THE RELEVANCE OF MONETARY INTEGRATION TO THE EUROPEAN UNION

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I. INTRODUCTION

Monetary flow within a market economy, by taking some liberties, can be compared to the circulation of blood within a human being. Money is by far the most important settlement of exchange, whether concerning goods, services, or labor. Enterprises need money, in the form of capital, to carry on business. States need money, in the forms of taxes and borrowing, to finance their budgets. The indicator of the performance of a national economy is calculated in terms of money in the gross domestic product. Economic circulations are described by flows of money.

The present legal framework for international trade[1] and the process of international economic integration are premised on the theory of free

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1. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A11, 55 U.N.T.S. 187, Preamble.

international trade. Economic and social progress is thought to be most effectively promoted by the division of labor and beneficial trade exchange among countries. The integration of national economies is expected to increase economic growth and social welfare through competitive interpenetration.[2] Thus, economic development is contingent upon international exchange and the mobility of money.

II. THE PRESENT STATUS OF EUROPEAN INTEGRATION

1992 has been characterized as a magic year for the European Community (EC or Community). The completion of the Commission's program, set out in the White Paper on the Completion of the Internal Market (White Paper),[3] seems to be in sight. At the same time, political, economic and monetary union, the EC's ultimate goal, has already taken shape. The Treaty on European Union (Maastricht Treaty) is the textual statement of these Community goals.

In December 1991, the European Council (composed of the EC heads of state) adopted the content of the Treaty on European Union at Maastricht, Holland.[4] The final version of the Treaty was signed by the Member States of the EC on February 7, 1992.[5] To enter into force it must be ratified by the national parliaments of all twelve Member States.[6] According to the original plans, the ratifications were expected within 1992, but Danish voters' rejection of the Treaty in the first referendum in June 1992[7] and the narrow approval by

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2. *See generally* BELA BALASSA, THE THEORY OF ECONOMIC INTEGRATION (1963) (discussing economic integration in general). *See also* TIBOR SCITOVSK, ECONOMIC THEORY AND WESTERN EUROPEAN INTEGRATION (1958); DENNIS SWANN, THE ECONOMICS OF THE COMMON MARKET (1988) (illustrating economic integration in the EC, specifically).

3. Completing the Internal Market: White Paper from the Commission to the European Council, COM(85) 310 final [hereinafter White Paper].

4. *EC on Second Day of Summit to Agree on Deadline for European Union*, [July-Dec.] INT'L BUS. & FIN. DAILY (BNA), at 1 (Dec. 10, 1991).

5. Treaty on European Union, Feb. 7, 1922, 31 I.L.M. 247 [hereinafter Maastricht Treaty]. *See generally* THE NEW TREATY ON EUROPEAN UNION, VOLUME 1: A PRACTICAL GUIDE (Belmont European Policy Centre ed. 1991); THE NEW TREATY ON EUROPEAN UNION, VOLUME 2: LEGAL AND POLITICAL ANALYSES (Belmont European Policy Centre ed. 1992); From the Single Act to Maastricht and Beyond: The Means to Match Our Ambitions, COM(92)2000 final.

6. Maastricht Treaty, *supra* note 5, Preamble.

7. Craig R. Whitney, *Danes Reject European Union Treaty by Slim Margin*, N.Y. TIMES, June 3, 1992, at A3.

the French in their referendum on September 20, 1992[8] complicated the process. In response to these setbacks, the United Kingdom decided to postpone the ratification procedure until the situation in Denmark would be clear.[9] A few days after the second Danish referendum on May 18, 1993, resulting in the approval of the Maastricht Treaty, the House of Commons of the British Parliament voted for its ratification. The pressure of organizing a referendum in the UK is thus diminishing.[10] In Germany two appeals have been submitted to the Constitutional Court regarding the "democratic deficit" and the loss of sovereignty brought by the European Union. Also, the Court has expressed its concern that there may be German constitutional problems with Germany's ratification of the Treaty on European Union.[11]

The Maastricht Treaty contains seven titles, eighteen protocols and thirty-three declarations.[12] Title II of the Treaty contains provisions amending the Treaty Establishing the European Economic Community (Treaty of Rome) with a view toward advancing the establishment of the European Community.[13] Among the eighteen protocols are the statutes of the European System of Central Banks (ESCB), European Central Bank (ECB) and European Monetary Institute (EMI).[14]

The stated objective of the European Union is:

> to promote economic and social progress which is balanced and sustainable, in particular through the creation of an area without internal frontiers, through the strengthening of economic and social cohesion and through the establishment of an economic and monetary union, ultimately

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8. Alan Riding, *Turmoil in Europe: French Approve Treaty, but Slim Margin Leaves Doubts*, N.Y. TIMES, Sept. 21, 1992, at A1.

9. *Britain's Major to Delay Maastricht Ratification*, WALL ST. J., Nov. 6, 1992, at A11.

10. *See European Union: Denmark Says Yes to Maastricht Treaty...The Second Time Around*, EUR. REP. (Eur. Info. Serv.) No. 1860, Section I, Institutions and Political Cooperation, at 3-4 (May 20, 1993); *Treaty of Maastricht in the Hands of the House of Lords*, EUR. REP. (Eur. Info. Serv.) No. 1861, Section I, Institutions and Political Cooperation, at 1 (May 26, 1993).

11. *(EU) Maastricht: Fifteen Questions from the Constitutional Court to the German Government - Debate in the House of Lords on 7 June*, POL. DAY (Eur. Agence Internationale D'Information Pour La Presse) No. 5986, at 3 (May 24 and 25, 1993).

12. Maastricht Treaty, *supra* note 5.

13. *Id.* Title II, art. G.

14. *Id.* Protocol on the Statute of the European System of Central Banks; Protocol of the European Central Bank; Protocol on the Statute of the European Monetary Institute.

