DEBATES ON EUROPEAN SINGLE CURRENCY ON EUROPEAN INTEGRATION PROCESS

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ABSTRACT

DEBATES ON EUROPEAN SINGLE CURRENCY ON
EUROPEAN INTEGRATION PROCESS

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This thesis looks at how European Single Currency (EURO) that began circulating on January 2002 as a legal tender will affect the European integration process. Because money has been accepted as one of the founding elements of a state for centuries, whether the Euro will be effective in the direction of a probable "United States of Europe" or not? Firstly, theoretical and historical roots of European integration are explained in the thesis as the basis of economic integration. The foundation, the stages and institutional mechanism of Economic and Monetary Union (EMU) is looked at throughout the thesis with the theories of Regional Economic Integration and Optimum Currency Areas (OCA). The thesis reaches the conclusion that economic integration may gradually bring about the need for political integration in the EU, but not necessarily.

Keywords: European Monetary Union, Euro, European integration.

ÖZ

AVRUPA TEK PARASININ AVRUPA ENTEGRASYON
SÜRECİNE ETKİLERİ ÜZERİNE TARTIŞMALAR

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Bu tez Avrupa Tek Parası olan ve Ocak 2002'de dolaşıma giren Euro'nun Avrupa Entegrasyon sürecine olan etkilerini incelemektedir. Para, bir devletin kurucu öğelerinden birisi olarak kabul edildiği için Euro'nun da olası bir "Avrupa Birleşik Devletleri" fikrini etkileyip etkileyemeyeceği tartışılmaktadır. İlk etapta, ekonomik entegrasyonun temelleri olarak Avrupa Entegrasyonu'nun teorik ve tarihsel kökenlerine değinilmiştir. Ekonomik ve Parasal Birlik (EPB)'in oluşturulması, aşamaları ve kurumsal yapısı, Bölgesel Ekonomik Entegrasyon ve Optimum Para Alanı (OCA) Teorileri ile birlikte anlatılmıştır. Bu tez, ekonomik entegrasyonun Avrupa Devletlerini adım adım politik entegrasyona götürebileceği, fakat bunun kesin olmadığı sonucuna varmaktadır.

Anahtar Kelimeler: Avrupa Para Birliği, Euro, Avrupa Entegrasyonu

To My Mother

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I would like to thank to my thesis supervisor Assist. Prof. Dr. Fulya Kip Barnard, for her suggestions, criticisms, and encouragements in this research.

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EC - European Economic Community

ECB - European Central Bank

ECOFIN - Economic and Financial Affairs Council

ECSC - European Coal and Steel Community

ECU - European Currency Unit

EDC - European Defence Community

EEC - European Economic Community

EFTA - European Free Trade Association

EMI - European Monetary Institute

EMS - European Monetary System

EMU – European Economic and Monetary Union

EPC - European Political Community

EPU - European Parliamentary Union

EUF - The European Union of Federalists

ERM – European Exchange Rate Mechanism

ESCB - European System of Central Banks

EU - European Union

GDP - Gross Domestic Product

ILO - International Labor Organization

IMF - International Monetary Fund

LMU - Latin Monetary Union

MS’s – Member States

OCA - Optimum Currency Area

SEA - Single European Act

TEU - Treaty on European Union

TNC’s - Transnational Corporations

UK - United Kingdom

UNESCO - United Nations Educational, Scientific and Cultural Organization

CHAPTER 1

INTRODUCTION

1.1 Subject Matter and Aim

On January 2002, € 132 billion in notes and € 37.5 billion in coins were introduced as legal tender for use in 12 European Union (EU) countries, in everyday transactions by more than 300 million people. Actually, European Economic and Monetary Union (EMU), more concretely European single currency (Euro) have been in the lives of the Europeans and also in a global world in the lives of most of the other people since its adoption in eleven EU Member States (Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland) on 1 January 1999, and soon twelve with Greece on 1 January 2001 as their national currency.

While European single currency was started to be used as deposit money on January 1999, it was circulated physically in coins and banknotes on 1.1.2002 in Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland and Greece. UK, Denmark, and Sweden were opted out from single currency, in other words these three EU member states are staying outside the monetary union. Besides, UK and Denmark have special status which allows them to decide when and if they will join the euro area.

The ten new member states who joined the EU on 1 May 2004 (Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia) and the two who joined on 1 January 2007 (Bulgaria and Romania) are required to adopt the euro as soon as they comply with the necessary monetary requirements and notably the

Maastricht convergence criteria on public finances, inflation, interest and exchange rates. The entrance of these new member states to the monetary union will probably strengthen the role of euro as a new reserve currency and also the role of Europe in the world because it will increase the territory and population of the area that euro will circulate and in turn a more integrated and stronger euro area could be a sign of the success of EMU.

Slovenia was the first Member State forming part of the group of countries joining the EU in 2004, which complied with all convergence criteria and was therefore allowed to adopt the euro. Euro notes and coins entered circulation in Slovenia on 1 January 2007.[1] Five years after euro was introduced into the EU, three years after Slovenia acceded to the EU and 15 years after Slovenia declared independence from the former Yugoslavia, Slovenia's adoption of the euro marks a new stage in the east-west integration of Europe.[2]

Cyprus, Malta, Estonia, and Latvia are expected to follow Slovenia and enter the monetary union in 2008, while Slovakia and Lithuania are aiming to adopt the single currency in 2009. The entry of the Baltic nations of Lithuania and Estonia which had been planned as 1 January 2007 was postponed because of the high inflation rate in their economies. Furthermore, Czech Republic is planning to enter in 2012, Hungary and Poland are aiming for 2013.

If we look at this last stage of European monetary integration, we can say that it can be named as one of the most ambitious, far-reaching and radical developments in the European integration process, besides the enlargement of the EU towards Central and Eastern Europe in the year 2004. It is significant at the same time, in the sense that the nation states were relinquishing their sovereignty in the monetary field to a supranational body of control. National governments have transformed their policy agendas according to the requirements of EMU and they have adapted to the new institutional framework created at the EU level.

I have become interested in this subject matter of European Economic and Monetary Union due to the attractiveness of the topic because money has been accepted as one of the founding elements of a state for centuries. Over the centuries, the national currency, bearing the head of the king, queen or president, has everywhere symbolised national autonomy. One of the very early acts of the new countries that sprang from the ashes of the ruined Soviet empire was to design a new currency.[3] Now twelve EU states left their sovereignty about controlling their national currency and monetary policy to the common institution of the EU, to the European Central Bank. The other reason why I have studied on this topic is that I believe that the economics and politics are interconnected in state affairs and in world affairs, as well. That is why I choose to study on an interdisciplinary field.

It is interesting that the EU is trying more and more to carry out the everyday functions of the nation states.[4] Currently monetary union is said to be the most visible, potentially irreversible, move away symbol from the traditional functions of the nation state. The Economist defined this stage in European integration process as “the biggest step yet toward European political and economic integration”.[5]

In this thesis, my basic question is going to be: Will single currency be a unifying factor for further integration of the EU, specifically in the way to the political integration of the continent or not? More idealistically, in the way to a “United States of Europe” or not? Or, will it constitute a risk for the members of the Union and stop the European integration process? The other questions that are tried to be answered are: Why were the European countries attempted to found such a monetary union? In what ways the countries, citizens and social groups of the EU have been affected from the introduction of a single currency? How do the citizens of the EU countries perceive the euro? Have it been internalized by the people or not approved yet?

EMU has been on the European agenda for many years. It remains to be a subject that has been argued by policy makers and academic economists both before and after its launch. Some European political leaders see EMU “as an economic means to a political end, rather than an end itself". However, some others say the opposite and see EMU as an end itself. Therefore, we can say that the arguments about EMU are related to the arguments about sovereignty, the future of the nation-state and the different views about which shape Europe would or should take.

Throughout the thesis it is assumed that the European integration process has an implicit federal aim of political integration. It is also assumed that functional integration of sectors of the economy is a means towards this end as cooperation in one area spills-over into other areas. As Haas presupposes, there is a link between welfare and high politics. Once most welfare issues (like economics) have been shifted away from the nation state, integration will inevitably spill-over to traditional fields of high politics (like defense and foreign policy).

1.2 Structure of the Study

This thesis consists of five parts excluding the Introduction and Conclusion. The object of the first four chapters is to analyze the theoretical grounds of European integration in general and economic and historical basis of European monetary integration in specific. Whereas in the last chapter, a cost and benefit analysis, in other words the pros and cons of EMU and the consequences of euro on the EU countries, citizens and social groups are analyzed.

In the thesis, the analysis is made mainly by taking into account the period of the EU with fifteen member states, in other words the period before its largest enlargement towards Central and Eastern Europe, plus Malta and Cyprus in the year 2004. Therefore the twelve euro area members of the fifteen that are Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland and Greece, and the other three non euro are members of the fifteen (Britain, Sweden and Denmark) are included in the analysis.

The thesis starts with the theoretical roots of European integration with the second chapter. Grand theories, which seek to provide a comprehensive explanation of the EU's nature and development is presented. The ideas about European integration after the 2nd World War is dealt with for making an analysis of the route the European integration process is taking place. Federalism, functionalism, neo-functionalism and spill-over effect, intergovernmentalism and transactionalism are studied. Therefore, the basic question of the second chapter is: What are the premises of integration theories about the nature and development of European integration?

The third chapter examines the stages of regional economic integration and economic integration in the EU. The evolution of the EU regional economic integration is studied and compared with the evolution of other world economies. Basic questions tackled throughout the chapter are as follows: What are the steps of regional economic integration and where does the place of EU economic integration fit in this process? What are the differences between regional integration in Europe and regional integration in other parts of the world? Is there a relation between monetary integration and political integration?

In the fourth chapter some examples of previous monetary unions from the history is dealt with. The integration process of Western Europe which started after the 2nd World War is also explained in the chapter because it is thought to be the historical basis of economic integration. It is concluded that the failure of European Defense Community project turned the direction of Western European integration process from political sphere to economic sphere at the start. In the second part of the chapter developments towards Economic and Monetary Union in Europe until the Maastricht Treaty**,** the attempts made in the way to monetary integration and the creation of EMU and the euro are examined. Also, the stages of EMU, provisions of Maastricht Treaty related to EMU and institutional mechanism of EMU are studied.

Chapter five is an analysis of the debates on social and economic repercussions of euro on Europe. The reaction of social groups to the single currency in Europe and

Theory of Optimum Currency Areas (OCA) as the basis of the economic literature dealing with the issue of currency areas or monetary unions are going to be explained. Therefore, the basic questions of chapter five are: How do the European social groups react to the single currency or euro? What does the Theory of Optimum Currency Areas telling about? In terms of OCA, is the European monetary union an optimum currency area or not? If not, what does it mean for the EU?

In the sixth chapter, a cost and benefit analysis of EMU is made. Therefore, the expected benefits and costs of EMU are dealt with. The attitudes of the EU citizens towards the euro is tried to be displayed by analyzing the public opinion surveys of the Eurobarometer. The basic questions of the chapter are: What are the consequences or impacts of the European single currency on some of the select EU countries (member countries of the EU before the 2004 enlargement)? Empirically, in what ways, for example, the UK, Germany and Italy and their citizens have been affected from the euro? Are they affected from this development in a positive or negative way? Or how do the citizens perceive the euro?

The last chapter reconsiders what was studied in the previous ones and reaches the conclusion that integrating sectors of economy (economic integration) which started with European Coal and Steel Community in 1951 and reached to the point of Economic and Monetary Union in 1999 may gradually bring about the need for the EU for political integration, but not necessarily. EMU seems to be the most important unifying factor for the EU in the foreseeable future, but at the same time it has even got the potential of dividing the members of the European Union, as well.

ENDNOTES

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CHAPTER 2

THE THEORETICAL ROOTS OF EUROPEAN INTEGRATION

Until the Twentieth Century, it has been an ideal to unify the countries of Europe. However, the post war environment of the Second World War promoted the integration in Europe. In that environment, the main criticism was about the existing national state system. The nation state was discredited in every possible way: Morally, it was discredited by its nationalistic chauvinism. Economically, it was not able to avoid crises. Militarily, since the nation state was no more successful in securing the safety of its citizens.[1] The main problem was the conflicts between the European countries, especially the conflicts between Germany and France and the final aim was the uniting of the European countries. Therefore, different strategies were proposed for uniting them: Strategies that were beyond and within the national state system.

There were many different views about which shape Europe would take. And there were many debates about which way to follow while giving Europe its new shape. But, the main point was to prevent a new war in Europe. For this aim, some saw that there must be more intergovernmental cooperation in Europe. Some, on the other hand, thought that a European federal state had to be established in order to prevent future wars among its constituent countries.[2]

Each school of thought has its own characteristics depending on the distinction between the strategies of political determinism and economic determinism. The distinction between those who say that economic relations determine the political structure (neo-functionalism, functionalism) and those who say that political relations are the determining factor within the national and international system as a whole (federalism, intergovernmentalism and con-federalism).

Even before the establishment of European Coal and Steel Community (ECSC) and up to the present moment, the difference has underlain the whole process of European integration. Would the direct transfer of powers from the nation-state to the Community level and the creation of new institutions lead more quickly to the purported goal of political union? Or would it be easier to start by integrating sectors of the economy, which would gradually bring about the need for political integration? The path actually has chosen lay closer to the second approach.[3]

Although there was an agreement about the final political goal of the European integration at the time of the signing of the Paris Treaty which set up the ECSC in 1950, the failure of the European Defense Community project and the establishment of the European Economic Community (EEC) and the Euratom in 1958 showed that such an agreement about the final political goal no longer existed. Therefore, the abandonment of direct political method and the adoption of the strategy of economic determinism was not the result of choice, but the result of necessity. The reason that an initiative on the nation state by means of a direct transfer of power in the political sphere would not be accepted at the start. Therefore, the logic of regional economic integration has come to dominate the political agenda and has driven the further institutional evolution.

Throughout the first chapter, first of all the post war environment of the Second World War is tried to be put forth for taking into consideration the atmosphere when the ideas of European integration had emerged. After that, the premises of the main integration theories, which seek to provide a comprehensive explanation of the EU's nature and development, is evaluated.

2.1 Federalism

The federal idea received fresh impetus from the post-war debate on the future of Europe. Following two devastating wars in just thirty-five years some political leaders, especially on the Continent of Europe, were convinced that the only way to ensure peace was to cement the countries of Western Europe together in a federal system of government. Given this context it is not surprising that most scholars writing on the subject had an essentially sanguine view of federal-like political arrangements.[4]

The most enthusiastic European integrationists would like to see a federal "United States of Europe" in which the current national governments would become little more than local governments, with the same kinds of powers as state governments in the United States. Before this could happen, the European Union institutions would at least have to be able to act on behalf of all the member states in foreign relations and a single European currency would have to exist.

Federalism has been seen as much a theory as a political strategy and a slogan. The federalist cause in Western Europe received strong support for a United States of Europe based on the American model, especially during the first years of the post war period. The European Movement of Federalists and the European Movement were among the organizations created in the late 1940's to promote the federalist cause. Initially, many hopes were centered on the creation of the Council of Europe born at the Hague Conference of 1948. Growing disappointment with it led the federalists to support M. Robert Schumann's idea for the creation of a Coal and Steel Community. Attention was not so much directed at the "functional approach" adopted by M. Robert Schumann. The fascination of this project lay in its "supranational" elements.[5]

A well known European federalist, M. Denis de Rougemont, in a pamphlet "The Way of Federalism", lays down six "governing principles" as a way to federation, the last of which he describes as follows:

> I see European federation growing slowly, in many different places and in many different ways. Here, an economic agreement, there a cultural affinity. And above all, private individuals will create, little by little, a series of networks for the exchange of ideas. All this is useful, and all this seemingly so dispersed, often so ineffective, will gradually build up complex structures, marking in outline the skeleton and blood vessels of what will be one day the body of the United States of Europe.[6]

Federalism sees war as the inevitable product of a system, which legitimizes the existence of a multitude of several entities with conflicting goals and the means to pursue them. Federalism puts forward that in order to attain peace and security; the current international system must be abolished or radically modified.[7]

Federalists reject any attempts to unite Europe by force. Federalists, like Altiero Spinelli, also reject unification by illegal and violent means from below, because they believe that the decisions to unite Europe must be taken by democratic governments. At this stage the nation states are the means to European unification. On the other hand, they are also obstacles because nation states are inclined to reject a European federation which involves the transfer of parts of their sovereignty to a supra-national authority.[8]

Spinelli's goal, like most federalists, was a new European state composed of individual states that had ceded their sovereignty to common democratic institutions. What made his brand of federalism more than just a description of a European federation, however, was his strategy for achieving a united Europe. In Spinelli's view, overcoming resistance from national governments required a popular pan-European movement that demanded an American-style constitutional convention.[9] He believed that only a dramatic leap to federalism would succeed in unifying Europe; functionalism's step by step approach would never create institutions strong enough to solve major problems or be democratic enough to respond to the people. He eventually saw the directly elected European Parliament as a possible constituent assembly and as a member of parliament, set about writing a new constitution for Europe.[10]

Spinelli's constituent concept stemmed from his belief that the functional approach to European unification will not achieve profound and irreversible unity. He never shared the conviction of the supporters of the functional approach that one can integrate selected sectors of the national activity without a federalist constitutional framework from the very start.[11] He was clearly aware that the functional approach stemmed largely from the contradictory nature of the attitudes of national governments to European unification. As objective historical circumstances force them to face the need for supranational unification, whilst they resist giving up their sovereignty, it is natural that they prefer an approach that postpones indefinitely the establishment of an authentic supranational authority.[12]

One needs to recognize, however that Spinelli accepted that unification could start with effective supranational powers being first confined to economic issues, while postponing their immediate adoption in matters of foreign and security policies (as provided in the draft treaty for European Union). But he always stressed the need for genuine federal institutions which would ensure the ultimate extension of supranational powers from economic to defense and foreign policies.

Federalism witnessed two debates in itself. One view was that a federal state in Europe would be established by a functional evolution in Europe, while the politicians, elites and the people found new ways of living together. The other federalists foresaw a constitutional approach to the problem, and started to get organized. One of the most important organizations in this line is “The European Union of Federalists” (EUF), made up of the Federal Union in Britain, Swiss Europa Union, Italian Movemento Federalista Europeo and the French La Federation. They regarded themselves as a revolutionary mass movement to reshape Europe on federal lines after the collapse of its national structures. In the Luxembourg Programme of 1946, they put forward as their final aim the creation of the European Union to develop a world community of peoples, a world government. However, the EUF was not strong enough to force national parliaments and governments to act. There were frequent disputes among them concerning their strategy.[13]

To ensure coordination between the various movements, a meeting was held in Paris on 20 July 1947. During that meeting, it was decided to set up a joint Liaison Committee to agree to common lines of action. The European Parliamentary Union (EPU) withdrew from the arrangement immediately afterwards, but other four associations agreed on 14 December 1947 to replace the loose Liaison Committee by a more effective Joint International Committee of the Movements for European Unity. In 1948, the Committee adopted the name “European Movement”. The federalists have a grand European project. The uniting of the European people would provide them with security against an interior (Germany) and exterior (Soviet Union) threat. The United States of Europe would bring prosperity to the European people because they would also be merging their domestic markets, resources and human potential. Such an economic unification was seen as the only cure to the destruction of the war. However, by 1950, the European Movement had passed its heyday as a united political force. In the end, there were no miracles and the desire of “making Europe” gave way to the functionalist approach.[14]

All the evidence suggests that the founding fathers of the European movement expected something more than this; that their initial attempts to build economic and military cooperation would indeed develop into federal-like arrangements. Few dispute that of the leading advocates of the European integration Schuman, Spaak, Spinelli, and Monnet, it was Monnet who was the main driving force behind the movement. It is clear both from Monnet’s memoirs and from contemporary research that Monnet’s ultimate aim was the creation of a united Europe. But it is also the case that Monnet was a gradualist, who viewed increasing economic interdependence as the means towards the federal end. For all his federalist rhetoric, he was convinced that political union could only come when the time was right. In this sense, Monnet, rather than being a federalist visionary, was a practical politician who was only too aware that cooperation between sovereign states could only be achieved if their interests coincided.[15]

By the 1960’s, therefore, most of the academic scholarship on the subject viewed federalism as a device for achieving particular political or economic ends. “Ever closer union" is happening because of a conviction among the interested parties that union is intrinsically beneficial and / or because the countries of the EU share a range of common interests which makes the objective of federation both feasible and desirable. However, a critical examination of both perspectives demonstrates that neither constitutes an adequate explanation of the origins of political unions.[16]

Contemporary federalists (often referred to as neo-federalists) tend to be more realistic about the prospects of realizing their goals than their predecessors and are prepared to build a federal union in incremental steps rather than all at once. Jean Monnet also espoused an "incrementalist" approach. Also today, European federalist groups are very active in promoting the idea of an EU constitution.[17]

Federalism is criticized by functionalism on the point that the United States is presented as a living proof as the way to unite the European countries and the world. In his book "A Working Peace System", David Mitrany states:

> The federalists asserted the idea of a federal European union often by pointing to the success of the American federation. That federation was born in much simpler conditions than those facing twentieth-century Europe. Federation was achieved in America when government did little and was intended to do no more. Now we are being swept forward by a revolutionary social current which demands continuous and increasing action by central governments and forces all the countries of the world to use new ways of economic and social planning.[18]

2.2 Functionalism

Functionalists, whose best representative has been David Mitrany, favor the strategy of gradually undermining state sovereignty, by encouraging technical co-operation in specific policy areas across state boundaries. Mitrany regarded nationalism as the biggest threat to world peace and favored a shift in human loyalties from the national to the international level through mutually beneficial international co-operation in sectors such as transport, agriculture, science and health.[19]

In his book "A Working Peace System", Mitrany proposed a solution to the problem of war. He argued that as cooperation between countries in functional areas "spilled over" from one area to another, the incentive to go war with partners would diminish and a "working peace system" would prevail.[20]

Indeed, Mitrany was directly opposed to the project of European regional integration. In his advocacy of "A Working Peace System", Mitrany proposed a universal, rather than a regional solution to what he saw as the "problem of our generation": "how to weld together the common interest of all without interfering unduly with the particular ways of each". In the pursuit of peaceful, non-coercive community building, nationalism at the nation state level must not, Mitrany argued, simply be replaced by nationalism at the European level.[21]

In order to control international conflict, which was considered as an inherent element of an international system composed of national sovereign units, and promote welfare at a world scale, the functionalists proposed the creation of various international agencies dealing with technical issues which extended beyond the national borders and which could be dealt with more effectively at the world level, with the proviso that politicians would not interfere with the work of experts.[22]

Functional integration would be pragmatic, technocratic, and flexible; it would deliberately blur distinctions between national and international, public and private, and political and non-political. As functional agencies were formed and joined, national divisions would become less and less important. Ultimately, a central authority might coordinate the various agencies, but such a government would not be necessary to successful international relations, and might not be desirable. Mitrany parted with many other functionalists (such as Monnet) and the neo-functionalists who believed federal institutions were essential to the success of functional integration.[23]

Jean Monnet, who is the initiator of European integration, also believes in a universal type of integration, the settlement of the disputes between France and

Germany by means of the establishment of common rules and institutions. According to him, those institutions should be supra-national in type. Monnet devised a specific strategy for the establishment of EEC, which is named as "Monnet Strategy" or more formally the "Community Method". Neo-functionalism, more narrowly defined as "Monnet Strategy" became almost the official strategy in the further development of EEC. The whole institutional structure of the EU rests on the Community Method-how supra-nationality works in the Community. According to Monnet, the particular form that integration took was less important than the requirement to launch the process on a practical footing. Instead of waiting as federalists preferred for a full scale constitutional revolution, Monnet suggested making modest steps to transcend national sovereignty.[24]

At the end of the two world wars, functionalism did not put emphasis on the theory of politics. It gives special importance to technical elements, rather than political elements. In other words, functionalists leave the integration to functional institutions established by technocrats, in other words, to the idea of technical rationality. In functionalist approach to integration, it is not necessary to have an institutional detailed plan because the emergence of needs for further integration takes time and adaptation and the nature of tasks determine in which form the institutions evolve in later steps.

The weakness of the functionalist approach seems glaring in the light of post-war history: for example, it assumes that functional co-operation can be separated from politics. However, the decisions of technical agencies are often highly political: several, such as the United Nations Educational, Scientific and Cultural Organization (UNESCO) and the International Labor Organization (ILO) have been torn by political disputes. Moreover, the creation of functional authorities has arguably made the states system work better rather than undermining it. There is also scant evidence that loyalties are shifting from the state level to international organizations.[25]

Likewise, while Mitrany had prescribed the necessary development of a new world community, quite how the transition from functional action to international society would take place was never clearly specified and relied on a rather organic process of expansion which was not consistently observable in practice.[26]

Nevertheless, functionalism as a theory was highly influential both for the development of subsequent theories of European integration, such as neo-functionalism, and as the method employed by two of the key architects of the European project, Jean Monnet and Robert Schuman, when they were establishing the ECSC in the early 1950's.[27]

2.3 Neo-Functionalism and Spill-Over Effect

The functionalist ideas were modified by Ernst Haas (1958) and later by Leon N. Lindberg (1963), Scheingold (1970) and Schmitter (1970), in the light of the European experience of the 1950's. Therefore, neo-functionalism possesses an empirical foundation that it is based on intensive study of an actual case. By the late 1950's Ernst Haas, in "The Uniting of Europe", described Western Europe as a "living laboratory" for the study of collective action between European states.[28]

Neo-functionalism is a theory of regional integration and a theory developed especially for the integration of Europe. European Commission is taken as an objective evidence of regional integration theory. In other words, by means of the Commission, the regional integration theory is to be tested. Like functionalists, neo-functionalists also believed in the priority of economic integration. In order for economic integration to result in political integration, there should be supra-national institutions that are beyond the states and that demand the delegation of sovereignty. These supra-national institutions should be in specific and crucial sectors.

