The original design of EMU: ‘a house without a roof’

The Dutch government and the design failures of Maastricht, 1985-1991

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Introduction

''For the EU as a whole, the euro is a keystone of further economic integration and a potent symbol of our growing political unity. And for the world, the euro is a major new pillar in the international monetary system and a pole of stability for the global economy.''[1] These words are nothing less than part of the introduction of Joaquín Almunia, Commissioner for Economic and Monetary Affairs, in a report to celebrate the huge success of the common currency in 2008: *EMU@10*.[2] And yes, at the time the introduction of the common currency seemed to be a huge success. Of course Joaquín Almunia also presented the major challenges for the Member States of the Eurozone. The foremost challenges: globalization, ageing and climate change. Stronger coordination and surveillance are mentioned in the report to tackle these problems in order to become the world-leading area in various fields.[3] Despite the challenges of the Eurozone, the sun was shining, and almost nobody could predict the outbreak of economic thunderstorms.

However, during the years 2007 and 2008 heavy clouds occurred above the construction of the euro. The architecture of the currency was designed and described in the Maastricht Treaty, signed by the leaders of the member states of the European Community on 7 February 1992. Paul de Grauwe, currently professor at the London School of Economic (LSE), used the metaphor of the weather conditions to explain what happened to the Economic and Monetary Union since 2007 and 2008. *''The Eurozone looked like a wonderful construction at the time it was built. Yet it appeared to be loaded with design failures. In 1999 I compared the Eurozone to a beautiful villa in which Europeans were ready to enter. Yet it was a villa that did not have a roof. As long as the weather was fine, we would like to have settle in the villa.''*[4] In 2007 and 2008 the rain started to fall. And the construction proved not to be ready to deal with the rain, named Global Financial Crisis. Since the outbreak of this crisis the Eurozone has been experiencing severe repercussions. The Member States of the Economic and Monetary Union experienced more or less three types of crisis: a banking crisis, a fiscal crisis and a severe economic crisis. The three crises were connected to each other. Especially the countries of the southern parts of the European Union and Ireland faced huge problems. And some problems are still there.

Although some of these countries are still facing an economic crisis, the past years the

[1] Commission (2008) iii.
[2] Commission (2008).
[3] Commission (2008) iii.
[4] De Grauwe (2013) 1.

leaders of the Eurozone proved to be able to come up with *ad hoc* measures and structural reforms in order to save the continuation of the currency. The result: the euro still exists. This thesis will not take a look at why it happened, and we take for granted that only *after* the outbreak of the Eurozone crisis, the European leaders made strong efforts to save the euro in the first place, and created a sustainable currency for the future. The leaders of Europe are still trying to reconstruct and redesign the Economic and Monetary Union, in order to create a safe and stable system. To return to the abovementioned words of Paul de Grauwe, they are trying to repair the design failures of the Maastricht Treaty.

The original design of the EMU of the Treaty of Maastricht contained various faults and proved to be insufficient to survive major repercussions. Not only economists and academics like Paul de Grauwe warned about these potential design failures. In retrospect also politicians admitted that the construction of the Economic and Monetary Union was not sustainable. For instance, Ruud Lubbers, one of the founding father of the new common currency, admitted in the Dutch newspaper *Trouw* that the creation of the Eurozone was a work in progress that was never completed. At the time of the creation and the years of transition after Maastricht, politicians tended to be undisciplined and unpunctual, according to Lubbers.[5] Wim Kok, Dutch Minister of Financial Affairs during the negotiations, admitted that the leaders of the European Community did not take into account the potential problems of a common currency in the design of the Treaty of Maastricht.[6]

Nevertheless, we will not focus on the question why the designers of Maastricht were undisciplined or short-sighted. We will rather take a look at what information was available; what could they know? And what did they with that? So, the research question of this thesis is about to what extent the politicians could know the design faults, and how they responded to that information. This it to say how the information was translated into statements, policies and proposals.

[5] *Trouw,* 3 May 2013: *Lubbers: de euro blijft een onvoltooid werk.* Available at: http://www.trouw.nl/tr/nl/4504/Economie/article/detail/3435868/2013/05/03/Lubbers-de-euro-blijft-een-onvoltooid-werk.dhtml)

[6] Interview with Roel Janssen, author of the book: *De Euro* (Amsterdam 2012). Available at: http://www.ftm.nl/exclusive/we-zij-de-euro-in-gerommeld/

I. Literature, objectives and research plan

As already mentioned in the introduction, among economists and other academics there is strong consensus about the very fact that the Economic and Monetary Union of the Maastricht Treaty contained several design failures. It is not my task to blame all the responsible actors of Maastricht, but it is rather interesting to see whether these actors could know the potential problems and how they reacted on this information. In order to focus I will research the position of the Dutch government. This introductory chapter serves to take a look at the existing literature about the topic and elaborates on how I will find answers on the research questions.

Academic considerations regarding the EMU and the crisis

The last few years several economists and academics published about the design failures of Maastricht. It's impossible to discuss all the literature, however I will elaborate of a few trends and the foremost academics. During the nineties some studies occurred on the functioning of the Economic and Monetary Union. During that decade, but even today, academics and economists focused on the functioning of the Eurozone from a perspective of the so-called Optimum Currency Area Theory (OCA). The famous economist Robert Alexander Mundell was more or less the founding father of this theory, although during the seventies, eighties and nineties, much of the theory was not yet interpreted.[7] The main research question with regard to the application of the theory on the EMU is: to what extent was or is the European Union an optimum currency and how could policy-makers prevent the occurrence of a-symmetric shocks? When it comes to labor mobility, the EU scores very badly. Other criteria like fiscal transfers are more or less absent and forbidden by the Treaty of Maastricht: no bail out, no monetary financing.

From this perspective one could expect that the designers of the Treaty of Maastricht took into account this information and did try to avoid potential problems by creating instruments, institutions or whatsoever. That is to say instruments to adjust a-symmetric shocks in case they occur.[8] Nevertheless, it did not happen and the OCA Theory was more or less ignored. Barry Eichengreen rightly observes that '*…the impact on policy-making was limited by the fact that the literature focused almost entirely on analytical constructs. There were few efforts to apply it to actual or prospective monetary unions like the one about to be construct-*

[7] De Grauwe (2006) 712.
[8] De Grauwe (2006) 720.

ed in Europe.'[9] So, the OCA seemed to be part of academic debate only.

Since the outbreak of the Eurozone crisis at lot of attention has been paid to the so-called design failures. The next chapter will elaborate on four main design failures. I will not only mention and explain the design faults, but also to what extent the contemporary academic world was aware of these potential design faults. In his very famous article in the *Journal of Common Market Studies* Barry Eichengreen refers to several authors who, at the beginning of the nineties, pinpointed potential problems that might occur due to the architecture of the EMU.[10]

Recent years, most of the academic literature is about the severe economic repercussions of the Eurozone and the design failures of the Maastricht Treaty. Barry Eichengreen, Paul de Grauwe and Maurice Obstfeld are some of the main economists and academics.[11] They do not only stress the design faults, but also try to present potential solutions to redesign the architectural fundaments of the Economic and Monetary Union. Also O'Rourke and Taylor emphasized the failing architecture and the lack of application of the OCA-theory during the making of the Treaty: ''*The fact that the eurozone scores so poorly on optimal currency area grounds suggests a need for mechanisms allowing smoother and more symmetric adjustment between its members.''*[12] Maurice Obstfeld, for instance, elaborates on the potential ways to reconstruct the design of the EMU. In a very large article he talks about the lessons we need to learn from the outbreak of the crisis and what is required to reconstruct the EMU in order to make the system sustainable and ready for the future.[13] Paul de Grauwe did the more or less the same.[14]

Another trend in the literature about the EMU are more general reflections on the process towards the ratification of the Treaty. Van Riel and Metten describe and analyze the process of negotiations leading up to the Treaty. Their study focusses on key issues of the negotiations, the controversies, the changing positions of the participating states and the dichotomy between the Germans and the French. Recently, Alman Metten wrote an article about the rationale behind Maastricht, and with the terrible developments of the recent years in mind, he reflects on the process of Maastricht on a more general level; analytical and less descriptive. He argues that Maastricht meant more or less the beginning of drafting the rules of the game of the EMU, rather than a final collection of the rules. Maastricht proved to be an insufficient

[9] Eichengreen (2012) 124.
[10] Eichengreen (2012) 123-125.
[11] For instance: Eichengreen (2012), De Grauwe (2013) and Obstfeld (2013).
[12] O'Rourke and Taylor (2013) 186.
[13] Obstfeld (2013).
[14] De Grauwe (2013).

compromise of the Germans and the French, and it was not sustainable to survive the crisis.[15] Here we return to the words of Paul de Grauwe mentioned in the introduction of his thesis: the EMU as a nice house, but without a roof, thus not finished yet.[16]

The introduction already mentioned that the political actors during the age of Maastricht admitted that the design was insufficient.[17] Roel Janssen collected a series of interviews with the main Dutch actors, active during the negotiations before and during the intergovernmental conference (IGC) of Maastricht. Main figures like Minister of Finance Wim Kok, Prime Minister Ruud Lubbers, Treasurer-General Cees Maas and the President of the Dutch Central Bank André Szász reflect in this book on the process and the shortcomings of the Treaty.[18]

However, these reflections are not only to be found in literature after the outbreak of the Eurozone crisis. Roel Janssen, again, wrote a little booklet on the financial system in 1993, just after the ratification of the Treaty. In this booklet he quoted the former President of the German Bundesbank, namely Karl-Otto Pöhl. Pöhl, surprisingly, compares the strategy of the Treaty of Maastricht to a strategy to win the last war, and not a strategy to win the upcoming war. Pöhl argues that Maastricht was the outcome of a terrible hurry of the European leaders; it was a well-intentioned reaction to the recent developments of the fall of communism and the reunification of Germany, but the Treaty was written too fast. At the time, 1993, there was already some awareness about the potential problems of bringing together economically very different countries and regions under a single currency. Roel Janssen mentions the example of western and eastern Germany: large fiscal transfer were required in order to introduce the German D-Mark, flows from the rich to the poor parts, from west to east. The same should be done for the Eurozone.[19] This indicates the potential awareness of design failures.

‘Filling the gap’

So we have literature concerning the design failures of Maastricht, and we have more general reflections on the process and outcome of Maastricht. What the academic literature more or less ignores is the question to what extent the actors could be aware of the potential designs faults and if so, how they responded to that ‘warning’ information. The current literature on

[15] Metten (2013) 64-65 and 71.
[16] De Grauwe (2013) 1.
[17] For instance Ruud Lubbers: *Trouw,* 3 May 2013: *Lubbers: de euro blijft een onvoltooid werk.* Available at: http://www.trouw.nl/tr/nl/4504/Economie/article/detail/3435868/2013/05/03/Lubbers-de-euro-blijft-een-onvoltooid-werk.html
[18] Janssen (2012).
[19] Janssen (1993) 133-134 and 144-150.

the EMU elaborates very extensively on the design faults and also elaborates on the underlying nature of the negotiations process towards Maastricht, but not on the information available at that time. If we focus on the literature about the Dutch, we might conclude that much attention has been paid to the role of the Dutch as mediators between the French and the German. Especially when it comes to the final weeks before the IGC of Maastricht; the Dutch really wanted to succeed. It seemed as if Lubbers and Kok sacrificed the wishes of the Dutch in order to find compromise.

Politicians like Lubbers admitted, in retrospect, that they made wrong decisions and did underline the statement that the rules of Maastricht were not sufficient to create a sustainable economic and monetary union. Nevertheless, in general the literature ignores the question to what extent the political actors were informed about the potential flaws during the road to Maastricht, and how they reacted on that information. In other words, how these insights were translated into statements of the Dutch government. This thesis aims at filling this 'gap' in the current literature. And maybe it also fulfills a bit of the wishes of the authors of a very recent article in the Dutch *Volkskrant*: *Wat wist de regering over de risico's van de euro?*[20] Or: what did the Dutch government know? However we are not interest in the 'why', why they did ignore potential information and potential warnings, but only to what extent this information was available and how these insights were translated into statements, policies and positions. We will not consider what happened with the information and the statements during the dynamic process of negotiations. In order to do that, we would require information from still closed archives and interviews with all the political stakeholders and diplomats.

