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Beyond Maastricht: The Long-Term Macroeconomic Impact of European Monetary Union

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1. J.D., University of the Pacific, McGeorge School of Law, to be conferred 1998; M.B.A., West Coast University, 1994; B.S., Milliken University, 1988. I would like to thank my family who, although far away, continue to provide me with inspiration and hope. I would especially like to thank my grandparents, without whose love and support law school would probably have remained a dream. This Comment is respectfully dedicated to the memory of Professor Jerome J. Curtis, Jr. With integrity and virtue, he taught us that real answers are found only when we have the courage to ask the truly difficult questions. A valuable lesson in the practice of law. An invaluable lesson in the practice of life.

I. INTRODUCTION

The European Union (EU) represents the world's largest trading bloc, with a population of over 372 million people and a combined Gross Domestic Product (GDP) greater than that of the United States.[1] Moreover, the EU continues to grow, spreading eastward, with possible membership for Estonia, Poland, the Czech Republic, Hungary, Slovenia and Cyprus as early as 2002.[2] It is the sheer size of this growing economic superpower that underscores the importance to the international law practitioner of understanding both the legal foundations and long-term, macroeconomic implications of European Monetary Union (EMU).

This Comment intends to provide that understanding. To provide a foundation upon which EMU may be analyzed, Section II of this Comment discusses the structure of the EU by examining the roles of its four institutional pillars—the European Parliament, the Council, the Commission, and the European Court of Justice. Section III examines the history of EMU by discussing previous attempts at monetary union by the EU. Section IV explains how the Single European Act provided the legal ability of EU members to further pursue EMU. Section V details the EU's attempt to establish EMU through the Treaty of Maastricht, including the economic obligations that the Maastricht Treaty[3] and the recently enacted Stability and Growth Pact[4] place on EU members. Section VI provides information and analysis of how EMU will affect EU Members' ability to control inflation, manage business cycles and borrow money. Finally, Section VII concludes by offering a brief summary of the questions and issues surrounding EMU.

II. THE INSTITUTIONAL STRUCTURE OF THE EUROPEAN UNION

The roots of the EU date back to 1957, when Belgium, France, Italy, Luxembourg, the Netherlands and West Germany signed the Treaty Establishing the European Economic Community (EEC Treaty).[5] The EEC Treaty went into effect

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1. *See Europe's Mid-Life Crisis, A Survey of the European Union*, THE ECONOMIST, May 31, 1997, at 2 [hereinafter *Europe's Mid-Life Crisis*] (summarizing the accomplishments of the EU's first four decades). Within its first four decades of existence the EU has grown from six to fifteen members, with a population of 372 million. *Id.* Currently, as the world's largest trading block, its GDP is well ahead of that of the U.S. *Id.*

2. *See* Wolfgang Strasbourg, *A Budget for Reform*, THE ECONOMIST, July 19, 1997, at 44 [hereinafter Strasbourg, *A Budget for Reform*] (explaining that the commission's Agenda 2000 package proposes to maintain a spending ceiling of 1.27% of GDP even if six new members arrive in 2002). Successful new applicants are listed as Estonia, Poland, the Czech Republic, Hungary, Slovenia and Cyprus. Wolfgang Strasbourg, *Eastward Ho, They Said Warily*, THE ECONOMIST, July 19, 1997, at 43 [hereinafter Strasbourg, *Eastward Ho*].

3. *See infra* notes 110-29 and accompanying text (discussing the Maastricht convergence criteria).

4. *See infra* notes 156-70 and accompanying text (analyzing the terms of the Stability and Growth Pact).

5. Treaty Establishing the European Economic Community, May 25, 1957, Belgium, France, Italy, Luxembourg, Netherlands, and West Germany, 163 U.N.T.S. 51 [hereinafter EEC Treaty]; *see* David Currie, Economist Intelligence Unit, *The Pros and Cons of EMU*, <www.eiu.com/latest/rr_emu/cr7zz100-10.html> (visited Oct. 19, 1997) (copy on file with *The Transnational Lawyer*) (stating that in 1958, the EU was established and included Belgium, France, Italy, Luxembourg, Netherlands, and West Germany). In 1973, Denmark, Ireland and

on January 1, 1958 and has been amended numerous times to reflect expanding membership within the EU.[6] In 1973, Denmark, Ireland and the United Kingdom were admitted to the EU.[7] In 1981, EU membership was expanded to include Greece, and in 1986, Portugal and Spain were also admitted.[8] Finally, in 1995, Austria, Finland and Sweden joined the Union, bringing total EU membership to 15 Member States.[9]

Article 4 of the EEC Treaty mandates that the activities of the Union will be carried out by a European Parliament, a Council, a Commission and a European Court of Justice.[10]

A. *The European Parliament*

Article 137 of the EEC Treaty mandates the creation of the European Parliament, which is to consist of representatives of the people of the individual states.[11] Although Article 138 states that parliamentary representatives are to be elected by Member States' citizens,[12] Article 137 essentially relegates the European Parliament to an advisory role.[13] Because the European Parliament is the only EU institution whose members are directly elected by the people, this has raised concerns that the structure of the EU is not sufficiently democratic.[14]

Talk of a "democratic deficit" within the EU is common and is blamed for an overall loss of support for the EU in general.[15] In fact, in Austria and Sweden, which

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the UK joined the EU; Greece in 1981; Spain and Portugal in 1986; and Austria, Finland and Sweden in 1995. *Id.*

6. *See* Currie, *supra* note 5 (listing the members of the EU).

7. *Id.*

8. *Id.*

9. *Id.*; *see Europe's Mid-Life Crisis, supra* note 1, at 2 (noting EU membership has grown from 6 to 15 Member States).

10. *See* EEC Treaty, *supra* note 5, art. 4; *see also* Dr. Mark L. Jones, *Doing Business in the European Internal Market: Putting "1992" in Perspective*, 9 J. INT'L L. BUS. 463, 468-69 (1992) (remarking that Article 4 of the Treaty states that the tasks of the Community are to be carried out by four institutions—a European Parliament, a Council, a Commission and a Court of Justice).

11. *See* EEC Treaty, *supra* note 5, art. 137; *see also* Jones, *supra* note 10, at 469 (noting that the European Parliament, originally called the Assembly, consists of representatives directly elected by the citizens of the Member States). The 518 members of the European Parliament sit according to political grouping rather than nationality. *Id.* Despite its name and claim to democratic legitimacy, the Treaty envisages that the Parliament will have an essentially advisory and supervisory role. *Id.*

12. EEC Treaty, *supra* note 5, art. 138.

13. *See* EEC Treaty, *supra* note 5, art. 137 (limiting the European Parliament to exercising the advisory and supervisory powers conferred upon it by the Treaty).

14. *See Europe's Mid-Life Crisis, supra* note 1, at 15-16 (concluding that the gap between the "bureaucrat in Brussels" and the man on the street is widening, and suggesting that Europeans would react more favorably to the EU if only its institutions were more democratic). Although in most EEC countries, the majority still feels that the EU is a good thing, the margins are steadily falling. *Id.* Norwegians have twice voted against EEC membership, and the Swiss have refused to ratify their membership in a free trade club, known as the European Economic Area. *Id.* The Danes shocked the Union by narrowly voting against ratification of the Maastricht Treaty, and the French, original EEC Treaty signatories, approved the Maastricht Treaty by a very thin margin. *Id.*

15. *Id.* at 16.

joined the EU as early as 1995,[16] opinion polls show that the majority of voters would not support EU membership now.[17] Proposals for making the EU more democratic often involve strengthening the role of the European Parliament by linking the appointment of commissioners[18] to Parliamentary elections within the individual Member States.[19]

Presently, there are 626 seats in the Parliament, which uses a system of weighted voting in which smaller countries are heavily overrepresented.[20] For instance, Germany, with a population of approximately 81 million people,[21] holds 99 seats within the European Parliament,[22] or roughly one seat for every 800,000 people. By contrast, Belgium, which has a population of approximately ten million people,[23] maintains 25 seats within the Parliament,[24] or approximately one seat for every 400,000 people. Thus, Belgium is disproportionately represented within the Parliament relative to Germany.

B. The European Commission

Articles 155-163 of the EEC Treaty mandate the creation of a European Commission.[25] The purpose of the Commission is to ensure the proper functioning of the common market.[26] In general, the Commission formulates proposals for the EU, enforces EU laws against Member States and individuals, and serves as the EU's

16. *See* Currie, *supra* note 5 (showing that Austria, Finland and Sweden joined the EU in 1995).

17. *See supra* note 14 and accompanying text (noting that opinion polls in Austria and Sweden suggest that a majority of voters would now vote against EU membership).

18. *See infra* notes 25-30 and accompanying text (discussing the role of the European Commission).

