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ECONOMIC AND MONETARY UNION: TRANSITIONAL ISSUES AND THIRD-STAGE DILEMMAS

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Economic and Monetary Union:
Transitional Issues and Third-Stage Dilemmas[1]

At Cannes in June 1995, the heads of state and government of the European Union, meeting as the European Council, restated their firm resolve to move to the third and final stage of Economic and Monetary Union by January 1, 1999, in strict accordance with the convergence criteria, timetable, protocols and procedures laid down by the Treaty on European Union.[2] Meeting in Madrid six months later, the leaders made their commitment to moving to EMU even more explicit, "confirming unequivocally that stage three of economic and monetary union will commence on 1 January 1999." (European Commission 1995, p. 9.) Despite the difficulties that many of the member states have encountered since those meetings in satisfying the criteria for entry to the third stage, the commitment remains intact and there is little reason--despite recurrent speculation in financial markets and elsewhere about the wisdom of delaying the advent of stage three a year or two--to think the EU will not in fact adhere to the provisions of Article 109j(4) of the Treaty and move to the third and final stage of EMU on the first day of 1999.

Armed with the European Monetary Institute's "reference scenario," the EU is now clearly on a course that will result in the creation of a new European System of Central Banks,

[1] Earlier versions were presented at the workshop on Supranational Governance: The Institutionalization of the European Union, Center for German and European Studies, University of California, Berkeley, November 1996; the Team Euro Retreat of the European Union Delegation of the European Commission, Washington, D.C., March 1997; and the Annual Meeting of the Inter-American Development Bank, Barcelona, Spain, March 1997. Various earlier versions appeared as working papers of the Center for German and European Studies, University of California, Berkeley and the Center for West European Studies, University of Pittsburgh.

[2] On the negotiation of EMU, culminating in the Treaty on European Union signed at Maastricht in February 1996, see, among many, Cameron 1995; Dyson 1994; Eichengreen and Frieden, eds., 1994; Kenen 1992, 1995; Padoa-Schioppa 1994; and Sandholtz 1993a, 1993b.

consisting of a new European Central Bank and the existing central banks of the member states, that will assume full responsibility for defining and conducting the monetary policy and foreign exchange operations of the participating member states, and the irrevocable fixing of exchange rates and creation of a new single currency, the euro.[3] Many transitional issues confront the EU as it moves toward EMU. Several of the most important were largely resolved in 1996. For example, a new "hub and spokes" version of the Exchange Rate Mechanism was designed that will link most, if not all, currencies of the member states that do not enter the final stage of EMU in 1999 to the euro, thereby diminishing exchange rate volatility and the temptation among the "outs" to pursue competitive devaluations. And at Dublin in December 1996, protracted negotiations within the Council of Ministers and European Council finally produced agreement on the contours of a so-called "stability pact" (later, at French insistence, renamed the "stability and growth pact") that will, its proponents hope, assure continued fiscal responsibility and create a "stability culture" among the participants in the third stage.

Despite the agreements negotiated in 1996, a number of difficult and contentious issues pertaining both to the transition to the third stage of EMU and the functioning of economic policy after the transition remain unresolved in the run-up to 1999. This paper examines two of the most consequential transitional and post-transitional issues. One--certainly the most consequential of the transitional issues--involves the question of which member states will qualify for participation in the third stage in 1999 by satisfying the 'convergence criteria' described in the Treaty and thereby earning the right to participate in the third stage. The other involves an

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[3] At Madrid, the European Council adopted the EMI's "reference scenario" for the phase-in of the single currency, and phase-out of national currencies, by mid-2002. For the scenario, see EMI 1995. For the Council's decision, see European Commission 1995, pp. 24-28.

important issue that will confront the member states participating in the third stage *after* 1999--the question of whether they will be able to redress the longstanding problems of low rates of economic growth and high levels of unemployment that afflict most of them. The paper concludes with a brief discussion of a larger issue of institutional design and governance in the EU--specifically, how, if at all, economic policy will be coordinated and conducted among the governments of the member states participating in the third stage of EMU and whether, finding themselves no longer able to control the exchange rate, monetary policy, and, to a large degree, fiscal policy, the governments of the participating member states will be able to exercise collective control of their economies.

The uncertainty that now surrounds the first issue, involving the identity of the member states that will move to the third stage of EMU in 1999, is compounded, of course, by the fact that the Council will not decide which states will participate in the third stage until early May of 1998, only months before it is to begin.[4] Likewise, the uncertainty that exists around the second issue, concerning how economic policy will be made in the third stage, is compounded by the growing realization that the Treaty, for all its elaboration of the structures and responsibilities of the ECB, does not provide an unambiguous answer. Given the considerable uncertainty surrounding both questions, any effort to hazard a guess as to their answers is

[4] In March 1997, the Commission proposed a timetable for the 1998 decision according to which it and the EMI would make their recommendations by mid-March 1998 and, after six weeks of consultation with national parliaments and the European Parliament, the European Council would make the final decision at a meeting in the United Kingdom by the end of April 1998. That timetable was adopted by the finance ministers at their meeting in Noordwijk in April 1997, at which time they agreed that the formal decisions on the recommendations would be taken by the finance ministers and the European Council in meetings on consecutive days in the first week of May, 1998. See *Financial Times*, March 1-2, 1997, p. 2; and April 7, 1997, p. 2.

fraught with peril. On the other hand, despite the obvious uncertainties that exist and that will inevitably remain until the decisions about the stage-three participants have been taken and the third stage of EMU has begun, a good deal is already known about EMU--enough, in fact, to enable one to outline the most likely answers to those questions with some degree of confidence.

The Transition to the Third Stage: Who Will Qualify?

The Treaty on European Union stipulates that the member states which move to the third stage of EMU must have achieved a "high degree of sustainable convergence." For each state, that means, by the terms of Article 109j(1) and Protocol 6, that it has achieved:

1) a "high degree of price stability" that is apparent from a rate of inflation, as measured by the change in consumer prices, which is "close" to, and does not exceed by more than 1.5 percentage points, that of, at most, the three best performing states;

2) an average nominal interest rate on long-term government bonds or comparable securities that does not exceed by more than 2 percentage points that of the three best performing states in terms of price stability;

3) observance of the "normal" fluctuation margins of the Exchange Rate Mechanism of the European Monetary System for at least two years without "severe tensions" or a devaluation "on its own initiative;" and

4) a government budgetary position such that the state is not the subject of a decision by the Council under Article 104c(6) that an "excessive deficit" exists;

Three of these "convergence criteria"--those pertaining to inflation, interest rates, and participation in the ERM--are quite straightforward and can be readily observed and measured.

