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European Monetary Union: The German Political-Economic Trilemma

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European Monetary Union: The German Political-Economic Trilemma

There is no dearth of literature on Europe's Economic and Monetary Union (EMU), a project invested with tremendous political and economic capital. The attention is deserved. Monetary union involves an unprecedented cession of national sovereignty. The creation of money is one of the most significant powers in the possession of national governing authorities. Even before EMU could be blamed for record levels of unemployment, it raised the ire of academic economists and invited political controversy. Particularly in Germany, public opinion has consistently opposed giving up the mark and expert opinion has been seriously divided.[1] Opponents view EMU as an economically flawed policy that will consign parts of Europe to intractable underdevelopment and give traditionally more profligate foreign countries a finger on the trigger of German inflation. Notwithstanding the allure of political opportunism, since 1969 successive German governments of both major political parties vigorously

1 In May 1998, Associated Press reported opinion polls showing 55 percent of the German public skeptical of EMU. Roughly one-third favored the policy with support measurably greater in the new Länder. "Deutsche laut Umfragen mehrheitlich gegen Euro," Associated Press 1 May 1998. More seriously, on January 2, 1998, four renowned economists appealed to the German Constitutional Court to rule for a delay of EMU. In early February 1998, another 150 German speaking economists began publicly circulating an open letter expressing their concerns that EMU would begin prematurely. Beat Gygi, "Widerstand gegen überstürzte Währungsunion; Wirtschaftswissenschafter rufen im Chor nach Verschiebung," Neue Zürcher Zeitung 10 February 1998: 17.

pursued steps toward EMU. Even during Bundestag deliberations for ratification, the Maastricht Treaty on European Union (TEU) encountered remarkably few objections.[2]

There are doubtless many reasons for which German decision-makers have endorsed EMU. Standard explanations suggest that the Kohl government's adherence to the detailed Maastricht agenda belied German national economic interest in currency stability. It is further argued that Bonn displayed reluctance during and after negotiations, but acquiesced for purposes of making German unification diplomatically more palatable to its West European partners.[3] In short, German acceptance of EMU is attributed to an 'unification imperative.' The analysis herein challenges such claims. For Germany, European monetary union is no mere diplomatic expedient that comes at the cost of the national economic interest.

For two decades before unification German decision-makers championed monetary union, both to bolster European integration and to escape a 'political-economic trilemma' deriving from the reserve currency function of the German mark. Since the late 1960s German monetary authorities have faced three undesirable options: uncompetitive exports, domestic inflation, or regional monetary hegemony. German export competitiveness depended on European exchange rate stability, the satisfaction of which meant that Germany either import inflation from its continental trading partners or export higher interest rates abroad. Institutionally and politically

2 "Europadebatte im Parlament. Breite Zustimmung für die Verträge von Maastricht. Über die geplante Währungsunion soll später neu entschieden werden," Süddeutsche Zeitung 9 October 1992: 1.

3 Such a line of reasoning is identified throughout the literature on EMU and German unification. See Ulrike Guerot, "Deutschland, Frankreich und die Währungsunion – über Diskussionen und Metadiskussionen" Frankreich Jahrbuch 1997: Politik, Wirtschaft, Gesellschaft, Geschichte, Kultur (Opladen: Leske + Budich, 1997) 227. On the assertion that EMU had little economic benefit for Germany and resulted from unification, see Barry Eichengreen and Jeffry Frieden, "The Political Economy of EMU: An Analytical Introduction," The Political Economy of EMU eds. Eichengreen and Frieden (Boulder, Colorado: Westview Press, 1994) especially 18.

averse to inflation, Germany became a hegemon not by design but default. Such hegemony, however, undermined the continued exchange rate cooperation of Germany's partners and the Kohl government's foreign policy commitment to European integration. EMU resolves this unique German predicament by supplanting the mark with a common European currency. Nonetheless, in the eyes of Germany's policy makers and electorate, the project's success requires solid guarantees of price stability.

Based on this analysis, the German position on EMU was not opposition but genuine determination to minimize the serious risks involved. Germany was not coerced into giving up the mark for national unity. Rather, quite apart from the positive diplomatic implications for unification, the logic of EMU for Germany rests on a solid foreign and economic policy foundation. After dispensing with the standard argument about Germany's motives for EMU, the 'unification imperative,' I shall elucidate the 'political-economic trilemma.'

The Unification Imperative

The unification imperative holds that Germany ultimately agreed to the provisions for EMU in the 1991 Maastricht Treaty "to reaffirm the country's commitment to European integration in the wake of reunification."[4] Pervasive in the literature that echoes this claim is the assumption that EMU offered Germany few economic benefits beyond the overplayed advantages of eliminating cross-border transaction costs and exchange-rate instability.[5] Along with the fact that the Federal Republic conceded an enviable hegemony in the European Monetary System (EMS),[6] its

4 Loukas Tsoukalis, The New European Economy: the Politics and Economics of Integration, 2d ed. (Oxford: Oxford UP, 1993) 208.

5 The European Commission's studies in the mid-1980s acknowledged that transaction costs and exchange rate instability did not warrant EMU, a point cited throughout the literature. Eichengreen and Frieden 6.

6 Elke Thiel refutes the notion of a unification imperative for EMU in many of her writings. It is not inconsistent that she also acknowledges the reality of German

stalwart insistence on stringent preconditions adds to impressions of German reluctance about EMU. The conclusion frequently drawn is that unification "tipped the balance" for Germany to agree.[7] An even stronger formulation comes from the German weekly, *Der Spiegel*: "The Chancellor of unity gave up the mark in favor of the euro—much earlier and under other conditions than he had ever planned and not even for unification, but only for the vague hope of a German-German confederation."[8]

A cursory view of events surrounding the EC Strasbourg Summit of December 8-9, 1989 indicates that German Chancellor Kohl was coerced into EMU. After expressing serious reservations about French demands for a firm date to convene the intergovernmental conference (IGC) on EMU in 1990, Kohl gave his assent at Strasbourg and conspicuously obtained the EC's endorsement of Germany's right to self-determination. Two days prior to the summit Mitterrand met with Soviet Premier Gorbachev in Kiev in an apparent diplomatic maneuver to forestall unification.[9] Kohl's advisor Horst Teltschik attests that "the guessing game over the intentions of the French President" had begun and, more to the point, admitted to a journalist on December 1 that "the German government finds itself in the position of having to agree to practically every French initiative for Europe."[10] *Der Spiegel* induces: "The prospects for German unity supplied the Frenchman [Mitterrand] the long awaited means of

hegemony in the 1980s. See, "Europäische Wirtschafts- und Währungsunion: Von der Marktintegration zur politischen Integration," APuZ B7-8/92 (1992): 3-11. For a discussion of the implications of German hegemony, please see below, 'Germany's Political-Economic Trilemma.'

7 Tsoukalis, 208.

8 "Dunkelste Stunden," Der Spiegel 18 (1998): 108. All translations in this paper are the author's.

9 Stephen Szabo's detailed account of the entire unification process illustrates such acrobatics. The Diplomacy of German Unification (New York: St. Martin's Press, 1992) 50.

