History of an Incomplete Economic and Monetary Union

Emmanuel Mourlon-Druol[1]

Introduction

The Economic and Monetary Union created in 1992 by the Maastricht Treaty was famously incomplete. The decision to create a European single currency was taken without agreeing at the same time on the introduction of some of the traditional accompanying features of some other monetary unions, namely: substantial financial transfers from richer to less developed regions, a credible framework for macroeconomic policy coordination, and European-wide provisions for banking regulation and supervision, to name but a few. The 1992 Maastricht Treaty set out an unfinished, or 'lopsided union',[2] with the predominance of monetary union over economic union. The titles of the multiple reports published since 1992, such as the Van Rompuy report of 2012, "Towards a *Genuine* Economic and Monetary Union," the Five Presidents' Report of 2015, "*Completing* Europe's Economic and Monetary Union," and the Commission's *Reflection Paper on the Deepening of the Economic and Monetary Union* of 2017 highlight this lopsidedness very well.[3]

The incomplete nature of the Maastricht construct makes it very fashionable to claim that EMU has been carelessly devised. Many commentators and academics assert that European policymakers ignored some fundamental well-known aspects aimed at supporting monetary unions.[4] European policymakers would have been culprit of a mix of incompetence, hubris, and panic at the prospect of a reunified Germany's hegemony over Europe after the fall of the Berlin Wall. Nothing could be further away from the historical record. There is a fundamental difference between stating that European policymakers were *intentionally* careless in the design of EMU, and their inability to have concluded a comprehensive and well-balanced agreement that would have included all necessary features of a smoothly functioning EMU. The first is simply inaccurate; the second is the story of the following pages.

This chapter draws a comprehensive historical reconstruction of the creation of this incomplete EMU. This chapter covers both the reasons leading to the creation of a monetary

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[3] Herman Van Rompuy, *Towards a Genuine Economic and Monetary Union. Report by President of the European Council*, Brussels, 2012; Jean-Claude Juncker, in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, and Martin Schulz, *Completing Europe's Economic and Monetary Union*, Brussels: Publications of the European Commission, June 2015; European Commission, *Reflection Paper on the Deepening of the Economic and Monetary Union*, May 2017. Emphasis added.

[4] See for instance Martin Feldstein, 'The failure of the euro: the little currency that couldn't, *Foreign Affairs*, January/February 1992; Niall Ferguson and Laurence Kotlikoff, 'The degeneration of EMU,' *Foreign Affairs*, 79:2, pp.110-121.

union, and the reasons for the limited progress on an economic union. 'Economic union' is here broadly conceived, as indeed most European policymakers until 1992 understood it, and includes the following policy areas: banking regulation and supervision, financial transfers of resources, capital market integration, and macroeconomic policy coordination. The chapter will provide an analysis divided into five chronological sections. First, the chapter covers the pre-history of European monetary cooperation and integration before the Treaties of Rome, including the development of the Bretton Woods system and of the European Payments Union (EPU). Second, it deals with the period of implementation of the Treaty of Rome, from the inception of the EEC in 1958 until the establishment of the European customs union. Third, it analyses the period witnessing the first concrete proposal about the establishment of an EMU in the EEC, namely the Werner Report. Fourth, it looks into the EEC's attempt at managing exchange rate in a globalising world, in particular with the creation of the European Monetary System. Finally, it scrutinises the move towards EMU looking in particular at the Delors Report, the Maastricht Treaty, and the adoption of the Stability and Growth Pact (SGP).

1. Economic and monetary cooperation in Europe before the Treaty of Rome

The rigidities of the interwar Gold Standard, and the ravages of the Great Depression made plain that a new international economic and financial framework should be designed after the end of the Second World War. This new system would support postwar reconstruction, international trade, and international economic cooperation.

1.1. The establishment of the Bretton Woods system

The delegates of fourty-four allied nations met in Bretton Woods, New Hampshire, in July 1944, to create a new international monetary system that would avoid the weaknesses identified in the interwar period.[5] To these ends, the delegates agreed to create a set of new rules and institutions known as the Bretton Woods system. The major feature was that members agreed on a system of fixed but adjustable exchange rates, in which currencies were pegged to the dollar, and only the dollar was convertible into gold. Currencies could fluctuate within a one percent band, and the value of the dollar was fixed at 35 dollars per ounce of gold. The United States was responsible for keeping this price fixed. The system was adjustable in that in case of economic hardship, a country could ask the IMF for authorisation to devalue their currencies by 10%.

To make this system work, two new institutions were created, the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD).[6] The IMF, created in 1945 and headquartered in Washington D.C., is responsible for monitoring the functioning of the new system, and, more generally, encouraging global monetary cooperation, and ensuring international financial stability. The IBRD, now part of the World Bank Group, established in 1945, provides financial assistance for the reconstruction after the Second World War, and for less developed countries.

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[5] Eric Helleiner, *Forgotten Foundations of Bretton Woods : International Development and the Making of the Postwar Order*, Ithaca, NY : Cornell University Press, 2014; Harold James, *International Monetary Cooperation since Bretton Woods*, Oxford : International Monetary Fund/Oxford University Press, 1996; Benn Steil, *The Battle of Bretton Woods: John Maynard Keynes, Harry Dexter White, and the Making of a New World Order*, Princeton: Princeton University Press, 2013.

[6] See Chapters 2.1 and 2.2.

The Bretton Woods system was agreed upon in 1944, but it only really became fully functional in 1958, when currencies became fully convertible. Until 1958, many participants maintained exchange controls, and as a consequence the free convertibility of one currency into another at the pegged exchange rate expected in the Bretton Woods system was not implemented.

The Bretton Woods system encountered an essential flaw, that Belgian economist Robert Triffin identified in 1960 in his book *Gold and the Dollar Crisis*.[7] The so-called Triffin Dilemma relates to the problems linked to the role of the US dollar in the overall system. The dilemma that Triffin identified was the following. In the Bretton Woods system, the US government was running important balance of payments deficits. If the US government decided to stop running such deficits, then the international community would be deprived of reserves. This shortage of liquidity would in turn contract the world's economy, leading to financial instability. But if the US government continued running balance of payments deficits, then the confidence in the value of the dollar would erode. The Bretton Woods system in theory constrained the US government to keep the dollar's value at 35 dollars per ounce of gold. If the US government continued 'flooding' the world with dollars, investors and policymakers would be less confident that these dollars could be exchanged into gold. The dollar would then no longer be accepted as a reserve currency, and the fixed exchange rate system would break down, leading to instability.

The 1960s witnessed the Triffin dilemma's fulfilment. The US balance of payment deficit expanded, following an increase in domestic spending due to president Lyndon B. Johnson's 'Great Society' programme, and then to John F. Kennedy's rise in military spending for the Vietnam War. Both decisions contributed to weaken confidence in the dollar, until president Richard M. Nixon decided to 'close the gold window.' On 15 August 1971, Nixon unexpectedly, and unilaterally – that is, with no prior consultation of the other participants in the Bretton Woods system – decided that foreign governments could no longer exchange their dollars into gold, and allowed the dollar to float against other currencies. Further to this, the US president decided to impose a temporary restriction on wages and prices in order to control inflation, and an import surcharge of 10 percent to protect US products from fluctuating exchange rates. Nixon's decision marked *de facto* the end of the Bretton Woods system, although further unsuccessful discussions took place afterwards to try and find an alternative arrangement to preserve the existence of a fixed exchange rates system. The Bretton Woods system formally ended with the signature of the Jamaica agreements in January 1976, which approved the dollar's floating, and effectively opened the era of the international monetary 'non-system' that is still in place today.

