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About the project

The Federal Trust convened in the first half of 2006 a broadly-based Working Group to examine possible future models for the governance of the European single currency. This report arises from the Working Group's discussions, but the Trust alone is responsible for the report's analysis and conclusions.

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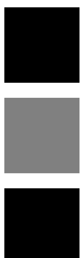
The Governance of the Eurozone

A Federal Trust Report

October 2006



enlightening the debate on good governance

Foreword

The European Union as a whole has, like the Eurozone, been a success story. But both could do better. The introduction of the euro was the high point of a Europe that had, in fits and starts, sought to implement the vision of its founders: ever closer union among the peoples of Europe. Ever closer union included political, economic and monetary union. The Maastricht Treaty, which enshrined Economic and Monetary Union, was the last will and testament of Kohl and Mitterrand – the final act in a drama of historic compromises between France and Germany which had been the motor force of political harmony and economic progress in post-war Europe.

Both men feared that they would represent the last generation of leaders who shared that vision. And so it has proved. In today's debate about the future of the European Union, Europe's leaders – and possible future leaders – understandably talk a lot about the right balance between institutional change and economic delivery. But they talk very little about the role of Economic and Monetary Union (EMU) in the future evolution of the European Union. It is hard to remember that EMU was the driving force of the European project less than a decade ago. Maybe we take the success of EMU for granted. Maybe we underestimate the success of EMU in preventing one generation from placing the burdens of debt and inflation on its successors.

This is not a timid report. But nor is it an intemperate one. It makes recommendations that are not just within the power, but the capacity, of governments to carry into action. If these recommendations were implemented, they might give a fresh impetus to political union, not for its own sake, but to help deliver the coherent governance Europe needs.

Sir Stephen Wall, September 2006

The Governance of the Eurozone

The rejection of the European Constitutional Treaty in the French and Dutch referendums of 2005 initially provoked in the European Union's leading politicians two contrasting sets of reactions. There were those, like the German government, who insisted that every effort should still be made to ratify the Treaty as it stood. Even after the French and Dutch referendums, Luxembourg, Estonia and Finland continued with their national ratification processes and fifteen of the twenty-five EU member states had ratified the Treaty by mid-2006. The clear hope of the ratifying countries was that their increasing number would expose the minority of non-ratifiers to growing political pressure for a speedy resolution of the impasse.

Others, notably but not only the British government, took little trouble to conceal their conviction that the Constitutional Treaty was beyond resuscitation. They pointed to the extreme unlikelihood of further referendums in France or the Netherlands to revise the original rejection of the Treaty by the French and Dutch electorates. Even on the implausible assumption that the French and Dutch voters could be persuaded to change their minds, a number of other countries such as Poland, Denmark, the Czech Republic and the UK would then also need to hold referendums on the text. It was highly unlikely that the electorates of all these countries without exception could be persuaded to vote for the Constitutional Treaty. The Treaty was, in anything like the form agreed in 2004, a dead letter.

In the intervening year, the argument of those sceptical about the ratifiability of the Constitutional Treaty has gained ground. 2006 has seen a number of suggestions from the European Union's leaders which, at least implicitly, accept that the Union will need to proceed in the short and probably medium term without the Constitutional Treaty. But this growing consensus has not led to any unanimity in the analyses and suggestions offered for the Union's most appropriate next steps. Disagreement about the survival of the Treaty has been replaced by disagreement about the consequences to draw from its disappearance.

The most radical prescription has come from the Belgian Prime Minister, Guy Verhofstadt, who has called for those countries which already form the Eurozone to deepen their integration over such a wide range of policies as to constitute what he calls in the title of his recent book "The United States of Europe" (Federal Trust, 2006). In particular, Mr. Verhofstadt calls for a restructuring of the economic governance of the single European currency, which, in common with many economists, he sees as under-developed in the face of the challenges and opportunities presented by Economic and Monetary Union (EMU). Although his starting-point is a deep personal and political commitment to the institutional integration of the European Union, Mr. Verhofstadt does not deny that the Union needs to do more for its citizens in the way of demonstrable economic progress. He believes, however, that the institutional deepening of the Eurozone is the best way to bring about this progress.

On the face of it, there are plausible grounds for believing that the Eurozone and the European single currency might be a appropriate vehicles for imparting a new impetus to the process of European integration, a process hampered, if not necessarily stalled, by the negative votes on the European Constitutional Treaty in last year's referendums. Arguably, the twelve (soon thirteen) members of the Eurozone are a more cohesive group than the twenty-five members of the European Union as a whole. Among them are all the founding members of the European Community and their very membership of the single currency strongly implies a willingness on their part to act as an integrative "vanguard". On the other hand, those who believed that the establishment of the Eurozone would rapidly and automatically lead to a new quality of economic and political integration among its members have not yet seen their expectations confirmed. For better or worse, the member states of the single European currency have retained until now more economic and financial autonomy within the Eurozone than many commentators expected.

This study by the Federal Trust is a critical review of the most important economic, political and institutional factors which have determined until now or which seem likely to determine in the future the evolution of the Eurozone and its structures of governance. It takes as its starting-point the belief that the single European currency does indeed present specific opportunities for deepening and accelerating the general process of

European integration. The study will, however, equally acknowledge that substantial political and economic barriers exist to any rapid restructuring of the Eurozone's workings and institutions. The range of likely changes that can reasonably be anticipated by the end of the decade is not wide. But if wholesale reconstruction of the single currency's governance is unlikely, immobility is not a foregone conclusion either. The recommendations with which the report concludes attempt to reflect this balance of analysis.

Historical background

The first moves towards European monetary union took place in the late 1960s, and led to the production in 1970 of the Werner Report, drafted by the then Prime Minister of Luxembourg. The discussions which preceded this report exposed important differences of opinion between the potential members of the European monetary union. In the 1960s, the German and Dutch governments regarded prior economic convergence and strong monetary discipline as the necessary ingredients for a successful European monetary union. France and Italy were more inclined to stress the enhanced real economic performance which they saw as arising from a monetary union among the then thriving economies of north-west Europe. In the event the Werner Report represented a compromise, calling for a European monetary union based on economic convergence, but with at its institutional heart a central bank modelled on the US Federal Reserve. The turbulent economic circumstances of the 1970s, however, put an abortive end to the aspirations of the Werner Report. The national economies of the European Community diverged so substantially among themselves that the convergence which the German and Dutch governments in particular had insisted was a precondition for monetary union was clearly unrealisable.

In the 1980s, the question of European monetary union returned to the political agenda. It was originally seen as a supplement and reinforcement of the Community's legislative programme to create a single European market by 1992. The political attractions of the project were increased by the end of the Cold War and German reunification. For Chancellor Kohl and for President Miterrand, a single European currency would serve to consolidate and stabilise the relationship between France and Germany in the new European landscape created by the end of the Soviet empire. This shared analysis was at the root of the Maastricht Treaty, signed in 1992 and which announced Economic and Monetary Union as a key objective of the European Union, set out a timetable for its achievement and adopted at least in outline a system for the governance of EMU.

