CHAPTER – 4

EUROPEAN INTEGRATION; THE EMU PHASE

The efficiencies and benefits from a single market (Economic Union) will only be maximised when the costs and risks of currency exchange are eliminated (Monetary Union)

Integration, the Experience

The conceptual framework of integration theory is not clearly distinguishable from its main empirical basis, the international relations of Western Europe. Integration was considered to be synonymous with a process observed only in particular regions: Western Europe, and, Central America and East Africa, as long as such processes continued. Western European integration was the product not only of a common culture and history and of a particular geographical proximity, but also of common experiences of disaster and predicament: the war and its aftermath, American hegemony and the Soviet threat.

Integration in Western Europe was initiated from the normative position of post-war French, German, Benelux and Italian policy makers that war must be avoided and that this could be by increasing economic cooperation among European countries. Inside the European Community as well, Germany could be managed (rather than balanced, as in more traditional diplomatic perspectives) and integrated by promoting

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the joint project of European-wide growth.\textsuperscript{3} The acceptance of security dependence within NATO was one of the essential compromises on which European cooperation and integration was built — a fact that makes it vital to examine the relationships between economics and security issues in other parts of the world.\textsuperscript{4} This set of conditions constituted the benchmark from which the aspects of integration theory emerged. Between the end of the war and 1950, British and Scandinavian leaders tended to present “Functionalist” views, favoring the coordinated provision of material needs among states, whereas continental Europeans tended to be “Federalists” advocating the establishment of a supranational state.\textsuperscript{5} European integration emerged from a practical impetus. The initial basis for European cooperation was the multilateral distribution of Marshall Plan aid funds between 1948 and 1951. While there was no formula or set criteria for distributing the aid, the Marshall Plan of March 1947 was conditional upon its European recipients cooperating closely in distributing the aid and agreeing to concerted policies for economic reconstruction among them.\textsuperscript{6}

Over half of the capital allocation of US aid was in economic sectors where the United States enjoyed a comparative advantage. The bulk of US aid was in the “4 F’s”: Food, Feed, Fuel and Fertilizer.\textsuperscript{7} While bureaucrats from western European countries first organised around the distribution of aid funds, European cooperation

\textsuperscript{3} Ibid.pp-236
\textsuperscript{6} Ibid pp-276

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was spurred toward the establishment of region-wide institutions to maintain communication links among government officials and to oversee inter-regional trade partly to reduce economic dependence on US aid. The institutionalisation of integrative processes was partly in response to perceived US corporate influence under the guise of Marshall Plan aid in the domestic economies of European countries. 8

Rather than trying to achieve unity among states in all aspects, the early strategists of European integration mapped their course in terms of the politics of different sectors. In 1950 the Schuman Plan to unify Europe’s coal and steel markets laid the foundations of Franco-German reconciliation which later developed into close cooperation and thus provided the cornerstone and main driving force of regional integration. 9 The coal and steel industries were of central importance to European integration for both economic and defense reasons. 10 Formal transnational economic cooperation developed from this narrow functional base. The 1951 Treaty of Paris established the European Coal and Steel Community (ECSC) to serve as a supranational authority over the production of coal and steel. A regional institution such as the ECSC, once it was formed sparked a qualitatively different and potentially self-sustaining process of spillover. 11

The Treaty of Rome followed in 1958 with the creation of a Customs Union in the form of the European Economic Community (EEC) and the European Atomic

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10 Holland Martin. European Integration From Community To Union, Pinter Publishers, London, 1993.,p-242
11 Ibid, p-256
Energy Community (EURATOM). European integration was founded on these three communities. The EEC was a culmination and extension of the Basic ECSC bargains crafted by Jean Monnet and Robert Schuman.\textsuperscript{12} The EEC was by far the most important and far reaching of the three communities. The European Economic Community provided a measure of assurance for a definite direction in economic development and thereby constituted a risk-reducing element in the calculations of firms considering border-crossing collaboration. The treaties of the Paris and Rome were also constitutional documents which created central decision-making institutions — the European Commission, the Council of Ministers, the European Parliament and the European Court of Justice — thereby formalizing the economic and political integration process in Western Europe.

At the time of the creation of the European Common Market in 1957, "integration" was used with at least four different meanings: political unification, economic unification, economic and political cooperation, and more free trade.\textsuperscript{13} The golden years of Western European integration, from 1958 to 1965, coincided with a period of continuing economic growth, with North America and Western Europe — the North Atlantic Area — the focus of the world economy, and the OEEC (Organization for European Economic Cooperation set up to coordinate Marshall Plan assistance) was transformed into a body closely paralleling NATO, the OECD (Organization for Economic Cooperation and Development).

\textsuperscript{12} Ibid.

The early success of the Community, in what retrospectively seems a rather special environmental condition, tended to produce illusions of inevitability among academics, and delusions of grandeur among Eurocrats. The Rome treaties, as Kitzinger observes, were drafted in some haste to exploit the political constellation of 1955–57, when Guy Mollet was the French Prime Minister, and before Konrad Adenauer [the Federal Republic of Germany’s first chancellor, 1949–1963] had to face his electorate in the autumn of 1957, and while the economies of Europe were experiencing a boom.14

During the 1960s and 1970s various shocks from inside and outside the region set back the process of political integration. Also, violent conflicts between states took place within regions where integration schemes were in effect — notably, in Central America and East Africa in 1969 and 1972 respectively.15 The European Community which emerged in the 1970s was characterised much more by intergovernmental bargaining, by intermittent summits which developed into regular European Councils, comprised of heads of state and government, by carefully crafted compromises rather than grand designs.16 The apparent dissipation of an incremental political process toward some perceived goal, albeit temporary, left integration theorists frustrated. Theorists were most disappointed with the inability of regional integration theory to include external factors in a model that was presumed to be explaining an exclusionary process. More recently, however, external events have contributed to European

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integration. In Europe, competitiveness on the global market remained the main issue, and now it appeared regional integration was, after all, the prerequisite. Sandholtz and Zysman propose that changes in the international structure triggered elite bargains between European Community institutions, national governments and leaders of major companies: The trigger has been a real shift in the distribution of economic power resources, America's economic decline relative to Japan's ascent. The success of the Japanese in gaining the leading edge in certain chip technologies in the 1980s was a major factor behind the decision of the major European IT (information technology) firms to push governments to create the Single Market and a European High Technology Policy in the 1980s.\textsuperscript{17}

The acceleration of EU integration through the European Single Market Program was in many ways a response to the perceived relative economic decline of Europe in the world economy since the 1970s. Nowhere has European concern been greater than in the area of high technology, where competition from American and Japanese corporations became intense over the past decade.

The saliency of external conditions as an impetus for European integration reappeared in the 1980s. This time, greater attention to the impact of transnational corporate alliances and FDI in the policy process was crucial to understanding the way in which policy in Europe has evolved.\textsuperscript{18}


Economic and Monetary Union

The concept of a United States of Europe has a long history. Down through the centuries, attempts have been made to unite the mosaic of European nations either through military might or though intellectual persuasion. Intellectuals continued to propagate the idea of European collaboration, though without much political support. Its immediate ancestry can be traced back to the First World War when Friedich Neumann advocated the creation of a common market and stressed the importance of the development of economic relationships between countries as a driving force for economic and then political integration. After the First World War the ideas on European Union were swamped by the tidal wave of nationalism and the idea of the nation-state which reigned supreme in the period 1914-1945. But after two wars, these ideas became relevant and fashionable again. The roots of a European single currency and monetary union can be traced back to the start of the common market in 1958.

