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EMU - 25 Years after Maastricht: Historical Challenges, Economic Ideas, Political Solutions

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The signature of the 1992 Maastricht Treaty was a major step in the development of the European Union (EU). It represented not only the key moment of the introduction of the single currency, but also the result of difficult negotiations during which important initial objectives fell by the wayside, notably the idea to accompany economic and monetary union (EMU) with stronger political integration. The financial and public debt crisis that started in 2008, as well as its later political fall-out, could hence be seen as the result of a political structure inadequate to foster economic and monetary integration. Therefore, a historical evaluation of the political context which led to this outcome of the 1991 Intergovernmental Conference (IGC) seems appropriate.

The European Parliament (EP) was an important actor in the preparatory phase and during the Intergovernmental Conference. Generally positively inclined towards stronger political integration as well as economic and monetary union different political families within Parliament nevertheless attached different weights to the two principal objectives. Parliamentary debates, resolutions and activities leading to Maastricht and the single currency are thus an important source to understand the context of monetary union. Different ideas and narratives preceded the decision to create a single currency. There were those who advocated more economic convergence and

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political integration before monetary union, on one side, and proponents of the neo-functional approach on the other. The latter claimed that the single currency would draw the Union towards more economic integration and would finally even be conducive to political integration.

The aim of the EP-EUI EU History Roundtable held on 31 May 2017 was to analyse the theories, ideas and models related to monetary union, such as Optimum Currency Area theory, monetarist and ordo-liberal thoughts or the so-called coronation theory of monetary integration. Contributions included institutionalist analyses as well as empirical economic and financial regulation research. The question whether EMU had an impact on European constitutionalisation was also examined.

Anthony Teasdale, Director General of the European Parliamentary Research Service, welcomed the event on one of the key episodes of the history of the European Parliament and the institutional history of the EU as an excellent occasion to deepen the knowledge on both and to ensure that the institutional memory of the European Parliament on one of the most defining steps in European integration was preserved.

In his opening remarks, **Ramón Luis Valcárcel Siso**, Vice-President of the European Parliament, highlighted that in most eurozone countries there was still consensus that EMU brought benefits to its members, and even to non-eurozone member states. However, as a result of the long double crisis of the banking sector and sovereign debt in Europe, many EU member state economies faced difficult social re-adjustment processes. Yet, regardless of voices pleading in favour of abandoning the euro in some countries, member states would need to collectively develop and apply new mechanisms to detect, prevent, and correct problematic economic trends.

Vice-President Valcárcel underlined the enormous importance of economic convergence of eurozone economies, in indicators such as labour costs, inflation, productivity, or growth, but, at the same time, conceded that transferring highly sensitive responsibilities from national authorities to the European level was no easy endeavour. The recent calls for an economic and social union, inter alia by Emmanuel Macron, then minister of the economy, and his German counterpart, Sigmar Gabriel, hence agreed on the need for a staged process of convergence that involved not only structural reforms (labour market, business environment) and institutional reforms (to improve the functioning of economic governance), but also social and tax convergence (e.g.

minimum wages and a harmonised corporate tax) to strengthen individual economies, establish a level playing field across the eurozone, and avoid downward tax competition and social dumping.

Regarding Parliament's contribution to tackling the financial and debt crisis, Valcárcel highlighted its newly won powers. After the entry into force of the Lisbon Treaty, the EP had participated in the detailed regulation of the eurozone. This involved, inter alia, the preventive part of the Stability and Growth Pact (SGP), as well as more diligent macroeconomic surveillance to prevent harmful imbalances following the financial crisis. The so-called 'Six-Pack' also strengthened Parliament's role in the economic governance of the EU, in particular through the introduction of the 'European Semester' and the installation of an 'Economic Dialogue'. The EP, moreover, very early on called for an extensive application of the powers of the European Central Bank (ECB) provided for under the Treaty – i.e. its obligation to determine the monetary policy pursued. Yet, the ECB's prerogatives should, according to Parliament, be balanced by democratic accountability. To this end, the 'Monetary Dialogue' was introduced: The President of the ECB, or another member of its Governing Council, appears before the European Parliament's Committee on Economic and Monetary Affairs at least once every three months to answer questions on the economic outlook and to justify the conduct of monetary policy in the euro area. In addition, the European Parliament routinely delivers an opinion on the ECB's annual report in the context of an own-initiative report.

Another example of new rules was the so-called 'Legislative Two-Pack', which entered into force in 2013, concerning the scrutiny and assessment of the budgets of the eurozone countries by the Commission. Here and in other situations where the EP possessed decision-making powers, e.g. with respect to the Single Supervisory Mechanism (SSM), it was able to obtain concessions from the member states and to advance its influence.

In addition, Parliament was consulted on a number of important issues:

- Agreements on exchange rates between the euro and non-EU currencies;
- Choice of countries eligible to join the single currency;
- Appointment of the President, Vice-President and other members of the ECB Executive Board;



- Legislation implementing the excessive deficit procedure provided for in the Stability and Growth Pact;
- General measures necessary for the use of the euro as single currency.

Vice-President Valcárcel closed his introduction with an outlook on potential future elements of EMU based on the so-called 'Five Presidents Report':

- Further Parliamentarisation: The European Parliament could engage in a plenary debate before the Annual Growth Survey is presented, and continue the debate following its adoption. A second dedicated plenary debate could be held upon presentation by the Commission of its Country-Specific Recommendations, in accordance with the relevant provisions of the 'Six-Pack' on economic dialogue.
- External role of the euro zone: There is a lack of uniform representation of the EU and the euro area in the international financial institutions. This fragmented voice means that the EU is punching below its political and economic weight as each euro area member state speaks individually. This is particularly true in the case of the IMF, despite the efforts made to coordinate European positions.
- Integrating intergovernmental legal instruments: Integration of intergovernmental legal instruments created during the crisis into the legal framework of the European Union is already foreseen in the Treaty on Stability, Coordination and Governance and should integrate also other agreements, such as the Euro Plus Pact and the intergovernmental agreement on the Single Resolution Fund. Moreover, in the medium-term, also the governance of the European Stability Mechanism should be fully integrated into the EU treaties.

Concluding, Vice-President Valcárcel underlined that the challenge facing the euro was a political one: would there be sufficient political will to create the arrangements needed for a successful currency union, or would the high political costs associated with this mean that Europe would have to endure an unsatisfactory system that could jeopardize its legitimacy with many citizens? In light of this political challenge, the future of the euro strongly depended on the right combination of solidarity, fiscal prudence and European-level instruments in supervision and crisis management.

In his keynote speech, **Roberto Gualtieri**, Chairman of the European Parliament's Committee on Economic and Monetary Affairs welcomed the opportunity to go beyond the current political events and to shed some light on the theoretical and historical foundations of the creation of EMU. Recalling the fundamental difference between the exclusive EU powers related to monetary integration and the shared competence between the EU and the member states in economic policy, he assessed this to be one important explanation of the asymmetries of the EMU. A further essential feature were the provisions in the Treaty on the Functioning of the EU (TFEU) concerning monetary union, notably its Art. 123 and 125 containing the so-called no-bail-out clause; in addition, there was only a budget for the single market, not for a financial union, and this was subject to the unanimity rule as regards the EU's own resources. All this led to what could be called an incomplete, asymmetric construction.

