Which Constitutional Economics for the Two-Decade-Old Eurozone?

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Abstract

The twentieth anniversary of the euro brings to light the feats and flaws of the European integration process and gives occasion to revise its peculiar configuration. This article contains reflections from a legal and economic perspective and is aimed to provide readers with an assembled vision of the monetary, fiscal, and constitutional features of the Eurozone. The critical analysis of the ECB's monetary policies on inflation and quantitative easing, along with comments on the judiciary conflicts that have arisen between the European Court of Justice and the German Constitutional Court, form the core of the article. Some attention is also paid to the Fiscal Union and the role of a European Fiscal Compact to balance the asymmetry of a single currency without a taxation-budget counterpart. A new constitutional consensus for the EU, endowed with sound economic foundations, is considered indispensable to fill the legitimation gap left by current 'fiscal dominance' in the monetary realm.

A 20-year-old euro: from the Great Moderation to times of unrest

Money cannot and never will be immune to the polar effect of the two widespread, contrasting visions of the state and markets.[20] Moreover, as lucidly emphasised by Charles Goodhart (1998), the logic of currency areas – the central topic of this article – requires a profound comprehension of the dialectical game of Metallist versus Cartelist traditions. Moreover, the Eurozone's insertion into the architecture of the European Union is a rarity in the historical and comparative panorama whose survival and development can hardly resist the passing of time and two major crises since 1999. In other words, a construct built on subtleties could become unaffordable and difficult to maintain when the big picture

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changes. The euro was devised and launched in a period of unprecedented economic, political, and social amenity, which included the 'Great Moderation' years and coincided with the Eastern European socialist bloc's collapse, along with its Balkan extension. Apparently, this left a vacuum at the disposal of its capitalist, democratic counterpart. Just when Western civilisation, whose crutch was the current EU, was undergoing a process of structural reform as a consequence of the Great Financial Crisis and the pandemic, the Ukrainian war broke out. Whether this event will undermine or foster the European integration process is difficult to predict, but sound reflection is required.

I am going to deal firstly with the up-to-date stance of the Eurozone monetary policymakers on the wider issue of the constitutional shaping of the European Central Bank (ECB) (section 2), then move on to the discussion of some economic misconceptions and wrong projections incurred by the ECB (section 3). I will later tackle the institutional trouble caused by the May 2020 German Constitutional Court decision on the ECB's asset purchase programmes (so-called quantitative easing, or QE) (section 4) and its derived strands. To finish (section 5), I will draw some conclusions and discuss the forthcoming scenario to discern the connection between monetary and fiscal policies and to what extent current EU fiscal rules will usher in the dawn of tighter integration.

Schmittian momentum for a Hamiltonian moment?

Federal criteria must be at play in order to manage any sort of pluri-national structure. Reflection on comparative history is of great use to learn from past experience and to shape specific responses to the problems raised by supra-state schemes. This - reflecting on comparative historical experiences - is what most of the best-endowed European (as well as non-European) brains have done with occasion of the two formidable challenges that the common currency has had to face, the Global Financial Crisis and the COVID-19 pandemic, not to mention the large task ahead: coping with the recent outbreak of the war in Ukraine and its aftermath.

When making the comparison, a milestone in American history comes to mind: the 1790 joint decision by Alexander Hamilton (US Treasury Secretary, promoter of the idea), James Madison (a life-long opponent of central banking), and President Thomas Jefferson (initially reluctant) for the US federal republic to absorb the states' debts after the War of Independence. This is more than scholarly vagary, as a formal statement by ECB President Christine Lagarde (2021) explicitly mentions the need for constitutional mutation in the EU in order to accommodate the big leap implied by the Eurozone member states' public debt mutualisation through a Fiscal Union. In a sophisticated and elegant legal-theory parlance, Lagarde makes additional reference to the American tradition by proposing how that mutation might be carried out, through European Court of Justice (ECJ) case law, in a trial-and-error fashion. Setting aside other implications, her call for activism on the part of European judges might be supported by the favourable precedent of recent ECJ jurisprudence on the ECB's legal stance in EU primary law, mainly in asset purchase programme cases, as we will see below. The ECB President goes further by expanding her creative interpretation of the law to other independent EU entities other than the ECJ, specifically the ECB. Which lawyer has not heard the demand to be more creative from a desperate client? I will return to this shortly after summarising the Hamilton experiment.

