



The Euro crisis: From the Treaty of Rome to the Stability Treaty.

Why trade unions and citizens can and should support the Stability Treaty.

[The purpose of this paper is to show that currency stability has been central to the European Community and its common policies from the beginning. In 1969 when the Bretton Woods fixed exchange rate regime began to break down the need for a single currency began to be considered. The original Werner plan of 1970 had 3 pillars at Community level, fiscal, economic and monetary, but the Report by Jacques Delors in 1988 which formed the basis for the establishment of the Euro opted for only monetary policy as an exclusive Community competence. The end of the Bretton Woods system in 1973 conferred extraordinary privileges on the American dollar as the global reserve currency, but introduced instability into the global financial system with speculative currency trading the precursor of “casino capitalism”. Social policy has been at the heart of the Community from the beginning, with substantial benefits for Irish workers, but it has always been contested, and has had to be fought for on a continuous basis. The political composition of the Franco-German leadership of Nicolas Sarkozy and Angela Merkel is different to past key periods in European integration, and this has had a significant influence on the response to the crisis. That will now change with Socialist Francois Hollande elected as the new French President, as he has committed to a new growth strategy for Europe. There is no disputing that austerity alone cannot work, and that new strategies for investment, growth and jobs at both European and national level are essential. However common fiscal rules are a necessary condition of a currency union, and the Stability Treaty is essential to ensure the survival of the euro, and is also necessary for Ireland to ensure that we continue to have access to affordable funding options. It is essential for workers and citizens generally that the euro survives and prospers as a single currency. That is the only means of generating expansionary economic policies insulated from the type of “casino capitalism” that floating currencies have facilitated in the past.]

1. Background.

Over the past year a number of economic commentators have argued that Ireland should not have joined the euro, in part because of the high proportion of our trade that is outside the Eurozone, while others have conceded that realistically we had to join, but have suggested that the creation of the euro was a mistake. The first proposition fails to take account of the determination of Irish policymakers to reduce our dependence on the UK, when we joined the Community in 1973, and which culminated in the decision to join the European Monetary System (EMS) in 1979 breaking the link with sterling. The second proposition is equally flawed, as it fails to take account of the importance attached to currency stability in the Community which was set out clearly in the Treaty of Rome of 1957.

In this paper it is proposed to set out the extent to which stable currencies and eventually a common currency have been an integral part of the Community since the first decade of its existence. In considering today the challenges that have emerged for Europe as a result of the continuing Euro crisis, it is important to remember that the EU has been a political and peace project from its inception with the goal of a united Europe, and it has never been just a free trade club, as some particularly in the UK would have preferred. In 1957 when the Treaty of Rome was agreed, the fixed but adjustable international currency regime agreed at Breton Woods in 1944, was in place but had not yet become fully operational among European currencies. It was thus expected that this new currency regime which was based on a fixed link to gold through the US Dollar, but still had a mechanism for adjustment if serious balance of payments issues arose, would provide the currency stability that was needed to pursue common economic policies at European level.

2. The Treaty of Rome.

The Treaty of Rome was signed in March 1957, and came into operation in January 1958. In May due to the Algerian crisis the French fourth Republic collapsed and de Gaulle returned to power, and though known to be critical of the Treaty decided to work with it. Monetary policy and its coordination among the six members of the European Economic Community (EEC) was considered to be an important issue as Articles 104, 105 and 107 of the Treaty of Rome shows:

Under Article 104 each member state was required to pursue the economic policy needed to ensure equilibrium in its overall balance of payments. Under Article 107 member states were required to treat policy with regard to rates of exchange as a matter of common concern to such an extent that if one member altered its exchange rate in manner inconsistent with the objectives set out in Article 104, then other member states were permitted to take counter measures. Article 105 went further and provided for the establishment of a Monetary Committee to facilitate and promote the coordination of monetary policy.

Article 105

- 1. In order to facilitate attainment of the objectives set out in Article 104, Member States shall co-ordinate their economic policies. They shall for this purpose provide for cooperation between their appropriate administrative departments and between their central banks. The Commission shall submit to the Council recommendations on how to achieve such cooperation.*
- 2. In order to promote coordination of the policies of Member States in the monetary field to the full extent needed for the functioning of a common market, a Monetary Committee with advisory status is hereby set up. It shall have the following tasks:*

- *To keep under review the monetary and financial situation of the Member States and of the Community and the general payments systems of the Member States and to report regularly thereon to the Council and The Commission;*
- *To deliver opinions at the request of the Council or of the Commission or on its own initiative for submission to these institutions.*

The Member States and the Commission shall each appoint two members of the Monetary Committee.

The Treaty of Rome was more than just a customs union and it established common European policies in unrelated areas such as Agriculture through the Common Agricultural Policy (CAP). But the extent to which even a customs union required common monetary and economic policies can be appreciated from a speech made in 1961 by the first President of the European Commission Walter Hallstein, when he said,

“For a customs union to exist it is necessary to allow free movement of goods within the union, For a customs union to be a reality it is necessary to allow free movement of persons. For a customs union to be stable it is necessary to maintain free exchangeability of currency and stable exchange rates within the union. This implies free movement of capital within the union. When there is free movement of goods, persons and capital in any area, diverse economic policies cannot be pursued.....The Community is not merely a customs union. It is an economic union.” (Halstein, 1961)

The UK had refused to participate in the discussions that led to the Treaty of Rome, and instead worked to establish the European Free Trade Association in late 1959 along with six other countries including Denmark Norway and Sweden. But by 1961 it had reconsidered and applied to join the Community. De Gaulle was opposed to British membership for a number of reasons, but primarily because he feared it would increase American influence in Europe, thereby reducing French influence. He was also opposed to the supranational provisions of the Treaty of Rome particularly the role of the Commission, and preferred cooperation to be on an intergovernmental basis. As an alternative De Gaulle sought to promote a plan (called the Fouchet Plan) to establish a separate European structure for political and defence cooperation on an intergovernmental basis. It did not come to pass due to opposition in particular from the smaller member states, but in its place de Gaulle reached agreement with Chancellor Adenauer of Germany on the Elysee Treaty of 1963 which among other provisions commits France and German to reach a common position on Community issues to this day. This is the context that led to the Franco-German alliance as the engine of European integration.

