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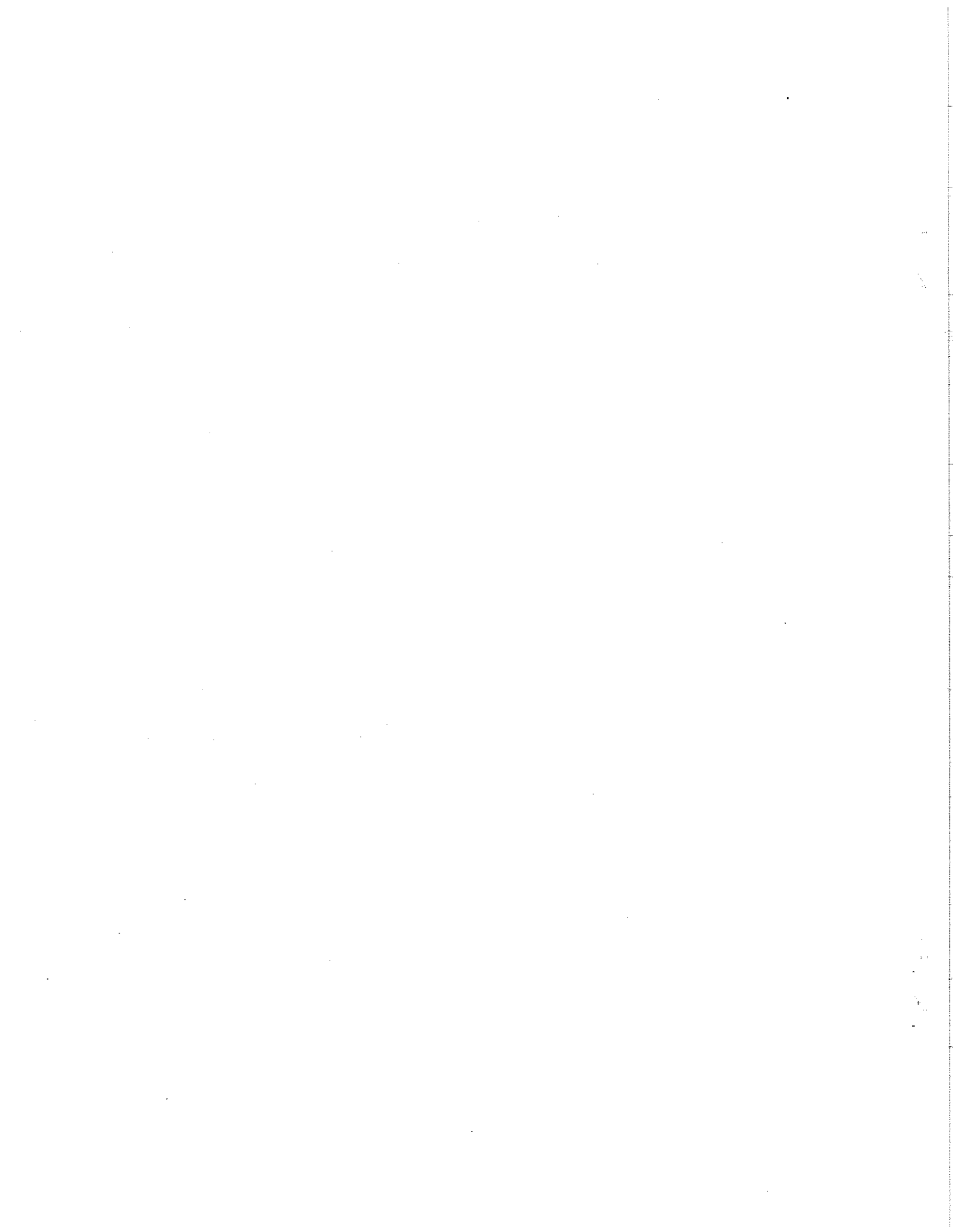
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MAASTRICHT: PROSPECT AND RETROSPECT*

JOHN M. LETICHE

The world is undergoing a process of global restructuring. While the causes and forms of the restructuring vary from country to country, invariably they are associated with fundamental changes in economic relationships between "centers" and "parts" internationally, interregionally and domestically. Plans for the most significant economic and monetary restructuring for the 1990s, and probably for the twenty-first century, which will directly and reactively affect the Asia-Pacific region and North America, are in place for Western Europe. Although uncertainties are only to be matched by weaknesses and complexities, the long-term results are likely to be robust. As early as 1985 the European Community (EC) signed the "Single European Act," which came into force in mid-1987, and was designed to eliminate by January 1, 1993 all remaining intra-EC barriers to the free movement of goods, services, persons and capital. The accord reached in 1991 to enlarge the 12-nation EC into a 19-nation European Economic Area (EEA), and the treaty initialed in December of that year at Maastricht, The Netherlands, to establish a European Central Bank (ECB) with a common currency before the end of the 1990s are truly historic events of global importance. Most of the 282 provisions of the Single European Act, ranging from removal of border controls and separate technical regulations to abolition of conflicting business law and discriminatory capital markets have already been passed by a

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majority of the EC nations. Clearly, the European single market will be established by January 1, 1993. Moreover the economic integration of the EC with the European Free Trade Area (EFTA) is likely to be completed before the end of the 1990s. It will constitute a larger economic entity than that of the United States, Canada and Mexico. Comprising a population of 360 million people, EC will be joined by a population of 32 million in EFTA, together accounting for almost 30 percent of world GDP and 45 percent of world trade. With per capita income in 1990 of about \$18,000 in the EC, and \$27,000 in the EFTA, prospects for further expansion of the intra-regional trade appears to be strongly based.

