Ten Years with the Euro.
From the Single European Act to the Treaty of Lisbon

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Introduction

After World War II, Europe was devastated and the economies of Germany, France, Great Britain, and the Soviet Union were destroyed. By the end of 1945, Europe was in a state of social and political collapse and, consequently, had disappeared as an economic power. As the economic situation worsened in 1946 and 1947, the United States, under President Truman advised by U.S. Secretary of State George Marshall, put together the Marshall Plan that consisted of $400 million in economic aid.[1] The U.S. Congress passed the Marshall Plan legislation, officially known as the Economic Cooperation Act, on March 30, 1948. The Marshall Plan required the cooperation of countries receiving economic aid, eventually leading to the need for greater integration. In fact, in April 1948, countries receiving economic aid, as designated by the Marshall Plan, created the Organization for European Economic Cooperation (OEEC), which would become the seed of the future European Union.

The creation of the European Economic Community (EEC) in 1957 meant that European countries had to compete in the same market by exporting similar products to gain surplus at one another's expense. However, soon after the Common Market was created, not only was Germany's gross domestic product the biggest in Europe but also Germany was considered the "European Community's biggest market and most countries' largest European Trading partner" (Mitchener 1993, 1).

However, when European countries could not resist the German pressure, it became common practice to opt for a competitive devaluation. Competitive devaluations in France and Italy were the ammunition that really hurt the German manufacturing industry. A competitive devaluation in these two countries meant that German goods and products would become more expensive overnight in France and Italy; hence, German goods and services would suffer from a substitution effect. The loss of market share in France and Italy would do away with a large percentage of Germany's profits, "since France and Italy together absorbed more that 25% of total German exports" (Halevi, 13). For instance, between September 1991 and March 1995, the Italian government devalued the Italian lira by more than 60% against the German mark in order to gain competitiveness (Mitchener 1992).

This practice was such in the 1990's that countries with strong currencies asked the European Union to "punish governments whose currencies [were] devalued" (Friedman 1995, 1). Some countries even considered employing "retaliatory measures against those governments that had made use of competitive devaluations" (Friedman 1995, 1). Hence, in order to end currency fluctuations and competitive devaluations, the European Monetary System (EMS) came into effect on March 13, 1979. The EMS had the blessing of the Federal Republic of Germany (FRG) which wanted to ensure its export grounds and surpluses by putting European currencies under the leash of the Exchange Rate Mechanism (ERM). The EMS became a

[1] Or $4.4 billion in 2008 prices.

successful mechanism and was operative until December 31, 1998 when Member States fixed their currencies to the euro.

The Road to the Euro

Germany's H. Schmidt and France's V. Giscard D'Estaing engineered the European Monetary System (EMS) to ensure currency stability. David Marsh (1994) explains that the European Monetary System (EMS), introduced on March 13, 1979, became the ultimate plan designed to obtain monetary cooperation among members of the European Union in order to finally provide the currency stability necessary for the introduction of a common currency. Because European countries trade more with each other than with the rest of the world, it made sense for them to get rid of currency fluctuations and transaction costs in order to allow trade to flourish even more.

The EMS was designed around two key elements: the European Currency Unit (ECU) and the European Rate Mechanism (ERM). The ECU refers to a composed currency (or currency basket) formed by pre-determined percentages of each one of the participating currencies. This percentage is based on the contribution of each country to the gross national product of the Community. Table 1 shows how the German mark was the largest element of the basket due to its repeatedly proven stability.

Table 1. ECU: Value and Percentage Weight of European Currencies during the Different stages of the ERM

	13 March 1979 through 16 Sept. 1984		17 Sept. 1984 through 21 Sept. 1989		21 Sep 1989 through 31 Dec 1999	
	Value	Weight (%)	Value	Weight (%)	Value	Weight (%)
Belgian fancs	3.8	9.64	3.85	8.57	3.301	8.183
German marks	0.828	32.98	0.719	32.08	0.6242	31.915
Danish krones	0.217	3.06	0.219	2.69	0.1976	2.653
Spanish peseta					6.885	4.138
French francs	1.15	19.83	1.31	19.06	1.332	20.306
British pounds	0.0885	13.34	0.0878	14.98	0.08784	12.452
Greek drachmas			1.15	1.31	1.44	0.437
Irish punts	0.00759	1.15	0.00871	1.2	0.00855	1.086
Italian lira	109	9.49	140	9.98	151.8	7.84
Lux. francs	*	*	*	*	0.13	0.322
Dutch gilder	0.086	10.51	0.256	10.13	0.2198	9.87
Portuguese escudo					1.393	0.695

The exchange rate mechanism was considered the most important pillar of the EMS. For each of the participating currencies, the EMS established a central type of exchange rate to the ECU, or central pivot, and some exchange rates for each currency with respect to the remainder (lateral pivots). The aim of this basket was to prevent

currencies movements[2] around parity in bilateral exchange rates with other member countries.

