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THE TRANSITION TO EMU
IN THE MAASTRICHT TREATY

LORENZO BINI-SMAGHI

TOMMASO PADOA-SCHIOPPA

AND

FRANCESCO PAPADIA



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS
PRINCETON UNIVERSITY
PRINCETON, NEW JERSEY

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The authors of this Essay are Lorenzo Bini-Smaghi, Tommaso Padoa-Schioppa, and Francesco Papadia. Dr. Bini-Smaghi is head of the Policy Division of the European Monetary Institute and formerly led the Research Department's Exchange Rates and International Finance Division at the Banca d'Italia. Dr. Padoa-Schioppa is Deputy Director General of the Banca d'Italia and has also served as Director General of Economic and Financial Affairs at the EC Commission and as Co-Secretary of the Delors Committee. Dr. Papadia is Senior Manager in the Foreign Department of the Banca d'Italia and was a member of the Italian delegation at the Intergovernmental Conference on Economic and Monetary Union of Europe. This essay is Dr. Padoa-Schioppa's third contribution and Dr. Papadia's second contribution to the publications of the International Finance Section.

PETER B. KENEN, *Director*
International Finance Section

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THE TRANSITION TO EMU IN THE MAASTRICHT TREATY

1 Introduction

The European Monetary System (EMS) and European Economic and Monetary Union (EMU) stand with Bretton Woods as the three most important attempts during the last fifty years to organize monetary relations among groups of economically interdependent countries. The original plans for the EMS and EMU call for the two to be closely interrelated, with EMU meant to replace the EMS. Recent events have shown that they are indeed interconnected, although not as originally envisaged; the EMS had virtually ceased to function as a binding exchange-rate regime by the time the EMU treaty came legally into force in 1993. The uncertainty of the political debate over the ratification of the treaty was an important cause of the prolonged crisis of the Exchange Rate Mechanism (ERM).

For the authors of this essay, who had always warned against the intrinsic fragility of the EMS and had advocated EMU as the remedy, it is not surprising that the supposedly utopian design, EMU, is legally in place, while the down-to-earth mechanism, the EMS, has been severely weakened. Yet, the turn events took in 1993 was unforeseen, especially because the EMS had always been considered one of the natural components of the transition. The outturn appears to vindicate those commentators, especially the academics, who criticized the very idea of a transition and advocated an instantaneous surprise move from the existing adjustable-peg system to a common currency (Froot and Rogoff, 1991; Giovannini, 1991; Lambertini, 1992). It also explains why

An early version of this paper was presented at a conference on The Monetary Future of Europe, organized by the Centre for Economic Policy Research and Banco Pastor in La Coruña on December 11 and 12, 1992. It appeared as Chapter 3 in *The Monetary Future of Europe*, London, CEPR, 1993. We wish to thank the conference participants and, in particular, the discussants Horst Schulmann and Santiago Fernández de Lis. We benefited as well from extensive comments by Fabrizio Ghisellini, Alexander Italianer, Jacques Melitz, Mario Sarcinelli, Hans Peter Scheller, and Dominique Servais. We also thank Pietro Catte for contributing to the chronology and bibliography and John Smith for improving our English. We remain fully responsible for opinions, errors, and omissions.

some observers even viewed the 1992-93 EMS crisis as a confirmation of their criticisms (Eichengreen and Wyplosz, 1993).

An instantaneous transition was never seriously considered in policy circles, however, nor was it advanced as a proposal at the negotiating table. There are several reasons for this.

First, a treaty is required for sovereign countries to move to a single currency, and a treaty cannot be drafted secretly or by surprise in a democracy; lengthy negotiations will always be necessary, including negotiations about the transition. A negotiated and signed treaty has, in turn, to be ratified. Provisions for even an instantaneous transition would not have made much difference to the 1992-93 crisis of the EMS, which broke out during the ratification process and was aggravated by its difficulties.

A gradual transition is necessary on technical grounds as well. Implementing EMU calls for a complex preparatory phase lasting years rather than months and defying compression beyond a certain point (Padoa-Schioppa and Saccomanni, 1992). The design, printing, and distribution of approximately 11 billion banknotes to replace those circulating today will take time, as will the creation of a single payment system. The same may be said for the other components of what we call, later in this essay, “the platform of a single monetary policy.”

From a political point of view also, a gradual transition is seen to be necessary to enable as many countries as possible to participate in the final stage of the union. The twofold nature—economic and political—of the convergence requirements inscribed in the treaty is described below. Suffice here to say that jumping into the final stage regardless of the initial economic conditions was never an option.

These considerations explain why gradualism was never a policy variable but, rather, a given from the moment the European Council asked the Delors Committee to study “stages leading towards” EMU.

Once it was agreed that a transition period was necessary, three basic questions had to be answered: What decisionmaking procedures should govern the passage to the final stage? How should economic convergence be assessed? What sort of monetary institution would be needed during the transition?

The answers given by the treaty (see Appendix A) are that (1) two conditions are necessary to move to stage three of EMU before 1999: the agreement of a qualified majority and the compliance with convergence criteria by more than half of the member states; in 1999, the move will be automatic and will be made only by the convergent countries; (2) convergence is to be assessed on the basis of well-defined

quantitative criteria, stated by the treaty, with some room for judgment; and (3) during the transition, there will not be a European Central Bank (ECB) but, rather, a temporary institution, the European Monetary Institute (EMI), which has limited powers to coordinate monetary policies and is assigned the task of preparing stage three. These answers jelled in the closing days and hours of the negotiations and were a compromise between different interests and positions.¹

Our purpose in this essay is to explain how this compromise was achieved. Insofar as we analyze the process rather than the product of the negotiations, we make no explicit assessment of the solutions reached. We do indicate, however, where, and in what sense, we would have liked them to be different. One important, but often ignored, aspect of the treaty provisions stressed in our discussion is that economic analytical concepts cannot always be easily translated into the sort of legal language necessary for a complex international contract between twelve states.

Section 2 of the essay gives the general background of the EMU negotiations. Section 3 shows how the questions of procedure, convergence, and transitional institutions emerged as the key issues and indicates the underlying problems involved in the negotiations. Sections 4, 5, and 6 examine each of these issues in detail, showing how the final text of the treaty gradually took shape under the influence of very diverse forces and considerations. In general, the period from 1988 to 1991 is divided into two subperiods by the watershed of the European Council in Rome (October 1990), where the Heads of State or Government approved key points of substance and procedure and passed them on to the Intergovernmental Conference (IGC), which started immediately afterward. Section 7 concludes the discussion. Appendices at the end of the essay contain the transitional provisions of the treaty, a chronology of main events, and a list of documents issued by the Italian delegation.

Because we were directly involved in all the stages of the negotiations and often defended precise positions, our effort to provide a complete and impartial account inevitably encounters a limit in the “partial” nature of our experience, judgment, and information.

It should also be noted that we have made no systematic attempt in this essay to read the negotiations and their outcome in the light of the

¹ Most of the work done after the completion of the Delors Report was devoted to the design of the transition; few changes or additions were made to the Delors Committee’s blueprint for the final stage (Sandholz, 1993).

laborious ratification process and the parallel exchange-rate crisis that followed the signing of the treaty. The problem of understanding the relation between these two events and the way the treaty designed the transition was very much in our minds, however, while writing the essay, and it occasionally surfaces in the text.

2 The Background of the EMU Negotiations

The Main Events Leading up to the Treaty

Monetary union emerged as an issue and objective for Europe in the late 1960s with the decline of the Bretton Woods regime, which had provided the monetary order for the European Community (EC) since its start.² A unification project outlined in the Werner Report was shelved after the first oil shock in 1973-74. A new start was made, in a milder form, when the EMS was created in 1979. After a long pause in the economic integration process, the Single European Act launched the Internal Market project in 1986, and the term “Economic and Monetary Union” was inscribed for the first time in the Treaty of Rome. In June 1988, German chancellor Helmut Kohl put EMU on the agenda of the European Council in Hannover. The participating Heads of State or Government restated the objective of EMU and entrusted a committee chaired by Jacques Delors and composed of the governors of the EC central banks and three independent experts with “the task of studying and proposing concrete stages leading towards this union” (European Council, June 1988). The “Delors Report,” issued in April 1989, contained a complete plan for the realization of EMU in three stages. Two months later in Madrid, the European Council endorsed the plan as a basis for the realization of monetary union; it decided to launch the first stage, which did not require changes in the Treaty of Rome, on July 1, 1990, and to undertake preparatory work for an intergovernmental conference.

The European Council, meeting in Strasbourg in December 1989, resolved to convene an intergovernmental conference for the end of 1990; its purpose would be to amend the Treaty of Rome in order to implement the second and third stages of EMU. Further preparatory work was carried out by the Council of Economic and Finance Minis-

² See Kenen (1992) on the origins of the EMU project.

ters (Ecofin), the Monetary Committee,³ and the Committee of Central Bank Governors during the course of 1990. At its meeting in Rome in October 1990, the European Council adopted (with the dissenting opinion of the United Kingdom) somewhat elaborate proposals for the institutional structure, contents, and procedures of EMU; these provided the basis and mandate for the IGC. The IGC began in December 1990 and was accompanied by a twin Conference on Political Union, which was charged with revising other parts of the treaty.

The initial treaty proposals for the EMU project were drafted by the EC Commission in the autumn of 1990 and presented at the first meeting of the IGC. In the meetings that followed, the delegations of the member states contributed draft amendments and treaty proposals. In June 1991, a complete draft of the treaty was produced and submitted to the EC Council by the Luxembourg presidency, which had chaired the IGC since the beginning of the year. The Dutch took over the presidency in the second half of the year and chaired the negotiations, which continued until December 10, when the European Council agreed on the substance of the treaty in Maastricht and settled unresolved issues. After a legal tidying of the text, the treaty was formally signed in February 1992 by the ministers of foreign affairs and finance of the twelve member states.

The Key Factors in the Background

As the above account shows, an idea that for years had been relegated to esoteric academic debate and to ritual declarations at European meetings suddenly took off. In little more than three years, it advanced to the point of being completely delineated and embodied in a legal text signed by twelve governments. This exceptional result was achieved against a background of rather special circumstances; the following four conditions can be regarded as the most important:

The political leadership. In the 1980s, the major European countries were governed by men whose cultural inheritance and background inclined them toward the idea of European unity. Their power base

³ The Monetary Committee is an advisory committee to the Council of Economic and Finance Ministers (Ecofin). It is composed of two members from each country, one from the finance ministry and one from the central bank, and two members from the Commission. The Committee of Alternates of the Monetary Committee is composed of the alternates for each member (Council decision of March 18, 1958). The Committee of Governors is composed of the governors of the central banks of the member states (Council decision of May 8, 1964).

was solid, they were united by regular personal contacts, and they were assisted by a favorable economic and social climate. Other factors also contributed: the weakening of the anti-supranationality bias that had seemed to be de Gaulle's permanent bequest to his successors; the loyalty that the German political establishment, notably Helmut Kohl and Hans Dietrich Genscher, showed to the European project even though this meant contributing the symbol of Germany's growing influence in Europe, its currency; and the presence of a personality of the stature of Jacques Delors at the helm of the Commission.

The importance of political leadership emerged clearly in 1990. From the fall of the Berlin wall in November 1989 to the first free elections in East Germany in March 1990 and the European Council meeting in Rome in October 1990, the settlement of the "German question" and the further integration of the Community closely interacted with, and provided the final thrust for, the project of European monetary union. The decisive element in the process was the determination with which, even in the face of internal opposition, Chancellor Kohl pursued the twofold objective of reunifying Germany and of integrating it into a stronger European Community.

The long economic expansion. A high level of economic activity always favors international cooperation. The fact that, starting in the early 1980s, the Community enjoyed one of the longest periods of economic expansion facilitated the solution of the distributional and coordination problems posed by international relationships. Political leaders, strengthened economically, found more room for maneuver in negotiations. The combination of sustained growth and financial stability created a favorable environment for relaunching EMU. In turn, because economic agents considered the EMS to be a quasi-monetary union, the EMU process helped to stabilize exchange-rate expectations.

The intellectual climate. The development of policy ideas supporting "minimum government" and economic deregulation made it possible in the early 1980s to further the integration of the Community without entailing a major confrontation with national sovereign prerogatives. These ideas, most forcefully expressed by Margaret Thatcher and shared by most governments, contributed to forming the key that unlocked the door to the Internal Market—minimum harmonization combined with mutual recognition. The Internal Market, in turn, paved the way for EMU.

The intellectual climate also favored a conception of EMU whereby (contrary to the Werner plan) monetary union would not require a centralized budgetary policy at the Community level. The Delors

Report advanced, instead, the idea of tempering decentralized fiscal powers with binding rules on national budgets.

Finally, growing support for price stability as the primary objective of monetary policy was accompanied by increasing recognition of the importance of central-bank independence. The Bundesbank provided an attractive model for a European System of Central Banks (ESCB), not only because its policies were successful, but also because the principals on which it is based can be adapted to the Community's peculiar institutional arrangements; a less independent, more centralized model, with greater discretionary powers, would have been far less suitable.

