

The third stage of Economic and Monetary Union

Source: CVCE. Pierre Gerbet.

Copyright: (c) CVCE.EU by UNI.LU
All rights of reproduction, of public communication, of adaptation, of distribution or of dissemination via Internet, internal network or any other means are strictly reserved in all countries.
Consult the legal notice and the terms and conditions of use regarding this site.

URL: http://www.cvce.eu/obj/the_third_stage_of_economic_and_monetary_union-en-e2e91dco-3a6d-49fc-b3f8-f96fb5f3addb.html

Last updated: 08/07/2016



The third stage of Economic and Monetary Union

At its Madrid meeting of 15 and 16 December 1995, the European Council adopted the scenario for the introduction of the single currency, scheduled for 1 January 1999, the target date set by the Treaty establishing the European Community, and determined the name of the currency — the euro — in all the official languages of the European Union. The logo and the designs for the notes and coins, which would replace the national currencies on 1 January 2002, were presented by Alexandre Lamfalussy, President of the European Monetary Institute, at the European Council meeting held in Dublin on 13 and 14 December 1996 and were finally approved by the 15 Member States at the Amsterdam meeting of the European Council which took place on 16 and 17 June 1997. It was then a matter of moving on to the implementation stage by creating the institutions and identifying the states that should be able to fulfil the conditions for adoption of the single currency and to comply thereafter with the rules of the Stability and Growth Pact adopted by the European Council in Amsterdam in June 1997.

On the institutional side, the European System of Central Banks (ESCB) was established, comprising the central banks of the Member States, which had to be independent of their respective governments, and the European Central Bank (ECB), independent of national governments and of the Community institutions. The whole structure was to be managed by an Executive Board and a Governing Council. The six-member Executive Board would undertake the day-to-day management of monetary policy, which was to be laid down by the Governing Council, comprising both the Executive Board and the governors of the national central banks, each of whom had one vote, regardless of the size of his or her country. The central banks would receive their guidelines from the European Central Bank. They were to transfer part of their reserves in gold and in currency to the ECB. The internal monetary sovereignty of the Member States would be exercised by the ESCB and the ECB. Issuing and administering the single currency were the responsibility of the ECB, whose task was to maintain its value and contain inflation, which was the Germans' main source of concern. The ECB set itself the target of ensuring that the cost of living did not exceed 2 % per annum. It also had to monitor exchange rates because of their repercussions on price levels. The ECB would be free to choose the instruments that it used to achieve the aim of price stability: setting interest rates and controlling liquidity ratios and loans. External management of the single currency through the exchange-rate policy was a shared responsibility: the Council of the European Union laid down general guidelines, which had to be compatible with the aim of price stability and respect the independence of the European Central Bank, while the ECB was responsible for the everyday conduct of exchange transactions.

On 30 June 1998, the European Central Bank, based in Frankfurt am Main, replaced the European Monetary Institute (EMI), which had been headed since 1994 by Alexandre Lamfalussy, a Belgian, until he handed over to Willem F. Duisenberg. Mr Duisenberg, former Netherlands Minister of Finance and ex-Governor of the Nederlandsche Bank, became the first President of the ECB. The governors of the central banks had agreed to nominate him to their governments, the European Council being responsible for the appointment of the ECB President. Jacques Chirac, President of the French Republic, however, had contested the nomination method and had put forward the name Jean-Claude Trichet, Governor of the Banque de France, believing that, since Germany had the seat of the ECB, the presidency ought to fall to France. The German, Netherlands and Belgian Governments supported Duisenberg, whom they saw as the guarantor of a strong euro. At the Brussels European Council on 3 May 1998, tension had run high between President Chirac and the German Chancellor, Helmut Kohl. In order to break the deadlock, given the impossibility of splitting the eight-year term of office prescribed by the Treaty, Wim Duisenberg had had to undertake not to serve his full term, although without specifying a retirement date. But it was tacitly understood that Trichet would succeed him, which he did in November 2003. Chancellor Kohl seemed to have lost this trial of strength, and that weakened his position on the eve of the elections. The Franco-German engine had broken down. The nomination of the five other members of the ECB's Executive Board also stirred up national rivalries. Tony Blair, the British Prime Minister, demanded a seat for a British representative, even though the UK had not signed up to the euro. His wish was not granted, but he did receive the promise of a seat once Britain had adopted the euro. Under French pressure, three seats were given to nationals of the three largest countries in the euro zone: a Frenchman, who became Vice-President, a German and an Italian. Spain then claimed the same treatment and secured the appointment of a Spaniard. The last remaining seat was assigned to a Finn. Such rivalries between Member States are inconsistent with the Statute of the ESCB, which states

