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The Creation of the European Union

There must be no doubt: we want political union. We do not want a glorified free-trade zone.

—Helmut Kohl, German Prime Minister, 1990

Who does not see that Germany is increasingly establishing its presence in the community, imposing on everyone its internal preoccupations, from the environment to interest rates? Who cannot see that Great Britain joined Europe only in order to control its development and to create a market for itself?

—Jacques Calvet, President of PSA Peugeot Citroën, 1992

On Sunday, September 20, 1992, French citizens were on their way to the polls to cast their vote for or against ratifying the Maastricht Treaty, the Treaty of the European Union (TEU). A "*oui*" to Maastricht would initiate what some saw as the greatest surrender of national sovereignty since German occupation in 1940. Under the provisions of Maastricht, France would lose not only its national currency, and with it control over monetary policy, but also significant control over immigration and visa policy. Non-French nationals of the European Community (EC) residing in France would be allowed to vote and even run in local elections. And the European Parliament would gain a new oversight role for legislation agreed to by national governments in the Council of Ministers. The changes implied by the Maastricht Treaty required that the constitution of France's Fifth Republic be amended before the treaty could be ratified. With the stakes so high, turnout was expected to be near 80%.

A "*non*" vote, advocates of European integration warned, could have weighty repercussions. A common currency offered the promise of lower transaction costs within the EU and greater weight in the international arena. "The United States has no counterweight," said France's economics minister, Pierre Bérégovoy, at the signing of the Maastricht Treaty in December 1991. "Europe can play this equilibrating role."[1] Critics noted, for example, that Airbus contracts were written in U.S. dollars rather than in a European currency. French Senator Alain Duhamel echoed this concern:

> The United States has never enjoyed such military, political and cultural supremacy. They are trying to create a unified economic area with Canada and Mexico. Japan is accumulating a financial and technological power that is as impressive as it is enviable. Is there therefore any alternative to a European Union, short of resigning ourselves to becoming a captive market, a regional franchise, a minor power?[2]

Professor Gunnar Trumbull prepared this case. This case was developed from published sources. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

The United States was not the only focus of European concern. Chancellor Helmut Kohl's decision to reunite Germany in October 1990 had raised concerns about the dominant role of a larger Germany within Europe. Recent neo-Nazi rioting in its new eastern states had focused attention on the prospect of a Germany unchecked by a deeper EC.[3] Would Germany turn its attention away from the west toward the newly independent nations of Eastern Europe? Would the center of gravity in Europe shift definitively to the newly enlarged German state? An opinion poll taken at the time of unification found that 42% of French and 33% of British respondents were fearful of a united Germany. (See **Exhibit 11**.) Christiane Scrivener, a French member of the European Commission, noted on the eve of the referendum: "The greatest concern, spoken or unspoken, is the risk of a Community dominated by the economic power of Germany. . . . With Maastricht, Germany will be even more closely bound to Europe."[4] It was a view shared by many Germans as well. Germany's former chancellor, Helmut Schmidt, warned:

> The French, Dutch, Italians, Poles, Hungarians and all the rest are faced with a clear choice. On the one hand, they can opt for progress in European political integration. . . . On the other hand they can choose to hesitate—and find that Germany, in 10 years, is too powerful as a neighbor to handle. If the latter happens, it will prove a development almost impossible to correct.[5]

Most agreed that the French referendum would determine the fate of the treaty. The first national referendum on Maastricht, held in Denmark in June 1992, had failed by a narrow margin to ratify the treaty. Former British Prime Minister Margaret Thatcher had welcomed the Danish outcome: "They have done a great service for democracy against bureaucracy."[6] If the treaty were also rebuffed in France, the project would go no further. Britain, Germany, and Spain had all decided to postpone their own treaty ratification plans until after the outcome of the French vote was known. As *The Economist* observed, "A French *Non* on September 20th would kill the Maastricht treaty and its goals of economic, monetary and political union."[7]

Background—War and Reconciliation

In the 20th century there will be an extraordinary nation. This nation will be large, which will not prevent its being free. It will be illustrious, rich, thoughtful, peaceful, friendly towards the rest of humanity. . . . It will be called Europe.

—Victor Hugo, 1867

Conditions in 1945 did not suggest that Europe had come any closer to Victor Hugo's vision. Germany had occupied France three times in the previous 75 years, including a period of two years during World War II. France had lost 2.1 million troops in World Wars I and II combined; Britain had lost 1.3 million troops. World War II had claimed nearly 10% of the German population, both military and civilian, and bombing by the Allied powers at the end of the war had destroyed nearly all of Germany's cities and factories. A cycle of aggression and retribution had made the European continent one of the most conflict-ridden regions on the globe.

At the center of these conflicts lay the coal-rich Ruhr Valley, which at the end of World War II had fallen within the British zone of occupation. In 1948, French businessman and millionaire Jean Monnet approached French foreign minister Robert Schuman to propose a novel solution to the problem of the Ruhr. In place of direct occupation, Monnet suggested that resources from the area might be jointly managed by a core group of European nations. The United States, which had already given $13 billion in reconstruction loans through the European Recovery (Marshall) Plan, applauded the Schuman Plan as a step toward a peaceful and prosperous Europe. The Soviet Union condemned it as a "plan for war" orchestrated by the United States against the East.[8]

In April 1951 the Schuman Plan was implemented. Leaders of France, Germany, Italy, Belgium, the Netherlands, and Luxembourg signed the Treaty of Paris creating the European Coal and Steel Community (ECSC). The ECSC was managed by a High Authority headed by Monnet, a Council of Ministers representing national governments, a Joint Assembly with members appointed by national parliaments, and a Court of Justice. These governing bodies oversaw negotiations to eliminate barriers to trade among the six member countries, first in coal and iron ore, later in scrap iron and steel imported from non-ECSC countries. The ECSC also worked to modernize production, to coordinate coal and iron output with national demand, and to standardize production and labor practices. "The goal of the proposed organization," wrote economist Pierre Uri at the ECSC's inception, "is to increase production and productivity by improving methods, enlarging the market, and rationalizing production."[9]

For Monnet, the plan's architect, the goal had always been more about politics:

> The Schuman proposals . . . must be revolutionary or they will fail. Their fundamental principle is the delegation of sovereignty in a limited, but critical, domain. In my opinion, any plan that does not begin with this principle can make no useful contribution to solving the major problems that confront us. Cooperation among nations, while important, will solve nothing. What we must seek is a fusion of interests among the European peoples, not simply the maintenance of a balance of interests.[10]

The Treaty of Rome

Coal and iron were only a starting point. At a meeting in Messina, Italy in June 1955, the six members of the ECSC proposed to create two new European authorities. Euratom would coordinate research into atomic energy. The European Economic Community (EEC) would broaden economic openness to include all goods, services, people, and capital. After two years of negotiation, the 1957 Treaty of Rome established both Euratom and the EEC. On July 1, 1968, the six signatories to the treaty announced that they had eliminated all internal tariffs and agreed to a common schedule of external tariffs that ranged from 15% to 25%.