Since the establishment of the European Economic Community (EEC) in 1957, attempt at monetary integration and, ultimately Monetary Union, have tended to assume importance only as a result of financial crisis and becoming a vague objective as soon as the crisis recedes. In recent years, however, this search has assumed greater urgency for three main reasons. First, monetary union can be viewed as a response by European policy makers to the increases of intra-European trade which has meant that different currencies and fluctuating exchange rates have become an increasing nuisance. Since the successful implementation of the Single Market Programme this

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19 Kevin McCauley and Malcolm Sawyer, From Common Market to EMU: a Historical Perspective of European Economic and Monetary Integration, 1998, p.34

has become more evident. Second, politically, there was a continual search for increased stability and security in Europe, which crucially hinged on anchoring Germany within Europe. And third, many economic interest groups perceived a single unified and integrated European economy as serving their interests.²¹

The drive for a single currency under the banner of Economic and Monetary Union (EMU) has been a recurring ambition of the European Union since the late 1960's, creating an environment of currency stability leading to promotion of trade and investment in a low inflation and interest rate zone, and also to the further integration of Europe. EMU will have a considerable impact upon both the politics and the economics of all of the European Union (EU) and other European nations, irrespective of when or whether they participate in this first wave. EMU is largely driven by the expectation of a number of economic benefits, including lower transaction costs, reduced exchange risk, greater competition, and a broadening and deepening of European financial markets.

The first concrete proposal for a Monetary Union was presented in the Werner Report in 1970.²² The Report was intended to pave the way for the establishment of a Monetary Union in the early 1980s. However, the proposals of the Werner Report were never implemented - being overtaken by world events. After the break-up of the Bretton Woods system and the shock of the first oil crisis in 1973, most western European economies were contaminated by the economic sickness popularly labelled "Eurosclerosis", characterised by high inflation and persisting unemployment. At that


time, the European economies were protected by regulations and financial markets were still poorly developed. In this environment, it was concluded that a Monetary Union would not be possible and the project was postponed.

The idea of establishing Monetary Union was revived only in 1988 and a detailed proposal was presented the following year in the Delors Report, after the launch (in 1985) of the Single Market programme on the free movement of goods, services, capital and labour. Because of the single market, the Report could be more explicit and credible with regard to how best to achieve closer economic ties between the EU economies before the introduction of a single currency. Moreover, the Report was supported by a detailed description of an institutional set-up geared towards ensuring stability-oriented economic policies.

Notwithstanding the thorough work invested in the Delors Report, almost 10 years of convergence and technical preparations were required in order to ensure the successful implementation of the euro on 1 January 1999. The euro coins and banknotes were introduced only in 2002 - 13 years after the presentation of the Delors Report and 32 years after the presentation of the Werner Report. In the proceeding pages of this chapter we will analyse the efforts made to establish an economic and monetary union through the history of European integration process. But special attention is paid to the period 1980s and 1990s, considered as New Regionalism phase.

Economic Union

Economic Union, on the other hand, has followed a smoother transition path. Economic integration was used after the Second World War to realise political goals,

chiefly to anchor West Germany within a Western European alliance. Under this scheme common governance was deemed to be the best structure; other structures such as intergovernmental cooperation were not perceived to be as effective. The European Coal and Steel Community (ECSC), in 1951, was the first attempt at creating such a governance structure, which was described by Jean Monnet, the ECSC’s architect, as the ‘first concrete foundation of a federation which is indispensable to the preservation of peace’.24 The ECSC treaty which set up a custom union for coal and steel materials was followed by the European Economic Community (EEC 1958), the Single European Act (SEA 1987) and the Treaty on European Union (TEU 1993), each new treaty either extending the scope of the community or refocusing its objectives.

The ECSC was unique in that it was the first time that institutional structures were established which had supranational powers. The Paris Treaty established an institutional structure for administering, controlling and supervising the tasks defined in the Treaty. There were four main institutions: the High Authority, the Council of Ministers, the Common Assembly and the Court of Justice. In addition a Consultative Committee was established, composed of representatives of producers, consumers and workers. It had the right to be consulted by the Higher Authority in most matters.

The ECSC was a limited exercise in economic integration involving only two, albeit important, sectors. A free trade area was created in coal and steel, tariffs and quotas were removed. At this stage, European monetary integration did not appear to be on the agenda, and this was for two main reasons. First, the Bretton Woods

exchange rate system was functioning with stable exchange rates which were not under pressure during the 1950s. Second, many of the European economies which were at the centre of the ECSC were performing in a similar manner in terms of economic growth and inflation.

Even though the ECSC was established under an economic pretext, there was, nonetheless, a clear political agenda as stated in the preamble to the Treaty:

_to substitute for their historical rivalries a fusion of essential interests_.
_to establish by creating an economic community the foundations of a broad and independent community among people long divided by conflicts; and to lay the basis of institutions capable of giving direction to their future common destiny._

The Treaty of Rome in 1957 lead to the creation of two more communities, the European Atomic Energy Community (Euratom) and the European Economic Community (EEC). The Treaty of Rome was less explicit about macroeconomic policy and monetary policy. Monetary policy was seen as an objective insofar as it facilitated the proper functioning of the common market. However, the Treaty of Rome did detail some general economic and monetary objectives: equilibrium in overall balance of payments, maintenance of confidence in currency, a high level of employment and stable prices. The EEC had a much broader agenda, the creation of a common market in all economic sectors through competition without distortion. It is to the EEC that we now turn.

25 Palmer and Lambert, 1968, pp. 167-8
26 Ibid (Article 104) pp185.
European Economic Community

In addition to the swath of articles of the Treaty of Rome establishing a customs union, Article 4 of the treaty created four main institutions to oversee the EEC. The institutional pattern of the ECSC was copied in the EEC. Article 104 of the Treaty of Rome gives the Council the power to coordinate the economic policies of member states. Council of Economic and Finance Ministers (ECOFIN) is one such session of the Council of Ministers, it usually meets monthly to discuss the macroeconomic situation in member states, to co-ordinate the Union’s position in international financial institutions and to adopt legislation in respect of tax harmonization, financial liberalization and the financing of the Union.

The Assembly, established by the Treaty of Rome, became known as the European Parliament in 1962. Its members were originally nominated by the parliament of the six member states, but they were not bound by instruction from national parliaments or governments. The EEC Treaty defines the Assembly’s powers as ‘advisory and supervisory’. Relating to its advisory power is the right to be consulted on budgetary matters, and to recommend action or policies on its own initiative. With its supervisory functions comes the ability to censure the executive and force it to resign, to put questions to members of the executive and Council, and to discuss the executive’s annual report. In 1979 members were directly elected to the European Parliament for the first time.

The EEC was based on the creation of a common market which was achieved through specific measures outlined in Article 3 of the treaty: the elimination of custom duties and of quantitative restrictions on intra-EEC trade; the establishment of a
common external tariff and of a commercial policy toward third countries; the free
movement for goods, services, persons, and capital; common policies in agriculture
and transport; the introduction of procedures to allow the co-ordination of economic
policies, and the rectification of disequilibria in the balance of payments; the
establishment of a system to ensure undistorted competition in the common market;
the approximation of laws to enable the proper functioning of the common market,
and the creation of the European Structural Fund (ESF) and European Investment
Bank (EIB) to improve employment opportunities, support economic expansion and
raise the standard of living. As mentioned above, there were important exceptions,
agriculture and transport where areas with a high degree of government intervention
and it would not have been practical to remove the barriers; instead a common policy
was adopted.

And in order to attain these objectives, three instruments were specified. First,
the coordination of economic policy through government and central bank
collaboration. In this respect, the Monetary Committee was enjoined with ensuring
that member countries complied with this objective. Second, the stabilisation of
exchange rates (Article 107). And third, member states had recourse to limited credits
and to other unspecified mutual assistance in event of balance of payment problems.

Despite these declared aspirations there were no specific provisions made in
the treaty regarding co-ordination in the macroeconomic field. Article 2 refers to the
‘harmonious development of economic activities’ and to ‘a continuous and balanced

28 Ibid, p-13
expansion’ but there were not sufficient instruments created to realise these objectives. Regarding the lack of precise instruments for macroeconomic co-ordination, several explanations can be offered. First, Keynesian ideas still held sway and governments wished to retain direct control over fiscal and monetary policies. Second, greater capital mobility across national boundaries would undermine the effectiveness of national monetary instruments. Thirdly, the governments did not wish to push too far in case the whole enterprise was placed in jeopardy.29 In addition, exchange rate stability and a basic framework for policy co-ordination were provided externally by the Bretton Woods system. Elsewhere the Preamble to the Treaty of Rome mention is made of narrowing the differentials between regions, but it was not until 1972 that the European Regional Development Fund was founded. Twelve years was set as the target for creating a customs union with the possibility of an extension to 15 years. In the event, all tariffs for EC internal trade were eliminated on 1 July 1968, one and a half year before the target date, and at the same time, the common external tariff came into force.

