

### Explaining the Single Market

- Liberal intergovernmentalism effectively explains the original commitment to the common market.
- Agreement to accelerate progress on the common market in the mid-1960s was interpreted by Lindberg (1963) as support for neofunctionalism because of the role of the Commission and industrial interests, but this was later contested by Moravcsik (1998).
- Academic explanations of the acceptance of the 1992 Programme in the mid-1980s agreed on the importance of the global economic environment, but disagreed on the respective role of national governments, the Commission, and supranational interests.
- Historical institutionalism provides an explanation for the continued momentum of the single market, based on the institutionalization of new rules and norms.

### Evaluating the Single Market

- The creation of an ever more integrated single market has been accompanied by a normative debate among political economists, with some highlighting its positive economic and social benefits and others pointing to its negative consequences.

### FURTHER READING

The great debate between theorists about the single market began with **W. Sandholtz and J. Zysman**, '1992: Recasting the European Bargain', *World Politics*, 42 (1989): 95–128; and continued with **A. Moravcsik**, 'Negotiating the Single European Act', *International Organization*, 45 (1991): 19–56. **P. Budden** responded to Moravcsik's arguments from a **pluralist** perspective in his article, 'Observations on the Single European Act and the "Relaunch of Europe": A Less "Intergovernmental" Reading of the 1985 Intergovernmental Conference', *Journal of European Public Policy*, 9 (2002): 76–97. Another contribution worth reading is that by **M.G. Cowles**, 'Setting the Agenda for a New Europe: The ERT and EC 1992', *Journal of Common Market Studies*, 33 (1995): 501–26. For a new institutionalist account, see **K. Armstrong and S. Bulmer**, *The Governance of the Single European Market* (Manchester: Manchester University Press, 1998).

On the case studies of telecommunications and energy, see **P. Humphreys and S. Padgett**, 'Globalization, the European Union, and Domestic Governance in Telecoms and Electricity', *Governance: An International Journal of Policy, Administration, and Institutions*, 19 (2006): 383–406.



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## Chapter 21 Economic and Monetary Union

### Chapter Overview

Economic and monetary union (EMU) first became an official objective of the European Community (EC) in 1969, but it was not achieved until thirty years later. This chapter examines the various attempts at EMU between 1969 and 1992, the launch of the single currency, the euro, and its subsequent progress up to and including the crisis that engulfed the eurozone in the late 2000s. It then looks at some of the explanations for and critiques of EMU that have been offered by various academic commentators.

### History

Economic and monetary union first came to the fore as an objective of the EC in 1969 when the Commission produced the Barre Report. In December of the same year, The Hague Summit meeting of the EC heads of government made a commitment to the achievement of EMU 'by 1980'.

To make the commitment to EMU was one thing, but to agree how to do it was another. There were two broad approaches that were represented most clearly by the positions of the French and West German governments. The French government wanted a system for the mutual support of fixed exchange rates between national currencies. It argued that this in itself would produce economic convergence (Dyson 1994: 79–80). The West German government rejected that approach because it believed that it would involve using up West Germany's considerable foreign currency reserves to support the currencies of states that were following what the Germans saw as irresponsibly lax and inflationary economic policies. For West Germany, common economic policies had to come first—and they wanted their preference for monetary stability, rather than the growth-oriented policies of France, to be the basis of the common policies. At the time, the French position was described as 'monetarist', because it advocated monetary union ahead of economic union, while the German position was described as 'economist', because it advocated economic union ahead of monetary union (Tsoukalis 1977; Dyson 1994: 79–80).

### The 'Snake'

This fundamental disagreement produced the compromise proposals of the Werner Committee in November 1970 (see Chapter 7, The Hague Summit). Werner proposed



that the co-ordination of economic policy and the narrowing of exchange rate fluctuations should proceed in parallel. This arrangement for approximating the exchange rates of member currencies one to another became known as the 'snake in the tunnel' because each currency could move up and down ('snake' up and down) between a minimum and maximum value against other currencies in the system, which formed a floor and a ceiling of fluctuation (the tunnel).

Although the original 'snake' collapsed following the ending of the convertibility of the dollar in August 1971, it was reconstituted in April 1972, only to run into the same problems as its predecessor. Essentially, the problem was that some of the economies of the member states were very much weaker than that of the strongest, West Germany, and the Germans were not prepared to support the value of the currencies of the weaker economies. For example, in 1972, the German Federal Bank (Bundesbank) refused to intervene in the foreign exchanges to support the pound, with the consequence that speculation forced sterling out of the system.

By 1974, economic divergence was glaringly apparent in the EC, indicating that there were definite structural weaknesses in the economies of the peripheral states, including Britain. France sat delicately balanced on the edge between centre and periphery. These strains caused the complete collapse of the original EMU experiment after 1973.

## The European Monetary System (EMS)

In October 1977, the Commission President Roy Jenkins took the initiative to revive EMU (see Chapter 8). It was taken up by West German Chancellor Helmut Schmidt and French President Valéry Giscard d'Estaing.

By this time, one of the main factors that had been a barrier to German enthusiasm for the original snake had been removed. Gradually, the governments of the other member states were coming round to accepting the West German economic priority of controlling inflation. Mainly this reassessment of policy was because of the acceleration of inflation following the 1973 oil-price rises. It was obvious that the economies that were having the least success in controlling inflation were also those with the highest rates of unemployment, and the poorest record on growth.

In December 1978, the Bremen European Council created the EMS. The central element was the exchange rate mechanism (ERM) for holding fluctuations in exchange rates within narrow bands. Accounting within the system was in a notional currency called the 'ecu', the value of which was an average of the values of the member currencies (Britain remained outside of the ERM, but sterling was included in the calculation of the value of the ecu). This system limited fluctuations in the values of the participating currencies for a number of years.

## Origins of EMU

Moves to strengthen and extend the EMS were part of the programme of the Delors Commission from the outset. However, the issue really came into the forefront of

### Insight 21.1 The Delors Report

The 'Delors Report' proposed a three-stage progression to monetary union.