The system of governance for the Eurozone envisaged in the Maastricht Treaty clearly reflected both the political realities and the prevailing economic philosophy of the time, with an independent European Central Bank (ECB) at its core, charged as its over-riding objective to maintain price stability. Some countries, such as France, would have preferred in the early 1990s to supplement the independent role of the Central Bank as anti-inflationary watchdog with more developed arrangements for a European "economic government", acting as the discretionary and political equivalent of the technocratic and rule-bound Central Bank. The German government in particular favoured, however, a preeminent role in the European single currency's institutional architecture for the new European Central Bank. It believed above all that German public and political opinion would be reassured by a governance structure for the euro which would mirror as faithfully as possible the central role in German economic management of the independent Bundesbank. Eager to ensure German participation in the single currency, the French government accepted unenthusiastically the German blueprint for the euro's institutional architecture.

But Germany was far from the only country in the early 1990s reluctant to establish for the Eurozone a strong European political institution as a pendant or counter-balance to the European Central Bank. Many other governments at the time were reluctant to set up central (or supranational) European institutions which could preempt national decision-making, particularly on politically controversial matters, inside the future Eurozone. This reluctance was reinforced by the gathering economic consensus of the day that governments in any case, be they national or European, should have only a marginal discretionary role in macroeconomic management. A noteworthy proponent of this view was the British government, which combined its traditional suspicion of any new European political institutions with the belief that a Eurozone essentially run by the European Central Bank would be a better-run arrangement than one with an interventionist European

"economic government" at its heart. The United Kingdom refused to commit itself to join the European single currency at the time of the Maastricht Treaty. The political and economic ideas, however, of the British government of the day were definitely reflected in the structure of the currency's governance.

Between the Maastricht Treaty and the physical introduction of the euro in 2002, a further important element was added to the Eurozone's governance. In 1997, the Stability and Growth Pact (SGP) was agreed. This Pact built on the Maastricht convergence criteria for EMU entry, in particular the undertaking of the Eurozone countries to maintain their public sector deficits below 3% of GDP. The SGP introduced a sanctioning mechanism for countries breaching the public sector deficit criterion. Furthermore, countries of the Eurozone accepted for themselves under the Pact the medium term objective of a balanced governmental budget over the economic cycle. Beyond the provisions of the Pact, which was revised in 2005, fiscal policy has essentially remained a national matter, resting in the hands of national governments. National medium-term fiscal policy goals within the European Union as a whole have been loosely co-ordinated over the last decade by a multilateral surveillance system in the form of Broad Economic Policy Guidelines (BEPGs) issued by the European Council, now superseded by the Integrated Guidelines of the revised Lisbon agenda of 2005. These Integrated Guidelines are more detailed and in the view of some commentators more constraining than the BEPGs. It remains to be seen, however, whether the revised Lisbon Agenda and the Integrated Guidelines which form part of it will have more impact on the actions of national governments than the original Lisbon Agenda. Critics argue that the fundamental flaws of design which hampered the Agenda from its birth in 2000 have not been corrected in its revised version of 2005.

Eurozone governance: a review

The European Central Bank

Although it was a precondition for ensuring German participation in the European single currency, the modelling of the European Central Bank on the Bundesbank of the late 1980s and early 1990s has proved controversial, particularly in the early years of the new institution. While the independence of the European Central Bank (replicating that of the Bundesbank) has not been widely questioned, criticism has been voiced, both by governments and commentators, of the supposedly unbalanced remit and actions of the Bank to pursue price stability as its primary objective, with other objectives such as high employment or growth being subordinated to this overarching goal. The Maastricht Treaty has been described by its critics as setting up a "bankers'" Europe, because its structure of governance is based upon a strong central bank primarily concerned to drive down inflation, without a corresponding central political institution to balance any potential deflationary bias arising from the ECB's mandate.

In the event, it cannot fairly be claimed that the European Central Bank has made in the eight years of its existence a cripplingly restrictive use of its main policy instrument against inflation in the Eurozone, namely interest rates. Indeed, the Monetary Conditions Indicator (MCI) of the Bank has always shown the Bank as following an accommodative monetary policy. The Bank has presided until recently over an extended period of stable and low interest rates, in itself a potentially attractive prospect for countries considering membership of the single European currency. Outside the Eurozone, the British economy has in the past eight years performed significantly better that the average of the countries within EMU, but British interest rates have been consistently higher than those of the Eurozone. If there is at any stage in the foreseeable future a referendum on British membership of the single currency, the prospect of lower interest rates will no doubt figure among the (controversial) arguments of those favouring the replacement of the pound by the euro.

At the beginning of its activity, the ECB was undoubtedly eager to reassure international markets that it possessed the determination and authority to carry out its anti-inflationary

mandate. This may have led in its early years to a rhetorical stress on its desire to bear down on inflation, which went beyond the economic reality of the Bank's practice. The Maastricht Treaty allowed the European Central Bank considerable latitude in its interpretation of its anti-inflationary remit. ECB statements initially suggested that zero inflation was the appropriate rate for which to strive, thereby fuelling concerns that the Bank was pursuing an over-zealous crusade against inflationary heresy. This objective has been clarified and revised over time. The Bank's goal is now "near to, but below two percent inflation" in the Eurozone. The ECB, it would seem, will seek to avoid in future the pursuit of zero inflation as much as it will seek to avoid the danger of high inflation. Some commentators have called for the Bank to go further and publicly adopt a symmetrical inflation target, with deviations in either direction away from the target being treated with equal concern. Such a change would mark an important evolution of the Bank's role, towards a definitely more discretionary interpretation of its remit, as the Bank attempted to assess whether deflationary or inflationary risks posed a greater threat to the European economy.

It seems unlikely that in the near future there will be the necessary unanimity for any significant change in the Treaty of Maastricht, in which the statutes of the European Central Bank were originally laid out. The German government and others see an independent central bank, charged above all with combatting inflation, as a major constituent element of any acceptable governance framework for the single European currency. It need not, however, be assumed that the ECB's own interpretation of its mandate will remain invariable. Although the Eurozone (in this reflecting the intellectual fashions of the time) was set up in a way that stressed rules rather than discretion in its governance, the European Central Bank is not today precisely the same institution that it was at its inception. Change in the way the Eurozone works is often slow, but it would be a mistake to discount the change in the ECB which has already taken place or the institution's capacity to learn from experience. There may be justice in the original criticism of the Bank as a poor communicator, although this criticism is now less often heard than it was five years ago. Critics of the Bank who depict it as a "secretive" organisation are, however, on weaker ground. Every meeting of the ECB's governors is followed by a Press Conference, the results of which are widely publicised by the Bank itself, online and in its monthly bulletin. Unlike the Bank of England, the ECB does not publish individual voting records, in a conscious attempt to preserve the collegiality and independence of the Bank. It is at least arguable that ECB Board members need a degree of anonymity if they are to make objective decisions free from political pressure to which they might be subject at the hands of their national media and political leaders.

