

# FEDERALISM: IS IT THE SOLUTION TO THE EUROPEAN UNION CRISIS? A PORTUGUESE VIEW<sup>1</sup>

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«IF THERE IS NO POLITICAL EUROPE, THE EURO WILL DIE. THIS DEATH COULD TAKE MANY FORMS AND THERE MAY BE MANY DETOURS ALONG THE WAY. IT COULD BE AN EXPLOSION, AN IMPLOSION, A SLOW DEATH, A DISSOLUTION, OR A DIVISION. IT COULD TAKE TWO, THREE, FIVE, TEN YEARS, AND BE PRECEDED BY A LARGE NUMBER OF REMISSIONS, WHICH, ON EACH OCCASION, GIVE THE IMPRESSION THAT THE WORST HAS BEEN AVOIDED»<sup>2</sup>.

«THE PURPOSE OF THE UNION IS NOT TO BRING AN END TO THE NATIONAL STATE, BUT RATHER TO STRENGTHEN THOSE STATES AS VIABLE DEMOCRACIES, GOVERNED BY THE RULE OF LAW AND A HIGH LEVEL OF SOCIAL WELFARE. WE MUST EXTRICATE OURSELVES FROM THE SIMPLE CHOICE THAT SOME WISH TO IMPOSE ON US WHEN IT COMES TO THINKING ABOUT EUROPE: EITHER A FEDERAL STATE OR A FREE TRADE ZONE»<sup>3</sup>.

The underlying federalist ambitions of the Communities/European Union integration process are well-known. The period from immediately after the 2nd World War to the moment when the Communities were formed in the 1950s was particularly rich in terms of these unification ideals. However, once achieved, they also fell short of their proponents' most ambitious expectations. But this does not mean that they had no impact on the path of European integration at relevant moments. This was visible not only at the moment of its foundation but also in the period immediately following the fall of the Berlin Wall and the end of the Cold War. In these cases, federal ideals had a marked influence on several of the mechanisms created by the Maastricht Treaty, notably the creation of the Euro. With the current crisis, which started in

## ABSTRACT

Federal aspirations have been sub-jacent to the integration of the European Communities/European Union since its inception. With the current crisis that started in 2007/2008, we have seen a new wave of ideas related with economic federalism. However, it is unclear what the concrete solution could be, particularly in terms of the division of competences and powers between the EU and the member states. The purpose of this paper is to identify and analyse the major proposals and/or federalist-oriented measures to resolve the Euro-zone crisis. It is also an aim to assess the eventual design of a more economically integrated European Union, based on any form of economic federalism, and discuss its implications and risks for Portugal.

**Keywords:** European Union, Economic crisis, Federalism, Portugal.

## RESUMO

**FEDERALISMO: SOLUÇÃO PARA A CRISE NA UNIÃO EUROPEIA? UMA PERSPETIVA PORTUGUESA**

As aspirações federais estão subjacentes ao processo de integração

das Comunidades/União Europeia desde o seu início. Com a atual crise iniciada em 2007/2008 temos assistido a uma nova vaga de ideias imbuídas sobretudo de um federalismo económico. Todavia, não é claro em que poderia consistir uma solução deste tipo, nomeadamente em termos de repartição de competências e poderes, entre a UE e os Estado-membros. O objetivo deste artigo é identificar e analisar algumas das principais propostas e/ou medidas de cariz federalista que têm sido efetuadas para resolver a crise da Zona Euro. Por outro lado, tentaremos também avaliar em que poderia consistir uma União Europeia mais integrada economicamente, numa lógica próxima do federalismo económico, bem como discutir as suas implicações e riscos para o Estado português.

**Palavras-chave:** União Europeia, Crise económica, Federalismo, Portugal.

type proposals and/or measures that have been advanced: European economic governance, banking and fiscal union, European bonds/Eurobonds, etc. It is also our aim to try to assess what a more economically integrated European Union would consist of specifically, given that a federal-type economic solution, whatever it may be, would first have to be a political solution.

To this end, the methodology used will be based on bibliographic and documental research, complemented by a comparative method. We start with a short analysis of classic political federalism models (the United States in 1787, Switzerland in 1848), as well as economic and monetary federalism, highlighting the case of German unification in the 19<sup>th</sup> century. We will then review the model used in current European integration, which can be qualified as integration by stealth<sup>4</sup>. This is followed by an analysis of some of the most relevant proposals on this subject in recent years from European institutions, think tanks and scholars, etc.. Lastly, a comparative method is adopted to discuss and assess the viability of the proposals of a «federal upgrade» in the European Union, both in relation to classic federal models and the already existing experience of European integration. The analysis will be completed with a short discussion on the foreseeable impact of such a solution from a Portuguese perspective.

### **THE CLASSIC FEDERALISM MODELS<sup>5</sup>**

There is extensive literature on federalism. The works published by Dimitrios and Wayne<sup>6</sup> and Burgess<sup>7</sup>, among others, provide a broad picture of the federalism problematic,

2007/2008, we have seen a new wave of ideas and proposals of a more or less federalist bent at the national political level, from European institutions, as well as from think tanks and academic experts. Indeed, calls for the need for «more Europe» and a «European economic governance» to resolve the current financial and economic crisis have frequently come from various national and political circles.

