STUDI E SAGGI

– 153 –

A Monetary Hope for Europe

The Euro and the Struggle for the Creation of a New Global Currency

Edited by
Max Guderzo and Andrea Bosco

FIRENZE UNIVERSITY PRESS
2016

A Monetary Hope for Europe : the Euro and the Struggle for the Creation of a New Global Currency / edited by Max Guderzo and Andrea Bosco. – Firenze : Firenze University Press, 2016.
(Studi e saggi ; 153)

http://digital.casalini.it/9788866559665

ISBN 978-88-6655-965-8 (print)
ISBN 978-88-6655-966-5 (online)

Graphic design: Alberto Pizarro Fernández, Pagina Maestra snc
Front cover photo: May Claerhout, Europe: Paul-Henri Spaak building of the European Parliament in Brussels

This volume has been published with the contribution of the EACEA (Education, Audiovisual and Cultural Executive Agency) of the European Union.

Peer Review Process
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Università degli Studi di Firenze
Firenze University Press
via Cittadella, 7, 50144 Firenze, Italy
www.fupress.com
Printed in Italy

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Designing a Non-National Currency: The European Monetary Union from the European Monetary System to the Euro

Mauro Campus

1. Introduction

The Eurozone crisis strongly challenges the integrity and the future of the European Union (EU). The International Institutions programme asked experts to assess the immediate and long-term implications of this crisis for the continent's political and economic future (De Grauwe 2010; Streeck 2015). It is nota coincidence that, eight years after the breakout of the Great Recession, the 19 Eurozone countries are still the most exposed to its effects on the real economy, whereas almost all other areas of the developed world, the US first, have recovered more easily and quickly than the 'old continent'. The crisis has also spread geographically, with its worst consequences becoming visible in the southern countries of Europe rather than in the financial centres of the world where it originated (Helleiner 2014).

In order to understand the reasons why the euro has set up challenges to the very existence of the EU, it is crucial to analyse the historical, political and economic reasons for its creation. This is the aim of this essay, which synthetizes the European political debate from the rise of the European Monetary System to the signing of the Maastricht Treaty (Eichengreen 1993, 2000, 2011; Apel 1998). It is in the European Monetary System (EMS) and in the Maastricht Treaty that the main pillars of the current economic and – in more than one sense – political structure of the EU, and of the euro area in particular, are to be sought (Gros, Thygesen 1992; Judt 2011).

2. The Bretton Woods collapse and the rise of the European Monetary System

The creation of the EMS is considered one of the milestones of post-war Western European history. Countless studies stress that it was an exam-

ple of how European elites coped with global economic change (Mourlon-Druol 2012; James 2012; de Saint Périer 2013). The advent of a floating exchange rate after the Bretton Woods system collapsed in August 1971 (Strange 1986; Feldstein 1988; Helleiner 1994; Basosi 2006) was harmful for Western European economies and the EMS constituted a European response (Padoa-Schioppa 2004). Indeed, it represented the first serious attempt to reintroduce a semi-fixed exchange rate system on a European basis (Giavazzi *et al.* 1988). It is even more important that the European response was to have a strong influence on the economic and social policies of many participating European countries from 1979 onwards. The EMS would be an external constraint – lauded or criticized – for the domestic economic policy choices of many European governments. Moreover, the importance of the EMS was represented by numerous European policymakers as the first necessary step on the road to an Economic and Monetary Union (EMU).

The European Currency Unity (ECU), the argument goes, was the forerunner of the euro. Though both these assertions are debatable, they do hint at one of Western Europe's perennial problems: the need to stabilize monetary relations in the richest world market (Marè, Sarcinelli 1998: ch. 5). From the nineteenth-century Latin Monetary Union to the present day euro, organizing currency fluctuations within Europe has remained a central issue for European policymakers. But the EMS was more than just an exchange rate system. The inception of the EMS was part of a wider trend towards the tentative affirmation of the European Economic Community (EEC) as an international actor amidst the profound economic, political, institutional and social transformations of the 1970s (Chassaigne 2012).

The EEC, created in 1957, had specific competences, multiple levels of governance and a varying record of successes and failures. But in the course of the 1960s and 1970s it witnessed a steady enlargement of its sphere of influence (Hirschman 1990: chs. 2-3). The EEC became a key international trade actor, set up diplomatic relations and concluded a trade agreement with the People's Republic of China. The European Political Cooperation (EPC) process, created in 1970, attempted to give a single voice to the EEC in foreign policy, with many failures but one important success at the Conference on Security and Cooperation in Europe (CSCE; see Möckli 2009).

