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Economic and Monetary Union at twenty: a stocktaking of a tumultuous second decade: introduction

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ABSTRACT

This contribution discusses the two main asymmetries of European Economic and Monetary Union (EMU) as they developed over the past two decades since the launch of the Single Currency. From the outset, EMU involved asymmetric degrees of integration in the area of 'economic' union (less centralised governance) versus 'monetary' union (more supranational governance). With the outbreak of the Sovereign Debt Crisis in 2010, the regime-shaping relevance of a second asymmetry emerged: one roughly between the member states of the Euro Area 'core' and those in the 'periphery'. Each of the two asymmetries have created a range of challenges — institutional, policy and political — that undermine the stability and sustainability of the EMU project.

KEYWORDS

Economic and Monetary Union; asymmetry; European integration; euro area; Sovereign Debt Crisis; Coronavirus (Covid-19) Crisis; European integration theory

Authors' note (21 March 2020).

As this collection of papers comes to print, the Coronavirus crisis has erupted, testing the capacity of Euro Area economic governance to respond to unprecedented economic challenges. Collective action by member state governments, using the mechanisms of economic governance, has once again been found wanting and immense pressure has been placed on the European Central Bank to resume non-conventional monetary policy to tackle the effects of the crisis, notably through asset purchases. Similar to the Euro Area Sovereign Debt Crisis, some member state governments and officials have publicly expressed their reluctance or opposition to support either these monetary policy measures or the extension of emergency support funds— demonstrating the longstanding fault-lines in member state preferences on both European monetary policy and economic governance. The political implications of the two asymmetries of Economic and Monetary Union discussed in this introduction are stark in the current context. The policy and institutional implications of these asymmetries remain the subject of increasingly acrimonious debate. Although the Commission triggered the 'general escape clause' and has suspended the fiscal policy rules of the Stability and Growth Pact, it remains to be seen if Euro Area member state governments are able to adopt additional joint measures that can successfully mitigate the mounting fiscal pressures facing the more heavily indebted member states of the Euro

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periphery. There is good reason to argue that the Coronavirus crisis will either make or break the Euro Area. This consideration is likely foremost in the minds of the more than four hundred academics who signed a petition urging the EU to issue Eurobonds immediately (Regan et al. 2020).

Monetary policy-making is one of the most far-reaching areas of European integration. Economic and Monetary Union (EMU) stands as one of the European Union's (EU) flagship integration achievements. Set up in 1999, with the large majority of EU member states at the time, EMU was described as 'asymmetrical' even prior to its start (Verdun 1996). From the outset, it involved asymmetric degrees of integration in the area of 'economic' union (less centralised governance) versus 'monetary' union (more supranational governance). Although a major element of the blueprint that paved the way for the final stage of EMU, the concept of 'economic' union was insufficiently developed. The second decade of the single currency gave rise to a second asymmetry, namely one between those Euro Area member states of the so-called 'core' and those of the 'periphery'.

Although it has been clear from the outset that the institutional architecture of EMU, as set-out in the Maastricht Treaty, had a fair-weather design, it was widely thought that there would be plenty of time and opportunity to reinforce EMU with deeper economic, monetary, political and financial integration prior to, or during, the outbreak of a major crisis. Critics, such as the late economist Martin Feldstein (1997), were less convinced of the project and argued that these design flaws would eventually lead to its collapse (see also De Grauwe 2006). Nevertheless, few expected that the EU would be confronted with a full-on financial crisis and subsequent recession of the magnitude witnessed between 2007–2015. During this time, many member states, particularly in the Euro Area periphery, experienced severe recession, with unemployment increasing significantly and public sector debt rising to unsustainably high levels. The real possibility of Greek government default became the most immediate menace for the survival of the Euro Area. If Greece left the euro, this could have created contagion, forcing the departure of other member states. The institutional and policy reforms needed to offset these challenges were subject to considerable disagreement in both public policy and academic circles. The EU institutions and the member states were often deadlocked on a number of major reform possibilities.

With the outbreak of the Sovereign Debt Crisis, the regime-shaping relevance of a second asymmetry emerged, one roughly between the Euro Area core and the periphery: between those member states that had benefitted significantly from cheap money during the first decade of EMU and those that had previously been accustomed to low interest rates. When the crisis struck, a number of the periphery countries were severely affected by the drying up of cheap credit, leaving both private debtors and sovereigns exposed and vulnerable. The Euro Area crisis also reinforced an existing asymmetry in power between 'core states' (inter alia Germany and France) and 'periphery states' (notably, Greece, Ireland, Italy, Portugal, and Spain) – a terminology that was present prior to the start of EMU (Bayoumi and Eichengreen 1993; Artis and Zhang 2001). It was transposed to the proverbial 'North' and 'South' – between creditors and debtors (see, for instance, Ubide 2014).

