What's Left *of* Maastricht?

An important insider offers the lay of the land.

BY OTMAR ISSING

Thirty years ago, on February 7, 1992, in the Dutch city of Maastricht, the foreign ministers of the twelve member states of the European Community signed the treaty named after that place. This was subsequently ratified by all member states and came into force on November 1, 1993. The Maastricht Treaty created the legal basis for establishing a currency union.

The idea of a European monetary union has a long history, but it has remained a vision, if not a utopia. With the increasing dissolution of the system of fixed but adjustable exchange rates decided upon in Bretton Woods in 1944, the exchange rate problem was considered the most important obstacle on the way to more intensive economic integration in Europe at the end of the 1960s.

With this in mind, the heads of state and government of the member states of the European Economic Community decided at the summit of December 1969 that a phased plan for the establishment of an economic and monetary union was to be drawn up. According to the so-called Werner Plan of 1970, named after the prime minister of Luxembourg at the time, Pierre Werner, the union was to be completed within ten years. Significant tensions subsequently arose between Germany and France due to differing ideas about the appropriate method of achieving monetary union.

The controversy ran under the banner of "monetarists" versus "economists." The monetarists—not to be confused with Milton Friedman's ideas—considered that the final fixing of exchange rates would inevitably lead to the convergence of economic policies in the other areas, from fiscal policy to wage policy, and should therefore proceed, and as soon as possible. This

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position was held primarily in France, while the German government, in association with most German economists, took the economist position. According to this, the irreversible fixing of exchange rates and thus the path to monetary union presupposed the prior adjustment of national economic policies. A premature fixing of exchange rates would inevitably lead to great tensions and endanger the whole project, if not doom it.

The more firmly the project of a European currency union took shape, the more the discussion focused on the question of whether and to what extent the potential member states would comply with the conditions of an "optimal currency area." The idea that the borders of the nation state do not necessarily have to coincide with the economic conditions of an optimal currency area goes back to work by Robert Mundell in 1961, Ronald McKinnon in 1963, and Peter Kenen in 1969.

Robert Mundell

Ronald McKinnon

Peter Kenen

The Conception

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—O. Issing

Numerous studies, some of them controversial, have subsequently been published on this question. As a result, one can say that the eleven countries with which the European Monetary Union finally began in 1999 only partially fulfilled the conditions of an optimal currency area. The question remains open as to whether the conditions of the optimal currency area theory are suitable as an exclusion criterion on the one hand and whether they are sufficient for the success of a monetary union on the other. Regardless of how one ultimately judges the importance of the relevant theoretical and empirical contributions, politicians ignored these critical arguments both in Maastricht and when deciding on the participating countries, which has not contributed to the stability of the monetary union.

The fiscal discipline benchmarks set limits for a government budget deficit of 3 percent and for the ratio of government debt to GDP at market prices of 60 percent.

The intention to introduce a monetary union by the end of the 1970s was premature and untimely. It was premature as there had been no progress in convergence between member States. It was untimely because the environment was characterized by exchange rate changes—no fewer than seventeen times in the European Exchange Rate Mechanism between 1972 and 1978.

On the initiative of French President Valéry Giscard d'Estaing and German Chancellor Helmut Schmidt, the European Monetary System was founded in 1979 as a way out of these crises. This was expected to not only lead to stable exchange rates between the participants, but also pave the way for the European currency.

At the summit of June 1988, it was decided to set up a group of experts to work out concrete proposals for a European monetary union. The group, named after its chairman Jacques Delors and made up of the central bank governors of the member states and three experts, presented its final report in the spring of 1989. The report made it clear that a new treaty was required for the "monetary union" project. The new central bank should

be independent and primarily committed to the goal of price stability. Because of the necessary unanimity, the ideas of the German side prevailed after difficult negotiations. The transition to economic and monetary union was to take place in three stages.

The Committee of Central Bank Governors played an important role. The Committee met under the chairmanship of Bundesbank President Karl Otto Pöhl. All the governors of the central banks of the EU member states belonged to the committee. This body had unanimously submitted a draft for the statute of the European Central Bank, which is essentially based on the law of the Deutsche Bundesbank with the central elements of independence of the central bank and priority for the goal of price stability. A controversial discussion was sparked by the following question: Should the vote of the central bank governor from the smallest member state, Malta, have the same weight as that of the Bundesbank president from the largest country? Ultimately, the decisive factor in favor of the principle of "one person, one vote" was the conviction that the governors of the national central banks should not act as representatives of their country when making monetary policy decisions, but were personally responsible for an appropriate monetary policy for the entire currency area.

