France and the Politics of European Economic and Monetary Union

Valerie Caton

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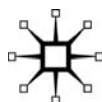

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For David

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Preface

France has been widely acknowledged as the principal driving force behind European economic and monetary union (EMU). Every French president from Georges Pompidou onwards has placed the creation of EMU at the centre of France's European policy. President François Mitterrand finally clinched the deal when, in December 1991, he secured German Chancellor Helmut Kohl's agreement at the Maastricht summit to a specific, irreversible timetable for the move to the euro by 1 January 1999.

In my first posting to the British Embassy, Paris, during 1988–92, as First Secretary for Internal Political Affairs, I witnessed the political events around this summit including, after the fall of the Berlin Wall, Mitterrand's increasingly desperate struggle to hold together a domestic consensus behind his agenda for modernising the French economy and integrating Germany into Europe, culminating in a wafer-thin 'yes' vote in the 1992 Maastricht Treaty referendum. In 1997, I returned to the Paris Embassy, as Economic and Financial Counsellor, to report on the country's recovery from the economic impact of German reunification and on the uneasy co-operation between a Gaullist President, Jacques Chirac, and a Socialist Prime Minister, Lionel Jospin, that eventually took France into the single currency in 1999.

At a reception in 1997, soon after I arrived in Paris, the *Daily Telegraph* correspondent asked me what my job in the Embassy was. When I told him, he looked at me pityingly: 'What a frightfully dry subject for a woman!', he observed. In this book, I wanted to show why, to me, it didn't seem dry at all. On the contrary, it seemed extraordinary that, for example, a decision in 1971 by President Nixon to de-link the US dollar from gold could ripple across the Atlantic and create political crises in Europe; or that a decision to peg one currency to another, or to let it float, could make the difference in how wealth was distributed across a society, or between countries. Yet, such 'technical' decisions rarely entered the political domain.

Why did a country like France, with such a strong national identity, want to give up the franc for the euro? Was European economic and monetary union a political project, motivated by Franco-German power-brokering at the expense of sound economic rationale? How

did successive French leaders influence its design? Why, once the euro was launched, did France lose its competitive edge over Germany? And today, as French public opinion becomes increasingly polarised and the eurozone struggles to recover from the global financial crisis, can France still play a role in shaping Europe's future?

In this book, I explore these questions. I began my research in early 2012, at the height of the eurozone crisis, after leaving the Foreign Office and attaching myself to St Antony's College, Oxford. I wanted to use my new academic freedom better to understand what seemed to be making a European initiative that had dominated the political lives of France's last five Presidents go off the rails. Having looked at France first from a political, and then from an economic and financial, perspective I realised that to appreciate why its leadership invested so much into this project, you needed to bring both perspectives together and to add the dimension of time. You also needed to look behind the public rhetoric. As the signs at French level-crossings say, 'Beware! One train might be hiding another!'

Alongside public material, I have drawn on newly available evidence in French and British Government archives of the private views of political leaders and official negotiators, as well as on interviews and conversations in France. Behind the debates in the media over the rights and wrongs of creating a so-called federal Europe, I found another existential question preoccupying the creators of EMU: could European governments, steadily losing their political and economic freedom to the capricious power of global financial markets, find a way both to open up their economies and to shield their societies from the worst effects of globalisation, by co-operating to create a stable, fairer and more democratic system?

I have tried to write as clearly and readably as I can, and on a subject where acronyms multiply like rabbits, to use them sparingly and only after their meaning is made clear. For anyone still perplexed, there is a list of abbreviations at the end of the preliminary pages.

I hope that this book will be of interest, not only to academic experts but also to readers in business, diplomacy, journalism and politics – and indeed to anyone who is just plain curious to know more about how decisions over money are made that affect people's jobs and lives.

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Lastly, a big thank you to my husband, to whom this book is dedicated, and to our daughter and son, who all took time out of their own multifarious activities to edit and vociferously criticise bits of the book.

If, despite all this assistance, any errors have crept in they are entirely of my own making.

List of Abbreviations

CDU	Christian Democratic Union
CFDT	Confedération Française Démocratique du Travail (French Democratic Confederation of Labour)
CGT	Confédération Générale du Travail (General Confederation of Labour)
EC	European Community
ECB	European Central Bank
ECOFIN	Council of Ministers of Economic and Financial Affairs
ECU	European Currency Unit
EDF	Electricité de France (French Electricity)
EEC	European Economic Community
EMS	European Monetary System
EMU	Economic and Monetary Union
EP	European Parliament
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
EU	European Union
FCOA	Foreign and Commonwealth Office Archives
FNA	French National Archives
FO	Force Ouvrière (Workers' Force)
IGC	Intergovernmental Conference
IMF	International Monetary Fund
INSEE	(French) National Institute of Statistics and Economic Studies
SGP	Stability and Growth Pact
SNCF	Société Nationale des Chemins de Fer (French National Railway Company)
SUD	'Solidaires', 'Unitaires', Démocratiques' – L'Union Syndicale Solidaires (United Trade Unions)
UNSA	Union Nationale des Syndicats Autonomes (National Union of Independent Trade Unions)

Part I 1970–91

Engaging Germany, Modernising France: The Drive for a European Treaty on Economic and Monetary Union (EMU)

1
Introduction: Why Did France Want EMU?

It is not obvious why a country with such a strong sense of national identity as France should be so ardent an advocate of pooling sovereignty in a European Economic and Monetary Union (EMU). Like its UK neighbour, which by contrast opted to keep its national currency, France has been a major colonial power and has a long history of independent foreign policy. It still maintains its own currency zone with a number of former African colonies.