In April 1989, Jacques Delors outlined what became known as the Delors Report to introduce the EMU. The goal of the EMU was to help countries adopt the common currency, the euro. Granell (1989) explains that the final approval for Delors Report and the introduction of the euro took place at the informal ECOFIN meeting on May 19-20, 1989, at the Hotel La Gavina in S'Agaro on the Costa Brava (Spain). This ECOFIN meeting took place in Spain because from January to June 1989 Spain held the Presidency of the European Council. Consequently, the Delors Report was adopted as the roadmap to work on the creation of the EMU during the Madrid European Council that took place in June 1989.

The Delors Report was a thorough three-stage plan. Stage one of the Delors Report, also known as the preparatory phase, stated that the Member States of the EU needed, from July 1990 to December 1993, to implement the first of the "four freedoms": the liberalization of capital movements. The 1992 Maastricht Treaty, which entered into force in November 1993, thoroughly spelled out specific targets concerning inflation rates, public finances, interest rates, and exchange rate stability. These requirements, which became to be known as the Convergence criteria or Maastricht criteria,[3] established the economic requirements that had to be observed by those EU countries willing to adopt the euro. Table 2 summarizes these requirements.

Table 2. Summary of the Maastricht Treaty criteria

Target	Requirement
Inflation rate	No more than 1.5 percentage points higher than the 3 best-performing Member States of the EU.
Public finances	The ratio of the annual government deficit to gross domestic product must not exceed 3% at the end of the preceding fiscal year.
Interest rates	The nominal long-term interest rate must not be more than 2 percentage points higher than the 3 best-performing Member States.
Exchange rate stability	Applicant countries should have joined the exchange rate mechanism under the European Monetary System for 2 consecutive years and should not have devaluated its currency during the period.

[2] Currency oscilation of + and – 6% for Italy and of + or – 2.25% for the rest of the currencies participating in the EMS.

[3] The part of the Maastricht Treaty related to the EMU can be divided into two parts. One part addresses the provisions related to the transition to monetary union; that is, the convergence criteria. The second part relates to the macroeconomic policy of the completed union.

Stage two of the Delors Report, also known as the transitional phase, covered the period from January 1994 to December 1998. During this phase, a new Exchange Rate Mechanism (ERM II) was set up in order to provide currency stability between the euro and the national currencies of those countries that were not yet part of the Eurozone. When the first eleven countries adopted the euro, the EMR was substituted by the ERM II. On March 16, 2006, the national central banks of Member States outside the euro, but aspiring to adopt the common currency, agreed on operating procedures for an exchange rate mechanism in stage three of Economic Monetary Union (EMU).[4] The main purpose of the ERM II is to make sure that EU Member States that want to adopt the euro succeed in implementing the adequate policies to maintain stable exchange rates between the euro and the participating national currencies. Table 3 indicates the exchange rates that some Member States must maintain in order to comply with exchange rate stability.

Table 3. National Exchange Rate to euro and Fluctuation Bands

Member State (national currency)	**Central rate (EUR 1)**	**Fluctuation band**
Denmark (krone)	7.46038	+/- 2.25%
Estonia (kroon)	15.6466	+/- 15%
Lithuania (litas)	3.45280	+/- 15%
Latvia (lats)	0.702804	+/- 15%

Additionally, the report specified that by June 1, 1998, the ECB would become the ultimate monetary authority, and the European Council decided at the Amsterdam meeting to adopt the Stability and Growth Pact (SGP) to ensure budgetary and fiscal discipline after the creation of the euro. On December 31, 1998, the conversion rates between the eleven participating national currencies[5] and the euro were established. These conversion rates were put in place on January 1, 1999, with the irrevocable fixing of the exchange rates of those eleven national currencies participating in the Eurozone.

Enforcing of conversion rates on January 1, 1999, triggered the start of the final stage of the Delors Report. On that date, the euro currency became a reality, and a single monetary policy was introduced under the authority of the ECB. Although the conversion rates for the euro were put in place on January 1, 1999, actual euro notes and coins were not in circulation until January 2002; this delay was intentional to provide a transition period for those eleven countries adopting the euro. Hence, those eleven national currencies legally ceased to exist on December 31, 1998 and on January 1, 1999, the Eurozone was born.