And if convergence were judged only by these three criteria, a significant number of member states would appear to have attained already the convergence necessary for adoption of a single currency and there would be little doubt that the transition to the third stage of EMU could take place in 1999 (if not earlier). Indeed, based on the most recent available data for rates of inflation and long-term interest rates on government securities, and the recent experience of the ERM, presented in Table 1, a *majority* of the member states would appear to have met the conditions required for entry to stage three of EMU under Article 109j(3) of the Treaty. Thus, had "sustainable convergence" been defined only in terms of those three criteria, nine nations--Belgium, Denmark, France, Germany, Ireland, Luxembourg, the Netherlands, Austria, and, after the markka's entry into the ERM in October 1996, Finland--would qualify for stage three on the basis of 1996 data and two others--Spain and Portugal--would come very close to qualifying.[5] Even Italy, which, after Greece, had the highest rate of inflation in the EU, would be within hailing distance after having rejoined the ERM in November 1996.[6]

Although there are good reasons for arguing that the evaluation of "sustainable convergence" should be based only on the criteria pertaining to inflation, interest rates, and

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[5] By February 1997, the annual rate of change in consumer prices in Spain had decelerated to 2.5 per cent, the lowest rate in twenty-eight years, and it continued to declerate in March and April, reaching a historic twelve-month low of 1.7 per cent. If sustained, that would almost certainly allow Spain to satisfy the 'convergence criterion' pertaining to the rate of inflation. See *Financial Times*, March 14, 1997, p. 3; and May 15, 1997, p. 3.

[6] In March 1997, the Commission issued the first set of "harmonized" rates of inflation for the EU. The data for the twelve-month period through January 1997 indicate that all of the member states except Spain, Portugal, and Greece would satisfy the Treaty criterion (and Spain and Portugal missed by only 0.1 per cent). Although flawed by its omission of health, education, and home ownership costs, the "harmonized" rate will be used in the 1998 decisions in assessing compliance with the Treaty criterion. See *Financial Times*, March 8-9, 1997, p. 2.

participation in the ERM--or, indeed, only on the criterion pertaining to inflation--those are not, of course, the only ones specified by the Treaty. The fourth criterion noted above stipulates that a member state not be the subject of a Council decision that an "excessive deficit" exists. By the terms of Article 104c and Protocol 5, an "excessive deficit" may exist when either of the following occurs: First, the ratio of the planned or actual general government deficit (that is, the combined deficit of all levels of government, including social security funds) to Gross Domestic Product exceeds 3 per cent, unless the ratio has declined "substantially and continuously and reached a level that comes close" to that figure or, alternatively, the excess over that figure "is only exceptional and temporary and the ratio remains close" to that figure; second, the ratio of government debt to GDP exceeds 60 per cent, "unless the ratio is sufficiently diminishing and approaching [that figure] at a satisfactory pace." A member state becomes the subject of a Council decision that an "excessive deficit" exists if the Commission considers that to be the case (or a possibility), addresses an opinion and recommendation to the Council to that effect, and the Council, after "having considered any observations which the Member State concerned may wish to make" and "after an overall assessment," decides, by qualified majority, to accept the Commission's recommendation.

The primary reason why so much uncertainty exists about the future of EMU, notwithstanding the Treaty and the commitments made at Cannes and Madrid, is the fact that so much uncertainty attaches to the likelihood that most of the member states that would otherwise qualify for participation in the third stage of EMU will be judged not to have an "excessive deficit" when the stage three decisions are made in 1998. At present, only five member states--Ireland and Luxembourg (both as of September 1994), Denmark (as of June

1996), and the Netherlands and Finland (both as of May 1997)--have been judged by the Council, acting in accordance with Article 104c(6) of the Treaty, not to have an "excessive deficit."[7] (In June 1996, the Council rescinded its earlier decision, taken in July 1995, that Germany did not have an "excessive deficit.")

If current projections of the ratios of deficits and debt to GDP hold, most of the other member states that are likely to meet the convergence criteria for inflation, interest rates, and ERM participation--Belgium, France, Germany, Austria, Portugal, Spain, and possibly Italy--are likely to find that either their deficit-to-GDP ratio or their debt-to-GDP ratio (or both) exceed the reference values specified in the Treaty. Thus, for example, the OECD's most recent forecasts of the 1997 deficit and debt ratios for the EU member states, presented in Table 2 (which also includes the most recent forecasts by the Commission and the IMF of the 1997 deficit ratio), suggest that, like the Netherlands, which was recently judged (with Finland) not to have an "excessive deficit," and like Ireland and Denmark, which were judged in 1994 and 1996 not to have such deficits, several member states--specifically, Belgium, Austria, and Portugal--will have 1997 deficits of less than 3 per cent of GDP but a stock of public debt equivalent to significantly more than 60 per cent of GDP. The Council's decisions in regard to Ireland, Denmark, and the Netherlands to waive the debt criterion in instances where the deficit

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[7] The decision in regard to Denmark reflected the fact that, as the EMI has noted (1996, p. 21), the gross debt for the country includes assets held by the Social Pension Fund against sectors outside the general government, government deposits at the central bank for management of the country's foreign exchange reserves, and amounts outstanding in government debt from financing of public undertakings. Excluding those funds from the calculation reduces the debt/GDP ratio to a range of 50-55 per cent. Despite the rationale, Germany formally objected to the decision. On the decisions pertaining to the Netherlands and Finland, see *Financial Times*, May 13, 1997, p. 1.

was well under 3 per cent of GDP and the stock of debt, relative to GDP, was, although in excess of 60 per cent, decreasing suggest that almost certainly in the case of Portugal, and quite possibly--despite the high level--in the case of Belgium as well, those member states ultimately will be judged not to have "excessive deficits."[8]

If the prospects are good that such member states as Austria, Portugal, and perhaps even Belgium will in time be judged to have satisfied the deficit criterion, the situation may be more problematic for Germany, France, Spain, and Italy. In Germany, France, and Spain, the 1997 deficit is predicted to be *greater* than 3 per cent--3.2 per cent in France and 3.4 per cent in Germany and Spain.[9] In the cases of France and Spain at least, it must be said that the governments *have* cut the deficit significantly in recent years, from 4.8 per cent in 1995 in France and from 6.6 per cent in 1995 in Spain. However, it is also the case that in Germany and Spain (although not in France, where the debt/GDP ratio remains under 60 per cent) the

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[8] In 1997, the Belgian public debt is projected to be 127 per cent of GDP. There are, however, three reasons (in addition to the obvious one pertaining to the importance of Brussels for the EU) why Belgium may nevertheless be exempted from an "excessive deficit" judgment. First, although very high, its ratio of debt to GDP *has* diminished markedly in recent years, much like the situation in Ireland and the Netherlands. Second, because its public debt is largely held domestically, it could be judged to have little impact on Belgium's neighbors. And third, because Belgium has a currency union with Luxembourg, even if it does not join stage three, as long as Luxembourg joins, the Belgian franc will, in effect, be irrevocably locked to the currencies of the stage three participants and the euro (although Belgium would not have the right to sit on the Governing Council of the ECB). In such circumstances, it is quite plausible that the European Council, if not the Council, will grant Belgium an exception to the "excessive deficits" criterion, provided its 1997 budget deficit does not exceed 3 per cent.

[9] We should note that in April 1997 the EU Commission forecast that the deficit/GDP ratio would be *precisely* 3 per cent in Germany, France, and Spain, while the IMF forecast that it would be 3.2 per cent in Spain and 3.3 per cent in Germany and France. The German government continued to predict, despite forecasted revenue shortfalls, that the deficit would be 2.9 per cent. For the Commission and IMF forecasts, see *Financial Times*, April 24, 1997, p. 2.

ratio of the stock of public debt to GDP has actually *in*creased in recent years--something that may make it more difficult for the Council to conclude that they do not have "excessive" deficits. On the other hand, in both countries, the ratio remains within the range that the Council has, in its earlier decisions in regard to "excessive deficits," found acceptable (provided the *deficit*/GDP ratio was under 3 per cent).