In 1965 de Gaulle initiated a major crisis in the Community when he withdrew France from the Council of Ministers over proposals by the Commission to establish the EEC's own resources(in place of national import duties) to fund the Common Agricultural Policy. This so called "empty chair crisis" was resolved in early 1966 after de Gaulle was re- elected President (defeating Mitterrand), by what was termed the "Luxembourg Compromise", which effectively deferred the Commission's proposal. While the other member states stood firm against de Gaulle, the result of the crisis was a weakened Commission and indeed Community as de Gaulle had also introduced objections to moves towards qualified majority voting. Not long after this de Gaulle exercised a second veto over the UK's application for membership.

In the late 1960's the exceptional economic success of the Community began to falter. In August 1969 the franc was devalued by 11%, in part due to the inflation that resulted from the crisis surrounding the tumultuous events of May 1968, followed a month later by a revaluation of the German D Mark by 10% (Gros et al, 1992). Under the Bretton Woods fixed exchange system European currencies operated within a 3% spread. However the strains in the Bretton Woods currency regime had grown during the 1960' due to a number of factors. In particular the cost of the Vietnam War and the "Great Society" programmes of President Johnson had led the US to run large fiscal and current account deficits, in effect printing dollars and in the process exporting inflation to Europe. The result of this was that the US did not have enough gold to meet the commitment under the Bretton Woods regime to exchange dollars for gold at \$35 to the ounce. While some European countries such as Germany had agreed not to seek to convert their dollar reserves for gold, others such as France under de Gaulle had refused to do so. In August 1971 President Nixon took the dollar off gold and precipitated the end of the Bretton Woods currency regime, which finally collapsed in 1973 (Helleiner, 2005). In response European countries tried to maintain the fixed currency regime with the "snake".

3. The Werner Report on Economic and Monetary Union (EMU)

When de Gaulle resigned in April 1969 after losing a referendum on an administrative change, which in reality was linked to the events of May 1968, the newly elected French President Pompidou called a special Community summit which was held in The Hague in December 1969 under the Dutch presidency. It was clear that de Gaulle's veto in relation to UK membership was going to be removed, but also that a deepening of the Community would be put in place at the same time. This has been suggested by some commentators as making it clear to the UK that they were joining a "political club," with the ambition of a United Europe, and not merely a free trade association. Shortly after the EEC was founded the UK had played a pivotal role in the founding of the European Free Trade Association (EFTA) in 1959, but soon concluded that membership of the EEC was in their economic interests. Two reports were commissioned by the Summit; the Davignon Report on the

development of a common foreign policy for the Community, and the Werner Report named after Pierre Werner the Prime Minister of Luxembourg who chaired the Committee on economic and monetary union. Agreement was also reached on the opening of accession negotiations for the UK, Ireland, Norway, and Denmark, which resulted in all except Norway joining the Community in January 1973. The initiative on monetary union, came from the German Chancellor Willy Brandt who wished to follow a new policy towards Eastern Europe and sought support from the Community. It was also in a context where currency difficulties were emerging in the Community with serious strains in the Bretton Woods currency regime.

The Werner Report was completed in 1970 and was adopted with a timescale set for monetary union within ten years. However the very difficult economic circumstances of the time with high inflation and the impact of the 1973 oil crisis made progress difficult. The Bretton Woods currency regime broke down completely in 1973 and a floating currency regime emerged globally. The European countries tried to maintain a fixed regime between themselves with a system called the “snake”, but it did not prove very successful.

The Werner Report on economic and monetary union (EMU) is particularly important in the context of the current difficulties that have emerged with the Euro crisis. A key conclusion of the report was that balance of payments between members states no longer mattered within a currency union, and that only the balance between the Community and the rest of the world was of importance. It is however clear from the current crisis that macroeconomic imbalances which are identified clearly by current account deficits on the balance of payments were an important contributory factor to the emergence of the euro crisis. The Werner Report however did recognise that there *“a grave danger of disequilibria if economic policy cannot be harmonised effectively”*

The Werner Report set out the three essential pillars of fiscal, economic and monetary policy required for a single currency to be decided at Community level. Budget policy would be decided at Community level for each country, taking account of the economic situation and the particular structural features of each country. This would include guidelines on the distribution between investment and consumption. There would be a Centre of decision for economic policy which would exercise independently in accordance with the Community interest, a decisive influence over the general economic policy of the Community. This new Community institution would be responsible to the European Parliament. There would be a Community system for the Central Banks, with a single European Central Bank to decide both monetary and credit policy. In addition it was considered that the Social Partners had an important role to play and should be consulted in a structured manner. The proposal for a centre of decision for economic policy was effectively a federal structure for economic governance, and it was not supported by the Gaullists in France who had a preference for intergovernmentalism. In the run up to actual monetary union in 1999, France pushed hard

for policy on economic governance to be decided at the Council level but without much success, as it was perceived as interfering with the autonomy of the European Central Bank (ECB). The Werner Report had opted for all the key decisions on fiscal, economic, and monetary policy to be decided at Community level. In many respects the initiatives taken by the European Council on improving the rules for the euro since the crisis began, are no more than a return to some of the original blueprint for monetary union. A common currency cannot survive without common fiscal rules. The simple fact is that the rules agreed were not adhered to, and more stringent rules were essential to calm the markets. This is an entirely separate issue from the policy discussions required about the balance between fiscal consolidation and new policies for jobs, investment and growth. By definition policies of austerity alone cannot work, and need to be supported by strategies for economic expansion. The failure to centralise credit supervision policy for the Euro as envisaged in the Werner Report was probably one of the key reasons behind the Irish property bubble and inevitable collapse.

