Political Aspects of European Monetary Integration After World War II

by

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I.

After World War II, an all-encompassing effort was undertaken to eliminate for the future the risk of war between European countries which twice in this century had spread to the whole world. From the beginning, also economic cooperation arid monetary integration were politically motivated--by tying the European countries together in a common institutional framework and by rebuilding their economies in a mutual coordinated effort. The objective was to avert large-scale social misery, in the past a fertile breeding ground for' nationalistic and antagonistic feelings and policies. As the Cold War started to unfold, another important reason was to strengthen resistance to communism in Western Europe. Yet, the history of European economic cooperation and monetary integration is most frequently described and analazyzed in economic terms. The expansion of foreign trade and the removal of custom barriers, the elimination of payment restrictions and the granting of credit lines lend themselves more easily to description and analysis in quantitative terms. Improved political cooperation and stability and the overcoming of political rivalry eludes precise analysis.

Policies to rebuild the war-shattered economies of Europe concentrated on the onehand on the creation of a world-wide economic order by establishing the International Monetary Fund (IMF), the General Agreement on Tariffs and Trade(GATT), as a stand-in for the never realized International Trade Organization, and the International Bank for Reconstruction and Development . (the World Bank) which initially was mainly intended to assist in the rebuilding of the European economies. On the other hand, the US-financed European Recovery Program (ERP), the Marshall Plan, was to give a strong initial boost to European countries, thus providing a basis for the liberalization of trade and the multilateralization of payments within Europe in the framework of the Organization for European Economic Cooperation (OEEC; established in 1947) and the European Payments Union (EPU; established in 1950). The policies pursued by these institutions were successful beyond reasonable expectations, and it can be stated with confidence that without their success, one could not have seriously thought of creating the European Economic Community (EEC).(1)

The OEEC also promoted greatly political cooperation among its member countriesand strengthened the awareness of mutual interdependence. That the creation of OEEC and EPU was in large part motivated by the political objective of promoting cooperation among former enemies in rebuilding their economies was exemplified by the inclusion of the western parts of Germany in the work of the ERP and the OEEC even before the founding of the Federal Republic of Germany in 1949. This was in striking contrast to the policies ofvictorious countries alter World War I. At the same time, the refusal of the Soviet Union (and itssatellites) to participate in the ERP and to join the OEEC as well as its decision not to join the IMF and World Bank foreshadowed the Cold War al an early stage. It also barred East Germany, the future German Democratic Republic, from the unfolding effort to overcome the consequences of the war. This development greatly contributed to the disparate evolution of the economies and societies in the two parts of Germany, a fact which came to the open with the social, economic and financial difficulties associated with German unification in 1990.

II.

The establishment of the European Communities was even more than the OEEC a political undertaking, moving in tim economic field from cooperation to integration and reaching in its ultimate objectives beyond the economic sphere. in aiming at integration for the heart of Europe--the six countries which in Western Europe were most deeply affected by the war--the goal was to make war between those countries impossible and to reconcile the "arch enemies" Germany end France. It was therefore no accident that the first area of integration was coal and steel, the availability of which was at that time the precondition for tim possibility to wage war. Germany was to be tied into a community of nations in Western Europe. For Germany, European integration promised to free the country of the legacy of

WW II and of its fateful central position in Europe where for centuries it was torn between east and west, between alliances and cooperation on the one hand, and isolation on the other hand.
Even if in its main part--the EEC-the European Community (EC) did not commit itself to much more titan tim establishment of a customs union, the ultimately political objective of European integration was clearly in the mind of such people as Jean Monnet, Robed Schuman, Konrad Adenauer, Aleida de Gasperi and statesmen in Belgium, Luxembourg and the Netherlands.
It was seen less in this way in tim Untied Kingdom. This was one reason why in 1957-after agreement on the creation of the EEC was reached-the UK proposed a large European free trade area, which would have encompassed and thus absorbed the EEC. What matters in this context are not the technical differences between a free trade area and a customs union but the difference between purely economic objectives and objectives which were ultimately political.