10 Horst Teltschik, 329 Tage: Innenansichten der Einigung (Berlin: Siedler Verlag, 1991) Quotes on 47 and 61, respectively.

pressure to extort from the German [Kohl] the necessary yes for monetary union and shake off the predominance of the German Bundesbank."[11]

Germany's position on EMU after Strasbourg is also interpreted through the lens of a unification imperative. Geoffrey Garrett offers one of the more crude versions, arguing that the need to allay American and European fears of a "bellicose remilitarization" led Germany to compromise on guarantees of price stability during the Maastricht negotiations.[12] Typical extrapolations of such an account describe the German position on EMU in the 1990s as driven by a need to compensate for conceding too much at Maastricht. Also critical of Germany's difficult negotiating position, Edmund Dell implies that Bonn intentionally delayed EMU in the 1990s:

> "it is the German Government and the Bundestag that are forcing deferment by insisting on economic convergence, the virtual abandonment of fiscal as well as monetary sovereignty, and a form of political union, including a strengthening of the European Parliament, not desired even by some of their partners committed to monetary union."13

Beyond accusations that Kohl purposefully delayed EMU, the misguided logic of the unification imperative is applied to his motives for linking European Political Union (EPU) to EMU. In this regard John Woolley speculates that the Chancellor conditioned his support for EMU on unrealistic demands for EPU as part of an underhanded attempt to overload and sabotage the Maastricht agenda entirely.[14] Arguments that the German

11 "Dunkelste Stunden" 109.

12 "The Politics of Maastricht," eds. Eichengreen and Frieden 58. Such analysis is especially problematic, for the Bush Administration is universally recognized in the literature as favorably disposed toward unification and the Maastricht Treaty usually criticized for overemphasis of price stability. See, Loukas Tsoukalis, The New European Economy Revisited (Oxford: Oxford UP, 1997) 171. Hereafter, Revisited.

13 "The Report of the Three Wise Men," Contemporary European History 2.1 (1993): 44.

14 John Woolley, "Linking Political and Monetary Union: The Maastricht Agenda

motive for EMU results from a unification imperative have many weaknesses.

The superficial coincidence of events notwithstanding, decisive steps toward EMU had been taken much before German unification catapulted onto the European agenda. In the Single European Act (SEA) of 1986, the EC agreed to hold an IGC on institutional reforms of the European Monetary System (EMS) at an unspecified time. Although no one in 1986 anticipated the conference for 1990, German Foreign Minister Hans-Dietrich Genscher began calling for a European Central Bank (ECB) during 1987 and in February 1988 issued a memorandum advocating EMU. Four months later the European Council in Hanover agreed to EMU and commissioned EC President Jacques Delors to prepare a report on the necessary steps. Meeting in Madrid the following year the European Council adopted the Delors plan for EMU and agreed to begin the first stage of the irreversible process on July 1, 1990. Madrid also commissioned preparations for the IGC, which was envisioned to commence soon after stage one. In the summer of 1989 the Guigou committee of personal advisors to the Foreign and Finance Ministers assembled to report to the European Council at Strasbourg on the essential questions for an IGC. Franco-German consultations in early October led to plans for a decision at Strasbourg on beginning the IGC in the latter half of 1990.[15]

Unification, meanwhile, was not a near term eventuality until roughly half a year later at the end of January 1990.[16] Although the East German regime displayed signs of instability in early 1989, the Berlin Wall remained closed until November 9, 1989. Unification quickly became inevitable,

and German Domestic Politics," eds. Eichengreen and Frieden 67-86.

15 Wilhelm Schönfelder and Elke Thiel, Ein Markt - Eine Währung: Die Verhandlungen zur Europäischen Wirtschafts- und Währungsunion (Baden-Baden: Nomos Verlagsgesellschaft, 1994) 17-21.

16 Hanns Jürgen Küsters, "Entscheidung für die deutsche Einheit: Einführung in die Edition," Dokumente zur Deutschlandpolitik, Deutsche Einheit: Sonderedition aus den Akten des Bundeskanzleramtes 1989/90, eds. Küsters and Daniel Hofman (München: R. Oldenbourg Verlag, 1998) 233.

but apart from Genscher no one imagined it to be imminent until months later.[17] In his Ten Point Plan of November 28, Chancellor Kohl cautiously envisioned a decade long process of confederation of the two German states within the context of a politically united Europe capable of absorbing German power.[18] The Chancellory's documentation reveals the perception that French President François Mitterrand supported unification in principle as early as July 1989[19] but that he did not conceptionalize it as a near term outcome until early 1990. He is depicted as "irresolute" in reaction to the sudden potential to overcome the division of Germany.[20] Similarly, his Foreign Minister Roland Dumas did not anticipate a quick unification.[21]

German consent to EMU and to the IGC in 1990 at Strasbourg predated most governmental prognostications of pending German unification. The primary determinants of the German decision for EMU therefore must be found in considerations relevant before unification and elaborated later in this paper. Still, as shown below, EMU undeniably had clear positive diplomatic externalities for German unification and the accelerating reality of German unification in early 1990 gave additional impetus to both France and Germany to overcome their outstanding differences over implementing the final two stages of the Delors plan. The following analysis of the French position and German reaction, as well as of the Strasbourg decision should help to disentangle cause and effect with regard to the question of a German 'unification imperative' for EMU. Although the process of EMU had begun, by early 1990 both French and Greman lea-

17 Szabo notes Genscher's unique prescience in this regard, 37. Condoleeza Rice and Philip Zelikow point to strong domestic East German support for the survival of their state. Germany Unified and Europe Transformed: A Study in Statecraft (Cambridge, MA: Harvard UP, 1995) 112.

18 Gespräch des Bundeskanzlers Kohl mit Präsident Delors, Bonn, 5 October 1989, Dokumente 445f.

19 Vorlage des Vortragenden Legationsrats I Bitterlich an Bundeskanzler Kohl, Bonn, 14 July 1989, Dokumente 346.

20 Küsters 232.

ders explicitly recognized that full monetary integration carried the benefit of constituting part of an international context favorable to German unification.

The Diplomatic Externality of EMU

To begin with, there was no necessity to coerce German cooperation in EMU or deeper political integration. German leaders gladly embraced the opportunity to demonstrate their commitment to Europe. Throughout the history of the Federal Republic the two objectives of European integration and German unification had been two sides of the same foreign policy.[22] For Kohl political and monetary union were the logical and desirable extension of earlier policies. It was no departure from the past to argue that "in the nineties the French and the entire European Community would have great advantages from the strengthened economic power of Germany."[23] That Kohl and Genscher vigorously supported this process should in no way indicate a preparation to abdicate Germany's right to self-determination.[24] Responding to the reservations of other EC leaders in Paris on November 18, 1989, the Chancellor stated, "no-one, neither in the East nor in the West, would be able to ignore a vote of all Germans for the unity of their fatherland."[25] Germany had a self-imposed precondition for its own unity that it occur in a favorable international context. In the same way, French concerns about German unification during 1989-1990 amounted neither to deviation from its foreign policy tradition nor to

21 Teltschik 26.

22 For one of the most comprehensive treatments, see Wolfram F. Hanrieder, Deutschland, Amerika, Europa: Die Außenpolitik der Bundesrepublik Deutschland 1949-1994 (Paderborn: Schöningh Verlag, 1995).

