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Currency Unification in the European Economic Community: The Mechanics, Politics, and Probability for Success

The Bretton-Woods Agreement of the 1950s was the first modern attempt to stabilize European currencies versus each other on a long-term basis.¹ The agreement was limited to minimizing changes in exchange rates on foreign exchange markets between a small number of European countries, far fewer than the European Economic Community (EEC) comprises.² The agreement lasted for nearly twenty years and was moderately successful in achieving its goal of stabilization.³ However, due to its limited scope, the agreement was inevitably doomed to failure as countries' individual priorities took precedence over the EEC-oriented goal of the agreement, namely exchange-rate stabilization.⁴ Increased inflation and other economic pressures during the late 1960s and early 1970s led the agreement's original participants (Belgium, France, Germany, Italy, Luxembourg, and the Netherlands) to abandon the constraints of the global policies set forth in the agreement in favor of policies that would improve their individual economies.⁵ The abandonment of the Bretton-Woods agreement led to wild fluctuations in exchange rates among many European countries and to uncertainty in European capital and goods markets.⁶ The failure of the Bretton-

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1. Aurther I. Bloomfield, *Historical Setting*, in *EUROPEAN MONETARY UNIFICATION AND ITS MEANING FOR THE UNITED STATES* 1, 22-23 (Lawrence B. Krause & Walter S. Salant eds., 1973).

2. *Id.*

3. *Id.*

4. Susan B. Shulman, *A Rapid or Evolutionary Approach: The EEC's Adoption of the ECU as a Common Currency*, 12 J. INT'L L. BUS. 392 (1991).

5. *Id.*

6. Bloomfield, *supra* note 1, at 23.

Woods Agreement also helped to usher in a period of soaring inflation and economic hardship throughout Europe.⁷

The current effort to stabilize markets and exchange rates in Europe, called the European Monetary System (EMS), is based in part on what the EEC learned from the successes and failures of the Bretton-Woods Agreement.⁸ Yet, the current endeavor by the EEC is far more comprehensive than the Bretton-Woods Agreement because it includes objectives in fiscal and monetary policy coordination as well as currency stabilization.⁹ The members of the EEC recognized that one of the major flaws in the Bretton-Woods system was the lack of political and fiscal coordination.¹⁰ Therefore, the EEC members also established the goals of creating fiscal, monetary, and political unification throughout the entire EEC region.¹¹ In addition to other differences, the current plan envisions the EMS as promoting not simply currency stabilization, which was the primary goal of the Bretton-Woods Agreement, but currency unification.¹²

A key feature of the EMS is the proposed establishment of a common currency for intra-EEC transactions that could eventually become a currency suitable for international trade.¹³ The current candidate for use as the sole currency throughout the EEC is the European Currency Unit (ECU).¹⁴ The basic premise of and problems facing the ECU are similar to those of the Bretton-Woods system.¹⁵ The problems include the tendency for countries to abandon their agreements during times of hardship in favor of policies supporting their own nationalistic interests.¹⁶ The success the EEC achieves in overcoming such problems will ultimately determine the success or failure of the EMS.¹⁷ The EEC may have already overcome one of its larger hurdles to achieving currency unification through recognition by the Member States that lasting economic stability throughout the region requires fiscal, monetary, and political uniformity and not simply currency stability.¹⁸

The purpose of this Comment is to demonstrate how the technicalities of creating a single currency are simple compared to the political complexities, and why,

7. *Id.*

8. Lawrence B. Krause, *Implications for Private Capital Markets*, in EUROPEAN MONETARY UNIFICATION AND ITS MEANING FOR THE UNITED STATES, *supra* note 1, at 114-15.

9. *Id.* at 115.

10. Shulman, *supra* note 4, at 407.

11. Krause, *supra* note 1, at 115.

12. *Id.*

13. HORST UNGERER ET AL., THE EUROPEAN MONETARY SYSTEM: DEVELOPMENTS AND PERSPECTIVES 2-3 (1990).

14. See generally OFFICE FOR OFFICIAL PUBLICATIONS OF THE EUROPEAN COMMUNITIES, THE ECU (1984) [hereinafter THE ECU].

15. MICHELE FRATIANNI & JURGEN VON HAGEN, THE EUROPEAN MONETARY SYSTEM AND EUROPEAN MONETARY UNION I (1992).

16. *Id.*

17. See generally Bloomfield, *supra* note 1.

18. Krause, *supra* note 1, at 115.

in the end, the political problems are likely to forestall any real progress towards currency unification. Part I discusses some potential effects of currency unification, including an overview of the EMS. Part II looks at the place of the ECU within the EMS and the progress the EMS has achieved toward currency unification. Part III evaluates the possibility of the successful introduction of a unified currency within the EMS.

I. What Could Currency Unification Mean Within the EMS?

A. A HYPOTHESIS

Just when the world thought that the latest series of corporate layoffs was ending, here they come again. Only this time they will likely be longer and more drastic than ever before. Europe, which once looked to be one of the world's most promising growth markets of the 1990s, has suddenly taken a turn for the worse. Europe is pitched in a deep recession with runaway inflation and pervasive high unemployment throughout the entire region. The prospect of 2 percent gross domestic product (GDP) growth in the United States, once thought to be stagnant, leads the world. Indeed, economists are predicting that Europe's GDP may even be shrinking in the face of overwhelming problems. High inflation in many European countries has led to sharp increases in unemployment throughout the region and a drastic reduction of disposable income for most Europeans.

The only difference between this slowdown in the European economy and similar slowdowns of the past is that the governments of Europe have lost the ability to control the situation. The result in the United States is much the same as it is in Europe. A reduction in personal income has precipitated a corresponding decrease in demand for products produced in the United States. The U.S. economy is experiencing a dramatic slowdown, an increase in the inflation rate in order to compensate for the lost profits, wages, and taxes, and high interest rates that harken back to the 1970s. The United States is also facing a new onslaught of corporate down-sizings.

The European governments precipitated this loss of control by relinquishing the major policy tools that had previously been available to them to correct these problems.¹⁹ No longer can an EEC member government use fiscal or monetary policy to help slow down inflation or decrease unemployment.²⁰ That power has been reserved for a central authority responsible for setting economic policy for the entire EEC.²¹ Everything from setting interest rates to printing money is controlled, not by each country, but by the European Central Bank (ECB).²²

19. Marc Dasse, *Selected Aspects of European Economic Community Law on Investments and Acquisitions in Europe*, 25 INT'L LAW. 375, 389-90 (1991).

20. Shulman, *supra* note 4, at 409.

21. *Id.* at 410.

22. *Id.*

Individual governments can no longer determine what the best economic course may be for their nations, but rather must live with decisions made by the ECB. Unfortunately, the decisions that the bank has determined to be the best for the region as a whole may not be in the best interest of any one particular country.²³ The result is that the separate policies that are in the best interest of each country individually are subordinated to a unified, and consequently less efficient, policy.²⁴ Governments have replaced precise management of economies at an individual country level with generalized policies suitable only for the "average" country in an entire community of states.²⁵ The ECB policy control is tantamount to a surgeon operating with a jackhammer or a musician playing the piano while wearing mittens.

This situation sounds like a plausible and even familiar illustration of governmental bureaucracy in action. Yet, it is possible that an entire community of countries could be making such a major strategic blunder. This devastation is a likely result of the move toward currency unification and a fully integrated EMS in the EEC.²⁶ When the national currencies of the EEC member countries are eliminated and a single currency takes over, the resulting loss of control by EEC members over their fiscal and economic policies is likely to cause the type of uncontrollable inflation and reduced demand that could send European and other world economies into a tailspin and result in another prolonged and deep recession, or even another depression.²⁷ This loss of policy control will lead to the exporting of inflation and unemployment throughout the EEC like that seen when the Black Plague descended upon Europe in the Middle Ages.²⁸ If such terrible destruction is a possible result of the adoption of a unified currency in Europe, the important consideration becomes how likely is it that currency unification will happen.

B. AN OVERVIEW OF THE EMS

The foregoing hypothesis predicting the economic destruction of the world was predicated on the assumption that the EMS was fully operational and that currency unification had taken place. The situation presented was one in which the governments of the EEC countries had little ability to influence the economic world on their own. The discussion now turns to what might motivate a logical government, knowing the potentially disastrous effects of unification, to get involved in such a plan.

23. Dassel, *supra* note 19, at 390.

24. *Id.*

25. Shulman, *supra* note 4, at 411.

26. W. Max Corden, *The Adjustment Problem*, in *EUROPEAN MONETARY UNIFICATION AND ITS MEANING FOR THE UNITED STATES*, *supra* note 1, at 177.

27. *Id.*

28. JACQUES VAN YPERSELE & JEAN-CLAUDE KOEUNE, *THE EUROPEAN MONETARY SYSTEM: ORIGINS, OPERATIONS AND OUTLOOK* 61 (1984).

The answer may be as simple as human nature. At some point in time, some unknown person had the idea that a Europe unified by currency would be better off than one divided.²⁹ And while that idea may have been valid in the past, it does not necessarily hold true today. However, human nature can lead the authors of a concept to feel obligated to accomplish it no matter how the situation has changed since the idea was first conceived.

Certainly, economic cooperation is not a newly conceived idea within Europe.³⁰ Even before the Bretton-Woods Agreement of the early 1950s Europeans were striving to make trade simpler throughout the region.³¹ Indeed, the European effort is quite understandable considering, for example, how difficult it would be to move throughout the United States if it were necessary to exchange currency upon entering a new state. Imagine trying to conduct interstate business knowing that you must have fifty different currencies available at all times. Businesses could end up spending more time trying to keep straight the exchange rates between all of the states than in trying to sell their products.

While other avenues for monetary cooperation are available, such as reserve pooling and reciprocal lines of credit, the EEC settled on monetary unification as its goal.³² The current attempt to achieve currency stability, the EMS, is not the first to be attempted by European governments.³³ In 1957 the Treaty of Rome was signed by Belgium, France, Germany, Italy, Luxembourg, and the Netherlands and was ratified by all six states by January of 1958.³⁴ The treaty provided detailed provisions and timetables for the creation of a customs union and the removal of barriers to movement of capital within the participating countries.³⁵ In addition, the aforementioned Bretton-Woods Agreement of the 1950s was an attempt to fix exchange rates in an effort to stabilize certain European currencies.³⁶ During the period that the Bretton-Woods Agreement was in effect, from 1957 until 1972, little meaningful progress occurred toward monetary and economic policy coordination.³⁷ This lack of progress resulted in the divergence

29. Harry G. Johnson, *Narrowing the Exchange Rate Bands, in EUROPEAN MONETARY UNIFICATION AND ITS MEANING FOR THE UNITED STATES*, *supra* note 1, at 79.

