VISION OR REVISION
Managing Europe's Way to EMU

Univ. Prof. Dr. Klaus Gretschmann
University of Technology , Aix-la-Chapelle (D) and EIPA

1. The Challenge

At first glance and in the general public's perception, the plan for and the pros and cons of *European Monetary Union* (EMU) appear to be derived from the purported dismal and often inconclusive discipline of *economics.* In the face of an, as yet, incomplete European Common Market, confronted with growing global competition and due to serious economic problems in Europe, such as unemployment and structural inertia, the creation of a common currency for Europe seems indispensable to its proponents and an incorrect strategy to its opponents.

At second glance, EMU is much more ambitious and appears to be part of a far-reaching *political* strategy of integration: in the course of its history, the EU has gone through different phases emphasizing different areas of integration. The period between 1957 and 1968, when the members of the then-EEC established their customs union, can be characterized as the phase of *trade-driven integration* (free movement of goods). After a considerable slow-down in integration efforts in the 1970s (mainly due to the collapse of the Bretton Woods system and the two oil crises), there was renewed momentum in the 1980s based on *factor-driven integration* (free movement of capital and labour). These developments were accompanied by ever closer cooperation and integration in a whole series of primarily national policy areas, such as taxation, budgetary, regional, social, environmental, industrial and other policies. The 1990s, eventually, have been characterized by what one might call *money-driven integration*, as laid down in the provisions for EMU in the Maastricht Treaty on European Union. The logical continuation of these long term developments may well imply the striving for Social Union, Fiscal Union and Political Union. In this context it is obvious that the future of European integration will crucially depend on the success or failure of EMU which is due to commence in 1999.

Unfortunately, the EU is presently being faced not only with serious challenges such as enlargement, reform of the institutions, its fiscal constitution and the distribution of the budgetary burden among the Member States. It is also subject to a deep *crisis of legitimacy*. This crisis may be caused partly by the EU's apparent inability to deal with the major political and economic problems of the continent and partly because Europe seems too distant to the citizens, incomprehensible and intransparent, and characterized by a lack of vision.

Under these – not exactly favourable – conditions, any policies designed to promote the EMU idea must be considered as extremely sensitive. However, during the past two years or so, there appears to be a tendency to *oversell* – and this might carry the unintended consequence of *overkilling* – the EMU undertaking. The promotion strategies – rather than emphasizing the special political features of EMU – are often rightly criticized as being designed like commercials for consumer products.

What is evident to everybody, but what many officials often do not dare to spell out, is that EMU is a – *necessary,* to be sure – *socio-economic experiment*. Regrettably, the credibility of EMU is seriously endangered by official voices omitting to emphasize this fact.

A convincing and more credible strategy would emphasize the following elements: (1) EMU contains risks and opportunities; (2) and so does the world without EMU; (3) Europe undergoes fundamental changes even without EMU, changes which may involve temporary welfare losses; (4) the potential losses from reforms can be minimized, if EMU brings the expected benefits; (5) if not, the situation will not be worse than without EMU. *In theoretical terms*: the convincing argument is not that EMU cannot go wrong and will make everybody better off. What it would be advisable to emphasize is its potential to help bring about the necessary changes by making reforms less painful and by making the social and economic costs of the changes manageable!

It goes without saying that, under the circumstances outlined above, the necessary ingredients to make EMU 'tick' and make it acceptable to the peoples of Europe – the building of consensus on common goals and objectives, common strategies and actions, and the right models of integration – will not be easy to create.

In what follows, I will argue that what is much more important than the widely discussed and the selectively emphasized economic aspects is the politics of EMU. Rather than discussing at length the significance of economic variables, such as deficits, debt, inflation or interest rates, measured in precise figures, what should be discussed is common European interests and ideals. What is crucial is the *convergence of policy models, of the beliefs in the minds of policy makers, and the ideas of social groups and the general public as to where Europe should go from here*.

It appears as if, despite lipservice to the contrary, (a) national positions with regard to EMU still diverge widely in models, beliefs and interests, and (b) often EMU is 'exploited' through *'scapegoating',* i.e. by putting the blame for domestic austerity measures on the EMU as a *European* undertaking. This, of course, creates legitimacy problems and causes a lack of popularity *vis-à-vis* a common European currency amongst the national electorates of Europe.

2. Belief Differences and Conflicts of Interests

2.1 Convergence – What Convergence?

As is well known, after a decision by the EU Heads of States and Government in April 1998, EMU is to commence on 1 January 1999 with the irrevocable fixing of exchange rates of those countries found eligible to join a monetary union on the basis of the so-called convergence criteria.* Half a year earlier, the European System of Central Banks

consisting of the European Central Bank (ECB – the decision-making institution) and the National Central Banks – the operating arms of the ECB – will be established. A single European currency, the 'EURO', will be introduced as a bookkeeping currency as of 1999 and is intended to replace the national currencies (notes and coins) as legal tender as of 2002.

