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EMU: the constitutional implications

This paper examines the constitutional implications (and thus to some extent also the political implications) for the UK of a decision to participate in the planned Economic and Monetary Union. It therefore complements Research Papers 97/94, 97/124, 98/35 and 98/39 which deal with the historical background to EMU, the economic arguments, the convergence issue and the state of opinion in other EU states. The issues were most recently debated in the House of Commons on 21 July 1998 (on a Liberal Democrat opposition day motion).

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Summary of main points

Eleven Member States of the European Union (all but the UK, Denmark, Sweden and Greece) are due to lock their currencies together irrevocably from 1 January 1999. New "Euro" banknotes and coins are due to be introduced in 2001 to replace national banknotes and coins. The Euro will be managed by a European Central Bank (ECB) at the centre of a network of national central banks.

Most of the Member States committed themselves to this decision when they ratified the Maastricht Treaty during 1992-3. The UK and Denmark negotiated special terms under the Treaty which allowed them to postpone the decision whether or not to join the single currency; Sweden, a more recent entrant to the EU, has also decided, in effect, to opt out for the time being; Greece was keen to join, but has not yet satisfied the agreed economic criteria.

The policy of the British government is to prepare to join the new European Monetary Union (EMU), subject to five economic tests announced in October 1997, with a view to making a decision early in the next parliament. It sees no constitutional bar to such a move, but is committed to making the decision the subject of a referendum. The position of the Liberal Democrat party is similar, except that it would prefer to hold the referendum, and make a decision to join, earlier. The position of the Conservative Party, as the official opposition, is that it would oppose a decision to join EMU on both economic and political/constitutional grounds in this parliament, or the next, but a decision to join after that is not ruled out.

The political and constitutional dimension of the single currency decision has proved just as controversial as the economic because:

- control of money has long been closely associated with national sovereignty, but sovereignty over monetary policy is in practice quite limited
- some are sceptical about the new forms of shared sovereignty operating in the EU
- EMU is based on monetary policy being determined by an independent ECB, but the UK has already gone down the same route, without waiting to join EMU
- independent central banks inevitably raise questions about democratic accountability
- there is disagreement as to whether the planned accountability of the ECB is sufficient
- democracy and political accountability at the EU level may either develop rapidly or prove fatally weak compared to the strength of national politics
- EMU may lead inevitably to fiscal union, and then full political union or it could founder on the reluctance of the Member States to go further towards federalism
- the political and economic dimensions of EMU are ultimately inseparable
- there is a significant element of uncertainty - EMU is intended to be successful and permanent, but could prove to be neither - predictions are largely declarations of faith
- EMU implies a major change in the political culture of the Member States, which not all may be ready to make

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I Introduction

> There is no doubt that the desire to achieve a more stable monetary environment through the removal of political powers over central banks raises serious constitutional difficulties, in the United Kingdom as elsewhere. Nor do the difficulties disappear when the problems are transposed to the European level…[1]

It has been accepted on all sides that there is a constitutional as well as an economic dimension to the debate about a possible UK decision to join the third stage of Economic and Monetary Union (EMU) and therefore adopt the Euro as the principle currency used in the UK.

When the Chancellor of the Exchequer announced the Government's policy to the House of Commons on 27 October 1997 he stated explicitly that this was the case:

> …it must be clearly recognised that to share a common monetary policy with other states represents a major pooling of economic sovereignty.
>
> There are those who argue that this should be a constitutional bar to British participation in a single currency, regardless of the economic benefits that it could bring to the people of this country. In other words, they would rule out a single currency in principle, even if it were in the best economic interests of the country. This is an understandable objection, and one argued from principle, but in our view it is wrong. If a single currency would be good for British jobs, British business and future prosperity, it is right in principle to join. The constitutional issue is a factor in the decision, but it is not an overriding one. Rather, it signifies that, in order for monetary union to be right for Britain, the economic benefit should be clear and unambiguous.[2]

The Shadow Chancellor, Peter Lilley, took a different view:

> The greatest weakness of the tests that the Chancellor has laid down is the absence of any political or constitutional test. He cannot wipe aside - as he tried to do in his preamble - the constitutional issue as if this matter merely concerned monetary policy. The key issue is whether entry into the single currency requires centralisation of taxation and of borrowing powers. Will there be the power at the centre to transfer resources from prosperous countries to those that are handicapped by joining the single currency? Does the right hon. Gentleman not recognise that, to most of our continental partners, this is not primarily, or to some extent even at all, an economic venture, but a political venture? Does he not recognise that, up to now, there has never been a currency without a Government to run it, or a Government worthy of the name without a currency to

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1 Terence Daintith, "Between Domestic Democracy and an Alien Rule of Law? Some Thoughts on the "Independence" of the Bank of England", [1995] *Public Law* 132

2 HC Deb 27 October 1997 cc 583-4

> run? The attempt to establish a single currency in Europe without a Government to run it is intended by many to be temporary, not permanent. Why does not the right hon Gentleman tell us where the Government stand on that pre-eminent issue? Does he want to see, will he connive in, will he agree to, the centralisation of political power over tax, borrowing and the transfer of resources to other countries in the single currency area? Until he answers that question, we cannot accept that it is right to sign up in principle to a single currency.[3]

The Liberal Democrat spokesman, Malcolm Bruce, did not address the constitutional issue on this occasion, but made clear his party's strong support for early UK participation in EMU.[4] However, the Liberal Democrat leader, Paddy Ashdown, has more recently tied his support in principle for the Euro to the need for a new written constitution for the EU. In a speech to the Centre for European Reform on 16 July 1998 he said that the Euro would:

> create an immensely powerful economic institution, set within an immensely weak and shambolic political one… This will very quickly prove unsustainable. We will be forced by events, if we are not first forced by our own people, to strengthen our political institutions so as to contain and counter-balance it.[5]

Since the UK does not have an entrenched written constitution, if the UK were to join EMU there is no question of having to consider formal constitutional amendments, as Germany and France have had to do, but anything which permanently alters the organisation of decision-making is "constitutional" in effect. However, it is difficult to assess the constitutional implications of EMU because, first, it is not yet clear whether and to what extent monetary union will necessitate closer integration in other matters, going beyond the provisions of the Maastricht Treaty[6] and because, second, until the passage of the *Bank of England Act 1998*, which some have seen as paving the way for EMU, the UK monetary constitution rested largely on unwritten custom and practice.[7]

There is a further problem in that some of the key monetary issues, such as the prevailing base rate of interest and the rates of exchange between sterling and other currencies are now only to a limited extent decided or influenced by central authority. In a world of deregulated currency markets and global financial movements "constitutional" bodies of any kind, whether governments or central banks, have very limited influence. Furthermore, this influence, such as it is, can often be exercised most successfully by concerted international action and this, inherently, involves some dilution of sovereignty.

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3 HC Deb 27 October 1997 c 591

4 ibid, c 593

5 *The Guardian*, 17 July 1998, p 12

6 All the treaty provisions governing EMU are to be found in the Maastricht Treaty of 1992 (the Treaty on European Union and protocols – Cm 3151, pp 85-98 and 192-226). The Amsterdam Treaty of 1997 (not yet in force) left the EMU agreements unchanged.

7 Mervyn King, "The Bundesbank: a view from the Bank of England", *Bank of England Quarterly Bulletin*, 33 (2), p 273

One of the underlying reasons and possible justifications for EMU is the fact that in recent years it has become less and less possible to exercise national state power over monetary policy. This is not to say that the EU represents the only or the best possible grouping of states for this purpose: in recent years there have been regular initiatives to concert elements of monetary policy through the G7 group of major industrial and trading powers and there is also a school of thought which sees the UK as grouped more naturally with an “Atlantic” grouping.

