European Monetary Union and Single Currency – *a Road to Crisis*

Discussion material for the international school, Gent 1997

Price: 1 EURO

European Monetary Union

One of the most important, if not the central project of the ruling class in Europe is the European Monetary Union (EMU) with the introduction of the single currency, the Euro, planned in 2002.

Whereas in North America and South-East Asia the US and Japan are the overwhelmingly dominant powers with huge domestic markets, the situation in Europe is somewhat more complicated. Although Germany (and formerly West Germany) is the largest economic power in the EU, its domestic market is relatively small, and its closest competitors such as France and Britain are not so far behind. Europe is cut through by state boundaries and currency barriers. The mutual links, and dependencies are much more intensie then in the other regions. That's why the issue of a stable currency arrangement was and still is much more important than in the other regions mentioned, especially as the economic and commercial integration has increased over the decades since the setting up of the EEC/EU and currency fluctuations have again and again disrupted these links. In 1970 there were already plans to introduce step by step an Economic and Monetary Union, even a political union, by 1980, which however, were never realized.

Currency Relations

The stages of capitalist economic development are also expressed in currency relations.
In the post-war period the Bretton Woods Agreement governed worldwide exchange rates to keep them stable. The dollar was the leading currency internationally and covered at a fixed rate by the gold reserves of the USA. In 1971 the US gave up the gold standard, and the exchange rates fluctuated ever more freely. The background to this was that the US economy had forfeited its leading status and the dollar was no longer the undisputed leading currency. Her international competitors, especially Germany and Japan, had cought up.
On the eve of the first simultaneous worldwide recession (1974/5) in 1973 the Bretton Wood system broke apart.

Because of the increasing tendency of the capitalist world economy to go into crisis, and the fact that international competition became tougher, two important developments were reinforced: Firstly the swelling of the finance markets, and secondly the regionalisation and formation of the three competing economic blocks (North America / the European Union / Japan and South-East Asia), even though the degree of integration varied.

After Bretton Woods and the free floating of the dollar, the then member states of the EEC tried, at least amongst themselves, to maintain narrow ranges of 2.25% to the mean dollar level. This corridor, tht so-called „currency snake", did not survive the 74/75 recession. There remained a small hard currency bloc with fairly stable exchange rates around the D-mark, which included the Benelux countries and Denmark, whose economies were closely linked the West Germany anyway.

In 1979 a second attempt was made and the European Monetary System (EMS) was set up, where this time the currencies were not linked to the dollar, but to the ECU within a narrow range (2.25 above and below). (ECU = a bundle of currencies arithmetically worked out, into which the currencies flow in proportion to the economic strength of the member states, the D-mark accounts for a third, and is therefore regarded as the „anchor" currency.)
In addition, if the tensions within the system became too great - when the central banks could no longer sustain the narrow currency ranges by intervening on the currency markets - the exchange rates could be realigned. The EMS survived the recession at the beginning of the '80s by the skin of its teeth. However, the currency rates were realigned no less than 11 times between 1979 and 1987.
It was only the extended economic upswing in the late '80s that led to a certain stabilisation. At the same time, due to the increased dependency of the natiional states on the international finance markets because of their high state deficits, the pressure to link their currencies to

the strong D-mark and orientate their monetary policies to the Federal Bank of Germany grew. By devaluation of their currency or reducing interest rates, they would not have been able to attract and/or keep enough capital in their country, which always flows in the direction of hard currencies and high interest rates.
This enforced alignment of currencies meant a few years' peace in the EMS, even if it was a deceptive one, for the uneven developments of the real economies in each country continued to deepen despite this.
It was during these years that the Treaty of Maastricht was born, the core of which is the EMU. The Maastricht treaty had hardly been signed in 1992, when the tensions erupted again against the background of the international recession at the beginning of the '90s, and the onset of currency turbulence rendered the EMS a dead duck. In September 1992/3, the pound and lira had to leave the club. The Swedish Krona, which had been voluntarily linked to the EMS with a view to forthcoming entry into the EC, had to be uncoupled. Finally, a currency corridor of 15% above and below was agreed, which meant a fluctuation range of 30% and was tantamount to free floating exchange rates alltogether. This rate still applies today. Twelve of the 15 EU member states today participate in the EMS (with the exception of Britain, Sweden and Greece). After the crisis in 1993 and the de- and revaluations enforced by markets and speculators alike, a group of countries has developed in the last few years whose currencies have remained relatively stable against the D-mark, i. e. Benelux, Austria and with reservations, France and Denmark too.