> including a single currency in accordance with the provisions of this Treaty.[15]

Issues concerning the establishment of a unified financial market, monetary policy and a single currency will be among the key legislative and administrative topics within the EC in the coming years. This is evidenced by the contrast between the specifically drawn obligations of the Economic and Monetary Union (EMU) and other development objectives in the Maastricht Treaty. The Treaty leaves the content of many of these other objectives to be developed in the future.[16]

The EC must adjust not only to the deepening of integration, but also prepare for enlargement through the new European Economic Area (Area) and new applications for membership. In April 1992, the EC and the European Free Trade Association (EFTA) countries concluded negotiations on the Treaty Establishing the European Economic Area (EEA Treaty).[17] The EEA Treaty was signed in May 1992.[18] It has already been ratified by the European Parliament and by most national parliaments of the EFTA countries[19] and was supposed to enter into force in the beginning of January 1993.[20] However, as a result of the Swiss rejection of EEA in a referendum on December 6, 1992, the Agreement will not come into force before early 1994.[21]

The EEA Treaty is designed to achieve the free movement of goods, services, capital, and persons in the enlarged EEA market, and to encourage cooperation in collateral policies, such as the environment, research and development, and education. The provisions concerning basic freedoms in the EEA Treaty correspond to those of the Treaty of Rome and the relevant EC

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15. *Id.* Title I, art. B. As noted in a protocol to the Treaty, the United Kingdom is not committed to move to the third stage of the EMU. *Id.* Protocol on Certain Provisions Relating to the United Kingdom of Great Britain and Northern Ireland.

16. *Id.*, Title VI, ch. 4.

17. Rowena Whelan, *EC-EFTA Initial Deal to Force Biggest Trade Zone*, REUTER'S BUS. REP., Apr. 14, 1992, *available in* LEXIS, Nexis Library, Allnews File.

18. Treaty on a European Economic Area Agreed by the EEC, the ECSC, the E.C. Member States and the EFTA Member States, May 2, 1992, *reprinted in* ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW ¶ B8-651 (perm. ed. rev. vol.) [hereinafter EEA Agreement].

19. *Trade Relations EC-EFTA*, EC COMMENTARIES (Coopers & Lybrand) ¶ 5.2 (Mar. 18, 1992).

20. EEA Agreement, *supra* note 18, General Note.

21. *See* Whelan, *supra* note 17, at ¶ 5.2.

legislation will form the common legal basis for the functions of the Area.[22]

The EEA Treaty will probably not provide a lasting basis for the relationships between the EC and countries in the EFTA. Negotiations for EC membership have started in Spring 1993 between the EC and Austria, Finland, Norway, and Sweden. Switzerland, too, has applied for membership.[23] A precondition for membership will be that the applicants commit themselves to accept the Maastricht Treaty.[24]

The EC has also signed association agreements with Poland, Czechoslovakia, and Hungary.[25] It is in the interest of many of East European countries to become members of the EC in the near future because membership will enable them to modernize their economies through infusion of capital and knowledge brought by trade with the developed EC nations. The structures of Europe are on the move.

III. DEFINITIONS

The core of the economic policy of a nation state is formed by implementing monetary policy (including control of the state's own currency), issuing notes and coins, and conducting foreign-exchange operations. The Economic and Monetary Union (EMU) seeks to create total economic integration. The EMU will have a single currency or irrevocably fixed-exchange rates for the national currencies of Member States and a common macro-economic policy, or at least centralized control over the macro-economic management of Member States.[26] The tension between national sovereignty and international integration, as evidenced by the attitude of the EC Member States towards monetary issues at any given time, illustrates the difficulty of creating a coordinated monetary policy.

International trade presupposes an organized system of payments. Near the close of the Second World War, the international monetary system was reviewed and the rates of currency exchange were fixed against the U.S. Dollar

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22. *See generally* ACCORD EEA: COMMENTAIRES ET REFLEXIONS (Olivier Jacot-Guillarmod ed. 1992).

23. Marie Treinen, *European Economic Area Extends Single Market Across Western Europe*, BUS. AM., Sept. 7, 1992, at 10.

24. *Id.*

25. 1992 O.J. (L 114) 1; 1992 O.J. (L 115) 1; 1992 O.J. (L 116) 1.

26. *See* BALASSA, *supra* note 2, chs. 4, 12.

by the terms of the Bretton Woods Agreement in 1944.[27] In 1945, the International Monetary Fund (IMF) was established to enhance the operation of a multilateral payments system.[28] The activities of the Organization for Economic Cooperation and Development (OECD) also played a role in furthering the free movement of money.[29]

Monetary elements are inherent at early stages of economic integration. A common market cannot function without automatic authorization to settle payments in connection with the sale of goods or services and a supply of foreign currency to complete settlement. Furthermore, free movement of the factors of production cannot be accomplished without free movement of capital.

The EC Commission defined the internal financial market, or the single market in financial services, as a market in which

> "a bank can offer the full range of its services throughout the entire Community and set up branches in another Member State as easily as in its own, where insurance can be bought on the most reasonable terms and be valid throughout the Community, and where the market for securities and capital is of a size sufficient to meet the financing needs of European industry and attract investors from all over the world."[30]

The financial industry consists of banks, securities and investment service firms, all under the common name of credit institutions, and insurance companies.[31] The common name for all three types of enterprises is financial institution or financial firm.

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27. *See* Sir Joseph Gold, *Strengthening the Soft International Law of Exchange Arrangements*, 77 AM. J. INT'L L. 443, 445 (1983). The Bretton Woods Agreement established a system where world currency values were tied to the price of gold in U.S. Dollars.

28. Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, 60 Stat. 1401, 2 U.N.T.S. 39.

29. *See generally* OECD, Code of Liberalization of Capital Movement (1992) [hereinafter OECD Capital Movement]; OECD, Code of Liberalization of Current Invisible Operations (1992).