that the members of its decision-making bodies — like Members of the European Commission — shall not seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. They certainly asserted their independence when the governments called on them to cut interest rates. Nevertheless, the desire of the ‘big guns’ to be represented on the Executive Board still persists. For example, when the mandate of the Spanish member expired, the Council decided by a qualified majority at its Brussels meeting of 25 March 2004 to appoint another Spaniard, which roused the anger of the smaller countries, because Belgium and Ireland had both put forward a candidate.

Although the single currency was to be managed by an independent ESCB, economic policy remained the responsibility of governments, which were bound only to comply with the common rules designed to ensure monetary stability, particularly through their national budgets. The Member States, however, retained control of their budgetary policies, direct taxation and the allocation of public expenditure. Economic and Monetary Union (EMU) provided only for closer coordination of national economic policies. This coordination was the task of the Economic and Financial Affairs Council (the Ecofin Council), which took decisions on matters of budgetary and economic policy at the level of the Union, acting by consensus on the most important subjects. In order to coordinate national economic policies, the Ecofin Council adopted a set of ‘broad economic policy guidelines’ every year after the European Council had discussed them, reviewed excessive public deficits and monitored compliance with the Stability and Growth Pact. It could, in response to a proposal from the European Commission, make recommendations to the defaulting states or decide to impose sanctions on them. The activities of the Ecofin Council were prepared by the Economic and Financial Committee, which comprised representatives of the ECB, of the national central banks and of the Finance Ministers of the Member States. Its members were appointed on a personal basis and were independent. The Economic and Financial Committee was the body in which discussion took place between the Commission, the ECB and the Member States.

There was, however, one problem: not all of the 15 Member States represented on the Ecofin Council had signed up to the single currency. This is why France, which had long recommended a form of ‘economic governance’ of the euro zone, whereby a political authority would be able to counterbalance the ECB, called for the creation of a body limited to the Member States within the monetary area. The Germans, however, were reticent, fearing for the independence of the ECB and afraid of possible interventionist economics, especially since the Socialists under Lionel Jospin had just been voted into office. Franco-German agreement was finally reached on the establishment of an informal Council, which would discuss coordination but leave any decision-making to the Ecofin Council. The governments of the euro-zone countries agreed, but those that had remained outside protested, demanding the right to be part of the Council on the euro, at least as observers. Tony Blair even went so far as to claim a full seat, threatening to use his veto. Then, in the face of the firm stance adopted by Jacques Chirac and Helmut Kohl at the European Council meeting in Luxembourg on 12 and 13 December 1997, they had to be content with half a loaf: when the Council on the euro dealt with matters of common interest to the 15 Member States, the non-euro-zone members could be invited to attend, or they could ask that the matters in question be discussed by the Ecofin Council. The European Council stipulated that these meetings of the euro-zone countries, which were to take place before each monthly Ecofin meeting, would be ‘informal’ and stressed that the power of decision lay with the Ecofin Council. In this way, the existence of the Euro Group was recognised (the Germans had wanted to avoid the term ‘Council’) in the guise of a discussion forum rather than an instrument of ‘economic governance’ of the euro zone.

