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# Eurozone Crisis as Historical Legacy

## The Enduring Impact of German Unification, Twenty Years On


Mary Elise Sarotte


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# Introduction

As former U.S. secretary of state James A. Baker III once observed, "Almost every achievement contains within its success the seeds of a future problem." The eurozone crisis of 2010 provides a trenchant example of this phenomenon. When the long-sought but controversial implementation of an European Monetary Union (EMU) finally began—as part of the bundle of deals that produced German reunification twenty years ago on October 3—it represented a significant accomplishment. Though the idea of a single European currency had been around at least since the Werner Plan of the 1970s, German reunification provided the necessary catalyst. For all the success of that achievement, however, it left behind fateful seeds, which sprouted into the 2010 crisis.

The eurozone crisis resulted not only from the economic woes of weaker member states but also from flaws in the Maastricht Treaty and from Germany's long-term decrease in interest in European cooperation. Since a crisis is a terrible thing to waste, the members of the eurozone should use the sovereign debt debacle of 2010 as a second "1989 moment." They should retrofit the eurozone with the greater political institutionalization needed in the post–Cold War era—a goal that Germany sought but failed to achieve at the end of the Cold War and now no longer prioritizes. In other words, the best way to deal with today's issues is to finally address two decades of unfinished business.

# The Bargain of 1989–90

European integration, and especially monetary integration, has a long history of "stop-and-start" activity. The 1970 Werner Plan was a prime example: it originally called for an EMU within a decade, but each subsequent effort stalled short of implementation. The prospect of denationalizing currency and surrendering control over a fundamental tool of statecraft—currency valuation—was daunting to the member states of the European Community (EC). Politicians knew that they risked running afoul of voters if they surrendered too much sovereignty. West Germans, in particular, felt an extremely strong attachment to their postwar currency, the deutsche mark; for them, it was synonymous with the economic renewal, prosperity, and stability of the Cold War years, following on the trauma of the Weimar and Nazi eras. Beyond political worries, national capitals clashed over the question of independence for a future European Central Bank (ECB): West Germans cherished their independent Bundesbank and felt certain that it should have independence; the French prioritized political control over central bankers and how strict the convergence criteria should be—that is, how much inflation and sovereign debt would be acceptable.

It took the opening of the Berlin Wall on November 9, 1989, and the actions of two decisive leaders—West German chancellor Helmut Kohl and French president François Mitterrand—to cut through the controversy and make the single currency a reality. Historian David Marsh singles out

the bargain that Kohl and Mitterrand negotiated in 1989–90 as "the essential deal that launched Europe on the Maastricht monetary union path." The deal originated in the work of European Community Commission president Jacques Delors. Heading an eponymous committee, Delors made a fresh effort to map out a path to EMU in an April 1989 report. He found that the critical step, from which all else would follow, would be to convene an intergovernmental conference (IGC) for the purpose of implementing a single currency. However, the Delors Committee Report left deadlines vague, jeopardizing the prospects for its success.

With the collapse of the Berlin Wall, Mitterrand saw an opportunity for rapid convocation of Delors's IGC. He understood that the wall's collapse would motivate Kohl to seek German reunification, and he realized that the smart move would be to embed increased German strength in a monetary union as soon as possible. Both Mitterrand and Kohl realized that it would be extremely difficult to reunite Germany if EC members became worried about a threatening resurgence of German nationalism. Kohl always believed strongly in European integration; the opening of the wall did nothing to undermine his trust in Konrad Adenauer's saying that "German problems can only be solved under a European roof." Kohl fundamentally agreed with the goal of a common currency, although he had previously indicated that it should be accomplished in future decades. Nevertheless, he understood that West German voters, a majority of whom favored European integration and worried about the costs of rebuilding East Germany, would resist a go-it-alone reunification process that alienated the EC. Given France's weight in the EC, this meant that Kohl needed Mitterrand's approval to proceed.

