treaty base regarding climate change and energy solidarity, and by providing that a group of member states with the necessary military capability may establish permanent structured cooperation within the Union in the field of defence. Among the concessions to secure member states' acceptance to the mandate were those providing that the UK could opt into or out of policies concerning frontiers, asylum, and judicial cooperation, together with exemption from application of the Charter of Fundamental Rights to UK domestic law. The UK Independence Party should be pleased with the provision for negotiated secession from the Union.

Taken as a whole, the Reform Treaty comprises a broad agenda for making the Union more effective and democratic: a necessary counterpart for effective and democratic government in member states.

Chapter 4

Single market, single currency

While peace among the member states remained at the heart of the Community's purpose, from the second half of the 1950s a large common market became the focus for its action. The strength of the US economy was a striking example of the success of such a market; the Germans and the Dutch wanted liberal trade; and the French accepted the common market in industrial goods provided it was accompanied by the agricultural common market that would favour their own exports.

The idea of a large common market had a dynamic that endured through the subsequent decades, because it reflected the growing reality of economic interdependence. As technologies developed, and with them economies of scale, more and more firms of all sizes needed access to a large, secure market; and for the health of the economy and the benefit of the consumers, the market had to be big enough to provide scope for competition, even among the largest firms. So as the European economies developed, the EEC's original project, centred on abolition of tariffs in a customs union, was succeeded in the 1980s by the single market programme, then in the 1990s by the single currency.

There were both economic and political motives for each of the three projects: the benefits of economic rationality; and the consolidation of the Community system as a framework for peaceful relations among the member states. Economics and politics were also both involved in the substance and outcomes of the projects, because the integration of modern economies requires a framework of law, and hence common political and judicial institutions. Nor would success in either the economic or the political field alone have been enough to sustain the Community. There had to be success in both, which the customs union and the single market each achieved. It was also a combination of economic and political motives that secured the launch of the single currency, though not yet the participation of all member states.

The single market

Tariffs and import quotas were, in the 1950s, still the principal barriers to trade. The international process of reducing them began under American leadership in the Gatt (General Agreement on Tariffs and Trade). But the member states of the Community wanted to do more. The result was the EEC's customs union, abolishing tariff and quota barriers to their mutual trade, and creating a common external tariff.

Customs union, competition policy

Tariffs and quotas on trade between the member states were removed by stages between 1958 and 1968. Industry responded positively and trade across the frontiers grew rapidly, more than doubling during the decade.

While tariffs and quotas were the main distortions impeding trade, they were not the only ones. The Community was also given powers to forbid restrictive practices and abuse of dominant positions in the private sector. The treaty gave the task to the Commission, without intervention by member state governments; and in 1989 the Commission was also given the power to control mergers and acquisitions big enough to

pose a threat to competition in the Community. Armed with these powers, the Commission has done much to discourage anti-competitive behaviour and has been seen as the toughest cartel-buster in the world. Thus in the first quarter of 2007, it fined Siemens €397 million and ThyssenKrupp €479.7 million for their activity in price-fixing cartels. Because of the volume of work, the Commission sought to return some of these responsibilities to the member states' competition authorities. There was pressure from business interests to prevent this, because they find it convenient to have the Commission as a 'one-stop shop', but some degree of decentralization did occur with the creation of the European Competition Network, in which the Commission and national authorities share information and coordinate investigations.

Unfair competition can also take the form of subsidies given by a member state government to a firm or sector (in the EU jargon 'state aids'), enabling it to undercut efficient competitors and undermine their viability. The Commission has been given the power to forbid such subsidies. But it has been harder to control governments than firms. The Commission has been able to enforce some difficult decisions on reluctant governments; but especially in the 1970s, after it had been weakened by de Gaulle and with the economies hard hit by recession, it could do little to stem the rising tide of subsidies.

Along with the subsidies, non-tariff barriers proliferated in those years, becoming the main obstacle to trade between member states. One reason was technological progress, generating complex regulations differing from one state to another. More important was pressure for protection from those who were suffering from the prevailing 'stagflation'. The European economy was indeed in bad shape, vividly evoked by the term 'eurosclerosis'. A way out was sought; and the Commission, together with leading business interests, persuaded governments that a programme to complete the Community's internal market was required.