I. TREATY ON EUROPEAN UNION

The Single European Act and the Maastricht Treaty—which was signed in February 1992—suggest the form of economic and monetary restructuring most Western European countries are likely to achieve. Inter alia, the objectives of the Maastricht Treaty are to provide a framework for "economic convergence" of those EC members which, in three stages, would be capable of fulfilling the following conditions for membership in the European Monetary Union (EMU).¹ First, the inflation rate of the member state must not exceed by more than 1.5 percentage points the average inflation rate of the three best performing member states, measured in terms of the Consumer Price Index (CPI).² Second, the nominal long-term interest rate of the member state must not exceed by more than 2 percentage points the average nominal long-term interest rate of the three best performing member states in terms of price stability.³ Third, the budget deficit of the public authorities of the member state must not exceed 3 percent, and total

debt 60 percent, of its GDP.⁴ Fourth, the exchange rate of the member state must have attained stability, denoted by having remained within the narrow band (a range of 4.5 percent, i.e., $\pm 2.5\%$) within the Exchange Rate Mechanism of the European Monetary System for a period of two years without serious pressure on the exchange rate nor a devaluation vis-à-vis the currency of any other member state.⁵

From 1985 through 1990, only the Federal Republic of Germany (FRG) and Luxembourg met all four convergent criteria.⁶ Most of the economically developed member states, such as Belgium, Denmark, Italy, The Netherlands and United Kingdom did not meet them. These countries fulfilled all four criteria in two years, three criteria in one year, and two in three years. The less developed economies, such as Greece, Ireland, Portugal and Spain either failed to meet any of the requirements in any year or, as in the case of Spain, fulfilled only one requirement each year. More specifically, as regards the inflation-rate requirement, in addition to the FRG and Luxembourg, only The Netherlands met this requirement each year. Belgium met it most years but the remaining eight member states did not, and with respect to the nominal long-term interest rate criterion, in addition to the FRG and Luxembourg, The Netherlands met the requirement each year; Belgium each year but one; France each year but three; and the remaining seven member states failed to meet the criterion most years. In regard to the budget deficit of the public authorities, in addition to the FRG and Luxembourg, Denmark, France and United Kingdom met the criterion each year. Of the remaining seven member states, Greece and Spain met it only one year, and the other five member states, never at all. As for total indebtedness of the public authorities, in addition to the FRG and Luxembourg, France, Spain and United Kingdom met the criterion each year, but the remaining seven member states failed ever to meet

it. Concerning the exchange-rate criterion, in addition to the FRG and Luxembourg, France, Greece, Spain and United Kingdom fulfilled the requirement each year, but the remaining seven member states failed to do so any single year.

According to national sources and staff projections of the IMF, convergence indicators for 1992 are as follows: only Denmark, France and Luxembourg would satisfy all criteria.⁷ If not for flexibility and exceptions provided in the Treaty, events in Germany since unification in October 1990 have brought about economic conditions that would have made it impossible even for that country to fulfill the four convergence requirements. The Commission, however, had been granted more latitude in enforcing the criteria, especially in regard to fiscal policy. Accordingly, a member state with a deficit in excess of 3 percent of GDP would not be deemed as having an excessive deficit if the ratio had declined substantially and continuously and had reached a level close to the reference value. Moreover, an exception could be granted if the excess over the reference value was *exceptional and temporary*, provided that the deficit remained close to the reference value. Further, an excessive debt ratio would be acceptable should it be sufficiently diminishing and approaching the reference value at a satisfactory pace. Even if the member state fails to meet these criteria, the analysis must still take into account whether the deficit exceeds government investment expenditure as well as other relevant factors, including the medium-term economic and budgetary position. This means that three more member states would meet the four criteria on the basis of convergence indicators for 1992: Germany, Ireland and The Netherlands. For Germany, the budget deficit is 3.1 percent of GDP and would be considered temporary, although it may persist longer than has been anticipated. For Denmark and Ireland the debt ratio is decreasing quite rapidly; in Ireland and The

Netherlands the budget deficit as a percent of GDP is 2.6 percent and 3.6 percent, respectively.⁸ The convergence indicators for Belgium, United Kingdom and Spain are less satisfactory. While Belgium has had a low rate of inflation for many years, its budget deficit as a percent of GDP remains high (-5.9 percent) and its debt ratio, extraordinarily high (133.4 percent). Having suffered from a severe and protracted recession, the budget deficit of the United Kingdom might be considered as temporary; nonetheless, it is comparatively high (-5.5 percent of GDP). The indicators for Spain on inflation, budget deficit and long-term interest rates are all above the reference values, but not by large amounts and the debt to GDP ratio is only 48.0 percent. The 1992 data for Greece, Italy and Portugal would classify them as outliers; they definitely would not fulfill the convergence criteria.

The recent record indicates, therefore, that all member states would face an arduous task to comply with the rigorous demands of the Maastricht Treaty. Two or three groups would likely emerge. With two groups, one would comprise Germany, Luxembourg, France, Belgium, The Netherlands and United Kingdom; the other would consist of Denmark, Greece, Ireland, Italy, Portugal and Spain. If three groups were to emerge, one group would comprise those member states with a distinctly superior record: Germany, Luxembourg, The Netherlands, France, Denmark and United Kingdom. As De Grauwe and Gros have shown, this group "is rather homogeneous in terms of the EMU indicator...with an above-average performance."⁹ The second group would consist of Belgium, Portugal, Spain and Ireland, which have experienced a slightly below-average performance in terms of a composite EMU indicator.¹⁰ The third group would consist of Greece and Italy; from 1983 to 1992 Greece has been by far the worst case in terms of the EMU indicators. Although Italy's indicator "is not too far from the group of slightly

below-average performers,"¹¹ it is nonetheless, "much worse off than countries that are usually ranked higher, such as Portugal and Spain."¹² The preceding first group would likely form the core of the EMU; the majority of the second group, for an extended period, would probably be delegated to the status of "derogation"; and the third group is likely to be classified in that status well beyond the establishment of the EMU.

The Maastricht Treaty contains a provision that all member states must ratify the treaty before it can be put into force on January 1, 1993. But a referendum held in Denmark in June 1992, narrowly failed to obtain its ratification, holding the case of Denmark in abeyance. The remaining member states shortly thereafter voted unanimously to continue the process of ratification, without any modification of the terms of the Maastricht Treaty.