4. The European Monetary System (EMS).

The difficulties that emerged in relation to proceeding with the plan for economic and monetary union can be seen in the divergent economic performance between member states that emerged in the 1970's. Between 1974 and 1977 inflation rates in the nine member states of the Community ranged between 25% and 100% in total, with growth rates between 1% and 10%, which along with differences in the trend of exchange rates made any form of monetary cohesion impossible. Exchange rate fluctuations among European currencies caused significant problems for common European policies such as the Common Agricultural Policy (CAP). The so called "green pound" negotiations at the Council of Ministers were a regular feature of meetings in the 1970's. These related to what were called Monetary Compensatory Amounts (MCA's) which adjusted common prices for agricultural products for exchange rate fluctuations. In 1977 the new President of the European Commission Roy Jenkins returned to the theme of economic and monetary union, when in a lecture delivered in Florence he emphasised the need for monetary union to appeal to both weak and strong economies, rich and poorer countries. He did not favour the US federal approach pointing out that already a very high proportion of spending on welfare took place at national level. He did however support the view expressed in the McDougall Report that an increase in Community spending from the then 1% of GNP to possibly between 5% and 7% would be required to support economic and monetary union (Jenkins, 1977).

When French elections in 1978 returned the existing Government to power an initiative was taken by France and Germany to revise the ineffective snake system to bring about greater currency stability. This was also influenced by developments in the US which was perceived by Europe to be deliberately weakening the dollar to restore US competitiveness.

The US policy of “talking down the dollar” left Germany and other European countries with a dilemma that if they sought to defend the dollar through currency intervention they risked increasing the domestic money supply, while if they let the dollar fall it risked a loss of competitiveness for them in global markets. This European concern about US policy in the late 1970’s was one of the key factors that persuaded the French President Valéry Giscard d’Estaing and the German Chancellor Helmut Schmidt that a new stable currency regime in Europe was essential. As part of that process Germany also agreed to expand domestic economic policy.

In 1979 the European Monetary System (EMS) was established and Ireland decided to join without the UK, and in the process broke the 150 year old link with sterling. The main reason why Irish policy makers considered joining, even though the UK opted to stay outside was that it was hoped that an EMS anchor would assist in the determination to reduce inflation. Also at that stage sterling was considered to be adding an inflationary bias to the punt. There were numerous agreed adjustments in exchange rates in the early years of the EMS, with Ireland devaluing on a number of occasions before revaluing by 3% in advance of adopting the Euro in 1999. When Mitterrand was elected President of France in 1981 he commenced an expansionary economic and fiscal policy that eventually threatened France’s position in the EMS, and it was Jacques Delors his Finance Minister who persuaded him to change course to protect the franc and to follow what became known as the “franc fort” policy. In the early 1990’s a crisis developed in the EMS as a result of Germany’s post-unification economic policy with the result that a number of currencies including the punt came under speculative attack by the markets. Both sterling and the Italian lira left the EMS, and it became necessary to widen the bands considerably to avoid continuous speculative attack by the markets. An important factor in this crisis also was that capital liberalisation had occurred in most of the Community member states by 1990, and that increased the capacity of the markets to mount speculative attacks on European currencies. This made proceeding with the creation of the euro essential to provide economic stability for citizens and protect national economies from speculative attacks.

5. The Delors Era

In 1985 Jacques Delors the then French Finance Minister became probably the most successful ever President of the European Commission. It commenced a process of profound change within the Community with a deepening of economic integration and an expansion of social policy provisions alongside it. The Community had suffered from stagnation during the 1970,s due to the economic crisis and the failure of Keynesian demand management policies to cope with the economic challenges and the oil price shocks of that decade. The Delors Presidency revived the Community which also had to cope with successive crises due to the Budget rebate negotiations demanded by the new UK Prime Minister Margaret Thatcher. The plan to create an internal market without border control of

goods was agreed under the Single European Act (SEA) of 1986, which also made reference to Economic and Monetary Union (EMU) for the first time in the Treaty. Indeed John Major the former British Prime Minister noted in an article in the Financial Times last year that his European colleagues had expressed their annoyance when he opted out of the single currency during the Maastricht Treaty negotiations, on the grounds that Britain under Prime Minister Margaret Thatcher had strongly promoted the completion of the internal market and that the need for monetary union was very clear in the Single European Act. The ratification of the Single European Act was delayed until 1987 due to the requirement for a referendum in Ireland after the Supreme Court judgement in the Crotty case. The main reason for the referendum requirement was the extension of competences for the Community into the area of foreign policy. The Single European Act also made provision for measures to tackle economic and social cohesion which led to a doubling of spending through the various structural funds, and with Ireland a very significant beneficiary. This was consistent with previous approaches when Ireland had gained increased funding support on joining the EMS. Perhaps the most important development of the Delors era as Commission President was the recognition that the economic liberalism associated with the completion of the internal market by 1992, must also be accompanied by corresponding developments in the social policy field benefiting workers. It is certainly the case that Europe as a Social market economy came to the fore under President Jacques Delors. The Community Charter for the Fundamental Social Rights of Workers was adopted by the Council the following year, while the Single European Act had made provision for European wide social dialogue between the Social Partners.