Moreover, unlike the UK, which openly prides itself on its ability to adapt its economy and financial markets to global competition and which moved quickly in the early 1980s to a relatively flexible labour market, France maintained a relatively closed and inflexible domestic economy until the late 1980s. Even now, after several decades of partial and full privatisation, state shareholdings in French domestic enterprises are proportionally higher than elsewhere in the European Union.

The differences in attitude between the two countries are essentially political and come down to their different experiences, not only of World War II (1939–45), but also of the breakdown, in the early 1970s, of the stable post-war economic order which had helped both countries to recover. The majority political support which, after a decade of declining UK competitiveness, Prime Minister Margaret Thatcher was able to forge, in the early 1980s, behind the radical supply-side reforms needed to cope with an open economy did not then exist in France.

On the contrary, the state interventionist 'exceptional' French economic model still commanded the strong domestic support it had enjoyed since the end of the Second World War. At that time, it reflected the needs of a generation emerging from the humiliations of wartime occupation to rebuild the country's devastated infrastructure and its sense of national pride. Nationally owned companies like the electricity

giant EDF, Air France and SNCF (French Railways) proved successful in galvanising and organising workforces to deliver national reconstruction. Prestigious state academies (*les Grandes Écoles*) for civil servants and engineers provided high quality managers who passed seamlessly between government Ministries and strategic industries. They placed France at the forefront of modern technology through 30 years of uninterrupted post-war growth up to the mid-1970s, known as the *Trente Glorieuses*.

Of course, French attachment to a strong, centralised state runs much deeper, back through Napoleonic times all the way to Louis XIV and Colbert. It has long been associated in French popular perception not with bureaucratic interference and the curtailment of individual liberties, as it tends to be in the UK or US, but with fairness, social justice and equal treatment of citizens across a highly diverse country. The alternative to a strong state was – and still generally is – seen to be petty corruption, trafficking of influence, inequality and injustice.

Since French public opinion is – between revolutions – profoundly conservative, there is little doubt that, were the economic model of the *Trente Glorieuses* still available today, it would continue to command solid political support on left and right alike.

But by the mid-1970s, the conditions which had made France's post-war model viable no longer existed. The final demise in 1973 of the US-brokered international monetary system, known as the 'Bretton Woods system'[1], leaving the dollar and other currencies to compete in an unstable relationship of fluctuating values, dramatically changed the international economic environment. For France, it spelled the end of an uninterrupted period of economic recovery and rising prosperity. Unable rapidly to adapt the country's economy to such a sudden change without putting its political stability at risk, French leaders looked instead for a new way of restoring a stable monetary environment.

External monetary drivers for EMU

Why was monetary stability so important to France? The earliest French advocates of European economic and monetary co-operation harked back beyond Bretton Woods to the international gold standard of the late nineteenth century, a period of rapid industrial growth and rising prosperity in France, as elsewhere in Europe. They were in large part motivated by the desire to stimulate France's economic recovery from war by creating a similarly stable external environment for French trade. By pegging currencies to gold, they hoped to maintain steady

prices, encourage investment and minimise the opportunity for France's trade competitors to seek a competitive advantage by devaluing their currency.

The French regarded a peg to gold as more advantageous to them than the Bretton Woods system, which the US had established in 1944 at a time when France, devastated by war and occupation, had been unable to play an active part in the negotiations. Under Bretton Woods, European and other currencies were pegged to the dollar, which in turn was pegged to gold. The French saw this as giving the US unilateral control over the world's money supply and a disproportionate competitive advantage in the dollar's status as dominant global currency for trade and investment. Initially, though, as US dollars flowed around the world, trade soared and the French economy benefitted from US Marshall Aid, the new monetary system brought stability and helped growth and recovery.

By the late 1960s, however, Bretton Woods had become increasingly fragile as the German economy boomed and the US economy struggled to cope with a large budget deficit and the costs of the Vietnam War, putting the US peg to gold and the dollar's parity to the deutschmark under severe strain. France began to explore ideas for a European EMU as an alternative to Bretton Woods. In 1969, at a Summit in The Hague, European leaders adopted EMU as a formal goal. The first blueprint on how to achieve such a union, the 1970 Werner Report, drew on French ideas, especially those developed in the late 1960s by the economics professor (later Prime Minister), Raymond Barre, while serving in the European Commission. It proposed the creation in three stages, over ten years, of a common European currency, underpinned by a centrally managed fund pooling reserves from its member countries and centrally agreed frameworks for national budgets.

Unfortunately for France, most other European partners were sceptical that the proposal could be made to work. The Germans in particular disliked the idea of creating an alternative to the deutschmark. Their country had been deeply scarred by the experience in the 1920s of currency hyper-inflation which had destroyed the value of savings, ruined lives and contributed to the war. Since the end of the war, Germany's central bank, the Bundesbank, had made building a strong, stable currency its top priority. Underpinned by Germany's rapid industrial recovery, it had by the late 1960s succeeded. This was a matter of great national pride and an achievement which Germany would not lightly put at risk. The Werner Report's proposal to support a common European currency through a pooled reserve fund was especially

anathema to the Germans, who foresaw great risk that some countries would spend irresponsibly and then expect German savers to bail them out. The Werner-Barre vision remained just that.

