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Saving the Euro at the Cost of Democracy?*

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Abstract

This article explores the implications of the financial crisis for the relationship between monetary integration and democratic government in the European Union (EU). As the crisis has exposed the original balance that economic and monetary union (EMU) sought to maintain between monetary integration and policy diversity to be unsustainable, the eurozone is put before the choice of one of three governance models: executive federalism, democratic federalization or EMU dissolution. Notably, these three governance models perfectly illustrate Dani Rodrik's 'trilemma of the world economy', which maintains that of the three goods – economic (and monetary) integration, the nation-state and democratic politics – one will always have to give. In light of this, the article concludes that the present course towards executive federalism can be justified for preventing euro dissolution and recognizing the value of national self-government. Nevertheless, it threatens to come at a democratic price. Hence, it is imperative to consider possible flanking measures that can mitigate this effect.

Introduction

'United in Diversity' – thus ran the motto that the abandoned EU Constitutional Treaty envisaged for the European Union (EU). It underlines that integration in the Union takes place with due respect for the diversity among its members. Clearly, however, there are tensions between unity and diversity: wherever unity is pursued, diversity risks being suppressed. With regard to the euro, such a tension is apparent between the benefits of monetary integration and the diverse tendencies in national socio-economic policy-making. The key benefits of monetary integration lie in the reduction of intra-EU transaction costs and the stabilization of international financial relations (European Commission, 2008). At the same time, however, monetary integration imposes constraints on the financial and economic policies that can be adopted at the national level. Such policy autonomy is of value in that it allows national governments to respond to the diversity in the economic conditions and the political preferences they face. These forms of what Fritz Scharpf (2002) has aptly labelled 'legitimate diversity' come under pressure in the context of monetary union. In the present financial-economic crisis, these pressures have become particularly acute and seem to force a structural reconsideration of the balance between monetary integration, on the one hand, and economic and political diversity, on the other.

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This article explores the implications of the financial crisis for the relationship between monetary integration and democratic government in the EU. The objective of this exploration is to systematically lay out the strategic political choices available. For this purpose, it develops a normative framework around three key values (democracy, national determination and monetary integration) and reviews the fate of these values under three governance models of the eurozone. Importantly, as the focus of the article is on the governance of the eurozone, its purpose emphatically does not extend to the wider issue of how Europe is best to address the economic crisis and to find its way to growth (again).

Among the three governance models that I distinguish, the one that appears to have been prevalent in the crisis response thus far can be characterized as 'executive federalism' (Habermas, 2011b). In this model new powers are uploaded to the European level, but political control remains with the (creditor) states and surveillance takes place through depoliticized procedures and technocratic institutions. However, two alternative models can be distinguished: 'democratic federalism', in which a centralization of competences is accompanied by the establishment of a genuine European democratic federation; and 'EMU dissolution', in which the monetary union is dissolved to return economic and monetary competences to the Member States again. Obviously, these models are theoretical constructions; in practice one may expect elements of each of them to coexist. Still, as models, they help to clarify the principles that underlie the different political options, and the likely implications as well as the costs and benefits of moving in one direction rather than another.

To properly frame the exploration of the three models, the next section sheds some light on the exact entwinement between democracy and national determination in the context of the eurozone, thus seeking to specify the exact stakes of monetary integration. A second section provides a brief reconstruction of the historical rationale of economic and monetary integration in Europe and its ambiguities. Then the models are presented. Having reviewed all three of them, I conclude that the present tendency towards 'executive federalism' does not just emerge as a tragic choice or a matter of political expediency, but also as a strategy with considerable justification. In particular, this strategy bears witness to the likely costs that abandoning monetary integration would involve as well as to the primacy of the nation-state as the harbour of self-government. Nevertheless, it threatens to come at a democratic price. Hence, it is imperative to consider possible flanking measures that can mitigate this effect.

I. What is at Stake? Disentangling Democracy, National Determination and Diversity

In his widely acclaimed book *The Globalization Paradox*, Dani Rodrik has coined the phrase 'the political trilemma of the world economy'. This trilemma holds that 'we cannot simultaneously pursue democracy, national determination and economic globalization' (Rodrik, 2011, pp. xviii, 200ff.) – pursuing any two of these political goods precludes maintaining the third. According to Rodrik, it is possible to combine globalization and democracy, but only if we move our political structures to the international (and, eventually, the global) level and give up on national self-determination. However, if one wants to maintain the ability to make autonomous political choices at the national level, then one either has to abandon globalization and recede behind the walls of national democratic communities, or one has to abandon democracy and accept that the rules needed to govern globalization are set through international negotiations and technocratic elites.