In return, Mitterrand asked that Germany assent to move toward a single currency as soon as possible, with the crucial IGC convening by the end of 1990. Mitterrand further insisted that the opening of the IGC be announced in December 1989 during the French presidency of the European Council. If the French president could preside over a significant declaration about the future of European integration on French soil, Mitterrand would advocate within the EC for German unification. In the interest of success, Mitterrand acceded to German wishes for the full independence of a future ECB. Mitterrand's offer was well framed—Germany would get a currency union largely on its terms, but Kohl would have to compromise on timing. Kohl agreed to Mitterrand's bargain.

Consequently, the 1989 Strasbourg summit announced both the opening of the IGC and the EC's favorable attitude toward German unification. The IGC commenced roughly a year later in Rome, on December 15, 1990, and completed its work in December 1991 in Maastricht. In the end, the EC convened two IGCs in December 1990—one on EMU and another on political union between the EC's member states. During this period, the West German officials pushed for integration and hoped to combine the single currency with a matching increase in political institution-building. Mitterrand was willing to consider robust economic governance of the eurozone, but was loath to create new political institutions, and he prevailed—Europe would share a currency but not a treasury.

It is surprising and somewhat ironic that Kohl and Mitterrand achieved one of the greatest feats in the history of money. Neither had expertise, or even interest, in economic and monetary matters, apart from their political impact. Indeed, the despairing president of the Bundesbank in the 1980s, Karl Otto Pöhl, told the *Financial Times*—while he and Kohl were both in office—that the chancellor knew nothing about economics.

# The Maastricht Treaty and Its Legacy

In the mad rush toward German unification and EMU, the IGC's grand bargain overlooked critical details. The final Maastricht Treaty, ratified in 1992, contained insufficient crisis contingencies; monetary union proceeded without real political coordination and with excessive faith in the omnipotence and omniscience of financial markets. The treaty's implementation relied on a hope that its terms would become self-fulfilling, obviating the need for real enforcement.

The Maastricht Treaty established convergence criteria specifying that general government budget deficits of potential members should not exceed 3 percent of gross domestic product (GDP). The treaty fixed the permitted ratio of government debt-to-GDP at 60 percent. Potential participants were to have, over the year prior to joining, an average rate of inflation that did not exceed the performance of the best three member states by more than 1.5 percent. Similarly, they were to have average nominal long-term interest rates that did not exceed the best three by greater than 2 percent. The later Stability Pact, requested by the Germans, supplemented these criteria by, in theory, levying fines on violators. Further, the so-called no bailout clause specified that member states should not be liable for, nor assume, the commitments or debts of any other. The ratification of the Maastricht Treaty also started an irrevocable countdown toward implementation of EMU among qualifying countries by 1999. Finally, as part of this treaty, the EC reestablished itself as the European Union (EU). While this decision had some practical effects, such as greater cooperation in producing a Common Foreign and Security Policy (CFSP), the effects were nowhere near as profound in the political arena as they were in the economic realm.

As the eurozone crisis demonstrates, the hope that the Maastricht criteria could run the common-currency area in lieu of careful economic governance proved false. Six factors explain Maastricht's failure. The first is the momentum acquired by the growing membership of the single currency. Policy-makers wanted the new currency to succeed, and started using the number of members and applicants as an oversimplified metric of success, thereby allowing weaker economies to join without due scrutiny. Such laxness allowed the entry not only of members with ratios of debt-to-GDP well in excess of 60 percent (Belgium, Italy) but also of applicants like Greece, which not only flouted the rules but also falsified its records. Second, once accepted into the union, weaker member states could borrow at roughly the same interest rate as Germany due to the ECB practice of treating the sovereign debt of all eurozone members equally at its discount window. This practice contributed to increased spending without reference to what nations could actually afford. Third, more members in the currency area meant more seats at the table, rendering decision-making about enforcing criteria more difficult.