19. *See Europe's Mid-Life Crisis, supra* note 1, at 15-16 (analyzing proposals for making the EU more palatable to its citizens, one of which involves linking appointment of commissioners to Parliamentary elections).

20. *See id.* at 12 (listing each Member State's percentage of the EU's population, votes in the Council of Ministers, Seats in the Parliament and number of Commissioners). The Council of Ministers uses a system of weighted qualified-majority voting in which small countries are heavily over-represented. *Id.* They are also over-represented in the Commission and in the Parliament. *Id.*

21. INTERNATIONAL MONETARY FUND, INTERNATIONAL FINANCIAL STATISTICS YEARBOOK, Vol. XLVIII, at 390-91 (1995) [hereinafter IMF].

22. *See Europe's Mid-Life Crisis, supra* note 1, at 12 (showing that Germany currently has 99 seats in the European Parliament).

23. *See* IMF, *supra* note 21, at 232-33.

24. *See Europe's Mid-Life Crisis, supra* note 1, at 12 (listing Belgium as holding 25 seats in the European Parliament).

25. *See infra* notes 26-30 and accompanying text (discussing the purpose of the European Commission).

26. *See* EEC Treaty, *supra* note 5, art. 155; *see also* Jones, *supra* note 10, at 469 (interpreting Article 155 to mean that the Commission's purpose is to ensure proper functioning of the common market). Specifically, the Commission formulates proposals for Community legislation, enforces Community law against Member States and individuals, and generally acts as the executive arm of the Community. *Id.*

executive branch.[27] Article 157 mandates that the Commission include at least one but not more than two nationals of each Member State.[28]

Commissioners are appointed for four year terms by Member States' governments, and according to Article 157, are to be "completely independent in the performance of their duties."[29] Moreover, commissioners are to represent the interests of the Union and not their home states. Article 157 proclaims that in the performance of their duties, commissioners may neither seek nor take instructions from any government or body.[30]

C. The European Court of Justice

Articles 164 through 188 of the EEC Treaty mandate the creation of the European Court of Justice.[31] Judges in the European Court of Justice (hereinafter referred to as the Court) are appointed by Member States' governments for a term of six years and must be qualified to occupy the highest judicial offices in their respective countries.[32] The Court is to consist of 13 judges who are authorized to form chambers of three to five judges to undertake "prepatory inquiries" or adjudicate cases over which the EEC Treaty has given them jurisdiction.[33]

The Court has original jurisdiction to determine whether Member States have failed to comply with their treaty obligations.[34] Under Article 169, should the Commission believe that a Member State has failed to fulfill a treaty obligation, it may bring the matter before the Court.[35] Also, under Article 170, one Member State may bring another Member State before the Court if it feels that state has failed to comply with its treaty obligations.[36] Finally, under Article 177, the Court is given jurisdiction to issue preliminary rulings concerning the interpretation of the EEC Treaty, the validity and interpretation of the acts of other institutions of the Union

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27. *See* Jones, *supra* note 10, at 469.

28. *See* EEC Treaty, *supra* note 5, art. 157 (listing the requirements for the Commission). The European Commission must include at least one national of each of the Member States, but may not include more than two members having the nationality of the same State. *Id.* The members shall be completely independent in the performance of their duties and may neither seek nor take instructions from any Government or from any other body. *Id.*

29. *Id.*

30. *Id.*

31. *See infra* notes 31-37 and accompanying text (discussing the role of the European Court of Justice).

32. *See* EEC Treaty, *supra* note 5, art. 167 (establishing the requirements for Judges and Advocates-Generals in the Court of Justice).

33. *See* Jones, *supra* note 10, at 469 (explaining the purpose of the European Court of Justice). The Court is to consist of thirteen judges who may form chambers of three to five judges to hear particular categories of cases. *Id.* The Court is assisted by six impartial and independent Advocates-General whose duty is to make reasoned submissions in cases before the Court. *Id.*

34. *See id.* (interpreting Articles 169-171 as giving the European Court of Justice original jurisdiction over enforcement actions against Member States for failure to fulfill an obligation under the EEC Treaty).

35. EEC Treaty, *supra* note 5, art. 169.

36. *Id.* art. 170.

and the statutes written by the Council, as long as the statutes provide for such jurisdiction.[37]

D. The European Council

Article 145 of the EEC Treaty establishes the Council and charges it with ensuring that the objectives of the Treaty are fulfilled.[38] As the Community's principle law-making body, the Council is to coordinate Member States' economic policies.[39] In many cases, however, the Council may only act upon a proposal by the Commission and only after obtaining the opinion of the European Parliament.[40]

Interestingly, European Council meetings are not open to the general public.[41] In fact, the European Council is presently the western world's only legislative body that passes its laws in secret.[42] Moreover, Council members are appointed by Member States' governments,[43] and thus are not directly accountable to the voters of those states.

Under Article 7 of the 1986 Single European Act,[44] which replaces Article 149 of the EEC Treaty, if the Council acts in cooperation with the Parliament, then it needs only a qualified majority vote to act instead of the unanimous vote it needed in the past.[45] Recall that the European Parliament is the only European institution elected by the people.[46] For this reason, Article 7 could represent a move towards a more democratic form of EU government by at least providing an incentive to the Council to act in cooperation with the opinions provided by Parliament.

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37. *Id.* art. 177.

38. *See id.* art. 145 (stating that to ensure that the objectives set out in the EEC Treaty are attained, the Council shall ensure coordination of the general economic policies of the Member States).

39. *Id.*; *see* Jones, *supra* note 10, at 469 (summarizing the duties of the Council as coordinating the general economic policies of the Member States and referring to the Council as the principal decision-making institution in the law-making process).

40. *See* Jones, *supra* note 10, at 469 (explaining the limitations on the Council's decision-making power).

41. *See Europe's Mid-Life Crisis, supra* note 1, at 16 (analyzing suggestions to make the EU more democratic and criticizing the fact that the council is the only legislative body in the western world that passes laws in secret by calling it "shameful").

42. *Id.*

43. *See* EEC Treaty, *supra* note 5, art. 146 (mandating that the Council shall consist of representatives of the Member States delegated by each Member State's government).

44. *See infra* notes 99-109 and accompanying text (discussing the impact of the Single European Act upon the EU's attempt to establish a monetary union).

45. *See* EEC Treaty, *supra* note 5, art. 149, 1, ¶¶ 1, 2(a) (stating that if the Council acts on a proposal from the Commission, unanimity is required for any act constituting an amendment to that proposal). But, if the Council acts in cooperation with the European Parliament, it needs only a qualified majority. *Id.*

46. *See supra* notes 11-24 and accompanying text (discussing the composition and duties of the European Parliament and noting that Article 138 of the EEC mandates that Parliament members be elected by Member States' citizens).

In passing its laws, the Council uses an intricate system of weighted voting, and like the European Parliament, smaller countries are greatly overrepresented.[47] For instance, Germany, with a population of approximately 81 million,[48] gets 10 votes on the Council,[49] or approximately one vote for every 8.1 million people. On the other hand, Belgium, with only 10 million people,[50] gets 5 Council votes,[51] or roughly one vote for every 2 million people. Presently, there are 87 total votes in the Council, with 62 needed for a qualified majority.[52]

Although this disparity in voting power was most likely intended to calm smaller states' fears of being dominated by their larger counterparts, this structure has begun to cause contention within the EU as it spreads eastward.[53] Considering the likely membership of Estonia, Poland, the Czech Republic, Hungary, Slovenia and Cyprus as early as 2002,[54] the number of votes in the Council will inevitably expand. Accordingly, the larger states—namely Germany, Britain, France, Italy and Spain, which account for roughly 79%[55] of the EU's 372 million people[56]—will be even more underrepresented relative to their populations than they already are. Moreover, should the EU continue to grow to include such applicants as Estonia, Poland, the Czech Republic, Hungary, Slovenia and Cyprus,[57] the larger states could find themselves overwhelmed in the Council by the smaller ones.[58]

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47. *See supra* notes 20-24 and accompanying text (showing the disproportionate representation among smaller countries within the European Parliament).

48. *See supra* note 22 and accompanying text (noting Germany's population of 81 million people).

49. *See Europe's Mid-Life Crisis, supra* note 1, at 12 (showing that Germany has 10 votes in the Council of Ministers).

50. *Id.*

51. *See id.* (listing Belgium as having 10 votes in the Council of Ministers).

52. *Id.*

53. *See* Strasbourg, *A Budget for Reform, supra* note 2, at 44 (recommending that, if the EEC is serious about enlargement, it should reduce the underweighting, relative to their populations, of the large countries, which risk being overwhelmed by the small ones); *see also Europe's Mid-Life Crisis, supra*, note 1, at 12 (stating that the imbalance in favor of small countries may have been tolerable when there were only 6 members, composed of 3 large and 3 small countries, but not in a union of 25 with only 5 or 6 large members). The question of voting weights has already caused considerable friction. *Id.* Britain and Spain threatened to block the most recent round of enlargement (in 1995, taking Austria, Finland and Sweden) unless the weights were altered. *Id.*

54. *See supra* note 2 and accompanying text (noting that Estonia, Poland, the Czech Republic, Hungary, Slovenia, and Cyprus have successfully applied to the EU and could join as early as 2002).

