



University
of Glasgow

Mourlon-Druol, E. (2014) *Don't blame the Euro: historical reflections on the roots of the Eurozone crisis*. *West European Politics*, 37 (6). pp. 1282-1296. ISSN 0140-2382

Copyright © 2014 The Author

<http://eprints.gla.ac.uk/94413/>

Deposited on: 11 November 2014

Enlighten – Research publications by members of the University of Glasgow
<http://eprints.gla.ac.uk>

Don't Blame the Euro: Historical Reflections on the Roots of the Eurozone Crisis

EMMANUEL MOURLON-DRUOL

The article argues that many of the issues that are causing trouble in the eurozone today had long been debated, but not solved, prior to the beginning of the so-called euro crisis. Three thematic examples are used to show this: the decade-long discussion surrounding economic convergence and the question of a transfer union; the dispute over the alleged use of financial mechanisms as a substitute for addressing structural economic weaknesses; and the development of European banking regulation and supervision before the creation of the single currency. Finally, the article argues that even though some of the features of today's crises – in particular the debt and deficit issues – were outlined at the time of the euro's introduction, some important recent developments such as the various new operations undertaken by the European Central Bank were not. This should command modesty and cautiousness in the analysis of the evolution of the euro crisis.

'[I am stunned] that some may believe that one can correct budgetary mechanisms or wage mistakes by monetary mechanisms.'¹ It is not Angela Merkel who made this statement during one of the (many) European Council meetings devoted to the euro crisis since 2009. The statement, moreover, was not about Eurobonds. This remark is from Helmut Schmidt, West German chancellor from 1974 to 1982. He was commenting on a discussion about the state of monetary cooperation in Europe during a European Council meeting in Luxembourg in April 1976. Schmidt, rather ironically, recently criticised what he described as the current German 'National Egoism' in an interview in *Der Spiegel* (2012). The German conception of economic and monetary policy has not really changed over the past decades and has remained quite remarkably consistent both across time and between Social Democratic and Christian Democratic/Christian Social/Free Democratic Party governments.

For contemporary observers of the eurozone crisis and above all for international economic historians, the question 'Have we been here before?' is both

Correspondence Address: emmanuel.mourlon-druol@glasgow.ac.uk

© 2014 The Author(s). Published by Taylor & Francis.

This is an Open Access article distributed under the terms of the Creative Commons Attribution License <http://creativecommons.org/licenses/by/3.0/>, which permits unrestricted use, distribution, and reproduction in any medium, provided the original work is properly cited. The moral rights of the named author(s) have been asserted.

intriguing and relevant – the latter because history may contain lessons for the current crisis. The easy answer would of course be ‘no’: the euro has no perfect historical precedent, and any comparison with similar systems of the past is doomed to end up in concluding that, after all, things are not fully comparable (Nordvig 2012). The Latin Monetary Union or the gold standard were not, properly speaking, equivalent to the euro, and the circumstances under which they emerged and disintegrated were different. But some of the issues at stake in today’s discussions nonetheless have antecedents. The underlying factors and arguments about economic convergence in the European Union are virtually the same today as they were 40 years ago. Anyone familiar with the European Monetary System (EMS) negotiations would be struck by how similar the arguments used then are with our current debates. Furthermore, it is vexing for those with a longer-term view to see commentators marvelling at the allegedly ground-breaking novelty of creating a banking union – the foundations of which in fact were already discussed, to no avail, 50 years ago.

The current eurozone crisis therefore highlights long-term continuities in the history of European monetary cooperation that predate the euro’s creation. To be clear, this article does not argue that the two periods are fully comparable: apart from anything else, capital mobility was not as high then as it is today, and debt and deficit levels had not reached levels as high as today’s. As a consequence, many of the solutions being implemented or envisaged go further than other similar ideas suggested in the past (Vallée 2014). That said, many of the long-term issues that create challenges today were long debated, but not solved, prior to the inception of the euro. This article uses three thematic examples that are central to the current travails of the eurozone in order to illustrate this point: the issue of economic convergence in the EU in the 1970s; the discussions over the reform of the ‘snake’ in the mid-1970s, culminating in the negotiations over the creation of the Exchange Rate Mechanism (ERM) of the EMS in 1978–79; and finally, the debate over the development of European banking regulation and supervision in the 1960s and 1970s and its non-discussion during the 1990s Maastricht Treaty negotiations. These three examples underscore wider, perennial themes and challenges to EMU – such as intergovernmental versus supranational solutions, creation of a substantial and redistributive EU budget – that can shed light on our current predicament.

Economic Convergence and the Question of a Transfer Union

One of the underlying factors that contributes to the eurozone’s travails is the lack of economic convergence among its members. This problem is far from new, as it was a central argument of the opponents to the Maastricht Treaty. But even before the discussions about the creation of the single currency, economic convergence was a hotly debated topic in the European Union. Back in the 1970s, when EU (then still European Economic Community, or EEC) member states tried to keep their currencies orderly by floating into some sort

of EEC mechanism – dubbed the ‘snake’ in the early 1970s, which then became the EMS in 1979 – questions of economic convergence were central.