In the case of Portugal, there seems to be consensus among the main political forces that increasing the European Union's competences (namely through a «European economic governance») is a suitable and necessary way of solving the current crisis. However, it is not clear what this kind of solution would entail, notably in relation to the distribution of competences and powers at the national and European level, or what their long-term implications would be for member states – and Portugal in particular – and the actual European Union. This reflection therefore aims to identify and analyse some of the main federalist-

namely in terms of concepts, theories, case studies, and current trends. Rather than reviewing this literature here<sup>8</sup>, we will make a brief and very selective look at some examples of classic federalism, from both the political and economical stance. Closely following Andreas Føllesdal<sup>9</sup>, federalism can be defined as the theory or defence of federal principles for the division of powers among political units and common institutions. Unlike a unitary State, sovereignty in federal political orders is not centralised but is based on at least two different levels. The units at each level have their own authority and, in certain areas, may be self-governed. The political obligations and rights of citizens are therefore guaranteed by two different authorities. The division of power between the political units and the centre may vary. The centre usually exercises power over defence, foreign policy and finance. The political units may also participate in the decision-making process of the central bodies.

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Typically, but not necessarily, a federal State is the result of a merger between several states or political units that were previously autonomous. In general, they are small or medium-sized states or political units that renounced or were forced to renounce their full sovereignty and form a new, larger, political unit. The federal solution may also result from the transformation of a central and unitary State (usually a large territory) to a model with a different internal organisation and division of powers that confers extensive autonomy to its regions and provinces. In this case, the process involves shared internal sovereignty, with regions or provinces being called federate states or another equivalent designation. This is usually referred to as a «false federation» or «imperfect federation»<sup>10</sup>, as it does not result from the joining of political units which had previously been sovereign. Federal Germany, founded in 1949 after the 2<sup>nd</sup> World War, is an example of this situation in Europe. It succeeded the centralised Germany of the 3<sup>rd</sup> Reich and the not so decentralised Weimar Republic. (However, there had been several sovereign political units at moments in history before the unification in 1871). Whatever the case, the federal State is the only one that exercises sovereignty externally (foreign policies, diplomacy, and armed forces are exclusive spheres of the federal State).

It is not always easy to define the boundaries of a federation compared to other similar units, such as confederations. In theory, the political units that are part of a confederation – the sovereign States – essentially maintain their sovereignty and, as a matter of principle, may voluntarily abandon the confederation. Typically, a confederation is based on common interests that lead to their joint sovereignty in certain fields (for example, defence in foreign affairs, and trade in domestic matters). It should be noted, however, that there can be quite different forms of confederation, which can range from being similar to a federation with a mere intergovernmental cooperation agreement. Returning to the federation case, the most studied examples of classic federalism are

probably those of the United States of America, in 1787, and Switzerland, in 1848. It should be noted that these two historical examples of federations occurred in very different circumstances to those currently found in the European Union. Federation in the United States came in 1787, as mentioned above, and took place over a short eleven-year period after independence in 1776. Among other specific circumstances of the time, the population of the then thirteen British former colonies totalled less than three million inhabitants. A relevant aspect is that there was not much difference in the size and heterogeneity of the political units that formed the federation in 1787. The most populated State, Virginia, had 538,000 inhabitants vis-à-vis 45,000 in the least populated, Rhode Island, representing a difference of 1 to 12 in these two extremes. This, however, was exceptional, with the difference falling to 1 to 6 between the second largest State and the last but one, and 1 to 3 between the other States in general<sup>11</sup>. It is also important to note that none of the thirteen former colonies had any long-standing sovereign State-nation tradition when they decided to transform the confederation into a federation. When Switzerland evolved to a federation in 1848, replacing the medieval Helvetic confederation with the modern federal Switzerland, the size of the population was similar to that of the thirteen British colonies that founded the North American federation in 1787.

Turning to political institutions, what are the typical features of a federal State's institutions within these two models of classic federalism, particularly in the case of North America? One of the most characteristic political features is the existence of a bicameral parliament, based on a balance between the small and large federate units. The first parliamentary chamber prevents the large, less numerous, federate units from being dominated by a coalition formed by the smaller units. On the other hand, the second parliamentary chamber tries to protect small political units from hegemony by the larger units. Nonetheless, it is important to remember that, within this classic federalism, equality among representatives was facilitated by the fact that the differences were relatively small due to the small size of all the federate units.

Another typical characteristic of the North American federal model is the institution of presidential government; this seeks to function as a strong link for the whole group with direct democratic legitimacy conferred at the ballot by the majority of the federation's citizens. The Swiss case was also influenced by the North American bicameral model, which was incorporated into the Swiss Constitution. Its most original element is seen in the Federal Council, the federation's executive body, for which consensus among the main parties is the basis of government. And so a tradition from the times of the Helvetic Confederation has remained in place; moreover, the federal State's competences are reduced to the minimum. Legislative power is essentially in the hands of the cantons. This leads to a distinction from the Helvetic model that is common practice in direct democracy: the use of a referendum to ratify changes to the constitution or on other political matters considered of such importance that they require citizens' direct approval<sup>12</sup>.

We not turn to the economic dimension of federalism by examining the historic example of German unification in the 19<sup>th</sup> century, notably its monetary unification. Before analysing this aspect, it is important to stress that the German unification of the 19<sup>th</sup> century was not a voluntary and peaceful accession process like that of the Communities/European Union, which was also only possible after the tragedy of the 2<sup>nd</sup> World War. Diplomatic manoeuvring and war played a crucial role in the creation of the German federal State in the 19<sup>th</sup> century. The word *realpolitik*, commonly used in this period, captures the spirit of the time. The formation of the German Reich in 1871 took place under the conquering leadership of William I of Prussia and Otto von Bismarck, who originally brought together twenty seven previously independent States, of which Prussia was the largest. These States (*Staaten* or *Bundesstaaten*), in other words, federate states, were given the name *Länder* during the Weimar Republic (1918-1933), and it remains the term today.