Monetary Union; early attempts of EMU

In 1959 and again in 1961 pronouncements by Monnet’s Action Committee for the United States of Europe called for monetary integration. In response to a persistent balance of payments surplus with the rest of the world among the EEC members, the need to co-ordinate exchange rate management and international monetary policy was felt. In 1962 the EEC commission in ‘The Action Programme of the Community for the Second Stage’ proposed an adjustable peg exchange rate system and a reserve

currency established by the end of the decade. Yet these calls went unheeded because exchange rate stability and a framework for macroeconomic policy coordination were provided externally by the Bretton Woods system. That remained the case until the collapse of the international system of fixed exchange rates eventually propelled the community toward monetary integration.

Europe's position vis-à-vis the outside world and related loss of control over monetary affairs for internal stabilization purposes which originated the major impetus. Both internal and external factors were important: Economic and Monetary Union (EMU) was born as a result of a convergence of widely different interests, ranging from a German need for 'Westpolitik', to a concern about the customs union and Common Agricultural Policy (CAP), the CAP price system was threatened by the exchange rate fluctuations; from the safeguarding of fixed exchange rates to the protection of the community from British entry and the possibility of its dilution into a free trade area, and the need to adopt a common policy vis-à-vis the United States.

The speedy implementation of the customs' union coupled with the erosion of the stability of the dollar-centred Bretton Woods system fractured the external exchange rate stability of the EC resulted in calls for monetary union to protect the EC from break-up. The increased monetary instability of the 1960s lead to the Barré Report in 1969, the Commission proposed that to counter currency instability, macroeconomic co-ordination should be improved, and that fluctuation margins around the currencies of the six should be eliminated on the first step towards fusing

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31 Tsoukalis, 1977, p. 169
them into a single currency. In this respect, an early landmark was the decision of the EEC heads of states and governments, at *The Hague summit of December 1969*, to proceed gradually to EMU, a decision which made monetary integration an explicit Community objective. The goal of a single currency was agreed by ECOFIN in February 1970 but differences in opinion among members meant that precise details were not agreed. Instead a special study group under Pierre Werner was established to review EMU in greater detail and to propose a concrete plan for moving ahead. *The Werner Report 1971* advocated the movement toward economic and monetary union by 1980. Like the Delors Report which it preceded, it proposed an EMU in three stages. There was a clear view of what monetary union entails:

"A monetary union implies inside its boundaries the total and irreversible convertibility of currencies, the elimination of margins of fluctuation in exchange rates, the irrevocable fixing of parity rates and the complete liberation of movements of capital . . . monetary union . . . may be accompanied by the maintenance of national monetary symbols or the establishment of a sole Community currency. From the technical point of view the choice between these two solutions may seem immaterial, but considerations of a psychological and political nature militate in favour of the adoption of a sole currency which would confirm the irreversibility of the venture."

The *first stage*, which was intended to last from 1971 to 1973, was directed at getting economic underpinning right and preparing the ground for any institutional development in order to facilitate coordinated policy-making. The second stage consolidated economic and institutional progress of the previous stage. At this stage exchange rate changes could only be made with the explicit agreement of members. The first two stages would see increased policy co-ordination leading to convergence,

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33 *Werner Report, 1970*, p. 5
a common policy on government budgeting, and a progressive narrowing of currency fluctuation bands. Institutional tinkering would, however, be kept to a minimum, although the European Monetary Cooperation Fund (EMCF) would be created in stage 2 to manage a proportion of the member states reserves and to provide short- and medium-term finance for intervention. The EMCF was responsible to the Committee of Central Bank Governors, which itself was charged with co-ordinating monetary and exchange rate policy. ECOFIN would meet more regularly to co-ordinate macroeconomic policy. Co-ordination entailed the prescribing of medium-term objectives and of annual programmes which were to be based on multilateral surveillance. And in stage 3 exchange rates would be irrevocably fixed and a community central bank would be created to centralise monetary policy.

In March 1971 the ECOFIN Council agreed on EMU, although only stage 1 was elaborated. Mechanisms for closer co-operation among central banks were agreed. An ‘opt-out’ clause was included if agreement on the second and more substantive stage of EMU was not reached by January 1976, then monetary co-operation measures should be abandoned. The notion of irrevocably locking exchange rates together without any margin of fluctuation, as suggested in the Werner report, was abandoned in favour of a mechanism to reduce the margin of fluctuation around the central parities when one EEC currency was exchanged for another. Intra-EEC exchanges were confined to a narrower band of fluctuation than was permitted in respect of EEC currencies against the dollar. This attempt to limit intra-European exchange rates would serve to advance the objective of EMU by promoting trade in goods and
services and capital flows within Europe. In addition it would help to reduce the cost of servicing the CAP, the Community’s agricultural support system.34

The emerging economic conditions of the early 1970s were impropitious to establishing EMU. Faced with rising unemployment and slow economic growth, the USA pursued an easy monetary policy which was the converse of that desired by the authorities in European countries. The tensions created by these divergent policies eventually lead to a series of speculative attacks against the dollar.

Progress toward EMU was persistently hampered: first, the shocks to the international monetary system that followed the dollar crisis in 1971-73, and the first oil crisis and inflationary push of 1973; and, second, conflicting national objectives and unwillingness to surrender national sovereignty in pursuit of a Community objective. With the collapse of the Bretton Woods system and the floating dollar, the process of EMU ground to a halt. When the Commission eventually came round to consider proceeding to stage 2, no agreement could be reached at the ECOFIN Council and EMU was abandoned in December 1974.

Dissenting voices had argued against speedy monetary union. The Marjolin Report (1975) argued that monetary union should be postponed until after the achievement of a high degree of economic integration in the EC. It advocated that a single unified market would provide a sound basis from which to launch monetary union. From another standpoint, the MacDougall Report (1977) stressed the role of a

34 Klein, 1988, p. 5
unified fiscal system in a monetary union and concluded that a monetary union would not be viable without a sufficiently large community budget for fiscal policy.\textsuperscript{35}

The EMU project did have concrete achievements and it would serve as a blueprint for those proposing EMU in the future. Foremost among these achievements were the strengthened co-operation among central banks with the creation of the EMCF and the agreement on the attainment of a high level of convergence of the economic policies of member states. It highlighted the economic and political difficulties associated with such moves towards EMU. It also demonstrated that a sustained record of stable currency management was an indispensable precondition for any serious attempt to adopt a single currency, vague commitments without a firm timetable fixed in advance were no good, no lasting progress towards EMU could be achieved without appropriate institution reforms guaranteeing a transfer of responsibility in the macroeconomic field from nation to European level.

\textbf{The European Monetary System; as a step stone to EMU}

In 1977 Roy Jenkins, President of the Commission, reactivated plans for establishing a monetary union. Support for his plan was provided by a Franco-German alliance without which it would have been a non-starter.\textsuperscript{36} In July 1978, the heads of state of the member countries, the original six plus three new entrants (UK, Ireland and Denmark), met to discuss closer monetary co-operation. The European Council adopted a resolution establishing the European Monetary System (EMS) later that year. A new attempt at establishing monetary stability was launched in March 1979

\textsuperscript{35} Fratianni and von Hagen, 1992, p. 13

\textsuperscript{36} Pinder, 1996, p. 130.
with the EMS. The second stage, the creation of the European Monetary Fund to replace the EMCF was planned for two years later; however, the deteriorating economic climate put this move on hold.

The EMS was established to pursue three main policy objectives: the creation of a 'zone of monetary stability' involving both low inflation and stable exchange rates; the provision of a framework for improved economic policy co-operation between member states; and the easing of world monetary instability through the adoption of common policies in relation to third countries.\textsuperscript{37} Finally, it was hoped that the EMS would lead to economic and monetary convergence, and ultimately a stepping stone to economic and monetary union. It introduced innovations to overcome problems that had lead to the collapse of the earlier attempts.