France's monetary problems were soon compounded by the final breakdown of Bretton Woods. Ironically, it was France's President de Gaulle who had earlier helped to precipitate its eventual downfall[2] by insisting on France's right to redeem its dollars for gold at a time when it was clear that the US no longer had enough gold reserves to justify the dollar's peg. Equally, the US had done nothing to cut its own spending to defend the dollar, nor would it countenance devaluation of its currency. Something had to give.

In May 1971, under the pressure of speculative flows of money relentlessly driving up the value of the deutschmark against the dollar, Germany decided it had no option but to let the deutschmark float. Soon after, France sent a battleship to take home French gold from the US Federal Bank's vaults. In August 1971, President Richard Nixon announced that the US would no longer exchange foreign-held dollars for gold. His Treasury Secretary, John Connally, brutally told Europeans that the dollar was 'our currency, but your problem'.

France found itself particularly ill-equipped to cope with the resulting global financial turbulence. Under Bretton Woods, which had maintained a system of capital controls between countries, there had been limitations on the scope for currency speculation. In the 1970s, that began to change as currency traders began to find ways around capital controls to make gains from fluctuating exchange rates. The growth of the eurodollar market, the forced German decision to allow the deutschmark to float upwards, combined with increasingly large and unpredictable capital flows between the dollar and the deutschmark, all increased the strain on the French economy and the practical difficulties involved in managing the European Economic Community (EEC)'s common policies. Most importantly for France, compensation payments for politically powerful French farmers under the EEC's Common Agricultural Policy were adversely affected by the impact on the deutschmark of inward capital flows, requiring complex readjustment negotiations. The absence of a stable monetary system thus threatened to disrupt what was then the EEC's most important common policy and would make it difficult to develop new European policies.

Eventually, the Germans agreed to French demands for closer European currency co-operation. In April 1972, the 'Basle Agreement' set up an ingenious system known as the 'Snake in the Tunnel', which allowed European countries to limit the fluctuations of their currencies

against each other, while also allowing them to continue to float against the dollar within the margins which had already been set by the US-brokered December 1971 'Smithsonian Agreement' (so named after the Smithsonian Institute in Washington where it had been agreed in a last-ditch attempt to salvage some elements of Bretton Woods).

The respite was short-lived. Nixon's decision in March 1973 to float the dollar broke the Smithsonian Agreement and marked the end of US-led global efforts to stabilise exchange rates. This, combined with sharply rising oil prices and German anti-inflationary measures, rapidly made the franc-deutschmark parity unsustainable. Under the 'Snake' system, the franc, as the weakest currency, had to make all the effort to defend itself, rather than parities being defended collectively. The franc came under repeated pressure, leading to a series of costly and humiliating currency crises. In January 1974, France was forced to withdraw from the Snake. It re-entered in 1975 and left again in 1976.

The French economy was highly vulnerable to dollar movements: a sharp upturn fed inflation through higher commodity prices which stoked wage demands, while a downturn sparked capital flows into the deutschmark, which strained the franc-deutschmark parity and damaged French exports. France repeatedly found itself caught in the crossfire between US and German monetary policy and destabilised by the transatlantic flows of speculative 'hot money' which followed each decision by the US Federal Bank or by the German Bundesbank. Although partial capital controls were still in place, they became increasingly ineffectual as financial markets grew and became more adept at circumventing the rules. In the chaotic conditions of the late 1970s, as the franc lost credibility and value against the deutschmark and volatility returned to the oil market, inflation in France rose steadily, reaching just under 14 per cent by 1981.

In April 1979, on the initiative of French President Valéry Giscard d'Estaing and German Chancellor Helmut Schmidt, the European Monetary System (EMS) was set up, creating a new common currency, the 'European Currency Unit' (known as the ECU, which to French ears sounded pleasingly like the 'écu', a medieval French coin first minted in gold in the reign of Louis IX), based on a basket of European currencies. From a French perspective, the EMS had the advantage of offering improved collective financial mechanisms for defending parities. The currency which showed greatest divergence from the ECU rate, rather than as previously the weakest currency, was in the front line of defending the parity (i.e. if the deutschmark rose sharply above the ECU rate, the Germans would now have to take action rather than the

weaker currencies). The EMS gradually helped to inject some stability into the French economy as currency realignments became less frequent (six from 1979 to 1982; five from 1983 to January 1987; just one from February 1987 to September 1992).

Overall, though, the franc lost around two-thirds of its value against the deutschmark between 1973 and the final fixing of exchange rates between ECU basket currencies under the first phase of EMU in November 1993.[3]

This chronic weakness of the franc over a long period meant that the French public had relatively little emotional attachment to it.

At the political level, the franc's weakness was seen to place France in the humiliating position of *demandeur*, perpetually requesting realignments within the EMS, which in turn gave the strong currency countries, and Germany in particular, the whip hand in running the system. The internationally respected German Bundesbank became the *de facto* money manager of Europe, although, as the French were keenly aware, its decision-making remit related only to German economic interests. Weaker EMS currencies like the franc were repeatedly forced to adopt higher interest rates than were appropriate for their economies, which depressed growth and job creation. By contrast, the EMS served to lock in Germany's competitive advantage by keeping the deutschmark undervalued in real terms between realignments.[4] Since each realignment of currencies within the Exchange Rate Mechanism (ERM) of the EMS involved a painful negotiation and carried a high political cost, French governments inevitably kept this as a last resort. As a result, Germany made significant gains in market share in Europe throughout the period when the EMS was in operation.