The terms of implementing the Treaty were carefully laid out into three stages. Stage one actually began as early as July 1, 1990, when the Community's Commission appointed a Committee of EC Central Bank Governors to recommend reforms for the coordination of monetary policy among the member states, as well as for its coordination with that of the European Monetary System (EMS). De juré, stage one would last from January 1 to December 31, 1993. During this period, the recommendations of the preceding Committee would form the basis for reforms to be undertaken at the initiative of individual member states.¹³

Stage two would last from January 1, 1994 to December 31, 1996. It would be a period in which the member states would endeavor to fulfill the requirements for membership into the prospective EMU. In January 1994, a European Monetary Institute (EMI) would be established for the express purpose of assisting the member states to meet the Maastricht Treaty conditions and to coordinate their monetary, fiscal and exchange-rate policies toward economic convergence.

The national central banks of the member states would, in this stage, retain unrestricted responsibility for their respective monetary policies. To identify serious distortions and inconsistencies, the EC Commission would monitor the development of the budgetary situation and of the public-sector debt in each member state. The Commission would then prepare reviews and make recommendations to improve monetary policy, to introduce new monetary instruments and to implement new procedures in the subsequent stage. Notably, during the second stage, a ban would be applied on "monetary financing" of public-sector deficits: Central banks would be prohibited from granting overdrafts and other credit facilities to public institutions.¹⁴ The Committee of the EC Central Bank Governors and the European Monetary Cooperation Fund would be dissolved and their functions assumed by the EMI which, in turn, would report annually to the Council of Ministers on each member states' preparedness for entry into the EMU.

Stage three would begin on or after January 1, 1997; it would apply only to those member states that had fulfilled the designated four criteria. The EC Commission and the EMI would jointly serve as penultimate arbiters. Before January 1, 1997, they would prepare progress reports on each member state, determining whether it had fulfilled the inflation-rate criterion in the year preceding the assessment. Similarly, they would determine whether the exchange-rate criteria had been maintained for two years preceding the assessment and so forth. These reports would be submitted to the Council of Ministers which, meeting as special representatives of Ministers of Economics and Finance (ECOFIN), would render the decision as to whether the full convergent criteria had been fulfilled by a qualified majority of the member states. Furthermore, before January 1, 1997, the Council of Ministers, represented by Heads of State/Government would decide on the basis of the ECOFIN recommendations whether it would be appropriate for

the EC to enter into stage three. Should the decision be favorable, the Council of Ministers would set the precise date for the beginning of stage three. This decision would entail "irreversible entry" for the designated member states. However, if the date for the beginning of stage three is not set by the end of 1997, stage three would nonetheless begin on January 1, 1999. In that event, the assessment procedure by the ECOFIN would be repeated before July 1, 1998, and the Heads of State and Government would proclaim the list of member states fulfilling the convergent criteria. In this second decision-making process, membership would be automatic and there would be no need for a qualified majority of member states to fulfill the convergent criteria or for the Council of Ministers to declare entrance into stage three to be appropriate. Moreover, under these circumstances, on July 1, 1998—six months before the beginning of stage three—the ECB would be established among those member states that had fulfilled the necessary requirements. Once these conditions had been satisfied, the irreversible formation of economic convergence of EC, begun with the signing of the Maastricht Treaty, will be accomplished. Consequently, stage three would begin no later than January 1, 1999, and the technical preparation would be organized in such a way that the ECB would be fully operative by that date.

Only with the official beginning of stage three would the responsibility for monetary policy be transferred to the ECB. At that time, the EMI would go into liquidation. During stage three both the ECB and the national central banks would be empowered to conduct open market operations. The right of the national central banks to issue bank notes, however, would also be granted to the Governing Council of the ECB. The basic tasks of the European System of Central Banks (ESCB) would be to determine and implement the monetary policy of the EC, to

conduct foreign exchange operations, to hold and manage the monetary reserves and to promote the smooth functioning of the payments system. According to provisions of the Maastricht Treaty, quantitative credit controls are incompatible with a competitive, market-clearing economy.¹⁵ Hence they would be prohibited. The ESCB would provide monetary-clearing arrangements both within the EC and with banks in non-EC nations. The ECB and the EC national central banks would be empowered to act as fiscal agents for the Community's public institutions. However, to achieve price stability—the primary objective of the ECB—the Treaty proclaims that in formulating and in conducting monetary policy the ECB would be independent of instruction from any other institution responsible for economic policy, be it at the Community or national level.¹⁶

The EMU would thus come into force sometime between January 1, 1997 and July 1, 1998, or on January 1, 1999. From the designated date onward, monetary policy would be transferred to the ESCB from members who have fulfilled the four criteria. Also from that date onward, the ESCB would be responsible for the management of the Ecu which would be linked to the participating currencies via fixed exchange rates. In effect, the Ecu would lose its characteristic as a "currency basket." Finally, as yet at an undetermined date, a single European currency would be introduced. It would still bear the name Ecu and would replace the national currencies of the participating member states in the EMU. The operation would be entirely formal: for it would entail no change in the real value of assets, liabilities, costs or selling prices. The respective currencies would simply be converted into the Ecu at the exchange rates prevailing at the beginning of the third stage. A supranational monetary system would therefore be created for which the ESCB would bear sole monetary responsibility. The ESCB would

conduct refinancing operations at uniform central-bank rates and deploy central-bank instruments on identical terms throughout the EC. Only after the Ecu had been instituted as the common currency would it become sole legal tender of the member states participating in the EMU.

Member states that had not fulfilled the entry requirements into the EMU would be treated as EC members with a "derogation." Specified provisions of the Maastricht Treaty would not apply to them. If, at a later date, they should meet the requirements, entry would be granted to them.