1.2. The European Payments Union

In Western Europe, the question of currency convertibility dominated policy debates in the immediate postwar period. In 1945, trade between European countries was pursued only through bilateral arrangements. Any deficit had to be offset by a surplus; trade was guided by outstanding debts, and based on US dollars, which European countries lacked.

In July 1950, the Organisation for European Economic Cooperation (OEEC, inherited from the Marshall Plan), agreed to create the European Payments Union (EPU).[8] The EPU

[7] Robert Triffin, *Gold and the Dollar Crisis : the Future of Convertibility*, Yale : Yale University Press, 1960.
[8] Barry Eichengreen, *Reconstructing Europe's Trade and Payments: The European Payments Union*, Manchester: Manchester University Press, 1993; Barry Eichengreen (ed), *Europe's Postwar Recovery*, Cambridge: Cambridge University Press, 1995.

created a multilateral system of payments replacing the bilateral payment agreements. Only a multilateral system would be able to relaunch the European economy. Each country accumulated its deficits and surpluses with all other countries into one central account with EPU, which was debited or credited by the combined net result of all intra-European transactions. This system allowed countries not to be concerned about a deficit with some countries, since this deficit could be offset by a surplus with some other countries into the overall EPU account on a monthly basis. EPU thus removed bilateral bargaining, reduced transaction costs, and restored multilateral trade in Europe. EPU functioned from July 1950 until December 1958.

2. An economic union before a monetary union? The early EEC

In 1957, six states signed the Treaty of Rome creating the European Economic Community (EEC). The EEC set out to implement a customs union, a common/single market (that is, the abolition of barriers to the free movement of goods, people, capital, and services among its members), and the establishment of a number of common economic policies. The Treaty contained, however, no explicit reference to monetary integration. This section looks at the early implementation of the provisions contained in the Treaty of Rome, and in particular at the economic integration/monetary integration conundrum.

2.1. The Treaty of Rome and economic and monetary cooperation in Europe

The EEC's first decade was primarily focused on the establishment of a customs union, and the development of some common policies, including most importantly the common agricultural policy (CAP). The Treaty of Rome envisaged a so-called transitional period of twelve years (article 8) during which all quantitative restrictions to the movement of goods between EEC members should gradually be abolished, and a common external tariff be set up. Customs union was completed nearly two year ahead of schedule, on 1 July 1968.

Monetary cooperation was present in the Treaty of Rome insofar as it regarded general economic policymaking and trade issues. No provision anticipated the creation of a future exchange rate system, let alone a monetary union. Articles 103 to 109 ('Conjunctural Policy', 'Balance of Payments') called for economic and monetary cooperation, in particular to avoid disequilibrium in the balance of payments, in order to preserve the functioning of the common market. Monetary issues were thus seen from a common market perspective, rather than in their own right.

A fundamental prerequisite of monetary union is the free movement of capital. The Treaty of Rome provided for the removal of barriers to the free movement of capital (article 67 to 73), but in a more restrictive fashion than for the other three freedoms (goods, people, and services).[9] The Treaty indeed enshrined the liberalisation of capital movements but only "to the extent necessary to ensure the proper functioning of the common market." (article 67) Such a phrasing leaving some interpretative leeway to the EEC members states represented the result of a compromise reached during the Treaty of Rome negotiations. While Germany generally supported the idea of the free movement of capital, other member states (especially France, but also the Netherlands) considered international capital movements as potentially destabilising the

[9] For more details, see Age Bakker, *The liberalization of capital movements in Europe : the Monetary Committee and financial integration, 1958-1994*, Dordrecht, Boston: Kluwer Academic Publishers, 1996; John A. Usher, *The Law of Money and Financial Services in the EC*, Oxford: Oxford University Press, 2000.

domestic economy. As a consequence, full capital market integration remained unpalatable to many European policymakers at the time.

2.2. Europeans tensions within the Bretton Woods system

The 1960s witnessed many tensed debates about economic adjustment in Europe against the backdrop of international instability.[10] Three periods of adjustment stand out: the German revaluation of 1961, the Italian balance of payments crisis of 1964, and the monetary crises in France in 1968. The 1961 revaluations of the Deutsche Mark and the Dutch guilder highlighted the weaknesses of cooperation on monetary matters within the EEC. The discussions of March 1961 indeed took place within the IMF, rather than between EEC members. In spite of agriculture prices being discussed in Brussels in the framework of the nascent common agricultural policy (CAP) with its EEC partners, the German government prioritised instead negotiations in Washington. In 1964, Italy faced a balance of payments crisis following a speculative attack in March. Like the German government three years earlier, the Italian government looked for a solution outside the European framework. The Italian government sought help from the IMF and the World Bank, rather than by using the existing EEC financial support mechanisms. US-based institutions showed more understanding to the Italian circumstances than Italy's EEC counterparts, and in the form of swap arrangements, credits, and repurchase of Italian government bonds.

What was the EEC reaction to these first two crises? The German and Italian governments' quest for Atlantic, rather than European solutions, made plain the lack of coordination among EEC central bankers. The European Commission's Action Programme for the Second Phase of the Community, published in October 1962, thus suggested the creation of a committee of central bank governors so as to address this lapse in EEC coordination. A Council Decision of 8 May 1964 created the Committee of Governors of the Central Banks of the EEC. More generally, the Action Programme also drew a very clear link between monetary issues, and economic union broadly speaking, making explicit the logical link between the two. The EEC commissioner for economic and financial affairs Robert Marjolin, who largely drafted this paper, had been a constant advocate of this since 1958. Marjolin called for the further development of macroeconomic policy coordination within the EEC. This line of thinking would largely continue with his successor, the French economist Raymond Barre.

The third crisis that stands out relates to the French franc. After the 'events' of 1968 in France, and the wage increases that followed, the French currency came under attack. In July 1968, central bank governors agreed to activate the EEC mutual assistance mechanism. The French government, wary of the political implications of calling for IMF assistance, privileged an action within the European setting. This raised the question as to what kind of response could the EEC offer? After the proposals set out by Marjolin, the European Commission maintained its activism in the monetary field. In February 1968, the Commission presented a brief memorandum on monetary affairs in the EEC to the finance council in Rome. More importantly, the Commission published a 'Memorandum on the coordination of economic policies and monetary cooperation within the Community,' known as the first Barre Plan, in February 1969.

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[10] See Harold James, *Making the European Monetary Union: The Role of the Committee of Central Bank Governors and the Origins of the European Central Bank*, Cambridge, MA: Harvard University Press, 2012, pp.36-88; and Horst Ungerer, *A Concise History of European Monetary Integration: from EPU to EMU*, London: Quorum Books, 1997, 57-66.

The recommendations were threefold: improve the convergence of medium-term economic policies, coordinate short-term economic policies, and develop a Community mechanism of monetary cooperation. Barre reiterated the core of this plan in a communication to the finance council on 4 March 1970, often referred to as the second Barre Plan. In addition, this second plan outlined the realisation of economic and monetary union over a ten year period.