- (1) The EC currencies that remained outside the ERM of the EMS (those of Britain, Greece, Portugal, and Spain) would join, and the wider band of fluctuation would disappear.
- (2) Economic policy would be closely co-ordinated, the band of fluctuation of currencies within the EMS would be narrowed, and the governors of central banks would meet as a committee to prepare the ground for the institution of a European Monetary Co-operation Fund (EMCF).
- (3) National currencies would be irrevocably locked together, and the ecu would become a real currency in its own right, administered by the EMCF.

debate in the aftermath of the decision to free the internal market by the end of 1992.

At the end of 1985, the Luxembourg European Council agreed on the terms of the Single European Act (SEA), including a commitment to monetary union. Further progress had to wait until the June 1988 Hanover European Council, which agreed to set up a committee of central bankers and technical experts, under the chairmanship of the President of the Commission, to prepare a report on the steps that needed to be taken to strengthen monetary co-operation. The report of this committee (see Insight 21.1) was accepted by the June 1989 European Council meeting in Madrid. The momentum was sustained when the December 1989 European Council in Strasbourg agreed to set up an intergovernmental conference (IGC) to consider the institutional changes that would be necessary in order to move towards monetary union.

## Monetary Union in the 1990s

The IGC on monetary union took as its negotiating text the report of the Delors Committee, which recommended that movement to monetary union should be to a timetable. This starting point still left plenty of significant details to be negotiated. Before the IGC began to meet in 1991, West Germany was reunified with East Germany in October 1990. Germany entered the negotiations as clearly the largest state as well as the largest economy in the EC, putting it in a particularly strong negotiating position. Also in 1990, Britain joined the ERM.

Early in the IGC, there was a consensus that a monetary union would only be sustainable if it were underpinned by a considerable degree of economic convergence. The Treaty on European Union (TEU) provided five convergence criteria that would have to be met by any state before it could take part in the monetary union. Prospective members would have to have:

- a budget deficit of not more than 3 per cent of gross domestic product (GDP);
- a public debt of not more than 60 per cent of GDP;
- a level of inflation no more than 1.5 percentage points above the average level achieved by the three states with the lowest levels of inflation;



- interest rates that were no more than 2 per cent above the average level of the three states with the lowest levels;
- a record of respecting the normal fluctuation margins of the ERM for two years.

These criteria reflected the policy priorities of the German government in that they were all concerned with monetary stability.

Although the criteria were stringent, the Treaty did appear to leave room for some relaxation if states were moving in the right direction on all of the relevant indicators. At the same time, it was written into the Treaty that any state that did qualify would join the monetary union when it was set up, which would be in 1997 if possible, and not later than 1999. Only Britain was initially allowed to opt out of signing up for the monetary union in advance, although following the rejection of the Maastricht Treaty in the Danish referendum in June 1992, Denmark was granted a similar opt-out clause in a Protocol to the Treaty.

## Putting Maastricht into Operation (1992–2002)

On 16 September 1992, Britain was forced out of the ERM by intensive speculation against the pound. The next day, the Italian lira also had to leave the mechanism. Then, in August 1993, the system came under so much pressure that it only survived by allowing the value of each national currency to fluctuate by 15 per cent either side of its notional value within the system. This was a very large margin of fluctuation for a system that was supposed to approximate to fixed rates of exchange.

One interpretation of these developments was that the member states were not ready for a single currency if they could not hold their exchange rates. Another interpretation was that the episode showed how important it was to move to a single currency so that speculators could not push the economies of the members apart. Certainly the problems deflected neither French President François Mitterrand nor German Chancellor Helmut Kohl from their commitment to monetary union.

It was not entirely clear, though, how much support the President and the Chancellor had in their own countries. In France, high unemployment made the policy of tying the franc closely to the Deutschmark increasingly unpopular, and the country was paralyzed by strikes in the later months of 1995, as the government tried to introduce policies that would allow it to meet the convergence criteria. In Germany, public opinion polls showed growing opposition to abandoning the Deutschmark, despite a consensus among the political elite to insist that the monetary union was the only course for the country. In November 1995, a poll published in *Die Woche* indicated that 61 per cent of the German people were opposed to the single currency (*Financial Times*, 11–12 November 1995).

Public scepticism about the single currency put the German government in an even stronger position in the bargaining about the detail of the arrangements. It could always argue that unless the German public was confident in the arrangements made,

### Insight 21.2 The European Central Bank

The TEU set up an ECB charged with conducting the monetary policy of the eurozone. Its governing council consists of an Executive Board plus the governors of the national central banks. The Executive Board consists of a President, a Vice-President, plus four other members. They are appointed by common accord of the member states for a non-renewable term of eight years, and must be 'of recognized standing and professional experience in monetary and banking matters' (TEU A. 283(2)). In October 2011, Jean-Claude Trichet completed his term as President of the ECB and, in the midst of the crisis in the eurozone, was replaced by Mario Draghi, a former governor of Banca d'Italia.

there would be no German participation, and therefore no single currency. In this way, Germany won all of the main arguments.

It was agreed that the European Central Bank (ECB) (see Insight 21.2) would be located in Frankfurt; then, that the name of the new currency would not be the 'ecu', which the French preferred because it was the name of an old French coin, but the 'euro', because the German people did not have confidence in the existing ecu.

France put up a stronger fight on three other issues:

- (1) the level of political control that would be exerted over the ECB;
- (2) the rules that would govern budgetary policy after the start of the single currency;
- (3) the identity of the first president of the ECB.

On the level of political control, the German government insisted that the ECB should be as independent as it was possible to make it. This was the only way that the German people would have confidence that the single currency would be run on a sound basis. The French government never accepted this: it wanted the ECB to be answerable to national governments.

This fundamental philosophical clash also underlay the differences between the two governments on the terms of the budgetary rules that would apply after the start of the single currency. The German government wanted the Maastricht convergence criterion for budget deficits—that budget deficits should not exceed 3 per cent of GDP—to become permanent. It also wanted a system to penalize states that overshoot this target, and proposed a fine that would be automatic. The French government argued that the fine should be discretionary, and that the finance ministers should decide the issue in the light of prevailing economic circumstances. The clash between the German preference for 'rules-based' economic governance and the French preference for discretionary governance has long had an impact upon the politics of the single currency, including in the context of the post-2008 crisis (see this chapter, The Eurozone Crisis).