30. See generally Bloomfield, *supra* note 1.

31. *Id.*

32. Johnson, *supra* note 1, at 79.

33. Bloomfield, *supra* note 1, at 22.

34. *Id.*

35. *Id.*

36. Shulman, *supra* note 4, at 392. According to Shulman the ECU had many predecessors. The European Payment Union set up the first unit of account in 1950. This unit was valued in gold, and had the same weight in gold as the U.S. dollar. The unit could be converted into national currencies based upon the Member States' fixed exchange rates under the Bretton-Woods Agreement. The degeneration of fixed exchange rates led to experimentation with many different units of accounts within the Community. Most notably, in 1972 the EEC adopted the "snake." The "snake" permitted exchange rate fluctuations of $\pm 2.25\%$ against the U.S. dollar and $\pm 4.5\%$ between any two Community currencies. *Id.*; see *infra* text accompanying notes 40-42.

37. Bloomfield, *supra* note 1, at 22-23.

of inflation rates and economic trends among the participating countries.³⁸ The lack of coordination also led to a series of crises in the balance-of-payments between the EEC Member States.³⁹

In March of 1972, in an effort to correct the problems caused by the recent de facto abandonment of the fixed exchange rate system, the EEC governments made the first moves toward the creation of an informal mechanism for coordination of monetary policy, which they referred to as the "snake."⁴⁰ The "snake" only managed to achieve moderate success in stabilizing exchange rates within the EEC.⁴¹ The main impediment to greater success of the "snake" was its lack of two items: (1) policy coordination (both fiscal and monetary) and (2) the financing necessary to implement exchange-rate intervention.⁴²

In 1970, in an effort to strengthen the monetary union that the Bretton-Woods Agreement had begun, the Werner Report explicitly set out the implications of monetary union.⁴³ In addition, where the Bretton-Woods Agreement left many aspects of economic policy ambiguous, the creators of the Werner Plan left no ambiguity about the desirability of freedom of private capital movements within the region.⁴⁴ The report "envision[s] a situation in which 'policy harmonization and coordination' will eliminate speculative capital movements and avoid . . . problems" caused by restricted movement of capital.⁴⁵

Where the Bretton-Woods Agreement was limited to exchange-rate stability, the EEC, through the Werner Report, recognized that in order to establish an effective economic and monetary union, the free movement of capital between Member States was essential to the agreement.⁴⁶ The Werner Report viewed the free movement of capital within the EEC as not only advancing economic welfare, but as essential to the formation and maintenance of an effective economic and monetary union.⁴⁷ In 1979, recognizing that the creation of a monetary union is more complex than the simple mechanics of creating a single currency, the EEC

38. *Id.*

39. *Id.*

40. Stephen Zamora, *Introduction to Resolution of the European Council of the Establishment of the European Monetary System (EMS) and Related Matters*, in BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW 457 (Stephen Zamora & Ronald A. Brand eds., 1990).

41. *Id.*

42. *Id.*

43. Krause, *supra* note 1, at 114. The report called for three main items: (1) total currency convertibility, (2) elimination of exchange rate fluctuations, and (3) the fixing of parity ratios. *Id.* at 114-15.

44. *Id.* at 115. "One should not take the mistaken view that the Werner group was unaware of the problems that private capital movements may cause for governments; indeed, the report points to the enormous growth in speculation as an argument for monetary union." *Id.*

45. *Id.*

46. *Id.* at 116.

47. *Id.*

developed the EMS.⁴⁸ At first, some members of the EEC did not receive the concept of the EMS positively.⁴⁹ The majority of economists predicted an inevitable and most likely quick departure for the agreement.⁵⁰

The EEC has operated under the EMS for fourteen years and the EMS has achieved some moderate success.⁵¹ The EMS has already gone through at least three distinct phases of development since its inception.⁵² The first phase lasted from the beginning of the EMS in 1979 until approximately March of 1983.⁵³ "During those early years the ECU . . . failed to gain the importance that had been widely hoped for. It did not play a major role either as a reserve asset or as a means of settlement of intervention debts."⁵⁴ This failure occurred notwithstanding the fact that the ECU was a key feature of the EMS.⁵⁵ The second phase began in March 1983 and continued into 1987.⁵⁶ In a drastic change of policy, the French Government led the way by abandoning their expansionary policies and by accepting a significant drop in the central rate of the French franc with respect to most other EEC currencies.⁵⁷ "The emergence of a common economic policy approach had its corollary in the operational field. The Deutsche Mark, as the currency with the most consistent record of stability among the major exchange rate mechanism (ERM) currencies and in its role as reserve currency, emerged as the 'anchor currency' of the EMS."⁵⁸ Since approximately September 1987, when the EMS signed the Basle/Nyborg agreement, the EMS has been working through its third phase.⁵⁹ The agreement marked the beginning of the

48. FRATIANNI, *supra* note 15, at 1. "The EMS followed several unsuccessful attempts to stabilize exchange rates among the Community members. Its charter describes the goals of the EMS as 'a greater measure of monetary stability,' 'growth with stability,' and 'convergence of economic development.'" *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

52. UNGERER, *supra* note 13, at 2-3.

53. *Id.* at 2. This first phase was characterized by trial and orientation during which time the member countries followed different economic policies in attempts to cope as best they could with exogenous disturbances. *Id.* These policies acted many times in diverse and discordant ways. *Id.* The differences in approach actually increased divergences in economic developments among the EEC Member States. *Id.* "Several realignments—seven including the one in March 1983 . . .—took place to compensate, at least in part, for price and cost differentials." *Id.*

54. *Id.*

55. See generally THE ECU, *supra* note 14.

56. UNGERER, *supra* note 13, at 2-3. This phase primarily consisted of economic policy consolidation where the EEC Member States increasingly aligned their economic policies in an effort to begin to create some level of monetary stability within the Community. *Id.*

57. *Id.*

58. *Id.*

59. *Id.* at 3. The third phase is typified by the reexamination of the monetary system and its effects on individual Member States in an effort to generate more equitable results between the members. *Id.*

third phase and set out new rules for Member States' access to the so called very short-term financing facility.⁶⁰

The EEC's inclusion of elements of economic, monetary, and political union within the EMS constitutes a clear recognition that more than exchange rate stability is necessary for success of the EMS.⁶¹ In comparison to the narrow goals of the "snake" and the Bretton-Woods Agreement, the EEC created the EMS to be a comprehensive system aimed at broader economic integration objectives.⁶² A likely reason for the notable successes of the EMS in weathering conflicts as well as it has, and certainly better than the Bretton-Woods Agreement, is its concentration on integration of all aspects of the monetary system.⁶³

The EMS comprises three main operational elements.⁶⁴ The first is an exchange rate mechanism backed by regulations strong enough to force Member States to actively attempt to reduce fluctuations in exchange rates within the EEC.⁶⁵ The second is a financing mechanism that provides the necessary short-term credit to enable member countries to effect the required intervention in the foreign exchange markets in order to reduce fluctuations.⁶⁶ The third encompasses regulations that entrench the ECU as the official reserve asset as well as the official accounting unit for the EEC.⁶⁷

The EEC did not design the EMS to be an end in itself, but adopted the EMS as a step on the road toward accomplishment of complete monetary union.⁶⁸ Coordination of economic policy will be through the ECB.⁶⁹ The EEC set up the ECB within the framework of the EMS agreement to control monetary policy, including the setting of interest rates, throughout the EEC.⁷⁰ The actual shifting of policy determination power to the ECB will not take place until the later stages of the agreement, allowing time for adjustment on the part of EEC Member States.⁷¹ At the point of power shifting, the system of fixed exchange rates will

60. *Id.*

61. MICHAEL EMERSON & CHRISTOPHER HUNE, *foreword to* THE ECU REPORT 6 (1991).

62. UNGERER, *supra* note 13, at 2. "Whereas the snake—not in its original intentions, as envisaged in the Werner Plan, but in its actual realization after the breakdown of the Bretton-Woods system in 1973—was limited to being an exchange rate agreement, the EMS aimed at exchange rate stability through the convergence of economic performance." *Id.*

63. *Id.*

64. Stephen Zamora, *Introduction to Agreement of 13 March 1979 Between the Central Banks of the Member States of the European Economic Community Laying Down the Operating Procedures for the European Monetary System*, in BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW, *supra* note 40, at 471.

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.* at 472.

69. EMERSON, *supra* note 61, at 17.

70. *Id.*

71. *Id.*

disappear and the ECU will become the single currency used throughout the EEC.⁷²

The EEC's plan for economic, monetary, and political unions has the potential of accomplishing far more than simply altering the balance of economic power within the EEC and throughout the world.⁷³ These unions have the potential to effect the reshaping of Europe as fundamentally in the future as did the convention of Vienna in 1815 and the Yalta summit in 1944.⁷⁴ The agreements forged by the EEC, if taken to their logical and intended conclusion, will shift some political power from the Member States' governments in the EEC to a central body responsible for managing the region as a whole.⁷⁵ The Member States of the EEC clearly demonstrated, by adopting a resolution at the meeting launching the EMS in 1978, that the ECU was to be the pillar of the EMS and was designed to be the unified currency of the EEC.⁷⁶ The EEC also signaled an expectation for broad unification within the EMS by providing within the 1978 agreement "for the future consolidation of all existing credit mechanisms inside a European Monetary Fund."⁷⁷

The exchange-rate mechanism, for which the ECU serves as the method of settlement, includes an obligation on the part of participating central banks to intervene in exchange-rate markets whenever a currency is at risk of crossing its fluctuation limit relative to other currencies.⁷⁸ Implicit in this obligation is the requirement that credit mechanisms exist to supply the funds necessary for intervention in the foreign exchange markets.⁷⁹ Thus, the EMS has three primary uses for the ECU within its context as a reserve asset: (1) very short-term financing, (2) short-term monetary support, and (3) medium-term financial assistance.⁸⁰

