Cumulative Regional Decline, Institutional Inadequacy and the "Democratic Deficit": Is European Monetary Union Economically and Politically Sustainable?

by

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EMU now seems increasingly likely to progress as planned with a broad membership of eight to ten countries in 1999. The political determination of Europe's leaders has developed a momentum that makes the birth of the *Euro* ever more likely. Other influential people also support the introduction of the single currency, amongst them bankers, farmers and large corporations who operate in many European currencies. Current discussions focus on the technical details of EMU: the interpretation of the Maastricht 'convergence criteria', speculation of who might be 'in' and who might be 'out', the re-denomination of national debts, and the operational structure of the European Central Bank (ECB). These debates deflect attention from a very much more fundamental issue of enormous importance.

This paper will examine the economic case for EMU. It will contrast the economic benefits of EMU with the dramatically important sacrifices which Member States have made by signing the Maastricht Treaty. Unless the true objective of EMU is something quite different to what we are led to believe, it is astonishing that EMU has been able to progress so far given the weakness of the economic case in its favour. It will discuss the traditional role of government in running its own affairs and will demonstrate the implications of EMU in severely restricting policy choice.

The paper will suggest that without the parallel development of other European institutions, the current design for EMU has the potential to become disordered and break down. For EMU to function in a way that genuinely benefits the people of Europe, movement towards an overt political union, however dressed up and amorphously defined, will inevitably be required. The study will discuss the political benefits of closer European union and will assess different national motivations for closer European political integration. It will discuss whether monetary union is the first step of a policy package towards full social and political union.

The paper will then address the larger issue of whether the single currency is the best way to contribute to the achievement of a united Europe. It will make an argument that tensions created by the current design of the single currency *could* build a momentum which may threaten European unity. It will suggest that the biggest argument in support of EMU is the combined will of Europe's people and the existence of a genuine 'European spirit'[1]. This is not to denigrate the noble quest for Monetary Union but to highlight the potential dangers of attempting to achieve Political Union *by* Monetary Union. An inadequate and ill-considered EMU design has the potential to threaten the long-term sustainability of the broader European project.

The study endorses the view of Richard Cooper that a distinction must be maintained between 'the desirability of the objective [monetary union] - which is sure to be controversial - and the desirability of the Maastricht Treaty as the surest and best way to achieve the objective'[2].

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[1] Volker Clausen and Manfred Willms (1994) 'Lessons from German Monetary Union for European Monetary Union' *Journal of International and Comparative Economics* 3, 195-228. The authors maintain that Germany could absorb the substantial adjustment problems of unification because of the existence of a common 'German spirit'. They argue that this 'spirit' may be crucially absent in the process of closer European integration.

[2] Richard Cooper (1994) 'Yes to monetary unification, but no to the Maastricht Treaty'.

An economic case for EMU?

'The Community shall have as its task, *by establishing a common market and an economic and monetary union* ... to promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among member states'.

Article 2 of the Treaty on European Union signed in Maastricht on 7 February 1992 (emphasis added)

If EMU is desirable then its benefits must exceed its costs. In other words, what we are gaining must be more than what we are giving up. Presented here are the commonly held arguments in favour of EMU[3]. The next section will argue that the EMU that Maastricht is to create - in its existing form - may not meet the objectives of the Maastricht Treaty as things stand.

Many serious economic discussions build a case in support of EMU around the (trivial) welfare gains accrued from a *reduction of transaction costs*. At best, and using the Commission's own figures, these gains represent somewhere between one quarter and one half

[3] The economic benefits of a common currency are not evaluated in any great depth. For a fuller discussion see De Grauwe (1994). These supposed economic benefits are contested in this book. De Grauwe concludes that in the absence of any convincing evidence 'the decision to go ahead with monetary unification has clearly been inspired by the political objective of European unification. In this dynamic, many objections expressed by economists ... have been brushed aside'.

of a percent of Community GDP[4]. Proponents of EMU argue that this direct economic benefit is supplemented by indirect but comparably trivial benefits. A single currency, for example, might create price transparency across Europe which will bring all costs down to the lowest common denominator with direct benefits to the consumer. Whether the Law of One Price actually exists is a questionable proposition.

