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## HISTORY OF THE ECONOMIC AND MONETARY UNION

The economic and monetary union (EMU) is the result of economic integration in the EU. A common currency, the euro, has been introduced in the euro area, which currently comprises 20 EU Member States. All EU Member States – with the exception of Denmark – must adopt the euro once they fulfil the convergence criteria. A single monetary policy is set by the Eurosystem, comprising the European Central Bank's Executive Board and the governors of the central banks of the euro area.

### LEGAL BASIS

- Article 3 of the Treaty on European Union (TEU); Articles 3, 5, 119-144, 219 and 282-284 of the Treaty on the Functioning of the European Union (TFEU);
- Protocols annexed to the Treaties: Protocol 4 on the statute of the European System of Central Banks and the European Central Bank; Protocol 12 on the excessive deficit procedure; Protocol 13 on the convergence criteria; Protocol 14 on the Eurogroup; Protocol 16, which contains the opt-out clause for Denmark;
- Intergovernmental treaties comprise the Treaty on Stability, Coordination and Governance (TSCG), the Europlus Pact and the Treaty on the European Stability Mechanism (ESM).

### OBJECTIVES

EMU is designed to support sustainable economic growth and a high level of employment through appropriate economic and monetary policymaking. This comprises three main fields: (i) implementing a monetary policy that pursues the main objective of price stability; (ii) avoiding possible negative spillover effects due to unsustainable government finance, preventing the emergence of macroeconomic imbalances within Member States, and allowing the Member States to coordinate their economic policies among themselves to a certain degree; (iii) ensuring the smooth operation of the internal market.

### ACHIEVEMENTS

The euro is already part of daily life in 20 Member States of the European Union. The single currency has a number of advantages, which include lowering the costs of financial transactions, making travel easier, and strengthening the role of Europe at international level. It helps complete the internal market.



## HISTORY OF EMU

At the summit in The Hague in 1969, the Heads of State or Government defined a new objective of European integration: economic and monetary union (EMU). A group headed by Pierre Werner, Prime Minister of Luxembourg, drafted a report outlining the achievement of full economic and monetary union within 10 years. The collapse of the Bretton Woods system produced a wave of instability in respect of foreign exchange, which called into serious question the parities between the European currencies. The EMU project was brought to an abrupt halt.

At the 1972 Paris Summit, the EU attempted to impart fresh momentum to monetary integration by creating the 'snake in the tunnel': a mechanism for the managed floating of currencies (the 'snake') within narrow margins of fluctuation against the dollar (the 'tunnel'). Thrown off course by the oil crises, the weakness of the dollar and differences in economic policy, the 'snake' lost most of its members in less than two years and was finally reduced to a 'mark area' comprising Germany, the Benelux countries and Denmark.

Efforts to establish an area of monetary stability were renewed at the Brussels Summit in 1978 with the creation of the European Monetary System (EMS), based on the concept of fixed but adjustable exchange rates. The currencies of all Member States, except the UK, participated in the exchange rate mechanism, ERM I. Exchange rates were based on central rates against the ECU (European Currency Unit), the European unit of account, which was a weighted average of the participating currencies. Over a 10-year period, the EMS did much to reduce exchange rate variability: the flexibility of the system, combined with the political resolve to bring about economic convergence, achieved currency stability.

With the adoption of the [Single Market Programme](#) in 1985, it became increasingly clear that the potential of the internal market could not be fully achieved as long as relatively high transaction costs linked to currency conversion and the uncertainties linked to exchange rate fluctuations, however small, persisted.

In 1988, the Hanover European Council set up a committee to study EMU under the chairmanship of Jacques Delors, the then Commission President. The committee's report (the Delors report), submitted in 1989, proposed strengthening a three-stage introduction of EMU. In particular, it stressed the need for better coordination of economic policies, the establishment of fiscal rules that set limits for deficits in national budgets, and the creation of an independent institution that would be responsible for the Union's monetary policy: the [European Central Bank](#) (ECB). On the basis of the Delors report, the Madrid European Council decided in 1989 to launch the first stage of EMU: the full liberalisation of capital movements by 1 July 1990.

In December 1989, the Strasbourg European Council called for an intergovernmental conference to identify what amendments to the Treaty were needed in order to achieve EMU. The work of this intergovernmental conference led to the [Treaty on European Union](#), which was formally adopted at the Maastricht European Council in December 1991 and came into force on 1 November 1993.