According to Gualtieri, in orthodox economics, three theoretical assumptions framed the functioning of EMU:

- Output and employment fluctuated in response to external shocks on aggregate supply and demand;
- Economic shocks were absorbed through short-term variation of volumes, due to imperfect information transmission in markets and typical incentives for private agents to react to price changes;
- Neither fiscal nor monetary intervention on aggregate demand could significantly alter potential output and the unemployment rate, leading mainly to increased inflation.

However, the Maastricht treaty and the definition of EMU within it was not simply the result of economic ideas and models. For a full account, an encompassing historical and political analysis was needed to highlight the policy area under the assumptions of different theoretical schools of thought on the dynamics of European integration, such as intergovernmentalism or neo-functionalism, which in a multi-dimensional approach took into account bargaining within and between member states, domestic politics, and the role of experts and ideas. Gualtieri underlined that there were excellent accounts, for instance, of France's approach to EMU, scrutinising the views of the French administrative elite on the *Franc fort* policy and European power politics in general. The role of American monetary unilateralism, the strength of the Deutschmark and of German unification are also well known. Some key players in France eventually accepted



German strategic positions during the crucial period from 1988 to 1991 (e.g. Jacques Delors and Jacques de Larosière). Nevertheless, some studies of the so-called ‘battle of ideas’ between France (‘political discretion’) and Germany (‘respect for rules’) are not fully convincing. Ideas and objectives were contested between different epistemic communities also within member states.

Over the early years, many observers thought that the asymmetry between the monetary and the economic part of EMU could work, if sufficient budgetary buffers were built up by euro area members in good times. However, the persistent structural differences between national economies were mainly compensated through a quasi-private financial transfer system run by major banks, moving financial resources from rich euro countries to the periphery. This amplified the European sovereign debt crisis triggered by an originally US-based problem.

On the other hand, the crisis also triggered relevant changes in eurozone governance:

- The European Stability Mechanism (ESM) was created, with a strong emphasis on conditionality of financial support.
- The ECB became involved in massive open market operations such as the Outright Monetary Transactions (OMT).
- A second reform of the Stability and Growth Pact in 2011 and, a few months later, the creation of the European Fiscal Compact.

Again, the outcome of these negotiations was a political trade-off between public opinions in member states and financial governance requirements.

Roberto Gualtieri noted a slightly paradoxical introduction of much stricter rules, on the one hand, and the acceptance of more flexibility on the other. The role of the Commission and the European Parliament was essential for finding such a compromise and balanced to some extent German insistence on fiscal discipline and the insertion of balanced budget rules in national constitutions. Of particular importance was the final phrasing of Art. 2 and 3 of the Fiscal Compact. While Art. 2 provides that the Fiscal Compact is only valid if its provisions are compatible with EU law, notably the Stability Pact and the treaty, Art. 3 contains a modified definition of what a balanced budget is, as defined by the European Commission. Hence, even in an

intergovernmental setting, European dynamics and EU law had a strong impact.

Even though one may say that many aspects of the current governance structure are the result of rapid responses to the crisis rather than of the implementation of a clear design there clearly are very coherent and logical components such as the evolving banking union, which hopefully will lead to a more sustainable financial integration of the eurozone. Gualtieri expressed his conviction that the current construction is suboptimal, but not unsustainable and that it could gradually be made more coherent. A leap into a fully-fledged fiscal, federalised Union was hence not the only possible solution.

The Commission’s Reflection Paper on the Deepening of the EMU would certainly also reflect some ideas submitted by the European Parliament in three recent reports that aimed to strike a balance between a strict convergence code and the creation of an EU fiscal capacity to absorb future shocks. A completed banking union and a coordinated aggregate fiscal stance of member states could therefore become a sound foundation of eurozone governance. Moreover, growth-friendly economic policies such as those included in the Commission’s country-specific recommendations, although not yet implemented in a perfect way, were an important step towards a more coordinated fiscal policy.

Finally, Roberto Gualtieri stressed that democratic scrutiny had to be applied at the level at which decisions were taken, through an intelligent multi-level enhancement of parliamentary control. No treaty change was required for that, just the political will to create a dynamic eurozone as the internal engine of a stronger EU in a global context.

After these introductory remarks, the discussion dealt with core economic concepts and ideas behind economic and monetary union, including reflections on the EP’s role in the run-up to EMU; the intellectual masterminds behind EMU; models that help track the gaps and flaws in EMU’s architecture; and observations on the nascent banking union.



The European Parliament on the Road to the Maastricht Treaty

To lay the ground for the discussion, **Angelos Delivorias**, policy analyst from EPRS's Members' Research Service, spoke on important milestones on the way to the Maastricht treaty. He focused on the European Parliament's positions expressed in numerous resolutions in reply to major policy reports (such as the Werner, Delors or Christophersen reports) or events (such as the Smithsonian agreement or the Single European Act (SEA)). After a brief look at the situation in the 1950s and 1960s, he focused on the period from 1970 to 1993.

Due to the existence of a general framework for trade and payments (Bretton-Woods, GATT, OEEC, EPU, EMA), missing EC membership of the United Kingdom (GBP) and the overall stability of the international monetary situation, the 1950s and 1960s did not witness much talk about an European economic and monetary union. The declared focus of this period rather laid on establishing a common market, a customs union and common policies. However, during the 1960s the European unit of account (EUA) was created. As a reaction to the balance of payments issues in the United States of America (USA), the devaluation of the French Franc and revaluation of the Deutschmark, first ideas for an EMU were formulated at the end of the 1960s, especially in the Barre Plan, The Hague Summit, and the Werner Plan. The latter envisaged a three-stage process to achieve EMU within a period of ten years. As a reaction to the Werner Plan, the EP called for national and Community competences to be specified and for itself to exercise democratic control over those competences. It, moreover, asked to be consulted on important decisions concerning EMU. On the occasion of the Smithsonian agreement that followed the temporary suspension of US Dollar convertibility into gold in 1971, the EP placed great hopes on the European Monetary Cooperation Fund (EMCF) as an intervention tool into European currency markets and called for greater powers for the Commission. In a subsequent 1973 resolution on the reform of the international monetary system, the EP called for a dominant place of Special Drawing Rights (SDRs) in the composition of currency reserves and for interest rate policy coordination to address disruptive effects of international capital.

Yet, it was only in 1978 that the debate on EMU got new impetus from France and Germany, leading to the European Council meetings of Bremen and Brussels as well as to the proposal for a European Monetary

System (EMS). The EP remained critical of the proposals of Bremen and asked for more control, a common economic policy and convergent member States policies. After the Brussels European Council, while adopting a more conciliatory tone and welcoming the EMS, the EP repeated its call for more convergence of national and Community economic policies.