In a similar way to the federalist school, the neo-functionalists provided both a theory and a strategy for integration. The main difference was that, while the federalist approach was never put into practice, the neo-functionalists analyzed a strategy, which was both accepted – at least implicitly – and followed by some of the main political leaders in Western Europe.[29]

Haas insists that we should look at political integration as a process:

> Political integration is the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new center, whose institutions possess or demand jurisdiction over the preexisting national states. The end result of a process of political integration is a new political community, superimposed over the preexisting ones.[30]

As the process of integration proceeds, it is assumed that values will undergo change, that interests will be redefined in terms of regional rather than a purely national orientation and that the erstwhile set of separate national group values will gradually be superseded by a new and geographically larger set of beliefs.[31]

Haas recognized that functional integration was taking place in Europe, but that functionalism as a theory had failed to explain why decision makers chose to integrate in some areas and not others. Functionalism needed a theory of politics, which Haas provided.[32]

Far from focusing on the very separate demands of different functional tasks, Haas focused on the potential linkages between sectors. It was this focus on linkage politics which, in part, contributed to the image of the political integration as an inexorable process: a snowball, constantly gathering momentum as the process of integration rolled on.[33]

The neo-functionalist approach shares with Mitrany's functionalism, a focus on social actors and technical experts. However, Haas did not share Mitrany's vision of politically neutral actors carrying out technical / functional tasks unaffected by political conflict. Less idealistic, Haas's pluralist-based neo-functionalism recognized the continuing importance of national political elites and emphasized the key role played by interest based politics in driving the process of integration.

The essence of the neo-functionalist argument is that political integration comes about less through pressures from functional needs or technological change, and more through the interaction of political forces, interest groups, parties, governments, international agencies which seek to exploit these pressures in pursuit of their own interests. According to the neo-functionalist theory, a new centre of authority gradually supersedes the states, building its own competence in sector after sector of public life. The shift of loyalties, expectations and activities then describes the development of a new supra-national state.[34]

Haas states:

> The good Europeans are not the main creators of the regional community that is growing up. The process of Community formation is dominated by nationally constituted groups with specific interests and aims, willing and able to adjust their aspirations by turning to supranational means when this course appears profitable.[35]

Supranational orientations develop among elite and bureaucrats over time as a result of political interaction which lead to de-polarizations on issues. Neo-functionalists argue that the supranational orientation is not restricted to elite and the bureaucrats. Various interest groups may also display similar tendencies like civil servants and bureaucrats towards internalization.[36] These groups reflect and protect their common interests at the regional level like European labor and trade organizations. The interest groups may articulate their expectations and goals in an internalized context through these organizations.[37]

The neo-functionalist school explains the single internal market and formation of the Economic and Monetary Union (EMU) in the 1980's within the same framework. According to this perspective, the conditions were right for the formation of a monetary union and provided the kind of external stimulus of a technical and economic type needed to create an economic movement.[38] European monetary integration was a result of the continuous political interaction between governments, European multinationals and the European Commission.[39] In the formation of EMU, European multinationals, European business community, local industrial groupings, central bankers and the European Commission played significant roles. Also, single market was perceived as a result of elite bargaining between European industry and European Community (EC) institutions. Although the governments were the negotiators, the EC and non-political elite forced to reach an end.

Neo-functionalist writings laid great emphasis on the role, which the supranational institutions should play in promoting further economic and political integration. The supranational institution should also act as an honest broker and try to reconcile conflicting interests. Its aim should be to promote the “European interest” but also to reach compromises out of seemingly irreconcilable national or sectional interests. Ideally, the supranational institution should strive for compromises based on an “upgrading of common interests”. For this objective, the method of package deals has been used rather extensively. The idea behind this method is that any interested party, which may stand to lose from a particular common arrangement, is compensated by a simultaneous agreement for joint action in some other, even unrelated, field from which it may expect certain benefits. The method of package deals, if successful has the main advantage that while solving a deadlock, which may be the result of conflicting interests, it also promotes integration to new fields of activity. The bargain struck mainly between the French and the Germans on Common Agricultural Policy is the first example of this method.[40]

Haas also used Mitrany’s concept of spillover as the driving force of integration, but by dividing into three elements: Technical/Functional Spillover, Political Spillover and Geographical Spillover.

Technical/Functional Spillover referred to the process by which cooperation in one agreed area (for example agriculture) would require further cooperation in a second related area (for example, food hygiene standards) in order to be successful. Political Spillover referred to the shift in the expectations and activities of individuals which might be expected to emerge in response to the new policies emerging at the European level. Geographical Spillover referred to the impact which the Community had on non-member states, not least by altering existing trade patterns. As excluded states felt the effect of the economic giant on their doorstep, they would increasingly be inclined to join the Community.[41] This is an aspect of neo-functionalist spillover which is often overlooked but which has clear resonances today as the EU seeks to accommodate an increasing range of demands for membership.[42]

Not only had the Rome treaties been signed in 1957, providing a good example of sectoral spillover, but by the early 1960's, a number of the competitor European Free Trade Association (EFTA) had begun to apply for membership of the EEC. Hence a type of geographical spillover had also begun. Political spillover, was in clear evidence, as interest groups mobilized, for example, around the issue of the Common Agricultural Policy.[43]

One basic element of the theory is the distinction made between "welfare" and "high" politics. It is believed that most economic issues can be separated from high politics where questions of prestige and power play a dominant role. Haas has argued that in the Western European societies of the post war period, welfare politics occupy a key position. On the other hand, it is assumed that there is a continuum between welfare (such as coal and steel) and high politics. This means that once most welfare issues have been shifted away from the nation state, integration will inevitably spill over to traditional fields of high politics like defense and foreign policy.[44]

The neo-functionalist school came under strong attack both by the federalists and by the traditional school of international relations. Both argue that economic functionalism has its limits and that beyond a certain point no real progress towards political integration can be achieved, unless some hard political decisions are taken and new institutions are created. Sr. Altiero Spinelli, one of the founding members of the "Movimento Federalista Europea" (European Federalist Movement) has argued that European integration is bound to fail unless it can harness a mass political movement. For him, the neo-functionalist strategy can only lead to a "Europe of supranational offices" and nothing more. He points out that the Commission can develop much influence within national bureaucracies as long as governments allow it to do so. Therefore, the whole process depends on the goodwill of national governments.[45]

Lindberg first draws on Haas to define "political integration", then goes on to identify conditions for integration. The central roles played by political actors are key to Lindberg's views of the integration process. New central institutions, for instance, help "precipitate unity"; political groups "restructure their expectations and activities" in response to integration; and member states must possess "the will to proceed" if integration is to continue. Also important is the role of "spillover", which propels integration forward as cooperation in one area spills over into other areas.[46]

The central role of the transfer of loyalty in early neo-functionalist explanations of the process of political integration is undisputed. However, Lindberg and Scheingold (1970) stressed the importance of the extent to which authority for decision-making had been transferred to the European level. The degree to which authority-legitimacy transfers had taken place would, they argued; provide a measurable indicator of progress towards a new political community.[47]

Something, which the neo-functionalist theory has entirely ignored, is the possible influence of the external environment or factor on the process of integration. It has been implicitly assumed that nations involved in such a process live in some form of capsule, which separates them from the rest of the world. Thus, the effect of integration on the outside world as well as the possible feedback, which this may generate, can be left out of the analysis. The importance of the external factor has been emphasized by the power politics school.[48]

Neo-functionalism seemed to capture the essence of European integration fairly well until the mid 1960's, when the actions of the French President Charles de Gaulle reminded scholars of the important role an individual leader could play in slowing up the various processes of spillover. By the early 1970's, when the oil crises struck and world economic recession set in, the inexorable processes of spill-over through which the nation state would eventually become irrelevant were much less apparent. Scholars, accordingly, sought a theoretical approach that could account for the impact of external shocks and the continued importance of national governments within the integration process.[49]

In his later writings, Haas also argued that the power of nationalism and the influence of external factors (international events) had both been underestimated. In addition, he recognized that European integration was too complex to fit neatly into any theoretical model.[50] Problems with the neo-functionalist theory continued to mount in the early 1970's, and in 1975 Ernst Haas declared that regional integration theory (read neo-functionalism) "obsolescent".[51]

2.4 Inter-governmentalism - A State Centered Approach

The question of British membership and the two unsuccessful applications for entry in the 1960's seem to have had a big influence on EEC monetary cooperation. The United States has played a decisive role in the process of European integration. The power politics school has provided in a sense an intellectual justification to Gaullist policy on European integration. The quotation from a speech made by General de Gaulle, "There is no European reality other than our nations and the states which are their expression. To build Europe, there is no solution other than co-operation between nations", fits with the ideas of intergovernmentalism.[52]

Economic integration in Western Europe, where it has taken the most advanced form among all other postwar attempts, has not been regarded by some political observers as an entirely new phenomenon, which would demand new tools of analysis. Such attempts were not considered as going beyond the nation-state and thus fell within the realm of the conventional theory of international relations. International organizations are seen as nothing more than the sum of their parts and thus there is no place in the theory for any so called supranational institution. The will of each individual nation and the balance of power between them are the only determining factors in an international or regional system.[53]

Intergovernmentalism emphasizes the importance of the international system and role that national governments played in defending the interests of their people in the integration process and is associated with the work of Stanley Hoffman (1966). Hoffman produced an insightful critique of the neo-functionalist approach. There were a number of potential brakes upon the kinds of spillover that Haas had identified: brakes that would stop national governments from becoming an irrelevance in the process of European integration. He argued that national governments might allow a certain degree of spillover to take place in areas of "low politics" (economics and welfare issues) where such spillover did not threaten their vital interests and indeed where cooperation might enhance their position within the international environment. However, in areas of "high politics" (such as foreign policy, security and defense), national governments would be much more wary and would swiftly put a stop to any attempts to encourage spill-over.[54]

The power politics school sees all recent attempts towards integration as being limited to the realm of the welfare. A certain discontinuity is assumed to exist between such mundane things as economic issues and those related to defense and the traditional foreign policy, which are the core of high politics. Together with the neo-functionalists, the power politics school separates welfare from high politics. The main difference between them is that, while the former believe that integration in the field of welfare will automatically spill over to high politics, others see a discontinuity between the two.[55]

While the neo-functionalist school gives significant importance to supranational institutions or agents in European Union, the intergovernmentalist school attributes little influence to them, and some detect little genuine supranational characteristics in the European Union.[56] According to the intergovernmentalist school, the supranational regime building progressed in the EMU after national economic preferences converged, after governments designed, proposed and initiated the process, after national statesmen entrepreneur, after asymmetries in national bargaining power were brought to bear, and after international institutions were given the task of locking commitments.[57] Therefore, the intergovernmentalist school perceived the national governments that are responding to changes in international climate as the main force behind the formation of EMU.

For Hoffman, national governments were more “obstinate” than “obsolete” in the process of European integration. This was clearly a serious challenge to the snowball effect of co-operation proposed by the neo-functionalist approach.[58] For example, it has been argued that the election of more market-oriented governments in member states in the 1980’s, and the consequent convergence of “national interests”, was a major factor in the development of the Single European Market Programme. Andrew Moravscik (1998) who is one of the leaders of intergovernmentalist school, also bases in his theory of liberal intergovernmentalism on descriptive intergovernmentalism (the loose form of intergovernmentalism saying that the governments should not be the dominant actors in the Union, but are for good or ill, the key actors in the Union).[59]

2.5 Transactionalism (Communications School of Thought)

Transactionalist approach (communications school of thought) was based on extensive comparative research on how political communities and a sense of identity are developed. Deutsch focused primarily on the manner in which increased interaction between European countries intensified, would contribute to an increased sense of mutual responsiveness between previously disparate populations. It was argued that as a result of a complex learning process, in which shared symbols, memories, values and norms were allowed to develop, individuals in Europe would eventually begin to view themselves as a people with a shared sense of identity. Under these conditions, the process of European integration would flourish.[60]

The work of Deutsch and other scholars working within the transactionalist / communications tradition, focused on the conditions necessary for political integration to occur. Mutual transactions or communications were, for Deutsch, a necessary, but insufficient prerequisite for the development of a political community.

This view of political integration presents affiliation or attachment in largely functional terms. Affiliation, whether to the national or EU level, is thus contingent upon the perceived benefits to be reaped. Deutsch, for example, argued that “The issue of political integration (thus) arose primarily when people demanded greater capabilities, greater performance, greater responsiveness and more adequate services of some kind from the governments of the political units by which they had been governed before. Integration or amalgamation were first considered as possible means to further these ends, rather than as ends in themselves”.

The transactionalist / communications school approach was widely criticized, not least for its methodological focus on transaction flow indices which did not provide an adequate picture of the multi-faceted integration process.[61] It was heavily criticized in the late 1960’s because an increasing level of transactions did not seem to have led to any discernible increase in mutual responsiveness between European peoples.[62]

Wherever the truth lies, the European Union has emerged as a new species of international organization that does not easily fit most of the conventional explanations about why states cooperate. Terms such as federal, functional, neo-functional, intergovermental and supranational have only limited value in describing and understanding the European Union. Attempts to define its nature are complicated by the fact that its dimensions and identity have changed over time. Therefore, in order to make the theoretical and conceptual approaches to the European integration empirical, we should also look at the route the European integration is taking place in practice.

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CHAPTER 3

THE PROCESS OF REGIONAL ECONOMIC INTEGRATION AND EUROPE

Since the Second World War, global politics have witnessed the emergence of a new political phenomenon: the cooperation and integration of states on "regional" scale. The prime example among these regional groupings is the EU, but all over the globe states seeks to institutionalize cooperation in different ways. The EU is a particular case in this respect not so much because it came first, but because it has gone furthest in terms of the powers transferred from its members to the central institutions. Regional alliances of states elsewhere are still essentially about cooperation among states rather than, as in Europe their integration and the resultant creation of a new polity.[1]

To understand the process of integration, economists have developed integration theories in the twentieth century, one of which is regional economic integration theory. According to this theory, there are numerous stages of economic integration and these stages, first described by Bela Balassa in 1961 in his work "The Theory of Economic Integration". Most processes of economic integration, however, can not go beyond the second stage of integration that is going to be described below.

3.1 The Stages of Regional Economic Integration

There are several types of integration, which may be interpreted as steps from a situation of several independent countries towards full integration. In other words, the types of integration may differ from regional cooperation to regional integration. In terms of the degree of integration, the stages of economic integration can be classified as:

Free Trade Area: In this stage, all tariffs and quatos on goods, in other words all internal trade restrictions between the member states are eliminated, but there is not an application of common trade policy; any common external tariffs and quotas with respect to third parties. An example is European Free Trade Association (EFTA) of 1960, composed of Iceland, Norway, Switzerland and Liechtenstein. The EU was a free trade area from 1958 to the early 1960's.

Customs Union: The countries in a customs union have the same free internal trade as in the free trade area. Further, they have a common trade policy and common external tariff applied to third parties. It is implemented from 1958 to 1968 between the six founding Member States (MS's) of the EU for industrial commodities. With full establishment of a customs union between the MS's of the EU in 1968, the power of the EU in external trade negotiations has increased.

Common Market: Since it includes common policies between member states in areas such as agriculture, transport, competition law, tax laws and regional policies, it can be accepted as a higher degree of integration than the customs union. Despite being commonly known as the common market throughout the 1970's and 1980's, in reality the EU was a customs union during much of its existence.

Economic Union: It is a higher degree of integration than the common market because it includes the free movement of labor and capital, no cross-border restrictions on the provisions of services, the effective coordination of macroeconomic policies (budgetary, monetary and exchange rates) and possibly, provisions for mutual assistance between member states. Free movement of goods, services, capital and labor was only implemented with the introduction of the Single European Market in the EU on 1 January 1993, as a result of the increase in the pace of economic integration during the 1990's.

Monetary Union: Usually this stage of integration is considered as the ultimate stage of economic integration composed of the following conditions: the guarantee of a complete and irreversible convertibility of the currencies, the full liberalization of capital flows and the complete integration of the banking and financial markets between member states, the irrevocable fixing of exchange rates without any margin of fluctuation and a single monetary policy managed by a single central bank. The national currencies may eventually disappear to be replaced by a single currency. An example is the monetary union in the EU which was outlined in the Maastricht Treaty of 1992 and became effective with the introduction of the European common currency in January 1999. In modern times, in no other region of the world has it been reached to this level of economic integration.

Full Economic Union: A full economic union is an economic and monetary union in which the countries agree on a common policy on most important matters. A full economic union is operating like a new (larger) country. Together with the integration in many areas, it implies political integration, for example in the form of a confederacy. The full economic union has a larger extent of political integration.[2]

As a result, we can say that the stages of integration are based on combinations of four aspects that can be integrated. These aspects are the products, the production factors, the monetary system, and the political system.[3] At the beginning of a process of integration countries often decide to integrate product markets. This results in free trade of commodities and services. It is, however, also possible to integrate production factor markets. This leads to the free mobility of production factors between the countries. The third possible aspect for integration is the monetary systems of the countries. With a process of monetary integration, countries agree on a common currency or fixed exchange rates. Finally, the process of economic integration often goes together with political integration. Differences between the stages of integration are often differences in the extent of political integration.[4]

Although it is supposed that there is a causal connection between customs union and common market, between single market and economic and monetary integration, actual integration may combine the types of integration described above. It is almost impossible to establish a customs union or a free trade area without some sort of common policy. Therefore, integration is often a mixture of economic integration and political integration that may differ from the stages described above.[5]

3.2 Globalization and European Regional Integration

In the academic literature, recently the attention has been shifted to the dual nature of relationship between integration and globalization. In this framework, the EU is said to be acting both as a shelter and accelerator of global processes. That is to say, European regional integration is regarded either as an expression of globalization, which may mean globalization itself or as a protective shield against the negative consequences from globalization.

In the first perspective, the EU is little more than local variant of the global trends. If anything, globalization is accelerated by the policies of the EU. Multinational corporations benefit from improved access to markets, and there is general trend towards greater concentration of economic power in certain regions and large firms. States abdicating their traditional welfare responsibilities in order to satisfy the demands of efficiency and price stability imposed by the single market and single currency. Supranational institutions have little to put in place instead and the trend is towards an unevenly regulated marketplace. So, the development of a supranational legal order is based on the needs of economic integration, not the result of an explicit programme of political integration.[6]

According to Eric Helleiner, who is a political scientist at the University of Waterloo and interested in international political economy, European Monetary Union and the euro can be accepted as being part of a global trend. He says that “A striking trend in recent years has been the growing unpopularity of ‘territorial currencies’; that is, currencies which are exclusive and homogeneous within the territorial borders of a nation-state. One manifestation of this trend is the new enthusiasm for currency unions. Such enthusiasm is of course most pronounced in Europe, where eleven members of the European Union have agreed to eliminate their national currencies in favor of a supranational currency by 2002".[7]

The acceleration of the process of European integration during the 1990's is also explained as mainly driven by the desire to make the EU more competitive in an increasingly globalized economy.[8] There are many reasons that explain the gathering of pace of European economic integration during the last few years of the twentieth century, but all of them are linked to the process of economic globalization. Proponents of globalization underline that since the 1970's a new world economic system has emerged. The main feature of the new global economic system is, the high mobility of capital, goods, labour, and, to a lesser extent, services across the world, marking a radical break with the post Second World War past of strong national economies.[9]

The dual processes of globalization and regional economic integration is not specific to the EU. Multilateral negotiations and global economic competition paved the way for an increase in the regional economic cooperation among the states during the 1990's. The observers named this trend as "new regionalism".

The critical point to be made at the outset of this discussion of the "new regionalism" is the dynamic relationship between developments in different parts of the world. As countries in one continent agree to integrate their economies, creating free trade zones, customs unions, or more, the effects are felt elsewhere. Frequently, there has been a response "in kind", i.e. the attempt to match the efforts of economic integration elsewhere. On the whole, these forms of regionalism differ from European integration in only focusing on economic matters and relying on a very limited degree of institutionalization.[10] (see Table 1)

Table 1: Differences between Regional Integration in Europe and Regional Cooperation in Other Continents

Parameters	Regional Cooperation	European Integration
Institutional characteristics	Reliance on purely intergovernmental forms of decision making	Presence of autonomous supranational institutions that initiate and enforce common policies
Forms of decision-making	Consensual decision making (i.e. states have veto over decisions)	Extensive use of qualified majority voting (i.e. states have no veto over decisions)
Degree of legal integration	Arbitration and dispute settlement of individual cases	Permanent court system developing a supranational legal order
Extent of political integration	Concentration on economic cooperation among states	Development of a political union with a system of economic, social, and political rights for citizens
Range of issues covered	Emphasis on trade, investment, and related economic issues	Expansion of competences into much wider areas (single currency, environments, culture, etc.)
Presence of democratic procedures	Minimal, if any, involvement of parliaments	Establishment of a democratic process, based on a directly elected parliament
Foreign policy cooperation	Coordination of external relations limited to participation in multilateral trade negotiations	Development of a common foreign, security, and defense policy

Source: John, Baylis, and Steve, Smith. The Globalization of World Politics. New York: Oxford University Press, 2005, p.57.

3.3 The Relation between Monetary Integration and Political Integration

One of issues that has long been debated among the economists is the link between monetary integration and political integration. On the question of the connection between monetary integration and political integration, there exist three positions:

- The first is that monetary unification necessarily entails political integration. This argument is advanced by those who believe that a stronger European Parliament is needed to hold the European Central Bank accountable and encourage the development of a common fiscal policy at the EU level,

- A second view is that political integration necessarily entails monetary integration. This is the position held by those who believe that European integration has always been and continues even now to be driven by functionalist spillovers, in this case from the monetary to the political domain. It is the conclusion of those who see the single currency as signaling the irreversibility of the European project and providing a powerful identify symbol,

- The third position is that there is no intrinsic connection between monetary and political integration; this is the opinion of British politicians and Eurosceptics generally.[11]

The Anglo-American view is that there is no connection between economic and monetary unification, whereas the French and the German governments insist that economic integration without monetary integration cannot provide a political equilibrium. German leaders further insist that monetary integration requires political integration in order to lend credibility to the governments' commitments to pursue fiscal policies consistent with price stability and to endow the EU with adequate enforcement powers.[12]

In virtually all of today's advanced industrial countries, political unification has preceded monetary unification. When the United States was a loose confederation of former British colonies, individual states retained the right to issue their own money-like liabilities. Only with the decision to form a political union and the adoption of the U.S. Constitution in 1788 was the right to issue legal tender limited to the federal government.[13]

In Germany, economic unification began with the creation of the Zollverein in 1834. Its constituent states initially had separate systems of coinage. Although they eventually negotiated treaties designed to standardize their coinage and fix the exchange rates between their currencies, this was not a monetary union in the strict sense. The individual German states refused to allow their right to issue paper money to be regulated by treaty. Governments created note-issuing development banks and otherwise subordinated monetary policy to the goal of state-led development. They were willing to agree to a uniform currency and common central bank only after political unification in 1871.[14]

Similarly, Italy had several currency systems in place at the time of political unification in 1861. The states brought together in the Kingdom of Italy each depended on bank notes issued by a single institution (often private, or semi-private), except for Sardinia, which had two banks of issue. Although the newly created government of the Kingdom of Italy saw the merit of creating a single central bank, it had difficulty limiting the prerogatives of the local banks. The creation of a true central bank, by the Banking Act of 1893, required political integration that subordinated regional interests to the national interest.[15]

Historically, monetary unions between sovereign governments have only been sustainable in the long term where member countries maintain close political links with one another (not necessarily economic integration).[16] An argument that dominates discussion in Europe today is whether monetary integration is feasible without political integration. It is discussed that monetary unification requires political unification, because only with political unification will it be possible to prevent reckless fiscal policies from destabilizing the common currency.[17]

Hans Tietmeyer, one of Europe's most influential central bankers, said in 1998 that EMU has to be accompanied by a "high degree of political unity at European level". He also warned that "if everyone goes their separate ways, that could lead to conflicts with what will be a supranational monetary policy."[18]

A stronger justification for political integration is to render the ECB accountable to the European citizenry or, alternatively, to hope that the ECB's legal legitimacy will substitute for its lack of democratic legitimacy. It is possible that the Europeans will come to respect the authority of the ECB because they are confident of its dedication to its legal mandate.[19]

The introduction of the European common currency in January 1999 represented a further step towards full economic union. In other words, EU is at present a monetary union that is the previous of last step of full economic integration. But, this does not mean that monetary union makes full economic union inevitable, but makes it more likely and brings it a stage closer. Yet, full economic integration will not be completed without a much greater degree of economic harmonization and political integration.