How? Methods

How I am going to find answers on these questions? The next chapter will elaborate on the general process towards Maastricht, the EMU and the Treaty itself. The chapter after that deals with the outbreak of the Eurozone crisis and the design faults that occurred during the crisis. So this chapter is more or less the descriptive and analytical basis for this research. A very important part of this chapter is the question to what extent the design faults were already part of academic research. Of course, we cannot blame the designers of the Maastricht Treaty for things they could not know. So I will not only describe and explain the design faults, but also indicate to what extent the academic world was aware of the potential problems at the end of the eighties and the beginning of the nineties.

[20] *De Volkskrant,* 7 March 2015: *Wat wist de regering over de risico's van de euro?* Available at: http://www.volkskrant.nl/opinie/wat-wist-de-regering-over-risicos-van-de-euro~a3889486/

The fourth and fifth chapter are the analytical part of this research. The fourth chapter is about the information provided to the Dutch government parties by advisory boards and the Dutch Central Bank. Keep in mind that during the period we discuss, namely between 1985 and 1991, three coalitions were in charge under supervision of Minister-President Ruud Lubbers. Lubbers I and Lubbers II were a combination of the Christian Democrats (CDA) and the Liberals (VVD). Lubbers III was a coalition of the Christian Democrats and Labor (PvdA). By advisory boards I mean three types. Firstly, the Social and Economic Council of the Netherlands, or in Dutch: Sociaal-Economische Raad (SER). Then the Scientific Council for Government Policy (Wetenschappelijke Raad voor het Regeringsbeleid, WRR). And finally, I will use some material of the Dutch Central Bank (De Nederlandsche Bank or DNB). So this chapter elaborates on the question to what extent the Dutch government was informed about the design failures. That means that we will focus on the design faults mentioned in the second chapter. Then the fifth chapter will shortly go into the reaction of the Dutch government and governmental parties with regard to that information. Did they use it? Of did they ignore? Therefore I will take a look at official publications, letters to the Dutch Parliament and reports of meetings of the States General. Thus, the analysis this thesis is more or less threefold: from the design failures in the academic literature, to the advises of the advisory boards and the DNB, to the Dutch government.

Last but not least, it is a good thing to mention and explain the timespan of this study. I will consider the period between 1985 until 1991. Why 1985? That is because this year was marked by the publication of the White Paper of Delors on the completion of the internal market.[21] This report was an important step towards the new Treaty of 1986: the Single European Act. This act merely aimed at the stimulation of the free flow of goods, services, capital and people. The Single European Act also hints the convergence of economic and monetary policies, thus set a basis for further integration towards an economic and monetary union. So the Single European Act provided the legal basis for the transformation of the Common Market of the Treaty of Rome (1957) into the Internal Market, and further up to the Economic and Monetary Union. This study ends of course in 1991, when the Treaty was written, and ultimately signed in February 1992.

[21] Commission (1985).

II. The concept Economic and Monetary Union and Maastricht Treaty

The idea and political commitment to create an economic and monetary union were not entirely new. The very start of thinking about the creation of a monetary union was much older than the installation of the Delors Committee. In this short introductory chapter we will take a brief look at the history of the process of the creation of an economic and monetary union, important theoretical matters, and the so-called Maastricht criteria.

Before the Delors Committee

Since 1944 the international regime of exchange rates was based on the so-called Bretton Woods system. In short, this system meant that the exchange rates were fixed and connected to the US dollar. And the dollar could be converted to gold at a fixed price of 35 dollars per ounce. However, 'fixed' didn't necessarily mean that any mutations of exchange rates were impossible. The exchange rates of other currencies could be adjusted in case it was necessary. For more than two decades this global system of fixed exchange rates worked very well. However, during the last years of the 1960s the system did not function anymore. Due to the immense costs of the Vietnam War, the United States of America was not able to maintain its position in the system. As a consequence the system collapsed and participating countries had to look for alternative systems.[22]

The countries of the European Economic Community wanted to avoid a situation of exchange-rate instability. The states of the EEC thought that this kind of instability would cause severe effects on international trade. In a system of free float of currencies trading partners have less certainty regarding the value of foreign currencies and this would cause e decreasing levels of trade. This fear and the strong willingness of the political elite to cooperate on European level pressed the European leaders to come up with a first attempt to establish an economic and monetary union. The problems regarding the administration of the Common Agricultural Policy (CAP) are an additional factor to clarify the European attempt to avoid strong currency fluctuations.[23] It seemed that the leaders, or the political elite, of the European nation-states wanted to move forward when it comes to economic and monetary integration, and ultimately wanted to adopt a single currency for the European Economic Community. However, according to Kathleen McNamara: *''This occurred despite the lack of either empirical or theoretical proof of the clear necessity of a single currency for the single market to*

[22] El-Agree (2011) 163.
[23] McNamara (2005) 143; McNamara (2006) 173.

function efficiently.''[24] Later on, we will return to this kind of eagerness of political leaders.

At the The Hague Summit of December 1969 the heads of state and government decided to appoint Pierre Werner, the prime minister of Luxemburg, to chair a committee to draw a plan for the creation of an economic and monetary union. In 1970 Pierre Werner presented his so-called Werner Plan. The goal of the EMU looked quite comprehensive and simple, according to Desmond Dinan: *''…fixed exchange rates, a common monetary policy and a single monetary authority…''*[25] But how to achieve? There was a lot of disagreement among the six member states about the ins and outs of the creation of a monetary union. However, after a series of negotiations the plan for an EMU was adopted in 1971. Nevertheless it proved to be a major failure. Despite good intentions, only one of the three stages was ultimately implemented; the exchange-rate regime, the 'snake' was adopted in 1972 (in this system the exchange rates might fluctuate within a certain bandwidth) and implemented in 1973. However, the system collapsed very soon as a result of the international exchange-rate crisis, and only continued to exist for a few countries, connecting their currencies to the German D-Mark.[26] In 1974 the Council failed to continue the project to the second stage. Mutation of the plan didn't make it.[27]

The plan to establish an economic and monetary union collapsed due to several reasons like the outbreak of the oil crisis in 1973, high levels of inflation and other economic repercussions. Instead of cooperation and attempts to converge economically, the member states of the European Economic Community maintained their own policies to attack the economic repercussions.[28] The end of the era of Bretton Woods was more or less marked by the floating of the German D-Mart in March 1973. It was not only a definitive collapse of Bretton Woods, but marked also the beginning of a period of almost five years of disagreement amongst the members of the European Economic Community with regard to the solutions to tackle the problem of exchange rates.[29] Nevertheless, the Werner Report marked more or less a new approach towards the idea of economic cooperation. Alfredo Panarella argues that *''The Werner report, in fact, emphasized the insufficiency and incompleteness of the Common Market and defined the basic elements for the existence of a full scale EMU.''*[30] In retrospect, it seemed that the creation of a monetary union with a common currency was only a matter of

[24] McNamara (2005) 143.
[25] Dinan (2004) 132.
[26] McNamara (2005) 144; Dinan (2004) 134-135; McNamara (2006) 173; Baldwin and Wyplosz (2012) 385-387.
[27] Panarella (1995) 20.
[28] Dinan (2004) 126.
[29] Issing (2008) 5.
[30] Panarella (1995) 18.

time.

The abovementioned system of the snake in the tunnel proved to be a disappointing system that persisted for only a few states. These participating countries were prepared to connect their currencies to the German D-Mark. During the late 1970s a new European system for exchange rates was proposed, the so-called European Monetary System (EMS). I will not elaborate on the technical details of this system, but we might conclude that this system looked quite similar to the snake in the tunnel. In March 1979 the EMS began to start functioning, and a lot of European countries were participating from that very moment: Germany, France, Italy, Ireland, Denmark, the Netherland, Belgium and Luxemburg joined the exchange rate mechanism (ERM). Despite some doubts about the system, because it was more or less like the disappointing 'snake', it proved to be a success. During the initial years of the EMS the system was a bit instable, due to the fact that the international financial world was worried about the high levels of inflation in France. After a change of the economic and monetary policy of France, the whole system became more and more stable. The success of the EMS throughout the 1980s and converging ideas about how to create exchange rate stability stimulated a new sense of creating a monetary union.[31]

From the Single European Act to the Delors Report

In 1985, the new elected president of the European Commission Jacques Delors decided that it was time for a revival of economic integration. Based on Lord Cockfield's White Paper on the Common Market, Delors pushed for intense economic integration, transforming the Common Market of the Treaty of Rome (1957) into the Single Market. The Single European Act of 1986, adopted by all member states in 1987, aimed at the completion of the internal market. It set an legislative basis to remove trade barriers, and barriers that block the free flow of capital throughout the Community. All in all the Single Market Programme of Delors was created to fulfill the promising goals of the Treaty of Rome, namely the free movement of goods, capital, services and people.[32]

The success of the functioning of the European Monetary System and the Single European Act, and of course the efforts of a very pro-European Jacques Delors, created an atmosphere facilitating further ideas about integration. During the Summit of Hannover in 1988 the heads of state and government appointed the so-called Delors Committee to draft a plan for the creation of an economic and monetary union. The European Council received the De-

[31] McNamara (2005) 144; Baldwin and Wyplosz (2012) 394.
[32] Baldwin and Wyplosz (2012) 24-25 and 499.

lors Committee Report in June 1989 during the Summit of Madrid. The proposals of Delors were rather controversial and deterministic.[33]According to Charles Wyplosz: *''The Delors Report goes at great length to present the monetary union as a natural, indeed unavoidable consequence of the Single Act.''*[34] And Katheleen R. McNamara: *''The success of the single market programme (…) in moving towards the dismantling of barriers to trade and commerce seemed to forge a logical link with a move forward towards a single currency.''*[35]

The Delors Report delivered more or less a concrete path towards a monetary union. The report advises that the economic and monetary union should be implemented by three states. And in order to introduce the EMU, Treaty change would be required.[36] After the presentation and the start of the IGC's Delors did not hesitate; the horse towards the EMU galloped at full speed. And this is where criticism on the EMU-project comes in. The speed was too fast and Delors was too eager to move straightforward to a new Treaty. The publication of the Commission report on the costs and benefits of an economic and monetary union, '*One Market, One Money*', came too late according to the observation of Charles Wyplosz. The train was at full speed already and didn't stop. Before the academic world and other specialists on this topic could react on the proposals of Delors, the negotiations were moving towards the draft and signing of a new Treaty. In other words: *''The Delors Committee Report was transformed into the Maastricht Treaty before views from outside official circles could significantly affect key decisions.''*[37] And this may have let to major design failures in the original architecture of the EMU. The academic world was not able to warn the officials and the drafters of the Treaty. At the end of 1991, only two years after the presentation of the Delors Report, the Treaty was there.

It worthwhile to say something about the dimension of the unification of Germany and the impact on process of creating the Economic and Monetary Union. Some scholars argue that the fall of the Berlin Wall in November 1989 was decisive for the creation of the EMU. However, Van Riel and Metten argue that this is not the case. The Summit of Hannover of 1988 appointed the Delors Committee in order to explore the possibilities for the creation of the EMU. And during the Summit of Madrid, a few months before the fall of the Berlin Wall, the first decisions to move on with the creation were made. Nevertheless, the Berlin Wall did accelerate the process of decision-making. Van Riel and Metten mention the agreement

[33] Thygesen (1989) 637.
[34] Wyplosz (2012) 212.
[35] McNamara (2005) 145.
[36] Committee for the Study of Economic and Monetary Union (1989).
[37] Wyplosz (2012) 210-211.

among Kohl and Mitterrand to set a starting date of intergovernmental conferences (IGC) just after the happenings in December 1989 in Strasbourg. Furthermore, the unification of Germany required political approval of for instance France, of course in exchange for support of the German for the common currency. The high costs due to the backward situation of the former DDR caused that Germany was not able to stick to the convergence criteria; German's deficit spending was too high. This damaged the powers of the Germans during the negotiations before Maastricht.[38]

The Maastricht Treaty: Economic and Monetary Union

The Delors Committee report set a good standard for the change of the Treaty; it was taken seriously by the heads of state and government. After a few years of negotiations the Treaty was signed in Maastricht in 1991. I will elaborate on the negotiation in the third chapter. On 1 November 1993 the Treaty on the European Union came into force. The new Treaty was not only about the Economic and Monetary Union, but the component 'EMU' was, of course, the most important. All member states joined the monetary union except the United Kingdom and Denmark. Despite the so-called opt-outs the Maastricht Treaty prescribes that all member states should join the Eurozone as soon as possible, but only if an individual member state would be ready to join.[39]

The rules, regulations, and conditions of the EMU of the Maastricht Treaty are rather similar to the Delors Report, although not all details are the same. As Charles Wyplosz observes: *''The Maastricht Treaty faithfully took up nearly all the proposals made in the Delors Committee Report.''*[40] But what does the Maastricht Treaty describe about the Economic and Monetary Union? In fact there are different components. Firstly, the Treaty describes the main goal of the creation of the EMU, namely price stability in order to ensure to support the general economic welfare of the Member States.[41] Furthermore the Treaty describes how the system will function, the creation and the role of the ECB (statutes) and the entry-conditions of the Eurozone. In Maastricht too, the Member States agreed on a time-path. The entry conditions and the time-path of the economic and monetary union were the two main topics during the negotiations before the signing and ratification of the Maastricht Treaty.