30. TOWARDS A BIG INTERNAL MARKET IN FINANCIAL SERVICES (Commission of the European Communities ed. 1988). A revised version of the brochure has been published in 1992, European file 3/1992.

31. *See generally* RAPPORTS POUR LE XV FIDE (Congress Lisbonne ed., 1992) [hereinafter RAPPORTS] (describing the structures and volumes of national financial market in the different EC Member Countries).

IV. MONETARY ELEMENTS IN THE TREATY OF ROME

In its original version, the Treaty of Rome explicitly provided for the creation of a common market, but did not envision complete economic and monetary union. The Treaty's limited reference to monetary policy and its lack of any specific monetary targets can be attributed to the unwillingness of the governments of the EC Member States to surrender their sovereignty. On the other hand, there was no special need for dealing with exchange rates in Europe, due to the success of the Bretton Woods agreement in providing a worldwide fixed exchange rate system.[32] Accordingly, the Treaty of Rome contained only the provisions necessary for the creation of the Common Market.

The Treaty of Rome contains several provisions aimed at creating a common financial market. The provisions on mobility of money and capital are found in Articles 67 to 73 (free movement of capital)[33] and in Articles 106 to 109 (on authorization of payments in relation to goods and services and the conduct of macro-economic policy such as conjunctural policy, exchange rate policy, and questions connected with balance of payments).[34] In addition, Article 52 provides for the abolition of restrictions on the freedom to establish a business in another Member State.[35] Articles 59 to 66 abolish restrictions on the free provision of services in Member States and allow for the provision of cross border financial services.[36] According to the Court of Justice's interpretation, in the landmark cases *Reyners*[37] and *van Binsbergen*,[38] Articles 52, 59 and 60(3) are directly applicable, thereby creating enforceable rights for individuals.[39] Thus, these articles require the Member States to abolish discrimination due to nationality or residence in another Member State against

32. *See* Hugo J. Hahn, *The European Central Bank: Key to European Monetary Union or Target?*, 28 COMMON MKT. L. REV. 783, 785 (1991); JEAN-VICTOR LOUIS, FROM EMS TO MONETARY UNION 11-12 (Commission of the European Communities ed., 1990).

33. TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY] arts. 67-73.

34. *Id.* arts. 106-109.

35. *Id.* art. 52.

36. *Id.* arts. 59-66.

37. Case 2/74, Jean Reyners v. Belgian State, 1974 E.C.R. 431, 656-57.

38. Case 33/74, Johannes Henricus Maria van Binsbergen v. Bestuur Van de Bedrijfsvereniging voor de Metaalnijverheid, 1974 E.C.R. 1299, 1312-13.

39. EEC TREATY arts. 52, 59, 60(3).

persons providing services.[40]

The Treaty of Rome, however, did recognize the special position of the financial sector. In its original version, Article 57(2) required unanimity of the Member States when deciding on "measures concerned with the protection of savings, in particular the granting of credit and the exercise of the banking profession."[41] Additionally, Article 61(2) provided that the liberalization of banking and insurance services would be effected in step with the liberalization of movement of capital.[42]

Although the free movement of capital is one of the basic freedoms provided by the Treaty of Rome, the Council has not enacted any significant measures to protect this right. It should be noted, as well, that the free movement of capital has not been held directly effective by the Court of Justice. In the leading case of *Casati*,[43] the Court explained that the tight relationship between the movement of capital and Member State monetary and economic policy precluded the freedom of movement of capital from being directly effective.[44] The combination of the Council's inactivity and the Court's refusal to empower individuals to enforce their own rights under the Treaty of Rome has resulted in Community inactivity in this area.

The process of abolishing restrictions on financial services was, in any event, very limited prior to the White Paper.[45] Actually, only two measures

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40. *See generally* John Usher, *The Implications of the Single European Market for Banking and Finance*, *in* NORDIC PERSPECTIVES ON EUROPEAN FINANCIAL INTEGRATION (P. Timonen ed., 1992) [hereinafter Usher I]; JOHN USHER, THE SINGLE MARKET AND THE LAW OF BANKING (Ross Cranston ed., 1991) [hereinafter USHER II]; FINANCIAL SERVICES AND EEC LAW: MATERIAL AND CASES (Martijn van Empel ed., 1990).

41. EEC TREATY art. 57.

42. *Id.* art. 61(2). It is interesting to note that from the outset the directives on the movement of capital presupposed that Member States would allow direct investment. Council Decision of May 11, 1960 on the Application to Algeria and to the French Overseas Departments of the Provisions of the Treaty concerning Capital Movements, 1960 J.O. (919); Council Directive of 17 November 1986 amending the First Directive of 11 May 1960 for the Implementation of Article 67 of the Treaty, 1986 O.J. (L 332) 22. *Compare* Council Directive 88/361 of 24 June 1988 for the Implementation of Article 67 of the Treaty 1988 O.J. (L 178) 5 [hereinafter Directive on Capital Movements] (replacing the preceding directives). These directives relate to the establishment and acquisition of existing undertakings. This is a clear link with the different monetary provisions of Community law, and it illustrates their interplay. *See generally* Usher I, *supra* note 40.

43. Case 203/80, Criminal proceedings against Guerrino Casati, 1980 E.C.R. 2595, 2619-20.

44. *Id.*

45. White Paper, *supra* note 3.

enacted before the Single European Act (SEA) eliminated restrictions on the free provision of banking service: the First Banking Coordination Directive of 1977[46] and the 1983 Directive on Consolidated Supervision.[47] The SEA added Article 102a to the Treaty of Rome[48] which created the European Monetary System (EMS) and envisioned its evolution towards a European Monetary Union (EMU),[49] a target which would become the specific goal of the Maastricht Treaty.[50]

V. The Program for a Single Financial Market

A single market in financial services would increase opportunities and reduce costs for both business and consumers. The Commission of the EC has repeatedly emphasized the vital role that financial services play in the European economy.[51] In a 1983 communication, the Commission noted that "[a] European financial market is as necessary as ever: its failure to appear is hampering the reinforcement of the Common Market and preventing the Community economy from efficiently tapping available savings."[52]

In the White Paper, the Commission compared financial services with industrial and agricultural products. The Commission stated that a "minimum coordination of rules," similar coordinated rules already in place in industry and

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46. First Council Directive 77/780 on the Coordination of Laws, Regulations and Administrative Provisions relating to the Taking Up and Pursuit of the Business of Credit Institutions, 1977 O.J. (L 322) 30.