With regard to EU monetary cooperation, most of the long 1970s saw the opposition of two camps, referred to as the ‘economists vs. monetarists’ debate (Dyson and Featherstone 1999: 29–30; Eichengreen 2000). The economists argued that economic convergence should precede monetary union. This line of thought was also dubbed the ‘coronation theory’, in that monetary union resembled the coronation of a king or a queen after a long period of preparation. The monetarists – not to be confused with Milton Friedman’s brand of monetarism – held the opposite view: a monetary union would induce economic convergence. The German and also the Dutch governments tended to be economists while the French and Italian governments or the European Commission tended to be monetarists – though admittedly the lines were often blurred between the two strategies, as both sides had valuable ideas.

The debate between economists and monetarists went to the very heart of the EEC/EU’s possible monetary unification. When it put forward a plan in 1974 to further European monetary cooperation, the European Commission thus explained that the proposal would ‘push countries in the direction of greater convergence of economic policies than is being achieved, or is likely to be achieved under the present system’.² The European Commission articulated its monetarist thinking even more clearly in its 1975 *Report on European Union* – a report the Commission wrote at the request of EEC heads of government to explore the ‘transformation of the whole complex of the relations of Member States into a European Union’. ‘The achievement in due course of Monetary Union’, the Commission concluded, ‘is a precondition for economic integration within the Union and its cohesion in the world at large’ (European Commission 1975: 16). Conversely, the German government maintained strong opposition against any move towards further monetary cooperation so long as the EEC’s member states’ economies were so divergent. In preparing an informal meeting between EEC heads of government that took place in Paris on 14 September 1974, Helmut Schmidt noted:

the time has not yet come to return to the pursuit of economic and monetary union: Extreme disequilibria in current balances of payments might cause the Community to drift farther apart rather than grow closer together. ... Under these circumstances, the only way to success is to continue a European stability programme with a view to harmonising national economic policies.³

Only two years later, during a European Council meeting in The Hague in November 1976, Schmidt even stated that given the current economic disparities, an ‘Economic and Monetary Union ... is only a dream of diplomats’.⁴

Whether a dream of diplomats or the engine of economic convergence, EMU remained an important topic on the agenda and hence the issue of

economic coordination with it. Yet in the 1970s, European policy-makers did not talk of any 'growth compact' as they did in 2012 (European Council Conclusions 2012). During the EMS negotiations, the key expression was 'transfer of resources'. A report produced in 1977, the so-called MacDougall report on the role of public finance in European economic integration, recommended a considerable increase in the EEC budget, 'from 0.7 to around 2–2.5%', so as to make it more redistributive (MacDougall 1977: 17). Its recommendations were not followed. This theme of increased redistribution across EEC member states was recycled at the time of the EMS negotiations in the so-called concurrent studies that ran in parallel to the technical discussions about the inception of the ERM. These studies focused on the possibility of creating some sort of EEC-wide transfer of resources, from the richer states – chiefly Germany – to the less developed member states – chiefly Ireland, Italy, and Britain (Ludlow 1982; Mourlon-Druol 2012). The reasoning behind this request was that weaker economies needed these resources in order to sustain their participation in a stricter exchange rate system. The Irish and Italian governments wanted concrete transfers of resources (that is, other than mere loans). The global amount of transfers, according to the Italian government, should reach 2 per cent of GDP in subsequent years. The German opposition to such transfers, however, was total, and the French government indirectly backed the German government, as France most likely would have been among the contributors. Although he agreed that 'concurrent studies' could take place in parallel to the negotiations over the ERM, Schmidt seemed able or willing to countenance assistance only in the form of loans. And indeed the only agreement eventually reached was on European Investment Bank (EIB) interest rate subsidies for Ireland. This was quite far away from the MacDougall-inspired dreams of a more substantial redistributive budget or even from the more modest Italian and Irish proposals.⁵

This story should sound all too familiar to any observer of the current developments in the eurozone. Announced with great fanfare, the 2012 Growth Pact was in fact composed of very limited measures. Among the €120 billion allocated to stimulate growth are, in fact, many elements that are not really new: €55 billion comes from unallocated structural funds, €60 billion from EIB loans resulting from a €10 billion capital increase of the EIB (*European Council Conclusions* 2012). Perhaps even more striking is the contrast between the initial dramatisation of the additional negotiations, focused on economic convergence, and the eventual result.

Back in the late 1970s, the 'concurrent studies' threatened to endanger the very inception of the EMS. Unable to reach an agreement on resource transfers, the Irish and Italian governments were about to reject EMS membership. 'We must prepare ourselves for failure', Schmidt said gloomily during the Brussels European Council of December 1978.⁶ In the end, the Irish and Italian governments asked for a 'pause for reflection', allowing the creation of the EMS, but with only six members (the British government had already announced it opted out). Yet it only took a couple of weeks to secure the

eventual Irish and Italian agreements to participate in the EMS (Mourlon-Druol 2012: 255–7). The Irish government obtained extra loans and interest rate subsidies, though, importantly, it did so through bilateral agreements rather than through an EEC-wide scheme. Meanwhile, the Italian prime minister, Giulio Andreotti, undertook extensive domestic political consultations in order to convince his majority to support EMS membership.