Especially France and Italy wanted to ensure the irrevocability of the EMU and wanted to set a number of data towards the completion of the EMU. The member states agreed on

[38] Van Riel and Metten (2000) 64-65 and 108.
[39] Baldwin and Wyplosz (2012) 436-440.
[40] Wyplosz (2012) 212.
[41] Treaty establishing the European Community, article 4 and 105.

a 'time-path' of three stages. According to the Treaty, the first stage began on 1 July 1990; the start of the liberalization of the movement of capital. Other important components are the completion of the functioning of the common market and economic convergence. The second stage commenced on 1 January 1994. This stage contained the creation of the institutional framework of the Eurozone. That is to say the European Monetary Institute, the predecessor of the European Central Bank. This institution aimed at enhancing cooperation between the national central banks This stage was more or less a period of transition before the introduction of the euro, and therefore, again, there was strong emphasis on economic convergence. The final stage, beginning on 1 January 1999 at the latest , was the ultimate introduction of the single currency: the euro. This meant that all national currencies were at a certain level, the introduction of the euro in the financial system (banks), and finally the physical introduction of coins and banknotes.[42] The heads of state and government ultimately decided, in accordance with the Treaty, on the exact starting point of beginning of the third stage. But, stage three would start automatically on 1 January 1999, if there would be no agreement on this date at the end of 1997.[43]

Another major topic of discussion during the negotiations were the entry criteria. Especially Germany and the Netherlands wanted to incorporate the so-called 'convergence criteria'. The member states agreed on five criteria in order to enter the Eurozone. Firstly, the inflation rate of a Member State might not be higher than 1,5 percentage points of the average of three countries with the lowest inflation rates. Secondly, the long-term interest rate (nominal) should be less than 2 per cent higher than the three countries with the lowest inflation rates. Thirdly, the government debt should be lower than 60 percent of the Gross Domestic Product (GDP). And the annual budget deficit should be less than 3 per cent of the GDP. An additional criterion prescribes that a potential member state of the Eurozone should participate in the Exchange Rate Mechanism (ERM) for at least two years, without devaluating its currency. In the end, it would up to the Council of the EU to decide whether countries might join the Eurozone, based on the criteria.[44] We should keep in mind that the time-path and the entry criteria both were highly disputed during the negotiations before Maastricht.

[42] Molle (2001) 380-390.
[43] Panarella (1995) 42-55.
[44] Molle (2001) 381-382; Baldwin and Wyplosz (2012) 436-438,

Theoretical character of the Maastricht Treaty

However, before we move to the design flaws in the original architecture of the EMU, we will take a brief look at the theoretical background of the discussions towards Maastricht. This is useful to see and explain a bit why different countries took different positions during the negotiations. It seems that the Treaty of Maastricht is more or less an outcome of negotiations between countries 'connected' to different theoretical schools. The negotiations before the ratification of the Maastricht Treaty were characterized by a dichotomy between monetarists on the one hand and economists on the other. The last school is also known as 'behaviorist'.

The Dutch and the Germans were more or less supporting the ideas of the economist school. That means that they are in favor of a system of convergence before moving forward to a monetary union. So: first a long period of harmonization of economic policies, and if countries proof to be ready to enter a monetary union, they may enter. In this scenario there is no time-path or deadline. Only if a country meets certain levels of convergence it could enter the Eurozone. This clarifies why the Germans were so eager to add real quantitative criteria of convergence: inflation rate, real interest rate, etcetera. Once a common currency is introduced there is no option anymore to adapt the exchange rate. And without this instrument other measures are required in order to become competitive, the so-called alternative adjustment mechanisms. For instance to lower wages to ensure competitive unit-labor costs. These measures are very difficult to implement according to economist view, so they want to rest assure that a certain level of economic convergence is reached before losing the instrument of exchange rate adaptions. Of course, all this has to deal with the ability of participating member state to correct internal imbalances. We will return to this later.

The other school consists of the so-called monetarists. The Italians and the French were advocates of this school of economic thought. They believed that once the common currency and institutions were introduced, convergence would be of less importance. The introduction of fixed exchange rate, without taking into account the level of convergence of participating states, would automatically mean that politicians opt for measures that restore a certain balance in the Eurozone; options like reducing deficit spending or lowering wage levels in order to keep pace with other participating countries. The monetarist camp opted for the irrevocability of the introduction of the EMU, a strict time-path and agenda to introduce the new institutions.[45]

Overall the plan of the EMU looks quite economist at first sight. The Maastricht Trea-

[45] Wyplosz (2012) 216-216; Molle (2001) 372-374.

ty lays strong emphasis on the entry criteria and the process of convergence. Meanwhile the Treaty set a timetable (the three stages) and is very clear about the irrevocability of the Economic and Monetary Union. So in the end, the Maastricht Treaty is a mix of both economist and monetarist elements. We should keep this underlying background when we will take a look at the design failures and more in particular the negotiations I will elaborate on in the fourth chapter.

III. The design failures in the Maastricht Treaty

Initially the Economic and Monetary Union was a huge success. The system was rather stable. The Member States of the Eurozone could profit from a smooth functioning of the payment system, a strong and stable common currency, price stability and many other benefits of the introduction of the euro. In May 2008 the Eurozone celebrated *EMU@10*, a decade of success of the common currency. Almost nobody could predict that a huge financial crisis in the Eurozone would break out only a few months later. Unfortunately, this crisis proved to be threefold. A triple crisis occurred: the sovereign debt crisis, the banking crisis, and the outbreak of a deep recession.[46]

The triple crisis was a major test; would the Eurozone survive or not? Due to painful measures and strict crisis management the EMU survived. But still; the fundaments of the EMU building proved to be weak. The Eurozone crisis revealed some major design flaws in the original architecture of the EMU. This chapter will elaborate shortly on the causes of the triple crisis. We need this information, because it shows us the weak parts of the design of the EMU. The second part of this chapter will closely look at the design flaws.

The Eurozone Crisis

What went wrong? We will take a brief look at the facts of the Eurozone crisis in chronological order. The outbreak of the Eurozone crisis commenced more or less with the outbreak of the Global Financial Crisis in 2007. The fall of the Lehman Brothers in September 2008 marked the beginning of a period of financial chaos. In Europe there were already underlying problems before the outbreak of the Global Financial Crisis. In the first place the high levels of public debt in countries like Greece and Italy. These countries never realized a lower debt than 60 per cent of GDP, which was nevertheless one of the entry criteria to enter the Eurozone. The public debts of the southern countries were much higher than those of Germany and the Netherlands. However, the low spreads on the sovereign debt bonds indicated that the market was not worried about this situation. The highly indebted countries could borrow at a low interest rate. This was not an incentive to restructure public debt or change policies in order to reduce public debt. In particular Greece did almost nothing to reduce deficit spending, but rather maintained the exceptional benefits of the welfare state. Another major problem was the flow of huge amounts of money to the southern states. Due to the introduction of the Eurozone, and liberalization of capital flows, the banks in the southern states could easily bor-

[46] Pelkmans (2014) 1-2.

row from banks of the northern countries. This caused big current account imbalances across the zone. These large flows of capital to the south were also facilitated by low levels of interest; it was cheap to borrow money. The flows of capital from the northern banks were used for deficit spending of the government.[47] Another part of the story, according to Philip Lane is that *''…lower interest rates and easier availability of credit stimulated consumption-related and property-related borrowing...''*[48] A large part of this money was used to invest in real estate. The investments in real estate caused a property boom. Lane observes that these investments had little effect on the productivity growth, which meant that countries like Spain and Portugal did not become more competitive (despite all the investments).

The global financial crisis of 2007 and 2008 caused a tempering of growth expectations and falling property prices. It became clear that the boom of real estate in for instance Spain could not keep pace with the demand of real estate. Less economic activity caused less tax revenues for the governments and higher costs due to unemployment (especially Spain). Meanwhile the same governments failed to restructure expenditures. In 2009, so two years after the outbreak of the financial crisis in the USA, it became clear that countries like Greece, Ireland and Portugal were in huge trouble. Greece, for instance, reported a budget deficit of 12.7 percent in 2009.[49] The financial markets overreacted. According to the design of the EMU, it's up the financial markets to discipline the market. The capitalist system itself would solve the problems as long as the system could function without barriers. However, the financial market failed to correct the imbalances.[50] Until 2008 and 2009 the spreads on sovereign debt were very low, but from 2009 onwards the spreads skyrocketed. The debt-to-GDP ratio's and interest levels on sovereign debt proved to be unsustainable, and over the years several bail-outs took place. It was the beginning of the sovereign debt crisis.

The financial markets recognized the fragile situation. The banks realized that the real value of sovereign debt on their balances was much lower than expected. And they were also faced with bad loans of consumers and (large) enterprises. They had to revise the value of for instance the mortgages on Spanish real estate. So both the value of sovereign debt and private debt had to be estimated again. After reassessments of the banks, a huge amount of banks couldn't meet anymore the international agreements on for instance tier-core 1 capital-ratio. The banks of the northern countries, which were also confronted with huge problems (for instance ING Group and Commerzbank), tried to pull back money from banks of the southern

[47] For instance Crédit Agricole invested major sums of money in sovereign debt of Greece.
[48] Lane (2012) 52.
[49] Idem, 56.
[50] Jaumote (2011) 41.

states. Between roughly 2005 and 2008 large sums of money flowed to the banks of the southern states, but from 2008 onwards the money traffic was the other way around. This endangered the financial system further; some banks became almost empty shells.[51]

The situation was so dramatic that governments started to nationalize banks. In most case the government had no other option. They had more or less only two options: to save a bank in trouble or to let collapse the whole financial system. The banking system had expanded rapidly after the introduction of the euro. The banking assets were in some cases larger than multiples of the GDP of a country. A lot of banks were so-called 'too big to fail'. And here we notice a combination of weak sovereigns in need of banks buys their sovereign debt with weak banks in need of sovereign that would come to the rescue. This phenomenon is called 'deadly embrace'.[52] And to mention again: the market overreacted. Jacques Pelkmans puts this as follows: *''Of course, this alarmed financial markets as well as credit rating agencies, after first having 'dosed away' for years. In other words, when risk taking should have been 'priced in', it was not. Once it was priced in – forced by rating agencies and jittery markets – it severely worsened the crisis both for banks and national budget authorities.''*[53]

The overall combination of financial and fiscal instability caused severe economic repercussions. Banks were not able or willing to provide loans to companies and people to buy for instance a house, a lack of confidence of customers, high unemployment rates, austerity measures, and so on and so forth. All this ultimately caused a deep recession of the Eurozone. The debate on the causes of this crisis and how to solve the problems is still ongoing.

The shortcomings of the Treaty of Maastricht: design failures

In retrospect we might say that the causes behind the triple crisis could be found in the original architecture of the EMU. The Eurozone crisis revealed several design faults in the Treaty of Maastricht. Let us try to categorize the main design flaws. In addition I will elaborate on the question whether the architectures of the Treaty could be aware of the flaws, based on a survey of the contemporary literature.