Within the EMS period until 1987, several EP resolutions called for measures to extend the use of the European Currency Unit (ECU) to control inflation, to draw up proposals for an international monetary agreement to counteract policies of third countries (like the USA), for Member States (such as the UK) to join and for others (like Italy) to abandon exception rules. Reacting to the Hannover European Council and the Delors report, EP resolutions on the road to Maastricht (1988 to 1992) called for greater integration between national economic and fiscal policies and for the role of the ECU to be extended to private transactions. Moreover, on the Christophersen report, the EP issued a resolution that agreed with the obligatory nature of EMU, while it called for greater EP powers over EMU, especially in view of the appointment of the governor and the board of the Central Bank, than the report offered (as it proposed only consultation), and the orientation and harmonisation of economic policies.

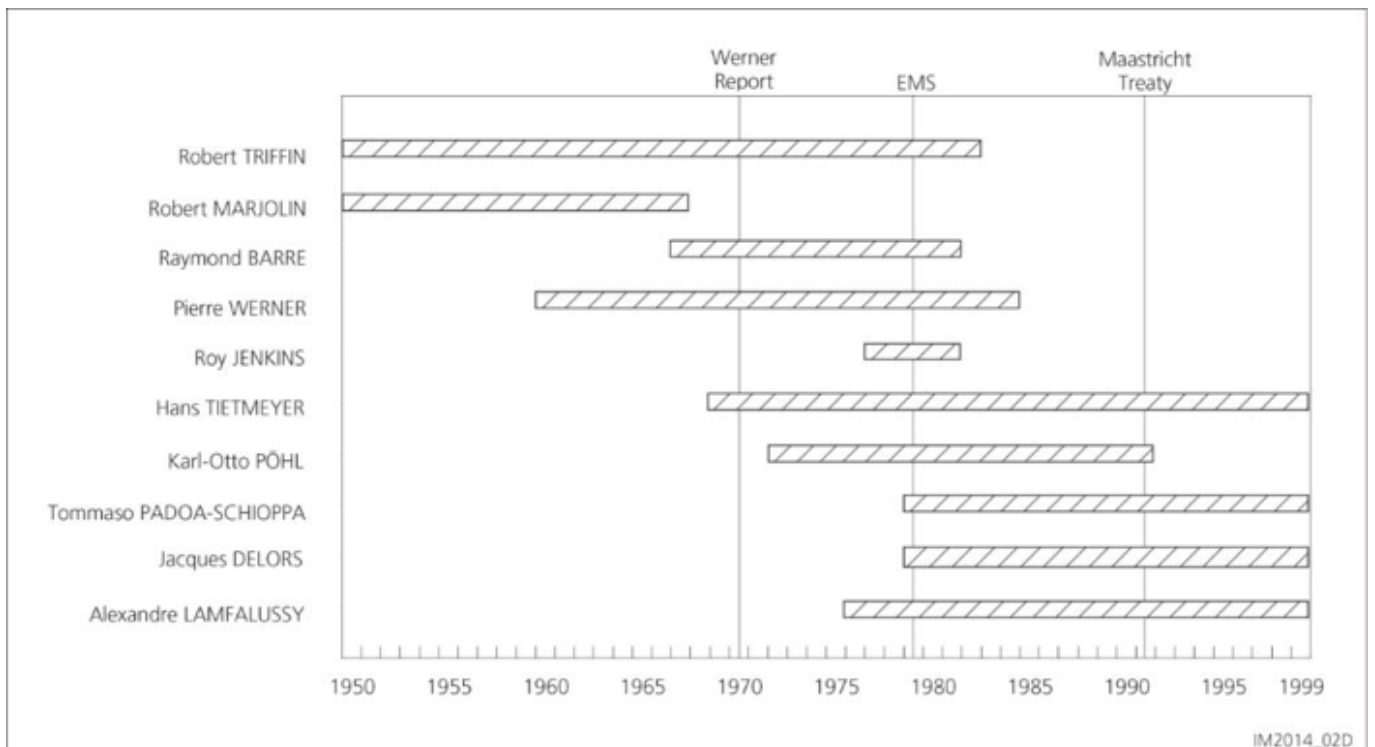
Concluding his presentation, Angelos Delivorias focused on the EP's resolutions during the IGC on the Maastricht treaty. There, the EP agreed with the conclusions on the coordination of monetary policies and the convergence of economic performance, defended a central role for itself in EMU and demanded co-decision for specific agreements. It, however, did neither discuss the capital/payments sections of the treaty, nor the debt-to-GDP criterion ceilings (3% and 60%). In its conclusions to the IGC, the EP underlined the fact that the new treaty failed to provide any economic policy authority with adequate democratic legitimacy to counterbalance the autonomous monetary policy of the ECB. It also deplored the fact that the scope of Parliamentary influence would suffer at national and European level through reduced parliamentary control, and hence the loss of disciplinary power that was not compensated by more powers for the EP.



The Architects of the Euro

Ivo Maes, Senior Advisor for Historical Studies of the National Bank of Belgium and Professor at the UC Louvain, discussed key ideational moments in the making of EMU. He particularly portrayed key intellectuals driving EMU's development and analysed the role and legacy of these architects of the euro, whose task it was to design a workable and sustainable monetary union. They were institutionally embedded actors, most typically in the European Commission or in European central banking, or both. Their expert role was providing substantive policy knowledge and managing the complex negotiation processes through their networking skills. They were exceptional actors at the interfaces of politics and academia as well as in national and European affairs. Maes' key insights were the reassertion of the value of biographical study, the claim that biography indeed mattered in the context of the evolving EMU and the fact that the nature of EMU was the true product of the individual intelligences of its original architects.

Presenting empirical evidence from a co-edited volume with Kenneth Dyson, Ivo Maes focused on 10 key actors in the development of the Euro. He reconstructed the situations of constraint and choice in which the architects of the euro operated and he alluded to parts of the urgency of the moment and teleological biases in narratives about EMU. He underlined that designing EMU was not simply a matter of realising a pre-formed economic or political vision. Under the conditions of a tight, politically defined timetable, the process was more one of precipitate self-revelation. The political patrons of EMU defined the institutional venues in which EMU was to be designed and vetoed certain matters as not suitable for further consideration. The main sources of the tactical and psychological advantage of the architects of the euro derived from the general lack of experience in economic, financial and monetary issues on the part of their political leaders.





According to Maes, the biographical study of the architects of the euro showed that they were bound together by certain shared, often implicit, understandings, which helped to define a discourse about Europe and to forge mutual consensus. A key factor in their personal backgrounds was the ‘shadow of history’ and a common generational experience, with shared memories rooted in World War II. They were part of the generation of post-1945 reconstruction, dedicated to creating a more civilised Europe founded on cooperation through trade, investment, growth and employment. Another common reference point were the problems of the Bretton Woods system and its eventual collapse in 1971-73. The search for monetary stability was hence a shared preoccupation of the architects. They also had in common their Europeanised experience in building and working within new institutional frameworks, from the European Payments Union to the European Economic Community and beyond. Finally, as loyal public servants, they were aware of the limits of their expertise, as they had to work within the constraints of political mandates.