The EC Council of Ministers would have considerable discretion in deciding whether member states had made sufficient progress in meeting the necessary conditions for entering the EMU and/or for adopting a common currency. Member states would be expected to implement multi-annual programs that would help them meet the convergence criteria. Moreover, the Council of Ministers would take into account additional economic indicators, such as trends in wages and productivity, competitiveness and current-account developments. The central decision-making body of the ESCB would be the Governing Council of the ECB, which would comprise the membership of the Executive Board of the ECB, as well as the Governors of the national central banks. As long as there are member states with a derogation, the Governors of their central banks would not be members of the Governing Council. The Executive Board of the ECB would be responsible for implementing monetary-policy decisions in cooperation with the national central banks. This structure would take due account of the federative character of the EC in the monetary sphere, without impairing the necessary consistency of monetary policy. Indeed, the representative, but centralist, decision-making structure of the system was especially designed to ensure such flexibility to accommodate member states. The Executive Board of the

ECB would consist of the President, the Vice-President and four other members appointed by the Heads of Government of the member states on the recommendation of the Council of Ministers. To promote independence, they would be appointed for a non-renewable period of eight years.¹⁷

To provide a link between the ECB and the national central banks of member states with a derogation, a supplementary General Council would be established. It would be composed of the President and the Vice-President of the ECB and the Governors of all national central banks—with all members having voting rights. The General Council would have no monetary-policy powers. The monetary policy of each member state with a derogation would remain its own national responsibility. But the General Council would have the special task of monitoring the exchange-rate system of these countries; their exchange rates would be permitted to fluctuate in terms of the Ecu within a narrow 4.5 percent band, i.e., ± 2.25 percent. The General Council would also serve as the coordinating body between the ECB and the central banks of the member states with a derogation. Consequently, the General Council, rather than the Governing Council of the ESCB, would deal with some of these more technical aspects of the ECB.

The initial capital of the ECB would be 5 billion Ecu, to be subscribed and held by the national central banks.¹⁸ The formula for capitalization is based on the respective member states' proportion of population and GDP of the entire EC, with a weight of 50 percent for each component. The formula would be adjusted every five years on the basis of the preceding terms. The income of the national central banks, derived from their monetary management, and the net income of the ECB would be allocated on the basis of the same formula. At first, the national central banks would transfer monetary reserves to the ECB in the amount of 50 billion Ecu. To avoid serious repercussions in foreign exchange markets during the third stage, the national

central banks would be permitted to conduct foreign-exchange transactions with the monetary reserves retained by them; but only with the consent of the Governing Council of the ECB. The sole exemptions would be to permit the national central banks to redeem obligations with international organizations and to conduct specified transactions within designated limits.

Although the Maastricht Treaty contains serious potential weaknesses, it is an incisive document that formulates the foundations for the success of economic restructuring in Western Europe. Ratified or not, its tenets probably will be adhered to by a majority of EC developed nations. The terms of the accord are significant because they formulate the principal conditions for a nation's long-term success in achieving internal and external economic balance. For that reason the postulated criteria can be used for comparative analysis of economic restructuring in other regions. If the Single Market provisions and those for the EMU are substantially achieved, they will provide a basis for the restructuring of Western Europe toward an unparalleled, comparatively stable and robust economic area.

II. PROSPECT

In a recent study conducted at the IMF a multi-region econometric model was used to estimate—in terms of deviations from a base line scenario in which there was no adjustment from the 1992 situation, except for developments already in the pipe line—the effects of convergence as generally defined by the Maastricht requirements. The assumed path for the deficit relative to the base line is 30 percent of the targeted reduction in 1993, 50 percent in 1994, 75 percent in 1995, and complete adjustment by 1996. Consistent with provisions of the Treaty, in countries

with high debt/GDP ratios, the deficit reduction results in a gradual decline in the ratio that would probably be acceptable even though the ratio remains considerably above 60 percent. The effects on economic activity in the EC and in other developed countries were found to depend "crucially"¹⁹ on the assumed consequences of fiscal adjustment for interest-rate differentials vis-à-vis Germany. While it is difficult to gauge the actual developments, even in the best case, where countries make large fiscal adjustments and there is a consequent sharp reduction in interest rates, the initial impact on economic activity in 1993 is rather small.

In the short term, the contractionary effects of reducing budget deficits is partially counteracted by lowered costs of servicing the public debt. Reduced budget deficits and attendant lower interest rates also tend to "crowd in" private investment. In terms of deviations from the base line, in the net, real GDP of the entire EC is reduced by less than one-half percent.²⁰ In the third year, 1995, the deviation is nil and, subsequently the deviation becomes positive. In terms of rates of growth, after a reduction of one-half percent in 1993, the annual rate of growth is enhanced by about 0.2 of a percentage point for a large number of years, resulting in a net permanent gain. Outside the EC, even in the first year the effects are negligible, less than 0.1 percent of GDP. Particularly in other developed countries, the relative decline in EC interest rates tends to appreciate their currencies and increase net imports. But this, in turn, tends to lower their interest rates and, combined with the subsequent higher growth of GDP in the EC, offsets the rise in their net imports from the EC. Therefore, current account equilibrium would tend to be restored.

Even in the worst case scenario, the IMF study concludes, the effects of the Maastricht Treaty on economic activity in most EC countries would be small, and its impact on the rest of

the world negligible.²¹ In countries with large fiscal deficits, however, the initial negative effects of reduced budget deficits is much stronger and more sustained than in the preceding scenario. Clearly, under such conditions structural reforms and policies fostering the decline in real interest rates would be ever more urgent, especially if the world economy were to operate at a sluggish pace. Under such circumstances, some of the important weaknesses of the Maastricht Treaty would render adjustments to the high unemployment rates in the EC more difficult, especially in the less flexible economies and in the less developed member states.