23 Gespräch des Bundeskanzlers Kohl mit Staatspräsident Mitterrand, Paris, 15 February 1990, Dokumente 849.

24 Teltschik 38.

25 Helmut Kohl, Ich wollte Deutschlands Einheit, dargestellt von Kai Diekman und Ralf Georg Reuth (Berlin: Propyläen Verlag, 1996) Quote on 151; see also 230.

opposition to German unification. Paris expressed three broad areas of reservation about German unity.

First, the monumental changes in East-West relations raised questions about the Federal Republic's foreign policy of integration in West Europe and membership in NATO. Perennial French anxieties about a modern day Rapallo accord between Germany and Russia had surfaced at critical times throughout the Cold War. Most recently, Dumas began to question Germany's continued Western moorings as early as 1986, after Mikhail Gorbachev had announced a program of domestic political and economic reforms.[26] Pond mentions that Bonn's contemporaneous position on arms control negotiations had added to "French fears about German reliability . . . and Gorbachev's seductive attractiveness."[27] France could not afford a neutralization of German security policy that for all practical purposes would extend Soviet military hegemony to its own border.[28] Further, France wanted to prevent an intensification of German relations with Eastern Europe and the Soviet Union from coming at the expense of the Franco-German political and economic axis, especially with regard to EC integration.[29] When the wall unexpectedly fell, Paris viewed Germany's future foreign policy orientation as conceptionally in flux and its own security at stake. Still, rather than endorse the Soviet proposal to weaken a united Germany by requiring each part to maintain its Cold War alliance

26 Hans-Dietrich Genscher, Errinnerungen (Berlin: Siedler Verlag, 1995), 381, 387.

27 Elizabeth Pond, Beyond the Wall: Germany's Road to Unification (Washington, D.C.: The Brookings Institution, 1993) 67.

28 Anne-Marie LeGloannec emphasizes a French Rapallo complex. "France, Germany, and the New Europe," eds. Dirk Verheyen and Christian Søe The Germans and Their Neighbors (oulder, Colorado: Westview Press, 1993): 13-34. On Mitterrand's views see, Roland Dumas, Hans-Dietrich Genscher, Hubert Védrine, "Frankreichs Deutschlandpolitik 1989/90 im Rückblick" eds. Brigitte Sauzay and Rudolf von Thadden Mitterrand und die Deutschen (Wallstein Verlag: Göttingen, 1998): 17-25. Helmut Kohl reports on related deliberations with Mitterrand, 236. On French concerns about German neutrality also see Rice and Zelikow, 171.

29 Genscher, 375. Szabo, 50.

membership, France sought uncompromised German participation in NATO.

A second closely related French reservation had to do with the loss of its own economic and foreign policy influence. For two decades France had made pursuit of economic parity with West Germany an objective of its industrial policy.[30] Through eventual unification West Germany would expand by seventeen million people[31] and emerge with its full sovereignty intact. In French eyes, Germany would have greater economic potential and fewer foreign policy inhibitions. A dominant German trade and investment presence in Eastern Europe would also marginalize Paris. Finally, the end of bipolarity would eliminate the need for French mediation between the Soviet bloc and the West. Kohl's sensitivity to such anxieties about German predominance reinforced his pursuit of European monetary integration.[32]

The last of Mitterrand's major reservations about German unification had to be carefully reconciled with the first two. Unification had large potential for jeopardizing support for Gorbachev's reforms.[33] After meeting with Gorbachev in Kiev, Mitterrand explained to Kohl in Strasbourg that he "could still not foresee and comprehend . . . how Gorbachev would react to a very rash development to unity. In the GDR stood the Soviet army, the GDR was a core country for the Warsaw Pact." Both leaders assessed the Warsaw Pact as a "fiction" but knew that Gorbachev's do-

30 For the relevance of such French concerns see Szabo, 48. Also, Richard Kiessler/Frank Elbe, Ein Runder Tisch mit Scharfen Ecken: der Diplomatische Weg zur Deutschen Einheit (Baden-Baden: Nomos Verlaggesellschaft, 1993) 62. On French economic dependence on Germany, see Christian Deubner, Udo Rehfeldt and Frieder Schlupp, "Deutsch-französische Wirtschaftsbeziehungen im Rahmen der Weltwirtschaftlichen Arbeitsteilung: Interdepedenz, Divergenz oder Struktureller Dominanz," Deutschland, Frankreich, Europa: Bilanz einer Schwierigen Partnerschaft ed. Robert Picht (München: R. Piper Verlag, 1978).

31 Mitterrand expressed this concern to Kohl. "Gespräch des Bundeskanzlers Kohl mit Staatspräsident Mitterrand," Paris, 15 February 1990, Dokumente 849.

32 Rice and Zelikow 145.

33 Rice and Zelikow 116.

mestic support depended on its existence. Kohl identified with Mitterrand: "the solution to the German question could not be allowed to provoke a new Russian tragedy."[34] United Germany's full membership in NATO, however, could make Gorbachev vulnerable to domestic accusations of having conceded Russia's sphere of influence to a cohort of its rivals. Gorbachev had told Mitterrand in Kiev that if Germany reunified "a Soviet marshal will be sitting in my chair."[35] The mismanagement of unification could produce destabilizing reactions, confronting Germany with an unfriendly East in a new geopolitical vacuum.

Mitterrand's preoccupation with East European stability and attempt to carve out a special French role in the unification process[36] placed him at odds with Kohl over Germany's formal recognition of the Polish border. The French President was skeptical of Gorbachev's rhetorical acceptance of Germany's right to self-determination and pleaded Poland's case that Bonn quickly recognize the Oder-Neisse line on behalf of a united Germany. Kohl, however, wanted to defer such recognition to a legitimately elected, united German parliament. He told Mitterrand "it would be a psychologically important point that the confirmation of the borders go together with reunification and not be a precondition."[37] Also Kohl wanted to avoid impressions of involuntary German territorial concessions made at the behest of the Four Powers.[38] Finally, Kohl would like to have had a Polish gesture disclaiming World War II reparations. Kohl's rationale notwithstanding, the impression was unavoidable that he was merely contriving reasons for delay to pacify a constituency of expellees from territory Poland had gained after the war.[39]

34 Kohl, 234.
35 Rice and Zelikow, 137.
36 Küsters 235.
37 Gespräch des Bundeskanzlers Kohl mit Staatspräsident Mitterrand, Paris, 15 February 1990, Dokumente 847.
38 Küsters 235.
39 Most accounts of Kohl‘s position on the Polish border also attribute his motives to a desire to pacify a vocal constituency of Geman expellees and gain Polish renun-

In order to preserve Germany's active engagement in European integration, maintain the balance in Franco-German economic and foreign policy relations, and avoid new instability in the East, Kohl and Mitterrand agreed to strengthen the EC and, over the longer term, enlarge its membership.[40] Before and after Strasbourg Kohl slowly convinced Mitterrand to take up EC institutional reforms along with the agenda for EMU.[41] The two leaders also agreed on the need for political treaties with Eastern Europe and the Soviet Union. If Russia became hostile, she would then be "isolated."[42] In this sense, it was once again Franco-German collaboration, the very core of previous major European initiatives, that set the priorities of the next decade—'deepening' would necessarily precede 'widening.'

