How democratic is the Euro?

By Dani Rodrik
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If the European Union is to remain viable and democratic at the same time, policymakers will have to pay closer attention to the demanding requirements of delegating decisions to unelected bodies. They should promote such a delegation of sovereignty only when it truly enhances the long-term performance of their democracies.

When Italy's president recently vetoed the appointment of the Euroskeptic Paolo Savona as finance minister in the government proposed by the Five Star Movement-League party alliance, did he safeguard or undermine his country's democracy? Beyond constitutional strictures specific to the Italian context, the question goes to the heart of democratic legitimacy. The difficult issues it raises need to be addressed in a principled and appropriate manner if our liberal democracies are to be restored to their health.

The euro represents a treaty commitment from which there is no clear exit within prevailing rules of the game. President Sergio Mattarella and his defenders point out that an exit from the euro had not been subject to debate in the election campaign that brought the populist coalition to power, and that Savona's appointment threatened a financial market meltdown and economic chaos. Mattarella's detractors argue that he overstepped his authority and has allowed financial markets to veto the selection of a minister by a popularly elected government.

By joining the euro, Italy surrendered monetary sovereignty to an external, independent decision-maker, the European Central Bank. It also undertook specific commitments with respect to the conduct of its fiscal policy, though these constraints are not as "hard" as those framing monetary policy. These obligations place real limits on the Italian authorities' macroeconomic policy choices. In particular, the absence of a domestic currency means Italians cannot choose their own inflation target or devalue their currency vis-à-vis foreign currencies. They also have to keep their fiscal deficits below certain ceilings.

Such external restraints on policy action need not conflict with democracy. Sometimes it makes sense for the electorate to tie its hands when doing so helps it achieve better outcomes. Hence the principle of "democratic delegation": Democracies can enhance their performance by delegating aspects of decision-making to independent agencies.

The canonical case for democratic delegation arises when there is a paramount need for credible commitment to a particular course of action. Monetary policy is perhaps the clearest instance of this. Many economists subscribe to the view that central banks can generate output and employment gains through expansionary monetary policy only if they are able to produce surprise inflation in the short run. But, because expectations adjust to central bank behavior, discretionary monetary policy is futile: it yields higher inflation but no output or employment increases. Accordingly, it is far better to insulate monetary policy from political pressures by delegating it to technocratic, independent central banks that are charged with the singular objective of price stability.

Superficially, the euro and the ECB can be seen as the solution to this inflationary conundrum in the European context. They protect the Italian electorate from their politicians' counterproductive inflationary tendencies. But there are peculiarities to the

European situation that make the democratic delegation argument more suspect.

For one thing, the ECB is an international institution, bearing responsibility for monetary policy for the eurozone as a whole rather than Italy alone. As a result, it will be generally less responsive to Italian economic circumstances than a purely Italian, but equally independent central bank would have been. This problem is aggravated by the fact that the ECB chooses its own inflation target, which was last defined in 2003 as “below, but close to, 2% over the medium term.”

It is difficult to justify the delegation of the inflation target itself to unelected technocrats. When some countries in the eurozone are hit by adverse demand shocks, the target determines the extent of painful wage and price deflation these countries must undergo to readjust. The lower the target, the more deflation they must bear. There was a good economic argument for the ECB to have lifted its inflation target following the euro crisis to facilitate competitiveness adjustments in Southern Europe. Insulation from political accountability was probably a bad thing in this case.

As Paul Tucker, a former deputy governor of the Bank of England, discusses in his masterful recent book *Unelected Power: The Quest for Legitimacy in Central Banking and the Administrative State*, the argument for democratic delegation is a subtle one. The distinction between policy goals and how they are implemented needs to be clear. Insofar as they entail distributional consequences or tradeoffs between contending goals (employment versus price stability, for example), policy objectives have to be determined through politics. Delegation is warranted at best in the conduct of policy that serves politically determined objectives. Tucker argues, correctly, that few independent agencies are based on a careful application of principles that would pass the test of democratic legitimacy.

This shortcoming is far worse in the case of delegation to international agencies or treaties. Too often, international economic commitments serve not to fix democratic failures at home, but to privilege corporate or financial interests and undermine domestic social bargains. The European Union’s legitimacy deficit derives from the popular suspicion that its institutional arrangements have veered too far from the former to the latter. When Mattarella cited the reaction of financial markets in justifying his veto of Savona, he reinforced those suspicions.

If the euro – and indeed the EU itself – is to remain viable and democratic at the same time, policymakers will have to pay closer attention to the demanding requirements of delegating decisions to unelected bodies. This does not mean that they should resist surrendering sovereignty to supranational agencies at all costs. But they should recognize that economists’ and other technocrats’ policy preferences rarely endow policies with sufficient democratic legitimacy on their own. They should promote such a delegation of sovereignty only when it truly enhances the long-term performance of their democracies, not when it merely advances the interests of globalist elites.

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