III. RETROSPECT

The available evidence shows that the U.S. recent recession reached its trough in the spring of 1991. In the fall of 1991, however, the mild recovery suffered a relapse that continued until 1992, with exceptional—though understandable—pessimism shown by households and firms. Both the pessimism and the relapse were associated with economic trends likely to have a significant impact on the United States and the world economy during the rest of the 1990s. Some of these economic trends had their origins in the 1970s and 1980s. They have been exacerbated by erroneous economic and financial policies in the leading industrial countries. There are no quick solutions to these long-term disequilibria which, in effect, have been adversely affecting cyclical and structural adjustments. As shown in Table 1, world total output actually declined in 1991. Moreover, while the world mean GNP growth rate was 2.7 percent for the period 1981-1985, it is projected by the U.N. Project Link, at 2.1 percent for the period 1991-1996. The projections for the United States, Japan and Germany are all below recent

TABLE 1

Projections of World Economic Indicators

	1991	1992	1993
<u>Gross National Product (GNP)</u>			
<u>Growth Rates</u>			
World	-0.4	0.6	2.7
Developed Countries	0.7	1.4	2.6
Eastern Europe and the former Soviet Union	-16.3	-16.1	-4.4
Developing Countries	3.2	4.5	5.6
Africa	2.4	1.7	3.1
South & East Asia	6.0	5.5	6.2
China	7.0	12.1	11.8
Latin America	3.3	2.4	3.0
Developed Countries			
Inflation rate	4.3	3.0	2.9
Unemployment rate	7.2	8.1	8.2
World Export Volume	3.6	3.9	5.6
<u>Per Capita GNP Growth Rates</u>			
World	-1.9	-1.0	1.0
Developed Market Economies	0.2	0.9	2.1
Eastern Europe and the former Soviet Union	-16.8	-16.6	-4.9
Developing Countries	1.3	2.5	3.6
Africa	-0.5	-1.2	0.1
South & East Asia	3.8	3.4	3.9
China	5.5	10.6	10.2
Latin America	1.3	0.5	1.1

SOURCE: United Nations, Department of Economic and Social Development, Project Link World Outlook, New York, NY, October 20, 1992, pp. 2, 5, 7, 8, 9.

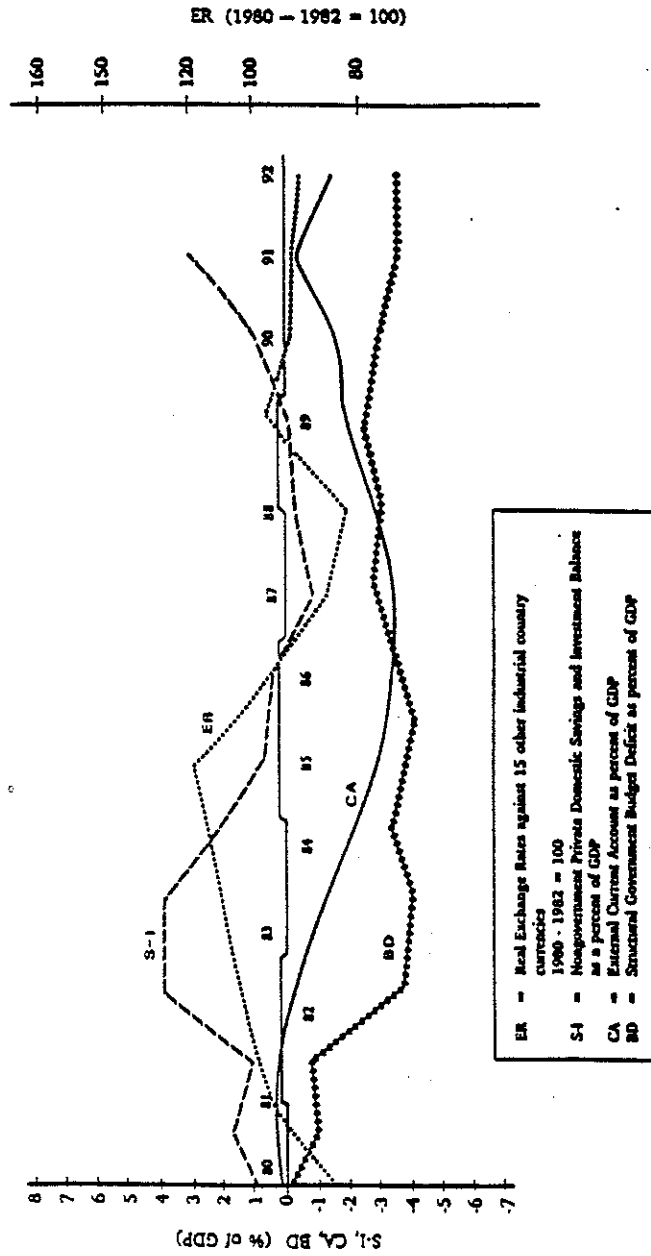


Figure 1. United States. Sources: J.P. Morgan, "World Financial Market" (New York, New York), various issues for real effective exchange-rate index; U.S. Government Printing Office *Economic Report of the President* (Washington, D.C., February, 1992), Tables B-1, p. 298, B-26, p. 328, and B-100, p. 412, respectively, for private savings-investment balance, current-account balance, and budget deficit as percent of G.D.P.; and Department of Commerce, B.E.A., *Survey of Current Business* (Washington, D.C.) as a check on private savings-investment balances.