The inner logic of integration. The chain of developments from the creation of the EMS in 1979, to the disinflation of the early 1980s, the adoption of the Internal Market in 1986, the early liberalization of capital movements in 1987-88, and the relaunching of EMU in 1988 was also driven by the stringent logic of what came to be called the "inconsistent quartet," that is, the impossibility of reconciling free trade, full mobility of capital, and fixed exchange rates with autonomous national monetary policies. The inconsistency emerged at the end of 1986, when speculative pressures unrelated to economic fundamentals forced countries to realign their currencies in the EMS. The Basle-Nyborg Agreement of September 1987 provided an insufficient response, while exhausting the scope for strengthening policy cooperation without treaty changes (Padoa-Schioppa, 1988).

Against this background, the crisis that developed between the summer of 1992 and August 1993, when the Exchange Rate Mechanism (ERM) of the EMS was virtually suspended, was a further confirmation of the inconsistency and of the view that EMU might be the only viable solution to it.

3 The Emergence of the Key Issues

The Principles Set Out in the Delors Report

The Delors Report treated the issue of the transition far less thoroughly than it treated the final stage, for which it prepared a precise blueprint. This choice was partly technical and partly political. On technical grounds, determining the point of arrival was deemed to be a logical priority with respect to identifying the path leading to it. On political grounds, the position sustained by the Bundesbank for years, that no change in the existing EMS arrangements could be envisaged without

prior agreement on the endpoint of the process, soon prevailed in the Delors Committee. In addition to these two powerful arguments, it is true also that agreement on something that is to happen in the distant future is easier to reach than agreement on something that must be done tomorrow.

Two options were available in designing the final stage of the Community's monetary system: to add, or link, the twelve national systems or to create a new, integrated, monetary system. The first option implied concentrating on the exchange rate and the external component of the monetary base. The second meant concentrating on the domestic channel of monetary-base creation and building on the same intellectual and technical foundations of national monetary systems. This latter was the strategy chosen by the Delors Committee, and it was challenged only after the presentation of the Delors Report, when the British government put forward its proposal for a "hard European Currency Unit (ECU)." This latter, however, never became a serious alternative to the Delors blueprint, and it is therefore not covered in this essay.

The strategy chosen by the Delors Committee was in line with that followed in the previous EC treaties. The Community was viewed, not as an international organization, but as a unique arrangement designed to produce public goods for a group of sovereign states, thus sharing important characteristics with domestic public organizations but not slavishly imitating them. This approach had already been accepted in 1985 and enshrined in the Treaty of Rome (Article 102A) with the Single European Act, which provides that any new step in the monetary area should have a clear legal and institutional basis, thereby bringing political union closer. This top-down approach to European integration, upheld right through to Maastricht, made the design of a smooth transition from twelve national monetary systems to one multinational system more difficult.

The problems of the transition were debated in the Delors Committee only after the broad lines of the final stage had been defined, and much less thoroughly. Yet, on three key aspects of the transition, the Delors Committee adopted a clear position that influenced subsequent negotiations. These were the indivisibility of monetary policy, the parallelism between the economic and the monetary aspects of EMU, and the creation and role of the new monetary institution.

The concept of indivisibility of monetary policy, as espoused in the report, implied that, at each stage of EMU, there should be no doubt as to who was ultimately responsible for decisions on monetary policy.

Ample scope was, however, provided for close monetary-policy coordination. Although each national monetary authority could decide its own course of action, it could do so only after taking account of the evaluation and judgment of the common monetary institution, the ECB. The possibility of the ECB using pooled reserves in its foreign-exchange operations was also envisaged.

Parallelism meant that economic and monetary integration should proceed in parallel and that “the process of achieving monetary union is only conceivable if a high degree of economic convergence is attained” (Delors Report, 1989, par. 21). This principle ruled out the option of moving to the single currency immediately, without a transition. Contrary to what the Maastricht Treaty was later to prescribe, however, it also implied that passage to the third stage of monetary union was not subject to explicit quantitative conditions in terms of economic convergence.

On the creation and role of the new monetary institution, the Delors Committee contended that the ESCB (with the ECB at its center) should be created at the outset of stage two, so that it might prepare for the transfer of monetary-policy responsibilities before being entrusted with them. On several other issues that were to become important in the subsequent negotiations, the report took no specific position. One such issue was the calendar for implementing EMU. The committee suggested July 1, 1990, as the possible starting date for stage one but gave no further indication as to subsequent dates. Indeed, the committee interpreted its mandate as primarily concerned with *how* EMU should be created rather than *when* or *whether*, two questions that could be answered only at the political level. Another important issue not considered concerned the procedures for moving from one stage to the next, notably the majority of countries that would be required to decide, and the “critical mass” of countries that would be necessary to proceed. The committee did, however, express a view on the issue of “variable geometry,” accepting some flexibility about the starting date of EMU and the conditions of participation.

After the publication of the Delors Report, the design of the transition soon emerged as the most difficult and unresolved problem in the preparation of the treaty (Sandholz, 1993). Two factors made negotiations on this issue particularly complex. First, there was the confrontation between the advocates and the opponents of EMU, which did not follow national lines but developed within countries and even within institutions. This confrontation intensified as the negotiations proceeded, especially with regard to the transition. Second, there was the intrinsic

difficulty of reconciling indivisibility with gradualism and of defining the role of institutions in preparing for the passage to the final stage of EMU. History and economic theory suggested that a monetary reform like EMU should be carried out within a very short time to avoid the risk of instability associated with the coexistence of several currencies and formally distinct monetary policies. As mentioned in the introduction, however, procedural, technical, and political realities required that movement toward EMU be gradual. It may be useful to examine all these problems conceptually before turning to the actual issues discussed at the negotiating table.

Indivisibility, Independence, Gradualism

As seen above, the Delors Committee endorsed the principle of indivisibility but also foresaw that, “while the ultimate responsibility for monetary policy decisions would remain with national authorities, the operational framework necessary for deciding and implementing a common monetary policy would be created and experimented with” (Delors Report, 1989, par. 57).

The issue of indivisibility is closely related to the principle of independence, which was also accepted by the Delors Report. Both principles state that responsibilities for monetary policy should be concentrated in the central bank. Independence has a constitutional dimension whereby national institutions other than the central bank are not allowed to share monetary-policy responsibilities. Indivisibility has a geographical dimension whereby national monetary-policy responsibilities cannot be shared with the central bank of another country. Although similar, the two principles have different implications for policy coordination: independence may enhance policy coordination, whereas indivisibility may impede it, if interpreted in an extreme and dogmatic way.

After the presentation of the Delors Report, some member states—in particular, France and the United Kingdom—resisted the idea of making their central banks independent before the beginning of the third stage. In addition, the German and Dutch representatives, interpreting the principle of indivisibility in an extreme sense, maintained that keeping monetary-policy responsibilities in the hands of national authorities in the second stage implied that no innovation to the monetary-policy arrangement could be introduced before the beginning of the third stage. The combined result of these two attitudes was that the transfer of monetary responsibility to the common central institution could only

take place simultaneously with the start of the final stage. This conflicted, however, with the need to define and implement on a collective basis the complex preparatory work necessary to replace twelve national policies with one policy at the beginning of the third stage.

The sharp contrast between an extreme formulation of the principle of monetary-policy indivisibility and the impossibility of effecting an instantaneous transfer of monetary powers was one of the fundamental difficulties in the design of the transition throughout the negotiations; we turn to this now.

Institutions, Behavior, Parallelism

By stating the principle of parallelism between economic and monetary integration and suggesting that the ECB should be created at the beginning of the transition so as to become an active agent in the implementation of the treaty, the Delors Report indicated a clear middle way between the two basic approaches that had confronted each other since the inception of the Community.

According to the first approach, which can be called “behavioralist,” the Community is to be built through the convergence of the economies and policies of member countries; the passage to a more advanced stage of unification must be the natural outcome of a process in which the behavior of economic agents and policymakers has converged. According to the second approach, which can be called “institutionalist,” the integration of the Community can only be achieved through institutional and legal changes that foster convergent behavior and policies. Versions of both approaches can be found in many areas of international cooperation, not only in the economic and monetary field and not only in the EC. In their pure formulation, these two approaches correspond to two different, and ultimately opposing, conceptions of the way a group of sovereign countries can peacefully and effectively pursue common objectives. The first is the method of intergovernmental, and in the end voluntary, cooperation. The second is the method of supranational institutions and powers. Historically, from the time of the Treaty on the Coal and Steel Community in 1951, the distinctive feature of the EC, and presumably the secret of its success, has been to follow the institutionalist approach so gradually and moderately as to make it acceptable to the behaviorist camp as well.

In the field of monetary integration, the two approaches were formulated at the time of the Werner Report and dubbed the “economist” and “monetarist” approaches. They confronted each other again in

the period from 1988 to 1992. According to the extreme economist (behavioralist) approach, the passage to monetary union was seen as the achievement of the convergence of countries' economic performances with respect to inflation, monetary and fiscal policies, and even standards of living, labor markets, and other aspects of economic activity. Convergence had to be measured according to precise quantitative criteria. According to the monetarist (institutionalist) approach, fixed deadlines and tangible institutional changes would, by themselves, lead to the adjustments in agents' behavior necessary for a smooth transition to the new monetary regime. In both approaches, elements of truth are mixed with unrealistic propositions. Institutions do influence behavior, but they also need to be sustained by consistent behavior, particularly when they are new and must build their strength and reputations.

Throughout the debates on EMU between 1988 and 1991, the main issue on which the behavioralist and institutionalist approaches continuously clashed concerned the transition to the final stage of EMU. The Delors Report took a balanced position by referring to "parallel" progress in the economic and institutional sphere. Subsequent negotiations, however, increasingly leaned toward the behavioralist approach.

The Problems on the Negotiating Table

The indivisibility of monetary policy and the role of institutions were not discussed in conceptual terms during the negotiations. They were embedded in the debates concerning three concrete transitional problems that the treaty was expected to solve: (1) the procedures for deciding the passage to the second and third stages of EMU, (2) the definition and assessment of the degree of economic convergence required to enter the final stage, and (3) the nature, design, and functions of the monetary institution in the second stage. The development of these debates is examined in the following three sections. Their sequential treatment should not, however, obscure the fact that they are closely interconnected.

It was widely recognized that the second stage of union was a very delicate one. Indeed, although the third and final stage was designed as a projection of a national monetary system and the first, at least formally, was a continuation of the then firmly established EMS, the second stage was unknown territory, made more treacherous by the impossibility of moving as fast as economic theory and earlier monetary reforms suggested would be desirable. There was also broad acceptance of the view that the risks of the transition could be reduced in three

ways: by determined action by the member states to achieve economic convergence, by the creation of a common monetary institution, and by the establishment of clear procedures for the passage to the third stage. There were, however, significant differences regarding the importance of each action and the details involved.

The interconnections between the three components of the transition had political as well as economic aspects. Every country had to give way on some specific issue, and only a package deal would allow the concessions necessary to reach an agreement. The difficult task of finding an economically sound and politically acceptable solution to the three issues of the transition lasted until the very end of the negotiations.

4 The Passage to the Second and Third Stages of EMU

From the Delors Report to the European Council in Rome

The Delors Committee refrained from setting a calendar for the realization of EMU but stated that “the creation of an economic and monetary union must be viewed as a single process” (Delors Report, 1989, par. 39) and that “a consensus on the final objectives of the Community, as well as participation in the same set of institutions, should be maintained, while allowing for a degree of flexibility concerning the date and conditions on which some member countries should join certain arrangements” (Delors Report, 1989, par. 44).

In a report issued in July 1990, the Monetary Committee, chaired by Mario Sarcinelli, elaborated a combination of the three principles set out in the Delors Report: the single nature of the EMU process, flexibility in participation, and the need for economic convergence. The Monetary Committee maintained that the achievement of economic convergence was required for passage to both the second and the third stages, with the conditions of convergence being most stringent for the third stage. A firm date for passage to the second stage was indicated as a possibility but was not supported by all members. The passage to stage two and subsequently to stage three would not necessarily be made by all the member countries at the same time.

In August 1990, the EC Commission issued a document covering all the aspects of EMU and setting out its views in advance of the crucial autumn meetings of the Council of Ministers and of the European Council under the Italian presidency. The document also elaborated the three principles of the Delors Report. For the starting date of the

second stage, the Commission suggested January 1, 1993, but stressed that the stage should have a short duration. Furthermore, the Commission admitted that certain members could have “safeguard clauses” in the transition, suggesting that they would have fewer obligations but also fewer rights than full members. The passage to the third stage would depend, *inter alia*, on progress in economic convergence. In this respect, the Commission advanced the idea that “countries where convergence is jeopardized would be encouraged to present medium-term strategies (including budgetary strategies) for reducing their disequilibria to levels compatible with participation in the subsequent stages of the process of union” (Commission, 1990, pp. 25-46). This proposal was later taken up by the Luxembourg presidency to overcome the contrast that emerged with regard to the convergence results required to enter the second stage of EMU.