Along with the deregulation of currency markets and the general globalisation of finance has come a marked trend in recent years towards the creation of central banks independent of governments, at least in respect of monetary policy. The thinking behind this trend is summarised in Library Research Paper 97/115 on the *Bank of England Bill*.[8] The House of Lords European Communities Committee commented in June 1998 that:

> The independence of the central bank and the primacy of the policy objective of price stability are foundation stones on which the practice of modern economic management rests.[9]

Broadly the argument is that central banks can be given a political and legal mandate to prioritise low inflation over all other goals, whereas governments have a range of political and economic goals, not all of which are necessarily consistent with permanently low inflation. As important as the actual behaviour of central banks and governments is their credibility in the eyes of the global market. The market will apparently believe that central bankers are unerringly committed to monetary stability, but is not equally trusting of politicians and will therefore demand a higher return on investments in what are perceived to be politically managed currencies.

The decisions about monetary decision-making announced immediately after the May 1997 general election and the subsequent passage of the *Bank of England Act 1998* have brought the UK more or less into line with the practice of those states which are planning to join EMU at the outset. However, as Gormley and de Haan point out, “many governments have become convinced that enhancing central bank independence is worthwhile, even if it were not necessary for monetary union”.[10]

For these reasons it is necessary to question whether the further changes to monetary decision-making which would be implied by a UK decision to join the single currency would indeed add up to a constitutional watershed and what the Europeanisation of UK monetary policy would mean for democratic accountability.

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8 pp 22-26

9 Select Committee on the European Communities, *The European Central Bank: Will it Work?*, 29 May 1998, HL 112 1997-98, para 101

10 Laurence Gormley & Jakob de Haan, “The democratic deficit of the European Central Bank”, *European Law Review*, April 1996, 21(2), p 96

II Are monetary powers fundamental to state sovereignty?

A. The arguments in favour

The power to control the minting of coins and printing of paper money has traditionally been closely associated with sovereignty. The most obvious symbol of this connection has been the representation of the sovereign's likeness on coins and notes. Hence the conclusion of many observers hostile to the EMU project that the Maastricht decision was both surprising and unprecedented. For example, Josef Joffe writes:

> …the twelve members of the European Union (now fifteen) gathered in early 1992 to pledge something which history has never recorded before. They would sign away several of the largest sovereign powers at the command of the modern nation-state. These are the power to mint money and the power to regulate its quantity as well as its price both at home (the interest rate) and abroad (the exchange rate).[11]

The French Constitutional Council ruled in 1992 that were stage three of EMU to come about "a State will be deprived of its own competences in an area in which the fundamental conditions for the exercise of national sovereignty are at issue".[12] However, constitutional amendments were subsequently made which allowed reciprocal transfers of sovereignty and therefore prevented the Court's initial ruling becoming a barrier to French ratification of the Maastricht Treaty. The original argument and the amendments reflect the fact that apparent surrenders of sovereign powers can sometimes be seen as acceptable sovereign acts, provided that they provide mutual benefit to co-operating states and are ultimately reversible.

Therefore, for some, it is the apparent irreversibility of EMU which provides the fundamental objection.[13] By contrast, under the Gold Standard as it operated in the late nineteenth and early twentieth century, and the Bretton Woods system in the post-war period, there were formal and informal pressures on states to keep within the rules, but states were free to opt in and out. The Treaty on European Union does indeed state that:

> At the starting date of the third stage, the Council shall, acting with the unanimity of the Member States without a derogation, (…), adopt the conversion rates at which their currencies shall be <u>irrevocably fixed</u> and at which <u>irrevocably fixed</u> rate the ECU shall be substituted for those currencies, and the ECU will become a currency in its own right.[14]

[11] Josef Joffe, "The Euro: the Engine that couldn't", *New York Review of Books*, 4 December 1997

[12] Jean-Pierre Duprat, "The independence of the Banque de France: constitutional and European aspects" *Public Law*, Spring 1995, p 136

[13] See, for example, Francis Maude's remarks in the debate of 21 July 1998, HC Deb c 993

[14] Article 109L (4), *Treaty on European Union*, Cm 3151, January 1996, p 98 (emphasis added)

Along with the irreversibility of EMU, the transfer of foreign reserve assets which form part of the ultimate guarantee of the currency to European Central Bank control in accordance with Article 30 of the ESCB/ECB Statute[15] is also seen by some as a gross violation of sovereignty:

> To give the proposed ECB unfettered powers to commit the assets of EU member states would be for the Governments of Europe to transfer their very sovereign power to it.[16]

B. The arguments against

The argument that monetary control is fundamental to sovereignty is necessarily false if it can be demonstrated that real control of key monetary levers such as exchange and interests rates is no longer available to most national governments (if it ever has been) but these governments are still regarded as possessing state sovereignty. For example, a recent study of "the new sovereignty" argues that,

> for all but a few self-isolated nations, sovereignty no longer consists in the freedom of states to act independently in their perceived self-interest, but in membership in reasonably good standing in the regimes that make up the substance of international life.[17]

It can also be argued that the powers surrendered are not worth having:

> Just what is it that countries are giving up by handing responsibility for monetary policy to the European Central Bank? The immediate answer is: sovereignty to inflate the economy and to devalue the currency. Presumably even eurosceptics favour neither.[18]

and that prudent economic management would in any case point to the monetary policy which EMU is designed to entrench:

> The thrust of the Government's policy is to achieve stability so that we can have long-term growth and low inflation. That will allow us to compete and converge with other European economies. Regardless of monetary union, the policies outlined by my right hon. Friend the Chancellor in his Budget, coupled with the [Bank of England] Bill, will be good for the country and good for business.[19]

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15 Protocol 3 of the *Treaty on European Union*, Cm 3151, January 1996, p 201

16 Howard Flight MP, "Anglo-Saxon Incompatibility", *European Journal*, February 1998, p 6

17 A Chayes & AH Chayes, *The new sovereignty: compliance with international regulatory regimes*, 1996, p 27

18 John Peet, "EMU: an awfully big adventure", *The Economist*, 11 April 1998, survey page 21

19 Alistair Darling, Chief Secretary to the Treasury, in the second reading debate on the *Bank of England Bill*, HC Debates, 11 November 1997, c 713

Even the argument that EMU is constitutionally unacceptable because irreversible is not universally upheld. Of course it is the intention behind the Maastricht Treaty that EMU should be seen as a one-way street. To have suggested otherwise could fatally undermine market confidence in the decision to lock and then unify currencies. However, treaties can be amended or set aside if the political or economic costs of implementing them become unacceptable. The EU treaties cannot be amended unilaterally and the process of amendment by mutual agreement can be long and uncertain, but if a deep crisis affecting one or several participants were to make EMU impossible to maintain in its planned form and composition, it would be in the interests of all the participants to find a political solution, which sooner or later would be legitimised by changing the treaty structure. M Pani• writes that the changes which would take place with the first phase of the third stage (ie 1999-2002),

> cannot prevent a state that regards the cost of this arrangement to be unacceptably high from leaving EMU. In that sense the first phase of Stage 3 is not much different from the classical gold standard or the Bretton Woods system.

He goes on to argue that:

> even the second phase of Stage 3 [the introduction of the Euro] will not alter this position radically. The introduction of a single currency to be managed by a single central bank is bound to remove what little vestige of national autonomy is left in monetary policy. But on its own it will not affect national sovereignty, and thus the ability of a country to leave the European Union. The second phase will, of course, significantly increase the cost of doing so compared with the cost of a similar action under the first phase.[20]

C. Has the EU transformed old arguments about sovereignty?

It is often claimed that the post-war European treaties on cooperation and integration have transformed old concepts of state sovereignty beyond recognition. The point is usually made in relation to the successive treaties which have led from the 6-nation European Coal and Steel Community in 1952 to the present 15-nation European Union. However, the analysis of how European cooperation has evolved must also take account of NATO and the Council of Europe (in the field of human rights) which have also impinged significantly on older British approaches to national sovereignty. Does this mean that the language of sovereignty is no longer applicable?