From an economic-monetary perspective, the change in currency and monetary policies in the different states to a single currency and central bank, the *Reichsbank*, was an interesting aspect of the 19<sup>th</sup> century German federal model. The move from monetary sovereignty to a common authority raised several problems. At the time, the loss of seigniorage income<sup>13</sup> from the states that had become part of the federation had a huge impact, particularly on the resources of smaller states. Today, this is generally no longer an issue, except in the case of economies affected by high inflation, where the power to issue currency can be considered a kind of « hidden seigniorage tax». The circulation of bank notes is another substantial difference with that of the economy today; at the time, it was almost marginal and the circulation of coins was much more widely used. Bank notes did not have the same legal tender as today; they were used mostly to facilitate business payments, in other words, they were generally seen as credit instruments.

In addition to these differences resulting from the economy's characteristics at that time, other interrelated aspects should be noted that are of greater relevance to today. The first, which is worth remembering again, concerns the creation of a political and economic federation in Germany in the 19<sup>th</sup> century – a process which was far from equalitarian or devoid of power struggles. Quite the contrary, the supremacy of the northern states, particularly Prussia, was visible in the design of the federation and in the bureaucratic-administrative state machine. To give an example: Friedrich List, the main theoretician of the customs union and German industrialisation, advocated a central bank to issue bank notes for the *Zollverein* group. What in fact happened was that the Prussian government, eager to maintain monetary control, followed a different course. It started by creating an exclusively Prussian central bank in 1847; it was only later, after

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the political unification in 1871, that this became the Bank of the Empire in the *Reichsbank* in 1876, as a clear symbol of its supremacy over the federation.

The second is that the Prussian and northern states' dominion gave rise to major economic and cultural-religious cleavages between Protestants and Catholics. The latter were the object of a *Kulturkampf* (culture war) driven by the protestant and Prussian elite that dominated the State. Max Weber's well-known *The Protestant Ethic and the Spirit of Capitalism*, published in 1905, to some extent reflects those deep-set divisions in Germany a century ago.

The third aspect concerns the use of this federal model for analogies with the current European economic and monetary unification. The comparison is not evident without taking into consideration the previous political unification – in the case of Germany in the 19<sup>th</sup> century but not in the European Union in the 21<sup>st</sup> century. As João Ferreira do Amaral pointed out, «contrary to what happened in the European Union, German monetary integration took place two years after the political unification (in 1871, and the German monetary union took place in 1873). Although this aspect made all the difference, it was underestimated by federalism, which continued to believe that the historic role played by the Euro would be to create conditions for the political unification of Europe<sup>14</sup>.

#### **THE EUROPEAN UNION AND INTEGRATION BY STEALTH**

The federal ideas that influenced the construction of the Communities/European Union can be simply grouped under two theoretical approaches: that of Jean Monnet, and Altiero Spinnelli's approach. That of Monnet, the French businessman, is characterised by its essentially pragmatic character and is not explicitly federalist. Above all, it opts in favour of advancing economic integration with the aim of ultimately triggering a spill over effect. This will lead to even greater economic integration which will require federal solutions and political institutions. The latter approach, championed mostly by the Italian left-wing politician, Spinnelli, is openly and explicitly federalist and advocates that federal solutions and political institutions should be adopted without waiting for the spill over effects of the economy. In fact, there is a certain scepticism about the possibility that the strategy to move towards economic integration may, in the future, generate a spill over effect that will lead to a federal political union.

Although the Communities/European Union is not a federation of states comparable to either of those analysed above, historically it echoes classic federal and other ideas. This is clearly the case within the European Union institutions, namely those with a supranational profile, such as the Commission, the Parliament, and the Court of Justice. The case of Altiero Spinnelli is emblematic. He was a member of the Commission consecutively from 1970 to 1976, and later a member of the European Parliament from 1979 to 1986. But the Court of Justice is the most interesting and possibly least well-known aspect (except in legal areas) of the federalist ambition pervading European institutions. An article by Eric Stein written over thirty years ago on the role played by this institution in the creation

of a transnational Constitution, through jurisprudence, clearly showed this tendency<sup>15</sup>. In fact, the case of European Union Law, in which historically the role of establishing the interpretation and application of the Court of Justice is enormous, is an example of what can be called *integration by stealth*<sup>16</sup>. This expression suggests the idea that integration is made by elite groups, backstage, almost furtively and away from the public eye.

It would be no exaggeration to say that the cases of *Van Gend en Loos versus Dutch Tax Administration* (1963) and *Flaminio Costa versus Enel* (1964) are permeated with legal federalism; the former in establishing the direct applicability principle, the latter in drafting the also jurisprudential principle of the primacy, or precedence, of the union's rule of law over national law. Nevertheless, neither of these principles is the direct and unequivocal result of the European Treaty texts. This jurisprudential formulation became dominant because it was generally accepted by the doctrine and national judges, and away from the eyes of public opinion. However, it does not completely set aside the possibility of contestation. Ultimately, the question of primacy would only be closed with a provision similar to the one in the abandoned European Constitutional Treaty project. Its article I-6 explicitly stated the following: «When exercising the competences granted, the Constitution and the law adopted by the institutions of the Union take precedence over the law of the member states». In other words, if it had been approved, the precedence of the primary law (Treaties) and secondary law (legal acts by the institutions) over any national rule, including the Constitution, would have been unequivocally established in writing.