The sequence of events indicates that Kohl considered EPU as much more central to unification diplomacy than EMU, to which he had already agreed. By anchoring a united Germany more firmly in the EC and thereby diluting its dominance, EMU could address the above French misgivings about unification. Küsters and Hofmann even call "the European binding of German monetary and economic power a decisive factor" in Mitterrand's agreement to unification.[43] For Mitterrand, 'deepening' the EC was even meant to nurture German unity: the further construction of Europe would bring us closer to the day, on which the division of the continent would be overcome, on which Germany could be reunified."[44] For these reasons EMU clearly had a positive diplomatic externality for

ciation of reparations. Szabo 68-75.

40 Gespräch des Bundeskanzlers mit Staatspräsident Mitterrand, Latché, 4 January 1990, Dokumente 689.

41 Teltschik, 70-71. "Gespräch des Bundeskanzlers Kohl mit Staatspräsident Mitterrand," Paris, 15 February 1990, Dokumente 849.

42 Gespräch des Bundeskanzlers Kohl mit Staatspräsident Mitterrand, Latché, 4 January 1990, Dokumente 687.

43 Küsters 231.

44 54. Deutsch-französische Konsultationen, Bonn, 2/3 November 1989, Dokumente 473.

German unification. A closer look at the Strasbourg summit further illuminates this.

Strasbourg and After: EMU and EPU

There existed two main Franco-German differences over the summit at Strasbourg. One disagreement had to do with when to convene the IGC for negotiating stages two and three of the Delors plan. The move to EMU had irreversibly begun in Madrid in June 1989, but much remained to be determined. Kohl had proposed at Madrid that the IGC begin coincident with the beginning of stage one of EMU on July 1, 1990. This would permit treaty ratification before the end of 1992, i.e. before the completion of the Single European Market (SEM) initiative.[45] As the Strasbourg summit neared, however, Kohl grew fearful that the IGC would fail for want of an exact mandate.[46] The French government did not share this fear and thought it more important to set a firm date for the IGC without necessarily preordaining all matters for discussion.[47] To the satisfaction of both France and Germany, the outcome at Strasbourg was to convene the IGC by the end of 1990, allowing sufficient time to draft a precise mandate.

The second fundamental difference was over the timing for institutional reforms. For two decades EMU German policy held that EMU was inseparable from EPU. As the East German government deteriorated and unification increasingly became the only option for stability, Kohl insisted more on EPU in connection with EMU. In October Kohl told Italian Prime Minister Andreotti that the final goal of European integration was not the completion of the SEM but EPU, "an existential question" for the Fe-

45 Gespräch des Bundeskanzlers Kohl mit Staatspräsident Mitterrand, Paris, 22 June 1989, Dokumente 308.

46 Gespräch des Bundeskanzlers Kohl mit Ministerpräsident Andreotti, Bonn, 18 October 1989, Dokumente 453f.

47 Vorlage des Vortragenden Legationsrats I Bitterlich an Bundeskanzler Kohl, Bonn, 2/3 December 1989, Dokumente 596f.

deral Republic. In this way, Kohl intended to show that the "ghost of Rapallo does not dwell among us."[48] The insistence on a "debate on the finality of the Community" led the Chancellor into direct conflict with French Prime Minister Rocard, who argued that it would be too late to take up the subject of expanding the rights of the Parliament at the summit.[49] Also, Mitterrand would only consider EC institutional changes after concluding a treaty on EMU. The German government viewed this as consistent with the "French tendency to confer the EP [European Paliament] only more symbolic rights" and suspected that Mitterrand held the demand for EPU to be a 'maneuver of diversion' from monetary union.[50]

On November 17, Teltschik briefed Kohl that French decision-makers worried that the opening of the Berlin Wall imperiled Strasbourg decisions on the Social Charter and EMU.[51] Ten days later Kohl proposed a timeframe for progress on EMU and EPU. Preparations for the IGC on EMU would be completed by the Rome summit of December 1990. Meanwhile, the Dublin summit of June 1990 would take up a report on institutional reforms. A two-phase IGC would begin in Rome covering EMU immediately and institutional reforms by the end of 1991. The IGC would conclude in December 1992. Ratification would ensue in 1993 in advance of elections to the European Parliament in 1994.[52]

In his correspondence to Mtterrand on December 5, 1989 Kohl revised his proposal, placing EPU on a parallel track with EMU. Conditional

48 Gespräch des Bundeskanzlers Kohl mit Ministerpräsident Andreotti, Bonn, 18 October 1989, Dokumente 453f.

49 54. Deutsch-französische Konsultationen, Bonn, 2 - 3 November 1989, Dokumente 473-476.

50 Vorlage des Vortragenden Legationsrats I Bitterlich an Bundeskanzler Kohl, Bonn, 2 - 3 December 1989, Dokumente 596f.

51 Gesamtgesprächsführungsvorschlag, Vorlage des Ministerialdirektors Teltschik an Bundeskanzler Kohl, Bonn, 17 November 1989, Dokumente 542.

52 EG-Gipfel in Straßburg am 8. und 9. Dezember 1989, Arbeitskalender für das weitere Vorgehen bis 1993, Schreiben des Bundeskanzlers Kohl an Staatspräsident Mitterrand, Bonn, 27 November 1989, Dokumente 566f.

upon preparations made under the Irish Presidency in the first half of 1990, Rome would also commission the IGC to deal immediately with expanding the rights of the parliament. The goal would be to submit the agreements on EMU and EPU to the Dutch Presidency in December 1991 with the finalization of the Treaty on European Union (TEU) in early 1992 and ratified that same year. Kohl argued that national parliaments would only accept the transfer of responsibilities to European institutions if the European Parliament gained power to the same extent that national legislatures abdicated it.[53]

Despite German agreement at Strasbourg to start the IGC in 1990, the rapid developments in East Germany during the month of January led policy makers in Bonn to worry that their commitment to European integration would fall under greater suspicion. Kohl's advisor Hartmann wrote that for politico-psychological reasons it would be

> "indispensable . . . to demonstrate our engagement for the economic and political integration of the European Community. We have done this in Strasbourg, but we must assume that our partners will very closely pay attention to whether this elan ceases in the now ongoing difficult preparations of the Intergovernmental Conference for EMU and other reform plans."[54]

With unification becoming more of an immediate prospect, the German government anticipated growing doubts about its foreign policy commitment to the EC.