Interestingly, as it became increasingly apparent in early 1997 that Germany might exceed *both* the deficit and debt reference values, the tone of the comments by German officials shifted. Whereas the predominant view in 1996 had been that if Germany did not meet the 3 per cent and 60 per cent target figures, Germany could not participate in the third stage and the starting date would have to be delayed a year or two, by March of 1997, as it became apparent that EMU in 1999 would occur in any event, officials who had previously articulated that position began to suggest that perhaps, after all, Germany could participate, and the third stage of EMU could begin on the first day of 1999, even if the deficit was larger than 3 per cent of GDP and the stock of public debt larger than 60 per cent of GDP. Thus, for example, at the meeting of finance ministers on March 17, Theo Waigel indicated that Germany would seek a flexible interpretation of the Treaty that would exempt it from the 60 per cent criterion, on the grounds that the increase in Germany's debt/GDP ratio in recent years reflected the exceptional circumstances of German unification (as well as the privatization of the railways). As he put it, "I always said that three means three. I never talked about 60."[10] Two weeks later, at the informal meeting of the finance ministers at Noordwijk, Waigel indicated that Germany would accept a more flexible view of the 3 per cent ceiling for the budget deficit--one that is consistent

[10] See *Financial Times*, March 18, 1996, p. 20.

with the Treaty--rather than the rigid view that he had heretofore espoused; thus, in contrast to what he had said two weeks earlier, he declared that "I have never nailed myself to the cross of three per cent."[11] And most recently, Waigel announced an ingenious scheme that, if approved by the Bundestag, would simultaneously reduce Germany's deficit and debt ratios. The scheme, which bears a certain resemblance to some of the earlier efforts in creative accounting undertaken by France and Italy in order to bring their deficit/GDP ratios down to 3 per cent, involves revaluation of Germany's gold and foreign exchange reserves. The gold reserves would be revalued from their current book value of some 14 billion marks to their current market value of some 56 billion marks--a gain of some 42 billion marks--while an additional 20 billion marks would appear, in the form of an extraordinary gain, on the Bundesbank's books. That gain, more than 60 billion marks in all, would then be transfered by the Bundesbank into the government's "redemption fund for historic burdens," thereby decreasing both the 1997 deficit and the net public debt.[12]

The situation with respect to the "excessive deficit" criterion is far more problematic in Italy than in the other three large member states. Italy's deficit was 7.1 per cent of GDP in 1995 and 6.7 per cent in 1996, and in 1996, the Prodi government proposed cutting the deficit

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[11] See *Financial Times*, April 7, 1997, p. 1. Subsequently, however, Waigel appeared to backtrack from what he said at Noordwijk, saying that "three is three and that is how it is staying....Everybody must get used to the fact that three does not mean three plus x...." See *Financial Times*, April 8, 1997, p. 3.

[12] See *Financial Times*, May 16, 1997, pp. 1-2; May 17-18, 1997, pp. 1-2. The French exercise in "creative accounting" occurred when the government decided in 1996 that the state-owned France Télécom, which was scheduled for privatization in the near future, would pay the government 37.5 billion francs in 1997, equivalent to about 0.5 per cent of GDP, to cover the cost of future pension liabilities.

by some 62 trillion lire in order to reach the 3 per cent figure in 1997--25 trillion via expenditure cuts, 12.5 trillion via revenue increases, 12.5 trillion via a "Euro" tax, and another 12 trillion via "Treasury operations." By early 1997, the Bank of Italy estimated that without another 15 trillion in revenues or expenditure cuts, the 1997 deficit would be 3.8 per cent of GDP. In late March, the government put forward a "mini-budget" to reduce the deficit by an additional 15.5 trillion lire. However, the measures involved such things as forcing companies to make advance payments on the tax due on funds set aside for paying employees who leave or are terminated (6 trillion), freezing for six months the "exit" payments to public sector workers (2.6 trillion), accelerating payments of inheritance taxes and the transfer of tax money held by banks (4.2 trillion), cutting ministerial spending (1.3 trillion), and instituting new postal charges (0.5 trillion). For the most part, and with the exception of the last two measures, these appeared to involve accounting gimmicks and one-off measures rather than enduring measures to reduce the deficit.[13] Especially harmful to the Italian government's claim that these measures would (even if fully implemented, which seemed highly unlikely) put the country on the road to "sustainable convergence" was the Commission's estimate, in the Spring of 1997, that the 1998 deficit/GDP ratio would *in*crease, to 3.9 per cent![14] (Meanwhile, the ratio of the stock of public debt, relative to GDP, remains at unusually high levels in Italy, relative to the levels observed in the other larger member states of the EU--in excess of 120 per cent--and

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[13] For details and discussion of the "mini-budget," see *Financial Times*, April 1, 1997, p. 2. At its meeting in Brussels in May, 1997, the Council of finance ministers warned Italy that it should replace the "temporary" measures adopted in its "mini-budget" with "structural measures with a permanent impact on the budget." See *Financial Times*, May 13, 1997, p. 1.

[14] See *Financial Times*, April 24, 1997, p. 2.

shows little evidence of decreasing in the near future.)

If the primary reason for the uncertainty surrounding the future of EMU has to do with the current prevalence of "excessive deficits" throughout the EU and the possibility that some member states--most notably, Germany and France, the two which are generally regarded as the most essential participants--will not fulfil that convergence criterion in 1997, some of the uncertainty derives also from the complex and ambiguous procedure by which decisions are made that such deficits exist. According to Article 104c, it is the responsibility of the Commission, which is to monitor the budgetary situation and the stock of government debt in each state--in particular, the state's "compliance with budgetary discipline"--to determine whether the member states satisfy both of the budgetary criteria described above. That determination must inevitably involve discretionary judgments about such issues as whether the deficit has declined "substantially and continuously," what level is "close" to 3 per cent, what constitutes an "exceptional and temporary" excess,[15] and in regard to the public debt, what constitutes a "sufficiently diminishing" ratio, what constitutes a "satisfactory pace," and what "approaching" means. All of these terms--"close," "substantially and continuously," "exceptional and temporary," "sufficiently diminishing," and "satisfactory pace"--obviously connote discretionary judgment, rather than specific and precise figures.

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[15] It was, of course, precisely this ambiguity that Germany sought to redress in its proposal for a "stability pact" among the stage three participants that would, for purposes of deciding whether an "excessive deficit" exists, define "exceptional circumstances" with a specific figure relating to the magnitude of the decline in GDP. Yet, interestingly, even after long and protracted bargaining at Dublin had narrowed the application of "exceptional" to annual declines in GDP of at least 2 per cent, the final language included the phrase "as a rule." And Commission and Council discretion remains in the case of declines in the range of 0.75 to 2 per cent. See European Commission 1996a.