In fact, this provision was one of the few that, for one reason or another, was not included in the current European Union Treaties (EUT) and the Treaty on the Functioning of the European Union (TFEU), in the text of the Lisbon Treaty. This was very probably for political reasons. It suggests an integration strategy that has been followed far from the eyes of public opinion. Such a provision – one that anyone initiated in matters of European Union Law can easily understand – would have clear political implications. The ordinary citizen would then «find out» that the Law of the Union prevails over any national regulation, even a constitutional ruling. Although this would not be a problem in some member states, in others, where public opinion is more Eurosceptic or there is greater scrutiny of European processes, it would probably be difficult to accept for political reasons. The option was to continue the integration away from the public eye, as has been the case so far. By not including this provision in the Treaties, it avoided a delicate political problem for governments. Using this subterfuge, they managed to sidestep the thorny issue of having to explain absolute primacy over national law to national electors. However, contrary to what a lay citizen might think, the solution obtained through jurisprudence is basically very similar: it has the advantage of working in a «closed circuit» and being reserved to experts with a European-federalist ideology. The article by Majone<sup>17</sup> on this specific European political culture and the fear of how citizens vote in referendums is one such example.

## THE USE AND ABUSE OF MONETARY INTEGRATION

As well as legal federalism and the jurisprudence interpretation of the Treaties, monetary integration is another interesting case of influence by federalist ideas. This aspect is mainly linked to the creation of the Economic and Monetary Union (EMU) initiated with the Delors Plan in 1988 and which culminated with the adoption of the Euro as

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physical currency on 1<sup>st</sup> January, 2002. Upon the creation of the EMU, it was established that member states wishing to participate in this process would have to comply with a set of rules, usually known as nominal convergence criteria. The aim was to ensure that they met all the necessary conditions to participate in the Euro without putting its good operation at risk. With this in mind, among other requirements that had

to be met – namely in terms of full liberalisation of the movement of capital and the independence of the central bank from governments – the following rules were determined: budget deficit no more than 3 per cent of GDP; an accumulated public debt not exceeding 60 per cent of GDP; inflation below the average of the three countries with the lowest rates, plus 1.5 per cent; long-term interest rates no more than the average of the three countries with the lowest rates, plus 2.0 per cent; exchange rate within the range of appreciation/depreciation admitted by the European Monetary System (EMS). In theory, these were *sine qua non* conditions for the Euro. The reality was different<sup>18</sup>. A flexible interpretation of these economic targets prevailed. In terms of accumulated public debt, for example, the criteria of not exceeding 60 per cent of GDP was replaced with a benevolent interpretation: it was enough to be reasonably close to this figure and show a downward trend in the accumulated public debt. As for the exchange rate, theoretically the criterion was that it had remained permanently within the narrow EMS band in previous years, with the maximum possible exchange depreciation/reappreciation rate of 2.25 per cent. However, this was also subjected to a more flexible evaluation (varying up to 15 per cent). As regards the deficit not exceeding 3 per cent of GDP, although most countries met (or nearly met) this requirement, European institutions were not concerned about (or were prevented from being concerned about...) the statistical method used to reach this figure. Apparently, at the time, the European Commission and Eurostat did not see the lack of statistical rigour or the dubious manner in which the actual national public accounts were presented as being problematic. Nevertheless, as we now know, systematically resorting to extraordinary revenue, privatisations, pension funds, etc., off-budget expenses and the questionable use of financial derivatives – at the time creating the illusion of a balanced budget and controlled public debt – were devices some States used freely.

To some extent, this explains how Club Med countries<sup>19</sup> were able to be part of the Euro from the start. At the time, there was no shortage of specialist literature warning of the risks of weak economies (which had chronic difficulties with their public accounts) adopting a strong common currency. The very idea of a common currency in the European Union was questioned by some economists, especially North Americans. The better known of these are Paul Krugman and Milton Friedman, two economists with very different views on the economy and from very different political backgrounds. Taking substantially different perspectives (Krugman with a Keynesian perspective, and Friedman neoliberal), both believed that the requirements for an optimum monetary area<sup>20</sup> in the European Union were not in place. For example, at the start there were no requirements on free movement of the workforce, generalisation of preferences, a suitable common budget, etc., so that the advantages of a common currency would clearly outweigh the disadvantages. In light of the Europeans' general distain at doubts raised about the success of the Euro, Krugman now speaks of a «vengeance of the optimum monetary area theory»<sup>21</sup>. What is the explanation for the flawed architecture of the Euro? And the ineffective rules for access to and remaining in the Euro? Was it technical and/or political ineptitude? Excessive optimism about the future creation of an optimum monetary area? Was the Euro being used as leverage for a federal-type political union? Any careful analysis shows that the project to create the Euro had significant shortcomings from the outset. The most obvious has already been pointed out: the requirements for an optimum monetary area were not verified. Such an intrinsic weakness should in itself have been a warning for a more careful, differently configured process, or, should that not be possible, delaying or even dismissing its adoption. To make matters worse, the convergence criteria outlined were often bypassed, especially by the Club Med/PIIGS countries<sup>22</sup>. Were the European decision-makers unaware of these risks? Probably not, but it is likely they were underestimated due to a set of intellectual and political constraints linked to the manner in which the European construction is usually viewed. Knowing the population's resistance to the federal idea, the European leader elite sought to overcome this by using strategies such as economic integration with the dual aim of acting also as an instrument for political union. In this way, the successive advances in economic integration – customs union, common market, the Euro, etc. – as proposed by Jean Monnet, would also be used to trigger a spill over effect for political unification – in diplomacy, common defence, in a federal-type budget and taxation, etc. According to João Ferreira do Amaral, this was actually one of the main motivations for the creation of the Euro. He notes that supporters of European federalism «trusted that the need to make the monetary union work would mean that federal institutions would have to be created (such as a single central bank, for example, and an adequately-sized European budget) [...]. Thus, no sooner had the single currency been created, they invested in approving a European constitution with a federal bent for this purpose, prepared by a convention similar to some historic cases of forming a federal State »<sup>23</sup>.

