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A Constitutional Treaty for an Enlarged Europe: Institutional and Economic Implications for Economic and Monetary Union

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Editorial

The ESCB/Eurosystem and the OeNB closely followed the debates on Economic and Monetary Union (EMU) issues within the Convention on the Future of Europe and the negotiations during theIntergovernmental Conference and contributed to them at various stages.[1] The ESCB/Eurosystem is part of the Community framework and has an institutional interest in developments within the EU. Essentially, all legal and institutional changes made in EMU determine the framework conditions under which the ESCB/Eurosystem operates.

As the Treaty establishing a Constitution for Europe (Constitutional Treaty) was signed by the Heads of State or Government of the Member States of the European Union on October 29, 2004[2], the Oesterreichische Nationalbank (OeNB) organized an international workshop titled *A Constitutional Treaty for an Enlarged Europe: Institutional and Economic Implications for Economic and Monetary Union.* The workshop, which took place on November 5, 2004 at the premises of the OeNB in Vienna, gave an overview of the institutional implications the Constitutional Treaty may have for EMU and analyzed the institutional framework for financial stability in Europe and the role fiscal policy and the Stability and Growth Pact play in an enlarged Europe. This volume puts together the papers and comments presented at the workshop.

In his opening remarks, *Josef Christl*, OeNB, stressed how important the Constitutional Treaty, which aims at rendering the enlarged EU more effective, transparent and democratic, was for European integration. According to Christl, the process of ratifying the Constitutional Treaty will be a great challenge but, at the same time, presents an opportunity to put the debate about the future of the European Union into a broader perspective and to bring the European integration project closer to the people.

Now that the EU has been successfully enlarged, the new constitutional architecture should be used to deepen the European integration process. The euro as the single currency plays a key role in this respect, serving as a catalyst for political integration and continuous economic reforms. It represents a successful step toward integration and stands for both unity and variety within Europe.

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[1] Article 48 of the Treaty on European Union stipluates that the ECB, and thus the national central banks, are to be consulted on any institutional changes in the monetary area.

[2] The Constitutional Treaty will be submitted to the Member States for ratification and shall enter into force on November 1, 2006.

René Smits, of the University of Amsterdam, held the keynote speech at the workshop, in which he outlined the structure of the Constitutional Treaty. The Constitutional Treaty contains only minor changes to the institutional framework of EMU; first and foremost, it reconfirms the ECB's independence and, at the same time, provides for its formal integration into the institutional framework of the EU. Furthermore, the Constitutional Treaty states that members of the Executive Board of the ECB have to be appointed by a qualified majority and that the Council of Ministers has to take decisions based on a double majority system. It also formally uses the terms Eurosystem and Eurogroup, introduces the function of a president of the Eurogroup, puts forward that euro area Member States are to have more competences, and contains a declaration by the Heads of State or government on the Stability and Growth Pact.

The so-called *exit clause* only partially defines the course of action for Member States wishing to leave the European Union and fails to provide a withdrawal procedure. The Constitutional Treaty takes an intergovernmental approach, introducing an EU foreign minister, electing a European Council president and principally holding on to the rotating EU presidency. By extending the scope of the codecision procedure, it renders the European Parliament more influential. The European Commission's role as a motor of integration is only slightly expanded.

In conclusion, the Constitutional Treaty simplifies all treaties established so far; nevertheless, compared with the U.S. Constitution, it is still complex. The stipulated amendment procedures do not exactly facilitate the evolution process of the Constitutional Treaty. One has to accept that creating a constitution is a continuous and dynamic process. Smits considers the current document a successful step toward integration but calls for further steps to follow.

Isabella Lindner and *Marlies Stubits*, OeNB, presented a study in which they examined how multilevel economic governance in the European Union is affected by the Constitutional Treaty and which implications these effects have for EMU in terms of effectiveness and efficiency. They argue that the Constitutional Treaty may improve the EU-25's ability to act on both the European and the international level by providing for stronger personalization of the EU's institutions and the Eurogroup and by reducing the size of the European Commission.