If, after an assessment of the deficit and debt ratios in the light of these ambiguous terms, the Commission decides that an "excessive deficit" exists, it must address an "opinion" to the Council. But it should be noted that the Treaty at no point specifically defines an "excessive deficit;" while the language implies that the two budgetary criteria described above define "excessive deficits," in fact they are described in the Treaty only as "criteria" by which "compliance with budgetary discipline" can be "examined." Therefore, whether a deficit is "excessive" depends not on the specific deficit and debt figures but, rather, upon the discretionary judgment of the Commission. Finally, of course, should the Commission render an opinion that an "excessive deficit" exist, it remains, by the terms of Article 104c(6) of the Treaty, for the Council to decide whether such a deficit in fact exists. This procedure is further complicated when it comes to the European Council's decision (to be taken, it should be noted, by qualified majority vote) regarding which states have achieved the sustainable convergence necessary to adopt the single currency because, by the terms of Article 109j, the leaders will have before them *two* reports--one from the Commission, the other from the EMI--that examine whether each of the member states has satisfied the convergence criteria,[16] as well as a recommendation from the Council as to whether each member state fulfills the necessary conditions for the adoption of a single currency.

The complex and ambiguous procedure by which the determination must be made as to whether each of the member states has (or does not have) an "excessive deficit" and whether each qualifies for the third and final stage of EMU--and, in particular, the latitude that is

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16 Importantly, the Commission and the EMI have agreed to submit identical recommendations as to whether each of the member states has satisfied the convergence criteria.

introduced for discretionary judgments by the Commission, the Council, and the European Council--inevitably casts a great deal of uncertainty about the identity of the member states that will qualify for the third stage of EMU. More important, the latitude for discretion means that *politics* will inevitably influence the decisions about which member states are qualified to participate in the third stage. That latitude for discretion, coupled with the precedents for waiving a Treaty-defined 'convergence criterion' that have already been created by the Council's decisions in regard to Ireland, Denmark, and the Netherlands, increases the likelihood that some of the member states that miss one (or possibly, as in the case of Germany and Spain, both) of the budgetary criteria will nevertheless, for *political* reasons, be judged to be qualified for participation in the final stage of EMU in 1999.

The latitude for discretion in regard to the judgments that must be made about qualification for the third stage of EMU, coupled with the precedents already created in regard to the debt criterion and the likelihood that political factors will enter into the decisions, suggests that something of a logroll may ensue, as a result of which, rather than a small number of states, a *large* number--probably as many as eight and perhaps as many as ten--will be judged worthy of participation in the third stage in 1999. For after all, if a waiver of one of the 'convergence criteria' has already been granted to three states, can a waiver of the same criterion be denied to other states with roughly comparable deficit and debt ratios? And if one of the criteria already has been waived, can a waiver of some *other* criterion--e.g., the one pertaining to the deficit ratio--be denied? Thus, just as the Council decided that Denmark, Ireland, and the Netherlands did not have "excessive deficits," despite debt ratios well above 60 per cent, so too the European Council may decide in 1998 (voting by qualified majority) that France, Germany, Belgium, Austria, Spain, and Portugal (as well as Denmark, Ireland, Luxembourg, the Netherlands, and Finland) all have achieved the "high degree of sustainable convergence" required for the adoption of a single currency, despite deficit and/or debt ratios in 1997 that are slightly larger than the reference values stipulated in Protocol 5 of the Treaty.[17]

For those who imagine that such a decision would violate the terms of the Treaty, it is useful to recall the words of one who knows the Treaty well; according to Jacques Delors:

> "When one reads the treaty carefully, one sees that it allows for a nuanced interpretation....We must read with great care a treaty which was cleverly drawn up and which leaves a margin for judgments of a political nature by the whole group of countries that want to join EMU."[18]

It will, of course, be important for the member-states wishing to enter the third stage of EMU in 1999 to demonstrate, in their budgetary and fiscal policy in 1997, a commitment to satisfying the 'convergence criteria.' And, of course, prior to the actual decisions in 1998 about participation in stage three, all of the relevant actors undoubtedly will continue to insist on the inviolability of the criteria. However, the complexity of the decision-making process in 1998,

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[17] Denmark negotiated an "opt-out" from the third stage which appears in Protocol 12 of the Treaty. After the Danish electorate rejected the Treaty in the referendum of June 2, 1992, Denmark negotiated a package of clarifications and "opt-outs" as the necessary condition for scheduling a second referendum. At the conclusion of that negotiation at the Edinburgh meeting of the European Council in December 1992, Denmark gave notice that it would not participate in the third stage. It was on the basis of that package of clarifications and "opt-outs" that Denmark conducted a second referendum in May 1993, in which the Danish electorate approved the Treaty. That being the case, any decision by a Danish government to enter the third stage of EMU in 1999 (or later) will presumably require approval not only by the Storting but by the electorate as well, in yet another referendum.

[18] *Financial Times*, April 19, 1996, p. 2.

coupled with the ambiguity of the language of the Treaty and the latitude for discretion it affords, as well as the existence of precedents for the waiver of certain of those criteria--and the important and often overlooked fact that the final decision will be made not by the finance ministers but by the European Council--would seem to insure that the decisions about which states participate in stage three in 1999 will be, to some extent at least, *political* ones, and that they will result in a relatively large number of member states--possibly eight to ten--entering the third stage in 1999, notwithstanding the fact that several may have deficit and/or debt ratios larger than those described in Protocol 5.

Economic Policy in the Third Stage: Will EMU Cure Low Growth and High Unemployment?

Article 2 of the Treaty on European Union commits all of the member states to promoting "a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection...." The countries moving to the third stage are likely to find it difficult, with exchange rates irrevocably fixed, monetary policy under the control of the ECB, and fiscal policy constrained by both the "excessive deficits" criterion of the Treaty and the sanctions on such deficits stipulated in the "stability and growth pact," to respond to asymmetric shocks that may affect particular regions and/or countries more than others and that could jeopardize their attainment of such objectives as "balanced development," "sustainable growth," a "convergence of economic performance," a "high level of employment," etc. They are likely to find it even more difficult to respond to a larger, more intractable problem--the sclerotic performance of their economies over the long term.

With few exceptions (Ireland in terms of growth, Luxembourg in terms of unemployment), the EU has become, during the 1990s, and is likely to remain, after 1999, an area of low economic growth and high unemployment. Thus, even when the rate of growth recovers after cyclical downturns (as it may in 1997), the level of unemployment remains at high levels--a reflection of the fact that employment has, to some extent, become uncoupled from the rate of growth. As a result, most of the member states of the EU, and, in particular, those which are most likely to move to the third stage of EMU in 1999, appear locked in to historically high rates of unemployment. Thus, as the data in Table 3 suggest, France, Belgium, Ireland, Finland, and Spain--all likely participants in the third stage of EMU--are projected to have unemployment rates of 12 per cent or more in 1997.[19] And in Germany, where the rate of unemployment is projected to be above 10 per cent for 1997 as a whole, the seasonally unadjusted rate of unemployment soared above 12 per cent in the first month of the year and remained near that level throughout the Spring.[20]

Some have assumed that eliminating exchange rate uncertainty through the creation of a single currency will reduce transaction costs within the single market and increase the risk-adjusted rate of return on investment, thereby stimulating higher levels of investment, which in turn will raise the rate of growth, thereby contributing to a reduction of the rate of

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[19] Thus, for example, the unemployment rate in France in February and March 1997 was 12.8 per cent.