One of the regularities of monetary economics has been the one-to-one correspondence between countries and currencies. It will be an unprecedented event if monetary unification is followed by political unification in Europe although there is little historical evidence to support this view.

Still, monetary integration may be needed to provide economic integration with a political equilibrium, and political integration may be needed to render monetary integration politically acceptable. The emphasis in this sentence, however, should be on the word "may", because neither case is clear cut.[20]

ENDNOTES

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CHAPTER 4

ORIGINS OF EUROPEAN ECONOMIC AND MONETARY UNION

People felt the need to create a uniform medium of exchange as early as in Ancient Greece and Medieval Europe. Monetary unification requires giving up sovereignty over monetary policy. In history, giving up sovereignty in monetary policy has never been successfully accomplished by major countries with different histories and languages. Also, in all of today's advanced industrial countries, mostly political unification has preceded monetary unification.

The idea of integrating European countries is also not new. Statesmen and politicians favored this idea as early as in the Middle Ages. Often, people advocated one united Europe to counterbalance Asia. However, after the industrial revolution developments in technology accelerated the process of European integration.[1]

In this chapter, some examples of previous monetary unions and history of European integration are going to be explained. Attempts and developments towards economic and monetary integration in Europe after the Second World War and the EMU itself are going to be dealt with.

4.1 Some Examples of Previous Monetary Unions

The first truly modern example of monetary integration would be the monetary union of Colonial New England. The four kinds of paper money printed by the New England colonies (Connecticut, Massachusetts Bay, New Hampshire and Rhode Island) were legal tender in all four until 1750. The governments of the colonies even accepted them for tax payments.[2]

A far more important attempt was the Latin Monetary Union (LMU). It was dreamt up by the French. Belgium already adopted the French franc when it became independent in 1830. The LMU was a natural extension of this franc zone and, as the two teamed up with Switzerland in 1848, they encouraged others to join them. Italy followed suit in 1861. When Greece and Bulgaria acceded in 1867, the members established a currency union based on a bimetallic (silver and gold) standard.[3]

The LMU was an official subset of an unofficial "franc area" (monetary union based on the French franc). This is similar to the use of the US dollar or the euro in many countries today. At its peak, eighteen countries adopted the Gold franc as their legal tender. Europe (especially Germany and the United Kingdom) was gradually switching at the time to the gold standard. But the members of the Latin Monetary Union paid no attention to its emergence. They printed ever increasing quantities of gold and silver coins, which constituted legal tender across the Union.[4] The LMU remained intact until the outbreak of World War I but was disbanded in 1926 after the disorderly and uneven depreciation of member state currencies because of war expenditures.[5]

The Latin Monetary Union had a loose type of political structure. An intergovernmental cooperation existed through political cooperation between nation states in Europe. The nation states, however, did not choose a supranational governing like a federal government. Rather, they had a considerable degree of independence. To illustrate, each member had a central bank and currency of its own. When the political will to have a monetary union ended with the onset of the war, the monetary union broke up.[6]

One of the most famous successful monetary unions is the Zollverein (German Customs Union). In 1834 a series of German states set up a customs union which became the embryo of what was to be full economic integration a few decades later. Therefore, Zollverein was established in order to facilitate trade by reducing its costs. This was done by compelling most of the members to choose between two monetary standards (the Thaler and the Gulden) in 1838. Much as the Bundesbank was to Europe in the second half of the twentieth century, the Prussian central bank became the effective Central Bank of the Federation from 1847 on. Prussia was by far the dominant member of the union, as it comprised 70% of the population and land mass of the future Germany.[7] The Zollverein was however a union of unequals. Prussia's political, military, and economic might in nineteenth century Germany allowed it to shape the Zollverein according to its own economic and political interests.[8]

Both cases, the Latin Monetary Union and German Monetary Union, would not have existed without political cooperation. In the former case, there was a looser type of cooperation in which members acquired a certain degree of freedom like being able to have separate central banks. In the latter case, a more intense type of cooperation existed between the German states, which promoted a common currency and a free trade area. Zollverein in turn helped the political integration process of many German and led to its state formation. Political cooperation existed in both cases although the degree was different.[9]

4.2 Developments towards European Integration after the Second World War

4.2.1 The Creation of the European Communities

The (political) process of integration of Western Europe started with the creation of the Council of Europe in 1949. At that time, the consequences of the world wars were still felt in Europe. The countries were unable to restore their economies. The new threat of the USSR and the vulnerability of Europe led to the plan of U.S. general Marshall to aid the Western European countries. With this plan the United States of America helped revitalize the European economies, on the condition that help was continent-wide and not based on states. Marshall Aid supported the execution of the idea of integration.[10]

The experiences of the two world wars supported the idea of integration. Because the European countries have been deeply influenced from the two world wars, the governments wanted to create an environment of lasting peace and welfare. After the failure of the European Defence Community (EDC) initiative, the idea turned out to be to start with economic integration. It was thought that economic integration would help to create lasting peace and welfare.

Robert Schuman, who was a cabinet minister in France, argued for a strategic and gradual integration of Europe. He initiated the foundation of the European Coal and Steel Community (ECSC) in 1950 together with Jean Monnet, who was at that time responsible for the French modernization plan. As a result of their efforts, the Treaty of Paris establishing the ECSC was signed in 1951. The ECSC started the process of integration for the six founding Member States of the European Union (EU) in the two sectors essential to making war that are coal and steel. By putting Franco-German production of coal and steel under a common High Authority which was to execute the policies relating to the coal and steel industries in the member countries, war between France and Germany would not only be unthinkable, but also materially impossible.

The principles of Robert Schuman's declaration – Schuman Declaration of 9 May 1950 announcing the plan put forth the characteristics of the European integration process: "Europe will not be made all at once, or according to a single plan. It will be built through practical achievements which will first create real solidarity".[11]

For European unity, 1954 had been an inefficient year. However, in 1955 the European Movement brought new ideas for further unification of Europe. At that time, the Benelux countries initiated the idea of common market in the fields of energy and transport.

After the failure of the EDC and the renunciation of the European Political Community (EPC) project, France seemed to be the main obstacle to future integration. It was, to be sure, no longer in a position either to propose a new project or to take a position of leadership. The “relaunching of Europe” occurred thanks to an action by Monnet and an initiative from Benelux. Monnet’s idea was to proceed with sectoral integration by creating a new community for the peaceful use of atomic energy. He pressed Paul-Henri Spaak into making an official proposal.[12]

The Benelux approach was that political unity would not come easily. It remained the final objective, but it could only come about over time. The more immediate objective should be economic integration. As the countries worked closely together in the economic field, political integration would follow naturally. The Benelux initiative called for the creation of a European Economic Community. In other words, a change from EDC to European Economic Community (EEC).[13] After the countries had met at Messina in June 1955, they approved the project and they started to work in order to establish a common market and atomic energy pool.

On 25 March 1957, the six countries of the ECSC signed the Treaty of Rome establishing EEC and Euratom as of January 1, 1958. The EEC aimed to establish a customs union. After that the process of integration was continued with free trade of production factors (common market) and an integrated policy in a number of important areas (economic union).

4.2.2 The European Defence Community Initiative (EDC)

The successful creation of the ECSC led to the plans to cooperate in military and security fields, to the creation of the European Defence Community and the European Political Community in 1950.

With the eruption of the Korean War in 1950, the United States proposed the rearmament of West Germany. France was against this idea, but French Prime Minister, Rene Pleven, suggested the establishment of a European army. In the face of an increasing threat from the Soviet Union to Central Europe, the establishment of the EDC was thought to allow the rearmament of West Germany under a common European command. In other words, the Pleven Plan of 1950, proposed to apply the functional approach of European integration to the area of a European common defence policy.[14]

The United Kingdom, while not opposed to the project, said it would not be party to it. However, the Six were positive and started negotiations in 1951 for a European Defence Community. It would include a Joint Defence Commission and a Council of Ministers. A Parliamentary Assembly and a Court of Justice would also be established, similar to those within the ECSC. Rapid progress was made and the EDC Treaty was signed in May 1952. With the signature of EDC Treaty, as supporters of federalism believed political integration would be a necessary further step, since the proposed European army would have to stand under effective political control. The ambitions of the Six did not stop there. If military capabilities were pooled, then this would leave little room for independent foreign policies.[15]

The French plan for a European Defence Community, was, however stopped by the French themselves. The parliaments of the other five countries in line for membership approved the EDC Treaty, but a succession of French governments did not show the courage to ask the National Assembly to ratify it. The treaty as it stood was in the end presented to the French Assembly which, by refusing to consider it, killed both it and the EPC. Some of the reasons behind were the fear of rearming Germany, the loss of French sovereign control of its military forces, doubts about the workability of an integrated army, unease that the strongest European military power, the United Kingdom, remained outside, and a belief that the end of the Korean War and the death of Stalin (in early 1953) would make the case for an EDC less urgent.[16]

At a time when the Six were setting up the ECSC, the launch of a similar supranational initiative in the much more sensitive defence sector was too ambitious.[17] The rejection of the EDC by the French National Assembly in 1954 was a clear setback in the political integration of Europe in the area of a common defence and foreign policy.[18] The end of the affair led supporters of supranationalism to concentrate on economic integration.

4.3 Developments towards Economic and Monetary Union until the Maastricht Treaty

After attempts to set up a European Defense Community and a European Political Community had failed in 1954, in 1957 negotiations about the creation of the European Economic Community started between the six founding member states of the ECSC till the signature of Treaty of Rome on 25 March 1957 establishing EEC.

Nevertheless, the first twenty years after the establishment of the European Economic Community were characterized by much talk and little action as regards monetary policy.[19] Although by the end of 1960's, the free movement of goods through the establishment of a customs union had been achieved, the free movement of workers, services and capital within the twelve-year time table set by the Treaty of Rome had not been realized. The goal of achieving coordinated national macroeconomic policies was also unfulfilled.[20] Nevertheless, the subject of Economic and Monetary Union (EMU) really only appeared prominently on the European agenda from the end of 1960's, when Bretton Woods international monetary system which had been based on exchange rates fixed to the U.S. dollar collapsed.[21]

The situation seemed to change in December 1969, when at the **Hague Summit** the political leaders of the Six adopted for the first time the target of full EMU. This had made EMU the official goal of European integration for the first time in 1969. It was a political decision reached at the highest level, and it was directly linked to the first enlargement of the Community and the further deepening of integration.[22]

After the departure of de Gaulle from his duty of being the president of the French Republic, attempts were made in the early 1970's to set the Community on a path towards a monetary union.[23] Also, the accomplishment of the customs union for industrial commodities in 1968 made the advantages of integration become evident. Therefore, there was great optimism about the integration. As a result of this optimism together with the very stable exchange rates, the first real steps in the direction of monetary union were taken in the early 1970's with the Report of the Werner Committee under the chairmanship of Pierre Werner, the then prime minister of Luxembourg.

The **Werner Report** which was completed in 1970 called for the completion of an economic and monetary union before 1980. In the transitional period a reduction in the exchange rate margins should be achieved. The exchange rates were linked to the dollar and they were determined to fluctuate no more than 2.25% on either side of the existing central rate in respect of the dollar. This band, which was called the tunnel, allowed for a total fluctuation margin of 4.5%. In 1972, the EC countries decided to restrict the margin of the tunnel to 2.25%. This band was called "the snake in the tunnel". However, a crisis in the dollar and the first oil crisis caused large exchange rate fluctuations among the various countries. Fluctuations were so great that the EC countries could no longer comply with the agreed margins. The tunnel was abolished, and the attempt to found the economic and monetary union stranded.[24]

Despite the serious set-backs suffered in the attempt to move towards EMU in the 1970's, interest in the subject never disappeared.[25] Actually, in the early 1980's the Community started to discuss how to revitalize European integration.

After "the snake" and "the tunnel" were abolished, the countries of the EC agreed upon the realization of economic and monetary union progressively. In the way to monetary integration, the "snake" was replaced by the **European Monetary System (EMS)** in March 1979. With the EMS, the European Currency Unit (ECU) and the European Exchange Rate Mechanism (ERM) were founded for creating monetary stability. The ECU, which was a basket currency including the national currencies of the members of the EC, functioned as the common currency unit of the EC. It was agreed that the exchange rates of the countries in the ERM should fluctuate within a margin of 2.25% and the complying with this rule would be the first step in the way to the creation of a monetary union.

Another step in the process of economic and monetary integration was taken by the first major revision of the Community treaties. The Commission's programme of completing the single market by the end of 1992 invoked the member states to negotiate revision of the treaties. The negotiations resulted in the signature of **Single European Act (SEA)**, which came into force in July 1987. The SEA extended the scope of majority voting in the Council to include most of the decisions required for completing the internal market, set monetary union as a Community objective and gave the European Monetary System a basis in the treaties.[26]

Building on this success, in June 1988, the European Council in Hanover set up a committee to study and propose concrete stages leading to the economic and monetary union, under the chairmanship of the then President of the Commission, Jacques Delors. As a result of the committee's work, **Delors Report** was signed in April 1989. In the report, the emphasis was put on the independence of the new institution-European Central Bank (ECB) that would be responsible from the monetary policy of the union. The ECB would be accountable to the EU institutions, but it was guaranteed to take no instructions from political authorities.

The European System of Central Banks (ESCB) would be established and based on a federal structure, composed of the ECB and the national central banks. The ESCB would define and implement monetary policy for the Union as a whole, it would conduct foreign exchange operations, and it would hold and manage the official foreign reserves of member countries. The ECB would have the exclusive right to authorize the issue of money, but it would not be permitted to lend to governments.[27]

Echoing the Werner Report, the resulting Delors Report listed three necessary conditions for a monetary union: the total convertibility of currencies, the complete liberalization of capital flows and full integration of financial markets, and an irrevocable locking of exchange rates. The first and second requirements, it noted, had already been met in Europe.[28] By meeting the third requirement, the EC would become a single currency area but would probably need to go further:

> The adoption of a single currency, while not strictly necessary for the creation of a monetary union, might be seen - for economic as well as psychological and political reasons - as a natural and desirable further development of the monetary union. A single currency would clearly demonstrate the irreversibility of the ... union, considerably facilitate the monetary management of the Community and avoid the transactions costs of converting currencies.... The replacement of national currencies by a single currency should therefore take place as soon as possible after the locking of parities.[29]

Addressing the European Parliament on July 9, 1991, the Foreign Minister of the Netherlands declared that "the Dutch EC Presidency regards the internal market as its absolute priority .... Without it there would be no monetary union, and without monetary union there would be no political union". This statement, and the momentum generated by the Delors Plan, suggests that the single market program was the sole reason for subsequent efforts to achieve European Union.[30]

4.4 The Stages of European Economic and Monetary Union

As was mentioned, the Delors Report proposed to achieve economic and monetary union in three discrete but evolutionary stages (but no dates were set down in the report), to establish a European Central Bank and ultimately create a single currency. But, in its basic design of EMU, much of the report found its way into the later Treaty on European Union (TEU).

In accordance with the Delors Report, at the Madrid European Council, in June 1989, it was decided to launch the first stage of EMU by 1 July 1990. Therefore, Stage 1 began before the Maastricht negotiations had taken place. Its objective was the completion of the internal market (scheduled for 1992), including the liberalization of capital movements within the EU.

The three steps of Economic and Monetary Union would be:

Stage One of EMU (1 July 1990)

The first stage would initiate the EMU process by taking a number of preparatory steps. On the economic front, the internal market would be completed, the Community's structural funds would be reformed and enlarged in order to reduce regional disparities within the EC, and a comprehensive framework would be introduced for policy surveillance and coordination, using agreed indicators.[31]

This stage began in 1990 and should have been completed by January 1993.

Stage Two of EMU, Establishment of the European Monetary Institute (EMI) and the ECB (1 January 1994)

Stage 2 involved the preparations for the single currency. All members were to be included in the narrow band of ERM, and the European Monetary Institute (EMI) was to be set up to promote the coordination necessary for EMU.[32]

The establishment of the EMI on 1 January 1994 marked the start of the second stage of EMU and with this the Committee of Governors ceased to exist. The two main tasks of the EMI were:

- to strengthen central bank cooperation and monetary policy co-ordination,
- to make the preparations required for the establishment of the European System of Central Banks, for the conduct of the single monetary policy and for the creation of a single currency in the third stage.

The second stage would usher in several important innovations. The surveillance of economic policy would be strengthened, and precise rules would be used to limit national budget deficits. The Commission would bring instances of noncompliance to the attention of the Council, which would propose remedial action when necessary, but the rules would not be binding until the third stage. Furthermore, the Community as a single entity would take part in international discussions on exchange rate matters and policy coordination. But the largest innovations would occur on the monetary front. The ESCB would be established, take over the tasks of the European Monetary Cooperation Fund and the Committee of Central Bank Governors, and begin to move from coordinating national monetary policies to designing and implementing a common monetary policy.[33]

This stage began in January 1994, but turmoil in the ERM meant that it was arguably never really completed.[34]

Stage Three of EMU, Irrevocable Fixing of Exchange Rates (1 January 1999)

The third and final stage of EMU would begin on 1 January 1999 with the irrevocable locking of exchange-rates, and a single monetary policy would be conducted under the responsibility of the ECB. Eventually, a single currency would be introduced to replace the national currencies. Foreign exchange reserves would be transferred to the ECB, which would conduct intervention vis-a-vis third currencies "in accordance with Community exchange rate policy". Finally, the fiscal rules would take full effect and be enforced by the Council, in cooperation with the European Parliament.[35]

Stage 3 was originally scheduled to begin in 1997. However, the TEU provided that if, by the end of 1997, no date had yet been set for the beginning of Stage 3, the latter would automatically start on 1 January 1999 with those Member States deemed ready by the European Council in terms of five macro-economic convergence criteria set by the Maastricht Treaty.[36]

4.5 Maastricht Treaty and Beyond

The decisions taken at and after the Madrid Summit reflected strong support for EMU - more than was expected by some members of the Delors Committee.[37] The outcome of the intergovernmental conference on EMU, together with the Delors Report, formed the basis of the agreements on EMU reached at Maastricht.[38] On December 10, 1991, at the Maastricht Summit, the members of the European Communities (EC) adopted the Treaty on European Union, usually called the Maastricht Treaty. The treaty which was signed in March 1992, due to delays in ratification at the national level, took effect in November 1993. It extends the domain of the EC in many directions one of which is the direction on economic and monetary union. These provide for the creation of the European System of Central Banks and the creation of a new currency to replace the national currencies of the EC countries.[39] The treaty defined the respective roles of the ECB and the Council that is Economic and Financial Affairs Council (ECOFIN) in monetary policy. It also set out EMU's goals: the importance of prudent financial management, price stability and sound public finances constitute an underlying theme of the TEU programme for EMU.[40]

Monetary union constitutes the most important and concrete part of the Maastricht Treaty, besides the commitment to the cooperation in the spheres of justice and home affairs and the shaping of a Common Foreign and Security Policy. The treaty and the attached protocol also refer explicitly to the political independence of the ECB and the national banks, thus following the German model. Actually, from the start of the subsequent negotiations, it was clear to all participants that the actual design of EMU would have to satisfy German concerns. The ECB would have to resemble the Bundesbank; it would have to be protected from political interference and dedicated to pursuing price stability.[41]

The main thrust of the TEU's references to economic and monetary policy was towards ever closer integration. The treaty, besides setting out a timetable towards monetary union and an institutional framework for the Union's central bank and its system of central banks, set out a set of convergence criteria for the economies of member states to converge.[42]

4.5.1 Maastricht Convergence Criteria

Four tests were set down in the Articles 104c and 109j of the Treaty on European Union (TEU) to be fulfilled by the participants to be eligible to enter Stage 3 of EMU. These tests are named as the Maastricht convergence criteria and consist of the following:

- a stable inflation rate (within 1.5 percent of the best three performing states in the EU),
- a low government deficit and government debt level (3 percent and 60 percent of Gross Domestic Product, respectively),
- had no devaluation of their currency in the ERM for the previous two years,
- stable interest rates (within 2 percent of the best three performing states in the EU).[43]

It was equally clear that there would be no "dash" to EMU. A long transition would be needed, as certain conditions would have to be met before the move to monetary union. These conditions came to be known as the convergence criteria. Some economists criticized this gradual approach. They conceded that time would be needed to make technical preparations but not to await convergence. Their views echoed those of the so-called monetarists in the debates of the 1970s, who had argued that a quick move to monetary union would be a major regime change and would thus induce the changes in economic behavior required for convergence.[44]

A special European Council meeting in Brussels on 2 May 1998 agreed that 11 of the 15 EU states were ready to join Stage 3 from 1 January 1999 according to the convergence criteria laid down in the Maastricht Treaty. All EU states except the UK, Denmark, Greece and Sweden were included, thus they formed what popularly became known as “Euroland”. Greece was the most enthusiastic to join “Euroland”, but the least ready to do so.[45] The transition to a single currency-the euro was to be gradual. The exchange rates of the participating states were to be fixed and to be upheld throughout the transition. The euro notes and coins were scheduled to appear after 1 January 2002. After a short interim period of a few months, the euro would replace each of the national currencies.[46]

4.5.2 The Structure and Functioning of the ECB

1998 was to see the start or the creation of the European Central Bank, which replaces the transitional European Monetary Institute and is the independent issuer of currency, and of the European System of Central Banks, the independent body responsible for the conduct of monetary policy and foreign exchange operations.[47]

The European System of Central Banks would have a fourfold mandate:

- The System would be committed to the objective of price stability;
- Subject to the foregoing, the System should support the general economic policy set at the Community level by the competent bodies;
- The System would be responsible for the formulation and implementation of monetary policy, exchange rate and reserve management, and the maintenance of a properly functioning payment system;
- The System would participate in the coordination of banking supervision policies of the supervisory authorities.[48]

The ECB would be governed by a six-member executive board, including a president and a vise-president, appointed for an eight year, non-renewable term by the European Council; and a governing council, consisting of the members of the executive board and the governors of the national central banks.[49]

National central banks had all to become independent by 1998. This is largely the position adopted in the Maastricht Treaty, which envisages an independent European Central Bank, run by "experts" and modeled on the Bundesbank, which is not under political control and has fixed objectives such as low inflation enshrined in its statute. An alternative position is that the conduct of economic policy involves political choices and the nature of these choices may change over time. This would imply the need for some political and democratic input into the process of economic policy-making. Ultimately there are few, if any, examples in history of a single currency existing without some form or government to support it.[50]

Even if one accepts the desirability of greater democratic control of the ECB, the question that arises is the overall form that any democratic control might take. This involves issues and principles which go far wider than even EMU, concerning the basic democratic nature of the EU and its institutions. Also, there is clearly a highly technical side to economic policymaking, and direct political control of the main levers of economic policy may prove technically inefficient, and could also result in a substantial loss in the credibility of EU economic policy vis-a-vis international capital markets.[51]

It is difficult to judge what the future may hold. Within the present international economic scenario of globalization and powerful, deregulated international capital markets, it is difficult to envisage an ECB which is not to some extent independent. At the risk of appearing to adopt an excessively Anglo-Saxon perspective, it may be that on balance the best and most realistic way forward might well consist of adopting a variant of the UK/New Zealand model in which the objectives of economic policy are determined by elected politicians, probably through the Council of Ministers (principally ECOFIN and the summits), while the implementation of these objectives is left to the experts who run the ECB.[52]

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[34] Richardson, p.328.

[35] Kenen, p.18.

[36] Patrick, Leblond, "Completing the Maastricht Contract: Institutional Handicraft and the Transition to European Monetary Union", Journal of Common Market Studies, 42, No.3 (2004), p.560.

[37] Kenen, p.19.

[38] Robert A., Jones. The Politics and Economics of European Integration (2nd ed). Great Britain: MPG Books, 2001, p.297.

[39] Kenen, p.1.

[40] Jones, p.297.

[41] Kenen, p.19.

[42] Jones, p.297.

[43] Laura, Cram, Desmond, Dinan, and Neil, Nugent (eds). Developments in the European Union . London: Macmillan Press, 1999, p.320.

[44] Kenen, p.19.

[45] On 19 June 2000, the EU Council at its meeting in Santa Maria da Feira, having assessed that Greece fulfils the requirements of the Treaty, approved its accession to the euro area as a twelfth member as from 1.1.2001.

[46] Cram, p.322.

[47] Richardson, p.330.

[48] Delors Report, 1989, paragraph 32.

[49] Tsoukalis, p.161.

[50] Richardson, p.330.

[51] Ibid, p.332.

[52] Ibid.

CHAPTER 5

SOCIAL AND ECONOMIC REPURCUSSIONS OF EURO IN THE EUROPEAN CONTEXT

In this chapter, debates on social and economic repercussions of euro on Europe are going to be dealt with. First of all, as a theoretical basis, the Theory of Optimum Currency Areas (OCA) which is the basis of economic literature dealing with the issue of currency areas or monetary unions is tried to be analyzed. Although the OCA theory is a theory of economics, it is believed to have social consequences, as well. In the context of social repercussions of euro, how do the European social groups, such as the business communities, banks, workers and their organizations, such as trade unions react to the single currency is tried to be explained.