III.
The EEC Treaty envisaged in essence only a customs union, to be supplemented by acommon trade policy and a common agricultural policy (CAP). In the treaty, not much is said about cooperation in the field of economic and monetary policies. Articles 103 to 109 evoke some general principles, call for the coordination of economic and monetary policies and provide for mutual assistance in case of balance of payments problems of member states. Even the liberalization of capital movements is required only "to the extent necessary to ensure the proper functioning of the common market" (Art. 67).
But if we look deeper, we discover political dimensions and ambitions. The EC Treaties set up a political institutional structure. In addition to the executive Commissions (in the case of the Community for Steel and Coal (ECSC), the High Authority) and the representation o[' the member states, the Council of Ministers, there are the European Parliament and the European Court of Justice. The preamble to the ECSC Treaty mentions safeguarding peace, substituting for age old rivalries the merging of essential interests; creating "the basis for a broader and deeper community among peoples long divided by bloody conflicts." The preamble to the EEC Treaty emphasizes the determination "to lay the foundations of an ever closer union among:the peoples of' Europe" and the pooling of their resources "to preserve and strengthen peace and liberty."
There are a number of reasons why the original EEC Treaty did not go much beyond establishing a customs union and does not provide for a close, leave alone binding cooperation in economic and monetary policies:
- the realization that such a binding cooperation and, even more, the establishment of an economic and monetary union (EMU) would substantially ' reduce national sovereignty;
- the European countries were aiming at (and achieved in 1958) the convertibility of their currencies in the context of the EPU, an important step in European monetary integration;
- the existence of a world-wide monetary framework under the auspices of the IMF that did not require on a regional basis detailed provisions for the coordination of monetary and exchange rate policies:
- the Bretton Woods system of fixed but adjustable exchange rates was functioning and the US dollar met its responsibilities as the key currency of the international monetary system;
- there was the belief that fixed exchange rates would prevail and in the EC context would only need to be safeguarded by escape clauses and provisions for mutual assistance in case of emergency (Art. 73, 10g and 109 EEC Treaty).
In the Sixties, the situation in the EC was mainly characterized by the energy consuming task of completing the customs union and implementing the common agricultural policy. This self-limitation had also an important political background; President de Gaulle was hostile toward a truly supranational EC. He wanted to preserve the traditional nation states and safeguard their identity, and therefore aimed at a "Europe of nations," with emphasis on national sovereignty. Yet, it was Charles de Gaulle who-together with Konrad Adenauer-brought about the reconciliation of France and Germany which was and has remained the linchpin for European integration. in this, he showed vision and proved to be a great statesman.

IV.
At the end of the Sixties, two events characterized the EC:
- the successful completion of the customs union and the implementation of the common agricultural policy; and

- the currency crises of 1965-69 which led to a significant devaluation of the French franc in August 1969 and a revaluation of the deutschmark in November 1969.
With de Gaulle off the stage, politicians aimed at two things:
- the widening of the EC by allowing the four countries (UK, Ireland, Denmark and Norway) that had applied for membership to join the EC (a move which had been vigorously opposed by de Gaulle), and
- the deepening of the EC by establishing EMU.
The first EC summit conference, later named European Council, in The Hague in December 1969 dealt with these issues. The communiqu, of the conference pointed clearly to the political significance of these initiatives. It spoke of preparing the way for a united Europe and of reaffirming the leaders' faith in the political objectives which gave the Community its meaning and significance.
Following the conference, in early 1970 a special committee was set up to study the realization of EMU by stages. Significantly, the committee was chaired by a politician, the Prime Minister of Luxembourg, Pierre Werner. Among its other six members, there were only ,' two central bankers, the remaining members being senior government officials and a high ranking representative of the EC Commission. In its report, the committee proposed to create EMU with a single currency and a European central bank in three stages over 10 years. It also recommended a common decision-making institution for economic policy and far-reaching' rules for the coordination of Fiscal policies.
While adhering to their objective of creating EMU, some member states, when faced with the recommendations of' the Werner Committee, in particular in view of the implied loss of sovereignty which could extend substantially beyond the monetary sphere, felt somewhat uncomfortable. It was therefore not surprising that the resolution of the Council of Ministers of March 22, 1971 was somewhat timid; it was long on general intentions and short on concrete measures. Nevertheless, by embarking on a move toward the creation of a monetary ' union when world-wide the trend was in the opposite direction, namely toward flexible exchange rates, underlined its political significance.(2)
Dealing only with the first stage, the resolution included the following measures:
- a narrowing of fluctuation margins between EC currencies, aiming at their eventual elimination;
- a better coordination of short-term economic policies and of monetary policies;
- the speeding up of the liberalization of capital movements within the EC which had largely stagnated since the early Sixties;
- a request for a report on the establishment of a European Fund for Monetary Cooperation.
The Fund was eventually established in April 1973, ho swever without real 'competencies. The most significant outcome of the Wemer Report was the agreement of the EC central banks in April 1971 to set up an arrangement for narrower fluctuation marginsbetween EC currencies as of June 1971.
But other events intervened.
Because of the pronounced weakness of the US dollar and under heavy speculativepressure, the deutschmark and the Dutch guilder were set free to float in May 1971, aftere fforts to agree on a common response by the EC to the crisis in international financialmarkets were unsuccessful. In August 1971, President Nixon suspended the goldconvertibility of the US dollar, and the dollar started to float freely against other currencies. The Smithsonian Agreement of December 1971 which attempted to restore the system offixed exchange rates by realigning the exchange rates of the major currencies (including adevaluation of the US dollar by about 10 percent) and the establishment of wider fluctuationmargins of + 2.25 percent around parities (instead of 1 percent) in order to add moreflexibility to the international exchange rate system, ultimately failed. In March 1973, the Bretton Woods system of stable but adjustable exchange rates collapsed and was replaced byworld-wide floating.(3) To avoid the floating of EC currencies against each other and to limit the impact of the wider margins on intra-EC exchange rates, the European common marginsarrangement (the "snake") was established in April 1972. Originally, under the blueprint ofthe Werner Plan, the narrowing of fluctuation margins was intended as a first step towardmonetary union. Now, it was a device to hold the EC together by a common exchange ratesystem. Even in this, the "snake" was not very successful as over time all major ECcurrencies but the Deutschmark left the arrangement. One important reason for thisdevelopment was the aftermath of the first oil price crisis in 1973. But more important was thelack of political will on the part of the EC countries to formulate a common response to the oilcrisis. The Werner Plan became its victim.