At the Dublin European Council in December 1996, it was agreed that states that ran a deficit in excess of 3 per cent of GDP would be fined, but the fine would be automatically waived if GDP had fallen by more than 2 per cent in the previous year. If GDP had fallen by less than 2 per cent, but by more than 0.75 per cent, the finance



ministers would have discretion to decide whether a fine should be imposed. This compromise allowed everyone to claim that they had won, but the rules-based system was generally in accord with the preferences of the German government.

When a new Socialist government was elected in France in June 1997, it made clear that it was unhappy with the stability and growth pact (SGP) that had been agreed at Dublin. At the Amsterdam European Council in June 1997, it was agreed that the SGP would be supplemented by an employment pact, and this was written into the Treaty. Nevertheless, as with Dublin, the outcome at Amsterdam on monetary union has to be seen primarily as a success for the German government. The French government accepted the SGP in return for much less than the employment chapter that it had originally wanted to be written into the Treaty.

Having lost the major arguments on EMU to Germany, the French government made an issue of the identity of the first president of the ECB. In May 1998, at a special European Council meeting in Brussels that had been called to launch the single currency, the French President, Jacques Chirac, refused to accept the nomination of the Dutchman, Wim Duisenberg, as the first president of the ECB. Duisenberg had been President of the forerunner of the ECB, the European Monetary Institute, and was the first choice of the clear majority of member states, including Germany. Eventually, in order to satisfy the French President, Duisenberg reportedly agreed to step down halfway through his term of office to allow the Governor of the Banque de France, Jean-Claude Trichet, to take his place (although this was publically denied by all parties) (Kaltenthaler 2006: 94–5). Trichet would eventually replace Duisenberg in 2003.

The launch of the single currency was only slightly marred by this political controversy, and the financial markets reacted calmly to the shenanigans. The euro formally came into existence on 1 January 1999 with eleven members. Only Greece, in the end, was excluded by the convergence criteria. Britain, Denmark, and Sweden met the criteria, but excluded themselves. Britain and Denmark were allowed to do this under the terms of their 'opt-outs'. Sweden was able to claim on a technicality that it had not fulfilled the conditions because it had not been a member of the ERM for two years prior to the launch of the euro. Denmark and Greece joined a revised ERM-2 that was set up at the same time as the launch of the single currency, but which retained the wide 15 per cent fluctuation band. Britain and Sweden chose not to join ERM-2.

The ERM-2 continues to operate as, in effect, a training area for future members of the single currency, in which they are obliged to adopt good habits of economic management. The 2004 enlargement committed all of the new member states to becoming members of the single currency, but they were required to fulfil the convergence criteria before being allowed in, and had to be members of the ERM-2 for two years. Slovenia, Cyprus, Malta, Slovakia, Estonia, and Latvia have since joined the euro (see Box 21.1).

## The Single Currency in Operation

### The Euro Group

Because decisions on matters relating to the monetary union needed to be taken by the governments of the participating states, in 1998 an informal 'Euro Group' was set up

### Box 21.1 Membership of the EMS and the Single Currency

1979	Start of EMS. Joined by Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, and the Netherlands (all of the then member states of the EC except Britain)
1986	Portugal and Spain joined the EC and the EMS
1989	Spain joined the ERM
1990	Britain and Portugal joined the ERM
1992	Britain and Italy forced out of the ERM
1996	Italy re-entered the ERM and Finland joined
1998	Greece joined EMS and the ERM
1999	Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain formed the eurozone. Denmark and Greece joined a revised ERM-2
2001	Greece joined the euro
2002	Introduction of euro notes and coins
2004	Estonia, Lithuania, and Slovenia joined ERM-2
2005	Cyprus, Latvia, and Malta joined ERM-2; rules of eurozone SGP revised
2007	Slovenia joined the euro
2008	Cyprus and Malta joined the euro
2009	Slovakia joined the euro
2011	Estonia joined the euro
2014	Latvia joined the euro

consisting of the eurozone finance ministers, each accompanied by one economic official, together with representatives of the ECB and the Economic and Financial Committee of EU officials. It meets ten to twelve times a year, usually on the evening before the formal sessions of the Economic and Financial Affairs Council (ECOFIN) meeting of the Council of Ministers. It elects a president for two years—since 2013 the Dutch finance minister, Jeroen Dijsselbloem—and it is the presidency that issues the invitations, prepares the agenda, and afterwards circulates an informal memorandum of the most important points discussed and agreed.

A system of 'Euro summits'—regular meetings of the heads of government of eurozone member states—has emerged alongside Euro Group meetings since 2010 and was institutionalized in the Treaty on Stability Co-ordination and Governance which entered into force in 2013 (see Chapter 11).

### Problems of Monetary Union

Although the single currency came into existence more smoothly than many economists predicted, it soon ran into difficulties. The external value of the euro fell steadily against the US dollar, and the eurozone itself began to exhibit some of the problems of having a single interest rate for such a diverse economic area. In particular macro-economic imbalances became apparent, with Spain and Ireland experiencing the symptoms of repressed inflation, including rapidly rising property prices and shortages of labour, while the core economies of Germany and France were experiencing sluggish growth. A majority of states within the eurozone experienced lower rates of growth



and higher unemployment than the economies of those EU member states—Britain, Denmark, and Sweden—that remained outside the single currency.

Against this background, it was perhaps unsurprising that the Danish people rejected membership of the euro in a referendum in September 2000, that the British government concluded in June 2003 that the time was not right to make an application to join, and that the Swedish people followed the Danish example in September 2003.