Furthermore, the Constitutional Treaty lays down several new provisions and voting rights pertaining exclusively to the euro area Member States. It also formalizes the Eurosystem, de facto integrates the Eurogroup and introduces a longer-term president of the Eurogroup, thus changing the current system of multilevel economic governance in the EU. As heterogeneity among Member States has increased with enlargement, the euro area is more and more turning into a *center of gravity* for integration.

Whether or not, the Constitutional Treaty will render the decision-making process more efficient will only be revealed when the treaty comes into effect. At any rate, introducing a double majority system signifies a radical departure from the previous voting system.

The Constitutional Treaty does not contain any substantial changes with regard to monetary union, as most of the changes are of technical nature only. It reaffirms the framework conditions for monetary union as embodied in the Treaty on European Union.

Fritz Breuss, Vienna University of Economics and Business Administration, stressed the intergovernmental character of the Constitutional Treaty. He warned that extending the powers of the Eurogroup and introducing a president of the Eurogroup could be a source of conflict among the Ecofin Council, the Eurogroup and the ECB. Economic policy coordination, whose core element is the Economic and Financial Committee, remains complex and cumbersome. It rests to be seen whether this type of coordination ultimately has more advantages or disadvantages. He declared the European Commission the big loser in the bargaining game for the distribution of powers among the European institutions.

Holger Wolf, Georgetown University, spoke about the challenges arising from financial integration concerning the institutional setup of financial market supervision. In view of the increasing number of cross-border an cross-sector financial institutions, Wolf advocated a two-tier system consisting of an EU authority responsible for supervising large European financial institutions and national authorities supervising only institutions that primarily operate in the domestic markets. When and how such a structure should best be implemented is a much more difficult issue. Since the number of institutions operating EU-wide remains low, and as Basel II brings about a range of substantial changes, a gradual transfer of supervisory powers to the current coordinating bodies (evolutionary approach) would be desirable.

When it comes to crisis prevention and the allocation of costs for lender-of-last-resort (LOLR) operations, however, a formal framework should be established as quickly as possible. Scenarios in which large international banks with their headquarters in a small EU Member State experience problems which exceed the national central bank's capacities are by all means realistic.

Karin Hrdlicka, OeNB, pointed out that the moment for changing the supervisory architecture has not yet come. The level 3 Lamfalussy committees have been established only recently, mainly to address challenges arising from the integration process by implementing EU legislation more consistently and by converging supervisory practices. In terms of stability, a European supervisory authority seems to be a realistic solution, but only in the long run and only if organized on a decentralized basis.

Stefan Collignon, London School of Economics, advocated establishing coherent fiscal policies at the EU level to optimize the European monetary and fiscal policy mix. There are more advantages than disadvantages to centralizing public finances (welfare and stability gains) while allocating budgets on a decentralized basis (efficiency gains).

The EU budget must have democratic legitimacy, and costs must be allocated more evenly. Net contributors are more prone to undergo excessive deficit procedures in times of economic downturns than net recipients, as, according to the rules for excessive deficits, net transfers from – as opposed to net payments to – the EU are not taken into account. Having its own source of funding (EU tax) would equip the EU better for its negotiations on the financial perspective; interregional transfers could be conducted via *tradable deficit permits*. Elections to the European Parliament would thus determine decisions on how to use European taxpayers' money. They would ensure that the EU budget reflects the preferences of the majority of citizens and overcomes individual interests. Discussing and voting on the budget in the European Parliament, with proposals from the Commission and the consensus of the Council (depending on the legislative procedure), would foster European democracy and identity.

José Marin, ECB, pointed out that there were different definitions of federalism in Europe. The current expenditure structure of the EU budget is by all means justified and corresponds to the fragile institutional balance within the EU, as well as to the current level of European integration. For most EU Member States, the implementation of a more fiscal policy-oriented federalism would currently not be acceptable.

Isabella Lindner
Paul Schmidt