Rodrik's trilemma nicely points to the three principled strategic options available for the future governance of the eurozone (cf. O'Rourke, 2011). Monetary integration differs from the general process of globalization through trade liberalization that Rodrik refers to, as it involves the deliberate institutional decision to give up national prerogatives over the exchange rate and the interest level for the sake of establishing a common currency. A crucial implication of this decision is, however, that eurozone members have significantly amplified their exposure to each other's economies, and in this respect monetary integration exerts even greater pressure on national economies and policy-making than globalization normally does. At the same time, the governments of the leading euro countries have refused to move powers definitively to the European level, but have insisted on retaining their national political controls. The logical victim of this combination of monetary integration and national determination is democracy, as the governance of the eurozone has decisively moved beyond any form of collective popular control. On the second horn of Rodrik's trilemma, there is the option of, what I call, 'democratic federalism', which involves bringing political decision-making structures effectively into line with the level of monetary integration by turning the eurozone into a democratic federation. Thus national politics is made subservient to EU decisions and national determination abandoned. Logically, the third option is 'EMU dissolution', in which monetary integration is abandoned to save self-determination and democracy at the national level.

The experience of the euro crisis demonstrates the pros and the cons of the different options to be more complicated in practice than they appear in theory. Part of these complications is that in the actual historical and political context Europe's leaders face, the pay-offs associated with the different options have become rather path-dependent. This is a point that I will return to below. Another source of complications is that the three goods – of integration, democracy and national determination – are somewhat harder to disentangle in practice than it appears in theory. This applies in particular to the concepts of 'democracy' and 'national determination', which are actually not fully defined by Rodrik and, at times, even seem to get conflated in the suggestion that democracy proper can only be realized within national self-determining communities (see, for example, Rodrik, 2011, p. 237).

To disentangle these two values it is helpful to start with the value of national self-determination. The nation is not a good per se; in fact, its historical record may well be adduced to argue the contrary. Rather, the underlying value upon which the goods of the nation and of national self-determination seem to depend is *diversity*. As Rodrik (2011, p. 232) puts it, 'we need to accept the reality of a divided world polity'. The nation is the way that the dividedness of the world polity has historically come to be embodied. What is more, by linking a political structure to collectively defined issues and a more or less integrated social and cultural sphere, the nation-state provides a well-established and integrated institutional infrastructure in which concerns can be addressed collectively.

The merits of diversity are nicely summed up in the four general reasons that Philippe van Parijs (2012) adduces in favour of decentralizing democratic government.[1] A first

[1] I slightly revise the order in which Van Parijs presents the four arguments.

Table 1: Key Macroeconomic Indicators for Selected Euro Members, 2010

	Germany	*France*	*Finland*	*Greece*	*Eurozone average*
GDP growth, 2009–10 (%)	4.3	2.7	4.2	−1.9	2.7
GDP per capita (at market prices) relative to eurozone average	109	108	121	73	100
Unemployment (%)	7.1	9.8	8.4	12.6	10.1
Inflation (%)	1.2	1.7	1.7	4.7	1.6
Trade balance (in % of GDP)	5.5	−2.2	0.9	−8.9	1.3

Source: Eurostat.
Note: Figures for Greece are provisional.

reason is that diversity in political orders increases the ability to respond to local conditions. Second, diversity 'makes it possible to have policies more responsive to local preferences, as shaped by the local public debate' (Van Parijs, 2012). This is closely related to the third reason, which holds that greater diversity contributes to the likelihood that decision-makers feel directly accountable to the people their policies are meant to serve. Finally, in allowing different approaches to exist next to each other, diversity facilitates experimentation and mutual learning.

These considerations come clearly into view once one considers the various economic and political manifestations of diversity in the context of EMU (cf. Scharpf, 2002, p. 650). Most apparent on the economic side is the diversity in economic conditions that countries face. There remain big differences between the economic structures of the eurozone members. For instance, while industry and construction contribute less than 20 per cent to the economies of countries like France and Greece, in Germany its contribution is close to 30 per cent.[2] In contrast, retail and personal services contribute more than a quarter to the Greek economy, while this is only 15 per cent in Germany. From these structural differences follows substantial divergence in growth levels as well as in the timing of the business cycle. Indeed, the experience of the first ten years of EMU suggests that monetary integration may well feed into further divergence instead of leading to convergence in the eurozone (Enderlein and Verdun, 2009, p. 495). Thus, the economic outlook (in terms of employment, price inflation, balance of trade and so on) of, for example, Finland remains completely different from that of Greece (Table 1). European integration aside, one would normally expect them to opt for quite different policies.