6. The Delors Report on Economic and Monetary Union (EMU).

The introduction of the Single European Act with the plan to complete the internal market by 1992, allowed the issue of the single currency to come on the agenda again. In June 1988 the European Council meeting in Hanover established a Committee under the chairmanship of Jacques Delors and with each Central Bank Governor as a member to prepare a report on economic and monetary union. Indeed in the Presidency conclusions the European Council recalled that *“in adopting the Single Act, the Member States of the Community confirmed the objective of progressive realisation of economic and monetary union”* The Delors Committee issued its report in April 1989 and set out a three stage transition process for economic and monetary union to be completed by 1999 with the introduction of a single currency, the Euro.

The Delors Report differed in important ways from the original Werner Report in the 1970's. It must however be remembered that the original report was written at a time when Keynesian demand management of the economy was the prevailing economy approach with fiscal policy accorded a key role in the fine tuning of the economy. By the time of the Delors Report a new market orientated neo-liberal economic philosophy had become

dominant. The Delors Report identified the need for greater convergence of economic performance within the Community, but concluded that the completion of the single market which was planned for 1992 would in itself increase the degree of economic integration. It also concluded that while voluntary cooperation should be relied upon as much as possible to arrive at consistent national policies, that there would also be a need for more binding procedures. The report noted that a degree of autonomy in economic decision making should remain with member countries with a balance to be struck between national and Community competences.

This introduced the “principle of subsidiarity” which was later enshrined in the Maastricht Treaty. The report concluded that the transfer of decision making power from Member States to the Community would arise primarily in the fields of monetary policy and macroeconomic management. This was then specified as “*macroeconomic policy coordination*”, including binding rules for budgetary policies. The Report emphasised the need for countries to accept that sharing a common currency imposed policy constraints. It then set this out as “*In the general macroeconomic field, a common overall assessment of the short- term and medium- term economic developments in the Community would need to be agreed periodically and would constitute the framework for better coordination of national economic policies.*” The Report concluded that a European Central Bank (ECB) was required to have sole responsibility for monetary policy, but that the need for common policies in the non-monetary field did not necessarily require any new institution. The coordination of economic policy would lie with the Council of Ministers, but there would be binding rules and procedures for budgetary policy to include upper limits on budget deficits and the definition of the overall stance of fiscal policy.

In contrast to the Werner Report which implied strong Community control of fiscal, economic and monetary policy, the Delors Report only proposed exclusive Community control of monetary policy. Economic policy and convergence was left to coordination among member states, and the pressure for integration that was expected to come from the single market. Binding rules and procedures for budgetary policy were explicitly set out, but this was still in a new context of a policy of subsidiarity, where the Community would only perform tasks that could not be done at the national level. However in contrast to the Werner Report which was not concerned about balance of payment problems, perhaps because the proposed structure would have minimised them, the Delors Report did emphasise the need to develop a more balanced economic structure within the Community, and warned that the emergence of imbalances could threaten monetary union. In what has proved to be an important observation in the Report on the need for countries to accept policy constraints it stated,

“Rather than leading to a gradual adaptation of borrowing costs, market views about the creditworthiness of official borrowers tend to change abruptly and result in the closure of

access to market financing. The constraints imposed by market forces might either be too slow and weak or too sudden and disruptive.”

A brief summary of the difference between the Werner and Delors Reports would be that in Werner a three Pillar structure of Community competence in fiscal, economic and monetary matters was proposed, whereas in Delors only one Pillar that for monetary policy survived. That reflected the differences in economic thinking between the two periods, and also probably the role of the UK in resisting the extension of Community competences and promoting subsidiarity. Apart from the establishment of the European Central Bank (ECB) with the sole competence for monetary (but not credit) policy, the main emphasis in the report was on coordination of policy by the member states. This approach may also help to explain why the binding rules on budget policies in the Stability and Growth Pact were not adhered to by member states. In giving the Pierre Werner Memorial Lecture in 2003 Hans Tietmeyer the former President of the Bundesbank, questioned whether the distribution of responsibilities between national and Community level proposed by Delors (in contrast to Werner) would suffice, and also observed that friction could only be avoided if all countries were *“willing to ensure the requisite discipline in fiscal policy.”*(Tietmeyer, 2003)

The European Council at meetings in October and December 1990 in Rome agreed to convene an Intergovernmental Conference on Economic and Monetary Union based on the Delors Report. In its contribution to the work of the Conference the Commission concurred that only one new institution was required (ECB) and that economic union would be founded on closer coordination of economic policies which would require multilateral surveillance. It also recommended that two rules concerning budget deficits should be incorporated in the Treaty providing for no monetary financing and no bail-outs. Both of these provisions were adopted in the Maastricht Treaty. The Delors Report had also recommended that monetary financing be ruled out.

7. The Maastricht Treaty

The Maastricht Treaty agreed in February 1992 followed the principles set out in the Delors Report and provided for *“the adoption of an economic policy which is based on the close coordination of Member States’ economic policies,” while the Council would formulate a draft for the broad guidelines of the economic policies of the Member States.* The only exclusive Community competence was for monetary policy with a European Central Bank (ECB) whose primary responsibility was price stability, and a Protocol on the Excessive Deficit Procedure which limited fiscal deficits to 3% of GDP and Government debt to 60% of GDP. However it also provided that in areas where the Community did not have exclusive competence, it can only take action *“in accordance with the principle of subsidiarity only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore by reason of the scale or effects of the proposed action, be better achieved by the Community.”* The provisions in the Treaty Protocol on the Excessive

Deficit Procedure were enhanced at the European Council meeting in Dublin in December 1996, under the Stability and Growth Pact which was adopted in June 1997. However a key problem later was that this important agreement on fiscal discipline was breached on a regular basis without sanction by the European Council including by Germany one of the main sponsors of the Pact.