As the founding members of the EMS recognized, the unified system will only

72. *Id.*

73. EMERSON, *supra* note 61, at 8.

74. *Id.*

75. *Id.*

76. THE ECU, *supra* note 14, at 15. "'A European currency unit (ECU) will be at the centre of the EMS' . . . The Heads of State or Government wanted it to be seen 'as a fundamental component of a more comprehensive strategy aimed at lasting growth with stability. . . .'" *Id.*

77. VAN YPERSELE, *supra* note 28, at 61. The creation of the EMF by the EEC was to be part of the EMS's institutional phase that has been plagued by delays from the beginning. *Id.* Prior to the creation of the ECU as part of the EMS, the EEC created a common currency called the European Monetary Unit of Account (EMUA) which primarily acted as an internal accounting unit between Member States and nothing more. *Id.* at 48. The ECU, however, "is not simply an accounting unit, and it has been assigned a more important role than the EMUA it has replaced." *Id.*

78. *Id.*

79. *Id.* In turn, these credit mechanisms require rules and instruments for settlement if they are to work properly and fairly. *Id.* The funds governments borrow in order to implement their intervention efforts are denominated in ECUs; similarly, when the borrowing government settles its account and pays back the loan, its payment is denominated in ECUs. *Id.*

80. *Id.* at 61. Very short-term financing is designed to aid Member States in intervening in foreign exchange rate markets to maintain exchange rate stability within the prescribed ranges. *Id.* The EMS designed short-term monetary support to help meet the financing requirements resulting from temporary balance-of-payments deficits that differences in cycles between EEC Member States'

work and last if there is significant convergence of not only currency but also monetary and fiscal policies.⁸¹ As the states participating in the Bretton-Woods Agreement had experienced, a lack of policy and political coordination increases the possibility that the good intentions of an agreement will readily give way to the short-sighted proprietary goals of the individual governments.⁸² At the outset of the EMS, major divergences in economic situations between EEC Member States existed, including wildly disparate inflation rates.⁸³ As an example, inflation rates at the formation of the EMS ranged from 2.7 percent in Germany to 12.2 percent in Italy.⁸⁴ Many of the principal objections to the EMS at that time were based on the economic divergences between EMS members.⁸⁵ EMS critics recognized three possible consequences of the divergences.⁸⁶ First, because of its rigidity, the system would not be able to accommodate situations with such great divergences and as a consequence might rapidly fail.⁸⁷ Second, the system might be able to continue for a time, but would lead to deflationary consequences that would negatively impact employment either by forcing high-inflation countries to become more restrictive in their policies or by forcing all Member States to suffer in competitiveness in order to support the weaker countries.⁸⁸ Third, severe inflationary consequences throughout the EEC could result because countries with a low rate of inflation would have to import inflation from the higher inflation countries via price supports and increases in their monetary bases.⁸⁹

In the end, unification will cause Member States to become more interdependent, trading more than ever with each other and forcing the adoption of unified economic and fiscal policies so as to avoid the otherwise inevitable inflation wars.⁹⁰ Because of increased interdependence within the EEC after currency unification, fiscal policy will become more important to the individual states in order to protect against unemployment and run-away inflation.⁹¹ The need for independent fiscal policy will become the chief paradox to the entire concept of a unified currency and monetary system; unified fiscal policy is essential to the

economies can cause. *Id.* Finally, the EMS envisions using the ECU for medium-term financial assistance "to any Member State that experiences difficulties or is seriously threatened by difficulties with its balance of payments." *Id.* at 62.

81. *Id.* at 66.

82. See *supra* notes 34-42 and accompanying text.

83. VAN YPERSELE, *supra* note 28, at 66.

84. *Id.* The oil shock of the 1970s, which dramatically affected the United States, also served to exacerbate the already huge spread in inflation rates present between the EEC Member States. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. EMERSON, *supra* note 61, at 72. At a minimum, coordination in fiscal policy will be necessary any time that the ECU exchange rate or the EC current account or both are in need of correction. *Id.*

91. *Id.* at 71.

success of any union, but independent fiscal policy is the most potent weapon at the disposal of individual Member States' disposal for battling inflation and unemployment.⁹² This dichotomy will be one of the chief stumbling blocks toward the accomplishment of lasting currency unification.⁹³

II. The ECU

A. THE MECHANICS OF CURRENCY UNIFICATION IN THE EMS

Creating a monetary union requires more than merely accepting a single currency as the means of trade within a geographic region.⁹⁴ "A monetary union has two essential components: exchange rate union and capital market integration."⁹⁵ The exchange rate union is the geographic area in which exchange rates for the Member States' currencies are permanently fixed in relation to each other.⁹⁶ The integrated capital market "is an area permanently without exchange controls for capital transactions, including interest and dividend payments."⁹⁷ In addition, the integrated capital market will most likely involve the harmonization of wages, taxes, and other measures that directly and indirectly affect the capital market.⁹⁸ For true currency unification, all national currencies would disappear, and a single currency would take over as the sole means of settlement, both public and private, within the system.⁹⁹

Currency unification has several implications. First, a tourist could traverse the entire region of the EEC, passing through country after country, without ever having to exchange currency.¹⁰⁰ Second, business people could give price quotes in one currency and be sure that exchange rates would not affect their profit.¹⁰¹ Third, consumers could directly compare prices for goods in two separate countries.¹⁰² Fourth, a trader could take advantage of price differences between goods coming from different countries in order to make buy and sell decisions more easily.¹⁰³ Fifth, bankers could lend and borrow throughout the region with concern only for credit risk and not exchange-rate risk.¹⁰⁴ And sixth, investors could build and invest where the cost was the least, knowing that the

92. See generally notes 81-91 and accompanying text.

93. *Id.*

94. W. Max Corden, *The Adjustment Problem*, in *EUROPEAN MONETARY UNIFICATION AND ITS MEANING FOR THE UNITED STATES*, *supra* note 1, at 159.

95. *Id.*

96. *Id.* at 159-60. The exchange rates of the currencies participating in the union may still vary widely in relation to nonunion currencies. However, they will move in unison with each other. *Id.*

97. *Id.* at 160.

98. *Id.*

99. EMERSON, *supra* note 61, at 11.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

marketability and cost competitiveness of exports would not be affected by exchange-rate shifts in the future.¹⁰⁵ "In short, a single currency would transform many economic relationships for the better."¹⁰⁶

In addition to the acceptance of a single currency for trade throughout the EEC, at least two other actions are needed to forge a truly complete union: (1) the EEC must pool the individual Member States' foreign exchange reserves, and (2) monetary policy must be centrally controlled.¹⁰⁷ The system will work only if the EEC Member States can sustain it.¹⁰⁸ Therefore, the stability of the system would seem to be of paramount importance.¹⁰⁹ The consequence of not having a central bank independent of political control is that the public's expectation that politicians will boost the economy, and consequently inflation, might become self-fulfilling, making it more difficult for the central bank to reduce inflation.¹¹⁰ Eventually, these unavoidable political pressures are likely to force the ultimate collapse of the system.¹¹¹ Thus, full integration of the economies of the EEC must be based on more than just a common currency.¹¹² The political power to set fiscal and monetary policy must be fully integrated within an independent political body such as the ECB.¹¹³

The Delors Report is the premier work outlining a number of proposed policies and goals of the EEC in creating the EMS. The report outlines three stages to integration: (1) increased convergence of economic performance by strengthening economic and monetary policy coordination within the current system, (2) a transitional period when learning and progress towards collective decision makings are of paramount importance, and (3) a final move toward irrevocably locked exchange rates that is designed to give way ultimately to a single currency (namely the ECU).¹¹⁴ The report also emphasizes that parallel progression of economic

105. *Id.*

106. *Id.*

107. Corden, *supra* note 1, at 161. If each Member State maintains the ability to set its own monetary policy, then one country can run a balance-of-payments deficit by expanding credit, forcing other countries to finance the deficit. *Id.* Thus, monetary policy must be centrally controlled, and no country must be allowed to engage in this type of domestic credit creation. *Id.*

108. EMERSON, *supra* note 61, at 55.

109. *Id.*

110. *Id.*

111. *Id.*

112. *See generally supra* notes 94-111 and accompanying text.

113. *Id.*

114. UNGERER, *supra* note 13, at 40-41. In the first stage, the focus on the economic field "would center on the completion of the internal market and the reduction of existing regional disparities. In the monetary field, the objective of a single financial area would be fully implemented." *Id.* In the second stage, the most important feature in the monetary field "would be the setting up of the ESCB [European System of Central Banks], which would absorb previously existing institutions . . ." *Id.* In the final stage, the effort in the economic field would concentrate on "common structural and regional policies would be further strengthened, and rules in the macroeconomic and budgetary field would become binding. The transition to a single monetary policy would be made, and the ESCB would assume all its responsibilities." *Id.*

and monetary policies among the Member States is of strategic importance.¹¹⁵ The report proposes that instead of setting deadlines, the EEC should be free to determine the beginning of new stages based upon the progress and success of the previous stages.¹¹⁶

As outlined in the report and in the EEC agreement, the current formation of the ECU is a basket of currencies in which each participating member's currency comprises a share of the total value of the ECU.¹¹⁷ The value and composition of the ECU when set up was identical to its predecessor, the EMUA, which also consisted of a basket of currencies but of a much smaller group of countries.¹¹⁸ "The currencies of the 12 countries participating in the EMS are counted in the basket of currencies that make up the European Currency Unit (ECU). . . . These same 12 governments have deposited gold and dollar assets with the European Monetary Cooperation Fund (EMF) in exchange for an equivalent amount of ECUs."¹¹⁹ In addition, "EC leaders reached a consensus (with reservations by U.K. Prime Minister, Margaret Thatcher) on a three-stage approach leading to full monetary union."¹²⁰ The EEC determined the respective weights of the participating currencies based on the GDP of each country and the countries' participation in the external trade of the EEC.¹²¹

By the inclusion of all Member States' currencies, the EEC intended to demonstrate the importance of the ECU as more than a simple technical unit.¹²² If the ECU were intended to be a mere technical unit, the EEC would have more appropriately limited the unit to only a few currencies so that its value could be easily calculable.¹²³ Normally, the EMS commission responsible for the basket composition will only reexamine the value every five years.¹²⁴ However, any Member State may request re-examination of the basket if the weight of any currency has changed by 25 percent or more during the period since the previous examination.¹²⁵ Revisions of the basket must be accepted by all EEC Member States.¹²⁶ Because of the recent strength of the German economy, the Deutsche

115. *Id.* at 40.

