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Debt Crisis in the Eurozone Against Legal Systems Proposed by Pierre Werner in 1970

Abstract

The debt crisis in the European Union has shown that the mistakes made during the creation of Economic and Monetary Union have contributed to the emergence of a crisis and have made it more difficult to help the states that are affected by it. The article compares the shape of the Economic and Monetary Union with the concept of monetary integration presented in 1970 by Pierre Werner, which assumed coordination at the level of the European Union fiscal and monetary policy. The text attempts to answer the question whether the application of solutions adopted by Pierre Werner would help avoid a debt crisis in the European Union.Key words: Economic Partnership Agreement, ECOWAS, European Union, primary commodities, product diversification.

Key words: debt crisis; Pierre Werner; Eurozone; economic connections; monetary policy

Introduction

The problem of excessive government debt is one of the biggest problems in the world economy. Although it is now largely related to the 2007+ financial crisis, this phenomenon is not new, because the first time that it has severely disrupted the global financial system was in 1980's. Then, after a series of oil crises, the debt crisis hit Latin

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American countries had a negative influence on the economic development of the region. Then, the effects of the crisis were felt not only in the countries which were hit by the crisis.

At present, the euro area debt crisis is one of the most pressing problems that the European Union is facing. The strong economic connections between countries in the zone have caused the problems of several countries to shift the functioning of the whole community, not only at the economic but also at the political level. The essence of the crisis is that the excessive indebtedness of some European Union states (especially Greece) has undermined the stability of the remaining and functioning economies of the Member States. The global crisis of 2007–2009, which had negative effects on the functioning of the global capital markets, was one of the most important causes of escalation of the crisis in the European Union (see more: Narodowy Bank Polski 2009). At that time, although the value of the euro was not weakening, the level of excessive indebtedness of individual states influenced their creditworthiness. This situation has started to become a threat to the rest of the community. Inflation increased and poorer Eurozone economies had problems with their competitiveness (see more: Narodowy Bank Polski 2010).

The debt crisis of the European Union has shown the weaknesses of the Economic and Monetary Union. Attempting to step out of the crisis and helping the Member States was at the same time an attempt to reform the Eurozone. When European Union was looking for solutions to the problems of the community, steps were made to deepen the integration and unification of those sectors which were not included in the Treaty From Maastricht[1]. One of the ways to solve problems, was the resumption to the Werner Plan which was presented in the 1970s. This report suggested that the implementation of the common monetary policy could be effective only in the pursuit of sound fiscal policy (Werner 1970, 17). By analyzing the causes of the current crisis in the Eurozone, the statement proposed by Pierre Werner has again become more relevant.

The article attempts to answer the question of the optimal shape of the Economic and Monetary Union, which would help avoid debt crises. The currently functioning model of the EMU was compiled with the EMU proposal designed by Pierre Werner 1970. Next, the main theses of the Werner Plan and EMU design flaws after the Treaty of Maastricht will be presented. Then, both solutions will be analyzed in the context of their efficiency and sovereignty of fiscal policy in the Member States. Finally, the issue of the effectiveness of EU crisis management and the fight against the effects

[1] The Treaty on European Union (TEU), Dz.U. C 191 z 29.7.1992

of the debt crisis will be discussed, with particular emphasis on the analysis of the mechanisms in EMU.

The starting point for this article was the critical analysis of publications on the debt crisis in the European Union (both domestic and foreign authors). In addition, an analysis was made of the most important legal acts that directly or indirectly affected the evolution of the crisis and the functioning of the EMU, as well as the reports of transnational institutions examining the macroeconomic situation in Europe. Then the results of the analysis of previous legal acts and the current ones were synthesized in order to obtain a holistic view of EMU management and to attempt to evaluate what would be the optimal structure of EMU.

1. The Main Thesis of Pierre Werner's Plan

Pierre Werner was the Prime Minister of Luxembourg in 1959–1974 and 1979–1984. During his political career he was actively involved in establishing the foundations for the functioning of the European Economic Communities. One of his most important contributions was the preparation of a plan for the creation of the European Monetary Union in 1970, which was called Werner's Plan. The plan assumed the creation of an economic and monetary union in three stages realized in ten years. The implementation of Werner's assumptions was interrupted by the oil crisis, which caused a collapse of "the snake in the tunnel mechanism" (similar to the current Exchange Rate Mechanism – ERM[2]). The integration planned by Werner was stopped at the first stage of his plan. Twenty years later, the Euro currency introduction plan written by Deloros (in the "Report on economic and monetary union on the European Community") largely benefited from Werner's accomplishments. Despite this, it was different in several key aspects. These differences have proven to have significant implications for the further functioning of the European Union.

The main assumption proposed by Pierre Werner was that the coordination of monetary policy at European Union level would be effective only if the rational budgetary policy was pursued. The strategy on how to closely coordinate these two policies was to hand over country competences in this area to the EU institutions.