[20] *Financial Times*, February 2, 1997. In March, the "headline" (seasonally unadjusted) unemployment rate was 11.7 per cent, compared to 12.2 per cent in February, and the seasonally adjusted rate was 11.2 per cent. See *Financial Times*, March 7, 1997, p. 16; and April 9, 1997, p. 1.

unemployment. Moreover, the existence of low rates of inflation in the member states participating in EMU, the improvement in their public finances, and the credibility of their commitment to maintain those policies for the foreseeable future are assumed to allow interest rates to be maintained at lower levels than at present, thereby further stimulating investment, growth, and employment.[21]

As plausible as such assumptions may be, it is by no means obvious that participation in the third stage of EMU will in fact have those salutary effects on investment, growth, and employment. The notion that use of a single currency will eliminate transaction costs that otherwise would prevent investment seems implausible given that most if not all major investors have long since learned the fine art of hedging as a means of reducing the uncertainty associated with transactions in multiple currencies, and the fact that most major international economic actors--including, almost certainly, those accounting for the vast bulk of investment in the EU--routinely conduct transactions in the various EU currencies. Although it would be difficult to demonstrate, since it would require information about all possible investments that were never made, it is probably the case that very few potential investments, if any, within the likely "euro-zone" in recent decades have failed to occur only because of the costs involved in operating in multiple currencies.

Regarding the putative beneficial effects on interest rates of moving to the third stage of EMU, it is possible, of course, that low rates of inflation, small public deficits, and public commitment to those policies will enable the EMU participants to enjoy lower interest rates.

[21] Certainly the most extensive analysis of the putative benefits of EMU is the one prepared by the Commission, which appears, in published form, as Emerson et al. (1992). The most important economic benefits described in that study are the ones described here.

But it is also the case that monetary policy will be under the control of a central bank that is free of political instruction, singularly committed to maintaining price stability, and--especially in its early years when the credibility of its commitment to maintain the value of the new currency will, to a large extent, be contingent upon its behavior--likely to maintain rates sufficient to prevent inflationary increases in the money supply (even at the cost of low growth and high unemployment) and depreciation of the value of the euro. It is possible, certainly, that interest rates under the aegis of the ECB could be lower than a weighted average of the current rates in the member states that participate in the third stage. However, it is probably more reasonable to anticipate that a central bank that is, by its founding statute (Protocol 3 of the Treaty), politically independent and committed to maintaining stable prices will maintain rates sufficiently high to prevent inflationary increases in the money supply, even at the cost of low growth and high unemployment--especially in the early years of EMU when it will be concerned with establishing its credibility as the guardian of the value of the euro not only with the markets but with the national publics which, with some considerable skepticism, agreed to give up their national currencies.

One means by which the EMU participants might seek to alleviate the pattern of relatively low rates of economic growth and high levels of unemployment would involve manipulating the external exchange rate of the euro vis-à-vis other currencies.[22] For example, by stabilizing the external exchange rate or otherwise keeping it from appreciating vis-à-vis other currencies such as the dollar and the yen, they might conceivably provide a price advantage for

[22] The nature of the relationship between the euro and the major non-EU currencies has received surprisingly little attention. Among the few works that examine the relationship in detail, see Henning 1996 and Kenen 1995, pp. 108-112.

"euro-zone" exports and make externally-produced goods less competitive *within* the "euro-zone"--both of which would boost growth and presumably create or maintain jobs within the zone. Article 109.1 of the Treaty on European Union, it should be noted, stipulates that the Council can conclude formal agreements on an exchange rate system with non-EU currencies, and it can adjust or abandon the rate of the euro in such systems. And in the absence of such an exchange rate system, Article 109.2 gives the Council the power to formulate "general orientations" for exchange rate policy with non-EU currencies.

The strength of the euro vis-à-vis non-EU currencies and, conversely, the propensity of the EU to pursue an aggressive external exchange rate policy that would give its exporters a competitive advantage in world markets, may, of course, depend on the membership of the "euro-zone." Presumably, a larger "euro-zone," including such member states as France, Italy, Spain, and Portugal among others, might be somewhat less inclined, all else equal, to pursue a "strong euro" policy than a "euro-zone" with fewer members and in which the member states with the "hardest" national currencies (e.g., Germany and the Netherlands) might have marginally more influence. Given our conclusion that a relatively large number of member states--possibly as many as ten, and including France, Spain, Portugal, and conceivably even Italy--are likely to be judged as having achieved the high degree of sustainable convergence necessary for adoption of the single currency, therefore, it is quite possible that the member states of the "euro-zone" will in fact pursue an aggressive external exchange rate policy that seeks competitive advantage in world markets for EU producers by stabilizing and/or undervaluing the euro relative to non-EU currencies.

However, while it is conceivable that the external exchange rate of the euro may be manipulated by the Council in such a way as to improve the competitive position of the "euro-zone" countries in global markets, it is important to note that the Treaty places certain constraints on the Council in regard to the external exchange rate. Article 109.1 stipulates that the Council must act unanimously, that it must act upon a recommendation from the ECB or the Commission, and that it must consult with the ECB "in an endeavor to reach a consensus consistent with the objective of price stability." In regard to the formulation of "general orientations," the Treaty stipulates that the Council must act, by qualified majority, upon the recommendation of the Commission, followed by consultation with the ECB, or upon the recommendation of the ECB. And as with the agreements described in Article 109.1, these "orientations" must be "without prejudice to the primary objective of the ESCB to maintain price stability."

Given the constraints specified in Article 109, the consultative role provided the ECB in exchange rate policy, and the admonition to adhere to the objective of price stability, it is more likely the case that the participating member states will obtain little or no relief from their condition of low growth and high unemployment via manipulation of the exchange rate of the euro than that they will be able to achieve higher rates of growth and employment through an aggressive external exchange rate policy. For rather than pursuing the latter policy, it is probably more likely, given the constraints introduced in Article 109, that the Council would allow the euro to float within a large and imprecisely defined range, just as the Mark and the other European currencies have floated in a large range in recent years, subject only to the occasional efforts of the G7 to "manage" the system when one currency or another goes well outside the largely-implicit "target range." And just as the Mark and the European currencies that track it closely have appreciated vis-à-vis non-EU currencies in recent years,[23] so too such an arrangement could very well cause the euro to appreciate in value relative to the dollar and the yen, something that would erode the competitive position of "euro-zone" producers both in export markets and vis-à-vis imports from non-"euro-zone" states in their home markets--which, in turn, could erode the rate of growth, employment, and income at home. Lest there be doubt about the likelihood that the euro will be allowed to float (even at the cost of domestic growth and employment) rather than stabilized and undervalued (at the cost of a higher rate of inflation), it is useful to note what one of the principal architects of EMU has to say about the relative importance of domestic price stability and exchange-rate stability:

> The Bundesbank always decided in favor of domestic price stability and sacrificed exchange-rate stability if necessary....The Bundesbank, I assume, is much happier [after the 1992-93 ERM crisis] living with a de facto floating system, with practically no intervention obligations for the time being, than with a system of fixed but adjustable exchange rates, which [has been] accurately called 'half-baked' because adjustments never take place at the right moment....The mandate of the ECB must be to maintain stability of the value of money as the prime objective of European monetary policy...Domestic stability of the value of money must take precedence over exchange-

[23] See the chart accompanying Samuel Brittan, "Right rate for the franc," *Financial Times*, September 12, 1996, p. 12. Kenen 1995, 111-12, notes that until the single currency replaces the national currencies (by July, 2002 at the latest), foreign exchange traders are likely to use the mark as a proxy for all of the currencies that are, as of January 1, 1999, irrevocably locked.

rate stability.[24]

If the preference for domestic price stability to exchange-rate stability that Karl-Otto Pöhl describes is in some sense the generic preference ordering of all central bankers, it is probably also the case that the Governing Council of the new ECB will be especially sensitive to that lexical ordering of priorities in its early years, as it attempts to establish credibility for itself and for the euro by demonstrating its commitment to maintaining stable prices. To the extent that is the case, then, one would expect the euro, like its predecessors that remained in the ERM after 1992-93, to be a strong currency relative to others such as the dollar and the yen--even if as many as ten member states enter the third stage of EMU in 1999. Thus, one would expect that it will be allowed to float and to appreciate, even at the cost of continued losses of export markets and, in turn, of production, jobs, and income at home. That is especially likely to be the case since the EU has gone to such lengths to immunize the ECB from those actors--exporters, workers, governments--who might conceivably prefer an undervalued currency that would give exports a competitive advantage to the alternative of maintaining stable prices.

Whatever the salutary consequences of moving to the third stage of EMU and irrevocably locking exchange--and there no doubt *will* be such consequences, most notably, perhaps, the elimination of the instability and fluctuation among the European currencies that occurred every time the Mark increased in value against the dollar--then, the move to the third stage in 1999 will, in all likelihood, do little to improve the competitive position of the "euro-zone" in the world and provide an export-based boost to growth and employment. Indeed, if anything, the

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[24] Karl-Otto Pöhl, "International Monetary Policy: A Personal View," in Gaidar and Pöhl 1995, pp. 61, 67, 109.

likely constraints operating on the external exchange rate of the euro may contribute to a *deterioration* in the competitive position of the economies of those participating member states in global markets, thereby accentuating the pattern of low growth and high unemployment at home that already characterizes so much of Europe.

The possibility that the low growth and high unemployment that now characterize most of the EU will continue within most of the member states that move to the third stage of EMU poses more than an economic challenge for the euro area. It is likely to pose a *political* problem as well, and not just for the citizens who suffer the immediate consequences of low growth and high unemployment and the national governments that, by failing to alleviate the problem, incur the wrath of voters. For one thing, just as the poor performance of an economy tends, all else equal, to cause a diminution of electoral support for the government, so too the continuation of low growth and high unemployment in the member states participating in the third stage of EMU may erode public support for the EU in general, and for the EMU project in particular. And even if that does not happen, the foundation of public support upon which the EMU project ultimately rests has *already* eroded significantly. Indeed, if one were to extrapolate from recent experience, it is quite conceivable that some of the governments in member states that can be expected to participate in the third stage of EMU may, at some point in the not-too-distant future, find themselves confronted by significant numbers of voters who have concluded that the costs of EMU exceed the benefits.

Tables 4 and 5 present the results of Eurobarometer surveys conducted in the member states of the EU in the Spring of 1996. The data in Table 4 indicate the extent to which the publics of the EU member states believed that their country had benefited from membership.

The data reveal that a widespread erosion occurred in the 1990s in the extent to which citizens of the EU member states believed their country had in fact benefited from membership. Thus, for example, compared with the situation in late 1991, the proportions of citizens believing their country had benefited from membership and those believing it had *not* shifted markedly toward the latter position in all but one of the member states (Ireland being the sole exception). In some--most notably, Belgium, Greece, Portugal, Germany, and Spain--the erosion in this measure of instrumental support for the EU has been dramatic. And although, as of early 1996, public opinion in ten of the fifteen member states appeared, on balance, to believe that the country *had* benefited from membership, it was nevertheless the case that in the other five--Germany, Britain, and the three 1995 entrants--Austria, Finland, and Sweden--more citizens felt their country had *not* benefited from membership than thought it had.[25] In sum, in many of the EU member states--most significantly, perhaps, Germany, France, Spain, and Britain--the public appears to be deeply divided over, and skeptical about, the value of membership in the Union, indeed perhaps more so than at any time since the Eurobarometer surveys began asking the question in the early 1980s.

The same Eurobarometer data reveal a substantial degree of opposition to the single currency, the feature that, in the view of the European public, is perhaps the most salient aspect of EMU. Thus, although, as the data in Table 5 suggest, as of early 1996 slightly more than

[25] Cameron 1996, Table 13.4, reports consistently strong inverse correlations across the member states of the EU between the level of unemployment and the proportion of the EU national publics believing their country has benefited from membership in the EU, and strong positive correlations between the magnitude of the increase in unemployment in the early 1990s and the magnitude of the erosion in the proportion believing their country has benefited from membership.

50 per cent of the EU public supported introduction of the single currency, a substantial minority (33 per cent) did not. And while in most member states, substantially larger portions of the publics favored introduction of the currency than opposed introduction, in at least six states--including, perhaps most significantly, Germany--the proportion opposing introduction of the single currency exceeded the proportion favoring its introduction. And in four of those six--Britain, Finland, Denmark, and Sweden--well over one-half of the public opposed introduction of the single currency. (On the other hand, one *does* note that, contrary to the conventional journalistic wisdom that support for the single currency would erode as the European public became more attentive to the issue, the degree of support actually *in*creased in the EU as a whole and in twelve of the fifteen member states from late 1995 to the Spring of 1996.)

Discussion:
Who Will Make Economic Policy in the Third Stage?

The discussion in the preceding section raises a larger issue of institutional design and governance that confronts the EU in regard to EMU and that will continue to confront the member states which participate in the third stage. That issue involves not simply a matter of electoral popularity, or the lack thereof, but the more fundamental question of whether the member states that participate in the third stage of EMU will be capable of addressing the enduring problems of low growth and high unemployment. The answer to that question depends, in turn, on whether the member states participating in the third stage of EMU will have the institutional capacity and authority to conduct economic policy. The Treaty on European Union is far from encouraging in that regard. Article 102a commits all of the member states, including those participating in the third and final stage of EMU, to conducting their economic policies with a view to achieving the objectives of the Community as described in Article 2. Article 103.1 stipulates that the member states will regard their economic policies as a matter of "common concern" and shall "co-ordinate them within the Council...." Article 103.2 stipulates that the Council, acting by qualified majority on a recommendation from the Commission, shall "formulate a draft for the broad guidelines of the economic policies of the member states and the Community," and that the European Council will then "discuss a conclusion on the broad guidelines" that will, in turn, become the basis for a Council "recommendation setting out these broad guidelines."