As quickly as it was created, the common market ran into political roadblocks. Beginning in the early 1960s, the German government came under pressure from the country's farmers to exclude agricultural products from the emerging common market. With fragmented land and backward techniques, the farmers worried that a free European market in produce would favor their relatively efficient French counterparts. But France, led by President Charles de Gaulle, insisted that free trade without agriculture would be unacceptable and would create a balance of trade problem for France.[11] Two years of intensive debate led to the creation of the Common Agricultural Policy (CAP) in 1962. CAP created a common internal market in agricultural products, as France wished, but also included price supports, export subsidies, import restrictions, and other forms of support to farmers in countries with less efficient agriculture.[12] These programs were expensive. Funding for CAP accounted for 76% of the EC budget in 1973. Funds were raised through agricultural levies, customs duties, and, beginning in 1979, a 1% national value-added tax. The largest cost was born by consumers, who by the late 1960s were paying four times world prices for butter and sugar.[13]

Other product markets also proved difficult to unify. While member states lowered formal barriers to trade, differences in regulations and technical standards often raised informal barriers. Efforts to overcome informal barriers by creating common standards typically upset member states or became mired in technical details. Legislation to harmonize mineral water standards, for example, required 15 years. Standards for labeling jams (with lumpy French jams confronting the smooth, sweetened Dutch jams) required a quarter of a century. Many European standardization efforts, greeted derisively as "euro-bread" or "euro-beer," never became law. But even new EC-level standards that did pass were rarely transcribed into member-state legislation. By 1974, for example, only one of 30 directives on industrial products had been adopted by member states. It was a situation that the European Commission described as "intolerable and anachronistic in a Community moving towards economic union."[14]

One area of notable EC success was in widening its membership. The biggest issue concerned Britain, which had eschewed the 1957 Treaty of Rome but subsequently applied for EC membership, first in 1963 and again in 1967. On both occasions its application was vetoed by French President de Gaulle, who argued that British entry would become a Trojan horse for U.S. influence in Europe: "In the end there would appear a colossal Atlantic community under American domination and leadership which would soon swallow up the European Community."[15] De Gaulle's resignation in 1969 opened the way for British accession in 1973. Denmark and Ireland joined at the same time. They were followed by Greece, in 1981, and Portugal and Spain in 1986.[16] By the time of the Maastricht meeting, Europe had grown from six to 12 member states and from a population of 194 million to 330 million.

Europe's "Government"

In 1965, the separate ECSC, Euratom, EEC, and CAP administrations were merged into a single organizational framework, the EC. Four governing bodies, borrowed from the ECSC, managed the new EC: the European Commission, the Council of Ministers, the European Parliament, and the European Court of Justice. With some adjustments in their organization and roles, these bodies remained the core institutions of the EC in 1992.

The *European Commission* was the executive branch and administrative center of the EC. Although granted no law-making rights, the Commission took the lead in developing policies and drafting legislative initiatives, and this made it a powerful player within the context of the EC. By 1992 the Commission had 17 commissioners, appointed by member states, and 16,700 staff, of whom 15% were translators and interpreters.[17] Its staff worked in 24 distinct bureaucracies, called directorate generals, which oversaw policy areas including competition, standards, and social policy.[18]

Legislation drafted by the Commission became binding through a vote of the *Council of Ministers*. This deliberative body, akin to the upper house in a representative government, was a forum for national governments. It included one representative from each member country, and depending on what issues were being discussed, different national ministers would fill the seats in the Council. Votes for each country were weighted based on country population. (See **Exhibit 8**.) Although the Treaty of Rome had called for simple or qualified majority voting in the Council of Ministers for most policies, the 1966 Luxembourg Compromise granted any member state the right to exercise a veto for reasons of "national interest," imposing *de facto* consensus decision making. For topics of broad importance, including amendments to the Treaty of Rome, the leaders of member states filled the council seats. (Most sent their prime ministers; France sent its president.) In this configuration the group was referred to as the European Council. Treaty amendments by the European Council always required unanimity. The Council of Ministers was headed by a president selected for six months on a rotating basis from among the leaders of the member states. By 1992, the Council secretariat included 2,200 officials drawn from the member states.

The EC's lower house, the *European Parliament*, was also its most controversial institution. By 1992 it had 518 members of the European Parliament (MEPs), each elected to a five-year term. As initially conceived, MEPs were delegates of national parliaments. Direct elections to the European Parliament were first held in 1979 amid criticism that this would undermine the authority of national democratic institutions. Yet the role of the European Parliament was still narrowly restricted. While MEPs could debate issues, they were given no control over final decisions. As if to emphasize its powerlessness, the parliament was geographically scattered. It convened its plenary sessions in Strasbourg, its staff of 3,500 worked in Luxembourg, and its 18 committees met in Brussels. For many member states it was perceived as a final landing place for graying civil servants.

The Treaty of Rome also equipped the EC with a judicial branch in the form of the *European Court of Justice* (ECJ). Its 13 members, appointed by national governments and based in Luxembourg, were empowered to hear private cases against member-state governments that infringed the laws of the EC. Akin to the U.S. Supreme Court, the ECJ both ensured member-state compliance with EC directives and interpreted the Treaty of Rome.

The court was often seen to create new legal standards in the guise of interpretation. In 1982, ruling in the *Cassis de Dijon* case, the court found that Germany could not block the import of the French black currant liqueur *cassis* simply because it did not meet German labeling requirements. This decision established the doctrine of mutual recognition, requiring that member states not block the import of goods meeting the regulatory requirements of other member states. Although no member government had ever formally agreed to the principle of mutual recognition, it had by the early 1990s become a basic principle of European trade and an alternative to regulatory harmonization as a means of overcoming technical barriers to trade. In 1990 alone the ECJ heard 380 mutual recognition cases and gave 225 judgments.

The Single Europe Act

By the mid-1980s, significant new informal obstacles to trade were being erected in order to protect faltering domestic industries. Government contracts increasingly favored domestic producers, growing state subsidies provided special advantages to domestic firms, and limits on currency exchange and capital flows increasingly restricted cross-border transactions.

The 1986 Single Europe Act (SEA) sought to overcome these nontariff barriers by altering EC decision-making procedures in the European Parliament and in the Council of Ministers. The benefits were potentially large. The 1988 Cecchini report on "The Cost of Non-Europe" projected that a common set of market rules in Europe would increase European economic output by 4.3% to 6.4% over five years, raise employment by 1.5 million to 2 million jobs, and lower consumer prices by 1.5% to 6%.[19] These benefits would be achieved through a set of 300 measures drawn up by Lord Cockfield, commissioner of the internal market, to be adopted by December 1992.