It is certainly true that the EU has unique and unprecedented characteristics as a method of organising relations between states. This is particularly true of its judicial system and legislative processes. If national sovereignty means that a state has an absolute right to accept or not accept a particular law, decision or obligation, then national sovereignty

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[20] M Pani• , "Monetary sovereignty under different systems", in Ian Davidson & Christopher Taylor (eds), *European Monetary Union: the Kingsdown Enquiry*, 1996, 205

now applies only in a limited number of cases where the treaty still provides for unanimity as the decision-making rule. However, in other areas, where qualified majority voting (QMV) applies and is combined in varying degrees with roles for the Commission and European Parliament, sovereignty is not so much abolished as quantified or rationed. Thus, a very small state such as Luxembourg has the degree of its sovereign influence in the Council of Ministers fixed at 2 votes out of 87, whereas large states such as Germany and the UK have theirs calibrated at 10 votes out of 87.[21] In the European Parliament the formula for distributing seats is different again: Luxembourg currently has 6, the UK 87 and Germany 99. In the Commission, which is not supposed to operate on the basis of nationality, the larger states each nominate two members, the smaller just one, but the single representative of Luxembourg is currently President of the Commission. With this diffuse but precise distribution of power both small and large states can sometimes find that their influence over decisions is more tangible than it would be under a less ordered system of negotiation.

In the case of EMU, broad guidelines on economic policy will continue to be agreed by QMV in the Economic and Finance Council ("ECOFIN"), consisting of the finance ministers of the Member States, although some decisions will have already been discussed, and agreed, informally in the Euro-X committee of the Euro area finance ministers.[22] Some specific decisions, for example concerning the relationship between the Euro and non-Community currencies, will be taken by unanimity in ECOFIN.[23] The decision-making process in the European Central Bank, which will manage monetary policy within the Euro area, will be different. Here each member state participating in EMU will be represented on the Governing Council by the governor of its national central bank alongside six officials (the president, vice-president and four other Executive Board members) appointed by common accord by the European Council and decisions will be taken by simple majority. In theory this mechanism gives each participating state an equal voice and none has a veto, but in practice the voting may seem to be weighted in favour of those states which supply the members of the Executive Board.

In short, the decision-making mechanisms for EMU are designed to bring about a "pooling" or "sharing" of sovereignty at the inter-governmental and inter-central bank level, rather than a transfer of sovereignty to a separately constituted "European government". To this extent EMU can be seen as a further stage of experimentation with cooperative systems. Whether it will actually be seen in that light will depend to a large extent on whether in practice the outcomes are acceptable to the whole range of participating governments and whether in practice the European Central Bank is seen to be democratically accountable if not in a day-to-day sense, then at least in the medium term.

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21 The idea of weighted voting is not in itself unique to the European Union – it is found in a number of international organisations, including the International Monetary Fund.

22 HC Debates, 1 June 1998, cc 88-89w

23 Article 109(1), *Treaty on European Union*, Cm 3151, January 1996, p 90

III The problem of accountability

A. Definitions

What is meant by accountability, and does it necessarily have to be "democratic" accountability? What is the ultimate purpose and what happens when institutions or individuals are "held to account" and found wanting?

The Treasury Select Committee, in a recent report on the *Accountability of the Bank of England*, admitted that:

> Accountability is an elusive concept and trying to find an accurate and comprehensive definition is correspondingly difficult.[24]

The Committee went on to consider alternatives to the traditional British concept of ministerial accountability to Parliament, noting the existence of other forms of accountability: financial, managerial, operational, legal, professional etc. The context of the Committee's report was the new Government's decision to transfer direct responsibility for the setting of interest rates from the Chancellor of the Exchequer to the Monetary Policy Committee of the Bank of England.

While the Chancellor of the Exchequer must face questions and respond to criticisms in the House of Commons, could forfeit his position if he or she were found to have lost the confidence of the House of Commons, and could ultimately be removed from Parliament altogether by a dissatisfied electorate, the Monetary Policy Committee is relatively much less exposed to democratic pressure and punishment. Its ordinary members are appointed for terms of up to three years in the first instance by the Chancellor (four members) or by the Governor of the Bank of England (two members). While the Treasury Committee, on its own initiative, has decided to hold "confirmation hearings",[25] the Government resisted the idea that these should acquire a formal status under the Bank of England Act.[26]

The thinking behind the change was precisely that decisions about interest rates should be made independently of the political process, but this principle necessarily makes political accountability in the traditional sense impossible. A critic, noting that the Bank of England Act broadly followed the doctrine which would also apply in EMU, concluded:

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[24] Treasury Committee, *Accountability of the Bank of England*, 23 October 1997, HC 282 1997-98, vi, para 7. Much has been written on the theory and practice of accountability. See, for example, Dawn Oliver & Gavin Drewry, *Public Service Reforms: issues of accountability and public law*, 1996; Robert Pyper (ed), *Aspects of accountability in the British system of government*, 1996.

[25] Treasury Committee, *Confirmation Hearings*, HC 571 1997-98 and *The Monetary Policy Committee of the Bank of England: Confirmation Hearings*, HC 822 1997-98

[26] Treasury Committee, *Accountability of the Bank of England: The response of the Government and the Bank of England to the first report from the Committee in Session 1997-98*, 22 January 1998, HC 502 1997-98, vi

> If that is the case – if Parliament no longer controls economic policy making – surely, at elections, the people will then find that the people they can vote for are not the people who take the decisions. The people they want to have an opportunity to vote for – the bankers – will be taking the decisions. Surely that makes a mockery of parliamentary democracy.[27]

Another avenue by which accountability may be achieved in some circumstances is judicial review. If the legal framework is sufficiently clear and it is possible to establish that a particular individual or entity has grounds for believing that their interests have been damaged by a public body abusing the legal framework, then it is possible for a court to ask the questions and reach the conclusions necessary for accountability, without involving Parliament or politicians. However, it is doubtful that the mandate given to the Monetary Policy Committee of the Bank of England is sufficiently precise in its implications and in its effects to be dealt with in this way.[28]

Raised to the level of the European Central Bank and the Euro area, the problem of accountability becomes yet more difficult. The judicial review option looks even less workable and the Treaty on European Union makes explicit provision that the decision-making bodies of the ECB should neither seek nor take instructions "from Community institutions or bodies, from any government of a Member State or from any other body".[29]

If the UK were to join EMU the changes made by the *Bank of England Act 1998* would not be sufficient to comply with the Treaty and further measures would have to be made to ring-fence the Bank of England from political influence in its dealings with the European System of Central Banks. This in turn would have a significant impact on the efforts of the House of Commons and its committees to monitor monetary policy. The Treasury Committee has summarised the prospect like this:

> Should the UK decide to join EMU it would not only have to meet the Maastricht Treaty criteria, but would also have to introduce substantial changes to the legislation governing the Bank of England in order to qualify under the independent central bank criterion. In particular, for the legislation to be compatible with the statutes of the European System of Central Banks, the Government would have to give up its power to set the inflation target, the Monetary Policy Committee would have to become an advisory rather than a decision-making body and the Treasury would need to give up the right to override the Bank in exceptional circumstances. In addition, if the Court of the Bank were deemed to be a decision-making body its members' terms of office

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27 Llew Smith MP in a debate on the convergence criteria, HC Debates, 21 April 1998, c 708

28 The argument for judicial accountability in the case of monetary policy is explored and ultimately rejected as unworkable in Terence Daintith, "Between Domestic Democracy and an Alien Rule of Law? Some Thoughts on the "Independence" of the Bank of England", *Public Law* (1995).

29 Article 107 and Article 7 of the Statute, Cm 3151, pp 89 and 194

> would need to be increased to five years. **We believe that new mechanisms for accountability of monetary and exchange rate policy would be required in such a circumstance.**[30]

B. Arrangements for accountability under EMU

The Treaty on European Union makes little specific provision for the European Central Bank, or the European System of Central Banks of which the ECB will form the hub, to be accountable. On the contrary, its most explicit provision in this area follows the doctrine of central bank independence and insists that the ECB/ESCB will be independent of all other bodies. This principle is enshrined in Article 107 of the Treaty and in Article 7 of the Statute.