Maurice Obstfeld argues that *''Because of the rapid growth in financial markets, several distinctive features of EMU have had consequences that were largely unforeseen before the single currency's launch, or that turned out to be even more damaging than could have*

[51] Obstfeld (2013) 7-24; Lane (2012) 55-57.
[52] Pelkmans (2014) 2; Véron and Wolff (2013) 3.
[53] Pelkmans (2014) 7-8.

been predicted then.''[54] That sounds like an 'adequate' explanation for the design flaws: 'un-foreseen'. We have to make a distinction between officials and leaders who designed the Treaty and people from the outside (academic) world of specialists and scholars. So we better ask whether the architects of the Economic and Monetary Union could know or not; could they be informed by the academic world? Therefore, this part of the chapter explores the designs failures and the position of the contemporary academic literature. We should keep in mind the very fact that the academic world published always some years after political developments.

Too intergovernmental

The first failure is not that complicated. The design of the governance structure of the EMU is rather intergovernmental. This means that there is no strong supranational body to control and supervise the Member State to see whether the state acts according to the Treaty. The European Commission has very limited power and states have to supervise each other on the basis of the principle of peer pressure. Eichengreen en Wyplosz argue that it is very unlikely that the leaders of the different Member States are going to impose sanctions on other leaders; this could cause political difficulties in the future. The intergovernmental set-up of the Eurozone also explains the lack of institutions to enforce Member States to comply with the rules. In absence of strong supranational institutions it could happen that for instance Greece and Italy could present results, facts and figures based on creative accounting. Eichengreen argues that the idea that the endeavor to comply with the rules (for instance on convergence) would start once the EMU was there was a bit naïve.[55]

The power of the existing institutions is limited according to the Treaty. The European Commission could only start procedures or give advice. Ultimately, key decisions about the further developments of the EMU and to decide whether countries do not comply with the rules (and should be sanctioned) are always up the European Council. For instance, the Treaty of Maastricht leaves some room to measure and decide whether candidate members meet the criteria. They can decide that, although the criteria are not met, a country restructures on a good pace).[56] In 1994 already, Bini-Smaghi and other scholars argued that the combination of a rule with an potential escape to not to fulfill the requirements, could lead diverging interpre-

[54] Obstfeld (2013) 1-2.
[55] Eichengreen (2012) 125-128; In addition: the Stability- and Growth Pact of 1997, to enhance fiscal discipline after entering the EMU, did not work out as expected. France and German did not comply with the rules after a few years, without consequences.
[56] Treaty of Maastricht (TEU), article 104.

tations of the rules of the Treaty. So again, way too intergovernmental.[57]

In the end, only one country did comply with the criteria of Maastricht. All other countries could enter due to the soft intergovernmental approach of Maastricht.[58] Peer pressure, peer review and unbinding agreements were simple not enough for the adequate functioning of the EMU. Member States did not feel enough incentives to comply with the rules; the design of the EMU allowed this attitude.

Macro-economic imbalances

Secondly, the architectures of the Treaty focused too much on budgetary surveillance. Especially the Germans were very eager to maintain fiscal discipline. Accordingly two of the entry criteria are about fiscal discipline, namely a debt/GDP-ratio of 60 percent and a maximum deficit spending of 3 percent of GDP. If a country fulfill these criteria, and some other conditions, it could enter the Eurozone. The Treaty does not take into account binding standards concerning macroeconomic coordination and cooperation. Eichengreen observes that before the outbreak of the crisis only Greece was in trouble when it comes to fiscal and budgetary discipline: *''Elsewhere in the Eurozone periphery, however, budgets had been in balance or even surplus before the crisis. Imbalances were concentrated in the private sector.''*[59] The problems commenced mainly in the sector of private banking and not in the fiscal sphere. Nevertheless, the problems of the banks led to fiscal problems due to the very fact that government had to save the banks. The design did not take into account this scenario, but focused too much on fiscal discipline, thereby neglecting other dimensions.

Divergent macroeconomic trends in the different member states of the Eurozone could endanger the zone as a whole. Paul de Grauwe, for instance, mentions the problem of divergences in unit labor costs and inflation. Especially the divergence of unit labor costs had led to a loss of competitiveness of the southern countries compared to the northern countries. Another major problem were the abovementioned current account imbalances. In general the northern countries experienced major surpluses and the southern countries the opposite. These divergent macroeconomic trends caused major problems.[60] In the end, the ability to correct the current account imbalances and the possibility of further deficit spending evaporated.

In the absence of the possibility to use the exchange rate or a national interest rate, the member states of the Eurozone should search for alternatives, in case of imbalances in the

[57] Bini-Smaghi, Padoa-Schioppa and Papadia (1994) 31.
[58] Wyplosz (2006) 217.
[59] Eichengreen (2012) 128.
[60] De Grauwe (2013) 7.

Eurozone.[61] One of the main costs of the introduction of the monetary union was the loss of the interest rate as an adjustment mechanism. The southern states could borrow at a very low real interest rate due to high inflation. One of the main consequences was the occurrence of a housing boom, part of a much broader trend of excessive credit growth. This credit growth caused higher inflation – notice a kind of a loop.[62] This caused huge liquidity shortages of the southern states. Because of the loss of the exchange rate mechanism and the standard adjustment mechanism, the interest rate, countries were required to opt for alternative adjustment mechanisms, according to the theory of optimum currency areas (OCA). The southern states could 'repair' the imbalance through the use of the competitiveness channel (generate cash flow due to low prices of products and services). However, the design of the EMU lacked institutions and policies to do this on an EMU-level or to enforce this; it is up to the Member States of the Eurozone to do that. To quote Charles Wyplosz: *''These 'real criteria' are nowhere to be found in the list of 'nominal' criteria that, after considerable debates (…) were incorporated into the Maastricht Treaty and came to be known as the Maastricht convergence criteria.''*[63]

Back to the OCA theory. Again, could they know the severe consequences of macroeconomic imbalances? Paul the Grauwe argues that during the years of the process towards an economic and monetary most academics supported the ideas of optimum currency areas. There were widespread doubts about the introduction of a monetary union among academic scholars. Already during the 1960s Mundell presented his classical theory about the optimum currency areas. In short, this is more or less an assessment to see whether or not it is attractive for a state to join a monetary union; that is to say the benefits exceeds the costs of joining. According to the OCA theory a state has to satisfy certain criteria or conditions in order to join a monetary union. Paul de Grauwe conceptualized the different criteria: symmetry of shocks, flexibility and integration.[64]

In case of a shock within the monetary union, there are potential alternative adjustment mechanisms; mechanisms in order to stabilize in case of shocks. These are: wage and price flexibility, labor mobility and fiscal transfers. The Treaty of Maastricht explicitly prohibits fiscal transfers. So, according to this theory, wage and price flexibility and labor mobility are required. The Eurozone scores very badly with regard to labour mobility compared to the USA, for instance. The people of Europe is less willing to move throughout the Union to find

[61] Jaumotte (2011) 41.
[62] Wyplosz (2006) 216.
[63] Idem.
[64] De Grauwe (2006) 709-715.

a job. Then price and wage flexibility. Unit labor costs diverged over the years, in favor of the northern countries. The policies of the southern countries were not aimed at lowering labor costs, wages were too high compared to the northern countries. This caused a major imbalance in the Eurozone. The original architecture of the EMU lacked instruments to repair the imbalances on macroeconomic level. Again, the Treaty offers no strong incentives to do so.

So we might consider that the theory in itself provided different critiques on the design. But why didn't they use this theory? Charles Wyplosz argues that *''Two problems stood in the way of making OCA theory the centerpiece of the Delors Report and the deliberations that followed its acceptance.''*[65] Firstly, the theory was very complicated and not formalized yet. The interpretation and understanding of the theory was a work in progress at the time. Secondly, there were additional problems to analyze to practical conclusions. For instance how to measure an OCA index. Wyplosz mentions Eichengreen as one of the first, who started to use the OCA, to attempt to make an index.[66] Thus, the reaction of the European Commission on the Delors Report, *One money, one market*, emphasized that the OCA theory could be very useful, but nevertheless it could not be used to analyze the consequences of the EMU.[67] The construction of the EMU was at full speed; there was no time to elaborate on the OCA theory.

Financial integration, national supervision

The third big design failure is the system for financial integration, the free flows of capital across the Eurozone, without creating a framework of supervision on a level above the Member States. Firstly, there was a lack of institutional powers to control and to supervise the banks. The Eurozone contained no banking union. Supervision of the banks was left to the national authorities.[68] Capital requirements, for instance, differed throughout the Eurozone. The introduction of a single currency stimulated cross-border flows of capital and credits. The balance sheets of the European banks grew rapidly during the 1990s and the first decade this century. The balance sheets of a lot of banks exceeded multiple times the GDP of the country of residence. At the time the banking system failed and big banks like Santander, ING, and many others, had to be saved by national governments for a simple reason: 'too big to fail'. The governments became responsible for the huge liabilities of banks, way too big for most countries, instead of a shared burden.

Since it was very unusual that banks go bankrupt in Europe, governments felt more

[65] Wyplosz (2006) 214-216.
[66] Idem, 214-215.
[67] Commission (1990).
[68] O'Rourke and Taylor (2013) 168.

obliged to rescue banks in case of emergency. This approach of European governments enhanced the problem of moral hazard; if a banks is big enough, the government will automatically come to the rescue. Bankers abused this situation and took way too large risks –lets gamble![69] And problems in one country could lead to problems in other countries, due to financial integration and big banking; the problem of contagion. The collapse of a bank in for instance Greece meant that banks in other countries had to amortize. Consequently, these banks were in hit as well.

In the end, the taxpayer and the depositor paid the price for the misbehaving an mismanagement of the banks and the lack of coordination, supervision and collective programs on a union level. The European Central Bank focused too much on price stability. Many of the other tasks were left to the national central banks, which didn't do their supervisory job very well. In order to summarize this problem, Baldwin and Wyplosz quote a former board member of the ECB, namely Padao-Schioppa, to express this problem: *''A normal central bank is a monopolist. Today's Eurosystem is, instead, an archipelago of monopolists.''*[70] And ccording to Barry Eichengreen: *''This revealed the contradiction between a single currency and single financial market, on the one hand, and 17 separate national bank regulators, on the other. National regulators at neither the lending nor the borrowing ends of intra-eurozone imbalances had adequate incentive to take the cross-border implications of lax domestic regulation into account…''*[71]

If we compare this situation to the USA, we notice that there are collective programs, collective deposit insurance and other permanent existing options to rescue a bank. The Eurozone had none of these options or instruments. If a bank fails, the tax payer or the depositor is the victim.[72] In a fully operating banking union, a huge amount of money is reserved for eventual rescue operations. This prevents the occurrence of 'deadly embrace': weak sovereigns rescuing weak banks, and weak banks rescuing weak sovereigns.[73] A banking union makes it possible to solve the banking problems on a union scale, sharing the costs instead of weak sovereigns forced to nationalize banks in trouble.[74]

But could they know? Barry Eichengreen and Maurice Obstfeld signalize that at the beginning of the nineties, yet before the introduction of the EMU, some scholars already warned about the potential consequences of the proposed EMU-model. In 1992, Folkerts-

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[69] Pelkmans (2014) 7.
[70] Baldwin and Wyplosz (2012) 435.
[71] Eichengreen (2012) 129.
[72] O'Rourke and Taylor (2013) 179-181.
[73] Pelkmans (2014) 17.
[74] De Grauwe (2013) 29.

Landau and Garber argued that the financial system should be repressed; common rules, standards, requirements and supervision were inevitable. Otherwise the ECB would be forced to step in with emergency liquidity in case of liquidity problems, to save the banking system. And indeed, it sounds strange that bank resolution and bank regulation were left to national authorities, and meanwhile these national authorities didn't have instruments like money creation or a role of lender of last resort. In retrospect, they were right; the ECB was forced to provide emergency funding, a role of lender of last resort. And that was not the initial role the designers of the Maastricht Treaty had in mind. Furthermore, Obstfeld paraphrases David Begg and other scholars who already emphasized 'this gap' in the framework before the start of the second stage of the EMU.[75]

Most of the critique originated in older theories. Let us focus on the theoretical background. The mix of financial stability, cross-border financial integration and national financial policies and supervision seems to be incompatible. This is the so-called 'financial trilemma'. Schoenmaker, using different models, observes that national financial policies become less effective if financial integration increases. A combination of two of the above-mentioned conditions is possible, but three not. He made his assumptions based on older ideas of R.A. Mundell.[76] So we might conclude that the designers of the EMU more or less ignored the old ideas about the incompatibility of fixed exchange rate stability, free movement of capital and national monetary policy. Part of the last-mentioned is supervision of the system.

