European States and the Euro

On 14–15 September 2000 the British Academy organized a conference on how Economic and Monetary Union is affecting European states. The conference covered epistemological and methodological problems in studying these effects. It also considered 'top-down' effects from the EU level, how different states responded to EMU and sought to reshape its development, and sectoral effects on labour markets, welfare states and financial market regulation. **Professor Kenneth Dyson FBA***, the organizer of the conference, reflects on some of the issues.*

It is generally agreed that the process of economic and monetary union (EMU) is having profound effects on European states and that, as a consequence, they are becoming more alike. The truth is, as so often, more complex. Profound changes are linked to EMU. But these changes often anticipated EMU and made it possible in the first place. EMU reinforced a commitment to an economic policy philosophy of 'sound' money and finance whose origins were outside this framework (notably in the growing structural power of global financial markets). It was, however, sometimes vitally important in influencing the timing and tempo of this philosophical conversion, for instance in Greece, Italy and Spain. Meeting the requirements of the Stability and Growth Pact on fiscal discipline has had major practical implications for these states. European states have also become more alike, most strikingly as a consequence of the institutionalization of 'sound' money and finance at the EU level. They share a commitment to price stability and to upholding a stability culture in economic affairs. But there is no evidence that EMU is functioning as a mechanism of convergence around an Anglo-American model of neo-liberal market capitalism. The processes of change under way in labour-market policy and welfare-state policy are more accurately characterized as about the redefinition of the European social model. This model stresses 'security in change' and emphasizes the state's role in assisting processes of economic adjustment by minimizing the risks that individuals must bear. EMU is not eroding the European social model in favour of neo-liberalism.

Building the pillars of EMU

Before returning to these questions, it is helpful to get some idea of the complex nature of the effects associated with EMU. Monetary union – a single central bank, a single interest rate, a single currency – is the most visible, supranational part. From 1 January 1999 the European Central Bank (ECB) in Frankfurt has set monetary policy for the Euro-Zone as a whole. Britain, Denmark and Sweden have chosen not to 'opt in', at least for the time being. But these states remain bound by the other two pillars of EMU whose rules are European Union-wide. The second pillar is a form of 'hard' co-ordination in fiscal policy through the Stability and Growth Pact, armed with sanctions against states transgressing its rules but dependent on peer-group pressure. The third pillar – economic policy and employment policy – represents 'soft' co-ordination, peer-group pressure without sanctions. Since the Lisbon European Council of March 2000, the EU has committed itself to an approach of 'benchmarking' best practice in policies to promote economic growth and employment generation. The 'big' story of EMU culminating in the Maastricht Treaty of 1993 was the institutionalization of monetary union. But since 1995–97 the 'big' story has shifted to the other two pillars. Their development keeps the so-called 'outs' still actively involved in EMU as participants. As the EU faces up to asymmetric economic shocks, the centre of political gravity will be fiscal co-ordination and economic policy and employment policy co-ordination. As a variable promoting domestic policy and political changes, EMU is itself changing.

The effects of EMU

In studying the effects of EMU, a temporal perspective is important. EMU did not begin on 1 January 1999 or with the signature and ratification of the Maastricht Treaty. As a process it can be traced back through the twenty-year existence of the European Monetary System (EMS). State elites learnt through processes of socialization and internalization, through the scope given to policy leadership by EU central bankers, and through emulation of the most successful European monetary power – Germany. The critical junctures varied from state to state: for Denmark 1981–82, for France 1983, for Italy 1992–93. But, however different the timing and tempo in individual cases, the ECB was able to start its institutional life in a setting of political culture that was highly supportive. Also, the major costs of monetary and fiscal convergence had already been managed by individual states before 1999, notably in lost output and employment during the 1990s. For these reasons – supplemented by the lengthy period of careful technical preparations – the final stage of EMU was able to start remarkably smoothly.

The effects of EMU are complex and wide-ranging and will take some time to exhibit themselves fully. Most potently, states are under pressure to be politically inventive. They have lost two policy instruments that have traditionally been associated with their sovereignty over economic policy. Neither interest rates nor devaluation are available to those states that have joined monetary union. Hence they have to consider how to devise new instruments to smooth processes of adjustment to economic shocks. This major change in the policy environment has shifted attention to the institutions of collective bargaining to promote greater flexibility at work, and to reforms of the welfare state and educational systems for the purpose of supporting employability. The result has not been retreat and dismantlement of collective bargaining and welfare-state provision. A major development since the early 1990s has been the negotiation of 'social pacts' at the national level, notably in Ireland, Italy and Spain. In Denmark corporatism has changed – becoming more Europeanized – rather than faded away. On the whole – Britain is very much an exception – state elites have preferred to negotiate with employers and trade unions. Gerhard Schröder's 'Alliance for Jobs' in Germany since 1998 is typical of a wider European practice. This preference for negotiating economic change has in turn directed political attention to what can be learnt from states like Denmark and the Netherlands. These states gave up de facto their sovereignty over monetary policy in the early 1980s and have used negotiated change by consensus as the main instrument for promoting economic adjustment. For this reason, at the level of economic policy practices, Denmark and the Netherlands have proved more important than Germany as a source of lesson-drawing in a post-EMU European Union.