The experience of these years fuelled the French desire to replace the halfway house approach of the EMS with a more ambitious single currency system. Full EMU came to be regarded by the French political elite, not as a ceding of national sovereignty, but rather as an opportunity to gain greater control of economic and monetary policy-making by binding Germany into shared European structures and circumventing the power of the Bundesbank. The aim was that far-reaching decisions now taken by unelected Bundesbank officials in the interests of Germany alone would, in future, be taken by Europeans jointly, at a political level.

A successful European single currency also offered the prospect of reducing France's vulnerability to fast-growing speculative capital movements and, ultimately, of challenging the international supremacy of the dollar. This was a prime French objective. Indeed, re-establishing international monetary stability was at least as important to France

as promoting economic and monetary integration on a European basis. Throughout the late 1970s and the 1980s, the French repeatedly attempted, through the Group of Seven (G7) wealthiest developed countries, to broker with the US a new multilateral system of managed exchanged rates. Their inability unilaterally to persuade the US to accept a shared global system to manage currencies, and the repeated breakdown of informal international efforts by monetary authorities to mitigate currency volatility, were major factors in convincing them of the need for European economic and monetary integration. They saw a European currency union, with Germany and France at its heart, as the only structure which could offer at least regional currency stability, as well as creating an entity capable of negotiating seriously with the US on global financial governance.

Economic and political drivers for EMU

There were also domestic economic and political reasons why the French leadership decided in favour of European EMU. Despite France's drastically reduced international room for manoeuvre after the end of Bretton Woods, French public opinion continued to hanker after a strong interventionist (*volontariste*) state that was capable of independent action to maintain France's key industries and its social model. The political effect of sharp dollar depreciation and rising oil prices in the 1970s was to provoke repeated resurgences of latent anti-Americanism and protectionism, both on the Gaullist Right and on the Communist Left. Presidents Pompidou (1969–74) and Giscard d'Estaing (1974–81) had moreover to cope with a French economy significantly weakened by the wage and benefit hikes conceded in the wake of the May 1968 student-led riots, which had almost brought down de Gaulle's Fifth Republic. Political stability was fragile and there was little prospect of achieving domestic consensus behind the kind of structural reforms needed to defend the franc on the open money markets or to make France credible to foreign investors.

At the same time, as inflation pushed up costs throughout the 1970s, France needed to obtain increasing levels of finance to modernise its industries and infrastructure and to sustain its (politically important) social benefits. Thanks to a law which Giscard himself as Finance Minister had introduced in 1973, just before the first oil crisis had put an end to France's current account surplus, governments were legally prevented from asking the Central Bank of France to create money. So Giscard's options when he won the Presidency in 1974 were strictly limited.

The President and his Centre-Right political base sought to counter domestic knee-jerk nationalism and protectionism by championing European economic and monetary integration as a bold French diplomatic initiative, designed to restore French prestige by containing German economic power within new collective European structures and by creating a counterweight to US *laissez-faire* monetary policy.

This high-level balancing act between domestic political and international monetary pressures became increasingly difficult by the late 1970s as inflation and unemployment levels rose. Nor did Giscard with his aloof, aristocratic manner make a good fist of explaining his policies to the French people. The tough but necessary economic measures Prime Minister Barre introduced in 1979 to underpin France's participation in the EMS served only to undermine what dwindling political support remained for Giscard and his government.

Ironically, it took the arrival in power of the Fifth Republic's first Socialist President, elected with Communist support, to deliver both EMU and the financial and economic reforms needed to put the French economy onto an equal footing with Germany.

Mitterrand's decisive role

By the time he was elected President in 1981, François Mitterrand (1981–8; 1988–95) was already 64 and a highly experienced politician with plenty of practice at getting out of tight corners. Unlike many French politicians, he did not come from a political family or a privileged background – his devoutly Catholic family had run a small business in South-west France – and he had had to find his own way to the top. During the Second World War, he had served as a non-commissioned officer (NCO) and been captured by the Germans. He escaped from a prisoner of war camp in Germany and made his way into Vichy France, where he looked after the affairs of returning prisoners of war for Pétain's provisional government, before founding his own resistance group and eventually joining de Gaulle's victorious entry into liberated Paris.

Mitterrand then became a Minister at the exceptionally early age of 30, the youngest Cabinet Minister since the French Revolution, and went on to serve in 11 Ministerial posts under the Fourth Republic before seeing his ambitions of becoming Prime Minister dashed by de Gaulle's return to power in 1958 in the wake of the Algeria crisis. Mitterrand became de Gaulle's bitterest critic, calling his Fifth Republic, with its strong Presidential powers, a 'permanent *coup d'état*', before deciding to run as President

himself against de Gaulle in 1965. He did not win, but did force de Gaulle into an unexpected second round run-off. Realising that he could only ever hope to become President if he could unite all the parties on the Left behind him, in 1971 Mitterrand succeeded in forging an alliance between his new Socialist Party, the Left Radicals and the Communist Party. This was an immense achievement, given that the Communists were then politically much stronger than the Socialists and regularly since the war had commanded between a fifth and a quarter of all French votes.