55. *See Europe's Mid-Life Crisis, supra*, note 1, at 12 (listing the percentages of the EU's population as Germany, 22%; Britain, 15.7%; France, 15.6%; Italy, 15.4%; Spain, 10.5%; these countries combine to account for 79.2% of the EU's total population).

56. *Id.*

57. *See* Strasbourg, *A Budget for Reform, supra* note 2, at 43.

58. *See supra* note 53 and accompanying text (pointing out the potential conflicts between the European Council's current voting structure and the EU's expanding membership).

III. Early Attempts at European Monetary Union

Attempts to establish monetary unions within Europe can be found both before and after the signing of the EEC Treaty.[59]

A. *Monetary Union Before the EEC Treaty*

In 1865, France, Switzerland, Belgium, Italy and Greece created the Latin Monetary Union.[60] Eight years later, Sweden, Norway and Denmark formed the Scandinavian Monetary Union.[61] Both Unions collapsed due to unforeseen economic and political circumstances.

Within the Latin Monetary Union, gold and silver coins of equal weight, and thus equal value, were accepted as legal tender throughout the Union.[62] However, when Italy began to continually incur budget deficits, it weakened the value of its coins relative to the others'.[63] Also, the exchange ratio used for the silver coins collapsed when new discoveries of silver unexpectedly increased the silver supply.[64] Finally, individual countries began to print large supplies of paper money to finance their war efforts during World War I.[65] However, this paper money was not recognized by other members and the Latin Monetary Union soon collapsed.[66]

Participating countries within the Scandinavian Monetary Union[67] minted a common gold coin, the Scandinavian crown.[68] Although the crown was to circulate freely throughout the Union, each country retained the right to mint its own version.[69] During World War I, the economies of Denmark and Norway grew much faster than Sweden's and, subsequently, so did the supply of money within those

59. *See generally* EEC Treaty, *supra* note 5 (documenting that the EEC Treaty was signed on May 25, 1957).

60. Lawrence Ingrassia, *Exchequered Past*, WALL ST. J., Jan. 13, 1996, at 1 (comparing U.S. monetary union with EMU and noting that past attempts at monetary union which didn't involve political union have failed). Skeptics of EMU note that the difference between the successful U.S. monetary union and the European plan is that the U.S. was a single country, whereas the EU consists of 15 separate countries. *Id.* To buttress their argument that a comparison between U.S. monetary union and EMU is not a valid one, critics of EMU cite the two most ambitious attempts at monetary union, the Latin Monetary Union and the Scandinavian Monetary Union. *Id.* Without political unity, countries within the monetary union would act in their own interest, thus bringing about the collapse of the monetary union. *Id.*

61. *See id.* (explaining the composition and structure of the Scandinavian Monetary Union).

62. *See id.* (describing the functions of the Latin Monetary Union).

63. *Id.*

64. *See id.* (detailing the reasons behind the collapse of the Latin Monetary Union).

65. *Id.*

66. *Id.*

67. Ingrassia, *supra* note 60, at 1.

68. *Id.*

69. *Id.*

countries.[70] Because of the inflationary increase in Denmark and Norway's money supply, their crowns soon became worth less than Sweden's.[71]

However, within the Union, Danish and Norwegian crowns could still be traded for the more valuable Swedish crowns on a one-for-one basis.[72] Accordingly, currency traders took their less-valuable Danish and Norwegian crowns to Sweden in order to exchange them for the more valuable Swedish coins.[73] After returning home, they used the Swedish coins to buy a greater number of Danish and Norwegian crowns, thus increasing their wealth by merely changing currencies.[74] In order to end the drain on its money supply, Sweden cut off the currency link, effectively ending the Union.[75]

B. Monetary Union After the EEC Treaty.

After the formation of the EU, it soon became apparent that a common measure of value was needed for conducting business within the Union.[76] Member States needed a measure of value in order to settle claims, establish the Community's budget, and express common prices for agricultural goods.[77] Since the signing of the EEC Treaty, there have been more than ten different units of account used by the EU.[78] This underscores both the perceived importance within the EU of establishing some type of monetary union and the difficulty in maintaining the necessary exchange rate stability in the face of volatile economic and political conditions.

One of the first modern attempts at creating a European monetary union occurred in 1950,[79] seven years before signing of the EEC Treaty.[80] Under the European Payment Union, Member States established a unit of account, valued in gold, which had the same value in gold as the U.S. dollar.[81] This unit could be converted into national currencies based upon fixed exchange rates.[82] Following President Nixon's decision to abandon the gold standard, fixed rate systems across the world began

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70. *See id.* at 10 (providing the reasons for the collapse of the Scandinavian Monetary Union).
71. *Id.*
72. *Id.*
73. Ingrassia, *supra* note 60, at 10.
74. *Id.*
75. *Id.*
76. *See* Susan B. Schulman, *A Rapid or Evolutionary Approach: The EEC's Adoption of the ECU as a Common Currency*, 12 J. INT'L L. BUS. 390, 391-92 (1991) (chronicling the evolutionary process which led to the implementation of the ECU as a unit of account).
77. *Id.*
78. *See id.* at 393 (noting that it is difficult for a common currency to survive in volatile economic conditions and divergent nationalistic goals such as varying inflation and unemployment rates).
79. *See id.* at 392 (describing the European Payment Union as a predecessor to the ECU).
80. EEC Treaty, *supra* note 5.
81. *See* Schulman, *supra* note 76, at 392 (explaining the functional aspects of the European Payment Union).
82. *Id.*

to degenerate as the currency to which they were tied, the U.S. dollar, began to float against other currencies worldwide.[83]

In 1972, with the decline of fixed rate systems, the EU adopted a program called the "snake."[84] The snake allowed Member States' currencies to fluctuate +/- 2.25% against the U.S. dollar and +/- 4.5% among any two currencies within the Union.[85] This allowed Member States' currencies to float together as long as individual central banks within the Union took the necessary steps to keep currency fluctuations within the narrow fluctuation range.[86] The oil crisis of the 1970s put the snake currencies under tremendous pressure and many participants withdrew from the program due to a perceived need for greater autonomy in currency management.[87]

In 1975, the EU created the European Unit of Account (EUA).[88] The EUA was comprised of specific quantities of the nine Member States' currencies.[89] When the European Monetary System (EMS) was established by resolution of the Council on December 5, 1978, the EUA was renamed the European Currency Unit (ECU).[90] The ECU now serves as an integral part of EMS.[91]

Under EMS, the ECU is considered a "basket currency" because it consists of a fixed amount of Member States' national currencies.[92] Once the amount of each Member State's component currency is set, it can only be changed by unanimous consent of the Council of Ministers.[93] Thus, each currency now has a central exchange rate within the EU measured against the ECU.

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83. *See id.* (stating that fluctuation margins were widened against the U.S. dollar and European currencies following President Nixon's announcement that the dollar was no longer convertible into gold).

84. *See id.* (describing the "snake" as the most notable attempt at establishing rate stability since the decline of the fixed rate systems); *see also* Currie, *supra* note 5 (showing that, in 1972, the "snake" exchange-rate mechanism was set up as the Bretton Woods System broke down).

85. *See* Currie, *supra* note 5 (explaining the "snake's" functional aspects).

86. *Id.*

87. *See id.* (noting the failure of the snake in the wake of the 1973-74 oil crisis). Thoughts of monetary union were set aside as inflation took off in the industrial countries following the Organization of Petroleum Exporting Countries' decision to raise the price of oil in 1973-74. *Id.*

88. *See* Schulman, *supra* note 76, at 393 (reporting that on April 21, 1975, the EU created the European Unit of Account). The EUA was made up of specific quantities of the nine Member States' currencies and was based on the International Monetary Fund's Special Drawing Right. *Id.* The EUA laid the foundation for the ECU. *Id.* When the EMS was established by a European Council Resolution on December 5, 1978, the resolution included a clause that renamed the EUA the European Currency Unit. *Id.*

89. *See id.* (explaining the composition and structure of the European Unit of Account).

90. *Id.*

91. *Id.*

92. *Id.*

93. *See id.* at 392 (noting the requirements for changing the amount of each Member State's component currency).