Contrary to some official pronouncements, the selection of the group of countries to participate in EMU will require much *more* than just a look at the 1997 statistics, in order to check which countries fulfill the entry criteria on the spot. This is linked with two problems: (a) the formulation of the legal text in the Maastricht Treaty leaves quite some leeway for divergent interpretations; (b) the criteria do not exactly betray a compelling economic logic (*Buiter et al 1994; de Grauwe 1994*). Therefore, they will most probably be *interpreted as first proxies* and they will have to be complemented by a well-balanced consideration of economic *and* political factors. Effects on export markets in the non-participating countries as well as existing structures of cooperation (such as the Belgium-Luxembourg monetary union) and political sensitivities (e.g. in Italy and Spain) will certainly have to be taken into account. A politically driven – bargaining – process rather than purely economic considerations will then determine the decision.

If this reasoning is correct, the issue arises as to what functions the convergence criteria really fulfill. Standard arguments hold that if there is a sufficient degree of convergence among national economies, they will neither be subject to asymetric shocks nor will they require diversified economic policy measures *(Gros 1996)*. Therefore, a sufficient (whatever that is) degree of convergence will make it *possible* to run a joint monetary (and economic) policy for the whole of the Union-to-be. In the eyes of the economist the EU is, admittedly, not yet an *optimal* currency area, but it will be able to perform as an *advantageous currency area (Commission 1990)*. Of course, this requires a careful selection of *structurally close or similar* national economies. Any selection will also make it necessary to solve the 'insider-outsider' problem: how to restrict the effect of the reaction of those Member States not found eligible to join the first round of EMU.

The crucial word above is *'possible'*. Whether the conduct of a joint optimal economic policy is *plausible* or even *probable* depends on other conditions. *Siebert (1997)* recently pointed out that a Monetary Union would require near-perfect agreement on the *philosophy* on which a common economic and monetary policy is to be founded. In the same vein, he argues that a coherent and jointly accepted *paradigm of economic explanation* is also an indispensible prerequisite. *Gretschmann and Kotz (1997)* argue that the creating of politico-economic *Wahlverwandtschaften (chosen relatives),* which is an indispensable precondition for EMU, requires much more than what is laid down in the provisions of the Maastricht Treaty and its recent complements like the 'stability pact'.

If the necessary conditions are not in place, the probability of conflicts over divergent interpretations, assumptions, philosophies and – ultimately – policies will rise sharply in an EMU, no matter what the hard economic criteria suggest. Even if countries have committed themselves to a common set of rules – like the Maastricht Treaty – they may tend to defect and renege once EMU is in place, provided there is no, or too little, *convergence in the minds of decision makers.*

2.2 Model Uncertainty and Disparate Beliefs

As analysed in the literature on policy coordination in the late 80s *(for an instructive overview see*: *Bryant 1995),* difficulties can be attributed to four main factors:

- there are different national constraints on the policy instruments available *(limited domain);*
- there is disagreement about the effects (size and degree) of specific policy changes on policy targets *(differences in beliefs);*
- there are cross-border differences in the degree of (inter-)dependence *(differences in spill-over effects);*
- there are different models of how national economies and the global economy work *(model uncertainties).*

Among these factors it is the second and the last which are intertwined and which seem to be of particular salience: decision-makers usually have only limited knowledge about the functioning of their national economies. They know even less about the working of the global economy. This means they are faced with the problem of having to decide between competing models, the properties and premises of which they hardly understand. This is already a bedeviling problem at national level. It will be even harder to solve and more complicated at international level.

The key EMU beliefs are both of an economic and a political character *Dyson (1994:316)*. Below, I have enumerated the most important and disputed beliefs about EMU:

- the belief that fixed exchange rates are superior to floating ones;
- the belief that the long-term costs of devaluation to competitiveness outweigh the benefits;
- the belief in the virtues of unconditional pursuit of price stability;
- the belief in the significance of the gains from eliminating transaction costs of a multiple currency regime;
- the belief in the superior benefits of economic policy coordination;
- the belief in the efficient workings of liberalized financial markets;
- the belief in the superiority of an independent Central Bank;
- the belief in the advantages of tying the hands of national monetary policy;
- the belief that EMU provides an efficient means of controlling the power of Germany;
- the belief that the blueprint for EMU can be implemented without any unintended or counterproductive political side-effects or social costs, etc.

Of course the degree to which individual Member States subscribe to such beliefs varies widely, and consequently their individual commitment and willingness to enter into the EMU process and to accept the structural constraints of an EMU regime are by no means the same.