2.3. Economic union in the 1960s

2.3.1. The coordination of economic policies in the 1960s

The proposals of Marjolin, and then Barre initiated decade-long discussions about the need to coordinate economic policies in a possible European currency area. The EEC created several committees to discuss the coordination of economic policies at the EEC level, and try to improve their coordination. In 1960, the Council set up a Short-Term Economic Policy Committee. Following on the 1962 Commission's Action Programme, the Council established in 1964 a Medium-Term Economic Policy Committee, and a Budgetary Committee. The aim of these committees was to improve consultation among national policymakers at the European level. Their concrete achievements were scarce – national economic policies continued being at times uncoordinated, contradictory, and/or potential harmful to their neighbours'— but it fulfilled one fundamental purpose, that is, to allow policymakers to meet. Such committees favoured the socialisation of national policymakers and allowed them to get acquainted with each other's aims and priorities.

2.3.2. The coordination of banking legislations

The regulation and supervision the European banking sector was the logical corollary to the establishment of a fully integrated European capital market, and the specific object of one of the chapters of the so-called Segré Report. With a view to identify the obstacles to the creation of a genuine European capital market, the European Commission tasked a group of experts chaired by Claudio Segré, Director for Studies in the Commission's Directorate-General for Economic and Financial Affairs, to study 'the problems confronting the capital markets of the Community as a result of implementation of the Rome Treaty.' The final report was published in 1966.[11] Differences in regulation and supervision across EEC member state could indeed constitute a barrier to the development of cross-border financial activities. The Segré report stressed the need to further develop the coordination between these different systems, and thus provided the theoretical foundations to the discussions related to banking regulation and supervision in the EEC.

Following the Segré report, several working groups and committees were created in order to improve the coordination of financial regulation and supervision at the EEC level, as well as to start the ground work for an eventual harmonisation of banking legislations.[12] In 1969, a group named 'Coordination of Banking Legislations' was created for that purpose. The European

[11] Claudio Segré, *The Development of a European Capital Market*, Brussels: Publication Services of the European Communities, 1966.

[12] See Emmanuel Mourlon-Druol, "Banking Union in Historical Perspective: the Initiative of the European Commission in the 1960s-1970s," *JCMS: Journal of Common Market Studies*, 2016; Larisa Dragomir, *European Prudential Banking Regulation and Supervision: the Legal Dimension*, Abingdon: Routledge, 2010.

Commission, which took the lead of the whole enterprise, displayed great ambitions. The European Commission originally aimed at harmonising all EEC member states' regulatory frameworks in one single directive. To that end Wilhelm Haferkamp, the European Commissioner in charge of the discussions, presented a draft directive on the co-ordination of legislative, regulatory and administrative dispositions concerning the access to the non-stipendiary activities of credit institutions and their exercise in July 1972. The Commission's ideas concerned several issues related to banking regulation and supervision, including authorisation procedures (section II, Articles 2 to 6), creation of branches (section III, Articles 7 to 9), ratios (solvency, liquidity, profitability – section IV, Articles 14 to 17), deposit insurance (article 18), activities of foreign banks in the EEC and of EEC banks abroad, credit information exchange/'centrale des risques' (that is, mutual information about large loans, article 20), and winding-up procedures and withdrawal of authorization (section VIII, Articles 24 to 27).

With the benefit of hindsight, the first attempts at coordinating European banking regulation and supervision from the late 1960s seem far-sighted. If the European Commission fell short of proposing the creation of a European supranational supervisor – such as what the ECB would become in 2014 – it did outline the other elements of today's banking union. The Commission's desire to harmonise banking regulations across the EEC corresponds, mutatis mutandis, to the Single Rulebook; the Commission aired the idea of a common deposit guarantee scheme; and the winding-up procedures discussed at the time correlate with the question of the resolution of failing/failed banks debated today.

Yet the situation of the 1960s and 1970s was very different from the conditions in which the Banking Union has developed post-2010. Capital movements in Europe in the 1960s were not fully liberalised, sovereign debt was not really an issue, and very obviously the EEC member states did not share a single currency. But on several occasions, members of the European Commission drew a clear link between monetary integration and banking regulation/supervision, in such a way that looks prescient of what happened in the 2010s.

2.3.3. The development of limited financial transfers of resources across the EEC

Finally, the development of a modest EEC budget and the establishment of common EEC policies were part and parcel of wider debates about the role of financial transfers in a future possible Economic and Monetary Union. The budget of the EEC in the 1960s was very modest, less than half a percent of the EEC's GNI, and was exclusively based on member states' contributions. This system of financing limited the EEC's autonomy, but article 201 of the Treaty included an option to move to a system of 'own resources.' In spite of the weakness of the EEC budget, a number of instruments were developed from 1957. The Treaty of Rome included the creation of a European Social Fund (article 123), and of a European Investment Bank (article 129). The ESF, the oldest of the so-called structural funds, aimed at developing social cohesion by facilitating the retraining of workers. The EIB funds projects that support the EEC's objectives by borrowing money on financial markets and lending it. The EIB therefore does not depend on the EEC budget. Finally, the Common Agricultural Policy (CAP), established in 1962, was not set out in detail in the Treaty of Rome, but was the first fully integrated EEC common policy.[13] The CAP would soon take over the largest share of the EEC's budget from 1962, peaking at 73% in 1985. The logic of these different programmes was redistributive, often

[13] Ann-Christina L. Knudsen, *Farmers on Welfare: The Making of Europe's Common Agricultural Policy*, Ithaca/NY: Cornell University Press, 2009.

moving money from richer areas of the EEC to less developed ones. The amounts involved were however very small on the scale of the European economies. Increasing these amounts – in particular in order to support a possible future monetary union – was a recurrent theme of discussion but proved politically sensitive.

3. The first attempt at Economic and Monetary Union: the Werner report

In spite of some previous talks about the possible creation of a European monetary union, the first comprehensive efforts at currency integration in the EEC was set out in the late 1960s, and did not really leave the EEC agenda until the creation of the euro.

Until the late 1960s, European policymakers and academic economists discussed the possibility of creating an EMU in Europe, but these discussions took little concrete form. The theoretical context, and the challenges associated to sharing a single currency in Europe were increasingly clearly set out, but the political move was not yet made. The Hague summit of EEC heads of state and government that took place in 1969 placed EMU as an official objective of the EEC. After the completion of the customs union ahead of schedule in 1968, EEC leaders were in search of a new flagship project. EMU was part of the famous tryptich of completion, enlargement, and deepening. EEC leaders agreed to set up an ad hoc expert group, under the chairmanship of Luxembourg's prime minister Pierre Werner to draw up a plan in stages for the creation of an EMU. The Werner Committee met fourteen times between March and October 1970. Members were appointed for their roles in the various EEC institutions, but also reflected the concerns of their respective governments.[14]

Name	Capacity
Hubert Ansiaux	Chairman of the Committee of Governors and Governor of the National Bank of Belgium
Gerard Brouwers	Chairman of the Conjunctural Policy Committee and State Secretary in the Dutch Ministry of the Economy
Bernard Clappier	Chairman of the Monetary Committee and Deputy Governor of the Banque de France
Georges Morelli	Coordinator of the Group's secretariat and Commission official
Ugo Mosca	Director-General for Economic Affairs, DG II, European Commission
Johann Baptist Schollhorn	Chairman of the Medium-Term Economic Policy Committee and State Secretary in the Federal Ministry of the Economy
Gaetano Stammati	Chairman of the Budgetary Committee and Treasurer-General in the Italian Ministry of the Treasury
Pierre Werner	Chairman of the Group. Prime minister and finance minister of Luxembourg