The Stability and Growth Pact

Given the reluctance of national governments to accept, even within the European single currency, constraints upon their national fiscal autonomy, it might be thought surprising that they were willing, in the Maastricht Treaty and in the Stability and Growth Pact, to accept a continuing limitation of 3% of GDP upon their annual public deficits (on current and capital account) and of 60% of GDP on total outstanding public debt as a precondition for entry to the single currency. A number of national governments, however, led by Germany, were concerned throughout the negotiations leading to the Maastricht Treaty that monetary stability and in particular the desired low rates of interest in the future Eurozone would be set at risk by fiscal imbalances in certain member states. These imbalances, they feared, would put pressure on lending throughout the Eurozone and thus lead to higher interest rates than would otherwise have been the case throughout the single currency area. The Stability and Growth Pact, therefore, adopted in 1997, stipulated that in normal times member states of the Eurozone should aim for their national governmental budgets to be 'close to balance or in surplus' over the medium term. In times when economic conditions justified a public sector deficit, this deficit should not exceed 3% of GDP. Since 1997, however, the philosophy and workings of the Pact have been surrounded by political controversy and questions as to their economic rationality.

From the inception of the Pact, doubts had been expressed about the apparently arbitrary figure of 3% as an upper limit for overall public deficits in any one year. Other critics have accepted that at the time of the Pact's signature such a figure was perhaps defensible in the light of prevailing growth and inflation rates, but ran the risk of inappropriateness in a different economic environment. The Pact was also criticised for its supposedly excessive concentration on the short term public account, without taking into consideration long-term public liabilities, such as state pensions and the burgeoning costs of public health care. Nor was any attempt made to differentiate

between different kinds of public indebtedness, whether derived from high public investment or an effective subsidisation of current consumption. Above all, doubt was expressed about the political willingness and capacity of national governments to observe the Stability and Growth Pact, particularly if its operation seemed likely to reinforce recessionary tendencies which were the proximate cause of a rising public deficit. The initial workings of the Stability and Growth Pact gave some substance to all these concerns.

The later 1990s were a period of relatively strong economic growth throughout the European Union, which made easier the observance of the Pact by countries eager to join the single currency. The incentive of membership in the euro, moreover, helped governments such as that of Mr. Prodi in Italy to persuade their electorates to accept painful action to reduce public deficits. Once the single currency had been launched in 1999, however, national voters were noticeably less willing, in an anyway more difficult economic environment, to tolerate unwelcome governmental decisions in the pursuit of an apparently arbitrary and inflexible target for the constraint of current public debt, "imposed by Brussels." In the periods of strong economic growth, national governments, particular in the larger countries of the Eurozone, had not always followed the injunction of the Stability and Growth Pact to reduce their structural public deficit towards zero to meet the cyclically adjusted deficit criterion. In times of weak growth or recession, they then found their margin for manoeuvre was uncomfortably reduced if they wished both to run a higher public deficit to stimulate growth, and simultaneously avoid infringing the Pact's stipulated maximum of a 3% current deficit.

In the early years of the new century, France and Germany regularly infringed the terms of the Pact, although their political weight within the Council of Ministers enabled them to avoid the full weight of the official sanctioning mechanism which might under the Pact have been visited upon them. Despite these infringements, the economic performance of both countries remained disappointing in this period. France and Germany found some sympathy in other member states for their arguments that strict application of the Pact would only compromise the long-term health of their economies in the interest of short-term financial orthodoxy and that their underlying public indebtedness was in any case sustainable in the long term. This sympathy was, however, far from universal. French and German infringements of the Pact are widely believed to have contributed to the rejection in the Dutch referendum of the European Constitutional Treaty. Although the Constitutional Treaty had no direct bearing on the Pact and its workings, Dutch voters seem to have taken particular exception to what they saw as two large countries flouting the agreements which other, smaller countries had painfully observed.

The Stability and Growth Pact revisited, 2005

In March 2005, the European heads of states and governments agreed on a reform of the Stability and Growth Pact. In the light of past non-compliance with fiscal targets, they decided, not indeed to abandon, but to apply these targets in future more flexibly. In its original version, the Stability and Growth Pact allowed an extension of the normal deadlines for countries to return beneath the 3% limit if they were confronted with a negative growth rate of their GDP of at least 2% in any given year. Now, any reduction of GDP (however small) or a significant period of growth below potential levels is sufficient to secure an extension. A founded claim by a national government that it has initiated structural reforms likely to improve its budgetary position in the long term will also in future be grounds for an extension of the deadline to return within the Pact's fiscal prescriptions. Nor need national governments wait for an economic downturn to have occurred for the Pact's conditions to be loosened: anticipated economic problems can also be taken into account in this context. The Eurozone's governments would certainly claim that these changes are welcome proof of their ability to learn from experience and refine the unworkable contents of the first Stability and Growth Pact. The governments would no doubt further argue that these changes meet some at least of the most frequently voiced fundamental criticisms of the original SGP.

Critics of the revised Pact still regret that the central core of the original Stability and Growth Pact has been conserved, with the questionable figure of 3% of GDP retained as the maximum allowable level for public sector deficits. They also argue that the potentially perverse effects of the Pact have not been eliminated, since governments may in times of economic difficulty still find themselves eventually forced to introduce deflationary tax increases or reductions in public spending precisely at the time when these measures are least

appropriate. These critics are dismissive of, or at least agnostic about, claims that in its new version the Pact now takes more account of changing economic realities, softening its constraints at the first sign of recession and encouraging national governments to introduce economic reforms which will improve the long-term health of their economies.

The revised Pact's supporters for their part have welcomed the reaffirmed commitment of the present generation of European leaders in 2005 to the fiscal discipline underlying the Pact, exemplified particularly by renewed efforts of the French and German governments to move towards meeting the Pact's targets and the announced desire of the new Italian government to follow their example. As ministers and governments moved further in time away from the signature of the original Stability and Growth Pact, so its implementation became more patchy and controversial. It may well be that the present generation of European leaders will feel more intellectual and political commitment to a revised Pact which they have themselves designed.

In any event, it seems likely that the national governments of the Eurozone will wish to apply the new and revised version of the Pact for several years before considering its further amendment. Calls for further changes to the Pact, or for its abolition, are unlikely to command any significant political support in the near future. For any such calls to win credibility in the medium term, they will need to be based on the contention that in its revised form the Pact has demonstrably acted as an avoidable brake upon economic growth and higher levels of employment. Even if the overall economic performance of the Eurozone continues to disappoint, there may well be controversy among economic analysts about the precise contribution of the Pact to this state of affairs. Those commentators and national governments that see the economic problems of the Eurozone's lagging economies as caused primarily by inflexible labour, product or service markets will not attach the same importance to the Pact's precise structure as those who lay more emphasis on the macroeconomic environment which the Pact helps to form.