Many observers believed that EMU, as a whole or in some part, would collapse if the EU member state leaders did not demonstrate the political will to rescue Greece and other periphery states. However, with the decision to adopt a number of emergency measures to protect the Euro Area and prevent the default of at least four periphery countries, the awareness grew of the need to set up new support mechanisms. The design of EMU governance from the Maastricht Treaty remained largely intact, having only experienced minor changes with the 2007 Lisbon Treaty that entered into force in 2009 (Enderlein and Verdun 2009, 498).

Confronted with the need either to deepen EMU to be effective and thus to add significantly to the Lisbon Treaty, a number of other policy and institutional mechanisms were conceived and implemented to complement the existing institutional structures. Some of these mechanisms were created without EU Treaty or legislative change: the Fiscal Compact, the European Financial Stability Facility (EFSF), and the European Stability Mechanism (ESM) were adopted outside of the EU framework. There were also changes that involved the usual EU legislative paths, but had the potential of having far-reaching effects in economic and financial integration: the so-called Six Pack and Two Pack (including the European Semester), the Macroeconomic Imbalances Procedure and various elements of Banking Union were adopted subsequently as part of the effort to address the incomplete institutional architecture that undermined the viability of EMU.

There have been major disagreements among member states on deeper integration to tackle these two main EMU asymmetries. Solutions were found to accommodate those member states opposed to further supranationalism and the reinforcement of EU institutions notably through the establishment of an intergovernmental institutional structure to manage a range of new policy making functions. Furthermore, without the full support of all the member states, a number of *ad hoc* arrangements were made to advance European integration outside the EU legal framework. United Kingdom government opposition to treaty change necessitated the adoption of intergovernmental treaties to establish both the Fiscal Compact and the ESM. Agreements on Banking Union involved (to date) only the Euro Area member states – further entrenching differentiated integration in the EU. At the same time, Euro Area member states were fundamentally divided on a range of possible reforms to stabilise the Euro Area. Two of the core elements of Banking Union – deposit insurance and a fiscal backstop for bank resolution – escaped agreement largely because of German government opposition (Howarth and Quaglia 2016). The German government also insisted upon an intergovernmental side agreement to adopt the Single Resolution Fund (SRF). Even as the EU member states and institutions are considering the next steps for EMU, as outlined in the White Paper and the Reflection Paper (European Commission 2017a, 2017b), various major proposed reforms – including the adoption of a Euro Area budget – remain contested by a number of Euro Area member states.

The two EMU asymmetries are presented here as a form of organising device. Not all of the contributions in this collection speak to both of them; some concentrate on only one asymmetry. Each of the two asymmetries straddle various dimensions. The first asymmetry is predominantly institutional, in that there is a supranational institutional structure in monetary policy making while the institutions involved in fiscal policy making operate more in the intergovernmental domain – despite important powers assigned to the European Commission – with predominant responsibilities lying with the member states. This asymmetry also has important policy and political dimensions, and raises questions about the legitimacy, democracy and effectiveness of EMU (Verdun 1998). In the negotiations leading to the Maastricht Treaty, those who designed the EMU blueprint were aware of this asymmetry (Dyson and Featherstone 1999). The second asymmetry – between core and periphery – also has institutional, policy and political dimensions, which overlap with but are distinct from those of the first asymmetry. This core-periphery asymmetry raises fundamental questions about necessary Euro Area macroeconomic policy coordination, the need for financial support and the conditions attached to this support, and the relative burdens of adjustment – all highlighting perceived redistributive implications. This asymmetry was also present in public and academic discussions from the pre-EMU and early EMU period, although the institutional, policy and political implications were inadequately explored (Bayoumi and Eichengreen 1993; Artis and Zhang 2001; see also De Grauwe 2018: 80. On 'core-periphery' in international relations theory, see Wallerstein 2004, 11–12).

This collection brings together scholars who assess various aspects of EMU based on different theoretically-informed analyses. The contributors adopt a pluralist approach to theory and methods, applying a variety of conceptual lenses to illuminate the complex and rapidly moving developments in European economic and monetary integration. The individual contributions offer analyses of the institutional design of EMU, the challenges of the past decade, and the issues with which scholars are confronted in studying the multifaceted institutional phenomenon that is EMU. Using distinct methodologies, each contribution draws out important insights with regard to the operation of EMU and seeks to answer – or at least shed new light on – some of the pressing questions that have emerged over the past decade.

Difficulties arising from the two EMU asymmetries became very much apparent in the wake of the financial and sovereign debt crises, along with the growing realisation that existing EU governance arrangements were ill-equipped to deal with the challenges they faced. Looking back at the second decade of EMU compared to the first (Dyson 2008; Enderlein and Verdun 2009; Warin 2010), we notice that while some issues are similar; others have changed considerably. EMU has generated redistributive effects. During the first decade of EMU, these effects did not translate into decreased legitimacy or an intensified perception of a democratic deficit. However, during its second decade, the immense difficulties facing EMU and the institutional responses to these difficulties have intensified legitimacy and democratic concerns and contributed to a further politicisation of EU policies. During its first decade, EMU coped with an asymmetrical institutional framework, with monetary largely decoupled from economic/political union. During its second decade, however, the need for economic/political integration has arguably increased given the political implications of the core-periphery asymmetry and the risks of disintegration.