Under the Exchange Rate Mechanism (ERM), these central exchange rates were used to create a grid of bilateral exchange rates among Member States' currencies.[94] Exchange rates were to be fixed so that they would fluctuate no more than +/- 2.25% against the central ECU rate,[95] thus reducing exchange rate volatility within the EU. The ERM soon became regarded as a proven success in providing exchange rate stability and many European leaders began to believe that it was time to further develop the EU's monetary system.[96]

Interestingly, the original EEC Treaty never spelled out the legal consequences of resolutions passed by the Council.[97] Thus, there was really no legal obligation for EU members to participate in EMS, since the resolutions were not considered legally binding. For this reason, it has been speculated that the success of EMS is due to the sheer political and economic will of Member States in pursuing greater exchange rate stability.[98]

IV. THE SINGLE EUROPEAN ACT

Although considered successful in its objective of providing exchange rate stability within the EU, the EMS was not legally recognized until passage of the Single European Act (SEA), considered the most far-reaching revision of the EEC Treaty to date.[99] First, the preamble to the SEA specifically mentions the EMS resolution and the 1972 Conference on European Monetary Union.[100] In addition, subsection II of Section 2 of the SEA amends the EEC Treaty to include Article 102a.[101]

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94. *See* Schulman, *supra* note 76, at 394 (explaining the functional aspects of the Exchange Rate Mechanism). The ERM attempts to create convergence among member countries' monetary policies by fixing member currency exchange rates to fluctuate no more than plus-or-minus 2.25%. *Id.* While membership in the ERM is not mandatory, Great Britain's recent assent to the mechanism means that all of the currencies making up the ECU, except the Portuguese escudo and the Greek drachma, are now part of the ERM. *Id.* A 6% fluctuation rate allows additional flexibility for new members of the ERM. *Id.*

95. *Id.*

96. *See* Currie, *supra* note 5 (noting that, in 1979, the EU launched the European Monetary System which was widely regarded as successful in providing exchange rate stability).

97. *See* Schulman, *supra* note 76, at 395 (claiming that "the legal foundation of the ECU and the EMS has been more political and economic will than any set of enforceable laws"). The EEC Treaty contains little on the subject of economic and monetary union. *Id.* "The European Council formed the EMS in an effort to fill this void and created EMS by resolution." *Id.* "Resolutions are not defined in the EEC Treaty, and thus the legal consequences of resolutions are not spelled out." *Id.* "As a result, there was no requirement to join the EMS because a resolution can not obligate member countries to do anything." *Id.* "Consequently, many think the success of the EMS is due to the political and economic will of the EU for some type of monetary policy convergence." *Id.*

98. *Id.*

99. *See id.* at 395 (explaining the effect of Article 2 of the Single European Act (SEA)). By amending the EEC Treaty, the SEA, unlike the EMS Resolutions, is binding on community members. *Id.* As such, it is considered the most important modification of powers and processes on European integration since the EEC Treaty itself. *Id.*

100. *See* EEC Treaty, *supra* note 5, art. 102a(1).

101. *Id.*

Article 102a proclaims that the convergence of monetary policy is necessary for the EU's continued development.[102] It then commits members to the objectives of Article 104,[103] one of which is maintaining confidence in Member States' currencies.[104] To accomplish this, 102a mandates that members "take account of the experience acquired in cooperation within the framework of the EMS and in developing the ECU."[105] Thus, while stopping short of a formal endorsement of EMU, the reference to the ECU at least provides formal, legal recognition of the European Monetary System.

Perhaps more significant is the second part of 102a. This clause states that Article 236 of the EEC Treaty, which authorizes the Council to call for a conference of Member States' governments,[106] shall be applied should further developments in the field of monetary policy necessitate any institutional changes.[107] This clause is considered the "enabling clause" of 102a and gives the EU the right, through the Council, to pursue monetary union.[108] Under the SEA, should these institutional changes be needed in order to implement EMU, unanimous consent of the Council, Member States and their central banks is required.[109]

V. European Monetary Union under Maastricht

The mandate of monetary union within the EU, as well as its timetable and the requirements for admission, can be found in the Treaty of Maastricht, which went into effect in 1992.[110]

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102. *See id.* Article 102a states that in order to ensure the convergence of economic and monetary policies, which is necessary for the further development of the Community, Member States are to cooperate in accordance with the objectives of Article 104. *Id.* In doing so, they are to take account of the experience acquired in cooperation within the framework of the European Monetary System and in developing the ECU and are to respect existing powers in this field. *Id.*

103. *Id.*

104. *See* EEC Treaty, *supra* note 5, art. 104. Article 4 states that "each Member State must pursue the economic policy needed to ensure the equilibrium of its overall balance of payments and to maintain confidence in its currency, while taking care to ensure a high level of employment and stable level of prices." *Id.*

105. *Id.* art. 102a(1).

106. *See id.* art. 236 (mandating that if the Council delivers an opinion in favor of calling a conference of representatives of the Governments of Member States, the conference shall be convened by the president of the Council for the purpose of determining by the amendments to be made to the EEC Treaty).

107. *Id.*, art. 102a(2).

108. *See* Schulman, *supra* note 76, at 396 (interpreting Article 102a(2) as the "enabling clause," giving the EU the unambiguous right to establish monetary union).

109. *See id.* at 397 (noting that under the SEA, the unanimous consent of the European Council member states and their central banks is required for any institutional changes regarding either EMS or EMU).

110. Treaty on European Union and Final Act, Feb. 7, 1992, 31 I.L.M. 247 [hereinafter Maastricht Treaty].

A. The Three Stage Process

Under the Treaty of Maastricht, a three phase timetable was formally endorsed which will lead to the establishment of a single currency.[111] Article 104(j)(4) of the Maastricht Treaty contemplates that phase one should last not less than 6 months[112] and the Commission estimates that phase one would not exceed 12 months.[113] The most probable starting date for phase two is January 1, 1999.[114] Thus, phase one should begin between January 1, 1998 and June 30, 1998.

During phase one, the Council will take the necessary steps to establish the European Central Bank (ECB) and the instruments necessary for conducting exchange-rate and monetary policy.[115] Also during this phase, the Council will confirm which Member States will be allowed to take part in EMU.[116] This decision will be based upon the degree to which they have successfully met the four convergence criteria.[117]

During phase two, the Council will fix the conversion rates of participating countries.[118] The ECU will then cease to be merely a basket currency[119]and will become a currency in its own right, with a conversion ratio of one-to-one with the former basket currency.[120] Crucial to the success of EMU in phase two is the creation of a "critical mass" of activities within the new currency.[121]

In order to establish the new currency's credibility within the financial markets by showing that the EMU process is irreversible, central banks, governments, banking and financial institutions will have to begin using the new currency to conduct key activities.[122] These activities include setting monetary and exchange

111. *See* Opinion of the Economic and Social Committee on the Practical Arrangements for the Introduction of the Single Currency, Jan. 22, 1996, at 54 [hereinafter Economic and Social Committee] (listing three phases: phase one, launch of economic and monetary union; phase two, effective start of EMU; and phase three, final changeover to the Single Currency).

112. *See* Maastricht Treaty, *supra* note 110, art. 109(j)(4).

113. *See* Economic and Social Committee, *supra* note 111, at 55. According to the Commission, phase one will last 12 months at the most, whereas Article 109(j)(4) of the Maastricht Treaty provides for a period of not less than 6 months; if phase two were to start on January 1, 1999, phase one would start sometime between January 1, 1998 and June 30, 1998. *Id.*

114. *See id.* at 55 (noting that the most probable starting date for phase two is January 1, 1999).

115. *See id.* (describing the measures to be taken during phase one).

116. *See id.* (explaining that the list of participating countries will be confirmed phase one).

117. *See infra* notes 130-32 and accompanying text (discussing the four convergence criteria of the Maastricht Treaty).

118. *See* Economic and Social Committee, *supra* note 111, at 56 (describing the measures to be taken during phase two).

119. *See id.* at 57 (explaining the activities to be undertaken during phase two).

120. *See id.* (detailing the process by which former national currencies are to be converted to the new currency during phase two).

121. *See id.* (describing widespread usage of the new currency in the non-retail markets as creating a "critical mass").

122. *See id.* (noting that the reasons for creating the critical mass are purely monetary in that it would reinforce the perceived credibility and irreversibility of the single currency).

rate policies, inter-bank transactions, capital and exchange transactions, incurring new government debt, and transactions within the wholesale payment systems.[123] Banking services will be expressed in both the new and national currencies, while consumers will continue to use their national currencies at the retail level.[124] Through this interface of currencies, it is expected that the new currency can be "created" with minimal disruption of national currency mechanisms.[125] Phase two is expected to last no longer than three years.[126]

Finally, during phase three, all national currencies will be converted into the single currency.[127] The new currency will then become the sole legal tender within the EMU zone.[128] Phase three is expected to last only as long as it takes to change the national banknotes into the single currency and to convert such everyday items as cash registers, ATM's and vending machines to the new currency.[129]

B. The Four Convergence Criteria

The four convergence criteria are found in Article 109(j) of the Maastricht Treaty and are as follows:[130]

> 1. Member States must achieve an inflation rate not more than 1.5% higher than that of the three countries with the lowest inflation.
> 2. Interest rates must be no more than 2% higher than the three countries with the lowest inflation.
> 3. Government debt must be no more than sixty and the current budget deficit less than 3% of GDP.
> 4. Member States must maintain their exchange rates within a narrow margin for at least two years before monetary union. This margin, known as the "currency band," was set at 2.25%.[131] This meant that, under the Exchange Rate Mechanism (ERM), EU currencies were not to fluctuate

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123. *Id.*

124. *See* Economic and Social Committee, *supra* note 111, at 58 (explaining how the new currency is to co-exist with existing national currencies during phase two).