No crisis management and tools

Last but not least, the lack of a mechanism for crisis management. After the outbreak of the Eurozone crisis it became clear that the EMU lacked the tools to forcefully implement policies that could solve the problems; that is to say preventing states or banks from going bankrupt (again the crisis showed us the interconnectedness between the two). In absence of these tools and mechanisms, the leaders of the Member States had to agree repeatedly on rather *ad hoc* measures and panic management. The Treaty of Maastricht did not contain the right tools and possibilities.[77] In general, the Maastricht Treaty comprises mainly articles about how to prevent a crisis, especially the convergence criteria. Marco Buti and Nicolas Carnot argue that one could find more or less no tools, regulations, procedures or whatsoever in the original architecture of the economic and monetary union.; its only about preventing crisis, and not

[75] Eichengreen (2012) 129-130; Obstfeld (2013) 5 and 32-34.
[76] Schoenmaker (2011) 57-59.
[77] Pelkmans (2014) 2.

about solving a crisis.[78]

The Eurozone crisis caused that several states, like Greece and Portugal, were not able to borrow money on the international financial market at sustainable levels of interest. The financial market overreacted, as described in the first part of this chapter, and was not willing to lend anymore to these countries. This is the so-called a 'sudden stop'. Before the introduction of the common currency, states could make use of the national central bank in order to create money in case of emergency. However, the introduction of the EMU had the severe consequence that states could not use this tool anymore. The role of the national central banks as lenders of last resort did not exist anymore.[79]

The alternative could be twofold: fiscal transfers within the Eurozone, in order to provide countries like Greece with cash, or inflationary debt monetization, that is to say: to print extra money. However, the Maastricht Treaty is very clear about these solutions: prohibited.[80] Article 104b says that member states are not responsible for the finances of other member states. The article prohibits to assume the debt of other member states. This is the so-called bail-out clause.[81] In addition, the Maastricht Treaty does not provide a framework for a Member States to leave the Eurozone. Thus this combination of no bail-out and no exit ultimately makes it that there are no other options than a search for alternatives. The risks of contagion were underestimated; so the crisis in Greece, Ireland and other southern countries caused crisis in the northern states through contagion.

The other abovementioned solution of debt monetization of deficits is also prohibited in the Treaty of Maastricht. Buti and Carnot argue that the drafters of the Treaty expected that the market would regulate and discipline the policies of the Member States. It did not happen. And once it happened, the markets overreacted.[82] Nevertheless, already during the beginning of the nineties Bini-Smaghi and others warned that the perceptions of the financial markets of the financial outlook of a country are not always translated into the right levels of interest for instance. The free market simply functions not always adequate.[83] The lack of crisis management caused huge troubles throughout the Eurozone. Without an adequate framework for crisis management, there was a lot of delay in solving or attacking the immense problems, due to negotiations between disagreeing states. Ad hoc measures saved the Eurozone, but nevertheless, the reconstruction of the EMU is still a work in progress.

[78] Buti and Carnot (2012) 900-906.
[79] De Grauwe (2013) 9-10.
[80] Buti and Carnot (2012) 900; Obstelfeld (2013) 26-29.
[81] Treaty of Maastricht (TEU), article 104b.
[82] Buti and Carnot (2012) 900-901.
[83] Bini-Smaghi, Padoa-Schioppa and Papadia (1994) 27.

Could the know? The academic literature at the time of the Maastricht Treaty does not provide extensive analyses regarding the topics of crisis management. The original designers of the Treaty could take a look at the system of the successful monetary union of the USA. O'Rourke and Taylor offer us an comparative overview of some important different monetary unions throughout history. The USA has the instrument of debt monetization[84] Of course, debt monetization could cause high levels of inflation. So especially Germany was against this tool. A fiscal union, more or less a logical new step alongside the road of crisis management, was a bridge too far. Price stability, that is to say low inflation, was the main concern of the Germans (and Dutch) during the design of the EMU. Nevertheless, the expectation that this kind of crisis management and other tools were not required due to the free working of the financial market, was a major miscalculation.

So we have four big design fault in the original design of the Economic and Monetary Union. This is actually a lot, and anno 2015 there is still a lot of work to be done to repair. Nevertheless, we should not look at the future only; we might ask why all this this could happen. And we could ask why all this information about the potential faults was more or less ignored by the architects. Again, Barry Eichengreen observes that *''…the impact on policy making was limited by the fact that the literature focused almost entirely on analytical constructs. There were few efforts to apply it to actual or prospective monetary unions like the one about to be constructed.''*[85] This is more or less an overall conclusion. The next chapter will elaborate on the Dutch case. What did governmental advisory boards and institutes know about the potential design faults in the Treaty of Maastricht?

Summarizing table 1

Design failures	**Part of academic literature?**
1. Too intergovernmental, causing insufficient compliance with the (fiscal) rules	Yes
2. Too much focus on budgets, less on other macro-economic imbalances	Yes, the OCA theory
3. Financial integration, though maintenance of national supervision	Yes, though not explicit 'banking union'
4. Lack of crisis management and mechanisms	No, only vague

[84] O'Rourke and Taylor (2013) 169 and 177-185.
[85] Eichengreen (2012) 124.

IV. What could the Dutch government know? The advisory boards

The previous chapter elaborated on the question to what extent the architectures of the Treaty of Maastricht could know the design failures, based on contemporary literature. This chapter is the second step and will elaborate on the role of the advisory boards of the Dutch government. To sum up: the Sociaal Economische Raad (SER), the Central Plan Bureau (CPB), the Wetenschappelijke Raad voor het Regeringsbeleid (WRR) and the Nederlandsche Bank (DNB). I will categorize the advices and comments of the four institutions under the four design faults in order to draft conclusions per design fault to what extent the Dutch government was informed.

General observations

However, let us first make some brief observations about the advises of the abovementioned institutions in general. This serves to see the overall attitude of the advisory boards towards the EMU, the years between 1985 and 1991. In June 1988 the European Council decided to appoint the committee of Delors in order to explore the possibilities to create an economic and monetary union. Nevertheless, the ideas about a common currency were much older, so the advises concerning more economic and monetary integration were already there before Hannover and the Delors Committee.[86] The advises after the publication of the Delors Report in 1989 were more or less reactions on that report. In particular, the publication *'Advies Economische en Monetaire Unie (advies 1990/22)'*, of the SER in 1990 was a reaction on that report and more or less the foremost source of advice for the Dutch government.[87]

However, first some general observations. We might conclude that there was not that much attention for the creation of the EMU shortly after the introduction of the Single European Act in 1986. After 1989 the attention increased. The Dutch Central Bank (DNB) did report regularly about the progressive plan for the creation of an EMU. But the Centraal Plan Bureau (CPB) did not publish at all on the creation of the Economic and Monetary Union. The WRR and the SER did report on a quite regular basis. However, not every single year these institutions did write about the plans. The SER reported about the creation of the EMU in four of the seven annual report between 1985 and 1991. Nevertheless, the WRR and especially the SER did write some very specific and extensive reports about the EMU, in particular about the costs and benefits of this plan.

In general the abovementioned institutions were very positive about the EMU. The WRR regarded the EMU as another logical step towards the completion of the internal market.

[86] SER (1990b) 8.
[87] SER (1990b).

The Single European Act was still not enough; in order to let the internal market function properly, economic and monetary cooperation would be necessary.[88] States would join the common currency if benefits exceeds the costs. I will not elaborate the potential costs and benefits and costs, but the WRR– author F. van der Ploeg – summarizes these as following: *''The calculus of participation (Hamada, 1985, Chapter 3) argues that an individual country will join a European Monetary Union when the benefits from participation (such as from the reduction in exchange rate uncertainty, the increase in bargaining power as a group, and the use of a common currency) exceed the costs (such as giving up an independent monetary policy).''*[89]

In addition, the WRR argued in a report in 1989 that the creation of the EMU was already behind pace. In 1979, the Werner Plan, failed, but the intentions were still there. The WRR also realized that the Netherlands was way too small to influence coordination on world-scale. The open Dutch economy, the increase of international capital flows and the growth international trade created the awareness that coordination was necessary. To influence international coordination, the Dutch should opt for European economic and monetary integration. As a strong block, the Europeans could influence coordination and policy on a world level.[90] Many of the reports referred to the so-called Werner Plan of 1979 and regarded the plans of Delors as a re-launch of the original plans of Werner. The plans, introducing a common currency in phases, looked quite similar. The Delors Committee re-introduced more or less the postponed plans of Werner, thereby fulfilling the idea of further European integration. The internal market and the creation of a common currency had been on the agenda for decades; it was like utopia, but now was the moment to realize it.[91]

The WRR argued that the creation of the EMU was not only the fulfilling of utopia, but also the only option. Due to the open character of a small economy like the Netherlands, it should be part of a bigger entity. Nevertheless, the organization was aware of the very fact that during times of elections government parties generally are not willing to propose international coordination that will lead to convergence, if this could lead to costs for the people.[92] The SER was also very much in favor of the idea of a common currency. The SER focused in some of its report for instance on the disadvantages for the Dutch trade and industries of the fluctuations of the exchange rates. More stability would be necessary to enhance the position

[88] WRR (1989a) 70.
[89] Idem, 94.
[90] Idem 64-65.
[91] For instance: WRR (1989a) 100-101.
[92] WRR (1989c) 7.

of the open Dutch economy. However, a common currency would not only mean more stability and less exchange rate risks – no more exchange rate fluctuations within the Eurozone – but also less cost due to transactions of currencies.[93]

In 1988 the SER showed some worries about the question to what extent the Europeans could compete with Japan and the USA. According to the SER, the European Market was still fragmented, the internal market not yet completed, and due to the still existing borders the costs for trade and industries too high. The completion of the internal market and the creation of one economic and monetary entity, by creating a common currency, would enhance the position of the Europeans *vis-à-vis* the USA, Japan and other strong economic blocks. The Cecchini report estimated a growth of GDP of approximately five percent, by completing the internal market only. The SER argued that the national governments should speed up decision-making and should be willing to take hard measures and decisions.[94] And the Dutch government should base decision-making on the developments of the creation of the common currency.[95]

The creation of the Economic and Monetary Union is more or less regarded as a natural consequence of the Treaty of Rome: more cooperation between the different nations of Europe. The WRR argues that the country does not have an alternative to enhance economic and administrative integration than the creation of an EMU; it's just another logical step of European integration which could be very beneficial for the open economy of the Netherlands.[96]

Another observation concerns the time-path of the project. In general, the advisory boards of the Dutch government emphasized the need for quick action. The open character of the Dutch economy required increasing integration in order to compete on a world scale. One of the main points of negotiation was the time-path of the stages towards the final introduction of the currency. The second chapter already elaborated on the dichotomy between the Germans on the one hand and the French on the other hand. The first did not want to write down a strict time-path, as the French were really eager to do that. In 1990 the SER advised the Dutch government that was not yet possible to set a definitive time-path because the criteria of transition were not formulated yet. The SER recognized the political motivation of some states to set a final datum of introduction of the common currency, but emphasized that fulfilling the

[93] SER (1986b) 9-10.
[94] SER (1988) 95-97.
[95] SER (1991) 7-8.
[96] WRR (1989a) 38; SER (1991) 7-8.

criteria are of main importance.[97]

Last but not least something about the composition of the states constituting the Eurozone. The design of the Treaty prescribes more or less that all member states of the European Union should join the Eurozone. Of course, only if an individual Member State meets the criteria of the Treaty. However, the WRR doubted in 1989 whether it's a good idea to create one monetary union for Europe as a whole. The WRR presents the possible alternative, proposed by Rudiger Dornbusch, of a separate approach between the northern and southern states. This could be more sensible to make sure that the levels of competitiveness within the different currency areas would be stable and not diverging.[98]