Missing elements in the euro jigsaw?

A striking feature of the institutional arrangements underpinning the single European currency is the wholly centralised structure it envisages for monetary, notably interest rate policy, and the largely decentralised approach permitted by the system to fiscal policy. This disjunction partly reflected a political decision of the Union's leaders at the time of the Maastricht Treaty that they wished to institute monetary union on the basis of the irreducible minimum of sovereignty pooling and partly an economic analysis which anyway stressed the supposedly overwhelming importance of stable monetary policy. On this view, the future success or failure of the single European currency would depend almost exclusively on the successful workings of the European Central Bank and little more was required of the national governments than that they should avoid jeopardising the monetary stability of the system, a goal which the Stability and Growth Pact was designed to achieve.

The Broad Economic Policy Guidelines to which the Maastricht Treaty referred were seen by some governments signing the Maastricht Treaty as the precursor of more definite arrangements for co-ordinating the national macroeconomic policies of the Eurozone's national governments. Until now, however, national exigencies, both in the formulation and execution of these Guidelines, have clearly superseded any serious attempt at an even loosely co-ordinated macroeconomic policy for the Eurozone. The absence of such macroeconomic co-ordination has significantly shaped the governance of the Eurozone, both economically and politically.

The economics of co-ordination

Few economists would deny the potential benefits in a single currency area of consistency between fiscal and monetary policy, and between the various components of fiscal policy, made up in the Eurozone by the fiscal policies of the individual member states. The institutional arrangements for the Eurozone make either form of consistency particularly difficult to achieve. Sustained co-operation between the ECB and national governments is of necessity ruled out beforehand by the absence of any centrally co-ordinating mechanism between the member states. There is no single source of fiscal policy within the Eurozone, with which, if it wishes, the European Central Bank can co-ordinate its own policy stance. If any

consistency of fiscal and macroeconomic policy emerges between the Eurozone's member states, it can only be by chance and irregularly. The Governing Council of the European Central Bank meets monthly and is regularly revising and refining its view of the overall present and likely future direction of the Eurozone economy. It is supported in this by a large, full-time staff of officials. No similar intellectual or administrative support is available to the member governments of the Eurozone meeting together. Their capacity to act in a co-ordinated fashion, to deal with either routine developments within the Eurozone or with common economic shocks, is correspondingly limited.

A single currency forges uniquely strong links among member states by creating interdependence between national economies through a common foreign exchange rate and a single monetary stance arising from the decisions of the European Central Bank. National economic policies therefore inevitably produce "externalities" for other member states, making economic governance an obvious matter of potential common concern. Yet the Eurozone has no central mechanism, constraining or even consultative, to improve the overall economic performance of the single currency area. The euro's system of governance is currently designed in such a way as almost to rule out a priori any possibility of mutually beneficial coordination either between national fiscal authorities or between Eurozone governments and the European Central Bank. Many critics see in this a continuing and fundamental weakness of the Eurozone's governance structure.

The politics of non-co-ordination

If the minimalist arrangements for the co-ordination of macroeconomic policy throughout the Eurozone derived at least partly from political considerations, these arrangements have also had a political impact on the public perception of the single European currency's workings. National politicians may well have believed that their national electorates would find it easier to accept their country's entry into the single currency if national politicians retained the largest possible measure of autonomous decision-making within the Eurozone. But even if this calculation was originally correct, the specific institutional arrangements of the Eurozone have also created political difficulties for public acceptance and understanding of the single European currency. These arrangements can all too easily create an asymmetry of public perception, whereby economic problems and difficult decisions are seen as having their origin in the single European currency, and economic success is seen as exclusively the consequence of national decision-making. Because the Eurozone has in the minds of its own citizens no identifiable political expression, public perception of the euro is always refracted and sometimes distorted through national political debates.

In the period immediately preceding the institution of the single currency, a number of countries were forced, in order to meet the criteria for entry, to carry out painful consolidation of their governmental budgets. Similar unwelcome decisions have fallen to members of the present Eurozone in order to meet the terms of the Stability and Growth Pact. Understandably, national politicians have often found it easier to justify corrections in their budgetary imbalances by reference to the external constraint of the Pact, rather than to past mistakes by themselves and their predecessors which now needed to be made good. The Stability and Growth Pact has been a convenient scapegoat for decisions, many of which would have needed to be taken by member states even if they had not joined the euro. In earlier years, the consensual prestige enjoyed in many member states by the European Union would have sufficed to legitimise disagreeable decisions of national governments. At a time when the whole continuing process of European integration is a more controversial one, public confidence in the European institutions is rather reduced when "Brussels" is portrayed by national politicians as the source of unpalatable innovations. The negative principal component of the Pact, forbidding governmental deficits above a certain level, has created in the minds of many European citizens an image of the single European currency as simply a heartless instrument of financial correction, rather than as a provider of new economic opportunities. The governance structure of the single currency has in its turn favoured such a public perception.

The European budget

In setting up a single currency with effectively no central budget, the European Union was conducting an experiment unique in modern times. It may well be that the same mixture of economic and political considerations which precluded the setting up of strong co-ordinating mechanisms for national macroeconomic policies in the Maastricht Treaty persuaded (and probably continue to persuade) national governments that no substantial central budget was necessary.

The existing central budget of the European Union is small, inflexible and entirely unsuited to the stabilising function traditionally associated with an economically significant central budget in a single currency area. While national public budgets will no doubt be sufficient to achieve whatever degree of national social redistribution is thought appropriate in the individual member states of the Eurozone, the Eurozone does not currently have any budgetary mechanism to stabilise economic activity by transferring resources from areas of high or excessive growth to areas of low or insufficient growth. This is distinctly unusual in a monetary union such as that of the Eurozone. The absence of any such stabilising redistributive capacity (contrary to the recommendations of the prestigious MacDougall Report in 1977) at the centre of the European single currency is in striking contrast to the institutional arrangements which underpin or have underpinned other highly decentralised monetary unions such as the United States or Germany in the era of the Deutschmark.

Whether in the long term the member states of the Eurozone will be willing to set up a significant budget for their single currency can only be a matter of speculation. Nothing in the recent history of the Union's budgetary negotiations suggests that any such move is imminent. 2005's negotiations about the European Union's budget were so acrimonious precisely because the net contributors to the budget are evidently determined that their European payments should be restrained rather than increased. Even if economic theory might suggest that the single European currency would function better, particularly in times of crisis, if it were geared around an economically significant central budget, the Eurozone seems likely to lack this potential instrument of economic management for many years to come. Proposals have been made, both at an academic and political level, for the setting up of a small "rainy day" fund, which could be made available on a temporary basis for countries in particular economic difficulty and might be a factor for economic stabilisation within the Eurozone. Even this less ambitious proposal has been met with great scepticism, and cannot be regarded as in any way an imminently realisable project.