The European Council in Dublin in June 1990 decided to convene two intergovernmental conferences. The first should prepare the creation of a political union. This project was mainly based on the idea of Federal Chancellor Helmut Kohl, who was convinced of the necessary parallelism of political union and monetary union. This initiative met with strong resistance, especially from France, and ultimately came to nothing. The other intergovernmental conference had the task of preparing for economic and monetary union. The successful conclusion of this conference finally led to the Maastricht Treaty.

According to the treaty, the ECB and the national central banks are prohibited from lending to the public sector and from directly purchasing public debt instruments.

According to the decision of the European Council of March 12, 1990, the introduction of economic and monetary union was to take place in three stages. The first stage began on July 1, 1990, with the removal of restrictions on the movement of capital between member states and greater coordination of national economic and monetary policies. In the Maastricht Treaty, the start of the second stage was set for January 1, 1994. This was to prepare the transition to the final stage. The newly founded European Monetary Institute played an important role in this. At the December 1995 meeting, the European Council decided to start the third stage on January 1, 1999, introducing the new common currency under the name euro. The treaty stipulated that only those countries should participate in the monetary union that were adequately prepared for accession. The contract stipulated the so-called convergence criteria as a criterion for this examination.

France in particular insisted on setting a latest end date for the start of economic and monetary union. One can see in this a success of the monetarist position, while the fulfillment of economic convergence conditions corresponds to economist ideas.

When the Maastricht Treaty was signed, it was assumed that, in principle, all EU member states should also become members of the monetary union. This principle implies that a member country that fulfills the convergence criteria must in principle also adopt the euro as its currency. Denmark and Great Britain received an exception clause from this obligation. With the exit

Signing of the Maastricht Treaty, February 7, 1992.

from the European Union, this has been done for Great Britain. (The case of Sweden is legally controversial). As long as some EU member states do not also belong to the monetary union, different rights and obligations result from the contract.

In addition to the general responsibility of the EU Commission, the Council of Finance Ministers was created to coordinate the economic policies of the member states and monitor budgetary discipline. The Eurogroup is an informal body made up of the economics and finance ministers of the member states of the monetary union. They discuss issues related to responsibility for the euro. The fiscal discipline benchmarks set limits for a government budget deficit of 3 percent and for the ratio of government debt to GDP at market prices of 60 percent. In 1997, at Germany's urging, the European Stability and Growth Pact was adopted, in which the procedure for monitoring budgetary discipline and the coordination of economic and financial policy is specified.

As protection against misconduct in fiscal policy by individual member states, the treaty contains the so-called no-bailout clause. According to this, the liability of the community and of all member states for obligations of individual member states is excluded.

The European System of Central Banks consists of the European Central Bank and the central banks of the member states of the European Union (national central banks). Since not all EU member states belong to the monetary union, the ECB introduced the term Eurosystem. This includes only the national central banks of the member states that belong to the monetary union. The decision-making bodies are the Governing Council and the Executive Board. The Extended Council consists of the president and vice-president of the ECB and all the governors of the central banks of the EU member states. It acts as a link to the central banks of the EU countries that do not belong to the monetary union.

The critics of the currency union are consistently unable to answer the question of how things would have developed without the move to the common currency.

According to the treaty (including the protocol), the most important task of the Eurosystem is to define and implement the monetary policy of the Community.

The elements in the Statute of the ECB that are crucial for the implementation of monetary policy are

- The ban on monetary financing;
- The independence of the central bank; and
- Priority for price stability.

According to the treaty, the ECB and the national central banks are prohibited from lending to the public sector and from directly purchasing public debt instruments. With the status of independence, the ECB and the national central banks may neither seek nor take instructions from public authorities (that is, primarily governments) of the member states, nor may public authorities attempt to influence the ECB or the national central banks. Maintaining price stability is the primary objective of the ESCB. To the extent that it can do so without jeopardizing this objective, the ESCB supports general economic policies, acting in accordance with the principle of an open market economy with free competition.

THE MAASTRICHT SUCCESS STORY?

The outstanding result of the Maastricht Treaty was the establishment of monetary union. The Union started on January 1, 1999, with eleven EU member states. The euro is now the common currency of twenty countries, and it is to be expected that other EU member states will join them sooner or later.