"Europe 1992" quickly became a rallying cry for Euro-enthusiasts, who saw in European integration the solution to a decade of slow growth and high unemployment. Through mergers and acquisitions, European companies would become global economic players. Reductions in state aid to companies would open protected national markets, while privatization of national producers would introduce competition to the telecommunications, transport, and energy sectors. Technology sectors such as pharmaceuticals would benefit from unified product standards and qualification procedures. Perhaps most important, a single market of 330 million consumers envisioned for "Europe 1992" would generate scale economies across all sectors.

The SEA would achieve this vision of a common market by changing EC governance. First, it formalized the mutual recognition standard first developed by the ECJ. Second, it applied qualified majority voting (QMV) to the area of internal market regulation. Legislative initiatives in the Council of Ministers could now pass with 71% support rather than unanimity. This opened the possibility for blocking minority coalitions but precluded single-country vetoes. QMV paved the way for the elimination of many nontariff barriers. Directives were quickly passed under the new voting rule that harmonized value-added taxes, created a framework for setting common technical and product standards, and, in 1988, committed member states to permit unrestricted flows of capital, including the right of EU citizens to open bank accounts in any member state.[20]

The third change in governance under the SEA was the creation of the so-called cooperative procedure, granting the European Parliament new authorities to propose draft legislative initiatives, to amend draft legislation written by the Commission, and to overturn QMV decisions (but not unanimous decisions) by the European Council.[21]

The Treaty of European Union

A great power is being born, one at least as strong commercially, industrially and financially as the United States and Japan.[22]

—François Mitterrand, Maastricht, December 1991

On December 11, 1991, the leaders of the EC's 12 member states came together in the quiet Dutch town of Maastricht to negotiate changes to the Treaty of Rome that would extend the project begun with the SEA. The new Treaty of European Union (TEU) would create a common currency, a European citizenship, a single European border policy, and rename the European Community the European Union. Negotiators met for 31 hours over the course of two days. The resulting draft document, signed February 7, 1992, set a broad agenda for economic and political union. (See **Exhibit 1**.)

Economic and Monetary Union

In August 1990, the European Commission published the report "One Market, One Money." It argued that the introduction of a single currency into the nascent single market could eliminate exchange rate uncertainty, eliminate exchange transaction costs, lower the risk of cross-border investment, promote price stability, and lower inflation. These benefits, taken together, would amount to savings estimated at 13.1 billion to 19.2 billion European currency units (ECUs) ($17.9 billion to $26.1 billion) per year.[23] The business community appeared to agree. In a 1991 survey, British business leaders estimated that a single European currency would save them an average of 0.5% of revenue.[24]

European Monetary System Since the fall of the gold exchange standard under the Bretton Woods agreement in August 1971, the EC had attempted to re-create its own intra-European fixed exchange rate regime. In April 1972, eight European countries (Italy, France, Germany, Belgium, Denmark, Ireland, the Netherlands, and Luxembourg) agreed to limit internal fluctuations in their exchange rates under a new European Common Margins Agreement (ECMA) to a band of ±2.25%.[25] But member countries felt little pressure to remain within the currency "snake," and countries moved in and out as they devalued their currencies to improve their export positions. Italy left the snake in 1973. France left in 1974, rejoined in 1975, and then left again in 1976. By the late 1970s, the ECMA was reduced to a narrow "mark area" including only Germany, Denmark, and the Benelux countries.[26]

To give the fixed exchange regime more credibility, the members of the EC in 1979 created the European Monetary System (EMS). Under the EMS, a complex matrix of bilateral exchange rate bands, called the exchange rate mechanism (ERM), limited intra-European currency fluctuations to ± 2.25%. A new basket currency, the ECU, served as a reserve currency backed by 20% of gold and dollar holdings of member states. A new European Monetary Cooperation Fund used these holdings to provide short-term loans to help stabilize member currencies. Countries wishing to realign their currencies required approval from the EC's Monetary Committee, with any changes approved by a unanimous vote of the member states in the Council of Ministers.[27] This restriction was particularly galling to Britain's prime minister, Thatcher, who saw it as an infringement of national sovereignty. The United Kingdom only joined the ERM in October 1990.

The Delors Committee European Commission president Jacques Delors had first pushed a single European currency onto the EC agenda at the European Council meeting of June 1988 in Hannover, Germany. For the next year the "Delors Committee" of central bankers and monetary experts met to discuss the possibilities for monetary union.

The president of the *Bundesbank*, Frederick Pöhl, represented Germany on the Delors Committee. Pöhl opposed adopting a common currency on the grounds that it would lead to inflationary monetary policy, thus violating the *Bundesbank*'s mandate to stabilize prices.[28] Under pressure from the government of German Chancellor Kohl, Pöhl eventually accepted monetary union but imposed four "preconditions" for *Bundesbank* support: central bank independence, capital account liberalization, strict convergence criteria, and centralized control of member-state fiscal policy.[29]

These goals were eventually incorporated into the Delors plan, which also set out a timeline for achieving monetary union. A first deadline, set for January 1, 1994, would see the creation of a "European Monetary Institute" and free capital flows. For the common currency to be introduced on January 1, 1997, at least seven member countries would have to meet economic convergence criteria. These included a budget deficit less than 3% of gross domestic product (GDP), national debt less than 60% of GDP, inflation within 1.5% of the three most stable EMS economies, and two years in the ERM without devaluation.[30] Failing this, any states meeting the criteria by July 1, 1998, would proceed toward monetary union. By January 1, 1999, states meeting the criteria would adopt a common currency.

Not everyone agreed with the Delors plan. In early 1991, Britain proposed an alternative mechanism, based on the "Hard ECU." In this approach, the ECU would be transformed into an independent 13th currency set to match the inflation of the most stable European currency. A Hard ECU Bank would manage it. Rather than being forced upon member states, market demand for a common currency would dictate the spread of the Hard ECU.[31] France favored a rapid transition to a common currency but felt that national governments should retain political control over the monetary and exchange rate policy of any European central bank. It argued that national governments working through the European Council of Finance Ministers (ECOFIN) should set external guidelines for a European central bank and consult in decisions concerning international exchange rate agreements.[32]

The EMU debate Many economists had concerns about European monetary union (EMU). Some worried that the separation of monetary and fiscal policy would lead to inflation. Because the benefits of fiscal expansion would be local while the costs in terms of inflation would be spread across the 12 member states, individual countries would have incentives to pursue inflationary spending.[33] Others argued that Europe did not constitute an optimal currency area.[34] Without greater mobility of capital and labor within the EC, they argued, external shocks were likely to have asymmetric effects that would require very different macroeconomic responses. The International Monetary Fund (IMF) felt that the convergence criteria proposed by the *Bundesbank* were simply too stringent. It estimated that the Maastricht criteria would reduce economic growth by 0.4% to 0.8% over the period 1993–1996.[35]