Because the principle of independence is entrenched in a treaty which can only be amended by unanimous agreement of all EU member states, the guarantee is actually stronger than has been the case for most independent national central banks which have generally been subject to national legislation amendable at any time by national parliaments. The independence of the German Bundesbank has never been constitutionally guaranteed, although a constitutional amendment was adopted in 1992 which links the eventual transfer of monetary powers from the Bundesbank to the European Central Bank with the independence of the latter.[31]

Nonetheless, the ESCB and ECB will have certain relationships under the Treaty with both ECOFIN and the European Parliament. The ECB will be required to address an annual report on its activities to both as well as to the Commission and the European Council. This implies that these activities are likely to be scrutinised by all these bodies, including the heads of government meeting as the European Council. In the case of ECOFIN and the European Parliament the President of the ECB will be required not only to send an annual report, but also to present it. The treaty refers explicitly to the possibility (and therefore, in practice, to the strong likelihood) of the president's report being debated in the European Parliament and to hearings being held by its relevant committees.

There has already been some discussion of the possibility that the EP finance committee might meet jointly with representatives of national parliament finance committees to carry out its scrutiny of the ECB, but it is not yet clear what institutional form this activity would take.[32]

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30 Treasury Committee, *The UK and preparations for stage three of economic and monetary union,* 22 April 1998, HC 503-I 1997-98, vii, para 15

31 Article 88 of the Basic Law, as amended on 21 December 1992. See also Roland Sturm, "How independent is the Bundesbank?", *German Politics*, April 1995, p 28

32 *The Guardian*, 16 April 1998

There will be no external budgetary control over the ESCB/ECB, but in some relatively minor respects the ESCB/ECB will be in a relationship of dependency to the Council and the European Parliament. For example, should the bankers in future wish to extend their powers to regulate credit and other financial institutions, or to amend their statute in any way, a decision of the Council and the assent of the EP would be required.

The Governor of the Bank of England, Eddie George, described the arrangements for accountability in the following terms to the Treasury Committee:

> Q159. Governor, in your view to whom will the European Central Bank be accountable?
>
> (*Mr George*) The public at large I suppose is the basic answer to that question. The statute establishes what its mandate is and I think it will be clearly judged by the public and by politicians – national politicians and euro politicians – on how successful it is in complying with its mandate.
>
> Q160. How will it express that accountability?
>
> (*Mr George*) Its mandate is to preserve price stability throughout the euro region. We will get very regular measures of that published month by month so that is the kind of measure against which we will comment.
>
> Q161. You do not think that the European Central Bank will have an obligation to explain itself to the general public?
>
> (*Mr George*) Well, it has an obligation to produce annual reports which are to be addressed to the European Parliament and also to the European Council. (…) Of course the European Parliament and national parliaments will be able to invite the President and the members from the national central banks to go and explain what the policies are. I think myself that clearly it will be in the European Central Bank's interest to explain to the world at large and to all those representatives of the world at large precisely what it is up to because I think that will strongly enhance its credibility…[33]

A similar argument about the interest of the European Central Bank in appearing accountable has been put more bluntly by Helene Rey:

> Ensuring proper accountability for the ECB is also important, to ensure long run political support for the common currency. An opaque Central Bank reluctant to explain its monetary policy decisions would be more likely to become a scapegoat for European public opinion if the euro area were to experience a serious economic downturn in the future.[34]

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[33] Treasury Committee, *Preparations for Stage Three of Economic and Monetary Union*, Volume II, Minutes of Evidence, HC 503-II 1997-98, pp 41-2. The Governor also indicated to the Committee that if the UK were to join EMU and he were the UK representative on the ECB, he would have no hesitation in appearing before the Committee in that capacity (QQ 163, 5, p 42).

[34] Helene Rey, "Gearing up for a fight: the euro, the dollar and the international monetary system", *CentrePiece*, Summer 1998, p 6

As matters currently stand, the ECB could be caught awkwardly between different pressures. If, as Eddie George argued, the ECB is to be judged primarily on its success in delivering the Article 105 mandate of price stability, this could conflict at times with its need to avoid responsibility in the eyes of the public for a future recession. In an ideal world the Bank's judgement and forecasting powers would be such as to steer faultlessly between the perils of inflation and recession, but it will also need to contend with the financial markets and to achieve "credibility" in the market sense. The recent (spring 1998) competition between Dutch and French candidates for the first presidency of the ECB might be seen as a surrogate debate about possible different approaches to this problem. Similarly, the call for greater democratic accountability has at times been interpreted as a call for looser money, the insistence on strict independence and a narrow definition of "price stability" as code for a more monetarist approach.

The Treaty permits all these interpretations and has been widely criticised for not making accountability arrangements clearer. The French finance minister, Dominique Strauss-Kahn, is said to be one of those who would like to see treaty amendments to deal with this.[35] There had been calls for such amendments to be made during the "1996" IGC which culminated in the conclusion of the Amsterdam Treaty, but in the event it was decided not to touch the EMU articles at all for fear of allowing the Maastricht agreement to unravel.

The case for thinking again about accountability in the context of EMU was put to the Treasury Committee by John Arrowsmith of the National Institute of Economic and Social Research:

> That [accountability] is an issue which has been dodged at the European level. It was dodged when the question of balance of power between the different European bodies arose in the negotiations running up to the Amsterdam Treaty. If the Amsterdam Treaty is to be revisited it might be an occasion on which to raise the accountability of the European Central Bank.[36]

In the Commons debate of 21 July 1998 the Liberal Democrat spokesman Malcolm Bruce argued:

> The European central bank should be made more accountable. We do not entirely agree with the bank's mechanisms, as compared with those of the Bank of England, which has a degree of political accountability. However, we understand the reasons for the difference, which is due to historical factors. The United Kingdom could suggest beneficial ways to make the European central bank more accountable, and we could do that more effectively if Britain was a founder member of the euro.[37]

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[35] *The Guardian*, 29 May 1998

[36] Treasury Committee, *Preparations for Stage Three of Economic and Monetary Union*, Volume II Minutes of Evidence, HC 503-II 1997-98, p 4

[37] c 983. Criticisms of this argument were made at c 1003 by John Cryer.

By contrast, the House of Lords European Communities Committee has recently endorsed the accountability arrangements already agreed, provided that the European Parliament show "boldness" in playing its appointed role:

> In the euro zone which will comprise many nations, for the ECB to be free from influence of national governments, the bank must derive its independent status from a supra-national source: the Treaty. We do not accept that this puts the ECB in a position where it is unaccountable and could become unacceptably insensitive to the real economy without any prospect of redress. We see the accountability of the ECB to the European Parliament as an adequate framework arrangement which will need to be given substance by the boldness of the European Parliament in calling the ECB publicly to account and by the readiness of the ECB to listen, to explain and, if necessary, to learn. Like all new institutional arrangements, the accountability of the ECB cannot, in advance, be guaranteed to work perfectly; but we think that the arrangements are sensible and capable of proving effective, if the qualities we have identified as necessary from the European Parliament and the ECB are displayed.[38]

C. Is democratic accountability possible at the European level?

No doubt adjustments could be made to the treaty provisions to clarify or develop the accountability of the ECB to the European Parliament, but these would by no means satisfy all the critics because the European Parliament is not universally accepted, even by its own members, as an effective forum for holding the European institutions to account. Most of those who appear before the Parliament as representatives of these institutions to answer questions and explain policies cannot be removed from office by the Parliament; other sanctions or measures of censure available to the Parliament are much less strong than the equivalent mechanisms in national parliaments. Moreover MEPs are generally elected from larger constituencies and on much lower turnout than members of national parliaments and, in most cases, their election campaigns are fought on domestic rather than European issues. All of these factors weaken the ability of the European Parliament to be the primary link in democratic accountability on Europe-wide issues such as the single currency. The underlying problem is perhaps that national electorates have not so far come to regard the European Parliament as representing them and their interests. As one commentator puts it:

> Although the market has grown far beyond the scope of democratically organised political and cultural identities, electorates still regard national democratic politics as their principal source of protection, not least from economic

[38] Select Committee on the European Communities, *The European Central Bank: Will it Work?*, 29 May 1998, HL 112 1997-98, para 113

> dislocations caused by "market forces", and perceive supranational governance as an undemocratic imposition of external control.[39]

Peter Lilley, speaking as the shadow Chancellor in response to Gordon Brown's statement on the British approach to EMU, saw the absence of accountability at the European level as a fundamental objection to British participation:

> The planned European central bank has no inflation target laid down by a democratically elected Government - still less a Government responsible to the House. Only one of its directors will be British, and he or she will take an oath that they will act not in Britain's particular interests but in the interests of the whole. It will not be accountable to any Parliament or Government, least of all Britain's Parliament or Government. Nor will any Government - certainly not the British Government - be able to override its judgment if they think that the national interest requires it.[40]

The former Defence Secretary Michael Portillo has put forward a similar criticism of the European project as a whole:

> The European Union is entirely made up of member states that are democracies. But the European Union itself is not democratic.[41]

Similar reservations can also be heard from the other side of the European argument:

> The largest long-term danger, however, is that EMU will call for a counterweight on the democratic side, and does not have it. The most enthusiastic European does not claim that the European Parliament works well; (…) …one of the largest fears about greater integration is that it will leach away national democracy without creating a credible transnational substitute.[42]

But is a "transnational substitute" conceivable? The Leader of the Opposition has argued that it is not, at least at the present time:

> Some may wish it otherwise but voters today live their lives in nation states. Voters expect national governments to be accountable to them for the state of their economy: growth, employment, interest rates, mortgages and inflation. If a government is thought to have performed badly it can be changed by the ballot box. That is the essence of our democracy, and underpins its stability.[43]

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39 Wolfgang Streeck in Francis Snyder (ed), *Constitutional dimensions of European economic integration*, 1996 p 233

40 HC Debates, 11 November 1997, c 732

41 Michael Portillo, "Democratic values and the currency", *European Journal*, February 1998, p 5 (also issued as a separate pamphlet)

42 John Lloyd, "Fifteen nations in search of a story", *New Statesman*, 10 April 1998, pp 20-1

43 William Hague, speech at INSEAD, 21 May 1998

A radically different view has been put forward, albeit tentatively, by the French political commentator Bernard Guetta:

> The single currency implies no retreat from democracy. Rather to the contrary, it could, provided we wish it, give new life to the political debate. Because it will confront the parties with new problems, with the complexity of a whole continent, with the necessity of communicating with different peoples, Europe is going to force them into a “day of reckoning” (…) The dynamics of the Euro could, as a result, remake the chess board and soon bring about the emergence of European political forces which would allow citizens a new influence and the chance to redefine the face of the Union, to exercise the power which nation states now offer only in theory since the globalisation of the economy.[44]

A similar point has been made by Christian Joerges:

> Economic and monetary interdependence foreclose the way back to the nation state and its democratic integrity. We are bound to search for supranational institutions which acquire a legitimacy of their own.[45]

In summary, there appear to be three possible scenarios for the future democratic accountability of Euro-area monetary policy. The situation now beginning to emerge is more or less as was envisaged by the Maastricht Treaty, ie a strong form of independence for the ECB with only a small degree of indirect accountability to the European Parliament. As long as the single currency project proceeds smoothly and brings economic gains across the Euro area, this could prove to be sufficient, just as in the case of the German Bundesbank where a small degree of indirect public accountability has proved to be acceptable to the German electorate in the past. If, on the other hand, the early years of the Euro turn out to be turbulent and the varying impacts on different parts of the Euro area give rise to political controversy, the already common criticism that the Maastricht Treaty pays inadequate attention to questions of accountability could gather strength.

A second scenario would therefore build additional mechanisms on to the Maastricht system. For example, a Euro-area inflation target might be adopted periodically by ECOFIN (probably on the advice of Euro-x), subject to the co-decision procedure or the assent of the European Parliament. In order to reflect variations not only between Member States, but also within them, the opinion of the Committee of the Regions might also be sought. The process of presenting ECB annual reports to the European Parliament might also be widened to include representatives of national parliaments (as has already been proposed informally) and the Committee of the Regions. Another possibility would be that the procedures agreed at Amsterdam for the nomination and confirmation of

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44 Bernard Guetta in *Le Nouvel Observateur*, 30 April 1998

45 in Francis Snyder (ed), *Constitutional dimensions of European economic integration*, 1996, p 27

future presidents of the Commission could be applied to presidents of the ECB, although this would risk introducing an element of party politics to the ECB.

The third scenario would be the more radical vision presented by Bernard Guetta, namely the possibility that monetary policy might prove to be so sensitive and so "political" at the European level that it would actually bring about a transformation of the political institutions, forcing the existing loose federations of European political parties to become genuine transnational movements and ensuring that in future European Parliament elections would be fought on European economic issues, giving the European Parliament a new legitimacy and opportunity to insist on the kind of accountability which the more active parliaments achieve at the national level. Thus, according to this analysis, one of the medium-term by-products of EMU could be the long-heralded but elusive state of "political union".

IV The single currency and the "slippery slope"

European integration has passed through many stages in the post-war period. Some politicians have viewed each stage pragmatically as an achievement worthwhile in itself (or not), while others have seen each new development as the working out of a grand plan which they either welcomed or resisted. Broadly speaking the detail of the successive EC/EU treaties has reflected the pragmatic and cautious approach, whereas the declaratory language of the treaty preambles has pointed to the more ambitious long-term approach. In practice, while there have been some quite long lulls and some severe setbacks to the process of intensifying economic and political cooperation, there has rarely been a moment when the process has seemed to reach a logical and enduring equilibrium. Since the mid-1980s new rounds of fundamental negotiation and new treaties have become regular approximately five-yearly events and the tendency to view any treaty change as part of a progressive evolution has, if anything, strengthened, despite the cross-currents of scepticism and hostility which the process continues to encounter.

Hence, it is not surprising that, just as the single currency can be portrayed as the logical culmination of the single market, many now see the single currency as introducing a new half-way house with a slippery downhill slope beyond to full fiscal union and to much closer political union than currently exists.

The connection between monetary union and political union was clearly made in 1990 when it was decided to convene two parallel intergovernmental conferences (IGCs), one of finance ministers, the other of foreign ministers. The connection was also clear in numerous speeches by German leaders, including Helmut Kohl, which portrayed monetary and political union as logically interdependent, as well as desirable each in its own terms. In the event the two sets of negotiations began to diverge and came to very different conclusions. EMU was inherently an all-or-nothing project which would require particular states to be clearly included or excluded, whether on grounds of economic readiness, or, in the case of the UK and Denmark, political willingness. The EMU IGC therefore concluded with an agreement that those states which were in favour in principle of a single currency would commit themselves subject to economic criteria, with special political arrangements to cover the UK and Denmark. By contrast, EPU (an abbreviation then used frequently, now rarely) was a less tangible concept and, to be successful, would have to embrace all of the Member States. The Member States could not achieve consensus on an acceptable strong form of EPU and concluded the political IGC with relatively low-key modifications to the institutions and decision-making processes and a weak commitment to a Common Foreign and Security Policy.

Since the Maastricht Treaty was concluded at the end of 1991 and brought into force in 1993, there has been a new round of negotiation at the 1996-7 IGC, culminating in the conclusion of the Amsterdam Treaty, but the decisions which might be regarded as moving towards political union are still considerably less dramatic in their implications than the impending unification of monetary policy under EMU.[46]

While enthusiasts for the European project have expressed disappointment about the slow rate of progress and, in particular, are frustrated by the failure to agree a greater degree of "deepening" of European integration before the next round of "widening" of the EU, it is still a matter of debate as to whether EMU contains within itself the inevitable implication or requirement of closer cooperation in other areas.