The absence of a discretionary central budget is of itself a barrier to the emergence of a transparent and publicly comprehensible structure of governance for the single European currency. As always, the Eurozone's national governments have sought corporately to strike a balance between the maintenance of national economic sovereignty and the sovereignty-pooling apparently demanded by the good governance of a monetary union, and concluded that this balance should tilt firmly in the national direction. The absence of an economically significant central European budget is, deliberately or otherwise, a substantial impediment to the creation of anything that could reasonably be described as an "economic government" for the Eurozone.

An economic government for the Eurozone?

Although most governments that signed the Maastricht Treaty hoped and believed that the limited central governance structure which they gave the euro would be sufficient, a minority certainly believed that the pressure of economic events would inevitably lead over time to the evolution of an "economic government". This "economic government" would ensure better economic co-ordination between the actions of national governments and would act as a political manifestation of the single currency area, whether in dealings with the European Central Bank or at the international level. But while there has been serious discussion of single representation for the Eurozone countries at such international financial institutions as the IMF, national governments have been tenacious in defence of their national competences within the Eurozone. Far from ushering in an era of accelerated economic integration among the Eurozone's member states, the single currency has until now been marked by national policy-making, national debates and differing national analyses.

Many observers have hoped or feared that the group of Eurozone member states meeting in the Eurogroup might be in embryonic form the forerunner of a more developed system of "economic governance" By suggesting a permanent Presidency for the Eurogroup, a proposal then implemented later in the same year, the European Constitutional Treaty of 2004 seemed to suggest a tentative move in that direction, although the Treaty was generally notable for the caution with which it approached economic questions. Two features of the Eurogroup, however, should not be overlooked, which restrict its present capacity to act as a coherent decision-making forum for the Eurozone. The Eurogroup has no permanent staffing resources and its agenda has traditionally primarily been that of mobilising within the Council of Ministers a majority on matters of policy and legislation for the European Union as a whole, rather than considering in a structured fashion broader economic questions affecting the Eurozone. If they wished, national governments could certainly endow the Eurogroup with much more in the way of resources than it currently possesses and give it an agenda which went beyond that of a caucus for the meetings of the whole EU's Council of Ministers. Whether they have or will have the political will to do so is a question for further consideration at the end of this report.

Tax and social harmonisation within the Eurozone

In the same way as differing commentators have feared or hoped for the emergence of an "economic government" for Europe, differing commentators and national governments have hoped or feared that the single European currency might be the occasion for moves towards greater tax and social harmonisation within the Eurozone. These hopes and fears have not been borne out thus far within the euro area. Indeed, the legal relationship between the Eurozone and those member states which have not joined the European single currency will for the foreseeable future act as a substantial brake on harmonisation in the areas of tax and social policy within the Eurozone.

The majority of those countries which today comprise the Eurozone would either advocate or at least be prepared to accept a greater degree of harmonisation of tax rates and tax bases between themselves than is currently the case. They would do so either in the belief that such greater harmonisation is necessary to make the EU's single market work, or because they judge that the deepened economic integration arising from the single European currency makes such greater harmonisation of tax rates and bases logical and necessary. Of the twelve current members of the Eurozone, Ireland would probably come nearest to rejecting this analysis entirely, and there would be a spectrum of views as to what degree of harmonisation would be necessary. The intellectual and political climate among the present members of the Eurozone, however, would certainly be more favourable to the general concept of tax harmonisation than it would be within the Union as a whole.

Within the twenty-five members of the whole European Union, there are, however, a number of countries, notably the United Kingdom and most of the new EU members from Eastern and Central Europe, profoundly sceptical of the case for further tax harmonisation, particularly harmonisation of tax rates. Their underlying fear is that in the longer term such harmonisation will converge towards higher rates of tax, traditionally associated with an economic model which they regard as inimical to their own preferred national economic structures. Since the matter of tax harmonisation is one that the European Treaties prescribe for decision by unanimity, the likelihood of the European Union as a whole being willing in the near or medium term to move towards any substantially greater degree of harmonisation in this area is remote. If the countries of the Eurozone favourable to greater harmonisation of tax rates and bases are to achieve in the foreseeable future any such supranational harmonisation, then they have at first sight a better chance of achieving it between the present members of the Eurozone than within the European Union as a whole.

As long, however, as the Eurozone and the European Union as a whole are not identical in their extent, legal problems may always arise for the interaction between the two entities, particularly where tax-related matters are at issue. Many of the measures of tax harmonisation that the present or future countries of the Eurozone might wish to adopt would run the risk of incompatibility with the Treaties governing the European Union and its single market. In particular, any attempt by the Eurozone countries to exclude goods or services from EU countries outside the Eurozone on the basis that they did not confirm to harmonising standards of taxation adopted only by the Eurozone would be illegal under EU law. An important

motivating force for many of those advocating greater harmonisation of tax rates within the EU as a whole is their desire for protection against "fiscal dumping". It is difficult to see how the Eurozone can ever give such protection to its members without putting at risk the whole concept of the EU's single market, an achievement which few member states inside or outside the Eurozone would be prepared to see jeopardised.

Similar considerations apply to questions of "social harmonisation" within the Eurozone and the Union as a whole. Some measures falling under this agenda (such as the transferability of pensions between member states) might well be capable of adoption by the whole Union. Others (notably employment protection or rights of consultation at the workplace) certainly would not. Even if, as may be the case, a consensus could be developed within the present or future Eurozone for more demanding social standards in these areas, this consensus could only be applied within and between the countries of the Eurozone. The United Kingdom and others would ensure for many years to come that no such consensus be obtained within the Union as a whole. Any attempt by Eurozone members to apply their own social standards in a discriminatory way against EU members not in the Eurozone would be doomed to legal challenge and reversal in the European Court of Justice. As so often in the European Union's debates, the reality of the existing Treaties circumscribes, for better or worse, possible developments of the Union that their advocates or opponents insist are genuine possibilities. The legal scope for a significantly more "socially harmonised" Eurozone within the European Union is severely restricted.

Economic Reforms in the Eurozone

Many of those who most enthusiastically advocated the setting up of the single European currency did so in the belief and expectation that it would expose the members of the Eurozone to an enhanced degree of competition between themselves, with the inevitable result that "best practices" within the Eurozone would be generalised for potential laggards to remain competitive. In particular, their hope was that the member states of the single European currency would find themselves better equipped to confront the challenges of globalisation by the increased competitive pressure to which economic actors in the Eurozone would be exposed. This enhanced competitive pressure within the Eurozone was seen indeed by some governments and commentators as forming a keystone of the economic governance of the Eurozone, with the free market encouraging or even forcing national governments to adopt the most appropriate macroeconomic and microeconomic policies. The first years of European Monetary Union have given some succour to the optimists, but not in regard to all members of the Eurozone. The microeconomic and macroeconomic performance of certain countries within the Eurozone has been highly successful. Until recently, however, a number of the Eurozone's larger economies have undergone several years of low growth, dragging down average indices for the Eurozone.