These developments on Economic and Monetary Union were accompanied (as had been the case with both the EMS and the Single European Act) by significant improvements in Structural and Cohesion funding with €8 billion in additional funding the main outcome of these Treaty negotiations for Ireland.

In Article 108 of the Treaty of Rome there was provision for mutual assistance for a Member State in difficulties with regard to its balance of payments with provision for the granting of credits by other Member States. In its Report to the Intergovernmental Conference on EMU where the Commission had proposed the no bail-out and monetary financing rules, it had also called for a *“specific financial support scheme which would be activated when major economic problems arise.”*

The Maastricht Treaty authorised the Council acting unanimously to provide financial assistance to a Member State in difficulties caused by exceptional occurrences beyond its control, or acting by qualified majority to do so in the case of natural disasters. In the Nice Treaty in removing the requirement for unanimity the revised Article 122.2 reversed the order and provided for financial assistance to a Member State arising from difficulties due to natural disasters or from exceptional occurrences beyond its control. In addition the Maastricht Treaty amended the provision for mutual assistance in Article 143 and confined it to Member States with derogation, that is those outside of the Euro. It is clear that the current account imbalances that were a feature of the “programme Member States” including Ireland prior to the crisis were also an underlying cause of the crisis. The Treaty basis for the funding currently provided for “programme Member States” is Article 122.2 which as outlined is now primarily geared to natural disasters. It seems clear that in the evolution of Treaty provisions since the Maastricht Treaty was agreed in 1992, there was no specific provision to cover the type of crisis that actually emerged. Also the mutual assistance Treaty provision (Article 108 in the Treaty of Rome) was amended to exclude Eurozone countries. That is now being addressed as the basis for the European Stability Mechanism (ESM) will be added to Article 136 of the Treaty which is specific to the Eurozone. It appears that there may have been some concerns about the legal basis of using Article 122 of the Treaty for financial assistance to programme countries under the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM). Also while the Maastricht Treaty made provision in Article 127.6 for the Council acting unanimously to confer upon the ECB the task of the supervision of credit and other financial institutions this was never implemented. The ECB exercised its mandate of

price stability on a Eurozone wide basis and did keep inflation very close to the target of 2% over its first decade of existence, but banking supervision remained a national responsibility. While the Werner Report had specifically recommended that credit supervision be centralised at Community level, the Delors Report in keeping with the principle of subsidiarity had not done so. The responsibility for the property bubble and consequent banking failure in Ireland is a national failure of policy and the unregulated banking practices that were the responsibility of the Irish Central Bank and Financial Regulator and not the European Central Bank (ECB)

8. Social Policy in the European Union.

From the beginning Social Policy provisions aimed at improving working conditions were an important part of the Treaty of Rome. Article 117 confirmed the agreement of member states on the need to promote improved working conditions, with Article 118 setting out the areas of employment, labour law and working conditions, vocational training, social security and the right of association and collective bargaining for cooperation. Perhaps the most important from an Irish perspective was Article 119 on equal pay which was directly responsible for the first major success on gender equality in the public service with the abolition of differentiated pay scales and the marriage bar. In the early years of the Community progress on social policy issues was highly contested with a number of member states arguing that the Commission should not take the initiative and that only measures required to support economic integration should be considered. The Paris European Summit of October 1972 established the basis for the first Social Action Programme of 1974, but the major initiatives began with the adoption of the Single European Act in 1985 which established the practise of directly linking progress in the field of economic integration to social progress linked to an improvement in working conditions. The Delors Commission was particularly active in setting out a basis for Social Europe with the Community Charter of the Fundamental Social Rights of Workers followed by the Social Chapter in the Maastricht Treaty. Finally the Charter of Fundamental Rights of the European Union attached to the Lisbon Treaty completed the Treaty revisions of social policy. For a more detailed analysis of the impact of EU Social Policy in Ireland see “The Importance of the European Union for the development of Workers’ Rights in Ireland” at www.thechartergroup.ie

9. The Stability Treaty

The Stability Treaty has emerged as one of the solutions to the threat to the very existence of the Euro that stemmed from panic in the bond markets once the crisis arose in 2008. This exposed serious design flaws in the construction of the single currency that were either not foreseen in the 1990’s, or were underestimated. The history of economic integration set out in this paper shows that stable currencies were central to the European project from the beginning. Common European policies like the Common Agricultural policy (CAP) could not survive floating European currencies. The creation of the single internal market in 1992 was

predicated on a single currency, and could not survive a breakup of the Euro. When the Bretton Woods currency regime began to break down in the late 1960's, the European response was to plan for the single currency. It was the economic turmoil of the 1970's that delayed its implementation. The completion of the internal market was based on a single currency because it is simply not possible to have a properly functioning European single market with multiple floating currencies. It is also clear that even a pegged currency regime cannot survive with free movement of capital as speculative market attacks would destroy it. This is clear from the decision to widen the bandwidths in the EMS to 15% in 1992. The Bretton Woods system was based on capital controls, but free movement of capital is one of the four freedoms in the EU alongside, people, goods and services. In a report by the Commission entitled "*One Market, One Money*" in 1990 following the Delors Report, it was accepted that the EMS would not be able to withstand speculative attacks once capital controls were removed as planned in the early 1990's. A move to a single currency was thus inevitable. (Commission,1990)

The original design for the Euro set out in the Werner Report of 1970, had three Pillars for Fiscal, Economic, and Monetary where decisions would effectively be made at Community level. In the case of fiscal policy it would of course take account of individual circumstances in each country. However Werner also provided for Community input in decisions on consumption and investment a far more intrusive approach than the standard rule based approach of the Stability Treaty.