The large number of countries that have chosen the euro as their currency alone seems to speak for the unrestricted success of the Maastricht project. But critical observers see things differently. For them, the project of the common currency is, if not a failure, at least in difficulties that threaten its very existence. The euro has gone from being an idea of peace to becoming a rift. When asked about his verdict on the French Revolution of 1789, Chinese Prime Minister Zhou Enlai reportedly said it was "too early to say." Well, we won't have to wait that long for the euro, but experience to date shouldn't suffice for a definitive statement about monetary union. After so much political capital was invested in the monetary union project and the failure or even the exit of an important country would be associated with such great economic and political costs, everything indicates that the monetary union and thus the euro will endure. (There is no "forever guarantee" for anything in this world.)

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The critics of the currency union are consistently unable to answer the question of how things would have developed without the move to the common currency. The frequent exchange rate changes before Maastricht and above all the currency market turbulence of 1992–1993 with massive revaluations and devaluations threatened the existence of the single market. In addition to the economic aspects, the political conditions must not be ignored. For example, it is difficult to imagine that the dominance of the Deutsche Mark and the monetary policy of the Deutsche Bundesbank would have been accepted in the long term, particularly by the other large countries. What remains is the difficulty, all too familiar to economists, of developing a counterfactual comparative position.

The Statute of the ECB can be described as the greatest achievement of the Maastricht Treaty. The independence of the central bank and priority for the goal of price stability can be seen as crucial elements of an optimal central bank constitution. The fact that Maastricht decided in favor of the independence of the future European Central Bank—at a time when the Deutsche Bundesbank alone was the only truly independent national central bank—is anything but a matter of course. In addition to the "Bundesbank model," the decision was also promoted by a global wave in favor of independence. The ban on monetary financing of government spending is less clear. As has been shown above all in the political disputes and the proceedings before the European Court of Justice and the German Federal Constitutional Court, the ban laid down in the treaty does not set any clear legal barriers. All in all, the problems that have arisen are not due to legal weaknesses in the treaty, but to the monetary policy being practiced.

By right, a stronger anchoring of the independence of the ECB is hardly conceivable. The contract can only be changed unanimously. In some countries, this would require not only parliamentary approval, but also a successful referendum. But in fact, the independence of the ECB is threatened by being overburdened with new tasks (microprudential and macroprudential supervision), an extensive "interpretation" of its mandate when taking responsibility for environmental policy, and acting on the borderline to fiscal policy with the massive purchases of government bonds. As a consequence of President Mario Draghi's "whatever it takes" in 2012, the ECB has taken responsibility for the composition of EMU which must remain in the domain of politics.

One can rightly criticize the treaty's disregard for the real sector when assessing the convergence of the economies of the candidate countries. The main problem here, however, lies in the excessively "generous" interpretation of the criteria for actual admission to the monetary union by politicians. Setting a latest day for the start has contributed to this attitude and the following problems. The treaty was unable to prevent wage policy from repeatedly getting out of hand in a number of countries, the growth and stability pact being permanently disregarded, and the no-bailout clause *de facto* not being observed.

The main shortcoming and thus the greatest danger to the success and ultimately the long-term existence of the monetary union does not lie in the treaty itself, but in its "stand-alone" character. Contrary to the wishes and demands of Chancellor Helmut Kohl in particular, there were never any serious efforts to achieve political parallelism with monetary union. Despite all the problems that keep coming up, the community is probably further than ever from the goal of a political union.

Member states are fundamentally unwilling to subject their national fiscal policies to the dictum of European control geared towards stability.

This is not the place to discuss the pros and cons of a political union. However, this consequence of the *status quo* remains unavoidable: as long as the members are essentially sovereign states, the problem of a monetary policy aimed at price stability without a financial policy that conforms with it seems hardly solvable. As the endless discussions about the "reform" of the Stability and Growth Pact show again and again, the member states—at least the most important ones—are fundamentally unwilling to subject their national fiscal policies to the dictum of European control geared towards stability. This state of affairs is bound to lead to repeated tensions which can also threaten the very existence of monetary union.

Finally, one important limitation: In this article, only economic and political aspects of European integration were discussed. Economic and even more so political integration has a profound impact on what happens in a nation. How much "closeness" the different countries and their citizens want or tolerate is not least a cultural question. From this point of view, one can understand the Maastricht Treaty as a political intention to overcome such differences—or as an example of where deep-seated national idiosyncrasies can lead. ◆