Meeting in Paris on February 15, 1990, Kohl described to Mitterrand his fleeting ability to control events on the ground, referring to the ninety thousand eastern Germans that had fled to the West in the new year.[55] The

53 Schreiben des Bundeskanzlers Kohl an Staatspräsident Mitterrand, Bonn, 5 December 1989, Dokumente 614f.

54 Aufzeichnung des Ministerialdirigenten Hartmann, Bonn, 29 January 1990, Dokumente 729.

55 Gespräch des Bundeskanzlers Kohl mit Staatspräsident Mitterrand, Paris, 15 February 1990, Dokumente 845.

next day Delors emphasized the importance of intensifying efforts for EPU at the planned extraordinary summit in Dublin.[56] For Kohl, Dublin had to offer more than 'lip service.' He named strengthening the rights of the European Parliament, Delors' suggestion for reform of European Political Cooperation (EPC) in foreign policy, and questions of community efficiency.[57] At Dublin, EPU was finally placed on a parallel track with EMU. The European Council in Rome would receive concrete suggestions for creating a European Union and convene a separate IGC on EPU. Ratification was envisioned for the end of 1993. These efforts notwithstanding, after Germany's allies and the Soviet Union formally consented to its unification in the Two Plus Four Treaty, Kohl openly worried that the objective of EPU would yield to the goal of EC widening, reducing the Community to a free trade area .[58]

Summary

Under closer analysis, that Germany agreed to EMU for purposes of unification is anachronistic, at best. There can be very little doubt as to the commitment of the Kohl government to European Union, i.e. EMU and EPU, for its own sake. Both the French reaction to the events leading to German unity and the response of the Kohl government reflect an extension of each country's traditional postwar foreign policy. Neither country saw EMU as a price for German unity but as part of a favorable context for such an eventuality. Decisions taken at Strasbourg and after did not entail whether but how to proceed with EMU and contend with its political ramifications. Rather than sacrifice EPU and concede to EMU in order to gain French acceptance of unification, Kohl drove a harder bargain for EPU.

56 Gespräch des Ministerialdirigenten Hartmann und des Ministerialrats Ludewig mit Präsident Delors, Paris, 16 February 1990, Dokumente 853.

57 Schreiben des Bundeskanzlers Kohl mit Präsident Delors, Bonn, 13 March 1990, Dokumente 936.

58 56. Deutsch-französische Konsultationen, München, 17 – 18 September 1990,

To be sure, the decision on the IGC on EMU diplomatically favored Germany's long-term unification. Both Germany and France understood this in the context of broader European Union and more than simply a *quid pro quo*. Strasbourg accommodated Kohl's concerns to allow time to develop an exact mandate for the IGC and included a statement on the need for EC institutional reforms. The decision was not narrowly targeted at a distant unification but at current events throughout Eastern Europe. Genscher notes, the immediate interest was to ensure that "the dynamic of integration of the European Community kept in step with the East-West development."[59] Kohl's advisor Bitterlich commented to the same effect that Mitterrand sought a "'necessary acceleration' of the integration process – as answer to the 'challenge from the east.'"[60] Once unification became a near-term reality in early 1990, both the German and French governments resolved to accelerate EPU, indicating that EMU itself was not a *quid pro quo* for French acceptance of unification. As at other momentous times during the Cold War, what alarmed the French government in late 1989 was not German unification, but the uncertainty of German foreign policy under the Soviet and East European dynamic of the late 1980s.

Even less compelling is the claim that Germany compromised on guarantees of price stability at EMU during or after the Maastricht negotiations, by which time "Kohl already represented a Germany 'united' in the formal sense."[61] During the IGC on EMU Germany obtained strong assurances that EMU would not be inflationary, most notably an independent ECB modeled on the Bundesbank and economic convergence criteria for stage three. In their detailed study of the negotiations, Wilhelm Schönfel-

Dokumente 1545f.

59 Genscher, 390.

60 Vorlage des Vortragenden Legationsrats I Bitterlich an Bundeskanzler Kohl, Bonn, 2 - 3 December 1989, Dokumente 598.

61 Roger Morgan, "France and Germany as Partners in the European Community" Patrick McCarthy ed. France-Germany, 1983-1993: the Struggle to Cooperate (New York: St. Martin's Press, 1993) 103.

der and Elke Thiel unequivocally reject claims that the German position on EMU softened after unification:

The idea that ‘false’ compromises were entered into for purposes of German unity is in no way accurate. The German negotiating process was at all times exclusively oriented around the actual problem at hand [EMU]. Also, among the negotiating partners it was not recognizable that they allowed their position on EMU to be somehow influenced by the German question.[62]

German unification did not factor directly into the Maastricht negotiations, which is consistent with the occurrence of events.

The ‘unification imperative’ is especially troubling because it insinuates that EMU has no intrinsic value for German policy makers; i.e. that the D-Mark is a ransom paid to capricious European partners, who, after forty years of cooperation, still harbor the prejudice that Germans possess an alarming proclivity for militarism. This latent polemic could become active throughout Europe, should EMU not live up to the economic aspirations of the statesmen whose brainchild it was. There is also widespread sentiment that Germany succumbed to French demands for EMU in trade for empty French promises for Political Union. The logical extension of the ‘unification imperative’ is that Germany would likely abort its commitment to monetary integration if the project became politically and economically costly. Yet, the adherence to the unpopular EMU agenda throughout the 1990s more likely reflects genuine support for EMU for its own sake. The plausibility of a ‘unification imperative’ notwithstanding, the fortuitous relationship of EMU to unification was more likely a positive foreign policy externality. The following analysis provides a viable alternative explication of German motives for EMU, thereby placing the ‘unification imperative’ into more modest perspective.

62 Schönfelder and Thiel 22.

Germany's Political-Economic Trilemma

Since the late 1960s, depreciation of the U.S. dollar has destabilized European currencies, disrupting regional trade and the sensitive Common Agricultural Policy (CAP). The resulting pressure for appreciation on the mark relative to other European currencies threatened the price competitiveness of German exports. In the inhospitable international economic climate of the early 1970s and 1980s European exchange rate regimes offered German exporters relief. At the same time, however, the maintenance of fixed currencies confronted Germany with the risk of either importing inflation from its European partners or becoming a monetary hegemon. Averse to inflation, the Bundesbank neglected both to intervene in defense of the nominal parities and to lower domestic interest rates to ease speculation against weaker currencies pegged to the mark. To avoid depletion of foreign reserves and maintain the exchange rate, weak currency countries could not lower interest rates independent of the Bundesbank. The onus of macroeconomic policy adjustment fell asymmetrically upon weaker currency countries. As much as German leaders renounced all hegemonic aspirations, the exigencies of exchange rate and price stability led inexorably to that outcome. By the mid 1980s the sustainability of fixed exchange rates came into question, resurrecting German fears of EC devaluations that would erode its competitive gains in productivity. Hegemony was also a foreign policy liability, as Germany faced accusations of deliberately using its position in the EMS to exploit its EC partners.

Attempts to shift the burden of macroeconomic policy adjustment to Germany had only limited results. Whereas tensions arising from German monetary hegemony led to a breakdown of fixed exchange rates and a reappreciation of the mark in the 1970s, a decade later European leaders pressed on with integration. Capital liberalization and dollar weakness in the mid-1980s exacerbated the asymmetric operation of the EMS and reinvigorated the goal of monetary union. German unification reinforced this ambitious agenda, intensifying preexisting foreign policy and economic imperatives. EMU for Germany thus resulted primarily from the trilemma of uncompetitive exports, domestic inflation, and monetary hegemony. Germany's commitment to EMU is incomprehensible outside of this context.