The language of these Articles--the use of such phrases as "common concern," "co-ordinate ...within the Council," "formulate a draft," "broad guidelines," "discuss a conclusion," and "recommendations setting out these broad guidelines"--makes it apparent that the Treaty creates no new authority or competence in the field of economic policy. No new institutional body is established in the area of economic policy that would include only the member states participating in the third and final stage of EMU, and no new competences or policy instruments are created for use by those participating member states in the realm of economic policy. Instead, the Councils, composed of the representatives of all of the EU member states, will simply formulate guidelines, discuss conclusions, and make recommendations based on those guidelines and conclusions.

The extent to which the Treaty fails to create the authority and institutional capacity by which member states participating in the third stage of EMU could act collectively in the domain of economic policy becomes most obvious when the cursory language of Article 103 is juxtaposed with the extensive discussion in Articles 105-109 and Protocols 3 and 4 pertaining to monetary policy, the ESCB, and the ECB. In the single-minded effort to create a strong independent central bank, the authors of the Treaty ignored a simple and obvious fact of political life--that no central bank, independent or otherwise, has ever, or could, operate without a political counterpart that is responsible for shaping the overall contours of economic policy.

Some voices within the EU have recognized the need for such a counterpart once the third stage of EMU has commenced. Thus, for example, at his meeting with Chancellor Helmut Kohl in Nuremberg before the December 1996 meeting of the European Council in Dublin, President Jacques Chirac called (yet again) for a political force to offset the power of the ECB, for precisely such a "political counterpart." A short while later, the French minister of finance Jean Arthuis repeated the French call for the creation of some institutional form--perhaps, he suggested, a council for stability and growth composed of the representatives of the member states participating in the third stage of EMU--to act as a political counterweight to the ECB. Not surprisingly, the central bankers reacted negatively to these proposals, as when Hans Tietmeyer, the President of the German Bundesbank, denounced the effort to create a *pouvoir politique* and warned that such an effort did not conform to the Treaty. Nevertheless, the French government continued to advocate creation of such a council, and in February 1997 it received the endorsement of Jacques Delors, who suggested that a protocol be added to the Treaty allowing for the creation of a council to coordinate macroeconomic policy.[26]

At a meeting of the finance ministers and heads of the central banks of France and Germany in Lyon in March 1997, the German officials appeared to shift their position to one

[26] On the comments by Chirac, Arthuis, Tietmeyer, and Delors, see, respectively, *Financial Times*, December 10, 1996, p. 16; December 17, 1996, p. 1; January 20, 1997, p. 1; and February 28, 1997, p. 2.

of qualified support for the French proposal for a "stability and growth" council, composed of the finance ministers of the member states participating in the third stage, which would coordinate economic policy. That occurred, apparently, after the French officials had assured the Germans that the proposed council would be informal, would concern itself with economic policy and not monetary policy, and would not intrude upon the independence of the ECB.[27] However, several days later, at a meeting of the fifteen finance ministers, the Council, while accepting the idea in principle, indicated the proposed body would have little power, would not act as a "political counterweight" to the ECB, and would not possess responsibility for exchange rate policy (which would remain in the hands of the full Council).[28] Notwithstanding these efforts to water down the original French proposal, and the likelihood that as a result no such "counterweight" will be created prior to the advent of the third stage, however, it is quite likely that, as low growth and high unemployment continue to characterize economic life in the EU after 1999, as they almost certainly will, citizens and governments of the member states participating in the "euro-zone" almost certainly will ask, even more frequently than they do now, who makes economic policy in the EU and why is the EU unable to achieve higher rates of growth and reduce the high levels of unemployment. And the asking of those questions will almost certainly lead, in turn, to renewed calls for the creation of precisely that *pouvoir politique* that is now absent and that the finance ministers are so reluctant to endorse.

Conclusion

In 1998, the member states of the EU will decide which of them will move to the third

[27] See *Financial Times*, March 13, 1997, p. 16.

[28] See *Financial Times*, March 19, 1997, p. 2.

and final stage of Economic and Monetary Union on January 1, 1999. Several issues associated with the transition to the third stage have been largely resolved--most notably, those involving relations between the euro and the currencies of non-participating member states, constraints on budget deficits in the third stage, and the legal status of the euro. However, several other transitional and post-transitional issues remain unresolved and the subject of continuing speculation and disputation. This paper has considered two of them. One involves the question of which member states will qualify for participation in the third stage of EMU in 1999. The other involves the question of economic policy in the participating member states after the advent of the third stage and, in particular, whether they will be able to address the long-term problems of low growth and high unemployment that afflict so much of Europe.

The paper suggests, for the supporters of EMU, some reason for optimism in regard to the first issue. The complexity of the process by which the qualifications of the member states for participation in the third stage will be assessed, coupled with the latitude for discretionary judgment accorded by the Treaty, the existence of precedents for waiving certain of the 'convergence criteria,' and the fact that the final decision will be made by the European Council, rather than the Council of finance ministers, suggest that not only will the third stage of EMU begin on the first day of 1999 but that the "euro-zone" that comes into being on that day will, in all likelihood, include a *large* number of member states--almost certainly as many as eight and probably as many as ten or eleven. On the other hand, the paper also suggests some reason for concern and pessimism in regard to the second issue. Most of the member states participating in the third stage of EMU are likely to continue experiencing low growth and high unemployment. There is not much reason to think that either monetary policy or exchange rate policy will be deployed in such a way as to generate any significant increase in the long-term rate of economic growth or *de*crease in the high levels of unemployment that now exist in most of the likely "euro-zone" members. And as was suggested in the concluding discussion, the Treaty creates no institutional capacity for collective action in economic policy that might enable the member states participating in EMU to redress those problems and there appears to be little desire in the EU as a whole to create that institutional capacity.

Table 1

The Convergence Criteria for the Third Stage of EMU:

Performance of the Member States of the EU in 1995-96 in regard to Inflation, Interest Rates, and Participation in the ERM

	Inflation (% Change,cpi) 1995	Inflation (% Change,cpi) 1996	Interest Rates (Long-term govt. sec.) 1995	Interest Rates (Long-term govt. sec.) 1996	Participation in the ERM w/o "tension" or devaluation for at least 2 yrs, as of 5/97
Belgium	1.5*	2.1*	7.4*	6.3*	Yes*
Denmark	2.1*	2.1*	8.3*	7.1*	Yes*
Germany	1.8*	1.5*	6.8*	6.1*	Yes*
Greece	9.3	8.5	17.3	...	No
Spain	4.7	3.6	11.0	8.2*	Yes*
France	1.7*	2.0*	7.7*	6.5*	Yes*
Ireland	2.5*	1.7*	8.3*	7.4*	Yes*
Italy	5.4	4.0	11.8	9.0	No**
Luxembourg	1.9*	1.3*	7.6*	6.6*	Yes*
Netherlands	1.9*	2.0*	7.2*	6.5*	Yes*
Austria	2.3*	1.8*	6.5*	5.3*	Yes*
Portugal	4.1	3.1	11.4	8.6*	Yes*
Finland	1.0*	0.6*	7.9*	6.0*	No**
Sweden	2.9*	0.5*	10.2	8.0*	No
U.K.	3.4	2.4	8.2*	8.1*	No

* Satisfies criteria stipulated in Article 109j and Protocol 6: For inflation, a rate that does not exceed by more than 1.5 percentage points the average of the three lowest (underlined). For interest rates, a rate that does not exceed by more than 2 percentage points the average of the rates in the three countries with the lowest inflation rates. For the ERM, state has respected the "normal" fluctuation margins without severe tensions for at least the last two years without a devaluation made on its own initiative.