[14] Elena Danescu and Susana Muñoz (eds), *Pierre Werner et l'Europe : pensée, action, enseignements/Pierre Werner and Europe : his Approach, Action, and Legacy*, Brussels : Peter Lang, 2015

Table XXX: Members of the Werner Committee[15]

The first concrete discussions about how to reach economic and monetary union in the EEC witnessed the emergence of two different and hotly debated strategies, known as the 'economists' vs. 'monetarists' debate.[16] The so-called economists claimed that full monetary integration including the eventual creation of a single currency could only happen in the EEC once the economies of the would-be currency bloc would have fully converged. The 'economist' viewpoint was also dubbed the 'coronation theory', in that it was only after a long time of preparation that a king or a queen could be crowned. The so-called monetarists held the opposite viewpoint. Monetarists – not to be confused with Milton Friedman's brand of monetarism – argued that the introduction of a single currency in the EEC would force the economies of its member states to converge, and hence make the currency area viable. The monetarist viewpoint was also nicknamed the 'Nike approach', in that the best way to implement monetary union was to 'just do it'. West Germany, the Netherlands, and Denmark are often portrayed as economists; France, Italy, and the European Commission are often described as monetarists. Yet positions were most of the time blurred in policymaking debates, as both economists and monetarists generally held valid arguments. There was little point in making a monetary union function properly if the economies of its members were not similar enough; and there was little hope that these economies would naturally converge without some form of constraining mechanism. Since the 1960s/1970s however, the discussions about the creation of EMU revolved around these two poles of economic thinking. The improvement of EMU since 1999 has also arguably followed the same path, under different guises.[17]

The final report was made public on 8 October 1970.[18] The report set out an EMU to be implemented in three stages by 1980, and adopted a so-called parallelist approach, aimed at combining and reconciling some of the features dear to the 'economists,' and some of the features dear to the 'monetarists.' The report however provided a detailed roadmap for the first stage only, and did not make detailed proposals regarding the political institutional architecture. One striking difference with the later Delors Report to which the Werner Plan is often compared is the emphasis on economic union. The Werner report advocated the development of common EEC policies, the improvement of greater coordination among national budgets, and some degree of tax harmonisation. On 22 March 1971, after intense discussions, the Council and the representatives of the EEC member states eventually adopted a 'resolution on the achievement by stages of EMU.'[19] This set in motion a process towards the implementation of an EMU.

The collapse of the Bretton Woods system examined above however severely impacted the implementation of the original plan. Just as international economic and monetary instability surged, the original strong diverging interpretations about how to approach the making of EMU

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[15] The final report also lists the 'adjoints' to the members, respectively : J. Mertens de Wilmar, A. Looijen, J.-M. Bloch-Lainé, none for G. Morelli, J.-C. Morel, H. Tietmeyer, S. Palumbo, and J. Schmitz.

[16] On this famous controversy, see for instance Ivo Maes, "On the origins of the Franco-German EMU controversies," *European Journal of Law and Economics*, 17:1, 2004, 21-39.

[17] Emmanuel Mourlon-Druol, "Don't Blame the Euro: Historical Reflections on the Roots of the Eurocrisis," *West European Politics*, 2014, pp.1282-1296.

[18] Rapport au Conseil et à la Commission concernant la réalisation par étapes de l'union économique et monétaire dans la Communauté, « Rapport Werner », *Supplément au Bulletin 11-1970 des Communautés européennes*, available online at http://ec.europa.eu/archives/emu_history/documentation/chapter5/19701008fr072realunionecomon.pdf.

[19] Resolution on the achievement by stages of economic and monetary union in the Community, 22 March 1971

among EEC member states resurfaced. European currency relations had lost their international monetary cocoon. The end of the Bretton Woods system made the implementation of the Werner plan both more difficult, and more pressing. The Werner plan had not been devised to be implemented in a world of fluctuating currencies, and most European policymakers did not foresee that state of affairs. But the fluctuation of EEC currencies, and the tensions that arose in the European adjustment process, invited European policymakers to reflect on ways to reintroduce currency stability in the EEC.

Three concrete realisations came out of the Werner Plan. On 21 March 1972, the Council decided to reduce the fluctuation margins between EEC currencies to 2.25%. This currency arrangement came to be nicknamed as the 'snake.' The long-term idea remained to eliminate fluctuation margins. The European Monetary Cooperation Fund (EMCF) was created on 3 April 1973. The EMCF mostly served for accounting purposes in the operation of the EEC's exchange rate system, rather than a substantive policy role, that remained in the remit of the Committee of Govenors. Finally, the further development of macroeconomic policy coordination from 1974 was a direct part of the implementation of the Werner plan. It is true that these efforts were consciously building on, and reforming, the framework set out by the European Commission under Marjolin, and then Barre, but economic policy coordination was now explicitly part and parcel of achieving the goal of EMU. In February 1974, the Council took a decision on "the attainment of a high degree of convergence of the economic policies of the member states of the EEC." The Council explained: "there can be no gradual attainment of Economic and Monetary Union unless the economic policies pursued by the member states henceforth converge and unless a high degree of convergence is maintained."[20] With this decision, Council created an Economic Policy Committee (EPC). The EPC replaced three pre-existing committees (Short-Term Economic Policy Committee, Medium-Term Economic Policy, and Budgetary Policy Committee). The EPC consisted of four representatives of the Commission and four representatives of each member state, and the Commission provided the EPC secretariat. The very different economic policy courses followed by the EEC member states amply show that the 1974 Council Decision was not properly implemented. As Marjolin noted in his study on EMU published in 1975, "The coordination of national policies is a pious wish which is hardly ever achieved in practice."[21]

Financial transfers of resources in the EEC remained limited to the mechanisms already in place, namely the CAP, the ESF, and the EIB. An important development occurred however, with the creation of the system of so-called 'own resources' in 1970. Instead of being based on member state contributions, the EEC budget would be derived from three types of resources that the EEC was generating, namely, customs duties, agricultural levies, and a share from each member state based on the Value Added Tax (VAT). If realisations did not match the ambitions, there was no shortage of thinking. In 1974, two important studies were commissioned – the Marjolin, Tindemans and the MacDougall reports, detailed below – highlighting that European policymakers kept thinking about the development of EEC economic integration in the perspective of the making of a monetary union.

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[20] Council Decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community, 74/120/EEC.

[21] Commission of the European Communities, *Report of the study group 'economic and monetary union 1980'*, Brussels, March 1975, available at http://ec.europa.eu/archives/emu_history/documentation/chapter7/19750308en57reportstudygroup.pdf.

4. European exchange rates coordination in a globalising world

In early 1974, EEC member states unofficially abandoned the implementation of the Werner plan, and with it the ambitious idea to build an EMU by 1980. Instead, European policymakers focused on mere exchange rate coordination, first through the snake, and then through the creation and development of the European Monetary System. Behind the scenes, intense debates carried on as to whether economic and monetary union was an appropriate objective for the EEC.