The Hamiltonian move had already been evoked, most remarkably by Thomas J. Sargent (2012) in his 2011 Nobel Prize discourse where he made the US–EU comparison. Some other economists labelled this episode as Hamilton's Eurozone tour (James, 2012). Sargent summarises how the experiment came to an end in the US in the early nineteenth century and ultimately with the 1861–1865 Civil War. In a nutshell, the outcome was a surge in public debt, hyperinflation, consequent price instability, economic fragmentation, and a more profound political disaffection which contributed to the armed conflict. The expansion of federal tax revenues as a result of the states' debt mutualisation gave creditors the illusion of a deep pocket that faded away a few decades later when the US Treasury restructured its debt (a sort of repudiation) in 1848.[21] This happened in a context of non-constitutional coverage, insufficient political consensus, and, not surprisingly, the creation of the American central bank prototype in 1811, the First Bank of the United States. To tell the whole story, Hamilton himself had put his finger on the key issue of fostering institutional reforms both to assure the states' fiscal discipline and to avoid their debt appetite at the expense of federal tax pooling. None of these reforms took place. As has historically been the case, institution-shaping procrastination and the neglect of the matrix of incentives for stakeholders are the coincidental features of the Hamiltonian US and the present EU.

However, Lagarde's innuendo regarding the role of the ECB and its position within the architecture of the EU seems much more worrisome to me than the debatable pertinence of the historical comparison. Should the ECB become the EU's constitutional father-reformer, history would be made. Lagarde grasps hold of Justice R.B. Ginsburg's allegation, 'prestige to persuade, but not physical power to enforce', to underpin her intended constitutional rule-making mission of the ECB before the current threats to the Eurozone. Though the accurate discussion of such a proposal is beyond the scope of this article, it leaves a remarkable nuance unattended: the ECB is an independent *authority*, not an independent *power*. Central banks' autonomy relies on the specific mandate jointly received from the executive and the legislative powers to be in charge of monetary policy; this mandate must be specified and implemented on the grounds of their technical capability and subject to the law. Along with administrative accountability and control by the courts of justice, central banks are under the pressure of the reputational opprobrium derived from their mistaken analyses, wrong forecasts, and misled measures.[22] As a branch of the government, giving central banks responsibility for making law, whether of a constitutional nature or not, whether through formal enactment or case-by-case decisions, would convert them into the type of sovereign that Carl Schmitt considered was reserved for one capable of declaring a state of emergency: *Salus populi suprema lex esto*.[23] What would become in the meantime of the Orsian pristine authoritative knowledge of independent bodies such as the central banks?[24] Regarding inflationary trends and price stability, in the case of the ECB, as we will see, these could have been lost due to its Schmittian metamorphosis. The ECB's projections on inflation (that is, the institution's core goal) have been not only wrong but also biased since the very beginning of the Eurozone.

Beyond the 'old monetary malpractice' and 'spaghetti economics': understanding inflation to make sound policy decisions

There is nothing more useful than a good theory, providing it is able to explain reality in causal terms. But this does not mean that wrong theories are useless, at least to policymakers, whether fiscal or monetary. Moreover, politicians at all levels are prone to use wrong theories if they endorse their policies. That is what happens with Modern Monetary Theory (MMT), which has become both the most mistaken theory and the one that best explains both governments' fiscal misbehaviour and central bankers' monetary errors. MMT's holistic scope from taxation to money must not be missed to appraise its appeal.[25] *Necessitas non habet legem* (i.e., 'necessity knows no law'), nor theoretical restrictions.