The late 20th century debate about an institutionalization of European monetary arrangements continually evolved into a wider context of discussions on the global monetary system and its problems. Debates about new institutional mechanisms (such as a basket currency) that took place on global level were also replicated with respect to European affairs. The first discussions about a monetary union occurred in the late 1960s and culminated in the Werner Plan as a way of managing a European response to the crisis of the dollar and the ensuing breakdown of the fixed exchange rate system that had been devised in 1944 at Bretton Woods (Louis 1993; Gavin

2004). The next two surges of European Monetary institutionalization followed crises in the international system.

The European Monetary System ought to be considered as the end of a period in which part of Europe opposed the hegemony of the United States in the monetary field (de Cecco 1988). During the 'decade of the four shocks', when Germany was almost alone in urging a bulwark of monetary stability against double-digit inflation in the United States, France and Britain devalued their currencies under the pressure of quite different circumstances. Conversely, a few months later (October 1969) Germany, albeit sensitive to the American cycle, under the pressure of constant surplus was forced to a revaluation of the mark – something which happened throughout the decade – when the D-mark value grew steadily against the dollar and other European currencies (Sargent 2015; Kloten 1980).

This was the time when the decisions in the eighth paragraph of the Hague Agreement (1969) were adopted and swiftly extended by the goals of the Werner Report (1970), which provided for the establishment of a European monetary system within the decade (Draghi 1978). The formula was correct but still unable to deal constructively with the collapse of the fixed exchange rate system. Nevertheless, these decisions began to lay the foundations of the project for Community economic and monetary union (Guasconi 2004). From the very beginning of the discussion about a European Monetary Union in the 1960s it had been clear to many participants that some support mechanism for regional funds or short-term lending facilities would be required to move along the new monetary mechanism. And such transfers would be likely to involve governments if there were to be more than short-term revolving credits. The 1969 Barre Report, which proposed greater economic coordination, brought new impetus and the Economic and Monetary Union became a formal goal at the Hague summit in 1969. European leaders set up a High Level Group led by the Prime Minister of Luxembourg, Pierre Werner, to report on how the EMU could be achieved by 1980.

In the 1970s the Werner Plan (a major proposal of monetary union) and a new institution, the European Monetary Cooperation Fund (EMCF) initially foreseen as a potential federal reserve system for Europe, were supposed to be at the heart of monetary reform. Some countries wanted such a Fund to make major transfers between members; others (notably Germany) were extremely reluctant. The Werner Group submitted its final report in October 1970, setting out a three-stage process to achieve the EMU within a ten-year period. The final objective would be the irreversible convertibility of currencies, the free movement of capital and the permanent locking of exchange rates – or possibly a single currency. To achieve this, the report called for closer economic policy coordination, with interest rates and management of reserves decided at Community level as well as agreed frameworks for national budgetary policies.

It is common opinion that the 1970s were a decade of failure and unsolved problems. Growth collapsed and inflation soared. Budgets came under strain. These problems also generated vigorous institutional activity in search for solutions. Judging by results, the 1970s marked a low point of international cooperation. However, the failures were so apparent that a massive number of schemes and plans on monetary and financial issues were formulated, at both global and European level.

It is appropriate that the major symbol of the troubled era of European monetary cooperation in the 1970s became the exchange rate system called 'Snake'. Created by EEC members to narrow the fluctuation margins between their currencies, thereby implementing one of the measures listed in the first step of the Werner Plan, the System came into force on 24 April 1972 (Ingram 1973). The four EEC candidates took part in the Snake negotiations and joined the scheme. Austria, Spain, Switzerland and Sweden sooner or later expressed an interest in it, partly because of their strong commercial relationship with this monetary zone. Sweden was the only country to formally request an association with the exchange rate system, while the other three maintained a *de facto* stable exchange rate relationship with the Snake. The only limitation for the non-EEC members was that they could not benefit from EEC monetary support mechanisms. Their association took the form of bilateral agreements with each and every central bank of the Snake.

A ceiling (2.35%) was placed on fluctuations between currencies by intervening on the currency market. For a short period the Snake undulated in a sort of tunnel. Indeed, between 1972 and generalized floating in 1973, the Snake currencies respected established bands of fluctuation *vis-à-vis* the dollar (4.5%). Over time, however, the overall Snake system became a D-mark zone since the British pound, the French franc and the Italian lira rapidly abandoned it. The overall implementation of the Werner Plan soon ran into difficulties mainly because it implicitly relied on a functioning Bretton Woods system – which was collapsing at precisely the time the Plan's first stage was being applied. The Werner Plan, its goal and its method would, however, continue to influence European monetary cooperation in the second half of the 1970s (Draghi 1978).