EMU in the 1970s

Prior to the Hague summit of 1969, monetary integration in Europe was limited to the modest provisions of the 1957 Rome Treaties, which cited stable exchange rates as an essential aspect of the future customs union, single market and common agricultural policy (CAP). The treaties envisioned macroeconomic policy consultations to reinforce domestic policies aimed at full employment, low inflation, and balance of payments equilibrium.[63] Preoccupied with implementing the customs union and owing to exchange rate stability, the EEC had little need to emphasize monetary integration before the latter 1960s. The monumental achievement of the period in the way of macroeconomic cooperation was setting up the consultative Committee of Central Bank Governors in 1964. By the time the customs union was in place in 1968, however, U.S. macroeconomic expansion had undermined exchange rate stability as an operating assumption in the course of international trade and payments. The differential rates of inflation that followed distorted the CAP, common market, and German export competitiveness. European differences arising from the trade-off between exchange rate stability and domestic inflation were present in the earliest debates over EMU.

Whereas 'monetarist' countries (e.g. France, Belgium, and Luxembourg) advocated fixed parities to arrest the depreciation of their currencies, Germany, along with the Netherlands, took the 'economist' approach of prioritizing macroeconomic convergence. The French strategy for economic growth relied on fixed parities to restore confidence in the franc, counter inflation, and ultimately permit lower interest rates. A fixed ex-

63 Article 105 provides for the establishment of a consultative Monetary Committee of Finance Ministers and Central Bank Governors. Article 108 calls for balance of

change rate regime would include intervention and credit facilities to shift the burden of adjustment to surplus countries. This, however, assumed that surplus countries, e.g. Germany, would risk domestic inflation to finance French deficits or defend the franc on international markets. The Bundesbank probably loathed nothing more than the specter of importing inflation. For Germany, coordinated anti-inflationary policies were the *sine qua non* of fixed currencies, the purpose of which would be to alleviate the mark appreciation. In the German view, exchange rate stability could not be superimposed but had to ensue on the basis of macroeconomic convergence. In short, France wanted to use the exchange rate for price stability and growth, while Germany wanted to use coordinated anti-inflation to achieve foreign exchange stability.[64]

The outcome of the monetarist-economist quarrel was an agreement to simultaneously pursue price and exchange rate stability as prescribed in the October 1970 Report of Luxembourg President Pierre Werner, which called for a three-stage transition to EMU by 1980. To this end, various credit mechanisms were established by 1972. The first stage included fixed parities and macroeconomic policy coordination. The final stage entailed the centralization of monetary policy decisions with regard to interest rates, exchange rates, internal liquidity, and the management of reserves. The Report also called for an agreement governing national fiscal policies, i.e. debt financing and surplus allocation, and reiterated the importance of implementing the Common Market.[65] A system of central banks and an organ for common economic policy decision making were to be added to the proliferating array of European institutions. Very much a prototype of the modern day EMU agenda, the Report comprehensively spelled out the political and economic consequences.

payments assistance along with the abolition of exchange controls.

64 For differences in the French and German led positions, see Tsoukalis, 178; also, Hanrieder 314.

65 The Common Market, also referred to in the 1980s as the Single European Market (SEM), is defined by the free movement of goods, services, capital, and labor.

The elimination of independent monetary policies and new constraints on national fiscal policies would deprive members of the traditional instruments of stimulating the economy. This left available three mechanisms to stimulate the economy in depressed regions: wage and price flexibility; mobility of capital and labor; and fiscal expansion. The first of these would attract investment by reducing the local costs of production. However, this was politically infeasible thanks to obstructive labor unions, leftist parties, and corporatist institutions.[66] Meanwhile, the EEC lakked the budgetary resources for fiscal transfers. The mobility of capital and labor, on the other hand, was already included in the Rome Treaty provisions for a Single European Market (SEM), according the Community a legal basis to act. In fact, EMU and the SEM were mutually dependent. Access to capital and the ability of excess labor to emigrate to regions with better employment prospects would temper the effects of a common monetary policy that proved overly restrictive for certain localities, while stable exchange rates constituted the foundation for the flow of goods, capital, services, and labor.

The EEC adoption of the Werner Plan and resolution for the SEM in March 1971 addressed the threat of dollar depreciation to Germany's European export competitiveness. However, these measures ran up against international monetary turbulence and deficient monetary coordination. Amidst growing pressure for appreciation and despite closing the foreign exchange market, the mark floated in May 1971. The Smithsonian agreement of December the same year reinstituted an international monetary system with fixed-rates, albeit with wider margins of fluctuation totaling 4.5 percent. For the EEC, however, currency fluctuations within these margins were expected to prove damaging to the CAP and SEM. For Germany, in particular, appreciation of the mark remained a concern.[67] In an effort to "insulate their currencies from the potent external pressure

66 John B. Goodman, Monetary Sovereignty: the Politics of Central Banking in Western Europe (Ithaca: Cornell UP, 1992).

67 Hanrieder 319.

generated by the loss of confidence in the dollar"[68] and to progress toward the goal of EMU by 1980, EEC members formed among themselves narrower bands of fluctuation set at 2.25 percent of EC-dollar parities. Agreed in March 1972, the intra-EEC margins constituted the 'snake' inside the 'tunnel' of the wider Smithsonian limits. Consistent with the 'economist' and 'monetarist' parallelism of the Werner Plan, economic policy coordination was to supplement provisions for joint interventions and short-term credit. Britain, Ireland, Norway, and Sweden participated as non-EEC members.

At the behest of the Bundesbank, Germany introduced capital controls to prevent external inflationary pressure from the new regime. Theoretically, such measures could have solved the German trilemma, cleverly permitting exchange rate stability and anti-inflationary policies without inducing regional monetary hegemony. However, during 1972 the Bundesbank demand for an intensification of this approach dissipated as Finance Minister Helmut Schmidt made the necessary government approval dependent on his own ministry's participation in Bundesbank decisions. In other words, capital controls could become a Trojan horse for political influence over Bundesbank policies.[69]

The snake fell victim to continued international economic turmoil and the subsequent cacophony of national macroeconomic policies. In July 1972, sterling and the punt were the first casualties. A vain attempt was made at the Paris Summit to lend credibility to the snake by reaffirming the dual EMU and SEM agenda and calling for a European Union by 1980. With

68 Goodman 186.

69 Jürgen von Hagen's treatment of the Bundesbank's deliberations in the 1970s includes discussion of the importance of exchange-rate considerations in the Bundesbank's decision to continue the use of monetary targetting. The analysis reflects the Bundesbank's early 1970s preference for capital controls to reconcile a fixed exchange rate with domestic price stability. "Geldpolitik auf neuen Wegen (1971-1978)," Fünfzig Jahre Deutsche Mark: Notenbank und Währung in Deutschland seit 1948, ed. Deutsche Bundesbank (C.H. Beck Verlag, 1998) 448-449.

the dollar falling under more speculation in January 1973, the Bundesbank pointed to the inefficacy of capital controls and argued in favor of closing the foreign exchange market, a measure that would not compromise its political independence. Schmidt, however, feared that any German unilateral approach would conflict with EMU and opted to buy time for a joint European solution by temporarily strengthening capital controls.[70] After jointly closing foreign exchange markets, snake constituents agreed to float against the dollar in March 1973.

