Will the Monetary Union collapse or will the present troubles lead into a European Super State?[1]

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1. Introduction

The former Austrian Chancellor *Alfred Gusenbauer* (in office 2007/ 2008) once stated under the impression of the financial crisis: 'I do not want to imagine where we would stand today, if we did not have the Euro. … The Euro is the only currency which was not attacked by speculation, it has established itself on the market as the strongest currency and it functions as a stability anchor.'

Yes, at first glance he may be right, because we are facing a debt crisis of some smaller EU Member States and not (yet) a Euro crisis at the moment (according former German Chancellor *Helmut Schmidt* in the German weekly newspaper *DIE ZEIT*, Hamburg, 22.06.2011). Besides this the statement applies only within the context of the financial markets' view as far as the Euro has dried up lucrative business of financial capital funds and investment banks thus protecting the Eurozone countries against irrational speculative currency attacks. But even in the financial markets' context Mr. *Gusenbauer*s optimism can be questioned seriously because it ignored that business activities of those investment banks and hedge funds dealing with so-called financial market innovations such as derivatives have shifted to speculation with Credit Default Swaps (CDS) by an interplay of these financial alchemists with US Credit Rating Agencies (CRA). As the Austrian and Swiss-German economic researcher *Stephan Schulmeister* and *Thomas Straubhaar* respectively pointed out this interplay by assigning credit ratings for issuers of (government) debt obligations in combination with CDS speculation leads to downgrading of the concerned states' credit scores. This raises interest rates of the bonds because of higher default risks being expected (*Schulmeister* in: *Die Presse*, Wien, 18.06.2011) and may even create a vicious circle provoking state default rumours (*Straubhaar*, in: *Focus*, München, 16.06.2011).

Irrespective of this in terms of the 'real' economy [*Realwirtschaft*], however, there is no reason to forget all the economic and social disparities between Euro-countries putting potentially the Monetary Union (MU) at risk – even of its collapse, in particular if certain compensation mechanisms are not sufficient. The necessity of those can be demonstrated clearly by means of the **'Optimum Currency Area' (OCA)** theory.

I am not an expert in banking matters and business. So in the following I shall **at first deal with problems of the 'real' economy** (section 2) and I shall not primarily argue in terms of financial economy[3], financial crisis, defaulting and indebtedness, last but not least because in my view the fundamental problems of the MU would have become apparent even without the present financial troubles. **They may be aggravated by the financial crisis** and may have become apparent earlier than it would have been the case without the crisis. Up to now the Euro may have delayed but it will not prevent completely the slopping over of the crisis to the real economy nor does it remove real economy disparities - on the contrary, these even could be increased.

Following the real economy problems I shall focus **mainly on the institutional aspects of crisis management** and the implications of the crisis in particular with respect to the shaping of new features and elements approaching the EU more and more towards a conventional state (section 3), and I shall not deal directly with the widely discussed individual problems of certain Member States and the question whether all these rescue packages under discussion would be really sufficient or not. Finally the last section (4) shall only raise some questions without indicating definite answers how a future framework of European integration could look like.

1 Revised version of a paper presented to the workshop ***International Indebtedness and the Future of the Eurozone*** on the occasion of the EUDemocrats Annual Meeting in Budapest, 18 June 2011. This version was finalized on 24 June 2011 when the European Council agreed on a further aid package for Greece provided that the country will decide extensive economic reforms and austerity programs challenging democratic legitimacy seriously by these measures. The first section (I) of this paper and the first topic (1) of the second section (II) is partly based on the author's articles *The Euro and the OCA: Will the Monetary Union collapse?* and *The financial crisis: Strengthening or weakening the EU*, published in: EUWatch, November 2006 (Issue 3) and December 2008 (Issue 13); reprinted in: *Klaus Heeger/ Károly Lóránt* (eds.), The EU from a Critical Perspective - A selection of articles from EUWatch, Independence/ Democracy Group in the European Parliament, Luxembourg 2009. The central arguments of this paper had not been affected, but on the contrary confirmed rather by the results of the extraordinary summit meeting on 21 July 2011 which only could be indicated in this paper without going into the details.

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3 *Real economy* means all that we can see and touch such as consumption, investment ('real' capital), exports, imports. *Financial economy* means how this is financed ('financial' capital). This cannot be seen immediately or only when we would have a look into bank accounts (if certain financial operations are not hidden for criminal fraud intentions).

2. Problems of the 'Real' Economy: The Theory of Optimum Currency Areas

Exactly 50 years ago in 1961 *Robert A. Mundell* published an article in the *American Economic Review* (vol. 51, issue 4) on ***A Theory of Optimum Currency Areas*** (for which he was also awarded the Nobel Prize in 1999 - the same year when the third stage of the MU was started by fixing the exchange rates between the candidate currencies). In the early 1990s several economists (*B. Eichengreen*, *J. v. Hagen*, *M.J.M. Neumann*) applied *Mundell*'s ideas f.e. by asking whether Europe could be an Optimum Currency Area and by analyzing the real exchange rates within and between Currency Areas. One of the most important books on the economics of monetary integration dealing with the OCA theory and the costs and benefits of monetary integration was published 1992 by *Paul De Grauwe*, Professor of Economics at the University of Leuven, Belgium. It is now available in the 8th edition (2009, Oxford University Press) titled *Economics of Monetary Union*.