4.1. Navigating international and European currency instability

The implementation of the Werner plan was unofficially abandoned in early 1974. The perturbations of the international monetary regime heightened tensions among EEC member states, and revived the disagreements about how to reach EMU. But the Werner plan's child – the snake – remained at centre stage in European economic and monetary policy debates. Until the creation of the EMS, European policymakers indeed questioned the need to maintain, improve, or change the snake's functioning. Whatever the outcome of European policymakers' discussions, the snake remained the attractive point of the EEC's economic and monetary policymaking. It became however gradually clear in the first half of 1974 that the implementation of the Werner plan halted. The Council decision on economic convergence adopted as part of the Werner initiative in February 1974 was the swan song. The French franc had already left the snake – the Werner plan's tool for currency integration – a month earlier, in January 1974. Prospects of a real implementation of the report looked therefore slim. The plan was unofficially discarded, but remained a mantra in policy debates. For example, during its inaugural meeting the Delors committee used the Werner report as the starting point for its discussions as this report was the last blueprint produced for EMU.

4.1.1. <u>The impossible improvement of the snake</u>

The period between the abandonment of the implementation of the Werner plan and the creation of the EMS witnessed the multiplication of proposals aimed at improving the snake, or introducing a single currency in Europe altogether.[22] Reforming the functioning of the snake was the goal of many EEC countries – predictably most of the non-snake members, but not only. The problems in the functioning of the snake arose from the fact that the burden of adjustment always fell on the weaker currency countries. These countries – France, Italy, the UK – considered that keeping their currency inside the margins of fluctuation of the snake could prove too difficult because of the appreciation of the leading currency, the deutsche mark. They argued that this burden should be more equally spread among the member states participating in the snake.

First to propose a reform of the snake was the French government, in 1974. The so-called Fourcade memorandum, presented by the French finance minister Jean-Pierre Fourcade, proposed to organise the EEC exchange rate system around a reformed European Unit of Account, that would be made of a basket of EEC currencies. This new organisation was meant to remedy the weaknesses of the snake as it worked until then, namely, to impose the burden of adjustment on weaker currency countries. The Fourcade memorandum held that if exchange rates were determined with respect to an EUA-basket, the burden of adjustment would be spread more

[22] For a detailed analysis of each of these proposals, see Emmanuel Mourlon-Druol, *A Europe Made of Money: the Emergence of the European Monetary System*, Ithaca/NY: Cornell University Press, 2012, chapters 2 to 4.

fairly as it would take into account the respective depreciation and appreciation of all currencies. If the West German government – and more generally the snake members – staunchly opposed the Fourcade memorandum, the French proposal however foreshadowed a key feature of the EMS negotiations that would take place four years later.

A wealth of other proposals for EEC monetary reform from many different EEC member states and institutions reflected the centrality, and sensitivity, of the question of the burden of adjustment in the EEC exchange rate system. Such proposals put forward in the course of the second half of the 1970s, including the proposals of the Dutch finance minister Wim Duisenberg in 1976 and 1977 on target zones, the initiative of Belgian finance minister Gaston Geens in 1977 to increase monetary support, the plan of the Belgian chairman of the Monetary Committee Jacques Van Ypersele in 1978 to improve European monetary cooperation. Finally, president of the European Commission Roy Jenkins delivered a speech calling for monetary union in Florence in 27 October 1977.[23] Jenkins lecture allowed to re-open the debate, and set in motion public discussion about the benefits and drawbacks of monetary union in Europe.

4.1.2. The creation of the EMS

The worsening of the international context led the West German government to become more open towards the finding of a European monetary counter-reaction.[24] From 1977, the fall of the dollar started worrying Bonn.[25] The West German government was concerned that the deutsche mark would start appearing as a refuge value, and as a consequence that it would harm its exports. West German chancellor Helmut Schmidt however realised that West Germany, alone, would not be able to provide a reaction on the international monetary stage. A coordinated reaction at EEC level was needed, in order to counteract more effectively US macroeconomic policy.

In the meantime, the French government had become more amenable to running a consistent stability-oriented economic policy. The appointment of prime minister Raymond Barre in 1976 considerably reassured the West German government. Barre, a former economics professors, and a former commissioner in charge of the economic and financial portfolio in Brussels, decided to implement a time-consistent strategy aimed at fighting inflation. Barre and Giscard rather unexpectedly won the general elections in 1978, which opened the door to a continued stable working relationship with the West German government.

Schmidt took the lead in proposing a new European monetary arrangement. Schmidt's initiative was later reframed and embedded within a Franco-German context. In early 1978, the West German chancellor started displaying his willingness to move on the European currency front. In a meeting with British prime minister Callaghan, Schmidt first aired his plan, namely, "to create another European snake, but of a different kind."[26] Once Giscard and Schmidt agreed to move on the matter, they tasked a group of three experts to work out the details of the new exchange rate system. The group was composed of the governor of the Banque de France, Bernard Clappier, a close advisor to Schmidt, Horst Schulmann, and the second permanent secretary of the Treasury, Ken Couzens. Couzens eventually dropped out of the group, as it became increasingly clear that the British government was not keen to join the system, although

[23] Roy Jenkins Europe's Present Challenge and Future Opportunity, Lecture at European University Institute in Florence, 27 October 1977, available at http://aei.pitt.edu/4404.
[24] Mourlon-Druol, *A Europe Made of Money*, chapters 5 to 8; Peter Ludlow, *The Making of the European Monetary System*, London: Butterwooths, 1982.
[25] Dimitri Grygowski, *Les États-Unis et l'unification monétaire de l'Europe*, Brussels: Peter Lang, 2009.
[26] Quoted in Mourlon-Druol, *A Europe Made of Money*, pp.164-165.

it lost an opportunity to shape its creation. The text produced by the group became the basis of discussion in the next European Council held in Bremen in July 1978, and of what would be later known as the so-called Bremen Annex, that is, the draft of the new EEC exchange rate system that was under discussion in the second half of 1978. After intense negotiations, the European Council agreed to set up the EMS, initially among only six EEC members (Belgium, Denmark, France, Germany, Luxembourg, and the Netherlands), later followed by Ireland, and Italy, but not by the UK which declined to join.

The EMS agreed upon in 1978, and entering into force in 1979, bore a striking resemblance with the snake. The fluctuation margin remained identical at 2.25 percent, and central rates could be adjusted after consultations. The EMS also allowed for wider fluctuation margings at 6%, which Italy adopted. A divergence indicator was introduced, that was able to pinpoint at the currency that was diverging, that is, reaching 75 percent of its maximum spread. But the identification of the diverging currency could only lead to consultations among central banks, and no automatic action as suggested during the negotiations, which rendered the measure largely meaningless. The creation of a European Monetary Fund was envisaged within two years of the creation of the EMS, in spite of strong scepticism, but would eventually not be realised.

4.2. Economic union in an impasse

Discussions about the improvement of European economic integration to cope with the consequences of exchange rate coordination, and even the possible creation of a single currency, remained on the EEC agenda throughout the 1970s.

4.2.1. <u>The difficult strengthening of macroeconomic coordination</u>

Tentative economic policy coordination remained however confined to the Franco-German bilateral level. The EPC created in 1974 was only a consultative committee. Orientations of economic policy were intensely discussed in the European Council, also created in 1974, and were indeed one of the primary functions of the new EEC leaders' regular meetings. But these discussions gave birth to little concrete coordinated economic action.[27] EEC heads of state and government often disagreed on the root causes of current problems, or simply did not understand them, and disagreed on the actions to be implemented. The situation changed in the course of the second half of the 1970s, when Giscard appointed Barre as prime minister. Barre, a respected economist and former vice-president of the European Commission in charge of the economics and financial affairs portfolio, decided to implement a time-consistent stability-oriented economic policy, which lasted until the end of Giscard's presidential mandate in 1981. The German government – and Schmidt in particular – placed considerable trust in Barre and his government's economic policy. This renewed trust between France and Germany led to a clear rapprochement of both countries, and facilitated the agreement on the creation of the EMS. This renewed Franco-German entente also gave birth to an attempt at improving the economic and financial cooperation of the two countries. In 1977, both governments agreed to further intensify their economic cooperation in the framework of the Élysée Treaty. Nothing concrete came out of these meetings, but they signalled that economic policy coordination was being bilateralised rather than communautarised.

