

MAASTRICHT: A BRIDGE TOO FAR

European monetary union and a single currency are at the heart of the 1991 Maastricht Treaty that transformed the European Community into a European Union. Were the financial plans too ambitious? What are the costs and benefits of a single currency and a uniform monetary policy? This article looks at the arguments for and against the Maastricht agreements and concludes that its reach exceeded both the realities of European economies and the political consensus within Europe for such a scheme of Euro-Federalism.

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WHEN THE TWELVE member states of the European Community (EC) cobbled together the Maastricht Treaty in December 1991, they probably had no inkling of its unintended repercussions. Maastricht burdened the newly-named European Union (EU) with two new commitments when they were least prepared to absorb them: a common security and foreign policy, undertaken at a moment when the member states found themselves so at odds over the war in the former Yugoslavia that the project was stillborn, and monetary union just as the European economies were tumbling into serious recession due to Germany's policy decisions surrounding unification.

This unfinished business from the conclusion of the century's two World Wars was addressed in a quiet, southern Netherlands town, by the river Maas, bordering on Belgium and Germany. The meeting produced one of those historic markers that transcend the linguistic inventions for which Brussels is famous. Disunion and disarray, however, have been the outcomes of Maastricht -- precisely the opposite of its promise. It contributed to a rekindling of nationalism in the EU countries and has been a major obstacle to recovery from recession. Why did this happen? What was in Maastricht that encouraged the very passions of European nationalism and economic retrenchment it was supposed to avoid?

THE SEEDS for Maastricht were planted in 1987 with the EC's adoption of the Single European Act, whose main thrust was a collection of 279 directives that reduced barriers to trade within the

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Community. It also replaced an unwieldy system of voting by unanimity with a form of weighted-majority voting and formalized "national treatment" as the norm for one member country accepting another's products and services. This is shorthand for saying a product produced in any EC member country must be accepted by any other so long as it meets minimum Community-wide health and safety standards. To achieve all this a five-year deadline was set with a review in 1992. What came to be called the EC92 project, therefore, led to the Maastricht meeting but in such a radically changed environment that no one in 1987 could have foreseen its significance.

Midway through the EC92 project, the wall in Berlin came down. Two years later the Soviet Union disintegrated. During the planning for Maastricht, EC countries slipped into recession for reasons directly associated with German reunification. At the same time, the EC92 project was beginning to run out of steam. The first pickings from the 279 directives were relatively easy to digest, dealing mostly with technical problems of harmonization of national standards. The more knotty EC problems of trade in services, public procurement, and national champions remained unyielding to change as they had before and have continued to this day. As one wall came down in middle Europe another went up in Brussels and supporters of EC92 found themselves frustrated by barriers inside the EC. Brussels planners took advantage of the changed circumstances in Europe to divert attention from the uncompleted EC92 project by constructing new targets, new projects, and new deadlines in order to sustain the momentum for European integration.

Maastricht became, therefore, not just the interim review meeting that had been planned for the EC92 project. It became a venue for addressing the profound geo-political changes in Europe and

for unblocking a stalled economic integration. Unfortunately, the wrong policies were chosen, applying Monetary Union austerity to economies needing stimulation and imposing a Eurofederalist solution when the Cold War glue binding Europe together was evaporating.

The principal geo-political problem in Europe was the new Germany, which especially troubled France. Its President, Francois Mitterand -- World War II resistance member and the last European political leader from a generation whose formative development came from the war -- embodied his country's ambivalence toward reunification. Ending a Cold War hot spot that had always threatened war was attractive to France, but it also feared a larger and more powerful Germany. Indeed, the very origin of the Common Market at the Treaty of Rome (1957) builds on the French plan for the European Coal and Steel Community (1952), which was deliberately designed to fold West Germany's ambitions into a prosperous western Europe, to direct their energies toward common economic objectives and away from geo-strategic ones.

So the problem of a reunified Germany and what to do about it was nothing new to French and other European policy planners. It was simply a variation on an older theme that involved finding a new mechanism for submerging Germany deeper into a unified and prosperous Europe, and by so doing divert its attention from any revanchist idea about expanding eastward or westward beyond its recognized borders.

Maastricht, therefore, became something it was not supposed to be, and its proposals were not carefully vetted. The consequence for EU members follows the typical pattern for sunk costs.

