THE COMPLICATED ROAD TO ECONOMIC AND MONETARY UNION

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The last century was witness to significant changes. In regard to European economic and monetary integration, which has also been the subject of much discussion and activity in Slovakia, three core initiatives may be distinguished:

– the Werner Plan for achieving economic and monetary union by 1980,

– introduction of the European Monetary System (EMS) in 1979, and

– the Delors Report of 1989 and the Intergovernmental Conference devoted to the issue of economic and monetary union.

These stemmed from an endeavour to relaunch European integration, the aim of which was to secure the political and economic development of Europe and to make Europe more competitive at the international level. Unlike the last of these initiatives, the first two also represented a response to international monetary crises. In the case of the Werner Plan, it was the collapse of the Bretton Woods system – the culmination of increased fluctuations in exchange rates; as for the EMS, it was the adverse effect of movements in foreign currencies, especially the US dollar.

The Intergovernmental Conference in 1991 was held at a time of exchange rate stability among the member states. Moreover, in contrast with the 1970s, this was a period marked by economic growth. These conditions created the scope for new economic and monetary integration. Eventually, a three-stage plan for the establishment of European economic and monetary union (EMU) became a central part of the Treaty on European Union concluded at the Maastricht Summit of December 1991 ("the Maastricht Treaty").

It was following the collapse of the Bretton Woods system at the end of the 1960s that the European Community first voiced support for economic and monetary union. The leaders of EC countries called for the union to be created by 1980, though this was gradually shown to be unrealistic. The complexity of the whole process was seen almost ten years later with the drafting and adoption of the Single European Act; in its preamble, member states confirmed their willingness and obligation to gradually implement EMU. The fact that the provisions of the Single European Act on the Community's monetary authority were too conservative – with reference to the experience gained from cooperation within the EMS – indicated the need for more substantial political pressure for the creation of new integration.

Progress in achieving the objective of new integration came with the introduction of the single internal market. It's establishment reflected an awareness of the new possibilities for increasing the dynamics of economic growth among the member states. It was in 1985, at a time of economic stagnation in European countries, that the European Commission published the White Book, identifying around 300 measures that would have to be adopted in order to complete the single internal market. The aim of this book was to bring about the conditions under which market activities are conducted as straightforwardly within the Community as they are within a single country. Thus the conditions were to be created for removing barriers and obstructions to economic activities with the objective of increasing efficiency, growth, trade, employment and prosperity. Even before the programme was launched to introduce the single European market, a group of economists were putting forward the view that a common market with common policies would, in the long term, only be possible within an integrated framework of macroeconomic and monetary policies. All the conditions for creating the single market were established in 1992, and the nexus between completing the creation of the single market and launching EMU started to be stressed within member states after implementation of the single market had begun. In August 1990, the EC had stated that a single currency would be the natural corollary of the single market. The benefits of these changes would support and complement each other. Standpoints and information from official EC bodies repeated the view that the creation of a single currency was a natural and essential feature of a smoothly functioning single market.

The Community's approach to EMU was set out in a binding document entitled "Report on economic and monetary union in the European Community", drafted under the leadership of Jacques Delors, the then President of the European Commission. The Delors Report did not make an explicit statement on whether the creation of EMU was necessary to the success of the single market. Nor did it include a cost-benefit analysis for the introduction of the new union. The drafting committee, comprising the central bank governors from the 12 member states, two European Commissioners and three independent experts, instead outlined how EMU could look and what steps should be taken to bring it about. The Report defined the union as including "a guarantee of full and irreversible currency convertibility, total liberalisation of capital movements and full integration of banking and other financial markets, the elimination of margins of fluctuation and the irrevocable fixing of parities in exchange rates". The Report identified four basic features of the new union:

– a single market in which people, goods, services and capital can move freely;

– a single policy of economic competition and further measures aimed at strengthening market mechanisms;

– common policies on structural change and regional development;

– the coordination of macroeconomic policy, including budgetary policy.

The gradual introduction of three of the above features was already underway when the Report was published. The single market programme was being implemented and basic limits for uniform rules of economic competition within the single market had also been laid down. In seeking to make the single market a success, the member states agreed in 1988 that it was essential to increase support for regional development. In 1992, the Cohesion Fund was set up for the benefit of less developed member states and to assist their entry into EMU.

The last feature, the coordination of macroeconomic policies, represented a new concept, under which the Report emphasized the need for centralized control of national fiscal policies in order to ensure the successful functioning of economic and monetary union. The Report addressed the setting of upper limits on the budget deficits of individual member states and the exclusion of access to direct central bank credit. In regard to administration, it also focused on the introduction of a system of central banks that should comprise a central institution and national central banks; its main role would be the formulation a common monetary policy. The Report reflected the strength of influence exerted by Bundesbank and its then governor, Karl Otto Pöhl. The primary objective of the system of central banks was to be price stability and independence from government influence and control.