The Delors Report differed significantly from the original Werner Report in that it essentially provided for only one Community Pillar for the construction of the Euro, that for monetary policy with the creation of the European Central Bank(ECB). A key reason behind this change was the principle of subsidiarity that had emerged in the 1980's, that restricted Community competences to only essential areas. Also the approach to economic management of national economies had changed with demise of Keynesian demand management and the rise of the new neo liberal market based approach to economic policy. The Maastricht Treaty provided for coordination of economic policies among member states, and for rules on deficits and debt levels that were subsequently incorporated in the Stability and Growth Pact. Importantly there were no specific mechanisms or rules to monitor or address macroeconomic imbalances in relation to current account deficits. The Stability and Growth Pact became impossible to enforce as even Germany its main proponent breached its rules. Ireland ran budget surpluses that hid an actual structural deficit as a significant proportion of revenue was based on transient taxes. In addition economic thinking in Ireland began to view domestic led growth as superior to export led, and even the high proportion of external bank borrowing identified by the current Governor of the Central Bank in 2006 was not perceived by him or others as a cause for concern (Honohan, 2006).

Once the global crisis emerged in the Autumn of 2008 the bond markets awoke from a decade long slumber, which ironically the Delors Report had identified but made no specific proposals to address. In 1999 when Ireland joined the Euro, bond rates converged on German rates and did not move even when Ireland breached the entry criteria on inflation within eighteen months of joining the single currency. Suddenly something which had never been foreseen happened, and with no lender of last resort function available in Europe through the ECB, individual member states were completely at the mercy of the bond markets. In effect each country was borrowing as if the Euro was a foreign currency. In addition because this was not foreseen there was no clear Treaty based mechanism for financial assistance similar to the mutual assistance provision in the Treaty of Rome as that was now confined to non-Eurozone countries. While there has been much criticism of the slowness of the response at European level, it must also be borne in mind that the crisis exposed deep structural flaws in the design of the single currency that was never going to be easy to address, particularly when it needed agreement among seventeen member states.

It was clear last year that even the so called “six pack” amendment to the Stability and Growth Pact was not sufficient to calm the markets. Also German’s insistence on private sector involvement in restructuring from 2013 onwards while morally correct was actually adding to market pressures. Fear of default by weaker member states was reducing the price of their bonds on the secondary markets which automatically increased the bond yield. Irish rates had gone to 9% in autumn of 2010 which made the Troika financial assistance inevitable. This is usually referred to as a bail-out, even though they are loans as Article 125 of the Treaty specifically excludes a write off of debts. It was clear last year that the markets could push up yields for both Italy and Spain to levels that would make borrowing unsustainable and that the amounts involved would make financial assistance from other member states impossible. A potential catastrophic default and the breakup of the euro could arise in those circumstances.

There were two outcomes to this fundamental threat to the Euro’s very existence. These were the decision at the European Council last December, on the Stability Treaty and the dropping of proposals for private sector involvement (PSI) in restructuring (other than for Greece). Interestingly a senior European economic commentator Paul de Grauwe had warned that the danger with the PSI proposal was that it would build in a speculative option for the bond markets, similar to that for the currency markets under the EMS, with consequent permanent instability for the Euro.(De Grauwe,2011)

The Stability Treaty goes further than the Maastricht Protocol on deficit and debt levels by proposing in effect a balanced budget rule based on the concept of structural deficits rather than nominal outcomes. It introduces a limit of 0.5% of GDP for the budget deficit and sets out a timescale to reduce debt levels below 60% of GDP. However it also allows for flexibility

in the case of a severe economic downturn. It is in fact less intrusive than the likely approach had the Werner Plan been adopted. It must be remembered that this approach was known when we joined the Community in 1973. Indeed had it been implemented it could have saved the country from the disastrous Budget strategies of 1977 and 1997 to 2001. The plain fact is that both major recessions in Ireland in this generation have been solely caused by lax fiscal policy. The Stability Treaty also provides flexibility where economic circumstances require it, and is based on a medium term approach rather than for each single budget. The new European Stability Mechanism (ESM), which will replace the EFSF, next year will only be available to Member States that sign the Stability Treaty. It is clear that bond markets will not for the foreseeable future allow bond yields to converge again as they did when the Euro was created. Member States who do not adopt the Stability Treaty will as a result face significantly higher borrowing costs that will hamper economic recovery and most likely would be unable to borrow at all except at prohibitive rates. Some opponents of the Treaty have suggested that other mechanisms would be available, but this is not true and even if it were it would not be a realistic option as the conditionality attached would be most likely even worse. Opponents of the Treaty also have to outline how they propose that the Euro can survive as a single currency if a big country such as Italy or Spain were to refuse to sign. In Ireland's case the main impact of not signing up would be likely to be confined to this country, and could possibly lead to an exit from the euro. A refusal by Italy would skyrocket bond yields and lead to the collapse of the Euro after an Italian default. In either scenario a "punt nua" could emerge which would sink like a stone, leading to a catastrophic fall in living standards.

A common currency requires common fiscal rules across the Eurozone, and there is no escaping from that fact, if we wish to keep the euro as our currency. A default where we could no longer borrow or the collapse of the euro would have disastrous economic consequences for Ireland. It would most likely also involve a return to economic dependence on the UK and sterling, a reversal of fifty years of economic policy.