Taking this gulf into consideration, what then is the real worth of the Maastricht criteria to which politics in Europe so often refers? At first glance they seem meaningless and even intrinsically worthless, since they

will not be able to avoid deep policy differences among EMU members. They make joint policy optimization possible, but only to the extent that covergence of beliefs already exists.

To be even more explicit: The ongoing argument about the deficit ceiling of 3% of GDP, the issue as to whether three percent is 3,0% or 3,5% or otherwise is *absolutely misleading*. The figures are nothing but indicators of the beliefs, of the willingness to follow a generally accepted policy-model, a symbol for joint, non-defective policy behaviour in a Monetary Union.

Therefore, in order to make sense, the criteria require to be reinterpreted: their primary purpose seems to be that they carry some informational value. They may be able to reveal the true preferences, commitments and beliefs of the individual potential EMU Member States. They are intended to serve as an, admittedly imperfect, proxy for creating rational expectations with regard to future economic decision-making of the partner countries. This way, they are a safeguard to optimize mutual (dis)trust and to decide on one's own willingness to commit national interests to the common cause of EMU *(Winckler 1995)*. Their major function is to serve as a signalling device!

3. EMU's Main Political Problem: Scapegoating

The main problem with EMU's popularity can be found in the fact that many Member States' governments have exploited and instrumentalized EMU commitments in order to implement unpopular and austere domestic economic policies in a politically cost-efficient way. Such policies, which would have to be conducted anyway, even without EMU, *can be enforced much more easily* by blaming a supranational body or regime, i.e. the EU. In the framework of the EU, so the argument goes, a country has to comply – willingly or unwillingly – even with undesirable decisions imposed on them externally. This argument is often used by national policy-makers to deflect negative social and political reactions of the losers from the introduction of a particular policy.

This strategy of *externalizing domestic legitimacy costs* can be called *'scapegoating'*. It is exactly this pattern that permeates also the EMU approach. In almost all EU Member States it has been extremely difficult indeed to marshal the domestic political support necessary for implementing unpopular economic measures, such as savings in public budgets, cut-backs in welfare expenditure or deficit reduction and tax reform. The political resistance from vested interests made it very costly to push reforms through. Commitment to EMU as well as compliance with other measures decided in an intergovernmental or supranational institution like the EU, facilitates the taking of unpopular decisions. Membership of such institutions is rational and beneficial -amongst other things – because (a) it allows domestic politics to shift legitimacy losses onto third parties and (b) it furnishes arguments and excuses.

But scapegoating not only helps export political costs, it also contributes to *importing pressure to change*. Such pressure may be necessary in cases where national economies are no longer able to reform themselves, to break rigidities and overcome inertia. Also, from this vantage point, EMU carries some benefits: As several authors have pointed out, EMU – due to the loss of the exchange-rate as an instrument for bolstering adjustment processes – will lead to more competitive pressure, more mobility, more comparability of prices and wages etc.. Although not all participating countries will frankly subscribe to these objectives, it gives them options which would otherwise not exist. These options would be difficult to create without an external scapegoat: As *Marks et al (1995)* observe, Member States' political executives can hide behind decisions made by the ECB, the Council or the Commission. They can fend off domestic opposition and defuse dissatisfaction by arguing that they are duty bound to adjust to arrangements they cannot change unilaterally. This way, EMU may be used as a *garbage can (Ostrup 1995)* into which Member States 'voluntarily' toss unpopular economic policies in order to avoid their electorates holding them accountable for unpopular actions.

Even though scapegoating helps promote domestic economic reforms and externalizes the political costs incurred, it is not without cost itself: As a matter of fact, externalizing costs onto an international player or regime does not reduce total costs but just shifts, i.e. redistributes, them. If this were to involve diffusion over several parties, it could be considered beneficial due to burden sharing and lower perceptability. However, in the case of EMU we witness, rather, a concentration and an accumulation of the political costs onto one party (the EU) only, i.e. an increase in perceptibility. This is clearly a major reason for the lack of popular support for European integration among the peoples of Europe.

This may also backfire on the domestic level via the following feed-back loops: the more successful the strategy of scapegoating, the greater the loss of popularity of the European common cause, the more difficult it is to run a successful policy for integration at national level and, consequently, the higher the proclivity of national electorates to fall for nationalistic political ideologies.