In 1978 the European monetary regime was rebuilt, but the Committee of Governors (CoG) did not play a central role in the reform. The major initiative came from politics and in particular from the French President, Valéry Giscard d'Estaing and the German Chancellor, Helmut Schmidt. These high-level debates were charged with lofty geopolitical ideas and the new monetary arrangements were frequently seen as a challenge to the preponderant role of the dollar in the international monetary system. European policymakers were sceptical or hostile. The CoG's involvement was largely confined to an elaboration of the so-called Belgian compromise, which reconciled divergent French and German conceptions on how to institutionalize fixed-exchange rate agreements. In the end, however, despite an enormous amount of political

energy expended on the project, not much actually changed. The agreement on a new basket currency could have been a basis for monetary unification but in practice it was not. There was no EMF and the outcome was difficult to distinguish from a strengthened or revitalized Snake (James 2012).

The experience of 1978 showed that reform could not come from a political initiative alone, however great the eloquence and passion of the political leaders. By 1978 a number of different plans for European monetary reform were in the air, or at least in the filing cabinets: the Fourcade proposals, the Duisemberg Plan, the Van Ypersele Plan, the All Saints' Day Manifesto, proposing specific rules of devaluation, the initiatives of Belgian Finance Minister Gaston Jeens to increase financial support in the community and reinforce budgetary and monetary discipline and coordination or the Times Group scheme. Europe was under great economic stress with wildly varying rates of inflation and sharp dollar depreciation against the D-mark that exacerbated the strains of the other European currencies (Eichengreen 2011). The Snake was confined to a very small group of countries and had basically become a D-mark zone while the other large EEC currencies, the franc, the pound and the lira, floated. There were simply both too many ideas and too many problems (Ludlow 1982).

The eventual outcome of the intensive negotiations of 1978 – the European Monetary System (EMS) – is often regarded as a transformative step on a progressive path to monetary integration. But was it so? Or was it nothing more than an elegant repackaging of the Snake arrangements? In 1978 a fundamental lateralization of monetary discussion occurred. The Franco-German relationship was always at the core of debate about reshaping the monetary order, but in 1978 a series of personal initiatives was launched by Schmidt and Giscard d'Estaing. One outcome was that the role of the Bundesbank, as a possible obstacle to the new initiatives, assumed new importance since it appeared to possess a right of veto. Schmidt often seemed to regard the German Central Bank as his primary adversary.

The new proposal appeared to have political origins in particular within the European Commission. The President, Roy Jenkins, tried to reignite the currency discussion through a grand and visionary proposal launched in Florence at the European University Institute in October 1977 (Campbell 2014). In December, at its Brussels meeting, the European Council reaffirmed its attachment to the objective of economic and monetary union. At the same time it admitted that, although such union was an integral part of the process leading to a European Union, it was clear that since 1972 this great endeavour had been stagnating.

The rapid 'death' of the Snake did not diminish interest in trying to create an area of currency stability. After particularly swift negotiations led by the major European central bankers, the EMS was launched in March 1979 with the participation of all Member States' currencies except for the British pound, which joined later in 1990 but remained only for two years. It came

as a reaction to the large fluctuations of the dollar and was stimulated by the belief of policymakers that intra-European exchange rate uncertainty was detrimental to trade and investment in Europe. The primary purpose of the founders of the EMS was therefore to create a zone of relative exchange rate stability which, if successful, could contribute to better prospects for growth of income and trade in Europe. Moreover, it was hoped that the construction of the EMS would facilitate the convergence of EEC economies. By doing so, it would create the necessary conditions for further economic and political integration in Western Europe.

The conceptual core of the European Monetary System (EMS) was the result of a Franco-German project the main lines of which were presented at the Copenhagen European Council on 7-8 April 1978 by Giscard d'Estaing and Schmidt. The plan aimed to reconcile France's ambition for a more balanced system in which her continental leadership could be reaffirmed with Germany's austerity, which had earned the D-mark control over European currency markets. The project involved the creation of an international monetary system formally independent of the dollar and the international financial institutions, based on the pooling of currency reserves (within two years after the launch of the system) and the creation of a fluctuation band of ± 2.5% periodically corrected by the central parity realignment mechanisms needed to ensure stability. The compromise at the roots of the system had to overcome the resistance of both the Governor of the Bundesbank, Otmar Emminger, and the German economic establishment, which believed the D-mark might replace the dollar as the key currency of European capitalism (Watt 1979). In 1978, all the political and economic conditions for this transition existed, but the solution would not meet the needs of such an economically integrated and complementary productive environment as the Community had become. The situation was even more complex because of the lack of confidence in the resilience of the new system and the concerns of the German Central Bank about inflation risks due to the fixed exchange rate.