Although the Euro time schedule has been postponed for two years (by the way, without anybody making any great fuss about it), the European governments basically tried to stuck to it.
The plan is this: in April 1998 the group of countries taking part at the start of the EMU will be decided. As of 1.1.1999, all monetary policy will be put into the hands of the European Central Bank (ECB), which by the way enjoys almost dictatorial powers, is controlled by no-one and whose sole target is to maintain monetary stability. „Irrevocably fixed exchange rates" are to be set between the member states participating at the start and towards the ECU/ Euro. If this „irrevocably fixed rates" and a strict monetary policy of the ECB is maintained over a period of three years, the Euro would become the only legal tender currency as of 1.6.2002. In that case, this last act would in fact be no more than a technicallity.

However, experience shows that in every economic crisis currency arrangements exploded or at any rate made very threatening noises. Only in the „golden" postwar era was it possible to maintain stable exchange rates for longer periods of time. And then only on condition that one all-powerful economic state realised it on its own terms and that the international capital flow was kept in strictly regulated channels. Even in the boom, from time to time realignments had to be decided. On a capitalist basis, uneven economic development is a fundamental feature. To avoid tensions, currencies have to be readjusted accordingly. Today, the world economy is in a phase of stagnation and depression; competition between the major imperialist powers and the blocs has increased, particulary since the demise of the Eastern Bloc which kept inner-imperialist competition within certain confines. In addition, the finance markets are almost completely deregulated and there are hardly any controlls anymore on the flow of capital.
On a capitalist basis, it is impossible to merge a number of nation states into one single currency- and monetary union.
It is quite possible that EMU will actually start on 1.1.1999. But it is extremely unlikely that a fixed currency system and a united European monetary policy can be sustained for three years and that the Euro will come in 2002. Even with the current weak rates of growth with the ensuing increased competition between the nation states for the shrinking markets, this would hardly be possible - and certainly not when the recession sets in.
It is therefore probable that in the course of the EMU realisation process - whether before of after the start - there will be a dramatic crisis.

Driving forces behind the EMU

Why is the EMU project still being pushed, despite the foreseeable problems?

The driving forces behind the EMU are the banks and the European global players.

* They want to strengthen and institutionalize neoliberal policies vis-a-vis the working class in the interest of big business and finance capital. All the governments should be forced to maintain currency stability, to deregulate the labour market and consolidate their budgets, in a way automatically by virtue of the convergency criteria, the Euro and the stability pact. They want to prevent governments giving in to movements of the workers, i. e. higher budget deficits to compensate for social faults. In the interests of their competitive position against other regions of the world, wages, social benefits, environmental standards are to be driven down to the lowest possible level.

* They want to establish a unified monetary and currency zone to expand the previously attained level of economic integration within the European internal market. They wish to prevent nation states from doing their own thing in regard to monetary and financial policies and thus, in a way, go a step further in lowering national barriers.

* They hope that a unified currency and monetary zone would bring greater independence from the dollar, and also act as a counter-weight to the other two blocs. This zone is intended to be an attractive place to invest for international finance and credit capital. „The Euro will also mean that the world has a second reserve currency. Whoever controlls it, has more room to act.“ (Hilmar Kopper, ex-Chairman Deutsche Bank, speech 21.6.96.) „At present the dollar dominates with 60%, whereas the D-mark only has 15%. The new European currency could reach 30%, thus attracting new business.“ (Schröder, Economist from the Commerzbank, Wirtschaftswoche 24.8.95.)