47. Council Directive 83/350 on the Supervision of Credit Institutions on a Consolidated Basis, 1983 O.J. (L 193) 18 [hereinafter Directive on Consolidated Supervision]; *See* Kieran Bradley, *The Common Market in Financial Services: An Introductory Guide to Existing and Proposed Community Legislation*, JUS LETTER BULL. (July 1989); THE SINGLE MARKET AND THE LAW OF BANKING (Ross Cranston ed., 1991); ROB DIXON, BANKING IN EUROPE: THE SINGLE MARKET (1991); OPPORTUNITIES IN EUROPEAN FINANCIAL SERVICES: 1992 AND BEYOND (Spicers Center for Europe ed., 1990) (all discussing various aspects of the development of the single financial market). *See also* RICHARD M. BUXBAUM & KLAUS J. HOPT, LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE, CORPORATE AND CAPITAL MARKET LAW HARMONIZATION POLICY IN EUROPE AND THE U.S.A. 167-93 (1988) (analyzing the field of company and market law harmonization).

48. EEC TREATY art. 102a (as amended by the Single European Act, Feb. 17, 1986, 1987 O.J. (L 169), 25 I.L.M. 503).

49. EEC TREATY art. 102a.

50. Maastricht Treaty, *supra* note 5, Title I, art. B.

51. White Paper, *supra* note 3, at 26, ¶¶ 101-3.

52. COM(83) 207 final.

agriculture, which was designed to cause mutual Member State recognition of each state's public safeguards, would greatly facilitate the exchange of financial products across national borders.[53] The White Paper signalled the adoption of a new approach to coordinating financial industry standards. Whereas the earlier policy of harmonization sought to create identical common standards, the new idea was to introduce acceptable minimum standards, which would be sufficient to guarantee the safety and stability of the financial industry.[54]

This method of introducing minimum standards has proven successful, although it is too early to judge its practical consequences. The Commission's program consisted of approximately forty proposals for directives specifically covering financial services. These proposals address banking, insurance, securities, and investment services firms.[55] Once the program is completed and the laws of the Member States are harmonized in conformity with the directives, a financial services firm authorized in its home country will be permitted to carry on business throughout the EC without any additional formalities.[56] These firms will not necessarily need to be physically present or established in the country where the services are offered.[57] Several directives, some of which came into force on January 1, 1993, form the basis for this right, sometimes termed the EC passport or single passport.[58] Among the "passport" directives are the Second Banking Coordination Directive,[59] the Own Funds Directive,[60] and the

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53. White Paper, *supra* note 3, at 26, ¶ 102.

54. *Id.*

55. *See generally* EUROPEAN COMPANY AND FINANCIAL LAW: EUROPEAN COMMUNITY LAW TEXT COLLECTION (Klaus J. Hopt & Eddy Wymeersch eds., 1991) (listing a selection of the directives in force and the proposed directives); BILL POOL, THE CREATION OF THE INTERNAL MARKET IN INSURANCE (1990) (discussing the effect of the internal market on insurance).

56. Second Council Directive of 15 December 1989 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions, Amending Directive 77/780/EEC, 1998 O.J. (L 386) 1 [hereinafter Second Banking Directive] (distinguishing between branches and subsidiaries, treating the establishment of branches like the supply of services, but requiring host State authorization for the establishment of a subsidiary).

57. *Id.*

58. Peter Farmery, *Looking Towards a European Internal Market in Financial Services: Some Paradoxes and Paradigms*, 4 EUR. BUS. L. REV. 94 (1992).

59. Second Council Directive 89/646 of 15 December 1989 on the Coordination of Laws, Regulations and Administrative Provisions relating to the Taking Up and Pursuit of the Business of Credit Institutions and amending Directive 77/780, 1989 O.J. (L 386) 1.

60. 1989 O.J. (L 386) 14.

Directive on a Solvency Ratio.[61]

The Second Banking Directive reserves the responsibility of authorizing financial services firms to the firms' home states.[62] Monetary policy, on the other hand, will remain mainly within the province of the host state.[63] Market risk and liquidity requires collaboration between home states and host states regarding firm supervision. The Directive on Consolidated Supervision[64] was revised in April 1992 to remedy perceived regulatory problems elucidated by the Bank of Credit and Commerce International (BCCI) scandal.[65] The Directive now permits a parent company's home state to examine the financial position of all of the holding company's subsidiaries regardless of where the subsidiaries are incorporated.[66] Therefore, the Directive places primary regulatory responsibility in the parent company's home state. The revision seeks to prevent financial institutions from avoiding supervision by spreading their operations through multiple states.

The Commission has long stressed the importance of the free movement of capital as an essential precondition of a single financial market. According to the Capital Movements Directive,[67] all restrictions on the free movement of funds were to be abolished by July 1, 1990, except for a transitory period of liberalization for Greece, Portugal, and Spain.[68] In practice, free movement of funds was substantially achieved before that date, however.[69] The Directive does not yet include the free movement of money, in other words, the right of a private citizen to move cash or to open current accounts without authorization. The Maastricht Treaty's new capital movement provisions will make the freedom

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61. Council Directive 89/647 of 18 December 1989 on a Solvency Ratio for Credit Institutions, 1989 O.J. (L 124) 16; A Council Directive on Investment Services in the Securities Field (93/22/EEC) was adopted by the Council in May 1993, but it will not come into effect until the beginning of 1996. 1993 O.J. (L 141) 27. This means that there will be no EC passport for investment services firms, and thus no level playing field. *See* Marc Dassesse, *The Investment Services Directive*, BUTTERWORTH'S J. INT'L BANKING & FIN. L. 6 (Jan. 1992); Michael Gruson & Wolfgang Feuring, *The New Banking Law of the European Economic Community*, 25 INT'L LAW 1, 3 (1991).