Among the strongest and most consistent proponents of this argument have been the governing council of the German Bundesbank and its president since October 1993, Dr Hans Tietmeyer. As early as September 1990, before the IGC on EMU had even begun, the Bundesbank made clear its view that:

> …the participating economies will be inextricably linked to one another in the monetary field, come what may. The implications of this - especially for the value of money - will depend crucially on economic and fiscal policy and on the stance of management and labour in all member states. They will have to satisfy in full the requirements of an Economic and Monetary Union. In the final analysis, a Monetary Union is thus an irrevocable joint and several community which, in the light of past experience, requires a more far-reaching association, in the form of a comprehensive political union, if it is to prove durable.[47]

Dr Tietmeyer enlarged on the concept of a comprehensive, but federal political union in an essay in honour of the retirement of his Dutch counterpart in 1994:

> In my opinion there is good reason to believe that, to ensure lasting success, a monetary union requires – over and above the joint central banking system – a more far-reaching political association than that defined in the Maastricht Treaty.

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[46] See Library Research Paper 97/112, *The European Communities (Amendment) Bill: Implementing the Amsterdam Treaty*, November 1997

[47] Statement by the Deutsche Bundesbank on the establishment of an Economic and Monetary Union in Europe, 19 September 1990 – from http://www.bundesbank.de/en/presse/

> This does not mean that a centralised solution should be sought at Community level. On the contrary, the requisite political solidarity, on the one hand, and the necessary subsidiarity, on the other hand, can no doubt best be ensured in the longer term at Union level by way of a federal concept with a clear allocation of powers and responsibilities…
>
> It is quite apparent that, in some member countries, there are misgivings about any further expansion of the political component of the integration process. These are clearly motivated mainly by the fear that the national identity of the countries concerned could be jeopardised by a far-reaching union. The valid kernel of such reservations certainly needs to be taken into consideration in the process of expanding the Union's political component. On the other hand, the use of such arguments to block the path towards further development of political union could not only call into question the process of further integration but could also, in the final analysis and in view of the hazards outlined above, pose a threat to that which has been achieved so far.
>
> It would be overstepping the bounds of a central banker's brief to map out suitable basic concepts of development towards political union. That is a task for the political bodies, governments and parliaments…[48]

He made the same point more succinctly in an interview of March 1995 with Will Hutton:

> I am saying that monetary union is more than a union of central banks - a system which decides monetary policy. Every politician, and I think every voter in the country, should be aware that monetary union is more. It has a political dimension.[49]

According to Dr Tietmeyer, it will be in the realms of fiscal and wages policy that EMU will require the closest political co-ordination. He told a press conference on 18 October 1995:

> [the Member States] will have to give up their national sovereignty not only in monetary policy, but also in financial and wage policy, and be assessed together by the financial markets. […] It is an illusion to believe that the States will retain their independence in fiscal policy.[50]

To some extent these issues have already been addressed by the Stability and Growth Pact of June 1997 under which participants in the single currency agreed to a system of

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48 Hans Tietmeyer, "The relationship between economic, monetary and political integration", in Age Bakker and others (eds), *Monetary Stability through International Cooperation: Essays in Honour of André Szas•* , 1994, 29-30

49 *The Guardian*, 16 March 1995

50 *Frankfurter Allgemeine Zeitung*, 18 October 1995. These remarks have often been quoted in English as referring to <u>autonomy over taxation policy</u>. However, the German report refers to *Fiskalpolitik*.

sanctions which would come into effect if any state were to run excessive public expenditure deficits.

There have been differences of opinion as to how much the Stability and Growth Pact would actually constrain national fiscal policies. The Pact would not directly affect either the mix of taxes and other measures on the revenue side or the ability of a government to vary fiscal policy under a certain ceiling in order to achieve desired economic effects. According to the Treasury document which accompanied the Chancellor's statement of October 1997:

> In EMU the UK would still retain flexibility over fiscal policy. With monetary policy targeted at EMU-wide monetary conditions, it would be important that fiscal policy is able to respond to country-specific events in the UK, as elsewhere. Given the Government's commitment to sound public finances… (…) ...there would be headroom within the Growth and Stability Pact to adjust fiscal policy if circumstances required.[51]

Similarly, the Treasury Committee was told in 1996 by its specialist advisor Christopher Johnson that fiscal policy:

> is an area in which governments will retain a great deal of independence, provided that they stick to the Maastricht deficit criteria… It will still be possible for governments to choose their policy mix… They will be able to loosen or tighten fiscal policy for the needs of their own economy. They will be free to choose the kind of tax they raise and the way in which they spend public money…[52]

Another branch of the argument concerns transfers between states. It is often held, sometimes by analogy with the operation of a single currency within the United States, that a successful single currency in Europe would require substantial transfers of resources between states in order to deal with economic "shocks" or "disturbances" which affected them unevenly. On this point, the Treasury Committee was told, by Sir Nigel Wicks, the British official most intimately involved in the preparations for EMU:

> There is a view that if you have a single monetary policy you need a big Community budget and you need an ability to make transfers around the Community from a much bigger Community budget… I think I can say with certainty (…) that is not on the agenda… The overwhelming majority of Member States are not contemplating a new system of transfers within the single monetary area.[53]

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[51] HM Treasury, *UK Membership of the Single Currency: An Assessment of the Five Economic Tests*, October 1997, p 17

[52] Treasury Committee, *The Prognosis for Stage Three of Economic and Monetary Union*, HC283-I 1995-96, xxvi

[53] ibid, xxvi-xxvii

While some argue that the need for greater fiscal coordination and/or transfers, followed by greater coordination in other economic fields, will become ever more apparent once EMU gets under way, and will therefore inevitably happen, others argue that it cannot and will not happen, for political reasons, and that therefore EMU will run into severe difficulties.

For example, Lord Dahrendorf writes:

> Fiscal policy is for many probable members of EMU a much less dispensable element of sovereignty than money. Even Luxembourg may be reluctant to give up its comparative advantages in this regard. The remarkable difficulties in harmonising VAT (to say nothing of exemptions from it) tell the story.[54]

Similarly, Niels Thygesen (who was the Danish member of the Delors Committee on EMU) argues that harmonised decision-making would be much more difficult once extended beyond the monetary field:

> In the monetary field it is possible to delegate authority to a joint institution, the European central bank, because the latter is given a clear mandate, *viz* to pursue (medium-term) price stability for the EU as a primary objective. In the non-monetary field, in contrast, shorter-term discretionary reactions to cyclical developments of a partially asymmetric nature will continue to be desirable and it is much more difficult to define a common mandate according to which ECOFIN can conduct a joint policy.[55]

Further steps down the "slippery slope", such as the harmonisation of social policies in order to create a more flexible Euro-area labour market, would be very difficult to achieve, even assuming a strong political union, unless there were to be considerably more convergence in thinking about social protection than is evident at present. Thus, there is a possibility that the economic pressure to achieve a fiscal and social policy union may, instead of encountering a "slippery slope", collide with strong resistance from most member state governments, producing serious strains in EMU.