Thus, it was not only that there was no progress in monetary integration which in turncould have led to more political integration but the lack of political cooperation evenundermined economic objectives and achievements.

V.

The Seventies were a time of stagnation and unhappiness in the EC. Initiatives on npolitical level for closer cooperation in the field of exchange rate and monetary policies (Fourcade and Duisenberg proposals) and the idea of a European parallel currency proposedby a number of academics (All Saints' Day Manifesto and OPTICA reports (4)) did not find'acceptance. it was with a speech at the European University Institute in Florence in October 1977 that then EC Commission President Roy Jenkins tried to jumpstart the process of European integration by reviving the idea of EMU.(5) There was no immediate positiveresponse from EC countries but it is known that some leading politicians discussed mattersinformally with Jenkins.

In 1978, the German Chancellor Helmut Schmidt and the French President Valery. Giscard d'Estaing took the initiative for the creation of the European Monetary System (EMS)which came into being in March 1979. While this initiative was much less ambitious than the Werner Plan, it had a clear political motivation: to shield the EC from monetary disturbances, originating mainly from the US dollar, and to give a new impetus to integration.(6) It is interesting to note that in launching the EMS, the regular EC channels and bodies, such as the Monetary Committee, were bypassed. In the end, the EMS was not created by a decision of the Council of Ministers but, on the basis of the resolution of the Europe am Council of December 5, 1978, by an agreement of the EC central banks. The relevant texts concentrate' very much on monetary and exchange rate policies, and there is no explicit mention of the EMS being a step toward EMU.

In the conclusions of the presidency of the European Council meeting in Brussels in December 1978, it is only mentioned that [the EMS will] give fresh impetus to the progress of European unity."(7) Obviously, while politically motivated, one did not want to overreach as in the case of the Werner Plan.(8)

A European Monetary Fund, envisaged to be set up after two years, aspart of undertaking "to consolidate ... into a final system the provisions and procedures" of the EMS, did not come into being, because the political and economic preconditions for such a move did not exist.

An important aspect of the creation of the EMS was the strong opposition of the United Kingdom. In the end, the UK decided not to become a participant in the exchange rate mechanism (ERM), the operational heart of the EMS, although it because a nominal member of the EMS. The debate whether "the time was ripe" to participate in the ERM went on for years, and it was not until October 1990 that John Major, then Chancellor of the Exchequer, persuaded Prime Minister Margaret Thatcher to permit the UK to enter the ERM. To disentangle the political and economic arguments in this debate and in the final decision, and to analyze the misconceptions and mistakes on both sides of the debate could be the subject of a different paper.