Prof. *De Grauwe* is one of the most distinguished monetary economists (worldwide) and has been also member of the Group of Economic Policy Analysis advising EC President *Barroso* and member of the Belgian Senate until 2003.

All these economic research results had been well known in those years of the early 1990s when the Austrian negotiations joining the EU were in progress which at the same time comprised - just as for the old Member States - future MU membership under the new regime of the Maastricht Treaty coming into force at the end of 1993. In this time I was a staff member of the Austrian Finance Ministry being involved in the preparations of these negotiations. Thus as civil servants in the role of economic policy advisers we called our political leaders' attention to these problems saying YES, you can do it, but be aware - it is a project under risk that only could be minimized if the implications will be considered carefully. These implications had been demonstrated clearly by means of the OCA theory.

The OCA theory postulates that MU candidate countries should form an **area which is sufficiently similar if not homogeneous from an economic and social point of view** (concerning common economic and social standards and performances) to provide a stable basis for the common currency. As MU means **centralization of monetary policy and giving up national exchange rate autonomy** asymmetric economic shocks cannot be absorbed by national exchange rate policy any longer (in particular by devaluation of the national currency to regain competitiveness of national goods and services on the world market). The OCA theory therefore developed several **criteria or conditions which justify giving up exchange rate autonomy** by entering the MU. These are in particular:

- **sufficient flexibility of wages** in the future MU;
- **sufficient labour mobility** in the future MU (i.e. within and between the MU member candidates);
- **freedom of capital mobility** within the MU;
- **stability of the real exchange rate behaviour** (variability) between the candidate countries which is measured by the price level and cost ratios (in real terms) between the candidate economies.

It is self-evident that these conditions are more differentiated than those 'simple' and with respect to the political respect by Member States and the practice by the EU institutions more or less 'soft' criteria stated by the Maastricht Treaty 1992 (although being specified by the Stability Pact 1997) which focus mainly on budgetary discipline by avoidance of excessive government deficits in the first place and stock of government debt as well (although in the second place).

Whereas the freedom of capital was introduced on 1 July 1990 and later linked to the first stage of the European MU by the Maastricht Treaty 1992 (thus pulling down already one of the most important bastions of national economic policy - this date may therefore already fix somehow a point of no return), **the other criteria in reality are not fulfilled** (although freedom of movement for workers is legally guaranteed by the Treaty). **This causes economic and social disparities between the MU member countries putting the MU at risk** - even of its collapse as a whole or of a breaking away of those members who are under pressure because of significant disparities. In the latter case perhaps that 'hard core' of countries which had already pegged their currencies before the first stage of the MU started, namely Germany, the Netherlands and Austria, would remain. This area, which is nearly identical with the Holy Roman Empire of the German Nation, would according to the empirical findings of the OCA economists mentioned above mostly fulfil the OCA-criteria. From a historian's point of view this may be regarded as a fascinating result of historical continuity and congruence.

The main idea of the OCA theory focuses on **minimizing the risk** mentioned above. This is only manageable if several **compensation mechanisms** are (going to be) established, namely:

- **more funds** for the Union budget to establish a (partly automatic, partly discretionary) **fiscal equalization system** (similar to that in several European federal states) in a more effective way than it is provided by the structural funds up to now leading last but not least into a **Transfer Union**
  - by augmenting national contributions to the Union budget,
  - if this would turn out to be impossible or not sufficient, by introducing EU taxes, in particular income taxes (i.e. partly centralization of taxation policy which could be called **Tax Union**);
- **more Union competences (centralization)** in the field of income policy, social policy, employment and labour market policy (in particular to improve the comparative advantages and thus the competitiveness of the MU economies and the European economy as a whole); in the world of neo-liberal theories this would mean more deregulation, in eurocratic practice however, presumably more re-regulation at supra-national level; partly this can be viewed anyway as elements of some kind of **Social Union**.

Last but not least only a **Political Union** could guarantee all the functioning of these compensation mechanisms because dealing with economic and social disparities and activating compensation mechanisms causes political and social conflicts, needs political support and above all democratic legitimacy. **Centralization of monetary policy alone would turn out as insufficient** since the limits of a purely economic integration and – in addition to that - the deficits of political legitimacy of the independent European Central Bank (ECB) would become evident.

As far as the limited budgetary resources are concerned we should be aware that according to the present EU Financial Framework 2007-2013 the maximum percentage of budgetary commitment appropriations amounts to 1.12 % of the European GNI (Gross National Income at market prices) and the maximum percentage of payment appropriations (i.e. the own resources ceiling) amounts to 1.23 % of GNI. These are peanuts in comparison to the GNI shares of national Member State budgets.

All these facts are well-known in the world of academic economics since 1961 *Mundell* published his path-breaking article on the OCA theory.