To realise these objectives the EMS provides a tool called the Exchange Rate Mechanism (ERM) which consisted of four components: European Currency Unit (ECU), the Parity Grid, the Divergence Indicator, and Credit Financing.

When in 1986 the EU amended the Treaty of Rome with the Single European Act, the end of 1992 was set as a target date for the removal of all remaining barriers to the free flow of goods, services and resources. A greater degree of macroeconomic co-ordination among member states was now required. As a consequence of which, the EMS was strengthened because of the desire to achieve greater convergence in economic policies, the \textit{Basle/Nyborg agreement} was reached in 1987.\textsuperscript{38} This introduces a series of measures aimed at promoting the co-ordination of economic

\textsuperscript{37} European Commission, 1989, p. 2
\textsuperscript{38} ibid
policies through the surveillance of economic indicators and the refinement of the EMS intervention mechanism to counter speculation after capital liberalisation.

Until 1992, it appeared that the EMS was an unqualified success; however, the system had not weathered a crisis. There was a suspicion that a large aggregate demand shock would unsettle the whole system, and in 1992 the system was about to be tested. Germany was grappling with the cost of financing the restructuring of East Germany, and had historically high interest rates to curb inflationary pressure. Tight monetary policy in Germany acted as a trigger for the ERM crisis.

Faced with the strain of keeping their currencies within their respective bands, the UK and Italy were forced to abandon the ERM. This was followed by six other devaluations: the Peseta in September 1992; the Escudo and Peseta in May 1993; the Punt in January 1993, and again the Peseta and Escudo in May 1993. France remained within the ERM only after heavy intervention in the foreign currency market by the Bundesbank and the Bank of France. Pressure was eased in the spring of 1993 when the Bundesbank made three interest rate reductions. Respite was only temporary and when the Bundesbank failed to lower the interest rate in August 1993 as was expected, it started a run on the Franc and the currencies of Denmark, Spain, Portugal and Belgium.

In summary, the attempt to create a monetary union, EMS and direct elections to the European parliament could be pointed to as the defining moments of the period.39 The EMS seemed to have succeeded in promoting convergence in inflation

rates, interest rates, budget deficits and government debt as percentage of GDP from 1987 to 1992.

The Single Market and the SEA; taking ahead economic union

In the early 1980s, recession had hit the European economies hard, with it came the winds of change bringing a new ideology to Western Europe. The tenets of this ideology were deregulation and neo-liberal theory. In USA, President Reagan and in Britain, Prime Minister Thatcher were applying these doctrines in the belief that they would restrain inflation and reinvigorate the economy. Interest in the completion of the single market among the new ideologues was inspired by the notion that liberalisation of the markets would improve efficiency and promote growth. The neo-liberal politicians were not alone in this respect; business leaders were also supportive of a single market, though they doubted the Commissions ability to deliver one.

Despite the doubts, the Commission played a key role in promoting the single market as evidenced by the encouragement it gave to technological collaboration in the Community. High technology was an area that would clearly benefit from the single market, yet it was in these areas where no common market existed. Apart from the fiscal, physical and technical barriers preventing cross-border trade, national public procurement practices was another problem with which the high technology industry had to contend. Governments would direct purchases towards national companies. Financial support to national companies was also provided in the form of state aid. Considerable headway was made in addressing the issue of competitiveness when leading firms in the electronics industry launched the European.

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40 Vic Kerman, 1992, p. 130
Strategy Programme for Research and Development in Information Technology (ESPRIT) in order to promote closer intra-European R&D and to end the fragmentation of the single market. This approach provided the template for other similar schemes and lead to a proliferation of joint R&D programmes. Moreover, the ESPRIT programme demonstrated that the Commission could be a constructive partner and an agent for economic revival. It also helped to cast aside persistent doubt on the Commission’s capability to deliver a single market.

Europe’s loss of competitiveness and the subsequent loss in jobs and rise in unemployment were linked, in part, to the fragmentation of the European market due to the existence of non-tariff barriers. Despite tariff elimination the single market was still fragmented by non-tariff barriers. The White Paper, the Cockfield Report of June 1985 was a supply oriented ‘Programme for the completing of the Internal Market’. It tackled the issues involved in dismantling non-tariff barriers and creating a genuine and homogenous frontier-free internal market by 1992. The 1992 Programme was widely accepted and seen as a panacea for European problems and an added boost to integration. The main aspects off the programme were the removal of non-tariff barriers for internal trade, increased competition, and promotion of cooperation among firms in R&D, unification of factor markets through liberalisation of factor mobility, monetary integration and social protection.

On its own the White Paper was not sufficient to guarantee the completion of the single market; it would undoubtedly have become bogged down in procedural wrangling in the Council of Ministers. The Single Market Programme highlighted the

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41 Tsoukalis, 1997, p. 36
42 Jovanovich, 1997, p. 16
need for institutional and constitutional reform of the Community as did the assertiveness of the newly elected European Parliament and the accession of Spain and Portugal.\(^{43}\) This provided the required impetus for reform resulting in the Intergovernmental Conference that led to the Single European Act. Another force for change which placed institutional reform on the agenda was the Dooge Report which identified ‘priority objectives’ to realise European Union. These were a homogeneous internal economic area, restrictions on the use of unanimity in the Council of Ministers, enhanced legislative role for the European Parliament and greater executive power for the Commission.\(^{44}\)

The SEA advocated the adoption of measures which would bring about an integrated internal market ensuring the free movement of goods, services and resources by December 1992 and recognised that the smooth implementation of the 1992 Programme required a change in the decision-making process of the EC. The subsequent reform of the Treaty of Rome by the Single European Act (1 July 1987) helped speed up the 1992 programme. The SEA extended the use of majority voting to most areas except for fiscal matters, rights of employees and free movement of people, thereby sweeping aside the Luxembourg Compromise.\(^{45}\) This seemed to shift the balance of power to the EC from the national governments: the Council of Ministers got new powers to act on a qualified majority basis after consultation with the European Parliament and the Economic and Social Committee; the Commission


\(^{44}\) Dinan, 1994, p. 142

gained in importance as it had to prepare proposals for the Council of Ministers to realize the 1992 Programme; and the European Council was formalised. The Single European Act was the community’s response to demands for institutional reform and was the first major amendment to the Treaty of Rome. It gave formal recognition to the European Council and formalised procedures known as European Political Cooperation.\(^{46}\) The Single Market Programme was initially realized quickly but got bogged down in legislation field not only was the problem in the detail, but over the Community’s budget. To fulfill expansion in budget expenditure created by the Cohesion Fund, the Commission arrived at a 5 year budget plan in 1988.

But, the Single European Act was more than a simple device to achieve a Single Market: ‘The 1992 goal was clearly intended as completion, but new policies had been substantively embraced and institutions had been strengthened, this deepening was in hand, and widening had occurred for a third time without momentum being lost’. At the end of 1995, the Commission estimated that 93.2% of SEA directives had been implemented by member states. However, in important areas such as public procurement the figure remained below that level.\(^{47}\)

The SEA focuses on economic integration and does not explicitly mention EMU except through the need to converge economic and monetary policies ‘for further development of the community’. To this end the Delors Committee was set up to examine ways of achieving EMU. The EMS was established primarily to create monetary stability, but it should also be seen as an attempt to move the Community

\(^{46}\) Ibid

\(^{47}\) Bean, Charles R., "Economic and Monetary Union in Europe," Journal of Economic Perspectives, Vol. 6, No. 4, Fall 1992. 31-52,
towards the goal of a monetary union. Therefore the SEA should be seen as the economic complement to the EMS and both could be described as stepping stones to monetary union.

**The Delors Report; agenda for EMU**

When Jacques Delors took up his position as President of the Commission in 1985, he had a number of priorities: a single market, institutional reform, new monetary initiative and extending Community’s competence in the field of foreign policy and defence\(^48\). Delors would have preferred to concentrate on EMU but realised that monetary policy lay too close to the core of national sovereignty. If he chooses to follow such a politically sensitive strategy, then it would have provoked hostility from national governments and created tensions within the community. Instead he sought a shared problem where consensus could be reached on achieving a solution. At the time a common shared problem was recession hit economies, Europe had experienced the worst recession since the war. European industry was losing its competitiveness against American firms in new technologies and newly industrialized countries in old ones.