The *Financial Times* journalist Wolfgang Münchau (2021a) has named this the 'dedicated follower of fashion's syndrome'. But unlike haute couture, in monetary policy fashion followers do not coincide with fashion victims – not even close. Revolving doors show us the trend. They no longer function from the financial industry to central banking/financial regulators, and the other way round, but instead function between the latter and conventional politics. The examples of Mario Draghi, Lagarde, Luis de Guindos, and Janet Yellen need no further comment. A kind of mimesis is taking place between the knowledgeable and the partisan-vested ones. In practice, MMT is receiving robust backing from central banks' monetary measures in the form of a new version of the 'old monetary malpractice', money printing.

The ECB's reaction to the surge in inflation, initially labelled as 'provisional', also shows the same addiction to noble lies, now regarding the other aspect of the ECB's balance sheet operations, QE. As Juan Castañeda (2021: 27–28) has stated, for MMTers, public debt purchasing by central banks is not simply an option but is, in fact, the latter's proper role. And it must be carried out in a way that throws double-entry accounting into oblivion: 'central banks could simply credit the account of the government without any other counterbalancing debit being required'.[26] MMT's simplicity is beyond all doubt. But it converts financial theft into an exercise of banality, as if the mere fact that those who do it may sanctify the practice.

Sergio Leone's followers might gladly accept my denomination of the ECB Executive Board member Fabio Panetta's (2021) explanation of inflation as 'spaghetti economics'. He talks about three kinds of inflation: the 'good', the 'ugly', and the 'bad'. The 'good' inflation is the one that falls inside the ECB's 2 per cent target, when demand is high, the output is potential, and unemployment is high. The 'ugly' inflation is the persistent one. Finally, the 'bad' one is linked to supply shocks. To sum up Panetta's stance, these three kinds of inflation have a common feature: none of them has much to do with the ECB's actual policy measures. 'Good' inflation has occurred sporadically during the ECB mandate. The same happens with the 'ugly' one, because current inflation is not going to be persistent but is transitory, an idea the ECB strongly upholds, though nobody knows how transitory it will be. Ultimately, 'bad' inflation is related to macroeconomic instability caused by exogenous factors outside the control of the ECB: first the pandemic, and then by the Russia–Ukraine engagement.

Isabel Schnabel (2021), another ECB Executive Board member, has recently provided us with a formidable, *digital* analytical tool for inflationary forecast: 'we keep our finger in the wind to determine whether the breeze [of inflation] will turn out to be more long-lived than just a transitory gust'. The effective result of this method has been the ECB's life-long navigation in the dark when it comes to the Eurozone's inflation estimates, its main and founding goal, as has been noted, among others, by F. Canepa (2021).[27] The ECB's projections on inflation are not only wrong but also biased because what lies beneath the discourse is a mistaken theory on inflation.[28] Panetta's 'good' inflation revisits the Keynesian version of the Phillips curve.[29] 'Ugly' inflation is here to stay for a long time, and it has been caused by the unprecedented increase in the amount of money in the economy derived from the ECB's monetary policies, that is, the zero/negative interest rates and the pharaonic asset purchasing programmes. The 'bad' one, simply put, is not inflation, though disruptions of supply chains due to warfare are more harmful in inflationary contexts, as is the case with the current Eurozone. It is more important than ever to recall Milton Friedman's (1970: 24) saying: 'Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output.' Ad hoc, cost-based theories of inflation only explain relative price fluctuations, not that of overall prices; thus the control of the quantity of money, which monetary theories of inflation advocate, permits the mastery of overall price levels (see Greenwood and Hanke, 2021). Juan Castañeda and Tim Congdon (2020) have shown how the analysis of the evolution of money aggregates supports an accurate ascertainment of inflation trends and the outline of robust, consistent projections.