5.1 The Theory of Optimum Currency Areas (OCA)

The theory of the Optimum Currency Areas (OCA), also known as the Optimal Currency Region (OCR) of Robert A. Mundell[1] is the basis of the economic literature dealing with the issue of currency areas or monetary unions.[2] This theory questions the geographical region in which the entire region sharing a single currency would maximize economic efficiency. The theory also argues whether or not a certain region is ready to become a monetary union, one of the final stages in economic integration.[3]

Robert Mundell laid the theoretical foundations for the European Monetary Union. His theory of optimum currency areas, highlighted in the Nobel Committee's citation as one of his most significant scientific contributions, has served since the 1960’s as an analytical framework for numerous debates on the validity of the creation of a European currency. Mundell was an ardent supporter of the euro, of which he is considered the godfather. Paradoxically, his theory has been used by numerous economists to oppose the European Monetary Union and question its chances of success.[4]

Some authors proclaim that one of the reasons behind the creation of the euro is because the countries of Europe individually do not each form an optimal currency area, Europe as a whole forms an optimal currency area. Another group of authors proclaim that according to the OCA criteria, the EU does not constitute an optimum currency area because it met the criteria only partially and therefore the euro should not be a successful union of currencies. However, it is also expected that the creation of the euro will in itself encourage the conditions mentioned in the OCA theory by Mundell.

According to the OCA theory, in the context of reaching optimality, which means in order for a group of countries to benefit from a common currency, six single criteria should be satisfied: the degree of factor mobility, economic openness, product diversification, financial integration, similarity in inflation rates, and the existence of social and political unity within the union.[5]

Mundell argues that the principal criterion for an optimum currency area is the existence of a high degree of factor mobility and / or wage flexibility in which labor mobility is the key criterion.[6] That is to say if countries in a monetary union are going to be hit by an asymmetric economic shock (shocks affecting only some regions but not others) then they should at least have a high degree of labor mobility between them if they are to remain in the union.[7] The general idea here is that the recession in the asymmetric country causes unemployment to rise in that country. If the unemployed workers are able to easily move to other parts of the monetary union and find jobs, then the adverse impact of the shock will not be felt as much. Basically, what this is saying is that a monetary union should involve a blurring of national identity in some fashion. If countries are separate, than an adverse shock that hits the entire economy will leave workers and the economy badly off because they are left without jobs. However, if the countries are truly unified, then workers will not be as badly off because they can move to another country and find work.[8]

All these criteria stand in relation to the ability to deal with asymmetric shocks. Symmetric shocks are less problematic in a currency area as the currency will depreciate or appreciate to the needed level for all areas, while asymmetric shocks will create an exchange rate that is too high for one area and one that is too low for the other.[9]

Even though the European countries share many common cultural, economic and political links they remain a fairly diverse group of countries both in terms of their economies and their people. Even though travel within Europe has been greatly facilitated by the creation of a single Europe, there are substantial barriers to the mobility of labor. Language and other barriers make it difficult for an Irish worker can move to Portugal and find a job with anywhere near the same ease that a displaced worker from Virginia can move to California and find a job.[10] According to the job studies by OECD, it takes five times longer for the unemployed French workers than US workers to find new jobs and at the same time French workers are five times less likely to become unemployed.

The INSEAD (one of the world's largest graduate business schools) paper on "Regional Labor Market Dynamics in Europe" revealed that in the US when a state undergoes a recession, one generally sees US workers uprooting themselves and moving themselves to those states in economic boom. In contrast, European workers drop out of the labor force and tend to stay in the depressed region. This result is discouraging for the future of EMU, because given the low level of labor mobility, there is no natural mechanism of adjustment … different national currencies and exchange rates could help with these disparities.[11] So if the labour mobility in Europe is insufficient, then one can claim that it was a mistake to unify European currencies.[12]

In the U.S., 3 percent of the national population, close to eight million people, moves officially every year from one state to another. This kind of labor force mobility helps explain why a single currency can function in the U.S. By contrast, only 0.1 percent of the total EU population moved from one country to another in 2000 and only 1.2 percent changed region within a country. Although the EU has taken important steps towards ending the formal barriers which existed for citizens of any of the member states to move to and live and work in another member state, significant informal barriers remain. Linguistic and cultural differences are major impediments to wide scale cross country migration, and the possibility of accumulated pension rights accruing from employment in different countries is extremely limited, especially for ordinary workers. The EU, in fact, is divided by 11 national languages and with unemployment figures close to 10 per cent in many EU countries, these countries ability to receive large numbers of foreign job seekers is restricted.[13]

Kiel Institute of World Economy have reported in 1998 that "Problems in the labor market could reach such a scale that some countries might want to go back to national currencies … but since the Treaty does not give the possibility of secession, this could lead to serious political tensions".[14] This forecast had been realized in Italy. Italy has been frequently mentioned as a candidate for leaving the EMU and in 2005 even called for the return of Lira. Therefore, the argument of Walter Munchau in his writing in the Financial Times "the irony is that the conditions for the break up of EMU are exactly the same as those that could lead to even more political and economic integration and centralization"[15] is fitting to the Italy's case.

Besides the labor mobility option, in the case of an asymmetric shock, there are other adjustment mechanisms that can be referred to. If the labor mobility is insufficient to offset the exchange rate instrument in a monetary union, fiscal transfers can take place. In other words, a common currency can work also within an area which is not an optimum currency area provided that there is a political will to allow fiscal transfers. Such a will usually exists in national states but is hardly supposed to be in supranational entities. Unlike the nation states the EU has not got the economic-policy instrument, the fiscal policy, at its disposal. The European Union has a common currency, but lacks the common fiscal policy.[16]

Fiscal harmonisation is a central pillar of political union – since it means centralised decision-making over what is spent and how that is financed. In the EU, in terms of fiscal policy for redistribution of income (transferring tax revenues or other resources from countries that are doing well to countries that are doing poorly), it would be difficult to see how it would be politically feasible for the French government to raise taxes on its citizens so as to redistribute them to assist displaced Portuguese fishermen. The national identity of these countries coupled with the lack of mobility must mean that transferring taxes in the EMU will pose potentially significant political problems.[17]

Although these criteria are not exhaustive and far from absolute, they are generally accepted as a sufficient measure if a certain region is ready to become a monetary union or not. According to this economic theory there are no adjustment mechanisms to deal with asymmetric shocks in EMU, as effective substitutes for the exchange rate.[18] On the other hand, first of all, there are other benefits of a single currency which may outweigh the costs of giving up floating exchange rates. Second, more recent economic theory has raised doubts about the benefits of using exchange rate reductions as a macro-economic tool. Third, the theory ignores the part played by political calculations in the making of macro-economic policy decisions.[19]

As a result, most empirical work on the issue reaches the conclusion that EMU is not an optimal monetary union, at least it is less optimal than the US monetary union.[20] Therefore, there are serious doubts about the success of EMU and the preposition that EMU will secure its own success through its realization has to be considered carefully. But, the political will that have shown by the European countries about it shows that their willingness and the possibility of success should not be underestimated.[21]

5.2 Social and Economic Repercussions of Euro

The neo-functionalist thought explains the political cooperation in European integration process through the interaction of interest groups both at the national and supranational levels. The neo-functionalist school explains the single market and formation of the EMU in the 1980's within the same framework.[22]

European multinationals, as very interested elite, had a distinctive stake in creating the conditions for the extension of their market well beyond by the national borders of individual states because of increased competition in the world trade. European business community also supported the EMU because they considered the monetary union as a natural continuation of the single market idea in Europe in the 1990's.[23]

Besides the interests of social groups, nationally defined interests cannot be neglected in the process of decision making in the EU. However, it would be wrong to reduce EMU to an exclusively inter-state bargain mediated by suggestions on the part of the Commission. At least with respect to the broadening of public support after the difficulties of the Maastricht referenda in Denmark and France, the Commission started to involve explicitly more economic experts, opinion leaders and the business community in campaigning for the common currency. At first glance, large corporations and banks have been in favour of EMU, since they believed that removing the uncertainties of currency fluctuations would help them realise the full promise of a single European market, and give them a larger effective home base from which to confront outside competitors. Yet lower transaction costs, more market transparency and better management calculation were only the immediate effects influencing transnational corporations (TNC's) to support EMU.[24]

The first point to note when considering which social forces support EMU is that European integration is not simply an economic project. It's much more fundamentally a strategic project, but not simply in the sense of a unified Europe as a means for Germany and its key allies to forge geopolitical strategy.[25]

In Europe, some support for EMU, particularly in economic liberal circles had the motivation: abandoning the national currency in favor of the euro will prevent national policy makers from pursuing “out-dated” Keynesian macro-economic policies. Some neo-liberals in both regions have also seen the abandonment of national currencies as a way to force domestic deregulatory policies that might have been difficult otherwise to promote politically. In Europe, the elimination of exchange rate adjustments is seen as a tool to fostering more flexible domestic wages; in the European Commission’s words, the euro will bring “increased labor market discipline” as devaluations can no longer be used to offset higher wage demands from workers.[26]

It is a truism that the extension of competition as a side effect of EMU has been welcomed by the European business community and neo-liberal politicians. In particular, two consequences are regarded as very promising: first, it establishes a direct link to further deregulation of industrial relations systems, since the new common currency intensifies the pressure on trade unions in terms of collective bargaining. Due to more visible and therefore comparable wage cost differentials, national and regional bargaining regimes are subjected more explicitly to the dynamics of regime competition. Besides, the general downward pressure on working and income conditions is exacerbated by the fact that EMU forecloses the opportunity of currency depreciation. Thus, in a short-term perspective, economic and political actors have only a few adjustment mechanisms at their disposal to compensate for poor economic performance and competitive disadvantages. The choices are wage reduction, longer working hours or an intensification of work. Second, EMU affects industrial relations regimes more indirectly by compelling governments to pursue more or less rigorous politics of austerity. This fosters not only the dismantling of the welfare state, reduced social provisions and services, a poor public sector, or insufficient infrastructure, but also an economically depressive situation characterised by poor business performance, high unemployment and weak trade unions.[27]

On the political front, some European nationalist parties oppose the euro as part of a more general opposition to the principle of a European union. A significant group of these include the members of the Independence and Democracy bloc in the European Parliament. Additionally the Green Party of England and Wales is opposed for antiglobalisation reasons but the rest of the European Green Party bloc in the European Parliament does not share their stance.[28]

At the one extreme of political debate, we will find out old and new style protectionists who believe that Europe can be shielded from the rest of the world and also from change. At the other extreme, we will find globalization missionaries preaching the virtues (and usually the alleged inevitability) of the shrinking world, together with market fundamentalists who want to strike down all barriers in order to unleash the forces of competition. According to them, politics should simply submit to superior economic logic. The majority of Europeans will situate themselves somewhere in between. The point of compromise can be decided only at the political level.[29] However, some social movements criticize the globalization process on the economic front saying that globalization leads to high unemployment rates, inequality, poverty for most of the societies and the financial crisis. They add that while the obstacles on the free movement of capital, product and services are tried to be removed, the same effort has not been shown to the removal of obstacles towards the free movement of labor.

In a statement made by the Socialist Equality Party on 18 March 2005, it is said that:

> The aim of economic integration under the umbrella of the European Union is to make Europe's major powers and transnational corporations competitive on the world arena against their international rivals by destroying the living standards and democratic rights of the European working class. The new European constitution does not guarantee the rights of European citizens, but rather the rights of big business and the ruling elites at the expense of working people. It allows the free movement of "services, goods and capital," while imposing strict limitations on the freedom of movement of workers.[30]

The tight monetary policy followed by the ECB (which is supported by the business community and the banks) is for the benefit of the financial sector, investors and multinational companies. However, it is not for the benefit of the exporters and also for the labor. The low inflation target of the ECB leads to low economic growth and high unemployment rates in the EU. This, in turn, may lead to discontent among the workers unions.[31] Although Alan Milward perhaps overestimates support for Maastricht's fiscal rectitude and for the single currency when he claims “the interest in stability of savings is high everywhere”, his basic point still stands: in an economically polarised continent, many of the more powerful social forces are in favour of strong anti-inflation policies, almost regardless of the scale of unemployment.[32]

The ECB was designed as a conservative bank in conformity with German preferences and the prevailing economic orthodoxy. It behaved accordingly during its first four years of operation, putting the emphasis virtually exclusively on price stability, defined by the ECB as an average eurozone annual inflation rate within the range 0-2 percent, at the expense of other considerations such as growth, employment, or financial stability.[33]

Indeed, despite the reluctance of the Bundesbank and the majority of the German electorate to give up the D-mark, and their doubts about the wisdom of a single currency, the German government pushed towards the introduction of EMU. Yet, while it is the case that Germany has set the convergence and institutional conditions for entry to the inner core of the EMU project, there is confusion about the weight and scope of the social forces that support a tough anti-inflationary stance. Many have pointed out the dangers of an inflexible approach to fiscal and monetary policy when mass unemployment scars the European social landscape. In fact, there are powerful social forces operating in Europe that stand in support of the German perspective.[34]

The envisioned consequences of EMU in its planned and realised shape have been generally detrimental to employees and trade unions. Hence, it was no surprise that, against the background of persistent mass unemployment, the Maastricht Treaty became a symbol of the crisis of European legitimacy. The fragile approval of the population in referenda and opinion polls was only one indicator, followed later by a series of protests, demonstrations and strikes against the social consequences of tough fiscal discipline. In almost every member state the number of people engaged in anti-Maastricht campaigns increased. This was of course a sign of growing distrust as regards the further course of European integration as well as towards neo-liberal adjustment strategies of national governments. Since governments refused to give up the primacy of monetarist objectives, they suffered electoral defeat.[35]

Therefore, a statement made by the Socialist Equality Party on 14 May 2004, it is proposed that:

> Workers must be politically hostile to both sides of the official debate on the European Union. They have no interest in supporting any aspect of the EU project, which is being carried out entirely at the behest of big business and the banks. In the event of a referendum being held on any aspect of EU consolidation, therefore, the working class must vote “no”.[36]

However, the divisions among workers cut across the smaller European countries. Those in the export sectors tend to support the trend, while those depending upon the domestic markets are more reluctant. Established workers may be co-opted into the new “historical bloc” while other workers, the unemployed and the social movements are left out.[37]

In Austria, Privalangeslellten (White Collar Workers' Union, or GPA), which was the strongest individual union within the Austrian Federation of Trade Unions (ÖGB) - representing the white-collar workers in industry, crafts, money and credit, trade, social insurances, insurances, agriculture and forestry - was never positive about EU membership. Accession was opposed, especially in the sheltered and regulated areas of transport companies and the food processing industry because of the likely job losses.[38]

In Sweden, within the unions, there was a split between transnational sector, industrial unions in favour of membership and national sector unions opposing it. In particular the Swedish Trade Union Confederation (LO-S) affiliates, the Paper Workers’ Union and the Metal Workers’ Union, supported EU membership. Both sectors were heavily export-dependent (the paper sector exports about 80 per cent of its products, and the engineering sector more than 50 per cent), and the engineering sector is also characterised by some of Sweden's most important transnational corporations such as Volvo, Ericsson and Electrolux.[39]

In Norway, nationally-oriented labour had the upper hand. Fearing cuts in government spending and a decrease in subsidies to domestic industries, nationally-oriented labour opposed EU membership and campaigned actively against it. Internationally-oriented labour, on the other hand, argued that EU membership would best serve the interests of the export industries. The Norwegian Confederation of Trade Unions (LO-N) leadership shared the concern of internationally-oriented labour and was clearly in favour of EU membership. At the (LO-N) congress, however, arguments against were given more weight, which left the (LO-N) leadership unable to campaign in favour of Norwegian accession to the EU.[40]

The international policy-making apparatus operates in concert with private agents: for example, International Relations Councils such as the Trilateral Commission (which has a large EU membership, with elite political and economic interests represented), the World Economic Forum, the Group of Thirty (particularly important in money and finance), and think tanks such as the UK's Institute of Economic Affairs and the Adam Smith Institute, the American Brookings Institute and the American Enterprise Institute, as well as the fora for leaders of large corporations. It involves European fora associated with corporate influence on the making of public policy, such as the European Round Table of Industrialists (ERT) which involves among its membership 20 of the top 100 firms in the world, according to the United Nations Conference on Trade and Development's World Investment Report of 1995.[41]

This neo-liberal transnational historical bloc thus has a significant basis within the EU. It includes state interests associated with the German-dominated unification project, large-scale finance and productive capital of global reach, as well as European companies, and associated privileged workers and smaller firms. The European Commission's (EC) 1995 Green Paper, moreover, illustrates that backing for EMU is strongly linked to the interests of large financial houses and firms, government bureaucracies and EU organizations, with the governments of Germany and France pressing strongly for its realization. Thus the concept of “historical bloc” enables us to understand how the present political formations, based on the dominance of transnational capital, are also constituted by and incorporate a wider range of interests and identities, including many privileged workers, members of the professions and small business people. That is to say, the bloc comprises interests of both capital and labor, and elements of the state apparatus, although it is dominated by the largest and most internationally-mobile transnational firms and their political and economic networks. The bloc also includes small investors, many of whom have come to adopt aspects of a rentier mentality in the context of the world-wide stock market boom that has characterised the 1990s. As a result, the interests and perspectives of many blue and white-collar workers correspond to the rentier perspective noted above. And, indeed, until recently, these workers have been less concerned with the plight of the unskilled and unemployed than they have been with maintaining their own living standards. This bloc forms the primary political formation that promotes neo-liberal restructuring in Europe and supports EMU.[42]

Not surprisingly, the EU's implementation strategy for EMU is partly based on mobilising this set of forces: it stresses the need to involve the most powerful economic agents first, and to draw in local/national interests associated with the EMU project to deepen its social basis. This entails working through the banking and financial sector, public administrations, enterprises and consumers (savers) to widen public support. The strategy assumes an economic order dominated by knowledge-intensive, internationally mobile capital (institutional investors, banks and transnational corporations, especially those that have large financial services arms).[43]

Despite all the evident disadvantages, trade unions still support the chosen path of integration. The political discussion revealed that the intentions and anticipated effects linked to the project of the Internal Market has been highly controversial. It is no surprise that it was strongly supported by neo-liberal politicians, employer organisations and big business. In addition to the stimulus for increased productivity, they approved or even deliberately welcomed the side effects of social dumping and "regime competition". In contrast to this stance, many employees, trade unions and Social Democratic (as well as Green and Communist) parties have all been more sceptical. In the mid-1980s there was a common awareness that liberalised capital and financial markets and the generalised principle of "mutual recognition" have necessarily profound and - from a trade union point of view - adverse repercussions on labour markets and industrial relations. Nevertheless, and this seems at first glance surprising, most of the left-wing parties and trade unions by and large accepted the SEA. Although the vision of "1992" - above all the foreseeable effects of deregulation, cross-border capital mergers, and accelerated rationalisation - represented a threat to trade unions, they partly even solicited for its completion. This indicates that many employees and trade unions - primarily those of export-oriented industrial sectors - have already been drawn into a transnational historical bloc of hegemonic social and political forces.[44]

Admittedly, many issues dealt with by European institutions do not lend themselves to passionate public debate. Economic regulation, for example, is hardly the subject to mobilize citizens. The arcane language often used by professional Europeans does not help matters either. Even EMU did not generate much debate in the majority of member countries. Being the product of intergovernmental negotiations, it enjoyed consensual support from most mainstream political parties, which had also earlier endorsed the precepts of the new economic orthodoxy. More Europe was supposed to be good for the economy, and also for peace and security. And the minority who objected spoke mainly in terms of less Europe.[45]

ENDNOTES

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[1] Since 1965 he has envisaged a European monetary area that would parallel the dollar and sterling areas. In December 1969, he presented a paper in favor of the creation of a European currency and became his "Plan for a European Currency," which he launched in March 1970 at the Madrid Conference on optimum currency areas.

[2] Emmanuel, Apel. European Monetary Integration: 1958-2002. London: Routledge, 1997, p.95.

[3] "Optimum Currency Area", http://en.wikipedia.org/wiki/Optimal_Currency_Area

[4] Alexandre, Swoboda. "Robert Mundell and the Theoretical Foundation for the European Monetary Union", IMF Views and Commentaries, December 13, 1999.

[5] The more open the economy, the more sensitive it will be to shocks and the less stable and liquid its currency will be.

[6] Elif Senem, Erkenci. "European Monetary Union from a Political Economy Perspective." Unpublished Master of Thesis, Middle East Technical University, 2002, p.73.

[7] Because exchange rate instrument is removed, in case of a possible asymmetric shock, adjustment should be supported through the channels of labor mobility or wage flexibility.

[8] Akila, Weerapana. Economics Course Lecture Notes, Wellesley College, Spring Semester 2003-04, http://www.wellesley.edu/Economics/weerapana/econ213/econ213pdf/lect213-17.pdf

[9] "Optimum Currency Area - Eurozone", http://en.wikipedia.org/wiki/Optimal_Currency_Area

[10] Weerapana.

[11] Graeme, Leach. "The UK and the Euro – Better Out Than In?", IoD Research Paper, April 1999, p.11.

[12] Petr, March. "The Euro Keeps Germany in Recession", 10 September 2004, http://www.petrmach.cz/cze/prispevek.php?ID=180

[13] Kjell M., Torbiörn. Destination Europe: The Political and Economic Growth of a Continent. Manchester: Manchester University Press, 2003, pp.145-46.

[14] Leach, p.12.

[15] "Could EMU Collapse?", Financial Times, March 23rd, 1998.

[16] March.

[17] Weerapana.

[18] Swoboda.

[19] Simon, Hix. The Political System of the EU (2nd ed.). New York: Palgrave Macmillan, 2005, p.310.

[20] Forrest H., Copie, and Geoffrey E., Wood (eds). Monetary Unions: Theory, History, Public Choice. New York: Routledge, 2003, p.44.

[21] Swoboda.

[22] Elif Senem, Erkenci. "European Monetary Union from a Political Economy Perspective." Unpublished Master of Thesis, Middle East Technical University, 2002, p.51.

[23] Ibid.

[24] Andreas, Bieler and Adam David, Morton (eds.). Social Forces in the Making of the New Europe. The Restructuring of European Social Relations in the Global Political Economy. New York: Palgrave Macmillan Press, 2001, p.102.

[25] Ibid, p.52.

[26] Eric, Helleiner, "Why are Territorial Currencies Becoming Unpopular?", TIPEC Working Paper, 01/2, pp. 15-16.

[27] Bieler, p.103.

[28] "Euro", http://en.wikipedia.org/wiki/Euro

[29] Loukas, Tsoukalis, "Managing Diversity and Change in the European Union", Journal of Common Market Studies, 44, No.1 (2006), p.6.

[30] "Unite European Workers and Youth against Militarism and Social Reaction", Statement of the Socialist Equality Party and World Socialist Web Site, 18 March 2005, http://www.wsws.org/articles/2005/mar2005/euro-m18_prn.shtml

[31] Jeffry, Frieden. "Euro: Kazananlar, Kaybedenler", Foreign Policy, Güz 1998, pp.28-29.

[32] Bieler, p.56.

[33] Loukas, Tsoukalis. What kind of Europe?. Oxford: Oxford University Press, 2003, p.159.

[34] Bieler, p.53.

[35] Ibid, pp.103-104.

[36] "No to the European Union-Yes to the United Socialist States of Europe", Statement by the Socialist Equality Party (Britain), 14 May 2004, http://www.wsws.org/articles/2004/may2004/euro-14m_prn.shtml

[37] Bieler, p.xi.

[38] Ibid, p.124.

[39] Ibid, p.130.

[40] Ibid, pp.132-133.

[41] Ibid, p.54.

[42] Ibid, pp.54-55.

[43] Ibid, p.55.

[44] Ibid, p.99.

[45] Tsoukalis, p.219.

CHAPTER 6

A COST AND BENEFIT ANALYSIS OF EUROPEAN MONETARY INTEGRATION IN THE NATIONAL CONTEXT

Although most of the continental European countries tend to be more pro-European, there are also eurosceptic ideas existing in one way another. Eurosceptics oppose the idea of a centralized European state, a United States of Europe as the United States of America, which some see as the inevitable outcome of current integration process. Some of them accept that the concept of the EU is an invention of bureaucrats seeking to create a bureaucratic and undemocratic superstate. For example, in France on the left of the political spectrum some parties, such as Parti des Travailleurs and Communist Party see the European Union as a means through which unpopular economic measures of free market and free trade are imposed on the French public as part of a right-wing agenda.[1]

One of the issues that the eurosceptics focus on is the disadvantages of the euro. The Netherlands had known to be one of the most enthusiastic countries in favor of European unification until 2002. But, after the introduction of the euro, when the prices of the goods and services rose enormously, in 2002 many Dutch people have started to blame the euro. As a continuation of this skepticism, the European constitution was also rejected by the Dutch in 2005 by a majority of the population.[2]

When we look at the United Kingdom (UK), we can see not a different picture. Eurosceptics in the United Kingdom see the European Union as anachronistic for its attempts to unite a whole continent politically and economically, arguing that the trend for centralized blocs is increasingly outdated in a world where globalization and localism are the main competing economic philosophies. Therefore, recent UK polls show that the majority of the British electorate is opposed to UK's membership in the euro.[3]

Furthermore, in European Parliament, in 2004, 37 parliamentarian from the UK, Poland, Denmark and Sweden founded a new Parliament group called "Independence and Democracy". The main goals of this group were to reject the "Treaty Establishing a Constitution for Europe" and to oppose further European integration. Some delegations within the group, notably the United Kingdom Independence Party, even advocated the complete withdrawal of their country from the EU.