Besides this particularly in the case of rising unemployment a lot of contradictions and inconsistencies between economic policy instruments would become tangible, namely between supply-side oriented OCA conditions (flexibility of wages, movement of labour and capital - in this sense based more on neo-liberally influenced economic theory favouring market economy) and demand-side oriented national fiscal policy instruments (based on Keynesian economics favouring state interventions if necessary). The latter will come more and more under pressure because of the requirements to achieve the Maastricht and Stability Pact criteria (although these criteria may be viewed as a simplistic vulgar economics approach of monetarist epigones). Thus, if the EU member states will refuse to provide additional funding of the Union budget to counteract economic disparities between Member States (in particular those of the MU, but even more as regards to the MU candidates) the 'second best' solution could only consist in maintaining sufficient budgetary autonomy at the national level – even by allowing increasing national budget deficits to enable member states to manage their economic problems at home by themselves by following rather the Keynesian line of economic thinking. This, however, would contradict the Maastricht Treaty and Stability Pact criteria.

Whatever economic paradigm will prevail we usually see a complex pattern of partly centralized (i.e. Union), partly decentralized (i.e. nation state) competence and responsibilities which is continuously changing in the course of the integration process. So it has to be analyzed carefully according to the **subsidiarity principle** whether and how far any Union action shall be taken or not. This would mean to identify clearly what kind of responsibilities should/ could be centralized and what should/ could remain decentralized i.e. in the hands of Member States. As it is stated in the Treaty (Article 5.3 TEU) the Union shall take action in areas not falling within its exclusive competence 'only if and insofar as the objectives of the proposed action **cannot be sufficiently** achieved by the Member States, ..., but can rather, by reasons of the scale or effects of the proposed action, be **better** achieved at Union level.' Although the principle may be well known and have been discussed intensively it might not be respected and established sufficiently by the real practice.

From the subsidiarity point of view it could be seriously questioned whether - apart from certain common minimum standards - it makes sense to centralize all kind of matters of social and employment policy as the OCA compensation mechanisms would suggest. Usually people are concerned by these matters in their daily life experience and standard of living. So there are good arguments that these matters can be better organized at the Member State level and there even at the regional and local level. Therefore according to the subsidiarity principle the Union should take action only with respect to those objectives which can be better achieved at its level, f.e. by establishing common minimum standards.

If - in the worst case - neither sufficient funds for establishing a fiscal equalization mechanism on the supra-national level nor additional funding from national budgets can be provided, we shall perhaps experience a lot of **Mezzogiorno effects** within the MU. This reminds to a saying of the former President of the Milan Chamber of Commerce, *P. Bassetti* (in an article published in the German weekly newspaper *DIE ZEIT*, Hamburg, 04.06.1993), that the economic problems of Mezzogiorno had been created by the Italian monetary union in 1861. This would mean that the MU will imply rather disintegrative effects and will not unfold those integrative effects which had been intended by the founding fathers (and mothers) of European integration. As the Mezzogiorno example further demonstrates we can in principle identify the same problems demonstrated by the OCA theory in the context of any nation state such embodying nothing else as a (national) monetary union between its regions showing more or less significant interregional disparities irrespective of the fact whether we are dealing with a federal (decentralized) or a centralized nation state.

With respect to systems of fiscal federalism the European Commission emphasized some remarkable differences between certain existing federal systems in a study titled *One market - one money* and published in 1990 (*European Economy*, vol. 44). This was part of some kind of cost-benefit-analysis of the MU being in the stage of realization. Concerning fiscal autonomy and effectiveness to reduce interregional income differentials caused by asymmetric shocks a trade-off between fiscal autonomy and redistribution effects of fiscal equalization among western federal systems was stated. Accordingly because of constant monitoring the public debt of her constituent states Australia (5) has the lowest degree of fiscal autonomy within her fiscal system after (1) Switzerland, (2) Canada, (3) USA, (4) Germany, but the highest degree of effectiveness of interregional redistribution by fiscal equalization such showing nearly the reverse order of the states just mentioned with respect to this criterion. This might have been an implicit hint what kind of a future model of European fiscal federalism could be preferred by the Commission economists.

To sum it up:

- **Building the MU has enormous impacts on more centralization in other policy areas for compensating the risks when the OCA conditions are not fulfilled.**
- **Only a Political Union can at last guarantee all the functioning of these compensation mechanisms for reasons of necessary political support and democratic legitimacy.**
- **The less homogeneous the MU area, the greater the economic and social disparities within the area - the greater the risks of a purely monetary integration and therefore the more intensive the impacts and tendencies for centralization towards a Political Union will turn out.**
- **If the Union will not succeed in minimizing the risks pointed out by the OCA theory, economic and social disparities would not only been reduced sufficiently but on the contrary even increased by stimulating disintegrative tendencies and in the worst case the MU could collapse.**
- **This would mean an enormous setback of European integration which probably would be tried to be prevented by all means being manageable under the given political, economic and legal restrictions.**
- **In principle we can identify exactly the same problems with respect to interregional disparities within the national context when looking on the monetary, fiscal, socio-economic and political system of any nation state before joining a MU with other nation states.**

As in many other cases of significant historical events it is not possible to differentiate clearly whether these general centralization impacts of the MU had been the outcome of a 'grand design' of sophisticated eurocratic *planification*, whether they had been followed simply implicit (unspoken) secondary objectives of the decision to centralize monetary policy or whether all this did happen more or less accidentally by using a window of opportunity opened by the global political constellation (breakdown of the Iron Curtain and German unification). Probably all three possibilities did coincide, but besides this one should remember that 1 July 1990 is a remarkable date. Not only freedom of capital linked to the first stage of the European MU had been introduced, but also the German monetary and economic union had been established some months before the political unification was finalized. Historians may draw their conclusions.