The contributions to this volume deal with the two asymmetries from different angles. More specifically, the volume hones in on the following ten topics, which collectively form part of a comprehensive assessment of EMU developments over the past two decades. First, the Euro Area crisis brought to the fore the long-sought possibility that the asymmetry of economic and monetary policies in EMU could be solved through more federalisation – more 'political union'. The past decade demonstrates how this process of federalisation followed an accidental – rather than a planned – design. At the same time the federalist ideals were there for member state governments and EU institutions to pick and choose from (Hodson 2020). Second, the Euro Area crisis has also transformed the role of the European Central Bank (ECB). This EU institution was effectively the only one that could act on behalf of the entire Euro Area. No other institution was as able to act without having to consult member state governments or reach watered down compromises. However, ECB unconventional monetary policies and participation in the Troika also resulted in considerable concept stretching as to its mandate and challenges as to the legitimacy of its operation (Chang 2020). Third, due to the lack of deeper integration in the fiscal domain, other types of arrangements were necessary to coordinate budgetary and fiscal policies. Some member state governments were very concerned about providing large sums of money to debtor countries. Thus, coordination of macroeconomic policies needed to be achieved through other, more ad hoc, mechanisms. The EU institutions and member state governments drew on a mix of theoretical insights about optimal policy solutions whilst being forced to be practical about what was attainable. The result involved drawing on mechanisms first experimented with in the Open Method of Coordination by introducing policy coordination through a mix of benchmarking, rules and sanctions. In due course, the European Semester was developed to assist with fiscal policy coordination (Haas et al. 2020). Fourth, how have the problems faced by euro periphery member states demonstrated the faulty design of the EMU architecture? How does the current EMU design intensify or mitigate the challenges that these periphery member states face? Notermans and Piattoni (2020) examine how the euro periphery has dealt with these challenges by studying the case of Italy. Pagoulatos (2020) examines how EMU contributed to the Greek crisis and what the EU's rescue of Greece has meant for EMU governance. The three Baltic States suffered considerably during the global financial crisis, but – against the advice of the International Monetary Fund (IMF) – decided to pursue euro adoption rather than floating exchange rates (Dandashly and Verdun 2020).

The ad hoc nature by which EMU governance has developed, since the outbreak of the Sovereign Debt Crisis, has led many policy makers and academic observers to question whether the legitimacy of the EU (or, more specifically, of Euro Area governance) has been compromised. How has the democratic legitimacy of EMU been affected by the crisis? Are the concepts of output and input legitimacy still of use in this context (Crum and Merlo 2020)? Next, since the onset of the Euro Area Financial Crisis, public opinion has surprised observers. On the one hand, the public has remained supportive of the euro and the EU institutions that back it. On the other hand, there has been a gradual decrease in the permissive consensus on the notion of European integration more generally. Some of the Original Six member states have become clearly less enthusiastic about European integration. Banducci and Loedel (2020) provide an innovative feminist account to examine whether women continue to hold more sceptical views on the Single Currency and whether this is the case across various age cohorts. Howarth and Quaglia (2020) examine the new financial institutional framework of the EU that emerged as it became clear that the Union was unable to deal with the challenges posed by the Sovereign Debt Crisis. The deeper integration among Euro Area members in Banking Union possibly increases the schism between Euro Area member states and the EU member states that remain outside the euro, which in turn potentially undermines the Single Market. Finally, the Franco-German motor that has driven European integration since the 1950s, and ultimately the EMU project, has also developed significantly over the past twenty years. The increasingly prominent position of Germany in recent years has brought to the fore the challenge related to the core-periphery asymmetry, in particular with reference to the relative influence on EMU of two core member states – France and Germany. Schild (2020) assesses the implications of this asymmetry for recent and future institutional and policy developments.

Taken together, this collection of papers provides new insights into what an asymmetrical EMU means following two decades of Euro Area operation. The analyses of the contributions of this volume broaden our understanding of the main concepts, processes and effects of European economic and monetary governance. The crises of the past decade shook the EU to its very foundations. The current Coronavirus crisis will likely bring about further reform to economic governance as member states struggle to mitigate the destabilising social and economic effects of the crisis and notably in the Euro Area periphery. In the next decade, EU and member state government leaders will need to address the institutional weaknesses of economic governance that persist and have been thoroughly analysed in this collection focused upon EMU's two asymmetries.

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Disclosure statement

No potential conflict of interest was reported by the authors.

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