A second argument popularly heard is that there are long-term dynamic welfare gains deriving from the *elimination of uncertain future movements of exchange rates*. In a world populated by risk-averse individuals, increasing certainty may increase overall welfare by encouraging investment in a future fixed return. Exchange rate uncertainty also introduces uncertainty about future prices of goods and services. By reducing this uncertainty economic agents can make higher quality future investments. The welfare gains should increase with economic openness. With the completion of the Single Market and the removal of capital controls in 1990, any gains that do accrue may be increased. In the words of the European Commissioner for Economic Affairs, Yves-Thibault de Silguy, 'monetary union will create a sound economic framework in which growth and job creation are easier. Investors from third countries will be attracted by the anti-inflationary credentials of the euro-zone and the sound economic policies that it will have[5]'. These are difficult claims to substantiate, however, and

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[4] European Commission (1990) 'One market. One money' in *European Economy,* 44. The *Economist* (1995) estimates that EMU would benefit European business by $30 billion of foreign-exchange transactions.

[5] De Silguy (1997). Of course the euro zone has no anti-inflationary credentials at present. Whether it does will be the result of the as yet undefined monetary policies of the European Central Bank.

there is little serious literature that would make a compelling argument around them. Any gains that may be realised are likely to be small, concentrated and nebulous.

One Market, One Money?

An argument most commonly used by advocates of EMU is that the Single Market 'is not complete' without a Single Currency. The European Commission (1990), for example, have argued that 'one market needs one money' and that 'only a single currency allows the full potential benefits of a single market to be achieved'. This argument maintains that distinct currencies cannot exist in an exchange rate mechanism *over the long-term* when the barriers to capital flows have been removed. The Single European Act of 1987 removed these restrictions to capital mobility. Any system (including the Exchange Rate Mechanism) that permits discrete realignments will be subject to speculative attacks if a realignment is thought imminent. If a currency is expected to be devalued, people who hold large quantities of it will sell it. The *possibility of* devaluations (and notably competitive devaluations) therefore undermine the potential benefits of a single market[6].

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[6] Some authors draw on Mundell's 'assignment problem' to illustrate the inevitability of Monetary Union in Europe (McNamara, 1996). Mundell's theoretical proposition holds that a national Government can only ever choose two of the following three policy options at one time: free capital flows, fixed exchange rates and monetary policy autonomy. If a state wants to keep its exchange rate fixed in the context of international capital mobility, national monetary policy must be used to maintain the exchange rate parity and cannot be directed to other goals. In Europe high capital mobility has forced states to give up domestic policy independence if they want to keep a fixed exchange rate. McNamara argues that a new consensus across most European States emerged in the 1980s.

There are many things that Governments in Europe seem to disagree about. But clearly there is a consensus in Europe on the pursuit of economic 'stability' as a concerted European policy objective. Yet definition of 'economic stability' is difficult. It seems that the pursuit of 'zero inflation' has taken over from all other economic objectives. Maastricht goes one step further than controlling inflation. The essence of EMU is that this policy objective can be best achieved by a *Federal* European Monetary Institution, the European Central Bank. By signing Maastricht thirteen European countries believe that a Federal monetary institution could do a better job of inflation control than their own national institutions[7].

It remains to be seen therefore whether full Monetary and Currency Union will generate long-term dynamic benefits to the Continent. European integration itself over the last forty years has brought trade benefits and EMU may do the same[8]. This is a view that is empirically and theoretically difficult to support because we have to make assumptions about the actual costs and benefits of an alternative to EMU[9]. In this sense the advantages of the single currency are a matter of personal opinion.

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[7] The UK and Denmark signed Maastricht with attached protocols which did not commit them to participate in EMU. Sweden, Finland and Austria did not join the EU until 1995 and signed the Maastricht Treaty on their accession.