What we can see up to now besides the MU are **sector elements of Union concepts** which hardly can be called Transfer Union, Social Union or Tax Union (for the Economic Union see below) and from an economic point of view there is at least one thing which can be stated clearly in any case: **There are serious indications that we are witnessing the final of the Euro** according to an article of the Austrian economic researcher *Stephan Schulmeister* (*Endspiel um den Euro*, in: *Die Presse*, Wien, 18.06.2011). Therefore let me now have a look on some institutional aspects of the recent political discussion of some strategies followed by the European political class to avoid a collapse in any case.

3. The EU becoming more and more a conventional state

What we can see now in particular under the impression of the present financial crisis as new institutional elements are **patchwork, muddling-through** and more or less convulsive, sometimes even **desperate and legally doubtful attempts** to establish mechanisms under the legal regime of the Lisbon Treaty **to improve effectiveness of crisis management** and its political backing by creating subsidiary instruments which should provide similar legitimacy as conventional state interventions at the national level. I restrict myself in the following arguments on **four institutional aspects** on the European level without trying to identify specific problems of certain well known Member States and dealing neither with technical details of financial operations like debt release or haircut, granting easier terms of repayment and/ or voluntary private creditor contribution by roll-overs of existing debts and last but not least budgetary cut back management, privatization and structural reform of these Member States. All this is widely discussed in these days and weeks.

These four institutional aspects as elements of the muddling-through patchwork will exclusively be regarded in the following *prima facie* without any value judgement whether they could be a good or a bad thing from an economic point of view managing the present crisis. So the main focus will be on the institutional point of view when looking at the predominant logic of European integration whether and how far they would establish new state elements such embodying more centralization and approaching the EU to a conventional (super) state. All this may be the result of the centralization impacts of the MU mentioned above.

(1) European economic governement (*gouvernement économique*):

It is really not surprising that in the event of the financial crisis the question of a **European economic government** as a political counterpart to the independent ECB was again raised by French President *Nicolas Sarkozy*, as this is in line with an old French postulate based on the typical French tradition of é*tatism* dating back to *Colbert*, the French minister of finance under King Louis XIV. It conflicts with the anti-etatist neo-liberal mainstream which perhaps has come under pressure under the influences of the present crisis although there are not yet sufficient indices that it has been really overcome. These mainstream ideas had been fully unfolded under the dominant ideology of the freedom of capital mobility established on 1 July 1990 and later linked to the first stage of the MU. Now we seem to harvest its rotten fruit.

In the mid-1990s, the Germans (*Theo Waigel* then finance minister) advocated the Maastricht Stability criteria, strictly following the neo-liberal monetarist mainstream. This was answered by the French proposal of a *gouvernement* économique which was immediately rejected by Germany because it feared that this would threaten the ECB's independence. The outcome was (1) the adoption of the Stability

Pact at the Amsterdam summit 1997 and (2) the establishment of the Euro-Group composed of the finance ministers of the Euro-countries as a compromise answer to the French demand.

Sarkozy – perhaps following his specific personal ambitions – **revived the old idea of an economic government** (1) by setting up the Euro-Group in the composition of the Heads of State or Government and (2) by achieving an agreement of European leaders on stressing the necessity of the existing coordination procedures among all 27 Member States (and not exclusively among the Euro countries), whatever this at each opportune moment steadily repeated formula could mean. **In *Angela Merkel*'s words** on the occasion of an informal European Council meeting on 7 November 2008: 'The Council in the composition of the Heads of State or Government… is of course a body dealing with economic questions – **just call it economic government**. The crucial point is that it covers all 27 Member States.' This seems to indicate sufficiently that she was not really happy with the French initiative because the old German *Bundesbank* ideology keeping central banks free from any political influence would be jeopardized.

(2) Euro-Plus Pact:

Three years later in 2011 this led to the **Euro-Plus Pact**, also called the **Competitiveness Pact**, which was agreed by the Eurozone Heads of State or Government on 11 March 2011 and confirmed by the European Council on 24 March 2011 (together with the permanent rescue funding program ESM - see below). In this 'Pact' Member States made commitments to a list of political reforms which are intended **to improve fiscal strength as well as coordination of economic policies**. It had been advocated by the French and German governments for more widespread adoption by other Eurozone countries embodying again a typical French/ German compromise between French *étatism* and German reserves against *gouvernement économique*. As such it is intended as a more stringent successor to the Stability and Growth Pact of 1997, which has not been implemented consistently enough in the past. In principle this does not alter the fact that the concept of a European **Economic Union** still exists only in the form of more or less strengthened **coordination procedures** whose strengthening seems to have become a permanently repeated EU exercise demonstrating nothing else as symbolic use of politics. So the finance ministers agreed once again on strengthening economic governance at the ECOFIN Council on 20 June 2011.

