HISTORY OF ECONOMIC AND MONETARY UNION

Economic and monetary union (EMU) is the result of progressive economic integration in the EU. It is an expansion of the EU single market, with common product regulations and free movement of goods, capital, labour and services. A common currency, the euro, has been introduced in the euro area, which currently comprises 19 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) and is complemented by fiscal rules and various degrees of economic policy coordination. Within EMU there is no central economic government. Instead, responsibility is divided between Member States and various EU institutions.

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 the result of step-by-step economic integration, and is therefore not an end in itself. 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 coordinating to a certain degree the economic policies of the Member States; (iii) ensuring the smooth operation of the single market.
ACHIEVEMENTS

The euro is now part of daily life in 19 Member States, of the European Union. Other Member States are expected to adopt it in the future. 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 single 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 according to a plan to be carried out in several stages. The ultimate goal was to achieve full liberalisation of capital movements, the total convertibility of Member States’ currencies, and the irrevocable fixing of exchange rates. The collapse of the Bretton Woods system and the decision of the US Government to float the dollar in 1971 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 (when it was still part of the EU), 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. A grid of bilateral rates was calculated on the basis of these central rates expressed in ECU, and currency fluctuations had to be contained within a margin of 2.25% either side of the bilateral rates (with the exception of the Italian lira, which was allowed a margin of 6%). 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. However, as a result of speculative attacks against several currencies in 1993, the fluctuation margins were expanded to 15%.

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 addition, many
economists denounced what they called the ‘impossible triangle’: free movement of capital, exchange rate stability and independent monetary policies, which were deemed incompatible in the long term.

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 by the Heads of State or Government 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), which was tasked with strengthening cooperation between the national central banks and with carrying out the necessary preparations for the introduction of the single currency. The national central banks were to become independent during this stage;

— 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. Since the United Kingdom left the EU in 2020, 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. The exemption arrangements are detailed in a protocol annexed to the EU Treaties. At the time of writing, 19 of the 27 Member States have adopted the euro.

In the aftermath of the European sovereign debt crisis, which unfolded in 2009-2010, 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 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. That same month, 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.

In the autumn of 2021, in the light of a faster than forecast economic recovery, and with inflation picking up unexpectedly quickly (although possibly only for a limited time), a discussion gained momentum within the Eurosystem concerning a possible careful tapering of quantitative easing as of 2022, as well as possible increases in interest rates in the medium term.

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 overshot on a temporary basis and for climate change to be taken into account in the Eurosystem’s decisions.

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 Article 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 part 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, who 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.

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