[4] Europa, "Exchange rate mechanism (ERM II) between the euro and participating national currencies," Institutional and Economic Framework of the Euro. http://europa.eu/scadplus/leg/en/lvb/l25082.htm (accessed December 2, 2008).

[5] Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, and Finland.

Greece, which that was not able to meet the convergence criteria to join in 1999, finally qualified in 2000 and was admitted to the Eurozone on January 1, 2001. Denmark[6], Sweden[7], and the United Kingdom[8] did not adopt the euro; these three countries are part of the EMU but still not part of the Eurozone. Of the ten new countries that joined the EU in 2004, Slovenia qualified in 2006 to adopt the euro on January 1, 2007, and Cyprus and Malta adopted the euro on January 1, 2008. Finally, Slovakia joined on January 1, 2009. Therefore, as of January 1, 2009 the Eurozone has sixteen Member States.

Table 4. List of EU countries, National Currencies, and euro Actual and Expected Adoption Date

Country (Native Currency)	EMU Entry Date Actual	EMU Entry Date - Expected
Austria (Austrian schilling)	January 1, 1999	
Belgium (Belgian franc)	January 1, 1999	
The Netherlands (Dutch gilder)	January 1, 1999	
Finland (Finnish markka)	January 1, 1999	
France (French franc)	January 1, 1999	
Germany (German mark)	January 1, 1999	
Ireland (Irish pound)	January 1, 1999	
Italy (Italian lira)	January 1, 1999	
Luxembourg (Lux. franc)	January 1, 1999	
Portugal (Portuguese escudo)	January 1, 1999	
Spain (Spanish peseta)	January 1, 1999	
Greece (Greek drachma)	January 1, 2001	
Denmark (Danish krone)		Never joined
Sweden (Swedish krone)		Never joined
United Kingdom (Sterling pound)		Never joined
2004 EU Enlargement		
Cyprus (Cypriot pound)	January 1, 2008	
Czech Repub. (C. korine)		2013
Estonia (Estonia kroon)		2011
Hungary (Hungaran forint)		2012
Latvia (Latvia lats)		2013
Lithuania (Lithuania lites)		2010
Maltan (Maltese lira)	January 1, 2008	
Poland (Polish zloty)		2012
Slovenia (Slovenian tolar)	January 1, 2007	
Slovakia (Slovak korune)	January 1, 2009	
2006 EU enlargement		

[6] Denmark has an “opt-out” clause from the Masstricht Treaty. The country held two referéndums and both rejected the adoption of the euro, the latest public referendum took place in 2000.

[7] Sweden has to join the euro by the 1994 Act of Accession agreement. Although Sweden was not at, the beginning, meeting the economic conditions to join the Eurozone, in 2003 the country was meeting the requirements; however, a public referendum rejected euro membership.

[8] The U.K. has an opt-out from eurozone membership under the Maastricht treaty. The U.K. meets the economic conditions to join the Eurozone; however, the Government has not yet put the question to public referendum.

Country (Native Currency)	EMU Entry Date Actual	EMU Entry Date - Expected
Bulgaria (Bulgaria lev)		2012
Romania (Romania leu)		2014

The Introduction of the euro: Treaties that Shaped the Common Currency

The introduction of the euro as common currency in sixteen Member States is the result of arduous negotiations and numerous compromises among governments and citizens of twenty-seven countries comprising the European Union.

The EU has been shaped by a number of treaties all of which have influenced the introduction of the common currency. The most significant Treaties are the Single European Act, the Maastricht Treaty, and the Lisbon Treaty once it gets ratified by all Member States.

The Single European Act (SEA) and the euro

The Single European Act (SEA)[9] is the first major revision of the Treaty of Rome. It was signed in February 1986 and entered into force on July 1, 1987 with the main objective to introduce the steps necessary to help gradually reach a full single market in the EU by 1992. This single market has erased national borders, bringing national economies closer together, and forcing governments into economic integration. Scheller (2006, 20) believed that, in order for the single market to achieve its full potential, it needed a common currency to "ensure greater price transparency for consumers and investors, eliminate exchange rate risks within the single market, reduce transaction costs and, as a result, significantly increase economic welfare in the Community."

Treaty	Contribution
The Single European Act (SEA) • Signed on: February 17 in Luxembourg and on February 28, 1986 in the Hague • Entered into forced on: July 1, 1987	**Objective**: to improve the economic and social situation by extending common policies and pursuing new objectives: the Single Market **Article 20:** Introduced a new Chapter 1 in Part three, Title II of the EEC Treaty reading: *Cooperation in Economic and Monetary Policy (Economic and Monetary Union)* **Article 23**: A title V shall be added to Part Three of the EEC Treaty: - *Title V: Economic and Social Cohesion*

[9] Euro-Lex, ¨Single European Act,¨ *Official Journal L 169 of 29 June 1987*. http://eur-lex.europa.eu/en/treaties/index.htm (accessed December 12, 2008).