Member states nonetheless eventually supported EMU, if for different reasons. For France, a commonly managed currency seemed to offer a more equitable distribution of the burden of maintaining Europe's monetary system. Within the EMS, policymaking was asymmetric. Because the German *Bundesbank* kept the tightest reign on inflation, the burden of adjustment to maintain the ERM seemed to fall disproportionately on the EC's other members. (See **Exhibits 3** and **5**.) Moreover, a single currency would eliminate exchange rate risk among European currencies, allowing countries with traditionally weaker currencies to enjoy lower interest rates. French officials also believed that asymmetries in macroeconomic policymaking had structurally undervalued the Deutschmark (DM), boosting Germany's current account surplus.[36] "Without a European currency," wrote France's economics minister, Edouard Balladur, "Germany will stay free to act as it likes. This is the present situation which is the most damaging to France's sovereignty."[37]

For Germany, support for EMU was closely tied to the project to reintegrate the five states of the German Democratic Republic into West Germany. With the opening of Eastern Europe, France had become concerned about the increased economic might of a unified Germany. In a deal arranged with French president Mitterrand, Kohl agreed to accept monetary union in return for European support of a unified Germany.[38] But the Kohl government also saw monetary union as a means to make an end run around the tight money policy of the *Bundesbank*. Tension between the German government and central bank had been rising through the 1980s. Although the *Bundesbank* was formally independent, Kohl had been pushing the *Bundesbank* to loosen monetary policy, first in order to match a depreciating dollar and then to offset the shock of German unification.[39] Because any jointly managed European central bank was likely to have a looser monetary stance than the *Bundesbank*, EMU offered an indirect means of achieving monetary loosening.

Political Union

Speaking in October 1989, Germany's Kohl insisted that EMU be tied to a deepening of political union, including a broadening of the scope of QMV, greater parliamentary powers, and a common foreign policy.[40] This view was endorsed by the German financial and business community. Helmut Schlesinger, Pöhl's successor as president of the *Bundesbank*, affirmed "a monetary union can only be effective if a dominant political will exists to tackle the serious social problems which can result from such a monetary union."[41] Eberhard von Koerber, head of German operations at ABB, argued that "political union is the most important issue. . . . Within ABB we have been bringing together different cultures for years to create a single efficient company, now we want to see politicians do that."[42]

EU citizenship The idea of EU citizenship was proposed by Spain, a newly democratized state interested in locking in basic freedoms. Citizenship would confer the right to live in any member state, the right to vote and run for local and European Parliament office in that state, and the right to receive diplomatic and consular protection from offices of any member state.[43] Germany strongly advocated a common visa policy. Its traditionally liberal immigration policy had recently become a lightning rod for extreme-right groups. Moving debate to the European level would remove it from the domestic political agenda and perhaps legitimate a lower level of immigration.[44]

The right of EU citizens to vote in local elections of any member state raised concerns because it had the potential to shift the domestic political balance in some countries. In Luxembourg, for example, 28% of the population was foreign, mostly from other European countries. Indeed, some communities in Luxembourg were nearly half foreign.[45] In France, foreign residents were fewer (6.3% of the population were foreigners, 2.5% were non-French Europeans), but under its electoral system locally elected officials served as an electoral college for national elections.[46] This meant that foreigners could, via local elections, affect national political outcomes.[47] This was a particular concern for parties on the political right, which feared that the new foreign constituency would be primarily workers and therefore more likely to vote for the left.[48]

The social chapter Along with EU citizenship, the Maastricht negotiators added a "social chapter" that would set minimum standards for workers in Europe. Based on the social charter signed by member states in 1989 stating, "Social consensus strengthens the competitiveness of enterprise," the social chapter of Maastricht set common provisions for workers in the member states. Its main provisions included similar training and social allowances for "atypical" (part-time) workers, equal pay for men and women, a limit of 48 hours weekly work, and a work-free Sunday. Britain objected, on the grounds that it would undermine the country's liberal labor-contracting rights. Continental European member states in turn worried that Britain would engage in "social dumping" by applying diminished labor protections.[49]

Common foreign and security policy As European heads of state met in Maastricht in December 1991, looming military conflicts in the Balkans and the Persian Gulf helped to put foreign and security policy on the agenda. The first was the dissolution of Yugoslavia. In December 1991, Germany's foreign minister, Hans Dietrich Genscher, had announced that he would unilaterally offer diplomatic recognition to the breakaway Yugoslav republics of Croatia and Slovenia with or without EC support. Despite warnings from the United Nations and the United States that this could trigger greater conflict in the region, the EC reluctantly acceded to German interests and recognized the new countries.

The second conflict was the emerging Persian Gulf War against Iraq. EC member states had shown diverse responses to the Iraqi invasion of Kuwait. Britain had sent 43,000 troops, 75 planes, and 15 ships to the gulf, at a peak operating cost of $15 million per day. France reacted more slowly but did send 4,000 troops, 48 helicopters, 30 fighter planes, and 48 tanks.[50] In Germany, the war fed a heated domestic debate about acceptable roles for the German military, which the German Basic Law restricted exclusively to defensive purposes. In lieu of military support, Germany provided $12 billion in aid to the anti-Iraq coalition in 1990 and 1991, along with some transportation for equipment.[51]

These conflicts at the periphery of Europe highlighted both the need for a common foreign policy and the difficulty of achieving that goal. In a poll in August 1992, 41% of Europeans said the Yugoslavia war showed a need to boost European integration; 45% said it showed the EC's impotence.[52] Speaking at Maastricht, Mark Eyskens, a Belgian diplomat, called the EC "an economic giant, a political midget, and a military larva."[53]

But if member states agreed on the need for greater military and foreign policy coordination, they had difficulties agreeing on the means to achieve this. Italy suggested that the new EU take control of the French and British seats on the United Nations' Security Council. This proposal met a cold reception. France and Britain, the two big European contributors to the Gulf War, both supported a greater military role for Europe within the North Atlantic Treaty Organization (NATO), but for different reasons. France, which had withdrawn from NATO's integrated military structure in 1966, wanted to create a European pillar of NATO that would be less dependent on Washington, D.C.