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The Eurozone's bizarre architecture and the German legacy: taxation through monetary regulation by an ECB without fiscal counterpart

One of the main conclusions of Simon Mee's (2019: 313) formidable book *Central Bank Independence and the Legacy of the German Past* is that the euro is the monument to the deutschmark. Twentieth-century German historical experience of inflation is a swelling soar. But it is much more than that, insofar as it has been engraved in their constitutional framework, the Grundgesetz (GG), along with the explicit enshrinement of a Ricardian fiscal regime that subjects the increase of money supply through budgetary imbalances to severe restrictions.[30] Article 110(1) GG guarantees fiscal equilibrium, and Article 115 sets up explicit quantitative limits to public debt and indebtment, something which might be surprising to any constitutional expert. In short, the 'no taxation without representation' motto has its more solemn recognition in German constitutional law. Certainly, 'monetary dominance' through a sound currency and fiscal austerity is the keystone of that nation's institutional system. Broadly said, we may talk of the prevalence, at least in this realm, of the German, southern Catholic vision over the Prussian, northern Protestant one, in a paradoxical response to the well-known nineteenth-century budgetary conflict finally won by Chancellor von Bismarck.[31] Whether this trend could be reversed to get back to the Prussian style is a question that will remain unanswered here.

In this context, nobody can be struck by the disagreements between Germany and the EU, both as a whole and inside the European comitology, and their conveyance to the ECJ and the German Constitutional Court (the Bundesverfassungsgericht, or BVerfG) level. Since the 2007–2008 Global Financial Crisis, which gave rise to the Eurozone's sovereign debt turmoil a few years later, and and the ECB's reaction by the assets purchase programmes, a line of conflicting case law has emerged. Specific BVerfG requirements of clarification to the ECJ in the form of preliminary ruling procedures are at the root of the latter's decisions on the Gauweiler (2015) and Weiss (2018) cases, preceded by the

Irish-induced Pringle one (2012).[32] However, the bombshell fell on the occasion of the 5 May 2020 BVerfG decision,[33] already known as the ultra vires judgement.[34] At the core of the issue was the ECB itself and its pandemic emergency purchase programme (PEPP). To summarise the dispositive part of the ruling, the BVerfG states that the German Federal Government and the German Bundestag (the German Parliament) violated the German constitution (the principle of democracy) by omitting to take appropriate measures against the ECB not checking and explaining whether the PEPP was in compliance with EU law (the principle of proportionality). The BVerfG concludes that 'the PSPP constitutes an ultra vires act, given the ECB's failure to substantiate that the programme is proportionate, their responsibility with regard to European integration (*Integrationsverantwortung*) requires the Federal Government and the Bundestag to take steps seeking to ensure that the ECB conducts a proportionality assessment in relation to the PSPP' (emphasis intended). The German Constitutional Court settled accounts with the ECB and the ECJ's jurisprudence by considering itself the supreme interpreter of both German constitutional law and EU primary law, as the BVerfG upheld that the preliminary ruling remedy to the ECJ was correctly depleted through Gauweiler and Weiss. The BVerfG gave the ECB a three-month transitional period to adequately justify the PSPP in the following terms:

> [T]he ECB Governing Council adopts a new decision that demonstrates in a comprehensible and substantiated manner that the monetary policy objectives pursued by the ECB are not disproportionate to the economic and fiscal policy effects resulting from the programme. On the same condition, the Bundesbank must ensure that the bonds already purchased under the PSPP and held in its portfolio are sold based on a – possibly long-term – strategy coordinated with the ESCB.

Thus, the Bundesbank may no longer participate in the implementation and execution of the said PEPP.

This BVerfG judgement raises many troublesome issues that cannot all be mentioned here. The European Commission reacted by initiating infringement proceedings against Germany in June 2021, based on the BVerfG's violation of EU primacy and autonomy law. In less than six months, on 2 December, the Commission closed proceedings by way of an extremely brief official announcement declaring that they had received proper assurance from Germany, which 'commits to use all the means at its disposal to avoid, in the future, a repetition of an *ultra vires* finding, and take an active role in that regard'.[35] To go out on a limb, let me say that the BVerfG just asked the ECB for what Paul Tucker (2018: 419) calls the basic demand of the Principles for Delegation on independent authorities such as the ECB; 'that the monetary objective should be observable and central bank's actions comprehensible', nothing more, nothing less. It is hard to find in the ECB's decisions on the asset purchase programmes anything that duly justifies (a) the monetary impact of the measure according to Article 119 of the Treaty of Functioning of the EU (TFEU); (b) adherence to the sovereign debt monetisation ban in accordance with Article 123(1) TFEU; (c) the non-privileged financing of member states rule of Article 124 TFEU; or (d) the prohibition of member states financing by the EU envisaged by Article 125(1) TFEU. Other critical aspects have been left behind the Schmittian-like Mario Draghi's mantra 'whatever it takes', basically the wealth distributional effects of the ECB's asset purchases and the potential losses to be absorbed by its member states shareholders, and consequently by their citizens because of non-performing sovereign bonds (the principle of democracy alleged by the BVerfG).