* Despite distended international finance capital which is chasing in particular short-term dividends around the globe, there is still a world-wide race for longer-term capital investments. Especially the high state deficits in many countries leads to a shortage of capital. Unifying the currencies and monetary policy is therefore intended to create an attractive, united monetary zone for international investors.

* As the „anchor“ currency of the EMS, the D-mark has been under strong pressure to revalue in the last few years, with the corresponding disadvantages for exports, because progress in productivity tended to be balanced out by exchange rate losses. The German Confederation of Industry hopes that „a European currency would not be under the same pressure to revalue as the Mark“. Despite their complaints about wages being too high, big business has worked out that only about a third of increased wage unit costs are due to „domestic“ causes, whereas two thirds are caused by devaluations and currency shocks. (BDI-Report on Industry Forum, EMU, 96). Mercedes boss Werner puts the profit losses due to devaluation for Mercedes alone at 2.6 billion DM. He expects from the Euro that „productivity increases would not be lost abroad due to devaluation caused by speculation, but would rather strenghten the national base considerably“ (SZ 12.4.96).

* Between 1991 and 1995 the external value of the DM increased in real terms against 18 industrial countries by more than 10%, according to the IMF. A strong D-Mark means that international competitors can also offer their products more cheaply on the domestic market. From the standpoint of the German global players, they are interested in getting rid of this pressure, i. e. transferring it onto all-European shoulders.

* Under the old EMS, the other states were forced to keep their exchange rates stable and bow to the German Federal Bank's monetary policy. Expecially the french economy suffered in the past at the hands of the Federal Bank's high interest rates and the pressure of devaluation on the franc (when the currency is devalued, risk premiums have to be paid for loans on the finance markets). If the D-mark was dissolved into a unified European currency, and monetary policy was more under „European“ control with the setting up of a European Central Bank, the other countries hope for advantages for themselves and more influence.

On the political plane, the German ruling class wants to entrench its position as foremost power against the other countries in Europe, i. e. to prevent other major European powers from building hostile alliances towards her. This is reflected in the comments of ex-Chancellor Schmidt, a radical supporter of the Euro who is worried that „if there is too much D-mark chauvinism and Germany's claims to leadership are too uncompromising, an anti-German coalition could form for the third time." (Zeit, 29.9.95)

In the last few years, Germany's position as foremost political and economic European power has been strengthened by the annexation of former East Germany, capital concentration, takeover and expansion of market positions in the EU. The German ruling class has profited most of all from the EU's closer relations to Eastern Europe after the collapse in 1989; by virtue of her strategically dominant economic and political role, she has created her own „back yard", a kind of „Hong Kong at the back door".

Germany handles about 59% of EU trade with mid-East European countries and is also the biggest creditor in Eastern Europe.

This leaves two options: Either the process of integrating further East European countries is continued - under the hegemony of Germany, it is true, but at least with the involvement and checks of other major powers; or, as the policy document on Europe of the CDU/CSU parliamentary group threatened in 1994: „Without further Western European integration, Germany could feel obliged, or even tempted for reasons of national security to carry out the stabilisation of Eastern Europe on its own and in the traditional manner".

That is what Kohl means whith his warning that „the unification of Europe is a matter of peace or war in the 21st century".

The road layed down in the Maastricht treaty is a capitulation to the dictates of the finance markets. This is reflected in the choice of the monetary convergency criteria: interest and inflation rates, state deficit. Employment, growth, productivity, and other real economic data are relegated to the background.

For the rich, monetary stability is important because it guarantees high real interest rates. Budget consolidation at the cost of state benefits ensures that the state debts are served. In all EU countries, a large part of the budget is used for serving the public loans; in Germany it's almost every forth mark in the budget. This amounts to a gigantic redistribution of wealth in favour of the rich.

Fundamental Contradicitons and Consequences

Europe's national ruling classes neither want to surrender the nation state, nor can they do without it. They still need the nation state as a means of defending their economic and political interests both at home (against the workers) and abroad, the latter despite all the talk of „globalisation" which does not so much refer to production as to the financial markets.