Finally, at his third Presidential attempt, Mitterrand reached his political goal. The rising baby-boomer generation of French voters opted in 1981 to give the French Socialists and their Communist allies a chance of delivering what Giscard d'Estaing had not: full employment, political independence and restored international prestige. In his campaign, Mitterrand had appealed to these younger voters, later dubbing them the 'Mitterrand generation' (glossing over his own political vintage). Unlike Mitterrand, though, this new political generation had as its reference points the war in Algeria, the upheavals of May 1968 and the protests against the Vietnam War, rather than the war with Germany. It was comfortably off, idealistic, first-generation suburban and internationalist rather than European-minded. In its own Marxist or Keynesian way it was, however, just as interventionist as its Gaullist predecessors. Mitterrand's party slogan '*changer la vie'* offered hope of a better life and the promise of a vigorous state in pursuit of new goals that were more social, more egalitarian and internationally more 'moral' and responsible.

The first Socialist/Communist Government under Mitterrand, led by Pierre Mauroy, introduced improved benefits to stimulate demand and nationalised a raft of 'strategic' industries, including the largest French banks, who were told to improve France's poor record of lending to businesses as the vanguard of a major national effort to modernise key industries and meet the rising demands of the new urban middle classes. Unfortunately, the timing could hardly have been worse: France's European and US trading partners had just reached a consensus to introduce counter-inflationary policies. Moreover, France's chaotic, antiquated financial system proved slow to lend to French industries, so that increased demand ended up simply sucking in more imports and driving up costs as the dollar's exchange rate soared against the franc.

By 1983, with France's public deficit running at 3.2 per cent of GDP (from a balanced budget in 1980) and the franc yet again under pressure in the EMS, the real limits of Mitterrand's ability to deliver the kind of change his electorate wanted had become only too clear. For weeks,

the President agonised over whether or not to break with his predecessor's European policy by taking the franc out of the EMS altogether and putting up trade barriers.

Why did France not attempt to regain competitive advantage by letting the franc float? Although Mitterrand loathed the constraints imposed by the ERM and seriously considered leaving it in 1983, in the end, he opted to stay for economic as well as political reasons. He knew that French reserves were insufficient effectively to defend the franc[5]. He deeply distrusted 'Anglo-Saxon' financial markets and feared speculative attacks. Certainly, France at that point had no track record of economic rigour or of political consistency to convince the financial markets, and it risked paying a high price for this absence of credibility. Allowing the franc to fall freely could, some of his advisers judged,[6] result in as much as 20 per cent devaluation, which would have significantly increased the size of France's burgeoning 330 billion francs public debt.

Above all, Mitterrand knew that, if France eventually had to turn to the International Monetary Fund (IMF) for financial help, it could expect to be required to make cuts to public spending on a scale which could be politically destabilising and would certainly be deeply humiliating for the Socialists, as it had been for the UK's Labour Party in 1976, destroying the Left's economic and political credibility for years to come.

Nor could France seriously afford what Mitterrand dubbed the 'Leninist option'[7] of putting up protectionist barriers against capital markets and trade, given its need for investment and modernisation and its export-oriented industries. Such an option could, moreover, from a political perspective, have risked propelling France into the Soviet sphere of influence and thus reversing the coalition balance of power between Mitterrand's support base in the Socialist Party and the Moscow-oriented Communist Party, which Mitterrand cordially loathed and whose electorate he was seeking to capture. Equally, it could have precipitated a right-wing backlash and, ultimately, the end of the Socialist government. Mitterrand was well aware that both the Cartel of the Left in 1926 and Léon Blum's 'Popular Front' government in 1937 had fallen attempting desperately to protect the franc against speculation.

Only the option of economic and political alignment with Germany, France's largest trading partner, offered Mitterrand some political room for manoeuvre, and the hope over time of negotiating a better deal for France. It would allow the franc to benefit from the credibility of its anchor to the deutschmark within the European Monetary System while retaining *in extremis* the option of a negotiated devaluation.

Mitterrand's final decision to stay in the EMS and to negotiate currency realignment with Germany was an historic one. By creating the basis for an effective, if unavowed, left-right mainstream consensus – dubbed in the press 'the single mindset' ('*la pensée unique*') – behind the drive for European monetary integration, it determined the subsequent course of French economic policy.

Despite a carefully cultivated public image disdainful of economic issues, Mitterrand undoubtedly appreciated the economic as well as the political consequences of his decision and appointed all subsequent governments with mandates for budgetary rigour and reform. Their task was clear: France had to bring down inflation in line with Germany's by pegging its currency ever more tightly to the deutschmark and cutting its costs, or it would lose what Mitterrand referred to as France's 'economic war' for competitive advantage in the European Single Market, as well as the ability to borrow from financial markets the funds it needed to sustain living standards and avoid social unrest.

For all his loathing of financial markets, Mitterrand recognised the need to 'take account of the power of money'[8], and, master tactician that he was, he took a strategic decision[9] to turn the market forces which had just undermined his 1981 electoral programme to France's advantage. From now on, he would help finance domestic social benefits and the modernisation of French industry by borrowing more cheaply from markets, and he would enable French businesses to do likewise, thanks to a credible monetary policy aligned to Germany's and a liberalised French financial system, including the efficient marketing of French debt.