62. Second Banking Directive, *supra* note 56.

63. *Id.*

64. Directive on Consolidated Supervision, *supra* note 47, at 18.

65. 1992 O.J. (L 110) 52.

66. *Id.*

67. Directive on Capital Movements, *supra* note 42, at 5.

68. *Id.*

69. *Id.*

of movement of capital resemble the Treaty of Rome's other freedoms. These provisions apply not only to movements between Member States, but also to movements between Member States and third countries.[70]

Despite the success of the Commission's legislative program, it is doubtful that the term "financial product" is, in fact, helpful. Financial services cannot simply be bought and removed as goods can be; instead, a long-term legal relationship is often involved, the nature of which may depend upon the national legal system.[71]

It should be noted that even after the completion of the internal market program, EC law will not be a single, coherent legal system. In spite of a broad legislative framework for the single market in financial services, the laws of the Member State laws will continue to be applicable, and these laws often differ significantly.[72] Some of the rules will be completely harmonized, but others will be harmonized only partially or not at all. The differing levels of harmonization can be illustrated by distinguishing four different subject areas (in order of decreasing degrees of harmonization): (1) supervision of economic operators (access to professional activity and carrying on business); (2) supervision of the workings of the markets; (3) legal provisions to ensure the fairness of commercial transactions and protection of the public and consumers; and (4) private law provisions applicable to contractual relations.[73] For example, responsibility for developing business conduct rules will remain the prerogative of the home state.[74] There have not yet been any earnest attempts to harmonize the varying commercial laws of the Member States or to create a uniform commercial code for the EC.[75] Therefore, it is no wonder that many regulatory

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70. Maastricht Treaty, *supra* note 5, Title II, art. G(15) (amending EEC TREATY, art. 73b). *See* Maria Dakolias, *The Second Banking Directive: The Issue of Reciprocity*, 1991/2 LEGAL ISSUES OF EUROPEAN INTEGRATION 69, 75 (1991) (discussing the reciprocity requirements between EC and non-EC banks).

71. USHER II, *supra* note 40, at 76.

72. EEC TREATY art. 189. *See also* Farmery, *supra* note 58, at 95.

73. About the analysis, *see also* the Opinion of the Economic and Social Committee on the Proposal of the Commission for a Council Directive on Investment Services in the Securities field 1989 O.J. (C 298).

74. Farmery, *supra* note 58, at 95.

75. *See* Thomas Wilhelmsson, *European Contract Law Harmonization: Aims and Tools*, 1 TUL. J. INT'L & COMP. L. 23 (1993).

tensions exist and will continue in the 1990's.[76]

During the period beginning with the emergence of the Eurodollar in the 1960's and ending around 1985, the financial market became truly internationalized. Branches abroad are now very common and cross-border transactions are routine, everyday business. Effective international payment and clearing systems are also now in existence. Many securities are listed on multiple stock exchanges in different countries.

Despite this progress, a great number of other differences will continue to impede the exchange of financial services across national borders and to prevent the development of a homogenous internal market. Among these barriers are differences in market structures, cultures, and business methods.[77] Retail banking within the EC has remained largely a national business. Wide variations in prices as well as products in the financial services industries of different Member States continue to exist. Currency and tax differences also form barriers to an unimpeded internal market in financial services.

Keeping in mind that monetary policy issues significantly affect the condition of the financial markets, and that individual national currencies are apt to keep national markets separated from each other, it is questionable whether an integrated financial market can be achieved before the development of a common monetary policy and common currency unit. The EMU might not only be the next step in European integration, but also a key to concluding the previous step.

VI. TOWARDS THE ECONOMIC AND MONETARY UNION

A. *The European Monetary System*

Creating a monetary identity for the EC has been an existing goal of the Community since the mid-1960's. The first concrete proposal for the creation of a monetary union was made by the Commission in 1961.[78] However, the Member States did not agree to draft a plan to accomplish this purpose until

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76. *See* Dassesse, *supra* note 61, at 5; Farmery, *supra* note 58, at 94-95. *See also* Tim Herrington and Richard Parlour, *The Regulation of Global Trading and Investment*, 1 J. INT'L BANKING L. 9 (1992).

77. *See* Farmery, *supra* note 58, at 95. *See generally* FINANCIAL TIMES MANAGEMENT REPORT, BANKING IN THE EC 1991: STRUCTURES AND SOURCES OF FINANCE (Financial Times ed., 1991) (discussing the differences in market structures); RAPPORTS, *supra* note 31 (discussing national legislation in the EC and EFTA countries).

78. *See* SWANN, *supra* note 2, at 179.

1969. This decision resulted in the creation of the "Werner Plan" of 1970, which was designed progressively to realize economic and monetary union.[79] The Werner Plan was adopted by the Council and by the representatives of the Member States in 1971 and 1972.[80] As a consequence of the oil crises of the 1970's and the resulting disruption of the international balance of payments system, however, the Werner Plan was never implemented.[81]

In 1971, the Bretton Woods system of fixed exchange rate parities collapsed.[82] In the wake of this collapse, the Member States of the EC agreed in 1972 to work collectively to limit Community currency exchange rate fluctuations within a band of 4.5 percent.[83] This exchange rate association was known as the European "currency snake," and it was enforced by the central banks of the Member States.[84] In addition, the European Monetary Cooperation Fund (EMCF) was established in 1973 to coordinate the economic policies of the Member States.[85] This system did not, however, fulfill the expectations of the Member States, and many therefore withdrew their currencies.[86] By 1979, when the system was replaced by the European Monetary System, only four Member States continued to participate.[87]

In July 1978, the Council implemented a "scheme for the creation of closer monetary cooperation leading to a zone of monetary stability in Europe."[88] The European Monetary System (EMS) was created by an agreement between the central banks of the Member States,[89] and it began to function in 1979.[90] The EMS's basic objectives are to create a zone of internal

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79. *Id.* at 182.