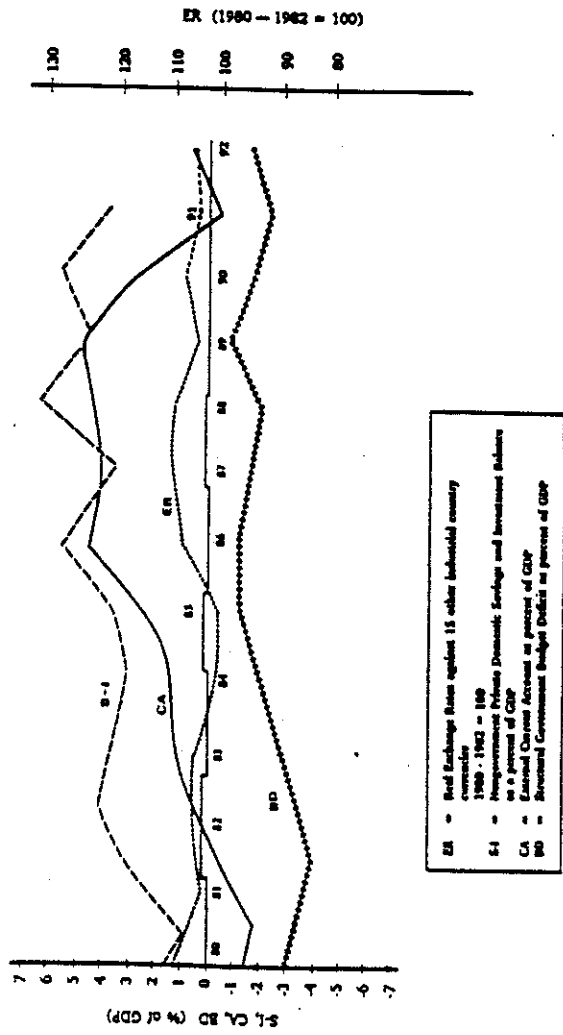


Figure 2. Federal Republic of Germany. Sources: J.P. Morgan, "World Financial Market" (New York, New York), various issues for real effective exchange-rate index; O.E.C.D. (Paris), for current-account balance and budget deficit as percent of G.D.P.; The Deutsche Bundesbank (Frankfurt), for private savings-investment balance as percent of G.D.P.

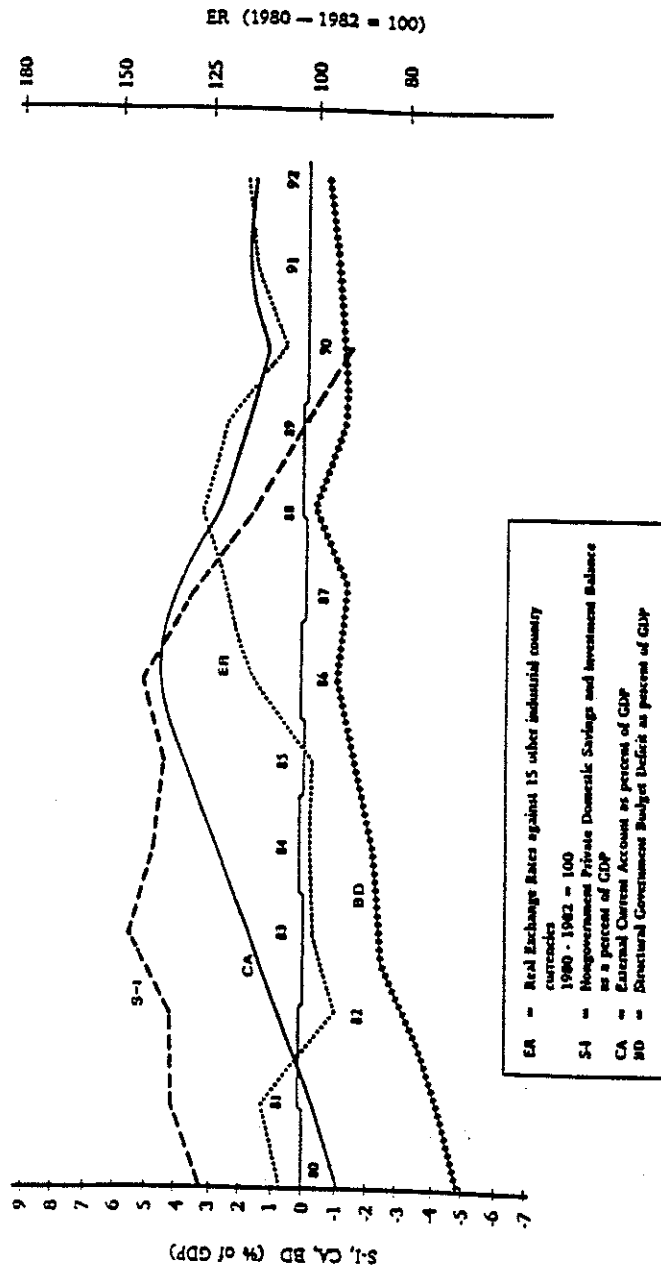


Figure 3. Japan. Sources: J.P. Morgan, "World Financial Market" (New York, New York), various issues for real effective exchange-rate index; O.E.C.D. (Paris), for current-account balance and budget deficit as percent of G.D.P.; Economic Planning Agency "Distribution of National Income": (Tokyo, November, 1992), for private savings-investment balance. It is the total of net savings by non-financial incorporated enterprises, financial institutions, private non-profit institutions serving households, and households.

historical trends, as they are for the rest of the industrialized world. But turnaround in GNP growth rates has occurred in the aggregate, in Latin America and the Caribbean, as well as West Asia and the Middle East—both the latter recovering from the Gulf War. In toto, however, it appears likely that the restructuring not only of Western Europe, but also of North America, the Asia-Pacific Region, Eastern Europe, the Commonwealth of Independent States and sub-Saharan Africa will occur, at least in the foreseeable future, in a world environment of moderate rather than robust economic growth.

As shown in Table 1, according to U.N. Project Link projections, the real GNP growth rate for the world for 1992 will be only 0.6 percent, following a decline of 0.4 percent in 1991. The per capita GNP growth rate of the world for 1992 is projected to be negative for the third year. The economies of Germany and Japan at the close of 1992 entered a state of "growth recession." A new phenomenon has developed among the Newly Industrialized Economies (NIEs) of Southeast Asia: their interregional trade has been expanding primarily as a result of their own high growth rates, independent of the so called "locomotive effects" of the United States, Japan and Germany. With the exception of the NIEs of Southeast Asia and China, prospects for rapid economic growth in the rest of the world appear to be bleak. The restructuring process is being characterized by acute down-sizing of industries, and consumer and investor confidence has been and is being adversely affected by the fragility of the banking system. This is clearly demonstrated in Japan with the crash in real estate and asset values. Its saving minus investment balance as a percent of GDP continues to decline. As shown in Figures 1, 2 and 3, even the non-government private domestic savings and investment balance in the United States, Japan and Germany has declined to levels that, for the foreseeable future, would