[8] This is the rather spurious argument that Sir Leon Brittan, External Relations Commissioner at the EU, has made (Brittan, 1994).

[9] Brian Hindley and Martin Howe (1996) do however attempt an alternative hypothesis scenario for the UK

Cumulative Regional Decline

A major unanswered question of Maastricht's EMU is how a country responds to the unenviable cumulative decline of its wealth generating base. Let us consider a situation in which one country is faced with the prospect of an isolated slump, depression, shock or cumulative process of economic decline. The example illustrates that assenting to EMU does in a very real sense limit the sovereignty of a Member State.

Suppose one country in the EMU is experiencing unemployment above and economic growth below the EMU average[10]. This may be caused by a specific structural shock, by the decline of a regionally concentrated industry, by demographic change or by a country's differential position on the business cycle. For whatever reason it is experiencing stagnant economic growth due to circumstances beyond its control. Of greater concern it might be a cumulative process of decline. As things currently stand the Government of that country would choose to devalue its currency (by cutting interest rates) to prevent the already high rate of unemployment escalating. The Government would attempt to provide some kind of economic stimulus to its indigenous industries. In monetary union these circumstances would be exacerbated.

Suppose that macro-economic conditions are different in the rest of the Union. Economic growth is strong, unemployment low and there is evidence that inflationary pressures are mounting. The European Central Bank, observing its clear and rigidly defined terms of

[10] This section draws on Godley (1991) and Godley (1992)

reference, would be required to put up interest rates. The result is that the country in question is faced with macro-economic conditions which are exactly the opposite of what it needs to generate growth and increase employment.

There is nothing unusual so far about this situation. Levels of economic activity and wealth always differ across currency zones. Under normal circumstances, there are three mechanisms through which a region may respond to macro-economic differences across what might be called a sovereign state.. The first adjustment mechanism is labour movement. If one region suffers sustained recession, workers may move. Unemployment would decrease, as workers move to high employment regions. This kind of labour force mobility mitigates aggregate job loss in recessions. In EMU there are a significant number of informal cultural, linguistic and social barriers to labour mobility. Few people move round the EU for a job in the way that they do in other Federations[11]. This may change, but EMU cannot rely on cross-border labour movement as a macro-economic adjustment to a shock.

A second adjustment mechanism might be wage change. Wages might be expected to decrease in the affected region, stimulating economic recovery. The evidence on wage flexibility in Europe is uncertain, but suggests that wages are slow to respond. If demand falls in one country or region, unemployment tends to rise and stay high for some time, if not forever, before wages adjust.

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[11] The US Census Bureau estimates that 17% of all Americans move in a typical year. Moreover there are striking differences by age. In the USA 35% of individuals aged between 20 and 24, and 30% of 25-29 year olds move states in a typical year. See Lindsey (1996).

Thirdly, in a functioning Federation a Government or *some* federal agency would operate automatically counter-cyclical fiscal transfers from wealthier regions to poorer ones. This fiscal transfer guarantees that there is a floor to any region's decline. In the natural course of events a Government provides an 'invisible floor' under component regions which are relatively poor or may be in distress for structural reasons. Automatic stabilisation properties of a progressive tax system manifest themselves in a regional re-distribution of (usually income) tax. Without anyone really noticing common standards of public provision (health, education, pensions and unemployment benefits) combine with a common, hopefully progressive, burden of taxation to maintain a minimum standard of welfare.