According to a research "Attitudes sur l'euro", made by Gallup Europe in November 2002, 49.7 percent of the EU population was very happy or quite happy with their new currency, but this share varied widely across eurozone[4] countries: in Belgium, almost 80 percent were happy with the new currency, in Germany the number was only 28 percent.[5]

In this chapter, a cost and benefit analysis of the European single currency is going to be made, the attitudes of European citizens towards the euro will be reflected, and also the eurosceptic views about the euro, in other words the other side of the coin is going to be dealt with. It is also tried to find out an answer to the questions of how are the countries and citizens of EU affected from the introduction of a single currency and how they perceive the euro. In this analysis, some of the select countries of the eurozone, such as Germany, Italy, Netherlands, Ireland and Greece are taken into consideration. Moreover, Britain and Sweden are also included into the analysis as members of the EU, but as willing outsiders of the eurozone. The ten new member states who joined on 1 May 2004 (Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia) and the two who joined on 1 January 2007 (Bulgaria and Romania) are not included in this analysis.

6.1 The Costs and Benefits of Economic and Monetary Union

European monetary unification - the creation of a single European currency and a European Central Bank - has been the ostensible goal of the member states of the European Union since the late 1970's. However, the advent of euro has brought lots of questions. The main question is: "Will this hankering for a beloved national symbol pass, as consumers see the benefits of a single currency? Or could it snowball into deep resentment, something that could block or even reverse the process of European unity?"[6]

The arguments in favor of EMU concentrated around political, consumer, business and trade and economic issues. In terms of politics, by means of surrendering political independence, euro was supposed to bring a shelter for the countries in order to be protected from the negative consequences of globalization. In terms of consumers, prices and wages would be easily comparable across the European countries, the currency conversion costs would decrease, and therefore there would be more competition and price transparency. In terms of business and trade, it was expected to simplify cross-border trade and investment in an atmosphere of currency certainty. The euro is expected to force the firms in the Euroland to think in European terms when they are doing business. At last, in terms of economics, the introduction of the euro would contribute to higher economic growth, lower unemployment and provide economic and monetary stability.

EMU supporters go further and expect that euro would also contribute to the development of a European identity saying that Euroland citizens are coming closer, drawn together by the psychological impact of "one currency-one destiny". This facilitates the political unification sought through the EMU. Political unification will in turn permit Europe to play the role it might on the world stage-a rival to the US at times, an equal partner and ally at others.[7] Nevertheless, its contribution to the development of a European identity is questionable.

In fact, European monetary unification (EMU) is both an economic and a political phenomenon. It is economic in that it will radically transform economic policy and performance in Europe. Transaction costs will be reduced by the creation of a single currency, stimulating cross-border exchange. National monetary autonomy will become a thing of the past, limiting the use by participating countries of the inflation tax and of the exchange rate as an instrument for adjusting to nation-specific shocks. EMU is also a political phenomenon in that the decision to create a single currency and central bank is not made by a beneficent social planner weighing the costs and benefits to the participating nations. Rather, it is the outcome of a political process of treaty negotiation, parliament ratification, and popular referenda. Interest groups support or oppose the initiative depending on how it is likely to affect their welfare, not the welfare of the nation or the Community as a whole.[8]

As a political phenomenon, it can be proposed that the creation of a single currency and central bank was not made by means of calculating the costs and benefits to the participating states. Nevertheless, as it is the case with any economic reform, there are benefits and costs of replacing multiple currencies with a single currency. Although the costs or risks of the European Single Currency- the Euro are not obvious for the moment, they will be revealed in the long run.[9]

When 12 member countries started to use Euro, at the same time they relinquished sovereignty over monetary policy. Member countries have not got the right to determine their own money supply, interest rates or exchange rates although their national bank governors are represented in the European System of Central Banks. Such a step is so important that it is appropriate to ask what the major benefits and costs are expected for Europe from the EMU?

The direct economic benefits of monetary unification may be relatively small, and may not be dominated by the costs. The most important economic benefit is that EMU will likely stimulate economic growth of the EU. Another benefit is the reduction in currency-conversion costs for consumers and especially for the businesses. Businesses would save by not having to hedge against possible exchange losses while doing intra-trade. For this reason, businesses in the EC were in favor of the common currency. Due to replacing 12 national monies with one currency the currency conversion costs would be reduced such amounts that it might be evaluated as an economic justification for EMU. Nevertheless, it is not so, because the costs of currency conversions are small.

The European Commission has estimated that conversion costs absorb no more than 1% of Gross Domestic Product (GDP) for the Community's less-industrialized economies, and that they fall to as little as 0.1% of GDP for the large member states for which international transactions are less important. Overall, savings from a single currency amount to 0.3% to 0.4% of EU's Gross Domestic Product.[10] This, clearly, is a small return on a monetary unification process involving uncertainties and risks.

Reduction in currency conversion costs is advantageous particularly for the people living in towns near international borders. Freiburg is such a town which is located in the Black Forest of southwestern Germany and which has borders with Switzerland and France. Because the citizens of the town is benefiting from the advantages of euro, the town's mayor says that most of the people in the town are absolutely for the euro and they support all initiatives for the euro. Furthermore, he even says that the lines between countries will be drawn in the future more by economies, not by borders.[11]

The calculation of the benefits from the elimination of currency conversion may fail to capture the real efficiency gains from a common currency. Such gains may derive from the fact that the creation of a single currency, by eliminating exchange rate uncertainty, will encourage intra-EC trade and investment. In turn this will lead to a more efficient allocation of resources both within and across member states.[12] The removal of separate national currencies across Europe would encourage cross-border investment because single currency removes one of the final barriers to free trade, which is the uncertainty in currency conversion.

Elimination of exchange rate uncertainty makes transactions easier among the countries, which causes an increase in intra-EU trade. Eurozone members, including France and Germany, have seen their trade with each other rise significantly since the introduction of the euro – on average, the increase amounted to 3 percent of GDP between 1999 and 2001. Since 1999, trade between the euro countries has increased by 40%, but for the three countries outside the euro area the increase is only 19%.[13]

As financial capital has become increasingly mobile, governments have found it increasingly difficult to maintain a credible fixed exchange rate or even a well managed floating rate. Countries that have let their currency float freely have also often experienced significant short-term exchange rate misalignments which have been quite costly for open economies. In these contexts, the idea of creating an irrevocably fixed exchange rate through a currency union or full dollarization has become increasingly attractive to many of those seeking to promote international economic integration. For example, many Latin American supporters of full dollarization argue that exchange rate risks vis-a-vis the dollar must be eliminated in an effort to encourage foreign investment, stop flight capital, and eliminate the possibility of disruptive speculative attacks against the national currency.[14]

Existing evidence suggests, however, that exchange-rate variability and uncertainty have only small effects on trade and investment. Traders can use forward markets, hedges and a variety of financial institutions to lessen the risks attendant on exchange rate changes.[15] The IMF has found that there is not a proven link between volume of trade and exchange rate volatility. Japan and the United States had very wide fluctuations in their exchange rates through the 70's and 80's but trade expanded at high amounts. Also, countries have the opportunity cost in joining the common currency that is losing one of their major macro-economic policy instruments when reacting to economic shocks: exchange rate adjustments.

As a matter of fact, sharing the same currency makes transactions easier among the countries, but this does not open trade in all situations. In case of the EU, the countries' self interests undermine the free trade. For example, Germany has a comparative advantage in industry and France in agriculture, but Germany tries to restrict imports of agriculture from France to protect its domestic industry, even though they share the same currency.

An American observer Martin Feldstein has written in Foreign Affairs explains this point as:

> EMU would be an economic liability. A single currency would cause at most small trade and investment gains but would raise average unemployment, and increase the risk of protectionism. EMU is nevertheless being pursued in order to create a political union. Fundamental disagreements among member states about economic policies, and the sharing of political power are likely to create future intra-European conflicts …with uncertain consequences for world stability and peace.[16]

It is normal that not all of a country benefit from the EMU. Although this is the case, it may still improve the welfare of particular groups in that country. This makes the government to pursue their preferred policies. EMU has been supported by international banks and corporations strongly, while domestically oriented economic actors have opposed it. For example, at the beginning of 1980's, in France and Italy, the policies about a fixed exchange rate were strongly opposed by workers in the import competitive industries, such as steel and automobiles.

Especially liberal circles supported EMU because abandoning national currencies and using the euro would prevent national policy makers from pursuing "out-dated" Keynesian macro-economic policies. In an age of global financial integration, a supranational authority such as the European Central Bank might be able to challenge the markets more effectively and insulate countries from their effects. The territorial currencies have becoming unpopular stemming from a reconsideration of the proper economic role of the nation state generated by the triumph of neo-liberal economic ideas and intensifying international economic integration.[17]

In other words, in many EU countries, much support for the Euro has come from liberal circles who would like to see the management of money removed from national government's hands. Others have become persuaded that, even if they wished do so, the active management of a national currency is no longer an option in an atmosphere of high capital mobility.[18]

This point should not be overstated, however. In Britain, for example, many nationalists - including strong supporters of economic liberalism - portray the euro as a challenge to British identity on the grounds that a national currency is central to a nation's sense of sovereignty. In Germany too, many politicians have insisted that support for the euro is conditional on the German people knowing that it will be managed in line with their national preference for "sound" money. If this goal is not realised, they warn that Germans will see the euro as more of a challenge to their national identity and oppose it.[19]

One of the other benefits of the EMU is said to be the price transparency. When goods are measured by a single European currency in all 12 EU member states, the price differences become apparent for the consumers. The usage of internet shopping in Europe will accelerate this trend. By making prices easily comparable across countries, the common currency would increase competition and push down the prices of goods and services. Besides lowering the prices, price transparency is supposed to lower inflation as well. For example, it was predicted that the euro would reduce cost differences in cars. Car prices across Europe differed by as much as 50% on some models, such as Wolkswagen Golf because of varying tax rates.

For some people, price transparency will influence prices, but the impact could be exaggerated. For example, for consumers, price transparency may encourage more overseas purchases, but harmonization and lowering of prices across Europe will be limited owing to transport costs, indirect taxes and cultural influences.[20] The cost of living in different parts of UK varies considerably because of differences in levels of taxation as well as variations in labor, property and transportation costs.

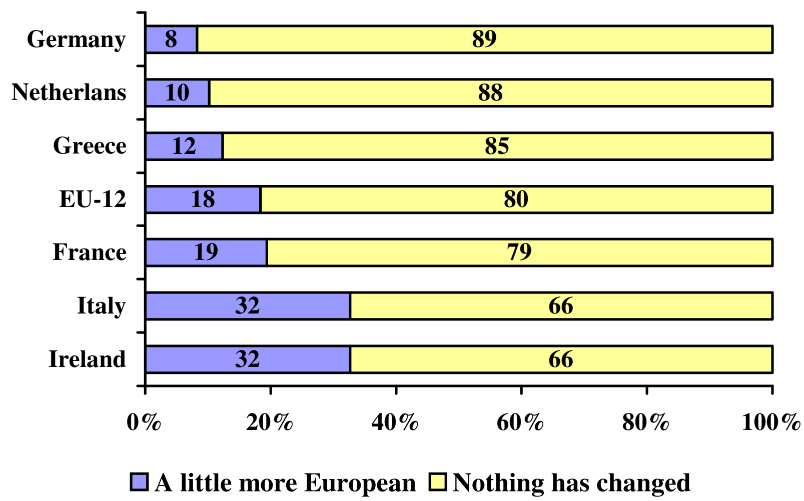
According to the results of the survey of Eurobarometer titled as “The Euro: 3 Years Later” which was realized in November 2004, after three years of using the euro, citizens in the euro zone still remain skeptic about the contribution of the single currency to the reduction of price differences. Indeed, 51% indicate that they do not believe the euro had such an effect on prices. Country results show that the French are the most convinced that differences in prices have not been reduced, with a rate of 59%.[21]

The Euro could be a factor or a motivator in the development of a European identity which is necessary for further integration in Europe. One of the reasons why territorial currencies were created in the 19th and early 20th centuries was political-cultural: they were seen to strengthen national identities. Policymakers recognized that coins and notes could act as important carriers of nationalist imagery aimed at constructing a sense of collective tradition and memory.

Therefore, nowadays the growing unpopularity of territorial currencies can be interpreted to some extent as an indicator of a desire to transcend national identities. In this respect, the creation of a supranational currency in Europe presents an interesting case to examine. It is clear that some of the motivation for creating EMU stems from a sense that it will promote a greater sense of European political unity. As one group of scholars put it, EMU has "acquired symbolic meaning as a cornerstone of European political unification" and it is driven partly by political forces committed to a more "Europeanized" form of identity. More concretely, enthusiasts for European integration also hope that EMU will encourage spillover effects - particularly the need for stronger federal fiscal arrangements - that foster further European political integration. In addition, many Europeans have seen EMU as an initiative that could bolster Europe's collective identity on the global stage.[22]

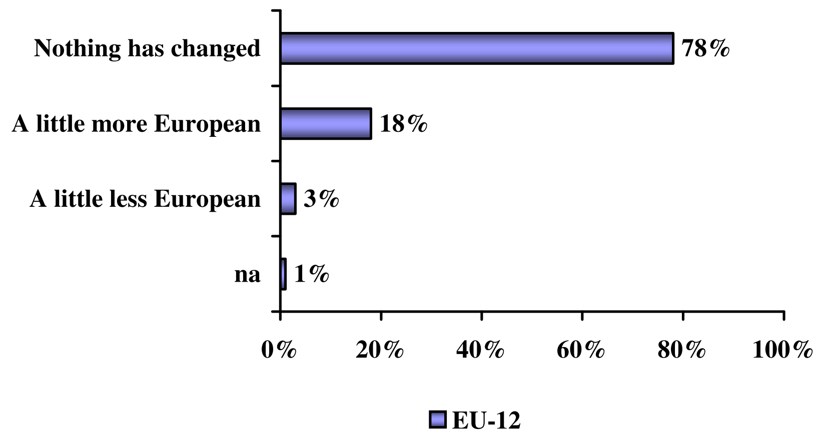
When we look at the results of a survey “*The* Euro-One Year Later” made by Eurobarometer in November 2002 across the EU, one year after the introduction of the euro, using the single currency did not appear to change the feeling of being European for respondents in the twelve countries of the euro zone, as 80% believed nothing had changed in their feeling of belonging to Europe, only 18% believed they felt a little more European[23]. Two countries were more supportive of the fact that the euro would develop European identity: Ireland and Italy. 32% felt a little more European in these countries. Three countries had opinions that were less assertive: in Germany, 8% felt a little more European, 10% in Netherlands, and 12% in Greece.[24] (see Table 2)

Table 2: Development of the European Identity since the Introduction of the Euro



It is possible that over time the concept of European identity might develop. However, according to the results of the survey titled as "The Euro, 4 Years After the Introduction of Banknotes and Coins", realized in October 2005, still most of the citizens in the euro area (78%) did not see the euro as having any effect on their feeling of being European in either a positive or negative way. 18% of respondents felt a little more European since the introduction of the common currency, and a tiny share of 3% considered that the euro made them feel a little less European. Thus, it can be concluded that the adoption of the euro has only a mild effect on the respondents' personal identity construction as a European.[25] (see Table 3)

Table 3: Since Using the Euro, Personally Feeling European or Not?



The first way that national currencies were seen by the nineteenth century thinkers to promote national identities is through the imagery emblazoned on them.[26] Although key supporters of the EMU driven by the objective of “Europeanized” identity, they did not use the new currency symbolically to promote a sense of common European identity. One of the sides of the coins has common signs of the EU, such as a map of the EU and the stars of the EU flag, but the other sides include traditional nationalist images. There are no images of a common history or culture which is found on most of the national banknotes.

The quite limited use of imagery on the new euros to cultivate a common European identity undoubtedly reflects the limited extent to which political support exists for such a conception of identity within the EU. There is much stronger support among Europeans for the EU as a community that offers certain political rights and economic benefits than there is for the EU conceived as a unified organic-people with a common cultural identity that replaces the nation. For this reason, EMU supporters appear much more comfortable discussing how the euro will promote "one market" than its role in cultivating a sense of "one people".[27]

Nevertheless, the potential symbolic role of the euro should not be entirely discounted. While the imagery on the new banknotes may not go very far in building up a common cultural identity, it does eliminate the presence of nationalist imagery. And although the euro coins retain nationalist motifs, the EU has made an effort to cultivate a more cosmopolitan outlook by allowing every coin to circulate across all Member States. This will create the possibility that a French citizen will be able to buy a hot dog in Berlin using a euro coin carrying the imprint of the King of Spain.[28]

As a result, we can say that besides the expected benefits, the euro raises problems in the euro zone, as well. Sweden refused in a referendum to accept the euro. In the past years, Germany, France and Italy broke the Stability and Growth Pact's rule on the 3% deficits of GDP.[29] Moreover, France received the European Commission's recommendations and was likely to get fined if it continued to run a large deficit. This raises some questions, such as "Could the fiscal rules of the eurozone be practically enforced? Is it possible some of the members could get fined and how will this affect their relations with others in the EU? Finally, what is the future of the euro?"[30]

The major cost of monetary union comes from losing independence in monetary and exchange rate policy. When a country gives up its currency and joins a monetary union, it is giving up its autonomous monetary policy. When it gives up its autonomous monetary policy, it imposes a cost on itself in its ability to respond to external shocks. Therefore, the potential disadvantages of adopting a common currency may come from the elimination of the exchange rate between participants in the union because it would not be possible to let the exchange rate absorb shocks asymmetrically affecting the regions of the monetary union.

What is more, in spite of today's strong euro, some eurosceptics argue that the creation of the single currency was an elite project with little public support which will not last long.[31] Very eminent commentators have highlighted the economic and political risks of the euro, and they have questioned why it is a "treaty too far". They think that euro participation is like a giant game of snakes and ladders. It may ultimately result in a scenario whereby economic gains ascend the ladder of deeper political integration. More likely however is a snaky descent towards political and economic tension. Even the

EMU is portrayed by some as "Alice in Wonderland" economics together with its risks.[32]

Although the entire EU has been accepted by some as a top-down process, with the political elite driving integration from Monnet to Werner and to Delors and the euro can be accepted as no different in this regard, its wholesale acceptance by the world shows that it is here to stay.[33]

6.2 Attitudes of EU Citizens towards the Single Currency

To see the general standing of the citizens of Eurozone members towards the euro, we could look at the results of the "Eurobarometer surveys on attitudes of Europeans". Eurobarometer has been monitoring the evolution of public opinion in the member states for the EU Commission since 1973 in terms of some major topics, one of which is the euro.

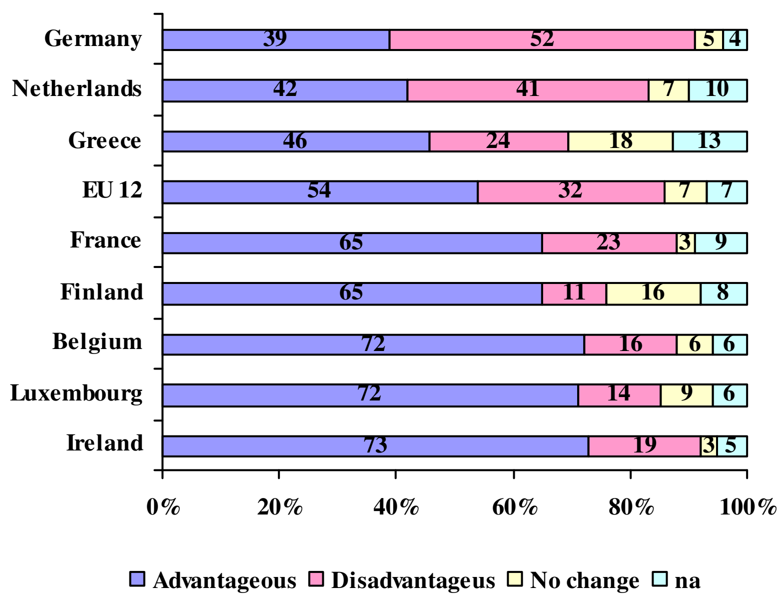
According to the results of a special survey of Eurobarometer "The Future of Europe" which was published in May 2006, when the European citizens are asked about the most positive results of European unification, almost one out of two Europeans (43%) answer that peace among member states is the most positive result of European unification. After that in the eyes of a quarter of them (%29), the Single Market is the EU's biggest success story. The Euro comes in the third place with a percentage of ten.[34]

Again, according to the "The Euro-One Year Later" survey made by Eurobarometer in November 2002, when asked the question one year after the introduction of the euro "The adoption of the euro: an overall advantageous or disadvantageous operation?", in twelve Eurozone countries, the answers show socially differentiated views on the euro's benefits, but a little more than the half of the respondents (54%) believe the adoption of the euro is an overall beneficial operation for their country (see Table 4).

Countries most positive about the advantages stemming from the adoption of the euro include Ireland (72%), Luxemburg (73%), Belgium (72%), Finland (65%) and France (65%). On the other side of the scale, there are Greece, the Netherlands and Germany with 46%, 42% and 39%, respectively, of respondents recognizing that the adoption of the single currency is "mostly advantageous" for their country. Germany became the only country with a majority of negative opinions on this issue (52%). According to social and demographic categories, the most striking differences of opinion regarding the assessment of the adoption of the euro are:

- men (62%) compared to women (46%),
- those under 25 (65%) compared to those aged 55 and above (48%),
- the more educated (69%) versus the less educated (43%) are more positive about the advantages stemming from the adoption of the euro.[35]

Table 4: The Adoption of the Euro:Advantageous or Disadvantageous Operation?



According to the results of "The Euro, Four Years After the Introduction of Banknotes and Coins" survey of Eurobarometer, four years after the introduction of euro, 51% of the citizens in the euro zone continue to perceive the adoption of the euro as an advantageous event in their country, but with a slight amount (1%) more than the sum of the other answers. This amount (51%) is less than the one that was extracted from the results of the survey made in 2002 (54%), after one year of the introduction of the euro. Notwithstanding this result, the score obtained in 2005 is the lowest since the first survey conducted in 2002. At the same time, the share of the answer "disadvantageous overall" increases slightly by 3 points. Accordingly, it can be noted that a slight negative trend is started to be perceived. The Netherlands (48%), Greece (49%) and Germany (48%) are the countries who assess the adoption of the euro to be disadvantageous overall outnumber those seeing the event in a positive light.[36] (see Table 5)

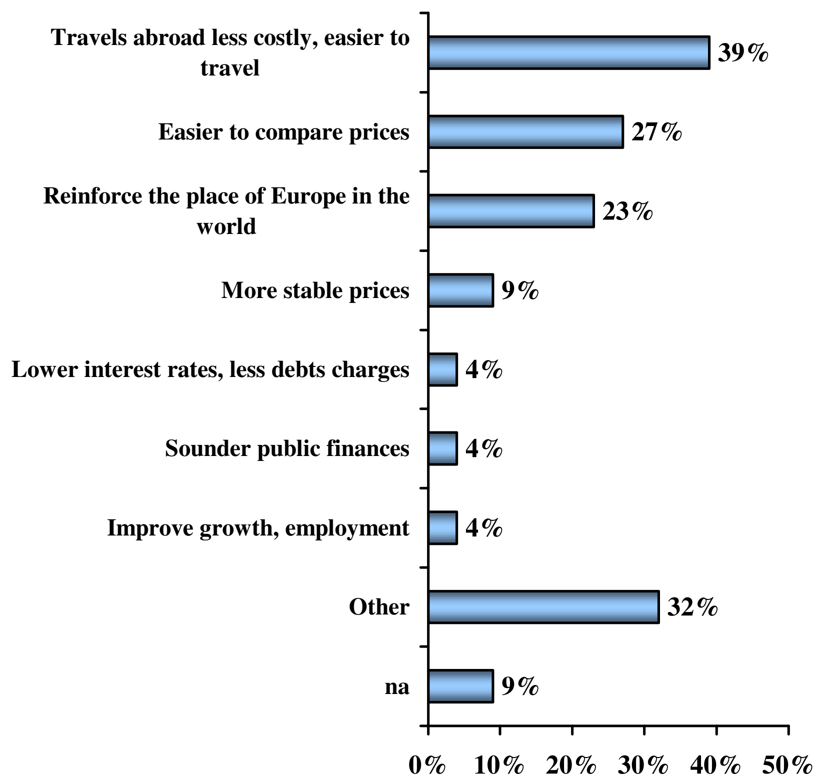
Table 5: The Adoption of the Euro: Advantageous or Disadvantageous Overall?