In October 1990, the Bundesbank, in a statement on the establishment of EMU in Europe, took the position that “a particularly important point in the Bundesbank’s eyes is that the transition to another stage (no matter whether this is a transitional stage or the final stage) should be made solely dependent on the fulfillment of previously defined economic and economic policy conditions, rather than on specific timetables. Hence the transition to another stage must not be linked to deadlines fixed in advance” (Bundesbank, October 1990, pp. 40-44).

Thus, although the Delors Committee had refrained from making a technical case for establishing explicit convergence conditions and had recognized the political nature of the setting of the calendar, the idea of such conditions gained ground during the summer of 1990 and received technical support.

The report submitted by the president of the Ecofin Council, Guido Carli, to the European Council in Rome on October 27 and 28, 1990, reflected these developments and indicated three possible approaches to the passage from the first to the second stage of EMU: first, the fixing of a precise deadline; second, no deadline, but the achievement of certain specific conditions—in particular, with regard to economic convergence; third, the combination of a deadline with convergence conditions. In Carli’s view, the third option represented an acceptable compromise.

The problem of the passage to the second and third stages of EMU came to the fore at the European Council meeting. Eventually, the Heads of State or Government, with Britain expressing reservations, concluded that:

The second stage will start on 1st January 1994. . . . At the latest within three years from the start of the second phase, the Commission and the Council of the monetary institution will report to the Ecofin Council and to the General Affairs Council on the functioning of the second phase and in particular on the progress made in real convergence, in order to prepare the decision concerning the passage to the third phase, which will occur within a reasonable time. The General Affairs Council will submit the dossier to the European Council. The treaty may lay down transitional provisions for the successive stages of economic and monetary union according to the circumstances of the different countries. (European Council, October 1990)

Thus, in October 1990, the Heads of State or Government established a firm date for the beginning of the second stage and an indication (“within a reasonable time”) for the beginning of the third.⁴

The Intergovernmental Conference

It is hardly surprising that, in discussing the passage to the later stages of the union, in particular, the final one, the IGC had to rediscover issues that are *loci classici* of the Community. The long and complex Article 8 of the Treaty of Rome shows how tricky the problem of passage to further stages of integration had proved to be in 1957 with regard to establishing the European Economic Community (EEC). Yet, there appeared to be little historical memory among the (treasury and central-bank) officials who carried out most of the work on EMU at the IGC. Two sorts of competence were needed at the conference: technical-economic and legal-institutional. The first was in abundant supply, but the second was scarce, owing in particular to the secondary role played by officials from foreign affairs ministries, who were mainly involved in the preparation of the Treaty on Political Union.

The IGC started the negotiations on passage to the third stage on the basis of the draft treaty presented by the Commission in December 1990, following the conclusions of the European Council in Rome.⁵ This draft helped the IGC to shift, from the outset, from report language to legal language. Although the first IGC ministerial session did not officially endorse the Commission draft, and although it invited national delegations to submit other contributions, this draft was, in

⁴ The date of January 1, 1994, for the second stage was a compromise between those wanting an earlier date (January 1, 1993) and those wanting no date at all.

⁵ The IGC was initially organized at two levels, one of ministers and one of personal representatives. At a late stage of the negotiations, a working-group level was added. In the following discussion, nonqualified references to the IGC allude to the personal-representative level, where the bulk of the work was done.

practice, the basic reference document in the IGC for the first half of 1991.

According to the Commission draft, the decision to move to the final stage was to be taken by the European Council and enacted by the Council of Ministers by qualified majority. The Council of Ministers would also decide which countries should have a “derogation,” whereby their participation in the third stage would be delayed as a result of their failure to achieve economic convergence.

Although a draft text presented by the French delegation did not differ substantially from that of the Commission, that presented by Germany’s finance minister required that formal unanimity by the European Council be required for the decision to move to the third stage. Not only was a right of veto for every country at variance with the conclusions reached in Rome by eleven Heads of State or Government, including the German chancellor, but it also implied the indefinite postponement of EMU. The surprising position of the German delegation at the IGC highlighted a difficulty that was to resurface throughout the negotiations: the different attitudes toward EMU of the German chancellor and foreign minister, on the one hand, and of the finance ministry and the Bundesbank, on the other (Sandholz, 1993, also makes this point). Similar differences, albeit less pronounced, existed in several other countries.

The presence of different attitudes within countries resulted in a pendular movement between more and less advanced solutions as the EMU negotiations shifted back and forth between the heads of state and the ministers and technicians. This additional difficulty in the negotiating process was made even more serious by the fact that the mechanisms for coordinating the two Intergovernmental Conferences (on Economic and Monetary Union and on Political Union) were, as noted above, rather weak.

The unanimity requirement had the full support of the U.K. delegation; a formal right of veto was the best assurance that EMU would only be realized if Britain thought it appropriate. The Spanish delegation took an intermediate position, requiring unanimity until a certain date and a majority thereafter.⁶

⁶ This was consistent with the position presented by the Spanish finance minister on September 25, 1990: “Spain . . . feels that the Intergovernmental Conference must stay the course and observe the substance of the original Delors Report, refraining equally from postponing indefinitely stage three, dispensing with a meaningful stage two or replacing stage two by an extended stage one” (Spanish Government, September 1990, pp. 5-9).

In April, the French personal representative, Jean Claude Trichet, lent some Cartesian clarity to the debate by stating three basic procedural principles for passage to the third stage: (1) *no veto*, so that no member country could prevent the others from moving to the third stage of EMU if they so wished, (2) *no coercion*, so that no country could be obliged to participate against its will, and (3) *no arbitrary exclusion*, so that no member fulfilling the economic-convergence requirements could be prevented from participating in the union.

These principles, and the idea that the European Council should take the decision and the Council of Ministers should implement it, were accepted as the basis of further negotiations after their endorsement by Jacques Delors. It soon became clear, however, that the interpretation of these principles was highly controversial, so that, instead of closing the debate, the French formula opened a new one that ended only in Maastricht.

The draft presented by the Luxembourg presidency in June 1991 contained only a first attempt at establishing a procedure respecting these principles. It provided for the Commission and the ECB to report to the Council of Ministers by the end of 1996 and for the Council of Ministers to report to the European Council after consulting the European Parliament. The European Council was to decide on the beginning of the final stage after establishing whether a sufficient degree of economic convergence had been achieved. The Council of Ministers was to adopt the necessary implementing measures by qualified majority.

The issue came forward in earnest in July, at the beginning of the Netherlands presidency, and it soon became clear that the crucial question concerned the interpretation of the “no coercion” principle. This could be formulated in such a way that signing and ratifying the treaty would imply no undertaking to move to the third stage. Alternatively, it could grant a specific exception to the United Kingdom (and possibly Denmark)—which all along had opposed the idea of the irreversibility of EMU—while committing at the time of ratification all the other countries to move to the third stage.

At the end of August, the president of the IGC, Cees Maas, proposed a draft stating that the Council of Ministers, or the European Council, should

- discuss which Member States fulfill the conditions for participation in stage three and the date of the beginning of this stage;
- in the light of this discussion, Member States which fulfill the conditions

shall decide whether they will participate in stage three at the proposed date. (Netherlands Presidency, August 1991, p. 3)

By adopting such a formulation, signing and ratifying the treaty would have implied no meaningful commitment at all, and the treaty would have been downgraded to the level of a mere declaration of intent. Presumably, this was not the intention of the drafters, who perhaps lacked familiarity with delicate institutional issues and with the historical background of the EC.

The presentation of the Maas proposal marked the moment in which the pendulum swung farthest away from the solution proposed by the Delors Report and inscribed in the Rome conclusions. It coincided with, and accentuated, a difficult period for the conference, two months during which negotiations on the transition provisions seemed to be completely blocked. The French and Italian delegations weakened their influence on behalf of EMU by failing to act convincingly on two points crucial to Germany: central-bank independence and fiscal adjustment. The German delegation, reflecting domestic German reservations about EMU, resisted the idea of substantive innovations in the area of monetary-policy coordination during the transition. The British skillfully supported anyone opposing firmer commitments for the transition phase. And the president of the IGC sided with the conservative camp. This combination of interests and cross-interests risked producing an empty bag, an agreement unable to lead the Community to stage three (Papadia, 1992).

At the ministerial level, the Dutch proposal was vigorously attacked by several ministers and by Jacques Delors. Wim Kok, president of the IGC (ministerial level), sensing the political dangers of his staff's proposal, distanced himself from it, downgrading the document to technical status and announcing a revised draft. Support for the Maas proposal came only from the German and U.K. delegations, with the U.K. delegation trying to reintroduce unanimity for the decision on passage to stage three.

The new draft presented at the end of September nevertheless still contained some of the main problems inherent in the earlier Dutch proposals, clearly spelling out what came to be known as the generalized "opt-out clause," that is, within six months of the Council's decision to move to stage three, any country could exempt itself from the decision.

Finding a narrow passage between the unwillingness of the United Kingdom, and then Denmark, to commit themselves to EMU and the risk of depriving the treaty of any real force was a difficult task. What

the officials participating in the IGC failed to see was that such a path could only be made by restricting the opt-out clause to the United Kingdom (and Denmark); all the remarkable skills of British diplomacy were deployed to hide this reality.

The pendulum changed direction as awareness spread of the true significance of the generalized opt-out clause and as the debate moved from the allegedly technical table of officials to the political table of ministers and Heads of State or Government. Intense negotiations took place in October and November. At an Interinstitutional Conference meeting in November, members of the European Parliament voiced their opposition to a generalized opt-out clause. By mid-November, thanks also to the intervention of foreign affairs ministries, opposition to such a clause became widespread. The delegations from Belgium and Luxembourg proposed wording that would narrow the opt-out clause to countries that had declared their unwillingness to move to the third stage at the time of treaty ratification. At the end of November, the idea of eliminating any reference to “opting out” in the main text of the treaty gained support, while the “no coercion” principle was to be assured in a specific protocol on the United Kingdom, with possible extension to Denmark.

In the last meetings of the conference before Maastricht, four significant amendments to the transition procedure were made: (1) the opt-out clause was eliminated from the main text of the treaty and the settlement of the U.K. problem was left to the Heads of State or Government; (2) the move to the third stage would be decided by the European Council, which would adopt the voting rules of the Council of Ministers; (3) unanimity would be required to take a decision in 1996; and (4) if the unanimous decision for a majority of members to move to stage three were not taken in 1996, a decision would be taken in 1998 by simple majority.

Although the decisionmaking procedure had some loose ends from a technical and legal point of view, it clearly reflected the principle stressed by the French, German, and several other delegations in the closing days of negotiations that “Maastricht is irreversible.”⁷ The principle, established in the Delors Report, that starting the process implied a commitment to complete it was thus restored and brought to its logical conclusion. It was clear to all those participating in the negotiations that this new, forceful push reflected the active interest of

⁷ Protocol annexed to the treaty on the transition to the third stage of EMU.

the Heads of State or Government in the run-up to the Maastricht meeting.

The split between the United Kingdom and Denmark and the other member states was completed in Maastricht at the eleventh hour and was dealt with in two specific protocols granting broad opt-out clauses to those two countries. For the other countries, the decisionmaking procedure for passage to the third stage before December 31, 1996, was changed in the main text of the treaty from unanimity to a qualified majority. More important, it was agreed that, in any case, the third stage would start on January 1, 1999, even if a decision had not been taken by the end of 1996 and even in the absence of a majority of economically convergent countries. This decision, taken in Maastricht directly by the Heads of State or Government, had been publicly advocated a few days earlier by the Committee for the Monetary Union of Europe, co-chaired by Valéry Giscard d'Estaing and Helmut Schmidt. The idea, borne out of bilateral contacts between François Mitterrand and Giulio Andreotti, had gained momentum with the assent of Helmut Kohl.⁸

5 The Definition and Assessment of Convergence

The issue of the economic-convergence requirements for the passage to EMU was extensively debated both at the time of the Werner Report and in the early 1980s, when an attempt was made to strengthen the EMS without amending the treaty. This section reconstructs the debate on this issue from the time of the Delors Committee to the last meeting of the IGC in Maastricht. The different political and intellectual positions of the negotiating parties underlying the rather technical debate on convergence criteria have been outlined above. The issue of budget deficits, by far the most important aspect of the convergence requirements, is discussed in greater depth below.

From the Delors Report to the European Council in Rome

The insertion in the conclusions of the European Council in Hannover of the words “economic and” before “monetary” in defining the mandate of the Delors Committee was the first harbinger of the forthcoming debate on convergence criteria. The Delors Committee, searching for a balance between the institutionalist and behaviorist approaches,

⁸ See Sandholz (1993) regarding the surprise Chancellor Kohl's decision sprang on the German delegation.

indicated that “parallel advancement in economic and monetary integration would be indispensable in order to avoid imbalances. . . .” but also indicated that “perfect parallelism at each point in time would be impossible and could even be counterproductive” (Delors Report, 1989, par. 42). No explicit quantitative economic-convergence preconditions were mentioned in the report for the passage to the final stage of the union. The possibility was mentioned, however, of “flexibility concerning the date and conditions on which some member countries would join certain arrangements” (Delors Report, 1989, par. 44), suggesting that lack of economic convergence could delay the participation of some countries in the third stage of EMU.