Turning to the political manifestations of diversity, it has often been pointed out that there are fundamental differences in the institutional regimes that European states have established to accommodate the market economy. Typically, a distinction has been drawn between liberal (like the United Kingdom) and co-ordinated market economies (like most countries of continental Europe) (Hall and Soskice, 2001; Albert, 1993). More fine-grained analyses suggest further subdivisions among the co-ordinated market economies of the European continent, distinguishing the archetypical case of the German Rhineland model from the social democrat model in Scandinavia (Esping-Anderson, 1990), the 'Latin capitalism' of the countries in the Mediterranean (Rhodes and Van Apeldoorn, 1997) and the 'dependent market economies' in east central Europe (Nölke and

[2] Eurostat figures for 2010.

Vliegenthart, 2009). Each of these models is supposed to have its own internal logic and none of them is inherently superior to the other (even if the (neo-)liberal model may appear most infectious in the international competition between them). They rather reflect differences in political and institutional traditions, and in that sense they are deeply inscribed in the political identities of the countries involved. Each in their own way, they offer citizens a trusted conception of the balance between state and economy, and between work and welfare (Scharpf, 2002, pp. 650–1).

On top of these institutional differences, there is of course variation in the political preferences on economic policy-making. There are different preferences in different countries. Moreover, within each country these preferences tend to vary over time. Governments make different choices on the importance they attach to growth, solidarity and sustainability. This diversity in choices is not merely a reflection of the diversity in economic conditions. More fundamentally, it is an expression of political autonomy in steering one's national economy.

Here it becomes clear how diversity as it is expressed in different nation-states touches directly upon the value of democracy, understood as a model of government in which the norms that govern people's behaviour are determined by the people involved themselves with equal opportunities of political involvement. At the level of nation-states, effective ways to institutionalize democracy have been found. Many of these institutional mechanisms (for example, parliaments, elections and an accountable executive) can be transferred to the international level, and in that sense it is possible to talk about the democratization of international politics.

Yet, for democratic institutions to effectively secure the exercise of collective political autonomy, a number of preconditions have to be met (cf. Dahl, 2000, esp. Chapter 4). One is that there has to be a stable constitutional order that guarantees that the procedures through which decisions are adopted are widely perceived to be legitimate. A second precondition is that there needs to be a shared space for common political debate and will-formation that is equally accessible to all members of the political community. Finally, the political process needs to facilitate the development and confrontation of different, competing positions on the decisions to be taken.

While these preconditions have effectively been realized within European nation-states with a stable constitution, national media that carry the public debate and an effective competitive party system, they remain insufficiently fulfilled at the European level (cf. Crum, 2012). For one, the constitutional order of the EU remains in continuous development and contested. Notably, as the cases of the initiation of the Schengen co-operation on open borders and the more recent Fiscal Compact illustrate, on major, urgent decisions EU states may even abandon whatever supranational constitutional order there is to adopt decisions merely on the basis of international law. Second, European citizens do not take part in a single integrated process of political debate and will-formation. As the responses to the financial-economic crisis nicely illustrate, they rather operate within 27 different national debates. Finally, rather than being geared towards developing and highlighting policy alternatives, the European political process tends towards consensus and depoliticization (Føllesdal and Hix, 2006). Even the European Parliament (EP) is inclined to decide by big supermajorities to reinforce its own position in the overall EU political system. In decisions from which the EP is excluded, like macroeconomic policy, Member States tend to be keen to underline that they operate by consensus rather than that they publicize the alternatives that circulate among them. Hence, as the EU remains more of a negotiation system than a system of autonomous political will-formation, whatever form of democratic government it can offer is inferior to that of nation-state democracy.

To sum up, the two values that Rodrik distinguishes – the nation-state and democracy – partly coincide as they both underline the effective exercise of political autonomy. At the same time, they point in somewhat different directions. The insistence on the value of the nation-state risks reifying the incidental fact that diversity has historically come to be embodied in the nation-state. On the other hand, the insistence on the value of democracy, and the institutions through which it is normally realized, runs the risk of establishing institutions without ensuring that the conditions needed for their successful functioning are in place.

II. The Shifting Balance between Monetary Integration and Diversity

There is thus a wide range of forms of 'legitimate diversity' (Scharpf, 2002) that touch upon financial and economic policy-making, including both the ability to adequately respond to a variety of economic conditions as well as the political autonomy to do so on one's own terms and according to one's own preferences. Monetary integration has put pressure on these forms of diversity and this pressure has become acute as a consequence of the financial-economic crisis. Thus, the question is whether it is possible to properly (re-)balance monetary integration and diversity.

While EMU can be seen as a logical outgrowth of the market integration project that European integration started out as, it takes on a rather distinctive form. It is not governed through harmonized legislation that is adopted in accordance with the trusted Community Method, in which the European Commission proposes, the Council and the EP review and adopt legislation, and the Court of Justice arbitrates. Instead EMU hinges on the adoption of a common currency, and in that sense monetary policy is correctly labelled an 'exclusive' EU competence.[3] On the other hand, the sustainability of this common currency depends on the co-ordination of economic policies that essentially remain national; instead of being subordinated to EU legislation, co-ordination is to be assured by an intergovernmental process in which common guidelines are set that serve to review national policies and to issue recommendations upon them.