Article 20 of the SEA introduces a new chapter – Chapter 1. This Chapter is titled Cooperation in Economic and Monetary Policy (Economic and Monetary Policy) and its Article 102.a declares that

> In order to ensure the convergence of economic and monetary policies which is necessary or the further development of the Community, Member States shall co-operate in accordance with the objectives of Article 104. In so doing, they shall take account of the experience acquired in co-operation within the framework of the European Monetary System (EMS) and in developing the ECU, and shall respect existing powers in the field.

Article 23 of the SEA introduces a Title V on Economic and Social cohesion which Article 130a states that

> In order to promote its overall harmonious development, the Community shall develop and pursue its actions leading to the strengthening of its economic and social cohesion. In particular, the Community shall aim at reducing disparities between the various regions and the backwardness of the least-favoured regions.

Further Article 130b states that

> Member States shall conduct their economic policies, and shall coordinate them, in such a way as, in addition, to attain the objectives set out in Article 130a. The implementation of the common policies and of the internal market shall take into account the objectives set out in Article 130a and in article 130c and should contribute to their achievement. The Community shall support the achievement of these objectives by the action it takes through the structural Funds (European Agricultural Guidance and Guarantee Fund, Guidance Section, European Social Fund, European Regional Development Fund), the European Investment Bank and the other existing financial instruments.

As the EU project was getting consolidated and the idea of a monetary and economic union was becoming more popular. The Treaty on the European Union, or Maastricht Treaty, signed on February 7, 1992, introduced Title VI on "Economic and Monetary Policy." This Title sets the structure of the EMU by introducing the Convergence criteria which established the requirements that Member States must achieve in order to adopt the euro.

The Lisbon Treaty, once it is ratified by all countries and entered into force, does not alter the requirements of the Maastricht Treaty but does, however, include for the first time the "exit clause" for those countries deciding to leave the EU.

The Maastricht Treaty: The introduction of Economic and Monetary Policies

The success of the Economic and Monetary Union (EMU) and the euro rests on three pillars: the credibility of monetary and economic policies achieved through the commitment of Eurozone Member States to maintain price stability; the observance of the fiscal criteria; and, the implementation of structural policies, particularly in the labor market.

Meeting these three sets of requirements is the major guarantor of a long-lasting euro. *Price stability* is the result of a sound and indivisible monetary policy implemented by the European Central Bank at a supranational level. *Fiscal criteria* are a set of fiscal requirements that must be achieved at the national level to maintain control of government debts and spending. *Structural policies* are policies implemented by national governments to achieve, for instance, the requirements established by the Lisbon Strategy to improve the labor market and strengthen social cohesion. The connection between monetary policy, economic policy, and the EMU is depicted in table 5

Table 5. Connection Between the EMU and the Monetary and Economic Policy

Economic and Monetary Union (EMU)	
A. Monetary Policy	**B. Economic Policy:**
-1. European Central Bank (ECB)	-2. Fiscal Policy: Stability and Growth Pact (SGP)
	-3. Structural Policies: Lisbon Agenda

The Maastricht Treaty, signed on February 7, 1992, introduced a chapter on the foundation of EMU as well as the *Convergence criteria or Maastricht criteria,*[10] that is, the economic and monetary requirements European Union Member States must fulfill in order to be eligible to adopt the euro and become part of the EMU.

The requirements for the Maastricht criteria are specified in the Protocol ¨On the Convergence criteria¨ which, in six articles, set the requirements that must be respected in order to adopt the euro.

Table 6. Protocol on the Convergence Criteria

PROTOCOL
ON THE CONVERGENCE CRITERIA REFERRED TO IN ARTICLE 109j OF THE TREATY ESTABLISHING THE EUROPEAN COMMUNITY

THE HIGH CONTRACTING PARTIES,

DESIRING to lay down the details of the convergence criteria which shall guide the Community in taking decisions on the passage to the third stage of economic and monetary union, referred to in Article 109j(l) of this Treaty,

HAVE AGREED upon the following provisions, which shall be annexed to the Treaty establishing the European Community:

ARTICLE 1
The criterion on price stability referred to in the first indent of Article 109j(l) of this Treaty shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1½ percentage points that of, at most, the three best performing Member States in terms of price stability. Inflation shall be measured by 30 means of the consumer price index on a comparable basis, taking into account

[10]Europa Glossary, “Convergence Criteria.” http://europa.eu/scadplus/glossary/convergence_criteria_en.htm (accessed August 27, 2008).

differences in national definitions.