There was an common agreed solution, the completion of the Single market, the establishment of a common market had stimulated the economies of the original six, non-tariff barriers had since fragmented the single market, the completion of the single market would do similarly now. Delors recognized quite quickly that the single market was the obvious option. It was simply reaffirming an objective that had been

agreed by the heads of states under the Treaty of Rome. Moreover, successful implementation of the Single Market could be a mechanism for improving decision-making and renewing interest in EMU. The momentum created by the Single Market Programme and the success of the EMS in achieving monetary stability did focus attention back onto EMU. And at the European Summit in Hanover on June 1988, the heads of government agreed to establish a committee with ‘the task of studying and proposing concrete stages leading towards this union’. The committee delivered its findings in the Delors Report, the following year, at the Madrid Summit.

The report identified four key elements to achieve economic union. First, the creation of a single market; second, competition policy to strengthen the market mechanism; third, macroeconomic policy coordination coupled with binding rules for budget deficits; and, fourth, common policies to strengthen structural change and regional change.

Economic union would not require a single economic policy. By contrast monetary union would necessitate a common monetary policy to be controlled by a central institution, though a single currency was not mandatory. Prerequisites for monetary union were identified as the total and irreversible convertibility of currencies, the complete liberalization of capital transactions, elimination of margins of fluctuation and the irrevocable fixing of exchange rate parities. The central institution overseeing the Community’s monetary policy was a European System of Central Bank (ESCB) based on federal lines, which would formulate and implement

49 Brewer, L. Thomas and others (ed). Globalising Europe: Deepening Integration Alliances, Capitalism And Structural Statecraft, Edward Elgar, USA,2002pp-157
policy. Its primary objective would be price stability while it would maintain total independence from member states.

The report recommended a transition towards full monetary union in three stages. To insure momentum the transition would be a single process. The first stage defined as an initiation process towards EMU, advocated the convergence of economic performance and cooperation in monetary and fiscal polices. The common market to be completed by the removal of all restrictions to intra-community capital movements, in principle all countries should enter the Exchange Rate Mechanism (ERM) at the narrow band and measures to encourage convergence of key macroeconomic indicators. It also addressed the issue of non-participating states in the ERM. An Intergovernmental Conference would be convened at a later date to determine treaty revisions that would be needed in subsequent stages. This stage would see the expansion of the role of the Committee of Central Bank Governors in coordinating policy. The organisation and the remit of the committee would be redefined and an economic unit was added. The committee chairman was permitted to attend ECOFIN meetings; otherwise the institutional structure was sufficient to fulfill the requirements of the first stage.

The second stage was a transition period where consolidation of procedures established in stage one would take place and an institutional framework created. Policy would still remain in the hands of national government, though policy guidelines would be mandated by majority voting. A framework would be established for key economic objectives with a monitoring function, for setting non-binding rules on the size of annual budget deficits and for the EC to behave as a bloc in matters.
relating to economic and exchange rate. A European System of Central Banks (ESCB) which would coordinate the independent monetary policies of member states. The ESCB would also seek to achieve harmonisation of supervisory and regulatory functions.

The third and final stage would begin with the irrevocable fixing of participating states’ exchange rates whilst national central banks would relinquish control of the domestic money supply to the EC institutions. Eventually national currencies would be replaced by a single currency. Other key developments were that macroeconomic and budgetary rules and procedures would become binding, structural and regional policies would be strengthened. The ESCB would pursue a single monetary policy that would entail engaging in foreign exchange market interventions and union-wide open market operations, formulation and implementation of monetary policy, and the technical preparation necessary for a single currency.

The first stage was adopted unanimously by the European Council at the Madrid Summit in June 1989 and began on 1 July 1990, timed to coincide with the liberalisation of capital movements as part of the Single Market Programme. After agreement at Maastricht on a new treaty to delegate responsibility for monetary policy to a new common institute, the second stage began on the 1 January 1994.

The European Monetary Institute (EMI) was created to assume a coordinating role. The EMI was set up as a precursor to the ECB - the central institution of stage III. The EMI’s role is to strengthen cooperation between central banks and the coordination of monetary policies of member states, to monitor the functioning of the

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EMS, to take over the tasks of the EMCF and to facilitate the use of the ECU and oversee its development. In addition it has the general responsibility to make preparations for stage III of EMU. In so doing it should draw up recommendations on the overall orientation of monetary policy and exchange rate policy, policies which might affect the internal or external monetary situation and to members concerning the conduct of their monetary policy. The Monetary Committee assists in monitoring economic convergence at stage II and becomes the Economic and Financial Committee at the beginning of stage III. Member countries (except Denmark and the UK) were required to take measures to make their central banks independent.

The third stage, the completion of full monetary union by either 1997, if a majority of the countries meet convergence criteria, or 1999 even if only a minority of countries meet the criteria, would see the Maastricht Treaty and the creation of the European Monetary Institute (EMI) which was the forerunner of the European Central Bank (ECB) by 1994. And finally, in May 1998 the European Council was to meet to announce which countries met the necessary conditions for the adoption of a single currency. The third and final stage of EMU would begin on 1 January 1999. It would see participating states adopt 'irrevocably fixed' exchange rate, the Euro would be substituted for national currencies, and the ECB would become the sole issuing authority for Euro notes. In addition the creation of the ESCB composed of ECB and national central banks, to replace the EMI.

Maastricht and Beyond

The period leading up to the Intergovernmental Conference on EMU was one of cheerful optimism, the Single Market was nearing completion, and European
economies were buoyant. The Rome Summit in December 1990 launched a year long process of intensive bargaining. And eventually at Maastricht the Treaty on European Union was signed in December 1991, establishing a union which consisted of three pillars: the Treaty of Rome, the Common Foreign and Security Policy, and cooperation on Justice and Home affairs. In addition majority voting on implementing decisions and unanimous on principle were accepted. The Maastricht Treaty was a political compromise where each country gave some ground in order to gain some movement on an objective. In a nutshell the Maastricht Treaty can be shown to reflect this compromise. The single currency and defence and foreign policy arrangements satisfied France's ambitions, the increase in the power of the European Parliament and the direction of the money policy was German inspired. The cohesion fund and the Social Chapter were included to satisfy Spain and the Netherlands respectively. Britain secured two opt-outs, one from the social chapter and one for the single currency. Maastricht was also a compromise in other respects; for those who wished to set a ceiling on integration by emphasising subsidiarity and intergovernmentalism and those who wished to strengthen European Union.

At Maastricht, greater detail was added to the process towards economic and monetary union, which was seen as a means to 'promote economic and social progress which is balanced and sustainable'. The Maastricht Treaty added to the Treaty of Rome and setup a number of new institutions as well as specifying the stages by which EMU was to be achieved. EMU was not seen as a means in itself rather as a means of securing 'economic and social progress' (Article B TEU) and 'price stability' (Article

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51 Jovanovich, 1997, p. 16
52 Wallace, 1994, p. 64
3a EEC). The underlying argument behind this assumes that the efficiencies and benefits from a single market (economic union) will only be maximized when the costs and risks of currency exchange are eliminated (monetary union).

The Maastricht Treaty adopted the Delors three stage plan with some important revisions. At stage II, the EMI would replace the CCBG and inherit the duties of EMCF. Agreement was reached to set strict criteria which would have to be met before a nation had to join the final stage of monetary union.

**Convergence Criteria for Participation in EMU.**

**Price stability.** The average rate of consumer price inflation over the previous 12 months must not exceed by more than 1.5 percentage points that of, at most, the three best performing member states and this performance should be sustainable.

**Public finance.** The financial position of the member country's government must be sustainable, as evidenced by the country not being subject to an excessive deficit. In particular, (I) the general government deficit should not exceed the treaty's reference value of 3 percent of GDP, or it should have declined substantially and continuously and have reached a level close to the reference value, or the excess over the reference value should be temporary and exceptional; and (ii) the gross debt total of the general government should not exceed the reference value of 60 percent of GDP or, if it does, it should be sufficiently diminishing and approaching the reference value at a satisfactory pace.