Ignoring German misgivings, the plan (Bremen Annex) was presented to the European Council on 7 July, negotiated during the following six months and launched on 5 December. Three years earlier Bonn would have never dared to embark on anything so independent of the United States. A set of variables had played a role in this change of attitude towards the agreement. In 1978 the international monetary system was still centred on the dollar, but the Carter administration claimed that the US currency had formed listing markets unrelated to Washington's policies. This was perceived as yet another signal of the abdication of American leadership in Western Europe and helped undermine Schmidt's confidence in Carter and US foreign policy in general. In addition, Carter repeatedly spoke in favour of the creation of a European Monetary System.

Italy showed immediate interest in the initiative and promoted it at the Monetary Committee: the establishment of a reserve fund, i.e. a more flex-

ible system than the Snake, did not preclude later expansion to members in difficulty (the United Kingdom), symmetry in the adjustment process and intervention in favour of the less developed areas of the Community. However, even if entry to the EMS soon came to be perceived as the best means to overcome the crisis, the road from Bremen to Brussels and Rome proved to be particularly tortuous. The experiment of joint float was the most significant international economic turning-point for Italy since the accession to the Common Market (de Cecco 1988).

The creation of the EMS in 1979 was a conscious response to the rapid decline of the dollar in 1978-79, the perceived crisis in American leadership under Jimmy Carter and the consequent search for a new international mechanism to replace the dollar standard. The core of the new approach was originally meant to be a basket currency as an account unit – the European Currency Unit (ECU) – which conveniently echoed the name of an ancient French coin. A new European currency would possibly be a replacement for the dollar, take some of the strains out of the international monetary system and redesign or reform the IMF's artificial currency, the Special Drawing Right. In the 1980s the dollar again caused worldwide chaos as its value soared up to 1985 and then declined rapidly. Europeans felt vulnerable because they did not control an international reserve currency that could stand up to the dollar. Europe's response to that international uncertainty began with the report to the Delors Committee in 1989 and continued through the negotiations and approval of the Maastricht Treaty up to the legal realization of the euro in 1999.

The establishment of the physical currency had its origins in an attempt to devise a mechanism that could generate a more stable global exchange rate regime. The critical policy innovators, in particular French Finance Minister Eduard Balladur, started to advocate its realization at European level also to address the 'German question'. By the 1960s the Federal Republic had emerged as the strongest European economy, with a dynamism built on a powerful export performance. German current account surpluses, driven primarily by trade surpluses, which appeared briefly in the 1950s, were corrected after a currency revaluation in 1961 but emerged again in the late 1960s, in the late 1970s, even more powerfully in the late 1980s, as capital movements were liberalized, and again in the 2000s. They had just disappeared in the 1990s, when the costs of German unification pushed the German external account into deficit, and Germany's relations with its European partners became more harmonious in consequence. The reform proposals that led to initiatives for European integration in 1970, in 1978, and again after 1988, were all conceived as means of addressing imbalances between European States. These dates were also moments of crisis in the global system. The most radical approach to Europe's problem was monetary union. This had the intrinsic appeal of apparently making current account imbalances vanish, as well as providing a mechanism for non-Germans to constrain or limit the Bundesbank.

The European Monetary System was built on the concept of stable but adjustable exchange rates defined in relation to the newly created ECU, based on a weighted average of EMS currencies. Within the EMS, currency fluctuations were controlled through the Exchange Rate Mechanism (ERM) and kept within ±2.25% of the central rates, with the exception of the Italian lira, the Spanish peseta, the Portuguese escudo and the pound sterling, which were allowed to fluctuate by ±6%. In August 1993, these bands were widened to 15% in order to counter speculative pressures, but by 1996 all currencies had moved back to their original fluctuation margins. The system included an intervention mechanism and a preventive tool: once the exchange rate of a currency reached 75% of the maximum authorized fluctuation margin, the currency was considered as 'divergent' and the country had to take remedial action through interest rates and fiscal policy adjustments. In the event of the maximum fluctuation margin being reached, central banks had to intervene by buying or selling the currency to avoid the margin being exceeded.