ARTICLE 2
The criterion on the government budgetary position referred to in the second indent of Article 109j(l) of this Treaty shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 104c(6) of this Treaty that an excessive deficit exists.

ARTICLE 3
The criterion on participation in the Exchange Rate Mechanism of the European Monetary System referred to in the third indent of Article 109j(l) of this Treaty shall mean that a Member State has respected the normal fluctuation margins provided for by the Exchange Rate Mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against any other Member State's currency on its own initiative for the same period.

ARTICLE 4
The criterion on the convergence of interest rates referred to in the fourth indent of Article 109j(l) of this Treaty shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best performing Member States in terms of price stability. Interest rates shall be measured on the basis of long term government bonds or comparable securities, taking into account differences in national definitions.

ARTICLE 5
The statistical data to be used for the application of this Protocol shall be provided by the Commission.

ARTICLE 6
The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, the EMI or the ECB as the case may be, and the Committee referred to in Article 109c, adopt appropriate provisions to lay down the details of the convergence criteria referred to in Article 109j of this Treaty, which shall then replace this Protocol.

All these requirements must be met and respected by those countries willing to adopt the euro as a common currency. Once the euro has been adopted, countries must comply with the economic and monetary requirements established in *Title VI of the Maastricht Treaty.*[11] This title sets the rules to respect and the procedures to follow for the proper functioning of the Eurozone and the success of the euro.

Table 7. Summary of the Maastricht Treaty

Treaty	Contribution
Treaty on European Union Signed on: February 7, 1992 in Maastricht Entered into forced on:	Sets its objectives in connection with the EMU to: Establish an **accurate calendar** to carry out EMU, split into three phases. Introduces **Common Provision, Article 2**: *to promote economic and social progress* which is balanced and sustainable, in

[11] Euro-Lex, ¨Treaty on European Union,¨ *Official Journal C 191, 29 July 1992.* http://eur-lex.europa.eu/en/treaties/dat/11992M/htm/11992M.html (accessed December 26, 2008).

November 1, 1993	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*. **Title VI: Economic and Monetary Policy** *Chapter 1*: Economic policy – Article 104 Art 102.a: - Free competition Art 103: - Guidelines of the economic policies Art 104C-1: - Excessive government deficits Art 104C-2a: - Government deficit to GDP Art 104C-2b: - Government debt to GDP - Protocol on excessive Deficit Procedures *Chapter 2*: Monetary policy – Article 105 Art 105.1: objective: price stability by European System of Central Banks (ESCB) Art 105.2: explains tasks of ESCB Art 107: Independence of the ESCB *Chapter 3*: Institutional provisions

Chapter 1: Economic Policy

The Maastricht Treaty deals with the Economic Policy in Chapter 1, Title VI. Article 102.a explains that Member States and the Community not only should respect the principle of an open market economy with free competition but also "conduct their economic policies with a view to contributing to the achievement of the objectives of the Community." In order to guide this achievement, Article 103 highlights that the correct implementation of economic policies is a matter of common concern. It also sets the procedure to follow stating that ¨Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council, in accordance with the provisions of Article 102a.¨

Chapter 1, therefore, focuses on spelling the importance of avoiding excessive government deficits and points outs that "the reference values are specified in the Protocol on the excessive deficit procedure annexed to this Treaty." For that matter, Article 104.C.3 clearly explains that "if a member state does not fulfill the requirements under one or both of these criteria, the Commission shall prepare a report," stressing the importance of these two requirements for the proper functioning of the common currency.

Moreover, the EU has in place the Stability and Growth Pact (SGP). The SGP, adopted by the European Council at the Dublin Summit in December 1996, consists of Council Regulations 1466/97 and 1467/97. The SGP requires adherence to the fiscal policies that Member States of the EU must comply with to help "contribute to the overall climate of stability and financial prudence underpinning the success of Economic and Monetary Union (EMU)."[12] In particular, Council Regulation

[12] EurActiv, "Stability and Growth Pact," Economy and Euro, December 7, 2004. http://www.euractiv.com/en/euro/stability-growth-pact/article-133199 (accessed September 1, 2008).

14466/97[13] was signed on July 7, 1997 and is titled "on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies." The purpose of this regulation is to set out

> the rules covering the content, the submission, the examination and the monitoring of stability programmes and convergence programmes as part of multilateral surveillance by the Council so as to prevent, at an early stage, the occurrence of excessive general government deficits and to promote the surveillance and coordination of economic policies.

