The second stage of Economic and Monetary Union

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The second stage of Economic and Monetary Union

The provisions on the establishment of Economic and Monetary Union (EMU) are set out in the Treaty on European Union. They form part of the European Community pillar but, given their importance, are included in intermediate institutional mechanisms between the Community system and intergovernmental practice. With respect to the most important Council decisions concerning the establishment of EMU, the Commission may put forward only recommendations, not proposals, which the Council could reject only by a unanimous vote. The Commission therefore does not possess the power to negotiate with the Council on these matters. The European Parliament, for its part, plays only an advisory role: it is informed, and it delivers opinions, but it does not possess codecision powers with the Council and may use the cooperation and assent procedures only with regard to some technical issues.

On the other hand, the Council, in the composition of the Ministers of Economic Affairs and Finance (Ecofin Council), is the primary power. It takes the major decisions: adoption of the broad economic policy guidelines, monitoring their application by the Member States and the adoption of exchange rate policy guidelines. The European Council, in the composition of the Heads of State or Government and, in exceptional circumstances, of the Finance Ministers, plays the most important political role in EMU: it discusses the ‘broad guidelines’, appoints the President of the European Monetary Institute at the beginning of the second phase, then the President of the European Central Bank and other members of the Board of Directors at the beginning of the third phase, for which it sets the date of the entry into force of the single currency for those States that meet the Maastricht criteria.

Pending transition to the second phase of EMU, the first phase, which began on 1 July 1990, had established the free movement of capital, the strengthening of multilateral monitoring of the economic situation and the convergence of macroeconomic policies. Yet its implementation was difficult because of the slowdown in activity from 1991 to 1993. The European Monetary System looked as if it might fall apart. In order to fund the huge expenditure incurred during reunification, Germany resorted to borrowing at extremely high interest rates. Accordingly, the Deutschmark appreciated on the exchange market while the dollar fell. The other European currencies could not keep up with the pace and became vulnerable to speculation. In September 1992, the Finnish mark was devalued, followed by the Italian lira, the Spanish peseta and the Portuguese escudo. The Bundesbank stopped supporting the weak currencies, and the pound sterling withdrew from the EMS and was allowed to float. As for the French franc, it, too, was under threat, but its withdrawal from the EMS would lead to the collapse of the European Monetary System, and the adoption of the single currency would then become highly unlikely. The franc–mark parity was maintained thanks to high interest rates and joint action, in response to President François Mitterrand’s request to Chancellor Helmut Kohl, by the Banque de France and the Bundesbank. Following the victory of the Right in the French general elections of 30 March 1993, Balladur’s government continued with its ‘strong franc’ policy. Germany, the backbone of the EMS, refused to withdraw from it or to continue to intervene so that the weak currencies could remain in it.

In order to prevent the collapse of the EMS, the Ministers of the Twelve decided on 2 August 1993 to widen the fluctuation margin of currencies temporarily and to increase it from 2.25 % either side of a central rate vis-à-vis the ECU to 15 %, in other words a 30 % band instead of 5 %. This exempted banks from taking action in the event of wild fluctuations and from exhausting their resources. Speculation was thus discouraged. The EMS remained in existence by allowing currencies to float somewhat, but the Member States did not take advantage of it and sought instead to regain the former narrow fluctuation band. A drop in interest rates was made possible since there was no longer a need to raise them to defend the exchange rates.

Transition to the second stage of EMU was carried out in accordance with the Treaty on Maastricht of 1 January 1994. It was a preparatory phase for the changeover to the single currency, involving the coordination of the monetary policies of the Member States and the monitoring of their economic policies in order to promote their convergence.

The European Monetary Institute (EMI) was established in Frankfurt, the headquarters of the Bundesbank

and of the future European Central Bank. It was presided over by the Belgian, Baron Alexandre Lamfalussy, former General Manager of the Bank for International Settlements (BIS), who had been a member of the Delors Committee on EMU. The Council consists of the governors of the central banks of the Member States. The EMI performed its task very efficiently by coordinating monetary policies and by laying the groundwork for the future European System of Central Banks as well as preparing the notes and coins of the single currency.

The European Commission also took on an important role — although not provided for in the Treaty — in preparing for the transition to the single currency. Yves-Thibault de Silguy, Commissioner with special responsibility for monetary affairs, endeavoured to lay down the precise procedures to be followed by forging further links with the economic and banking worlds. This led the Commission to adopt a ‘Green Paper’ on 31 May 1995 which put forward a multistep scenario that the EMI would take into account.

The Council of Economic Affairs and Finance Ministers had to ensure that monetary policies were coordinated. Upon a recommendation from the Commission, and following the European Council’s decision, it established broad guidelines and ensured that all the Member States complied with them. The Commission was responsible for monitoring the Member States and did this by gathering information and submitting a report to the Council, which, by a qualified majority vote, could address recommendations to a Member State in breach of the guidelines. The Member States had to implement sustainable triennial convergence programmes, to be assessed by the Commission and validated by the Council, with the aim of encouraging the Member States to introduce budgetary policies promoting non-inflationist growth and high employment levels as well as respecting the convergence criteria of the Treaty of Maastricht for the changeover to the single currency. Excessive public deficit, identified by the Commission, was the subject of a recommendation, adopted by qualified majority vote in the Council, addressed to the Member State at fault. Such measures were needed, given the considerable disparities between the Member States. In 1994, the Council noted that all the Member States had an excessive deficit, with the exception of Ireland and Luxembourg. The average rate for the Twelve was 6 % of GDP, instead of the 3 % recommended rate. There was still a lot of headway to be made. It quickly became apparent that the first option laid down in the Treaty to adopt a single currency was impracticable. The deadline of 1 January 1999 therefore had to be respected. To this end, the Madrid European Council, held on 15 and 16 December 1995, adopted the timetable proposed by the EMI and approved by the Ecofin Council. The list of countries meeting the criteria was due to be finalised in early 1998 on the basis of the 1997 out-turn and adopted by the European Council. The European Central Bank would then be established. The third stage of EMU began on 1 January 1999 with the irrevocable fixing of exchange-rate relations between national currencies and the single currency. The single currency began to be used in commercial and banking transactions. From 1 January 2002, notes and coins entered into circulation in the public domain and were used in tandem with national currencies until 1 July 2002, when the latter lost their status of legal tender.

The final task involved finding a name for the new European currency, which replaced the ecu (European Currency Unit), the accounting unit of the EMS. The French preferred to maintain the term ‘ecu’, reminiscent of the old French coin, but the Germans stated that the ecu had decreased 40 % in value since its creation and therefore the term ‘ecu’ should be scrapped, particularly since the German mark was due to disappear. Other names were suggested but all had their individual drawbacks. Finally, on a proposal from Felipe González Márquez, the Spanish Prime Minister, the word ‘euro’, the same in all languages of the Union, was adopted.

Considerable progress had therefore been made in the process leading to the introduction of the single currency. The timetable had been set, the name chosen, the Commission had adopted the € symbol (the Greek letter epsilon), composed of two parallel lines, the symbol of stability, and the models of euro notes and coins had been presented at the Dublin European Council on 13 and 14 December 1996. The euro became a tangible reality and could be introduced to the public. Yet the most difficult task of meeting the Maastricht criteria lay ahead for the countries of the Union, many of which were still far from achieving it.