The intellectual atmosphere in which «Europe cannot stop» – to use the common political-mediatic jargon – linked to the preliminary concept that «more Europe» is always good, were determinant factors towards the decision to create the Euro. In fact, the ideologically contradictory coalition that supported its creation can only be understood by taking this intellectual atmosphere into account, which worked as an obstacle to critical thought in the political debate. «In fact, the single currency was only created because (the initially highly unlikely) convergence between the federalist and the neo-liberal views was possible in the 1990s, and was on the rise in areas connected to business and economic policy-making bodies»<sup>24</sup>. In the end, the idea that the single currency could implicitly help attain political union seduced the European left-wing parties with marked pro-federal affinities, which therefore accepted the «creation of monetary union institutions that reflect the main neo-liberal conceptions». The problem that resulted from this was that the whole macro-economic adjustment tends to be «made at the expense of labour (by increasing unemployment or decreasing salaries)» with this configuration of the Euro. Furthermore, «the survival of the so-called social European model is put at risk, a possibility welcomed by neo-liberalists as they believe the European social model is not compatible with globalisation».

Despite agreeing with the diagnosis of the failure of current European economic governance, the proponents of a federal solution for the European Union naturally put forward another interpretation, and above all, another solution. This is the case of Jean-François Jamet<sup>25</sup>, who defends that a European economic government, based on budgetary federalism, is the best way out of the current crisis in the Euro area. As for the weakness of the current European economic and monetary architecture, Jamet describes it as: «The crisis has revealed this model's weaknesses both in terms of its effectiveness and legitimacy. Faced with recession and the added risks of sovereign and bank insolvency, it was the European Central Bank (ECB) that played the stabilising role. But this entailed going beyond its mandate by buying part of the public debt of States in difficulty, for example, notably to stop speculation over the Italian debt»<sup>26</sup>. Furthermore, the «member states' economic coordination policies and budgetary rules lost credibility, either because they were not enforced, like for example the budgetary rules of the Growth and Stability Pact, or because the institutional tools were not adapted to a crisis situation (the Union's budget is not in itself enough to have a significant relaunch effect, and budgetary and fiscal decisions require the unanimity of member states and, therefore, long diplomatic negotiations), or because they simply listed objectives without defining an obligation of means», as in the Lisbon Strategy. According to Jamet, the inability to resolve this crisis is essentially due to what he qualified as being the weakest and most «decentralised [part] of the European economic crisis». This added a «political uncertainty and even a feeling of economic impotence and uncertainty», that made it impossible to «prepare a clear common urgent strategy in response to the crisis». Jamet concluded that «Europe did not know how to communicate in a united voice, nor extend the right level of solidarity and control among member states».

## **THE ALTERNATIVE OF THE EUROPEAN ECONOMIC GOVERNMENT/ ECONOMIC FEDERALISM**

We now examine the current economic governance model, and what it consists of besides its monetary aspects. As expected, it results in part from the above-mentioned European preference for integration by stealth, with its ensuing consequences, including that of its questionable democratic legitimacy. But before our critical analysis, we will review its fundamental features and also take a close look at the presentation made by Jamet<sup>27</sup>. He states that the current European economic governance «has been characterised by the compromise between the joint management of a limited number of competences, a power to regulate under common negotiated rules, and an invitation to coordinate the policies based on national decisions». Jamet talks of three domains in which this model is used, the main features of which are described below.

The first domain is that of competences centralised at a European level; these are typically «technical» matters that come under the responsibility of an independent supranational institution. It is the case, for example, of the ECB in monetary policies; the Court of Justice in controlling the enforcement of legal regulations within the European Union; the Commission in areas related to the customs union and common market (trade policy and competition policy, for example), «redistributive policies» such as the economic and social cohesion policy, or policies addressing concerns such as self-provision, food safety, and the farming community's standard of living (the common agricultural policy). These last two policies absorb the bulk of the EU's budget (over 80 per cent of total expenditure), which represents about 1 per cent of the GDP of EU28 countries as a whole. This is the quintessential domain of European technocratic governance in which government matters are «depoliticised», and taken to an extreme in the case of the ECB with its status as totally independent from the democratic power of national governments.

A second domain of European economic governance is that of ensuring national policies are coherent with a specific set of rules negotiated among the member states. Examples of these are the previously mentioned budgetary rules for the Eurozone, which sought to prevent quite distinct national policies putting the common currency at risk. The idea of further solidarity if there were any budgetary difficulties was also implicit. Note that these are not legal regulations subject to jurisdictional control by the European Union's Court of Justice; they are political provisions, only subject to political control by the member states through the Council. Linked to this is what could be considered a third domain of European governance of «weak regulation»: the coordination of national policies through non-binding objectives on competitiveness and employment matters (for example, R&D expenditure of around 3 per cent of GDP, as foreseen in the Lisbon Strategy).