The EMS was a radical new departure because exchange rates could only be changed by mutual agreement between participating Member States and the European Commission, which constituted an unprecedented pooling of monetary sovereignty. In the first few years many currency realignments occurred, but by the time of the negotiations on the Maastricht Treaty in 1990-1991, the EMS had proved to be a success: short-term volatility of exchange rates between European Community currencies was substantially reduced, thanks to a wise mix of converging inflation rates and interest rate management targeting the exchange rate. This success created an encouraging backdrop to the discussions on the EMU, as did the valuable experience in the joint management of exchange rates acquired by the Community's central banks.

The case for the EMU emerged from the need to complete the single market, the programme adopted in 1985 for removing all remaining barriers to the free movement of goods, services, people and capital. It was clear that the full benefits of the internal market would be difficult to achieve with the relatively high business costs created by the existence of several currencies and unstable exchange rates. In addition, some economists and central bankers took the view that national monetary autonomy was inconsistent with the Community's objectives of free trade, free capital movements and fixed exchange rates. For most of them this view was later confirmed by the turmoil which hit the ERM in 1992-93, causing the withdrawal of the Italian lira and the pound sterling, and the widening of the fluctuation bands to 15%.

3. The Delors Plan and the Economic and Monetary Union

Although at the beginning of the 1980s the EMS turned out to be successful (Giavazzi *et al.* 1988), lowering the inflation rate and reducing exchange-rate stability, by the end of the decade the growth rates of its members were per-

forming very poorly basically due to the 'antigrowth bias' of the system. Over these ten years the entire system had been *de facto* dominated by German preferences, since in effect the D-mark became an anchor currency asymmetrically influencing the policies of the other Member States. This asymmetry was firstly addressed by France in the 1987 Basle-Nyborg agreement and would eventually result in the proposal of a monetary union in which France would have regained parity *vis-à-vis* her 'rival' (Gardner, Perraudin 1993). The proposal was consequently supported by an influential report by the Italian economist Tommaso Padoa-Schioppa (1987), one of the leading figures behind European monetary cooperation, who endorsed the establishment of a monetary union, pointing out that «capital mobility and exchange rate fixity together leave no room for an independent (national) monetary policy».

Just as Schmidt and Giscard had been crucial to the establishment of the EMS, so Helmut Kohl and François Mitterrand were the key players in the EMU and the Maastricht compromise. However, the main novelty was certainly the election of the French socialist Jacques Delors as President of the Commission from 1985 to 1994. He was destined to change the role of this body, making it the strongest engine of a deeper European integration. In June 1988, following Mitterrand's victory at the French Presidential elections, at the Hanover Summit of the European Council, Kohl proposed the establishment of a committee mainly composed of the governors of the European central banks, which would establish the basis for the EMU. Delors was a natural choice to chair the committee, in which he participated also as commissioner responsible for monetary policy, together with another member of the EC, twelve governors and three independent experts. Delors proved to be an exceptional diplomat, managing to keep on board many different visions about the common economic and monetary policy, and eventually delivering his report in April 1989.

Although Delors was not really satisfied with the report, due to the lack of a direct call for a single currency, the document paved the way to the provisions of the Maastricht Treaty a couple of years later: the EMU had to be approached through a three-stage process in which liberalization of capital movements and macroeconomic cooperation among Member States was the first step, the establishment of a European System of Central Banks the second step, and the progressive direction of national economic and financial policies by EC authorities the final step.

From an economic and historical perspective, the new EMU had a major impact. It reinforced the Franco-German axis and personal relations between Mitterrand and Kohl and opened the definitive rift between Delors and the intransigent UK Prime Minister, Margaret Thatcher, who saw in him the personification of 'evil', essentially due to his political allegiance and strongly pro-federal and pro-European attitudes. Thatcher was opposed not only to Delors for being the main advocate of the EMU, but even

more to the Governor of the Bank of England, who signed the report and the Governor of the Bundesbank, Karl Otto Pöhl, one of her strongest allies against the communitarization of monetary policy. Her intransigence compromised relations with her Foreign and Finance Ministers and was eventually to drive her out of office.

The international context in which all this was happening is crucial: the collapse of the Berlin wall in November 1989 played a decisive role in speeding up the achievement of the EMU, once again with the key cooperation of the French President and the German Chancellor. A unified Germany would signify a total readjustment of the European balance at one of the most delicate moments of European integration. The two processes were intrinsically intertwined since, as recalled by David Marsh (2009: 133), «if unification had not happened, it is highly unlikely that France would have been able to persuade Kohl to agree the EMU timetable to replace the D-mark by the euro». Establishing control over German monetary policy had been Mitterrand's core objective since 1983, when he had been obliged to give up his expansionary economic programme in order to remain within the EMS, and a unified Germany was a further alarm signal that a supranational monetary institution had become imperative.