(3) Bypassing the No Bailout Clause and a remarkable provisional role of the ECB as a substitute player in the face of insufficient and controversial political action:

The famous **No Bailout Clause** was introduced by the Maastricht Treaty (now Article 125 of the Lisbon Treaty - TFEU) stating that the Union and any Member State as well shall **not** be liable **for** or assume **the** commitment of national governments of any Member State or another Member State respectively (without prejudice to mutual financial guarantees for the joint execution of a specific project). This clause marks an important difference to the financial regulations within some federal nation states and their systems of fiscal federalism.

In 1837 several US states faced a financial crisis raising a discussion about state insolvency and federal bailout. Although then the federation refused bailout because of explicitly missing legal authorization by the US Constitution bankruptcy declaration of the involved states could be prevented by debt conversion operations. During the last two years the debate about a the need of a legal basis to bailout struggling and defaulting states by federal taxpayers raised again including the question to allow states to reorganize their debts by declaring bankruptcy. Both is strictly opposed by a bipartisan majority of the US Congress (cf. an article in *The Wallstreet Journal* on 24.01.2011 quoting US House of Representatives Majority Leader *Eric Cantor*: 'No Federal Bailout of States'). So now as ever state and local governments depend on ad hoc subsidies by the federal government to balance their budgets.

Apart from institutionalizing a fiscal equalization mechanisms which is significantly more effective in Germany than in the USA (cf. the Commission study *One market - one money*, mentioned above) we can in principle find the same legal situation in European federal states like Austria and Germany as far state insolvency and federal bailout is concerned, namely that it has not been foreseen and thus not considered by the constitution. Therefore one shall not see states, regional and local governments - despite defaulting in economic terms - legally declaring bankruptcy. Nevertheless from a political point of view in many cases defaulting will cause economic and political pressure so that federal bailouts may turn out unavoidable. So the same informal rule that fits to large banks, namely that they are too big to fail, also fits to states of a federal union, namely that they are politically (although not necessarily also economically) too important to fail, in other words: that it would be perhaps politically too sensitive to let them fail because of the risk to get lost political credibility and legitimacy. This is now going to be experienced in the EU although in the Greek case and even in the case of a similar involvement of Portugal and Ireland this could and even should be manageable with respect to a percentage share of these economies of not more than 5 or 6% of the Common Market (*Helmut Schmidt*, in: *DIE ZEIT*, 22.06.2011). This is relatively spoken significantly less than the Germans had face with managing the German unification in the 1990s and even up to now. In this sense the attempt to bypass the No Bailout Clause in the EU becomes understandable. On the other hand it demonstrates an important further element approaching the EU to a conventional state. Legally this was managed as follows:

On 16 December 2010 the European Council agreed a two line amendment to the Treaty to be inserted into Article 136 TFEU that was thought to avoid any referendums in the national ratification procedures (whether this could succeed seems a question to be answered from the point of view of Member States constitutions). The amendment is nothing else as some kind of bypassing the No Bailout Clause which seems not completely free from legal doubts. It reads: 'The member states whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting

of any required financial assistance under the mechanism will be made subject to strict conditionality' (whatever this could mean).

Consequently the **European Stability Mechanism** (**ESM**) as a permanent rescue funding program was institutionalized by the Eurozone Heads of State or Government on 11 March 2011, politically confirmed by the European Council on 24 March 2011 and legally confirmed by the ECOFIN Council on 20 June 2011. Legally it will be based on a special treaty between the Eurozone Member States and shall be launched in mid-2013.

It succeeds the present **temporary European Financial Stability Facility EFSF** (agreed by the Eurozone members according ECOFIN Council decision of 9 May 2010 and based on their guarantee commitments of 440 bn EUR) and the **European Financial Stabilization Mechanism EFSM** (agreed by the EU Member States according Council Regulation of 11 May 2010, guaranteed by the European Commission and based on the EU budget).

The **new permanent ESM** will be composed of three parts: (1) Basic capital stock directly deposited by all Eurozone Member States (80 bn EUR); (2) guarantee commitments by Eurozone Member States (620 bn EUR) - both according to their shares in the ECB capital; (3) credits of the International Monetary Fund (IMF). The ESM will be allowed to give emergency credits as rescue funding program and to buy loans - the latter has been allowed temporarily to the EFSF as well beginning with March 2011.

The same has already been practiced by the ECB since 10 May 2010 when the ECB Governing Council decided 'measures to address severe tensions in financial markets ... to conduct interventions in the euro area public and private debt securities markets (Securities Markets Program)' which in clear text meant buying up problematic ('toxic') loans of those states facing serious debt problems, i.e. taking them out of the market. This could be questioned from a legal point of view looking at the ECB's definition of competence in the Treaty and it could be even questioned from an economic point of view because of potential inflationary effects by an increase of money supply, apart from the risks the ECB has to face like a 'usual' bank before it could be sure to be rescued by the Eurozone member countries. This would challenge its independence seriously and furthermore it demonstrates clearly the ECB's dilemma by taking the role of some kind of substitute player in the face of insufficient and - because of controversial positions - hesitating action of the responsible political leaders as prominent German social-democratic political leaders, meanwhile retired, former Chancellor *Helmut Schmidt* and former finance minister *Peer Steinbrück* pointed out clearly in the distinguished German weekly newspaper *DIE ZEIT* (Hamburg, 22.06.2011, the latter in an article titled *Wir tun nicht, was wir wissen* - ' We do not do what we know').