125. *See id.* (alluding to the reason for the gradual phasing in of the new currency).

126. *See id.* (noting the time frame of phase two).

127. *See id.* (detailing the activities to be carried out during phase two).

128. *Id.*

129. *See id.* at 59 (explaining the duration of phase three).

130. *See* Maastricht Treaty, *supra* note 110, art. 109(j); *see also* Dr. Dieter Kugelmann, *The Maastricht Treaty and the Design of a European Federal State*, 8 TEMP. INT'L & COMP. L.J. 335, 340 (1994) (listing the convergence criteria as follows: 1) the achievement of a high degree of price stability apparent from an inflation rate not more than 1.5% higher than that of the three countries with the lowest inflation; 2) interest rates no more than 2% higher than that in the three countries with the lowest inflation; 3) government debt no more than 60% of GDP and budget deficit less than 3% of GDP; and 4) maintaining of the exchange rate within a narrow margin for at least two years before the monetary union).

131. *See* Currie, *supra* note 5 (listing the key features of EMS including its main feature, the ERM's currency band of plus or minus 2.25% of the central ECU rate).

more than 4.5%—plus or minus 2.25%—against the European Currency Unit.[132]

The recent collapse of the ERM has called into question the willingness of Maastricht Treaty signatories to comply with their obligations at the expense of national economic objectives.

C. Collapse of the Exchange Rate Mechanism (ERM)

Beginning in September, 1992, the European Monetary System began to experience a crisis which called into question the very future of the EU.[133] The German government had relied heavily on deficit spending in order to finance its reunification with the former East Germany.[134] By June of 1992, German domestic deficit spending exceeded 7% of GDP[135] which, in turn, ignited higher than usual inflation within Germany's economy.[136]

In response to this rising inflation, Germany's central bank, the Bundesbank, raised its prime lending rate to the highest level since 1981.[137] This, in turn, bolstered the strength of the German deutchmark relative to Germany's EU partners' currencies. Other EU countries, including France and Great Britain, were forced to either allow their currencies to devalue against the German mark or raise interest rates in order to protect their values.[138]

At the time, Britain was deeply mired in a recession, and desperately needed an interest rate cut in order to stimulate growth.[139] However, British Prime Minister, John Major, believed that devaluing the pound against the mark would be seen as a failure of his administration's pro-European, anti-inflationary economic

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132. *Id.*

133. *See* Craig R. Whitney, *Blaming the Bundesbank*, N.Y. TIMES, Oct. 17, 1993, at 48 (describing the EMS crisis and the subsequent attempts of the European Monetary Committee to rectify it as a last-ditch attempt at salvaging the "European Dream").

134. *See* Christopher Young, *The Ramifications of the Exchange Rate Collapse in Europe: Implications for Monetary Union*, 13 B.U. INT'L L.J. 263, 275 (1995) (explaining that Germany incurred substantial government deficits in financing its reunification).

135. *See* Whitney, *supra* note 133, at 48.

136. *See* Currie, *supra* note 5 (pointing out that Germany, having to contend with rising inflationary pressures after unification, was out of sinc with Europe's other economies). Other countries, including the UK and France, were in the middle of recessions and rising unemployment. *Id.*

137. *See* Whitney, *supra* note 133, at 44 (stating that a united Germany meant not only both large government outlays and private borrowing, but by the summer of 1992, higher inflation than usual); *see also* Currie, *supra* note 5. As the Bundesbank drove up interest rates to contain German inflation, other European central banks were forced to raise their interest rates to maintain their EMS parities, even though this worsened recessions at home. *Id.* Foreign exchange markets asked how long the French, Italian, Spanish and UK governments would be able to sustain these high interest rates, unpopular with the electorate. *Id.*

138. Currie, *supra* note 5.

139. *See* Whitney, *supra* note 133, at 44 (noting that Britain, having been in a recession since 1989, needed lower interest rates).

policies.[140] Thus, he chose to maintain high interest rates in order protect the British pound.[141] France followed suit, and the French Central Bank actually raised its interest rates from 7.75% to a full 10% overnight,[142] although they too were struggling with a recession and rising unemployment.[143] This exacerbated both countries' recessions by making it more expensive to borrow money.[144] Currency speculators soon began to wonder how long political pressures would allow Britain and France to maintain such interest rates.[145]

On September 16, 1992, dubbed "Black Wednesday," the speculators were given their answer when Britain was compelled to withdraw from the ERM altogether.[146] Soon after, currency speculators began to sell billions of French francs for German deutchmarks.[147] Central banks were unable to coordinate a defense to the run on the franc in order to maintain EMS parity.[148] By July 30, 1993, "Black Friday," it became obvious that emergency actions were necessary.[149] On August 2, after a weekend-long emergency meeting, the European Monetary Committee announced that the EMS currency band would be widened from 2.25% to a full 15%.[150] It is widely believed that allowing EU currencies to fluctuate against each other by up to 30%—15% on either side of their ECU rates—left the EMS alive in name only.[151]

It is ironic that the same feature of the Bundesbank which made the German mark the "anchor" currency of the EMS, its obsessive commitment to low in-

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140. *See id.* (arguing that the prestige that came from maintaining their own currency against the mark seemed to matter more to the politicians than whether or not higher interest rates were good for their countries' economics).

141. *See id.* (discussing political pressures behind John Major's decision to maintain high interest rates in the middle of a recession).

142. *See id.* (examining the actions taken by the French Central Bank in order to protect the value of the franc).

143. *See* Currie, *supra* note 5 (pointing out that France, Italy and the UK were struggling with recessions and rising unemployment rates and that raising interest rates to maintain EMS parities exacerbated their economic downturn).

144. *See* Whitney, *supra* note 133, at 44 (explaining how the high interest rates needed to bring about EMS parity affected European economies). High interest rates made it more expensive for people and companies to borrow, which discouraged spending by consumers and investment by the companies that supply them. *Id.*

145. *See* Currie, *supra* note 5 (noting that Britain and France were not similarly situated to Germany, and thus, could not easily maintain such high interest rates).

146. *See* Young, *supra* note 134, at 276 (characterizing September 16, 1992 as "Black Wednesday" and the first "crack" in the system).

147. *See* Whitney, *supra* note 133, at 44 (describing the events behind the run on the franc).

148. *See* Young, *supra* note 134, at 277 (describing July 30, 1993 as "Black Friday" and the second crack in the system); *see also* Whitney, *supra* note 133, at 48. By July 29, Germany had realized a $37 billion increase in its money supply due to the sheer volume of francs and other currencies exchanged for deutchmarks. *Id.*

149. *See* Whitney, *supra* note 133, at 44 (chronicling the events leading up to the emergency meeting of the European Monetary Committee).

150. *Id.* at 59.

151. *Id.*

flation,[152] was also responsible for the collapse of the ERM. In Germany, the horrors of 1923's monthly hyperinflation of almost 30,000%[153] and the resulting economic collapse, which gave rise to the Nazis and World War II, are still taught to every schoolchild.[154] The Bundesbank, by raising interest rates, thus behaved like an inflation-conscious German Central Bank, and not an independent European Central Bank like other EU members had wanted.[155]

D. *The Stability and Growth Pact*

Another of the Bundesbank's concerns was that, through monetary union, fiscally irresponsible states would be encouraged to engage in excessive borrowing to the detriment of the EU.[156] Presently, should a Member State want to borrow money, it is limited by the size of its capital market.[157] If the Member State wants to borrow more than its domestic market can supply, it must borrow in a foreign currency, which would expose it to exchange-rate risks.[158] These risks would presumably serve as a disincentive to excess government borrowing.

Under EMU, Member States' governments would no longer be limited to their own domestic capital markets, but rather would have access to the entire EMU zone.[159] Thus, Member States would be able to borrow far more without incurring any currency risks. By increasing demand for the new currency, prolifigate borrowers, it was argued, would drive up real interest rates within the EU.[160] Fellow Member States, through higher interest rates, would thus end up subsidizing this excess borrowing.[161] Even worse, should those prolifigate borrowers become insol-

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152. *See id.* at 44 (noting that with the Bundesbanks doing the best job of any European central bank in keeping inflation low, the German mark naturally became the anchor of the European Monetary System when it was set up in 1979).