116. *Id.*

117. THE ECU, *supra* note 14, at 9.

118. Resolution of the European Council on the Establishment of the European Monetary System (EMS) and Related Matters, *compiled in* MONETARY COMMITTEE OF THE EUROPEAN COMMUNITIES, COMPENDIUM OF COMMUNITY MONETARY TEXTS § 2.1 (1986) [hereinafter Resolution of the European Council].

119. Zamora, *supra* note 40, at 458-59.

120. *Id.* at 459. These reservations are important in the discussion of the potential political pitfalls that are pervasive in the current agreement because they are symptomatic of the underlying inadequacies of the entire concept of a unified currency. *Id.*

121. THE ECU, *supra* note 14, at 9.

122. *Id.*

123. *Id.*

124. *Id.* at 12.

125. *Id.*; see Resolution of the European Council, *supra* note 118, § 2.3.

126. THE ECU, *supra* note 14, at 12; see Resolution of the European Council, *supra* note 118, § 2.3.

mark has become the de facto anchor currency of the ECU, making Germany the "point of orientation for monetary policy."¹²⁷ The development of the German currency as the anchor has enabled EEC Member States with weaker currencies to import stability and increase credibility in their currencies through their participation in the EMS.¹²⁸

The ECU is not a goal in itself, but is a tool to aid in accomplishing the principal goal of the EMS, establishing a region of stability among the EEC members' currencies.¹²⁹ "This is accomplished through the operation of an exchange rate mechanism (ERM) that consists of two principal instruments for monitoring exchange rate volatility—the parity grid, and the divergence indicator."¹³⁰ This mechanism contains two components.¹³¹ The first mechanism is grounded on what is called the concept of bilateral parties.¹³² Under this concept rates are set as bilateral central rates between currencies of each of the states participating, around which bilateral limits of fluctuation are established and maintained with the use of compulsory and unlimited intervention on the foreign exchange market.¹³³ The second mechanism is based on what is called the divergence indicator.¹³⁴ The EEC created this indicator in order to establish a presumption of action by the appropriate body in charge of the currency of the Member State's government whose exchange rate fluctuation exceeds the EEC's limits.¹³⁵

127. UNGERER, *supra* note 13, at 6.

128. *Id.* Germany was initially reluctant to allow its currency to adopt the paramount role of anchor currency for the EMS because of the risks posed to their nationalistic monetary policies. *Id.* The German authorities viewed the accumulation of large Deutsche mark holdings by other governments as a threat to German monetary policy autonomy. *Id.*

129. Zamora, *supra* note 40, at 459.

130. *Id.*

131. VAN YPERSELE, *supra* note 28, at 50.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

All the EEC currencies . . . have an ECU-related central rate . . . The ECU-related central rates are expressed as a certain quantity of currency per ECU . . . By linking together the ECU-related central rates we obtain for each currency participating in the EMS a series of bilateral central rates, the juxtaposition of which constitutes the parity grid. Central rates can be changed by common consent, following a procedure in which all the countries participating in the exchange rate mechanism are involved, along with the Commission.

Id. at 50-52.

One of the new elements of the EMS that makes it different from the snake, which was based only on the parity grid, is the divergence indicator. This device makes it possible to locate the position and movement of an EMS currency relative to the Community average represented by the ECU.

To do so, one calculates first the maximum divergence spread for each currency. This spread represents the maximum percentage appreciation or depreciation which the market rate of the ECU in terms of a given currency may show against its central rate. It will be reached when the rate of this currency deviates by 2.25% in the same direction from all the other EMS currencies . . .

The divergence indicator shows the extent to which a given currency is nearing its

Each country participating in the EMS is required to establish a central currency rate for its currency in terms of the ECU.¹³⁶ "This central rate becomes the lynch-pin in assessing whether bilateral rates (exchange rates between pairs of ERM-participating currencies) fall within the margins prescribed by the EMS."¹³⁷ This rate, when put in a matrix with the rates from other EMS members, forms a grid of exchange rates known as the parity grid.¹³⁸ The maximum deviation of a participating currency from the parity grid rate is 2.25 percent above or below the average rate as represented by the ECU.¹³⁹ Members of the EMS agreement that did not participate in the "snake" were initially allowed a greater margin of deviation from the parity grid rate.¹⁴⁰ "Deviations outside of the parity grid are to be avoided through a process of coordinated intervention in foreign exchange markets, which is undertaken by central banks that purchase and sell the appropriate currencies."¹⁴¹

The primary use of the ECU as a financing mechanism becomes important as a source of funding for the necessary intervention.¹⁴² The parity grid thus requires EMS participants to maintain a band of stable exchange rates vis-à-vis each other, and the EMS assists in the maintenance by providing a short-term source of funds for intervention.¹⁴³ The divergence indicator is designed to maintain stability of another sort; it is designed to measure EMS Member States' currencies' exchange rates versus the ECU basket as a whole.¹⁴⁴ The ERM has established a threshold spread of divergence that is 75 percent of the maximum spread.¹⁴⁵ Attaining the threshold spread requires the participating EMS member to take corrective policy measures in order to stabilize their currency and prevent further divergence of the exchange rate.¹⁴⁶ "Intervention in participating currencies is compulsory when the intervention points defined by the fluctuation margins are reached."¹⁴⁷ "When a currency crosses its 'threshold of divergence' this results in a presumption that the authorities will correct this situation by adequate measures, namely: (1) diversified intervention, (2) measures of domestic monetary policy, (3) changes

maximum spread. This is done by relating the premium or the discount, in the market rate of the ECU in terms of that currency, to the above-mentioned maximum spread. This ratio, expressed in percent, is the divergence indicator. When it reaches 75%, the implicated currency is said to be at its divergence threshold.

Id. at 53.

136. Zamora, *supra* note 40, at 459.

137. *Id.*

138. *Id.*

139. *Id.*; Resolution of the European Council, *supra* note 118, § 3.1.

140. Zamora, *supra* note 40, at 459.

141. *Id.*

142. *Id.* at 461.

143. See generally *supra* notes 127-41 and accompanying text.

144. Zamora, *supra* note 40, at 459-60.

145. *Id.* at 460; see also Resolution of the European Council, *supra* note 118, § 3.5.

146. Zamora, *supra* note 40, at 460; see also Resolution of the European Council *supra* note 118, § 3.5.

147. Resolution of the European Council, *supra* note 118, § 3.4.

in central rates, and (4) other measures of economic policy.¹⁴⁸ In the context of the EMS system described above, the ECU serves three principal functions in the EEC: (1) it is the principal accounting unit among members of the EMS; (2) it serves as a means of settlement under EMF financing facilities; and (3) it is the common denominator of the ERM.¹⁴⁹

B. PROGRESS TOWARDS CURRENCY UNIFICATION

As described above, since its inception in 1979, the EMS has achieved some success.¹⁵⁰ But just how much progress has occurred and in what areas? During the period between 1957 and 1972 the economic, monetary, and fiscal policies employed by the EMS members were highly divergent.¹⁵¹ These divergences in policy led to the collapse of the previous stability system, the Bretton-Woods Agreement.¹⁵² Despite the creation of the EMS, fiscal policy divergence among the EEC members continues even now.¹⁵³ High governmental budget deficits in ERM countries accompanied marked differences in fiscal performance among the group stretching from double-digit deficits in Italy to huge surpluses in Denmark.¹⁵⁴

The EMS is designed to avoid some of these pitfalls.¹⁵⁵ Indeed it has achieved some success.¹⁵⁶ The EMS members agreed to the first of the three stages of the unification process, the creation of the ERM, in 1990.¹⁵⁷ The first stage involves participation in the ERM by all Member States.¹⁵⁸ This stage has already begun to yield benefits.¹⁵⁹ These benefits include exchange rate stability for Member States' currencies and price stability throughout the EEC.¹⁶⁰ Participation in the ERM by the Member States also implies that, so long as realignment of the basket is not adopted, one of the main costs of creating a single currency, loss of the policy mechanism of exchange rate adjustment, is already being paid.¹⁶¹

The second stage, creating a system of European central banks to run the

148. *Id.* § 3.6.

149. Zamora, *supra* note 40, at 460.

150. *See generally supra* notes 114-49 and accompanying text.

151. *See supra* note 37 and accompanying text.

152. VAN YPERSELE, *supra* note 28, at 66.

153. UNGERER, *supra* note 13, at 31.

154. *Id.*

155. *See generally* EMERSON, *supra* note 61; VAN YPERSELE, *supra* note 28; UNGERER, *supra* note 13.

156. *See generally* THE ECU, *supra* note 14.

157. EMERSON, *supra* note 61, at 6.

158. *See supra* note 114 and accompanying text.

159. EMERSON, *supra* note 61, at 131.

160. *Id.*

161. *Id.* The loss of this policy mechanism causes inflexibility in the EEC Member States' ability to react to changes in economic outlook. Dassesse, *supra* note 19, at 390.

EMU, officially began in November 1993.¹⁶² A review of the move to the third stage is set to take place no later than 1997.¹⁶³ All members of the EEC except the United Kingdom have agreed to this review.¹⁶⁴ To date, the EMS seems to have garnered a modicum of support throughout the EEC and has achieved a broader success in a much shorter period of time than the Bretton-Woods Agreement was ever able to accomplish.¹⁶⁵

Acceptance by the governments that have expended a huge amount of political time and clout in order to develop the EMS is unremarkable. But how have the private markets reacted to the system and the ECU in particular?¹⁶⁶ Although private goods markets have not yet accepted the ECU as a hard currency for private trade, a private market for the ECU has developed to the point that soon it may dwarf the public use of the currency.¹⁶⁷ The first public uses for the ECU were primarily in the area of ECU denominated bonds that were floated by public utility companies such as STET, the Italian public telecommunications company.¹⁶⁸ In addition, more than 200 banks throughout Europe accept deposits in ECUs.¹⁶⁹ Many banks also participate in an ECU clearing mechanism for transactions between banks in the EEC.¹⁷⁰ A few banks even issue ECU-denominated certificates of deposit.¹⁷¹ The EEC also decided in 1984 to issue ECU credit cards and travelers checks.¹⁷² This swift growth of a private market for the ECU reflects the public's desire for a true common European currency.¹⁷³ Thus, while the governments participating in the EMS may move slowly and cautiously in an effort to maintain stability, the private

162. Treaty Establishing the European Community, Feb. 7, 1992, art. 4A, 1992 O.J. (C 224). Stage two will involve the slow but progressive narrowing of exchange rate fluctuation bands from the current 2.25% to as close to zero as possible and will allow any significant divergence from target values only for exceptional circumstances. EMERSON, *supra* note 61, at 17.