According to Maes, notwithstanding their shared understandings, the architects of the euro differed in their views on EMU. These differences become apparent in their positions on a supranational EMU. While Raymond Barre was reluctant, Robert Marjolin, Karl-Otto Pöhl, and Hans Tietmeyer were cautiously positive, whilst most others supported it. A similar variety of views was apparent as regards monetary cooperation before the final stage of EMU. Again, Pöhl and Tietmeyer were reluctant, Barre, Alexandre Lamfalussy and Pierre Werner were cautiously positive, while Jacques Delors, Tommaso Padoa-Schioppa and others were in favour.

With respect to the legacy of the architects, Maes highlighted that they – by and large – escaped the charge of being responsible for the flaws of EMU. The causes of EMU’s weaknesses rather included the imperfect knowledge that centralised decision-makers possessed in a highly heterogeneous EMU, characterised not just by local structural differences, but also by varying economic cultures.

While the architects all had serious doubts and reservations on EMU, they differed in the precise objects of concern. For some, like Pöhl and Tietmeyer, but also Padoa-Schioppa and Delors, European political union was the missing headstone. EMU required deep reserves of democratic legitimacy at the European level that were however lacking, not least to ensure compliance with fiscal rules. For Roy Jenkins and others of a Keynesian persuasion the prime requirement was a counter-cyclical stabilisation facility. As the international consensus shifted towards active fiscal stimulus to kick-start economic growth, the euro area was perceived as poorly designed to deliver. Robert Triffin’s much earlier proposal for a European Reserve Fund had pointed the way to provision of a risk-sharing facility to give member states time and support to adjust. Last, but not least, Alexandre Lamfalussy, from his time at the Bank for International Settlements (BIS), had identified the problem of macro-prudential supervision and regulation.

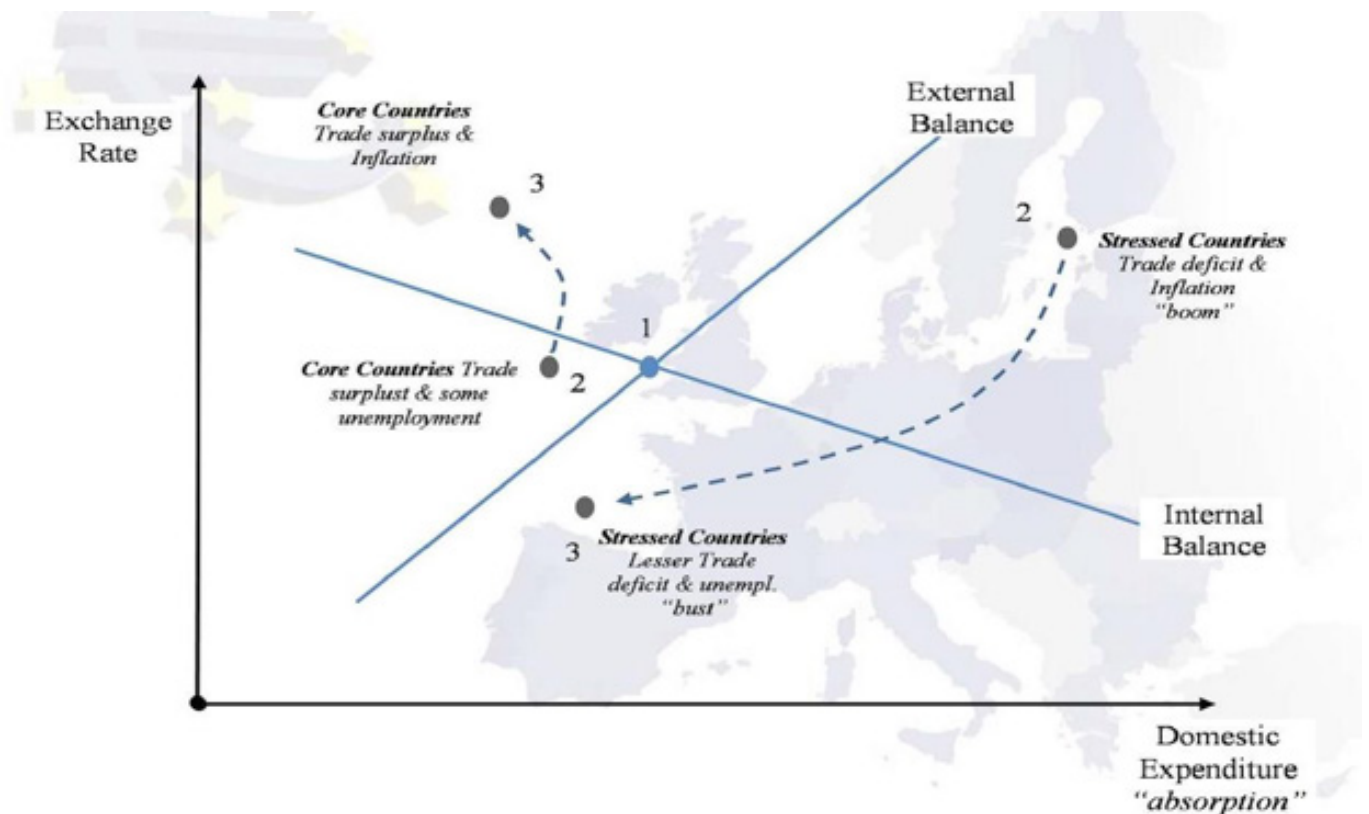
Monetary cooperation in the first stage	A supranational EMU		
	Reluctant	Cautiously positive	Favourable
Reluctant		Tietmeyer Pöhl	
Cautiously positive	Barre		Werner Lamfalussy
Favourable		Marjolin	Triffin Jenkins Padoa-Schioppa Delors



Economic Concepts and Ideas behind EMU

Francesco Paolo Mongelli, Senior Adviser in Directorate General Research at the European Central Bank (ECB), and honorary Professor at the Johann Wolfgang Goethe University of Frankfurt, explored the explanatory potential of key theories, ideas and models related to EMU. He focussed on three theoretical frameworks developed to explain adjustment processes, policies, and shared institutional settings. Each of these approaches had an empirical dimension and left room for national customisation. Moreover, each model was ‘harmed’ in reality by bad governance, poor political economy, slow reforms, a lack of dynamism and foremost by the legacy of the crisis. The approaches included the ‘Swan Diagram’ discussing the trade-off between internal and external balances, Bela Balassa’s work on regional integration, and Optimum Currency Area (OCA) theory.