Initially, EMU was set up in a way that sought to accommodate diversity in financial and economic policy-making. Inevitably, the adoption of a single currency restricted the discretion Member States enjoyed in adopting their financial and economic policies. They lost control over their exchange rate and much of their ability to manipulate the level of interest was moved to the European Central Bank (ECB). However, a complete harmonization of financial and economic policies was considered unnecessary. Member States retained the ability to set their own policies as long as they remained within the parameters of the Stability and Growth Pact (Heipertz and Verdun, 2010). This pact was to cement the indispensable trust between the eurozone governments that none of them would engage in profligate policies at the expense of the others (cf. Føllesdal, 2007, pp. 359ff.). Concretely, the pact ensured that the European Commission would monitor national budgets and that governments would keep their deficits below the threshold of 3 per cent of their gross

[3] Article 3.1(c) Treaty on the Functioning of the European Union (TFEU).

domestic product (GDP). National responsibility for financial policies was underlined by the 'no bail-out clause'[4] that precluded the possibility of a Member State in financial trouble calling upon the others to take over its financial obligations. Notably, the macroeconomic 'autonomy within constraints' that euro members enjoyed has been perceived to be essential for them to tailor their own policy responses given the inherent uniformity of monetary policy in the eurozone (Jones, 2002; Enderlein, 2006; Enderlein and Verdun, 2009, p. 495).

The present financial and economic crisis has revealed that this initial mix of monetary integration with a considerable degree of policy tolerance in financial and economic affairs is not sustainable (Overbeek, 2012). When, in the wake of the banking crisis and the general economic downturn, the financial position of countries like Ireland and Greece deteriorated, confidence in their ability to repay their debts sharply declined and the interest rates on their bonds increased (De Grauwe and Ji, 2012). A vicious circle of budget problems and decreasing confidence of the financial markets loomed, with national default as its logical endpoint.

The default of one euro member is bound to have major fallout on the rest of the eurozone (Scharpf, 2011, p. 183). It would involve major losses for foreign firms (financial institutions in particular) with significant investments in the country. More importantly, however, it would put the whole monetary union into question. For one, it is doubtful whether, after having gone bankrupt, a country can stay in the eurozone or whether it has to introduce a currency of its own again. What is more, the default of one eurozone member would affect the confidence in other states and open the risk of a domino effect with one country defaulting after another. Finally, the euro exit of debtor states would undermine the trade position of the creditor states because of the dissolution of export markets and the appreciating effect it would have on the exchange rate of the euro. Hence, the euro countries cannot afford to have one of them go bankrupt. Nor, however, can they unconditionally vouch for each other – this would go against the 'no bail-out clause' and the importance of assuring that the prime responsibility for financial and economic affairs lies with countries themselves.

However, the crises in 2010 in Ireland and Greece did not leave the European leaders the option of not responding. Their solution was to provide financial support to these countries with strict policy conditionality. Initially, the financial support took the form of bilateral loans. Subsequently, steps have been taken to set up a common fund for eurozone members in crisis: first the European financial stability facility and then the more permanent European stability mechanism. The conditions attached to the loans aim to restore the sustainability of the national budgets and the confidence of the financial markets. In practice, these conditions mix short-run increases in government income (for instance, through the privatization of public assets) with structural budget cuts and the strengthening of tax collection capabilities. The formulation and monitoring of the necessary measures is in the hands of the so-called 'troika' of the European Commission, the ECB and the International Monetary Fund. To maximize their realization, the measures are formulated as directly and concretely as possible. Notable measures that have been imposed this way involve increases in value-added tax (VAT), restructuring of the pension systems and the suspension of sectoral agreements (Scharpf, 2011, p. 185).

[4] Now Article 125 TFEU.

To avoid national default, countries in crisis are thus forced to surrender their political autonomy in macroeconomic policy-making. As Loukas Tsoukalis (2012, p. 34) puts it for the case of Greece:

> The program imposed on Greece by its creditors is punishing, even though considerable improvements have been made in successive revisions of it. Arguably, it is still more than any government in a democratic country can deliver.

In fact, countries in crisis do not even seem to retain the choice to leave the eurozone, and thus to regain this autonomy, as became apparent in November 2011 when Greek Prime Minister Papandreou floated the possibility of subjecting the decision to accept the European loan package with the conditions attached to it to a national referendum.

In short, the financial crisis has fundamentally distorted the balance of trust among the eurozone elites (cf. Føllesdal, 2007, pp. 359ff.). Creditor countries perceive debtor countries as having shirked on the terms of EMU. In turn, the debtor countries find themselves being forced to pay an enormous price in terms of their national political autonomy for saving monetary integration.

