

While the separation is firmly enshrined in EU law, it appears – as was indicated above -- in the course of the Eurocrisis to be collapsing in practice, one effect of this collapse being that the realm of monetary policy is expanding, the ECB adopting 'unconventional instruments' such as the announcement of an Outright Monetary Transactions (OMT) Programme on 6 September 2012. This development, however, does not appear to result in a rethinking of the given set of institutions for economic and monetary policy. Rather there are two main reactions: On the one hand the ECB's actions are challenged as violating the law and monetary orthodoxy – the most vocal proponents being German economists;[20] a return to 'conventional' monetary policy is demanded even if this may have disastrous consequences for euroarea members subject to speculative attacks such as Greece. On the other hand ECB policies are held to fall squarely within the ECB mandate, a conclusion that is being reached by granting great deference to the superior expert knowledge of the ECB whose experts alone know what policy measures are needed to achieve the objective of price stability. This

[16] *Supra* note 7, p. 29.
[17] *Ibid*., p. 30.
[18] *Ibid.*
[19] B. Eichengreen, European Monetary Integration with Benefit of Hindsight, 50 Journal of Common Market Studies (2012), p. 123, at 131.
[20] http://www.faz.net/aktuell/wirtschaft/eurokrise/neuer-appell-deutsche-oekonomen-werfen-der-ezb-staatsfinanzierung-vor-12569316.html.

view can be illustrated with reference to the opinion of Advocate General Cruz Villalòn in the ongoing preliminary reference proceeding before the Court of Justice of the European Union concerning OMT.

In his opinion Cruz Villalòn stresses the expert knowledge of the ECB which sets it apart from other institutions:

> *"In fact, the Treaties confer on the ECB sole responsibility for framing and implementing monetary policy, for which purpose it is given substantial resources with which to undertake its functions. On account of those resources the ECB also has access to knowledge and particularly valuable information, which permits it to perform its tasks more effectively whilst also, over time, bolstering its technical expertise and reputation. Those features are essential for ensuring that monetary policy signals actually reach the economy since, as has previously been stated, one of the functions of central banks today is the management of expectations, and technical expertise, reputation and public communication are basic tools for carrying out that function."*[21]

It is due to its access to expert knowledge and information that the ECB can assess that 'unconventional monetary policy measures', such as the OMT programme, are needed to 'unblock' the unions monetary transmission channels. Reading the Advocate General's opinion it indeed appears that there is a secret science of 'unblocking transmission challenges' to which only ECB experts have access – in any case not the Advocate General:

The ECB defends the lawfulness of the OMT programme on the basis that it is a measure intended to 'unblock' the Union's monetary policy transmission channels. As has been explained above, those monetary policy transmission channels do not function as mechanisms producing immediate effect but as a framework through which the ECB sends out a series of 'impulses' or signals with a view to them reaching the real economy. According to the ECB, monetary policy may be affected by factors external to the transmission channels, factors which are liable to disrupt the proper functioning of the signals sent out by the ECB: an international political or economic crisis, or a significant change in oil prices, amongst other factors, may severely interfere with the 'impulses' that the ECB sends out via the monetary policy transmission channels.

When a situation of that kind occurs, the ECB considers it has competence to intervene using its own instruments with the aim of 'unblocking' those channels. In such a case the actions it takes are different from those which are part of the ECB's normal practice, since they can be said not to involve so much a 'standard' operation but rather an operation to 'unblock' and subsequently restore monetary policy instruments properly so-called. [22]

It is not my intention to mock the AG by quoting this lengthy passage. But I believe it shows how a creeping increase in powers of the democratically unaccountable European Central Bank is being justified by reference to its superior knowledge as concerns the secrets of monetary policy. In any case one may conclude that both sides – those who critique the ECB and those who defend it -- appear not to question either the fundamental separation of monetary and economic policies or the need to entrust monetary policy to an institution insulated from democratic politics. It may turn out that this lack of institutional imagination is the most severe loss caused (or at least promoted) by monetary integration in the EU.

[21] Opnion AG Cruz Villalòn, C-62/14, para. 110.
[22] Paras 115, 116.

III. Research Questions for the Project on Monetary Sovereignty

It therefore should be the aim of the project on monetary sovereignty to engage in institutional (re-)imagination. A valuable starting point for rethinking the relationship between money, democracy and economic and fiscal policy appear to me the works of proponents of the Modern Money Theory which build on the state theory of money. They remind us that the distinction between fiscal and monetary policy is not a question of economic necessity. Rather monetary policy could be considered fiscal policy if the state uses the creation of money to finance public Investment.[23] If we look at monetary sovereignty this way – as a source of public credit – then we see that what states are giving up through monetary integration in the EU is more than the ability to set their own interest rates and to use interest rate policy to address economic shocks. Rather they divest themselves of the possibility to exercise monetary sovereignty to activate idle productive capacities, for example through the institution of a public job guarantee.[24] In further research I would like to identify past national and local experiments in exercising monetary sovereignty in this respect. I am particularly interested in institutional linkages between the issuance of currency and the protection and use of scarce natural resources.[25]

[23] L. R. Wray, From the State Theory of Money to Modern Money Theory: An Alternative to Economic Orthodoxy, Levy Economics Institute Working Paper No. 792, March 2014.
[24] Bill Mitchell.
[25] Cf. R. Douthwaite, Degrowth and the Supply of Money in an Energy-scarce World, 84 Ecological Economics (2012), 187.