From the EMS to EMU

An additional observation is that many of the reports between 1985 and 1991 still focus on the system of the EMS. The European Monetary System was created to enhance monetary stability. The EMS was an important part of the conditions to enter the Eurozone. Already mentioned in the second chapter: according to the Treaty of Maastricht, participation of the Eurozone requires active and successful participation of the EMS (that is to say without devaluation or revaluation). So, not surprisingly, the EMS is an important part of the analysis of the advisory boards. The maintaining of stable exchange rates and the growth of international capital flows is often approached in the reports from the perspective of the EMS. Nevertheless, the EMS was presented as a scientific experiment or proof the support for the next step. In other words: the success of the EMS was one of the main factors in favor of the idea of Delors.[99]

The European Monetary System proved to be a stable system. The Dutch focused mainly on the policy of the German Bundesbank. The German D-Mark was stable and by connecting the Dutch guilder, the Dutch profited from that stability. Nevertheless, the WRR expected a limited role of the German on a world level. The German role as a 'key currency country' meant a *status quo* on an international level. More integration and expansion of EMS system were required to keep pace with economic blocks like the USA, Japan and other upcoming big countries. The creation of an EMU was just a logical step.[100]

The Dutch Central Bank (DNB) reported in 1985 that the EMS functioned very stable, despite some adjustments. The stability of the system could be explained by real convergence

[97] SER (1990b) 59.
[98] WRR (1989b) 139.
[99] For instance: WRR (1989a) 45 and 101.
[100] WRR (1989a) 65-66

of economic developments of the participating states. The elements of convergence were regarded as important conditions for more monetary cooperation. And the functioning of the EMS enhanced confidence about the possible creation of an economic and monetary union. During its presidency of the Monetary Committee the DNB signalized a general sense of willingness to start talks about the creation of an economic and monetary union.[101]

According to the SER the internal market could only function properly if the wish to create an economic and monetary union would be fulfilled during the next years.[102] The SER advised the government from the perspective that the EMS ultimately should be the fundament for the creation of a common market. Existing institutions should be reformed and prepared for the common currency. The SER mentioned the ultimate institutional example: the current European Monetary Cooperation Fund should be replaced by a kind European Monetary Fund (Europees Monetair Fonds) with additional powers and competences. And, in turn, this institute should be the forerunner of a European Central Bank. Thus, here we notice the quite deterministic approach of the SER.[103]

Too intergovernmental

'In the general macroeconomic field, a common overall assessment of the short-term and medium-term economic developments in the Community would need to be agreed periodically and would constitute the framework for a better coordination of national economic policies. The Community would need to be in a position to monitor its overall economic situation, to assess the consistency of developments in individual countries with regard to common objectives and to formulate guidelines for policy.'[104] This was the general approach of the Delors Committee. The approach was more intergovernmental than supranational. They preferred the principle of subsidiarity and a strong role for the Council, instead of the creation of strong supranational institutions to supervise the performances of the Member States.

In general the SER was aware of potential creative interpretations of excessive deficit spending. The participating states should formulate very clear standards, procedures and rules in order to avoid possibilities for excessive deficits. With regard to deficit spending and debt levels the SER offered different potential solutions, based on the ideas of the Monetary Committee. The SER emphasized that a common budget policy would not be necessary. And the advisors wanted to leave some space for the participating states to correct or stabilize short-

[101] Wellink et. al. (1997) 106-107.
[102] SER (1986a) 23-24; SER (1989) 18-22.
[103] For example: SER (1986b) 27.
[104] Committee for the Study of Economic and Monetary Union (1989) 20.

term imbalances by 'using the tool of deficit spending'. Nevertheless the SER was really eager to note that binding rules and procedures would be required, and possibilities to impose sanctions in case of breaking the rules.[105]

In 1991 the Dutch Central Bank argued that it is very important to avoid flexible interpretation of the criteria in. The consequence of the creation of an economic and monetary union is the transfer of some power to a supranational power or authority. Nevertheless, the transfer of sovereignty is limited. The criterion with regard to deficit spending, for example, contains to some extent a bandwidth. Deficit spending is allowed, but with a maximum of three percent of GDP. Budgetary policy and power is left to the participating member state, but monetary policy would be transferred to the ECB. So, the overall structure is rather intergovernmental. According to the DNB, it is very important to maintain strict criteria and leave no room for creative interpretation.[106]

The SER, for instance, argued for more obliged coordination procedures. The procedures for coordination and convergence were still too voluntary. According to the SER it was desirable to coordinate more strictly in order to meet the goals of economic convergence and coordination. In a very extensive report about economic and monetary cooperation the SER argued that further convergence is not assured without enhancing the procedures for economic and monetary cooperation. Coordination should be the key to tackle problems on a European level, but also on a national level; because it becomes increasingly difficult to solve problems like unemployment, when the internal market functions more properly and the financial market becomes more and more open and liberal.[107]

Macro-economic imbalances

The main criteria of the Maastricht Treaty focus very much on deficit spending and the maximum level of debt. Surveillance in order to maintain the formulated goals was one of the main objects of the Treaty of Maastricht. However, the Treaty does not focus on other parameters like the labour market and other variables that expose potential economic imbalances in the zone. I will sum up different observations of the boards, in order to prove the awareness of dangers of macro-economic imbalances. There is no chronological order, but I tried to categorize the advises to some extent.

However there was awareness of these issues amongst the advisory boards. Neverthe-

[105] SER (1990b) 37-39 and 42-43.
[106] Wellink et. al. (1997) 255-256.
[107] SER (1986a) 24; SER (1986b) 22-23.

less, the focus on budgets was very pregnant. In particular, the SER focused very much on budgetary discipline. The committee approached macro-economic policies of the participating member states, mainly from the perspective of the government budget (deficit spending).[108] Though, besides, one of the main concerns of the SER was the very fact that due to the loss of the exchange rate mechanism, imbalances should be prevented and, in case of an imbalance should be repaired by other 'tools', the so-called alternative adjustment mechanisms: wage and price policy, labour mobility and fiscal policy. In 1990 the SER referred to the Delors Report by paraphrasing different causes of imbalances. Firstly, different reactions on the process of restructuring due to increasing integration. Secondly, different impacts of externalities on the different national economies. Furthermore, there are diverging trends when it comes to the developments of labour costs and other types of costs. And last but not least the different economic policies of the member states. Without the disciplinary working of the balance of payments and, thus, the exchange rate, imbalances could occur. The SER argued that more binding coordination would be required in order to prevent and correct imbalances.[109]

However, the SER concluded that the Delors Report was rather vague about how to coordinate national policies in order to prevent divergences. And indeed, if we take a look at the Delors Report, we might conclude that the report emphasizes the need for more economic cooperation several times, but remains rather vague on how.[110] The report focuses on the developments of the wages and labour mobility; ''*Wage flexibility and labour mobility are necessary to eliminate differences in competitiveness in different regions and countries of the Community. Otherwise there could be relatively large declines in output and employment in areas with lower productivity.*''[111] But how to create a certain level of convergence is unclear: monitoring and more coordination, but still non-compulsory. The Delors Report mentiones 'new procedures', but exclusively focusses on fiscal and budgetary policies.[112] And although the SER was very much in favour of more macro-economic coordination, the committee remained rather vague, just like the Delors Report. The SER argued that the Member States should have to negotiate about to what extent national competences should be transferred to a supranational levels. Thereby, the SER maintained the principle of subsidiarity: only transfer of competences, if necessary.[113] Nevertheless, the SER was aware of the importance of unit labours costs. But, instead of emphasizing the importance of convergence within the Euro-

[108] For instance: SER (1990b) 37.
[109] SER (1990b) 10 and 21.
[110] Committee for the Study of Economic and Monetary Union (1989) 11, 15, 16, 17 and 19.
[111] Idem, 19.
[112] Idem, 20.
[113] SER (1990b) 26.

zone, in order to prevent imbalances, the SER stressed the need for maintaining the Dutch very competitive.[114]

The WRR in 1989, for instance, emphasized the need for more coordination between the member states on economic level. That is to say wage levels, fiscal harmonization, etcetera. The advice is from the perspective of the EMU at the end of the horizon, but mainly for the functioning of the European Monetary System. This system was doing well at the time and the WRR argued that more coordination could improve the system further. That, coordination, is to say convergence of national policies and harmonization of rules and standards.[115] The completion of the internal market, liberalization of the capital market, fixed exchange rates, and the increase of structural funds could, after a process of convergence, lead to the creation of a monetary union. Here we notice again the position of an advisory board with regard to the EMU: it should be the final destination of the process of integration.[116]

In addition, the SER advised in 1990 that further economic convergence was one of the foremost conditions to move on with the project. Although, the SER argued that setting a time-path is very important to speed-up the process and to make the creation an irrevocable fact, but the start of the third stage could be postponed if the necessary convergence is not sufficient. The economic statistics, policies, and future prospects should be on a similar level, and macro-economic imbalances in the zone should be avoided.[117]

In addition the WRR laid strong emphasis on two big issues before the start of the EMU in 1992. The WRR argued that coordination of monetary policy alone was not sufficient. And convergence and coordination of fiscal policies were also necessary. Though it was vague whether it was about direct or indirect taxes. In a report in 1989 the WRR was very clear about the desirability of convergence and coordination. However, the WRR did not elaborate on that. Questions like how, what, when, etcetera with regard to these key concepts remain unanswered.[118] In 1988 the SER also emphasized be need for more coordination of budgetary policy and wage policy in order to enhance further monetary cooperation and thus to strengthen the EMS.[119]

Furthermore the WRR argued that functioning of the common market is crucial for the eventual functioning of an Economic and Monetary Union: *'The completion of the European Common Market leads to more identical structures and therefore may facilitate the movement*

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[114] SER (1990c) 9-10.
[115] WRR (1989c) 49.
[116] Idem, 51.
[117] SER (1990) 32.
[118] WRR (1989b) 14.
[119] SER (1988) 18 and 95.

of the European Community towards an optimal currency area.'[120] The WRR did not elaborate of how the completion of the common market would lead to an OCA. And maybe this was a bit shortsighted. Of course, the EMU could function better to the degree there is 'more' OCA, but, unfortunately, the WRR presented only rather general ways to 'create' an optimum currency area; if the internal market would be completed, this would automatically lead to an OCA. To sum up: the SER and WRR hammered very much on the completion of the internal market and more coordination and convergence.

Now back to the OCA theory. At the time, as mentioned in the second chapter, there was a lack of consensus and in general a lack of knowledge to interpreted the Optimum Currency Area Theory, and the WRR was rather vague how coordination of monetary policy and economic convergence would enhance an optimum currency area. Based on scientific literature of Basevi and Giavazzi, Van der Ploeg of the WRR stated in addition that economic convergence and coordination of monetary policies in itself was not enough: ''…*coordination of monetary policies within Europe will facilitate the movement towards monetary union in Europe only as long as the European economies are hit by identical shocks and have identical structures.''*[121] Here we notice the awareness of the application of the OCA theory.

The reports of the advisory boards did warn about the potential dangers of macro-economic imbalances. The WRR for instance, emphasized that Member States would lose their exchange rate mechanism , so they should focus on remaining or becoming competitive. *'However, if there is unemployment, wages are inflexible and the exchange rate cannot be devaluated, one must rely on fiscal action to fight unemployment…'*[122]Fiscal policy is just one of the options.