To shed light on the issue, let me retrieve the proposal by C.M. Reinhart and K.S. Rogoff (2013) for the confiscation of private savings through compulsory haircuts to avoid sovereign debt defaults. Surprisingly, they do not seem to realise that inflation puts into effect the same taking of wealth without any procedure or identifiable decision. Additionally, net sovereign debt balances inside the ECB's books, combined with the rollover practice, produce a result identical to cancellation, in all but name.[36] It is by no means insane to think that the ECB has circumvented constitutional rules and sensible financial standards. Both perpetual public debt and inflation confirm the point made by N. Kocherlakota (2010): one cannot eliminate the costs caused by central banks' intervention but must simply shift them among certain groups in the economy.

Towards the end of the twentieth century, before the euro entered into force, R.A. Musgrave (1999: 175) wisely identified the central issue as the absence of a fiscal central counterpart to the ECB able to be in charge of stabilisation measures: 'The entire responsibility for stabilization is thus left with the common central bank and its monetary policy.' German tradition led to an asymmetrical construction that relies on some sort of competitive, incomplete federalism based on the economic rivalry among member states inside a common framework of deficit and debt limitations that coexist with a single, centrally managed currency. Should this asymmetry be tolerated for a long time? Should it bear the fruit of an integrated, recognisable EU?

Some conclusions: the way forward

Let me conclude and share some conclusions in the following points:

- Monetary policy tools have very limited effect. The same can be said of fiscal ones. A sensible combination of both in a single package is as necessary as it is difficult to achieve, even more so in the case of complex, pluri-national architectures such as that of the EU. The current Maastricht–Lisbon

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framework provides the EU with an asymmetrical, unconventional monetary-fiscal structure that largely relies on the Mundellian optimum currency areas paradigm of perfect mobility of economic factors and member states' rivalry.[37] This has worked reasonably well up to now,[38] but the 20-year-old euro shows clear signs of fatigue after having survived two severe crises that have converted the ECB into the common stabilisation artefact of the EU in the absence of a meaningful centralised fiscal lever. Certainly, the EU's real economy improvement is the issue, and how to shape an institutional framework that fosters productivity and gives shock-absorbing relief without counter-incentives to member states is the hard task ahead. Maintaining a situation of fiscal dominance through monetary policy willing to support government finances constitutes an unsustainable deficit of legitimation that undermines European cohesion and deepens the schizophrenia caused by a dual ('South' vs 'North') Eurozone.[39]

- In the meantime, the ECB's reversal of the monetary policies of the last decade in an effort to address rampant inflation seems to be a forced course of action to return to price stability, rather than the outcome of a rule-based monetary strategy and solid economic analysis.[40] The Eurozone needs prestigious central bankers who care about their professional reputation, not politicians in technicians' clothes. The euro is in jeopardy, and the EU's industrial decline could be the last nail in the coffin.[41] On the fiscal side, the proposal to eventually mute of the Stability and Growth Pact,[42] as well as the EU budget stabilisation measures introduced to address the effects of the pandemic and the war in Ukraine, might be the continuation of the same approach, rent distribution by money printing (see Feás Costilla, 2021).

- Undoubtedly, the euro is a political project whose survival and prosperous development needs political traction, and thus political commitment. A going-Prussian Germany longing to recoup its role as a Central European catalyst and East–West cushion would make possible a shift in the present state of affairs and the creation of a new equilibrium. But a consequential constitutional consensus for the EU will be indispensable, including some sort of Buchanian monetary and fiscal meta-rules.[43] The essence of every tyranny, even that of the benevolent dictator, consists of the enforcement of rules that are not applied to the ruler.[44]

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