### Redefining the Stability and Growth Pact

While Britain and Sweden were in the process of deciding that they did not want to be part of the eurozone, serious disputes broke out among the member states that were in the single currency over the application of the SGP. The pact effectively made the Maastricht convergence criteria permanent requirements for the participating states. In particular, they were expected to keep their budget deficits below 3 per cent of GDP. This proved very difficult to achieve in the context of low growth, teetering on the brink of recession. Although agreement was reached on making both Portugal and Ireland come into line when they breached the spending limits, by 2003, the states in the dock were the two giants of the eurozone: France and Germany. In November 2003, the eurozone finance ministers discussed a formal proposal from the Commission that sanctions be applied against both France and Germany unless they took steps to reduce their budget deficit for 2004 below the 3 per cent limit. Once it became obvious that there was no majority for the Commission's proposal, the Italian presidency proposed a suspension of the sanctions, and this was accepted by a majority vote. With this decision, the SGP in effect became no more than a set of guidelines on policy to national governments.

Yet, neither Germany nor France ever challenged the principle of the pact, and in an attempt to minimize the damage that their action might cause, both agreed voluntarily to try to reduce spending for 2004. This seemed to make it clear that the principle at stake was not the need for fiscal discipline, but who was in charge: national governments or the European Commission.

That principle was also the reason for the decision of the European Commission, in January 2004, to take the Council to the European Court of Justice (ECJ) under Article 230 (previously 173) of the Treaty. The decision was taken by a majority vote in a badly divided College—but the view prevailed that it was the duty of the Commission in its role as guardian of the Treaty to test the legality of the pact. In July 2004, the ECJ ruled that the Council had acted illegally in suspending the pact's mechanism for sanctioning member states, but affirmed that responsibility for making the member states observe budgetary discipline lay with the Council, not the Commission (*Financial Times*, 14 July 2004).

In March 2005, the SGP was revised to relax the conditions under which a 3 per cent deficit would not be considered 'excessive', and the timetable for correcting an excessive deficit was stretched. A member state exceeding the 3 per cent deficit could argue that it was doing so legitimately if it was trying through its excess expenditure to achieve European goals or to 'foster international solidarity', both of which are very broad objectives. Conditions for the correction of an excessive deficit were also considerably eased. These reforms to the pact were made possible by an apparent

convergence in French and German interests, with the latter accepting (at least temporarily) greater flexibility and discretion in economic governance.

### Euro Notes and Coins

The other main development in monetary union after 1999 was the introduction of euro notes and coins on 1 January 2002. Between 1999 and 2002, the euro officially existed as an international currency, but national currencies continued to be used for domestic purposes. The replacement of the national currencies with the euro notes and coins was a significant development because it gave physical form to the new currency for ordinary citizens of the eurozone, and made it a part of their daily lives. The creation of a single currency in physical form provided an important symbol of European integration and for some signalled an important step towards the development of a European identity (Risse 2003).

### The Eurozone Crisis

The various causes of the eurozone crisis, which began in 2009, are debatable. It has been connected to the broader financial crisis of the capitalist world which began in 2008, itself the consequence of excessive risk-taking and indebtedness by banks, other financial institutions, and publics in Europe and beyond (see Insight 11.1). It has been connected to the more specific weaknesses in the governance of the single currency: the failure of states to follow rules or of European institutions to enforce them, and the weakness of the rules themselves to address macro-economic imbalances in the eurozone. More generally, it has been connected to a perceived lack of political and economic (particularly fiscal) integration in Europe, which for many is a necessary but missing counterpart to monetary integration.

A flurry of activity from EU institutions and actors in response to the crisis sought to address each of these issues. This was done through a combination of crisis management aimed at bringing short-term respite and substantive reforms aimed at establishing a more robust system of monetary and economic governance (see also Chapter 11, *The Unfolding Eurozone Crisis*). It also entailed—albeit to a much lesser and arguably insufficient extent—ensuring proper regulation of banks and financial institutions.

### Crisis Management

The EU was largely reactive in its response to the unfolding crisis in the eurozone (see also Chapter 11, *The Unfolding Eurozone Crisis*). When the crisis first became manifest in Greece in 2009—following its sovereign debt downgrade and the realization that its budget deficit was far worse than it had reported—EU leaders were relatively slow to appreciate and react to the wider implications. After some procrastination, a €110 billion bailout for Greece was agreed as part of a bilateral agreement with other eurozone member states and the International Monetary Fund (IMF). But as the bond markets and credit rating agencies turned their attention to other eurozone states, and it became clear that Greece would not be a stand-alone case, the EU and IMF put



together a larger financial support mechanism worth €750 billion. This had three components: the European Financial Stability Facility (EFSF), backed by member states, was authorized to raise €440 billion; the European Financial Stabilization Mechanism (EFSM), backed by the EU budget, was able to raise €60 billion; and the IMF was to provide a further €250 billion. In 2010 and 2011, support packages were put in place via these mechanisms for Ireland, Portugal, and Greece (its second 'bailout'). In each case, these packages were operationalized following negotiation with the European Commission and the IMF of domestic-reform programmes which required unanimous approval by the Euro Group and the signature of a memorandum of understanding (MoU) by the relevant state. The implementation of these programmes was to be assessed by the European Commission, IMF, and the ECB (known collectively as 'the troika'). As noted below, these financial support mechanisms were subsequently superseded by a permanent mechanism, meaning that, after 2012, support was no longer channelled from EFSF/EFSM.

In addition to these various support mechanisms, the ECB played an active role in crisis management. In particular, at the end of 2011 it injected money into Europe's struggling banks through so-called Long-Term Refinancing Operations (LTRO). This provided temporary liquidity to a banking sector in which banks were nervous even to lend to each other. The ECB intensified this interventionism in 2012 with its commitment to so-called Outright Monetary Transactions (OMTs): a pledge to purchase member states' sovereign debt if required. With this move, the ECB was able to calm markets, radically narrow bond–yield spreads within the eurozone, and ease the burden of debt refinancing on struggling member states (for a discussion of its controversial nature, see Chapter 11, *Power in Crisis EU*).

In addition to these acts of 'fire-fighting', the EU developed long-term reforms aimed at both solving the crisis and preventing its recurrence. Despite clear differences within the EU on both the major causes and potential solutions to the crisis (see also Chapter 11, *Crisis Politics*), a programme of substantive reform did emerge, which, as with the initial design of EMU, was generally in line with German preferences (see also Chapter 11, *Power in Crisis EU*).