Fourth, German attitudes soured on European integration. After the onset of the housing bubble crisis in the United States and the bankruptcy of financial institutions such as Bear Stearns and Lehman Brothers, Berlin signaled that each individual European country would look after its own banks. With unification long a fait accompli, and populist resentment toward paying for the sins of other Europeans, German chancellor Angela Merkel ceased to prioritize repairs to the "European roof."

Given the state of the eurozone, it is no longer possible to deny a fifth problem: the insufficiency of the Maastricht Treaty. Neither the mere existence of a no bailout clause nor the action of financial markets was, in fact, sufficient to prevent the need for bailouts. Even worse, the treaty contained no guidelines indicating how to proceed if inter-European economic rescue became necessary. Lacking guidance, European leaders held a series of panicky meetings in spring 2010, culminating in the May decision by most eurozone members to pay €500 billion in bailout, and by the ECB to intervene in markets to buy debt. Merkel insisted on involving the International Monetary Fund (IMF), which gave €250 billion in a political move meant to ensure that Europeans would not bail out Greece alone and subsequently face voter wrath.

Sixth, and finally, the crisis spotlighted the weakness of eurozone economic governance. Member states had not wanted to impose overly strict penalties on treaty violators, in case they themselves fell into difficulties. Germany in particular was in a sensitive spot. The expense of renovating East Germany and the unrealistic one-to-one exchange rate between eastern and western marks inflated its money supply, destroyed already weak Eastern industries, and increased the final bill for unification. Germany's economic competitiveness declined, with the result that the member state expected to act as the guardian of monetary union standards failed to meet the Maastricht criteria itself. Germany had to ask, humiliatingly, for lenient implementation of the Stability Pact it had insisted upon, and the EU agreed. After such circumstances it was much harder for subsequent German governments to act in a holier-than-thou fashion toward any other member with economic woes. The fact that the French also found themselves in a fiscal hole for much of the 1990s only compounded the problem.

## Conclusion: Implications for Today

The 2010 crisis has had some fortunate consequences. It exposed weaknesses within individual countries and in the Maastricht Treaty. It confirmed that the eurozone cannot rely on financial markets to address its own weaknesses. It revealed that some kind of permanent bailout procedure is necessary. And it showed that European leaders are still grappling with the seeds sown by the rapidity with which both German unification and the Maastricht Treaty were achieved.

The challenge now is governance reform, not expulsion of member states. Reverting to national currencies would drive the values of reissued southern currencies into the ground and the deutsch mark into the sky, thereby undermining Germany's export competitiveness and job market, to say nothing of the collateral damage to the EU and the single market. The eurozone crisis should not signal the end of the euro but rather the start of a long-overdue overhaul. The idea of a European Monetary Fund endorsed by Wolfgang Schäuble—an elder statesman from the days of German unification and now a subordinate of Chancellor Angela Merkel—faded after Merkel dismissed it, but deserves broader support. Germany also needs to reconsider its calls for painful fiscal discipline on the part of the weakest countries until their economies regain footing. Ideally, but perhaps not realistically, Merkel should return to previous German form and spearhead a revision of the Maastricht Treaty, leading a fresh effort to do for political union what Kohl and Mitterrand did for monetary union.

The unlikelihood of such a move exemplifies a fundamental problem within the whole EU: there exists a built-in tension between the lofty goals of integration and member states' collective unpre-

paredness to think through the consequences of their ambitious project. The great achievement of the past has been to reconcile these contradictory impulses by focusing on practical agreements. It is time to do so once again, and to realize that the necessary consequence of monetary union is greater political union. European integration has already transformed most of a famously bellicose continent into a stable zone of peace. Europeans should learn from the woes of 2010 and use them to produce momentum and legitimacy for deeper integration.

# About the Author

**Mary Elise Sarotte** is a professor of international relations at the University of Southern California. She is the author, most recently, of *1989: The Struggle to Create Post-Cold War Europe.*