By the mid-1980s, as these policies of 'competitive disinflation' began to bear fruit and France's economy was recovering strongly, Mitterrand resolved for his second Presidential term to return to the charge with Germany by conducting a high-level diplomatic campaign to promote closer European social, economic and monetary integration. His initial aim on returning to office in 1988 was to justify to a reluctant domestic constituency France's support for a more liberal European Single Market, due to be launched in January 1993.

A Europe based on liberalising trade and opening borders carried little political appeal inside France. For Mitterrand, it could only muster support if it was offset in other areas by initiatives with clear benefits for the French people. He therefore held out the promise, through European EMU, of wresting more control from Germany over monetary decisions affecting France's economy and, through initiatives on 'Social Europe', the hope of creating collectively on a European basis the more equal society which had eluded him inside France during his first term in office.

A year later, as the Warsaw Pact began to fall apart, raising the spectre of a reunited Germany dominating Central and Eastern Europe, this strategy acquired a new motivation. The need to contain a now much bigger Germany within a strengthened European Union suddenly became a politically urgent factor for France.

So France's drive for European EMU, which began in the late 1960s and 1970s as a technocratic attempt to deal with a currency problem which was undermining the smooth working of the European Common Agricultural Policy, was transformed by the political and social upheavals of the 1980s. In a turbulent and evermore open global economy, it offered a way for the French leadership to navigate between, on the one hand, the ambitious social and political demands of a rising middle class French electorate and, on the other, the external forces unleashed by the free circulation of capital and the restoration of German economic strength. It provided the compelling political vision of a shield against the worst external risks and the hope of a better future which would persuade French opinion to accept the tough reforms and diplomatic deals needed to make France more stable, more open and more competitive in a new Europe.

For France, EMU thus became a bold political response to an existential dilemma. It was born of necessity rather than driven by ideology. Pushing through the EMU project involved a leadership élite making a series of difficult pragmatic choices which ran ahead of, and even contrary to, public opinion. Paradoxically, public support in France for a strong steering role for the state helped to make that a viable strategy.

2
1984–88: How the EMU Treaty Project Took Shape

Prelude

French diplomatic efforts to promote closer economic and monetary integration at first made slow progress during the 1980s as the Germans, unsurprisingly, were comfortable with their commercial advantages under the European Monetary System (EMS), and the Bundesbank remained resolute in opposing any moves which could undermine its inflation-fighting mandate.

President Mitterrand worked patiently, however, to build up a relationship of trust with Germany's Chancellor, leader of the conservative Christian Democratic Union (CDU), Helmut Kohl. By the decade's end, this Franco-German relationship across the political divide was to have far-reaching consequences as the collapse of Soviet power threw all the political cards in Europe into the air. Relations would be further strengthened by a remarkable turnaround in the performance of the French economy. By the late 1980s, as the European Community was preparing to create in January 1993 the world's largest single market, France's economy would be outstripping Germany's on most key indicators. It was this fast approaching European Single Market and, above all, French agreement to lift all remaining capital controls, which was to become the catalyst for France and Germany agreeing to move beyond the EMS to a much more ambitious European single currency.

Initially, though, no one could foresee such dramatic changes, and Mitterrand was preoccupied from 1984 onwards with the consequences of his decision to anchor France's economic fate to that of Germany. The 1983 franc-mark EMS realignment had been pulled off only after a bruising game of brinkmanship, in which Mitterrand had theatrically prolonged the public uncertainty over whether France would quit the

EMS long enough to tip Germany into raising the deutschmark rate more generously than the Bundesbank had initially wanted (a 5.5 per cent deutschmark revaluation and a 2.5 per cent franc devaluation). A significant period of fence-mending was needed.

Mitterrand's tactical preference for the remainder of his first Presidential term was to work with the Germans on European initiatives closer to their own interests such as creating the European Single Market and strengthening European defence and security, rather than to force the pace on monetary policy which, as Chancellor Kohl pointed out at the December 1985 Luxembourg European Council, would require full-blown treaty change. Throughout the 1980s, Mitterrand gradually built up the bilateral relationship with Kohl, giving layer after layer of substance to the Franco-German Elysée Treaty, which de Gaulle and Adenauer had signed in 1963 but then left largely devoid of content.

Mitterrand knew, moreover, that France would only regain German respect and be credible as an equal negotiating partner on European monetary and economic issues once the country had tackled its own economic weaknesses.

Changing France: the drive for economic competitiveness and political credibility

Mitterrand followed up his painful 1983 decision to stay inside the EMS with a major effort to make France economically successful and internationally competitive. According to his close adviser at the time, Jacques Attali, Mitterrand was 'obsessed'[1] with reducing inflation and cutting taxes to boost purchasing power and growth. To avoid having to raise funds through taxation, he pushed France to reform its sclerotic financial markets and to make use of international capital markets to finance borrowing. Under his mandate, the second Mauroy Government (1983–84) and its successor under Laurent Fabius (1984–86) took advantage of the boost to the French economy from the favourable 1983 EMS realignment to consolidate difficult economic reforms at home and to encourage saving and investment.