** The Finnish markka joined the ERM in October, 1996. The Italian lira rejoined in November, 1996.

Source: IMF 1997, p. 69; OECD 1996, pp. A19, A39; 1997, p. 27. The 1996 rates of inflation for Denmark, Luxembourg, the Netherlands, Austria, Portugal, and Sweden are for eleven months, as are the 1996 interest rate figures for Ireland, Italy, and the Netherlands.

Table 2

The Budgetary Criteria for the Third Stage of EMU:

Government Deficits, Public Debt, and "Excessive Deficits," 1995-97

	General Government Deficit/GDP			Public Debt /GDP			Council Decision that "Excessive Deficit" Exists
	1995	1996e	1997e	1995	1996e	1997e	
Belgium	4.1	3.2	2.9* (2.7,2.9)	133.7	129.9	127.2	Yes (9/94)
Denmark	1.6*	1.5*	0.4* (-0.3,0.1)	71.9	71.9	70.4	No (6/96) (Yes, 9/94)
Germany	3.5	4.1	3.4 (3.0,3.3)	58.1*	61.3	63.2	Yes (6/96) (No, 7/95) (Yes, 9/94)
Greece	9.1	8.2	5.7 (4.9,5.1)	111.8	108.5	104.5	Yes (9/94)
Spain	6.6	4.8	3.4 (3.0,3.2)	65.8	68.0	68.9	Yes (9/94)
France	4.8	4.1	3.2 (3.0,3.3)	52.8*	55.1*	56.6*	Yes (9/94)
Ireland	2.3*	1.5*	1.1* (1.0,1.6)	84.8	80.2	76.0	No (9/94)
Italy	7.1	6.7	3.7 (3.2,3.3)	124.9	124.4	122.9	Yes (9/94)
Luxembourg	-0.4*	-2.0*	-...* (-1.1,0.1)	6.1*	...*	...*	No (9/94)
Netherlands	4.0	2.6*	2.3* (2.3,2.2)	80.0	78.0	76.0	No (5/97)
Austria	5.9	4.3	3.0* (3.0,2.5)	69.0	71.8	73.3	Yes (7/95)
Portugal	4.9	3.8	2.9* (3.0,2.9)	71.7	70.3	67.6	Yes (9/94)
Finland	5.4	2.9*	1.7* (1.9,1.9)	59.2*	60.1	60.2	No (5/97)
Sweden	7.9	3.8	2.5* (3.6,3.8)	79.4	78.7	78.5	Yes (7/95)
U.K.	5.7	4.8	3.7 (2.9,3.1)	53.9*	56.1*	56.5*	Yes (9/94)

[Continued]

* Equal to or less than reference values stipulated in Protocol 5 (3 % for the deficit and 60 % for public debt).

Source: 1995 data and estimates for 1996 and 1997 reported in OECD 1996, pp. 9, A33, A69. The negative signs for Luxembourg for the deficit indicate a budget surplus. The figures in parentheses under the entries for the 1997 Deficit/GDP ratios are the forecasts published in April 1997 by the European Commission and the IMF, respectively. The latter are reported in *Financial Times* April 24, 1997, p. 2.

Table 3

Growth and Unemployment in the European Union, 1995-97

	% Change in "Real" GDP			% Unemployed (Commonly-used measures)		
	1995	1996e	1997e	1995	1996e	1997e
Belgium	1.9	1.3	2.2	13.0	13.2	13.0
Denmark	2.8	1.9	2.9	10.3	8.9	8.6
Germany	1.9	1.1	2.2	9.4	10.3	10.4
Greece	2.0	2.2	2.5	10.0	10.1	10.3
Spain	2.8	2.1	2.7	23.3	22.7	22.4
France	2.2	1.3	2.5	11.7	12.4	12.5
Ireland	10.3	7.0	6.2	12.2	12.0	11.8
Italy	3.0	0.8	1.2	12.0	12.2	12.2
Luxembourg	3.7	2.4	3.1	3.0	3.1	3.0
Netherlands	2.1	2.7	2.7	7.1	6.6	6.2
Austria	1.8	1.1	1.4	5.9	6.2	6.5
Portugal	2.4	2.6	2.9	7.2	7.2	7.1
Finland	4.2	2.5	3.5	17.2	16.4	15.5
Sweden	3.6	1.7	2.2	7.7	7.9	7.4
U.K.	2.4	2.4	3.3	8.2	7.6	7.4
EU	2.5	1.6	2.4	11.2	11.4	11.3

Source: OECD 1996, pp. A4, A24.

Table 4

Support for the European Community:

Percent Believing Country Has/Has Not Benefited from Membership

	April-May 1996			
	Percent Saying Membership			
	Has Benefited Country	Has Not Benefited Country	Net	Change from Oct.-Nov. 1991 in Net Per Cent Saying Membership Has/Has Not Benefited Country
Ireland	86	7	79	+12
Netherlands	70	14	56	-6
Portugal	68	20	48	-25
Luxembourg	59	19	40	-17
Greece	59	29	30	-29
Denmark	59	28	31	-11
Italy	57	20	37	-7
France	44	35	9	-13
Spain	40	34	6	-23
Belgium	38	30	8	-40
Germany	38	40	-2	-24
U.K.	38	43	-5	-12
Finland	34	49	-15	na
Austria	33	46	-13	na
Sweden	17	56	-39	na
EU	45	34	11	-20

Full wording: "Taking everything into consideration, would you say that [our country] has on balance benefited or not from being a member of the European Union?"

Source: European Commission 1994, pp. 89-97; 1996b, p. 14.

Table 5

Public Support in the EU for Introduction of a Single Currency, April-May 1996

	% Favoring/Opposed to Introduction of Single European Currency*			
	Yes	No	Net	Change in Net % Favoring from Oct.-Dec. 1995
Italy	78	9	69	+11
Ireland	66	16	50	+7
The Netherlands	66	26	40	+4
Greece	64	21	43	+11
Luxembourg	63	26	37	-
Spain	62	15	47	+7
France	59	22	37	+2
Belgium	53	22	31	+5
Portugal	52	22	30	+5
Germany	40	49	-9	+2
Denmark	36	58	-22	+6
Finland	35	57	-22	-2
Austria	34	45	-11	+9
United Kingdom	34	53	-19	+5
Sweden	27	61	-34	-9
All EU	53	33	20	+6

Full wording: "Are you for or against the European Union having one European currency in all member states, including (respondent's country)? That is, replacing the (name of currency) by the European currency? Are you very much for, somewhat for, somewhat against, very much against, neither for nor against, or don't know?" Yes = % saying "very much for" and "somewhat for." No = % saying "very much against" and "somewhat against."

Source: European Commission 1996b, p. 45.

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