163. *Id.*

164. *Id.*

165. See *supra* notes 156-64 and accompanying text.

166. See generally THE ECU, *supra* note 14; EMERSON, *supra* note 61; VAN YPERSELE, *supra* note 28; UNGERER, *supra* note 13.

167. VAN YPERSELE, *supra* note 28, at 93. "Privately, the ECU is used in particular for: (i) public issues of bonds, (ii) bank loans and deposits, (iii) the interbank market, [and] (iv) commercial transactions." *Id.*

168. *Id.* The response to the issue of bonds from STET was so tremendous that the telecommunications company was forced to raise the amount of the issue from 25 to 35 million ECU in order to satisfy the demand. *Id.* Since the STET issue, the number of issues has grown at an ever-increasing pace, up to 100 for a total of seven billion ECU by mid-1984. *Id.*

169. *Id.* at 94.

170. *Id.*

171. *Id.* Corporations have also quickly developed a high degree of attraction to use the ECU to cover against exchange rate risk in almost every type of international trade and business within the EEC. *Id.*

172. *Id.* at 95.

173. *Id.* The ECU is now quoted on a growing number of stock exchanges including the Paris and Brussels Stock Exchanges (where it is quoted officially) and in Milan and Rome (where it is quoted unofficially). *Id.*

markets have been overwhelming in their acceptance of the ECU both conceptually and functionally.¹⁷⁴

Nevertheless, acceptance is not everything. Another important requirement for success is for the governments involved to develop strong enough support to ensure continued progress towards complete unification. From the phenomenal acceptance of the ECU, it might appear at first that the underlying governmental support is strong. However, a basic difference in approach to monetary integration among the EEC members may well keep unification from happening.¹⁷⁵ This difference in approach presents the EMS with a kind of chicken and egg paradox—whether creating the institutions will bring about monetary policy unification or whether monetary policy unification will bring about the necessary institutions.¹⁷⁶ This difference in approach is not new, having dominated debates on monetary integration since the 1960s.¹⁷⁷

One group, led by the Bundesbank, argues that monetary union should be the “coordination” of a long process of economic integration and macroeconomic convergence gradually aligning the countries with high inflation and profligate policies to the countries with low inflation and prudent fiscal policies.¹⁷⁸ The other group, led by the French Government, argues instead that monetary union is an instrument for achieving convergence, and therefore, a monetary union can be created before convergence has been achieved.¹⁷⁹ Furthermore, this group regards monetary union and economic integration as interactive processes that should proceed in parallel.¹⁸⁰

These basic differences in approach demonstrate one of the reasons why commitment to the ECU was less than complete initially and why any future agreement will do little to strengthen it.¹⁸¹ Therefore, while the ECU may have wide public support as a trade simplifier, any further progress is in jeopardy so long as the EMS Member States cannot agree on the fundamental notion of how to proceed.¹⁸²

174. See generally *supra* notes 168-73 and accompanying text.

175. UNGERER, *supra* note 13, at 39.

It has often been cast in terms of a debate between the “monetarists” and “economists”—those who favor strong reliance on the building of institutional monetary arrangements, and those who favor a gradual approach, with strong emphasis on narrowing existing differences in economic policies and developments and, in the longer run, also in basic economic and social conditions. The first group argued that common objectives in the field of monetary policy can best and most rapidly be achieved by introducing institutional commitments and constraints. The second held that a consensus has to be reached about economic policy priorities and a very high convergence of economic performance achieved before moving to common institutional arrangements in the monetary field. *Id.*

176. See *supra* note 175.

177. UNGERER, *supra* note 13, at 39.

178. FRATIANNI, *supra* note 15, at 5.

179. *Id.*

180. *Id.*

181. UNGERER, *supra* note 13, at 7.

182. See generally *supra* note 176-81 and accompanying text.

Acknowledging the differences of opinion within the EEC on how to proceed, the next question is what effect those differences of opinion are already having on the progress towards currency unification? To begin with, the EEC countries have severely limited the role of the ECU as a reserve asset and means of settlement.¹⁸³ At the center of the lack of commitment by EMS members to the ECU, and the reason that the United Kingdom did not participate in the ERM, is the desire of members to maintain an independent monetary policy in order to prevent high inflation and high interest rates.¹⁸⁴ Recent high inflation within the United Kingdom is an additional reason why the United Kingdom has hesitated to fully participate.¹⁸⁵ For these reasons, the United Kingdom has considered a commitment to the ECU not only unnecessary but also undesirable.¹⁸⁶ "[T]he official attitude to the EMU—shared by both Treasury and Bank of England officials—is one of skepticism."¹⁸⁷ This skepticism is not meant to indicate that the United Kingdom is totally against the internal market program, including financial integration.¹⁸⁸ To the contrary, for the United Kingdom, the accent would be on allowing the single market program to lead the way while monetary union would lag cautiously behind.¹⁸⁹

Since fiscal policy is only one piece of the policy jigsaw puzzle, the next inquiry to make is whether the other policy areas are faring any better. To begin, evidence on the economies of EMS members shows that divergence in monetary policy among the members continues today.¹⁹⁰ The lack of a common policy is demonstrated by the fact that "correlation of short-term interest rates in ERM countries with rates in Germany, the anchor country, have been weaker in most countries than would have been expected with a high degree of monetary conver-

183. UNGERER, *supra* note 13, at 7. A number of factors caused the limitations on the use of the ECU. *Id.* First, the creation of the ECU was only temporary and was limited by the European Monetary Cooperation Fund (EMCF). *Id.* Second, the agreement on ECU creation was subject to regular reconfirmation. *Id.* Third, due to the lack of a market for its use as a currency, the ECU could not be used directly for intervention to support exchange rates. *Id.* Fourth, the emphasis on intramarginal intervention during the evolution of the EMS diminished the ECU's role. *Id.* Fifth, official ECUs could only be used within the ERM context. *Id.* And sixth, central rates are determined bilaterally and not by using the ECU as the starting point. *Id.*

184. *Id.* at 4.

185. UNGERER, *supra* note 13, at 4.

186. *Id.* at 43.

187. Heidemarie C. Sherman, *Conclusions and Prospects for EMU*, in *MONETARY IMPLICATIONS OF THE 1992 PROCESS* 148, 161 (Heidemarie C. Sherman ed., 1990). The officials in the United Kingdom share a strong feeling that euphoric and premature moves into a monetary union, such as the quick adoption of a single currency, need to be avoided. *Id.*

188. UNGERER, *supra* note 13, at 43.

189. Sherman, *supra* note 187, at 161. While other countries may be leading the charge for quicker acceptance of currency unification, domestic criticism in the United Kingdom for its cautious approach is almost nonexistent. *Id.* Because of the lack of any criticism within the political landscape of the United Kingdom, the current government in Britain is unlikely to commit to stages two or three of the Delors Report soon, or even at all. *Id.*

190. UNGERER, *supra* note 13, at 30-31.

gence.”¹⁹¹ And although the Delors Report represents one of the most concrete proposals on unification to date, not all countries agree with the report.¹⁹² “Great Britain, in particular, is opposed to this idea and has developed its own proposal. Britain’s alternative, known as the ‘hard ECU’ proposal, sees no need to mandate the acceptance of the ECU as the EEC’s currency.”¹⁹³ The Delors Report recognizes the desire for political independence, but also recognizes that in order to achieve a lasting union, independence of monetary policies must dramatically decrease.¹⁹⁴ The report identifies the need for convergence in at least four areas: (1) inflation rates within the Member States, (2) unemployment rates within the Member States, (3) budgetary policies, and (4) competition policies.¹⁹⁵

While the Report encourages some autonomy among the Member States in order to accomplish the desired convergence, the report favors the transfer of power out of the Member States and into EEC institutions whenever the transfer would benefit the development of the monetary union.¹⁹⁶ The Delors Report also favors a single currency on the grounds that it will facilitate monetary management within the EEC.¹⁹⁷ At the 1990 EEC intergovernmental conference, the Delors Report lost a significant amount of backing, while support for the more cautious and slower developing United Kingdom proposal increased.¹⁹⁸ Spain, France, and Italy all added support to the British plan.¹⁹⁹ Thus, coordination in monetary policy seems to be falling prey to the same sense of protectionism that has inhibited the development of a cohesive fiscal policy for the EEC.²⁰⁰

Despite all of the discussions recognizing the need for increased coordination of policies, Member States have apparently made little effort to coordinate.²⁰¹ Fiscal imbalances and divergences in fiscal policy among the EMS members have

191. *Id.* at 31.

192. Shulman, *supra* note 4, at 391.

193. *Id.* Under the British proposal, the EEC would allow market forces, and not mandates, to determine the acceptance of the ECU in the foreign exchange markets. *Id.* The British proposal would also scrap the idea of a single ECB, in favor of another institution, called the European Monetary Fund, that would operate alongside the EMS Member States’ own central banks, thus leaving some policy autonomy at the Member State level. *Id.* The British proposal also envisions the ECU as merely a dual currency, available on demand in lieu of Member States’ currencies. *Id.*

194. *Id.* at 407.

195. *Id.*

196. *Id.*

197. *Id.* at 408. The Delors Report further indicates a strong belief that a single currency would also remove exchange rate uncertainties and reduce transaction costs arising from trade between entities within different EMS Member States. *Id.*

198. *Id.* at 420. One of the reasons for the loss of support for the Delors Report was the awareness, by Member States, of the persistent divergences in their respective economic performances and the need for increased coordination before they proceeded further.