Italy also hesitated very much to participate fully in the EMS. In this case, mainlyeconomic arguments were advanced against joining, in particular whether the italian economy was strong enough to stand up to the discipline required by the participation in a system of fixed, even if adjustable exchange rates. in the end, political as well as economic arguments were decisive: as a founding member of the EC, Italy did not want to remain outside a major effort to increase economic and monetary integration, and the constraints of the EMS were seen as an opportunity to strengthen domestic financial discipline. However, to preserve someflexibility, Italy availed itself of the wider fluctuation margins of :1:6 percent, compared with the regular margins of + 2.25 percent.

Any evaluation of EMS has to be conducted in monetary policy and operational terms.(9) But it is also clear that the consolidation of the EMS in 19112-83 was based on the political determination of a core of EC countries to move on with economic integration. At that time, serious exchange rate and balance of payments problems were overcome by a combination of comprehensive realignments and domestic stabilization programs, particularly in France.(10) The continued existence and the success of the EMS were considered essential for the EC as a whole as well as its individual member states. The emerging consensus on stability-oriented monetary and economic policies among a number of EC countries, in particular among those who from the beginning adhered to the narrower margins within the ERM, allowed the EMS to become the rallying point for intensified integration efforts. The achievements of the EMS provided the basis for the single market program, as incorporated in the Single European Act of 1986. Even the United Kingdom acknowledged this when, in the context of the debate about the Delors Report, it argued for basing any move to closer economic integration on the EMS.

In a later phase, the EMS displayed again a political dimension, although less solidly based on economic realities. From January 1987 on, there was no general realignment in the EMS for more than 5 1/2 years. This reflected in large part the degree of economic convergence which had been achieved by those EC countries which participated in the ERM from the beginning. At the same time and as a result of its success, the EMS was increasingly seen as a forerunner to EMU. There was a tendency, in anticipation of EMU and far ahead of reality, to regard exchange rates as more or less permanently fixed and to expect that this could be sustained by convergence efforts which would result from the need to prepare and qualify for participation in the EMU.

This image of the EMS as a quasi-monetary union was shattered by the turmoil in 'European financial markets in late summer and autumn of 1992, in particular in September. The unexpected difficulties experienced in the referenda on the Maastricht Treaty in Denmark (rejection by a very small majority) and even more in France (narrow approval only) put into question the notion of nearly automatic progress in convergence. They brought to light that a number of' ERM countries-those who had joined the ERM more recently (Spain, UK, Portugal) and/or made use of the wider fluctuation margins of 6 percent (in the case of Italy until January 1990)--lived on "borrowed stability," based on large interest rate differentials and overly optimistic expectations. As a result, the pound sterling and the Italian lira left the ERM and the Spanish peseta, the Portuguese escudo and in February 1993 the Irish pound had to be devalued. On May 13, the peseta and the escudo had to be devalued again. Ironically, Finland, Norway and Sweden who had hoped to strengthen their ties with the EC by linking in 1991 their currencies to the ECU, had to sever those links.

Another crisis developed in the EMS in July 1993 when the ability of' the French authorities to sustain their strict monetary, policy was questioned. This caused heavy speculation against the French franc and led on August 2, 1993 to a decision by the EMS countries to widen the fluctuation bands in the ERM from ñ 2.25%. and ñ 6%, respectively, to ñ 15%. From a political point of view, it is of interest that it was decided to maintain the system as such with central rates (which remained unchanged) and fluctuation bands although those were significantly widenend. This was to demonstrate the determination of the EMS countries to continue the process of monetary integration and the efforts to establish EMU. (11)

VI.

In early 1988, a big debate started about asymmetry in the design and the operation of the EMS. This debate was only on the surface about technical issues such as interventionpractices, financing of intramarginal intervention or interest rate differentials.

In examining '.those problems, economists had a field day.(12) in economic terms, the key issue was therelative roles of financing and adjustment in balancing an exchange rate system. Politically, itwas by no small measure also a debate about two closely related issues:

- the role of the Deutsche Bundesbank in European monetary policies, or--to ' put it in more abstract terms--the function of an anchor currency in an exchange rate system, and
- more generally, the role of central banks in economic policies, i.e., the independence of central banks.

This debate was conducted on a political level by politicians such as the Finance Ministers of France and Italy, Balladur and Amato, and the German Foreign Minister Genscher and Finance Minister Stoltenberg. It brought the political aspects of monetary and exchange rate management into the center. Insofar, it was a conspicuous precursor toimportant issues which later on were intensely discussed in connection with the Dolors Report and during the Intergovernmental Conference on EMU which began in December 1990. in addition, the single market program gave rise to two interrelated questions:

- Was the single market feasible without a common monetary policy and a common currency?
- Was a single currency needed for the optimal realization of a single market?