As the crisis unfolded, EU leaders recognized, in December 2010, that a more permanent financial assistance mechanism than EFSF/EFSM (due to expire in 2013) would be required for dealing with crisis situations in eurozone member states. This permanent institution, the European Stability Mechanism (ESM) was agreed by treaty and established on 27 September 2012 with a lending capacity of up to €500 billion. To receive assistance from this mechanism ESM member states must—as with previous mechanisms—sign a MoU and must have ratified the 'fiscal compact'. In other words, assistance would once again come with significant conditionality, particularly in terms of so-called fiscal consolidation. In 2012 and 2013, respectively, Spain and Cyprus first received funds through this new mechanism, while Greece, Portugal, and Ireland continued to receive funds from the temporary mechanisms.

The major reforms to economic governance sought to render meaningful and substantially 'harden' the previously-flouted rules associated with the SGP. The 2011 'six-pack' of legislation was aimed at reinforcing both fiscal surveillance mechanisms and enforcement mechanisms of the SGP, while also increasing EU oversight of member states' budgetary and economic policies in order to avoid large macro-economic imbalances. Such oversight was facilitated by reforms to the economic co-ordination

timetable, particularly the introduction of the so-called 'European semester' after 2011, which allowed for closer monitoring of national budgets by the Commission. The 2013 'two-pack' of legislative reforms built on the 'six-pack', reinforcing oversight with respect to eurozone member states and particularly those in receipt of financial assistance.

The 'fiscal compact' within the Treaty on Stability Co-ordination and Governance (TSCG) (on the Treaty see Chapter 11, *Insight 11.2*) referred to and built upon these reforms and significantly contributed to this reinforcement of economic governance. It was signed by twenty-five member states (all excluding the UK and Czech Republic) and called for balanced-budget rules to be written into national laws or constitutions. At its heart was the so-called 'golden rule' which limits structural deficits to no more than 0.5 per cent of GDP over the full economic cycle. Along with the above-mentioned legislation, the TSCG also referred to monitoring by the European Commission of national economic and budgetary policies and foresaw costly sanctions for governments that breached the SGP deficit limit of 3 per cent. This can only be blocked by a 'reversed qualified majority' in the Council: in other words, a qualified majority (see Chapter 12) is needed to reject (rather than approve) the Commission decision. The accent of these reforms was, in accord with German preferences, on greater fiscal discipline and increased powers of oversight from the EU centre. For Germany, such discipline is regarded as the quid pro quo for the collective commitment to bailout mechanisms such as the ESM, which might otherwise create a situation of so-called 'moral hazard', whereby states in receipt of financial assistance are able to continue in their profligate ways. However, a number of academics were highly critical of these disciplinary measures and, as discussed in Chapter 11 (*Crisis Politics*), such opposition manifested itself in various forms of political opposition to these moves.

German concerns about moral hazard are perhaps the key reason why certain other proposed collective-action initiatives were not pursued. Chief among these is the idea of 'eurobonds', which would involve collectivizing debt obligations within the eurozone. The maximalist version of this idea would entail replacing all sovereign bonds within the eurozone with a single 'eurobond', meaning that eurozone member states take collective responsibility for overall debt. The effect would be to reduce the cost of borrowing for those member states under pressure from the bond markets, although it would perhaps increase these costs in the short term for Germany. The Commission proposed moves in this direction (albeit emphasizing the need for even greater discipline as its counterpart) and France, particularly after the election of President Hollande in 2012, backed the initiative. Germany was resolutely opposed, however, because of the moral hazard concern.

In terms of regulatory reforms of the finance sector, a proposal for a European Banking Union (EBU) received strong support from the European Commission. The EBU would centrally regulate European banks and contribute in particular to the breaking of a negative feedback loop between private and sovereign debt (whereby banking debt becomes sovereign debt when the sector is bailed out by national governments). While such a proposal appeared to have the backing of most member states, the progress that had been made up to 2014 reflected a compromise deal that left many dissatisfied (Barker and Fleming 2014). And some commentators doubted whether the reforms had in fact broken the aforementioned 'feedback loop' which was so important in the context of various crises (Smaghi 2013).



More generally, the Commission proposed a number of policies aimed at closer and more co-ordinated regulation of the banking and finance sectors, including a controversial financial transactions tax. The tax did not have the backing of all member states, but as of 2014 a sub-group of member states was in discussions about implementing such a tax (under so-called 'enhanced co-operation' procedures—see Chapter 12, The Post-Lisbon Architecture of the EU). While the EU has successfully implemented certain rules aimed at clamping down on forms of speculative activity in the financial markets which were perceived to have exacerbated the crisis, many critics argued that reforms did not go nearly far enough (see, for instance, Patomaki 2013).

## Explaining and Critiquing EMU

Academics have vigorously debated both why the decision to adopt a single currency was finally made, and why the particular form of monetary union was agreed. Supranationalist and intergovernmentalist explanations have both been offered in the literature, while international factors form the background to both sets of explanation. Moreover, both before and particularly during the crisis, a range of voices, emerging in particular from a critical political economy literature (see Chapter 4, Critical Political Economy), offered an important critique of EMU.

### Spillover

It could be argued, as it was argued by the Commission, that pressure for monetary union came as spillover from the decision to free the internal market. Making a reality of the single market implied eliminating the fluctuations in exchange rates that were a source of interference with trade across national boundaries. However, Sandholtz (1993: 20–2) rejected the argument that there was a clear functional spillover from the single market to a single currency. The reasoning behind it was contentious:

**Among economists, there is no consensus on the desirability of monetary integration, much less on its functional necessity.**

(Sandholtz 1993: 21)

However, he argued that there was clearly what others have called 'cultivated spillover'. This occurs when the Commission 'cultivates' pressure on the governments of member states to adopt further measures of integration (see Chapter 1, International Relations Theories of European Integration).