199. *Id.*

200. See generally *supra* notes 191-99 and accompanying text; cf. notes 184-90 and accompanying text.

201. DAVID FOLKERTS-LANDAU & DONALD J. MATHIESON, *THE EUROPEAN MONETARY SYSTEM IN THE CONTEXT OF THE INTEGRATION OF EUROPEAN FINANCIAL MARKETS* 4-5 (1989).

not only continued, but in some cases have actually increased.²⁰² Contributing to this inability of the EMS members to coordinate policy are the differences in preferences about the balance of inflation and unemployment among the EMS Member States.²⁰³ These preferential differences cut at the heart of any unification plan and have the potential to make the introduction of a common currency extraordinarily costly for all the economies involved.²⁰⁴ Based on current economic and political conditions within the EEC, the large divergence in unemployment and inflation rates, and the difference of opinion on what the proper balance is for those factors, the EEC is not currently suited for the adoption of a single currency.²⁰⁵ In the context of the divergent economic situations and policy preferences that pervades the EEC, currency union is a desirable but distant goal.²⁰⁶ Considering the massive reformation necessary in fiscal and monetary policy and the lack of cooperation between EMS members in these areas so far, the EEC appears unable to achieve enough convergence among its members to make a unified currency possible.²⁰⁷

C. BENEFITS AND COSTS OF CURRENCY UNIFICATION

The next step in this analysis is an investigation of the potential costs and benefits of unification. First, the EEC has come to a general consensus on the most appropriate economic and monetary policy for the EEC members.²⁰⁸ "Exchange rate stability and price stability have become twin objectives. Realignments have been used to offset cost and price differentials but have been supported by internal adjustment measures signaling the determination of the authorities to make price stability the priority of economic policy."²⁰⁹ The result has been that "consensus on economic policy priorities, the increasing convergence of key nominal variables, and the mostly successful management of exchange rates,

202. *Id.* at 4.

203. See generally PAUL DE GRAUWE, *THE ECONOMICS OF MONETARY INTEGRATION* 13 (1992).

204. *Id.* As De Grauwe explains, the various combinations of choices of inflation rates balanced with unemployment rates can be represented by a Phillips curve much like a supply and demand curve. *Id.* If two countries such as Italy and Germany were to choose different preferences about the combination of unemployment and inflation rates, whatever fixed exchange rate they have chosen will be unsustainable to either one, the other, or both. *Id.* The cost of monetary union for the two countries lies in the fact that if Italy and Germany want to keep the exchange rate fixed they will have to choose another (less preferred) point on their Phillips curves, so that an equal rate of inflation becomes possible. Italy might have to accept less inflation and more unemployment than it would do otherwise, and Germany might have to accept more inflation and less unemployment. *Id.* at 13-15 (figure 1.4).

205. Shulman, *supra* note 4, at 421.

206. Sherman, *supra* note 187, at 41. Because unification seems to be a distant goal, proposals such as the "Genscher Initiative," which call for the quick establishment of the ECB, can be viewed as political attempts to use a common currency as a symbol to continue support for unification at a time when the system of agreements may be on the verge of collapse. *Id.*

207. See generally *supra* notes 176-206.

208. UNGERER, *supra* note 13, at 5.

209. *Id.*

intervention, and interest rate differentials go a long way toward explaining why for more than three years . . . there was no general realignment of central rates in the EMS.²¹⁰

In addition to the general requirements of policy coordination, the EEC has advanced several goals of economic convergence, including improving living and working conditions for people within the EEC Member States.²¹¹ At least within the EEC, unification is a positive sum game that all can win as opposed to a zero sum game where gains by one come at a cost to another.²¹² One obvious benefit is that currency unification can potentially eliminate the costs of currency conversion.²¹³ The elimination of currency conversion costs has been estimated to have the potential to save more than 15 billion ECU per year, which amounts to approximately 0.4 percent of the EEC's annual GDP.²¹⁴ Currency unification could help to decrease transaction costs for all trading companies.²¹⁵ The impact would be greatest for small and medium-sized trading companies where transaction costs are currently estimated at 15 percent, or more, of their profit.²¹⁶ Currency unification could also help to alleviate the foreign exchange risk.²¹⁷ Exchange-rate risk imposes one of the major obstacles to trade between EEC Member States by increasing the costs of international goods transactions.²¹⁸

The EEC could also realize several other benefits from unification that are more difficult to quantify. One is improvement of EEC policies in areas of EEC-wide importance.²¹⁹ Another likely benefit is the reduction in uncertainty that investors

210. *Id.* at 6.

211. *Id.* at 22. In addition to fiscal policy convergence, economic convergence is also considered necessary in the context of the EMS to establish stable exchange rates within the member countries. *Id.*

212. EMERSON, *supra* note 61, at 168. The essence of this argument is that by creating a unified and completely open trading block, including the use of a single currency for all trade, the benefits that the Member States could achieve will far outweigh the costs of reduced or eliminated fiscal and monetary policy flexibility. *Id.* However, it remains consistent with the concept of a positive sum game to point out that some Member States will continue to argue for a greater share of the gains that they expect by the redistribution of budget resources in their favor or through lower contributions. *Id.*

213. *Id.* at 32.

214. *Id.* The gains mostly consist of financial gains from the disappearance of bank commissions and the elimination of the spread that banks charge businesses on such transactions. *Id.* Thus the logical question is whether the elimination of these costs is a true savings benefit or a mere redistribution of wealth within the fixed economy. Corporations may also be able to save costs by eliminating the treasury departments that they maintain in order to manage their own multiple currency transactions. *Id.* The elimination of treasury departments, of course, implies a corresponding reduction of jobs and increase in unemployment. The question again becomes whether these reductions are a real benefit of the adoption of a single currency or a way of shifting dollars from the pockets of those who used to work to the now defunct treasury departments to the pockets of their former employers. *Id.*

215. *Id.*

216. *Id.* at 33.

217. *Id.*

218. *Id.*

219. *Id.*

feel with respect to economic prospects.²²⁰ Such an easing of uncertainty has the potential of lowering the risk premiums that firms have to pay in order to raise capital and increase investment.²²¹ Finally, reduced uncertainty could result in sustained growth in income and a decrease in unemployment.²²²

Thus, the EEC must be aware of the possibility in the future of at least modest benefits from currency unification.²²³ But benefits standing alone do not tell the entire story. In order for the EEC Member States to make a fully informed and reasoned decision about the intelligence of adopting unification, they must necessarily understand the costs involved. For the EEC Member States to adopt a unified system would make no sense unless they believe the potential benefits outweigh the potential costs.

While currency unification may potentially have many benefits, "[t]here is no categorical or unconditional reason to conclude that a monetary union is preferable to a flexible exchange regime."²²⁴ Some opponents of the ECU-based system have expressed a fear "that the greater symmetry implied by such a system would have inflationary consequences, since it allows for the possibility that a strong currency could diverge owing to the simple fact that the combined weight of weaker currencies might become dominant in the basket."²²⁵ Thus, a strong currency could reach its divergence limit before the weak currency and force its country to intervene and endure accelerated inflation, thus financing the weak currency country's lower inflation.²²⁶

While the EEC Member States might begin to realize some of the benefits mentioned above at the inception of the EMS, they will only achieve the full benefits of the union in the final stage.²²⁷ Thus, the problem comes not in receiving the benefits, but in achieving the final stage where the Member States can truly realize the benefits.²²⁸ Motivation to continue on the path to unification is likely

220. *Id.*

221. *Id.* "Preliminary estimates show that even a reduction in the risk premium of only 0.5 percentage points could raise income in the Community significantly, possibly by as much as 5 to 10 per cent in the long run." *Id.*

222. *Id.*

223. See generally *supra* notes 212-22 and accompanying text.

224. FRATIANNI, *supra* note 15, at 4.

On one hand, a monetary union eliminates exchange-rate flexibility and the attendant degrees of freedom economies enjoy in coping with supply and demand shocks. Because certain shocks are better handled with a common monetary policy while others are better handled with independent national monetary policies, the preferability of a unified option depends critically on the nature and the mix of the shocks to which the participating countries are exposed. On the other hand, a common monetary policy—which is a direct implication of a monetary union—can be seen as a collusive agreement among multinational banks with the intent of raising the benefits of inflation. Collusion by central banks damages the discipline imposed on them by competitive monetary policies and leads to higher inflation. *Id.*

225. VAN YPERSELE, *supra* note 28, at 49.

226. *Id.*

227. EMERSON, *supra* note 61, at 131.

228. See generally *supra* notes 176-207 and accompanying text.

to wane when it becomes apparent to the members of the EMS that the savings from transaction costs alone, which constitute much of the benefits that will be achieved during the transition period, will be too small to justify unification.²²⁹ The reason is that European mobility "is relatively low even within nations using the same language, let alone across language barriers."²³⁰ Finally, movement toward a single currency limits the fiscal policy options of the EEC Member States and essentially handcuffs them in their attempts to react to supply and demand shocks in their own economies.²³¹ Currency unification will also result in the loss to the EMS Member States of an important policy instrument, namely the ability to control national currency in order to exert influence over the national economy.²³² When the internal market becomes imbalanced, the likely result for the EEC is that the costs associated with reestablishing an equilibrium in domestic and trade accounts will be less under a policy of currency devaluation than the cost of using the exchange rate mechanism in order to accomplish the same goal.²³³ Losing control over monetary policy can have harsh effects on a country's economy.²³⁴ Exchange rate flexibility allows a country, at least in the short run, to choose inflation rates in order to help control the rate of unemployment.²³⁵

III. Conclusion

A. REQUIREMENTS FOR SUCCESS

Understanding the potential cost/benefit relationship of the EMS leads to several conclusions about the potential for success in unifying currencies. First, however, what are the requirements for successful integration? Successful unification requires high coordination in three areas.²³⁶ The first area for coordination

229. EMERSON, *supra* note 61, at 12-13.

230. *Id.*

231. Dasseze, *supra* note 19, at 390. The move to a single currency imposes significant limitations on the ability of Member States to finance deficits. *Id.* The move toward a single currency throughout the EEC implies that not only can the individual Member States not finance their deficits through borrowing from their national central bank, but they also cannot finance their deficits by obligating their national banks, insurance companies, and similar institutions to purchase government bonds. *Id.*

232. DE GRAUWE, *supra* note 203, at 42.

233. *Id.* Several EMS members have achieved some noteworthy cases of successful currency devaluations recently. Most notably, devaluations in France in 1982-1983 (which France used as a correction for a long period of major policy errors) and the Netherlands in 1982 were successful in reestablishing domestic and trade equilibrium. *Id.* Neither devaluation caused significant increases in unemployment in the local economies. *Id.*

234. Shulman, *supra* note 4, at 397-98.

235. David Laidler, *The Case for Flexible Exchange Rates in 1980*, in *EUROPEAN MONETARY UNION: PROGRESS AND PROSPECTS* 152, 155 (M. T. Sumner & G. Zis eds., 1982).