The debate about the extent to which monetary union implies or leads inexorably to other strong forms of policy co-ordination within the Euro-area is important because it touches sensitive political nerve ends. The Leader of the Opposition argued in his speech to INSEAD:

> The powers to raise taxes from one's citizens and to spend the money on their behalf are defining features of a sovereign state. I believe that to delegate powers over taxation and spending to the EU would take us beyond the limits of political

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54 Ralf Dahrendorf, "Disunited by a common currency", *New Statesman*, 20 February 1998, 33

55 Ian Davidson & Christopher Taylor (eds), *European Monetary Union: the Kingsdown Enquiry*, 1996, 184

> union towards the creation of what would in effect be a European state. It would be to cross a line and abandon the independence of nation states with all the consequences for the future stability of Europe which I have set out today.[56]

The French commentator Pierre Jacquet appreciates the sensitivity, but is less convinced about the inevitability of the process:

> …the feeling that EMU is but a Trojan horse for the introduction of an uncontrollable momentum towards political union may well explain in part the latent opposition to the project, both within member states and among them… Sharing monetary policy sovereignty is a strong act of political co-operation; but the presumption that this, in itself, will generate a natural dynamic in respect of other dimensions of political integration, such as institutions and defence, is not fully convincing.[57]

V Some comparisons

In general the constitutional implications of EMU have been debated less in the other members states than in the UK. In particular, the problem of accountability has received less attention, possibly because all of the other member states have longer experience than the UK of central bank independence.[58] This section highlights some of the differences in approach as between the UK, Denmark, France and Germany. A much fuller account of the background to EMU preparations in other EU states may be found in Library Research Paper 98/39, *EMU: Views in the other EU Member States.*

A. Denmark

Denmark negotiated a special protocol to the Maastricht Treaty under which the automatic progress towards EMU which was to apply to all other Member States other than the UK would not apply to Denmark if its government gave a notification to this effect before the Council of Ministers carried out its first assessment of compliance with the convergence criteria.[59] This "delayed opt-out" was linked to the fact that participation in EMU would have required a special referendum under the Danish constitution, the result of which could not be guaranteed in advance. The idea of advance commitment to EMU was therefore incompatible with the constitution.

In the event, and even taking account of the protocol, the Maastricht Treaty was rejected by the Danish electorate in a referendum of June 1992. In order to prepare the way for a

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56 William Hague, speech to INSEAD, 19 May 1998

57 Pierre Jacquet, "EMU: a worthwhile gamble", *International Affairs*, January 1998, p 57

58 Laurence Gormley & Jakob de Haan, "The democratic deficit of the European Central Bank", *European Law Review* April 1996, 21(2), p 96

59 *Treaty on European Union*, Cm 3151, Protocol 12, p 225

second referendum the Danish government negotiated a series of side agreements with the other Member States at Edinburgh in December 1992. One of the Edinburgh terms was that the Danish government would make its notification of non-participation in EMU immediately, ie concurrently with its ratification of the treaty as a whole. This, along with other understandings agreed at Edinburgh, allowed the government to re-submit the treaty to the Danish electorate in May 1993 with an absolute commitment that Denmark would not join EMU in the foreseeable future.

The irony of this situation is that Germany is Denmark's principal trading partner and the Danish *krone* has been tied to the DM at a fixed rate since 1987. Moreover, this policy enjoys the support of all the main political parties, regardless of their stance on participation in the EU. Denmark has had a fully independent central bank since 1936, but the fixed exchange rate policy means that this independence can be expressed only by following in the footsteps of the Bundesbank. Unable to use monetary policy for counter-cyclical adjustments, Denmark uses adjustments to fiscal policy instead. It has remained well within the constraints implied by the Stability and Growth Pact and would easily have qualified for EMU participation under the convergence criteria, were it not for the political rejection of EMU.[60]

The Danish refusal to participate in EMU, a decision made on explicitly constitutional rather than economic grounds is, perhaps, less contradictory than it may at first appear. Denmark is a small country with a long history of defending its sovereignty against more powerful neighbours. The close economic links which Denmark has with the potential Euro-area in general, and with Germany in particular, make it more rather than less anxious to retain the symbols of sovereignty.

B. Germany

The long-serving German government of Chancellor Helmut Kohl has been, along with its successive French counterparts, the principal sponsor and progenitor of EMU. EMU as envisaged in the Maastricht Treaty is based very largely on the German approach to price stability and central bank independence in the post-war period. Moreover, since the DM has been Europe's strongest and most stable currency over a long period, it was always likely that any successful currency union would be based on the enlargement of the existing DM area.

Given that the German electorate has come to place a very high value on the stability of the German currency and that the Bundesbank enjoys a high level of public trust, it has not always been easy for the German government, having made its commitment to the idea of EMU at the end of the 1980s, to persuade its electorate and key players such as

60 For a summary of the section on Denmark in the EMI Convergence Report see European Legislation Select Committee, *Twenty Fourth Report*, 14 May 1998, HC 155-xxiv 1997-98, Annex A

the council of the Bundesbank, that EMU did not put German currency stability at risk and that Germany would receive something in return.

In 1989-90 it was possible to argue that EMU formed part of a grand bargain in which the other Member States (especially France) agreed to smooth the way for German unification and the incorporation of eastern Germany into the EU. Once unification had taken place, the long-term benefit of EMU could be sought in the progress of that political union which Chancellor Kohl always saw as its essential and inevitable companion piece. Political union was seen as a permanent guarantee of peace in Europe and of Germany's place in a peaceful European order.

This has made EMU a highly political project in Germany, and a project (as Kenneth Dyson and Kevin Featherstone have put it),

> pregnant with political questions: (1) about the nature and use of German power; (2) about whether the price (loss of the D-Mark) that Germany is being asked to pay is too excessive; and (3) about whether those who push the EMU project have neglected its legitimacy.[61]

When the Maastricht Treaty was ratified by Germany in 1993 both the Bundestag and the German Constitutional Court held to the principle that Germany could not be finally committed to EMU without a further political decision in the form of approval by both chambers of the German parliament. The final point of decision came in the spring of 1998 when it was clear that a sufficient number of Member States, including Germany itself, would have broadly met the convergence criteria.

In the event the Bundestag voted in favour of the launching of EMU on 23 April 1998 by 575 votes to 35 with 5 abstentions. The opposition SPD chancellor candidate Gerhard Schröder spoke and voted in favour, but criticised the government for not appearing to take public anxiety on the issue seriously, admitting that "the introduction of the Euro poses a problem of legitimacy". On the following day the Bundesrat endorsed EMU by a similar margin.

The parliamentary votes in favour of proceeding with EMU came despite opinion polls indicating that 60% of the German electorate were still opposed to the move. This means that the debate is likely to continue through the September 1998 general election campaign. Given the basically positive attitude of the main political parties towards EMU, the arguments about the degree to which Germany will in future be able to guarantee the stability of its shared currency have already moved on and now focus on the extent to which the European Central Bank will follow strictly in the footsteps of the Bundesbank. The quarrel over the presidency of the ECB at the May 1998 European Council no doubt reflected this concern.

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61 "EMU and Economic Governance in Germany", *German Politics*, December 1996, 326

The selection of the Dutchman Wim Duisenberg, seen as a strong follower of the Bundesbank tradition and ethos in monetary policy, to be the first president of the ECB, should meet German concerns about the early years of EMU. While some German politicians, like Gerhard Schröder, are concerned by issues of "legitimacy", this does not mean that they would like to see the ECB made more accountable to democratic politicians. On the contrary, many German politicians see accountability in this context as a code for a more malleable and therefore less desirable approach to monetary policy.

C. France

France adopted the doctrine of central bank independence and a stable monetary target before the UK, but long after Germany. The French political magazine *Le Nouvel Observateur* has summarised the background to EMU in the following way:

> …the decisive episode for France took place in March 1983. After a dramatic week of hesitation, Francois Mitterrand, facing his third devaluation since becoming president of the republic, opted for discipline and for keeping the franc in the European Monetary System. There is no doubt that this was the day on which the fate of the Euro was settled: without that decision the Germans would never have accepted that their monetary destiny should be tied to ours.[62]

The policy of the "strong Franc", ie keeping the Franc relatively stable and "high" in value against the DM paved the way for a the decision, which was finally made in the negotiations for the Maastricht Treaty, to tie the Franc irrevocably to the DM. However, the element of guaranteed central bank independence also had to fall into place: this was to be a "concession" made in the Maastricht negotiations. The fact that France might be willing to make such a shift in return for the "Europeanisation" of the D-Mark and the Bundesbank had been hinted at from around 1988 onwards and formed part of the background to the Delors Committee's report.[63] The shift in official French thinking implied an acceptance that the unilateral fiscal decisions of the incoming Mitterrand administration in 1981 would be impossible in the future.