There are more methods. The SER argued that the developments of the wages should be controlled in a disciplinary way. That is to say no high increases of the wages. However, the SER was also aware that wage policies were not always the best mechanism of adjustment. It could endanger socials cohesion and solidarity. The board opted for possible solutions on a communal level, although the SER remained vague about what instruments could be implemented; freeriding and other tools that endanger discipline of the states should be avoided.[123]

Then back to fiscal adjustment mechanisms. The SER emphasized the possibility to use fiscal instruments by the national governments. And here again, we might notice something like 'tunnel vision', a rationale that diverging (labor) costs could be solved by using the

[120] WRR (1989b) 57.
[121] Idem, 56
[122] WRR (1989a) 98.
[123] SER (1990b) 50.

fiscal instruments. But what if other member states with lower (labor) costs also implement lower fiscal burdens? The SER mentioned the intention of the Community to harmonize direct taxes like value added tax (VAT). A good thing, according to the SER, in order to complete the internal market. Now they focused changed to direct taxes. Member States could become more competitive by changing direct tax policies. However, this change of policies has also disadvantages, according the SER. Effecting solidarity for instance. Unfortunately the SER did not translate this observations into concrete recommendation for the national government.[124] In addition the WRR also emphasized the possibility to use fiscal tools in order to become competitive, could cause a race to the bottom.[125]

The WRR emphasized that there is a strong case for the creation of an economic and monetary union in a world without externalities and severe unemployment. However, this could never be the case. In a monetary union the participating states lose the tool of the exchange rate to enhance the levels competitiveness in order to reduce unemployment. That means that other ways are necessary to stabilize the imbalances within the monetary union. According to the OCA theory there is a strong need for price and wage flexibility, and labor mobility to correct the imbalances and to restore stability. In retrospect the high relative high unit labor costs of the southern member states of the Eurozone proved to be a disaster and obstructed the restoration of inter-Eurozone balances. Besides the WRR warned for the need for flexible adjustment of wages: *''However, when certain areas of Europe are depressed and suffer from unemployment and wages do not adjust immediately to clear all labour markets, the case for a European Monetary Union is much weaker, especially as there is little mobility of labour between the member states of Europe.''*[126]

The Dutch Central Bank was also worried about the potential loss of the exchange rate mechanism to correct imbalances. Due to this loss, the participating should focus very intensely on the developments of the wages. Diverging unit labor costs throughout the zone could endanger the zone as a whole. The rationale behinds this, was that the DNB wanted to avoid (fiscal) transfers from the more wealthy areas to less wealthy areas. That meant that the DNB was not in favor of eventual fiscal transfers. Thus, besides the importance of control of deficit spending, the participating member states should coordinate and converge when it comes to for instance wages and other criteria of the OCA theory. And, of course, this would

[124] SER (1990b) 77.
[125] WRR (1989a) 98.
[126] WRR (1989b) 138.

affect, to some extent, the sovereignty of the participating states.[127]

However, although it seemed that coordination and convergence were the main concerns of the Dutch, in order to avoid imbalances in the future Eurozone, the SER wanted to maintain the policy for wages and prices on a national level. Due to the creation of the common currency, the 'disciplinary tool' of the balance of payments will not exist anymore. Hence, it will be very important that participating states have similar statistics like unit labor cost in order to avoid too large gaps of competitiveness. Coordination, not only on a voluntary basis, is required, but, nevertheless, the SER wants to keep that on an intergovernmental level.[128] Although the SER was, like the DNB, against fiscal transfers, the committee opted for enhancing the economies of these (southern) states through the programs of regional policies. The programs should enhance structural reforms and improvements in order to make these regions competitive.[129]

Lack of international supervision

Not surprisingly, the Dutch Central Bank focused on the developments with regard to the liberalization of the international capital market. The SER and WRR did not advise about this topic. The Netherlands was one of the leading countries when it comes to the liberalization of the international market for capital and credit. And the DNB supported the idea to harmonize the standard and rules, and mainly the supervision of the banking system.[130] The DNB supported this principle in 1985. A few years later, after the presentation of the Delors report, the DNB opted for the creation of an institution on a European level to assure sufficient supervision of banks that operated in more than one country. There was also awareness of the fact that national supervision would be insufficient to control and correct the 'policy and behavior' of the ever increasing big banks throughout the European Community. Banking supervision could be part of the main tasks of the future European Central Bank, according to the DNB. And, of course, the DNB supported the ideas of more cooperation between the national authorities of supervision, on the basis of the principle of subsidiarity.[131] In 1991, the DNB formulated the support for more harmonization and coordination again. Harmonization of the reports of the different central banks, was mentioned as one of the examples.[132]

The DNB was very much aware of the consequences of the developments of big bank-

[127] Wellink et. al. (1997) 186-187.
[128] SER (1989) 37-39
[129] SER (1986b) 18-19; SER (1989b) 59.
[130] Wellink et. al. (1997) 109.
[131] Idem, 209.
[132] Idem, 269-270.

ing and the internationalizing of capital flows. Geographical borders became increasingly vague. The DNB recognized the very fact that a lot of improvement was made on enhancing international coordination and harmonization of supervision. In addition, the European Community should also cooperate with the rest of the world. An isolated policy within the European Community would be insufficient.[133] In addition the SER argues that there is a strong need to bring the jurisdiction with regard to financial activities to a common standard. In order to do so, the European Community could negotiate with the rest of world as one strong uniform power.[134]

Lack of mechanisms in case of trouble

Last, and in this case least, the lack of mechanism for crisis management. The advisory boards of the Dutch government did not take into account the options for crisis management. One could not find descriptions of scenarios in which things could go wrong. Transfers of money from one state to the other, or monetary financing could be options to stabilize the system and prevent a collapse (notice the creation of the European Stability Mechanism in 2011). The SER and WRR did elaborate on that.

The WRR explicitly stated that the ECB could never be a lender of last resort for governments in need of credit.[135] Indirectly, the SER was also against the principle of 'fiscal' transfers of money from one country to the other. The SER warned for the fact that the Delors Plan offered options for extra financial support for countries that, due to the creation of the EMU, would lose the exchange rate instrument. That is to say that these (southern) countries could not devaluate anymore after the creation of a common currency. Delors opted for financial support for these countries. Structural funds were a good option to enhance competitiveness, but permanent or regular fiscal transfers were no option.[136]

The SER was also very clear about problems concerning excessive deficit spending and too high debt to GDP ratios: no extra financial support.[137] The approach of the SER emphasized prevention of problems and gave less options to solve problems. The committee recognized the inability of the market to discipline member states that break the rules with regard to deficit spending. The Delors Report summarized that problem: *'However, experience suggests that market perceptions do not necessarily provide strong and compelling signals and*

[133] Wellink et. al. (1997) 210-211.
[134] SER (1986b) 20-21.
[135] WRR (1989c) 75.
[136] SER (1986b) 18-19; SER (1989b) 59.
[137] SER (1990) 37.

that access to a large capital market may for some time even facilitate the financing of economic imbalances. Rather than leading to a gradual adaptation of borrowing costs, market views about the creditworthiness of official borrowers tend to change abruptly and result in the .closure of access to market financing. The constraints imposed by market forces might either be too slow and weak or too sudden and disruptive.'[138] The SER agreed with that and argued that it was of utmost importance to limit the possibilities of excessive deficit spending. So again: it was all about prevention. The SER supported the 'no bail-out' clause; member states should be responsible for their own finances. Monetary financing and indirect monetary financing (borrowing money from outside the Eurozone) should be limited by formulating binding rules.[139]

Summarizing table 2

Design failures	**Part of academic literature?**	**Reported by the advisory boards and DNB?**
1. Too intergovernmental, causing insufficient compliance with the (fiscal) rules	Yes	Yes. Strict interpretation of the criteria, though focus on coordination.
2. Too much focus on budgets, less on other macro-economic imbalances	Yes, the OCA theory	Yes, focus on convergence and alternative adjustment mechanisms (based on subsidiarity)
3. Financial integration, though maintenance of national supervision	Yes, though not explicit 'banking union'	Yes, but DNB only concerned with this. Focus on harmonization and coordination and cross-border banking.
4. Lack of crisis management and mechanisms	No	No, explicit against fiscal transfer and monetary financing

[138] Committee for the Study of Economic and Monetary Union (1989) 20.
[139] SER (1990b) 36-37 and 42-43.

V. The attitude of the Dutch government *vis-à-vis* the design failures

Last but not least a short history about the position of the Dutch government with regard to design failures. One basis of the preceding chapter, we might argue that the Dutch government could know that the architecture would be insufficient to become a stable house for the common currency. This chapter will elaborate on the question to what extent these insights were transmitted into official statements of the Dutch government. Thus this chapter will not elaborate on the general position of the Dutch government during the different intergovernmental conferences of Strasbourg, Madrid, Rome and Maastricht. Once the archives containing information about the negotiations will be open, we will be able to reveal the rationale behind the (changing) positions and statements during the negotiations. Of course, we will also need interviews with all the leaders and diplomats involved in the negotiations at the different intergovernmental conferences at the time.

General observations

The second chapter was about the most controversial points during the negotiations towards the final draft of Maastricht: the convergence criteria, the time-path and the transfer of sovereignty. The negotiations were characterized by a dichotomy between the German on the one hand and the French on the other. The Germans and the Dutch supported the economist approach; that is to say that a certain level of convergence would be required in order to move on to the next steps of the EMU. The French and other southern countries supported the ideas of monetarists; they wanted to stick to a time-path and argued that the creation of the institutions would automatically lead to convergence. For instance during the Summit of Rome in October 1990 the French and the Germans clashed on the issues concerning the transfer of sovereignty and setting a definitive time-path.[140]In general the Dutch supported the ideas of the Germans, but they were really eager to successfully establish the economic and monetary union.[141] As a small country, it was sometimes rather difficult to expose its own ideas about how to create the common currency. For instance the 'Miljoenennota' of 1992, presented in September 1991, did not emphasize the opinion of the Dutch government; information about the creation of the EMU reflected more or less on the negotiations.[142]

Before we are going to take a look at the technical parts of the story, we might observe that the Dutch government did not go very often into detail about all the technical parts of the

[140] Van Riel & Metten (2000) 25.
[141] For instance: Miljoenennota 1989 (1988) 44.
[142] For instance: Miljoenennota 1992 (1991) 18 and 75.

design of the new Treaty. Just like the advises and policy papers of the advisory boards, most of the statements on the creation of the architecture of the EMU were a reaction on the original plan of Jacques Delors. This report was rather vague in many aspects, and not about all details, and mainly focused on the entry criteria. As we saw before, the design failures are more about the situation after the start of the economic and monetary union; further integration, surveillance, macro-economic imbalances and crisis management. However the content of the statements of the government and the official opinions of the government contained commentaries and ideas about the general rationale behind, and the overall architecture of the EMU. It seemed that more technical details were left to specialists, technocrats and specialized civil servants. Nevertheless it is possible to distil some information with regard to design failures from the literature and official documents like the 'Miljoenennota' and letters of the ministers to commissions of the Dutch Parliament. We will take a brief look at these statements and ideas. Again categorized.

Too intergovernmental

And although the advisory boards, like the SER, advised to formulate very strict rules and standards, Wim Kok stated that the application of the criteria should be not 'mechanical'. During the Dutch presidency the Dutch opted for strict application of the criteria and even suggested to divide the potential participant into two groups; one group that could start if all the criteria would met, and the other countries that not yet fulfilled the criteria; these countries should postpone membership. However, Kok withdrew these suggestions after protests of the Commission and Italy and France.[143] The interpretation of the criteria became very loose in general. And the assessment of the policy plans and results of the participating states remained on a rather intergovernmental level. The process and the willingness of participating states was more or less sufficient, as long as the trend towards meeting the target was maintained. Kok argued that long-term perspectives regarding economic and budgetary developments should be part of an overall assessment.[144] Of course, this leaves some room for creative interpretations of the criteria.