80. *Id.* at 183.

81. *Id.* at 183, 187.

82. Hahn, *supra* note 32, at 785.

83. *Id.* at 786; SWANN, *supra* note 2, at 185.

84. Hahn, *supra* note 32, at 785; SWANN, *supra* note 2, at 185.

85. SWANN, *supra* note 2, at 186.

86. *Id.* at 187.

87. Hahn, *supra* note 32, at 786.

88. Agreement of 13 March 1979 Between the Central Banks of the Member States of the European Economic Community Laying Down the Operating Procedures for the European Monetary System, *reprinted in* 1 BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW 475 (Stephen Zamora & Ronald A. Brand eds., 1991).

89. *Id.*

90. *Id.*

and external monetary stability with low inflation, and to provide a framework for a closer cooperation between Member States on economic policy.[91] Within EMS, the European Currency Unit (ECU) is used to establish exchange rates between Member States and to serve as a medium of exchange between central banks.[92] The ECU is also a reserve instrument.[93]

The EMS controls the exchange rates of the Member States through the intervention and exchange rate mechanism (ERM). ERM is based upon parity rates of exchange between each EC currency and the ECU.[94] Each Member State central bank is responsible for ensuring that its own currency trades within 2.25 percent of the bilaterally established parity rate.[95] A Member State central bank must intervene if its currency approaches this limit against another currency.[96] Realignments of the parity, or central rates, must be agreed to by all of the participants in the system.[97] Realignments occurred every year until 1987, however, none occurred between January 1987 and September 1992. The EMS thus appeared to succeed in creating a zone of monetary stability and it had high credibility in the currency markets. In reality, however, it played more of a role as a convergence factor, reflecting, rather than causing, a growing synchronization of the monetary economies of the Member States. The inflation rates of many member countries have declined during the last few years, and differences among interest rates in the Member States have become smaller.[98]

As of July 1991, Norway, Sweden, and Finland unilaterally bound the exchange rates of their currencies to the ECU.[99] This attempt at wider exchange rate stabilization in Europe was not long lasting, however. In

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91. SWANN, *supra* note 2, at 190.

92. *Id.* at 191.

93. *See generally* LOUIS, *supra* note 32 (discussing the history of monetary cooperation in more detail).

94. SWANN, *supra* note 2, at 193.

95. *Id.*

96. *Id.* at 193-94.

97. *Id.* at 193.

98. *Consumer Prices: Inflation Relatively Stable in May*, EUR. REP. No. 1779 (Eur. Info. Serv.), Section II, Economic and Monetary Affairs, at 3 (June 24, 1992); *Finance Council: German Interest Rate Rise Discounted by France*, EUR. REP. No. 1785 (Eur. Info. Serv.), Section II, Economic and Monetary Affairs, at 5 (July 15, 1992).

99. *European Monetary System: New Upheavals After Norwegian Krone Breakaway*, EUR. REP. No. 1820 (Eur. Info. Serv.), Section II, Economic and Monetary Affairs, at 1 (Dec. 12, 1992) [hereinafter *European Monetary System*].

September 1992, Finland became the first to cancel its commitment, allowing the exchange rate of the FIM to float for an indefinite time.[100] At the same time, the Bank of Sweden raised its short-term marginal rate from 75 percent to 500 percent in an effort to support its currency.[101] Even that extremely high short-term rate could not support the Swedish Krona, and on November 19, Sweden was forced to unlink its currency from the ECU.[102] Finally, on December 10, Norway also decided to float its Krona temporarily.[103]

These backwards steps were indicative of the uneasy state of EC currency markets in the Fall of 1992. Dissatisfaction with government economic policy increased in several Member States due to the continuing downturn in economic growth and the high level of interest rates.[104] The weakness of the U.S. Dollar and uncertainty regarding the upcoming French referendum on the Maastricht Treaty further confused the situation. Uneasiness and speculation increased in the global currency market, resulting in tremendous outflows of capital from countries with weak currencies.[105] The central banks of these countries could no longer combat pressure against the exchange rates of their currencies at a reasonable cost. As a result, the EC's Monetary Committee allowed the United Kingdom and Italy to withdraw the pound sterling and the lira from the ERM in mid-September 1992 (the lira was devalued by 7 percent on September 13), and allowed Spain to devalue the peseta by 5 percent.[106] In Ireland, Portugal, and Spain, limited regulation of currency transactions was introduced. On November 23, the escudo and the peseta (again) were devalued.[107] The EMS was shaken. By Summer 1993 stability has not been restored, one indication being the third devaluation within eight months of the peseta and escudo on May 13.[108]

Despite the currency market problems of Fall 1992, the EMS remains a key element of general economic policy coordination within the EC. It is

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100. *Id.*

101. Tony Austin, *Focus-Sweden to Keep Crown Unchanged Despite ERM*, REUTERS, Sept. 17, 1992, Money Report Section, *available in* LEXIS, Nexis Library, Reuters File.

102. *European Monetary System*, *supra* note 99.

103. *Id.*

104. *EMS: Irish Pound Devalued by 10%*, EUR. REP. No. 1832 (Eur. Info. Serv.), Section II, Economic and Monetary Affairs, at 1 (Feb. 3, 1993).

105. Austin, *supra* note 101.

106. *European Monetary System*, *supra* note 99.