As this was the economic governance model at the time of the 2007/2008 crisis and there is broad consensus that it was unable to respond to a crisis of this size and gravity, it raises the question of alternatives. The main proposals have been that of moving towards a banking and fiscal union, issuing Eurobonds, and, in more general terms,

European economic governance. Our focus goes to this last proposal as it is the most ambitious and has the greatest impact. Before assessing its merits or shortcomings, it is important to understand what European economic governance means. The first problem is that the use of the concept has taken various shapes and forms. Originally, the term was used by François Mitterrand in around 1990 after the presentation of the Delors Plan when the first phase in the creation of the Euro began. At the time, it was primarily a kind of slogan for the European Union used in French politics. Meanwhile, it re-emerged in the context of the current crisis. As Jamet pointed out, one decade later the German chancellor, Angela Merkel, started using the term but now shaped by her government's vision on how to solve the European crisis<sup>28</sup>. Essentially, European economic governance is therefore now understood to be «a strengthening of the rules for budgetary discipline linked to the use of more automatic control mechanisms ». This perspective has to a great extent been the inspiration for a number of directives and regulations proposed by the Commission and voted by the Parliament and the Council. Among others, it includes the creation of the European semester<sup>29</sup>, which allows for the Commission and the Council to issue opinions on proposals for national budgets. The idea of European economic governance underwent further developments. In the summer of 2011, Germany and France introduced a clearly political dimension to the debate. They proposed the creation of «a Council of Heads of State and Government of the Eurozone, which would meet twice a year, and be headed by a stable presidency for two and a half years ». Former ECB President Jean-Claude Trichet joined the debate by stating his preference for «a confederal government with a confederal finance minister, who could assure the governance of the Eurozone and enforce this or that decision». How would this European economic government be put into effect? Various proposals were made. One was that there would be a common Presidency of the Commission and European Council, headed by the same person. Another was that the European Commissioner for economic and financial matters would also chair the Council (of Ministers) meetings on economic and financial affairs (ECOFIN). The aim would be that the European Union would «express itself with one voice in international institutions, as is already the case in the WTO through the Commissioner for International Trade».

According to Jamet, these proposals for European economic governance have two main flaws: they «do not link national parliaments and they do not endow this government with resources for its own budgetary intervention ». He adds that the first flaw could be overcome if the «national parliaments and the European Parliament were linked to the European semester and the European decisions on budgetary matters» by «creating an interparliamentary conference linking representatives of national parliaments and European Parliament » for example, as proposed by the well-known pro-federalist member of the European Parliament, Alain Lamassoure<sup>30</sup>. As for the second flaw, the solution would be an «increase in European budgetary capacities, which could take various forms: funding investment projects through European loans (project bonds), creation of a European

treasury and joint issuance of part of the member states' debt (Eurobonds) – most likely with a *bonus-malus* system to reward States with better budgetary behaviour, increase in the European budget, or increase in the loan capacity of the European Investment Bank ». While aware of the advantages of this solution, Jamet recognises that it would be difficult to put into practice. In his own words, it is in the «area of the increase in the European budget capacities that, technically and politically, advances will be most difficult to accept». He does, however, point out that the crisis is slowly pushing the EU towards « a growing federalisation of economic policy», which can cause problems as it is being done «without any previous design or sufficient political legitimation».

### **CONCLUSION: THE RISKS OF AN ECONOMIC FEDERALISM SOLUTION**

We now turn to analysing the advantages of a solution of European economic federalism as described above from a Portuguese perspective. This implies two major risks from the outset, not to mention the question of democratic legitimacy, which for the purposes of simplicity we do not analyse herein. The first risk is intrinsically Portuguese and derives from the economy's inability to grow significantly over the last fifteen years. Going back further in time, it should be recalled that at the time of Portugal's adhesion to the European Communities on 1<sup>st</sup> January 1986, the Portuguese currency – the escudo –, like the Spanish peseta, was left out of the exchange mechanism. Preserving exchange sovereignty was not a political choice but was due to the weakness of both economies. Portugal's entry in the EMS, at the same time as Spain, came later at the end of the 1990s, when the system became more flexible in terms of exchange rate fluctuations. However, it had been Portugal's aim since the launch of the EMU to participate in the creation process of the Euro. Successive Portuguese governments established it as a «national goal», more important than political divisions domestically. As a result, the Portuguese economy was able to meet – statistically at

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least – most of the required nominal convergence criteria. Partly on its own merit, and partly because of the above-mentioned flexible interpretations of the nominal convergence criteria, Portugal was a founding member of the Euro in 1999/2002. Ironically, a high price was paid and will probably continue to be paid for this success; a price which Portuguese society is only now beginning to fully understand.

Before the 2007/2008 crisis, the Portuguese economy was already remarkably weak. GDP growth rates were below the European average over the entire previous fifteen years. Whether it was a coincidence or not, the fall in the growth rates stems back to the end of the 1990s, when the exchange rates were fixed for the 3<sup>rd</sup> stage of the EMU.

Instead of converging, the country fell further behind the European average for GDP per capita – the main indicator of the populations' standard of living. As of 2002, and now coinciding with the physical introduction of the Euro, non-compliance with the budgetary deficit below 3% became a chronic problem. As the 2007/2008 economic-financial crisis unfolded, the situation became dramatically worse, reaching its climax when the Portuguese State had to request an international loan of 78 billion Euros in 2011.

The second risk involves a subject that is not officially part of European rhetoric: the power relationships within the European Union. Once we admit that strengthening European integration is, in itself, advantageous, it is important to reflect on how a federalising solution could be conceived and implemented. Basically, what should its precise form be? We will take the case of the broadest and most ambitious idea of European economic governance. Not only is there no official proposal that clearly outlines the discussion, but different meanings and appeals for the Southern and Northern EU countries are implicit from the outset. In countries like Portugal (Greece, Spain, etc.), traditional net beneficiaries of the European budget, it brings financial transfers to the minds of politicians and citizens. In almost thirty years of European integration, Portugal has never been a net contributor and, realistically, will not be so in the foreseeable future. In other words, the idea of an EU of transfers is implicit when this subject is discussed. Another underlying idea is that of access to funding on international markets on similar conditions to Germany, the Netherlands or France, for example, through the issue of Eurobonds. Looking at the matter from the perspective of the Eurozone's core countries (Germany, but also, to different degrees, Austria, Finland, the Netherlands, Luxemburg, and partly France), which are traditional net contributors, European economic governance has other nuances. Even though the language used is similar, implicitly the design is another one; it is different from the one feeding the pro-European imagination of financial solidarity for southern countries. The idea evoked is above all a logic of budgetary discipline and public accounts, following a pattern close to the one already used in those countries, as the ideas advanced by Germany's Angela Merkel demonstrate.