The view that the convergence requirements for moving from one stage of the union to the next had to be “objective,” and that “objective” meant “quantitative,” progressively gained ground in the Monetary Committee in 1990-91 under the influence of the German and Dutch delegations, which were largely inspired by the Bundesbank. The argument used was that every aspect of the treaty, which needed to be seen as a contract between the member states, had to be legally unambiguous in order to be enforceable. Lack of precision in defining the criteria for assessing convergence would have entailed the risk of future disputes on the meaning of the term “convergence,” possibly jeopardizing the enforceability of the contract embodied in the treaty.

The Monetary Committee’s July 1990 report to the Ecofin Council on the preparation for the IGC took a first step by stating that “the decision to advance (from stage 1 to stage 2) must be based on *objective* criteria,” although it conceded that “the criteria cannot be applied in an automatic way but will require the exercise of judgment.” The report also identified five key convergence variables:

- a high degree of *price stability* compatible with full monetary union;
- observance of *budgetary discipline*: no monetary financing and no excessive deficits;
- *participation in the EMS* narrow band and a high degree of stability within the System;
- a positive assessment by the markets of the *sustainability* of convergence;
- completion of the *Internal Market*: passage of the necessary legislation at the Community level, its transposition into national law and its implementation. (Monetary Committee, July 1990, pp. 47-59)

The convergence issue was intertwined with that concerning the nature and length of stage two. The Monetary Committee recommended that the convergence criteria be applied to passage to both the second

and third stages. It also held that the transition should be as short as possible and merely technical, so that the crucial screening would occur at the start of stage two, which should be considered the point of no return. However, because underlying economic conditions in several member states were not sufficiently convergent—in terms of inflation, and even more in terms of budget deficits—it was feared that setting the crucial hurdle between stages one and two would indefinitely delay progress beyond the first stage. The countries adhering to this view therefore wanted to give momentum to the process by setting a firm date for passage to the second stage and by making the conditions for entry to this stage primarily political; the member states would agree to adopt at this time the measures needed to achieve convergence before the start of the final stage, when the crucial test of convergence would be made.

The European Council in Rome did set a firm date, January 1, 1994, for the start of the second stage, subject to two conditions of an institutional, rather than behavioral, nature: the exclusion of monetary financing and the prohibition of any bail-out of a member state by the Community or by another member state. Somewhat surprisingly, the independence of national central banks was not included as a condition; the German delegation accepted without serious objection the noncommittal formulation espoused by the French.⁹ The Council also stated, however, that to move to the second stage, “further satisfactory and lasting progress in economic convergence should be achieved, especially price stability and sound public finances” (European Council, October 1990). The idea of the Delors Report that participation in the third stage would be flexible, in the sense that it could be delayed for some countries, was retained.

The Intergovernmental Conference

At the IGC, the first issue to come to the fore concerned the convergence conditions necessary for passage to stage two. This issue was eventually settled in April 1991. The Luxembourg presidency opened the discussion on whether the conditions of economic convergence mentioned in Rome for the start of the second stage were to be interpreted as legal constraints, as maintained by the German, Dutch, Irish,

⁹ The European Council conclusions state that “the second stage will start on 1 January 1994 after . . . a process has been set in train designed to ensure the independence of the members of the new monetary institution at the latest when monetary powers have been transferred” (European Council, October 1990).

and Portuguese delegations, or as a political commitment, as argued by the Commission and the French, Belgian, and Italian delegations. A proposal by the EC Commission to request countries to draw up multiannual adjustment programs aimed at ensuring convergence and to present them before the start of the second stage was finally endorsed by the conference.

The institutional conditions established in Rome for the passage to the second stage, that is, the prohibition of monetary financing and the principle of “no bail-out” of indebted member states, were also included. Further, as regards the independence of the national central banks, members were to start the process during stage two and to complete it before the start of stage three.

From this point on, the convergence conditions for entry to stage three occupied the center of discussion at the IGC. A crucial question was whether the criteria should be given treaty status (that is, specified in the treaty or in a protocol annexed to the treaty), so that they could be modified only by a unanimous vote and through a complex procedure, or established in secondary Community legislation that could be modified by the Council with majority voting. The Italian, Belgian, Greek, and Portuguese delegations were strongly in favor of the latter solution, on the grounds that economic developments might result in some of the criteria, notably those concerning public finances, proving excessively strict. Indeed, on the basis of 1991 data, only three countries satisfied the proposed convergence criteria. Moreover, Germany, the Netherlands, and Belgium—founding members and strong-currency participants in the ERM—were not among them. At the other end of the spectrum, the German and Dutch delegations maintained that treaty status was a necessary safeguard against the propensity of politicians to relax sound economic principles in order to pursue a European grand design. According to this view, the fact that only three countries qualified in 1991 was not an argument against strict criteria but evidence that economic conditions were not yet ripe for a move to stage three. The French delegation, seeking a compromise on the content of the criteria, supported the German view that the convergence criteria should be inscribed in the treaty so as to preclude future modifications. The solution eventually adopted in the treaty was that the convergence criteria may only be modified by a unanimous decision of the Council.¹⁰

¹⁰ See Appendix A: Treaty, Article 104c, No. 14, and Protocol on the Convergence Criteria, Article 6.

The debate on the legal status of the criteria proceeded in parallel with the debate on their content, that is, on the variables to be used to assess convergence and on whether quantitative reference values should be specified. This discussion was conducted at the IGC and, for the more technical aspects, in the Monetary Committee. Membership of the two bodies was largely the same and, from July 1, 1991, both were chaired by Cees Maas, who was strongly inclined toward the behavioralist approach. These circumstances, plus the technical nature of the political issues at stake and the fact that the more EC-oriented ministers and national officials were taken up with the parallel IGC on political union, permitted the consensus to drift away from the balance struck by the Delors Committee.

The IGC asked the Monetary Committee to continue working on the basis of its previous report on the convergence criteria for passage to the final stage. The Committee restated, in September 1991, its earlier formulation requiring that assessment of convergence be based on a few, clearly specified criteria, but that these not be applied in a mechanical way. The Committee identified the three main convergence criteria as (1) inflation, which should be as close as possible (suggested 1.5 range) to the two or three best performers, (2) no excessive deficit, and (3) participation in the ERM, without devaluation attributable to a country's own conduct and without heavy intervention.

The rationale for the inflation criterion was that, if such a major policy change as the irrevocable fixing of exchange rates did not take place in an environment in which economic agents' behavior was highly convergent, it would be likely to have negative repercussions on all the regions of the newly created union (Bini-Smaghi and Del Giovane, 1992). The appropriate measure of inflation was discussed, with consumer prices being preferred in the end, despite the risk that cross-country comparison would be distorted by indirect taxation and the differing behavior of prices of nontraded goods.

As for budgetary discipline, about which specific rules were also to be established for the final stage, it was considered that conditions for entering the last stage had to be the same as those that would be required for countries under full monetary union.

Participation in the ERM, the third criterion, had been mentioned in the 1990 report by the Monetary Committee and explicitly stated in the French draft treaty proposal of January 1991. The criterion was accepted by the various members for different reasons. For the French delegation, it gave the EMS the "institutional" role of preparing the road toward full monetary union. For the German delegation, it was a

guarantee that economic agents and policy authorities would become familiar with the constraints of a fixed-exchange-rate system in advance of union. Furthermore, the ERM would avoid the risk of competitive depreciations on the eve of the final stage. Other countries, however, expressed reservations about the instability that could develop before the two-year ban on devaluations and about the difficulty of running a quasi-fixed-exchange-rate system with monetary policies still being conducted autonomously at the national level. The first objections were dealt with by adding the words “on its own initiative” to qualify the ban on devaluations. The second, more fundamental objection was countered by the expectation, based also on the fact that there had been no realignments since 1987, that the prospect of EMU would stabilize exchange rates, despite formally distinct monetary policies in the second stage, and that the new monetary institution would foster monetary coordination, thereby contributing to exchange-rate stability. The 1992-93 exchange-rate crisis showed how unjustified this expectation was.

The German delegation proposed adding the convergence of long-term interest rates as a fourth criterion, arguing that the durability of the convergence achieved should be reflected in the verdict of the market, that is, in a virtual harmonization of capital-market rates. Other members of the Monetary Committee, including the French and Italian delegations, opposed this request, arguing that long-term interest rates could hardly be compared, especially in view of the differences in taxation and market depth, and that they did not necessarily reflect underlying economic developments.

Other criteria were given a back seat in September 1991 by the Monetary Committee because no consensus was reached. For example, the balance of payments on current account was given a secondary role, because, as the Spanish and Portuguese members insisted, external deficits can be desirable in certain circumstances to finance the growth of lower-income countries. The U.K. members proposed other criteria, in particular concerning the flexibility of labor markets, but these were not retained owing to the difficulty of measurement.

Although a consensus had been reached within the Monetary Committee, agreement within the IGC proved more difficult and was achieved only at the very end of the conference. This was because the treaty draft presented by the Netherlands presidency in September had moved away from the consensus by adopting a rigid, rather doctrinaire approach. Indeed, it differed in several respects from the Monetary Committee conclusions in that (1) the assessment of convergence was

based on the mechanical application of the criteria over a period of two years (“the achievement of a high degree of convergence must be shown by the fulfillment of the following criteria to be verified over a period of two years”), (2) the benchmark for inflation was restricted to just one country, instead of three, (3) the reference to a “country’s own initiative” in the criterion banning devaluations in the last two years of participation in the ERM was dropped, and (4) the convergence of long-term interest rates was included as a criterion and given the same importance as the other three.

The difference between the two documents, despite the same person having chaired both the Monetary Committee and the IGC (personal-representative level), was heavily criticized by several delegations. This led the Netherlands presidency to promise a revised version for the end of October. The new proposal did not really correct the bias, however, and continued to be judged unsatisfactory by several delegations.

Disagreement dragged on until the last meetings of the conference, especially on the criteria for excessive deficits. Delegations eventually yielded to German insistence on adding the convergence of long-term interest rates as a specific criterion, whereas the recommendations agreed upon in September by the Monetary Committee were adopted for the other criteria. In particular, (1) a mechanical use of the criteria was rejected: “The Reports [by the Commission and the EMI] shall also examine the achievement of a high degree of sustainable convergence by reference to the fulfillment by each Member State of the following criteria. . . .” (Treaty, Article 109j). In treaty language, “by reference to” implies the use of judgment and the exclusion of any automaticity in assessing the degree of convergence achieved by the member states; (2) the assessment of whether a country’s deficit is excessive was to be made by the Council of Ministers, acting by qualified majority on the basis of a recommendation by the Commission; (3) the reference to devaluations “on a country’s own initiative” was reinserted. It should be noted that, when the treaty states that “normal fluctuation margins” should be respected in the two years preceding the move to stage three, it does not explain what “normal” means. In part, this was intended to allow a further narrowing of the margins during the second stage, as the Danish authorities had proposed—it is not clear today whether the wider ERM margins decided on August 1, 1993, should be considered “normal” or not; and (4) the observation period for the convergence of inflation and interest rates was reduced from two years to one year.

The Issue of Budget Discipline

As mentioned above, the issue of budget discipline was so crucial in the negotiations of the treaty provisions that it needs to be examined separately. The provisions concerned both the qualifications to enter or start stage three and the functioning of EMU in that stage.

The rationale for establishing budgetary rules was twofold. On the one hand (as the Latin American debt crisis had shown), market discipline was felt to have a limited impact on government deficits, especially in a fiscally decentralized monetary union. On the other hand, the size of some member countries implied that major deviations from budgetary discipline could represent a threat to overall monetary and financial stability. Accordingly, the Delors Report had called for “binding rules for budgetary policies,” arguing that even though “market forces can exert a disciplinary influence, . . . experience suggests that market perceptions do not necessarily provide strong and compelling signals and that access to a large capital market may for some time even facilitate the financing of economic imbalances” (Delors Report, 1989, par. 30).

The Delors Report referred to the need for “binding rules” for the functioning of stage three, but not as a condition for entering that stage. The adoption of “binding rules” was advocated on the grounds that “uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community.” Moreover, the protection of monetary policy against pressure for “monetary expansion” was as important as achieving “a coherent mix of fiscal and monetary policies” (Delors Report, 1989, par. 30).

In the Monetary Committee and in the IGC, the need for binding rules was defended mainly by the German and French delegations on the grounds that, because EMU entailed a loss of sovereignty in the monetary field, countries should also be willing to give up some sovereignty in the budgetary field. The strongest opposition came from the British delegation, which defended the view that market mechanisms were sufficient to impose discipline. Other participants, in particular the Italian delegation and the EC Commission, opted for an intermediate solution, proposing a procedure aimed at the avoidance of “excessive deficits,” while allowing countries to maintain sovereignty over budgetary policy as long as such rules were respected.