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Interest rates. Long-term government bond yields averaged over the previous 12 months should not exceed by more than 2 percentage points those of, at most, the three member countries with the lowest inflation.

Exchange rates. A country should have respected the normal fluctuation margins of the ERM for at least two years without severe tensions and without devaluing its currency against any other member's currency on its own initiative.

As well as the four conditions above, there was a provision made for the European Commission and the EMI to make regular reports to the ECOFIN Council on the economic performance of the member states regarding the convergence criteria. Ecofin's responsibilities were extended by the Maastricht Treaty which gave it a supervisory role, in collaboration with EMI, of the progress towards EMU.

The European System of Central Banks (ESCB) and European Central Bank (ECB) are to assume responsibility for monetary policy in the Euro zone at the beginning of stage III. Article 105 of the Maastricht Treaty enjoins the ECB with the primary objective 'to maintain price stability... smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system'. The ECB has the general right of consultation on all legislation, European or national, in its area of competence.

The year 1992 was supposed to have been a triumph for the EC; it was to begin with steps towards ratification of the Maastricht treaty and to end with the completion of the Single Market Programme. Instead currency crises hit the EMS in 1992 and

again in 1993 seemed to have permanently derailed monetary union. And a series of events unfolded which caused set backs on the road to EMU: concern over loss of sovereignty and democratic deficit in Brussels, compounded by pending recession and EMS currency crisis, ratification problems in some countries (Danish referendum defeat of June 1992, and difficulties ratifying the Treaty on European Union in the UK) and war in the former Yugoslavia. However, this prognosis was soon to appear premature as the nations pushed for monetary union with greater vigour and the start of full monetary union was merely postponed from 1997 to 1999.\textsuperscript{55}

At the insistence of the German government, the Dublin Summit in December 1996 introduced the Stability and Growth Pact, and this Pact ensured the continuation of limits on budget deficits in member countries. This provided the detail to an otherwise vague recommendation on excessive deficits in the Maastricht Treaty. It specified limits for deficits and procedure to follow in case limits are exceeded and outlined the sanctions that the deficit country would incur if it breached the limits though it did provide automatic and discretion exemptions under certain conditions. Also at the Dublin Summit meeting, arrangements were made for ERM II, which outlined the exchange rate system for countries who had opted out of third stage or did not meet the Maastricht criteria.

In May 1998, the European Council selected the countries qualified to participate in Stage III of EMU. Their decisions were based on reports, submitted by the EMI and European Commission submitted in March 1988, assessed how each country had complied with the convergence criteria. In June 1998, the ECB replaced

\textsuperscript{55} Kenen, Peter, \textit{Economic and Monetary Union in Europe: Moving beyond Maastricht}, Cambridge University Press, 1995. pp-235
the EMI and in January 1999, it took over responsibility for monetary policy within
the Euro zone.

The Maastricht Treaty, which provides the institutional framework for the
introduction of the single currency was laid down, was signed in late 1991, which was
a time when neo-liberal ideas held sway and when political power was generally held
by the right. Neo-liberal ideas still prevail, though perhaps in some decline as
evidenced by the electoral victories of the left of centre parties in France and
Germany. But the neo-liberal agenda has moulded the environment within which the
euro was introduced. The Euro is embedded within an institutional and policy setting
which we have elsewhere described as 'new monetarism'.

France and European Integration: Economic and Monetary Union
Few would question the importance of the role played by France in the integration of
Western Europe, but there is little agreement over French motives, or over whether
those motives were the same for each decision taken to surrender sovereignty over
the entire postwar period. It is sometimes forgotten, particularly in Britain, that
the question of European integration has been a deeply divisive one in France,
cutting across political parties, the administration and sectoral interests. The treaty
of Maastricht was accepted by the most slender of majorities — 51 per cent of those
who voted in the 1992 referendum. The disagreement in explaining French policy
towards European integration stems partly from the difficulties which historians face
in gaining access to the official record, particularly under the Fifth Republic, and

56 Ibid pp-254
57 Contemporary European History, 13, 1 (2004), pp. 117—121
partly from differences in interpretation of that record. But the disagreement is also due to debates conducted mainly within the political science and international relations literature about the causes of European integration in general.

Taking the postwar period as a whole, several questions have so far dominated discussions about France. First, why, despite the success of their system of national economic planning, did the French agree to adopt the liberal framework of the European Economic Community? Second, why did they not agree to integrate defence? Third, why was it that De Gaulle, the arch-opponent of supranationalism, was responsible for the most supranational of policies, the Common Agricultural Policy? And finally, why did the French agree to Economic and Monetary Union with its restrictive Growth and Stability Pact, rather than retain the flexibility of the European Monetary System? The debate in the literature, simplified here for our purposes, is between those who argue that France's interest in European integration has been driven by the geopolitical imperative of reconciliation and coexistence with Germany and those who claim that its primary purpose was to advance France's domestic policy choices, however they were defined. Once under way integration was then extended either through a process of institutional spillover or through intergovernmental bargaining in which economic and commercial interests had priority.

Three books, all written by non-historians; contribute either directly or indirectly to this debate. Indeed, Craig Parsons sets out to extend the parameters of the debate by reviving an early interpretation of French policy towards European integration — namely the role of the pro-community ideas held by key policy-makers in France. Parsons's central claim is that not only do ideas matter in politics but also that each of the key decisions taken by French governments to surrender a degree of sovereignty, namely, the decisions to form the European Coal and Steel Community (ECSC), the European Economic Community (EEC), the Common Agricultural Policy (CAP) and Economic and Monetary Union (EMU), was taken primarily because of the pro-community ideas held by some of the policy-making elite at critical junctures. How this elite interpreted French interests was, he claims, quite removed from any definition of their objective position. To prove his thesis Parsons, unusually for a political scientist, dips into the French archives (almost entirely those in the Ministry of Foreign Affairs), draws upon a formidable range of secondary literature and conducts extensive interviews with politicians and high-ranking civil servants. What emerges is a picture of French leaders with considerable freedom to choose and implement their European strategies due to the difficulty which political parties had in elaborating coherent positions, and to the lack of information given and hence of interest in European issues shown by voters at major elections. On each occasion when the French leaders chose to surrender sovereignty (and on the occasion of the European Defence Community (EDC) when they chose not to), Parsons, displaying a mastery of the literature, examines the alternatives open
to them in considerable detail. These alternatives he classifies as a traditional defence of the institutional status quo, or broad intergovernmental co-operation.

**Economic and Monetary Union**

In analysing the two most recent extensions of integration, the Single European Act and Economic and Monetary Union, Parsons enters largely undocumented territory. Believing that 'the broad pattern of French mobilization on European issues in the 1970s followed the lines that gelled in the 1950s' (p. 156), he sets out to test his ideational theory against the competing theories based on defence of France's domestic policy choices or geopolitical concerns. As against claims that the Single European Act (SEA) was a response to earlier failures of policy to deal with growing economic interdependence, he claims that the standard response to greater interdependence would have been greater liberalisation. The reason why the French chose institution-building rather than greater liberalisation was that they had a 'pro-community leader' (Mitterrand) who stood out from his coalitional support (p. 179). Mitterrand is also credited with securing support for EMU in France. 'French pursuit of full EMU was decided personally by Mitterrand, over objections from some of his closest allies and advisors' (p. 203). This view is shared by David Howarth in *The French Road to European Monetary Union*. In a detailed analysis of the causes of the French decision to support EMU, based on interviews with French politicians and officials as well as a wide range of secondary literature, Howarth agrees that 'Mitterrand was central to the successful conclusion of a deal at Maastricht' (p. 142).

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Unlike Parsons, Howarth explains Mitterrand's motives primarily in geopolitical terms. The French president hoped through monetary union to increase France's power in relation to both Germany and the United States. In the words of Dyson and Featherstone, 'EMU was about rebalancing international and European monetary power in France's favour'.