In EMU, where labour mobility and wage flexibility are low, what happens to this country - now reduced to a region? A logical response might be that in the absence of the first two adjustment mechanisms which it is generally agreed would not operate in EMU for the time being, the role of the third (fiscal transfer) is all the more significant. This was identified by Sir Donald MacDougall in 1977 *and* Jaques Delors in 1989 in influential Reports on the design of EMU[12]. No meaningful federal institution will exist in the European Monetary

[12] The 'MacDougall Report' (EC, 1977) was charged with assessing the applicability of fiscal federalism to the creation of Economic and Monetary Union. It concluded that EMU would require a fiscal re-distributive mechanism amounting to somewhere between 5 and 7% of Community GDP. MacDougall concluded that such a mechanism was needed to ensure that the 'benefits of closer integration [EMU] are seen to accrue to all'. The 'Delors Report' (EC, 1989) which set the blueprint for EMU concluded in a similar vein. Without specifying the precise level of fiscal transfer, the Report states that a common monetary policy requires 'a high degree of compatibility of economic policies and consistency in a number of other policy areas, particularly the fiscal field'. Nevertheless EMU makes no meaningful provisions in economic co-ordination.

Zone to provide any fiscal transfer[13]. At the same time, under the strict borrowing ceiling it has assented to in the Maastricht Treaty, an individual Government is unable to provide a significant fiscal stimulus. Without an effective fiscal transfer mechanism at the Community level, a region may be left facing a depressing and cumulative decline into poverty. This in turn might impart a disinflationary bias across the area as a whole. What is more, the member state affected has no method of influencing a policy decision which has dire consequences for the welfare of its people. This scenario will very optimistically never occur. The point is that as things stand there is no mechanism to *prevent* this happening.

The role of 'Government': A Reflection

> 'No one owes any of us a standard of living'
>
> Eddie George, Governor of the Bank of England in Speech to the British Chambers of Commerce Conference, May 11 1995

To illustrate how post-EMU Europe will differ from the current situation and why it should be of concern, it is necessary to reflect on exactly what Governments do and have done for the last fifty years. A reasonable start would be to make the statement that the concerted goal of Government is to promote the overall well-being of the nation and to protect it from shocks of various kinds to which it will inevitably be subjected in a global economy. To do this it makes a number of social, economic and ultimately moral judgements. The validation

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[13] It is true that there do exist structural and cohesion funds which are re-distributive. There impact is minuscule, however, representing about 1.7% of Community GDP.

and acceptance of these judgements is protected by the principle of electoral democracy. A sovereign Government determines the overall level of public provision. It assesses the burden of taxation. It tries to ensure the correct allocation of expenditures between competing requirements and the just distribution of this tax burden. It also determines the extent to which the gap between spending and income is financed, by making a draft on its Central Bank, or financing it by borrowing.

There is nothing simple that can be said about any of these economic policy instruments or the ways in which they inter-relate. What can be said is that the way Governments decide these issues and the interaction with the decisions of individuals, corporations and foreigners will profoundly influence the distribution and level of income and wealth between individuals and between whole regions.

The concept of Federal Government is about more than just equalisation. Governments are also responsible for steering their whole economic system by using a variety of monetary and fiscal instruments. The combination of policy tools provides a mechanism that regulates the economy as a whole country *vis a vis* other countries. Internally the government regulates economic growth and differentials *within* its national borders. A European monetary zone must have a fiscal counterpart not only to operate equalisation across the Eurozone, but to steer the *whole European* economy in the right direction.

EMU's 'staggering omission': Inadequate Institutional Development

EMU as it is currently proposed therefore contains a staggering institutional omission. EMU removes from governments their fundamental ability to run their economies in the manner they would normally choose. Whether removing economic sovereign power from a country to act independently is a good thing or a bad thing is open to debate. The fact remains that Maastricht fails to create any new authority with the power which its member governments have relinquished by assenting to it. Protecting the European monetary zone from natural economic shocks and cycles has to exist *somewhere* in the economic system. The staggeringly powerful and bewilderingly unaccountable European Central Bank is the only Federal Institution that Maastricht creates[14]. For EMU to work effectively there must be a system at the Community Level which fulfils the functions presently exercised by the central governments of individual member countries.

Political Union: The real agenda?

It is clear that the desirability of EMU based on economic arguments is unconvincing and that without institutional development EMU could be divisive and disruptive, particularly in depressed regions. On face value it is perverse that European countries have consented to giving up very significant economic sovereignty to blindly pursue a monetary union when

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[14] Of course there are other Federal institutions, the European Commission being the obvious example.

there are no clear economic arguments in its favour. To a sceptical mind this might suggest that the true objective of EMU is something quite different.