Programme to complete the single market by 1992

With the success of the internal tariff disarmament in the 1960s in mind, some business leaders and members of the Commission's staff worked on the idea of a programme to remove the non-tariff barriers. When Delors became the Commission's President in 1985, he fastened onto this idea as the only major initiative that would be supported by the governments of all the member states: the majority because of its economic merits and the political aim of 'relaunching the Community' after two rather stagnant decades; Mrs Thatcher because of economic liberalization alone. But she did the Community the service of nominating the highly capable Lord Cockfield, who had been trade minister in her Cabinet, as a Commissioner to work with Delors on the project.

Delors and Cockfield put the project to the European Council in June 1985. Whereas the programme for eliminating tariffs in the 1960s could be specified in the treaty in the form of percentage reductions, the removal of non-tariff barriers required a vast programme of Community legislation. Frontier formalities and discrimination resulting from standards and regulations, from public purchasing, and from anomalies in indirect taxation all had to be tackled. The Commission published a White Paper specifying that some 300 measures would have to be enacted and proposing a timetable for completing the programme within eight years. This was approved by the European Council and incorporated in the Single European Act, making completion of the programme by the end of 1992 a treaty obligation.

The removal of non-tariff barriers was already implicit in the Rome Treaty, which prohibited 'all measures having equivalent effect' to import quotas. But because the practice of voting by unanimity had impeded the legislative process, the Single Act provided for qualified majority voting on most of the measures needed to complete the programme. The Commission also

reduced the legislative burden by building on the principle of mutual recognition that the Court had established by its judgment in the Cassis de Dijon case, and by delegating decisions on much of the detail to existing standards institutes. Nevertheless, the single market remained a huge enterprise, surely one of the greatest programmes of legislation liberalizing trade in the history of the world.

It was an outstanding success. The latter half of the 1980s was a period of economic regeneration in the Community. While one cannot be sure how much of that was due to the single market programme, economic research has given it at least some of the credit. The programme certainly contributed to the recovery by generating positive views of business prospects as well as stimulating trade, together with structural reform exemplified by a spate of cross-border mergers. The industrially less-developed states – Greece, Portugal, and, at that time, Ireland and Spain – fearing they would be damaged by stronger competitors, had secured a doubling of the structural funds to help them adjust; and they too, assisted by this and by the expanding Community economy, benefited from the programme.

Politically, the single market enjoyed a remarkable degree of approval across the spectrum from federalists to eurosceptics. It has been a classic example of a purpose that is, as the treaty's article on subsidiarity puts it, 'by reason of scale ... better achieved by the Community'. The legislative framework has guaranteed producers a very large market and given the consumer a reasonable assurance of competitive behaviour among them. The Commission, Council, and Parliament were strengthened by their successful output, comprising a large part of the vast 'acquis', as the jargon puts it, of Community legislation; and the role of the Court was accordingly enhanced.

The programme was largely completed, but significant gaps still remain. The most notable area of difficulties has been in

Non-tariff barriers

When the Community was founded, the main barriers to trade were tariffs and quotas, and the Rome Treaty provided for their abolition in trade between member states. The Treaty also banned 'measures having equivalent effect', i.e. other barriers, generally known as non-tariff barriers (NTBs), which might not be expressly designed to limit trade but would actually have that effect. These include divergent standards or regulations on goods and services in the different states; frontier controls on goods and people; some discriminatory indirect taxes; and national preference by public purchasing authorities and state enterprises. The Treaty also provided for control of government subsidies to firms or individual sectors, to prevent unfair competition with more efficient enterprises in other member states.

As technologies developed and the economies became more complex, NTBs proliferated; and in the recessions of the 1970s governments resorted to them and to subsidies as protective devices. This led to the project to complete the single market through a vast programme of legislation to tackle NTBs. The bulk of the programme was completed as planned by the end of 1992, though the continual creation of new barriers meant that the Commission still is actively working to remove them.

the field of liberalization of services. Despite representing over two-thirds of EU GDP, there is little cross-border provision, not least because of fears in old member states about cheap labour coming from Central and Eastern Europe. This was seen most vividly in the French referendum campaign on the Constitutional Treaty in 2005, when the 'Bolkestein Directive', which aimed to liberalize services within the Union, became a symbol of social dumping, and the 'Polish plumber' an object of intense political

concern. When the Bolkestein Directive was agreed in 2006, it had undergone much modification, weakening its impact.

The single currency

A monetary union requires that money in all its forms can move freely across the frontiers between member states and that changes of exchange rates between them are abolished. The single market programme went far to fulfil the first requirement and the Exchange Rate Mechanism prepared the ground for the second.