Britain, by contrast, feared the fall of the Soviet Union would trigger a U.S. withdrawal from the European continent and felt that a stronger European pillar of NATO would keep it there.[54]

Finally, at a Paris meeting in October 1991, Kohl and Mitterrand announced plans for a joint 35,000 rapid-reaction force. Decisions about how this force would be organized and deployed were left for later discussions.[55]

EU Governance

The growing scope of EC activities, especially since the SEA, had raised concerns about its accountability and legitimacy. Many sought greater powers for the European Parliament as a means to address the so-called democratic deficit. But France and Britain objected that a more powerful European Parliament would undermine their own domestic parliaments, sacrificing democracy at home to promote democracy in Europe. France proposed instead that national and European parliaments work together, meeting every three years in a "conference of parliaments" to consult on important EC issues.[56] After much negotiation, Maastricht added a "co-decision procedure" on issues relating to the internal market, as well as for education, culture, public health, and consumer protection.[57] Under the co-decision procedure, the European Parliament gained new rights to send legislation directly to the Council of Ministers without approval by the European Commission and to negotiate compromises with the Council for legislation that failed to attain a qualified majority. It also gained a simple majority veto of any legislation passed by the Council.[58]

In order to overcome deep national concerns about political union, European policy was separated into three "pillars." The first pillar, the common market, would be subject to qualified majority voting and the co-decision procedure for the European Parliament. The second pillar included foreign and security policy, while the third pillar involved home affairs, including immigration and asylum policy, the police, and justice. Legislation falling within the latter two pillars would require a unanimous vote in the Council of Ministers, a procedure that posed a significant obstacle to further integration in these areas.[59]

The treaty also provided for the first pillar, the internal market, to be governed by the subsidiarity principle. Subsidiarity represented a commitment by the EC always to pursue action at the lowest level of government possible, whether EU, national, regional, or local. For Germany, whose states enjoyed a high level of independence within a federal structure of government, subsidiarity assuaged concerns that European institutions would usurp state authority. In the words of Max Streibl, state premier of Bavaria, one of Germany's most fiercely independent states, the inclusion of the subsidiarity principle in the Maastricht Treaty pushed back "the evil spirit of centralism."[60] For Britain, too, subsidiarity seemed to limit the tax that Maastricht would levy on that country's national sovereignty.

On December 11, 1991, in last-minute treaty negotiations at Maastricht, Britain opted out of EMU and the social chapter, retaining the possibility to join at a later date.

The Referendum

President Mitterrand had not always been a strong advocate for the Maastricht Treaty. In the days following his acceptance of the draft treaty in December 1991, his own popularity rating had fallen to 29%, the lowest level since his first election a decade earlier.[61] Following the defeat in the Danish referendum, however, his campaign for the new EU intensified. He made frequent public appearances across France, sometimes together with Germany's Chancellor Kohl, in which he argued that further integration would enhance Europe's position in the world. Some observers felt he was using Maastricht to drive a wedge between the political parties on the French right in preparation for upcoming legislative elections.[62] (See **Exhibits 14** and **15**.)

The European Commission was not making Mitterrand's job easier. The French government had distributed 45 million copies of the treaty to the population, but the French public reportedly found the text turgid and obscure.[63] The final draft of the Maastricht Treaty included 33 pages on economic and monetary union and 220 pages on political union. The European Commission had also spent the summer drafting directives that would restrict French bird hunting, change the color of traditional French sausages, and ban the export of raw-milk cheeses, including Camembert. Between June and September of 1992, French support had fallen from 69% in favor to an even split.[64] As the French vote approached, Delors virtually shut down the Commission to avoid further scrutiny. As one commission official noted at the time, "We want to be noticed as little as possible."[65]

One week before the referendum, Mitterrand, 75, went into the hospital with prostate cancer. Anti-Maastricht voices were quick to draw the analogy between the president's tumor and the growing European bureaucracy in Brussels.

Dying for Dresden?

The idea of a common European currency in the absence of a stronger European polity was increasingly raising concerns. Never before had an important currency emerged without a government behind it. Even previous economic unions, including the American colonies in the 18th century and the German duchies in the 19th, had first moved to political union before creating common currencies.[66] They may have had sound reasons for waiting. Currencies had historically played a role in national defense. In times of war, countries commonly paid troops and purchased weapons by printing money, using the resulting inflation as a tax to finance the war effort.[67]

Most important in the European context was national control over monetary policy. This concern was particularly poignant in the Europe of 1992. Germany's decision to reintegrate the five former East German states into a larger single Germany, coupled with a promise by Chancellor Kohl not to raise taxes, had driven government spending into deficit. The government had also decided, over objections from the *Bundesbank*, to accept East German postmarks in exchange for western Deutschmarks at parity, even though postmarks were generally considered to be worth much less. Easterners with an appetite for western goods drove a demand boom that threatened to push prices up further. The *Bundesbank* responded by raising interest rates to 10% by September 1992.

This restrictive monetary policy made sense for the overheated German economy but not necessarily for its EMS partners, which had no choice but to follow suit in order to maintain the EMS currency pegs. In Britain, where a recession was already under way, the high interest rates needed for it to remain within the EMS were aggravating an economic recession. In Italy, Carlo De Benedetti, chairman of Olivetti, worried that the high interest rates in response to Germany's reunification could cost Italian jobs. "We are not ready to die for Dresden," he announced.[68] In France, Socialist politician Jean-Pierre Chevènement warned: "The prospect of a single currency will lead to a competition in monetary and budgetary virtue among the twelve resulting in a deflationary politics just at the moment when we are plunging into a recession."[69] The *Bundesbank* had increased its discount rate to 8% immediately following the 1991 Maastricht summit, Germany's highest rate in 60 years, and continued to raise it through the spring and summer of 1992. The EMS partners had been compelled to raise their rates as well.[70]

At the heart of the debate lay a concern about national sovereignty articulated clearly, as usual, by Thatcher: ''The issue of a currency like sterling . . . is one of the most powerful expressions of sovereignty which you can possibly have.''[71] In France, conservative MP Philippe Sequin explained: "We are opposed to a regional central bank because it will be run by appointed technocrats from a dozen nations, and France will have no say over its own monetary policy."[72] Perhaps most disquieting, a poll conducted in Germany in June 1992 found that 72% of Germans opposed giving up their national currency.[73]

Black Wednesday

The EC's ERM, the system of narrow exchange rate bands that the common currency would someday replace, came under attack in September 1992. Speculation that France and Germany had agreed to proceed with a two-speed Europe, leaving Europe's weaker currencies behind, led to large speculative attacks on these "soft" currencies.[74] Ireland and Spain responded by reimposing capital controls, slowing the outflow of hot money.[75] On September 13 Italy devalued the lira by 5% within the ERM. Britain, already in the middle of a recession, came under intense pressure to maintain the sterling's 2.95 DM value necessary to remain within the ERM. Prime Minister John Major had staked his reputation on this rate, calling any pound devaluation "a betrayal of our future." On the morning of September 16, 1992, "Black Wednesday," the Bank of England pushed interest rates up from 10% to 12% in order to defend the pound and then announced a further increase to 15%. But domestic political pressure proved too great, and when France and Germany refused Britain's request for an "orderly" realignment, the British pound pulled out of the ERM and immediately depreciated by nearly 10%. The Italian lira followed suit.