Private discussions invariably reveal that Monetary Union is really a vehicle to achieve political union. The notion of a political union in Europe is a complicated one. No-one really knows what it is. An Italian, German and Briton would almost certainly define it very differently. To assess the potential benefits and costs of political union is foolhardy since there exists no notion of what political union is. In the policy arena there has been no official discussion of the idea. Yet so often the argument is made in serious academic work that monetary union is only a vehicle to political monetary union. Political Union, one might remember, is not part of any manifest agenda.

Despite any economic benefits of EMU being small and far from clear, EMU has become an article of faith for France and Germany since President Valéry Giscard d'Estaing and Chancellor Helmut Schmidt drew up a blueprint for the creation of the European Monetary System in 1978. Their successors, François Miterrand and Helmut Kohl, shared a similar affinity for promoting EMU. There are reasons for both countries to favour closer political integration. For France, EMU presents an opportunity to harness German economic might. Since March 1983 France has explicitly followed German monetary policy. To see the creation of the ECB with a French representative on the Board of Governors means to regain control over its own monetary policy and to retain its role as a European superpower (A similar argument counts for Austria and the Netherlands which have also attached their currencies to the D-mark and hence made the Bundesbank their *de facto* Central Bank).

For Germany, EMU is a chance to gain real European and international recognition. Fearful of an anti-German backlash from its European partners, EMU presents an opportunity to create a federalising Europe in German-style order. Some authors have argued that Chancellor Kohl may have made commitments to EMU when he sought support from other countries, especially France, for German re-unification. Another explanation may come from the observation that Germany is more involved than other western countries in Eastern Europe. There is a suggestion that the German government committed itself to a very large aid program to Russia in return for the latter's acquiescence in unification, and that there is a sense in German politics that the political tasks which lie ahead are too complex for one nation to solve alone[15].

It is unimaginable that EMU will go ahead without both Germany and France. Other European countries also have strong political reasons to support monetary union. Belgium and Luxembourg have been in a currency union since 1932. For these countries the idea of currency union is nothing new and represents an opportunity to get political power with their immensely larger neighbours at the Heart of Europe[16]. Spain and Portugal, less than 25

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[15] Cameron (1995) argues that in exchange for France's acceptance of German re-unification, Kohl agreed to an accelerated ratification of Maastricht in April 1990. See Bertram Schefold at Jerome levy Economics Institute EMU Forum (October 1992) and Garrett (1993) on German commitments to Eastern Europe. David Cameron has argued that there is also a good economic argument for Germany to remain tied to other European countries and remain committed to EMU. Analysis of German Balance of Payments in the EMS and EMU regimes shows that German exports to other European countries have benefited from EMU by keeping the value of the D-Mark artificially low in relation to other European currencies. See Cameron (1991).

[16] These two countries have played a very significant role in promoting EMU on the policy agenda since a Dutchman - Pierre Werner - first proposed European Monetary Union in 1969. The probable first Governor of the European Bank, Wim Duisenberg, is Governor

years ago, were dictatorships. EMU presents an opportunity to bury Franco and Salazar to gain permanent democratic credentials. Ireland has benefitted enormously from agricultural subsidies and EU Membership has helped attract Foreign Investment which has boosted the Irish economy.

Political leaders in a number of different countries regard EMU as a unique opportunity to unite Europe. European Countries which have been enemies in three wars in the last 100 years can be locked together into peaceful co-existence. Monetary Union, as emphasised by David Currie, offers 'a fleeting opportunity to grasp a historic prize. They [pro-Europeans] regard EMU as essential to creating a stronger EU, with greater economic, political and social cohesion'[17]. Last month's inconclusive Amsterdam Summit was evidence that for the time being development in political and social policy in the EU remains a long way off. At the broad *political* level there are powerful reasons for many countries to participate in European *Monetary* Union.