The Delors Report is best known for proposing the individual stages in the creation of EMU:

– 1st Stage: free movement of capital and closer monetary and macroeconomic cooperation between member states and their central banks;

– 2nd Stage: creation of a system of central banks with the role of monitoring and coordinating national monetary policies; greater supervisory powers for Community institutions (especially the European Parliament and Council); progressive narrowing of the EMS fluctuation bands;

– 3rd Stage: irreversible fixing of exchange rates.

Although the stages were clearly defined, the Report did not mention any schedule for their fulfilment. This may have been a result of the unsuccessful attempt in 1972 to establish a monetary union by the end of the decade. The Report merely recommended that the first stage commence prior to 1 July 1990, when the movement of capital was to be liberalized as part of the single market programme.

Publication of the Report was followed by various political controversies centred on the issue of national sovereignty. The majority of ERM members had already surrendered control over national monetary policy, and by the end of the 1980s their currencies were pegged to the mark, which represented a kind of unofficial anchor of the system.

Sovereignty and the establishment of economic and monetary union was an issue grounded in political motives. Money was not only a means of making transactions but also a symbol of national identity. Sir Leon Brittan, a European Commissioner at that time, put forward an interesting compromise proposal according to which existing coins and banknotes would be preserved and their value in the new currency would simply be stated on one side. The crisis surrounding ratification of the Maastricht Treaty indicated the strong relationship between countries and their national currencies, especially in Germany, where the mark represented the post-war period of prosperity and stability.

At this time when the future of union was under discussion, the Commission did not attempt a cost-benefit analysis of the new economic and monetary union. Member states had to reach their own conclusions, and most were clear that the potential benefits outweighed the intangible political costs. The majority of countries had already sacrificed national sovereignty by having joined the ERM, and some of them, such as Italy, viewed the Community's strict rules for national fiscal policy to be the only way of reducing their huge budget deficits and public debt.

Meanwhile, the efforts to build EMU were coming in for comment from influential economists. In 1992, American professor Martin Feldstein set out his arguments against the single currency and monetary integration, claiming that the transition to the common currency would in fact restrict trade within Europe. It would probably reduce prosperity, too, by leading to an increase in unemployment and greater cyclical fluctuation in economic activity within individual countries. It could cause inflation to rise in comparison with the current monetary system. The loss of governments' possibilities to use the currency rate and interest rate was, according to him, the key problem with economic and monetary union. He cast doubt on the view of the union's framers that the elimination of exchange rate fluctuations between EMU members would bring an expansion of trade, with entrepreneurs not having to be concerned about the risk of devaluation or exchange rate fluctuation affecting the currency in which a transaction had been made. Feldstein claimed, on the contrary, that the rigidity of the currency rate could hamper trade. Data from the US had shown that fluctuations in the dollar's exchange rate did not affect the movement of foreign trade in the US. In Feldstein's view, the debate on transition to EMU had seen political considerations outweigh economic ones (fast-track progress to political union) and a monetary union would not be beneficial for Europe due to purely economic reasons.

Bayoumi and Eichengreen produced an analysis of the effects of currency integration in Europe based on comparing the occurrence of supply and demand shocks in the US and Europe. Included among the costs of monetary union was the loss of member states' currency autonomy, the loss of their capacity to issue money for budget deficit financing, and the loss of their scope to have a different fiscal policy. The real costs would depend on asymmetric shocks in the countries of the monetary union. These economists were at the same time concerned about the effect and development of the internal market and its combination with demand shocks.

Particular discussions also affected the drafting process for the Maastricht Treaty. The Treaty laid down that the single currency would be introduced at the beginning of the third stage, as of 1 January 1999. At the beginning of the 2nd stage, the European Monetary Institute was to be created in order to prepare for the third stage and to monitor whether individual countries were observing the requirements of participation in the economic and monetary union.

On the basis of the Maastricht Treaty, those member states that are interested in joining the third stage have to meet several criteria in order to ensure a high level of sustainable economic convergence (Article 121 of the Treaty). These are known as the Maastricht criteria.

It cannot be clearly said how these discussions affected the formation of EMU. The criteria laid down in the Maastricht Treaty – the Maastricht convergence criteria – basically ignored the theoretical approaches of economists who, like Mundell, McKinnon and Kennen, stressed mainly macroeconomic factors. The Maastricht criteria – on price stability, currency stability, the level of budget deficit and government debt, and interest rates – had a predominantly macroeconomic character, and to a certain extent reflected the theoretical ideas of Ingram and Haberler. It should also be noted that the stress on achieving low inflation and low budget deficits and government debt implied a combination of neutral fiscal and monetary policy amid conditions of flexible exchange rates.

What may be said is that the microeconomic and macroeconomic criteria should not be strictly set against each other, since the fulfilment of one of the criteria (for example, high mobility of production factors, flexible wages and prices) creates the conditions for overall macroeconomic stability. The ideal would certainly be if monetary union met all the microeconomic and macroeconomic criteria. The quantitative setting of all criteria would, however, be very demanding, if not impossible, especially in the case of microeconomic criteria. Even if it were possible to set such criteria, their fulfilment would be highly complicated and the practical realization of monetary union would be put back significantly.

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