In June 1988, at its meeting in Hannover, the European Council charged a special committee to study ways to establish EMU. It was chaired by Jacques Delors, President of the EC Commission, and in addition consisted of the governors and presidents of the central ' banks of twelve EC countries, one more member of the EC Commission and three independent experts. The decision to have top central bankers form the core of the committee was significant and in large part determined not only the results of the committee's work butalso the future discussions and negotiations about the nature of the intended monetary union.

The Delors Report was published in April 1989.(13) It is of interest to note that the Delors Committee --in contrast to the Werner. Committee- did not recommend the setting upof a common decision-making institution for economic policy, assigning this task mainly tothe Council of Ministers, i.e., the representatives of the member states. In the same vein, itsrecommendations regarding the coordination of fiscal policies fell noticeably short of therecommendations of the Werner Committee. While the Werner Report did not discuss in detail institutional aspects of the proposed European Central Bank, the Delors Committeemade the independence of such a central bank end its commitment to price stability as theprimary objective of monetary policy the centerpiece of its recommendations. Its proposals for the institutional setup of the bank were closely modelled after the Deutsche Bundesbank -- an aspect of economic as well as political importance acknowledging the achievements of German monetary policy and recognizing that without guarantees for a stability-oriented European monetary policy Germany could not be persuaded to give up its currency for a'single European currency.
In June 1989, the European Council accepted the Delors Report as basis for furtherwork on EMU and agreed that the first stage toward the realization of EMU would begin on July I, 1990, coinciding with the deadline for the liberalization of capital movements for most EC countries, a cornerstone of the single market program. In early 1990, Chancellor Kohl and President Mitterand called for the formation of a political union, however without giving aclear indication of the meaning of this term. it was decided that intergovernmental conferences on EMU and political union would start in December 1990.

VII.
From the beginning of the discussions about EMU in 1987-88, and especially after the Delors Committee had published its recommendations, the United Kingdom expressed'opposition to a concept of' EMU which was characterized by common policies andinstitutions. Prime Minister Thatcher, in an appearance before the House of Commons on June 29, 1989, voiced serious doubts about the transfer of sovereignty in monetary matters and a European Central Bank which-in her view-would be run by "governors [who] would not bedemocratically accountable in any way," and announced "alterative proposals."(14)
In November 1989 the UK authorities presented a paper, called "An Evolutionary Approach to Economic and Monetary Union."(15) It advocated an approach under which existing national currencies would compete with each other in a multicurrency system toensure stable prices and thus stable exchange rates. The EMS could evolve into a system ofmore less fixed exchange rates, and in this way over time a "practical monetary union" couldbe achieved. The proposal was seen by many observers as an attempt to derail furtherdiscussions about EMU on the basis of the Delors Report.
In June 1990, then Chancellor of the Exchequer John Major presented in a speech anew proposal which contained certain institutional aspects. The ECU (European Currency Unit) -- composed of a basket of twelve EC currencies - would become a currency in its ownright which would exist alongside and compete with existing EC currencies. It would beissued and administered by a European Monetary Fund and would never be devalued againstany EC currency ("hard Ecu"). As the "hard ECU" would be more widely used, "it wouldbecome a common currency for Europe [and] in the very long term, if peoples and governments so choose, it could develop into a single currency. "(16)
There was no great enthusiasm for the British proposals on the part of the other ECcountries who preferred the "institutional" approach of the Delors Report under which in athree stage process a European Central Bank (ECB) would be set up and a single Europeancurrency be created. As the Intergovernmental Conference on EMU proceeded, it became ':-clear that the United Kingdom could not easily be persuaded to accept a concept of EMUwhich was based on the Delors Report. Determined to make the conference a success and toavert a British veto, the other EC countries offered solutions they hoped would be acceptable to the United Kingdom. In the final phase of the conference, at the European Council meeting in Maastricht on December 9 and 10, 1991, Prime Minister Major obtained important concessions from his partners not only with regard to EMU but also in the areas of foreign, defense and social policies. Concerning EMU, the UK was given the option of not joining EMU even if it would meet the required economic conditions, and the right to join later at anydate if it so desired.
At a late stage in the negotiations, Denmark also requested and secured specialexemptions. With regard to EMU, it would be allowed to make its participation in EMU subject to a referendum. But even this concession was not enough to induce the Danish voters to accept the Maastricht Treaty in a

referendum on June 2, 1992. At its meeting in December 1992, the European Council agreed to grant Denmark an outfight exemption from EMU as well as from a common defense policy. On this basis, a second referendum took place on Mayi g, 1993 in which the Danish voters approved the treaty with a comfortable majority.