	Advantageous Overall	Disadvantageous Overall	No Change	na
September 2002	59%	29%	8%	4%
November 2002	54%	32%	7%	7%
November 2004	53%	36%	5%	6%
October 2005	51%	39%	6%	5%

Source: Eurobarometer Surveys, Flash Eurobarometer Report 175, November 2005.

Among the reasons of why the respondents who perceive the adoption of the euro positively, easier travel tops the list. When asked in the survey "The Euro, 4 Years after the Introduction of the Banknotes and Coins" which was realized in November 2005, what are the main advantages ensuing from the adoption of the euro, 39% of respondents mention easier and cheaper traveling. Facilitated price comparisons (27%) and strengthening the status of Europe in the world (23%) follow next. In some countries, a notably high percentage of "other" replies were detected. This was the case especially in Spain (55%), Germany (49%) and France (33%). It was interesting that when having a rough look at the lists of "other" replies in these countries, two main lines of answers can be extracted: having a strong currency and having a common currency, the first referring to the economical and financial benefits stemming from the euro and the latter to a more socially-oriented perception of the euro as a uniting factor in Europe.[37] (see Table 6)

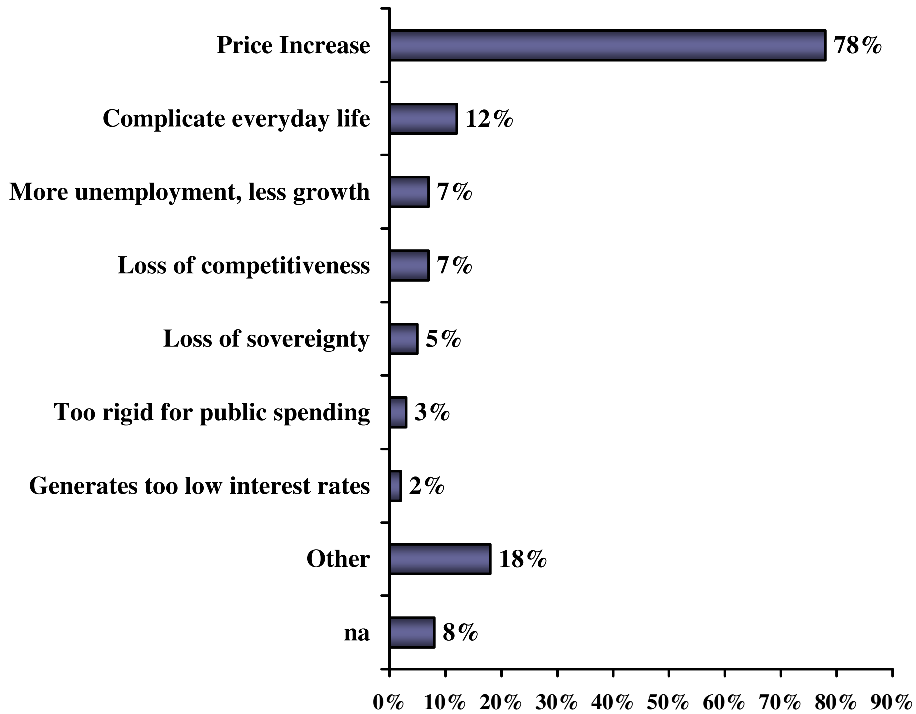
Table 6: Reasons for Positive Perception of the Euro



In country by country analysis, Luxembourgish (69%), Austrian (67%) and Irish (66%) respondents perceive significantly more often the main benefit of the adoption of the euro to be less costly and easier to travel abroad. In the case of easier price comparisons, Austrians (49%) and Germans (41%) are most likely to mention this option. Italians mention by far most frequently the option of reinforcing the status of Europe in the world.[38]

When asked about the reasons for viewing the adoption of the euro as an overall disadvantageous event, an overwhelming majority (78%) of respondents explain their negative perception by an increase in prices. Other options follow way behind the increase in the complexity of everyday life ranking next with only 12% of respondents stating this option. Also in this question, though to a lesser extent, in some countries the share of those stating reasons as other reasons is notably high, especially in Germany (32%) and Spain (31%). Again, a glance at the listed "other" answers reveals some patterns. Comparisons with the former national currencies are made frequently, also the rounding of prices and the halted evolution in salaries compared to price increases obtains a number of mentions.[39] (see Table 7)

Table 7: Reasons for Negative Perception of the Euro



At country the level, Italians (89%), Greeks (85%) and Austrians (89%) denote most often the increase of prices as a reason for their negative perception on the adoption of the euro whereas respondents in France, Belgium and Ireland (61%) mention this option less frequently. Of the other options, it can be picked up that 24% of Portuguese respondents and 20% of Italians mention that the euro has complicated their everyday life. When it comes to socio-demographic variables, women (80%) mention somewhat more often the increase of prices than men (74%), and so do respondents in the youngest age group (83%) compared to the other age categories. [40]

One of the interesting points that can be concluded from the negative results of the survey is that a great majority of the people in the eurozone think that the euro has added to the increase of prices, but at country level, unlike Italians, Greeks and Austrians, Germans are not the ones at the top level, as is expected. The other interesting point is the low percentage (5%) of the answers of "Loss of Sovereignty", that might have been thought as a critical point for the Europeans.

6.3 The Consequences of Single Currency on Europe

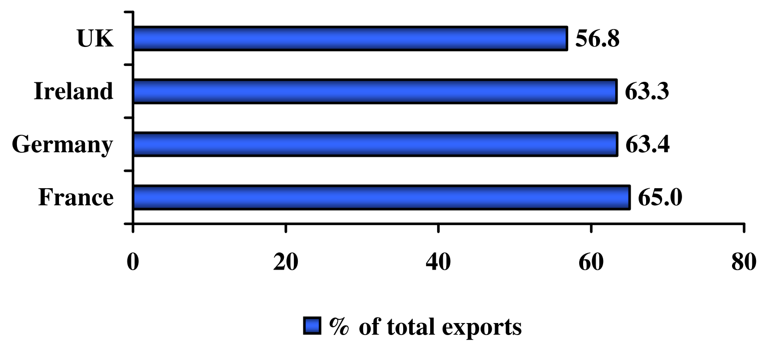
6.3.1 The UK and the Euro

"Before long, all Europe, save England, will have one money". This was written by William Bagehot, the Editor of "The Economist", the renowned British magazine, 120 years ago when Britain, even then, was heatedly debating whether to adopt a Single European Currency or not.[41]

Britain, along with Sweden and Denmark, is one of the three countries decided to remain outside the euro which has been circulating since January 2002, but is keeping its options open. But, opinion polls in the UK show a consistent majority of the British public is against joining the euro. Some perceive euro as loss of British political and economic sovereignty; others are unconvinced of the case for change from their currency-Sterling. However, one of the main reasons for opposition is the perceived failure of the euro in Eurozone economies - the UK has enjoyed superior economic performance to major Eurozone economies, such as in public spending and employment. The large future unfunded pension liabilities of continental Europe's ageing populations (unlike in the UK where pension liabilities are generally well-funded, and the UK's population is not declining) are often cited as major economic arguments against joining.

It is accepted in the UK that the UK economy is very different from Euroland in terms of large scale of economic variables, such as trade and labor mobility. One of the benefits of euro for participating countries is to foster the intra-EU trade. The more open an EU economy is to intra-EU exports – as % of total exports – then the more it is likely to gain from participating in the euro. Nevertheless, intra-EU exports account for 57% of total UK exports, whereas in the case of Ireland the proportion is 63%, in Germany 63% and in France 65% (see Table 8).

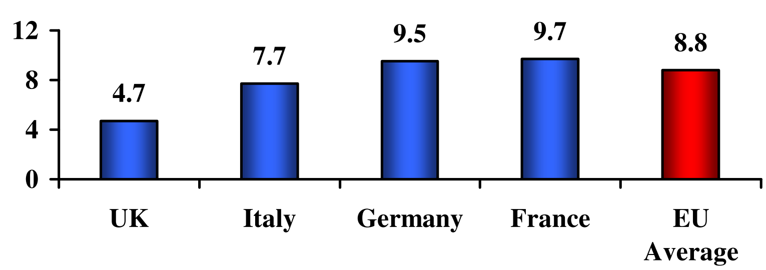
Table 8: Intra-EU Exports



Source: Economist Intelligence Unit Database, 2005.

In terms of unemployment, the UK has the lowest rate of unemployment in the EU's largest economies, at 4.7% as of 2005. In contrast, the EU average is 8.8%, with 9.7% in France, 7.7% in Italy and 9.5% in Germany (see Table 9). Also, Britain is said to have the most flexible labor market which means more jobs.

Table 9: Total Unemployment Rate (%)



Source: Eurostat, Structural Indicators, Employment Data, 2005.

One of the latest surveys of Ipsos Mori[42], "EMU Entry and EU Constitution", made in the year 2005 shows that most British people are still opposed to joining the single European currency. Three in five (55%) would vote against joining if there were a referendum and a quarter (30%) would vote for joining.

Some of the topline results of "EMU Entry and EU Constitution" survey are:

Question 1: If there were a referendum now on whether Britain should be part of a single European currency, how would you vote?

	%
In favor of a Single Currency	26
Against a Single Currency	57
Don't know	16
Refused	-

Question 2: If the Government were to strongly urge that Britain should be part of a single European currency, how would you vote?

	%
In favor of a Single Currency	30
Against a Single Currency	55
Don't know	15
Refused	1

If we look at the supporters of the single currency in the UK, we can say that they lack coherence. They include bureaucrats and ex bureaucrats, academics, labor leaders, multinational businessmen and politicians who have in common disbelief in the nation state, but they do not include the ordinary people. Britain is in particular trying to persuade a deeply eurosceptic public of the advantages of the euro. It is argued that the weak participation of the British people to the European Parliament elections shows the poor esteem to the EU in this country, with the EU institutions are perceived as being unaccountable and over-bureaucratic.

The European project is said to have always had a huge democratic deficit – it remains a project run by elites who privilege business interests and pay scant regard to the concerns of ordinary people. The fact that there was no move to expel Britain from the EU for attacking workers' rights, reducing benefits and deliberately creating unemployment during Mrs. Thatcher's term of office confirms that the EU isn't really about spreading social benefits at all. It's about maximizing opportunities for making money, and covering this with a mere pretence of a social policy for the victims of capital movements and the greater freedoms and privileges the EU accords to business. That's one of the reasons why European states hardly dared to call a referendum on entering the euro. Ordinary people are right to feel insecure, and experience gives them no reason to trust the EU to place social goods above the interests of capital.[43]

Although there is a more robust counter argument for each argument in favor of UK participation in the euro, the arguments in favor of participation can be divided into three distinct groups. The first group contains the so called "inevitability" theories that the UK has been outside European integration in the past, only to subsequently come on board later on less favorable terms. The second group contains "positive" theories, and the alleged benefits – such as lower interest rates – euro membership will bring. The final group contains "negative" arguments, and the alleged costs – such as lower foreign direct investment – EMU membership will avoid.[44]

In Britain, some people warn that if Britain doesn't join the euro, she will not be included in key decisions in the EU, particularly in an EU which expanded to 25 members. But there are many people who say it is possible to be pro-Europe, but against membership of the euro. Arising from isolation from the currency union, it is declared that the UK has slipped from being one of the more prosperous countries of the EU to being amongst the four poorest.

Several large multi-national companies have expressed misgivings about the prospect of Britain staying out of the euro and have stated that it could affect future decisions to invest in British jobs.[45] Inward investment in Britain has not yet been adversely affected by Britain's non-membership of the euro, on the contrary it shows an increasing trend after 2002, but it will be a different matter if Britain states categorically that she does not intend to join. There is then a real risk that companies will shift their operations away from Britain.[46] (see Table 10)

Table 10: Total Inward Foreign Direct Investment ($ Billion)

Source: Economist Intelligence Unit Database, 2005.

Nowadays in the UK, the issue of European single currency becomes a power play rather than the national economic interest. While John Major's Conservative Government was in power, the UK's attitudes appeared to be hardening against the EU, with the Eurosceptics in the Conservative Party gaining increasing sway over the government. But, the election of the labor government under Tony Blair in May 1997 heralded a "new start" in the UK's relation with the EU.[47]

Today, the opponents say that it's all about the battle between Mr. Brown (Gordon Brown is the Chancellor of the Exchequer) and Mr. Blair (Tony Blair is the Prime Minister). Gordon Brown is in favor of joining the single currency when it is in the UK's national interest and set five economic tests in 9 June 2003 for measuring the

UK's readiness to enter the euro. These tests measure whether Britain will benefit or suffer from the single currency in terms of economics. Though maintaining the government's positive view on the euro, the report came out against membership because four out of the five tests were not passed.

The other parties, such as Britain's Conservative Party, which is currently the second largest political party in the UK, is suspicious of ceding sovereignty in Brussels. The party insists that they are pro-Europe, but against joining the euro in the near future.[48] The Liberal Democrats, which is one of the main political parties, want to see more commitment to the euro from the government.

About membership to the single currency some people say that in UK: "We should recognize that joining the euro is a political decision more than economic one. It would necessitate joining the federal 'United States of Europe' with the consequent loss of sovereignty and nationality. Therefore, we should never join". However, some others also say: "In a 24-hour economy that spans the world, countries are no longer able to have even a limited influence over their national economies. Multinationals rule the global economy and only a much stronger currency can stand up against these global powers that are the real, and absolutely unelected, rulers in this world".[49] So, if regional integration is accepted as a global trend, the question will be if Britain can stay out of this trend or not? In other words, if British people will accept to become marginalized from the rest of the continent or not?.

6.3.2 Sweden and the Euro

When we look at Sweden, we can see that Sweden was the first country to vote on the euro since the single currency went into circulation in 2002. 56.1% of the population voted against adopting the euro, whereas 41.8% were in favor. One of the reasons of this result was that Swedish economy had been outperforming the eurozone economy; therefore Swedes were not attracted by the idea of EMU.

As the analysts and European officials said, “Because of stagnant growth, excessive budget deficits of the biggest economies, such as France and Germany and the existing impression that there was one law for the big countries and another for smaller states made the eurozone unattractive to the potential members in Western Europe. Given the very bad shape of the euro zone, this poor image was probably decisive in Sweden," said Daniel Gros, director of the Brussels-based Centre for European Policy Studies.[50]

The other reason why Swedes voted against adopting the euro was that they had seen the EU as a bureaucratic, corrupt and undisciplined bloc. They opposed the transfer of power from the people to the European Central Bank which might not take the needs of their small country into account when shaping monetary policy.

In fact, with Austria and Norway, Sweden had always been sceptical about European integration. Instead of the European Union (EU), they joined the European Free Trade Area (EFTA) in 1960. In particular, Social Democratic parties in these countries argued that the EU was dominated by “big capital” and Christian Democratic parties. Supranational integration led by these forces would imply the danger of undermining social democratic achievements of full employment, social equality and generous welfare provisions.[51] Nevertheless, in these countries, trade unions enjoy a significant role in policy-making through their participation in corporatist institutions. It can, therefore, at least be argued that the overall positive trade union position on EU membership in Austria and Sweden and the negative evaluation in Norway was one of the important reasons for the different results in the referenda.[52]

According to the Swedes, monetary union is not serving to democracy. With the introduction of the euro, control of interest rates passed from member states’ central banks to the ECB, a decisive factor in the Swedes’ rejection of the euro. Thus monetary union is a fundamentally undemocratic project. It has stripped member states of their power to tailor economic policy to local and national circumstances and placed it instead in the hands of an institution which is open to neither scrutiny and democratic audit nor influence.[53]

For the Swedes, monetary union is not serving to equity and social justice, as well. It seems European monetary union will not serve the interests of progressive internationalists, equity, social justice or democracy. It won't serve the interests of environmental protection, either, as power transfers to exactly those corporations whose activities environmentalists would like to see regulated further.[54]

"Across Europe people are very skeptical to the entire EU project, because it shifts power up to Brussels and Frankfurt. Single currency was a proposal to shift power and that is why many voted no," Nils Lundgren, a leading campaigner for the "no" camp, said after the referendum in Sweden. At the heart of the issue for many Swedes was a distaste for supranationalism and the firm belief that "we can take care of ourselves better than Europe can", with major concerns focusing on the future of their generous welfare society.[55]

It is true that supranational institutions, such as the EU, are far removed from the citizens they are supposed to serve. But there is a dilemma: a more efficient EU with greater decision-making capacity and better able to respond to the challenges of globalization, is likely to be more centralized and even less responsive to the preferences of citizens and elected governments.[56]

6.3.3 Germany and the Euro

In Germany, immediately after the physical introduction of the euro, the euro had caused a huge increase in prices, especially in service industries and restaurants which German government and the National Bank also admitted. Therefore, the biggest complaints in Germany had been about price rises. Because the conversion rate was approximately 2 Deutschemark equals to 1 Euro, there had been examples of shopkeepers replacing deutschemark sign with a euro, which means rising prices by 100 percent. As a result, consumer spending and confidence in the country decreased and the Germans began to name the new currency as the "teuro" that was reproduced from the

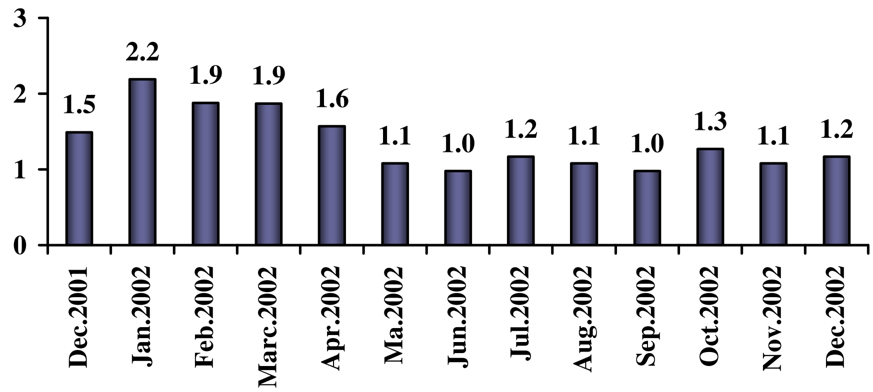
German word “teuer” which means expensive. In that period, according to a poll carried out by Allensbach Institute, %54 of Germans said they wanted the euro to be replaced by Deutschemark.

It is questionable even now whether EMU has majority support in Germany. Further, most German households were directly affected by the euro until 2002 when the Deutschemark cash and bank accounts disappear. Political opposition may increase as the reality of the end of the Deutschemark takes hold.[57]

Hans Eichel, Germany's finance minister in 2002 accepted at that time that the introduction of euro notes and coins almost in five months led to significant price rises across the country and left consumers feeling they were carrying the burden of the transition to the new currency.[58] As a matter of fact, the prices were only gone up by 0.2% in the Eurozone after the introduction of euro and that increases were temporary, according to Eurostat, the EU’s statistical agency. Actually, the price increases were proposed to be the result of rounding up prices by the retailers.

Federal Statistics Office of Germany analyzed in 2002 the impact of the physical introduction of euro banknotes and coins on price trends. The results of the study indicated that the introduction of euro banknotes and coins did not have a major influence on the overall consumer price index for all households in Germany. The study, which analyzed some 18,000 prices series from 35 groups of selected everyday consumer goods, indicates that when adjusted for special effects (tax increases and weather-related prices for fruit and vegetables), the rate of price increase was 2.2% in January 2002, which was in line with the trend of the preceding months.[59] However, by the end of the year 2002, the year in which the euro first launched physically, consumer price inflation was only 1.2%, which is lower than the rate of 1.5% at the year end 2001 (see Table 11).

Table 11: Germany - 2002 Monthly Consumer Price Inflation (%)



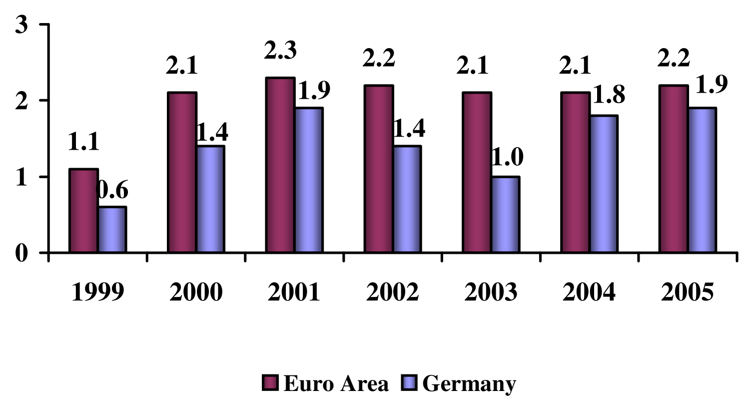
Source: Economist Intelligence Unit Database, 2006.

Contrary to the psychological impression the euro have on the people, Europeans refused to believe that they were simply imagining the price rises. Even by the end of 2002, Europeans thought that year-on-year inflation was running at more than twice the officially recorded rate. The result was an unprecedented gap between actual inflation (as measured by statistical agencies) and perceived inflation (as measured by surveys of European consumers).[60] Swiss economist Hans Wolfgang Brachinger developed a special price index of perceived inflation. In the past decade, as the AFP news service reported, the average perceived inflation in Germany was “approximately four times higher than the official inflation rate”. Although Brachinger's methods and conclusions have been fiercely contested by Bundesbank economists, there's no denying that a gap between real and felt inflation exists.[61]

The belief can have serious economic consequences. Sluggish consumer spending can put brakes on a country's overall economic performance, as happened in Germany for many years. Swiss economist Hans Wolfgang Brachinger said that “If the German economy has any interest in sustainably reviving consumption, it should work towards significantly lowering the perception of inflation among consumers”.[62]

The European Commission and the ECB appeared largely to ignore the uproar. They pointed to inflation statistics that showed little or no impact of the currency changeover. True, in January 2002, when the euro first hit the high streets of Europe, consumer price inflation jumped to 2.7 percent year on year, compared with 2.3 percent in December 2001. But inflation came down quickly afterwards, and for 2002 as a whole it was actually lower than the year before (2.2 percent, compared with 2.3 percent in 2001). Eurostat explained that the price rises in early 2002 had more to do with bad weather, which pushed up food prices, than with the euro. The euro may have led to some prices rises, Eurostat belatedly conceded, but it should have contributed no more than 0.2 percentage points to first-half inflation in 2002.[63] Eurozone inflation has been coming down further in 2003 and 2004, as well (see Table 12).

Table 12: Euro Area and Germany - Annual Average Consumer Price Inflation (%)



Source: Eurostat, Structural Indicators, General Economic Background Data, 2005.

In Germany, there is widespread dissatisfaction with the euro in general. But, according to Richard Hilmer, the managing director of market researcher Infratest, based in Berlin, German public opinion about the euro tended to divide along generational and class lines. “The older generation is a bit more sensitive towards the euro and the Eastern Germans are also a bit more sensitive as they had to change in 1990 (the year of reunification) from the East German Mark to the Deutschemark”, he said.[64] Older generation is more sensitive towards the euro because they related the Deutschemark to the post-war economic revival of Germany. Germans had been disappointed after the introduction of the euro because they had been told that the euro would be as strong as the Mark which was Europe's most successful post-war currency. However, at that time euro was weak against the dollar. Therefore, we can say that in Germany the attitudes of older generation towards the euro may have an emotional side. Furthermore, younger people in Germany and people with a higher education have a more positive attitude towards the euro than older people or people with less education. However, none of the four groups perceive widespread advantages towards the euro conversion.[65] The results of the Eurobarometer opinion polls also supported this conclusion. The educated tend to be the most pro-euro. Second, those who believe themselves to be well-informed are also the most pro-euro.[66]

Although around half of all people in the eurozone say they are happy with their new currency, this number has been falling in recent polls. Faced with sluggish economic activity and growing unemployment, many people in Germany and elsewhere did not feel like celebrating. Some claimed that the euro itself should be held responsible for Europe's economic woes. They also claim that the euro has stifled economic growth and contributed to high unemployment.[67]

Today, the unemployment rates of France and Germany emphasize the euro area's economic problems. France's unemployment rate hits a five year high of 9.7% in 2005, Germany's rate is 9.5% as of 2005 and is expected to be 11% at the end of 2006. Some workers who lost their jobs in Germany blamed the euro for its decision to make the workers redundant. The reason for this is explained as the euro having resulted in added cost pressures which lead to take action by the companies to protect their trading position.

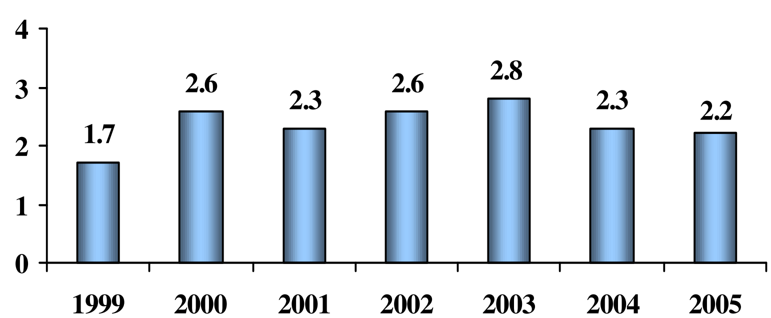
In Germany, the euro is blamed for the economic weakness of the country, as well. Economic advantages of the euro eroded because of high interest rates that is determined by the European Central Bank and that can not be lowered by the countries themselves. High interest rates is said to restrict the growth of the slower growing core economies, in particular Germany.