On the question of whether in fact EMU would not help France to achieve such an objective, economic theory nor was the advice of the French financial administrative elite unambiguous. As Parsons shows, a body of opinion which included the French Finance Minister who negotiated EMU preferred central bank co-ordination or a 'parallel' European currency (as promoted by Britain) to the delegation of monetary control to the European Central Bank. Many French elites saw the EMS and SEA themselves as causes of their monetary predicament. Indeed, divisions of opinion within the financial administrative elite are used by Howarth as evidence that Mitterrand's decision to support EMU was taken to enhance French power rather than in response to economic realities or economic theory, and by Parsons to support his theory that Mitterrand's actions can be explained by his pro-Community ideas. But apart from differing in their interpretation of his motives, both Howarth and Parsons agree on the key role played by Mitterrand in the EMU project. (Interestingly, Mitterrand is not even mentioned in Tommaso Padoa-Schioppa's insider account of the road to monetary union in Europe.) They also


64 Tommaso Padoa-Schioppa, The Road to Monetary Union in Europe. The Emperor, the King and the Genies. Oxford University Press, Oxford and New York: 2000, p 253
share a common view of the divisions within French political parties and the administrative elite over French strategy towards Europe.

These divisions play little part in Mairi MacLean's *Economic Management and French Business from de Gaulle to Chirac*. Concerned to explain how France moved away from economic protectionism to espouse liberalism and the values of corporate capitalism, MacLean emphasises the common views and influence of the administrative elite. She describes the graduates of the Ecole Nationale d'Administration (ENA) and of other Grandes Ecoles as coming from a 'common mould' and educated in a 'common world view' (p. 71), and attributes French economic successes to the agreed ideological lines emanating from this institutional framework.

Awkward questions, such as whether interdependence or integration was the more appropriate framework for enabling French business to compete internationally, are carefully avoided. Implicitly, European integration is seen as serving the interests of French business.

In fact the ideological struggle which MacLean analyses concerns only two of the alternative institutional frameworks so cogently presented by Parsons. She thus fits into a long tradition of writing about France which focuses exclusively on the debate between the state and the market, between autarchy and free trade.

**German position on European monetary integration**

This section explores the sources of the German government's position on European monetary integration since the first attempt at monetary union. The German policy on European monetary integration was, until after EMU, driven by German foreign policy elites' perception that integration could be used to achieve their primary geo-political
goal, embedding Germany in European institutions to dismantle the security dilemma with its European neighbours, particularly with France. After the signing of the Maastricht Treaty, this situation was reversed, as domestic economic interests and state financial authorities have taken the lead in shaping Germany's policy on European monetary integration, with foreign policy elites playing a secondary role. Thus German policy has come to resemble more the policies of other European monetary union member states, in that domestic economic concerns have taken precedence over geo-political interests in the making of policy on European monetary integration.  

No country has played as important a role as Germany in shaping the trajectory and institutions of European monetary integration. German policy-makers were the primary driving force behind the first launch of European monetary union (EMU) in the late 1960s, they were the principal architects behind the launch of the European monetary system (EMS) in 1979, and they defined the shape of the institutions that would result in EMU in 1999. So it is no exaggeration to say that Germany has been at the centre of European monetary affairs since the late 1960s.

While we know quite a lot about the content of German policy on European monetary integration, what is less well understood are the sources of that policy. Scholars have disagreed over what has driven German policy on European monetary integration. Some have argued that policy is driven by concerns about German security.

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66 Hanrieder, W. Germany, Europe, and America: Forty Years of German Foreign Policy. Yale University Press New Haven, 1989, p275
in Europe. Others have tried to explain the sources of German policy in terms of domestic economic interests. These various arguments demonstrate that nothing approaching a consensus on this subject has developed.

On what drives German policy on European monetary integration we can argue that to start with it was, driven by German foreign policy elites' perception that monetary integration could be used to achieve their primary geo-political goal: embedding Germany in western institutions to dismantle the security dilemma with its western neighbours, particularly the French. But foreign policy elites' goals were always constrained by the power of German domestic economic interests and state actors with financial policy purviews. After German unification, this situation was reversed, as domestic economic interests and state financial authorities have taken the lead in shaping Germany's policy on European monetary integration, with foreign policy elites playing a secondary role. Thus German policy has come to resemble more the policies of other EMU member states, in that domestic economic concerns have taken precedence over geo-political interests in the making of policy on European monetary integration.

Let us examine the interests and actions of German state and societal actors that came to shape German policy to determine if they fit the argument presented here. The cases to be examined are the first attempt to create a European monetary union, the creation of the European monetary system, EMU and the stability and growth pact. These four cases of institutional creation were chosen because they represent the most

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68 Brandt, W. (1976) p- 158
important institutional agreements in the history of European monetary integration. Thus, these were very salient issues in the German political scene and would have aroused interest from both state and societal actors.

There have been innumerable studies that have examined German policy on European monetary integration. These tend to fall into two types: those that assume that geo-political concerns drive German policy and those that assume that German policy is determined by domestic economic interests. Garton Ash (1993), Dyson and Featherstone (1999), Hanrieder (1989), and Tsoukalis (1996) are proponents of the view that German policy on European monetary integration has been driven by the concerns of high politics. Their argument is that policy was part of the German grand strategy to facilitate the resumption of its normal place in the political and economic affairs of the world. Their focus is on the foreign policy elites who defined Germany's actions toward its European partners in the process of monetary integration. They pay only secondary attention to the role of domestic economic interests in the shaping of Germany's monetary integration policy. Their preferences are subsumed under those of the foreign policy elites. It is assumed that it has been in Germany's national interest to further the cause of European monetary integration. Germany's geo-political position as a distrusted and defeated state drove its policy, not the preferences of domestic political actors.


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elites, like those of other EU Member States, acted to secure the interests of powerful domestic economic players when they fashioned monetary integration policy. Thus, German policy on monetary integration is not the result of foreign policy elites acting to realise the national interest, but rather the result of a domestic political process whereby those that wield domestic economic power can define the policies of the state that can affect their interests.

But both these perspectives make assumptions that fail to take into account the dynamics of the distribution of power among state and societal organisations in Germany that determines policy output. The geo-political perspective assumes that German policy-making is the responsibility of state actors and thus domestic societal actors have no role to play in defining policy. The domestic political economy perspective seems to assume that state decision-makers are relatively weak compared to societal actors, who have the upper hand in defining policy.\textsuperscript{70} To understand who shapes policy one must treat state and societal organisations as players in a dynamic political game who come together with the desire to define policy according to their preferences. The relative power of those organisations to shape policy is determined by the institutional and political resources they can bring to the struggle and that can change across time as policy coalitions change membership.

In the case of German policy-making on monetary integration, it has several interested state and societal actors. The state actors with the institutional authority to shape aspects of German monetary integration policy are the Chancellory, the Finance Ministry, the Foreign Ministry and the Bundesbank. Because of the very organised

nature of German society and the access organised interests have to the policy process in Germany, one must also examine the preferences and behaviour of interested societal organisations as part of the story of who defines German policy. The societal organisations most interested in German policy are those who perceive that the policy is most likely to affect their economic interests. In the policy area of monetary integration that would be the organizations of the financial and industry sectors. These organisations also have significant power resources as they control crucial sectors of the economy and they can mobilise public opinion if they see an advantage in doing so.

This means that if one wants to understand the content of this policy area, one must look to see which state and societal organisations have the interest and power to dominate the policy process. In terms of German policy, there have been two general coalitions with interests in European monetary integration that have vied for control. The first is, the foreign policy coalition. This has an interest in using monetary integration as part of a broader strategy of European integration, as a way of improving Germany's relationship with its European neighbours, principally France, which is viewed as necessary in order to overcome the security dilemma with those countries and to improve Germany's international image. Thus its interests are primarily geopolitical. By tying Germany to France through monetary arrangements, France will fear Germany less and that will reduce the likelihood of security or economic tensions.

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between the two erstwhile enemies. This coalition has consistently included the Chancellory and the Foreign Ministry.  

The second coalition is the monetary stability coalition. This consists of those organisations that have a primary interest in maintaining domestic price stability in Germany. This coalition has been led by the Bundesbank and includes the Finance Ministry.