Withe the Euro, they intend on the one hand to create a unified currency and monetary zone. On the other hand, the nation states continue to exist. This dilemma which is endemic in capitalism gives rise to a great explosive potential. A unified monetary policy would tend to undermine the national economies, whereas at the same time, these remain the social base of the nation state.

What consequences would introducing the Euro have?

First of all, we are not talking about a currency reform or a devaluation, like e.g. after a period of high inflation. All values expressed in monetary terms would just be changed to the Euro at fixed rates. This in itself would not mean loss of purchasing power or transfers of wealth in the course of the technical transition to the Euro.

The problems are to be found elsewhere. The adjustment of exchange rates up until now meant that economic inequalities could be balanced out to a certain extent. For example, weaker and less competitive economies were able to compensate by devaluing their currency. With the Euro, the inequalities could no longer be „balanced out". Although in the recent period, competitive devaluation tended to create

more problems, because the relevant country then got a name as a „soft currency country" and had to pay higher rates of interest in the international money markets, and because there was also the danger that short-term investors would ditch the currency after devaluation. Nevertheless it was possible to counteract this at least temporarily to a certain extent.
So if the Euro was introduced, the buffer of exchange rate adjustment would no longer exist.

At the same time, according to Maastricht, the European Central Bank will take over interest rate and monetary policy as of 1.1.99. This means that the individual states no longer have significant montary instruments at their disposal. For example, it would no longer be possible to stimulate the national domestic economy by reducing interest rates. This again has become more difficult recently since all countries are more or less dependent on international investors to finance their growing state deficit, and too big a difference in interest rates can cause capital to go somewhere else. Nevertheless, it was still a potential instrument.

A unified currency and monetary zone, without the buffers of currencies, means tougher competition. Without currency barriers, the most productive companies can push through their agenda. And the EMU will mean „even more than today, that wage agreements which are not in line with regional productivity levels, will have a directly negative effect in employment" (Minister for Economy, Rexrodt, Handelsblatt 31.12.96).

International capital will flow predominantly into the economically strongest regions. Industrial and economic structures in the less competitive areas would be totally eradicated. The winners would be a few giant corporations, some rich high-tech-regions of Europe and a small part of the population. The rest would be left to fend for itself.

German experiences with currency union

Even though not totally comparable, there are some parallels between German currency union in 1990 and what would happen in the EMU. On entry into the „D-mark-zone", the less productive parts of the East German economy were put directly at the mercy of West German competition which was a major reason for the destruction of the industrial base, except for a few pockets of investment.
Huge sums of money have since been transferred to former Eastern Germany. This did not result in any independant economic development, but merely prevented the economy from collapsing completely.
Once the currency had been given up, other budgetary and monetary instruments of the then still existing East German state did not work anymore either. The state disintegrated, and although not planned, after the currency union the state unification had to follow in a haste a few month later.

It is true that there is not the fundamental differnece between the economic systems in the EU as there was between East and West Germany. Nevertheless the gap between some states and regions within western europe is enormous; this also applies to the presumable participants of the EMU. The 25 most prosperous regions have a pro capita income which amounts to 142% of the EU average, whereas the 25 poorest regions only reach 55%. Unemployment rates range from 4,6% to 27%
Within the boundaries of a ntion state, this uneven development can be balanced out to a certain extent by transfer of funds and regional subsidies. The transfer from West to East Germany amounts to 200 billion DMark per annum. Total EU funds to regional structure and development programmes come just to 50 billion DMark (1995). The neceassary dimension of transfer in a currency union are just impossible and not feasable on a European scale - and are to be prevented anyway. As Dieter Hundt from the German Employers federation stated: „No way should social policy on a European level be made to compensate for inadequate attempts of refom by the individual states. We need a union of stability, based on performance and competitiveness, not a union of redistribution for transferring ever-increasing funds between the different member states."