Half-thought-through schemes become set in concrete with a powerful bureaucracy behind them. Politicians are on a public record they are unwilling to contradict for fear of what it might do to their electoral prospects. Opinion leaders develop an interest in perpetuating bad ideas, circling the wagons to defend them, because their reputations depend on never having a bad idea. One detects from statements on and off the record by public officials that Maastricht was a mistake, but no one is prepared to depart from the group and own up to it.

Maastricht was not the first time that Monetary Union and common foreign and defense policy became part of EC proposals. But Brussels has a proposal on almost anything. There was no evidence previously that these were high priority items except, perhaps, among Jacques Delors --EC President, colleague of Mitterand in the French Socialist Party, visionary designer of the Single European Act and Maastricht -- and his supporters of a federalist Europe.

Monetary Union, for example, was part of the EC92 project. There were general proposals for a European Central Bank, giving the European Council of Ministers powers over national fiscal policies, with attendant deadlines, stages, and undertakings. But virtually nothing happened with the project by 1992 and no one took it very seriously.¹ These plans were periodically taken off the shelf, dusted off, and trotted out to remind EC members of the endgame targets for European integration, in order to focus their attention on the incremental and difficult steps required to move toward them.

MAASTRICHT, in its quest for monetary union, was a great leap forward and a departure from the incrementalism that had previously served the Community. The argument that further economic integration can only be achieved by the elimination of national fiscal and monetary policies is a significant digression for the EU. Heretofore members of the Community respected national economic policy differences so long as trade and commerce was liberalized. Harmonization into European-wide standards was reserved largely for technical matters. Monetary Union, however, obliterates national differences at the very core of the nation state. It is unprecedented in the forty-year history of European economic integration.

The Maastricht Treaty provided for three stages of movement toward monetary union: freedom of capital movements and more cooperation among central banks (1993); the creation of a European Monetary Institute, as a precursor to a European Central Bank (1994); an irrevocable fixing of exchange rates, issuance of a European currency, and shifting of monetary policy to the European Central Bank (1997-1999). All this is to culminate in the formal inauguration of the Monetary Union by the year 2000.²

To participate in the final stage of development of the Monetary Union countries must meet three macro policy criteria: a rolling inflation formula that in 1996 would set the rate at no more than 3%; public sector debt no more than 60% of GDP; and a budget deficit less than 3% of GDP.³ The stringency of these criteria has left only Luxembourg qualifying for entry as of 1996.

This is not the only recent instance of plans exceeding post-Maastricht economic realities. The European-wide recession of the 1990s has made it difficult for the EU to sustain its 1979 Exchange Rate Mechanism (ERM). Great Britain and Italy were forced by financial markets to depart from the system of fixed exchange rates in 1993; Spain and other weaker members were allowed to leave the narrow fixed bands of the ERM; and finally France in 1994 could only stay inside a nominally fixed rate system by blowing up the acceptable band of fluctuation from plus-or-minus 2.25% to 15%. These exchange rate commitments predate Maastricht by some dozen years and were taken as a given in 1992. But even this foundation has now been shattered. With very little of the economic underpinning for monetary union in place, political leaders and opinion elites have found another use for Maastricht: A device to force EU countries to undertake structural economic adjustment.

THE RATIONALE for linking monetary integration to economic integration revolves around a Eurofederalist idea of international competition. To compete with the United States, Japan, and the newly-industrializing-countries of Asia, European companies have to become larger and of the right scale. No one country, so the argument goes, is large enough to match the economic power of its rivals in North America and Asia. Monetary Union will allow Europe to achieve the right production scale by lowering transaction costs associated with currency conversions. Transaction costs, it is first argued, now impede mergers and acquisitions. Secondly, without the cost and nuisance of currency conversion, a larger internal market would be created. Product price, finally, would be lowered by eliminating transactions costs, allowing European companies to become more price competitive.

Every argument, therefore, turns on the issue of transaction costs.⁴ If transaction costs are the problem, however, a single currency is a very costly and ineffective policy answer. First, transaction costs can be lowered directly by a more efficient clearing mechanism among banks at considerably lower cost, risk, and uncertainty than by monetary union. Modern marvels of information processing, computer power, and telecommunication wizardry are ideally designed to tackle the very core of this problem. Second, currency conversion costs do not now inhibit multinational competitors outside of Europe from globalizing production, dealing in multiple currencies in countries on every continent of the globe, and coming out with a price competitive product. To build a commercial aircraft Boeing, for example, has contractors in several dozen countries. Somehow they do it and succeed. It is done -- and this is the third argument against the necessity of monetary union to solve the problem of transaction costs -- through financial markets that have innovated in futures contracts, hedging arrangements, and derivatives as a way to satisfy the demand for risk minimization associated with foreign exchange transactions.