The snake did not survive without its shelter for very long, however. The lira and the franc departed in January 1974 and March 1976, respectively. The mark anchored the remaining currencies (Benelux countries, Denmark, Sweden, and Norway) in a progressively shrinking zone of stability. Sweden withdrew in August 1977 and Norway in December 1978. Tsoukalis concludes,

”For Germany, the snake contributed towards a certain undervaluation of the DM . . . . For the smaller countries, the corresponding appreciation of their currencies against the DM seemed to be offset by the greater stability of the exchange rate and the increased credibility of their economic policies.”[71]

By diverting pressure for appreciation from the mark, fixed exchange rates helped maintain German export competitiveness in Europe. However, given the political and economic limitations of capital controls, German achievement of price stability exerted pressure for adjustment on partners whose lack of anti-inflationary credibility required interest rate policies more rigorous than its own. Weaker currency countries, most importantly France, had to endure subjugation to German monetary hegemony in the form of exchange rate overvaluation and high interest rates. Ultimately they opted out.

70 Von Hagen 449.
71 Tsoukalis 182.

From the European Monetary System to EMU

As the main advocate of the EMS, Chancellor Helmut Schmidt sought to protect German export competitiveness from the dollar volatility of the latter 1970s. In an effort to entice renewed French, British, and Italian participation, the new regime was geared toward overcoming the asymmetric burden of macroeconomic policy adjustment faced by the weaker currency countries.[72] Any remedy for the problem of German hegemony still entailed, however, a certain risk of inflation. Anticipating the resistance of the Bundesbank, Schmidt and French President Giscard d'Estaing presented their decision to create the EMS as a *fait accompli*.[73] An agreement among national central banks, the EMS retroactively took effect on January 1, 1979 and instituted among constituents the margins of fluctuation of the defunct Smithsonian accord. Unlike the Werner Plan, the EMS relegated specific considerations for monetary union to the future.

Once again, fixed exchange rates had broad appeal in the EC. In addition to sheltering the common market from dollar fluctuations, the EMS would keep the CAP intact and foster a united European identity independent of the United States.[74] On one hand, Germany's partners had begun to convert to the Gospel of disinflation and intentionally acquiesced to German hegemony to gain anti-inflationary credibility.[75] On the other hand, three measures existed to enervate the asymmetry. First, the EMS was constructed as an adjustable peg, i.e. realignments could ease pressure on exchange rates and domestic policies. Second, intervention and credit mechanisms were developed to ease the burden of deficit countries. The central banks of surplus countries bore an obligation to intervene when currencies reached the bilateral margins of fluctuation and preferably even

72 Von Hagen 467.

73 Guerot notes that Schmidt even threatened to change the Bundesbank's mandate if the institution acted against the EMS, 235.

74 Tsoukalis 183f.

75 Goodman 189-196; Tsoukalis 184.

beforehand. Such interventions and settlements of account were to be conducted in ECU, in order to drive EMS inflation toward an average of currencies in the Exchange Rate Mechanism (ERM) rather than toward the lowest rate. To assist deficit countries, members pooled foreign reserves in the European Monetary Cooperation Fund (EMCF) and also expanded the credit facilities of the early 1970s.[76] Finally, the EMS was born under the zodiac of capital controls, a measure to which, *inter alia,* France auspiciously resorted. During the operation of the EMS each of these measures was steadily eroded, while renewed international monetary turmoil exacerbated the prevailing asymmetric tensions. The preservation of exchange rate stability and progress toward the SEM essentially left one option, EMU. Amid growing concerns about the overall competitiveness of the EC in an age of globalization, a single currency would be the crowning achievement of a consolidated SEM.

In the first two years of the EMS, capital controls and unilateral devaluations prevented vast differences in macroeconomic policies from subverting the system. However, after the lira devaluation of February 1981, the Monetary Committee began to call for domestic policy changes to accompany realignments.[77] The Committee's ability to coerce reforms seems to have rested on its willingness to prevent devaluations from fully compensating for price and wage differentials, thereby producing continued disinflationary pressure. As the mark never devalued, this meant a "gain in competitiveness for Benelux countries and Germany" against Italy and Spain, for example.[78] Other than narrowing the bands of fluctuation for the lira to the normal 2.25 percent, there were no realignments from 1987

76 Tsoukalis details these mechanisms (184-186).

77 There were many exceptions to this rule, for example, the French devaluation of October 1981. As an indirect beneficiary of other realignments, Italy also circumvented the demand for new policies. See Goodman 199.

78 Tsoukalis acknowledges the difficulty with measuring competitveness, but nonetheless concludes that the "lira stands out in terms of its cumulative overvaluation," 193-195. Goodman supports this point about the advantageous effect for Germany, 195-200.

to 1992. Thus, as currency realignments became less frequent and subject to more control, the asymmetric burden of adjustment became more severe.

Meanwhile the intervention and credit mechanisms did not operate to eliminate either the need for realignments or the asymmetry that prevailed. Despite the agreement that central banks would have a 'presumption' to intervene when currency rates exhausted an agreed upon intramarginal divergence indicator, the Bundesbank refrained from shoring up weaker currencies for fear of stoking domestic inflation. Until 1987, the Bundesbank also headed off speculative pressure and circumvented the obligation to provide credit to weak currency countries by convincing other members to preemptively realign. For these reasons external inflationary pressure never materialized to the degree the Bundesbank might have feared at the outset of the EMS.[79] Instead, the burden of adjustment continued to fall on weak currency countries and a division of labor emerged in which the Bundesbank intervened against non-ERM currencies, particularly the dollar, while other EMS members intervened on intra-ERM exchange markets.[80]

The period of stability and downward convergence of inflation after 1983 temporarily kept the lid on asymmetric pressures. However, after the Plaza Agreement of 1985 the weakening dollar eroded modest European export growth and set in motion a new appreciation of the mark vis-à-vis other European currencies.[81] Adding to the tension, belated capital liberalization after 1987--part of the SEM agenda--abolished the last line of weak country defense against German hegemony. The move to full capital liberalization had languished since the early 1970s and was revitalized in the SEA. The SEA focused on establishment of the Common Market and drew the consequences for monetary integration by calling for an IGC to

79 Goodman 194-201.
80 Tsoukalis 198-200.
81 Tsoukalis 202.

negotiate institutional reforms of the EMS. Absent capital restrictions, divergent monetary policies would more directly lead to asymmetric pressures. As long as the Bundesbank neglected to intervene on foreign exchange markets and to reduce interest rates to accommodate the EMS partners, German monetary policy would exert hegemonic pressures on other countries in the system. Only a common monetary policy could satisfy the conditions of fixed exchange rates and full capital mobility, and only a common currency guaranteed common monetary policy. In sum, vitiation of the realignment mechanism, the Bundesbank's circumvention of intervention and credit obligations, and the dismantling of capital controls all exacerbated asymmetric tension.