In addition, Council Regulation 1467/97 was signed on July 7, 1997 and it is titled "On speeding up and clarifying the implementation of the excessive deficit procedure." The purpose of this regulation is to set out "the provisions to speed up and clarify the excessive deficit procedure, having as its objective to deter excessive general government deficits and, if they occur, to further their prompt correction."

Opponents of the SGP believe that the SGP is pro-cyclical and anti-growth. Bini Smaghi (2007, 2) explains that "the 3% deficit ceiling set by the Maastricht treaty, which tends to be reached in cyclical downturns, is likely to push countries to adopt corrective measures in bad times and thus to implement pro-cyclical budgetary policies." Evidence that the SGP had a pro-cyclical effect—particularly during an economic downturn—convinced heads of state and government to reform the SGP and during the March 2005 Summit, it was agreed to revise the SGP. The result was that rules were relaxed to make the SGP more enforceable.

Despite its dissenters, the SGP remains one of the most important policies of the Directorate General for Economic and Financial Affairs, led by Commissioner[14] Joaquín Almunia. The SGP is considered the answer to those with concerns on the continuation of budgetary discipline in Economic and Monetary Union (EMU) (EUB2 2006). The SGP forces Eurozone Member States to coordinate national government budget policies to avoid excessive government budget deficits. In particular,

Chapter 2: Monetary Policy

The Maastricht Treaty in its Title VI, Chapter 2, sets the basis for the monetary policy of the EU. Hence, the European Central Bank (ECB) has been responsible for implementing the adequate monetary policy and introducing a new monetary system for the Eurozone. Further, it is considered to be a supranational monetary organization because the Maastricht Treaty took monetary policy-making from the national level to the supranational level. Hence, the ECB became an independent body and its monetary policy-making has been shielded from possible political influences.

[13] Euro-Lex, "Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies." http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997R1466&model=guichett (accessed January 2, 2009).

[14] Europa, Getaway to the European Union. Economic and Financial Affairs DG. *Directory Chart*, October 7, 2005. http://europa.eu.int/comm/dgs/economy_finance/organisation/ecfin_org_chart_en.pdf (accessed November 1, 2008).

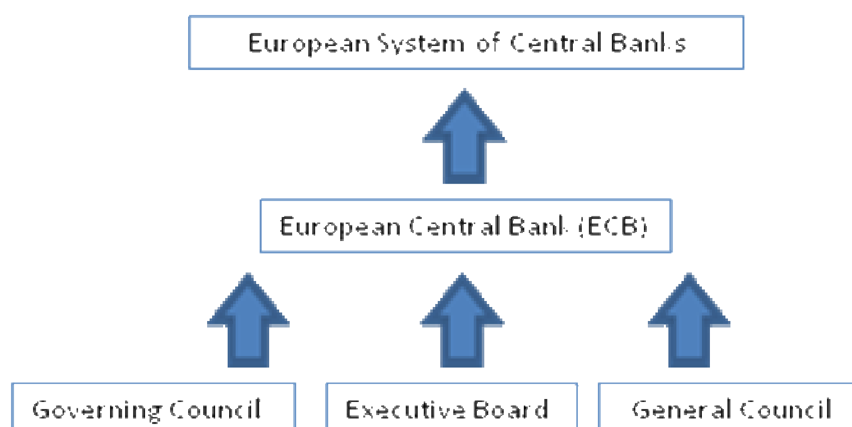
The predecessor of the ECB, the *European Monetary Institute* (EMI), was established during the second stage of the EMU as a transition vehicle to the ECB. The duties of the EMI are specified in Article 109f of the Maastricht Treaty[15].

Table 8. The European Monetary Institute and the European Central Bank

ARTICLE 109 f 1. At the start of the second stage, a European Monetary Institute (hereinafter referred to as 'EMI') shall be established and take up its duties; it shall have legal personality and be directed and managed by a Council, consisting of a President and the Governors of the national central banks, one of whom shall be Vice-President. The President shall be appointed by common accord of the Governments of the Member States at the level of Heads of State or of Government, on a recommendation from, as the case may be, the Committee of Governors of the central banks of the Member States (hereinafter referred to as 'Committee of Governors') or the Council of the EMI, and after consulting the European Parliament and the Council. The President shall be selected from among persons of recognized standing and professional experience in monetary or banking matters. Only nationals of Member States may be President of the EMI. The Council of the EMI shall appoint the Vice-President. The Statute of the EMI is laid down in a Protocol annexed to this Treaty. The Committee of Governors shall be dissolved at the start of the second stage.