[27] Emmanuel Mourlon-Druol, "Steering Europe: Explaining the Rise of the European Council, 1975-1986," *Contemporary European History* 25:3, 2016, pp.409-437.

4.2.2. Banking regulation/harmonisation at a standstill

In the field of banking regulation and supervision, the Council adopted a directive in 1977 on the 'coordination of laws, regulations and administrative provisions relating to taking up and pursuit of the business of credit institutions.'[28] The banking directive was a modest development in comparison to the ambitions of the late 1960s. The 1977 directive fell short of actual banking harmonisation, but provided an important step introducing some ideas, and importantly creating the Banking Advisory Committee (BAC). This committee could not agree on harmonising regulations on its own, but represented an important forum for regulators and supervisors to meet on a regular basis within an explicit EEC framework. Until then, the points of reference were the more informal Groupe de Contact, created in 1972 with a European scope, and the Basel Committee on Banking Supervision, hosted at the Bank for International Settlements, created in 1975 with a global reach.[29]

4.2.3. Financial transfers and the creation of the regional fund

The issue of financial transfers of resources from richer to less developed areas of the EEC came through two channels, namely, policy realisations, and expert reports. In addition to the ESF, a new fund was created in 1975, the European Regional Development Fund (ERDF). The establishment of the ERDF was partly a consequence of EEC enlargement, as not only Italy but also Ireland and the UK pushed for developing mechanisms aimed at reducing economic disparities in the EEC. A few years later, in 1978, the EMS negotiations revived debates about financial transfers. The EMS negotiations were effectively split into two parts. The first and most famous one focused on the new Exchange Rate System to be set in place. The second one, dubbed the 'concurrent studies', centred on the ways in which the participation of weaker currency countries in the new system could be supported through transfer of resources from richer member states. The Irish, Italian, and UK governments supported the development of such transfers, and explained that their participation in the EMS – an exchange rate system dominated by a strong currency, the Deutsche Mark – would be very difficult for them without economic support. The debates during the concurrent studies were revealing, but their outcome minimal. Instead of a comprehensive EEC framework, or more simply an increase of the existing funds, the only policy results were bilateral agreements, and interest-free EIB loans.

Academic and expert thinking about financial transfers remained however very vivid. Three important reports were published in the course of the second half of the 1970s, and related to this issue: the Tindemans, Marjolin, and MacDougall Reports. In December 1974, the EEC leaders meeting at the Paris summit commissioned the Belgian prime minister Leo Tindemans to write up a report defining "what was meant by the term 'European Union'."[30] Tindemans called for reviving EMU discussions, and for accepting a two-speed Europe in which some members would proceed to faster and deeper integration, while others would not. In dealing with EMU,

[28] First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, OJ L 322, 17.12.1977, p. 30–37.

[29] Catherine R. Schenk and Emmanuel Mourlon-Druol, "Bank regulation and supervision," in Youssef Cassis, Richard S. Grossman, and Catherine R. Schenk (eds), *The Oxford Handbook of Banking and Financial History*, Oxford: Oxford University Press, pp.395-419.

[30] Bulletin of the EC, Supplement 1/76, European Union, Report by Leo Tindemans to the European Council.

Tindemans called for greater economic integration in support of monetary integration. In 1975, the Marjolin Report mentioned above called for the development of a sizeable EEC budget, and in particular for the creation of a Community unemployment insurance. In order to explore more specifically the role of public finance in European integration, the Commission asked a group of economists chaired by Donald MacDougall to study the issue. The expert group published its findings in the so-called MacDougall Report in 1977.[31] This report remained famous for advocating a substantial increase in the EU budget. Noting that the EEC budget represented 0.7 percent of the EEC GDP in 1977, the report called for its increase in order for public finance to sustain the monetary union. The report mentioned that at a federal stage, the budget could reach up to 20-25 percent of GDP as in other federations.

The different studies, if most often headed to the filling cabinet, reflected a concern about the economic conditions necessary to sustain participation in the EEC exchange rate system, and, a fortiori, in a possible monetary union. They foreshadowed many of the debates of the 1980s and 1990s on the creation of the single currency.

5. The advent of a lopsided union: the Delors Report and the Maastricht Treaty

5.1. The working of the European Monetary System, 1979-1987

From a political standpoint, the EMS provided a stronger commitment from which departing would be difficult. From an economic point of view, the EMS constituted a framework for closer and more frequent consultations among policymakers.[32] From 1981, French domestic political economy decisions strongly affected the functioning of the EMS. Francois Mitterrand, elected French president in May 1980, had promised an expansionary economic policy. In hindsight, the 1981 economic stimulus would however only be half the stimulus that the Chirac government triggered in 1975. But politically the 1981 programme was more symbolic, lasted longer, and was part of a broader debate within the French left that would leave its mark on French political life until the present day. In March 1983, after weeks of intense debate, Mitterrand chose to prioritise a stability-oriented economic policy, and continued membership of the EMS.[33] This reinforced the French commitment to economic and political cooperation within the EEC.

The objective to establish a single market in the EEC by 1992, enshrined in the 1986 Single European Act (SEA), posed a challenge to monetary policymaking. Free movement of capital was part of the 1992 programme. As a consequence, all capital controls within the EEC were gradually removed between 1986 and 1990.[34] Could the single market with unrestricted capital movements function without a common monetary policy? This was the difficult question of the second half of the 1980s.[35] Some argued for a 'hardening' of the EMS: exchange rates

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[31] Commission of the European Communities, *Report of the Study Group on the Role of Public Finance in European Integration*, Brussels, April 1977.

[32] Horst Ungerer, *A Concise History of European Monetary Integration, from EPU to EMU*, Westport: Quorum Books, 1997, pp.169-198; Laurent Warlouzet, *Governing Europe in a Globalising World*, Abingdon: Routledge, 2017, chapter 7.

[33] Vincent Duchaussoy, *La Banque de France et l'Etat, de Giscard a Mitterrand : enjeux de pouvoir ou resurgence du mur d'argent ? 1978-1984*, Paris : L'Harmattan, 2011

[34] Abdellal, Rawi, *Capital Rules: the Construction of Global Finance*, Cambridge, MA: Harvard University Press, 2007.

[35] James, *Making the European Monetary Union*, chapter 6; Tommaso Padoa-Schioppa, *The Road to Monetary Union in Europe. The Emperor, the Kings, and the Genies*, Oxford: Oxford University Press, 2000.

could be stable in a single market if there was a high degree of convergence. Some argued that free trade, full capital mobility, fixed or managed exchange rates, and monetary policy autonomy could not co-exist, and that one had to give. This was the view put forward by the Italian economist Tommaso Padoa-Schioppa in his famous 'inconsistent quartet.' A monetary union would need to complement the single market. The debate was not settled, although the fear of speculative attacks against the EMS – as the 1992-1993 crises would later show – tended to highlight the vulnerability of the EMS in a world of free capital movements.