The Treaty provided for EMU to be introduced in three stages (some key dates of which were left open and would be set at later European summits as events progressed):

- Stage 1 (from 1 July 1990 to 31 December 1993): establishing the free movement of capital between Member States;
- Stage 2 (from 1 January 1994 to 31 December 1998): convergence of Member States' economic policies and strengthening of cooperation between Member States' national central banks. The coordination of monetary policies was institutionalised by the establishment of the European Monetary Institute (EMI);
- Stage 3 (which started on 1 January 1999): implementation of a common monetary policy under the aegis of the Eurosystem from the very first day and the gradual introduction of the euro notes and coins in all euro area Member States. Transition to the third stage was subject to the achievement of a high degree of durable convergence measured against a number of [criteria](#) laid down by the Treaties. The [budgetary rules](#) were to become binding and any Member State failing to comply [could face penalties](#). The monetary policy for the euro area was entrusted to the Eurosystem, made up of the six members of the ECB's Executive Board and the governors of the national central banks of the euro area.

In principle, by adhering to the Treaties, all EU Member States agreed to adopt the euro ([Article 3 of the TEU](#) and [Article 119 of the TFEU](#)). However, no deadline has been set and some Member States have not yet fulfilled all the convergence criteria. These Member States benefit from a provisional derogation. Furthermore, the United Kingdom and Denmark had given notification of their intention not to participate in the third stage of EMU and therefore not to adopt the euro. Today, only Denmark currently benefits from an exemption with regard to its participation in EMU's third stage, but maintains an option to end its exemption. At the time of writing, 20 of the 27 Member States have adopted the euro.

In the aftermath of the European sovereign debt crisis, which unfolded in 2009-2012, EU leaders pledged to strengthen EMU, including by improving its governance framework. A Treaty amendment, affecting [Article 136 of the TFEU](#), allowed for the creation of a permanent support mechanism for Member States in distress, provided the mechanism is based on an intergovernmental treaty, the stability of the euro area as a whole is threatened and the financial support is linked to strict conditionality. This led to the establishment of the European Stability Mechanism (ESM) in October 2012, which replaced several ad hoc mechanisms. In addition, ECB President Mario Draghi announced in 2012 that 'within our mandate, the ECB is ready to do [whatever it takes](#) to preserve the euro'. To this end, it created the [Outright Monetary Transactions \(OMT\)](#) instrument. The OMT allows the ECB to buy the sovereign bonds of a Member State in distress, provided the country signs a memorandum of understanding with the ESM, thus indirectly making ECB support subject to [strict conditionality](#). To avoid a reoccurrence of a sovereign debt crisis, EMU's secondary legislation was upgraded. The European Semester was established, which strengthened the Stability and Growth Pact (SGP), introduced the Macroeconomic Imbalance Procedure (MIP), and endeavoured to further strengthen economic policy coordination. The improved economic governance framework was supplemented with intergovernmental treaties,



such as the Treaty on Stability, Coordination and Governance (TSCG or 'Fiscal Compact') and the Europlus Pact.

A first attempt to further elevate EMU was proposed by the Commission in its [Blueprint for a deep and genuine EMU](#) in 2012. The ultimate aim would have been the establishment of a political union. Another 2012 initiative, the less ambitious 'Four Presidents' Report', failed to initiate substantial changes to EMU's economic governance framework. In 2015, taking inspiration from the Blueprint, the Presidents of the European Commission, the European Council, the Eurogroup, the ECB and the European Parliament published a report on [Completing Europe's Economic and Monetary Union](#) ('Five Presidents' Report'). It outlined a reform plan aimed at achieving a genuine economic, financial, fiscal and political Union in three stages (to be completed by 2025 at the latest). However, in order to fully realise the grand plans of the Blueprint or the 'Five Presidents' Report', it would be necessary to amend the EU Treaties in a substantial way. As no Treaty changes have been made since then, the most ambitious projects could not be realised.