Others have emphasized the role of central bankers in designing EMU. Verdun (1999: 317), for instance, identified the central bankers as an epistemic community in this process (see Chapter 2, New Institutionalism). Central bankers were certainly involved early on, notably through their participation in the Delors Committee, which produced the report on EMU. Later, they played an active role in the drafting of the relevant articles of the Treaty. Central bankers agreed that the aim of monetary policy was to achieve price stability. Verdun (1999) argued that they tended to agree that, to achieve this, monetary policies had to be freed from political influence. They

all supported a supranational regulatory agent in the form of the European System of Central Banks (ESCB). However, Kaelberer (2003) argued that there was a lack of consensus between the central bankers on how to approach monetary union, with the divisions between the French monetarist and the German economist positions apparent. Contrary to the definition of an epistemic community, there was, for Kaelberer, a clear hierarchy within the Committee because of the strong bargaining position held by the Germans. Both Verdun and Kaelberer had some sympathy with intergovernmental arguments to the extent that they viewed EMU as a political decision made by governments. Central bankers—whether or not they agreed with the concept of EMU—were 'trapped' into engaging with its implementation. That said, whether it was primarily the Delors Commission or member states that mobilized central bankers in this process is debatable.

Irrespective of whether the initial moves to EMU can be regarded in terms of functional spillover, some commentators read the subsequent crisis itself as providing the functional spillover pressures that would lead to further economic and political integration. For instance, German journalist, Gabor Steingart, interpreted the crisis as 'the birth pangs of a new country... the United States of Europe' (*The New York Times*, 22 May 2010). It is certainly too early to adjudicate on such predictions. However, at the time of writing, the direction of reform did not support them (Cohen 2012: 698), and for other commentators some kind of 'dis-integration' remained a possible consequence of the crisis (see, for instance, Webber 2013).

### Intergovernmentalist Explanations

Intergovernmentalists have often argued that a government might welcome having its hands tied by commitments to the EC/EU and this argument can be applied to EMU in particular:

**monetary union would provide price stability for governments that would be unable, for domestic political reasons, to achieve it on their own.**

(Sandholtz 1993: 35)

This hypothesis might explain why German preferences prevailed on the issues of the independence of the ECB and the constitutional commitment that the ECB should aim for price stability above other goals. Whatever other governments' public protestations that they found the German preferences too restrictive, in private they perhaps welcomed the opportunity to be tied into policies that they believed to be right, but did not believe that they could persuade their electorates to support. In states in which the general value of the EU was never in doubt, this technique was used without undermining the legitimacy of EU membership itself. Arguably this was due to the concept of 'output legitimization': the notion that the EU can, despite removing certain policy areas from national democratic oversight, maintain its legitimacy—and a 'permissive consensus'—as long as it delivers a set of positive outcomes, particularly economic (see Chapter 3, Democracy). In the context of the post-2008 crisis such output legitimacy was significantly undermined (see Chapter 11, Crisis Politics).

Another explanation for EMU starts from the experience that member states had of the EMS. Sandholtz (1993: 27–30) noted that the EMS was working well, but that



there was growing discontent in France and elsewhere with the way in which decisions on interest rates were made by the Bundesbank in the light of conditions only in West Germany, and these were then transmitted throughout the EMS member states because of the need to keep all currencies aligned. Furthermore, Cameron (1997) identified the way in which adjustment costs within the EMS fell particularly heavily on the weak-currency states. If the exchange rate of a weak-currency country threatened to fall below the range of its parity, it was expected to take the necessary action to support its currency. Failure to maintain the parity could lead to a devaluation, which would again place adjustment costs on the weak-currency state by feeding inflationary tendencies. Relatedly, states that had higher levels of inflation would find that their exports were relatively less competitive while states with lower rates of inflation would find their exports becoming steadily more competitive. This is how West Germany came to run large surpluses with all of its main EC trading partners (although, as noted above, such imbalances were not overcome in the context of EMU). To these factors, Loedel (1998) added a further motivation for France: international monetary influence. It was with West Germany that the United States conducted such dialogue as it held with Europe on international monetary matters, while other members of the EMS had no say in such monetary diplomacy.

It is clear, though, that the asymmetries in the EMS do not explain why West Germany supported the single currency. After all, the EMS was a system that favoured German interests. Here, Sandholtz (1993: 31–4) invoked West German foreign policy aims. EMU can be seen from this perspective as a means of balancing West German policy to the east with a strengthening of its interdependence with the EC. In particular, the issue became linked to German reunification. In late 1989, Kohl produced a ten-point plan for German unification. Shortly afterwards, the EC states agreed to convene the IGC on EMU in 1990. Sandholtz suggested that this decision was precipitated by the concern of France and other neighbours of Germany that the reunified German state would lose interest in the EC, and might even become nationalist again. Such a danger became a theme of speeches given by Helmut Kohl in defence of the single currency. He repeatedly associated the single currency with European integration, and European integration with the avoidance of war in Europe. The single currency was an essential step on the way to political union, which in turn was essential to peace and stability.

In contrast, Moravcsik (1998: 381) was dismissive of the explanation based on German reunification because, he maintained, the timing was wrong. Firm commitments by France and West Germany to move decisively forward with EMU—and opposition by Britain to that goal—predated the fall of the Berlin Wall and remained unchanged after unification was completed in August 1990. He argued that there was a German economic interest in monetary integration. The steady appreciation of the Deutschmark against other currencies was reducing the competitiveness of German exports, and merging it into a wider European currency offered the opportunity to dampen down this trend. Concerns about currency appreciation intensified in the 1990s in the face of the large costs of reunification and the collapse of the ERM in 1992 (Moravcsik 1998: 392).

Kaltenthaler (2002) attempted to cut through the dichotomy between explanations of German policy that stressed geo-political factors and those that stressed economic interests by distinguishing three distinct groups of actors who influenced German

policy on monetary union whenever it was proposed. The first group was a 'foreign policy coalition', consisting of the Foreign Ministry and the Chancellor's office. The second group was a 'monetary stability coalition' of state actors with responsibility for financial and monetary policy, consisting primarily of the Finance Ministry and the Bundesbank. The third group consisted of societal actors, predominantly bankers and industrialists operating through organizations such as the Federation of German Banks (BDB), the Federation of German Industry (BDI), and the German Chambers of Commerce (DIHT). There was always a tension between these actors. The foreign policy coalition had the primary aim of 'embedding Germany in western institutions' (Kaltenthaler 2002: 70), and was particularly concerned to maintain the key diplomatic relationship with France. The monetary stability coalition, as the name implies, was concerned to ensure that domestic monetary stability was maintained. Which of these coalitions had the greater success in influencing policy was largely determined by their ability to attract the support of the third group, the societal actors (Kaltenthaler 2002: 72–3).