107. *Id.*

108. *See, e.g.*, EUR. REP. No. 1859 (Eur. Info. Serv.), (May 15, 1993).

questionable, however, whether the EMS is sufficiently encompassing to accomplish true monetary integration. Exchange rate stability with free movement of capital implies a single monetary policy for the European Community. These recent developments demonstrate the difficulties that can result from the lack of a single monetary policy.

B. The Proposal for Monetary Union

The achievements of the EMS during the second half of the 1980's gave new impetus for the creation of the EMU. In June 1988, the Council entrusted the "Delors Committee" with the task of proposing concrete stages of development to lead toward monetary union. The Delors Report[109] forms the basis of present endeavors to establish the EMU.[110] The draft Statute of the European System of Central Banks (ESCB) was drawn up, in turn, by the Central Bank Governors Committee.[111] It has been foreseen that this Committee may, in fact, become the institutional starting point for a future ESCB.[112]

The Council targeted July 1, 1990 as the date for initiation of the first stage of the EMU; this also was the date for completion of full liberalization of capital movements.[113] According to the Maastricht Treaty, the second stage will begin on January 1, 1994.[114] The Maastricht Treaty states that, during the transition period leading to the EMU, economic convergence, economic and monetary policy coordination, and the consolidation of the EMS will be reinforced.[115]

A European Monetary Institute (EMI) will be established at the outset of

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109. JACQUES DELORS, THE DELORS REPORT ON ECONOMIC AND MONETARY UNION (Committee for the Study of Economic and Monetary Union ed., 1989).

110. *See generally* M.J. Artis, *The Maastricht Road to Monetary Union*, 3 J. COMMON MKT. STUD. 299 (1992) (comparing the Delors Report's approach to monetary union with that proposed in the Maastricht Treaty).

111. The Committee of Governors of the Central Banks of the Member States was already established in 1964 and has become a central instrument for promoting monetary cooperation. It functions independently without being subject to the instructions of any community organ.

112. Hahn, *supra* note 32, at 787.

113. OECD Capital Movement, *supra* note 29.

114. Maastricht Treaty, *supra* note 5, Title II, art. G(25) (amending EEC TREATY, Title VI, art. 109e).

115. *Id.* (amending EEC TREATY, Title VI).

the second stage.[116] The EMI is designed to strengthen cooperation between the national central banks and the coordination of monetary policies of the Member States.[117] The EMI will specify the regulatory and organizational framework for the ESCB by December 31, 1996.[118] The second stage will also feature encouragement of the use of the ECU as a common currency.[119]

The final stage of the EMU is scheduled to begin on January 1, 1997, provided that circumstances are then favorable and that a majority of the Member States can pass the qualifying economic criteria.[120] A summit meeting will be held by the end of 1996 to consider these issues. Article 109j, proposed by the Maastricht Treaty, presupposes that the EMU will be introduced no later than January 1999, regardless.[121] In the final stage of the EMU, the Community will have a single currency (the ECU), a single monetary policy, and economic oversight by Community institutions.[122] The primary objective of the ESCB, which will consist of the European Central Bank (ECB)[123] and of the central banks of the Member States, will be to maintain the price stability.[124]

The Member States will formally continue to have ultimate responsibility for their own economic policies, but these policies will be coordinated intensively at the Community level. The Maastricht Treaty provides several instruments for

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116. *Id.* (amending EEC TREATY, art. 109f).

117. *Id.*

118. *Id.*

119. *Id.* (providing that the Treaty will "facilitate the use of the ECU and oversee its development including the smooth functioning of the ECU clearing system.")

120. *Id.* (amending EEC TREATY, art. 109j). The criteria are: "[1] the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability; [2] the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 104c(6); [3] the observance of the normal fluctuation margins provided for by the Exchange Rate Mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State; [4] the durability of convergence achieved by the Member State and of its participation in the Exchange Rate Mechanism of the European Monetary System being reflected in the long-term interest rate levels." *Id.*

121. *Id.* (amending EEC TREATY, art. 109j).

122. *Id.* (amending EEC TREATY, art. 109l).

123. *Id.* (amending EEC TREATY, art. 109l(2)). As soon as the ECB is established, it will take over the tasks of the EMI and the EMI will be liquidated.

124. *Id.* (amending EEC TREATY, art. 105).

accomplishing this coordination. Broad economic guidelines and multilateral surveillance will be established to ensure that Member States' economic policies conform to the coordinated policy of the Community.[125] Member States will be prohibited from financing budget deficits by monetary means; in other words, national governments will have to finance their deficits on the financial markets on equal terms with other debtors.[126] The Community will not "bail out" those Member States that have difficulty paying public debt, and therefore a Member State with sound public finances can expect lower interest rates than those with large deficits or debt.[127] Two objective criteria are used to determine whether a budget deficit is unsound: maximum government deficit is three percent of Gross Domestic Product (GDP) and maximum total government debt is sixty percent of GDP.[128]

The Community's coordinated economic policy will be created by the ESCB. Article G(25) of the Maastricht Treaty defines the basic tasks of the ESCB as:

- defining and implementing the monetary policy of the Community;
- conducting foreign exchange operation consistent with the provisions of Article 109;
- holding and managing the official foreign reserves of the Member States; and
- promoting the smooth operation of the payment system.[129]

Under the new Article 105a, the European Central Bank will have exclusive rights to authorize issuance of bank notes within the Community.[130] This currency will be the only form of legal tender in the EC.[131] Furthermore, the wording of Article 105 implies that the prudential supervision of financial institutions, other than insurance undertakings, may be entrusted to the ECB.[132]

125. *Id.* (amending EEC TREATY, art. 103).

126. *Id.* (amending EEC TREATY, arts. 104, 104a, 104b).

127. *Id.* (amending EEC TREATY, art. 104c).

128. *Id.* at Protocol on the Excessive Deficit Procedure, art. 1.

129. *Id.* (amending EEC TREATY, art. 105).