Under certain conditions contributions of private creditors for refunding debts (legally to be enabled by so-called 'collective action clauses' in the case of default) and some kind of state insolvency procedure by public debt rescheduling of those Member States facing serious financial difficulties will be possible under the future ESM regime. Under the present temporary EFSF regime encouragement of the private banking sector has been discussed controversially. On their meeting on 14 June 2011 Eurozone officials failed to narrow controversial positions how to get Greece's private creditors to contribute financing the country's mounting public debt which has been advocated in particular by German finance minister *Wolfgang Schäuble* against the reservations of the ECB which (supported by France) raised concerns that those extremely sensitive creatures on which *tout le monde* seems to look like the rabbit on the snake, namely the financial markets, could be worried and the Credit Rating Agencies (CRA) perhaps could feel compelled to downgrade the heavily indebted countries' credibility completely to default if contribution of private creditors (banks) would become obligatory. This controversy threatened to delay the decision on a new aid package for Greece at the moment. On their bilateral meeting on 17 June 2011 the European Super Couple *Nicolas Sarkozy* and *Angela Merkel* agreed one of their typical German-French compromises saying that private creditor contribution should be established on the basis of a voluntarily self-commitment according to the successful model of the so-called Vienna Initiative being launched 2009 in the Eastern European emerging economies in cooperation with IMF and World Bank. The Eurozone ministers confirmed this compromise at their meeting on 20 June 2011 although it was also stated that the Greek fiscal consolidation programs being reviewed by the 'Troika' of European Commission, ECB and IMF more or less by means of political pressure should be evaluated at first before deciding a new rescue package. The political pressure finally was increased by the European Council on 23 June 2011.

In particular in Germany these new financial rescue instruments - although being mainly guarantee commitments - have raised intensive controversies because of fears that they could build a nucleus of a 'Transfer Union' and last but not least because of internal constitutional reasons (impairment of the parliament's sovereignty in budgetary matters if these enormous amounts of liabilities become payable). That a transfer union by establishing a fiscal equalization mechanism is regarded as a normal thing in a federal state on the national level (being called fiscal federalism) has been nearly neglected in this partly even polemic discussion.

(4) Last but not least some remarkable dreams: European Finance Ministry, Eurobonds and European Monetary Fund - partly come true by the Extraordinary Summit Meeting on 21 July 2011?

Besides this several important persons have some remarkable dreams: ECB-President *Jean-Claude Trichet* is dreaming of a **European Finance Ministry** (on the occasion of being awarded the *Karls-Preis* in Aachen on 2 June 2011). President of the Euro Group *Jean-Claude Juncker* is dreaming of **Eurobonds** which should be emitted by a special debt agency in the name of all Eurozone members instead of the present debt regime being managed independently by each Member State. This should equalize interest rates, in particular by reducing high interest rates for countries facing financial difficulties (because of the higher risk in these countries). On the other hand it would mean higher interest rates for more stable economies like Germany thus being strictly

Fig. 1

opposed by these countries. The debt agency finally could become the **core of a future European Monetary Fund (EMF)** being proposed already by several prominent political leaders (among others German Finance Minister *Wolfgang Schäuble*). *Stephan Schulmeister*, Austrian economic researcher, highly welcomed the proposals establishing the EMF on the basis of the intended Stability Mechanism ESM whereby the (new) EMF should be authorized for emission Eurobonds. These would prevent enormous increase of debt interest rates in the countries facing a debt crisis because of the higher risk.

In this context the euro area leaders took - in their view full of hope and optimism - three important decisions at an extraordinary summit meeting on 21 July 2011:[4] 'We improved Greek debt sustainability, we took measures to stop the risk of contagion and finally we committed to improve the eurozone's crisis management'.

This should be achieved in particular (1) by granting a new aid package to Greece; (2) by lengthening the maturity of future EFSF loans to Greece, (3) by reducing interest rates for EFSF loans to Greece; (4) by private (financial) sector involvement (contribution) supporting Greece on a voluntary basis as it had been discussed controversially five weeks ago already, and (5) by improving the effectiveness of the EFSF and of the future ESM above all to address contagion by increasing flexibility of this facility/ mechanism, namely by 'allowing them to act on the basis of a precautionary programme; finance recapitalisation of financial institutions through loans to governments including in non programme countries; intervene in the secondary markets on the basis of an ECB analysis recognizing the existence of exceptional market circumstances and risks to financial stability and on the basis of a decision by mutual agreement of the EFSF/ ESM Member States, to avoid contagion.'

It is thought that the provisional and legally doubtful role of the ECB as a 'substitute player' will be transferred to the EFSF/ ESM thus becoming the **core of a (future) European Monetary Fund** by allowing them precautionary operations, buying loans (intervening in the secondary markets) and financing recapitalisation of financial institutions all of which comes **rather similar to Eurobonds**. According *Frankfurter Allgemeine Zeitung FAZ* (Frankfurt 21.07.201) critics as *Hans-Werner Sinn* (ifo Institute for Economic Research Munich) and *Ansgar Belke* (German Institute for Economic Research Berlin) raise serious doubts saying that 'socialisation of debts' will continue cheerfully (*Sinn*) and the process of changing the Monetary Union to a complete 'liability union' will be opened (the 'Transferunion' being institutionalized already - *Belke*). In political terms according *Wallstreet Journal* (New York, 22.07.2011) the summit results represent a German/ French deal by which German Chancellor *Angela Merkel* in the face of domestic opposition to creating a 'Transferunion' opened the door to greater fiscal aid than her country had once contemplated. In return to this new Greek bailout, 'she won a commitment that banks and other private creditors - and not just taxpayers - would have to bear some of the burden.' Nothing has to be added at the moment.