Few economists would deny that an important part of the functioning of the economy within a currency union is determined at the microeconomic level. Individual countries of the Eurozone can no longer manipulate their relative economic standing by way of changes to their currency's (nominal) exchange rate or to their domestic interest rates. Countries wishing to maintain or improve their competitiveness need to do so by a continuing process of real changes which make their goods and services more, or at least no less, competitive than before. This process is well illustrated by two examples from opposite extremes of the economic spectrum. Germany has considerably improved its cost competitiveness over the past 5 years – reflected in high levels of net export. On the other hand, Italy's dramatic failure to maintain its global competitiveness has been crystallised in a particularly painful way as a result of the narrower choice of policy instruments now available for the Italian authorities, devaluation above all no longer being an avenue open to them.

Realisation that within a monetary union microeconomic policy acquires an enhanced salience has led to plans, or at least aspirations for common action throughout the Eurozone and indeed the Union as a whole. The main pan-European effort to co-ordinate economic policies supporting microeconomic reforms is the Lisbon Agenda. Adopted in March 2000, the Agenda sought to make the EU 'the most competitive and dynamic knowledge-driven economy by 2010'. Central to the Agenda was the goal of creating a new knowledge-based economy, by investing in education and research, by boosting innovation and labour productivity; and by reducing market rigidities and regulatory burdens.

Even in 2000, critics claimed that the Lisbon Agenda represented little more than a catalogue of pious aspirations, the realisation of which was entrusted to national governments rather than to European institutions. If national governments had not succeeded in the past in achieving desirable economic reforms in their own countries, there was no obvious reason to believe that the Lisbon Agenda would of itself encourage them to do so. A mid-term review of the Lisbon Agenda in 2004 appeared to confirm the pessimism of the critics. The review criticised the Lisbon strategy for suffering from a lack of focus, poor co-ordination and conflicting priorities. It concluded that the main chosen instrument of the Agenda, namely "benchmarking" between member states, was a theoretically desirable one, but in political reality unlikely to make a real difference to the behaviour of member states. The Agenda was relaunched in 2005, with a new focus on 'jobs and growth' as keys to the future prosperity and sustainability of the European economy. Although the concept of "benchmarking" was not abandoned, the Agenda would in future hinge on the adoption, implementation and monitoring of National Reform Programmes (NRPs) for every member state. Critics of the relaunched Agenda doubt whether even in its new form it will greatly alter existing national policies and economic performance.

The political and institutional discussion about microeconomic reform in the Eurozone and the European Union more generally is illuminating in a number of respects. The unwillingness of the member states to involve other than marginally the European Commission in national processes of economic reform is a further example of the refusal of member state governments to share at the European level non-monetary economic sovereignty. At the outset, the Lisbon Agenda was conceived as an arrangement between governments, with all that implied for the absence of centralised sanctions or legal compulsion. The revised Agenda of 2005 speaks of "a partnership between the member states and the Community level", but does not fundamentally modify this underlying reality. Those who regard the European institutions as usually better equipped to implement common policies than national governments acting voluntarily among themselves will not be surprised by the tardy progress so far on realising the Lisbon Agenda.

It is a common phenomenon of economic reform that its initial effects may be painful and unevenly distributed. While arguably all will benefit in the longer term, a cost may well need to be paid in the short term, either by the economy as a whole or by specific sectors of it. In the 1980s and early 1990s, a number of national governments engaged upon microeconomic restructuring, including the British government, were able to mitigate these negative effects in the short term by running a loose monetary or fiscal policy which ensured that necessary reform caused the minimum possible amount of disruption to economic growth and employment. Within the Eurozone, mitigation of short-term economic pain for their citizens is much less easily available to national governments, since monetary policy is in the hands of the independent European Central Bank and the constraints of the Stability and Growth Pact circumscribe the room for manoeuvre of national governments eager to impart a fiscal stimulus to their national economy.

How large a Eurozone?

While three countries that were members of the European Union before the most recent round of enlargement (Denmark, Sweden and the United Kingdom) have decided to remain outside the Eurozone, at least for the time being, all the ten countries which joined the European Union in May 2004 are bound by Treaty to seek to join the European single currency. With the possible exceptions of Poland and the Czech Republic, there is currently a political and social consensus in all those countries to become part of the Eurozone as soon as possible. But fiscal and monetary conditions vary greatly between the ten countries in question, with a number of governments finding it more difficult than they had hoped to meet the convergence criteria for joining the single currency. These economic difficulties are likely to slow down accession to the euro even for those countries politically most eager to join. The Hungarian government has recently accepted that it will need longer than it anticipated to meet the Eurozone's convergence criteria. Others among those countries that joined the European Union in 2004 may well soon be following suit.

Nevertheless, the impending entry of Slovenia into the single currency has served to reassure some who feared that the Eurozone would simply remain in coming years the preserve of "old Europe". Lithuania had hoped to join the Eurozone at the same time as Slovenia, but a mechanistic and controversial application of the accession criteria for the single currency (specifically the inflation criterion) has led to what seems likely to be a postponement rather than refusal of its entry. In the medium term, Slovenia is likely to be followed by at least some other new members of the Eurozone, although there will almost certainly be for a number of years a mismatch between the membership of the European Union as a whole and that of the Eurozone.

It is widely and plausibly believed that the accession to the Eurozone of a number of Central and Eastern European countries would render less likely any prospect that the single currency area might be a vehicle of enhanced fiscal and social harmonisation. At their current stage of their economic and social development, many of these countries definitely favour a regime of low taxation and economic flexibility over one of high taxation and extended social rights. But in any event, and even without the participation in the Eurozone of such self-consciously liberal economic governments as those of the Baltic States, the capacity of those countries in the European single currency to adopt among themselves fiscal and social regimes much at variance with the rest of the EU's single market is very limited (see above). A more important consequence of a numerically larger and more economically heterogeneous Eurozone is likely to be the even greater difficulty of changing the existing structure of governance for the Eurozone. This difficulty is already a reality, and demonstrated by the difficulty of agreeing on even limited reform of the Stability and Growth Pact, in the negotiation of which reform the countries that recently joined the European Union also participated. The Maastricht Treaty and its arrangements for the governance of the euro represented a conscious and difficult compromise between very different approaches to the fundamental political and economic questions underlying the single European currency. To arrive at a substantially new compromise acceptable to all would be an even more challenging task for twenty or more negotiators than for the twelve member states who signed the Maastricht Treaty in 1991.

Future developments?