153. *See* Currie, *supra* note 5 (commenting that even during extreme circumstances, such as when the 1922-23 monthly rate of inflation in Germany reached nearly 30,000%, people continued to use their currency).

154. *See* Whitney, *supra* note 133, at 44 (explaining why the Bundesbank is committed to low inflation).

155. *See id.* at 48 (noting that the British wanted the Bundesbank not only to have the power and prestige of a European central bank, but also behave like one by relaxing monetary policy because it would benefit other countries even if that wasn't the right policy for Germany); *see also* Currie, *supra* note 5 (pointing out that in order to preserve a hard EMS the Bundesbank needed to behave more like a central bank of Europe and less like a central bank of Germany).

156. *EMU and What Alice Found There*, THE ECONOMIST, Dec. 14, 1996, at 24.

157. *See id.* (explaining the rationale for the Bundesbank's fear of excessive government borrowing).

158. *Id.*

159. *Id.*

160. *Id.*; *see also* Currie, *supra* note 5 (arguing that with a single currency governments can borrow partly at other governments' expense, because their extra demands on the capital market force the interest rate to increase across Europe, rather than merely increasing their own interest rate).

161. *See EMU and What Alice Found There*, *supra* note 156, at 24.

vent, fellow Member States might feel compelled to provide direct subsidies to keep them afloat.[162]

Motivated by this fear, Germany's finance minister, Theo Waigel, proposed the Stability and Growth Pact at the Dublin Summit in 1996.[163] Although initially opposed by several participants, the summit members eventually agreed to the essentials of the German proposal.[164] Interestingly, although Article 109(j) of the Maastricht Treaty does not require that Member States adhere to the 3% of GDP deficit ceiling indefinitely,[165] under the Pact, fines of 0.2% of GDP are to be levied upon Member States whose budget deficits exceed 3% of GDP.[166] An additional fine of 0.1% of GDP is levied for every additional one percent breach of the ceiling, with a maximum fine of 0.5% of GDP.[167]

In the event of a breach of the three percent ceiling, the European Commission is to report the discrepancy to the Council of Ministers, which will decide by a qualified majority whether exceptional circumstances exist which justify the deficit.[168] Exceptions are to be automatic in the event of a natural disaster or if the Member State's GDP falls 2% or more within a year.[169] If the Member State's GDP falls between 0.75% and 2% within one year, the Council has the discretion of whether or not to levy fines.[170] The Stability and Growth Pact thus provides some limitations upon individual Member States' Fiscal policies.

VI. LONG-TERM MACROECONOMIC IMPLICATIONS OF EMU

Despite some clear advantages, the implementation of a single EU currency has profound ramifications for Maastricht Treaty signatories' ability to control inflation, manage the economic cycle and borrow money.

162. *See* Currie, *supra* note 5 (noting that should a government participating in EMU get into a debt trap there could be pressure on other member governments to provide subsidies to help service the debt or take over responsibility for the debt itself).

163. *See* Currie, *supra* note 5 (chronicling the development of the Stability and Growth Pact).

164. *Id.*

165. *See EMU and What Alice Found There*, *supra* note 156, at 23 (claiming that it was never envisaged that EMU members would be under a strict obligation to keep their deficits always below 3% of GDP, or that violators would face semi-automatic fines).

166. *See* Currie, *supra* note 5 (discussing the terms of the Stability and Growth Pact).

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

A. Clear Advantages

One of the most obvious advantages is the expected realization of lower transaction costs within the EU.[171] With fifteen separate currencies,[172] cross-border business requires conversion transactions, which cost both time and money.[173] In fact, it is estimated that if a European citizen changed 1,000 deutchmarks into each Member State's currency in succession, he would have only 500 left by the time he converted back to the deutchmark.[174] By no longer having to convert national currencies for EU-wide transactions, the EU's economy is expected to realize savings of between 0.3-0.4% of GDP, or approximately 20-25 billion ECU's.[175]

This broad forecast range is due to the uncertainty of the number of countries that will qualify to participate in EMU.[176] Naturally, the greater the number of EU countries participating in EMU, the less currency conversion will be required, and thus the greater the savings. Although this amount represents an ongoing savings, its relatively small size probably does not provide a strong reason for converting to a single currency.

Perhaps more significant, EMU is expected to completely eliminate exchange rate volatility within the EU.[177] Historically, exchange rates have been known to fluctuate erratically due to arbitrary speculation within the currency markets.[178] Eliminating this fluctuation would also eliminate the currency risks associated with cross-border financial planning and most likely encourage cross-border investment within the EU. For example: a Mercedes Benz factory in Frankfurt purchases component parts from Great Britain. Should the value of the British pound rise against the German deutchmark, Mercedes would have to pay more for those parts because it would take more German deutchmarks to purchase the parts valued in British pounds. Although EMS was supposed to alleviate this type of problem, the failure of Member States to fulfill their exchange rate obligations under Maastricht and the subsequent widening of the currency band[179] shows that EMU would present a clear advantage in this area.

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171. *See* Economic and Social Committee, *supra* note 111, at 52 (referring to the benefits of EMU to individuals and companies as "self-evident").

172. *See Europe's Mid-Life Crisis, supra* note 1, at 4.

173. *See* Economic and Social Committee, *supra* note 111, at 52 (citing the benefits of EMU).

174. *Id.*

175. *Id.*

176. *See id.* (explaining the reasons for the wide forecast margins of expected exchange transactions savings).

177. *See* Currie, *supra* note 5 (pointing out that a single EU currency means the elimination of all exchange rate volatility within the EU).

178. *Id.*

179. *See supra* notes 133-55 (discussing the collapse of the Exchange Rate Mechanism).

B. Controlling Inflation

In 1999, the European Monetary Institute (EMI), consisting of governors from former national banks, will assume its role as the European Central Bank (ECB).[180] The ECB will then begin exercising authority over European monetary policy, eventually controlling both interest rates and the money supply.[181] This, of course, means that individual EU nations will no longer be able to control their money supply or set their own interest rates. One of the advantages of relinquishing control of monetary policy to the ECB is that it could ensure long-term, low inflation rates for the EU as a whole.[182] As premiums for high inflation are removed from long-term interest rates,[183] interest rates throughout the EU would likely fall. This, in turn, would bolster the EU's competitiveness by making it cheaper to borrow money for new plants and equipment.

While these advantages may accrue to countries with high inflation, Germany, which has maintained low inflation rates for decades, would probably not realize the same benefits.[184] Moreover, Austria, France and the Netherlands have attached their currencies to the German deutchmark.[185] In doing so, they have adopted Germany's inflation-conscious Bundesbank as their de-facto central bank, and would also probably not realize lower inflation.[186]

Because the ECB is composed of governors of former national banks, one concern is that, as the EU expands eastward, it may lose its commitment to low-inflation monetary policies.[187] Presently, the EU's newest potential members—Estonia, Poland, the Czech Republic, Hungary, Slovenia and Cyprus—maintain per capita GDP's of only 11%, 14%, 20%, 19%, 42% and 71%, respectively, of the EU average.[188] Thus, it is reasonable to speculate that ECB governors from these new, poorer members may favor a more liberal monetary policy designed to promote

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180. *See* Kugelmann, *supra* note 130, at 341 (reporting that, together with the national central banks, the ECB will form the European System of Central Banks, and have the exclusive right to authorize the issue of banknotes within the EU); *see also* Currie, *supra* note 5 (explaining that National central banks will become branch offices of the ECB, which will set a common monetary policy across the EMU).

181. *See* Kugelmann, *supra* note 130, at 342.

182. *See* Currie, *supra* note 5 (noting that an important advantage of EMU is that the ECB could assure durably low inflation for the EMU area as a whole).

183. *See id.* (pointing out that low inflation would imply low interest rates, both short-term and long-term, as premiums for inflation would be eliminated from interest rates).

184. *See id.* (speculating that the ECB's performance may not be as good as the Bundesbank's and could scarcely offer more for Germany than the status quo).

185. *Id.*

186. *See id.* (noting that Austria, France and the Netherlands probably would not realize lower inflation through EMU).

187. *See id.* (noting that there is a concern that, as membership widens, governors of central banks from more inflation-prone countries could take a less robust line on limiting inflation).

188. *See* Strasbourg, *A Budget for Reform*, *supra* note 2, at 43 (listing per capita GDP as percentage of EU average for Estonia, Poland, the Czech Republic, Hungary, Slovenia and Cyprus).

economic growth, rather than a restrictive monetary policy designed to curb inflation.