5.2. The Basle-Nyborg agreement (1987)

After nearly ten years of experience in the functioning of the EMS, EEC finance ministers and central bankers were looking for ways to strengthen the EEC's exchange rate system. In 1987, the Committee of Governors set out some elements for discussion, many of which had been discussed since the creation of the EMS, but never formalised. The Committee of Governors, meeting in Basle, produced a report on 8 September 1987; and the Council of finance ministers endorsed it on 12 September at a meeting in Nyborg. This came to be known as the Basle-Nyborg Agreement, and it contained two main elements related to surveillance, and intramarginal interventions.[36] Under the Basle-Nyborg Agreement, the Monetary Committee and the Committee of Governors, on the basis of their indicators and projections, would intensify surveillance in order to underscore possible policy inconsistencies among EMS countries. Intramarginal interventions were not explicitly included in the original EMS agreement. Such interventions allowed to try and anticipate a currency reaching its fluctuation limit, and contribute to prevent speculation. Some further measures were adopted, including encouragement for less frequent and smaller realignments, and an extension of the basic time limit of the Very Short Term Financing (VSTF).

5.3. The Delors Committee and the Delors Report

The Hannover European Council on 27-28 June 1988 agreed to appoint a Committee of Wise Men chaired by president of the Commission Jacques Delors to reflect on how a monetary union could be achieved in the EEC.[37] The Delors Committee, known formally as the Committee for the Study of Economic and Monetary Union, met seven times between September 1988 and April 1989, and was composed of 19 members, including all EEC central bankers.[38] This was an important departure from earlier similar such groups, which often involved finance ministers and other monetary experts, who were assumed to be more easily in favour of European monetary integration. Central bankers were supposed to be more conservative and critical of monetary union, and the eventual outcome of the discussions looked grim, with German president of the Bundesbank Karl-Otto Pöhl and governor of the Bank of England Robert Leigh-Pemberton aboard. Delors' innovation was to bind them into the process of discussion, rather than side-lining them as was the case until then.

Name	Capacity

[36] James, *Making the European Monetary Union*, 222-228.
[37] Kenneth Dyson and Kevin Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union*, Oxford: Oxford University Press.
[38] James, *Making the European Monetary Union*, pp.210-323.

Frans Andriessen	Commissioner in charge of agriculture
Miguel Boyer	Independent expert, former Spanish finance minister
Demetrios J. Chalikias	Governor of the Bank of Greece
Carlo Azeglio Ciampi	Governor of the Bank of Italy
Maurice F. Doyle	Governor of the Central Bank of Ireland
Willem F. Duisenberg	President of the Central Bank of the Netherlands
Jean Godeaux	Governor of National Bank of Belgium
Erik Hoffmeyer	Governor of the Central Bank of Denmark
Pierre Jaans	Governor of the Monetary Institute of Luxembourg
Alexandre Lamfalussy	General Manager of the Bank for International Settlements
Jacques de Larosière	Governor of the Bank of France
Robert Leigh-Pemberton	Governor of the Bank of England
Karl Otto Pöhl	President of the Bundesbank
Mariano Rubio	Governor of the Central Bank of Spain
José Alberto Tavares Moreira	Governor of the Central Bank of Portugal
Niels Thygesen	Danish economics professor
Gunter Baer	Rapporteur
Tommaso Padoa-Schioppa	Rapporteur

Table XXX: Members of the Delors Committee

The Delors Committee produced a detailed plan to achieve EMU in three stages (see Table XXX), unanimously endorsed by the members of the group. The first stage involved the strengthening of economic and monetary cooperation. Stage two focused on introducing the new European System of Central Banks that would take over the EMCF and the Committee of Governors. Stage three entailed the irrevocable fixing of parities. The Delors committee however refrained from establishing a timetable for completion, as well as from setting out detailed conditions for economic convergence between member states, as it considered that this was a political decision that went beyond the committee's remit.

Stage 1 1 July 1990-31 December 1993	Improvement of economic convergence
	Cooperation among EEC central banks increased
	Free movement of capital completed
	Free use of the ECU
Stage 2 1 January 1994-31 December 1998	Creation of the European Monetary Institute
	Independence of national central banks to be achieved during this stage
	Member state's efforts towards convergence further increased
Stage 3 1 January 1999	Transition to this stage granted if Treaty of Maastricht's criteria fulfilled

	Introduction of the euro bills and coins
	Creation of a European System of Central Banks and of the European Central Bank to conduct a single monetary policy
	Entry into force of the Stability and Growth Pact
	Exchange rates fixed irrevocably

Table XXX: The three stages for the completion of Economic and Monetary Union in the Maastricht Treaty

The members of the Delors Committee did tackle issues related to 'economic union' broadly speaking in their discussions – in particular economic policy coordination and banking supervision – but the final Delors Report focused essentially on the monetary integration dimension. This was again mostly due to the fact that the central bank governors considered that economic issues were beyond their competence remit.

The Delors and Werner report, as the two most famous blueprints for EMU, call for a comparison. The nature of membership is the first obvious difference. The Werner committee was made up of the presidents of the EEC institutions and committees involved in economic and monetary policymaking, while the Delors committee was composed by central bankers only. Delors sensed that central bankers were potentially most opposed to the project, and was keen to bind them in to the process through their participation to the committee and the agreement on the final report. The second oft quoted difference relates to the weight given to the 'E' in 'EMU'. The Delors report mentioned economic coordination in more detail than what would eventually make its way to the Maasticht Treaty. But this was in no way comparable to the substance of the Werner report, which contemplated a greater centralisation of economic policy coordination in the EEC. In addition, the Werner report clearly envisaged the consultation of social partners in EMU.

5.4. German reunification, the Intergovernmental Conference (IGC), and the Treaty of Maastricht

At the time when EEC leaders agreed to revive discussions about monetary integration in Europe, and appointed the Delors Committee no one could anticipate German reunification and the end of the cold war. Even in April 1989, when the group finalised and agreed on its report, the fall of the Berlin Wall was not envisaged, and even less the unification of West and East Germany. Once this process was set in motion, the French government in particular pressed for firm dates to convene an intergovernmental conference on EMU, and bind a reunified Germany into the EEC.

The move to an EMU indeed required treaty change, and treaty change required the convening of an intergovernment conference (IGC).[39] The European Council in Strasbourg in December 1989 decided to convene an IGC. The IGC began in December 1990, the Maastricht Treaty was eventually signed on 7 February 1992, and the Treaty entered into force on 1 November 1993. Two IGCs operated in parallel: one on EMU, the other on political union. The

[39] Lorenzo Bini-Smaghi, Tommaso Padoa-Schioppa, and Francesco Papadia, "The Transition to EMU in the Maastricht Treaty," Princeton : Essays in International Finance, No. 194, November 1994.

IGC on EMU started its discussions on a solid basis, that of the Delors Report. The Maastricht Treaty essentially incorporated the substance of the Delors Report.[40]

The Treaty of Maastricht set out four criteria for joining the euro, known as the 'convergence criteria' (see Table XXX). These four criteria related to price stability, government finances, exchange rate stability, and convergence of interest rates.