Given the apparent reluctance of national governments to go further than hitherto in the way of pooling further national sovereignty within the single currency, and given the difficulty of treaty amendment to modify substantially the euro's system of governance, it is certainly possible that the Eurozone will continue with its present institutional arrangements for the indefinite future. Few economic and political commentators regard these arrangements as ideal, but most recognise the political constraints upon substantial change, however economically desirable this change might be in theory. There is no plausible prospect in the immediate future of a highly-developed "economic government" for the Eurozone, of the abolition of the Stability and Growth Pact, or of the substantial rewriting of the statutes of the European Central Bank. If such profound changes ever do come about, they are likely to be the result either of an overall crisis of the single European currency, or as the long-term culmination of a series of incremental changes within the operation of the Eurozone system. The evolution of the European Central Bank's role, the revision of the Stability and Growth Pact and the consolidation of the Lisbon Agenda have represented precisely such incremental change over the last decade, change which has been cumulatively significant for the workings of the single European currency.

There are serious commentators who believe that a crisis of the present governance structure for the Eurozone cannot be long delayed. Some of these commentators discern in the Eurozone's working an unsustainable "deflationary bias". Others believe the structure can never provide a satisfactory equilibrium between a centralised monetary policy and decentralisation for all other aspects of economic policy. But such a bleak analysis does not currently command consensus among commentators or within the Eurozone's governments. While the overall economic performance of the Eurozone over the past five years has been for many observers disappointing, it has been far from calamitous, and it is in any case widely debated how far this disappointing performance has been the fault of the way the single European currency is run.

Even so, the mediocre economic performance of the larger countries of the Eurozone and a growing sense of how historically unusual are the governance arrangements for the single European currency have undoubtedly created academic and political interest in possible evolutionary changes for the Eurozone's workings. Much discussion has centred on the Eurogroup, in which national finance ministers from the Eurozone gather to prepare a common position among themselves for the meeting of the twenty-five ministers in plenary session of the EU's Council of Finance Ministers. If the political will exists to expand the remit of the Eurogroup, its work could certainly be much more tightly structured than at present, with substantial consequences at both the practical and symbolic level.

Such a reinforced Eurogroup (or Eurozone sub-groups shadowing other formations of the Council of Ministers) would not need to have, at least initially, formal decision-making powers. Regular, structured and well-publicised consultation between the relevant national ministers on economic matters relating specifically to the Eurozone would represent a significant reinforcement of the political (as opposed to the technical) component in the governance of the European single currency. There is currently no coherent political expression of their single currency to which European citizens can refer, whether for praise or blame. The sense that national economic ministers from the Eurozone met, consulted and publicised their shared conclusions on the macroeconomic and microeconomic problems of the single European currency would be a powerful symbol of a gathering corporate identity for the Eurozone which was not merely monetary and technical. Far from enhancing the political legitimacy of the European single currency, the entirely decentralised and national nature of its non-monetary governance has all too often created confusion and a lack of confidence in the single currency's workings on the part of many European electors.

It may well be that European public opinion as a whole is not yet prepared to accept anything that could plausibly be described as a European economic government and that Mr. Verhofstadt's conception of such a government (particularly one run by the European Commission as he advocates) is politically unrealistic. But it can hardly be claimed that electors in the Eurozone find its present structure of governance reassuring. In the national French and Dutch debates on the European Constitutional Treaty, the governance of the Eurozone was a central locus of unease among voters over the current state of the European Union. The structure of decision-making within the Eurozone was widely seen as remote, technocratic and confusing. In so far as the French and Dutch electorates had any coherent picture of the Eurozone's governance, it was seen exclusively as a source of external difficulty and constraint, rather than as a shared enterprise from which all could benefit.

But the rationale for a more coherent and structured corporate identity for the Eurozone is not merely political in character. As long as there is not even a rudimentary central political direction for the single currency, the economic perspectives of the Eurozone will be inevitably confined. Counter-cyclical macroeconomic policy at the European level, serious dialogue between the European Central Bank and national governments and co-ordinated deflationary or reflationary policies within the Eurozone are all options of economic policy of which the Eurozone deprives itself by its non-existent central political structures. It will of course always be a matter for debate and controversy whether at a particular time a particular economic policy is desirable at the European level. The present governance structure of the euro dictates that there is no time at which the Eurozone can pursue economically co-ordinated policies, unless by chance its national governments all come independently to the same policy conclusions.

The next twelve months

The coming year will be a time of considerable political volatility in the Eurozone, with new heads of state and government highly likely in France, a new head of government likely in the Netherlands and uncertain coalitions governing Germany and Italy. This is not on the face of it an encouraging conjunction for substantial new steps in 2006 or 2007 towards any great deepening of European integration, whether economic or political. Much hope and political capital, however, has been invested in the German Presidency of the Union in the first half of 2007, when Mrs. Merkel and her colleagues may well be looking to reassert the leading and traditional role of Germany at the forefront of European integration.

The development of the Eurozone would certainly be a field in which Germany, as the largest economy within the European Union, would be well placed to take an appropriate initiative. The Eurozone is currently small enough and France and Germany are sufficiently large actors within it for a successful Franco-German initiative on reinforcing the Eurogroup to be a realistic possibility. Although she became Chancellor with little direct experience of European issues, Mrs. Merkel surprised and impressed her colleagues in the European Council by her decisive contribution to resolving the impasse over the European budget at the end of 2005. In a wider European Union, the possibilities for constructive Franco-German leadership are evidently limited. Within the present Eurozone, such leadership from the traditional "motor" of European integration is by no means impossible.

In reviewing the history so far of the single European currency, it is difficult to avoid the impression that a number of related questions remain unresolved about the precise amount and kind of sovereignty-pooling that is necessary, desirable or possible within the Eurozone. Inevitably, a spectrum of views exist, ranging from those who regard the present structure as sacrosanct to those who believe it to be, for economic or political reasons, unsustainable. Those who believe that more sovereignty-pooling is desirable or even necessary to make the single currency work better are not necessarily advocates of a "United States of Europe". Nor need greater sovereignty-pooling to make the single currency work better inevitably lead to the fiscal and social harmonisation favoured by some of those (including Mr. Verhofstadt) who call for greater European political integration, with the Eurozone as the immediate political vehicle of this integration. As ever within the European Union's institutional evolution, a number of separate debates, economic, social and institutional intersect in the field of the single European currency. The leading participants in these debates are not always able or willing to separate the various strands of their argumentation.