Ratification of the Maastricht Treaty has been completed in all EC countries after ratification by the United Kingdom took place in Augsut 1993 and in Germany in October 1993. In the UK, ratification appears to have been a tortuous process, in which considerationsof European policy and of principles of economic policy played an important role alongside intense competition between the two main political parties and intra-party ideological conflicts and rivnlries. On November 1, 1993 the Maastricht Treaty entered into force.

VIII.

Instead of dealing in detail with the discussions surrounding the Delors Report, this paper will consider a few problems which were widely discussed and are of special interest when we explore the political aspects of EMU.

The first problem is that of the independence of a European Central Bank. In the EC, there have been and still are widely differing arrangements for the relations between the political authorities and the central bank. They range from situations where the government is in charge of monetary policy decisions and where the central bank is not much more than a department of the treasury, with the task of implementing government decisions, to a situation where the central bank formulates and implements monetary policy independent ofinstructions from the political authorities. The reasons are not simply that one country may be more fearful of inflation than others. Also, it does not necessarily mean that there is a stronger belief in an effective trade off between inflation and unemployment in one country than in another. The reasons go deeper. Obviously, there is a desire on the part of politicians to yield as much power as possible in the economic field. In this way, they hope to shape economic developments according to their political beliefs and to influence elections. Behind this stands the general concept that all aspects of economic policy, including monetary policy, should be subject to a unified approach. it was the government -so goes the argument-- which through parliament was answerable to the electorate. Therefore, the principle of democratic accountability called for monetary policy powers to be in t. he hand of politicians.

Another view sees great risks emanating from the short-term policy interests and instincts of politicians for a consistent monetary policy oriented towards the longer-term economic and social needs of a country. It is believed that price stability is a precondition for longer-term stability and growth. Indeed, more recent economic theory and empirical research rejects the notion of a trade-off between inflation and unemployment except in the short-term, which is where the politicians are seen to come in. Inflation-free money--or non- political money-is considered an essential prerequisite for a functioning market economy.

Price stability is thus seen as a quasi-constitutional element of a free economic order, together with market economy principles, private property and free competition. Only an independent central bank could ensure price stability. Democratic accountability was provided by a clear legal mandate for the central bank, appropriate appointment procedures for central bank leaders, and the requirement to justify policy to the public. It is interesting to note that highly independent central banks exist in such countries with well-established democratic traditions as the USA, the Netherlands and Switzerland; and that there is or was no country with an authoritarian rule which had an independent central bank.

The Maastricht Treaty unequivocally provides for the independence of the ECB and for price stability as the primary objective of monetary policy (Art. 107 and 105,1., respectively). It also requires that national central banks be given independence prior to thetransition to EMU (Art. 108). In the meantime, legal action to grant their central banks moreindependence has been taken in such countries as Belgium, France, Italy and Spain.

IX.

Related to the issue of functional or instrumental independence of the ECB is thequestion who should be in charge of exchange rate policy-the ECB or the politicalauthorities. There is the view and actual experience that monetary policy can be eroded fromthe external side, and that therefore the ECB should be fully in charge of exchange rate policy. Another view sees the exchange rate as a powerful instrument which exercises a greatinfluence on the economy, in particular investment, growth and employment. Therefore,responsibility for exchange rate policy should rest with the political authorities. The negotiations at the Intergovernmental Conference on this issue were not easy. Theoutcome was that the ECB will be in charge of exchange transactions (Art. 105,2.). Thatimplies that in a world of floating currencies, the ECB is de facto in charge of exchange ratepolicy. The Council of Ministers may, however, acting by a qualified majority, formulate"general orientations." They "shall be without prejudice to the primary objective of the ECB(European System of Central Banks)to maintain price stability" (Art. 109,2.). Furthermore,when it comes to possible arrangements for an exchange rate system with non-communitycountries, consistency with price stability remains an important consideration. Decisions bythe Council in this respect must be unanimous; for the setting of parities in any such system, aqualified majority is required (Art. 109,1.).

