Understanding money to save the euro

Miguel Otero-Iglesias | Senior Analyst in International Political Economy, Elcano Royal Institute, and Adjunct Professor, IE University, Madrid | @miotei

This op-ed appeared in its German version in the Frankfurter Allgemeine Zeitung on 24 March 2018.

The Eurozone has a problem. The debate on how to reform and deepen European monetary union (EMU) is dominated by those who believe that establishing a fiscal and political union is not necessary to underpin the single currency's long-term stability. The recent recovery in growth and employment has only reinforced this view. Many, especially in the north of the continent, think it is enough to complete the banking union, advance in the capital markets union and stick to the Growth and Stability pact rules and that then all will be fine.

This is frightening for two reasons recently articulated by Jeroen Dijsselbloem at the London School of Economics. After five years at the helm of the Eurogroup, he recognised that the Eurozone was still ill-prepared to weather a new financial crisis. But he said something more disturbing. Asked what needs to be done to strengthen EMU he cited –yet again– Mundell's optimum currency area (OCA) theory and said that while the theory called for a central budget to overcome asymmetric macroeconomic shocks, it also demanded more flexible and mobile labour and capital markets. Hence, his message was: let us concentrate our efforts on establishing a more efficient market and then we can talk about 'the politics'.

> "To survive, the European monetary union needs to develop a European sovereignty, as Emmanuel Macron has pointed out and Helmut Kohl was well aware of"

The problem with the OCA framework is, however, that it treats money as a neutral commodity. Following the orthodox understanding of money developed by Adam Smith, and perpetuated in Economics text-books since, it believes that money emanates from barter and that its fundamental function is that of medium of exchange to reduce transaction costs. Money in this view is generated spontaneously from and by the market and, therefore, is apolitical. However, as Charles Goodhart explained in 'The two concepts of money', when the euro was born this interpretation of the nature of money, so popular among economists, was not supported by historical evidence.

In fact, most historians, anthropologists, sociologists and political economists who have studied money come to a different conclusion. As explained by Georg Friedrich Knapp in *Staatliche Theorie des Geldes*, money has always been primarily a unit of account to calculate value introduced or imposed by a political authority. Hence, money is always debt issued by a sovereign, which has a central role in any monetary space since it is the system's main debtor because it needs to borrow to provide the commons (security and other public goods), and it is also the main creditor because it can collect taxes from its subjects indefinitely (as long as it has the power and/or legitimacy to do so).

Since money is always debt, and therefore always consists of a social relationship between creditors and debtors, the sovereign is also crucial in mediating in conflicts between the two. This is usually done by the legislative branch (the Parliament), which decides on the redistribution of wealth, and the judicial branch (the Judiciary), which settles bankruptcy disputes.

If we understand the nature of money from this angle, the governance structure of the Eurozone is obviously flawed, and this is why further steps towards a political and fiscal union (in this order) are absolutely necessary. To survive, EMU needs to develop a European sovereignty, as Emmanuel Macron has pointed out and Helmut Kohl was well aware of.

To comprehend this, it is useful to analyse how the recent crisis was managed. Because the Eurozone did not have a proper governance structure, the response to the crisis was slow, chaotic and intergovernmental. Intergovernmentalism is particularly problematic because it tries to solve the inter-state, but also inter-personal, creditor-debtor tensions inherent in money by antagonising creditor vs debtor countries. This exacerbates nationalistic feelings and reinforces the EMU's democratic deficit.

"Because the Eurozone did not have a proper governance structure, the response to the crisis was slow, chaotic and intergovernmental"

When in 2015 Angela Merkel had the last word on whether Greece should stay or leave the euro she did so as the legitimate leader of Germany, but at the same time she took a decision that affected every single citizen in the Eurozone without having the European legitimacy to do so. Equally, when Finland asked for further guarantees from the Spanish government to approve the ESM credit line to rescue the Spanish banking sector, it did so under a perfectly legitimate national democratic mandate. But by doing so it showed that a Finnish citizen had more power than a Spanish citizen in the governance of the euro because Finland is a creditor country and Spain is not. Arguably, this is undemocratic, not least because Spain's 47 million inhabitants are far more creditor citizens than Finland's 5 million inhabitants.

The truth is that both the actions of the ESM and those of the ECB, the two big firefighters in the crisis, lack legitimacy. Sovereignty is about being included as a citizen in the decision-making process and this is not the case. In the ESM, for instance, it is discriminating that Germany, France and Italy have the power of veto. Furthermore, the memorandums of understanding signed with the rescue countries were seen as an imposition, and the troika officials that were sent out to supervise the programmes were portrayed as alien agents by both local press and populations. This is not the right way to run a monetary union and it is extremely worrying that such an intergovernmental arrangement might be consolidated, and even strengthened, by converting the ESM into the European Monetary Fund (the name alone sounds undemocratic). This type of technocratic governance might be acceptable for the IMF at the global level, where there is no monetary pooling of sovereignty, but it is totally unacceptable between Europeans who share a common currency and thus a common destiny.

But not only the citizens of the debtor countries feel disempowered. Ultimately, because the Eurozone leaders (especially Angela Merkel, who leads the EMU's biggest power) were not able to solve the crisis by moving towards political union, the task was left to Mario Draghi at the ECB, who saved the day by his 'whatever it takes speech' and the QE programme, which is distributing wealth from creditors to debtors (to the dismay of many German savers). The ECB's actions showed that when it comes to solving the tensions between creditors and debtors, the European level is far more effective, but this is just a temporary remedy. Once inflation creeps back up to 2%, the current retributive policies concealed by a technocratic veil would need to be decided openly by a legitimate political authority, which is missing in EMU.

"The ECB's actions showed that when it comes to solving the tensions between creditors and debtors, the European level is far more effective, but this is just a temporary remedy"

All this criticism does not mean that the Eurozone needs to become the Unites States of Europe by 2025, as suggested by Martin Schulz. This is unlikely to happen and, what's more, undesirable. Like the EU, EMU will continue to be a sui generis construct with a greater degree of integration than an international organisation but less than a federal union. However, more legitimacy and efficiency are needed. Its main body of governance, the Finance Ministers, who form both the Eurogroup and the ESM board need to be under closer scrutiny (and even control) by the European Parliament. In a monetary and banking union, transnational and transpersonal creditor-debtor tensions ought to be solved by legitimate supranational institutions. This would help make the reform programmes more palatable in the weaker countries. Not least because people such as Yanis Varoufakis could no longer say that reforms have been decided by an undemocratic body. For this same reason the Spitzenkandidaten process needs to be maintained and reinforced.

When it comes to the key task of creating a fiscal capacity, this will no doubt be a protracted process. But certain steps can be taken. An embryo Eurozone budget can be established to provide funds for those countries that need to undertake certain reforms. For the long term, however, it would be good to follow the sequencing logic proposed by Jacob Kirkegaard drawing on the US experience. Rather than demanding the creation of a big Eurozone budget without clear objectives, it is much better to identify more concrete public goods that can only be provided at the European level (border security, asylum and migration policy, defence capabilities, and autonomy in energy and telecommunications, for instance) and ask the citizens of the Eurozone to contribute to funding them.

This would help to construct a European sovereign able to secure the long-term sustainability of the euro through the usual historical contingencies that led to the creation of money in the first place. Namely, the formation of a common identity on the bases of, first, improving internal cohabitation and, secondly, being better protected from external threats.