not be able to provide the rest of the world with as much excess savings as heretofore. As shown in Figure 4, from 1984 to 1990, for the G-7 countries, the balance of national savings and investment as a percentage of GNP generally declined, becoming equal in 1990. The available evidence suggests that the current world recessionary conditions may last longer than the U.N. projections have estimated. Thereafter, however, the global economic restructuring may well set the foundation for a comparatively robust economic expansion. In that event, considering the reconstruction requirements of the former Communist countries, the Middle East, as well as those of Latin America and sub-Saharan Africa, the supply of world savings is likely to be smaller than the anticipated demand for world investment. As a result, real rates of interest would rise, moderating the expansion in investment and exacerbating the foreign debt problem of heavily indebted LDCs.

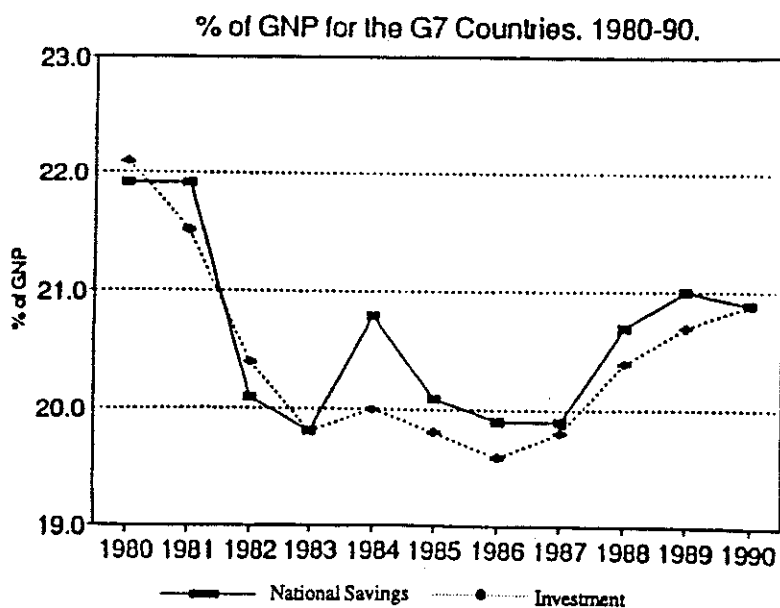


Figure 4. National Savings and Investment. Source: OECD, *Economic Outlook*, June 1991.

The expansionary effects of the Single European Market from January 1993 onward are likely to be considerably larger than those of the Maastricht Treaty even after the second stage of implementing the Treaty.²² In appraising the pros and cons of the EMU, three political-economic issues must be borne in mind. First, most member states—but not Denmark and Britain—are anxious to "Europeanize the mark": Maastricht would reduce the dominance of Germany over EC economic, monetary and exchange rate policy via enlarging the influence of the other member states that are capable of meeting the convergence criteria. Second, it is widely recognized that the decision to join the EMU would enforce discipline with respect to the reduction of budget deficits in the member states. Third, the economizing of reserves and the lowering of transaction costs associated with the establishment of the ECB and the Ecu as a common currency are regarded as an integral part of an expanding financial and banking industry on an EC and worldwide level.

While the Maastricht Treaty may be regarded as an important building block in a long-term historical process, nonetheless it is also likely to have injurious economic effects that will require ameliorative attention. Under the terms of this treaty the criterion for inflation is expressed in terms of differential rates of price increase vis-à-vis the three member states with the best record. This fails to deal with the situation which occurs when the entire EC experiences a considerable rate of inflation when, at the same time, the base group has a substantial rate of inflation. Another problem is in the area of the relation between budget deficits and monetary policy. While the ECB is delegated authority to manage the monetary aggregates, the governments of the member states retain excessive authority, *ex ante*, to indulge in deficit

financing. If significant economic disequilibria among member states are to be avoided, a tightening of provisions along lines of budgetary coordination is a primary requisite. Further, once exchange rates of member states are locked, authority over management of exchange rate variations vis-à-vis, say the dollar and the yen, is not clearly formulated. Principal and final authority appear to have been delegated to the EC Council of Ministers.

In retrospect, the experience of monetary unions indicates that there is a formidable need for substantial economic assistance to relatively underdeveloped regions with rigid cost structures downwards; this is particularly true during periods of recession and/or overall current account deficit.²³ The removal of exchange rate depreciation as an instrument of economic adaptation is likely to exacerbate the problem of mass unemployment in the less developed member states.

The Maastricht Treaty appears to assume that member states will act as a "conglomerate of independencies." To a significant extent this is correct. Before the exchange-rate crisis of September 1992, there was a recognized need for exchange-rate realignments among members of the EMS. Germany proposed an "overall solution," including appreciation of the DM and lowering German interest rates. France did not agree, thereby aborting a solution within the general framework of the ERM, and generating realignments via turbulent money markets. Confidence in the EMS was undermined, probably postponing the establishment of EMU until 1999. The Edinburgh Conference of December 1992 was successful in attaining an agreement with Denmark and in stabilizing money markets.²⁴ The different economic-political objectives of the member states will doubtless continue to generate friction and conflict among them. But the powerful historical process toward greater economic cohesion of which Maastricht is an integral part appears likely to operate in the direction of improving the relation between their

internal and external balance.