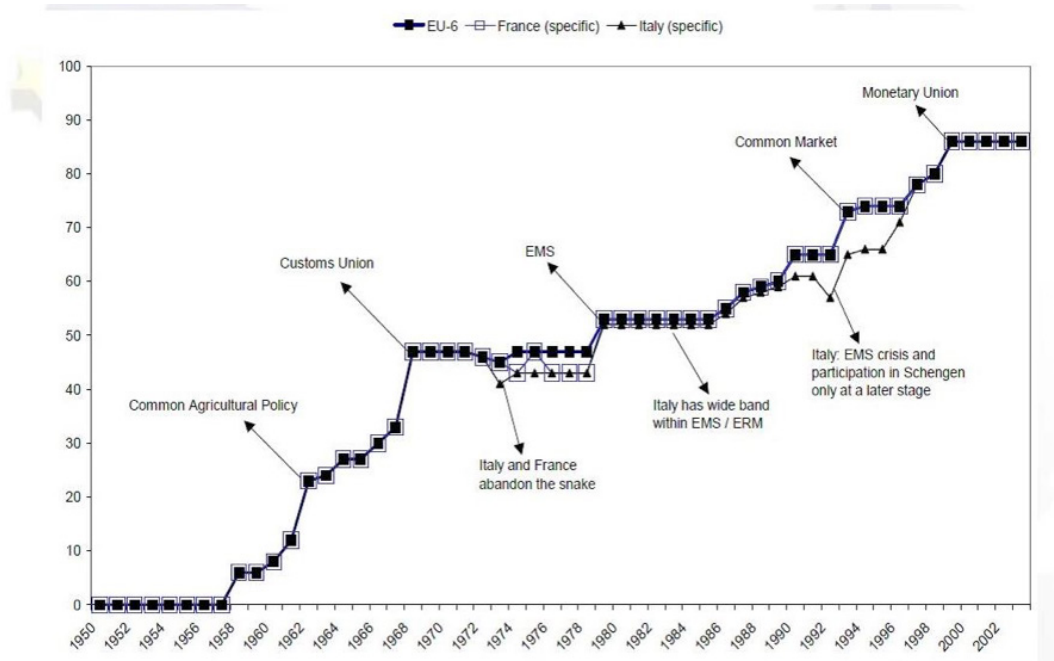
The ‘Swan Diagram’, elaborated by the Australian economist Trevor Swan in the 1950s focuses on two types of imbalances. Internal Balance (IB) portrays the combination of the exchange rate and domestic expenditure in which productive resources are fully employed and there is no unemployment and/or inflation; while External Balance (EB) describes the combination in which the Current Account is in balance. Applied to the current crisis, the Swan Diagram offered the following insight into the eurozone crisis as it helped visualise big imbalances, and macro-parameters going in opposite directions.





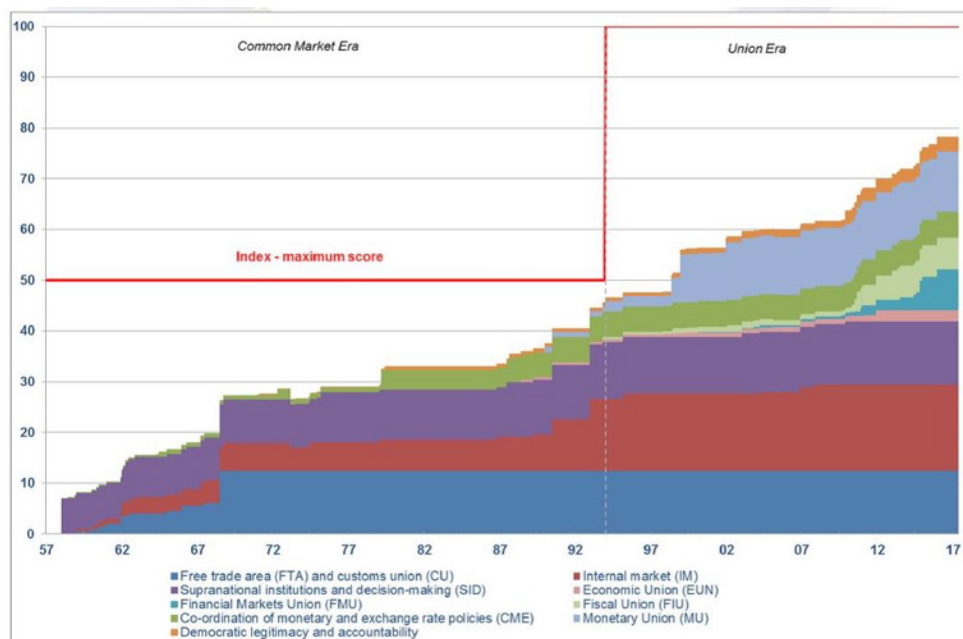
Grounded in Optimum Currency Area theory, Bela Balassa assigned scores to the level of institutional regional integration among partner countries. In this way, he identifies five main stages of integration (Free

Trade, Custom Union, Common Market, Economic Union, Total Economic Integration). In Mongelli's view, these five stages would develop in Europe in parallel.



In this way, Balassa's Index of institutional regional integration measured shared institutions and political economy, while national transposition and

implementation of policies and institutions remained a challenge.





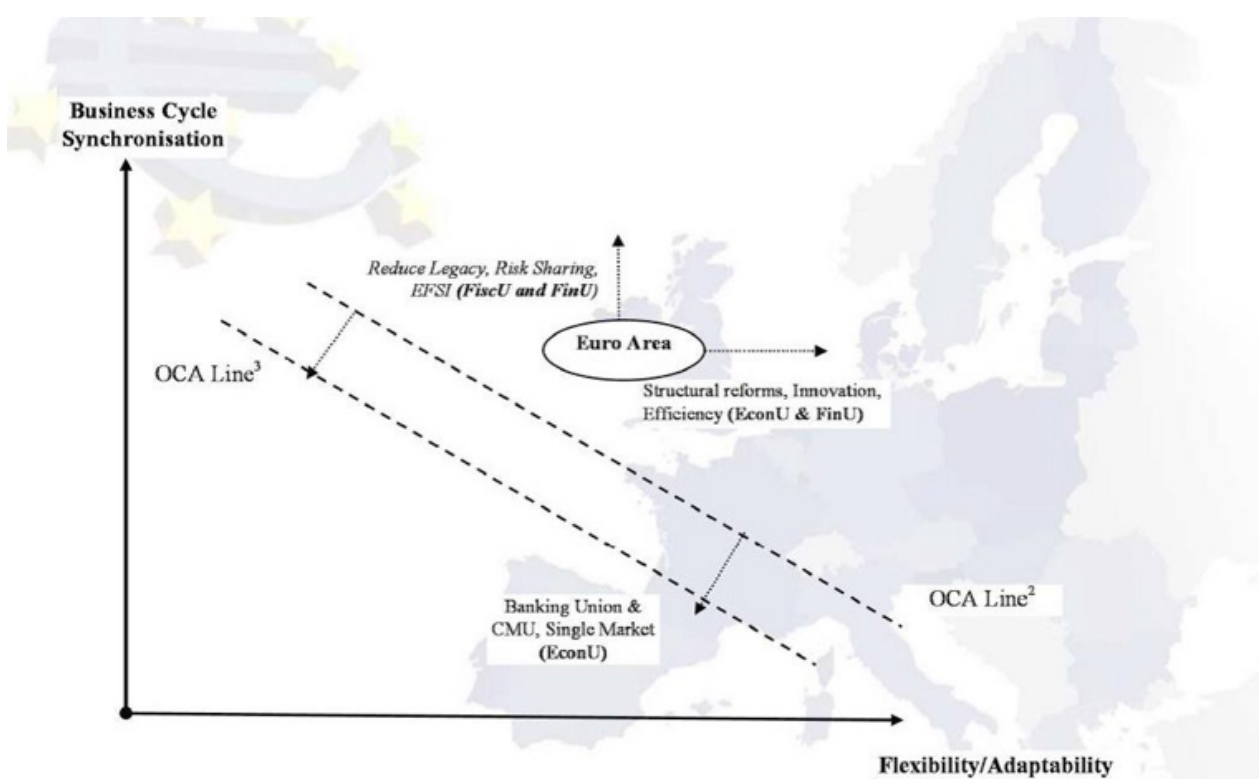
Finally, according to a simplified version of key assumptions of the Optimum Currency Area (OCA) theory, in order to have a stable and beneficial EMU, euro area countries would need to be