Democratic deficits

Beyond fundamental economics the current design for EMU has another flaw. It is undemocratic. Last month the French people voted out a Government which placed austere economic measures to ensure compliance with Maastricht's random debt criteria at the top of its policy agenda. The French people had the opportunity to express their dissatisfaction with

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of the Dutch Central Bank.

[17] David Currie (1997) *The pros and cons of EMU* London: HM Treasury

economic conditions and return a Left Wing co-alition with a new commitment to job creation. The French Government can now progress with a reflationary economic policy that its economy desperately needs, and optimistic notions of making the phoney 3% mark are forgotten.

Europe is currently experiencing persistent high unemployment and low growth. It is difficult to imagine how the *Euro* will in the short term rectify the situation. In the blind pursuit of price stability the ECB-to-be will seek to rapidly establish the Euro as a strong currency, pushing its value high and punishing exporting European manufacturing industries. Treaty commitments have the force of law across the Union, and Central Bankers are notoriously unconcerned with using unemployment rates as monetary targets. Current rates of high unemployment and low growth have the potential to further escalate.

If this happens the people of Europe will be able to do nothing but sit and watch[18]. They may turn to their governments and put pressure on them to increase social welfare spending, either to boost flagging regions or minimise the damaging impact of economic downturns. Unless regional problems are 'exceptional', or national GDP downturn extremely large (the pact allows for 2% fall in GDP in a year), Governments will find themselves unable to pursue a rational economic strategy.

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[18] Regardless of what the ECB does and how unpopular its decisions are, there is nothing that national or European political institutions will be able to do about them. The unaccountability of the ECB is enshrined in Article 107 of the Maastricht Treaty. Neither the Federal Reserve in the US, or Germany's Bundesbank enjoy such a high degree of political independence

The real case for EMU: Conspicuous by its absence

All of this would not be so bad if Europe's people understood the consequences of joining a single currency. If they did, the strongest case in favour of EMU would simply be the fact that the people of Europe want a single currency. It is clear from opinion poll data that support for EMU has not often been positive, and has never given a ringing endorsement of the project[19]. Referenda were held in only two countries, Denmark and France, where Maastricht was only given lukewarm support[20].

It is clear that the lack of popular support is a product of the distance between European institutions and the people they supposedly represent. There is also, as Lord Ralf Dahrendorf has recently argued, a large gap between the aspirations of the European 'superstate' and the reality of life for the average European. The process of integration has created is own agenda, which is largely unrelated to the real agenda of European politics in all the member states[21]. Despite Commission attempts to rectify this perceived 'democratic deficit', Europeans feel very distanced from EMU.

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[19] See Hamaui (1996), European Commission (1994), and *The Daily Telegraph of London* January 10 1997. According to *The Daily Telegraph*, 26% of Britons, 43% of Germans, 61% of French and 71% of Italians supported the introduction of the single currency in January 1997.

[20] In Denmark the first referendum rejected Maastricht on June 2 1992 by 50.7% to 49.3%. The European Council agreed to a National Compromise to Denmark, and the Treaty was ratified in a second referendum on May 18 1993 with 56.8% voting in favour. President Mitterrand held a referendum in France on September 20 1992 where 51.05% voted 'yes' and 48.95% voted 'no'.

[21] Lord Ralf Dahrendorf at Bard Center Evening Discussion 'Whither European Integration' published in *Annandale* Volume 136 Number 1, Spring 1997.

While there has been no great enthusiasm for European integration, there has, as Martin Slater points out, been little great hostility in the majority of member states (with the exception of Denmark, the UK and to a lesser extent Greece). Explanation may be sought in Slater's observation that in the case of the original Six 'membership remained largely uncontroversial because no rival political elites were willing or able to mobilise public opinion against membership. It is always easier to mobilise public opinion against a concrete set of institutions, than against an idea'[22]. Since there is no real political polarisation on the European issue at the national level, EMU has *never* been properly addressed in the public policy arena. Political debate in Europe today is focused on specific economic problems, in some senses caused by EMU itself, rather than on merits and realisation of a future economic (and political?) ideal. Those people who have objections to monetary union in general, or Maastricht in particular, have no meaningful organised and accessible political voice. (If we believe opinion poll data it is clear that 'those people' represents a large proportion of Europe's 370 million Citizens). Europe's real 'democratic deficit' is therefore at the level of national Governments.