From 1984 onwards, French banks and stock exchanges were modernised, new futures trading markets were allowed to set up and the French Treasury made increasing use of international financial markets to raise public finance and to manage the franc, issuing from 1985 onwards an attractive range of short- to long-term bonds. From the first Treasury bond (*Obligation assimilable au Trésor* or OAT) issue of 20 billion francs in Spring 1985, the volume of bonds traded annually had by 1988 soared

to 2,415 billion francs, of which government borrowing accounted for around half. On 1 January 1985, credit ceilings, in place since 1972, were abolished. French businesses, which for years had been under-capitalised by comparison with their German counterparts, were able to tap into increasingly liquid capital markets. For French banking and business opinion, traditionally wary of Socialist politicians, the Mitterrand years turned out to be a 'divine surprise' as Paris became a major European financial centre.[2]

By contrast, among Mitterrand's more traditional political supporters on the Left – who still harked back to his fiery speech in 1971 at the Socialist Party's founding conference calling for a 'break with capitalism' – disillusionment was intense. While France's recourse to the financial markets had enabled successive Socialist governments to avoid the most drastic and politically dangerous measures at home, they still had to apply sufficient rigour to reduce inflation and to maintain the franc's position in the EMS. Moves such as the freezing of the minimum wage and the de-indexation of public sector salaries introduced in the first austerity budget of late 1982, significantly improved the government's accounts but, with average annual inflation still running at around 10 per cent, demanded painful sacrifices of Left core voters.

Moreover, despite a marked improvement in purchasing power, France's economy was steadily shedding jobs as major industries such as steel and automobiles reduced capacity and modernised production to cope with foreign competition, steadily pushing up the unemployment level. By Spring 1986, State debt and deficit levels were healthy, annual inflation was down to 2.55 per cent, the franc was stable, French industry was more competitive – and the Socialists had lost the Parliamentary elections, ushering in two years of political 'cohabitation' between a Socialist President and a Gaullist-led government under Jacques Chirac.

The 1986–88 period of power-sharing with the centre-right may have been a short-term tactical setback for the Socialists, but it masked a far more important strategic victory for Mitterrand on several fronts. For the mid-1980s were a period of profound political and economic change in France, marking the quiet coming of age of the Fifth Republic, as the country came to terms with the historic policy choice its President had made. The Socialists became a credible mainstream political force; a broad left-right moderate consensus emerged on economic policy; and France at last had the prospect of peaceful democratic transition between left and right alternatives within a stable constitutional framework.

This strategic shift came about for two reasons. First, by successfully adopting economic reforms, a stable currency and a European vocation

for France, Mitterrand had by now decisively put to rest the image the Socialists had inherited from the inter-war years of being inept economic managers. From 1983 onwards, his Presidency had promoted a programme of economic and financial reform which had won over France's business and financial opinion. It soon became evident in French business circles that the Socialists were significantly better placed than the parties of the centre-right to deliver market reform and wage moderation. While a Right-led government attempting to cut public spending inevitably faced massive street protests organised by the Left-dominated public sector trades unions, Mitterrand's electoral alliance with the Communists kept these forces at bay. Although reluctant to admit this publicly, a majority of traditionally Right-leaning business opinion in France came to realise that bold Left reforms, like the de-indexation of public sector salaries, could never have been proposed by the Right without sparking massive economic disruption.

The Socialists' image as economic modernisers was also helped by the fact that, by the mid-1980s, Mitterrand had succeeded in emasculating the Communist Party as a political force in France. The experience from 1981–84 of being a junior partner in two Socialist-led governments had proven disastrous for the Communists. Whereas in the 1978 Legislative elections they had commanded 20.6 per cent of the first round votes, roughly comparable to the Socialists at 22.8 per cent, by the 1986 elections, they were trailing well behind, with 9.7 per cent of the vote to the Socialists' 30.8 per cent.[3] By moving to the economic centre ground after 1983, Mitterrand had forced the Communists to take disproportionately heavy political losses compared to his own Socialist Party. Economic rigour had come at the expense of many of the 110 promises of social change in the laboriously negotiated Socialist-Communist platform, a disappointment felt more acutely by the blue-collar workers who traditionally supported the Communist Party than by the Socialist Party's rather more well-heeled supporters.[4] The Communist Party would never recover from this reversal.

The 1986–88 period of cohabitation also helped Mitterrand strategically by consolidating the emerging left-right political and economic consensus behind his EMU policy and behind the domestic reform effort needed to achieve it. Despite allowing two franc devaluations and prompting several clashes over the privatisation of State-owned companies, Chirac's 1986–88 government was constrained from too brutal a confrontation with the President by pro-European business opinion, by the need to maintain France's credibility with financial markets and by Mitterrand's continuing power over European and defence policy as well

as over key appointments. In practice, Chirac's government extended its Socialist predecessor's financial market reforms. Even his moves to open up State-owned enterprises to private capital, though publicly contested by the Left, were in line with the logic of Mitterrand's economic choices, and would not be reversed when the Socialists later returned to power.

By late 1987, as the May 1988 Presidential elections approached, Mitterrand had every reason to be satisfied with the turn of events. He had recovered from the political low point of his Presidency – the humiliating 1983 domestic policy U-turn – and France's economic recovery was at last feeding through into rising political support for the Socialists and for his Presidency. With investment and growth rates accelerating (at 3.7 per cent and 2.2 per cent respectively in 1987) and optimism rising, the President judged that he could attract enough support from the political centre to see off the Gaullists and win a second term. The disarray of the Communists and the broad pro-European economic consensus across the moderate Left and Right of French politics assured him of a stable political platform inside France and allowed him to project a more confident and assertive French presence onto the European stage. Externally too, his strong relationship with Kohl, reinforced by France's credible track record of reform, meant that he was now well-placed to take full advantage of an unprecedented window of opportunity which was about to open up for France's European diplomacy.