Delors endorsed the French issue, arguing that a federal Europe was «the only satisfactory and acceptable response to the German question» (The Economist 1989: 50). The position of the UK was aligned with France as regards fear of a unified German power, but the means chosen to prevent it were diametrically opposed. According to Thatcher a more integrated Community would be more easily dominated by Germany; therefore the priority was not to strengthen integration but rather to boost expansion towards Eastern Europe, aiming at a looser and wider confederation, more difficult to manage and more unlikely to work effectively. Much more interesting was the position of Kohl, who tried to convince his partners that European integration and German unification were not contradictory processes: deepening and widening could be parallel steps, which Germany would accept only in exchange for European acceptance of German unification.

Notwithstanding Mitterrand's attempts to prevent it, German reunification preceded the EMU and in 1990 the first general elections crowned Kohl Chancellor of a united Germany. Using his position of strength he immediately endorsed not only the achievement of the EMU but also an authentic political union. Meanwhile, Thatcher had to leave Downing Street, essentially but not exclusively because of her intransigence towards further European integration, and Delors' influence was to reach its acme.

4. The Maastricht Treaty. What implications for the new EU?

The Maastricht Treaty was the political answer to German reunification and the end of the Cold War, and probably the best possible compromise in terms

of national interest between the two main agents of European integration, France and Germany. Kohl proposed the political and institutional reform of the Community as the *sine qua non* of his acceptance of the EMU, with an eye to strengthening the European Parliament's prerogatives and fostering more cooperation in foreign and defence policy – something France was not so keen on. Despite Mitterrand's reservations the Franco-German axis was strengthened by France's acceptance of Kohl's conditions and two parallel conferences were suddenly launched, one on monetary union (in France's interests) and one on political union (in Germany's interests).

The main opponent to the creation of a common monetary union was the powerful Bundesbank, with which Kohl embarked on a major battle. Its claim was that economic convergence should precede any kind of monetary union, which naturally meant adaptation of the other Member States to the German standards of inflation, interest rate and budget deficit. Here for the first time the concept of 'two-speed' Europe emerged, when the Bundesbank proposed to initially implement the EMU only for a small number of countries, such as Germany, France and Benelux, with the possibility for others to join later after a first successful round of economic convergence.

The political conference (the one that was to establish the second and third pillars of the Maastricht structure) was a concession to Kohl, who could accordingly make the entire debate acceptable at home. Conversely, the monetary conference was the key objective of the other Member States, with France on the front line, to make German reunification compatible with European integration. At this conference, the price to be paid for EMU implementation was the design of the European Central Bank (ECB) on the model of the Bundesbank – full independence of any external political authority whatsoever and the fight against inflation as a statutory goal. France would have preferred a political supervision over the bank but was, on the contrary, forced to make its own central bank independent. The Bundesbank, led by Pöhl and then Tietmeyer, strongly campaigned for the new central institution to replicate the German model, believing that other countries could not understand the Germans' entrenched historical fear of inflation or the importance of complete independence from any political influence. This was made clear with the insertion of the famous 'no-bail out' clause in the treaty, now Article 125 of the Treaty on the Functioning of the European Union (TFEU), according to which the ECB may not to act as lender of last resort for countries in financial difficulty, which is incidentally one of the causes of the current sovereign debt crisis affecting the euro area.

The Treaty on the European Union (TEU) was finally signed on 7 February 1992, with the ambitious core element being the achievement of a full monetary union by the end of the decade. While the monetary conference was undoubtedly successful, it is difficult to define the political one as such. Basically it maintained the second and third pillars – Common Foreign and Security Policy (CFSP) and Justice and Home Affairs (JHA) – at intergovern-

mental level, excluding Community institutions from the substantial decision-making process on those matters, and was a major disappointment for Kohl. This failure was also due to the divergence between France and the UK on one side and Germany on the other *vis-à-vis* the ongoing situation in Yugoslavia, which contributed to undermine the idea that a common foreign policy was easily achievable. Nevertheless, the treaty was reported as a victory both by France, which could claim Germany was now indissolubly linked to the destiny of Europe, and by Kohl, who was assured that the European monetary regime would essentially be based on the German model, with the path towards an irreversible political unity.