A third subject of great interest is the field of budgetary policies. It is here where thequestion could be asked whether monetary union will be viable in the longer term without apolitical authority determining in a community framework fiscal policies of member states. This would constitute an important element of a political union. Experience shows that astability-oriented monetary policy cannot be successful in the longer run if not supported byappropriate budgetary policies. The turmoil in international financial markets in September 1992 was in part related to a certain incompatibility between monetary and fiscal policieswithin as well as between a number of countries such as the USA, Germany, Italy and the UK.

For the Werner Committee of 1970, the challenge and the answer were clear. Committee decisions were to be taken on the size of deficits and their financing as well aswith regard to the main elements of budgets such as revenue and expenditure, and thedistribution of the latter between investment and consumption. In 1989, such a solution wasseen as neither politically acceptable nor as economically necessary. While the Delors Report- did not go as far as the Werner Report, it called for binding rules on budget deficits and their financing. This raised the question of national sovereignty. Budget authority is one of the main prerogatives of any parliament. Limiting this prerogative would be tantamount to reducing national sovereignty.

The Maastricht Treaty does not mandate binding rules for fiscal .policy. But it contains fairly strict provisions which him at responsible fiscal policies:

- no bail-out, i.e., no EC country or the Community shall be liable for or assume the financial commitments of another EC country (Art. 104,b.);
- no central bank financing of budget deficits (Art. 104,1.);
- the avoidance of excessive government deficits, as deœmed by quantitative criteria, relating to the size of the deficit and government debt (Art. 104c,I. and 2.);
- the possible application of gradually more severe sanctions (Art. 104c, i I.).

To many, it is obvious that market forces would not be enough to enforce discipline in fiscal matters, although they may exert some pressure; therefore the need for rules. However, given the political interplay between government, parliament, pressure groups and the public at large, fiscal policy cannot be separated from other policies such as social policy, industrial policy, subsidies for various purposes or from social developments in general. Therefore, one cnn have legitimate doubts whether the rules in the Maastricht Treaty will be sufficient to ensure responsible fiscal behavior or to prevent policy paralysis due to protracted discussions and tensions over national fiscal policies.

At the opposite ends of a wide range of options on this subject, one could formulate two views:

- To all those who see a link between EMU and political union, a common monetary policy requires and eventually will lead to common decision-making on budget matters.
- In the other view, any move toward political union and hence to the surrender of national sovereignty is not wanted; therefore a fullfledged monetary union, because it eventually will require some binding coordination of fiscal policies, is not desirable either.

X.

Another area where economic and political considerations will have to be brought intobalance, is the role of the European Council and the Council of Ministers in the decision-making process in EMU. The French government put particular emphasis on what it called,,government ,conomique."(17) This would allow a parallelism, a dialogue between the"p“le mon,taire"-represented by the ECB--and a "p“le ,conomique." The independence ofthe ECB could only be understood in the interdependence with a strong economicgovernment. With the latter, the French did, however, not have in mind a

central decision-making institution for economic policy but rather a strong involvement of the European Council and the Council of Ministers in decisions concerning EMU.
This idea was again apparent in an interview President Mitterand gave before the French referendum of September 20, 1992.(18) tie said: "[La future Banque Centrale] ned‚cide pas In politique ‚conomique [dont la politique mon‚taire sera l'application]. C'est le Conseil Europ‚en, ce sont les douze Chefs d'Etat et de Government,c'est-…-dire les politiques‚lus au suffrage universel qui d‚cideront." However, this interpretation of the Maastricht Treaty as far as it applies to monetary policy is not consistent with its actual provisions, andreflects more the French position at an early stage of the negotiations than its eventualoutcome.
The French proposal for an EMU treaty (19) envisaged that the European Council -would determine broad orientations for EMU and for the economic policy of the Community.Within such guidelines the Council of Ministers would coordinate the policies of memberstates and make recommendations to individual governments.
These ideas, although somewhat weakened, are reflected in the Maastricht Treaty. The Council of Ministers shall draft "broad guidelines" for the economic policies of memberstates, to be discussed by the European Council. On this basis, the Council of Ministersadopts, with qualified majority, a "recommendation" setting out these broad guidelines (Art.
103,2.).
On exchange rate policy, the French proposal envisaged that the Council of Ministers. would deœme the orientations of exchange rate policy. The Maastricht Treaty says that the'Council of Ministers may formulate "general orientations" which - as already mentioned -are not to conflict with the primary objective of monetary policy to maintain price stability. On monetary policy, the French treaty proposal provided for the possibility that the Council of Ministers could submit motions for discussion by the Council of the European System of Central Banks. This idea did not become part of the treaty.