Price stability	For a period of one year before the examination, inflation rate (consumer price index) should not exceed 1.5% above that of the three lowest rates of euro area members.
Government finances	Deficit should not exceed 3% of GDP and debt should not exceed 60% of GDP.
Exchange rate stability	Respect the normal fluctuation margins of the ERM without severe tensions for at least two years before the examination. Candidate should not have devalued within that period.
Convergence of interest rates	Average nominal long-term interest rate (long-term government bonds or comparable securities) should not exceed by more than 2 percentage points the rate of the three best performing member state in terms of price stability during one year before the examination.

Table XXX: Convergence criteria for joining the euro[41]

While the Treaty of Maastricht outlined well-defined criteria for joining EMU, it was however not clear how these criteria would be upheld once a member state would join the single currency. The Stability and Growth Pact agreed upon in 1997 was meant to address this concern.[42] The SGP sought to stress economic stability – a chiefly North European concern – by introducing a coordination and surveillance procedure of national budgets, while it promised to do so without damaging growth prospects – a predominantly Southern European concern. If the SGP rules were not respected, member states would face sanctions.

5.4. The ERM crises, September 1992 – August 1993

Just as European currency relations seemed to have stabilised very well since the Basle-Nyborg Agreement, the whole European arrangement appeared to fall apart. Between 1987 and September 1992, no realignment occurred within the ERM.[43] The crises of 1992 and 1993 in the

[40] Dyson and Featherstone, *The Road to Maastricht*, chapter 16. See the annex of Harold James' *Making the European Monetary Union* for a detailed comparison of the two texts.
[41] Protocol No. 13 on the convergence criteria, *Official Journal of the European Union*, C 115/281.
[42] Martin Heipertz and Amy Verdun, *Ruling Europe : The Politics of the Stability and Growth Pact*, Cambridge : Cambridge University Press, 2010.
[43] One partial exception is when the Italian lira joined in 1990 the narrower band of fluctuation.

ERM thus called into questions some assumptions that were held in Europe at the time, related in particular to what European monetary cooperation achieved, and what its future would be.[44]

The Danish rejection of the Maastricht Treaty triggered the crisis. The Danish voters' unexpected negative vote on 2 June 1992 in the referendum cast doubt on the eventual entry into force of monetary union. On 3 June 1992, Mitterrand announces the holding of a referendum on the Maastricht Treaty in France. Polls were initially very favourable to a 'yes' win, but they became 'too close to call' over the summer. Further to this bleak context, the economic consequences of German reunification were proving problematic for other European countries. The Bundesbank was maintaining high interest rates to counter inflation, which in turn impacted the policies of the other EEC member states, and mounted the pressures for realignments within the ERM.

This political and economic context provided a propitious backdrop for currency speculation to flourish. The rapid integration of international financial markets facilitated its unfolding. In the summer of 1992, the pound and the lira came under pressure and speculative attacks, while the Bundesbank faced significant financial inflows partly due to the weakening of the US dollar. There was considerable debate as to whether the pound had joined the ERM at an appropriate level in October 1990. On the so-called Black Wednesday, 16 September 1992, the pound sterling came under heavy speculative attacks (betting that the pound was overvalued), in particular from Quantum Fund, owned by George Soros, and registered in the Cayman Islands. In spite of its interventions, the Bank of England could not counter the speculation, given the sheer financial volumes involved. The pound left the ERM, and Soros won the nickname of 'the man who broke the Bank of England.'

International financial markets seemed to have calmed down in early 1993, until pressure mounted again, this time against the French franc. Poor unemployment figures raised speculation about the future of French monetary policy. The French franc came under severe pressure in late July, but the crisis was in fact wider and involved the Belgian franc, the Danish krone, the Spanish peseta, the Portuguese escudo, and the Deutsche Mark. A crisis meeting of the Monetary Committee took place in Brussels on 31 July-1 August 1993. After tensed exchanges, the participants agreed to widen the EMS margins to 15 percent, with a view to effectively sterilise speculation.

8 October 1990	British pound sterling joins the ERM
7 February 1992	Signature of the Maastricht Treaty
2 June 1992	Danish voters reject the Treaty of Maastricht (50.7 against, 49.3 in favour)
18 June 1992	Irish voters approved the Treaty of Maastricht (69% in favour, 31% against)
12-13 September 1992	devaluation of the lira and interest rate cuts in Germany, Belgium, and the Netherlands
14 September 1992	Italian government decides to devalue the lira by 7%
16 September 1992	'Black Wednesday: heavy speculation against the pound

[44] Olivier Feiertag, "Les banques centrales et les États dans la crise de change de 1992-1993: le baptême de la monnaie unique," in Olivier Feiertag and Michel Margairaz (eds), *Les banques centrales et l'État-nation/The central banks and the nation state*, Paris: Les Presses de Sciences Po, 2016, pp. 617-644 ; James, *Making the European Monetary Union*, pp.324-381 ; David Marsh, *The Euro: the Politics of the New Global Currency*, New Haven, CT: Yale University Press, 2009.

17 September 1992	pound and lira leave the ERM. After speculative attacks, devaluation of the Spanish peseta.
20 September 1992	French voters approve the Treaty of Maastricht (51% in favour, 49% against)
29-30 July 1993	Severe pressure on the French franc and several other ERM currencies. Situation increasingly untenable.
31 July-1 August 1993	Crisis meeting of the Monetary Committee in Brussels. Agreement to wider bands of 15%

Table XXX: Timeline of the ERM crises 1992-1993

Conclusions –

The so-called crisis of the euro area that started in 2008/2009 made plain the weaknesses of the EMU construct as set out in the 1992 Maastricht treaty, and witnessed throughout the history of European economic and monetary cooperation since 1957 Treaty of Rome. It is true that European policymakers did not anticipate a sovereign debt crisis in the preparations for the European single currency. But they did discuss most of the other issues currently at stake, including financial transfers, banking regulation and supervision, and macroeconomic cooperation. Debates about EMU since the 1950s witnessed frequent, regular, and lucid contributions, in spite of incomplete and sometimes inadequate policy decisions.

The monetary side of EMU was also arguably not fully developed by the Maastricht Treaty. The role of the ECB was not yet fully comparable with that of other important central banks in the world, mostly due to the fact that the ECB could not act as a lender of last resort for the euro area. The different operations that the ECB undertook since 2010 (Securities Market Programme, Long-Term Refinancing Operations, Outright Monetary Transactions, and more recently quantitative easing) show that its operating model has moved closer to traditional central banking functions.

More broadly, EMU debates witness very striking similarities throughout time.[45] The question of the role of dollar in the international system and its impact on the EEC constitutes a first perennial feature of policy debates between 1957 and 1992. A more sophisticated version of this debate relates to how the development of a European regionalism could contribute to the reform of the international monetary system.

The debate about the institutional setting that would allow the development of an economic union is a second regular feature of European debates. Should the institutional set-up be more intergovernmental or more supranational? Should the EEC have moved to a full political union before introducing a single currency? With the Treaty of Maastricht, European policymakers did not just ignore the economic theories related to the OCA discussions. European policymakers also disregarded the idea according to which money was to be issued by a state. Georg Friedrich Knapp, in the nineteenth century, famously developed that theory, which has

[45] Emmanuel Mourlon-Druol, "Don't Blame the Euro: Historical Reflections on the Roots of the Eurocrisis," *West European Politics*, 2014, pp.1282-1296.

been taken on by contemporary economists.[46] The development of the European Union in response to the euro area crisis of the 2010s suggests that Europeans are developing their own form of Union, which still falls short of being a state, and remains instead in-between a federal and an intergovernmental entity.

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