If the goal is lower transaction costs, monetary union is the equivalent of using a sledge hammer to hang a picture on a wall. Aside from the substantial political costs of imposing economic austerity on populations enduring high unemployment, budgets stretched to the limit, high tax rates, and a fraying social contract, the single currency has direct transition costs. I have been given estimates ranging from the equivalent of \$10 billion upwards for conversion. There are the costs of printing new coin and currency with one standard size when national currencies and coin are now of different size. Vending machines will have to be retrofitted, cash registers changed, bank sorting machines replaced, ATM machines re-tooled, and so on. A new EU Central Bank building is under

construction in Frankfurt, and a large (and highly paid) staff is being recruited to manage monetary policy. Opportunity costs are incurred as national financial managers divert their attention to monetary union.

If there are other ways to handle currency conversion at substantially lower financial and political costs, what of the argument that EU companies are not of the right scale to compete in the global economy, because their countries are too small. This presents several confusions about size. Japan is not a large country, nor is South Korea, Singapore, or Taiwan. For them an economic union with other countries has not been a prerequisite for their companies achieving the necessary scale of production. Nor would they ever concede sovereignty over their monetary affairs, which they adroitly manage to encourage production scale. The relationship between size of country or economic union and success is not apparent. While these small countries do very well, large ones falter: Nigeria or Brazil, for example.

A second puzzlement surrounds the multiple meanings of competition. Brussels has a competition policy and a powerful competition Minister. But the EU has never been clear on what it means by competition. To some it is the Anglo-Saxon free market idea of small firms with easy entry that forces existing enterprises to innovate constantly or die. To others it means precisely the opposite: gigantic European-wide enterprises, such as Airbus, that can compete with its global rivals. Here there is no entry and innovation comes from a professional commitment of managers to improve productivity. These two alternative ideas of competition

-- call them global competitiveness versus market competition -- explain much of the disputes in the EU between the extremes of Great Britain and France.

The very recitation of this problem of language and the meaning of competition invites another retort to the Eurofederalist insistence on Monetary Union. Europe has been successful without monetary union in aircraft production, high speed trains, and agriculture. Why has it been able to achieve global competitiveness in these spheres but not in others? Why couldn't it succeed elsewhere without a costly monetary union?

The fact is that even if monetary union were achieved it would not allow KLM to pick up passengers at Orly in France and fly them to Heathrow in Great Britain. It would not allow a German insurance company to market its product in Italy. It would not permit British Telecom to compete with France Telecom. One would not find a Spanish construction company working on a public building in Brussels. Fiat cars would continue to be a rarity on the traffic-clogged streets of Paris. In every instance the more difficult problem of opening markets to competition would persist after monetary union. Production scale would remain an illusory goal without directly confronting the internal barriers to entry and market competition.

The EU's problem is not scale in the first instance. It is scope. Without the enhancement of the scope of enterprises -- its reach into larger markets either inside or outside the EU with attractive products -- the problem of scale would continue. Monetary union is a costly and ineffective way to address problems of scope and transaction costs. It could be achieved at great financial and political

cost without fulfilling its objectives, because barriers to growth, scale, and scope are only remotely related to separate currencies and separate fiscal-monetary policies. A political explosion would follow as citizens react to promises unrealized, after enduring financial austerity and personal sacrifice.

THERE ARE disturbing indications that countries in the EU are beginning to feel such shock waves. In many EU countries nascent nationalist forces are surfacing, and Maastricht offers an easy target for its demagogic leaders. Alone that would not be cause to reconsider Maastricht, but there are legitimate reasons for questioning the stretch of that treaty, which went beyond the evolution of a consensus for this form of European integration. The virulent strain of nationalism cannot incubate without an hospitable host and Maastricht has provided one.

High unemployment, stagnant living standards, and strained social security systems, coupled with the obligations under Monetary Union, have pushed EU countries toward consideration of a partial dismantling of their social contracts. The call for flexible labor markets, reform of social security systems, and economic restructuring are coded ways to express the need to meet the Maastricht requirements.

Some reforms of European economies and adjustments in their social security systems are certainly in order. But to justify them on the basis of a Maastricht mandate, and not simply sell them on their own merits, invites a nationalistic response. It is, after all, precisely the social security

system, and its implied social contract, that has instilled national pride and has bound together populations that have historically been driven apart by class divisions.