236. Joseph S. Nye, *The Political Context*, in *EUROPEAN MONETARY UNIFICATION AND ITS MEANING FOR THE UNITED STATES*, *supra* note 1, at 40-41. "[S]uccessful progress to eventual monetary and economic union will require a move from attempted coordination to a unification of policies, at least in key areas such as money creation, determination of exchange rates, and pooling of reserves." Bloomfield, *supra* note 1, at 25.

is in the creation of institutions to organize and run the union.²³⁷ "Institutional integration is the creation and development of common institutions. This dimension is measurable in terms of the respective jurisdictions and budgetary resources of the institutions involved."²³⁸ The second area of coordination is in both fiscal and monetary policy making.²³⁹ Policy integration is the extent to which a set of countries act as a group in making policy decisions. This "political division of labor" is measurable by a locus-of-decision scale ranging from totally national to totally communal.²⁴⁰ The third area requiring coordination among the EMS members is the moderation of attitudes toward obligations to the EEC.²⁴¹ "Attitudinal integration is the extent to which people develop a sense of common identity and mutual obligation. This can be measured by survey research data."²⁴²

The need for common monetary policy and monetary union go hand-in-hand; one cannot succeed without the other.²⁴³ The implementation of the internal market program will have to be supported by a common monetary policy and monetary union.²⁴⁴ The optimal results of the internal market can only be achieved if the monetary arrangements for the EEC were to minimize, if not eliminate, the uncertainties resulting from independent national monetary policies and from exchange rates subject to adjustments and fluctuations.²⁴⁵ The argument can be summed up under the dictum of the "inconsistent quartet," that is, the incompatibility of free trade, full capital mobility, fixed exchange rates, and national autonomy in the conduct of monetary policy.²⁴⁶

The EMS requires a high degree of policy consistency and compatibility among the Member States for the EEC to avert disruptions in internal markets and pronounced regional imbalances.²⁴⁷ The Delors Report recognizes that in order to achieve the goal of free circulation of capital and integrated financial markets among the EEC countries, "member states' economic and monetary policies need to be more closely coordinated; this includes, but is not limited to, convergent inflation and unemployment rates and similar budgetary and competition policies."²⁴⁸ No matter what decisions are made with respect to fiscal and monetary

237. Nye, *supra* note 236, at 40.

238. *Id.*

239. *Id.*

240. *Id.*

241. *Id.* at 41.

242. *Id.* The three aspects of political integration change at different rates: some progress faster than others. *Id.* The leads and lags between the aspects are of great importance because successful and stable long-run integration requires high degrees of integration among all aspects. *Id.*

243. UNGERER, *supra* note 13, at 38.

244. *Id.*

245. *Id.*

246. *Id.*

247. *Id.*

248. Shulman, *supra* note 4, at 407. The obvious result of such broad policy and economic coordination is that the EEC Member States will become increasingly interdependent both financially and politically. *Id.*

policy within the EMS, unification of purpose and policy are vital to the success of the agreement.

If policy coordination were the end-all for unification, then it might be possible for the EMS members to agree on a successful solution. However, a number of other problems are holding up the development of a unified currency. A second prerequisite for moving to a single currency is a stable exchange rate.²⁴⁹ A stable exchange rate in turn requires convergence of costs and prices in goods since differences in inflation rates of traded goods will disrupt the balance of trade between high inflation and low inflation countries, thereby causing an imbalance of payments.²⁵⁰ However, while cost and price convergence is a prerequisite to achieving lasting stability, it is insufficient on its own to achieve the desired result.²⁵¹ In order to achieve and sustain stability throughout the EEC, the EEC members' disparate macroeconomic policies must converge.²⁵² A necessary precondition for achieving convergence in prices and costs is the requirement for wage-rate change coordination since wages are in large part responsible for the determination of prices and costs of goods.²⁵³ Wage-rate control, in turn, will require a change in public attitude throughout the EEC, since the changing of wage-rate growth will ultimately result in some countries living with more inflation than they would prefer and others enduring more unemployment than they feel is acceptable.²⁵⁴ Thus, the concept of discipline in the areas of costs, prices, and wages constitutes another of the important requirements for the success of unification.²⁵⁵

Economic integration alone will not bring about monetary union without a concurrent move toward political union.²⁵⁶ This political leap will only come about once each EEC Member State government believes that a European monetary union will aid it in achieving other political goals.²⁵⁷ One of the primary political leaps necessary for the success of any lasting economic union is in formation of a unified strategy.²⁵⁸ However, strategy coordination will not be sufficient; unification of strategy through centralization of the decision-making process is necessary for the success of a European monetary union.²⁵⁹

Eventually, economic integration will require a major transfer of economic

249. UNGERER, *supra* note 13, at 22.

250. *Id.*

251. *Id.* at 23.

252. *Id.*

253. W. Max Corden, *The Adjustment Problem, in EUROPEAN MONETARY UNIFICATION AND ITS MEANING FOR THE UNITED STATES*, *supra* note 1, at 164-65.

254. *Id.*

255. See generally *supra* notes 250-54 and accompanying text.

256. Sherman, *supra* note 187, at 157.

257. *Id.* Currently, the German, Dutch, French, and British Governments' views on monetary union are significantly different. *Id.* at 157-60.

258. Theo Peeters, *EMU: Prospects and Retrospects, in EUROPEAN MONETARY UNION: PROGRESS AND PROSPECTS*, *supra* note 235, at 15.

259. *Id.*

sovereignty to new EEC institutions capable of exercising that power.²⁶⁰ Because unification requires the abdication of substantial political power by all participating members of the EMS, continued progress toward unification requires political and economic will rather than enforceable laws.²⁶¹ In all, the success of currency unification and the EMU requires political feasibility and economic viability.²⁶² Both requirements suggest that gradualism is a key factor in any approach.²⁶³ In terms of pure politics, the argument is that, except for a major crisis such as a war, it is impossible to generate the political support necessary to bring about rapid currency unification.²⁶⁴ "Even the most devoted European among the political leaders of our Member States would prefer a transition process that would allow for gradual adjustments of institutional structures and a slow erosion, at least formally, of national sovereignty."²⁶⁵

Thus, the correction of a sustainable union will involve a number of distinct elements. These elements will include fiscal and monetary policy coordination; coordination of wage, price, and cost adjustments; attitudinal modification; and political power sharing.²⁶⁶

B. POSSIBLE OUTCOMES

In light of the costs, benefits, and requirements associated with unification, the adoption of a common currency will likely lead to one of three possible outcomes for the EEC.²⁶⁷ First, the attempt at European monetary union may turn out to be nothing more than a futile gesture.²⁶⁸ Second, the EEC may achieve enough success in the first step to create a genuine European currency.²⁶⁹ Third, European countries may accomplish no more than succeeding in narrowing exchange rate bands.²⁷⁰

By understanding these possibilities, the EEC should be able to choose the best plan to achieve the greatest success. It may be possible to use integration

260. Denis Lamb, *EC Project 1992: The Dynamics of Change*, DEP'T ST. BULL., Feb. 1989, at 31, 34. "The contemplation of this prospect accounts for much of the increasing attention being paid to eventually setting up a European central bank and establishing a single European currency. For the moment, however, what seems sensible and appealing to European policy-makers is a steady development of what exists." *Id.*

261. Shulman, *supra* note 4, at 398.

262. Peeters, *supra* note 258, at 9.

263. *Id.*

264. *Id.*

265. *Id.*

266. See generally *supra* notes 237-65 and accompanying text.

267. Harry G. Johnson, *Narrowing the Exchange Rate Bands*, in EUROPEAN MONETARY UNIFICATION AND ITS MEANING FOR THE UNITED STATES, *supra* note 1, at 80.

268. *Id.*

269. *Id.*

270. *Id.*

in one of the areas in order to create integration in another.²⁷¹ The key to this strategy is to find sectors with which to begin the transformation that are noncontroversial but politically symbolic and sufficiently insulated from other, more controversial sectors.²⁷² However, the fact is that objectives among the EEC members conflict with respect to the underlying political purpose of monetary unification.²⁷³ The EEC members continue to maintain conflicting objectives with respect not only to the political purpose of unification, but also toward the steps that should be taken to achieve it.²⁷⁴ This divergence of objectives is demonstrated in the lack of coordination in monetary and fiscal policy.²⁷⁵

Whether these differences in policy judgments and preferences make any practical difference is difficult to determine. One possibility is that the EEC Member States have not learned from the failure of the Bretton-Woods Agreement that proprietary policy determinations will only lead to a collapse of the system. Apparently they have not. For example, in direct confrontation with what the EEC requires for unification, Member States "have held firmly to their autonomy in decision making on domestic monetary and economic policies, relying on their right to alter exchange rates or to impose safeguard measures if need be in case of balance-of-payments problems."²⁷⁶ In addition to differences in basic policy objectives, the history of attempts at cooperation among the European countries, including the Bretton-Woods Agreement, demonstrates that crisis in monetary situations fosters dissent and division in implementing external monetary policy.²⁷⁷ Thus, the potential remains high for encountering the fiscal and monetary policy conflicts that have pervaded past relationships among EEC members and that endanger the future stability of the system.²⁷⁸ These conflicts will potentially lead to fiscal imbalances that will undermine market stability.²⁷⁹ These imbalances could also lead to unemployment spiralling out of control as low-inflation countries are forced to import inflation from the high-inflation countries in order to retain some semblance of stability in the system.²⁸⁰

271. Nye, *supra* note 236, at 45. "The Monnet, or neofunctionalist, method that has characterized the European Community was to avoid frontal clashes over sovereignty, and rather to let the natural linkages inherent in complex societies draw political actors gradually from integration in one sector to integration in another." *Id.*

272. *Id.* "Monetary policy has the advantage of political symbolism without rousing intense nationalist feelings." *Id.*

273. Johnson, *supra* note 267, at 79; see also *supra* notes 176-207 and accompanying text.

274. *Id.*

275. Bloomfield, *supra* note 1, at 24. Germany, for example, places much more importance than France upon restraining inflation as opposed to reducing unemployment. Policy preferences and instruments tend to differ from country to country as does the relative effectiveness of those policy choices. *Id.*

276. *Id.* at 24-25.