The Treaty establishing the European Community laid down the criteria for a Member State’s participation in the single currency. Applicant countries must meet the convergence criteria, namely an average rate of inflation for the previous year not more than 1.5 percentage points higher than the average of the three Member States with the lowest inflation rates, a nominal long-term interest rate no more than two percentage points above the average of the three countries with the lowest rates, a budget (including the national, local-authority and social-security budgets) that did not have a deficit equivalent to 3 % or more of gross domestic product (GDP), a level of government debt that did not exceed 60 % of GDP, or was approaching that level, and a stable exchange rate over a period of at least two years within the European Monetary System (EMS). The Treaty also specified, however, that progress towards fulfilment of these ‘Maastricht criteria’ must be assessed by the Commission, which was to conduct statistical studies and

submit proposals relating to admission. The Council, meeting in the composition of the Heads of State or Government, was to take the final decision.

So as to ensure that the adoption of the single currency actually took place on the scheduled date of 1 January 1999, the selection of eligible Member States was to be made in the spring of 1998 in the light of their economic performance in 1997. Since the conclusion of the Maastricht Treaty, however, the health of the European economy had declined. In 1996, the GDP of the Union at 1990 prices grew by only 1.5 %, compared with 2.8 % in 1994 and 2.5 % in 1995. Unemployment continued to rise, affecting 11 % of the workforce in 1996, as against 10.9 % in 1995. There was deepening pessimism about the prospects of achieving the aim of a single currency. In 1996, the criterion of a maximum 3 % government deficit was met by only the Netherlands, Denmark, Luxembourg, Ireland and Finland. Governments, however, were firmly resolved to make sacrifices in order to reduce their budgetary deficits and inflation rates.

In France, the right-wing government of Alain Juppé launched a programme of social-security reforms and cuts in public services, triggering a series of strikes that paralysed economic activity. President Chirac dissolved the National Assembly in the hope that the parliamentary elections would strengthen the presidential majority in favour of continued rigour, but the united Left won the day on 1 June 1997. Lionel Jospin, the new Socialist Prime Minister, was in favour of the euro, provided that the countries of southern Europe were part of the euro zone, that the convergence criteria were interpreted flexibly, that ‘economic governance’ was used to coordinate national economic policies and that social objectives were incorporated into the Growth and Stability Pact. He managed, however, to secure no more than an employment summit of the European Council, held in Luxembourg on 21 and 22 November 1997, which laid down common guidelines for national plans, including specific targets; unlike the convergence criteria for the single currency, however, these targets were not binding. The Socialist Government, faced with the prospect of a budgetary deficit amounting to 3.6 % of GDP for 1997, therefore activated a plan designed to remedy the situation by means of measures such as a reduction in defence appropriations and an increase in corporation tax.

The German deficit was 3.5 % in 1995. This prompted Chancellor Helmut Kohl to introduce an austerity plan entailing cuts in social spending, which met with fierce opposition from the trade unions. Nevertheless, the deficit was reduced, thanks to privatisations and surpluses in the health and pension funds.

Italy found itself in the most difficult situation because of political instability and the size of its budget deficits (6.7 % in 1996). It therefore seemed impossible for Italy to be part of the first group to adopt the euro — to the satisfaction, incidentally, of the countries of northern Europe, and particularly of the Bundesbank, which feared that the participation of the southern countries, sometimes ironically referred to as the ‘Club Med’, would weaken the euro. But Italy, one of the founder members of the European Communities, had no wish to be left on the sidelines. The elections of 21 April 1996 produced a left-wing parliamentary majority, the *Ulivo* (‘Olive Tree’) coalition. The new President of the Council of Ministers, university professor Romano Prodi, was made all the more determined to take Italy into the euro zone by the fact that Spain was also preparing itself for entry under the leadership of José María Aznar, head of the majority Popular Party, in spite of a government deficit of 7.3 % in 1996. The two men met in Barcelona on 16 September and presented their austerity plans. Prodi stabilised Italy’s public finances, raised taxes, including the introduction of a ‘tax for Europe’, took the lira into the SME and slowed down inflation. Aznar, for his part, continued the policy of budgetary consolidation pursued by his Socialist predecessor, Felipe González. The Portuguese Government also adopted austerity measures to reduce government deficits and debt.