- ‘Open’ vis-à-vis each other in terms of trade in goods and services, as well as financial integration;
- ‘Flexible & Adaptable’ in terms of domestic prices, wages and costs of production, but also in terms of mobility and adaptability of labour and other factors of production (geographical, occupational, and industry mobility); and
- ‘Synchronised’ with each other. There needs to be income correlation and business cycle synchronisation.

Applying these criteria to the current Eurozone situation, Mongelli presented the following results:

In general, OCA theory articulated openness, flexibility and correlation and highlights trade-offs. Applied to the Eurozone, OCA theory hence showed that the benefits of sharing the euro rested on high scores across all OCA properties.

Applying all three theories and approaches to the current eurozone crisis and the solutions proposed to fight it, Mongelli concluded that an exceptional and changing crisis had been met by formidable policy responses and that the new governance structures are working in ways that are slowly becoming apparent. At the same time, the four new Unions were charting a course toward a resilient EMU within the EU and the euro area sharing a ‘constitutional framework’ that is new in its formulation. If it was upon the choice of EU member states, Mongelli assumed that today most countries would probably like to pursue more ordo-liberal policies to avoid a repetition of a sovereign debt crisis. At the same time, several risk-reduction and risk-sharing mechanisms would





need strengthening and, provided that the different scores under the three frameworks would show signs of improvement, addressing the crisis legacy might set in motion benign feedback loops and support adjustment processes.

The Banking Union's Fiscal Backstop

Pierre Schlosser, Scientific Coordinator of the Florence School of Banking and Finance at the European University Institute, continued by focussing on the banking union. In his presentation, he especially highlighted Tommaso Padoa-Schioppa's role in the foundation of EMU, energetically advocating a European supervisory framework, insisting on the constitution of a European payments system and defending an embedded ECB, which would otherwise have risked suffering from 'institutional loneliness'.

Moreover, Padoa-Schioppa was a firm believer in discretionary liquidity support. In light of EMU's original architecture, according to Schlosser, Padoa-Schioppa noticed that 'crisis management is the issue on which most of the criticism of the present arrangements has concentrated in the early years of the euro. It has been argued that in euroland responsibilities to manage a banking (or more broadly financial) crisis are neither clearly assigned nor openly disclosed, and that the sheer number of authorities potentially involved would make the efficient provision of emergency liquidity unmanageable'. The post-euro crisis framework was still in line with this analysis, as Schlosser maintained.

In light of the above, Padoa-Schioppa offered to distinguish between three solutions to crisis management, which in Schlosser's view provided a convenient and very clear way to look at the new geography of Europe's banking union:

1. 'the private money solution' is market based and thus the preferable option. It includes both an ex-ante and an ex-post dimension.
2. 'the tax-payers money solution' comes into play in case of a significant insolvency.
3. 'the central bank money solution'.

Insisting on EMU's economic theory underpinnings, Schlosser reviewed the so-called 'tax-payers money solution', which in his view appeared to be the weakest crisis management element in Europe's current banking union. He argued that the 'private money solution' had been addressed by the Capital requirements (CRD IV/

CRR) package, the Resolution framework (BRRD) and the various resolution tools, which were all subject to the write down or conversion of the capital instruments of the Bank (SRB, 2017). Moreover, it was now reinforced by additional rules on subordination and liquidity provision as part of the new Banking Package. Crucially, the new Single Resolution Fund (SRM) was based on private sector provisions (although this was often forgotten). Similarly, the 'central bank money solution' seemed to have been boosted during the euro crisis with the incrementally growing provision of Emergency Liquidity Assistance (ELA) and the creation of the OMT instrument by the ECB. The third component of crisis management provision that Padoa-Schioppa termed 'the tax-payers money solution', by contrast, remained under-developed in its current form to guarantee a sustainable EMU. Pierre Schlosser closed with some ideas for institutional improvement and the need for institutional change.

As **Simona Piattoni**, Professor of Political Science at the University of Trento and Visiting Fellow at the European University Institute, commented in her discussion of the four contributions, it seemed fair to say that the general picture derived from all papers was that the creation of EMU and the euro did not stem from a need to sustain the common market (in other words, it was not the effect of a *structural spillover*), but from the coming together of different demands that, for different reasons, found a common answer:

- Germany's need to keep the appreciation of the Deutschmark under control, France's desire to strengthen its own currency, and Italian Treasury authorities' wish to put a brake on the escalation of inflation and the depreciation of the Lira.
- Germany needed to impose discipline on the other countries without becoming committed to helping them in case of need; other member states (F, I, B) needed discipline although they suggested a more flexible discipline than they eventually got.
- Supranational actors made use of this situation to push for the creation of (an imbalanced and imperfect) EMU.

The following debate dealt with a related set of questions:

1. Was EMU a package deal in which every party obtained something or was it just a case of 'Matthew effect', where the stronger became stronger and the weak weaker?



2. What is the ultimate explanation for the design of EMU? Group-think, a mix of misguided supranational pressures coupled with instrumental intergovernmental decisions, or conflicting economic models?
3. Were the European Monetary System and the Exchange Rate Mechanism indeed so insufficient that they needed to be overcome?
4. What role, if any, did the international context and the alternating economic and trade performance of the US play?
5. Solidarity was eschewed in the construction of EMU, but was it traded in for solidarity in other policy areas, like cohesion policy?
6. What was the input of the EP on the technicalities of the economic debate and the sustainability of EMU as well as the euro and in how far was the EP hampered by insufficient institutionalisation and conflicting partisan or ideological dynamics?
7. Was the creation of the European Monetary Fund indeed necessary and the creation of European Banking Union truly decisive to stabilise EMU and the euro?