Concluding remarks

The economic benefits of joining a single currency are far from clear and the gains are certainly not enough to generate the momentum towards EMU which can be observed. The EMU design as it presently stands leaves a huge chasm in the policy making institutions.

[22] Martin Slater (1982) 'Political Elites, Popular Indifference and Community Building' *Journal of Common Market Studies* 21 (Vol 1, No 2).

No-one seriously believes the notion that a monetary authority can exist without requisite economic institutions. History shows us that never has one successfully existed without the other. It is akin to the US trying to create the Dollar without having a President, Congress or any kind of meaningful political institution. In addition Europe has a social history of extensive welfare support and strong Government. EMU re-defines the European role of Government in a very real sense by denying Governments the ability to perform their traditional roles protecting the victims of market economies and steering their national economy in the direction they choose. The great lacuna of Maastricht is that *no* institution or supra-national body is creates which protects the people of Europe from the inevitable consequences of joining a single currency[23].

Chancellor Kohl rather unhelpfully refers to the EMU project as an issue so important that it will determine whether we have 'War or Peace' in the 21st century. It may not have occurred to him that experimenting with political union without requisite political institutions or discernible political support might in itself be politically very dangerous. Kohl's agenda is (un)clearly a political one. Whether political Union is the same as a Federal Europe is a much harder issue. Evidently the EU already has elements of a Federation: The Common Agricultural Policy and the Court of Justice are two notable examples.

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[23] It might be the case that other Federal Institutions will evolve retrospectively after the introduction of the single currency. This was the case in the US. It took 147 contentious years from the founding of the Republic until a true 'single currency' existed with a discretionary monetary policy which controlled money creation.

The implication of the paper is that if EMU is to be economically sustainable, a system of fiscal transfers will be necessary to support the convergence criteria in order to ensure that 'the benefits of closer integration [EMU] are seen to accrue to all' (European Commission, 1977). Is it possible to imagine fiscal equalisation processes being politically acceptable at the Community level - at which it needs to operate - in the near future. Will a German taxpayer be prepared to pay 5% of his tax to support flagging regions in Spain or the UK? As Volker Clausen and Manfred Willms (1994) write comparing the experience of German unification with European monetary unification, 'it is highly questionable whether the 'European spirit' of the population in the donor countries is sufficient to make them swallow the bitter pill of substantial permanent transfers. Whether the politicians are able to sweeten the pill remains to be seen'.

That leaves unanswered the question of why the route to closer European unity takes the route of a single currency, at this time. In other words, can the cart come before the horse? It would make sense to increase labour mobility and extend the European budget, as MacDougall recognised, before the introduction of the single currency. The larger question is then whether the single currency will lead to the achievement of a united Europe. As this paper has illustrated, the dynamics of EMU as currently designed may point in the opposite direction. One could foresee tensions building up in depressed regions which may focus on the role of the single currency and its limits on government expenditures and thus endanger the political sustainability of the European project.

In one of the most coherent analyses on the plans for monetary unification in Europe, Bryan Hopkin and Brian Reddaway conclude that a single currency might emerge, but if it did, 'It would be the unforced product of the experience of co-operative working. Nothing but harm can result from pressing ahead with plans that rest on illusion and wishful thinking'[24]. EMU has to evolve with the consent and understanding of Europe's people. It has to evolve with an awareness of the potentially disastrous political implications of its own failure. European policy-makers should take note. Not to rescind on their commitment to a single currency, but to create a sustainable mechanism that can really work for Europe's people.

[24] Bryan Hopkin and Brian Reddaway (1995) *Heading for breakdown: the plans for European Monetary Unification*

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