On the other hand, as a new financial institution, the ECB will need to prove its commitment to low inflation to the financial markets in order to establish its credibility.[189] Should the ECB choose to do this by maintaining high interest rates, it could exacerbate the EU's already high unemployment.[190] In 1997, unemployment within the EU stood at an average of 10.6%,[191] compared to the U.S. rate of only 4.9%.[192]

Specifically, in February of 1997, it was reported that unemployment in Germany had climbed to 4.7 million, or 12% of the workforce.[193] That same year, French unemployment stood at 12.6% and, in Spain, it reached a horrific 19.9%.[194] Interestingly, since 1991, unemployment in Britain has fallen to just 5.3%.[195] This underscores another challenge to the ECB: how to apply a one-size-fits-all monetary policy to individual nations whose economic cycles do not always coincide.

C. Managing the Economic Cycle

One of the inevitable consequences of relinquishing control of monetary policies to the ECB will be that individual nations will forfeit their ability to use monetary policy in order to deal with an economic downturn.[196] Instead, monetary policy will be controlled by the average circumstances existing within the EU.[197] While this may be appropriate for aggregate European economic downturns (those which affect all EU members), the effectiveness of such a monetary policy for asymmetric economic downturns (those that only affect certain economies within the EU) is questionable.[198]

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189. *See* Currie, *supra* note 5 (speculating that, unlike the Bundesbank, the ECB would have a reputation to establish and that a period of somewhat higher interest rates may be needed to demonstrate its anti-inflation resolve).

190. *European Employment, Fiddling*, THE ECONOMIST, Oct. 4, 1997, at 54 (noting that approximately 18 million EU citizens are jobless and that the EU has an average unemployment rate of 10.6%).

191. *Id.*

192. *Growth & Jobs, The Clouds Clear over Europe*, THE ECONOMIST, Sept. 27, 1997, at 86.

193. *Sweating for that euro*, THE ECONOMIST, Feb. 15, 1997, at 45.

194. *See European Employment*, *supra* note 190, at 54 (reporting that the latest unemployment rates for France and Spain were 12.6% and 19.9%, respectively).

195. *See Growth & Jobs, The Clouds Clear over Europe*, *supra* note 192, at 86 (stating that, since the early 1990's, unemployment in Britain has fallen from 10.5% to just 5.3%).

196. *See* Currie, *supra* note 5 (observing that, inside EMU, monetary policy could not respond to particular circumstances of a particular national economy and that, instead, monetary policy will be set to reflect average circumstances across the Union).

197. *Id.*

198. *See id.* (explaining that economic cycles within the EU do not always coincide). Evidence on the cycles across the European economies shows both a common element due to aggregate shocks and national elements due to so-called asymmetric shocks. *Id.* An example of an aggregate shock would be a fall in global demand, which would effect every European exporter in broadly the same way. *Id.* An example of an asymmetric shock would be an increase in the price of oil: The UK, as a net oil exporter would gain, while other European countries, who are

Moreover, the structures of individual EU financial systems vary dramatically,[199] and a single ECB policy will most likely affect those individual economies much differently. For instance, households in the United Kingdom tend to borrow more heavily and at a variable rate of interest than their German counterparts who borrow less and whose debt is usually at a fixed interest rate.[200] For this reason, an increase in the ECB's interest rate would have a disproportionately negative impact on demand within the UK.[201] Similarly, a cut in interest rates would have a disproportionately positive impact on UK demand.[202] Thus, using the ECB's prime lending rate as a tool for slowing or accelerating economic growth would tend to increase the volatility of the business cycles within the UK relative to those in Germany.

Deprived of their ability to use monetary policy under EMU, individual Member States would have to rely more heavily upon fiscal policy to correct an asymmetrical downturn.[203] Recall that the Stability and Growth Pact would impose significant fines on Member States whose deficits exceed the Maastricht three percent of GDP ceiling.[204] Although intended to prevent irresponsible fiscal policies among Member States,[205] this constraint can also serve to limit the ability of governments to use fiscal policies to correct economic downturns.[206]

For instance, during an asymmetric downturn, a Member State would inevitably experience a decline in tax revenues as higher unemployment rates would translate into fewer people paying taxes. Also, the Member State would be obligated to pay more money in unemployment benefits for those who lost their jobs. Intuitively, this combination would mean the government would have more financial obligations and less money with which to meet them.

If the Member State were operating at a deficit below the three percent ceiling during the downturn, its government would have to either raise taxes or cut spending in order to prevent its deficit from exceeding the ceiling.[207] Either way, it

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net importers of oil, would lose. *Id.*

199. *See id.* (explaining the difference between EU financial systems by pointing out the differences in both the levels and types of debts maintained by households in the UK and Germany).

200. *Id.*

201. *Id.*

202. *Id.*

203. *See EMU and What Alice Found There, supra* note 156, at 24 (noting that it seemed dangerous to tie governments' hands through the Stability and Growth Pact when fiscal policy would have to carry more of the burden of cushioning recessions).

204. *See* Currie, *supra* note 5 (explaining the terms of the Stability and Growth Pact).

205. *See supra* notes 156-70 and accompanying text (noting the concerns of the Bundesbank which led to the establishment of the Stability and Growth Pact).

206. *See infra* notes 207-11 and accompanying text (explaining the constraints that the Stability and Growth Pact place upon Member States' ability to use fiscal policies in order to correct economic downturns).

207. *See EMU and What Alice Found There, supra* note 156, at 23 (noting that fiscal adjustments would be needed during a recession in order to prevent the Member State's deficit from exceeding the 3% of GDP ceiling). Recent history has shown that the scale of these adjustments would be quite large. *Id.* For instance, when Britain went from an economic boom into a recession in the late 1980's, the public sector balance deteriorated from a

would work to deepen the economic downturn.[208] This would result in even less tax revenue and more unemployment obligations which would, in turn, make it even more difficult for the government to keep its deficit under the ceiling.

The Maastricht Treaty generally contemplates that powers over fiscal policy will remain at the national level.[209] Member States' powers to levy taxes on their citizens thus remain discretionary.[210] Should a Member State be required to pay the Stability and Growth Pact fine, which could be as high as 0.5% of GDP,[211] the EU would be powerless to require that state to raise sufficient taxes to finance its payment. Also, it is doubtful, for obvious political reasons, that any Member State would fail to meet its domestic financial obligations during a recession. Therefore, paradoxically, requiring payment of the fine, without the ability to require the Member State to raise sufficient taxes to finance its payment, could actually encourage deficit spending. For this reason, the ability of the Stability and Growth Pact to limit government borrowing during a recession seems at best tenuous.

D. Impact on Government Borrowing

One of the most significant aspects of EMU will likely be the impact that it has on government borrowing by Member States.[212] As discussed earlier, Bundesbank officials fear that EMU will make it easier for profligate governments to engage in excessive borrowing to the detriment of the Union.[213] In essence, concern may be warranted when governments are maintaining either a high but sustainable debt or a debt which is wholly unsustainable.[214]

If the Member State's debt is sustainable, meaning that the government is able to service the debt indefinitely,[215] the concern is that the increased demand in the

surplus of 3% to a deficit of 7%. *Id.*

208. *See id.* (explaining that the Stability and Growth Pact would require Member States to maintain budget surpluses during "normal" times in order to leave room for government borrowing during recessions). Without such surpluses, the Stability and Growth Pact would end up being more of a "deepen-your-recession" pact. *Id.*

209. *See* Currie, *supra* note 5 (noting that, in principal, monetary union does not necessarily place constraints on independent national fiscal policy and that governments remain free to borrow as they choose).

210. *See id.* (pointing out that a positive aspect of EMU is that governments will lose the capacity to use or abuse monetary policy, but will otherwise retain powers over tax and spending decisions).

211. *See* Currie, *supra* note 5 (explaining that the maximum fine imposed by the Stability and Growth Pact is 0.5% of Gross Domestic Product).

212. *See infra* notes 213-36 and accompanying text (discussing the impact of EMU upon Member States' ability to borrow).

213. *See supra* notes 156-59 and accompanying text (detailing the motivation behind proposal of the Stability and Growth Pact).

214. *See* Currie, *supra* note 5 (separating potential government debt problems within the EMU into two distinct types: unsustainable debt and high, but sustainable debt).

215. *See id.* (defining high, but sustainable debts).

capital markets could push up interest rates throughout the EMU zone.[216] Governments, it was argued, would be encouraged to borrow more since the cost of their excess borrowing, the increase in interest rates, would no longer be carried by them alone, but rather by all their fellow EMU members.[217]

An unsustainable debt would result when a government continually engages in excessive borrowing such that continuing the practice would lead to that government's insolvency.[218] The concern here was that, should a Member State become unable to service its debt, other Member States could come under pressure to provide subsidies to that state.[219] It was these concerns which lead to the Stability and Growth Pact and the Maastricht fiscal convergence criteria.[220] Informal constraints on excessive government borrowing can be found in the ECB's role in the open market.[221]

Under Article 107 of the Maastricht Treaty, the ECB is to operate independently of both the EU and Member States' governments.[222] This means that it will be able to choose which national debts it wishes to finance.[223] Theoretically, it could choose to hold the debts of those countries with sound fiscal policies and sell the debts of those with imprudent policies.[224] As such, it could provide an incentive to Member States to adopt responsible fiscal measures.