Economic and budgetary federalism does not necessarily mean a significant increase in the European Union's financial transfers, nor that Eurobonds are automatically issued, which would reduce the southern countries' funding costs on the market. Its most important feature may be the mandatory adoption of economic policies by all Eurozone members. In other words, although it would indeed provide greater European economic and political integration, it may become an instrument of the dominant vision of a restricted group of «directory powers». Recalling the aforementioned examples of classic federalism, we see that any significant increase in integration entails a fundamental problem due to the characteristics of the current EU28. A «Hamiltonian moment»<sup>31</sup> is highly unlikely to come about in the current context. The political units are vastly different in size, and this is aggravated by substantial economic heterogeneity.

In demographic terms, and taking the extremes, there are 81.5 million people in Germany which is 163 times larger than Malta's population of 0.5 million. This is not an exceptional case. Enormous disparities are also found in the following political units: France's population of 64 million people is more than 106 times larger than that of Luxembourg with 0.6 million; and Italy's population is more than 81 times larger than that of Cyprus, with 61 million and 0.75 million inhabitants, respectively. And when the EU's biggest political units, such as Germany and France, are compared with other medium-sized units, like Portugal or the Czech Republic (countries with similar-sized populations), Germany is 7.7 times bigger and France 6 times.

The obvious and unwelcome question is this: in light of the (extreme) heterogeneity of the political units forming the European Union, is it possible to advance towards some sort of federalism based essentially on a logic of equality and solidarity, in which the large political units would agree to reducing their power and sharing more wealth through European budgetary mechanisms? The answer is that it is extremely unlikely, at least in the current circumstances. The smaller or average-sized political units (Cyprus, Ireland, Greece, Portugal, etc.), are undoubtedly weakened by the crisis and by their (over)indebtedness. In terms of the negotiating power required to obtain a good deal on European economic governance or other economic federalism solutions, the time is not right. Portugal's already minimal influence on European matters, even in normal conditions, has been reduced to zero by its enormous dependence on foreign funding. Based on the arguments herein, in the current context, there is a real risk that a solution of economic and budgetary federalism would in practice be close to the logic of the «directory of powers». Indeed, there are signs that it is not a European Union with greater equality and solidarity that is emerging. Another European Union threatens to emerge under the guise of providing pro-European federalist solutions. With the façade of a European economic government, or some other, in this European Union, a restricted number of core States could acquire institutional powers and legitimacy to define broad mandatory guidelines. An in-depth discussion on which political choice to make is therefore of the utmost importance, and we must put a stop to empty clichés such as the need for «more Europe».

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1 The text corresponds essentially to a paper presented within the scope of the international conference: «40 Anos após o 25 de Abril. A Crise das Democracias Liberais» [40 Years after the 25<sup>th</sup> April. The Crisis of the Liberal Democracies], at ISCTE-IUL, in Lisbon, from 8<sup>th</sup> to 10<sup>th</sup> May, 2014. The author acknowledges the comments and suggestions by the scientific mediation which contributed towards improving the final version of the article.

2 LÉVI, Bernard-Henri – «Crise da zona euro: o federalismo ou a morte» [Crisis in the eurozone: federalism or death], in *Le Point*, 28<sup>th</sup> September, 2012. Available at: <http://www.presseurop.eu/pt/content/article/2777771-o-federalismo-ou-morte/>

3 SCHEFFER, Paul – «Federalismo: por favor, nada de Estados Unidos da Europa» [Federalism: not a United States of Europe, please!], in *NRC Handelsblad*, 5<sup>th</sup> December, 2013. Available at <http://www.presseurop.eu/pt/content/article/4380781-por-favor-nada-de-estados-unidos-da-europa>.

4 See MAJONE, Giandomenico – *Dilemmas of European Integration. The Ambiguities & Pitfalls of Integration by Stealth*, Oxford: Oxford University Press, 2005; MAJONE, Giandomenico – «The Referendum Threat», the Rationally Ignorant Voter, and the Political Culture of the EU», in *RECON Online Working Paper 2009/04*, Available at <http://www.reconproject.eu/projectweb/portalproject/RECONWorkingPapers2009.html>.

5 We use here analyses on federalism, from a political and/or economic perspective. See FERNANDES, José Pedro Teixeira – *Elementos de Economia Política Internacional*, 2<sup>nd</sup> ed., Coimbra: Almedina; FERNANDES, José Pedro Teixeira – *A Europa em Crise*, Porto: QuidNovi, 2012.

6 DIMITRIOS, Kamis and WAYNE, Norman (eds.) – *Theories of Federalism: A Reader*, New York: Palgrave Macmillan, 2005.

7 BURGESS, Michael – *Comparative Federalism. Theory and Practice*, London: Routledge, 2006.

8 There is an important archive of literature on federalism which we have not analysed directly here as it is beyond the specific scope of this article. Among others, we would like to highlight the work by Paul REUTER and Jean COMBACAU, *Institutions et Relations Internationales*, Paris, P.U.F., 1980, relevant, for example, for its conceptual distinction between internal federalism and international federalism. Also on a conceptual level, the collective work under the direction of Denis de ROUGEMONT – *Dictionnaire international du fédéralisme*, Brussels: Bruylant,

1994, is also an asset for a more thorough conceptual analysis. The article by John Pinder on the neo-federalism concept, entitled «European Community and Nation State: A Case for a Neo-federalism?», in *International Affairs*, vol. 62, N.º 1, 1985-1986, pp. 41-54, is relevant for the debate on the current European integration experience.