4. Conclusions

Let me end by raising some questions without indicating definite answers to stimulate discussion, because I am not able to give such answers and it is not even my intention to do so - all answers would be subject to the errors of constructivism according to the Austrian social philosopher's and economist's views *Karl Popper* and *Friedrich August von Hayek* respectively:

- What are the common features of this muddling-through patchwork of institutional setting?
- What could the final status of European integration look like?
- Do we see some contours/ outlines of a European Super State or are we dealing with more or less inconsistent and not extremely homogeneous steps of integration?

I hope I succeeded in indicating some kind of common logic of this patchwork of new instrumental and institutional approaches demonstrated above to manage the crisis. The logic consists of creating more and more state elements by persistent piecemeal engineering step-by-step, although the centralizing steps are not always consistent and the process in total is not homogeneous. Therefore in my view we are not approaching a perfect European Super State incorporating all features of a conventional nation state in the near future. Let me only sketch some metaphorical miniatures to underline this.

The dynamics of European integration we are watching now since exactly 60 years can be compared by moving within a spectrum of institutional arrangements with an increasing degree of coherence. The spectrum can be defined between two extreme theoretical positions which have no meaning in reality, namely isolated nation states on the one end and a European Super State on the other hand, see Fig. 1.

The interesting points are the positions **inside the spectrum**. Imagine that walking along the spectrum we will meet certain types of integration like pictures that could be visualized by a mechanism such as these old kinematographs and their predecessors to make pictures moving. Each of the types

4 The following three paragraphs were inserted after finalizing the paper for topical reasons to give a short and rough overview of the July summit meeting results. A more detailed analysis would need a separate research paper.

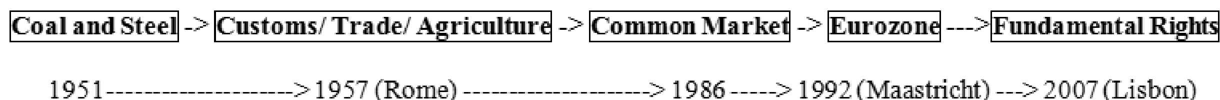

Fig. 2

shown in the following graph stands for a specific Union concept (although the terminology 'Union' has achieved legal qualification not until the Maastricht Treaty). Inside the spectrum lawyers have enormous difficulties to find a clear definition of the institutional setting achieved by the Treaties because it can neither called a confederation nor a federation. So lawyers help themselves by using a *sui generis*-terminology. Only if a European State (which may called 'United States of Europe') will be founded an important qualitative change would have taken place because this state would take full sovereignty, i.e. authorization to define autonomously its competence whereas the European Union up to now is not authorized to do this. It still depends on Member States' treaty making power to decide what kind of competence should be transferred to the Union. Fig 2 concentrates only on most significant marks of the integration process achieved by the respective treaties.

This simple methodology may enable to think about the consistency of the steps taken, whether one or more steps may have been jumped over or will turn out to be too big because the objectives set by the scenario writers (i.e. the contracting parties of the treaties) might have been too ambitious or certain deficiencies ignored so that steps might be overstretched involving a breakdown or collapse of the process. This could turn out to be the case with the MU if the centralization impacts indicated above died away without any echo. **Most important deficiencies of this integration process indicated above in section 2 and 3 can be identified in the field of economic policy (Economic Union), social policy (Social Union), taxation (Tax Union), fiscal equalization (Transfer Union) and above all Political Union.** In all of these fields we are confronted with a more or less coherent patchwork pattern and mixture of Union and nation state competence. As a conclusion of this model thinking exercise can be stated that undoubtedly substantial deepening of integration in the fields just mentioned before jumping over to the MU would have indicated a more consistent, homogeneous and thus less riskier path of integration. On the other hand these deficiencies call urgently need for action in these fields. As already mentioned one cannot identify clearly whether this situation happened more or less accidentally by using historic windows of opportunity or whether it can be viewed as an intentionally induced result of secret eurocratic designers.

Nearly forgotten may have been a significant example that an overstretch of one remarkable step of integration could be avoided. In 1952 a treaty establishing a European Defense Community (EDC) had been signed by those states which established five years later the European Economic Community (EEC) and the European Atomic Energy Community (EAEC) by the Treaties of Rome. It was intended a pan-European defense force in response to the American call for rearmament of West Germany. The plan never went into effect because the ratification of the treaty failed in one parliament, namely the French National Assembly. If it had not failed we would perhaps have a European army today unless we would have experienced an overstretch.