At any rate, political and social tensions would make this difficult. In the „winning zones" a kind of „prosperitiy chauvinism" would be encouraged. An example of this within one state is Italy, with its separatist tendencies in the North. With the introduction of the EMU, strains like this would open up all over the place. Capitalism based on profit and competition always leads to uneven developments. Problems that within a national state can just be precariously balanced out, can became a powder keg at European level, which could in the end trigger of increased tensions and nationalistic, chauvinistic and separate tendencies.

The presdident of the Bundesbank, Tietmeyer, a Euro-sceptic, also regards the EMU without a political union as fragile „given the historical experience that only those currency unions have prevailed which were installed hand in hand with a political union." (Handelsblatt, 31.12.96)

Soft Currency Risk

The dominance of international finance capital and the merging of serveral states into a monetary union make it necessary to win the confidence of international finance markets in the Euro as a hard currency. If international investors have not much confidence in the Euro as a save haven, there will be an exit of capital into other currencies such as the dollar and yen, which brings the Euro under dangerous downward pressure.

It is true that in the past 15 years the dollar has often been devalued for competitive reasons. But this did not harm the dollar too much, because it is backed up by the biggest and strongest national economy power in the world. There is one national economy, one national state, and US capital has a hold in economic policies.

This would be different in the EMU, where different national states and ruling classes would still be in existence, with the ever existing danger of pursuing their own national interests and policies. All the phrases repeated in a prayer-like fashion about the „Euro beeing as hard as the DMark" serve to win the confidence of the finance markets into a unified monetary and economic policies and a hard Euro. But a Euro as hard as the DMark is impossible, alreday for the one reason that it would not have the same real economic base, because it is underpinned by national economies of varying strength.

Even the strength of the DMark is no longer an accurate reflection of Germany's current economic position in the world economy. Real economic data have deteriorated; from beeing the biggest creditor, since unification Germany turned to now beeing the biggest debtor and net capital importer in Europe (a somewhat similar process that happened to the US in the 80ies). This - in reality weakened position - attracts international capital and pushes the DMark up. Because of its strong position and reputation herited from the past, international investors still regard Germany as a save haven. Should this change and capital be withdrawn in the course of the EMU, the DMark could go down and drag the Euro with it.

At present, there is no country apart from Luxembourg which fullfills all the convergence criteria. Othe states are making big efforts to meet the criteria in 1997. They are dong this partly by creative accounting and partly by filling their coffers with once-off profits from privatisations which will, however, not be forthcoming in the years thereafter.

If the criteria are handled strictly, even Germany will hardly qualify. Just like the other finance ministers, Waigel is corvering up the current holes in the budget by unsound adhoc maesures. In the coming years, the deficit will grow even bigger. The stability pact which was cobbled together at the Dublin summit will do little to change that. It is questionable as to whether the agreed fines for not keeping to budget dicipline can ever be enforced.

It is therefore likely that when the member states are decided on for the start of the EMU, the criteria wil be handled somewhat generously and political decisions wil be made, at least to some extent.

But the softening of the criteria and rising state deficits to be anticipated in the coming years could be regarded by the finance markets as a signal that the Euro will become a soft currency.

EMU only makes sense if there is a critical mass of member states at the start, so that the hoped for advantages can take effect. Germany and France will have to be included, along with the Benelux countries (despite the record overall deficit of Belgium) and Austria with it's satellite currency to the DMark.
The Italian lira is a notorious soft currency, because of the economic and political instability in Italy. If it was included, that would spoil the Euro's reputation from the start. However, to refuse entry to Italy would mean political tensions (Italy was actually one of the founding members of the EEC) as well as trade relation problems, when there is a currency rift between Italy, still a relatively large economy, and EMU participants like France and Germany.
And if Italy is included, why not Portugal and Spain? Just to take Belgium with its record deficit in, renders arguments against Italy futile. Finland and Irland will propably come close to fullfill the monetary criteria, just as well as France and Germany. But in real terms they are far less competitive. Irlands GDP even depends partly on EU subsidies. Irlands participation would also open a currency rift between itself and the most important trade partner, Britain. If they participated, they - and the EMU - would soon have problems.
The most likely scenario for 1998 is that a small group of „hard currency" countries will be earmarked for the start in order to try and limit the risks. But even the selection oft the firt group - as has been described - can give rise to considerable political and economic tensions. Fixing the external value of the Euro - which will be done at government level - is also potentially divisive. Because there are different political and economic interests, strains of many kinds can arise, e.g. trade relations of EMU member states with other parts of the world are of different intensity.