10. Austerity Policies need to be matched by a Growth and Investment Strategy

For opponents of the Stability Treaty to present it as a policy of Austerity is quite simply wrong. It is a rule based budget approach to protect the single currency, which with hindsight probably should have been in place from the beginning, and became unavoidable once the crisis began. There is a need for budget consolidation of debt levels as expansionary policies require stable markets, and that will be impossible without clear fiscal rules. Economic policies to resolve the greatest crisis since the Great Depression is a separate issue that needs to be addressed at both a national and European level. Increased debt is not the only way to fund expansionary economic policies, and arguably in current circumstances taxation should have more of a role to play. An investment strategy for jobs using innovative approaches such as off balance sheet leveraging of pension funds have

been proposed by Congress and individual Unions, and will be an important component of solutions to our economic crisis. At European level a new Growth and Investment strategy for Jobs is also urgently required, and it is now certain following the election of Francois Hollande as the new French President that this will be pursued. Some have suggested that he will renegotiate the Stability Treaty, but this is unlikely. It is more likely that either a Protocol for Growth will be agreed, or simply that a new Growth strategy outside the Treaty will be agreed. Either way it is good news for those who argue that a new Jobs initiative must accompany fiscal consolidation measures.

It would appear that this lack of a Growth strategy was a key reason why the European Trade Union Confederation (ETUC) did not support the Treaty, though it accepted that programme countries such as Ireland were in a different position. For the first times at a key moment in the development of European integration both the French and German leaders came from the same conservative political family. That factor has inevitably influenced the approach to the crisis. In the past with Pompidou and Brandt, Giscard d'Estaing and Schmidt, and Mitterrand and Kohl, it was always a Social Democrat/Christian Democrat combination. The prospect of that balance being restored will make a difference to how the crisis is handled. It would not however have meant that the Stability Treaty would not have emerged as it is essential anyway to the survival of the common currency. It would have put more emphasis on a growth strategy, and that is most likely to be the approach of Francois Hollande the new French President. The funding of such a growth strategy at European level is of course not straightforward given the levels of public debt that has resulted from the crisis, much of it due to the need for public financial resources to counteract the collapse in private sector spending.

The culpability of an unregulated global financial and banking sector for the crisis has allowed the "Tobin Tax" proposal of the 1960's to come back on the agenda in Europe, in a manner that now looks likely to result in a Financial Transaction Tax being introduced at least in the Eurozone area. This potentially can generate significant resources at Community level for a Jobs stimulus package, alongside investment from the European Investment Bank (EIB). The economic environment now is very different to the heyday of free market neo liberalism, and while it takes time before policy changes emerge, there can be little doubt that change will happen. The political reality now at national and European level is that Jobs will have to be the priority. There are other areas that will have to be addressed if stability is to be guaranteed in the Eurozone. For some time the issue of Eurobonds has been proposed by many economic commentators and even the European Commission as a part of the solution to the euro crisis. It has been very controversial particularly among triple "A" rated member states who see this approach as exposing their economies to profligate behaviour by other member states whose behaviour contributed to the crisis. Also it would likely increase their borrowing costs. Even in trade union discussions at European level there has not been a consensus on Eurobonds, though the European Trade Union Confederation

(ETUC) has supported the idea. The French President Sarkozy and German Chancellor Merkel have stated that they are not on the agenda at this point, but can be considered in the future. It is clear that Eurobonds in some form will have to be a part of the eventual solution to the crisis, as otherwise member states face a permanent risk of effectively borrowing in a foreign currency, with consequent higher bond rates that will impede their economic growth. Likewise the absence of a lender of last resort function for the ECB has inhibited it from dealing with the crisis, though its decision to lend to banks under the Long Term Refinancing Operation (LTRO) seems in practice an attempt to get around the Treaty constraint. It is a very controversial area and a Treaty amendment to change the remit of the ECB would be very difficult to secure agreement on among all member states. It is unlikely that that this Stability Treaty will lead in itself to a resolution of the euro crisis, but it is a necessary first step as inappropriate fiscal policies were a contributory factor in the crisis including in Ireland. Here loose fiscal policy turbo charged the property sector, the root cause of the banking failure. There are no circumstances where the single currency can survive without greater economic integration in Europe. The macroeconomic imbalances of significant current account deficits that emerged in the first decade of the Euro will now have to be addressed. That will require more than Eurobonds, monetary financing or more expansionary policies in Germany. It will most likely require fiscal transfers, as was envisaged in the 1970's.

11. The Floating Dollar: The Origin of "Casino Capitalism"

Some of the commentary in newspapers such as the Financial Times and by the US economist Paul Krugman calling for debt funded economic expansion should be viewed in a context that they doubt the wisdom of the Euro as the best currency option for the European Union (EU). This paper demonstrates clearly that European leaders have begged to disagree with this assessment for the best part of forty years. Also the capacity of both the US and UK Governments to follow debt funded expansionary economic policies is much greater than that for the Eurozone, which lacks both a reserve currency status and a lender of last resort function. The US dollar as the global reserve currency has had privileges from this unique status that no other currency, not even the Euro can achieve. It can pay for all its requirements in dollars without the need to be concerned about foreign exchange reserves, and can borrow at exceptionally low interest rates irrespective of the level of fiscal or current account deficits that it has. When President Nixon took the dollar off gold in August 1971, it removed at a single stroke the constraints that the dollar had within the Bretton Woods system, and laid the basis for the exponential growth of the international financial system over the next four decades. This growth had started with the Eurodollar market in the 1960's, but expanded enormously when OPEC's petro dollars became available for recycling after the 1973 oil crisis. One of the purposes of the Bretton Woods regime was to link currency trading primarily to trade and investment activities, in order to avoid a repeat of the speculative financial flows of the 1930's. By 1997 just two years before the creation

of the Euro the total global volume of exports was \$25 billion a day, whereas currency trading was \$1,500 billion having grown from \$15 billion in the early 1970's.