The ERM and monetary stability

The Exchange Rate Mechanism (ERM) was established in 1979, after the abortive attempt to move to monetary union in the 1970s. It required the central banks to intervene in the currency markets to keep fluctuations of their mutual exchange rates within narrow bands; and by the end of the 1980s it had, with the German Bundesbank as anchor, achieved a strong record of monetary stability. Here again, Britain stood aside at the start, only to join in 1990, at too high a rate and without the experience of the preceding decade of cooperation. In September 1992, currency turmoil forced the pound out of the ERM on what became known as Black Wednesday, making monetary integration a traumatic subject for many British politicians.

The ERM had the opposite effect in other member states. Most politicians as well as business organizations, having experienced the benefits of stable exchange rates, favoured the single currency. So did most trade unions. The costs of exchange-rate transactions, estimated at ecu 13–19 billion a year, which bear particularly hard on individuals and smaller firms, would be eliminated. But removal of the longer-term risks of exchange-rate instability would be the main economic benefit, definitively eliminating the exchange-rate risk, not just from trade but also, most significantly, from cross-border investments and from those that depend on reliable access to the Union-wide market: both of growing importance for the European economy.

Almost all the governments supported the single currency project, on grounds that reflected long-standing attitudes towards the Community. The most powerful commitment was in France, where a tradition of support for exchange-rate stability was bolstered by the desire to share in the control of a European central bank and thus recover some of the monetary autonomy that had in practice been lost to the Bundesbank. The French had also long wanted to equip Europe to challenge the global hegemony of the dollar; and in 1990 the single currency, already a keystone of the French political project for anchoring Germany in a united Europe, became for France an urgent necessity to respond to German unification. Other member states, apart from Denmark and the UK, accepted both political and economic arguments. For Germany, however, while the political motive for accepting the single currency as a French condition of unification was decisive, there were still reservations about replacing the deutschmark, with its well-earned strength and stability, by an unproven currency.

The success of the Bundesbank in securing monetary stability had demonstrated the merits of Germany's monetary arrangements. So other governments were ready to accept the German model for monetary union. For Germans, with their doubts about giving up the deutschmark, this was a *sine qua non*. They also continued to insist that monetary union alone was not enough, but that 'economic union' was required as well, with macroeconomic policies conducive to monetary stability.

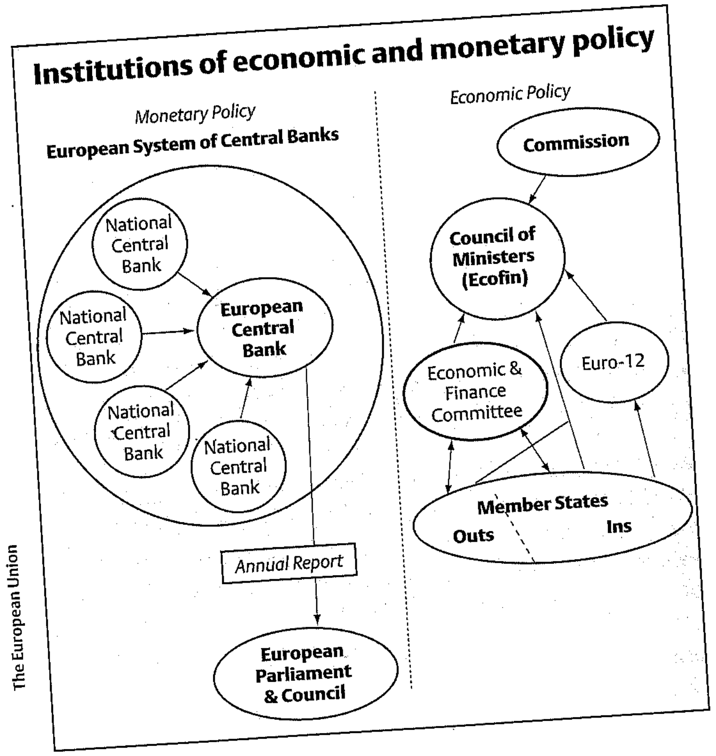
The aim of economic and monetary union

The Maastricht Treaty, in providing for economic and monetary union (Emu), established the European Central Bank (ECB) to be, like the Bundesbank, completely independent. The ECB and