After months of crisis and difficulty in the ratification process, the Maastricht Treaty came into force on 1 November 1993. The agreed convergence criteria for admission to the EMU were strict and modelled on German pretensions: in the year preceding the admission the inflation rate could not exceed the average of the three best performing countries by more than 1.5%; the annual nominal long-term interest rate could not exceed the average of the three best performing countries by more than 2%; the public deficit/GDP ratio could not exceed the threshold of 3%, as well as the public debt/GDP ratio could not exceed the threshold of 60%; finally, the exchange rate had to be maintained within the normal margins of the EMS pattern for at least two years without devaluations. These criteria would remain the bedrock of all subsequent reforms of European economic governance up to the present, including the Stability and Growth Pact (SGP), first introduced in 1997 and revised in 2005, and the so-called Fiscal Compact, agreed upon in 2012 (Eichengreen, Wyplosz 1998). All these instruments aim at assuring fiscal consolidation among Member States and basically strive for a coordination of national fiscal policies on the basis of intergovernmental bargaining.

5. The EMU's historic legacy 20 years on

The path which had begun in 1992 significantly evolved in the following 20 years and the process of European integration greatly advanced up to the Lisbon Treaty, which came into force on 1 December 2009. The integration of economic governance progressed even further, as the innovations achieved with the European Semester (2011), the Six Pack (2011), the Fiscal Compact (2012), the Europlus Pact (2012) and the still ongoing process of implementation of the Two Pack demonstrate.

Nevertheless, the very first years after Maastricht ratification were not easy. In 1992 several countries were obliged to devaluate and on the 'Black Wednesday', on 16 September, Britain even decided to pull the sterling out of the ERM as a consequence of rising German interest rates that pushed up the value of the D-mark and that of other currencies down. The crisis peaked in summer 1993, when Finance Ministers decided to enlarge the fluctuation

band of the ERM from 2.5% to 15% in order to alleviate tension among currencies (Amato 2015).

The following year the ancestor of the ECB, the European Monetary Institute, was established with the aim of coordinating the monetary policies of the Member States. With the election of Jacques Chirac (May 1995) in France and the weakening of Kohl (October 1994) in Germany, the equilibrium within the Franco-German alliance changed (Feldstein 1997). This was clear during the dispute for the election of the first President of the ECB, when Chirac obtained the appointment of Jean-Claude Trichet, after a temporary compromise installing the Dutch Central Bank Governor, Wim Duisenberg, at the head of the new institution. The ECB would assume responsibility for monetary policy in the middle of 1998 and definitively substitute the European Monetary Institute in 1999 (Duisenberg 1998, 1999, 2000; Spaventa, Chiorazzo 2000).

As for the common currency, the final decision to call it 'euro' was made by the European Council in December 1995. The definitive entry into force of the EMU was to be on 1 January 1999 and the introduction of the new currency on 1 January 2002. In May 1998, 11 countries were considered eligible to enter the EMU, to the great satisfaction of Italy which was admitted despite its macroeconomic deficiencies (in 1995-96 the values of the deficit/GDP and debt/GDP ratio actually more than doubled the criteria established at Maastricht) largely thanks to the diplomatic ability of the Treasury Minister, Carlo A. Ciampi. Britain and Denmark opted out, Sweden decided not to participate and Greece would eventually join in 2001 (Noyer 1998).

If we consider the advantages and disadvantages the EMU has brought to its members, we could note that it is hard to claim that the euro area is an Optimal Currency Area[1]. The reason for this is largely due to the impact of asymmetrical shocks on the different economies of Member States and the low mobility of labour (Mundell 1961; McKinnon 1963; Giannini 2004). Monetary policy has been 'communitarized' through the first pillar of the Maastricht Treaty but fiscal policy has remained at national level, so that the general instruments of economic policy have been decoupled and economic governance has become much more complicated and difficult to harmonize (Randall *et al.* 2012). The progressive steps of European economic governance thus pursued an attempt at harmonization of national fiscal policies, firstly addressed through the SGP, which contains the balance budget rule and the provision of sanctions in case of excessive deficit. Even with its most recent modifications (in 2005 and 2011), that have substantially made it more flexible, the SGP has been severely criticized by most economic scholars since it prevents Member States from using 'countercyclical policies' – for example

[1] According to Obstfeld *et al.* (2004) in an Optimal Currency Area the benefits of joining exceed the costs.

by an increment of public deficit in times of recession – compelling governments to use 'rules' rather than 'discretion'[2]. Further delegitimization came in 2003, when Germany and France pushed for and obtained a suspension of the excessive deficit procedure. Indeed, even after the subsequent modifications, the SGP still lacks an external and independent enforcer, its implementation depending on the European Council. The Fiscal Compact, signed in 2012 by 25 out of the 27 EU Member States, with the exclusion of the UK and the Czech Republic, continues on the same path, compelling Member States' governments to insert the balance budget clause in national legal systems, preferably at constitutional level.