The ECB was founded on June 1, 1998, and began operations on January 1, 1999, when the euro was introduced. The Maastricht Treaty in its Title VI, Chapter 2, sets up the structure for and functions of the *European System of Central Banks* (ESCB) and the ECB. The ECB, together with the national central banks (NCBs) of Eurozone Member States, form the *Eurosystem*. Further, the ECB and the central banks of all the EU Member States form the ESCB. The relationship among these various banking entities and their governing bodies is depicted in Table 9.

Table 9. Relationship Among EU Banking Entities and their Governing Bodies.



[15] The Maastricht Treaty: Provisions Amending the Treaty Establishing the European Economic Community with a view to Establishing the European Community. http://www.eurotreaties.com/maastrichtec.pdf (accessed September 13, 2008).

The ECB is comprised of the Governing Council, the Executive Board, and the General Council. *The Governing Council* is the most important decision making body in the ECB. It is responsible for establishing monetary policy and interest rates. It is comprised of the Executive Board of the ECB and the governors of the NCBs of the countries in the Eurozone that, when making decisions involving monetary policies, are not representing their countries' interests but rather acting as independent entities seeking the best position for the Eurozone. In essence, monetary policy decisions are made on the basis of *one person, one vote*. The *Executive Board* is formed by the ECB's president, vice president, and up to four other members in charge of implementing the monetary decisions made by the Board and informing the various EU Member States' NCBs of these decisions. Finally, the *General Council* is composed of the ECB's president, vice-president, and the governors of the NCBs of all EU Member States. Governors of those EU countries that have not yet adopted the euro cannot participate in decisions related to the euro, although they are invited to participate in discussions involving monetary policy issues.

In addition to its responsibility to set and maintain centralized monetary policy, the ECB is also responsible—as stated in Chapter 2, Article 105.2 of the Maastricht Treaty—for conducting *foreign exchange operations* as well as *maintaining the banking payment system* to ensure a stable financial system. Finally, Article 105 explains that the ECB (2) has the mandate to act "in accordance with the principle of an open market economy with free competition, favoring an efficient allocation of resources and in compliance with the principles set out in Article 3a."[16]

The ECB was designed to be independent (Article 107) from Member States and EU institutions. In order to achieve this objective, the ECB followed the structure of the German Bundesbank[17], which outfitted the ECB with political independence and was assigned its own budget to arm it with financial independent.[18]

Such unprecedented expansive authority is the reason why the ECB has been considered the most powerful independent institution not only in the Eurozone, but also in the EU. According to Petr Doucek (2005, 4) the ECB is the "embodiment of modern central banking […] It is independent within a clear and precise mandate; and it is fully accountable to the citizens and their elected representatives for the execution of this mandate."[19] Specifically, the second paragraph of Article 107 of the Maastricht Treaty proclaims the ECB's independence from other European Union institutions and national governments, emphasizing that European official should "respect this principle and not seek to influence the members of the decision-making bodies of the ECB."[20] Nevertheless, its independence relies on its legitimacy, which is granted because the ECB is accountable in front of democratic institutions. Hence, the ECB

[16] The Maastricht Treaty: Provisions Amending the Treaty Establishing the European Economic Community with a view to Establishing the European Community. http://www.eurotreaties.com/maastrichtec.pdf (accessed September 13, 2008).

[17] The Bundesbank governance structure: a president, a vice president, and two additional board members put forward by the German government. Four additional members of the executive board put forward by the Bundesbank.

[18] European Central Bank, "Independence." http://www.ecb.int/ecb/orga/independence/html/index.en.html (accessed September 13, 2008).

[19] Petr Doucek, "European Integration. Viribus Unitis – Bak to ideas of the "K & K" Traditions in the New Dimensions." http://www.sea.uni-linz.ac.at/conferences/idimt2005/session_a.pdf (accessed November 4, 2008).

[20] The Maastricht Treaty: Provisions Amending the Treaty Establishing the European Economic Community with a view to Establishing the European Community. http://www.eurotreaties.com/maastrichtec.pdf (accessed September 13, 2008).

is required to publish quarterly reports on the activities of the Eurosystem as well as a consolidated Weekly Financial Statement. In addition, it has to produce an Annual Report on its activities and on the monetary policy of the previous and the current year. The Annual Report has to be addressed to the European Parliament, the EU Council, the European Commission and the European Council.[21]

Nevertheless, the policy of independence has been repeatedly challenged by French President Nicolas Sarkozy. He has recently proposed to enforce publication of the ECB's meeting minutes and to enforce greater political co-ordination between national governments and the ECB; two proposals in total confrontation with the idea of independence stated in Article 107. President Sarkozy has blamed the ECB for maintaining a monetary policy that was oriented to fight an inflation that, in his opinion, did not exist. Parker and Atkins (2007, 1) explained that this monetary policy was "forcing up interest rates and the value of the euro against the dollar and other currencies" which, in turn, Sarkozy blamed for the negative economic performance of most Eurozone Member States.