4. Regaining Rather than Losing Sovereignty through EMU

Standard arguments against EMU refer to the loss of political sovereigny and the economic steering capacity going with it. However, also this argument clearly misses the point. The nation states of Europe long ago lost a large share of their political sovereignty and parts of their economic power of control over *liberalized and unrestricted global markets (Gretschmann, Heitzer-Susa 1997, pp. 327-330).*

Globalization has changed drastically the context within which national policy-makers operate. Globalization can be characterized as a loss of significance of physical, fiscal, economic, technical, and other such boundaries. It can be described as 'interconnectedness' determined by the degree of 'externalities and spill-overs' resulting from others' decisions. This involves changes in the structure, volume and distribution as well as in the efficiency of national policy-making: traditional deficit spending to stimulate the national economy of a country has become inefficient by leading to higher demand for imports; national tax policy has failed in the face of high international mobility of tax bases; autonomous national monetary policy has been rendered troublesome with perfectly liberalized and voluminous financial markets (US $ 1,400 billion turnover a day in forex markets). These and other examples demonstrate clearly that, in the face of global interrelatedness, the national capacity to control has been seriously reduced anyhow, i.e. even without political integration.

Against this background, international regimes (such as EMU) must be reinterpreted as *a means of regaining political control* (lost at the national level) at a higher intergovernmental or supranational level. In this vein, EMU will be able to contribute to an *increase rather than to a loss of political sovereignty vis-à-vis* market forces.

This clearly contains as a component the strengthening of Europe's influence *vis-à-vis* the USA and Japan. As a matter of fact, the period between 1950 and the present has been characterized by the monetary hegemony of the US dollar. The USA could afford to neglect the external implications of its domestic monetary policy due to the fact that the export share in US-GDP has remained continuously at no more than about 9%. Therefore, sharp movements of the US $ (ups and downs) did not really impact on their domestic economic situation. Consequently, the USA adopted an attitude of 'benign neglect' *vis-à-vis* other countries in their foreign economic policy. They abstained from taking into account how non-US currencies were affected by dollar volatility. With a Single European Currency in place, the European economies may be able to form a counterweight challenging the US economic hegemony on the monetary side *(Benassy, Italianer, Pissany-Ferry 1994)*. This will give all European economies and polities a heavier weight in the economic and political conflicts of interest in the 21st century *(Benassy-Quere 1996)*.

5. Conclusion

What our line of argument has displayed is that in fact (monetary) integration has so far not sufficiently overcome national interests and is still embedded in and constrained by disparate (economic) beliefs and ideas of what kind of Europe we should envisage. A fully-fledged and well-functioning EMU would require the political will to steer (fiscal and monetary) politics and policies in line with a, still poorly defined, common interest and a, generally accepted, common model. Considering the lack of these conditions and taking into account the challenges which the Union faces at the turn of the century, the conceptual, theoretical and political foundations on which EMU has been erected still appear rather shaky.

This problem is surely aggravated (a) by the fact that national governments may be inclined to use the *scapegoating* strategy as a means of domestic policy making and (b) by a lack of recognition that EMU does not really involve a loss of material sovereigny in the first place, but rather offers the opportunity of *regaining political and economic steering capacity vis-à-vis* global markets.

It is no minor mishap that the creation of a sufficient degree of convergence in models and beliefs has not occurred on the route to EMU. It is this deficiency that makes the creation of EMU so extremely difficult. The convergence of common ideas and the moulding of a common *European ideal* – today EMU rather presents itself as a series of *national deals* – appears to us the most important cornerstone of a successful EMU. It would give EMU the necessary popular support among the European peoples and the general public and it could help to shape a new vision of European integration, a vision Europe needs so badly on its way to the next millennium. ❑

NOTE

* The Maastricht Treaty, it will be remembered, stipulated the following conditions for eligibility: an inflation rate of no higher than 1.5 percentage points above the average of the 3 best performing countries; an interest rate (long-term) no higher than 2 percentage points above the average of the 3 best inflation performing countries; a deficit of maximum 3% and a national debt level of 60% of national GDP. Our own calculations and forecast yield the following prognosis for 1997 (see table 1).

Table 1: Criteria – Forecast 1997

Country	Long-Term Interest Rates (10 years Government Bonds)	Deficit / GDP ratios 1996	Deficit / GDP ratios 1997*	Level of Public Debts 1997*
L	5.54	0.9	0.5	6.8
NL	5.63	2.4	2.3	77.2
F	5.67	4.1	3.3	58.0
A	5.74	4.3	2.0	67.2
D	5.75	3.8	3.3	61.5
B	5.84	3.4	3.0	126.9
FIN	6.13	2.6	2.0	59.4
DK	6.33	1.5	0.5	67.3
IRL	6.50	1.1	1.5	72.0
P	6.54	4.0	3.3	70.0
E	6.68	4.4	3.3	66.2
S	7.03	3.3	2.0	77.0
UK	7.12	4.1	3.0	55.5
I	7.35	6.8	3.5	122.4
GR	9.28	7.4	7.0	109.0
Spread	3.74	6.5	6.5	-

Calculations by author, based on data from EU Commission, OECD, IMF, DB Research.
(* Estimates)

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