The economic crisis induced by COVID-19 has put considerable pressure on public finances. In March 2020, the Council activated the SGP's general escape clause to give Member States a limited time span in which they can increase their public debt beyond the constraints of fiscal rules. This allows, among other things, the temporary exceedance of the 60% debt-to-GDP ratio without risking EU sanctions. However, Member States which already display a very high debt-to-GDP ratio are requested only to increase their debt with much caution. Even with the general escape clause activated, the imposition of sanctions is still possible within the framework of the SGP. Also in March 2020, the ECB initiated the [pandemic emergency purchase programme \(PEPP\)](#), which includes the acquisition of large amounts of sovereign debt on the secondary markets. This provides liquidity to the markets and is designed to avoid the emergence of large spreads between German Bunds and government bonds from a number of highly indebted EU Member States. The amounts provided are very large, but the programme is limited in time.

A [strategy review](#) was conducted by the ECB in the summer of 2021, the first since 2003, aiming for a 2% inflation target over the medium term, allowing for the target to be overshoot on a temporary basis and for climate change to be taken into account in the Eurosystem's decisions.

All the effects combined of years of ultra-loose monetary policy, further driven by the post-pandemic economic situation, as well as the fall-out from the war in Ukraine, mainly in the form of steep energy price hikes, resulted in a historic increase in inflation in the euro area, which showed its first signs in 2022. Second-round effects materialised when the dramatic loss of purchasing power led to strong demands for wage increases, resulting in a possible wage-price spiral. The Eurosystem made a U-turn on its monetary policy, tapering asset purchases and increasing interest rates. Responding to fears that there would be excessive spreads for sovereign bonds of high-debt countries, the ECB announced an 'anti-fragmentation tool', the [Transmission Protection Instrument](#) (TPI), in July 2022.



A debate in the Eurosystem and among euro area Member States on possible changes to the SGP gained momentum in the summer of 2022. However, Member States' positions diverged so widely that there were doubts about the feasibility of any substantial changes. Yet a consensus emerged to allow high-debt countries additional time to bring down their debt-to-GDP ratio to within the 60% upper limit. There is also consensus to simplify, where possible, the excessively complicated enforcement procedures of the SGP, while the current 60% and 3% thresholds for debt and deficit will be maintained. The general escape clause is planned to be deactivated at the end of 2023.

In April 2023, the Commission made legislative [proposals](#) to amend the SGP, urging the completion of the legislative procedure by the end of 2023. The proposals, if adopted as they stand, would transfer substantial decision-making powers from the Council to the Commission (which, according to the Treaties, essentially has none in this field), allowing the Commission to directly influence the fiscal adjustment path of individual euro area Member States. It would also allow the Commission to de facto have an influence on the economic policies of each euro area Member State by vetting national reforms and investments. However, strongly diverging positions within both the Council and Parliament cast doubts on the achievability of a fast breakthrough.

In 2023, after 11 rounds of interest rate increases, inflation in the euro area began to recede, but remains well above the target of 2%.

## ROLE OF THE EUROPEAN PARLIAMENT

Since the entry into force of the Lisbon Treaty, the European Parliament has participated as co-legislator in establishing most of the detailed rules shaping the economic governance framework (based among others on Articles 121, 126 and 136 of the TFEU). However, on some dossiers the Treaty only provides for a consultative role for Parliament, including, inter alia, the preventive part of the Stability and Growth Pact, as well as macroeconomic surveillance. In addition, Parliament is consulted on the following issues:

- Agreements on exchange rates between the euro and non-EU currencies;
- Countries eligible to join the single currency;
- The appointment of the President, Vice-President and the four other members of the ECB Executive Board;
- Some parts of the legislation implementing the excessive deficit procedure.

Each year, the ECB presents its annual report, which the ECB President then presents in plenary. Parliament usually reacts to the report by adopting an own-initiative report. Parliament has no decision-making powers for the different stages of the European Semester, but is regularly updated by the Commission and the Council, which hold the executive powers. Parliament's role in the economic governance of the EU was somewhat strengthened by the European Semester, in particular through the setting-up of an 'Economic Dialogue' involving Parliament, the relevant Council formations and



the Commission. Parliament may accompany the Semester by adopting own-initiative reports.

By nature, Parliament is not formally involved in the establishment of intergovernmental treaties (e.g. the TSCG), or in the setting-up and running of intergovernmental mechanisms (e.g. the ESM), although Parliament establishes a variety of contacts and is involved in exchanges of views nevertheless.

For more information on this topic, please see the [website of the Committee on Economic and Monetary Affairs](#).

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