This solution finally gained ground, especially following recognition by the French and other delegations that a loss of national sovereignty on the budgetary side, with the inevitable consequence of a larger EC

federal budget, would not be politically acceptable and could overload the negotiations to the point of causing their failure, as had occurred with the Werner Plan. Furthermore, the academic debate that followed the Delors Report criticized the recommendation of binding fiscal rules on the grounds that, unless the Community moved toward a system based on a federal budget, national budgets would still have to be used to counteract country-specific disturbances or cyclical divergences (Buiter and Kletzer, 1991; Masson and Melitz, 1991; Wyplosz, 1991; De Grauwe, 1992).

The formulation of precise, even quantitative, rules for national budgets in a legally binding text was undoubtedly a difficult task, especially because the literature gave little guidance with regard to identifying excessive deficits. Several concepts widely used in economics were too broad for a text that had to be drafted in contractual language.

The provisions of existing federal states, moreover, were not of much help. A long discussion took place on whether a rule forbidding budget deficits on current account (the so-called “golden rule,” to which Germany adheres)—advocated until the end by the German and Dutch delegations—could be transplanted to the EC level. Most delegates felt that it would be counterproductive in the absence of a federal system of income stabilization, because it would encourage pro-cyclical fiscal policies, especially in recessions, thereby aggravating cyclical divergences. Furthermore, it was felt that the differentiation between current and capital expenditure was not sufficiently clear or harmonized across countries to be used as a criterion for assessing excessive deficits. Other concepts, such as cyclically adjusted deficits, which had been proposed by France, Italy, and other delegations, were rejected because they were not sufficiently clear or measurable to be legally enforceable. Similarly, the proposal to assess a country’s budgetary position over a multiyear period was rejected because it would have to be based largely on budget intentions rather than results. It was eventually agreed that limits would be set on annual government deficits and the dynamics of the public debt.

On the basis of this consensus, the Alternates of the Monetary Committee proposed in February 1991 that excessive deficits be identified by a formula whereby a government has a debt-to-GDP ratio greater than a reference value and has not taken appropriate action to stabilize and reduce it, or a government deficit exceeds its investment expenditure over a number of years, *and* its deficit as a ratio to GDP exceeds a reference value. It was also recognized that the assessment

of government deficits could not consist merely in the mechanical application of these criteria but that it would require judgment by the political authorities. The procedure to be followed in the evaluation of excessive deficits was therefore considered to be as important as were the reference values. After long discussions, the Monetary Committee endorsed the proposal in the spring of 1991—except for the “golden rule,” which the German and Dutch members insisted on having as a separate criterion and others wanted to eliminate altogether.

The idea of having quantified criteria thus became part of the consensus, in contrast with the initial proposals. Neither the draft treaty presented by the Commission in December 1990 nor the draft prepared by the Luxembourg presidency at the end of June 1991 had mentioned quantitative criteria; they had only provided for a judgment to be expressed on the existence or absence of excessive deficits.

The draft treaty proposal presented by the Netherlands presidency at the end of October 1991 read:

The Commission . . . shall examine compliance with the following two criteria which shall apply to each member State:

- the ratio of the planned or actual government deficit to gross domestic product shall not exceed a ceiling;
- the ratio of government debt to gross domestic product may only exceed a reference value if the ratio is sufficiently diminishing and steadily approaching the reference value. (Netherlands Presidency, October 1991, p. 4)

Two issues emerged: the level of the reference values and whether they should be given treaty status by being inserted in the treaty or in a protocol annexed to it.

Setting a reference level for the debt-to-GDP ratio was justified by the fact that a rise in the ratio has a different impact on financial markets depending on its starting position. Here again, the economic literature was of little help, and the choice finally fell on 60 percent, which was more or less the Community average.¹¹ Contrary to what is often stated, however, 60 percent was not considered to be the limit of acceptability for the debt but, rather, a threshold beyond which the constraint on its rate of change becomes relevant.

The discussion on the reference value for the ceiling on the government deficit was more difficult. Several delegations indicated that the

¹¹ The debt is measured as gross rather than net simply because estimates of the latter do not exist for many countries (Buiter, Corsetti, and Rubini, 1993).

initial proposal of 3 percent put forward by the Netherlands presidency on the basis of the Monetary Committee work could be too restrictive in certain circumstances, even though it was consistent in the long term with the 60 percent level for the debt-to-GDP ratio under the hypothesis of a 5 percent long-term rate of growth of nominal GDP.¹² In fact, historical experience showed that a country's deficit could well rise above the 3 percent range in a recession without necessarily undermining monetary stability. Furthermore, it was pointed out that looking at budget deficits year by year, without taking account of their dynamics, would distort the assessment. This position was held by those who also strongly opposed crystallizing in the treaty or in a protocol reference levels that would be difficult to modify subsequently. It became clear, however, that it would not be possible to reach an agreement on deficits unless all parts of the issue had the same treaty status.

After lengthy discussions, the delegates decided to insert the reference values in a protocol of the treaty but to formulate the criteria more flexibly, on the lines proposed by the Italians and French and supported by the British. Temporary and limited deviations from the 3 percent limit were allowed as long as there was evidence of adjustment measures designed to bring the deficit back within the limit. Thus, the criteria adopted in the treaty to assess levels of government deficit are based on both static and dynamic elements: "reference values" serve to trigger the procedure, but the declaration that a country has an excessive deficit and therefore should undergo the treaty-stipulated procedure of Community control, is based on judgment and takes account of the adjustment that has been taken or is expected to take place (Treaty, Article 104c). It was also agreed to make the golden rule an ancillary criterion, together with "all other relevant factors, including the medium-term economic and budgetary position of the Member State" (Treaty, Article 104c, No. 3).

Under the complex treaty procedure for assessing deficits, the Commission is required to report on the compliance of each member state with the above criteria and to address an opinion to the Council. The Council has to decide, "after an overall assessment," whether deficits are excessive. In particular, it will have to determine whether a deficit above the 3 percent limit is declining "substantially" and "contin-

¹² Because $d(B/Y)/dt = [(dB/dt) - (B/Y)(dY/dt)]/(1/Y)$ where B = debt and Y = income, setting B/Y equal to 60 percent means that the debt-to-GDP ratio remains constant, that is, $d(B/Y)/dt = 0$ if nominal income grows at a 5 percent rate and the government deficit is 3 percent of GDP.

uously” or is “temporary” and “exceptional,” and whether a debt-to-GDP ratio higher than 60 percent is diminishing “sufficiently” and at a “satisfactory” pace.

Statistics on the debt and deficit indicators have been widely publicized, although not always correctly. The criteria have also been examined in academic circles and criticized for being both too mechanical or too discretionary, sometimes by the same authors. Although it is not the purpose of this essay to rebut or endorse these criticisms, two remarks may help to put them in perspective. First, it should be recalled that the treaty specifies that the excessive-deficit procedure aims at avoiding “gross errors” (Treaty, Article 104c, No. 2), not at achieving optimal fiscal policies. Second, the literature suggests that, in a “second-best” world, fiscal discipline should be achieved through a “fiscal rule with an escape clause” (Alesina and Tabellini, 1990; Corsetti and Roubini, 1992). The treaty seems to provide both a rule and an escape clause. The first concerns the reference values, the second, the recourse to discretionary judgment, “with a view to identifying gross errors” (Treaty, Article 104c, No. 1). It is possible that the existence of both a rule and an escape clause will lead to differences of interpretation among authorities at some later date. However, no one has yet advocated that respect or nonrespect of the 60 percent and 3 percent criteria should be mechanically translated into a conclusion about the excessive or nonexcessive level of the deficit.¹³

6 The Monetary Institution in the Transition

The issue of the structure and powers of institutions in promoting and implementing common action has been a *locus classicus* in the debate on European economic integration since the 1950s. By contrast, in the debate on monetary integration, which dates back to the late 1960s, this issue emerged only slowly and with an approach that was initially more influenced by the institutional setting of the Bretton Woods system than by that of the EC. The Werner Committee of 1970 devoted little attention to the institution required by monetary union, confining itself to a vague reference to the need for a “Community central banking

¹³ In a conference at Bocconi University in Milan (March 15, 1993), Bundesbank president Helmut Schlesinger stated: “It is not so ambitious to set a deficit at 3 percent. . . . I consider differently the 60 percent ratio for countries, like Italy, whose ratio is much higher. Realistically, only two things can be demanded: first no further increase, second a gradual decrease of the ratio.”

system.” The European Monetary Cooperation Fund, created in 1973, was modeled on the International Monetary Fund. The EC resolution of 1978 that created the EMS stated that, in the “definitive system,” to be established within two years from the start of the EMS, a “European Monetary Fund” would be set up. It was from this not very advanced point that the Delors Committee had to start.

From the Delors Report to the European Council in Rome

The Delors Committee changed the approach. It dealt with the issue of the institution by drawing on two sources. For the final stage, it chose the model of a national central bank with a decentralized structure—the Bundesbank being the main example. For the transition, it followed the traditional EC approach of giving the planned institution an active task in the pursuit of the agreed goal, adopting the Community method of supranationality and institutional strength as the motor of the transition. The Delors Report accordingly envisaged that the ECB would be created at the start of the second stage and given significant responsibilities. Indeed, as noted by Italianer (1993), a new treaty was needed just to allow the creation of the ECB.

The idea of entrusting the ECB with a wide range of tasks in the coordination of monetary policies and of making it responsible for preparing the passage to a single monetary policy at the beginning of stage three was clearly expressed in the Delors Report:

In the monetary field, the most important feature of this [second] stage would be that the European System of Central Banks would be set up and would absorb the previously existing institutional monetary arrangements. . . . The key task for the European System of Central Banks during this stage would be to begin the transition from the coordination of independent national monetary policies by the Committee of Central Bank Governors in stage one to the formulation and implementation of a common monetary policy by the ESCB itself scheduled to take place in the final stage. (Delors Report, 1989, par. 57)

The powers of the ESCB, however, their distinction from those of the national central banks, and “the organization of a gradual transfer of decision-making powers from national authorities to a community institution” (Delors Report, 1989, par. 38) were not spelled out in detail, partly because some members of the Committee were perhaps more ready to describe heaven than the way to reach it. This was reflected in a lack of support for proposals advanced in the Committee, such as those of Carlo Ciampi and Niels Thygesen, which aimed at

achieving a coordinated monetary policy in the Community and which were published as annexes to the Delors Report. Ciampi stressed that, in all likelihood, a system of informal coordination of monetary policies would not be enough for the transition and that tighter forms of coordination would have to be devised. Noting that exchange-rate arrangements only establish international links among interest rates, but that they leave their level undetermined, he argued that a system based on the leadership of a national monetary authority was not a sustainable remedy to this indeterminacy, for sooner or later, differences of opinion about the desirable policy stance would inevitably develop. Ciampi went on to suggest that “this would have devastating consequences: as soon as the market realized that the mutual trust and voluntary compliance underpinning the system were in danger, it would test the commitment of monetary authorities to maintain parities, entailing the risk of large capital movements that could jeopardize the irrevocable locking of parities” (Ciampi, April 1989, pp. 225-232).

In its first round of work (report of July 1990), the Monetary Committee seemed to devote little attention to the issue of the monetary institution in the transition. The abandonment of the traditional Community approach adopted by the Delors Committee was initiated, however, when the German and Dutch delegates pressed the Monetary Committee into recommending that the creation of the ECB should take place “at an appropriate time before moving into the third stage” and, more importantly, into accepting the idea that the institution should not be an “empty shell” (Monetary Committee, July 1990, pp. 47-59). This statement had the innocent appearance of stating the very reasonable principle that there should not be a disproportion between the design of the institution and its functions. What it really meant, however, was a major departure from the method by which the Community had been successfully built in the past, that is, by entrusting the powers to implement integration to common institutions rather than to weak mechanisms of voluntary cooperation. In this phase of the preparation process of the IGC, those the British press called “skeptics” of EMU showed more understanding of the key issues and more determination in pursuing the desired objectives than did the convinced supporters of EMU. As will be seen below, the view that there should not be an empty shell was subsequently developed to mean that the name “Central Bank” should be attributed to the monetary institution only after it had been given the full prerogatives of a central bank, that is, on the verge of passage to the third stage, and that no real powers should be given to the institution before that stage.

This minimalist position was officially adopted by the German minister of finance, Theo Waigel, at the informal Ecofin meeting held in Rome in September 1990. In the same vein, in a statement released in October, the Bundesbank proposed that “no institutional changes which result in any curtailment of the freedom of action of national monetary policy may be made. . . . The Committee of EC Central Bank Governors could be transformed into a Council of Governors in due course” (Bundesbank, October 1990, pp. 40-44).

Once again, the European Council took a more advanced position, along the lines of the Delors Report. In Rome, it confirmed, albeit with the opposition of Britain, the will to set up the ECB at the beginning of the second stage, stating that “the second stage will start on the 1st of January 1994. . . . At the start of the second phase, the new Community institution will be established” (European Council, October 1990).