Notwithstanding the provisions for penalties on excessive deficit procedure, as well as the expanded form of structural funds and the establishment of a new Cohesion Fund—especially to help member states with a per capital GNP of less than 90 percent of the Community average—in time of economic stress, the economically powerful "center" is likely to expand its influence over the fiscal and monetary policies of the weaker member states. In consequence, while EMU would tend to moderate the rigorous demands of the Bundesbank regarding monetary, interest-rate and exchange-rate policies, thereby tempering Germany's influence both in the EC and in the international economy, during economic crises EMU would enhance Germany's influence over the weaker member states. Specific provisions for dealing with such economic crises, however, are wanting in the Maastricht Treaty. Experience suggests that their near-term implementation is of critical importance. If these weaknesses of the Treaty are gradually overcome, with due regard to the "principle of subsidiarity," the ratification and evolution of Maastricht could provide a required stabilizing element not only for the expanding European economic-political community but, by way of "strategic complementarity," for North America, the Asia-Pacific region and even the former Soviet States.²⁵

NOTES

1. See *Official Journal of the European Communities*, No. C 191, vol. 35, 29 July 1992: 92/C 191/01, "Treaty of European Union," signed at Maastricht on February 7, 1992.
2. Article 1 of the protocol to the Treaty on the convergence criteria reads as follows: "The criterion on price stability referred to in the first indent of Article 109(1) of this Treaty shall mean that a Member state has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1 1/2 percentage points that of, at most, the three best performing Member States in terms of price stability." *Ibid.*, No. C 191/85. De facto, the authorities have interpreted this Article as stated *supra* in the text.
3. *Ibid.*, No. C 191/85, Article 4.
4. *Ibid.*, Article 2 and second indent of Article 109(1) of this Treaty.
5. Protocol, *ibid.*, No. C 191/85, Article 3.
6. The analysis that follows is based on data of the European Commission. See also Wilhelm Nölling, "The Future of the German Currency Following the Maastricht Resolutions," which includes the viewpoint of the Bundesbank, *Hamburger Dairrage zur Wirtschafts- und Währungspolitik in Europe* (Hamburg, 1992), Appendix tables, pp. 53-56; Paul De Grauwe and Daniel Gros, "Convergence and Divergence in the Community's Economy on the Eve of Economic and Monetary Union," in *Setting European Community Priorities. 1991-92*, edited by Peter Ludlow (Brussels: Center for European Policy Studies, 1991), pp. 9-37; Andrew Britton and David Mayes, *Achieving Monetary Union in Europe* (London, 1992), Tables 1-4, pp. 114-117; and data included in essays on *Economic Convergence and Monetary Union in Europe*, edited by Ray Barrell (London, 1992).
7. See Jacques R. Artus, "Convergence: The Maastricht Approach to Economic and Monetary Union in Europe," paper delivered at the Fifth Special Financial Conference sponsored by the American Committee on Asian Economic Studies (ACAES) and the Federal Reserve Bank of Atlanta, October 29-30, 1992, Table 1, p. 8.
8. *Ibid.*, Table 1, p. 8.
9. Paul De Grauwe and Daniel Gros, "Convergence and Divergence in the Community's Economy on the Eve of Economic and Monetary Union," in *Setting European Community Priorities, 1991-92*, edited by Peter Ludlow (Brussels: Center for European Policy Studies, 1991), p. 31 and Table 5, p. 30.
10. *Ibid.*

11. Ibid.

12. Ibid.

13. As from January 1, 1994, all restrictions on capital movements between member states and between member states and third countries shall be prohibited.

14. A Protocol to the Treaty on the Statute of the European System of Central Banks and of the European Bank states: "In accordance with Article 104 of this Treaty, overdrafts or any other type of credit facility with the ECB or with the national central banks in favor of Community institutions or bodies, central governments, regional, local or other public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments." Chapter 1, Article 21, No. C 191/73.

15. Ibid., Chapter 2, Article 105, No. C 191/14.

16. Ibid., Article 107, No. C 191/15 and Article 7, No. C 191/70.

17. Ibid., Chapter 3, Article 109a (c) No. C 191/16.

18. Ibid., Chapter 6, Article 28,28.1, No. C 191/74.

19. See Jacques R. Artus, "Convergence: The Maastricht Approach to Economic and Monetary Union in Europe," (see fn. 7), p. 13.

20. Ibid., p. 14.

21. Ibid., p. 15.

22. For evidence and arguments in principle consistent with the position expressed in the text, cf. Rudiger Dornbusch, "Europe 1992: Macroeconomic Implications," *Brookings Papers on Economic Activity*, Brookings Institution, (Washington, D.C., 1989), Tables 2 and 3; Harry Flam, "Products Markets and 1992: Full Integration, Large Gains?" *Journal of Economic Perspectives* 6, No. 4 (Fall 1992), esp. p. 27; and Charles R. Bean, "Economic and Monetary Union in Europe," *Journal of Economic Perspectives* 6, No. 4 (Fall 1992), p. 51.

23. For comparative literature on this subject, see Olivier J. Blanchard and Lawrence F. Katz, "Regional Evolution," *Brookings Papers on Economic Activity*, Brookings Institution, (Washington, D.C., 1992), No. 1, pp. 1-61; Tamin Bayoumi and Paul Masson, "Fiscal Flows in the United States and Canada: Lessons for Monetary Union in Europe," International Monetary Fund, mimeo., May 1992; Tamin Bayoumi and Barry Eichengreen, "Shocking Aspects of European Monetary Unification," National Bureau of Economic Research, Working Paper No. 3949, January 1992; and Xavier Sala-i-Martin and Jeffrey Sachs, "Fiscal Federalism and Optimum Currency Areas: Evidence for Europe from the United States," National Bureau of Economic Research, Working Paper 3855, 1991.

24. See "Conclusions of the Presidency," European Council in Edinburgh, December 11-12, 1992, Part B; Reimut Jochimsen, "Current Matters of Bundesbank Policy, Particularly as They Relate to European Economic and Monetary Union," Centre for European Studies, Nuffield College Oxford, February 1, 1993; and Richard Portes, "EMS and EMU after the Fall," *The World Economy* (London, 1993, forthcoming).

25. As applied to international economics, "strategic complementarity" would mean that when one country (area) takes an action, it would lead to the second country (or rest-of-the-world compound) responding in a way that benefits both the first and second country. For a general discussion on strategic complementarity, see Gary S. Becker, *Rational Formation of Preferences* (Cambridge, forthcoming).

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