III. The Rise of Executive Federalism in Europe

In general, the European leaders have responded to the financial crisis in fits and starts (Salines *et al*., 2012, esp. p. 674). Nevertheless, some pattern can be discerned in the various measures that have been adopted over time, which is a tendency towards 'executive federalism' (Habermas, 2011b; cf. Habermas, 2011a, pp. 81ff.).[5] This tendency is aptly called 'federal' to the extent that it involves the deepening of common frameworks for financial and economic policy-making and the strengthening of European surveillance. Typically, even if central policy co-ordination is reinforced, much of that co-ordination allows for a certain level of diversity, and actually acknowledges it to be ineradicable. Thus the new legislation that has been adopted to strengthen fiscal discipline – the so-called 'Six-Pack' and the subsequent 'Two-Pack' (see Buti and Carnot, 2012, pp. 906ff.) – stipulates common indicators and benchmarks, but the actual evaluation of each Member State's performance takes place rather holistically with due regard to the particular national circumstances. Similarly, the Fiscal Compact that 25 of the 27 EU Member States signed in January 2012 binds the signatories to run a balanced budget and commits each of them to introduce legal provisions that automatically activate financial correction measures when this objective is not met. On top of that, the Compact provides that countries that run an excessive deficit will be bound to an *individualized* 'budgetary and economic partnership programme' that will specify the necessary reforms that they have to undertake, which will be closely monitored by the Council of Ministers and the European Commission.[6] It is particularly such individual contracts concerning national

[5] Commentators have suggested that this strategy might also be labelled 'intergovernmentalism'. However, I prefer 'executive federalism' for two reasons. One is that 'intergovernmentalism' is also prominently used to refer to an explanatory theory of European integration, which is not necessarily assumed in the governance model I outline here. Second, the inclusion of the term 'federalism' underlines the centralization of competences taking place, even if it remains executive-controlled, while the label of 'intergovernmentalism' would suggest any such shifts in competences to be much more hedged.

[6] Article 5 Treaty on Stability, Co-ordination and Governance (TSCG).

fiscal and economic policy and the ever increasing force with which they are imposed that mark a clear contravention of national financial autonomy (cf. European Council, 2012, p. 7).

At the same time, the tendency is clearly towards a form of *executive*-dominated federalism (cf. Puetter, 2012). The overall policy frameworks and the surveillance procedures remain under control of the national governments. This has three important implications. First, it means that these processes operate beyond effective parliamentary scrutiny. All the Fiscal Compact provides in terms of parliamentary control is that the president of the euro summit will report to the EP after every summit.[7] Further, it calls upon the budget committees of the European parliaments to engage in regular exchanges between each other.[8] Nowhere, however, are parliaments provided with any substantial powers to review or amend the agreements of the governments. At the same time, no parliament is likely to be able to revise such agreements at the national level as it can only address one government and this government can hide behind the collective dynamics of the decision-making process in the Council.

The second implication of the key role of executives is that this mode of decision-making basically evolves according to the logic of international power rather than that it is subject to procedural principles that ensure transparency, the equality of Member States and their right to self-government.[9] In other words, under executive federalism it is the creditor states that call the shots, leaving the debtors the simple choice of compliance or exit. Notably, according to Arthur Benz (forthcoming), this second implication provides some nuance to the first, as parliaments in strong Member States – most notably in Germany and France – may actually have seen their position in EMU strengthened, while 'those in Southern Europe surrendered to strong executives and external pressures'. In that light, the trend to executive federalism not only contributes to increased asymmetries between the governments of the eurozone but also to such asymmetries between their parliaments and, by implication, in the substantive quality of democracy enjoyed in the different states involved.

The third implication of the continued primacy of national governments in EMU is the prominent role attained by objectified guidelines and technocratic procedures in the governing process. As the national governments cannot themselves execute the actual supervision of each other's financial and economic policies, they delegate these tasks to technocratic authorities – most notably the European Commission and the ECB (cf. Føllesdal, 2007, pp. 364f.). However, to control these processes of delegation and to minimize the scope of policy discretion, they have to provide them with specific guidelines. Most notable is, of course, the rule that governments are precluded from running an excessive deficit. As said, initially an 'excessive deficit' was defined as any deficit above 3 per cent of their GDP. However, after several reviews the Fiscal Compact now sets the line at 'a structural deficit of 0.5 % of the gross domestic product at market prices'.[10] This train of events demonstrates how any percentage is eventually open to political contestation. However, the unity of the eurozone does not allow that political debate to be played out among the national governments at each and every occasion (cf. McKay, 2005,

[7] Article 12.5 TSCG.
[8] Article 13 TSCG.
[9] Cf. Article 4.2 Treaty of the European Union (TEU).
[10] Article 3.1(b) TSCG.

p. 537). At the same time, the continued primacy of national governments in the EMU prevents the establishment of a proper supranational political arena where such debates can take place. Hence, under the current conditions, EMU governance is only possible if the governments commit themselves to a specific value and turn it into some kind of fetish for the administrative institutions.