It would later be estimated that European central banks had invested $100 billion during September 1992 to support weak currencies. France spent $20 billion to defend the franc. Britain, which had spent $18 billion to support the pound, lost an estimated $1.8 billion due to the pound's devaluation. Germany, which had spent an estimated $30 billion to support the pound and the lira, also suffered significant losses. Among the winners was George Soros, whose Quantum Fund made $1 billion in a single day speculating against the pound.[76]

As the French went to the polls, a debate raged over the meaning of Black Wednesday. Some saw it as an example of why a common currency was essential to eliminate exchange rate risk. With currency traders placing constant pressures on the ERM, maintaining a fixed exchange rate regime within Europe seemed to require a single currency. But others felt it highlighted the foolishness of trying to lock in exchange rates among such disparate economies. On leaving the EMS, Britain's chancellor of the exchequer Norman Lamont accused it of forcing a tighter monetary policy than the United Kingdom required for fighting inflation.[77] This view was echoed in Germany by Joseph Joffe, foreign editor of the *Suddeutsche Zeitung*, in an editorial published on the day of the French referendum: "Alas, Europe has already failed the test of unity. A *'non'* would merely pull the plug on the comatose patient, while a *'oui'* would do little more than prolong the agony. . . . The demise of the European Monetary System might actually be a blessing in disguise. For it will provide enough monetary freedom to cushion the shocks . . . when the single market kicks in."[78]

Exhibit 1 Treaty of the European Union, Signed February 7, 1992

Title I. Common Provisions

ARTICLE A

By this Treaty, the High Contracting Parties establish among themselves a European Union, hereinafter called 'the Union'.

This Treaty marks a new stage in the process of creating an ever closer union among the peoples of Europe, in which decisions are taken as closely as possible to the citizen.

The Union shall be founded on the European Communities, supplemented by the policies and forms of co-operation established by this Treaty. Its task shall be to organize, in a manner demonstrating consistency and solidarity, relations between the Member States and between their peoples.

ARTICLE B

The Union shall set itself the following objectives:

- to promote economic and social progress which is balanced and sustainable, in particular through the creation of an area without internal frontiers, through the strengthening of economic and social cohesion and through the establishment of economic and monetary union, ultimately including a single currency in accordance with the provisions of this Treaty;
- to assert its identity on the international scene, in particular through the implementation of a common foreign and security policy including the eventual framing of a common defence policy, which might in time lead to a common defence;
- to strengthen the protection of the rights and interests of the nationals of its Member States through the introduction of a citizenship of the Union;
- to develop close co-operation on justice and home affairs;
- to maintain in full the *acquis communautaire* and build on it with a view to considering, through the procedure referred to in Article N(2), to what extent the policies and forms of co-operation introduced by this Treaty may need to be revised with the aim of ensuring the effectiveness of the mechanisms and the institutions of the Community.

The objectives of the Union shall be achieved as provided in this Treaty and in accordance with the conditions and the timetable set out therein while respecting the principle of subsidiarity as defined in Article 3b of the Treaty establishing the European Community.

Source: European Commission.

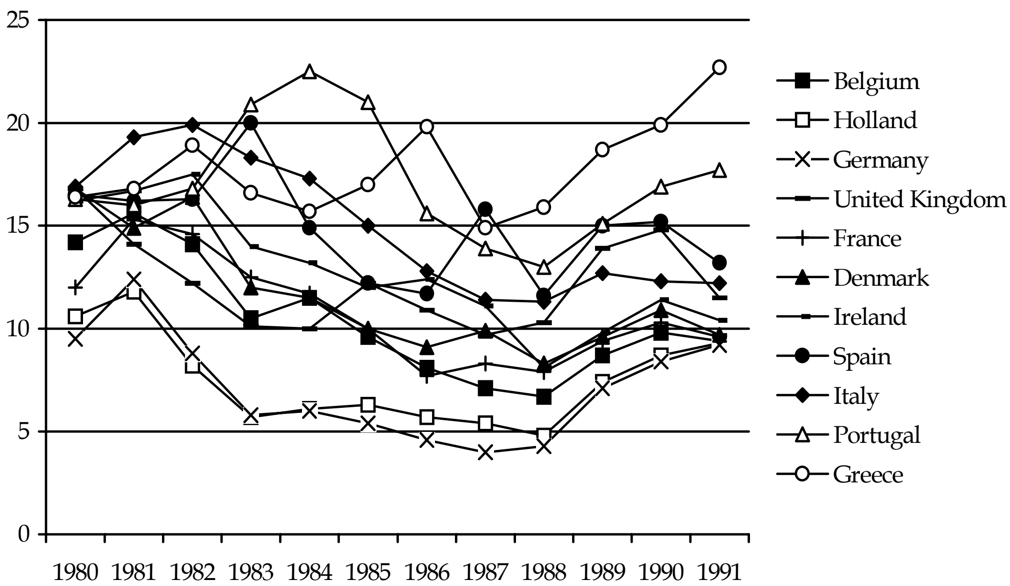
Exhibit 2 Economic Indicators, 1991

	Population (millions)	Unemployment Rate (%)	GDP (ECU billions)	GDP per Capita (ECUs)	Real GDP Growth (CAGR %)	
					1960–1979	1980–1991
Belgium	10.0	6.6	164	16,440	4.1	2.0
Denmark	5.2	8.4	108	20,846	3.4	1.5
Germany[a]	64.1	4.2	1,291	20,140	3.7	2.2
Greece	10.2	7.0	73	7,157	6.4	0.9
Spain	38.9	16.4	443	11,406	5.7	2.9
France	58.5	9.5	987	16,875	4.6	2.3
Ireland	3.5	14.7	38	11,029	4.5	3.5
Italy	56.8	8.6	939	16,542	4.7	2.2
Luxembourg	0.4	1.7	9	23,590	3.2	4.6
Netherlands	15.1	5.8	244	16,192	4.1	2.2
Portugal	9.9	4.2	65	6,636	5.6	3.1
United Kingdom	57.8	8.8	836	14,465	2.6	2.3

Source: Adapted from the European Commission, World Bank, Penn World Tables.

[a]Excluding five East German states.

Exhibit 3 Short-term Interest Rates of EC Member States, 1980–1991



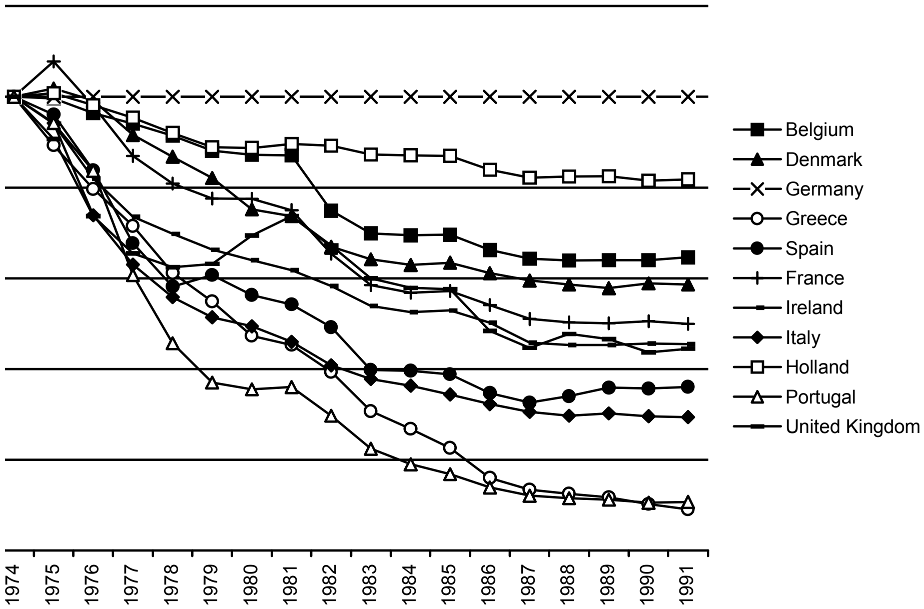
Source: Adapted from Eurostat.