XI.
The last area of interest I want to discuss are provisions for the transition to the finalstage of EMU. Here, the European Council will play an important role (Art. 109j,2.,' 3. and 4.). On the basis of the findings of the Council of Ministers, it will be up to the European Council to decide when the final stage should begin, somewhere between January 1, 1997 and January 1, 1999, and which countries would qualify for participation. The treaty contains a number of qualification criteria with regard to price stability, public finances, exchange rate sustainability and long-term interest rates. But in application of these criteria, a certain degree of discretion is allowed, and other aspects of economic performance, such as the balance of payments and unit labor costs, are to be taken into account (Art. 109j,I. and 2.).
It is this element of discretion that triggered a lot of criticism. Would the Council notbe tempted for political reasons to dilute the economic criteria for participation and thus endanger the viability of EMU from the start? Would there not be the danger of compromises and even of horse-trading? Would certain policy objectives, such as avoiding a multi-tiered Community, be not in conflict with sound economic principles?
All such questions can finally be answered only in the future. However, one wouldexpect or hope that the politicians in charge at that time would realize that establishing EMU is a serious business which in the longer run will determine the future of the Community and should not be seen from a short-term perspective of political convenience. Otherwise, the whole enterprise of EMU and the hope for future progress in economic and political integration would be at risk.

XII.
After the discussion of the political implications and consequences of certaineconomic aspects of European monetary integration, a few comments on the relationshipbetween the concepts EMU and political union. The concept of EMU has been much moreclearly defined than the concept of political union. Already the Werner Report presented aprecise definition of EMU.
As mentioned, Chancellor Kohl and President Mitterand established a link between EMU and political union in early 1990. It was in particular Kohl who felt, in connection with German unification, that--as a compensation for the future abandonment of the deutschmark--Germany should be firmly anchored in a more united Europe not only in economic but also in political terms. He was in particular concerned about a' more democratic rule of the Community and therefore in favour of more power for

the European Parliament. Such expectations were only partially met by the Maastricht Treaty. It does not envisage a political union in the sense of central institutions and majority voting with regard to political issues. The treaty mainly provides for intensified cooperation between member states in such areas as foreign and defense policies. Also, the European Parliament will only gain a limited extension of its responsibilities. In the Maastricht Treaty, the concept of national sovereignty has not been given up in favour of community responsibility.

Whether with regard to the question of national sovereignty versus community responsibility the treaty went far enough or too far, the debate in various countries led to different conclusions.

- One view strongly rejects any community role in matters of foreign, defense and social policies. There is even strong resistance to the concept of EMU. In this category seem to fall countries like Denmark and the United Kingdom.
- Another view shows strong attachment to national sovereignty in such "classical" areas as foreign and defense policies. However, EMU is strongly favored, in part because it is hoped to compensate for a loss in national autonomy in the monetary field by shared responsibility. France is an example.
- A third view, mainly found in Germany, all along seriously doubted the feasibility of a single currency unless supported by strict economic rules and built on a foundation of closer political union. Similar views seem to be held in the Netherlands and in Luxembourg.
- In quite a few countries, however, EMU is considered not only a worthy objective in itself but also an important step toward political union. A political union is seen to provide some protection against a possible hegemony of any of the larger countries or a coalition of larger countries. To this group belong Belgium, Italy, Luxembourg and the Netherlands.

XIII.

In order to sum up, it can be observed that from the very beginning, after WW II, the economic and monetary integration of Europe had a strong political motivation. Integration in : :the economic field was not only seen as a way to overcome the destruction of the war and to .. improve the standard of living for the people of Europe but also as a means to leave behind : century-old rivalries and to eliminate the risk of war in Europe.

Political objectives time and again helped to overcome difficulties in the economic field and to move forward to higher levels of integration. But it also must be noted that there was a strong adherence to concepts of national sovereignty and to nationally defined, often short-term economic interests. This undermined until now attempts in the EC to create an economic and monetary union that would combine the institutional elements of a common monetary order and a high degree of economic policy interaction and convergence which is widely considered an indispensable precondition for monetary union. There was even more difficulty to agree on meaningful elements of a political union which in the view of many would have to provide a solid foundation for EMU and which would justify the substitution of national currencies - powerful symbols of' sovereignty and independence, and in some countries like Germany also of political, economic and social achievements after a disastrous war -- by an untested single European currency. These are the questions which are at the heart of' the debate about the Maastricht Treaty. The answers will decide the fate of the vision embodied in this treaty.