There were essentially three options for the EMS: abandonment, reformation, or transformation. Having paid a heavy price to achieve currency and exchange rate stability, there was little motivation to jettison the system altogether. Exiting the regime meant not only the loss of access to credit facilities but defection from European solidarity and further integration. It also carried untenable domestic implications:

> "policy-makers generally consider a devaluation to be politically detrimental—because their constituents often interpret it as a sign of failed policy. Since weak-currency countries may not be able to resist pressure from Germany for a change in parities, their leaders gain a new incentive to adopt restrictive monetary measures."[82]

Reform was not only more attractive but vital.

Supported by Italy, Belgium, Spain and the Commission, France led the charge for EMS reforms.[83] Before the Strasbourg summit, Bitterlich linked the French demand for an IGC on EMU in 1990 to SEA provisions

82 Goodman, 200. Quote on page 198.

83 Schönfelder and Thiel 25-28. Tsoukalis 207. France and the Commission conditioned support for capital liberalization on the EMS reforms undertaken at Basle and Nyborg. Eckart Gaddum, Die deutsche Europapolitik in den 80er Jahren: Interessen, Konflikte und Entscheidungen der Regierung Kohl (Paderborn: Schöningh Verlag, 1994) 294 - 326.

on capital controls: "F[rance] has already offered its contribution, and namely through the liberalisation of capital flows and through acknowledgement/acceptance of the leading role of the DM and the German orientation (price stability, 'independence,' subsidiarity, etc.)."[84] France was prepared to stay in the EMS but wanted light at the end of the tunnel for the burden it had borne to arrest domestic inflation. The agreement reached in the cities of Basle and Nyborg in 1987 expanded EMS credit facilities. However, the Bundesbank sought to offset the risks to price stability by institutionalizing the practice of preventing realignments from compensating for inflation differentials and pledging non-intervention on behalf of overvalued currencies. The Bundesbank's countermeasures neutralized hopes that reforms could sufficiently remedy the asymmetry. In a speech in January 1988, one month before his memorandum advocating EMU, Genscher acknowledged that "without new institutional precautions" the scope for reform of the EMS was small.[85] It was futile to expect the Bundesbank to subordinate its 1957 mandate to guarantee domestic price stability to the objective of growth elsewhere in Europe. This left one option—deepening the system.

Germany faced the same trilemma. A collapse of the EMS would certainly lead to another appreciation of the mark. The EMS kept the currency competitive without causing domestic inflation, an enviable position that satisfied the first two conditions of the trilemma but gave rise to the third: a *de facto* German hegemony that imposed the burden of adjustment on partners. Unmitigated German monetary hegemony became a foreign policy liability[86] and undermined the very stability from which it resulted. The French commitment to the *franc fort* policy—a major reason for

84 Vorlage des Vortragenden Legationsrats I Bitterlich an Bundeskanzler Kohl, Bonn, 2 - 3 December 1989, Dokumente 597.

85 Schönfelder and Thiel 29.

86 Gaddum. He also argues that, in contrast to Schmidt, Kohl accepted Germany's large contributions to the EC budget and refrained from demanding CAP reforms in order to offset the costs to Germany's partners of participating in the EMS, 66 - 70.

which the system did not suffer the fate of its predecessors—grew more questionable as reforms failed to deliver relief.[87] Guerot writes that Germany was aware that "for political reasons a de facto existing monetary policy dominance over France and other European countries was not to be sustained for long."[88] Germany needed both to sustain the system and satisfy the other members. Reforms had not relieved the asymmetry, owing to the Bundesbank's aversion to inflation. EMU, however, had the potential to resolve the German trilemma by eliminating the pressure for appreciation and the asymmetry. Nonetheless, there had to be institutional guarantees against inflation—above all sufficient economic convergence and central bank independence. These were two of the most contentious points during the Maastricht IGC on EMU.

Ironically, whereas EMU uniquely held the promise to resolve Germany's political-economic trilemma, the pursuit of it in the 1990s seemed to jeopardize its achievement and harm Germany's European image. After Maastricht determined the details of the second two stages of EMU, the enormous public spending consequences of unification reactivated the German political-economic trilemma. Bundesbank interest rate rises to stymie inflation unleashed extraordinary asymmetric pressure, exacerbating record European unemployment. Under the circumstances, the ultimate ability of national governments to opt out of the 'irreversible' process that had begun at Madrid placed the credibility of the entire EMU project at stake. When the electorate rejected the Maastricht Treaty in Denmark and scarcely gave its approval in France, skeptics saw themselves vindicated. In September 1992, Britain and Italy were forced from the Exchange Rate Mechanism (ERM) after massive and costly interventions. Speculation against the franc the following summer led to a widening of the ERM margins of fluctuation to thirty percent, effectively eliminating

87 See Dana Allin, "Germany Looks at France" France –Germany, 1983 – 1993: The Struggle to Cooperate, ed. Patrick McCarthy (New York: St. Martin's Press, 1993) 43.

88 Guerot 228.

asymmetric pressure from Germany’s high interest rates but leaving the potential for currency fluctuations severe enough to damage the German export position. EMU seemed doomed by sheer unfeasibility. Inaddition to the political unfashionability, the economics profession assialed EMU on the basis of Optmial Currencya Area analysis, arguing that the denial of independent exchzange rates and mnetary policies would lessen the sufferability of widespread European joblessness. However, the realities of the EMS and existence of strong downward wage rigidietes already constrained the effectiveness of these mechanisms of macroeconomic adjstment.[89] The elimination of national interest and exchange rate policies was therefore no radical departure from the status quo. Indeed, given that the EXB would set interest rates based on conditions throughout Europe and not merely in Germany, EMU could even be more conduvcive to employment than was the EMS.[90]

There is widespread belief that the Kohl government´s position on EMU throughout the 1990´s derives from an unification imperative, i.e. the need to sacrifice the mark as a diplomatic expedient to attain unification and European political union. EMU, it is argued , offers Germany little economic benefit. Whatever the unpopularity, European leaders stayed the EMU course during the inauspicious 1990s and reached its achievement in 1999. More than either a fallacious economic policy or a geopolitical reaction to the disturbing foreign policy implications of sudden German unification, there is a cogent logic which explains the Kohl government´s unyielding commitment to a most unpopular enterprise. Germany´s position was conceivably not opposition but support, not cunning

89 The seminal theoretical expostition of OCAs is in, Robert Mundell, „A Theory of Optimum Currency Areas“, American Economic *Review* 51 (September 1961): 657-665. For indicators that the optimality of the euro zone compares to that of the United States see, „An Awfully Big Adventure“, *Economist: A Survey of EMU* 11 April 1998.

90 For specific expamples see, Agnes Benassy-Quere and Benoit Mojon, „EMU and Transatlantic Exchange-Rate Stability“ The EMU´s Exchange Rate Policy (Zentrum für Europäische Integrationsforschung, Bonn:Policy Paper B98-04), 25.

reluctance to concede hegemony but the imperatives of guaranteeing the success of EMU. The Kohl government had sound economic reason to pursue EMU, which entailed both a positive diplomatic externatilty for German unification in 1990 and, after the Treaty was negotiated, an unwarranted negative impact on Germany´s European image.

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