There could be no doubt that the Heads of State or Government, in agreeing to create “the new Community institution” at the start of the second stage, were referring to the ECB and not to a temporary institution. Indeed, in preparing the text of the Conclusions of the Presidency to be adopted in Rome, it was consciously decided, with the explicit agreement of Chancellor Kohl, to use “the” rather than “a.”

The European Council in Rome also agreed that the primary functions of the ECB in the second stage would be “to strengthen the coordination of monetary policies; to develop the instruments and procedures needed for the future conduct of a single monetary policy; to oversee the development of the ECU” (European Council, October 1990).

The Intergovernmental Conference

The reaction to the conclusions of the European Council came quickly, mainly from the ministers of finance and central bankers. Around the end of 1990, officials from Germany, the Netherlands, and the United Kingdom advanced the idea that the Rome conclusions were internally inconsistent, that the monetary institution of the transitional phase could not possibly be the ECB, because it would not have the full powers of a central bank.¹⁴ The idea was an offshoot of the “no-empty-shell” argument, whereby the creation of the ECB in the second stage

¹⁴ It is not clear whether, or to what extent, this position was a reaction to the weakening of the economic-convergence conditions for entry into stage two that were decided by the European Council meeting in Rome.

was deemed likely to confuse monetary-policy responsibilities and thus to undermine the credibility of the institution. The supporters of this position took up the idea of creating a council (or board) of governors of the Community central banks, with responsibilities and status essentially equivalent to those of the existing Committee of Governors.¹⁵

The refusal to contemplate even a partial transfer of sovereignty before the final stage was pleaded by the German delegation in order to postpone the creation of the ECB; in the end, this proposition prevailed even over that taken by the chancellor at the European Council in Rome.

The main argument against early creation of the ECB was indivisibility. Because ultimate responsibility for the conduct of monetary policy in stage two was to stay with the national central banks, a European central bank would have little to do, and its existence would only confuse markets as to where the responsibility for monetary policy rested. Although accepting that monetary-policy decisions would remain in national hands, the supporters of the “Delors-Rome” approach maintained that the creation of the ECB would serve not only as a sign of the commitment to the final goal and as a way of giving some teeth to policy coordination, but also, and more importantly, as the tool for preparing what the Italian delegation called the “platform” for monetary policy:

The unity and consistency of the monetary system on the basis of which the central bank operates are such obvious features of the economy that it is hard to imagine that they could be lacking. It is a “platform” that comprises a multiplicity of elements and institutions. . . . the steps to prepare the transition to economic and monetary union should be a thorough and systematic examination of current national platforms; their assessment in the light of the tasks of the European Central Bank; identification of the minimum content of the common platform; and construction of that platform by means of legislative acts and operational actions. (Padoa-Schioppa and Saccomanni, 1992, pp. 5-6)

In December 1990, the Banca d'Italia presented a document to the Committee of Governors in which it stated that “a fundamental distinction should be made between the ‘qualitative’ and ‘quantitative’ aspects of monetary policy. The ‘qualitative’ aspect concerns the structural characteristics of policy instruments. . . . The quantitative aspect concerns the effective size or level of a given instrument (e.g., interest rates or liquidity)” (Banca d'Italia, December 1990).

¹⁵ The German delegation presented this idea at the IGC in February 1991.

Qualitative action was needed to carry out the complex structural work necessary to conduct a unified monetary policy in stage three; quantitative action, that is, the coordination of national monetary policies, would make sure that monetary conditions were uniform across countries and conducive to monetary union. It was further argued that the ECB should have a primary role in the “qualitative” area, and that national central banks should retain responsibility in the “quantitative” area, albeit within a framework of close collaboration that would respect the principle of the indivisibility of monetary policy.

The discussion about the nature of the monetary institution in the transition came to the fore at the IGC in April, where the institutionalist and behavioralist camps were clearly defined. The European Commission and the French delegation, from the time of their respective treaty proposals, had been in favor of granting the ECB significant responsibilities. The Italian delegation reiterated the distinction between the qualitative and quantitative functions, now emphasizing more the need to prepare the ground for a unified monetary policy than the coordination of national monetary policies. Germany and the Netherlands insisted on their idea of a low-profile institution, a council or board of governors. The German delegation, with the support of the Dutch, was, in particular, adamant in rejecting any mechanism that would make monetary-policy coordination binding or consultation procedures stronger, even if these procedures left the last word to the national authorities. A less rigid view was taken about the idea of entrusting the monetary institution with the preparation of the third stage. Even in this regard, however, the German delegation kept a very guarded stance, preferring voluntary cooperation to majority decisions, lest the freedom of choice for the Bundesbank should be hampered in any way. The United Kingdom maintained its proposal for a European Monetary Fund responsible for the management of the hard ECU. Spain was in favor of creating the ECB at the beginning of the second stage but was still looking for some form of compromise with the British proposal that would allow the ECB to issue (hard) ECUs.

To overcome the stalemate, the head of the Belgian delegation, Baron Bernard Sney, proposed the compromise name of “European Monetary Institute” (EMI) for the monetary institution in the transitional stage, on the analogy of Luxembourg’s quasi-central bank, the Institut Monétaire Luxembourgeois.

This suggestion was not taken up by the Luxembourg presidency, which proposed in the draft treaty presented at the European Council in June that the transition be split into two subphases corresponding to

two different institutional bodies: a board of governors, to be created as soon as the treaty was ratified, and the ECB to be set up at the beginning of the transition phase, that is, on January 1, 1994 (but with its operations starting only on January 1, 1996). The functions envisaged for the board did not differ significantly from those of the Committee of Governors, except that price stability was to be the explicit basis for stepped-up coordination of monetary policies and that it was to promote the development of the ECU. The task of the ECB, when it became operational, would be to prepare the framework for the single monetary policy in the third stage, with special reference to instruments, payment systems, and statistics. In addition, once the passage to the final stage had been decided, the ECB would contribute through “the technical preparation of notes and coins in ECUs” and recommendations to national central banks. The Luxembourg proposal thus tried to remain at least partly faithful to the Rome conclusions and sought to achieve a compromise between the behavioralist and institutionalist approaches. It nonetheless implied a substantial downgrading of the monetary institution in the second stage in terms of status, name, powers, and responsibilities. The compromise found little favor with supporters of either approach.

In July 1991, the Netherlands presidency decided to adopt the Belgian proposal. Starting from the premise that stages two and three were very different as far as monetary policy was concerned and that “uncertainties and confusion in stage two about who is finally responsible for monetary policy should be avoided,” (Netherlands Presidency, August 1991), it suggested the creation of a temporary monetary institution—the EMI—at the beginning of stage two. The coordination and preparation tasks to be entrusted to the EMI were fairly vague and general and gave it relatively little power in comparison to that of the national central banks. The EMI compromise was accepted by all the delegations at the informal Ecofin meeting held in Apeldoorn from September 20 through 22. At Italy’s request, and despite the initial opposition of Germany, it was also agreed that the EMI would be dissolved at the beginning of stage three to avoid the coexistence of two institutions in the period before all the member states came to participate fully in the union.

Apeldoorn thus marked the definitive departure from the well-tried Community method of the 1950s. This method, endorsed by the Delors Report and the European Council in Rome, entrusted the “final” institution from the very beginning of the transition with the task of acting as the driving force in the achievement of the objective. The long

debate over the name of the institution thus had a much wider significance. From the Delors Report on, documents on EMU gave very clear indications regarding the structure and authority of the ECB. Using the same institution for the transition meant using that structure and that authority to move toward the third stage, that is, putting the whole transition process on a supranational and Community footing, rather than on an intergovernmental and voluntary base—although still leaving to national authorities the last word on current policy decisions.

After Apeldoorn, the focus of the negotiations shifted to the tasks and powers of the EMI, its structure and whether its president should be full time or one of the central-bank governors, its financial independence (that is, whether it should have its own capital or be financed by contributions from the national central banks), its involvement in the private ECU clearing system, its role in the management of external reserves, and its ability to take legally binding decisions. The two positions confronting each other in stage two over the creation of the ECB reemerged in the debate about the powers of the EMI. The minimalist position was defended mainly by the German and U.K. delegations; the French insisted on a role for the EMI in the management of foreign-exchange reserves; and the Italian delegation insisted on the need to endow the EMI with the powers necessary to prepare the platform for the third stage. In the face of strong German opposition, any idea of giving the EMI substantial responsibilities in the coordination of monetary policies was, *de facto*, withdrawn.

Following Apeldoorn, the Committee of Governors was asked to prepare a draft of the EMI statute and of the transitional provisions concerning the role of those central banks the currencies of which would not initially be part of the third stage. The alchemy of the Committee of Governors—based on intimate working contacts, an informal and depoliticized attitude, determined Bundesbank influence, and an efficient secretariat—allowed the committee (headed by Erik Hoffmeyer of the Danmarks Nationalbank after Karl Otto Pöhl's departure in July) to prepare a complete statute in little more than a month. On the basis of this draft, the Netherlands presidency submitted a proposal to the IGC with a rather restrictive definition of the functions of the EMI. In the field of monetary-policy coordination, there was no change with respect to the weak role of the Committee of Governors in stage one (on the ground that indivisibility would otherwise be violated): the decisions necessary for preparing the instruments for stage three required unanimity, the legal status of the EMI's acts

remained uncertain, and the EMI was to be made financially dependent on contributions from the national central banks.

On some important issues, the Netherlands proposal contained alternative formulations: Should the EMI only oversee, or also promote, the development of the ECU? Should the decision to entrust the management of foreign-exchange reserves to the EMI be unanimous or not? Should the president of the EMI be one of the central-bank governors or not? Should the decision to endow the EMI with its own capital be subject to a unanimous decision? In this debate, as in the two others reviewed above, the pendulum, which had swung toward a minimalist approach following the European Council in Rome, began to swing back late in October, leading to a partial recovery of the earlier, more advanced positions.

A gradual upgrading of the preparatory role of the EMI was accepted as it came to be recognized that building the platform was a difficult, complex, and time-consuming task. Ways were sought to grant significant powers and responsibilities to the EMI in this role without infringing on the principle of the indivisibility of monetary policy. Initially, it was suggested that the regulations of the EMI (for example, as regards minimum-reserve requirements) would be applicable only from the beginning of the third stage. The solution eventually chosen was that the decisions taken by the EMI would be submitted for approval to the ECB at the beginning of the third stage and become legally binding only afterward.

By November 1991, the ground was ready for a compromise: Wim Kok, president of the IGC (ministerial level), strongly advocated the idea that the EMI should have an external president and a limited amount of capital; the German delegation, led by Horst Köhler, conceded the possibility that the EMI could manage some reserves and recognized the importance of the task of preparing the instruments for the single monetary policy. In an Interinstitutional Conference meeting on November 13, the European Parliament expressed itself strongly in favor of an external president for the EMI.

Between November 29 and December 4, 1991, the IGC ended with a series of meetings at various levels in Brussels and Scheveningen; many issues were settled, including those concerning the EMI. The approach of the Maastricht meeting of Heads of State or Government and the clear perception that the German chancellor strongly desired a positive outcome were conducive to the creation of a more cooperative climate.

As regards the preparation of the platform, the formulation of the Dutch draft treaty concerning the tasks of the EMI was strengthened on the basis of an Italian proposal that was supported in the end by the IGC presidency and by the French and German delegations (Treaty, Protocol on the EMI Statute, Article 4.2). The German delegation, in particular, became convinced that serious preparatory work was necessary and could be carried out in a way that would not impinge on the Bundesbank's freedom in the conduct of monetary policy.

The spirit of compromise spread to other issues. The EMI would have an external president, appointed by the Heads of State or Government acting on a recommendation by national central-bank governors; it would be endowed with its "own resources," not capital, to finance operations; it would be granted the ability to "hold and manage foreign exchange reserves as an agent for, and at the request of, national central banks" (Treaty, Protocol on the EMI Statute, Article 6.4); and it would have the power to address opinions and recommendations, unanimously agreed upon by the EMI Council, to the national central banks.

Overall, the preparatory function and the structure of the EMI were somewhat reinforced with respect to the initial Dutch draft, but the responsibilities assigned to it in the field of monetary-policy coordination remained virtually the same as those given to the Committee of Governors; no steps were taken to counter the risk of inconsistencies developing in the transition period between the stability of exchange rates in the EMS and the autonomous conduct of monetary policies. That is why Kenen (1992) concluded that the final version of the EMI appeared to be closer to the institution favored by the Germans and British than to that envisaged by the French and Italians.¹⁶

The composite nature of the compromise reached on the EMI makes it difficult to judge whether the new institution will be strong enough to sustain the process of monetary unification during the transition. Because the crisis of the EMS intervened even before ratification of the treaty, that is, before the beginning of stage two, the conditions

¹⁶ The Bundesbank seemed to concur with this view: "In line with the thinking of the Bundesbank, the regulations for the transitional phase provide for responsibility for monetary policy remaining at the national level until the entry into the final stage of EMU, the main tasks assigned to the European Monetary Institute to be established at the beginning of 1994—i.e., strengthening monetary policy coordination and organizing the preparation of the final stage—are to this extent limited" (Bundesbank, February 1992, pp. 43-52).

under which the EMI operates have changed in a substantial and unexpected way. The provisions that emerged from the negotiating table concerning the transition will be tested in very different circumstances from those implicitly assumed when the treaty was drafted. Nonetheless, the weakness of the coordinating function will be an obstacle in progressing toward EMU, just as it was a factor in letting the EMS crisis take on a systemic dimension between the summers of 1992 and 1993.