This description fits well with what happened in 2012. During his electoral campaign and right after his election, François Hollande promised that he would ‘renegotiate’ the Fiscal Compact of December 2011, the terms of which had been discussed by his predecessor Nicolas Sarkozy, in order to include measures to support growth. He argued that balanced budgets and austerity could not be the only goals and that it was also necessary to encourage growth. Yet a proper renegotiation would have put at risk the existence of the treaty itself – not to mention the fact that some EU member states had already ratified this agreement. But almost as quickly as the Irish and Italian requests had faded away in 1978, Hollande in 2012 abandoned any ambition of actually renegotiating the fiscal compact. Instead, European leaders agreed upon the ‘Growth Pact’ outlined above, much more limited in scope,⁷ and the French National Assembly eventually ratified the treaty in spite of some domestic political difficulties. In 2012, as in 1978, no drama developed.

What these similarities highlight is a constant difficulty in moving from largely limited and intergovernmental solutions to more substantial solutions – be they intergovernmental or supranational. Calls for a more significant EU budget are frequent but remain today at the level of rhetoric, and they face much opposition. Herman Van Rompuy made the most recent call in his report ‘Towards Genuine Economic and Monetary Union’, which is still under consideration at the time of writing (Van Rompuy 2012). This parallel between what happened in the 1970s and our current predicament is only further reinforced by another notable similarity: that of the monetary and financial discussions, then and now.

Financial Mechanisms as a Substitute for Economic Weaknesses?

The discussions about the sovereign debt mutualisation recall some of the arguments advanced during the negotiations over the creation of the Exchange Rate Mechanism in 1979. In a nutshell, the idea behind what is often described under the general catch-word of ‘Eurobond’ is to create a new type of bond in euros, jointly issued by the eurozone members, thereby allowing those member states currently paying high interest rates to borrow at a lower cost (Claessens *et al.* 2012; European Parliament, Directorate-General for Internal Policies 2011). More specifically, the original Bruegel Blue-Red Bond proposal suggested mutualising debt up to a specific threshold (so-called Blue Bonds, up to 60 per cent of the debt of each member state). The remainder was to be financed on a national basis (so-called Red Bonds) in order to create market discipline and to avoid moral hazard. One of the key arguments of the opponents to any mutualisation

of debt at the supranational level, aside from its theoretical desirability, is that it would do little to improve the 'fundamentals' – that is, the budgetary situation of the eurozone members in trouble. The creation of Eurobonds might be a useful measure in the long term, they argue – but only once the budgets had been put back on a sound basis (Weidmann 2012).

Back in the 1970s, the debates revolved around a similar set of issues and reasoning, albeit regarding a different financial mechanism. One of the important points of negotiations during the discussions over the creation of the EMS was the institution of a so-called divergence indicator (Mourlon-Druol 2012: 229–42). The indicator would identify when a currency diverged from the average fluctuation, upwards or downwards, and therefore allow the tailoring of specific economic and monetary measures that would bring the currency back to the average. Among the monetary measures envisaged were automatic intra-marginal interventions (that is, interventions before the margins of fluctuations are reached) that would immediately correct the difference and bring the divergent currency back towards the average fluctuation.

The German government strongly opposed this proposal in terms that are virtually identical to those it uses against the Eurobonds today. No amount of monetary trickery, Schmidt argued, would be able in itself to bridge the gap between weak-currency countries and strong-currency countries. An Italian diplomat even reported that the German chancellor described the whole idea of a divergent indicator as 'stupid and incomprehensible'.⁸ The adjective 'stupid' was an exaggeration, but the proposal was incomprehensible from a German point of view: prior economic convergence was the key to any possible future monetary convergence. If a divergence indicator were created, the divergence indicated could only lead to consultations, not automatic intra-marginal interventions. Schmidt's view prevailed, and the divergence indicator created in 1978 was deprived from the very beginning of any effectiveness.

The German position remained constant throughout the 1970s (de Saint Périer 2006; Mourlon-Druol 2012; Thiemeyer 2004). When the French government in 1974 suggested reforming the snake in order to render it more flexible (that is, with larger bands), thereby helping the weaker currency countries to re-join it, the German government refused. The French proposal focused on what would be at the centre of the EMS negotiations a few years later, namely, the possibility of organising an exchange-rate system around a unit of account (Mourlon-Druol 2009). The snake so far set its margins of fluctuation by using the maximum differential between two currencies, thus creating a bilateral grid of parities. By contrast, the French proposal suggested setting the margin of fluctuation with reference to the value of the European Unit of Account (EUA). The French government argued that this would share the burden of adjustment more fairly, since that burden so far had fallen only on the weaker currencies. It would also help to identify more easily the currency that would diverge vis-à-vis the rest. The strongest opposition to such a proposal came from the German government (but also, more generally, the snake members). Technical problems concerning the feasibility of such a system aside, the