Paradoxically while Maastricht was supposed to head off renewed nationalism in Europe, it has contributed to its re-birth. Globalism -- and Maastricht is one form -- begets tribalism when policy decisions are removed from nation states. The passions of nationalism fill up the empty space vacated by governments. Democracy and the nation state have evolved together. To separate them, and render elected officials less able to influence events, weakens the fabric of the nation state and threatens this historically successful political institution. It is one thing to say in response that we need to find supranational political answers to supranational problems or to call for closing the "democratic deficit," as it is called in Europe, by strengthening an unwieldy European Parliament that does not provide effective representation. But the world is not yet there, as shown by the fact that political leaders pass up opportunity after opportunity to fulfill this promise at economic summits, and neither Brussels nor EU states are willing to cede real power to the European Parliament.

ECONOMIC problems in the EU countries are largely post-1991, an after-shock from German unification and Maastricht. The second half of the 1980s saw a European economic community coming together to rival the United States and Japan in both economic performance and in its special model of social capitalism. As an alternative to America's reliance on excessive individualism and Japan's on excessive conformity, it offered a third way toward the reconciliation of individual and public interests.⁵ Western Germany's leveraged buyout of eastern Germany, with heavy borrowing

instead of taxation, changed the economic landscape. Had that not occurred, there would not be reports about the clogged European system, the final days of social democracy, and the need to Anglo-Saxonize European markets. On top of the economic fallout from German unification, the Maastricht burdens have made it impossible to jump-start economic recovery.

Maastricht requires fixed exchange rates and movement toward monetary targets in debt and deficit. Recession makes the latter set of obligations more difficult because revenues decline, while spending entitlements for unemployment-related support increase. With diminishing room for budgetary maneuver under the Maastricht financial criteria, countries find themselves under pressure to reduce spending for social security, which in Europe involves much of what we call social spending in the United States. One does not have to be much of a Keynesian to accept the fact that planned deficits, for the express purpose of economic stimulation during recession, can aid in recovery.^a

Fixed exchange rates have a similar dragging effect on recovery. They operate through the pattern of relative interest rates in foreign exchange markets. In the current instance, Germany has had to raise its real interest rate -- nominal interest rate adjusted for inflation -- to attract the money to finance the absorption of eastern Germany. The size of the German economy in the EU makes it the leader and pattern-setter when it comes to interest rates and exchange rate policy. The deutsche

^aPlanned deficits are those deliberately designed to instigate an economic recovery. Unplanned deficits arise from the decline in tax revenues and increase in spending obligations during recession. While these have some stimulative effects, they do not have the same impact as a planned recovery strategy.

mark (D-mark) anchors the exchange rate system in Europe, much like the dollar does in the global economy, and its interest rate is the benchmark for all the EU members that subscribe to the exchange rate system.

Interest rates are linked to the exchange rate structure; this is why decisions taken in Germany between 1991 and 1992 affect all the countries in the EU. If France, for example, wants to attract capital, it competes for money by offering a rate of return to potential lenders -- the interest rate. If the rate is below its nearest competitor -- Germany -- capital will simply move out of the French franc and into D-marks where it can earn a higher return. This will have repercussions in exchange rates. The demand for French francs declines vis-a-vis German D-marks and the value of the French franc will decline, violating the stability agreed to under the EC fixed exchange rate regime and reaffirmed in Maastricht. To stabilize its currency, France will have to raise interest rates sufficiently to create a demand for and attract funds into the French franc.^b This is precisely what has been happening since 1991. Germany and its EU partners have sustained the highest real interest rates in the world in the midst of their most serious recession in 60 years, causing the departure of Great Britain from the exchange rate system in 1993 because it no longer wanted to maintain the required high interest rates.

Interest rates are a double-edged sword. High interest rates are needed to attract money into a currency and stabilize financial markets. But interest rates are also the cost of borrowing for

^bTo be more precise, exchange rates are connected to interest rates in a competitive market for capital, where players in the market assess comparative interest rates, adjusted for the risk of investing in different currencies.

investors in tangible capital formation -- factories, offices, new technologies. High interest rates discourage the very investments needed to nourish a recovery.