277. *Id.* at 23.

278. UNGERER, *supra* note 13, at 23.

279. *Id.*

280. See *supra* note 181 and accompanying text.

The possibility remains that either all of the obstacles will be overcome and unification will take place, or some of the requirements will be ignored and unification will proceed despite this deficiency. In either case, it is important to question the impact that policy divergence will have on Member States once currency unification has taken place. Moving to a single currency implies that countries cannot use exchange rates to fix imbalances.²⁸¹ External account imbalances are likely to the extent that cost and price convergence cannot be achieved.²⁸² The existence of a single currency will prevent the effects of the divergences from being offset by exchange rate adjustments.²⁸³ Thus, when imbalances occur within an EMS Member State's economy, the Member State will suffer losses in order to compensate.²⁸⁴ In addition to uncontrollable fiscal imbalances, parallel advancement of economic and monetary policy could result in spreading high unemployment and inflation throughout the entire EEC.²⁸⁵ These potential results demonstrate "the Delors Report's rigid and often unrealistic approach."²⁸⁶ Because countries will lose control of their domestic monetary policy to a centralized body within the EEC, the fixed exchange rate regime will cause countries with higher inflation to export their inflation to countries with lower inflation.²⁸⁷ Member States are likely to succumb to the export/import of inflation because the decrease in demand likely to occur from the increased inflation will cause increased unemployment.²⁸⁸ High unemployment, in turn, will cause an increase in inflation in other countries in order to correct it.²⁸⁹

281. Shulman, *supra* note 4, at 409.

282. UNGERER, *supra* note 13, at 24.

283. *Id.*

284. Corden, *supra* note 253, at 163.

Internal balance can be thought of as the combination of unemployment and inflation that a specific country prefers from an internal point of view, given the various combinations it can choose from at any particular point in time. To take the hypothetical case:

In a world of at least three countries where fiscal and monetary policies in each country are used to maintain internal balance, country *A* may need to depreciate and country *B* to appreciate relative to the outside world, if each is to maintain internal and external balance. However, if *A* and *B* form exchange rate union, they can jointly depreciate, which would suit *A*, or jointly appreciate, which would suit *B*. But they cannot alter the exchange rate to suit both. If the exchange rate adjustment leaves country *A* with a deficit, *A* will have to deflate, hence creating unemployment. If the adjustment leaves country *B* with a surplus, *B* will either have to be content with accumulating reserves or allow its wages and prices to rise.

Id. at 162.

285. Shulman, *supra* note 4, at 409.

286. *Id.*

287. *Id.* at 400.

288. DE GRAUWE, *supra* note 203, at 10.

289. *Id.* Using France and Germany as examples, if France were to relinquish control over its exchange rate by creating a monetary union with Germany, it would be saddled with sustained unemployment and a current account deficit. *Id.* That deficit could only disappear by deflation in France. *Id.* Essentially, France would feel the costs of a monetary union through a negative demand shock. *Id.* In the same way, Germany's cost of participation in the monetary union with France would be the need to accept more inflation than it would prefer. *Id.*

In addition to the Member States' loss of ability to correct inflation and unemployment imbalances, "[m]onetary union destroys the discipline of policy competition and thereby worsens the quality of the product—that is, it results in higher average inflation."²⁹⁰ Finally, countries have different optimal inflation rates.²⁹¹ The countries that currently maintain underdeveloped tax systems will tend to find inflation the most advantageous method of raising revenue, because the marginal cost of inflation will be less than the marginal cost of increasing taxes.²⁹² In the end, the advantages cannot outweigh the large-scale unemployment likely to result from unification.²⁹³

In addition to the potentially destructive fiscal and economic policy implications, the EEC Member States are likely to face a number of other detrimental possibilities. First, the initiative will likely invalidate a number of bilateral treaties between the United States and the EEC Member States.²⁹⁴ "[F]riendship, commerce, and navigation treaties will have to be replaced, or the United States will not be protected from discrimination. Aviation treaties will also have to be renegotiated."²⁹⁵

Second, differences in labor markets, especially wages, will increase the cost of unification because they "lead to divergent wage and price developments, even if countries face the same disturbances."²⁹⁶ Institutional differences in labor markets are likely to continue long after the EEC has fully implemented currency unification.²⁹⁷ These differences may lead to wage and unemployment differences and ultimately cause severe adjustment problems.²⁹⁸ Finally, from 1981–1990 the average yearly GDP growth rates of countries in the EEC ranged from a low of 1.8 percent in the Netherlands to 2.9 percent in Spain.²⁹⁹ These differences in the natural growth rates of EEC Member States will lead to trade imbalances and balance-of-payments problems that could cause the eventual destruction of any union.³⁰⁰

In the final analysis, economic reasoning will, as always, be subordinated to

290. FRATIANNI, *supra* note 15, at 164. "The theory of credibility implies that the trend inflation rate increases with the short-run orientation of monetary policy. The conclusion is that central bank independence is a prerequisite of price stability; indeed, the optimal monetary arrangement calls for complete monetary independence." *Id.* at 165.

291. DE GRAUWE, *supra* note 203, at 28.

292. *Id.*

293. Corden, *supra* note 253, at 177. The problem posed is one of a balance between the potential benefits from unification versus the costs; the benefits appear to be minimal as compared to the drastic consequences that seem to be an almost inevitable result of the loss of control by EMS Member States. *Id.*

294. *EC Will Have Common Currency by 2000, Member of European Parliament Predicts*, 6 INT'L TRADE REP. (BNA) 240, 241-42 (1989).

295. *Id.* at 242.

296. DE GRAUWE, *supra* note 203, at 18.

297. *Id.* at 35.

298. *Id.*

299. *Id.* at 25.

300. *Id.*

politics.³⁰¹ Currently, no political consensus exists in France, Italy, or the United Kingdom toward currency unification, and no evidence exists to support the belief that ideological differences within and among EEC members will disappear upon joining a monetary union.³⁰²

It can, of course, be argued that governments behave the way they do merely because they are too . . . short-sighted to recognize how limited their real freedom of action is. But even if that is true, there is no reason to believe that they will suddenly cease being . . . short-sighted merely because they have promised to behave more wisely in the future.³⁰³

Even if local governments relinquish power to an autonomous central bank, the people will still blame them for unpopular fiscal policy.³⁰⁴ For their own political protection, the local governments will be forced to take back the power that they relinquished.³⁰⁵ Flexible exchange rates are thus a reflection of the state autonomy necessary to control both local economies and the political realities of the situation.³⁰⁶ "Only a flexible-exchange-rate regime permits each country to choose its own degree of monetary discipline independently of choices made by others."³⁰⁷ In the final analysis, economic union requires monetary union for success, and the only way to achieve true monetary union is through political union.³⁰⁸ "And political union requires a different institutional structure, not merely when it has been achieved but as a condition to achieving it."³⁰⁹

Unless a more flexible approach is adopted, prospects are not good for success of the EMU.³¹⁰ "If the political priority given to EMU remains low in two or more of the larger Member States, then little further movement can be expected."³¹¹ Because of the lack of institutional development at present, if political momentum begins to shift toward the EMU, the strain of integrating the higher-inflation countries is likely to overwhelm the current institutions.³¹² Currently, growth rates among member countries and inflation rates in those countries are significantly disparate.³¹³ Thus, at the current point of evolution of the EMS a direct move to a system of fixed exchange rates could be disastrous for the EEC

301. Norbert Walter, *The EMS: Performance and Prospects*, in *EUROPEAN MONETARY UNION: PROGRESS AND PROSPECTS*, *supra* note 235, at 62.

302. David Marquand, *EMU: the Political Implications*, in *EUROPEAN MONETARY UNION: PROGRESS AND PROSPECTS*, *supra* note 235, at 239.

303. *Id.* at 238.

304. *Id.* at 239.

305. *Id.*

306. Laidler, *supra* note 235, at 166.

307. *Id.*

308. Marquand, *supra* note 235, at 247.

309. *Id.*

310. Sherman, *supra* note 187, at 163.

311. *Id.*

312. *Id.*

313. Shulman, *supra* note 4, at 401-02.

Member States.³¹⁴ The current development of political institutions for running the EMU is almost nonexistent and is unlikely to survive the political strains that are likely to emerge.³¹⁵ Thus, skepticism about the likelihood of progress is justified.³¹⁶

C. ALTERNATIVES

Considering the preceding discussion, EEC Member States would do well to put their greatest effort toward solutions that will not become embroiled in the politics that are destined to destroy even the most successful agreements. Until the EEC is willing to have supranational elections for EEC political positions, the idea of relinquishing political power to an "independent" foreign body is likely to provoke a strong public reaction.³¹⁷ Thus any solution attempting to develop greater economic unity among the EEC members will have to avoid this type of power delegation.

One example of how greater economic unity might be accomplished is through commercial joint efforts such as the Chunnel, the Airbus, or European Economic Interest Groupings.³¹⁸ This type of international cooperation helps to build a manufacturing base within the entire region that would not be possible for the participating countries acting independently.³¹⁹ These cooperative ventures may also help to coordinate economic policies in the participating countries by integrating the participants' economies.³²⁰ For example, if the economy worsens for a particular product, the affected countries must react with similar fiscal and economic policies in order to rectify the situation.³²¹ This interaction would also allow for the tailored use of economic and fiscal policy within each country that is necessary because of the inherent differences in each member's economy.³²² Even this type of cooperative solution will not prevent the inevitable economic downturns and upturns. In the end, however, it may prove more palatable than the alternative of states relinquishing their only power to control their economic situations: fiscal and economic policy.³²³

314. *Id.* at 402.

315. Marquand, *supra* note 235, at 244.

316. Johnson, *supra* note 267, at 79. "One can argue that the Europeans have become accustomed to making gestures toward integration as a fair-weather system while retaining autonomy of domestic economic policy. . . ." *Id.*

317. Sherman, *supra* note 187, at 157.

318. See Johan de Bruycker, *EC Company Law—The European Company v. The European Economic Interest Grouping and the Harmonization of the National Company Laws*, 21 GA. J. INT'L & COMP. L. 191, 215 (1991).

319. *Id.* at 197.

320. *Id.* at 216.

321. Shulman, *supra* note 4, at 407.

322. See DE GRAUWE, *supra* note 203, at 13.

323. See *id.* at 42.