To sum up, the way the EMU and the euro were conceived in Maastricht is very much linked to the crisis that the Eurozone and the EU as a whole are currently going through. The Maastricht compromise involved political, historical and economic dynamics that contributed to shape Europe and its economic governance as we know them now. It is certain that a change in the current model can only be achieved through a similar effort of 'diplomacy' in which, once again, the main powers will play the key role. This paper assumed a historical perspective because the analysis of facts clearly shows that the current structure of European economic governance is the result not so much of an irrefutable economic theory, but of deliberate political choices: setting inflation targeting as the main ECB goal, not making it accountable to any political body and preventing Member States from using countercyclical policies in case of necessity.

6. Conclusions

The euro began to circulate in 2002 but was conceived and formally established through the signature of the Maastricht Treaty in February 1992. The main reason for its adoption lay in lessons learned from the past, according to which fluctuating currencies were the most reliable predictor of political and economic unrest (European Central Bank 2000, 2001). The first two structural remedies to this problem saw the light respectively in 1972 and 1979, and both were semi-fixed exchange arrangements: the 'Snake' and the ESM. These two attempts were frustrated in the 1980s by the growing economic prevalence of Germany and critically undermined by the rising power of the Bundesbank, briefly making the D-mark the dominant currency of both systems. Through the Maastricht Treaty European leaders expressed their conviction that the only way to definitively stabilize the system was by fusing currencies into a common one: in their view, end-

[2] In October 2002 the former President of the EC Romano Prodi defined the SGP as simply 'stupid' for these very reasons: <http://www.telegraph.co.uk/finance/2830598/Euro-Stability-Pact-is-stupid-says-Prodi.html>.

ing the exchange rate fluctuation could provide the European Community with the means to foster growth, employment and investment (European Commission 2008, 2010).

As the current crisis demonstrates, this was not the case. The way in which the new EMU was set up prevents Member States from implementing the necessary measures to grow, strangling them with fixed rules that rule out discretion – which has proved to be catastrophic in economic policy. The years following Maastricht did not change the path, but stepped up the progress towards fiscal harmonization and consolidation up until very recent times. Not only did these policies prove ineffective in restoring a favourable economic cycle – as happened and is happening all over the world except for the Eurozone – they also entailed the risk of sidestepping democracy and jeopardising the very notion of a European 'Union' (Sen 2012; Aglietta 2012; Spinelli 2014; Vaciago 2014). Courageous changes are required if the EMU is to survive and, in the final analysis, if the entire EU project is not to crumble (Blinder *et al.* 2013; Orphanides 2010).

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Abstracts

DESIGNING A NON-NATIONAL CURRENCY: THE EUROPEAN MONETARY UNION FROM THE EUROPEAN MONETARY SYSTEM TO THE EURO

Mauro Campus

The article argues that the economic governance of the Eurozone set up in the early 1990s derives from the compromise between French President Mitterrand and German Chancellor Kohl about the issue of German reunification, and was built in such a way as to satisfy the parameters imposed by the German economic model. The dominance of the D-Mark was inevitable, as soon as the common governance was implemented, and continued through the different stages that brought to the Economic and Monetary Union. The current crisis of the euro therefore derives directly from the structural setting adopted in Maastricht and implemented throughout the 1990s and the early 2000s. The essay offers a historical analysis of the events that brought from the crisis of the Bretton Woods system in the early 1970s to the different stages of monetary integration – the 'Snake' at the beginning of the decade, the European Monetary System in the late 1970s and the Economic and Monetary Union in the 1990s. A special focus is devoted to the political context in which these developments occurred, in particular for what concerns the issue of German reunification and the end of the Cold War. The core part of the article focuses on the political debate surrounding the Maastricht Treaty, with an analysis of its consequences on the economic structure of the euro area. In conclusion, an analysis of the current economic situation of the Eurozone and its developments is exposed.

JEL: F02, F33, F53, E42, E58.
Keywords: Economic Interdependence, European Monetary System, Maastricht Treaty, Economic and Monetary Union, Stability and Growth Pact, Eurozone.