In addition, there is the problem of the relations between the participtaing member states (Ins) and the non-participants (Outs) For the latter, a new version of the EMS (EMS II) is planned. Like satellites they should revolve around the Euro as close as possible (but to be on the safe side, 15% above and below are allowed). In contrast to EMS I, the „outs" are supposed to stabilize their currency on their own bill, because there will be no duty to intervene for the ECB. Step by step, they are supposed to qualify for later participation by fullfilling tight convergency programms.
But in reality, things might develop somewhat different. The outs will be left behind very quickly and the gap will tend to widen. Already the decision about non-participation will probably lead to capital fleeing into other currencies, with the effect of devluation, turbulences and rising interest rates in these countries. On top, they would be punished by the finance markets with a risk premium on foreign loans.
Instead of being the dot on the EU common market, the EMU will open up a deep currency gap between the „ins" and „outs" and will intensify the economic and political tensions throughout the EU.

Already now, a growing state deficit after the decision on who participates is to be anticipated for various reasons:
The holes in the state budgets, which are now barley covered up, have to be tackled. A slow economic conjuncture could squeeze the budgets even more. The intensified competition between regions in the EMU will lead to higher subsidies for weaker companies and regions, because growing social and regional polarisation will lead to growing political pressure for compensation and subsidies.
Despite the stability pact, no government will allow others to decide, whether to give in vis-a-vis a mass movement and accept temporarily higher deficits or not.
Although the Maastricht treaty excludes expressly that anyone member state can be made liable for unsound budget policies of the others, this is hardly practicable. Because if one member state sucks in more capital for covering its growing deficit, in a monetary union this will push up the interests rates on the international markets for all the others as well.

Dilemma and crisis

All these factors make it highly probable, that the Euro would be a relatively soft currency, and this will become clear already before the start of EMU. This could lead to capital fleeing from the DMark (respectively the Euro) and trigger off a heavy crisiss on the international currency- and finance markets, which in turn could drag the real economy into recession. Not only would then the EMU fall apart, but also the deepest crisis since the founding of the EEC would develop.

The ruling classes in Europa a currently in a dilemma. The nearer the starting date comes, the bigger the problems and risks pile up. But a further postponement also becomes more and more difficult. The global players and finance markets have prepared themselves for the start. They would see a further postponement as the end of the plans for the unforseeable future (like happened to the plans in the 70ies). They would regard this as an admission, that the ambitious targets linked with the project can not be reached, and this would lead to strong reactions on the finance markets.
The German Employers Federation warns, that a postponment would lead to capital fleeing into the DMark and pushing it up again. The finance minister Waigel warns: „He, who puts a question mark behind the starting date, risks, that the pressure for budget consolidation gets lost." Indeed, with the Maastricht project, the way is already part oft the target, because „it allows the governments and parliaments to demand huge sacrifices from their peoples." (Waigel, Handelsblatt 24.3.92)
Today, it is very difficult to predict whether the EMU will start on 1.1.99, or whether the start will be postponed and buried altogether, and another variant of the old EMS will be installed. But both ways are leading to enormous currency-, economic and political turbulences. At the same time, the tensions between the European states will intensify instead of getting softened. This would already be the case, if the current slow economic uspwing drags on for some more yeras. It would all the more be the case, when the next recession sets in, where all the tendencies of the national states are sharpened to protect their domestic economy and companies.

Angela Bankert, April 1997