To decide which of these coalitions will define the direction of policy we need to understand the power of these coalitions ability to attract the support of the powerful German societal organisations of finance and industry. This argument yields the hypothesis that the coalition these organisations side with will define the nature of German policy on European monetary integration. The first major initiative by European Community (EC) Member States to form institutions of monetary integration was the failed attempt to create European Monetary Union in the late 1960s and early 1970s. German policymakers were at the centre of this unsuccessful project, being the principal Member State proponents of the EMU plan.

**German Unification and EMU**

As stated previously, the EMS created in 1979 was not fundamentally different from the system that had existed in the 1970s. This meant that the EMS functioned 'asymmetrically'. In other words, because of the anchor role played by the Deutschmark, the German Bundesbank made its monetary policy based on monetary and economic conditions in Germany, whereas the other EMS member states made their monetary conditions

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policies in order to keep their currencies within their exchange rate bands with the Deutschmark. The burden of policy adjustment in the system was asymmetric; Germany led, the others had to adjust in order to follow.\textsuperscript{73}

This system led to tensions in Franco-German relations from the onset of the EMS. The French franc came under devaluation pressure from the start. This pressure caused the French and German governments to engage in resetting the bilateral exchange rate for their two currencies several times in the early 1980s, causing the French government embarrassment as it had to explain to its public why the French currency always seemed to depreciate while the German currency always appreciated.\textsuperscript{74}

By the mid-1980s, the French government was committed to a 'strong franc' policy, which meant they would do what it took to keep the franc from depreciating.\textsuperscript{75} The French government also ruled out any new devaluations of the French franc \textit{vis-à-vis} the Deutschmark. This put a tremendous amount of pressure on the French government to adjust domestic monetary and fiscal policy to protect the external value of the franc. This also had a political cost for the French government as it had a deflationary effect on the French economy. France seemed to be forgoing some economic growth in order to keep the franc strong by following the strict Bundesbank monetary policy.

By the latter half of the 1980s, French patience with the EMS was wearing thin. There was a growing feeling in French policy-making circles that the EMS rules were

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\textsuperscript{75} Goodman, 1992.p-158
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unfair in that weaker currency countries bore the entire burden of policy adjustment and the anchor currency country bore no burden. This led to a feeling that a fundamental change in European monetary affairs was due. Attempts at reforming the EMS in 1987-88 had led to very insignificant changes in the way the system operated and attention in Paris turned to scrapping the system and moving to the next step in monetary integration - monetary union. Thus in early 1988, the French government proposed talks on creating a European Monetary Union.

The reaction of the German government to the French proposal was guarded and cautious. The German government declared that this was a proposal that needed time for consideration. This cautious response did not reflect the true preferences of the chancellor, Helmut Kohl, and his Foreign Ministry. Both Kohl and Genscher, the Foreign Minister, wanted to move toward monetary union. They believed that monetary union was the only way to overcome the tensions in Franco-German relations caused by the EMS. The problem was that the idea of monetary union was greeted with a great deal of scepticism on the part of the Bundesbank, the Finance Ministry, and the banking and industry community. They saw the French EMU initiative as a way of gaining control of German monetary policy and moving away from a strict price stability orientation. Because of these concerns, they voiced their scepticism of the EMU proposal and the Kohl government dragged its feet in moving

77 Kaltenthaler, 1998, p. 71
towards establishing intergovernmental negotiations on designing the institutions of EMU.

The calculus of banking and industry organisation support for EMU changed drastically in November and December 1989.\textsuperscript{80} When the East German communist regime began to falter and the Berlin Wall fell in the autumn of 1989, the prospect of German unification loomed. This changed political environment was not lost on the French government. There was genuine concern in Paris as to what German unification would do to the nature of power relations in Europe. A reunified Germany would be a much larger and potentially much more powerful country in the middle of Europe, which could be a threat to French security. The French government began to act on those fears by trying to develop support in Europe for slowing the momentum of German unification. However, another very important part of the French strategy of dealing with the issue of German unification was to pressure the German government to agree to a rapid move towards monetary union.\textsuperscript{81} In December 1989, the German government agreed to convene an intergovernmental conference (IGC) to devise a plan. This was German agreement to French pressure to move monetary union from being a topic of discussion to being a concrete issue that needed planning.

How did the prospect of German unification change the Kohl government's approach to monetary union? There are two reasons why the government agreed to move ahead rapidly. First, German unification was a bargaining chip played by the French government. Because the French were an occupying power, they had the ability


to block or delay German unification, which they made clear to German government officials.\(^8^2\) Because unifying Germany would be such a political bonus for the Kohl government in the eyes of the German public, the incentive to agree to EMU in order to achieve rapid unification was very great.

The second reason was that it could now get the support of German banking and industry organisations to move rapidly on EMU. Unification would be a huge boost to West German business and banking. There was an East German market waiting to be conquered. Commercial banking and industry organizations were willing to move towards EMU if it meant rapid unification, as the economic gains of unification would outweigh the potential problems associated with EMU.\(^8^3\) Thus they backed the Kohl government's move to proceed.

Once the IGC opened in 1990, the usual pattern of the German government negotiating monetary integration agreements became evident. The Kohl government faced a Bundesbank and Finance Ministry committed to shaping EMU according to their preferences. That meant an EMU that first and foremost had price stability as its goal. The best way to accomplish this was to replicate the institutions of the Bundesbank and its price stability mandate at the European level. The Bundesbank's position was backed by the banking and industry organisations that also wanted to avoid EMU becoming a way to re-inflate Europe.\(^8^4\) The Bundesbank had German public opinion on its side, which feared that EMU would replace the strong Deutschmark with a new weaker European currency. This meant that in the IGC negotiations, the

\(^{82}\) Ibid p-258


German representatives pushed for and achieved an EMU which conformed, to a very large extent, to the Bundesbank and its allies' institutional preferences.

Once again, the launch and realisation of the EMU proposal demonstrates that geo-political concerns drove the Kohl government's calculations on the monetary integration initiative. It was the need to placate the French government's concerns about German unification that made the Kohl government such a proponent of EMU. But just as in past episodes of monetary integration, it was the Bundesbank and its allies that shaped the German negotiating position on the shape of the institutions. Geo-political concerns pushed the momentum toward monetary co-operation but domestic economic interests defined, for the most part, how that co-operation would be shaped. It was the shift in power from the foreign policy coalition to the price stability coalition, brought about by the change in support offered by the banking and industry organisations that caused a shift in the nature of policy.

This study has found that German policy on European monetary integration has indeed been shaped by the relative power of two broadly-defined policy coalitions, the foreign policy coalition, whose top priority has been to use monetary integration to deepen Franco-German rapprochement, and the monetary stability coalition, whose primary interest has been to preserve the monetary policy autonomy of the Bundesbank in order to secure price stability in Germany. From the late 1960s to the early 1990s, the foreign policy coalition was the more aggressive of the coalitions, proposing monetary integration initiatives in order to improve relations with France. But while the foreign policy coalition proposed the plans for monetary integration, the monetary stability coalition shaped the final plans for the institutions of monetary integration. The key to
the monetary stability coalition's power to shape plans was its ability to bring on board the important societal organisations of banking and industry in support. This pattern of proposal and policy-shaping has changed as a consequence of EMU. Now, the monetary stability coalition has become the more proactive coalition. This is because EMU has made its primary interest - preserving domestic price stability - insecure. Because of the relative strength of this coalition vis-à-vis the foreign policy coalition, it has been able to dominate the German monetary integration policy agenda since the signing of the Maastricht Treaty.

Conclusion

Since the establishment of ECSC, the economies of member states have slowly integrated. The economics environment which existed in the 1950s is a far cry from the integrated European Community of today. In the 1950s, European currencies were not convertible and domestic trade was highly protected. Intra-European trade was based on bilateral clearing arrangements institutionalised by the European Payments Union. Today EU currencies are fully convertible. Capital controls, intra-EU tariffs and quotas have been eliminated, and the single market has been completed. EU currency has become relatively stable under the discipline provided by the ERM. Soon the ECB will determine monetary policy for the Euro area. And the ERM II will provide the framework for stability between Euro area currencies and the currencies of other EC states remaining outside the Euro zone.