This expansion of the international financial markets in the 1970's raised concerns among economist writing on International Political Economy such as Susan Strange who warned of the dangers of "casino capitalism," that free floating exchange rate regimes encouraged (Strange 1972). Like the Irish property bubble which was long in gestation before it finally collapsed, similarly the unregulated international financial market facilitated by the floating dollar survived many crises before it finally burst in 2008. The instability that the dollar exerted on the global system since the 1980's is evident from its link to many of the crises that have emerged. After Reagan became President of the US in 1981 his expansionary policies increased the fiscal and current account deficits significantly, but yet the dollar defied economic theory and increased enormously in relation to other major currencies. Such was the rate of increase that attempts were made to manage the major global currencies through the Plaza Accord of 1985 which resulted in the dollar falling by 50%, and the Louvre Accord of 1987 which was intended to halt its decline. The wild fluctuations of the dollar in the 1980's and 1990's had a major impact on other regions. The South America crisis of 1980's ,the Mexico crisis of 1994 and the East Asian crisis of 1997 can all in part be linked to the instability of the dollar to which many of their currencies were pegged. Also some economic commentators consider that the Plaza Accord which weakened the dollar significantly with respect to the Yen, gave rise to an expansionary domestic policy in Japan that helped to create the asset bubble that burst with disastrous consequences in 1990. During all of this period the US economy was in many respects immune from the impact of the currency market given the status of the dollar as a reserve currency. An important factor in the 2008 global collapse was the amount of dollar reserves built up in Asia as an insurance policy against a repeat of their exposure during the 1997 crisis. These reserves facilitated exceptionally low interest rates and were a contributory factor in the US subprime crisis, which precipitated the 2008 crash.

The evidence therefore is overwhelming that the global currency regime in place since the 1970's, with a floating dollar still remaining the global reserve currency has had a major destabilising effect on the world economy. The European Union approach of seeking to build a stable currency regime with the Euro, offers a better prospect for jobs, growth and an improvement in living standards. If the Stability Treaty limits fiscal options for the future at national level, then that is a necessary condition to ensure the Euro survives. In addition any national restriction can be more than compensated for by the capacity at European level to provide for growth and investment. That is where the argument must be made and won for expansionary policies. The introduction of the euro ended the currency instability that emerged in the 1960's which was having a major negative impact on all European economies. Unfortunately the removal of currency market discipline and the slumber of the bond markets allowed unsustainable economic policies to be pursued including in this

country. Just as many economists here during the boom ignored the lessons of history in international political economy with dire consequences, there are now those who mistakenly propose that Keynesian debt based economic expansion can be pursued on a national basis. That is not to suggest that the current economic crisis does not require urgent new policy approaches. There are worrying similarities to this crisis and the 1870's crisis in the US when the dollar became a single currency after the Civil War. The deflationary effect gave rise to the Greenback Movement of labour and agrarian interests pushing for expansionary policies that were constrained by the gold standard. (Sheridan, 1993) The fact of the matter is that the existence of the euro gives Europe the capacity for expansionary policies, provided it first addresses the design flaws in its creation. The Stability Treaty is a necessary first step to do that. The alternative is national economies permanently at the mercy of speculative market forces.

11. Conclusions

The history of the economic development of the EU shows very clearly that currency stability has been at the centre of economic policy making from the very beginning. Once the Bretton Woods regime began to break down the need for a single European currency began to be considered and planned for. The implementation of free capital movement in the 1990's, a cornerstone of the original Treaty of Rome along with people, goods and services made any currency regime prone to speculative attack by the markets and made a single currency inevitable. The speculative currency market attacks on the EMS in 1992 showed clearly that a pegged currency regime cannot survive free movement of capital. Common European policies such as the CAP made adjustable European currencies impractical as the experience in the 1970's showed. The agreement on the European Single Internal Market to be completed by 1992 required a single European currency to make it a reality. The only way that Ireland could have stood apart from these currency developments as the UK and Denmark did was to return to the sterling orbit which would have involved a complete reversal of policy since we joined the Community in 1973.

The original Werner Report effectively had the three Pillars of EMU, fiscal, economic and monetary as Community competencies. In the Delors Report only monetary policy became an exclusive Community competency with coordination by Member States based on the principle of subsidiarity the approach to fiscal and economic policy recommended in the Report. In essence this is the key to the design flaws in the Euro, in that both the fiscal and economic policy options pursued by many member states including Ireland were inappropriate to membership of a hard currency. A key belief was that a market based approach would provide the discipline for the economic policies required for a stable euro. When this proved to be disastrously mistaken the absence of both a lender of last resort, and a fund for mutual assistance as originally envisaged for balance of payment difficulties left some Member States at the mercy of the markets. The Stability Treaty is now essential

to provide the common fiscal rules that a common currency requires. Arguably if the Werner Report had been implemented there would have been even less national discretion in relation to fiscal policy than that now proposed in the Stability Treaty. The policy choices between consolidation and the need for expansionary economic policies for Jobs is a separate issue to the requirement for common fiscal rules. It is indisputable that a Growth orientated policy at both European and national level must be pursued, but the euro must also be stabilised, and protected from market turbulence for that to happen. The reality is that the foundations of the euro are weak due to its design flaws, and this could expose some countries to default and exit. Due to the limitations in the structure of the Euro debt based expansionary economic policies that can be undertaken in the US are not possible in Europe to the same extent. These limitations will have to be addressed but that will take time due to the need for unanimity. The outcome of the French election offers the best prospect for a new Growth strategy in Europe, and the Financial Transaction Tax and the EIB are likely to play an important role in that regard. The dollar has been a source of instability in the global financial system for some time, and the European approach has been in stark contrast to that and has aimed to provide a zone of currency stability that can allow policies for growth to be effective. Serious economic policy errors including in this country were made in the last decade, and the Stability Treaty is a necessary first step to protect the Euro and create the conditions for Jobs, Growth and Investment

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