The impact of these measures was enhanced by the improvement in the economic climate. The reduction in interest rates and the growth in consumer spending were conducive to an upsurge in economic activity. The GDP of the 15 Member States grew by 2.7 % in 1997, with the growth in tax revenue serving to reduce budget deficits. The European Commission and the EMI reviewed the position of the applicant Member States, assessing the efforts they had made and their expected progress. Luxembourg alone met all the criteria. As far as the deficits were concerned, the 3 % ceiling was generally respected, with France registering the largest deficit at 3.02 %. With regard to government debt, most countries were around the

60 % mark, but Belgium and Italy had twice that volume of debt. Consideration was given, however, to the fact that Belgium's excessive government debt had no adverse effect on inflation because of the high volume of private saving (twice GDP) and to the fact that the underground economy accounted for a quarter of Italian GDP, which put the debt figure in a less harsh light.

The list of the 11 countries of the European Union that were deemed to fulfil the conditions for adoption of the euro was published on 25 March 1998. These countries were Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Among the countries not on the list were Greece, which did not meet all the criteria but announced its intention of adopting the euro, which it did on 1 January 2001, and Sweden, which was not part of the European monetary system and had decided to wait. In a referendum conducted on 14 September 2003, 56.1 % of Swedish voters rejected adoption of the euro. The other countries outside the euro zone were Denmark and the United Kingdom, which secured an opt-out clause at Maastricht, thereby keeping the door open for accession at a later date. The Danish referendum of 28 September 2000, however, revealed strong opposition, with 53.1 % voting 'no' from a turnout of 89 %. As far as the United Kingdom was concerned, the new Labour Government was more favourably disposed to adoption of the euro, which was supported in economic circles, whereas the Conservatives remained very hostile, reflecting a large groundswell of public opinion. On 27 October 1997, Prime Minister Tony Blair announced that a referendum would be held sometime during the next legislative term, due to begin in 2002. On 9 June 2003, however, the Labour Government once again deferred Britain's entry until such time as the British economy was more in line with that of the euro zone.

The adoption of the single currency took place at the extraordinary meeting of the European Council held in Brussels from 1 to 3 May 1998. On the basis of the Commission's conclusions, the Ministers meeting as the Ecofin Council recommended admission of the 11 Member States in their proposal to the Heads of State or Government, who were meeting in the Ecofin framework to deal with these matters and who therefore took decisions, like the Ecofin Ministers, by qualified majority. Asked for its opinion under the consultation procedure, the European Parliament delivered a resounding vote of approval. The Council decided that the 11 countries fulfilled the conditions for adoption of the single currency on 1 January 1999. Moreover, to ensure that there were no concerted speculative transactions before the euro conversion rates were set for the various national currencies, the Council decided to announce immediately the fixed bilateral parities between the currencies of the euro zone. The irrevocable fixing of parities, and, hence, the value of the euro in terms of the other currencies, was to take effect on 31 December 1998. This precaution proved warranted, as the fall in the value of the dollar in September did not trigger the usual rise in the value of the mark at the expense of the other national currencies.

Before the official adoption of the common currency, the business community had been prepared for its introduction by bodies such as the Association for European Monetary Union, founded in 1987, and through the information campaign conducted by the Commission and, in particular, by Yves-Thibault de Silguy, the Commissioner responsible for economic, monetary and financial affairs. Between 1 January 1999 and 1 January 2002, the use of the euro as an accounting unit or bank money was optional. The euro was gradually adopted for banking transactions alongside the relevant national currency. Euro notes and coins went into public circulation as legal tender without a hitch on 1 January 2002.