The High Price of Our 'Low-Cost' Monetary Union

18. July 2018 by Viriato Soromenho-Marques, Ricardo Cabral

Mark Rutte, the Dutch Prime Minister, was particularly vocal during and even before the June 2018 European Council, against the modest reform proposals for the EU and the eurozone apparently agreed between Chancellor Merkel and President Macron in the so-called Meseberg Declaration. Rutte's repeated rhetorical attack against the idea of having a specific common budget for the countries sharing the euro is a meaningful sign of the political lack of wisdom and feeble common sense pervading the words and deeds of many European government leaders ('EU leaders deal. Macron Eurozone reform setback'). The present critical policy issues, namely the management of migration and common borders, the cooperation with neighbouring countries, the reform of defence structures and doctrines, countering the disarray affecting NATO on account of the strong winds blowing from Washington, and last but not least, the ongoing endemic flaws of the Economic and Monetary Union (EMU) itself, are all topics of European public policy that should be addressed using resources drawn mainly from a common budget, Therefore, all these issues considered together, drive us, precisely, to raise the key question: how can the European project survive without a strong budget to leverage especially its critical core, the Eurozone?

The forgotten past

One of the more dramatic prevailing features of the current European debate is the astonishing level of oblivion of our common history related to the tortuous path of the European coming together. Contrary to those who think that the structure of the EMU was a kind of divine creation, or an unavoidable natural condition, the EMU is a result of a strenuous political and intellectual process. The knowledge of the past discussions and ideas, no matter whose side have won in the past, is not an issue of historical erudition, but a vital resource to the Ariadne wire of critical memory. It is an essential asset, past knowledge that is key to finding out the best possible path to exit from the dangerous maze where the EU is currently lost.

The issue of a European common budget has always been present during the crossroads moments of the European integration process, namely those in which the blueprint of a common European future beyond a shallow 'integration' concept was clearly under evaluation. By the end of 1974, when the European Communities were already nine countries strong, the Commission assembled a team of seven highly respected professors to study 'the role of public finance in European integration, under the leadership of Sir Donald MacDougall. The results of the research developed by the Group were released in April 1977, in two volumes. Three scenarios were drawn, and the key distinctive brand in each of the three was determined by the size of the common budget:

a) **Fully-fledged federation**, similar to the United States of America and also to other federal experiments, including the Federal Republic of Germany, will mean a European budget around 20-25% of the Community's gross domestic product (GDP).
b) **An early stage federation** 'with a much smaller federal expenditure of the order of 5-7% of GDP, or roughly 7.5-10% if defence were included.'
c) '**Pre-federal integration**' with 'public expenditure at Community level rising to around, say, 2-2.5% of GDP during this period. (MacDougall Report, "Report of the Study Group on the Role of Public Finance in European Integration", Volume I: General Report, Brussels, Commission of the European Communities, April 1977, 68 pp.).

It's useful to point out that in 1977 the Community budget was of the order of 0.7% of the GDP. Even in the more modest pre-federal scenario it should be noticed that the threefold increase suggested by the Report was huge. We wonder what Sir MacDougall would say, if he could comment about the current status of the EMU, of the single currency and of single monetary policy (key federal instruments, whereby fundamental sovereign powers of member states were transferred to a central, independent and 'transcendent' institution, the ECB). Surely, MacDougall would consider our 2018 EMU, based upon a meager 1% of GDP common budget, as a unique low-cost 'miracle'. However, as is well known, too often what seems excessively cheap, ends up being very expensive. The shadows that overcast the EMU are not its budgetary costs, but its long-run resilience, development potential and sustainability prospects.

In the beginning of the 1970s the issue of a common budget had been already addressed in the first serious attempt to launch the EMU. The Werner Report is a striking example of the classical European debate opposing those who consider that a common currency (nominal convergence) should take the leading role in the integration path, against the party of real convergence, vindicating the previous need of having some level of economic harmonisation and politically binding solidarity before embarking in the adventure of sharing the issue-of-money sovereign prerogative. In 1970, like later in 1992 with the Maastricht Treaty that gave birth to the euro, the first school of thought, the one we may call 'monetary voluntarism', prevailed. However, even the Werner Report considered that, with the deepening and consolidation of the monetary union, 'the Community budget will undoubtedly be more important at the final stage than it is today.' (Werner Report, 'Report to the Council and the Commission on the Realization by Stages of Economic and Monetary Union in the Community', *Supplement to Bulletin 11-1970 of the European Communities*, Luxembourg, 8 October 1970, 65 pp.).