In accordance with the Delors Plan, the Dutch government argued that the creation of supranational powers to control the budgets was not desirable. Based on the principle of subsidiarity the policy should be up to the member states.[145] In 1991, the Dutch government al-

[143] Van Riel & Metten (2000) 27-28.
[144] Van Riel & Metten (2000) 28-29; Eerste Kamer (1991-1992) 27 november 1991, 31.
[145] Miljoenennota 1990 (1989) 43; Miljoenennota 1991 (1990) 20.

ready mentioned some of the possible criteria regarding budgetary policy. And sanctions should be part of the solutions to maintain fiscal discipline. The Dutch seemed very much aware of its own problematic situation of high deficit spending and wanted to maintain budgetary policy on a national level, as long as they could operate within the bandwidths of the criteria. Surveillance to maintain the criteria should be up to the EC Council of Ministers. They should signalize problems and decide on the actions; more or less based on a confidential approach of peer pressure. The governments of the member states had to judge about each other's performance. All in all this seems rather intergovernmental.[146]

Then something about the role of the European Parliament with regard to supervision and controlling decisions and proposals concerning the EMU. A strong position of the European Parliament could mean a more supranational approach. During the process of negotiations the Dutch opted for more power for the European Parliament. They supported the Belgians in order to try to place the EMU under the normal procedures of the Treaty of Rome. However, during the process of negotiations the minster of financial affairs Wim Kok argued it was desirable to enhance the powers of the Parliament, but there were some problems. According to Kok member states would be less willing to work and talk about their national positions if the role of the Parliament is too big. The approach should be confidential. So multilateral surveillance remained on the level of the Council, and decision-making on a rather intergovernmental level.[147]

Macro-economic imbalances

The Dutch government did not expose their views on how to prevent macro-economic imbalances. The focus of the documents and statements was often on deficit spending and debt levels. However, we can trace some awareness of imbalances and possible alternative adjustment mechanisms. The Dutch government emphasized regularly the need for more economic convergence, and avoiding economic imbalances. Nevertheless, the Dutch government remained very vague about how to avoid these imbalances.[148] Budgets seemed to be the core business concerning the question of more convergence. More economic convergence was a work in progress, ever since the creation of the internal market. The creation of the EMU was just another step, and should enhance the attempt for more convergence.[149] The Dutch Parliament also mainly focused on reducing deficit spending to meet the targets. Wage and price policies,

[146] Miljoenennota 1992 (1991) 18.
[147] Van Riel & Metten (2000) 73-75.
[148] For instance: Eerste Kamer (1991-1992) 27 november 1991, 31.
[149] For instance: Verenigde Vergadering (1989-1990) 19 september 1989, 2.

and fiscal policies in order to counteract imbalances were of less concern.[150]

The 'Miljoenennota' of 1990 elaborated on the strong need for more economic convergence. Nevertheless, the Dutch government hammered again mainly on discipline regarding the budgets of the participating states. The Dutch government was very much aware of the high labor costs in the Netherland comparing to some other states. The government opted for moderating increases of the wages and wanted to focus on producing high-tech products and services.[151] The dangers of using the tools of wage and fiscal policies in order to maintains the competitive position, were social and fiscal dumping. Piet Dankert, Secretary of State of Foreign Affairs, emphasized that some level of policy coordination on a European level was required to prevent these problems. The market could cause a race to the bottom.[152]

Then the issue of harmonizing fiscal policies. The Dutch government wanted to maintain the responsibilities of social policies (also social security system) on a national level, based on the principle of subsidiarity.[153] The Dutch were very much aware of the huge differences within the union concerning fiscal policies due to different standards of for instance social security. The harmonization of indirect taxes, in order to complete the internal market, were regarded as necessary, but the Dutch approach concerning harmonization of direct taxes was very reluctant.[154]

All in all it looked like the Dutch government did not really bother about potential imbalances and tools to correct these imbalances. Convergence was the main issue, whatever that meant. For instance, after the conference of Apeldoorn in September 1991, Kok stated that the Dutch government would hand in a convergence program. But, the content of the convergence programs remained rather vague and the programs of the other states were only allowed to circulate within the European Council.[155]

Financial integration, supervision on a national level

Cross-border capital and international banking were on the agenda of the Dutch government during the years before the Treaty of Maastricht. In general the Dutch government was very much in favor of more cooperation between the national supervisors. Already in 1987 the Minister of Financial Affairs Onno Ruding, about attempts on a European level to enhance legislation for criteria regarding supervision of the financial system, mutual recognition and

[150] For instance: Tweede Kamer OCV/UCV (1990-1991) 3 juni 1991, 20-21.
[151] Miljoenennota 1990 (1989) 50.
[152] Eerste Kamer (1991-1992) 8 april 1992, 29.
[153] For instance: Tweede Kamer OCV/UCV (1989-1990) 2 juli 1990, 18 and 21.
[154] For instance: Tweede Kamer OCV/UCV (1990-1991) 3 juni 1990, 9.
[155] Tweede Kamer (1991-1992) 21501-07 72.

cooperation between member states of the internal market.[156] Besides initiatives to enhance mutual recognition, common standards and rules, supervision on a supranational level was not really a topic of discussion. It was more about cooperation between the supervisory institutions. In 1990, for instance, minister of financial affairs Wim Kok informed the national parliaments about a legislative proposal to broaden the options to transfer information between national supervisory bodies.[157]

Supranational supervision was often connected to the creation of the ECB. In December 1988 the Secretary of State of Foreign Affairs, was very clear about the role of the ECB. Berend-Jan van Voorst tot Voorst argued that the ECB should focus on price-stability, that is to say low inflation, and exchange-rate stability. Furthermore, one of the other primary goals of the ECB should be supervising and the banking and credit system.[158] However, two years later the Dutch government was less clear about supervision of the banks. In 1990 the Minister of Financial Affairs declared that supervision of the banks should be remained on a national level. Issues regarding cross border effects of banking and the application of harmonizing measures should probably up to the ECB. Whether the role of the ECB should be coordinating or advisory remained rather vague.[159]

Lack of crisis management and crisis mechanisms

First we might observe that, just like the advisory boards, the Dutch government did not foresee the option that things could go wrong. The Dutch government did not expose ideas about tools and mechanisms which could prevent a collapse of the system. Maybe a collapse was regarded as unrealistic and was never in the minds of the designers of the Treaty and the Dutch government. After the outbreak of the Eurozone crisis *ad hoc* measures had to be taken in order to stabilize the system – the European Stability Mechanism (ESM) for instance.

Nevertheless, the Dutch government was very clear about monetary financing: no monetary financing in case of emergency.[160] In 1990 the Dutch government repeated its statement about the Delors Report concerning transfers of money from more wealthy to less wealthy states. The Dutch government argues that these suggested transfers were not desirable. According to the Dutch, transfers that would not lead to structural improvements, could enable receiving member states to maintain their levels of labor unit costs. So despite transfers,

[156] Tweede Kamer (1987-1988) 20200 IXB no. 30, 2-3.
[157] Tweede Kamer (1991-1992) 21800 IXB no. 21, 3.
[158] Wellink et. al. (1997) 185.
[159] Tweede Kamer (1991-1992) 21501-07 no. 43, 11.
[160] Miljoenennota 1989 (1988) 44.

the level of competitiveness would remain low, and more and more transfers would be required. The Dutch government argued that the less competitive states should improve their performance by structural reforms; that should not be the task of the Eurozone as whole.[161] So member states should be responsible for their own stability (that is to say to remain competitive). And maybe this attitude explains the lack of collective crisis management and mechanisms.

Summarizing table 3

Design failures	**Part of academic literature?**	**Reported by the advisory boards and DNB?**	**Statement of the Dutch government?**
1.Too intergovernmental, causing insufficient compliance with the (fiscal) rules	Yes	Yes. Strict interpretation of the criteria, though focus on coordination.	Strict interpretation of the criteria on the one hand, but leaves space for interpretation on the other. Approach rather intergovernmental
2. Too much focus on budgets, less on other macroeconomic imbalances	Yes, the OCA theory	Yes, focus on convergence and alternative adjustment mechanisms (based on subsidiarity)	Focus on the budgets, but also convergence (sometimes vague) to avoid imbalances. Awareness of alternative adjustment mechanisms (up to the states to use these tools)
3. Financial integration, though maintenance of national supervision	Yes, though not explicit 'banking union'	Yes, but DNB only concerned with this. Focus on harmonization and coordination and cross-border banking.	First in favor of supranational institutions, but later preference of subsidiarity and focus on coordination, cooperation and harmonization.
4. Lack of crisis management and mechanisms	No	No, explicit against fiscal transfer and monetary financing	No crisis management and mechanisms. Explicit against monetary financing and fiscal transfers

[161] Miljoenennota 1990 (1989) 43.

Conclusion

The EMU proved to be a house without a roof. The Treaty of Maastricht and the architecture of the common currency were too weak to prevent a severe crisis. According to many scholars and politicians, the Maastricht Treaty was more or less the beginning of a long process of improving and enhancing the architecture. For instance the Stability and Growth Pact of 1997 was one of the major improvements. Nevertheless, this was not simply enough if we consider the outbreak of the Eurozone crisis. The construction of the EMU building remained unfinished.[162] However, the Eurozone did not collapse and was saved by implementing *ad hoc* measures, structural measures and different tools that were not part of the original design.

Many politicians, academics and scholars and even members of the cabinets of Ruud Lubbers admitted that the original architecture contained different design failures. The Maastricht Treaty was more or less an unfinished work in progress. But could we blame the Dutch government? The first chapter mentioned a recent article in the Dutch newspaper *Volkskrant*; the authors plead for intense research in order to find out whether the former Dutch governments of Lubbers did know information concerning the risks and design failures.[163] This thesis is more or less a first attempt to find answers on this question. This research elaborated on the question to what extent the Dutch government was informed about the design failures by the advisory boards and the Dutch Central Bank. And how these insights and observations were translated into official statements.

The preceding three chapters were about these question. Let us sum up the main observations. With exception of the design failure regarding the lack of crisis management, all failures could be traced in contemporary literature and academic discussions. With regard to the lack of crisis management and tools, we might conclude that academics and the advisory boards could not predict the severe repercussions and problems that endangered the existence of the Eurozone as a whole. So we can't blame the government for that. With regard to the intergovernmental approach: the literature and the advisory boards warned the Dutch government for creative interpretations of the Treaty. In some cases the Dutch government defended these principles, but in the end, Lubbers, Kok and others left space for interpretation and not complying with the rules. With regard to the focus on the budgets, thereby neglecting other macro-economic imbalances, we might conclude that the academic literature mentioned the need for enhancing the adjustment mechanisms. The advisory boards and the DNB also

[162] Metten (2013) 64-65.
[163] *De Volkskrant,* 7 March 2015: *Wat wist de regering over de risico's van de euro?* Available at: http://www.volkskrant.nl/opinie/wat-wist-de-regering-over-risicos-van-de-euro~a3889486/

warned for imbalances. And although these boards elaborated on the OCA theory and the imbalances, there was much stress on 'vague' coordination and convergence. The Dutch government, in turn, was aware of the dangers of imbalances, but focused very much on the principle of subsidiarity. It was up to the states to remain competitive. Concerning international supervision of the financial system we might say that the academic world notified the incompatibility of liberalization, increasing big banking and free movement of large amounts of capital on the one hand, and national supervision on the other. The DNB opted for more coordination and harmonization, just like the Dutch government. Both parties mentioned at some point that the ECB could play a role on a supranational level, but later they opted again for more harmonization and coordination of the basis of subsidiarity.

All in all we might conclude that both the advisory boards and the Dutch governments did not had very clear ideas about the potential design failures. The Dutch government could know some of the design faults. Both were aware of potential problems, but focused very much on rather intergovernmental ways to prevent problems: coordination, harmonization, convergence and other terminology was common sense. But main approach was rather intergovernmental, non-compulsory and based on subsidiarity. Nevertheless, it seems that the government could not predict the severe crisis due to the weak architecture. The absence of crisis management, firewalls and other tools in the statements and documents of the government and, ultimately, the Treaty might explain that fact.

Although this is the end of this thesis, this is not the end of the research concerning this topic. In particular, I left out the dynamics of the negotiations. This could be another part of the story. But why did it happen? We could only speculate. As far as I could judge, it seems that the Dutch politicians were very eager to reconcile the French monetarists and the German economists. That meant too much focus on issues like the time-path and convergence criteria during the negotiations. And perhaps, more technical details like alternative adjustment mechanisms were ignored or neglected. Anyway, the Dutch were very eager to find compromise in Maastricht. Or was it the speed of the process? After the presentation of the Delors Report and due to the fall of the Berlin Wall, the process of transforming the internal market – not yet completed at that time – into the Economic and Monetary Union was at full speed; maybe too fast. And what about the personal intentions of political leaders? Did they want to succeed at all costs?

However, we could speculate for ages about the causes of the incomplete and instable architecture of the EMU. Once the archives will open, and all the stakeholders like Kok, Lubbers and Maas and other diplomats are willing to talk about the (technical) negotiations we

might eventually reconstruct why the design failures could occur in the original architecture of the EMU. So, to be continued...

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