German government insisted that key to convergence was economic adjustment, not monetary technicalities. When the same proposal was revamped during the EMS negotiations – though this time the exchange rate system was meant to be organised around the European Currency Unit (ECU), not the EUA – both the German economics and finance ministries stated: ‘a financial transfer to the economically weaker member states should not be provided through monetary mechanisms’.⁹

In 1976, when the Dutch government set out a proposal aimed at creating ‘target zones’ for the fluctuations of EEC currencies, again with the hope that it would allow non-snake members to re-join the EEC mechanism, the German government was once again opposed to the idea. Part of the Dutch proposal was comparable to the EMS divergence indicator in that it considered that the target zones would represent triggers for EEC member states to align their monetary policy with one another. Indicating what would be his position during the EMS negotiations, Schmidt expressed concern that this would merely nurture the illusion that a monetary mechanism could help solve problems that fundamentally lie with national economic policies. Only once national economic policies were put back in order could any Europe-wide mechanisms be envisaged.

This pattern of consistent opposition raises the question of why the German government changed position in early 1978 and accepted the creation of the EMS. Part of the answer lies in the fact that the EMS was not very different from its predecessor, the snake. The fluctuation margins were the same, with one slight modification: wider margins could temporarily be offered to those currencies that were no longer members of the snake. Only Ireland and Italy chose to benefit from them. The credit support mechanisms (very short-term financing, short-term monetary support, and medium-term financial assistance) were, it is true, quite substantially increased. But the divergence indicator involved no obligation to intervene; the ECU, introduced with great fanfare, was in fact a mere rechristening of the EUA introduced in 1975; and the negotiations over the creation of a European Monetary Fund (EMF) had meanwhile been postponed to a later date. The probability that these negotiations could ever be concluded was quite low from the beginning given the strong opposition of the Bundesbank. Indeed, talks about an EMF had been set aside during the EMS negotiations because of Bundesbank opposition.

Another part of the answer lies in the emergence of a new Europe-wide consensus on the need to pursue stability-oriented economic policies (MacNamara 1998; Mourlon-Druol 2012). After the appointment of Raymond Barre as French prime minister in August 1976, the French government started following a clear anti-inflationary policy. This stance starkly contrasted with the stop-and-go policies that had been followed up until then. Barre, a university professor of economics and former vice president of the Commission in charge of the economic and financial affairs portfolio, was less sensitive to political pressures than previously politicians had been. During the same period, the Italian government adopted an anti-inflationary stance. In 1978 Filippo Pandolfi, the

Italian finance minister, presented a plan tellingly entitled 'A Programme for Development, a Choice for Europe'. The economic policies of many EEC member states therefore followed similar orientations and, importantly, orientations that suited the German government.

Such an analysis could well apply, *mutatis mutandis*, to the German position in the eurozone's current predicament. Today, as throughout the history of European monetary union, a central issue is the consistency of economic and monetary policies. Mistaken or not, some policy-makers considered and still believe that some monetary or financial mechanisms devised in the wake of crisis are just illusory medicine. Eurobonds today, like automatic intra-marginal interventions for the divergence indicator in 1978 and failed plans for a reform of the snake in the mid-1970s, can be interpreted as a way to avoid addressing the 'economic fundamentals'. The history of European integration suggests that, should a solution to the present crisis emerge, it could well be much more limited, in technical terms, than some could hope. Both the ERM created in 1978 and the 'growth pact' adopted in 2012 fell short of many actors' hopes and expectations. The dynamic is similar in the case of EU banking regulation and supervision, as the next section will show.

The EU's Capital Market and the EU's Banking Regulation and Supervision

The issue of EU banking regulation and supervision was already on the agenda of European policy-makers in the 1960s. It was intensely discussed then and in the early 1970s, with few concrete results. Even before the international banking crises of the mid-1970s that spurred the launch of the Basel Committee on Banking Supervision (Schenk 2014, *forthcoming*; Goodhart 2011), the then-European Economic Community debated the question of setting up EEC-wide banking regulation and supervision.

The Segré report, published in 1966, raised the issue of capital market integration in Europe (Segré 1966). Such a capital market was needed, the report explained, in order to facilitate and improve the functioning of most of the existing EEC policies as well as a future monetary union. The emergence of a European capital market would inevitably raise the issue of regulation and supervision, partly to avoid unfair competition between banks resulting from regulatory differences from one member state to the other (Segré 1966: Chapter 12). The logic was, and still is, quite straightforward: a single capital market implies a single regulator and supervisor. As a consequence, the European Commission started investigating the possibilities of coordinating banking regulation and supervision across the EEC.¹⁰ One part of the question was to suppress the obstacles to the freedom of establishment (to fulfil the Treaty of Rome's objectives) and another part was to regulate and harmonise the rules governing these activities. In short: negative integration and positive integration.