The subsequent discussion was dedicated to the historical constraints of and political conditions for an effective economic and monetary union. As historians of EMU have shown in a number of studies, the role of the eurozone's biggest economy – Germany – has been a critical factor at many important junctures of EMU development. This was obviously not the priority of the other member states, nor the original institutional design of EMU or its predecessors, the EMS and the currency snake. To explain how Germany nevertheless became a hegemon-like actor in monetary integration, the panel started with an overview by **Michele Chang** from the College of Europe, Bruges, on 'Germany and EMU, Past and Present'.

Germany as a (Benevolent) Hegemon?

Professor Chang first outlined the particular set of priorities and norms determining the policy preferences of the German government during most of the process of monetary integration. As a general strategic choice, Germany was particularly interested in promoting and institutionalising its own preferences at the international level. Among those were first and foremost ensuring low inflation and a strong external value of its currency,

accompanied by an insistence on the respect of procedural and legal rules as a precondition of mutual trust and solidarity. The country's strong dependence on export-led growth and its demographics (a population ageing more rapidly than in most other EU member states) were also determining its economic policy-making. Germany was indeed repeatedly able to prevent steps towards integration that would require budgetary transfers between members and constrain its interests. For example, in 1978 a European Monetary Fund was proposed as a component of the EMS, but was foiled through opposition from the West German government and the Bundesbank.

However, in the course of the sovereign debt crisis the spate of reforms necessary to avoid the disintegration of the eurozone relied to a considerable extent on German acquiescence and willingness to make financial contributions, at least in the form of guarantees. A bail-out fund was created, the ECB acted as the euro area's lender of last resort (albeit stealthily and reluctantly), and the supervision and, where necessary, resolution of the euro area's largest banks have now been moved to the European level.

Over time, Germany's positions on the main parameters of EMU have been fairly consistent, but some of its former 'red lines' had to be shifted in order to prevent the collapse of the euro area. Still, achieving further progress on euro area governance, such as completing banking union or devising a euro area stabilisation fund, will continue to face German hesitations unless another major crisis makes them all but unavoidable. The parameters for banking union were further explored in a historical perspective by the next speaker.

Enduring Ideas and Interests in EMU and the Banking Union

Lucia Quaglia from the University of York (UK) dealt with 'Political dynamics in the construction of Economic and Monetary Union: Any lessons for Banking Union?' Professor Quaglia's demonstrated the path-dependency of the negotiating positions of major actors in EMU's development and how they impact also on the ongoing definition of the banking union, the latest component of post-crisis stabilisation efforts.

Two main political dynamics influenced the construction of EMU, as envisaged in the Maastricht treaty: first, there were economic and political 'spill overs' from the



single market and from previous European monetary integration, especially the functioning of the EMS. The European Commission argued that the gains of the single market could not be fully utilised without a single currency, notably in its influential and voluminous study *One Market, One Money: An evaluation of the potential benefits and costs of forming an Economic and Monetary Union* (1990).

On the other hand, there were intergovernmental dynamics, driven by the (often competing) interests and policy beliefs of member state authorities. The main line of division was between strong and weak currency countries – their preferences had to be reconciled in negotiations on EMU. Countries such as Italy and France tended to have higher inflation – with rates significantly above those in Germany – and normally ran balance of payments deficits, which undermined the value of their currency. For these countries, the establishment of EMU was seen and anticipated as a way to end German dominance of the EMS, and in particular to stop the virtual interest rate monopoly of the Bundesbank. In EMU, they would have a say in the making of a single monetary policy and a seat at the ECB, rather than obsequiously follow the monetary policy of the leading national central bank.

Of course, national preferences concerning EMU were far from monolithic at the domestic level. For instance, large German exporting firms supported EMU because the move to a single currency could give them a competitive advantage in relation to goods produced in other EU countries, notably France and Italy. French policy-makers saw EMU as the crowning of the *Franc fort* policy and part of a drive to make the country's industry more efficient (competitive disinflation). In Italy, technocrats at the Bank of Italy and the treasury supported their country's membership of the EMS and the EMU as welcome external constraints on domestic macroeconomic policies. In the UK, however, the political elite and public opinion, with the exception of parts of the financial industry, opposed the idea of a single currency, which was widely perceived to represent yet another step towards a federal Europe.

Addressing current policy developments towards establishing a banking union, Quaglia explored the theoretical background of the difficulties to define a balanced set of governing rules. Referring to Dirk Schoenmaker's financial trilemma she demonstrated that a combination of financial stability, an internationally oriented banking system and nationally defined financial and fiscal policies is hardly sustainable. Moreover, in

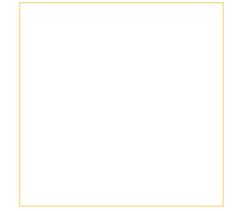
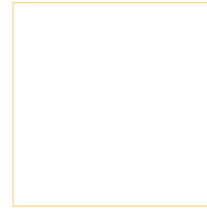
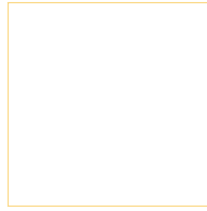
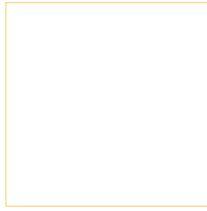
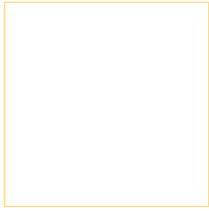
comparison to the construction of EMU, the role of the European Commission in the design of the banking union is less influential, but to a certain extent substituted by a more recent supranational actor, the ECB.

Finally, Lucia Quaglia underlined the importance of diverging narratives of the causes and solutions of the sovereign debt crisis in different countries. While a coalition led by France and including Italy, Spain and other countries in the euro area 'periphery' was keen on securing financial support mechanisms for ailing banks and sovereigns, another group, led by Germany, was reluctant to provide financial support to foreign ailing banks or their home countries' governments. These countries were mainly concerned about moral hazard, i.e. the undesirable effect of financial support feeding into continued economic and fiscal profligacy in debt-ridden countries.

Debt Restructuring – an Old and a New Challenge

The rising public deficits and debts in several EMU member states were the topic of the intervention by **Frédéric Allemand** from the University of Luxembourg, speaking on 'Debt restructuring in EMU: the known unknowns'. He recalled that the problem of unmanageable public debts and member state solvency is far from new. Not only during negotiations at the IGC preparing the Maastricht treaty the sustainability of public debt was one of the essential items on the agenda. It had already been examined since the European Council of Hanover in 1988. Recent debt crises having struck Mexico and Argentina as well as the state of New York were still fresh in negotiators' memory. They unavoidably raised the question of how best to prevent, correct and resolve unsustainable levels of debt although, despite cautionary comments from academia, severe debt restructuring was seen by political leaders as rather unlikely in the case of developed economies such as those of the members of the European Community. Nevertheless, the Commission included member states' budgetary situation in its annual economic reports.