Ultimately, the tendency towards executive federalism can be expected to lead to states being bound to ever more detailed policy contracts that hollow out their political autonomy in financial and economic matters. While the execution of these rules can be partly delegated to supranational institutions like the European Commission, the ECB and, maybe, the European Court of Justice, ultimately they remain under the control of the creditor states. Thus, as much as these states will follow the same reporting routine, the chances that they will actually see measures or sanctions imposed upon them remain rather slim.

IV. Democratic Federalism

The governance model of EU executive federalism undermines the political autonomy of the debtor states and challenges the basic idea of the equal worth of EU Member States. In light of these considerations, critics (most notably, Habermas, 2011a, b) have suggested that far-ranging institutional reforms are necessary to provide the deeper integration towards which the EU is led as a consequence of the financial crisis with the necessary democratic legitimacy. Rather than remaining with the Member States, the main responsibility for the necessary measures and their implementation will have to be transferred to a proper European economic government with a clear democratic mandate. At the heart of that economic government there would be an EU President, who would combine the economic responsibilities of the present Presidents of the European Council (van Rompuy) and the European Commission (Barroso), and a European minister for financial and economic affairs (cf. Trichet, 2011) – a function that would build upon the present position of the European Commissioner for monetary affairs. This government would need a direct democratic mandate of the European citizens, either by being elected by the EP or by the direct election of its President (for example, in a similar way to the election of the president of France). Such a set-up would reinforce the coherence of European policy and ensure the direct and equal political influence of all European citizens.

This strategy of transforming the EU into a democratic federation would seem to come with two important implications. First, democratic federalization would pave the way for a fiscal union. One oft-mentioned measure that would fit in this line of thought would be the introduction of eurobonds that allow the mutualization of debts among EU Member States. Further, in this scenario one would expect the EU budget to steadily increase beyond the 1 per cent of EU GDP that it is at present. This can, for instance, be facilitated by the introduction of European taxes (for example, on financial transactions or cross-border pollution) or by directly assigning a fixed share of VAT in all Member States to the EU budget. The second important implication follows from the fact that one cannot expect all present EU Member States to want to join such a step-change in integration. This is particularly likely to apply to those countries that have chosen to remain outside of the eurozone, but possibly even for some who have joined. The implication is that this strategy is likely to lead to a core Europe around a federal economic government with a second circle of members formed by states that are part of the single market and co-operate in some other policy domains but have opted out from closer economic (and monetary) co-operation (cf. Van Hulten, 2011).

This governance model thus seeks to save democratic government from monetary integration, but does so at the cost of the autonomy of the Member States. Notably, some of the recent proposals of the President of the European Council go in this direction as they, for instance, include the possibility of a new budget with fiscal capacity for the eurozone that would be separate from the non-euro members (European Council, 2012, pp. 4–5). One might expect such proposals to be tabled by the supranational actors involved. However, as they would involve major inroads into national determination, it is rather doubtful that they will command the necessary support among the Member States.

Beyond its strategic improbability, the main normative risk of democratic federalization is that its institutional aspirations fail for lack of an appropriate societal reception. An effective European democracy is not brought about by institutional reforms alone. It also requires corresponding changes in the attitudes of the European citizens and the development of a well-integrated party system and a common political culture (Filippov *et al*., 2004, s. 9.2; Føllesdal 2007, p. 367; McKay, 2005, p. 538). If political allegiance remains mainly located within the national political community and the federal institutions fail to elicit confidence from the European citizens, then a European economic government risks being little more than an institutional facade that lends the impression of democratic legitimacy to a process in which essentially well-entrenched elites impose their will on a disengaged people. In that light one may wonder whether this governance model is the right answer to the democratic critique of the existing trend towards executive federalism in the EU.

V. EMU Dissolution

Combining the position that the EU for now lacks the necessary preconditions for a truly integrated democracy with the virtue of diversity and self-government that I have highlighted from the start of this article, a third scenario comes to the fore: arguably, looking back at it, monetary integration has been a risky road to take that slowly but steadily hollows out the ability of the states involved to set their own financial-economic policies. The question then is whether it would not be desirable and wise to turn around and to give up on monetary integration to regain democratic autonomy.