[2] The Exchange Rate Mechanism was introduced in 1979 under the European Monetary System (EMS). Member States agreed to keep the rates of individual currencies within a specified range expressed in ECUs within +/- 2.25% of the agreed parity rate.

According to the assumptions, the proposed system of the central banking was modeled on the Federal Reserve System in the United States. This institution was responsible for the monetary policy. It was also the second most important institution designated as the "center of economic policy decisions". In the Werner's Plan it was responsible for the development of a broad budgetary policy and making macroeconomic decisions. This institution was accountable to the European Parliament (Nowak-Far 2001, 21) and was supposed to be able to influence the budgets of the Member States, particularly with regard to the deficit problem, sources of funding and the use of possible budget surpluses. The assumptions adopted by the Werner commission also assumed the harmonization of tax systems and the transfer of monetary policy to the level of the Community. This proposal required greater integration than the integration within the single market. It was associated with a significant limitation of the sovereignty of states in economic decisions, which, in the face of the oil crisis and related problems in the foreign exchange markets, were met with social resistance in the countries of the European Communities.

2. Disadvantages of the Economic and Monetary Union after the Treaty of Maastricht

Foundations of Economic and Monetary Union (EMU) and the plan to introduce a common currency with the criteria of convergence have been included in the Maastricht Treaty. When the foundations of the EMU were being created, for the above-mentioned political reasons, they departed from Pierre Werner's assumptions on shaping the budgetary policy shaping. The European Central Bank (EBC) was created in different institutional and functional shape from Werner's Plan (see more: Fedorowicz 2010, 139–156). EBC was the institution responsible for monetary policy of the EU. Due to political disputes the plan to construct an independent fiscal policy coordination institution was completely ignored. This was the issue that undermined the functioning of the EU, contributing not only to the current Eurozone debt crisis, but also to the negative implications for Member States' fiscal policies.

The primacy of politics over previously adopted economic assumptions was observed not only in establishing the legal basis for the EMU, but also in shaping the foundations of the Eurozone. While observing the process of selection of countries able to participate in economic integration, it is impossible to resist the impression that they are largely driven by political arguments rather than economic ones. It was already visible in 1997 when the shape of the euro area was decided upon. Although only two from eleven candidates fulfilled the criterion of budgetary convergence (and six out of nine debt-to-GDP ratios showed an upward trend), it was decided in May 1998 that all the candidate countries would begin to integrate at the same time (Szołucha 2012, 96). The problem has also been the enforcement of the convergence criteria, specifically the provisions of the Stability and Growth Pact, already in the near future, since the euro zone began to operate. The imposition of sanctions was strongly correlated with decisions of a strictly political nature, as reflected in the decision of the ECOFIN Council taken in 2003 to refrain from taking additional measures against Germany and France under the excessive deficit procedure (Panfil 2011, 162-164). This provision was repealed by the Court of Justice in Luxembourg. This situation clearly demonstrated the dependence of the sanctioning process on politics (Jędrzejowicz, Kitala, Wronka 2013). According to estimates, the convergence criteria were broken 60 times by the euro area countries between 2002 and 2011 and the European Commission's activities were limited to the so-called formal early warnings "blue letters" to governments (Cziomer 2012, 11).

In addition, it is important to mention the real problems of EU institutions in the control of countries, not only in terms of the convergence criteria, but also in the quality of the data they report on budgetary expenditures and the real economic situation in these countries. A good example is the situation in Greece, which at the time of the Eurozone entry was painted incorrectly due to falsified data sent to Eurostat, and untrusted information passed on to the EU institutions until the onset of the crisis in that country (see more: Wyżnikiewicz2015, 105-113).

It should also be noted that EU Member States have strengthened the process of economic integration while political integration was avoided. There was integration only in some random areas (Cziomer 2012, 11). This rhetoric was confirmed during the preparation and implementation of the Lisbon Treaty[3] and was yet another cause of the escalation of the effects of excessive debt.

[3] Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007, Dz.U. C 306 z 17.12.2007.

3. Dilemma of Sovereignty and the Shape of Fiscal Policy

Comparing the observed way of coordinating the fiscal policies of member states and taking into account the indispensable impact of policy on economic decision-making, Werner's message to create a self-contained institution that could influence the budgets of the Member States and at the same time control and coordinate budget policies to avoid financial crises seems well thought through. The discipline of fiscal and budgetary policy determines the effectiveness of monetary policy, which is particularly important at the time that emerging economies attempt to get out from the crisis (Gasz 2013, 64). The increase in debt causes increasing government bond yields, increasing debt servicing costs and calls for new sources of deficit financing.