130. *Id.* (amending EEC TREATY, art. 105a).

131. *Id.*

132. *Id.* (amending EEC TREATY, art. 105).

VII. CONCLUSION

It is clear that the EMU is a major qualitative institutional step, or indeed, a leap forward in the continuing integration of the EC. Common currency, central, independent decision making institutions for monetary policy, and truly internal and centrally supervised (at least to some extent) financial markets would create a homogenous financial zone in actuality. At the core of the economic and monetary policy of the entire community would be the maintenance of price stability, or in other words, the value of money. Setting specific and permanent policy goals in the Treaty creates a system which might be described as "policy by law."

While progress towards the EMU is well under way, it is also approaching fairly critical stages. A lesson from monetary economics demonstrates that free capital movement and a common Community currency are incompatible with the monetary autonomy of the Member States. The EMU thus means the loss of monetary autonomy of the individual Member States. They will relinquish the possibility of using monetary policy to handle their own macroeconomic policies, leaving fiscal policy as the primary remaining national policy instrument. Shocks and disturbances in national economies are asymmetries that require country-specific policies. Fiscal policy alone may be inadequate to combat economic cycles. These economic disturbances and shocks in individual Member States can not be combatted by Community monetary policy.[133] It is therefore understandable that the loss of monetary policy autonomy is a politically sensitive issue for many Member States. The first Danish referendum rejecting the Maastricht Treaty and the French referendum accepting it by a very narrow margin indicate political reluctance to relinquish sovereignty over economic policy.

Beyond its implications for economic sovereignty, the homogenous financial market may also lead countries to unsound and uncontrolled tax competition. If this becomes the case, the public sectors in the competitive Member States might become too small and present a risk to budgetary items that can only be financed collectively, for example, social, cultural, and

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133. *See* Seppo Honkapohja, ECONOMIC ISSUES IN THE FORMATION OF THE MONETARY UNION (Timonen ed.); Pertti Haaparanta, *Euroopan Rahapoliittinen Yhteistyo (European Cooperation in Monetary Policy)*, POLITIIKKA 34:3, at 223; Martin Feldstein, *The Case Against EMU*, ECONOMIST, June 13, 1992, at 20-21. *But see* Paul De Grauwe, et al., *In Reply to Feldstein*, ECONOMIST, July 4, 1992, at 67; Christopher Johnson, *Association for the Monetary Union of Europe*, ECONOMIST, June 27, 1992, at 6.

educational activities. Therefore, there might be a need for fiscal federalism.

It may be concluded that the EMU will bring the Community closer to a political union ruled by financial markets and market forces, rather than by democratic government. It is unclear whether there will there be any consideration given to short-term social policy considerations and preferences other than monetary values in the political bodies of the European Union. Will political bodies be effectively excluded from decisions affecting monetary policy which would be ruled by institutions such as the ESCB? A shift of power of this nature would be a dramatic break from Europe's common democratic and constitutional heritage.[134]

At the same time, the territorial nature of the nation state is changing. Deeper integration means that the economies of nation states will be transformed into market networks of economic power. The economic freedoms of the Community contribute to the mobilization of local resources. The association between territory, nation, and state thus becomes more relaxed. Economic circulations and exchange will become the constitutive principle of socio-political relations.[135]

The degree of cultural conformity and homogeneity demanded and required today is one of the main differences between the present information society and the former industrial society. For example, working life today is less rigid, more flexible and permits a greater variation of organizational arrangements than in the industrial society.[136] In societies at large, ethnic and linguistic identities of smaller groups are allowed,[137] but, on the other hand, compromises are needed. Management of the inevitable conflicts between these

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134. *See* Bruno De Witte, *Community Law and National Constitutional Values*, 1991/2 LEGAL ISSUES OF EUROPEAN INTEGRATION, at 1 ff., and especially at 7.

135. Raimo Vayrynen, *The Nation State, Territory and Nationalism*, *in* THE FUTURE OF THE NATION STATE IN EUROPE (Fin. Nat'l Commission for UNESCO ed., forthcoming Spring 1993).

136. Erik Allardt, *The Nation-State and Nationalism During Different Conditions of Production*, *in* THE FUTURE OF THE NATION STATE IN EUROPE (Fin. Nat'l Commission for UNESCO ed., forthcoming Spring 1993). *See* Juan Linz, *Early State-Building and Late Peripheral Nationalisms Against the State: The Case of Spain*, *in* BUILDING STATES AND NATIONS: ANALYSES BY REGION, VOLUME II 34-36 (Eisenstadt and Rokkan eds., 1973). *See also* ERNEST GELLNER, NATIONS AND NATIONALISM (1983).

137. It is stated in the Preamble of the Maastricht Treaty that the signatories are "desiring to deepen the solidarity between their peoples while respecting their history, their culture and their traditions." Maastricht Treaty, *supra* note 5, Preamble. *See* Harald Haarmann, *Language Politics and the New European Identity*, *in* A LANGUAGE POLICY FOR THE EUROPEAN COMMUNITY 103 (Florian Coulmas ed., 1991) (discussing language and identity).

groups is left to the states.

Within the European Union, sentiments of union solidarity and identity congruent to feelings of national identity will probably not develop.[138] Instead of common social identity, a monetary identity might result. It may be common currency and the competition for financial resources among the Member States, entities and individuals on equal terms in homogenous financial markets that will finally unite the Europeans. Will circulations of money remain the primary common connection among union citizens? Economics and politics are in the end indivisible, but will the union citizens be convinced that it is worthwhile to give social priority to price stability, the objective of the EMU? If that is the case, the EMU could be the key to the European Union.

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138. *See generally* Allardt, *supra* note 136. One of the objectives of the Maastricht Treaty is "to assert its identity on the international scene, in particular through the implementation of common foreign and security policy including eventual framing of a common defence policy, which might in time lead to a common defence." Maastricht Treaty, *supra* note 5, art. B.