When the French government, dissatisfied with the asymmetrical operation of the EMS, first proposed moving to full monetary union in early 1988, the immediate reaction of the West German government was cool. This reaction reflected the combined opposition of the monetary stability coalition and the societal interests, which saw the French proposal as a device to gain control of German monetary policy and move it away from its emphasis on price stability. Chancellor Kohl and Foreign Minister Genscher both supported the proposal for geo-strategic reasons, to shore up the alliance with France. The balance of power shifted, though, with the fall of the Berlin Wall and the prospect of reunification. The banking and industrial interests saw tremendous prospects for expansion into East Germany, and therefore very much favoured reunification. France, though, held a veto over reunification, because it was one of the four powers that had occupied Germany after the war (together with Britain, the United States, and the Soviet Union), and the agreement of all four was needed for reunification to proceed.

Kaltenthaler (2002: 80) disagreed with Moravcsik (1998) that reunification was unimportant in explaining the commitment to monetary union, but whereas Sandholtz (1993) emphasized the strategic thinking behind the decision—that Kohl and Genscher wanted to reassure France and the other EU member states that it was still committed to the EU—Kaltenthaler emphasized the politics behind the decision. The foreign policy coalition won the support of the societal interests when it seemed as though monetary union was the price that would have to be paid to get France to agree to reunification. However, in the IGC, the monetary stability coalition was able to dictate the terms of monetary union because, on the principle of monetary stability, it still had the backing of the societal interests.

### International Pressures

Pressures for monetary union from the global system were present at several stages in the story. From at least the early 1980s on, there was continuing and growing concern about the extent to which the United States was prepared to use the still-dominant position of the dollar in the international monetary system to benefit the US domestic economy. Large fluctuations in the value of the dollar threw off course the economic



and budgetary plans of the EC, and gave it a strong incentive to develop a single European currency that could displace the dollar from its position of pre-eminence in the international system, which it continued to hold more by default than because of the strength of the currency. While the euro did become an important competitor currency, it did not in its first decade displace the dollar as the major global reserve currency.

## Critical voices

It is not surprising that the crisis in the eurozone—a crisis of EMU and potentially of the EU more generally (see Chapter 11)—provoked a range of critical commentary from both within and beyond academia. It should be noted, however, that a number of scholars, particularly those adopting a critical political economy perspective (see Chapter 4, Critical Political Economy), were long-standing critics of the single currency and its design. Many such scholars critically expounded on the neoliberal (see Gill 1998; Cafruny and Ryner 2007) or German **ordo-liberal** (see Berghahn and Young 2013; Bonefeld 2012) bias inherent in EMU.

For instance, in the late 1990s Gill (1998) argued from a neo-Gramscian perspective that EMU's rule-based juridical regime (part of what he termed a neoliberal 'new constitutionalism') would significantly circumscribe the possibilities and flexibility available to the governments of member state in terms of economic-policy making. Such policies were portrayed as detrimental to distinct varieties of capitalism and welfare and also national democracy. The persistent breaching of the SGP in the first decade of the single currency brought into question Gill's assertions (Parker 2008). But the moves described above, to harden economic governance during the crisis, particularly for those countries in receipt of financial assistance, might amount to the realization of Gill's thesis. The crisis certainly served to reinforce claims of a democratic deficit in the EU (see also Chapters 11 and 3).

Many commentators and academics argued, from a 'neo-Keynesian' perspective, that the official reforms, geared towards policies of austerity, would undermine aggregate demand (consumption) and therefore economic growth in the European economy, and potentially extend and prolong the crisis (see, for instance, Patomaki 2013). Such 'neo-Keynesian' views were echoed in political debate during the crisis, as described in Chapter 11 (Crisis Politics).

For many of these critics, the roots of the crisis lay, above all, in the financial sector. Any policy reforms should therefore involve radical reforms to finance at various levels of governance. However, given the important entanglements between certain national economic growth models and such sectors—and the interconnectedness of populations and these sectors (through, for instance, mortgages and pensions)—such reform seemed likely to remain elusive.

## CONCLUSION

Economic and monetary union raises many of the issues that are consistent themes of this book. The debate between supranational and intergovernmental interpretations of the nature of

European integration rages as fiercely here as it does for the single market programme; and the creation of another independent **supranational institution**, the ECB, feeds the argument between the same positions about the nature of the EU and its institutions. The form of monetary union that was adopted gave rise to a chorus of critiques of EMU, that became all the louder in the context of the post-2008 crisis.

The previous history of attempts to achieve EMU clearly indicated that the attempt at the end of the 1980s would have to face up to the difficult issue of the form that the monetary union would take. French and German views on the matter had long differed. France favoured institutional arrangements that would put the ECB directly under the guidance and ultimate control of the governments of the member states. West Germany favoured an independent central bank, not because the West German government wanted to increase the degree of supranationalism inherent in the EC's institutional architecture, but because the West German post-war tradition was that the value of the currency should not be subject to political interference, but should be determined by an independent bank. The Bundesbank had always been fiercely independent of the federal government in West Germany, and the confidence of the West German people in the new currency would be vitally dependent on similar arrangements applying to the ECB.

In terms of economic governance, a divide between these two countries has also long existed. Germany favoured a strict rules-based system which would promote economic discipline (and convergence) among member states within the eurozone, while France favoured greater flexibility and discretion in national economic management. Ultimately German preferences prevailed on both the ECB and economic governance. However, persistent breaching of the SGP (including by Germany) created doubts about the effectiveness of economic governance. Such concerns intensified during the eurozone crisis.

In the context of the crisis, the German-inspired rules-based system was significantly hardened. At the same time, however, the crisis precipitated various forms of 'fire-fighting'—notably the deployment of financial assistance to struggling states and an increasingly activist and politicized ECB—which created anxiety in Germany. The conditions attached to financial support served at the same time to exacerbate the sense in heavily-affected 'debtor' member states that monetary union (and the EU more generally) had emasculated the ability of member states' governments to manage their domestic economies and thereby effectively undermined national democracy (see also Chapters 11 and 3).