7 Concluding Reflections

The transition to EMU effectively started when the Maastricht Treaty was signed in February 1992. Two years later, the treaty has come legally into force. Because the ratification process proved longer and more turbulent than had been envisaged, much of the momentum has been lost. The EMI has been created and has started its life, but in a restrained manner; countries have moved further away from the reference values of the performance indicators set in the treaty, although actual values are more “convergent” (less dispersed) than they were two years ago. Of even greater significance, the ERM, an essential component of the arrangements for the transition, has been virtually suspended, although market exchange rates have miraculously returned within the narrow margins of fluctuation, even though these margins are no longer binding.

At the time the treaty was signed, it was commonplace to take EMU for granted; it has now become commonplace to consider it most unlikely. Experience should teach more caution. EMU is now a legal and political commitment of all twelve member countries. All have agreed on a permanent change in the EC constitution, one that complements the Internal Market with a central bank and a single currency and with well-specified institutional and functional prerogatives. This is the fundamental achievement of the initiative taken by Kohl in June 1988 in Hannover and carried through until October 1993, when the supreme court in Karlsruhe gave the last green light needed to make the treaty legally enforceable. This major achievement should not be underrated.

This permanent change in the Treaty of Rome will have a decisive influence on European developments in the years to come. Whether or not EMU is eventually achieved will depend on many political and economic factors that could not be planned or predicted in the treaty negotiations and that cannot be predicted even today. Achieving EMU

will also depend, however, on the workability of the transition path designed by the treaty. On that, a few final comments are in order.

Although there is a tendency in the negotiating phase to measure success by the ability of the negotiators to agree, what counts from the first day after signing a contract is the contract's intrinsic quality. The part of the Maastricht contract that is the most crucial in this respect is that concerning the transition. To explain why and how this part was written as we now read it has been the purpose of this essay.

The Delors Report left many more questions open for the transition than for the final stage of EMU, although it set a few clear principles. In the two and a half years between the completion of the Delors Report and the Maastricht Summit, and especially in 1991, those blanks were often filled with formulae that diverged from the Delors Report and from the explicit will of the Heads of State or Government. This was largely a result of what we have called the behavioralist approach, and it is likely to make the transition more difficult.

Although the very sensible concept of an instantaneous transition could not be taken literally, it could have inspired a purely technical transition process, thereby limiting uncertainty about the move to the final stage. This would have required a solution that included a shorter transition period, a smaller group of countries at the outset of stage two, the creation of the ECB at the beginning of stage two, less pedantic convergence requirements, and a demonstrable will to withstand market pressures by all means necessary. For various reasons, virtually all the negotiating parties (perhaps Italy and France more than others) either failed to muster the will or lacked the strength to have such a forceful design adopted for the transition process.

The behavioralist camp had the strength—often supported by the presidency of the IGC—but insufficient will. The Federal Republic of Germany was divided between a highly pro-EMU part-time political level, perhaps even ready to accept immediate EMU but not prepared to impose it, and a much more reluctant full-time technical level. The British were consistently negative, responding in reaction to the prospect of a united continent (even peacefully united) with a centuries-old, political reflex of fear and aversion. As on previous occasions, but more effectively than in the past, U.K. negotiators masterfully forced a dilution of solutions, weakened in exchange for the mere hope that Britain would sign in the end. When the British lost the generalized opt-out clause, they produced at the last minute a special protocol in Maastricht that sharply parted *their* treaty from that of the other member states (whose vigor they had so skillfully undermined in the

previous eighteen months). The Dutch, once so lucid in seeing the historical and institutional path to a truly united Europe, used the presidency to pursue the chimera of a British-German accord, content as they were with the *de facto* absorption of their currency in the deutschmark sphere.

In the institutionalist camp, the advocates for EMU failed to support their will with the actions required to give negotiating strength to a more activist and forthcoming attitude. France failed to concede what was necessary to persuade German politicians and public opinion that monetary union was coming as part of a true political unity—a democratization of EC institutions and a more effective common foreign and security policy. Moreover, the reluctance to move rapidly toward an independent Banque de France fueled German fears and residual misunderstandings about the status of the future ECB. Finally, Italy failed to undertake the serious domestic adjustment needed to overcome the concern of its partners, particularly in low-inflation countries, that moving toward a single currency would allow Italy to continue on a course of budgetary laxity or of borrowed stability without paying the price. The Italian crisis of 1992-93 confirmed that fear.

The events of 1992-93 are not unrelated to the way the treaty was negotiated and, in particular, to the approach chosen for the transition. Both the difficulty of the ratification process and the long exchange-rate crisis were due, among other things, to the fact that public opinion and markets reacted to the impression that the treaty's signing had not brought to an end the debate between those countries and factions within countries that were fully convinced and those that still had reservations about EMU. This state of uncertainty had a profoundly destabilizing effect on both the political process of ratification and market sentiment.

What now? Will there be no EMU because the arrangements for the transition are unworkable? We think not. The compromise on the transition embodied in the Maastricht Treaty may not be optimal, but it can lead to the final objective of union.

The economic and historical forces leading toward a Europe united by a single currency are deep and powerful, although they entered, precisely in 1992, a low phase in the cyclical path they have followed for the last forty-five years. The Maastricht Treaty is, however, in place, notwithstanding the drawbacks of the transitional provisions. It has been democratically ratified by all the member states—by changing national constitutions where necessary—and it has already produced significant changes in the statutes of some national central banks. It

provides a clear plan and an explicit commitment to reach a single currency, just as the Treaty of Rome provided for the Internal Market. Also like the Treaty of Rome, it may require an amendment at some stage (its “Single Act”) to make the transition to stage three more workable. Burying this plan, however, and its commitment, would jeopardize the entire approach Western Europe has followed in the second half of this century to remedy the disasters of the first. Although this is possible, we consider it unlikely.

Appendix A: Extracts from the Treaty on European Union

TITLE VI

ECONOMIC AND MONETARY POLICY

CHAPTER 1

Economic Policy

Article 104c

1. *Member States shall avoid excessive government deficits.*
2. *The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline on the basis of the following two criteria:*
 - (a) *whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value, unless*
 - *either the ratio has declined substantially and continuously and reached a level that comes close to the reference value;*
 - *or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;*
 - (b) *whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.*

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

3. *If a Member State does not fulfil the requirements under one or both of these criteria, the Commission shall prepare a report. The report of the Commission shall also take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State.*

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

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

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

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

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

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

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

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

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

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

— to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities;

— to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned;

- to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Community until the excessive deficit has, in the view of the Council, been corrected;
- to impose fines of an appropriate size.

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

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

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

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

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

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

CHAPTER 4

Transitional provisions

Article 109e

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

2. *Before that date*

(a) each Member State shall:

- adopt, where necessary, appropriate measures to comply with the prohibitions laid down in Article 73b, without prejudice to Article 73e, and in Articles 104 and 104a(1);*
- adopt, if necessary, with a view to permitting the assessment provided for in subparagraph (b), multiannual programmes intended to ensure the lasting convergence necessary for the achievement of economic and monetary union, in particular with regard to price stability and sound public finances;*

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

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

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

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

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

Article 109f

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

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

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

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

2. The EMI shall:

- strengthen cooperation between the national central banks;*
- strengthen the coordination of the monetary policies of the Member States, with the aim of ensuring price stability;*
- monitor the functioning of the European Monetary System;*
- hold consultations concerning issues falling within the competence of the national central banks and affecting the stability of financial institutions and markets;*
- take over the tasks of the European Monetary Cooperation Fund, which shall be dissolved; the modalities of dissolution are laid down in the Statute of the EMI;*
- facilitate the use of the ECU and oversee its development, including the smooth functioning of the ECU clearing system.*

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

- *prepare the instruments and the procedures necessary for carrying out a single monetary policy in the third stage;*
- *promote the harmonization, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its field of competence;*
- *prepare the rules for operations to be undertaken by the national central banks within the framework of the ESCB;*
- *promote the efficiency of cross-border payments;*
- *supervise the technical preparation of ECU banknotes.*

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

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

- *formulate opinions or recommendations on the overall orientation of monetary policy and exchange-rate policy as well as on related measures introduced in each Member State;*
- *submit opinions or recommendations to governments and to the Council on policies which might affect the internal or external monetary situation in the Community and, in particular, the functioning of the European Monetary System;*
- *make recommendations to the monetary authorities of the Member States concerning the conduct of their monetary policy.*

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

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

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

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

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

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

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

Article 109g

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

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

.....

Article 109j

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

- the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability;
- the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 104c(6);
- the observance of the normal fluctuation margins provided for by the

exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State;

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

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

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

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

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

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

- decide, on the basis of the recommendations of the Council referred to in paragraph 2, whether a majority of the Member States fulfil the necessary conditions for the adoption of a single currency;*
- decide whether it is appropriate for the Community to enter the third stage,*

and if so

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

4. If by the end of 1997 the date for the beginning of the third stage has not been set, the third stage shall start on 1 January 1999. Before 1 July 1998, the Council, meeting in the composition of Heads of State or Government, after a repetition of the procedure provided for in paragraphs 1 and 2, with the exception of the second indent of paragraph 2, taking into account the reports referred to in paragraph 1 and the opinion of the European Parliament, shall, acting by a qualified majority and on the basis of the recommendations of the Council referred to in paragraph 2, confirm which Member States fulfil the necessary conditions for the adoption of a single currency.

Article 109k

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

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

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

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

4. In Articles 105(1), (2) and (3), 105a, 108a, 109 and 109a(2)(b), “Member States” shall be read as “Member States without a derogation”.

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

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

PROTOCOL
ON THE EXCESSIVE DEFICIT PROCEDURE

THE HIGH CONTRACTING PARTIES,

DESIRING to lay down the details of the excessive deficit procedure referred to in Article 104c of the Treaty establishing the European Community,

HAVE AGREED upon the following provisions, which shall be annexed to the Treaty establishing the European Community:

Article 1

The reference values referred to in Article 104c(2) of this Treaty are:

- 3% for the ratio of the planned or actual government deficit to gross domestic product at market prices;
- 60% for the ratio of government debt to gross domestic product at market prices.

Article 2

In Article 104c of this Treaty and in this Protocol:

- government means general government, that is central government, regional or local government and social security funds, to the exclusion of commercial operations, as defined in the European System of Integrated Economic Accounts;
- deficit means net borrowing as defined in the European System of Integrated Economic Accounts;
- investment means gross fixed capital formation as defined in the European System of Integrated Economic Accounts;
- debt means total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government as defined in the first indent.

Article 3

In order to ensure the effectiveness of the excessive deficit procedure, the governments of the Member States shall be responsible under this procedure for the deficits of general government as defined in the first indent of Article 2. The Member States shall ensure that national procedures in the budgetary area enable them to meet their obligations in this area deriving from this Treaty. The Member States shall report their planned and actual deficits and the levels of their debt promptly and regularly to the Commission.

Article 4

The statistical data to be used for the application of this Protocol shall be provided by the Commission.

PROTOCOL
ON THE CONVERGENCE CRITERIA REFERRED TO
IN ARTICLE 109j OF THE TREATY ESTABLISHING
THE EUROPEAN COMMUNITY

THE HIGH CONTRACTING PARTIES,

DESIRING to lay down the details of the convergence criteria which shall guide the Community in taking decisions on the passage to the third stage of economic and monetary union, referred to in Article 109j(1) of this Treaty,

HAVE AGREED upon the following provisions, which shall be annexed to the Treaty establishing the European Community:

Article 1

The criterion on price stability referred to in the first indent of Article 109j(1) of this Treaty shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1½ percentage points that of, at most, the three best performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a comparable basis, taking into account differences in national definitions.

Article 2

The criterion on the government budgetary position referred to in the second indent of Article 109j(1) of this Treaty shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 104c(6) of this Treaty that an excessive deficit exists.

Article 3

The criterion on participation in the exchange-rate mechanism of the European Monetary System referred to in the third indent of Article 109j(1) of this Treaty shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary

System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against any other Member State's currency on its own initiative for the same period.

Article 4

The criterion on the convergence of interest rates referred to in the fourth indent of Article 109j(1) of this Treaty shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than two percentage points that of, at most, the three best performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions.

Article 5

The statistical data to be used for the application of this Protocol shall be provided by the Commission.

Article 6

The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, the EMI or the ECB as the case may be, and the Committee referred to in Article 109c, adopt appropriate provisions to lay down the details of the convergence criteria referred to in Article 109j of this Treaty, which shall then replace this Protocol.