The independence of the Banque de France was brought about by two legislative acts of 1993 combined with the French ratification of the Maastricht Treaty. However, the Bank is still required under the 1993 legislation to "carry out its duties within the framework of the Government's general economic policy".[64] The 1993 Acts loosened the links between the Banque and the Government by providing that the majority of the members of the governing Council should be nominated by the presidents of the two chambers of

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[62] *Le Nouvel Observateur*, 30 April 1998

[63] The report of the Committee for the Study of Economic and Monetary Union, September 1989. The chairman of this committee, Jacques Delors, was president of the European Commission at the time, but had been the French finance minister 1981-84.

[64] Jean-Pierre Duprat, "The independence of the Banque de France: constitutional and European aspects", *Public Law*, Spring, 1995 p 139

parliament and by creating a mechanism for scrutiny by the parliamentary finance committees. Further legislation to bring the statute of the Banque de France fully in line with the requirements of EMU was submitted to the French parliament and completed its passage in May 1998.

In his study of the constitutional background to these changes Jean-Pierre Duprat also notes that the granting of independence to the Banque de France in respect of monetary policy in 1993 was not just a response to the Maastricht Treaty:

> It matches the psychological dimension resulting from the omnipresence of market logic. To protect the parity of the Franc, foreign dealers must be reassured.[65]

This is not to imply that there have been no doubts or hesitations on the part of French politicians since the Maastricht bargain was struck. There was only a narrow margin in favour in the French referendum on Maastricht ratification and there are some leading politicians of the right and the left who have declared themselves as "Eurosceptics".

Le Nouvel Observateur argues that Lionel Jospin, the socialist party leader who became prime minister following the parliamentary elections of 1997, agreed to go along with the EMU project only on the condition that it left room for Keynsian growth-orientated policies:

> In attaching four conditions to his support for the Euro, Lionel Jospin was successful in rallying all those who believe that the visible hand of politics should guide what are, in reality, such imperfect markets.[66]

The adoption of the Stability and Growth Pact with its excessive deficit procedures, the continued German insistence on an absolutely independent ECB and the appointment of Wim Duisenberg to head the ECB for at least the first four years, in preference to the Frenchman Jean-Claude Trichet, mean that the neo-Keynsian vision of European monetary policy has been sidelined, at least for the foreseeable future. Nonetheless, when the Assemblée Nationale came to approve the transition to the third stage of EMU by 334 votes to 49 on 22 April 1998 most socialist deputies voted in favour and it was the main opposition RPR which decided to abstain in order to avoid a public display of its internal divisions.[67]

Given this background, it is not surprising that French politicians are more concerned about the accountability issue than their German counterparts and are likely to return to it in the years to come. However, the impression remains in France that EMU will be a gain for French sovereignty and not a loss, because it will make France an equal partner

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[65] Duprat, ibid, p 148
[66] *Le Nouvel Observateur,* 30 April 1998
[67] *Libération* website, http://www.liberation.fr/quotidien/ (23 April 1998)

in the Euro area, rather than a grudging participant in the DM zone. As Pierre Jacquet, among others, has pointed out, during the period of exchange rate stability which lasted from 1987 to 1992, "all central banks were *de facto* shadowing the Bundesbank's monetary policy".[68] To underline the symbolic importance of EMU to France, at the conclusion of the May 1998 European Council President Chirac gathered together twelve of the thirteen surviving French prime ministers of the Fifth Republic for a celebratory dinner.[69]

VI The politics and the economics of EMU

To what extent is it possible to separate the politics from the economics of EMU? It would appear that the potential implications of the single currency, both positive and negative, feed back into political considerations at almost every point. Was the quarrel about the appointment of the first president of the ECB essentially about politics (French influence v German influence?) or about economics (hard Euro v soft Euro?). If the development of the single currency in its early years should impose uneven costs and benefits on the participants, how could this not bring increased political tensions in its wake, both within participating states and between them? A similar argument could be put about alternatives to EMU. Could the EU single market and all that goes with it survive a prolonged period of severely fluctuating exchange rates? What would the political consequences be if the UK were to have the only major EU currency outside EMU?[70]

Many commentators have predicted that EMU will add to the political strains which are already observed within the EU institutions and between the Member States. Obviously this will depend to an extent on the economic successes or failures which flow from it. However, even on the assumption that EMU brings gains to prosperity from reduced transaction costs, greater price transparency, more efficient use of resources in the single market, leading to growth and reduced unemployment etc, differences over financial discipline, reactions to asymmetrical shocks and "excessive" deficits, together with arguments over the appropriate value of the Euro against other major currencies, are likely to emerge sooner or later. While some commentators, such as Martin Feldstein,[71] are profoundly pessimistic about this, others are more sanguine and expect to see monetary policy issues fought over and resolved as part of the future "business as usual" politics of the EU.

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[68] Pierre Jacquet, "EMU: a worthwhile gamble", *International Affairs*, January 1998, p 62

[69] *Le Monde* website, 6 May 1998, http://www.lemonde.fr/dossiers/euro/

[70] The Governor of the Bank of England pointed out to the Treasury Committee in evidence on 29 January 1998 that if, without a UK decision to join EMU, the Euro were nonetheless to become widely used within the UK, "there would not be much role left for a sterling-based monetary policy" – Treasury Committee, *The UK and Preparations for Stage Three of Economic and Monetary Union*, HC 503-I 1997-98, xvii, para 61.

[71] Martin Feldstein, "EMU and international conflict", *Foreign Affairs*, November 1997

A common conclusion, from both sides of the argument, is that EMU, whatever its merits, will not leave the EU in stable political equilibrium: it is bound to have foreseen and unforeseen consequences with knock-on effects on all aspects of European co-operation. It will, for example, have effects on the enlargement process and on the next re-ordering of the central EU institutions.

In some respects, as noted above, EMU could give a new edge to the existing rivalries and conflicts between the Member States, but it could also stimulate the development of political mechanisms and institutions at the EU level. EMU may not mean the end of nation states in Europe, but it will certainly change the context in which they operate. While for some Member States this issue is secondary to the economic costs and benefits, the UK is not alone in giving it high priority and in seeing a referendum as essential before a final decision is made.[72] It was a former Chancellor of the Exchequer who commented in the Commons debate of 21 July 1998:

> It is the constitutional issue which divides the House across party lines; which divides the Conservative party; and which divides the Labour party, as we have just heard.[73]

Monetary policy has been at the heart of electoral and parliamentary politics in the UK for decades. From the devaluation dramas of the 1960s to the ERM debates of the 1980s it has formed the very stuff of politics.[74] Joining EMU would mean not only turning monetary policy into a "technocratic" matter, a process already begun in May 1997 and consolidated by the *Bank of England Act 1998*, but also consigning it to that realm of European technocracy hitherto associated with the multilingual jargon and acronyms of the European Commission. The Commission has operated on a non-partisan "consensual" basis, emphasising technical expertise over political loyalty, partly because it has to deal with complex technical issues of harmonisation, but also because a party-based Commission could not be tolerated simultaneously in all the Member States with their constantly shifting political complexions.

The European Central Bank will have to be an even less "political" and more technocratic body than the Commission. Therefore, one of the greatest changes for the UK, were it to join the single currency, would be that monetary policy would be permanently removed from the party political arena. British political culture might adapt to this change, particularly if the electorate came to see tangible benefits. The risk might be that political conflict over monetary policy might in fact continue as before, but with no constitutional means of expression.

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[72] See section V(A) on the position in Denmark

[73] Kenneth Clarke, HC Deb 21 July 1998 c 1008

[74] See, for example, Alec Cairncross & Barry Eichengreen, *Sterling in Decline: the devaluations of 1931, 1949 and 1967*, 1983; Philip Stevens, *Politics and the Pound: the Conservatives struggle with Sterling*, 1996

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