In July 1972, Wilhelm Haferkamp, the European commissioner then in charge of the discussions, wrote a draft directive on the coordination of legislative, regulatory, and administrative dispositions concerning access to the non-stipendiary activities of credit institutions and their exercise (European Commission 1972). There are noteworthy parallels between the Commission's plans of the 1960s and early 1970s and today's discussions. In 2014, the eurozone banking union is composed of three pillars: the Single Supervisory Mechanism (SSM), deposit insurance, and a resolution mechanism (Howarth and Quaglia 2013; Quaglia 2010). Whereas the Commission never set out to create a single supranational supervisor in the 1960s and 1970s, it did tackle the issues of deposit insurance and a resolution mechanism (under the more modest item of 'winding up procedures'). In other words, the Commission clearly articulated the link between the harmonisation of EEC banking regulation and supervision, on the one hand, and the further development European monetary cooperation, on the other.

The plans ran into member state opposition, and they raised particular concerns for one applicant to EEC membership: Britain. Already in the early drafts of the directives, an official at the Bank of England commented,

As it stands, there is virtually no article which we can readily accept in its present form. The whole philosophy of the directive is, of course, diametrically opposed to our system of informal supervision and it is difficult to see how the present text can be amended to accommodate it.¹¹

The Bank of England's tradition of supervision largely rested on moral suasion rather than the formal measures that the European Commission envisaged. And, of course, London was by far the biggest European financial centre and one of the most important in the world (Bussière and Cassis 2005). Added to this was a more general point, namely that financial regulation and supervision is a very sensitive national prerogative and hence difficult to Europeanise, let alone harmonise at an international level. As the chairman of the Basel Committee, George Blunden, explained in 1977:

The banking system of a country is central to the management and efficiency of its economy; its supervision will inevitably be a jealously guarded national prerogative. Its subordination to an international authority is a highly unlikely development, which would require a degree of political commitment which neither exists nor is conceivable in the foreseeable future. (Cited in Schenk 2011: 74)

The various texts advanced later were considerably watered down (British entry into the EEC obviously increased British influence on the negotiations), removing any immediate ambition at EEC-wide regulation and supervision to the directives adopted in the 1970s (Council of Ministers 1973, 1977; Louis 1995; Penn 1989).

More recently, the Maastricht Treaty negotiations sidestepped the issue of EU banking regulation and supervision (James 2012: 292, 313–17). During the drafting of the ECB's statute, the Bundesbank opposed any language alluding to an explicit role for the new central bank in supervising banks. The issue therefore remained unresolved until the 2008 financial crisis placed it back on the agenda. Set up by the president of the European Commission, José Manuel Barroso, a group chaired by Jacques de Larosière explored the future of EU financial regulation and supervision. It released its report in February 2009 (de Larosière 2009). Two recommendations were central to the report: the inception of a European Systemic Risk Council (ESRC), responsible for 'macro-prudential supervision', and the creation of a European System of Financial Supervision (ESFS), responsible for 'micro-prudential supervision'. Some institutions have already been created in 2011 (a European Banking Authority in particular), and the creation of a banking union for members of the euro area is being set in motion at the time of writing.

Eurozone banking regulation and supervision, in its current form, suffers from some weaknesses. The exclusion of London, the leading European financial centre and the single currency's most important financial market, which is not member of the eurozone, remains a central issue, as it did in the 1960s and 1970s (Roberts 2005: 309). The question of which banks will be subject to EU regulation and supervision is also problematic today, as it was in the 1960s and 1970s. The fact that some banks, and especially the German savings institutions, are excluded from the eurozone's banking union framework could further undermine the regulatory regime given their importance in the European economy (Hüfner 2010). These two central challenges to any European-wide banking regulation and supervision have therefore remained largely the same over the past 50 years, although current developments seem to bring more substantial changes.

Conclusions: The Pitfalls of Predictive Explanations

The three case studies presented above – economic convergence, financial mechanisms, and moves towards a banking union – underscore that the current travails of the eurozone highlight long-term issues that predate the euro's creation and are not linked to the euro *sensu stricto*. The discussion of economic convergence often centred on the role that an EU budget could and should have; the introduction of monetary and financial mechanisms depended on whether northern states saw them as trickery designed to hide fundamental economic differences, a lack of budgetary discipline, and reluctance to correct either; and the difficulty of transferring highly sensitive responsibilities from national authorities to the Europe-wide level hindered the development of EU-wide banking regulation and supervision. Far from suddenly appearing with the euro crisis, these three issues have been, with quite remarkable consistency, on the agenda of EU policy-makers for the last half century. This does not mean that the eurozone is doomed to repeat past mistakes. Rather, it means

that the eurozone's troubles reflect a longstanding series of concerns and challenges that the euro's successful first few years allowed policy-makers to forget.