As a conclusion I would like to compare the process of integration and its present status with the famous Echternach jumping procession. (Echternach is a small village in Luxembourg situated near the border with Germany.) This strange procession embodies a procedure of two steps forward followed immediately by one step back, but in the process of integration differently from this procedure we never can see the step backward. Instead European bureaucrats are extraordinarily experienced to jump on the same place persistently even for years or decades strictly avoiding the step backward and waiting for a window of opportunity to make new steps forward.

This would mean that there is **no reversibility of the process** unless any way back would be put up with extremely high costs. That with respect to the MU this would cause not only technical and legal problems because reversibility had not been foreseen and thus not considered in the Treaty, but also enormous costs can be heard permanently in a prayer book's manner by the ruling European political class and most of the public opinion leaders applauding and parroting these prayers. Although some arguments seem plausible we do not know whether this has ever been proved by an exact cost-benefit-analysis. I suppose it has not. The main argument to be heard against Greece's leaving the noble Euro club is the following: As a consequence of an enormous devaluation of the new/ old national currency the amount of Greek debts would increase enormously. This argument does not hold if the information given recently by a German economist (*Heribert Dieter*) in a short German weekly newspaper article (in: *DIE ZEIT*, 16.06.2011) is correct that 95% of Greek loans had been emitted under Greek law thus staying under legal control of the Greek parliament. Thus the author concluded that the Greek's leaving of the Eurozone would imply a horror scenario, but the alternative (namely to stay) would be even worse.

If the no reversibility argument is correct this would imply a well known German saying which goes *mitgehangen - mitgefangen*. The English equivalent is not in my mind at the moment. Perhaps it may read as follows: Being involved implies staying caught - in German also could be said *Auf Gedeih und Verderb* ('come what may') according to the heading of an article in Germany's most distinguished weekly magazine *DER SPIEGEL* (Hamburg, 20.06.2011). This means that we have to learn a bitter lesson: The Union em-

bodies a risk community, i.e. not only benefits but also costs have to be shared.

Finally you can compare the European bureaucrats' (*eurocrat's*) role with *Max Weber*'s famous picture of persistent boring of thick boards, and you can compare the political leaders' role with rowers of different physical fitness - thus embodying different economic standards of their countries - sitting in a not extremely stable rowing boat and rowing in different directions because of missing common political directives. Now the 'Troika' of European Commission, ECB and IMF is exercising a role similar to the Allied Control Council in the occupied zones of Germany after the end of World War II by incapacitation the Greek government and parliament as well. They organize review missions monitoring progress in the areas of fiscal consolidation, deficit reduction by downsizing the public sector, tax reform, privatization and structural reforms in general.

Besides this the oligopoly of US Credit Rating Agencies (CRA) which represent US financial market interests exclusively still is exercising quasi sovereign competence by assigning their credit ratings for issuers of public debts all over the world by an economic evaluation procedure which completely lacks transparency. Last but not least not only private sector companies are concerned of these value judgments but also in general the credibility of the states in general is going to be involved. Despite several misjudgments and fallacies of the US CRAs during the crisis these judgments are still treated similar to the dogmas of the Holy Roman Catholic Church demanding infallibility. This is an unreasonable demand which would in principle not even be solved by founding a European CRA according an idea of several European politicians (in particular in the European Parliament). It cannot be tolerated any longer because it really does not embody a homogenous European integration based on democratic legitimacy, but on the contrary it involves serious disintegrative tendencies. Does this correspond to the ideas of the founding fathers *Jean Monnet*, *Robert Schuman*, *Konrad Adenauer*, *Paul-Henri Spaak* and *Alcide de Gasperi* 60 years ago?

And last but not least what about people? Here too, the German saying fits, namely for both sides - the payers and the receivers of the bailouts which may either be too big or politically too important to let them fail: *Mitgehangen - mitgefangen*, i.e. being involved implies staying caught. Hopefully not exclusively failed banks but mainly the people concerned will be the receivers of the money. This is reflected in the public opinion and in the opinion polls of the net payer countries as well which show - although controversial - rather instable and fluctuating results.

On the one hand the distinguished financial economist, Professor at Harvard University and former IMF chief economist *Kenneth Rogoff* may be right raising the question in the *Financial Times* (German edition, Hamburg, 17.06.2011) why the Greeks, Irish and Portuguese should save and suffer by budgetary cutbacks only to support French and German banks. On the other hand German and Austrian boulevard press media supporting right-wing populist tendencies are echoing this by appealing to national political leaders: Don't waste our money for these Mediterranean guys. Nicely spoken this seems to be somehow a distorted perception of reality. Closer to the truth the London *Times* has come by transporting exactly the same message as the German saying mentioned above. It published a nice French cartoon on 12 May 2011 saying *Face à la crise - L'Europe affiche son unité. ... On coule ensemble!* ('Faced with the crisis. Europe demonstrates unity. We'll sink together!'). While according to *Times* columnist *Anatole Kaletsky* **'the bailouts don't work but they allow the EU to build up centralized power at the expense of nation states'**, it is indeed the taxpayers' money that keeps bailing out failed banking business and inefficient and even partly wasteful public sector institutions which undoubtedly cannot be denied on the one hand and it is the suffering of people being affected by austerity cutbacks of public funds threatening democratic legitimacy on the other hand that should not be forgotten.

All the rest may be left to the audience's and the reader's fantasy.

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