The fateful triangle of the EU

What should be the systemic location of a 'common budget' within the theory and praxis of European integration? We think the budget can assume the position of one of the three sides of what we may call the **integration triangle**, namely: political union, common currency and common budget. The traditional cleavage in European integration strategists was between the 'winners', those who considered wise to start the integration path by the common currency, and the 'losers', those who advocated the priority of a political union grounded in a Constitution binding its Member States. In Robert Mundell's seminal 1961 paper on "Optimum Currency Areas", the risks and success conditions for countries pondering to enter into a fixed exchange rate model were depicted with wisdom and neutrality. In a very subtle way, Mundell gave a prudent advice against the energetic enthusiasm of 'monetary voluntarists': 'Except in areas where national sovereignty is being given up it is not feasible to support that currencies [of independent States] should be reorganized' (adapted version, MUNDELL, Robert A., 'A Theory of Optimum Currency Areas', *International Economics*, New York: Macmillan, 1968, pp. 177-186).

Unfortunately, the road to the EMU was not based upon historical knowledge and theoretical prudence. In 1992, the ideological conviction already mirrored in the Werner Report reduced every opposition to marginal criticism. 'Monetary voluntarism' won the battle: 'Economic and monetary union thus appears as a leaven for the development of political union, which in the long run it cannot do without' (Werner Report, p. 12).

Contrary to a widespread misconception, Germany was not the stronghold of monetary voluntarism in the road to the euro. Germany was probably the country were the fight against a single currency, and irrevocable exchange rates, was more openly waged. The rules of the euro, enshrined in the Treaty on the Functioning of the European Union (TFEU) and in the Stability and Growth Pact (SGP), were indeed German rules, expressing, however, not enthusiasm but a deep defensive scepticism regarding the effectiveness of binding together so many rather diverse national economic landscapes under the same currency arrangement. The political framework of the German reunification is well known, as also is noticeable the intense French pressure to have a quick EMU deal. But the signs of German inclination towards the priority of political union are clearly abundant and evident. Only 3 months before the signing of the Maastricht Treaty, Helmut Kohl, speaking to the MPs in the Bundestag, said bluntly: 'The recent history, and not just that of Germany, teaches us that the idea, that it would be possible to maintain in the long term an economic and monetary union without political union, is absurd ('*Die jüngere Geschichte, und zwar nicht nur die Deutschlands, lehrt uns, dass die Vorstellung, man könne eine Wirtschafts-und Währungsunion ohne Politische Union auf Dauer erhalten, abwegig ist.*'), Helmut Kohl, 6 Nov. 1991. On the other hand, the German discussion on the EMU was also very lively, with a great deal of citizens' participation. A landmark in that public debate is the first Manifest subscribed by 62 economists, published on 11 June 1992. The point number 8 of the Manifest shows without ambiguity the option for the priority of a political union, as the only way to have a legal constitutional basis to uphold the financial transfers that would be unavoidable in the future, given the wide asymmetry and divergence of the economic structures and performance of the countries engaged in the monetary union: 'The economically weaker European partner states will face increased competitive pressure under a common currency, and, as a result, they will experience growing unemployment due to lower productivity and competitiveness ('*wachsende Arbeitlosigkeit erfahren werden*'). This will make high transfer payments in the name of 'financial compensation' necessary ('*Hohe Transferzahlungen im Sinne eines "Finanzausgleichs" werden damit notwendig*'). As far as no agreement exists concerning the structure of a political union, a system with sufficient democratic legitimacy to regulate this process is lacking'. (Ohr, Renate *et alia*, 'Erstes Manifest gegen den Vertrag von Maastricht. Die währungspolitischen Beschlüsse von Maastricht: Eine Gefahr für Europa', *Frankfurter Allgemeine Zeitung,* 11. Juni 1992).

Conclusion

The 1992 cry of alarm voiced by the 62 German economists was like a Cassandra prophecy: completely accurate, but also completely ignored. The ill established EMU is now 'a danger for Europe' ('*eine Gefahr für Europa*') always present in our daily life.

The EU, with the eurozone in its core, can be represented as a scalene triangle, in which the side length of the 'common currency' is much higher than that of the other two sides, the side of the 'political union' and the side of the 'common budget'. If the European project is to survive we need to move away from the imbalance of the scalene triangle towards the harmony of an equilateral triangle. This shift is going to be as difficult as it is absolutely necessary. Given the present political atmosphere of populism, distrust and bigotry, we doubt the first step will be developed by the enlargement of the 'political union' side. However, in the next financial, economic and political turmoil the need to enlarge the side of the 'common budget' could appear, even for the more narrow souls, as a matter of life or death. It could be the only political tool avoiding the EU from falling into the abyss of the euro collapse.