6.3.4 Italy and the Euro

It seems that in Italy, generally the euro has been used as a means of politics. Likewise, in 2003, the then Prime Minister of Italy - Silvio Berlusconi whose party contained at that time a eurosceptic wing said that "The single currency produced some positive effects, but today, there are more negative effects".[68] His explanation might be based on the general discontent of the public as consumers because Italians blame the single currency mostly for rising prices and a declining economy.

Italian consumers association said that because of the price increases, the usage of euro cost Italian households an average 2.800 euros from January 2002 to the year end of 2003. Also, it is proclaimed by the consumers that the prices gone up by between 20% and 30% immediately after the euro's launch. As a matter of fact, according to the numbers of Eurostat, the inflation rate in Italy had been 1.7% before euro was introduced. But, after the introduction of euro, it became 2.6% and 2.3% as at year ends 2000 and 2001, respectively. However, the reason of this increase is said to be not solely attributable to the euro, it was because the shopkeepers and the producers took advantage of people's confusion during changeover (see Table 13).

Table 13: Italy - Annual Average Consumer Price Inflation (%)



Source: Eurostat, Structural Indicators, General Economic Background Data, 2005.

There has been wide debate since the creation of the euro as to whether EMU will succeed, in the sense that all entrants will choose to remain or whether one or more will choose to withdraw. The country which has been frequently mentioned as a candidate for withdrawing from the EMU is Italy.[69] Italians, once among the most enthusiastic supporters of a united Europe, are becoming increasingly disillusioned, so much so that some are suggesting that Italy dump the euro and bring back the Lira.[70]

Roberto Castelli, Italian justice minister from the Northern League, a major coalition partner in the government of Silvio Berlusconi, said his party will present concrete proposals in June 2005 for calling a referendum on ditching the euro. “Does (the British pound) sterling have no economic foundation because it is outside the euro?” he asked. “Is Denmark living in absolute poverty because it is outside the euro? Are Swedes poor because they are outside the euro?”[71]

Nationalist feelings among voters about preserving sovereignty might result in political pressure on leaders to get out of the arrangement.[72] In the year 2005, Reforms Minister in Italy's government coalition explained his doubts on Italy keeping the euro, and even called for the return of the Lira.[73] It may not be a coincidence that politicians in Rome have been openly discussing the "exit option" as their country slides deeper into recession.[74] Although Reform Minister’s idea was not the official policy of the government and although the single currency might be used as a populist idea by the parties in government, the euro was facing with its testing period in 2005, when the country was in a recession period.

Apart from this political debate, an increasing number of scientific studies, notably by international investment banks such as Morgan Stanley, Societe Generale and Deutsche Bank, have shown concern with the Italian situation in EMU. There are real economic tensions underlying this political debate.[75] These large international banks have been saying that it is not all sunshine in the Eurozone. Economic and political tensions have built up and more may lie ahead.[76]

6.3.5 The Netherlands and the Euro

In the Netherlands, the "boom-bust" effects of the single currency is said to have driven the country into a severe economic downturn over the past four years, which could also be accepted as one of the reasons why Dutch voters reject the EU constitution. Unemployment rate increased from 2.2% in 2001 to 4.7% in 2005, while the economy has been in decline after a sharp recession in 2003. But despite the crisis, Dutch citizens remain the biggest net contributors to the EU budget, paying more than twice as much as Britons per capita.

Frits Bolkestein, former EU single market commissioner, told Dutch television that he regretted giving up the Guilder, the symbol of Dutch trading success. Joshua Livestro, a Dutch media commentator, said that ordinary voters linked their current troubles to the failures of EU economic policy, though their main focus was on price rises resulting from euro entry at an undervalued exchange rate - a fact that was known at the time but withheld from the public.[77]

A statement signed by 70 Dutch academic economists against EMU and published by one of the newspapers (De Volkskrant) in Holland on February 13, 1997. What they are saying in the statement displays their standing well:

> The national states, due to the unleashed policy competition, are contending with a restricted capacity for action. Trapped in a monetarist web, they are looking on as their problems of unemployment, social exclusion and environmental degradation grow. We conclude that the current EMU agenda is unsuited for the Europe of the future. We oppose the current situation in which the coming of euro-banknotes is seen in the Netherlands as a matter of course. The fact that the Union still offers no prospect of improvement for Europe's 20 million unemployed and 50 million poor is in itself sufficient grounds for our opposition.[78]

On the other side, some of the economists, such as Professor Lars Jonung from the Stockholm School of Economics does not find a contradiction between the ECB's policy of price stability and European governments pursuing jobs and growth.

According to him, unemployment in Europe is not due to high interest rates, but rather to structural problems in the European economies.

6.3.6 Ireland and the Euro

In Ireland, the Workers' Party opposed accession of Ireland to the European integration process by means of accepting the treaties. The European Union is accepted by Workers' Party as a capitalist project which is designed to achieve economic growth and increased profits. The concept of the single market and a common currency is a characteristic of this project. The Treaty on European Union demands the removal of controls on the movement of capital as part of the Single European Market. According to the party, the national economy would be laid open to the unrestricted and unrestrained movement of capital and the avarice of banks and multinational corporations whose sole objective is profit, not people. Nation states would be severely restricted in pursuit of their own social, economic, labor and environmental policies.[79]

The so called "lack of democracy" in the European Union has also long been a concern for the Workers' Party. It is proclaimed that power has been progressively transferred from national parliaments to Europe, but there has been no reciprocal democratization of the European institutions. The gap between the citizen and the decision-maker, the governing and the governed, has widened. The EU is a centralized and bureaucratic construction largely divorced from the citizens of the EU. Further integration and federalism will not address the democratic deficit; it will simply cause it to increase.[80]

6.3.7 Greece and the Euro

Greece is that as a late entrant (at the beginning of 2001) into the EMU, it is expressed recently that most Greeks are disappointed with the euro and their traditionally positive view of the European Union is fading, according to a Eurobarometer poll published Tuesday 2006. 53% of those surveyed said they were disappointed with the euro, while 46% said they still supported the currency compared with more than half in previous years and a European average of 60%.[81]

As it is mentioned in this chapter, besides the commonly acknowledged risks of the euro, there are also benefits that have to be compared with the risks, such as reduced transaction costs for trade within the EMU, price stability within euroland and a move toward a politically and economically unified Europe, in other words a USE - a United States of Europe. But, only the future will tell us where the balance between the costs and benefits will be - now that the great euro experiment has started. What's more, we should be prepared for the surprises.[82]

ENDNOTES

[1] "Euroscepticism", http://en.wikipedia.org/wiki/Euroscepticism

[2] Ibid.

[3] Ibid.

[4] The Eurozone (also called Euro Area, Eurosystem or Euroland) is the group of EUmember states which have adopted the euro and create a currency union.

[5] Katinka, Barysch, "The Euro and Prices", Centre For European Reform, Policy Brief, January 2003, p.4.

[6] "The Advent of the Euro", World Press Review, Viewpoints, March 2002, Vol.49, No.3. http://www.worldpress.org

[7] Kjell M., Torbiörn. Destination Europe: The Political and Economic Growth of a Continent. Manchester: Manchester University Press, 2003, p.143.

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[9] Lars, Jonung, "Euro: The Great Experiment", CNN The Euro Debate Series, http://www.cnn.com/SPECIALS/1998/euro/euro.debates/jonung.html

[10] Commission of the European Union. Directorate General for Economic and Financial Affairs. "One Market, One Money: An Evaluation of the Potential Benefits and Costs of Forming an Economic and Monetary Union", European Economy, October 1990, No.44, p 251.

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[12] Eichengreen, pp.270-71.

[13] Katinka, Barysch, "Britain and the Euro: How to Reap the Benefits", Centre for European Reform, Policy Brief, June 2003, p.2.

[14] Eric, Helleiner, "Why are Territorial Currencies Becoming Unpopular?", TIPEC Working Paper, 01/2, p.7.

[15] Eichengreen, pp.270-71.

[16] Martin, Feldstein, "The Euro and War", Foreign Affairs, November/December 1997.

[17] Eric, Helleiner, "One Money, One People? Political Identity and the Euro", TIPEC Working Paper, 01/6, pp.18-19.

[18] Ibid.

[19] Ibid, p.19.

[20] Graeme, Leach, "The UK and the Euro – Better Out Than In?", IoD Research Paper, April 1999, p.19.

[21] Eurobarometer Surveys, Flash Eurobarometer Report, No: 165, November 2004, p.32.

[22] Eric, Helleiner, "Why are Territorial Currencies Becoming Unpopular?", TIPEC Working Paper, 01/2, pp.21-22.

[23] The Eurobarometer (EB) survey series is a programme of cross-national and cross-temporal comparative social research conducted on behalf of the European Commission and is designed to monitor social and political attitudes in Europe.

[24] Eurobarometer Surveys, Flash Eurobarometer Report, No: 139, December 2002, p.71.

[25] Eurobarometer Surveys, Flash Eurobarometer Report, No: 175, November 2005, p.44.

[26] Eric, Helleiner, "One Money, One People? Political Identity and the Euro", TIPEC Working Paper, 01/6, pp.3-4.

[27] Eric, Helleiner, "Why are Territorial Currencies Becoming Unpopular?", TIPEC Working Paper, 01/2, pp.22-23.

[28] Eric, Helleiner, "One Money, One People? Political Identity and the Euro", TIPEC Working Paper, 01/6, p.7.

[29] Under the Stability and Growth Pact, any EMU country that runs a fiscal deficit greater than 3% of GDP annually is required to remedy the situation within ten months. Stability and Growth Pact is approved by the European Council meeting in Amsterdam in June 1997 in order to complement and to specify the Treaty provisions on EMU.

[30] "Who is Happy With the Strong Euro?", West Professors Comment on the Financial Aspects of European Integration, West European Studies Newsletter, November 2003, http://www.indiana.edu/~west/documents/November2003.pdf

[31] Ibid.

[32] Leach, pp.1-2.

[33] "Who is Happy With the Strong Euro?", West Professors Comment on the Financial Aspects of European Integration, West European Studies Newsletter, November 2003, http://www.indiana.edu/~west/documents/November2003.pdf

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[35] Eurobarometer Surveys, Flash Eurobarometer Report, No: 139, December 2002, p.69.

[36] Eurobarometer Surveys, Flash Eurobarometer Report, No: 175, November 2005, p.32.

[37] Eurobarometer Surveys, Flash Eurobarometer Report, No: 175, November 2005, p.34.

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[39] Ibid, p.35.

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[42] Ipsos MORI is the sum total of two successful research companies, Ipsos UK and MORI, which joined together in October 2005 to create the second largest research company in the UK.

[43] Michael, McCarthy, “Europe - A Miserably Elite Project”, 18 July 2002,

http://www.opendemocracy.net

[44] Leach, p.5.

[45] “Should Britain Join the European Single Currency?”, The Euro Debate.co.uk, http://www.theeurodebate.co.uk/arguments/trade.htm

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[47] Laura, Cram, Desmond, Dinan, and Neil, Nugent (eds). Developments in the European Union . London: Macmillan Press, 1999, p.321.

[48] Cram, p.322.

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[52] Ibid, pp.132-133.

[53] Caroline, Lucas, “The Corporate Currency”, The Guardian, 16 September 2003.

[54] Ibid.

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[56] John, Baylis, and Steve, Smith. The Globalization of World Politics. New York: Oxford University Press, 2005, p.52.

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[60] Katinka, Barysch, "The Euro and Prices", Centre For European Reform, Policy Brief, January 2003, p.2.

[61] "Euro Rises to New High but Europeans Remain Sceptical", Deutsche Welle, 29 December 2006, http://www.dw-world.de/dw/article/0,2144,2293669,00.html

[62] Ibid.

[63] Barysch, p.2.

[64] "The Single Currency", CNN Specials – The Changing Face of Europe, http://edition.cnn.com/SPECIALS/2000/eurounion/story/currency/

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[66] "Information is Key to Euro Support", The Guardian, 5 September 2001.

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[70] John, Phillips. "Italians Consider Trashing Euro, Returning to Lira", The Washington Times, 15 June 2005.

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[73] Davis.

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[81] "Most Greeks Disappointed with Euro: Poll", EU Business, 24 January 2006, http://www.eubusiness.com/archive/Euro/060124164926.9n322yr5

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CHAPTER 7

CONCLUSION

European regional integration process which has started after the Second World War has been surviving a new and difficult test with the launch of the EMU and single currency on January 1, 1999. This new stage in the process of European integration has been widely debated by the academics in terms of its implications on the political and economic front, and among the citizens of the European Union before and after its launch. Even today EMU remains to be a much debated issue.

The arguments have political and economic grounds and the views have pro-European and eurosceptic points. While the pro-Europeans generally focus on the advantages of euro, the eurosceptics focus on the disadvantages. All the way, it is a fact that the introduction of a new currency should have some costs and benefits on the European countries and citizens.

In economic terms, the benefits of a monetary union can be stated as reducing currency conversion costs, eliminating the exchange rate uncertainty, providing price transparency, and therefore decreasing the prices of goods. It was also expected to contribute to the economic growth of Europe and encourage intra-EC trade and investment. However, the economic returns may not outweigh the economic costs. The major cost of monetary union comes from losing independence in monetary and exchange rate policy. It would not be possible anymore for the euro area economies to adapt to asymmetric shocks affecting some regions of EU by means of exchange rate policy instrument.

According to the OCA theory mentioned in the thesis, there are no other adjustment mechanisms to deal with asymmetric shocks in EMU, as substitutes for the exchange rate. Labor mobility, wage flexibility and the political will to allow fiscal transfers is limited in the EU. So, it can be concluded that EMU is not an optimal monetary union, at least it is less optimal than the US monetary union. Therefore, there are serious doubts about the success of EMU among the economists.

The uncertainties and risks involved in this process can be observed in practice among the euro area members. Single currency affects the rest of Europe, as well. Many people in the euro area are certain that there has been a big increase in prices since the switch to the euro. This impact is felt by the people mostly in Germany and Italy. German people believe that euro led to significant price rises and left the consumers with the feeling that they were carrying the burden of the transition to the new currency. Besides, it is also believed that the new currency is contributing to the unemployment problem in Germany. Italians also blame the single currency for the price rises and the decline in the Italian economy. It is the country that has been frequently mentioned by its politicians as a candidate for withdrawing from the EMU.

However, it is interesting to find-out in the thesis that the eurozone economies have low inflation rate of around 2 percent over the period as measured by the official statistics. The result was an unprecedented gap between actual inflation (as measured by statistical agencies) and perceived inflation (as measured by surveys of European consumers). It is also a fact that unemployment in Europe is mainly related to the structural problems in the EU economies, but not solely attributable to the euro. These observations bring in mind the conclusion that German people generally relate the Deutschemark to the post-war economic revival of Germany, therefore they were expecting a currency as strong as the Deutschemark. Nevertheless, the euro was weak against the dollar immediately after its launch. It has gained strength in time and according to the ECB, at the year end 2006, the euro even surpassed the dollar in terms of the amount of bills in circulation worldwide.[1] However, it is not certain that it can rival the place of the dollar in the future.

Despite the euro's new-found muscle as it nears its fifth anniversary on January 1, 2007, many Europeans from the 12-member eurozone remain deeply skeptical about their common currency.[2] In Ireland, some circles opposed the European integration process and EMU firstly on the grounds that EU is a capitalist project which has the aim of increasing the profits of business world. A common currency is a continuation of this project. Secondly, the European institutions, one of which is the ECB, are accepted as having a "democratic deficit". The Maastricht Treaty envisages an independent European Central Bank, which implies lack of political and democratic input into the process of economic policy-making and which brings in mind the question of transparency and accountability of the central bank. Therefore, we can say that the eurosceptics in Ireland are dissatisfied with EMU because they see the EU as a centralized, bureaucratic construction largely divorced from the citizens of the EU.

There is not a different picture in Sweden and United Kingdom. These countries decided to stay outside the euro area after holding referendums on the issue, but the UK is keeping its entry option open. They involve a large eurosceptic population who has the opinion that the European integration is an elite project imposed on the citizens of Europe and monetary union is not serving to democracy, equity and social justice. Besides, in economic terms, these countries are outperforming the eurozone economies. Therefore, they see little benefit in entering the EMU involving risks and uncertainties and giving up sovereignty in monetary and economic policy making.

In political terms, a single currency is expected to facilitate further political integration. In the words of John Maynard Keynes: "he who controls the currency controls the government". EMU is such an important economic subject that developments in this area may influence the shape of the new European architecture because money has frequently been used as an instrument of wider political objectives, even though markets and economic fundamentals have not always obliged by adjusting themselves to the exigencies of high politics.[3] As an example, the rejection of the European Constitution by French and Dutch voters in 2005 can be named as a setback in the further integration of Europe.

There are also some weaknesses in the construction and functioning of EMU and there may arise in time conflicts between the member states that may constitute impediments in the further integration of Europe. The undemocratic structure, the weak democratic control (accountability) of the ECB is de-motivating the integration process as expressed in the Ireland case. The elitist and technocratic and to a certain extent inefficient character of European integration may constitute another impediment in the way to political integration. Furthermore, although launching a single currency should be accepted as a practical achievement in the history of the EU, EMU has the potential of even dividing Europe between “ins” and “outs”, in other words between the countries who are members of EMU and who are not because of their conflicting interests.

It is known that on January 1, 2007, Slovenia became the 13th member of the eurozone, however the other new members of the 2004 expansion of the EU are not so much enthusiastic about giving up their national currencies. Besides Slovenia, when Poland, Hungary, Estonia and the Czech Republic are admitted to the eurozone, the EU would comprise of the eurozone, willing outsiders and unwilling outsiders.

Economists had predicted that the 10 countries which joined the EU in 2004, mostly former members of the communist bloc, would adopt the euro no later than 2010. A first wave of three or four countries was expected to be ready by January 2007. But the forecasters failed to take into account that there would be governments that were able but unwilling to adopt the euro, others that were willing but unable, and some that were neither willing nor able. In the end, the club gained just one new member on January 1, 2007 when Slovenia's two million inhabitants gave up their tolars. Poland, for example, where eurosceptic conservatives have been in power for a year, has declined to set a timetable, simply saying that it aims to hold a referendum in 2010 on whether to give up the zloty - even though joining the single currency was one of the planks of the EU membership treaty already approved by Polish voters in 2003. Government of Poland points to the example of Sweden, which joined the EU in 1995 and decided to keep the krona after a referendum in 2003.[4]

As a result, this thesis showed that with the single currency and single monetary policy, the EU has gained wide range of powers and instruments in the economic front. But, just as the other steps in European integration, monetary unification is an evolutionary economic, political and even social process and one of the factors that the future of European integration is dependent on is the success of this process. Actually, it is early to say that EMU is successfully accomplished. The dynamic impact of EMU could continue to expand and “snowball”. Already, however, it is the major component of the developing process of European integration, and its impact deserves careful attention.[5]

This thesis also proposed that in order for the EU to further integration in the political front, which has started with the integration in the sectors of economy, there should be a separate defence and security policy. As was mentioned in the thesis, money and defence are the main elements of national sovereignty. There should also be a European constitution and language and a European identity. What is more, the EU must be closer to its citizens in order to make them a subject of the Union and to make them feel loyalty to the EU.[6] The mass support may be influential on further political integration, on the preferences of the elites. Most importantly, the workings of the European single currency should be revived in a more integrative direction that necessitates eventual participation of all EU members to the eurozone, including also Britain.[7]

In conclusion, the study in essence says that economic and monetary integration has negative and positive consequences for the EU countries. But the economic costs may be larger than the benefits for most of the countries. Consequently, political motives or expectations play role in the EMU process, thus integrating sectors of economy (economic integration) may in time bring political integration in the EU, but not necessarily.

ENDNOTES

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[2] Ibid.

[3] Loukas Tsoukalis, "Economic and Monetary Union: Political Conviction and Economic Uncertainty", in Helen, Wallace, and William Wallace. Policy Making in the European Union (4th ed.). New York: Oxford University Press, 2000, p.150.

[4] "Major Euro Zone Expansion Now on Hold", Deutsche Welle, 2 January 2007, http://www.dw-world.de/dw/article/0,2144,2296582,00.html

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APPENDIX A

THE TREATY ON EUROPEAN UNION

TITLE VI
ECONOMIC AND MONETARY POLICY

Chapter 1
Economic policy

Article 102a

Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives of the Community, as defined in Article 2, and in the context of the broad guidelines referred to in Article 103(2). The Member States and the Community shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a.

Article 103

1. Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council, in accordance with the provisions of Article 102a.

2. The Council shall, acting by a qualified majority on a recommendation from the Commission, formulate a draft for the broad guidelines of the economic policies of the Member States and of the Community, and shall report its findings to the European Council.

The European Council shall, acting on the basis of the report from the Council, discuss a conclusion on the broad guidelines of the economic policies of the Member

States and of the Community.

On the basis of this conclusion, the Council shall, acting by a qualified majority, adopt a recommendation setting out these broad guidelines. The Council shall inform the European Parliament of its recommendation.

3. In order to ensure closer coordination of economic policies and sustained convergence of the economic performances of the Member States, the Council shall, on the basis of reports submitted by the Commission, monitor economic developments in each of the Member States and in the Community as well as the consistency of economic policies with the broad guidelines referred to in paragraph 2, and regularly carry out an overall assessment.

For the purpose of this multilateral surveillance, Member States shall forward information to the Commission about important measures taken by them in the field of their economic policy and such other information as they deem necessary.

4. Where it is established, under the procedure referred to in paragraph 3, that the economic policies of a Member State are not consistent with the broad guidelines referred to in paragraph 2 or that they risk jeopardizing the proper functioning of economic and monetary union, the Council may, acting by a qualified majority on a recommendation from the Commission, make the necessary recommendations to the Member State concerned. The Council may, acting by a qualified majority on a proposal from the Commission, decide to make its recommendations public.

The President of the Council and the Commission shall report to the European Parliament on the results of multilateral surveillance. The President of the Council may be invited to appear before the competent Committee of the European Parliament if the Council has made its recommendations public.

5. The Council, acting in accordance with the procedure referred to in Article 189c, may adopt detailed rules for the multilateral surveillance procedure referred to in paragraphs 3 and 4 of this Article.

Article 103a

1. Without prejudice to any other procedures provided for in this Treaty, the Council may, acting unanimously on a proposal from the Commission, decide upon the

measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products.

2. Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by exceptional occurrences beyond its control, the Council may, acting unanimously on a proposal from the Commission, grant, under certain conditions, Community financial assistance to the Member State concerned. Where the severe difficulties are caused by natural disasters, the Council shall act by qualified majority. The President of the Council shall inform the European Parliament of the decision taken.

Article 104

1. Overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States (hereinafter referred to as "national central banks") in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments.

2. Paragraph 1 shall not apply to publicly-owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the ECB as private credit institutions.

Article 104a

1. Any measure, not based on prudential considerations, establishing privileged access by Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States to financial institutions shall be prohibited.

2. The Council, acting in accordance with the procedure referred to in Article 189c, shall, before 1 January 1994, specify definitions for the application of the prohibition referred to in paragraph 1.

Article 104b

1. The Community shall not be liable for or assume the commitments of central

governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.

2. If necessary, the Council, acting in accordance with the procedure referred to in Article 189c, may specify definitions for the application of the prohibitions referred to in Article 104 and in this Article.

Article 104c

1. Member States shall avoid excessive government deficits.

2. The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline on the basis of the following two criteria:

(a) whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value, unless

- either the ratio has declined substantially and continuously and reached a level that comes close to the reference value;

- or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;

(b) whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

The reference values are specified in the Protocol on the excessive deficit procedure annexed to this Treaty.

3. If a Member State does not fulfil the requirements under one or both of these criteria, the Commission shall prepare a report. The report of the Commission shall also take into account whether the government deficit exceeds government investment

expenditure and take into account all other relevant factors, including the medium term economic and budgetary position of the Member State.

The Commission may also prepare a report if, notwithstanding the fulfilment of the requirements under the criteria, it is of the opinion that there is a risk of an excessive deficit in a Member State.

4. The Committee provided for in Article 109c shall formulate an opinion on the report of the Commission.

5. If the Commission considers that an excessive deficit in a Member State exists or may occur, the Commission shall address an opinion to the Council.

6. The Council shall, acting by a qualified majority on a recommendation from the Commission, and having considered any observations which the Member State concerned may wish to make, decide after an overall assessment whether an excessive deficit exists.

7. Where the existence of an excessive deficit is decided according to paragraph 6, the Council shall make recommendations to the Member State concerned with a view to bringing that situation to an end within a given period. Subject to the provisions of paragraph 8, these recommendations shall not be made public.

8. Where it establishes that there has been no effective action in response to its recommendations within the period laid down, the Council may make its recommendations public.