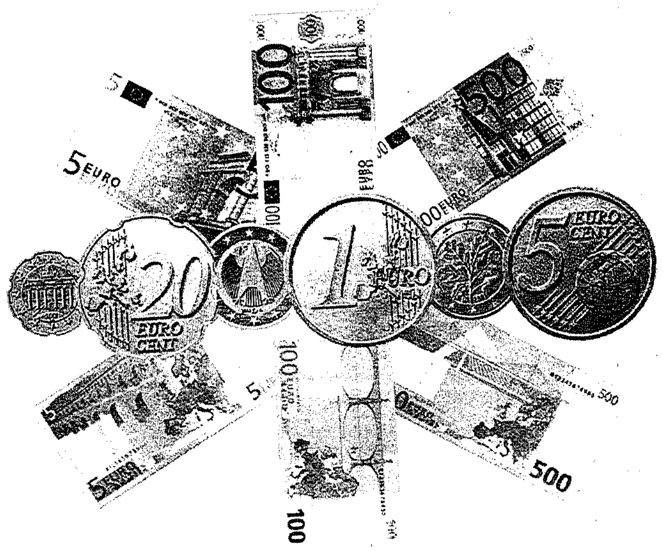
the central banks of the member states are together called the European System of Central Banks (ESCB). The six members of the ECB's Executive Board, together with the governors of the other central banks, comprise the Governing Council of the ECB; and none of these banks, nor any member of their decision-making organs, is to take instructions from any other body. The 'primary objective' of the ESCB is 'to maintain price stability' though, subject to that overriding requirement, it is also to support the Community's 'general economic policies'. The ECB has the sole right to authorize the issue of notes, and to approve the quantity of coins issued by the states' mints. In response to German preference, the single currency was named the euro, rather than the French-sounding ecu.

In order to ensure that only states which had achieved monetary stability should participate in the euro, five 'convergence criteria' were established, regarding rates of inflation and of interest, ceilings for budget deficits and for total public debt, and stability of exchange rates. Budget deficits, for example, were not to exceed 3% of GDP and public debt was to be limited to 60% of GDP, unless it was 'sufficiently diminishing' and approaching the limit 'at a satisfactory pace'. Only states that had satisfied the criteria were to be allowed to participate; and once again, stages and a timetable were fixed, in order to give at least a minimum number of states the time to do so. Others were to have 'derogations' until they satisfied the criteria, while the British and Danes negotiated opt-outs allowing them to remain outside unless they should choose to join.

In the first stage all were to accept the ERM, as Britain had briefly done before being ejected by market forces. In the second stage they were to make enough progress to satisfy the convergence criteria. The third stage began in January 1999 with the 'irrevocable fixing of exchange rates' among the participating states, leading in 2002 to the introduction of the new euro notes and coins which replaced the participants' currencies entirely.



During the mid-1990s, there had been much concern about which countries would be able to achieve the convergence criteria, partly for economic reasons (as with the case of Italy) and partly owing to more political factors relating to the degree of strictness with which the criteria would be interpreted by the EU. In the event, an economic upswing and strong political pressure allowed 11 of the 13 states to join in 1999, with only Greece being specifically excluded (although it was given the green light one year later), while the Swedish government had decided that membership was not politically viable and had asked not to move forward without its approval.



14. The euro: notes and coins

Thus by 2002 the very large majority of member states were eurozone participants and the issue of relations with those outside became a matter of some concern, because of the binary model of economic policy coordination it required. At least formally, all member states are committed to eventual membership, but in practice the lack of popular support in the UK, Denmark, and Sweden means that the situation is likely to persist for the medium term. In the UK, the government has effectively parked the issue for the foreseeable future, with its five conditions, as laid out by then-Chancellor Gordon Brown in 1999. These conditions relate to structural convergence, sufficient flexibility in eurozone economies, and the impact on various economic markers, but are suitably vague in their formulation, allowing any future government to make a decision on the basis of political factors. This was particularly important given the cross-party agreement that any decision would be made after a popular referendum.

The ambivalence of these three member states has been mirrored to a certain extent by newer members. While Slovenia was able to join the eurozone in 2007 (along with Malta and Cyprus from 2008), a number of other states have reined in some of their initial drive towards participation. Here the factors relate more to the economic flexibility that retaining a national currency allows, rather than any particular sense of the currency as a strong symbol of national identity. Moreover, all new member states are legally bound to introduce the euro as soon as possible, not having the opt-outs of the UK and Denmark.