Moreover, within EMU, different Member States' governments will be required to pay different rates of interest on their debts based on their credit ratings.[225] States

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216. *See id.* (noting the concerns surrounding Member States' maintenance of high, but sustainable debts). If the debt is merely high, rather than unsustainable, there should be no need to provide subsidies to the Member State maintaining it. *Id.* Instead, the concern is that if some governments are able to borrow too heavily, it will push up the general cost of borrowing throughout the EMU zone to the detriment of all. *Id.*

217. *See id.* (explaining the argument that with a single currency, governments can borrow partly at other governments' expense, because their extra demands on the capital market would force up interest rates throughout the EU). This theory has been called "financial externality." *Id.*

218. *See id.* (defining unsustainable debts). An example of an unsustainable debt is that held by Greece. *Id.* Debt levels in that country have risen steadily over the past 15 years such that deficit spending will eventually have to come to a radical end. *Id.*

219. *See id.* (explaining the concerns surrounding unsustainable debts).

220. *See* Currie, *supra* note 5 (claiming that these concerns led to formulation of the Maastricht fiscal convergence criteria).

221. *See infra* notes 223-25 and accompanying text (discussing the ECB's role in the open market).

222. *See* Maastricht Treaty, *supra* note 110, art. 107 (establishing the independence of the ECB). "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." *Id.*

223. *See* Currie, *supra* note 5 (explaining that ECB will face a choice as to which national debt it should buy or sell and suggesting that the most prudent policy would be holding only the debt of countries with "conservative" fiscal policies). The ECB could also opt for the mechanical rule of buying and selling the debt of the national governments in fixed proportions, based upon their economies' relative size within the EU. *Id.*

224. *Id.*

225. *See id.* (noting that, under EMU, different governments would be required to pay different rates of interest on their debt, depending on their credit rating). On top of the risk-free rate, high-debt governments are likely to face a risk premium reflecting the greater risk of holding their debt. *Id.* If that government is maintaining a fiscal

with higher relative levels of debt would naturally represent a greater credit risk.[226] These states would thus be forced to pay a higher rate of interest, reflecting the greater risk involved in holding their debt.[227]

This risk premium would not, however, apply to private debt held by private companies operating within that state.[228] Private companies within that state would instead have their own credit rating independent of their government's.[229] Thus, under EMU, it would be possible for a private company to actually be a safer credit risk than it's government.[230]

Historically, many European countries have chosen to finance their debt burdens by inflating their economies.[231] By issuing additional cash during times of rising prices, a government can reduce the relative size of its debt payments by inflating the amount it receives in revenues.[232] This so-called revenue, called "seigniorage," was later renamed the "inflation tax" and has been criticized as a form of taxation without representation.[233]

However, under EMU, the ECB and not national banks will be responsible for controlling inflation throughout the EU.[234] Member States will thus not be able to intentionally inflate their economies. Instead, they will be forced to finance their government borrowing through explicit taxes and not the hidden inflation tax.[235] This should, in turn, encourage sound domestic fiscal policies and public finance.[236]

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policy that allows debt to spiral upward, it would again be punished with higher risk premiums. *Id.* Currently, this process operates in the U.S., where different state governments pay different interest rates on their debt depending upon their creditworthiness. *Id.*

226. *Id.*

227. *Id.*

228. *See id.* (pointing out that, with a single currency, it would be easier for credit-worthy private borrowers to be distinguished from their profligate governments). Under EMU, private borrowers would no longer be "tarred" by their national currency. *Id.* Consequently, they could be given a higher credit rating than their government, which is currently not possible. *Id.*

229. Currie, *supra* note 5.

230. *Id.*

231. *See id.* (stating that, in periods of rising prices, when more money is needed to transact business, issuing additional cash brings appreciable revenues to the state). These additional revenues were historically called "seigniorage." *Id.*

232. *Id.* (explaining the functional aspects of seigniorage through historical example). Seigniorage has been the most important source of revenue during times of war as inflationary finance has been used during wartime to meet the unexpected spending on the military. *Id.* For instance, during the American Civil War, the Southern States' taxing ability was weak. *Id.* Thus, they simply decided to print the money they needed to finance the war effort. *Id.* Logically, inflation increased several hundred percent until Northern troops captured the Southern printing press. *Id.*

233. *Id.* (noting that Milton Friedman, founder of modern monetarism, argued against this form of "taxation without representation").

234. *See supra* notes 180-95 and accompanying text (discussing the ECB's role in controlling inflation).

235. *See* Currie, *supra* note 5 (concluding that under EMU, governments will no longer be able to reduce their debt burdens by letting inflation rise). In the end, governments will have to finance their borrowing through explicit taxes and not the "hidden tax" of inflation. *Id.* This, in turn, should encourage sound public finance. *Id.*

236. *Id.*

VII. CONCLUSION

As the deadline for European Monetary Union draws near, many questions remain concerning EMU's macroeconomic implications. The ability of the ECB to effectively handle inflation remains to be seen.[237] Moreover, application of a single ECB monetary policy to individual economies, whose business cycles do not always coincide, calls into question the ability of the European Central Bank to set effective monetary policy for all EU members.[238] Finally, it is uncertain whether the Stability and Growth Pact fines will be sufficient to deter profligate borrowing by individual Member States, who will ultimately remain in control of their own fiscal policies.[239]

Historically, imposition of a foreign currency upon a nation has been used to suppress it's sovereignty.[240] For instance, during the American Civil War, the circulation of the Northern currency within the Southern Confederation served as an important symbol of the supremacy of the North.[241] Today, use of a foreign currency for domestic transactions, such as use of the U.S. dollar within Russia or Mexico, is widely seen as a sign of economic weakness.[242] For these reasons, it is not difficult to see how surrendering one's currency, long an important symbol of national sovereignty,[243] can reawaken dormant nationalistic tendencies. Thus, it is not surprising that many EU citizens simply do not favor monetary union.[244]

For them, EMU most likely represents an undesirable and completely irrevocable step towards the creation of a federal Europe, in which their nation is subordinate to the federation.[245] The Treaty of Maastricht contains no provisions allowing Member States to reclaim former national powers surrendered to the

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237. *See supra* notes 180-95 and accompanying text (discussing the ECB's role in controlling inflation).

238. *See supra* notes 196-211 and accompanying text (analyzing the impact of EMU on Member States' ability to manage the economic cycle).

239. *See supra* notes 212-36 and accompanying text (summarizing the impact of EMU on government borrowing).

240. *See* Currie, *supra* note 5 (noting that imposition of a currency upon a country has often been an important part of suppressing its nationhood). One of the earliest acts of the new countries that evolved from the collapse of the Soviet Union was the design of their own currencies. *Id.* Likewise, resolution of the American Civil War was coupled with the imposition of the Northern currency upon the Confederacy. *Id.* This was a powerful symbol of the supremacy of the North. *Id.*

241. *Id.*

242. *See id.* (pointing out that, during precarious economic times, a strong foreign currency will often circulate alongside the national currency).

243. *See id.* (noting that, over the centuries, nations' currencies bore the heads of their kings, queens or presidents and, as such, became one of the most potent symbols of their nationhood).

244. *See Europe's Mid-Life Crisis, supra* note 1, at 16 (claiming that disillusionment within the EU is reflected in opinion polls and referendums, and graphically illustrating by country the net percentage of those in favor of a single currency).

245. *See* Currie, *supra* note 5 (identifying the argument that, if monetary and political union are the same, then EMU must bring a federal Europe in which nation states are subordinate).

European Institutions.[246] Theoretically, Member States could violate their Treaty obligations and withdraw from EMU once implemented. However, depending on the degree of their integration with the Union, the political, economic and social costs of withdrawal could prove to be an insurmountable obstacle.[247] In sum, under EMU, Maastrict Treaty signatories will trade some measure of sovereignty for the possibility of greater economic integration with the European Union. Whether this trade will be a good one remains to be seen.

246. *See id.* (noting that international treaties such as the EEC Treaty and the Maastricht Treaty generally do not allow for the reacquisition of powers surrendered to European institutions, while acknowledging that little could be done should a member choose to withdraw from the Treaty).

247. *See id.* (claiming that what would keep European countries in the Union would be a cost/benefit analysis, involving the political, economic and social costs of withdrawal). Withdrawal would logically be more costly for each Member State the greater their degree of integration within the EMU. *Id.*