To many of its supporters and critics, the project of the European single currency appeared at its birth a further and potent example of the "Monnet method". The broad, general decisions taken to set up initially the euro would require for their detailed implementation a series of consequential steps which would deepen the integrative process in ways not always foreseen by the original decision-makers. The future evolution of the European single currency will reflect the accuracy or otherwise of this analysis. Until now, the "method" of Jean Monnet has only been partly exemplified in the case of the euro. Some acceleration of economic integration has taken place within the Eurozone, particularly in the banking and financial services sector. But institutional innovations to rebalance its structure of governance and to enhance its available range of policy options have been striking by their absence until now. Even the tentative development of central co-ordinating structures that might be implied by the development of the Eurogroup has been a topic more of discussion than action. There is no reason to believe that public opinion throughout the Eurozone welcomes or is content with the present institutional architecture of the Eurozone, which it sees as confusing, erratic and technocratic. European public opinion might well react positively to initiatives designed to make the governance of the Eurozone more accessible, more sophisticated and more coherent. But such initiatives will not arise spontaneously from academic discussion or from civil society. They will require political will and leadership at both the national and the European level. As the European Union's leaders ponder their options over the coming year, they may well conclude that, thorny a topic as it may be, the governance of the Eurozone offers at least as much scope for progress as do attempts to resuscitate the European Constitutional Treaty.

The future governance of the Eurozone is not a matter of interest exclusively to its current members. The great majority of the Union's present member states have either already joined, or definitely aspire to join the European single currency. All of these states must logically wish for the governance structure of the euro to be as economically and politically sustainable as possible. Even if there are countries which decide to remain indefinitely outside the single European currency, they also will have an interest in the good functioning of the currency used by their major trading partners. Countries of the European Union which remain outside the euro will by their own choice have renounced the ability to influence its evolution. But they will continue to benefit from the single currency's successes and to be harmed by its failings.

Conclusions and recommendations

The Federal Trust recommends the following as realisable improvements to the workings of the Eurozone's structure of governance. The recommendations follow in the order of ease with which administratively and politically these changes might be made. The penultimate recommendation would involve a small, technical Treaty change. The one major Treaty change advocated, to modify the statutes of the European Central Bank, is put forward as a final recommendation, highly unlikely to be realised in the near term.

1. The Eurogroup should establish for itself a permanent secretariat, under the direction of the President of the Eurogroup. This secretariat should have the remit of advising the Eurogroup how the economic performance of the Eurozone could be improved, with particular regard to co-ordinating measures within the Eurozone in the fields of employment, enhanced productivity, public investment and economic reform. This reinforcement of the Eurogroup would not of itself transform the Eurogroup's consultative nature, but would make it administratively easier for the Eurogroup members, if they wish, to discuss and adopt closer co-ordination of their microeconomic and macroeconomic policies.

2. The agenda of the Eurogroup should be rebalanced, away from the establishment of common positions in the EU Council of Ministers and towards the structured discussion of macroeconomic and microeconomic issues of relevance to the overall economic performance of the Eurozone. The Eurogroup's meetings should normally discuss a standard agenda, in which the real economic performance of the Eurozone and ways in which that performance might be improved are considered under the headings of employment, productivity, public investment and economic reform. When questions arise concerning the external value of the euro or the co-ordination of national positions in international monetary fora such as the IMF, these matters also could figure on the Eurogroup's agenda. Regular and well-publicised meetings to discuss in an organised fashion economic matters of common concern within the Eurozone (normally with a concluding communiqué) would both symbolise and stimulate an awareness that a single currency inevitably creates common challenges and the possibility of common solutions for its members.

3. In parallel to the meetings of the Eurogroup, there should be annual meetings of a European Council for the Eurozone. Its agenda should be similar to that of the Eurogroup and the regular coming together of heads of state and government would appropriately symbolise the high importance which the Union's leaders attached to their membership of the single European currency. It would emphasise to an often indifferent and sometimes confused European public opinion that these leaders see the governance of the Eurozone as a matter requiring not merely a national, but also a supra-national political component.

4. Eurozone members of sectoral Councils of the European Union such as Competitiveness, Transport and Social Affairs, with obvious responsibility for economic decision-making, should meet once or twice a year to consider the contribution they can make to the governance of the Eurozone. The reports of their meetings should be forwarded to the reinforced Eurogroup and the European Council for the Eurozone. Both politically and technically, the work of ministers other than finance ministers (represented in the Eurogroup) or prime ministers and heads of government (the European Council) has a substantial contribution to make to reinforcing the consultative networks and potential collective action of the Eurozone.

5. There should be regular discussions between the European Central Bank and representatives of the Eurogroup. These discussions should take place on a purely consultative basis, with neither side seeking to trespass upon the rights and responsibilities of the other. Such meetings might well lead to a better co-ordination of monetary and fiscal policy within the Eurozone, particularly in the face of common economic shocks. They would also counter the damaging public perception that the leading economic actors of the Eurozone take their decisions entirely separately from each other, with no attempt to understand the views and decision-making of each other.

6. The European Central Bank should publicly adopt a symmetrical inflation target. This publicised target would be entirely compatible with the existing statutes of the Bank, as laid down by the Maastricht Treaty. It would be an important refinement of original public pronouncements of the ECB,

which seemed to imply that the driving down of inflation was an objective of policy to be pursued by the Bank in all circumstances and irrespective of any other economic considerations. It would give especial reassurance to those commentators and observers who believe that the Eurozone's structure of governance attaches too much importance to monetary and financial considerations, without sufficient weight being given to wider economic considerations.

7. The functioning of the revised Stability and Growth Pact should be regularly reviewed to ensure that it strikes the right balance between budgetary discipline and other economic goals such as growth, employment and public investment. The revision of the Pact was a recognition that the first version of the Pact may have been unbalanced and potentially economically perverse in its effect. Although the revised version of the Pact will no doubt continue in force for several years to come, it should not be assumed that this present version is incapable of improvement.

8. The inflation-related criterion for entry into the European single currency should be revised in such a way that it takes as its reference-point the inflation rates of the current members of the Eurozone, not of the members of the European Union as a whole. This basis of calculation would have allowed Lithuania to join the single European currency at the same time as Slovenia and would represent a fairer and more transparent system for future applicants.

9. The remit of the European Central Bank should in the long term be altered to allow it to take greater account in its decision-making of economic goals other than the repression of inflation, notably growth and higher employment. The ECB's original remit from the Maastricht Treaty reflected a particular political and intellectual conjunction of the late 1980s, at which time an indpendent, apolitical monetary policy was widely seen as the most effective cure for most economic ills. The remit also reflected the understandable concern of the single European currency's founders that the new currency should have monetary credibility in world markets. A European Central Bank charged above all with fighting inflation was seen as the best way of guaranteeing this credibility. But the single European currency is now firmly launched and inflation has not in recent years been the central problem of economic policy-making that it was fifteen years ago. With the passage of time, the European Central Bank has become more flexible in its interpretation of its own anti-inflationary remit. It might well be that in the long term the governments of the Eurozone will be prepared to follow the example of other countries in the developed world and allow the Central Bank of the European single currency to pursue more energetically other economic goals in parallel to the restraint of inflation. On balance, the image of the European Central Bank as an institution simply concerned to damp down inflation is damaging, rather than helpful to its credibility in the mind of many European citizens.

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