Top-down and bottom-up effects

In debate about EMU much attention has been given to the 'top-down' effects of EMU. EMU puts states under new pressures, and not just because their repertoire of policy instruments is radically changed and 'sound' money and finances more firmly institutionalized than before. Economic behaviour of consumers and of firms will also change. Firms will be operating in a single European market without the transaction costs of exchange-rate variability. They will also be offered new opportunities by the integrated financial markets spurred by a single currency, the first signs of which are to be seen in the explosive growth of the Euro-bond market. The result will be major corporate restructuring to anticipate and cope with new pressures of competitiveness. These pressures will be enhanced by the effects of the new transparency of prices and costs that will come with a single currency. Consumers and firms, armed with this information, are likely to seek out new ways of reducing costs and paying lower prices. The result will be new political pressures on European governments, notably over taxation questions. The combination of internet technology with a new price and cost transparency will empower European consumers to seek out advantages by shopping around the Euro-Zone. Hence 'top-down' effects will draw states into much closer webs of interdependence in managing tax and regulatory policies.

In practice, the Euro-Zone will exhibit a complex interplay between these 'top-down' effects and 'bottom-up' effects. Individual states 'construct' EMU in different ways. For the Danish elites the stress has been on the essential compatibility of EMU's 'sound' policy values with the welfare state. Their difficulty in persuading Danish public opinion to support EMU entry in the referendum of September 2000 had much to do with residual doubts about that argument. For the French elites EMU has been seen as a shield behind which to develop new forms of intervention in social and employment policies. For British elites EMU was a neo-liberal project for making welfare states and labour markets more compatible with the Anglo-American values of market capitalism. Behind these different constructions of EMU was discernible the influence of contrasting national economic structures. British views were strongly conditioned by the structural power of the financial institutions of the City. In Germany, the Netherlands and Denmark the institutional power of employer and trade union officials was more important in shaping attitudes. French views displayed the continuing role and self-interests of the grand corps. There was no sign of national traditions being torn up by the roots. EMU was being framed in different ways at domestic level to make it credible, comprehensible and legitimate.

Convergence?

Convergence is a term that has been applied too readily to characterise what is at work in the relationship between EMU and European states. It is more helpful to discriminate between pressures for convergence and other aspects. There are indeed powerful pressures for convergence, from financial markets as well as from EMU. Their effect is seen most clearly in the political ascendancy of ideas of 'sound' money and finance and the relatively easy way in which the ECB has been able to bed down as a new and powerful institution. But convergence is in other respects much more limited. There is some convergence of domestic policy processes. Finance ministries have been empowered by EMU to extend the scope and grip of their influence on domestic policies. They must, however, deal with powerful entrenched policy communities, for instance in welfare-state institutions that often involve traditions of self-management and also in often very autonomous systems of collective bargaining.

It is also difficult to identify convergence of policies and of policy outputs around a neo-liberal, market capitalism model. This type of convergence is most apparent in financial market regulation, where a shift in the direction of the Anglo-American model is discernible. The combination of the 'sound' money and finance values of EMU with an ascendant Anglo-American model of financial markets can be seen as the most powerful catalyst for a convergence around neo-liberalism. EMU then emerges as part of a process by which the model of shareholder value comes to reign supreme across Europe and efforts to manage capitalism – whether of the Schröder or Lionel Jospin type – come unstitched. This conclusion ignores two aspects of EMU. First, EMU also provides relatively small European states with a more powerful shield against currency volatility than they have known since the collapse of the Bretton Woods system. Secondly, the achievement of a 'sound' monetary and fiscal position via EMU is perfectly compatible with the continuation of high welfare-state spending and more active labour-market policies. Over the longer term the combination of security with change may prove to be a more sustainable and less costly model for coping with the vagaries and volatility of competitive markets than opponents of the European social model have recognised.

Professor Dyson is editing the conference proceedings as *European States and the Euro*, to be published by Oxford University Press in 2001. In addition to providing the introductory theoretical chapter and the conclusion, he is contributing a chapter on Germany and the euro. The volume follows on from his *The Politics of the Euro-Zone*, Oxford University Press, 2000 and (with Kevin Featherstone) *The Road to Maastricht: Negotiating Economic and Monetary Union*, Oxford University Press, 1999. He acted as consultant for the BBC2 series on the birth of the euro, broadcast in April 1998.