The Treaty of Lisbon: Its future influence in the euro

The EU is currently on the verge of approving the "Treaty on the Functioning of the European Union" (TFEU) or Treaty of Lisbon. Title VIII of the consolidated version on the TFEU is titled "Economic and Monetary Policy" and has five important chapters relevant for the functioning of the Eurozone and the euro as a common currency.

Table 10. Treaty of Lisbon: Title VIII

Chapter	Title	Articles
Chapter 1	Economic Policy	120-126
Chapter 2	Monetary Policy	127-133
Chapter 3	Institutional Provisions	134-135
Chapter 4	Provisions specific to Member States whose currency is the euro	136-138
Chapter 5	Transitional Provisions	139-144

In this Title VIII, Article 119 highlights that the EU is an open market economy which encourages free competition. Article 121.1 maintains that "Member States regard their economic policies as a matter of common concern and shall coordinate them within the Council." Article 121.3 explains that in order to make sure that there is coordination of economic policies among Member States, the Council "shall, on the basis of reports submitted by the Commission, monitor economic developments in each of the Member States and in the Union as well as the consistency of economic policies." It is also reminded the necessity of economic coordination as well as the

[21]European Central Bank, "Accountability." http://www.ecb.int/ecb/orga/accountability/html/index.en.html (accessed September 13, 2008).

importance of stable prices, sound public finances, and a balanced balance of payments. It is extremely important Article 125 which explains that neither the EU nor individual Member States are responsible for any other State debt liability. In this spirit the article reads that

> The union shall not be liable for or assume the commitments of central governments, regional, local, or other public authorities, other bodies governed by public law, or public undertakings of any member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local, or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.

For this matter, Article 126 reminds that Member States must keep on avoiding excessive government deficits by respecting government debt deficits and debt under the requirements specific in the Protocol.

Chapter 2, on Monetary Policy, reminds (Article 127) that the European System of Central Banks must maintain price stability, and, Article 128.1 explains that the European Central Bank has the "exclusive right to authorize the issue of euro banknotes within the union." Furthermore, Article 128.2 points out that "Member States may issue euro coins subject to the approval by the European Central Bank of the volume of the issue."

Chapter 4 specifies provisions that Member States using the euro must respect "in order to ensure the proper functioning of the economic and monetary union." Among them, the importance of maintaining coordination with respect to budgetary dis cipline and set out the economic guidelines that must be respected.

Finally, the Treaty of Lisbon includes for the first time an "exit clause" for those EU Member States that want to leave the EU. This "exit clause" was introduced in the failed "Treaty establishing the Constitution for Europe."[22] The failed Constitution included Article 60 titled "Voluntary Withdrawal from the Union" which has been maintained in the Treaty of Lisbon setting the "exit clause." In fact, point 40 of the "Explanatory Memorandum on the Treaty of Lisbon" published by the Foreign and Commonwealth Office of the U.K. explains that the Treaty "recognises a Member State's right to withdraw from the European Union and sets out procedures providing for such an eventuality."[23] However, this clause will become available once the Treaty of Lisbon is approved by all Member States and entered into force.

Conclusion

The introduction of the Economic and Monetary Union (EMU) and the adoption of the euro as common currency has been a long road guided by treaties that have shaped the EU.

[22] Europa, "Treaty establishing a Constitution for Europe". http://europa.eu/scadplus/constitution/index_en.htm (accessed January 6, 2009).

[23] Foreign and Commonwealth Office, "Explanatory Memorandum on the Treaty of Lisbon." http://www.fco.gov.uk/en/about-the-fco/publications/treaty-command-papers-ems/explanatory-memoranda/explanatory-memoranda-2007a/lisbontreaty (accessed November 2, 2008).

The SEA established the common market and induced the necessity to have a common currency. The Treaty of Maastricht shaped the EMU and set the stages and requirements necessary to be part of the Eurozone. It further set the structure necessary to sustain the viability of the common currency. Despite the fact that certain measures recognized in the Treaty of Maastricht have been criticized as rigid and counterproductive, the Treaty of Lisbon will maintain them. These requirements have been proven vital to warrant the euro's worldwide recognition as common and international currency.

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