9. If a Member State persists in failing to put into practice the recommendations of the Council, the Council may decide to give notice to the Member State to take, within a specified time limit, measures for the deficit reduction which is judged necessary by the Council in order to remedy the situation.

In such a case, the Council may request the Member State concerned to submit reports in accordance with a specific timetable in order to examine the adjustment efforts of that Member State.

10. The rights to bring actions provided for in Articles 169 and 170 may not be exercised within the framework of paragraphs 1 to 9 of this Article.

11. As long as a Member State fails to comply with a decision taken in accordance with paragraph 9, the Council may decide to apply or, as the case may be,

intensify one or more of the following measures:

- to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities;
- to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned;
- to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Community until the excessive deficit has, in the view of the Council, been corrected;
- to impose fines of an appropriate size.

The President of the Council shall inform the European Parliament of the decisions taken.

12. The Council shall abrogate some or all of its decisions referred to in paragraphs 6 to 9 and 11 to the extent that the excessive deficit in the Member State concerned has, in the view of the Council, been corrected. If the Council has previously made public recommendations, it shall, as soon as the decision under paragraph 8 has been abrogated, make a public statement that an excessive deficit in the Member State concerned no longer exists.

13. When taking the decisions referred to in paragraphs 7 to 9, 11 and 12, the Council shall act on a recommendation from the Commission by a majority of two thirds of the votes of its members weighted in accordance with Article 148(2), excluding the votes of the representative of the Member State concerned.

14. Further provisions relating to the implementation of the procedure described in this Article are set out in the Protocol on the excessive deficit procedure annexed to this Treaty.

The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the ECB, adopt the appropriate provisions which shall then replace the said Protocol.

Subject to the other provisions of this paragraph the Council shall, before 1 January 1994, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, lay down detailed rules and definitions for the application of the provisions of the said Protocol.

Chapter 2
Monetary policy

Article 105

1. The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a.

2. The basic tasks to be carried out through the ESCB shall be:

- to define and implement the monetary policy of the Community;
- to conduct foreign exchange operations consistent with the provisions of Article 109;
- to hold and manage the official foreign reserves of the Member States;
- to promote the smooth operation of payment systems.

3. The third indent of paragraph 2 shall be without prejudice to the holding and management by the governments of Member States of foreign exchange working balances.

4. The ECB shall be consulted:

- on any proposed Community act in its fields of competence;
- by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 106(6).

The ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence.

5. The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.

6. The Council may, acting unanimously on a proposal from the Commission

and after consulting the ECB and after receiving the assent of the European Parliament, confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

Article 105a

1. The ECB shall have the exclusive right to authorize the issue of bank notes within the Community. The ECB and the national central banks may issue such notes. The bank notes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community.

2. Member States may issue coins subject to approval by the ECB of the volume of the issue. The Council may, acting in accordance with the procedure referred to in Article 189c and after consulting the ECB, adopt measures to harmonize the denominations and technical specifications of all coins intended for circulation to the extent necessary to permit their smooth circulation within the Community.

Article 106

1. The ESCB shall be composed of the ECB and of the national central banks.

2. The ECB shall have legal personality.

3. The ESCB shall be governed by the decision-making bodies of the ECB which shall be the Governing Council and the Executive Board.

4. The Statute of the ESCB is laid down in a Protocol annexed to this Treaty.

5. Articles 5.1, 5.2, 5.3, 17, 18, 19.1, 22, 23, 24, 26, 32.2, 32.3, 32.4, 32.6, 33.1(a) and 36 of the Statute of the ESCB may be amended by the Council, acting either by a qualified majority on a recommendation from the ECB and after consulting the Commission or unanimously on a proposal from the Commission and after consulting the ECB. In either case, the assent of the European Parliament shall be required.

6. The Council, acting by a qualified majority either on a proposal from the Commission and after consulting the European Parliament and the ECB or on a recommendation from the ECB and after consulting the European Parliament and the Commission, shall adopt the provisions referred to in Articles 4, 5.4, 19.2, 20, 28.1,

29.2, 30.4 and 34.3 of the Statute of the ESCB.

Article 107

When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.

Article 108

Each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation including the statutes of its national central bank is compatible with this Treaty and the Statute of the ESCB.

Article 108a

1. In order to carry out the tasks entrusted to the ESCB, the ECB shall, in accordance with the provisions of this Treaty and under the conditions laid down in the Statute of the ESCB:

- make regulations to the extent necessary to implement the tasks defined in Article 3.1, first indent, Articles 19.1, 22 and 25.2 of the Statute of the ESCB and in cases which shall be laid down in the acts of the Council referred to in Article 106(6);
- take decisions necessary for carrying out the tasks entrusted to the ESCB under this Treaty and the Statute of the ESCB;
- make recommendations and deliver opinions.

2. A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States.

Recommendations and opinions shall have no binding force.

A decision shall be binding in its entirety upon those to whom it is addressed.

Articles 190 to 192 shall apply to regulations and decisions adopted by the ECB.

The ECB may decide to publish its decisions, recommendations and opinions.

3. Within the limits and under the conditions adopted by the Council under the procedure laid down in Article 106(6), the ECB shall be entitled to impose fines or periodic penalty payments on undertakings for failure to comply with obligations under its regulations and decisions.

Article 109

1. By way of derogation from Article 228, the Council may, acting unanimously on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach a consensus consistent with the objective of price stability, after consulting the European Parliament, in accordance with the procedure in paragraph 3 for determining the arrangements, conclude formal agreements on an exchange rate system for the ECU in relation to non-Community currencies. The Council may, acting by a qualified majority on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach a consensus consistent with the objective of price stability, adopt, adjust or abandon the central rates of the ECU within the exchange rate system. The President of the Council shall inform the European Parliament of the adoption, adjustment or abandonment of the ECU central rates.

2. In the absence of an exchange rate system in relation to one or more non-Community currencies as referred to in paragraph 1, the Council, acting by a qualified majority either on a recommendation from the Commission and after consulting the ECB or on a recommendation from the ECB, may formulate general orientations for exchange rate policy in relation to these currencies. These general orientations shall be without prejudice to the primary objective of the ESCB to maintain price stability.

3. By way of derogation from Article 228, where agreements concerning monetary or foreign exchange regime matters need to be negotiated by the Community with one or more States or international organizations, the Council, acting by a qualified majority on a recommendation from the Commission and after consulting the ECB, shall decide the arrangements for the negotiation and for the conclusion of such agreements.

These arrangements shall ensure that the Community expresses a single position. The Commission shall be fully associated with the negotiations.

Agreements concluded in accordance with this paragraph shall be binding on the institutions of the Community, on the ECB and on Member States.

4. Subject to paragraph 1, the Council shall, on a proposal from the Commission and after consulting the ECB, acting by a qualified majority decide on the position of the Community at international level as regards issues of particular relevance to economic and monetary union and, acting unanimously, decide its representation in compliance with the allocation of powers laid down in Articles 103 and 105.

5. Without prejudice to Community competence and Community agreements as regards economic and monetary union, Member States may negotiate in international bodies and conclude international agreements.

Chapter 3
Institutional provisions

Article 109a

1. The Governing Council of the ECB shall comprise the members of the Executive Board of the ECB and the Governors of the national central banks.

2. (a) The Executive Board shall comprise the President, the Vice-President and four other members.

(b) The President, the Vice-President and the other members of the Executive Board shall be appointed from among persons of recognized standing and professional experience in monetary or banking matters by common accord of the Governments of the Member States at the level of Heads of State or of Government, on a recommendation from the Council, after it has consulted the European Parliament and the Governing Council of the ECB.

Their term of office shall be eight years and shall not be renewable.

Only nationals of Member States may be members of the Executive Board.

Article 109b

1. The President of the Council and a member of the Commission may participate, without having the right to vote, in meetings of the Governing Council of the ECB.

The President of the Council may submit a motion for deliberation to the Governing Council of the ECB.

2. The President of the ECB shall be invited to participate in Council meetings when the Council is discussing matters relating to the objectives and tasks of the ESCB.

3. The ECB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and current year to the European Parliament, the Council and the Commission, and also to the European Council. The President of the ECB shall present this report to the Council and to the European Parliament, which may hold a general debate on that basis.

The President of the ECB and the other members of the Executive Board may, at the request of the European Parliament or on their own initiative, be heard by the competent Committees of the European Parliament.

Article 109c

1. In order to promote coordination of the policies of Member States to the full extent needed for the functioning of the internal market, a Monetary Committee with advisory status is hereby set up.

It shall have the following tasks:

- to keep under review the monetary and financial situation of the Member States and of the Community and the general payments system of the Member States and to report regularly thereon to the Council and to the Commission;
- to deliver opinions at the request of the Council or of the Commission, or on its own initiative for submission to those institutions;
- without prejudice to Article 151, to contribute to the preparation of the work of the Council referred to in Articles 73f, 73g, 103(2), (3), (4) and (5), 103a, 104a, 104b, 104c, 109e(2), 109f(6), 109h, 109i, 109j(2) and 109k(1);
- to examine, at least once a year, the situation regarding the movement of

capital and the freedom of payments, as they result from the application of this Treaty and of measures adopted by the Council; the examination shall cover all measures relating to capital movements and payments; the Committee shall report to the Commission and to the Council on the outcome of this examination.

The Member States and the Commission shall each appoint two members of the Monetary Committee.

2. At the start of the third stage, an Economic and Financial Committee shall be set up. The Monetary Committee provided for in paragraph 1 shall be dissolved.

The Economic and Financial Committee shall have the following tasks:

- to deliver opinions at the request of the Council or of the Commission, or on its own initiative for submission to those institutions;

- to keep under review the economic and financial situation of the Member States and of the Community and to report regularly thereon to the Council and to the Commission, in particular on financial relations with third countries and international institutions;

- without prejudice to Article 151, to contribute to the preparation of the work of the Council referred to in Articles 73f, 73g, 103(2), (3), (4) and (5), 103a, 104a, 104b, 104c, 105(6), 105a(2), 106(5) and (6), 109, 109h, 109i(2) and (3), 109k(2), 109l(4) and (5), and to carry out other advisory and preparatory tasks assigned to it by the Council;

- to examine, at least once a year, the situation regarding the movement of capital and the freedom of payments, as they result from the application of this Treaty and of measures adopted by the Council; the examination shall cover all measures relating to capital movements and payments; the Committee shall report to the Commission and to the Council on the outcome of this examination.

The Member States, the Commission and the ECB shall each appoint no more than two members of the Committee.

3. The Council shall, acting by a qualified majority on a proposal from the Commission and after consulting the ECB and the Committee referred to in this Article, lay down detailed provisions concerning the composition of the Economic and Financial Committee. The President of the Council shall inform the European Parliament of such a decision.

4. In addition to the tasks set out in paragraph 2, if and as long as there are Member States with a derogation as referred to in Articles 109k and 109l, the Committee shall keep under review the monetary and financial situation and the general payments system of those Member States and report regularly thereon to the Council and to the Commission.

Article 109d

For matters within the scope of Articles 103(4), 104c with the exception of paragraph 14, 109, 109j, 109k and 109l(4) and (5), the Council or a Member State may request the Commission to make a recommendation or a proposal, as appropriate. The Commission shall examine this request and submit its conclusions to the Council without delay.

Chapter 4
Transitional provisions

Article 109e

1. The second stage for achieving economic and monetary union shall begin on 1 January 1994.

2. Before that date

(a) each Member State shall:

- adopt, where necessary, appropriate measures to comply with the prohibitions laid down in Article 73b, without prejudice to Article 73e, and in Articles 104 and 104a(1);

- adopt, if necessary, with a view to permitting the assessment provided for in subparagraph (b), multiannual programmes intended to ensure the lasting convergence necessary for the achievement of economic and monetary union, in particular with regard to price stability and sound public finances;

(b) the Council shall, on the basis of a report from the Commission, assess the progress made with regard to economic and monetary convergence, in particular with regard to price stability and sound public finances, and the progress made with the implementation of Community law concerning the internal market.

3. The provisions of Articles 104, 104a(1), 104b(1) and 104c with the exception of paragraphs 1, 9, 11 and 14 shall apply from the beginning of the second stage.

The provisions of Articles 103a(2), 104c(1), (9) and (11), 105, 105a, 107, 109, 109a, 109b and 109c(2) and (4) shall apply from the beginning of the third stage.

4. In the second stage, Member States shall endeavour to avoid excessive government deficits.

5. During the second stage, each Member State shall, as appropriate, start the process leading to the independence of its central bank, in accordance with Article 108.

Article 109f

1. At the start of the second stage, a European Monetary Institute (hereinafter referred to as "EMI") shall be established and take up its duties; it shall have legal personality and be directed and managed by a Council, consisting of a President and the Governors of the national central banks, one of whom shall be Vice-President.

The President shall be appointed by common accord of the Governments of the Member States at the level of Heads of State or of Government, on a recommendation from, as the case may be, the Committee of Governors of the central banks of the Member States (hereinafter referred to as "Committee of Governors") or the Council of the EMI, and after consulting the European Parliament and the Council. The President shall be selected from among persons of recognized standing and professional experience in monetary or banking matters. Only nationals of Member States may be President of the EMI. The Council of the EMI shall appoint the Vice-President.

The Statute of the EMI is laid down in a Protocol annexed to this Treaty.

The Committee of Governors shall be dissolved at the start of the second stage.

2. The EMI shall:

- strengthen cooperation between the national central banks;
- strengthen the coordination of the monetary policies of the Member States, with the aim of ensuring price stability;
- monitor the functioning of the European Monetary System;
- hold consultations concerning issues falling within the competence of the

national central banks and affecting the stability of financial institutions and markets;

- take over the tasks of the European Monetary Cooperation Fund, which shall be dissolved; the modalities of dissolution are laid down in the Statute of the EMI;

- facilitate the use of the ECU and oversee its development, including the smooth functioning of the ECU clearing system.

3. For the preparation of the third stage, the EMI shall:

- prepare the instruments and the procedures necessary for carrying out a single monetary policy in the third stage;

- promote the harmonization, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its field of competence;

- prepare the rules for operations to be undertaken by the national central banks within the framework of the ESCB;

- promote the efficiency of cross-border payments;

- supervise the technical preparation of ECU bank notes.

At the latest by 31 December 1996, the EMI shall specify the regulatory, organizational and logistical framework necessary for the ESCB to perform its tasks in the third stage. This framework shall be submitted for decision to the ECB at the date of its establishment.

4. The EMI, acting by a majority of two thirds of the members of its Council, may:

- formulate opinions or recommendations on the overall orientation of monetary policy and exchange rate policy as well as on related measures introduced in each Member State;

- submit opinions or recommendations to Governments and to the Council on policies which might affect the internal or external monetary situation in the Community and, in particular, the functioning of the European Monetary System;

- make recommendations to the monetary authorities of the Member States concerning the conduct of their monetary policy.

5. The EMI, acting unanimously, may decide to publish its opinions and its recommendations.

6. The EMI shall be consulted by the Council regarding any proposed Community act within its field of competence.

Within the limits and under the conditions set out by the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament and the EMI, the EMI shall be consulted by the authorities of the Member States on any draft legislative provision within its field of competence.

7. The Council may, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the EMI, confer upon the EMI other tasks for the preparation of the third stage.

8. Where this Treaty provides for a consultative role for the ECB, references to the ECB shall be read as referring to the EMI before the establishment of the ECB.

Where this Treaty provides for a consultative role for the EMI, references to the EMI shall be read, before 1 January 1994, as referring to the Committee of Governors.

9. During the second stage, the term "ECB" used in Articles 173, 175, 176, 177, 180 and 215 shall be read as referring to the EMI.

Article 109g

The currency composition of the ECU basket shall not be changed.

From the start of the third stage, the value of the ECU shall be irrevocably fixed in accordance with Article 109l(4).

Article 109h

1. Where a Member State is in difficulties or is seriously threatened with difficulties as regards its balance of payments either as a result of an overall disequilibrium in its balance of payments, or as a result of the type of currency at its disposal, and where such difficulties are liable in particular to jeopardize the functioning of the common market or the progressive implementation of the common commercial policy, the Commission shall immediately investigate the position of the State in question and the action which, making use of all the means at its disposal, that State has taken or may take in accordance with the provisions of this Treaty. The Commission shall state what measures it recommends the State concerned to take.

If the action taken by a Member State and the measures suggested by the Commission do not prove sufficient to overcome the difficulties which have arisen or which threaten, the Commission shall, after consulting the Committee referred to in Article 109c, recommend to the Council the granting of mutual assistance and appropriate methods therefor.

The Commission shall keep the Council regularly informed of the situation and of how it is developing.

2. The Council, acting by a qualified majority, shall grant such mutual assistance; it shall adopt directives or decisions laying down the conditions and details of such assistance, which may take such forms as:

(a) a concerted approach to or within any other international organizations to which Member States may have recourse;

(b) measures needed to avoid deflection of trade where the State which is in difficulties maintains or reintroduces quantitative restrictions against third countries;

(c) the granting of limited credits by other Member States, subject to their agreement.

3. If the mutual assistance recommended by the Commission is not granted by the Council or if the mutual assistance granted and the measures taken are insufficient, the Commission shall authorize the State which is in difficulties to take protective measures, the conditions and details of which the Commission shall determine.

Such authorization may be revoked and such conditions and details may be changed by the Council acting by a qualified majority.

4. Subject to Article 109k(6), this Article shall cease to apply from the beginning of the third stage.

Article 109i

1. Where a sudden crisis in the balance of payments occurs and a decision within the meaning of Article 109h(2) is not immediately taken, the Member State concerned may, as a precaution, take the necessary protective measures. Such measures must cause the least possible disturbance in the functioning of the common market and must not be wider in scope than is strictly necessary to remedy the sudden difficulties which have

arisen.

2. The Commission and the other Member States shall be informed of such protective measures not later than when they enter into force. The Commission may recommend to the Council the granting of mutual assistance under Article 109h.

3. After the Commission has delivered an opinion and the Committee referred to in Article 109c has been consulted, the Council may, acting by a qualified majority, decide that the State concerned shall amend, suspend or abolish the protective measures referred to above.

4. Subject to Article 109k(6), this Article shall cease to apply from the beginning of the third stage.

Article 109j

1. The Commission and the EMI shall report to the Council on the progress made in the fulfilment by the Member States of their obligations regarding the achievement of economic and monetary union. These reports shall include an examination of the compatibility between each Member State's national legislation, including the statutes of its national central bank, and Articles 107 and 108 of this Treaty and the Statute of the ESCB. The reports shall also examine the achievement of a high degree of sustainable convergence by reference to the fulfilment by each Member State of the following criteria:

- the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability;

- the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 104c(6);

- the observance of the normal fluctuation margins provided for by the Exchange Rate Mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State;

- the durability of convergence achieved by the Member State and of its participation in the Exchange Rate Mechanism of the European Monetary System being reflected in the long-term interest rate levels.

The four criteria mentioned in this paragraph and the relevant periods over which they are to be respected are developed further in a Protocol annexed to this Treaty. The reports of the Commission and the EMI shall also take account of the development of the ECU, the results of the integration of markets, the situation and development of the balances of payments on current account and an examination of the development of unit labour costs and other price indices.

2. On the basis of these reports, the Council, acting by a qualified majority on a recommendation from the Commission, shall assess:

- for each Member State, whether it fulfils the necessary conditions for the adoption of a single currency;

- whether a majority of the Member States fulfil the necessary conditions for the adoption of a single currency,

and recommend its findings to the Council, meeting in the composition of the Heads of State or of Government. The European Parliament shall be consulted and forward its opinion to the Council, meeting in the composition of the Heads of State or of Government.

3. Taking due account of the reports referred to in paragraph 1 and the opinion of the European Parliament referred to in paragraph 2, the Council, meeting in the composition of Heads of State or of Government, shall, acting by a qualified majority, not later than 31 December 1996:

- decide, on the basis of the recommendations of the Council referred to in paragraph 2, whether a majority of the Member States fulfil the necessary conditions for the adoption of a single currency;

- decide whether it is appropriate for the Community to enter the third stage,

and if so

- set the date for the beginning of the third stage.

4. If by the end of 1997 the date for the beginning of the third stage has not been set, the third stage shall start on 1 January 1999. Before 1 July 1998, the Council, meeting in the composition of Heads of State or of Government, after a repetition of the procedure provided for in paragraphs 1 and 2, with the exception of the second indent of

paragraph 2, taking into account the reports referred to in paragraph 1 and the opinion of the European Parliament, shall, acting by a qualified majority and on the basis of the recommendations of the Council referred to in paragraph 2, confirm which Member States fulfil the necessary conditions for the adoption of a single currency.

Article 109k

1. If the decision has been taken to set the date in accordance with Article 109j(3), the Council shall, on the basis of its recommendations referred to in Article 109j(2), acting by a qualified majority on a recommendation from the Commission, decide whether any, and if so which, Member States shall have a derogation as defined in paragraph 3 of this Article. Such Member States shall in this Treaty be referred to as "Member States with a derogation".

If the Council has confirmed which Member States fulfil the necessary conditions for the adoption of a single currency, in accordance with Article 109j(4), those Member States which do not fulfil the conditions shall have a derogation as defined in paragraph 3 of this Article. Such Member States shall in this Treaty be referred to as "Member States with a derogation".

2. At least once every two years, or at the request of a Member State with a derogation, the Commission and the ECB shall report to the Council in accordance with the procedure laid down in Article 109j(1). After consulting the European Parliament and after discussion in the Council, meeting in the composition of the Heads of State or of Government, the Council shall, acting by a qualified majority on a proposal from the Commission, decide which Member States with a derogation fulfil the necessary conditions on the basis of the criteria set out in Article 109j(1), and abrogate the derogations of the Member States concerned.

3. A derogation referred to in paragraph 1 shall entail that the following Articles do not apply to the Member State concerned: Articles 104c(9) and (11), 105(1), (2), (3) and (5), 105a, 108a, 109, and 109a(2)(b). The exclusion of such a Member State and its national central bank from rights and obligations within the ESCB is laid down in Chapter IX of the Statute of the ESCB.

4. In Articles 105(1), (2) and (3), 105a, 108a, 109 and 109a(2)(b), "Member

States” shall be read as “Member States without a derogation”.

5. The voting rights of Member States with a derogation shall be suspended for the Council decisions referred to in the Articles of this Treaty mentioned in paragraph 3. In that case, by way of derogation from Articles 148 and 189a(1), a qualified majority shall be defined as two thirds of the votes of the representatives of the Member States without a derogation weighted in accordance with Article 148(2), and unanimity of those Member States shall be required for an act requiring unanimity.

6. Articles 109h and 109i shall continue to apply to a Member State with a derogation.

Article 109l

1. Immediately after the decision on the date for the beginning of the third stage has been taken in accordance with Article 109j(3), or, as the case may be, immediately after 1 July 1998:

- the Council shall adopt the provisions referred to in Article 106(6);
- the governments of the Member States without a derogation shall appoint, in accordance with the procedure set out in Article 50 of the Statute of the ESCB, the President, the Vice-President and the other members of the Executive Board of the ECB. If there are Member States with a derogation, the number of members of the Executive Board may be smaller than provided for in Article 11.1 of the Statute of the ESCB, but in no circumstances shall it be less than four.

As soon as the Executive Board is appointed, the ESCB and the ECB shall be established and shall prepare for their full operation as described in this Treaty and the Statute of the ESCB. The full exercise of their powers shall start from the first day of the third stage.

2. As soon as the ECB is established, it shall, if necessary, take over tasks of the EMI. The EMI shall go into liquidation upon the establishment of the ECB; the modalities of liquidation are laid down in the Statute of the EMI.

3. If and as long as there are Member States with a derogation, and without prejudice to Article 106(3) of this Treaty, the General Council of the ECB referred to in Article 45 of the Statute of the ESCB shall be constituted as a third decision-making

body of the ECB.

4. At the starting date of the third stage, the Council shall, acting with the unanimity of the Member States without a derogation, on a proposal from the Commission and after consulting the ECB, adopt the conversion rates at which their currencies shall be irrevocably fixed and at which irrevocably fixed rate the ECU shall be substituted for these currencies, and the ECU will become a currency in its own right. This measure shall by itself not modify the external value of the ECU. The Council shall, acting according to the same procedure, also take the other measures necessary for the rapid introduction of the ECU as the single currency of those Member States.

5. If it is decided, according to the procedure set out in Article 109k(2), to abrogate a derogation, the Council shall, acting with the unanimity of the Member States without a derogation and the Member State concerned, on a proposal from the Commission and after consulting the ECB, adopt the rate at which the ECU shall be substituted for the currency of the Member State concerned, and take the other measures necessary for the introduction of the ECU as the single currency in the Member State concerned.

Article 109m

1. Until the beginning of the third stage, each Member State shall treat its exchange rate policy as a matter of common interest. In so doing, Member States shall take account of the experience acquired in cooperation within the framework of the European Monetary System (EMS) and in developing the ECU, and shall respect existing powers in this field.

2. From the beginning of the third stage and for as long as a Member State has a derogation, paragraph 1 shall apply by analogy to the exchange rate policy of that Member State.