A final point concerns the difficulty of predicting the future evolution of the complex systems that the EU and the eurozone entail. This can superficially appear as a banal point, but the young history of the euro has underscored just how significant this was. In 2000, Niall Ferguson and Laurence J. Kotlikoff wrote a (partly) prescient article on the euro in *Foreign Affairs* (Ferguson and Kotlikoff 2000: 121). Fiscal problems, they argued, were such that the euro would sooner rather than later prove unsustainable. They specifically highlighted the debt and deficit problems in some eurozone members. Although the eurozone's current predicament suggests that they had a point, the intervening years have also uncovered two problems in their reasoning. The first concerns the possibility of leaving the eurozone: 'history shows there is always an exit', wrote Ferguson and Kotlikoff. Our current predicament certainly cannot exclude a future exit of a country from the eurozone, but it has by the same measure shown that it was not so easy – and certainly not as easy as Ferguson and Kotlikoff seemed to have assumed in 2000. As Barry Eichengreen (2007, 2010) argues, a country could obviously try and leave the euro area, but the technical and political difficulties would be immense. Looking only at the technical difficulties, the 'operational challenges' linked with reintroducing national currencies, the difficulties associated with the devising of new national monetary policies in times of crisis, and the reprinting of 16 billion euro banknotes – to name but a few – would create 'huge, possibly insurmountable, operational challenges' (Papadia 2014). The economic costs (as debt would remain denominated in the euro in many cases) would also be huge, and it is not obvious that the country would be better off in the long run, and, indeed, it might well be worse off (Eichengreen 2007, 2010). These important points highlight that leaving the euro does not have the same operational and economic implications as leaving the gold standard or the EMS. Since the beginning of the euro crisis, no single member has left the eurozone (rather the contrary, as two countries have joined: Estonia in 2011 and Latvia in 2014), and no single member has been expelled. A voluntary and orderly euro exit in 2014, although it cannot be excluded, appears less easy or less advantageous than it did in 2000.

The second problem with the Ferguson/Kotlikoff prediction lies in its static vision of EU institutions and policies. Their article excludes the possibility that the ECB could ever change its policy:

the Maastricht Treaty effectively rules out printing money; Article 104 of the treaty ... and Article 21 of the Statute of the European System of Central Banks enshrine a strict 'no bail-out' rule. Member states that hope to inflate away their debts will simply be turned away. (Ferguson and Kotlikoff 2000: 118)

It is true that the ECB's overriding objective is controlling inflation, and it technically cannot bail out a state. The main operations it undertook since 2000, however, show that the ECB, as much as many other actors involved in EU policy processes, can take unexpected and unpredicted policy measures. In 2000, it seemed inconceivable that the EU would adopt the series of measures that have been implemented in response to the crisis. In 2010, the ECB established a Securities Markets Programme (SMP), through which it can (to simplify somewhat) buy eurozone member states' bonds on the secondary market (ECB 2010). Second, in December 2011, the ECB carried out so-called Long-Term Refinancing Operations (LTROs) to support bank lending and liquidity in the eurozone (ECB 2011). Third, the ECB recently transformed the SMP into Outright Monetary Transactions (OMTs), whereby, under specific conditions, it can buy eurozone members' bonds on the secondary market with 'no ex ante quantitative limits' (ECB 2012). Far from being static and stubbornly concerned with anti-inflationary policy, incapable of devising any 'creative' measure in face of the urgency, the ECB has partly adapted itself to circumstances. Rhetoric has also evolved. Mario Draghi, the ECB's president, famously declared that 'within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough' (Draghi 2012). One may well argue that these reforms are wrong-headed, illegal, insufficient, and/or too late. The point stands, however, that such an evolution could hardly have been anticipated 14 years ago. In these developments, and in the broader history of European integration since the Second World War, lies perhaps a last lesson history can offer: the value of expecting the unexpected.

Acknowledgements

An earlier version of the paper was presented at the Munk School, University of Toronto in October 2012. I wish to thank Pepper Culpepper, Peter Hall, Randall Hansen, Willem Maas, Amy Verdun, as well as the two anonymous reviewers for their comments and suggestions.

Funding

Part of the research for this article was funded by the UK Economic and Social Research Council [RES-062-23-2423].

Notes

1. French National Archives (hereafter AN), site de Fontainebleau, 19900568, Article 400, Ministère des Affaires étrangères, La cabinet du Ministre, Le Conseiller technique, Conseil européen de Luxembourg, Compte-rendu résumé, 6 April 1976. This paper is based on a wide selection of British, French, German, Irish and Italian government and central bank archives as well as EU archives. English translations are mine unless otherwise noted.
2. European Commission Historical Archives (hereafter ECHA), BAC 565-1995 355, Commission of the European Communities, Directorate-General for Economic and Social Affairs, Note on concerted floating, undated, presumably October 1974.