The fiscal and budgetary policy of the euro area until the onset of the crisis was shaped ad hoc, in a chaotic and inconsistent manner. The crisis has shown that the targeting of fiscal monitoring on the nominal and structural balance of the public finance sector has proven insufficient to ensure macroeconomic security of the euro area (Gasz 2013, 67). There was a lack of institutions equipped with the tools to allow for fair scrutiny of the members of the Union, but also a lack in the tools and incentives to mobilize member states to save in times of prosperity. At the same time, the convergence criteria began to be questioned, particularly in peripheral countries, where they are viewed by some researchers as one of the causes of the crisis.

Establishing the solutions described above would require States to completely renounce sovereign public finance policy. While observing a package of anti-crisis measures taken within the Community, it is impossible to resist the impression that members are seeking deeper economic integration, but the renunciation of such an important instrument by the states can be a long-term process or even impossible in the current political situation (see more: Kubin 2007, 149–198). Werner, in his assumption of the Economic and Monetary Union, called for a higher level of Community budget, transnational development of medium-term objectives and short-term economic policy. He was also keen on tax harmonization, because in his way of thinking differences in this field affect the movement of goods, services and capital in the Community. It is currently limited to turnover taxes, excise duties and other indirect taxes, and can only be implemented to the extent that is necessary for the proper functioning of the internal market, for example by setting minimum limits on VAT rates (TEU art 93). Due to the subsidiarity principle, the process of tax harmonization was therefore limited to the necessary minimum, creating a situation in which decisions made by individual states could affect other members of the Economic and Monetary Union[4]. Despite the criticism of such a solution, which is one of the obstacles to complete integration and even mutual competition among euro area members, the state still does not want to waive the privilege of shaping its own tax policy (especially in the case of direct taxes). However, it is not a surprise that individual countries are apprehensive of one of the most important tools for shaping their economic policy, especially given the diversity of economies of the euro area member countries (see more: Szeląg 2003).

However, that the problem of Community fiscal policy undoubtedly was connected to the lack of real convergence of economies in the euro area. In combination with the renunciation of autonomous monetary policy and different challenges facing individual countries, this phenomenon would hinder the effective management of the euro area. These issues have not been noticed, either in the Werner Report or in the Maastricht Treaty, where the inflation target has allowed peripheral countries to relatively quickly pass nominal criteria and develop economic growth (TEU Art. 141 par. 1). The illusion of real convergence has been broken by a crisis that has shown some that countries' appearance of economic growth, in fact hid mismatched business cycles and non-synchronized economies. As a result, the problem of the so-called *one size fits all* came into light, that is, the mismatch of euroland interest rates to the economic situation of individual states or the general macroeconomic dispersion (Gotz 2012, 73). Consequently, the future shake-up only in one of the countries of EMU may also be a problem for countries in good economic conditions. On the other hand, with the current method of fiscal policy coordination, it is impossible to find another solution and a reliable control measure; one that would make it possible, for example, to create, at the time of integration, an aforementioned institution responsible for fiscal policy, which would operate in parallel to the ECB.

In the case of pursuing a common fiscal policy throughout the euro area, the issue identified by Philipp Bagus as a "Tragedy of the commons" should also be mentioned. It could be observed by analyzing Greece's behavior. Through its excessive credit expansion and populist government policies, it has contributed significantly to the

[4] Tax harmonization issues were also addressed in the context of the signing of the Euro Plus Pact in 2011. For the Europa Plus Pact see: More: Conclusions of the European Council 24-25 March 2011, online, access: 10.11.2016 (http:/www.consilium.europa.eu/uedocs/cms_data/docs/presdata/PL/ec/120311.pdf.)

problems not only in the euro area(see more: Bagus 2011, 80–94). The temptation "to stow away" by some members of the Economic and Monetary Union was also not taken into account by the Werner Report, and now, paradoxically, it has been strengthened by crisis-led instruments such as a fixed rate loan, TARGET2 settlement system, Emergency Liquidity Assistance, which can promote over-exploitation of the common goods (Gotz 2012, 73). In addition, the temptation to abuse is enhanced by the way the EU operates. The situation of misuse of rules and fractures of the basic assumptions of budgetary policy was noted at a time when it was no longer possible to punish the state, but it required support as was the case with the Greek debt crisis. This phenomenon is the voice of different political cultures in EU member states and different decision-making mechanisms. A striking example is the extreme approach to budget spending in Greece and Germany, where populist politics contrasts with budget pragmatism.