Exhibit 4 National Economic Accounts, 1986–1992

	1986	1987	1988	1989	1990	1991	1992
United Kingdom							**(billions of pounds)**
Gross domestic product	385	424	471	515	550	573	595
Private consumption	243	268	302	331	350	368	386
Gross fixed capital formation	65	74	90	103	106	96	92
Increase/decrease (-) in stocks	1	1	5	3	-1	-5	-2
Government consumption	79	85	92	99	110	122	130
Exports of goods & services	98	107	108	122	134	135	140
Imports of goods & services	-101	-112	-125	-143	-148	-140	-150
Gross domestic product, 1985 prices	372	390	407	416	418	409	406
Germany							**(billions of DM)**
Gross domestic product	1,936	2,003	2,108	2,249	2,439	2,631	2,773
Private consumption	1,066	1,108	1,154	1,221	1,312	1,421	1,492
Gross fixed capital formation	374	386	410	449	507	565	597
Increase/decrease(-) in stocks	3	-6	10	16	3	-9	-13
Government consumption	383	397	412	419	444	468	499
Exports of goods & services	637	638	688	788	882	1,013	1,063
Imports of goods & services	-526	-525	-566	-644	-719	-827	-866
Gross domestic product, 1985 prices	1,874	1,902	1,972	2,050	2,150	2,227	2,245
France							**(billions of francs)**
Gross domestic product	5,069	5,337	5,735	6,160	6,506	6,747	6,999
Private consumption	3,050	3,236	3,430	3,656	3,872	4,044	4,211
Gross fixed capital formation	978	1,055	1,188	1,315	1,391	1,409	1,401
Increase/decrease(-) in stocks	17	21	40	59	61	24	-28
Government consumption	973	1,019	1,073	1,122	1,183	1,250	1,323
Exports of goods & services	1,074	1,101	1,221	1,411	1,468	1,532	1,617
Imports of goods & services	-1,022	-1,094	1,218	-1,403	-1,470	-1,511	-1,525
Gross domestic product, 1985 prices	4,818	4,927	5,149	5,368	5,504	5,544	5,621

Source: Adapted from *International Financial Statistics*, IMF.

Exhibit 5 DM Exchange Rate Index, 1974 = 1



Source: Adapted from Eurostat.

Exhibit 6 Total Trade and Intra-EU Trade as a Percentage of GDP, 1991

	Total Trade		Intra-EU Trade	
	Exports	Imports	Exports	Imports
Belgium	68.5	66.2	43.2[a]	43.2[a]
Denmark	37.2	31.3	17.2	16.0
Germany	26.3	26.5	14.3	13.0
Greece	18.0	27.0	6.4	15.2
Spain	16.3	19.6	8.0	10.7
France	21.5	22.0	11.4	11.5
Ireland	57.9	52.9	39.2	29.6
Italy	18.5	18.6	9.2	9.7
Luxembourg	114.9	115.9	43.2[a]	43.2[a]
Holland	54.1	50.6	33.1	28.1
Portugal	30.0	37.2	16.4	24.3
United Kingdom	23.2	24.2	10.8	11.4

Source: Adapted from Eurostat.

[a]Belgium and Luxembourg report consolidated intra-EU trade figures.

Exhibit 7 Net Contribution to the European Community, 1987–1992 (ECU millions)

	1987	1988	1989	1990	1991	1992
Belgium	-128	-104	-281	-757	-1,159	-1,497
Denmark	-103	-153	-16	-204	-69	125
Germany	4,540	5,505	5,690	4,903	8,207	9,072
Greece	-1,185	-1,137	-1,584	-2,327	-2,470	-3,327
Spain	-399	-1,272	-1,040	-1,412	-1,897	-2,007
France	1,096	2,175	3,254	2,107	2,872	2,018
Ireland		-890	-1,179	-1,751	-2,121	-1,897
Italy		1,207	2,694	1,897	3,044	2,175
Luxembourg	-309	-230	-382	-452	-493	-511
Holland	-710	-1,417	-1,648	-796	128	556
Portugal	-428	-512	-509	-626	-1,269	-1,822
United Kingdom	3,216	2,567	3,717	3,604	981	2,670

Source: Adapted from "EC Balance of Payments," Eurostat.

Exhibit 8 Representation in the Council of Ministers and the European Parliament, 1991

	European Parliament		Council of Ministers		
	Number of Members (1991)	Population per Seat (thousands)	Number of Votes[a]	Population per Vote (thousands)	Population (millions)
Belgium	24	419	5	2,009	10.0
Denmark	16	215	3	1,724	5.2
Germany	81	3,358	10	8,059	64.1
Greece	24	430	5	2,064	10.2
Spain	60	1,625	8	4,876	38.9
France	81	2,448	10	5,875	58.5
Ireland	15	148	3	1,185	3.5
Italy	81	2,369	10	5,686	56.8
Luxembourg	6	16	2	196	0.4
Holland	25	633	5	3,036	15.1
Portugal	24	411	5	1,972	9.87
United Kingdom	81	2,417	10	5,801	57.8
Total	**518**		**76**		**330.0**

Source: Adapted from European Commission.

[a]A qualified majority requires 54 votes.

Exhibit 9 Inflation, Long-term Interest Rates, Deficit, and Consolidated Gross Debt, 1991

	Inflation	Long-term Interest Rates	Government Deficit	Consolidated Gross Debt
	(percentage)		(percentage of GDP)	
Luxembourg	n.a.	8.2	-1.9	4
France	3.1	9.0	2.0	36
Ireland	2.1	9.2	2.3	97
United Kingdom	6.5	9.9	2.3	35
Denmark	1.9	10.1	2.4	62
Holland	3.6	8.9	2.8	77
Germany	4.3	8.6	3.4	40
Spain	6.6	12.5	4.3	44
Portugal	14.6	17.1	5.8	64
Belgium	3.1	9.3	6.2	129
Italy	7.2	12.9	10.0	100
Greece	20.0	n.a.	11.4	91
Maastricht criteria as of 1991[a]	**3.9**	**11.4**	**3.0**	**60**

Source: Adapted from Eurostat.