Real interest rates in France have been over 6% during the recession, one of the highest in the world, and 1.5 to 2 points higher than in the U.S.⁶ The Maastricht accords, intersecting with the consequences of Germany's debt financing, are a better explanation for the source of European economic weakness than are its social democratic policies, notwithstanding the fact that some prudent adjustment in social security systems is warranted. Countries could dismantle their social contracts at great political cost and not produce economic recovery so long as the Maastricht mandates lock economies into dysfunctional economic policies.

Recession is the chief enemy of international trade. It both inhibits output and sales of any sort, including cross-border trade, and fosters economic nationalism. A renewed burst of market-opening steps in the EU will have to await recovery from recession. To the extent Maastricht retards recovery, it is also antithetical to the EU's achieving the next stage in its evolution of trade and open markets.

IF MAASTRICHT is not the answer to further European economic integration, what is? A return to first principles is required, one that fulfills the initial promise of a common market. This is a largely unfinished project. Entire sectors, such as air transport, telecommunications, insurance, have not yet become open to internal EU competition. EC92 directives accepted by national representatives have been slow to obtain approval from national governments, as required by the

Single European Act. The most ardent proponents of Maastricht -- Germany and France -- are two of the biggest foot-draggers. In 1995 they had the most complaints filed against them for flouting EU trade rules: Germany (54) and France (48). Germany has approved fewer directives than any other EU member.⁷

Completing the common market before making the leap to Maastricht would have other salutary results, as well. It would first make it easier for east-central European countries to join because they would not have to meet the more difficult and cumbersome Monetary Union criteria. Existing EU members would also find it easier to accept their applications because the difficulty of reconciling disparate, post-war foreign and military policies -- and lingering suspicions about the future -- would be taken off the table. Second, the influence of Germany -- one of the ostensible reasons for Maastricht -- would be reduced, although it would still be pre-eminent. But it would not have a European Central Bank to dominate as it does under Maastricht, which effectively allows it to determine monetary and fiscal policies for other European nations. Germany would be a significant, but not hegemonic, force in a wider and deeper common market.^c

The debate is not about further European economic integration or not. It is about its form: whether the unfinished project of open and expanded internal markets should proceed first, followed by the Maastricht mandates or whether the latter should take center stage. The debate is not about

^cGermany successfully stood down France, and its Bundesbank acquired control of the European central bank. The debate was over membership structures and whether the EU Council of Ministers or national central banks would appoint Board members. Inflation will be the chief concern of the Bank and countries can be fined for such fiscal policies as large budget deficits. ["My, How You've Grown," The Economist (January 25, 1992), p. 50.]

universalism or particularism, nationalism versus internationalism. It is about the type of universalism and the best way to head off the passions of nationalism with an internationalism that does not extend beyond the acceptable consensus in European states.

Placing all of the objectives of European integration before the court of reason leads to the unfortunate conclusion that Maastricht was a bridge too far. It has poured fuel on what William Pfaff calls the "furies of nationalism," has made it more difficult for western Europe to absorb new applicants from east-central Europe, worsened recession and stalled recovery, threatened the political stability of post-war European social-democracy, and elevated Germany to a stronger position in Europe.⁸ It is time for European leaders to recognize the mistake they have made, climb out from under their sunk costs, and get on with the statesman-like vision of the founders of European economic integration. Calling for an indefinite delay in the implementation of Monetary Union is the best way to do this.

ENDNOTES

1. "Europe's Internal Market, EC1992," The Economist (July 8, 1989), pp. 42-43.

2. Willem Molle, The Economics of European Integration. Theory, Practice, Policy, second edition (Aldershot: Dartmouth Publishing Co., 1994), p. 402.

3. Ibid., p. 414 and "The European Community. Back to the Drawing Board," The Economist (July 3, 1993), p. 14.
4. If there is a "textbook" on monetary union, it is: Paul De Grauwe, The Economics Of Monetary Integration, second edition (Oxford: Oxford University Press, 1994). See his Chapter 3 where he bases the case for monetary integration on transactions costs.
5. Will Hutton, The State We're In (N.Y.: Vintage Books, 1996); and Michel Albert, Capitalism vs. Capitalism (London: Whurr Publishers, Ltd., 1993).
6. Data are taken from: Organization for Economic Cooperation and Development, OECD in Figures (Paris: OECD, annual editions).
7. "Is the Single Market Working?," The Economist (February 17, 1996), p. 30. Germany is lowest among countries who were members of the EU in 1987 when the Single European Act was initiated.
8. William Pfaff, The Wrath of Nations (N.Y.: Simon & Schuster, 1993).