4. The Struggle with the Consequences of Excessive Debt and Crisis Management

During the fight against the effects of the financial crisis, the eyes of the observers were turned towards the European Central Bank, which also did not deal with criticism. As previously mentioned, Werner's plan advised to create a central banking system based on the American model. However, the solution was selected without giving ECB the central feature of the central bank functions, this of the last-instance lender. It was also forbidden to buy Member State bonds on primary markets (TEU art. 104). Such decisions made the ECB have limited capacity at the time of the crisis, and in the initial phase, engaging in repo operations (which were pledged), contributed further to deepening deficits in countries struggling financially. In addition, it is questionable to set inflation targeting as the main area of ECB activity, as it could lead to overheating of economies and the creation of artificial booms – such as in Ireland and Iceland (see more: Czernicki 2012). Introduction of the Werner Report's assumptions at the time of the ECB's establishment would create greater opportunities and better ways to deal with the crisis. The independence of this institution, whose weakness has been brutally exposed in the financial crisis, is also of great importance. The ECB had to reduce the credibility of repo securities under political pressure as a result of the first rescue efforts for Greek public finances. In 2012, the European Central Bank launched the Outright Monetary Transaction

(OMT) program, which was a contradiction of the ECB's assumptions, which could not directly finance deficits in the Member States (Gasz 2012, 67).

The establishment in 2011 of the so-called European semester[5], an annual cycle of economic policy coordination, seems important for fiscal harmonization. It is a solution aimed at ensuring sound public finances and preventing excessive disruption of macroeconomic imbalances which was introduced when a spillover problem was identified at Community level. In the same year, a package of directives called a six-pack[6], and a year later, a very controversial Treaty on Stability, Coordination and Management in the Economic and Monetary Union (Compact) were signed. In addition to strengthening the mechanism of penalizing the member states for failing to comply with budgetary discipline (Fiscal Pakt art 7 and 8), the provisions of the agreement oblige the state to inform about the plans for issuing public debt (Fiscal Compact art 6). This was done too late, as perhaps owing to such co-ordination and control if it were to be introduced from the very beginning of the existence of the euro area, problems with the real threat of Member States' default and the repercussions that the whole community had could be avoided. The issue of controlling and closer coordination of economic policies was also touched upon by Werner, who called for a periodic review of each of the countries in the community, in order to avoid differentiation of economic policies and, consequently, their lack of coherence over a longer period of time.

The crisis has also highlighted the lack of crisis management framework and the lack of anticipation of negative consequences of economic shocks in the European Union. It was only as a result of the existing problems that aid mechanisms were established for the Member States (eg the European Stability Mechanism) or the lack of supervisory bodies such as the European Banking Authority, the European Securities and Markets Authority, the European Insurance and Occupational Pensions Authority, European Systemic Risk Board was addressed. The European Stability Mechanism was established in September 2012. Its role is to mobilize funding

5 Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

6 In the six-pack are: Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area, Regulation (EU) No 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances and Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure.

and provide financial assistance to the euro area Member States with serious financial problems that may undermine the financial stability of the euro group as a whole. The ESM assumes two types of state aid. The first is a preventive credit line, which has no implications on the beneficiary's economic policy. The second source of aid is loans, which are subject to macroeconomic adjustments. In addition to state aid, ESM also received the option to purchase bonds in the primary or secondary market and to provide financing to financial institutions (Luc 2011, 145–167).

The actions described above may help avoid future problems or at least help identify them earlier. The negligence in integration process relating to such an important part, for example, to the banking union and the no-bail-out clause prohibiting the possibility of providing assistance to a country in financial trouble[7] is undoubtedly one of the causes of the crisis in the European Union. These problems were not foreseen by the legal basis of the Economic and Monetary Union but were also not addressed in the Werner report. The assumption of the self-sufficiency of states in the event of a crisis was undoubtedly a mistake and was contrary to the goal of economic integration. By creating a single market, with the single currency and monetary policy, only a optimistic vision of the future was pursued, without exploring any problems that could arise in the future.

Conclusions

Looking at the solutions chosen by the Economic and Monetary Union and the Werner report, it can be said that the concept created by the Luxembourg Prime Minister, in spite of a few shortcomings, was closer to realizing the basic conditions of an optimal currency area than the rules under which the current euro area functions. Looking at the causes of the crisis and its course, it could be argued that the Economic and Monetary Union, resembling that proposed in 1970, though much more difficult and taking longer to create, and requiring many political concessions, could be more resilient to internal abuse by individual members of the community. One of the causes of the debt crisis (even taking into account the failure to consider the elements of crisis management and the divergence of economies) is the artificial separation of monetary policy from fiscal and de facto management at different levels,

[7] Art. 125 Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007.

which caused the accumulation of many of the aforementioned problems. With the announcement by Greece of troubled debt repayments, they joined the domino effect, causing the first and at the same time, an extremely severe crisis in the euro area. Observing the EU's efforts to find ways out of trouble, it is impossible to resist the impression that it is slowly beginning to move towards Werner's suggestions. In order to effectively coordinate the functioning of Economic and Monetary Union, however, there is a need for a simultaneous political agreement, which is extremely difficult to accomplish, especially in the current political situation.

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