Questions raised by Emu

Following the introduction of the euro, four major questions need to be addressed: the macroeconomic effect on the Union and the several states; accountability; the political consequences; and external monetary relations, which are considered in Chapter 10.

The argument about Emu's macroeconomic effects on the eurozone has followed the classic dichotomy between the prevention of inflation and of deflation. The value of the convergence criteria in this was recognized in their permanent embedding in a Stability and Growth Pact agreed in the Amsterdam Treaty, which sought to ensure that all member states would engage in economic policy-making that would support the cohesion of the Union as a whole.

The Stability and Growth Pact introduced an 'excessive deficit' procedure that allowed states to be fined for poor economic management. However, this came at a time of an economic downturn. France and Germany failed to curb their deficits sufficiently and demanded a revision of the Pact, much to the disgust of the Netherlands; and this led to the Pact's reform in

2005, essentially weakening its potential impact. Consequently, the Union has increasingly focused on other means of dealing with those 'asymmetric shocks' that have an uneven impact on member states.

The main attempt to ensure this has been the Lisbon Agenda. At the March 2000 Lisbon European Council, member states agreed an ambitious programme of structural reforms with the aim of creating 'the most dynamic and competitive knowledge-based economy in the world' by 2010, by means of policies tackling unemployment, increased use of technology, and more market liberalization and deregulation. That aim did stimulate some progress, particularly within smaller states. But while the 'open method of coordination', which dispenses with the common instruments and legally binding commitments of the Community method, is suitable for those fields within the programme where the subsidiarity principle indicates that sovereignty should remain with the member states, it has little capacity to resist the centrifugal forces of domestic politics, particularly in the larger states, or of unforeseen shocks; and with the end of the dot.com bubble, national politicians retreated into more protectionist positions, thus undermining the ability of the Union to make the most of the benefits of the single currency. In other fields, the Community method is much more reliable.

There is also concern about differing economic cycles within the eurozone. Interest rates at levels that suit the average will not be optimal for states with inflationary pressures above or below the average; and this is a downside to set against the general benefits of Emu. But the suggestion that the British cycle has to follow that of the United States, and so differs structurally from the average in the eurozone, does not fit well with the facts that nearly 60% of British exports of goods go to the EU, compared with 13% to the US, and that cross-Channel investment has been growing fast. Nor is the economic cycle a force of nature that cannot be influenced by government policy aiming at adequate convergence.

The independence of a central bank being a new experience for all except the Germans, the question of the ECB's accountability has also been raised. The treaty requires it to address an annual report to the Community institutions; its President has to present the report in person to the Council and the Parliament; and the President and other members of the ECB's Board attend meetings of the Parliament's relevant committees. The system is similar to that of the United States, save that the Joint Economic Policy Committee of the Congress has over the years become a powerful body disposing of a big budget to provide it with the necessary economic analysis and advice. The European Parliament's Finance Committee should surely move in that direction.

This leads to the question of the implications of Emu for the EU's powers and institutions. It is often suggested that far-reaching tax harmonization will have to follow. But the principle of subsidiarity requires that member states choose the pattern of their own taxes unless this has an 'external effect' on other member states. Thus minimum rates of added-value tax and excise taxes were fixed as part of the single market programme, in order to prevent unfair competition should a state adopt unduly low rates. Emu strengthens the case for similar treatment of taxes that affect competition in the capital markets. But beyond that there is no need to harmonize tax rates. There is a case for a fund for use on the infrequent occasions when there are serious asymmetric shocks; and there is a strong case for reforming the institutions so as to enable the Union to conduct an effective external monetary policy. But in general the EU has, with the single market legislation, the single currency, and its budget, the main instruments of economic policy to be found in federal systems. Its need is not more instruments, so much as to make the most of those it has: to ensure the full completion of the single market; to secure the participation of all member states in the eurozone; and to provide a budget large enough to finance what the Union can do more effectively than the several member states.

Another suggestion is that Emu will lead inevitably to a federal state. But a federal state has to have power over armed forces; and this does not follow from the adoption of the euro. The argument about defence integration, which is addressed later, is a different one. As regards strengthening the institutions and making them more democratic, that is already desirable, with or without the single currency; and it will become essential if the Union is to be capable of satisfying its citizens' needs and avoid the risk of disintegration. The euro adds to the case for radical institutional reform, but is not the central motivating force.