At that time, some scholars pointed out that the equalisation of living standards across member states was one of the official goals of European integration and that this meant that member states would likely see support for another member state in financial trouble as a moral right, if not a legal obligation. Indeed, the European



Commission emphasised, too, that the no bail-out clause did not exclude ad hoc conditional financial assistance for states experiencing financial difficulties. This view was strongly supported by the Court of Justice of the European Union (CJEU) in its November 2012 decision *Pringle vs Ireland*. The Court analysed the preparatory work leading to Art. 125 of the treaty and concluded that the provision did not exclude financial assistance to a member state in difficulties if it remained directly responsible of its various debt instruments and obligations.¹

In order to master the tensions between the expectation of mutual solidarity and the solid management of public debt several solutions were, at least briefly, discussed during the IGC. The most far-reaching one, quickly dismissed as unrealistic, was to emulate inter-regional financial stability support in federal states. This would have required a strong increase of the European budget to about 5% of combined national budgets. Another idea was to let national budgetary policies only be disciplined by financial markets. The 1970s' fast growing exposure to international capital mobility and foreign investments indeed subjected national budgets and debts more and more to the permanent scrutiny of market actors. Yet, another group of policy-makers proposed to introduce a coordination of national budgets at the European level, which would imply strict rules on maximum public debt and budgetary balance – the solution which was finally retained in combination with steadily increasing market surveillance (dual discipline).

Allemand also described how both the European Commission and the European Parliament on many occasions proposed to create a mechanism of support for member states in financial difficulties, combined with conditionality as concerns the necessary reforms to prevent further liquidity or solvency problems. Again, the CJEU confirmed the compatibility of these proposals with the treaty in the decision mentioned above.

One set of legal instruments is, according to Allemand, still insufficient for a sustainable management and restructuring of debt in the eurozone: debt crises, notably solvency risks, are only partially addressed by European law, being predominantly the object of intergovernmental

instruments such as the ESM. This situation was criticised by the European Parliament already in its resolution of 20 October 2010, on 'Improving economic governance and the stability framework of the Union, in particular in the euro area'. In this resolution, Parliament stressed the need for a permanent crises resolution mechanism, including procedures for debt restructuring or orderly default and restructuring. This mechanism should be established in order to safeguard financial stability in the event of a sovereign- and private-debt crisis, while protecting the ECB's independence.

The Difficult Road to More Solidarity

Professor **Laurent Warlouzet** from the Université du Littoral (France) analysed the 'issue of solidarity since the Treaty of Rome (1957-2017)'. He recalled that under the Bretton-Woods system exchange rates were stable, but countries were periodically suffering from balance of payments crises. For instance, during the negotiation of the Treaty of Rome 1956-57 France experienced serious balance of payments difficulties. Hence, it argued in favour of and obtained the inclusion in the treaty of Art. 108 on 'mutual assistance' in case of a balance of payments crisis. France used this article twice, in 1958 and in 1968, in order to get exemptions from EEC legislation in times of temporary financial difficulties. However, EEC member states concerned by a balance of payment crisis, such as Italy in 1964 and 1977 and the UK in 1976, usually turned to the IMF for assistance, not to the European Community.

In the 1960s, many officials, such as for instance Jean Monnet, the economist Robert Triffin, or the first commissioner for economic affairs, Robert Marjolin, had submitted proposals for a 'European Reserve Fund'. In 1969, Federal Chancellor Willy Brandt gave his support to Monnet's idea of creating a Fund of Reserve. Similar ideas continued to be submitted throughout the 1970s, under difficult political circumstances. For instance, in March 1978, the French commissioner François-Xavier Ortoli emphasised the need to strengthen mechanisms of monetary and financial solidarity.

When the agreement to establish the EMS was reached in December 1978 the heads of state or government stressed that they remained "firmly resolved to consolidate, not later than two years after the start of the scheme, into a final system the provisions and procedures thus created. This system will entail the creation of the European Monetary Fund." However, as we know this fund never saw the light

1. "The 'no bail-out' clause [...] does not prohibit the granting of financial assistance by one or more Member States to a Member State which remains liable for its commitments to its creditors provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy." (Judgment in Case C-370/12; Press release No 154/12, p. 3)



of day. The main reason was that member states were too reluctant to share sovereignty on monetary matters until the 1990s. There also was an old cleavage between, on the one hand, those, who insisted on monetary solidarity, especially during financial crises, and those, on the other hand, who favoured more discipline in macroeconomic coordination.

These divergent views were prevalent throughout the 1980s and surfaced many times in European Parliament debates. A so-called 'transfer union' to assist a member confronted with a balance-of-payments deficit was seen as an essential component of monetary union by some and as an anathema by others. During the 1990s-2000s, the idea of a European Monetary Fund was less prominent. For instance, when the French government of Lionel Jospin (1997-2002) pushed for EMU reform, the focus was on the Stability Pact, which was hence renamed 'Stability and Growth Pact' in 1997. Only the global financial crisis of 2008 and the ensuing eurozone crisis led to the creation of ad hoc, and later permanent, mechanisms of financial solidarity.

Conclusions

The second part of the discussion provided complementary views on some crucial concepts of monetary and economic integration over the past 25 years, including elements of the earlier history of monetary integration of the European Community before Maastricht. Centred around the main ideological and political cleavages of each period (e.g. between those arguing in favour of economic convergence as a precondition for monetary union and those seeing monetary union as political project in preparation of political union) they illustrate the long and winding road the EC/EU had to travel to arrive at today's EMU. It is perhaps significant to note that, contrary to orthodox notions of what constitutes a hegemon, Germany did not succeed, ideologically, in imposing its own conceptions of the ideal monetary union to all other member states.

As Professor **Brigid Laffan**, Director of the Robert Schuman Centre for Advanced Studies of the European University Institute, observed in her conclusion, one of the prominent messages of the discussion was the tenacity of a few core ideas and concepts that persisted during the entire time span it took to prepare and create today's EMU. The power and impact of mostly normative beliefs such as economic convergence, moral hazard, respect for rules, or mutual solidarity should not be overestimated.

Laffan also underlined that the current discussion was convened at an apposite moment, i.e. on the very day of the publication of the Commission 'Reflection Paper on the Deepening of the Economic and Monetary Union'. The EP-EUI EU History Roundtable was thus a topical contribution to a historically and conceptually informed debate on future steps of economic and monetary integration, including the further sharpening of tools to prevent future asymmetric shocks caused by exterior economic developments.

Note: The graphs reproduced in this Policy Brief were presented by the respective speakers during the EP-EUI EU History Roundtable. Bibliographical references and further information may be obtained from the authors of this Policy Brief.

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Robert Schuman Centre for Advanced Studies

The Robert Schuman Centre for Advanced Studies, created in 1992 and directed by Professor Brigid Laffan, aims to develop inter-disciplinary and comparative research on the major issues facing the process of European integration, European societies and Europe's place in 21st century global politics. The Centre is home to a large post-doctoral programme and hosts major research programmes, projects and data sets, in addition to a range of working groups and ad hoc initiatives. The research agenda is organised around a set of core themes and is continuously evolving, reflecting the changing agenda of European integration, the expanding membership of the European Union, developments in Europe's neighbourhood and the wider world.

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