3. Historical Archives of the European Union (hereafter HAEU), EN 599, Ausführungen des Bundeskanzlers in Paris am 14 September 1974. See also AdsD, HSA, 1/HSAA009361, Unter Verschluss, Betr.: Auswärtiger Ausschuss am 25. September, Dr. Massion, 24 September 1974.
4. AN, 5AG3/911, Note du Conseiller technique du Cabinet du Ministre du Ministère des Affaires étrangères, Compte-rendu résumé du Conseil européen de La Haye, Verbatim résumé, 6 December 1976.
5. This debate also recalls the wider issue of introducing a *gouvernement économique* and the later debates over the Stability and Growth Pact (SGP) up to the Treaty on Stability, Coordination and Governance (TSCG) signed in 2011 (Verdun 2000).
6. National Archives of Ireland (hereafter NAI), Department of Foreign Affairs (thereafter DFA), 2008/79/1939, Notes of Michael O’Kennedy, European Council, Brussels, 4/5 December 1978.
7. This is also reminiscent of the story of the Stability and Growth Pact see (Heipertz and Verdun 2010).
8. The National Archives (hereafter TNA), FCO 30/4029, Telegram No. 504, German/Italian talks in Siena on 1/2 November, EMS, 2 November 1978. This is somehow similar to what Angela Merkel would have declared in 2012, namely that there would not be any Eurobonds ‘as long as I live’ (‘Chancellor Merkel Vows No Euro Bonds as Long as She Lives’ 2012).
9. Bundesarchiv Koblenz (hereafter BAK), B126/70440, Willmann to Lahnstein, Europäisches Währungssystem, 11 September 1978.
10. Bank of England Archive (hereafter BoE), 8A48/1, Commission of the European Communities, Possibilities for the coordination of banking legislation in the member states, 5 June 1969.
11. BoE, 8A48/4, unsigned note, Draft Directive on the Harmonisation of Supervision over Credit Institutions, 19 September 1972.

References

- Bussière, Eric, and Youssef Cassis (2005). *London and Paris as International Financial Centres in the Twentieth Century*. Oxford: Oxford University Press.
- ‘Chancellor Merkel Vows No Euro Bonds as Long as She Lives’ (2012). *Spiegel Online*, June 27, available at <http://www.spiegel.de/international/europe/chancellor-merkel-vows-no-euro-bonds-as-long-as-she-lives-a-841163.html>
- Claessens, Stijn, Ashoka Mody, and Shahin Vallée (2012). ‘Paths to Eurobonds’, Bruegel Working Paper.
- Council of Ministers (1973). ‘Council Directive on the Abolition of Restrictions on Freedom of Establishment and Freedom to Provide Services in Respect of Self-Employed Activities of Banks and Other Financial Institutions’.
- Council of Ministers (1977). ‘First Council Directive on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking up and Pursuit of the Business of Credit Institutions’.
- De Larosière Jacques (2009). ‘Report of the High-Level Group on Financial Supervision in the EU’, available at http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf
- De Saint Périer, Amaury (2006). ‘La France et la sauvegarde du système communautaire de change de 1974 à 1977’, in Eric Bussière, Sylvain Schirmann, and Michel Dumoulin (eds.), *Milieus économiques et intégration européenne au XXe siècle. La crise des Années 1970. de la Conférence de La Haye à la veille de la relance des Années 1980*. Brussels: P.I.E. Peter Lang, 51–8.
- Der Spiegel (2012). ‘Helmut Schmidt kritisiert deutschen “National Egoismus”’, *Der Spiegel*, September 22, available at <http://www.spiegel.de/politik/deutschland/preisverleihung-altkanzler-schmidt-kritisiert-merkels-europa-kurs-a-857352.html>
- Draghi, Mario. 2012. ‘Speech at the Global Investment Conference in London’ July 26, available at <http://www.ecb.int/press/key/date/2012/html/sp120726.en.html>
- Dyson, Kenneth H. F., and Kevin Featherstone. 1999. *The Road to Maastricht: Negotiating Economic and Monetary Union*. Oxford University Press.