For many observers, the underlying issue—long recognized but still apparently insoluble—is that monetary union does not amount to political and economic union, but might ultimately require such union (Cohen 2012). The post-2008 crisis, and assaults by the financial markets on the sovereign debt of certain member states, revealed—indeed, it may to some extent have been caused by—the weakness of a system which has a single centralized monetary policy but no common fiscal or transfer policy. However, radical reforms in that direction will not be easily achieved. Member states within the eurozone have very different views on what form any deeper integration should take and those outside are unlikely to want to become involved in the project in the near future (see also Chapter 11).

## KEY POINTS

### History

- In 1969, The Hague Summit committed the EC to achieve 'EMU by 1980'.
- There was tension over EMU between Germany and France. Germany made anti-inflationary policies the priority; France made economic growth the priority, even at the risk of higher inflation.



- This disagreement led to the compromise proposals of the Werner Committee for closer co-ordination of economic policy accompanied by tying together the exchange rates of member states within narrow margins of fluctuations (the 'snake in the tunnel').
- The snake was ultimately broken by a combination of divergence in the economic performance of the members and the US policy of allowing the dollar to devalue.
- In the period following the 1973 oil crisis, other member states began to follow Germany's lead in supporting a low-inflation policy. This removed a major barrier to greater currency co-operation.
- In October 1977, the Commission President, Roy Jenkins, called for a new attempt at EMU. This initiative was supported by German Chancellor Schmidt and French President Giscard d'Estaing.
- In December 1978, the Bremen European Council created the EMS.

#### Origins of EMU

- In 1988, the Hanover European Council set up the Delors Committee to report on the steps needed to strengthen monetary co-operation in the light of the single market.
- An IGC in 1991 set a timetable for completion of monetary union, which would be not later than January 1999.
- The Maastricht Treaty (1992) set stringent criteria to ensure the convergence of member state economies prior to participation in monetary union.
- Only Britain was initially allowed to opt out of signing up for the monetary union in advance. Following the rejection of the Maastricht Treaty in the Danish referendum in June 1992, Denmark was granted a similar opt-out.

#### Putting Maastricht into Operation (1992–2002)

- Germany won all of the main arguments over the details of the monetary union, including the name of the single currency, the criteria that would guide its operation, the location of the ECB, and the identity of its first governor.
- The euro was launched in January 1999. Only Britain, Denmark, and Sweden declined to take part, while Greece failed to meet the qualifying criteria.
- Denmark and Greece joined a revised ERM-2. Later members of the EU were required to be members of this system for two years before being allowed into the euro.

#### The Single Currency in Operation

- A Euro Group was set up by the members of the single currency, and it assumed considerable importance, weakening the main ECOFIN.
- Soon after it started, the euro ran into problems. Its value fell against the dollar, and the outlying economies experienced inflation at the same time as the core economies experienced recession.
- The economies that remained outside of the eurozone experienced high levels of growth. Between September 2000 and September 2003, Britain, Denmark, and Sweden all decided not to apply for entry. On the other hand, the new member states of the EU all wanted to join EMU as soon as possible.
- Euro notes and coins were introduced at the start of 2002.
- When France and Germany breached the rules of the SGP in 2002–03, they refused to accept censure from the Commission. In March 2005, the mandatory system for enforcing budgetary discipline was replaced by a more flexible set of guidelines.

#### The Eurozone Crisis

- The eurozone crisis began in 2009 when it was revealed that Greece had concealed the true state of its public finances and it became increasingly difficult for the Greek government to finance its debt. The crisis soon spread to other eurozone states.
- The EU responded with a series of crisis management 'fire-fighting' exercises, including a 'bailout' mechanism for struggling member states and a series of interventions by the ECB in support of both banks and governments.
- Bailouts came with tough conditions attached, which effectively imposed deflationary austerity programmes on governments in receipt of assistance.
- Germany and other northern 'creditor' member states emphasized lax rules of economic governance in explaining the crisis and their reform preferences were geared towards toughening such rules.
- France and southern 'debtor' member states emphasized the need for greater political management of EMU, and increased solidarity, particularly from Germany.
- The social, political, and economic effects of the crisis led to a sharp decline in the popular legitimacy of the EU.

#### Explaining and Critiquing EMU

- Supranationalist explanations have included spillover, the role of the Commission, and the role of central bankers as an epistemic community.
- Intergovernmental explanations have stressed geo-political factors and domestic economic factors.
- International factors form the background to both supranational and intergovernmental explanations.
- Critical perspectives on EMU argue that both its original design and recent 'crisis' reforms contain a neoliberal bias which privileges particular groups and is inherently anti-democratic.

#### FURTHER READING

The essential starting point for further reading is **D. R. Cameron**, 'Economic and Monetary Union: Underlying Imperatives and Third-Stage Dilemmas', *Journal of European Public Policy*, 4 (1997): 455–85, which examines why the member states perceived EMU to be in their national interest, and considers some of the practical problems involved in operating a single currency. **W. Sandholtz**, 'Choosing Union: Monetary Politics and Maastricht', *International Organization*, 47 (1993): 1–39, reviews the history of the decision on monetary union, and analyses it in the light of theoretical perspectives, including neofunctionalism and intergovernmentalism. Unsurprisingly, the intergovernmental viewpoint is best represented by **A. Moravcsik**, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (London: UCL Press, 1998), 379–471. An excellent, detailed history is provided by **K. Dyson and K. Featherstone**, *The Road to Maastricht: Negotiating Economic and Monetary Union* (Oxford: Oxford University Press, 1999). More recent books that provide valuable insights are **M. Chang**, *Monetary Integration in the European Union* (Basingstoke: Palgrave Macmillan, 2009), and **D. Marsh**, *The Euro: The Politics of the New Global Currency* (New Haven, CT, and London: Yale University Press, 2009). Books dealing specifically with the post-2008 crisis include **D. Marsh**, *Europe's Deadlock: How the Euro Crisis*