9 FØLLESDAL, Andreas – «Federalism», in *Stanford Encyclopedia of Philosophy*, Available at: <http://plato.stanford.edu/entries/federalism/>.

10 ZIPPELIUS, Reinhold – *Teoria Geral do Estado*, 3<sup>rd</sup> ed. Lisbon: Fundação Calouste Gulbenkian, 1997.

11 DUVERGER, Maurice – *A Europa dos Cidadãos*, Porto: Edições Asa, 1994, p. 47.

12 *Ibidem*, pp. 46-47.

13 As SCHOR, Armand-Denis explains – *Euro – O que é a moeda única?*, Lisbon: Publicações Dom Quixote, 1996, p. 22, seigniorage is the «difference between the face value of a coin and how much it costs to be produced. In the past, mints would turn the ingots into coins. The coin-shaped metal weighed less than the ingots, and the difference covered the production cost and the levy paid to the prince. By extension, any advantage connected to monetary power can be called a seigniorage tax».

14 AMARAL, João Ferreira – «Euro: um futuro incerto» [Euro: an uncertain future], in *Relações Internacionais*, n.º 27, 2010, p. 98.

15 STEIN, Eric – «Lawyers, Judges and the Making of a Transnational Constitution», in *The American Journal of International Law*, Vol. 75, n.º 1, 1981, pp. 1-27.

16 MAJONE, Giandomenico – *Dilemmas of European Integration. The Ambiguities & Pitfalls of Integration by Stealth*.

17 MAJONE, Giandomenico – «The 'Referendum Threat', the Rationally Ignorant Voter, and the Political Culture of the EU», in *RECON Online Working Paper 2009/04*.

18 On this matter, we also closely followed previous analyses. See FERNANDES, José Pedro Teixeira – *Elementos de Economia Política Internacional*; FERNANDES, José Pedro Teixeira – *A Europa em Crise*.

19 «Club Med» was the derogatory expression typically used in the 1990s to refer to the weaker and more undisciplined economies of Southern Europe, such as, Portugal, Spain and Greece, as well as Italy.

20 On the concept of an optimum monetary area see SCHOR, Armand-Denis – *Euro – O que é a moeda única?*, and AMARAL, João Ferreira – «Euro: um futuro incerto», among others.

21 KRUGMAN, Paul – «Revenge of the Optimum Currency Area», in *The New York Times*, 24<sup>th</sup> June, 2012. Available at: <http://krugman.blogs.nytimes.com/2012/06/24/revenge-of-the-optimum-currency-area/>.

22 PIIGS – the English derogatory acronym for – Portugal, Ireland, Italy, Greece, Spain.

23 AMARAL, João Ferreira – «Euro: um futuro incerto», pp. 97-98.

24 *Ibidem*, p. 98.

25 JAMET, Jean-François – *L'Europe peut-elle se passer d'un gouvernement économique?*, 2<sup>nd</sup> ed., Paris, La Documentation Française, 2012; JAMET, Jean-François – «Gouvernement économique européen: la question n'est plus quand mais comment», in *Question d'Europe*, n.º 216, 10<sup>th</sup> October, 2011. Available at <http://www.robert-schuman.eu/fr/doc/questions-d-europe/qe-216-fr.pdf>.

26 JAMET, Jean-François – «Gouvernement économique européen: la question n'est plus quand mais comment».

27 *Ibidem*.

28 *Ibidem*.

29 The European semester is «a coordination cycle of the European Union's economic and budgetary policies», centred on the first six months of each year. The aim is that, during those first months of the year, the member states «place their national economic and budgetary policies in line with the objectives and rules agreed on at European Union level». Cf. European Union Council – *O que é o Semestre Europeu?*, Available at <http://www.consilium.europa.eu/special-reports/european-semester?lang=pt>.

30 On Alain Lamassoure's federalist positions, see Union of European Federalists, *Alain Lamassoure, a case for an optimistic federalism*, 12th July, 2011, Available at <http://www.federalists.eu/uef/news/alain-lamassoure-a-case-for-an-optimistic-federalism/>.

31 Among us, and by analogy with the United States' federal process in 1787, Lobo-Fernandes backs the need for a «Hamiltonian moment» for the EU. «We have defended that the European Union needs a similar solution to that proposed by Hamilton and which we had the opportunity to show in terms of the need for a Hamiltonian moment. The new federal authority created at the time took on the debts of the former Confederation States, issued public debt bonds supported by direct taxes, and issued its own currency. The practical outcome helped to turn a recent nation into an economic power». Despite being intellectually appealing, based on the reasons given in the text, it seems a far-fetched analogy in the current European situation. Cf. LOBO-FER-

NANDES, Luís - «Pragmatismo e reforma numa UE mais coesa: a propósito da união bancária» [Pragmatism and reform in a

more cohesive EU: apropos the banking union, In *Occasional Paper* nº 58, Lisbon: IPRI-UNL, March 2014. Available at:

[http://www.ipri.pt/publicacoes/working\\_paper/working\\_paper.php?idp=854](http://www.ipri.pt/publicacoes/working_paper/working_paper.php?idp=854).

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