For countries like Greece, Ireland, Portugal and Spain, who have found themselves in urgent financial distress and appear only able to avoid bankruptcy by surrendering their financial-economic autonomy, monetary integration appears in hindsight as a Faustian bargain. For sure, these countries have benefited in previous years from major capital flows, but the bubble of the growth that this has made possible has burst in the crisis. Now they direly miss the policy instruments of devaluation and increasing the money supply that might have helped them to cope with the situation they now find themselves in.

However, to reinforce the commitment of the Member States, EMU deliberately does not provide for an exit procedure (cf. Athanassiou, 2009). No doubt, the potential costs of euro exit are huge. Just the practical organization of converting all money in circulation and all deposits into a new (or the old) currency is not something that is easily done from one day to another. Once such a process is initiated, it is bound to create great uncertainty among consumers, firms and investors; a bank run would be likely and investors might withdraw whatever investments they can. For the weak eurozone members, who would be the most likely candidates for such a scenario, euro exit would be followed by a sharp depreciation of the new currency compared to the euro. Scenario studies suggest that a weak state leaving the eurozone might see its currency devalue up to 60 per cent and its GDP halved (Belke, 2011, p. 9).

Importantly, however, the costs of euro exit would not be limited to the exiting country alone. It would raise the doubts among financial markets on the status of other debtor states. Hence, there would be a considerable risk that the euro exit of one country would force others to follow. Euro exit would have further costs for the remaining EMU members to the extent that they would have to take their losses on their investments in the exiting country and to the extent that euro exit would lead the euro to appreciate. Given the major economic upheaval that euro exit would occasion, one can appreciate that some observers have warned that this scenario might even put the whole European integration project at stake.

Such observations also invite consideration of measures that might help to minimize the risks identified. If it would come to this scenario, then clearly timing is of paramount importance. Once a country would be about to leave the euro, it would, for instance, be necessary to impose capital controls in the country involved (Belke, 2011, p. 7). Also one would expect the other eurozone members to provide flanking support by financial, institutional and political means. The contributions that they would otherwise have to field in a series of bail-out packages to keep each country on board the EMU would then rather have to provide for one major exit package to soften the landing as much as possible and to help the exiting country to get back on its feet as soon as possible. To allow the exiting country the prospect of growth, it would be particularly important to guarantee it the continuing full membership of the European single market. Indeed, if it can be managed, one may well wonder whether taking the one-time hit of a euro exit is not the cheaper and clear-cut option for all parties involved compared to the present alternative of leaving debtor states on a continuous lifeline of loan packages while curtailing their policy-making powers and offering them little prospect for self-induced growth again.

For sure, much goes to suggest that in the present crisis many euro members would have been better off without monetary integration. All members of the eurozone, debtor and creditor states, are paying a considerable price for monetary integration: in terms of the constraints it imposes on national policy autonomy, the governance problems that are currently experienced and, with increasing likelihood, the writing off of loans that have been deemed necessary to save the euro. However, EMU is an historical fact and the inevitable point of departure for any political strategy. In that light, it is clear that allowing one or more countries to leave the eurozone is an extremely risky and probably a very costly step to take – and it may even put the whole process of European integration at risk. The same considerations also seem to preclude any attempt to dissolve the eurozone for a reversion to something like the preceding European monetary system (EMS).

Conclusions

In a way, the three governance models for the eurozone that I have outlined neatly reflect Rodrik's 'trilemma of the world economy'. The model of executive federalism sacrifices democracy for monetary integration and the protection of national determination (at least of the creditor countries). In democratic federalism, monetary integration and democracy are preserved by abandoning the national autonomy of the EU Member States. The model of EMU dissolution gives up on monetary integration for the sake of maintaining national determination and democracy. Rodrik (2011, p. xix) has been remarkably frank about his normative position by submitting that 'democracy and national determination should trump hyper-globalization'.[11] Such an inclination towards EMU dissolution would seem to adequately reflect the generally recognized axiological order between the three goods: democracy having most intrinsic value and globalization appearing as the most functional or instrumental good of the three.

However, this axiological order is not necessarily reflected in the leverage that the three values can be expected to have on the political course adopted with regard to the future of the EMU. In fact, in actual political decision-making, preserving monetary integration is the undisputable pre-eminent value due to the immense costs and the rather uncontrollable risks associated with euro dissolution. In turn, the fact that the major EMU decisions are subject to intergovernmental decision-making assures that the national governments will carefully guard their interest in national determination. Together, these two considerations account for why in the actual handling of the euro crisis the strategy of executive federalism has prevailed so far.