PROTOCOL
ON THE TRANSITION TO THE THIRD STAGE
OF ECONOMIC AND MONETARY UNION

THE HIGH CONTRACTING PARTIES,

Declare the irreversible character of the Community's movement to the third stage of economic and monetary union by signing the new Treaty provisions on economic and monetary union.

Therefore all Member States shall, whether they fulfil the necessary conditions for the adoption of a single currency or not, respect the will for the Community to enter swiftly into the third stage, and therefore no Member State shall prevent the entering into the third stage.

If by the end of 1997 the date of the beginning of the third stage has not been set, the Member States concerned, the Community institutions and other bodies involved shall expedite all preparatory work during 1998, in order to enable the Community to enter the third stage irrevocably on 1 January 1999 and to enable the ECB and the ESCB to start their full functioning from this date.

This Protocol shall be annexed to the Treaty establishing the European Community.

Appendix B: Chronology of Events

1988

January	French minister Edouard Balladur circulates a memorandum calling for greater symmetry in the functioning of the EMS
February-March	German ministers H. Dietrich Genscher and Gerhard Stoltenberg circulate memoranda proposing a single currency and a European central bank
March	The Committee for the Monetary Union of Europe (chaired by Valéry Giscard d'Estaing and Helmut Schmidt) presents a proposal for a European monetary union
June	The European Council (Hannover) appoints the Committee for the Study of Economic and Monetary Union, to be chaired by Jacques Delors, president of the EC Commission

1989

April	Presentation of the Delors Report
June	The European Council (Madrid) accepts the Delors Report as a basis for proceeding to EMU; it decides that stage one of EMU should start on July 1, 1990, and that the competent bodies of the Community should carry out adequate preparations for an Intergovernmental Conference (IGC) with the task of setting the further stages of EMU
September	The informal Council of Economic and Finance Ministers (Ecofin) at Antibes creates a high-level study group, under the chairmanship of Elisabeth Guigou, to outline the main questions to be addressed by an IGC
October	Presentation of the Guigou Report The U.K. Treasury circulates a document outlining an alternative, evolutionary approach to monetary union
November	Fall of the Berlin Wall
December	The European Council (Strasbourg) calls for an IGC to amend the Treaty of Rome for the realization of EMU

1990

March	The Ecofin Council issues decisions revising procedures for policy coordination during stage one of EMU and for cooperation between the EC central banks
April	Chancellor Helmut Kohl and President François Mitterrand, in a letter to EC Heads of State or Government, call for more rapid progress toward European integration and for a parallel IGC on political union The special European Council (Dublin) endorses the Kohl-Mitterrand proposal
June	The European Council (Dublin) sets up a parallel IGC on political union. It also decides that the two IGCs should meet in December and that their results should be ratified by the end of 1992
July	German monetary unification
August	The Federal Republic of Germany and the German Democratic Republic sign a treaty setting October 3 as the date for unification. Pan-German elections are scheduled for December
September	The informal Ecofin meeting in Rome prepares for the meeting of the European Council
October	The European Council (Rome), with the exception of the United Kingdom, agrees on the fundamental aspects of EMU
November	The Committee of Central Bank Governors presents the draft statute of the ECB and ESCB to the Ecofin Council
December	The two IGCs (on EMU and political union) open in Rome The EC Commission presents its proposal for a draft treaty

1991

January	The Luxembourg presidency of the IGC begins
January-February	Proposals for the draft treaty articles on EMU are presented

	to the IGC by the British, French, German, and Spanish delegations
June	The European Council (Luxembourg) gives a positive assessment of progress made by the IGC and decides that final agreement on the text of the treaty should be reached before the end of 1991
July	The Luxembourg presidency of the IGC ends and the Netherlands presidency begins
September	Agreement is reached at the informal Ecofin meeting (Apeldoorn) on the creation of a European Monetary Institute (EMI), rather than the ECB, at the start of stage two
October	The Committee of Central Bank Governors submits a draft statute of the EMI to the IGC
November	The Committee for the Monetary Union of Europe calls for setting a date for passage to the final stage of EMU
December	The IGC is concluded The European Council (Maastricht) approves the treaty
1992	
February	Signature of the final version of the treaty by the foreign affairs and finance ministers (Maastricht)
June-December	The treaty is ratified by all EC countries except Denmark (where voters reject ratification in a referendum in June) and the United Kingdom; in Germany, despite approval by Parliament, final ratification is subject to a ruling by the Federal Constitutional Court; in the United Kingdom, parliamentary discussion on ratification is delayed until after ratification by Denmark
September	The British pound and Italian lira suspend their participation in the ERM of the EMS
December	An agreement is reached at the European Council (Edinburgh) to exempt Denmark from the treaty provisions on a single currency and a common defence policy

1993

May-August	Danish voters approve ratification of the treaty in a second referendum
	The U.K. Parliament ratifies the treaty
August	The fluctuation bands of the ERM are widened from 2.25 to 15 percent.
October	The German Federal Constitutional Court's ruling in favor of the treaty concludes the treaty's ratification by all member countries
November	The European Council (Brussels) declares the treaty to be in force
December	The Council completes the approval of secondary legislation for the start of stage two of EMU

1994

January	Stage two of EMU begins; the EMI is created, with headquarters in Frankfurt
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Appendix C: Chronological List of Relevant Documents

1988

- March Balladur, Edouard, "Memorandum sur la construction monétaire européenne," *Ecu Newsletter*, No. 3, March 1988.
- Genscher, H. Dietrich, "Memorandum für die Schaffung eines Europäischen Währungsraumes und einer Europäischen Zentralbank," press article, Deutsche Bundesbank, March 1, 1988.
- June European Council (Hannover, June 26-28, 1988), "Conclusions of the Presidency."
- September Pöhl, Karl Otto, "The Further Development of the European Monetary System," in the Collection of Papers Submitted to the Committee for the Study of Economic and Monetary Union, September 1988.
- October De Larosiere, Jacques, "First Stages towards the Creation of a European Reserve Bank," in the Collection of Papers Submitted to the Committee for the Study of Economic and Monetary Union, October 1988.
- Thygesen, Niels, "A European Central Banking System: Some Analytical and Operational Considerations," in the Collection of Papers Submitted to the Committee for the Study of Economic and Monetary Union, October 1988.

1989

- April Ciampi, Carlo Azeglio, "An Operational Framework for an Integrated Monetary Policy in Europe," in the Collection of Papers Submitted to the Committee for the Study of Economic and Monetary Union, April 1989.
- June European Council (Madrid, June 26-27, 1989), "Conclusions of the Presidency."
- November Monetary Committee of the European Community, "Economic and Monetary Union beyond Stage I," (Report to the Council by the President of the Monetary Committee), November 10, 1989.

*List includes nonpublic documents issued by the Italian delegation. It does not include documents issued but not made public by other delegations.

	H.M. Treasury, "An Evolutionary Approach to Economic and Monetary Union," November 1989.
December	European Council (Strasbourg, December 8-9, 1989), "Conclusions of the Presidency." Carli, Guido, "The Evolution towards Economic and Monetary Union: A Response to the H.M. Treasury Paper," Italian Treasury, December 1989.
	1990
March	Council of Ministers of the European Communities, "Council Decision on the Realization of a Progressive Convergence of Policies and Economic Performances during the First Stage of Economic and Monetary Union," March 5, 1990. Council of the European Communities, "Council Decision on Cooperation between the Central Banks of the Member States of the Community," March 12, 1990. H.M. Treasury, "The Next Stage in an Evolutionary Approach to Monetary Union," March 28, 1990.
April	European Council (Dublin, April 28, 1990), "Conclusions of the Presidency."
June	U.K. Chancellor of the Exchequer, "Economic and Monetary Union: Beyond Stage I," speech to the German Industry Forum, June 20, 1990. European Council (Dublin, June 25-26, 1990), "Conclusions of the Presidency."
July	Monetary Committee of the European Community, "Report on Economic and Monetary Union beyond Stage I [in Italian]," July 23, 1990; <i>Bollettino Economico</i> (Banca d'Italia), No. 15, October 1990. Banca d'Italia, "A Blueprint for Stage II of Economic and Monetary Union [in Italian]," July 25, 1990; <i>Bollettino Economico</i> (Banca d'Italia), No. 17, October 1991. Deutsche Bundesbank, "Statement on the First Stage of Economic and Monetary Union," <i>Monthly Report of the Deutsche Bundesbank</i> , July 1990.
August	Commission of the European Communities, "Economic and Monetary Union [in Italian]," August 21, 1990; <i>Bollettino Economico</i> (Banca d'Italia), No. 15, October 1990.

September	Spanish Government, "EMU: Staying the Course—A Proposal for a Successful Intergovernmental Conference [in Spanish]," September 25, 1990; <i>Boletín Económico</i> (Banco de España), October 1990.
October	Deutsche Bundesbank, "Statement on the Establishment of an Economic and Monetary Union in Europe," <i>Monthly Report of the Deutsche Bundesbank</i> , October 1990. Carli, Guido, "Report by the Chairman of the Ecofin to the European Council, Rome," October 27-28, 1990. European Council (Rome, October 27-28, 1990), "Conclusions of the Presidency."
December	Banca d'Italia, "The Functions of the ECB in the Second Phase of Economic and Monetary Union," December 24, 1990. Commission of the European Communities, "Draft Treaty," presented at the Inaugural Session of the Intergovernmental Conference, December 10, 1990; <i>Bulletin of the European Communities</i> , Suppl. 2, 1991. European Council (Rome, December 14-15, 1990), "Conclusions of the Presidency."
1991	
January	French Government, "Projet de traité sur l'union économique et monétaire," January 28, 1991; Agence Europe, Europe Documents No. 1686, January 31, 1991. Spanish Ministry of Economy and Finance, "The ECU and the ESCB during Stage Two," January 28, 1991; Agence Europe, Europe Documents No. 1688, February 1, 1991. H.M. Treasury, "Economic and Monetary Union Beyond Stage I: Possible Treaty Provisions and Statute for a European Monetary Fund," January 1991.
February	German Delegation to the IGC, "Composite Proposal for the Treaty Revision," February 26, 1991; Agence Europe, Europe Documents No. 1700, March 20, 1991.
April	Italian Delegation to the IGC, "The European Central Bank in the Second Stage [in Italian]," April 8, 1991; <i>Bollettino Economico</i> (Banca d'Italia), No. 17, October 1991.
May	Luxembourg Presidency of the IGC, "Draft Articles of the Treaty Establishing the EEC Amended with a View to the Setting-up of an

- Economic and Monetary Union,” May 2, 1991; Agence Europe, Europe Documents Nos. 1709-1710, March 3, 1991.
- June Luxembourg Presidency of the IGC, “Draft Articles of the Treaty Establishing the EEC Amended with a View to the Setting-up of an Economic and Monetary Union,” June 18, 1991; Agence Europe, Europe Documents Nos. 1722-1723, July 5, 1991.
- European Council (Luxembourg, June 28-29, 1991), “Conclusions of the Presidency.”
- August Netherlands Presidency of the IGC, “Draft Treaty Texts Concerning Articles 109c-109g,” August 29, 1991; Agence Europe, Europe Documents No. 1731, September 6, 1991.
- September Italian Delegation to the IGC, “Monetary Arrangements for the Transitional Stage of EMU,” September 2, 1991.
- Netherlands Presidency of the IGC, “Projet de traité vers l’union européenne contenant dispositions portant modifications au traité instituant la communauté économique européenne,” September 24, 1991; Agence Europe, Europe Documents Nos. 1733-1734, October 3, 1991.
- October Netherlands Presidency of the IGC, “Proposal by the Presidency of the Intergovernmental Conference on EMU,” October 28, 1991; Agence Europe, Europe Documents Nos. 1740-1741, November 1, 1991.
- Draghi, Mario, “Letter to the Chairman of Personal Representatives (Cees Maas) on the Procedure for Moving to the Final Stage of EMU,” October 22, 1991.
- November Netherlands Presidency of the IGC, “Projet de traité sur l’union,” Working Document Presented by the Netherlands Presidency, November 8, 1991; Agence Europe, Europe Documents Nos. 1750-1751, December 13, 1991.
- December Schmidt, Helmut, “Maastricht Should Put Monetary Unity First,” *Wall Street Journal*, December 5, 1991.
- European Council (Maastricht, December 9-10, 1991), “Conclusions of the Presidency.”
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- February Deutsche Bundesbank, “The Maastricht Decisions on the European Economic and Monetary Union,” *Monthly Report of the Deutsche Bundesbank*, February 1992.

December European Council (Edinburgh, December 11-12, 1992), "Conclusions of the Presidency."

1993

October European Council (Brussels, October 29, 1993), "Conclusions of the Presidency."

Federal Constitutional Court of Germany, Decisions No. 2 BvR 2134/92 and 2 BvR 2159/92 of October 12, 1993.

December European Communities, "Secondary Legislation for the Start of Stage Two of EMU" (EC Regulations Nos. 3603/93, 3604/93, 3605/93, and Council Decisions 93/716/CE and 93/717/CE), *Official Journal of the European Communities*, December 31, 1993.

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