[a]Inflation and long-term interest rates follow moving targets based on the experience of the best-performing member states. Inflation should not exceed 1.5 percentage points over the average of the three member states with the lowest inflation. Long-term interest rates should not exceed 2 percentage points over the average of the three member states with the lowest inflation.

Exhibit 10 Popular Support for Specific EC Initiatives, March 1991 (percentage)

	Common Foreign Policy	Social Charter (worker protections)	More Important Role for European Parliament	European Central Bank	European Citizenship
Belgium	74	65	67	58	58
Denmark	58	56	31	45	28
West Germany	76	65	59	55	50
Greece	73	78	62	56	73
Spain	73	78	62	52	78
France	71	64	65	64	62
Ireland	60	73	53	55	65
Italy	68	75	72	64	73
Luxembourg	69	63	43	51	48
Netherlands	55	74	66	67	56
Portugal	64	77	66	58	71
United Kingdom	55	60	50	41	49
Total EC	64	69	61	56	61

Source: Adapted from Eurobarometer 35, spring 1991.

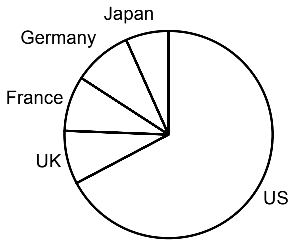
Exhibit 11 Survey Conducted Spring 1991: "Are you hopeful or fearful about German unification?"

(percent responding)

	Hopeful	*fearful*	*unsure*
Italy	70	13	17
Germany	65	30	5
Spain	64	10	26
Ireland	61	20	19
Holland	60	28	12
Portugal	59	18	23
Denmark	58	33	9
United Kingdom	53	33	14
Belgium	51	31	18
Greece	47	30	23
Luxembourg	46	32	22
France	46	42	12

Source: Adapted from Eurobarometer 35, spring 1991.

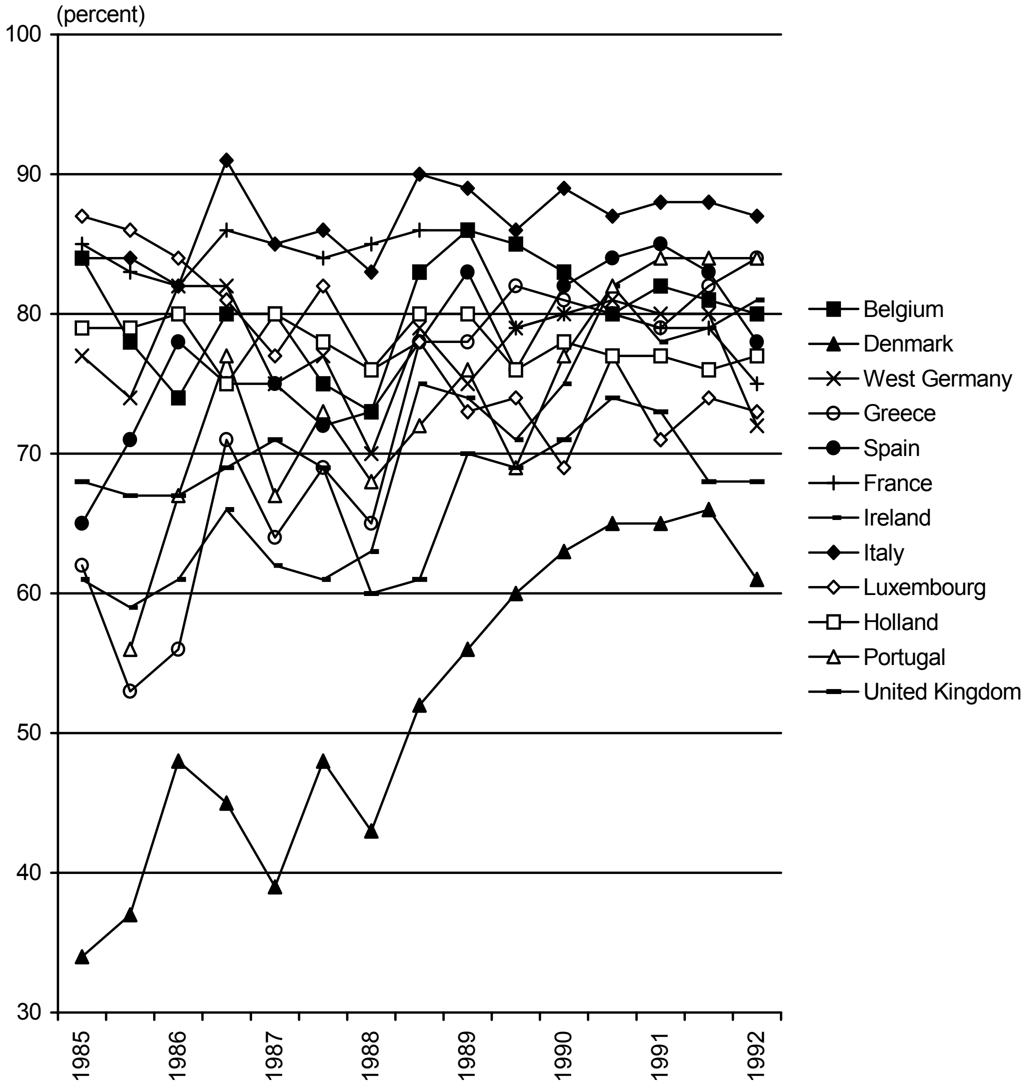
Exhibit 12 National Military Spending, 1990



	$ billions	*% of own GDP*
US	306	5.2%
UK	39	4.1%
France	39	3.6%
Germany	41	2.8%
Japan	31	1.0%

Source: Adapted from *World Military Expenditures and Arms Transfers 1998*, U.S. Department of State.

Exhibit 13 General Support for Efforts to Unify Western Europe, 1985–1991



Source: Adapted from Eurostat.

Exhibit 14 French Political Poster, Summer 1992

"Creating Europe makes us strong. Say *yes* to Europe on September 20."

Source: CIRIP.

Exhibit 15 French Popular Support for Maastricht, 1991, by Political Party

French Political Parties		Favor Maastricht Treaty	Oppose Maastricht Treaty	National Assembly Seats Won in 1988 Election
Left coalition	Communists (PC)	39%	61%	25
	Socialists (PS)	81%	19%	275
Right coalition	*Union pour la Democratie Francaise* (UDF)	61%	39%	131[a]
	Rassemblement pour la Republique (RPR)	33%	67%	130
	Total			575[b]

Source: Adapted from Assemblée nationale data.

[a]Including the *Union du Centre*, UDC.

[b]Fourteen *députés* had no party affiliation.

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