Notably, looking at the way the euro crisis has been handled thus far from the wider strategic context outlined above suggests that EMU may be much more robust than anticipated, exactly as it is subject to two conditions that have both structural as well as rational force (cf. Puetter, 2012, p. 162). On the one hand, crucial policies have come to be pooled at the supranational level and, because of structural interdependencies, functional benefits and institutional path dependencies, these are very unlikely to be rolled back. At the same time, national determination is unlikely to give way to an 'ever closer union' as the Member States remain the key strategic actors *and* the main repositories of democratic legitimacy within the Union. Under these conditions some form of executive federalism seems not only the logical empirical outcome, but looking at it through the lens of the trilemma of the world economy it also commands considerable normative justification for serving two important values: the preservation of (monetary) integration and the primacy of the nation-state as a vehicle of political autonomy and policy diversity (at least if one is not under special surveillance).[12]

Essentially, then, given the commitment to sustain monetary integration and the intergovernmental character of EMU, national determination takes precedence over any prospect of establishing truly supranational democratic structures. However, rather than succumbing to Rodrik's trilemma and accepting that this is the unavoidable price to be paid, the distinctive character of the EU invites the exploration of possible ways to reconstruct democracy under these particular conditions. Two tracks can be

[11] Notably, in line with his affirmed position, Rodrik has argued that Greece would be better off abandoning the euro (quoted in Hilhorst, 2011). However, on an earlier occasion, he showed more reservations with regard to the case of Spain: 'Spain could always exit the eurozone of course. But the acrimony and uncertainty that this will cause in the short-run does not make it a practical alternative' (Rodrik, 2010).

[12] Indeed, this equilibrium between extensive supranational pooling of competences and persisting national political determination may well be indicative of the EU as a whole (cf. Moravcsik, 2007, pp. 33–7), even if, as I have underlined before, the governance of the economic and monetary union is rather distinctive from the rest of the EU (for example in terms of institutional set-up and Member States involved)..

distinguished here. First, the persistence of national determination implies that democratic control and accountability are, first of all, to be assured at the national level. Importantly, for this claim to be credible to the peoples involved, it requires that a substantial degree of policy autonomy is preserved at the national level – not only for the creditor countries but also for the debtor ones. Such autonomy is hard to reconcile with any binding European authority over national budget and economic policy. Indeed, whenever such European authority is invoked, it will need to be transitional and bound to well-specified goals. This also implies that in cases in which – due to structural economic conditions – no prospect of the suspension of European surveillance is in sight, the alternative of a euro exit needs to be explored as it would allow the country involved to regain political control over its own monetary and, by implication, its budgetary and economic policy.

As a second track, any attempt to reconstruct democracy for EMU needs to respond to the undeniable power shift in budgetary and economic affairs from the eurozone members to the EU that the crisis response has involved. Typically, this centralization of power has been concealed by depoliticizing both the common standards adopted as well as the actual execution of policy surveillance. Eventually, however, such centralization of authority can only command the legitimacy necessary to be sustainable if it is complemented with appropriate sites and mechanisms for the brokering of political differences (McKay, 2005, p. 537).

A first precondition for the creation of such a political forum is to overcome the problem of many hands that is endemic to EMU governance, and to more clearly ascribe and mandate economic responsibilities in the EU (cf. Verdun, 1999). In particular, the political character of much of the tasks that now fall on the shoulders of the European Commissioner for monetary affairs needs to be recognized. One might consider the possibility of upgrading this position to an EU economic minister and having this person also chair the Eurogroup. Such steps would help to provide EMU policy with a clear political face and are a precondition for it being held to public account. Specifically, it would give more focus and weight to the 'Economic Dialogue' that the EP seeks to develop with regard to the economic policy surveillance cycle of the 'European Semester' (Hallerberg *et al.*, 2011).

Yet, as any supranational powers remain premised on the lasting primacy of national governments in budgetary and economic affairs, the introduction of genuine scrutiny power of the EP in EMU would need to be complemented with the reinforcement of, and co-ordination among, the national parliaments in the eurozone. In this regard, the suggestion in the Fiscal Compact[13] to organize a conference of budgetary affairs specialists from the national parliaments and the EP can serve as a useful stepping-stone. Yet, such a conference will need to be more than a mere platform for the exchange of opinions. One possibility would be to have such a conference review each package of conditions that the EU attaches to the granting of loans on its reconcilability with the right to democratic self-government of the state involved. Such a responsibility would seem a fitting extension of the role of subsidiarity guardians that the Treaty of Lisbon has already bestowed upon the national parliaments.

[13] Article 13 TSCG.

Obviously, there is no easy, straightforward solution to the governance trilemma of the eurozone. The commitment to prevent the dissolution of EMU and the political primacy of the member governments suggest that any response will follow the lines of executive federalism. Still, there remain important margins for manoeuvring particularly with regard to the political autonomy of the debtor states and the maintenance of effective institutions for democratic control and accountability. Ultimately, any policy that fails to maintain such democratic institutions risks being self-defeating as it may well turn citizens away from the integration project for good.

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