- ECB (2010). 'Decision of the European Central Bank of 14 May 2010 Establishing a Securities Markets Programme (ECB/2010/5) (2010/281/EU)', *Official Journal of the European Union*, May 20, L 124/8 edition.
- ECB (2011). 'ECB Announces Measures to Support Bank Lending and Money Market Activity', December 8, available at http://www.ecb.int/press/pr/date/2011/html/pr111208_1.en.html
- ECB (2012). 'Technical Features of Outright Monetary Transactions', September 6, available at http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html
- Eichengreen, Barry (2000). 'When to Dollarize', Paper presented at Conference on Dollarization hosted by the Federal Reserve Bank of Dallas, March 6.
- Eichengreen, Barry (2007). 'The Breakup of the Euro Area', Working Paper 13393. National Bureau of Economic Research, available at <http://www.nber.org/papers/w13393>
- Eichengreen, Barry (2010). 'The Breakup of the Euro Area', in Alberto Alesina and Francesco Giavazzi (eds.), *Europe and the Euro*, The University of Chicago Press, 11–51.
- European Commission (1972). 'Projet de Directive Visant la Coordination des Dispositions Législatives, Règlementaires et Administratives Concernant L'accès Aux Activités Non Salariées D'établissements de Crédit et de Leur Exercice'.
- European Commission (1975). 'Report on European Union', COM(75) 400.
- European Council Conclusions (2012). Available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/131388.pdf
- European Parliament, Directorate-General for Internal Policies. 2011. 'Eurobonds: Concepts and Implications. Compilation of Notes for the Monetary Dialogue'.
- Ferguson, Niall, and Laurence J. Kotlikoff (2000). 'The Degeneration of EMU', *Foreign Affairs*, 79:2, 110–21.
- Goodhart, C.A.E. (2011). *The Basel Committee on Banking Supervision: A History of the Early Years, 1974–1997*. Cambridge: Cambridge University Press.
- Heipertz, Martin, and Amy Verdun (2010). *Ruling Europe: The Politics of the Stability and Growth Pact*. Cambridge: Cambridge University Press.
- Howarth, David, and Lucia Quaglia (2013). 'Banking Union as Holy Grail: Rebuilding the Single Market in Financial Services, Stabilizing Europe's Banks and "Completing" Economic and Monetary Union', *Journal of Common Market Studies*, 51, 103–23.
- Hüfner, Felix (2010). 'The German Banking System: Lessons from the Financial Crisis', ECO/WKP(2010)44. Economics Department Working Papers No. 788. OECD, available at [http://search.oecd.org/officialdocuments/displaydocumentpdf/?cote=eco/wkp\(2010\)44&doclanguage=en](http://search.oecd.org/officialdocuments/displaydocumentpdf/?cote=eco/wkp(2010)44&doclanguage=en)
- James, Harold (2012). *Making the European Monetary Union: The Role of the Committee of Central Bank Governors and the Origins of the European Central Bank*. Belknap Press of Harvard University Press.
- Louis, Jean-Victor (1995). *Banking Supervision in the European Community: Institutional Aspects*. Bruxelles: Ed. de l'Université de Bruxelles.
- Ludlow, Peter (1982). *The Making of the European Monetary System: A Case Study of the Politics of the European Community*. Butterworths European Studies: Butterworths.
- MacDougall, Donald (1977). 'Report of the Study Group on the Role of Finance in European Integration', Commission of the EC.
- MacNamara, Kathleen R. (1998). *The Currency of Ideas: Monetary Politics in the European Union*. Ithaca, NY: Cornell University Press.
- Mourlon-Druol, Emmanuel (2009). 'Economist or Monetarist? The Difficult Creation of an Internal French Consensus about European Monetary Integration (1974–1976)', in M. Affinito, G. Migani and C. Wenkel (eds.), *Les Deux Europes / The Two Europes*. Bruxelles, Belgium: Peter Lang, 213–24.
- Mourlon-Druol, Emmanuel (2012). *A Europe Made of Money: The Emergence of the European Monetary System*. Ithaca, NY: Cornell University Press.
- Nordvig, Jens (2012). 'There is No Historical Precedent for the Break-up of the Eurozone', EUROPP. available at <http://blogs.lse.ac.uk/europpblog/2012/09/27/eurozone-breakup-jens-nordvig/>

- Papadia, Francesco (2014). 'Operational Aspects of a Hypothetical Demise of the Euro', *JCMS: Journal of Common Market Studies*, N/a–N/a. DOI:10.1111/jcms.12135.
- Penn, Graham A. (1989). *Banking Supervision: Regulation of the UK Banking Sector under the Banking Act 1987*. London: Butterworths.
- Quaglia, Lucia (2010). *Governing Financial Services in the European Union: Banking, Securities and Post-Trading*. London: Routledge.
- Roberts, Richard (2005). 'London as an International Financial Centre, 1980–2000: Global Powerhouse or Wimbledon EC2?', in Youssef Cassis and Eric Bussière (eds.), *London and Paris as International Financial Centres in the Twentieth Century*. Oxford: Oxford University Press, 287–312.
- Schenk, Catherine (2011). *International Economic Relations since 1945. Making of the Contemporary World*: Routledge.
- Schenk, Catherine (2014, forthcoming). 'Summer in the City: Banking Scandals of 1974 and the Development of International Banking Supervision', *English Historical Review*.
- Segré, Claudio (1966). *The Development of a European Capital Market*. Brussels: Pub. Services of the European Communities.
- Thiemeyer, Guido (2004). 'Helmut Schmidt und die Gründung des Europäischen Währungssystems 1973–1979', in *Aufbruch zum Europa der zweiten Generation. Die Europäische Einigung 1969–1984*, 245–68. Trier: Wissenschaftlicher Verlag Trier.
- Vallée, Shahin (2014). 'From Mutual Insurance to Fiscal Federalism: Rebuilding the Economic and Monetary Union after the Demise of the Maastricht Architecture', *International Economics*, DOI:10.1016/j.inteco.2013.11.003.
- Van Rompuy, Herman (2012). 'Towards a Genuine Economic and Monetary Union', available at http://ec.europa.eu/economy_finance/focuson/crisis/documents/131201_en.pdf
- Verdun, Amy (2000). *European Responses to Globalization and Financial Market Integration: Perceptions of Economic and Monetary Union in Britain, France and Germany*. New York: St. Martin's Press.
- Weidmann, Jens (2012). 'So wird der Euro stabil', *Süddeutsche Zeitung*, June 27.