The European diplomatic stakes

Mitterrand was well aware that the greatest European challenge for the 1988–95 French Presidential term would be the creation of a European single market for goods, people, services and capital, due to take effect from January 1993. This prospect focussed the French leadership's attention once again on the need to secure German agreement to shared management of European monetary policy.

The European move to liberalise capital flows was particularly risky for France's political leaders, on both the Left and the Right. Capital markets had grown significantly since the EMS had been set up in 1979 and so had the potential threat to common European policies from the destabilising financial flows washing between the dollar and the deutschmark. Especially politically sensitive on the Right in France was the risk of disruption to European level payments to farmers under the Common Agricultural Policy.[5] Then again, open borders could put at risk France's popular interventionist economic and social model. Once capital could move freely across borders, it would be much harder to

maintain the high tax rates underpinning France's social benefits. If the state received less revenue, this in turn risked weakening the franc. As increasing cross-border competition threw more light on the diverging performances of European economies, the less competitive ones looked likely to become increasingly prone to speculative attacks.

Yet the Bundesbank, which in practice ran the EMS' monetary policy, had a mandate to protect only German monetary interests. It would decide on when to intervene in markets and would determine the appropriate level of interest rates – but it did so only to maintain the stability of prices in Germany. Other countries anchored to the deutschmark had little option but to follow suit, even if the decision was ill-suited to their own economic circumstances. Unless they could change their economies to make them more like Germany's, a process referred to as 'economic convergence', these inappropriate decisions would damage their economies by making them grow too fast or too slowly. This in turn could affect their currency, attracting speculators, making the EMS unstable and forcing them into expensive and politically damaging readjustments.

So, why did the French in 1988 not resist European moves to lift capital controls? After all, they had in the past strongly resisted such moves and had more need of capital controls than the Germans, given the franc's greater vulnerability. The answer was threefold. Firstly, as we saw earlier, the French through the mid-1980s had reformed their financial markets. They saw Paris as potentially benefitting from liberalised financial services and were making increasing use of capital markets to raise finance. Secondly, for Mitterrand, the choice to shun protectionism and to accept France's European destiny had effectively been made in 1983, and the economic reforms introduced since then were by now paying off. So, by the late 1980s, the French believed that their country could withstand the competitive pressures of open markets better than some of their closest competitors in southern Europe. Lastly and most importantly, the French saw that German demands to abolish capital controls, as part of the move to a single market, could be a powerful negotiating lever to persuade Germany to share control of monetary policy at European level.

Ever since the earliest EMU proposals had been put forward in the Werner Report, French and German experts had been arguing fiercely over how best an effective economic and monetary union could be achieved. The French favoured what became called the 'Monetarist' approach, arguing that creating monetary union would in itself lead to economic convergence since it would shape both domestic inflation

expectations and market perceptions. The Germans by contrast (and especially Germany's all-powerful Bundesbank) had for years taken the 'Economist' view that real convergence of economies and the lifting of all capital controls were essential prerequisites to a successful monetary union.

Both sides, however, accepted the economic 'trilemma' argument [6] that the abolition of capital controls was impossible to combine with both fixed, or part-fixed, exchange rates and the maintenance of separate national monetary policies. This argument had been deployed in an influential report to the European Commission on the economic consequences of the single market and enlargement by an expert group led by the respected Italian economist Tommaso Padoa-Schioppa.[7] The April 1987 Padoa-Schioppa Report had underlined that the EMS would need to be significantly strengthened, since its halfway house of fixed but adjustable exchange rates would become vulnerable to speculative attacks and thus unstable once capital controls were fully lifted. So, by accepting the lifting of all capital controls and pointing to the convergence of economies that would ensue from this and from the creation of a single market, the French believed that they were removing a fundamental German objection to European EMU and creating an unassailable logic in favour of moving beyond a German-dominated EMS to a collectively managed European monetary policy.[8]

The French had already secured in the 1986 Single European Act a reference to the need for closer European economic and monetary co-operation and a strengthened EMS. With the franc evermore firmly anchored to the deutschmark, if Germany now could be persuaded to share economic and monetary policies at European level, France could hope to reap the benefits of access to capital markets while being shielded against the worst economic and financial risks – and against accusations at home that France had given up its monetary sovereignty to Germany.

The catalyst – how French and German political and economic interests converged

As the 1988 Presidential elections drew near, France's mainstream parties began to focus on how to demonstrate to a wary French public that their candidate could best lead France into the brave new Europe of barrier-free markets in 1993. They jostled with each other to build high level contacts with Germany on European economic and monetary issues. For the centre-right, former President Giscard d'Estaing

had been fastest off the mark, setting up in 1986 with former German Chancellor Helmut Schmidt a joint 'Committee for the Monetary Union of Europe'. This group, which came to be known as the 'Giscard-Schmidt Committee', consisted of 20 ex-Ministers, bankers and business leaders. In 1987, Giscard and Schmidt created a parallel 'Association for European Monetary Union' designed to stimulate a wider debate in European business circles. By late 1987, the Giscard-Schmidt Committee (one of whose members was Pierre Bérégovoy, French Finance Minister in the Fabius Government of 1984–86, soon to be reappointed in 1988) was beginning to draw up a voluminous 'Action Programme', which was to be published the following Spring. Ideas emanating from the committee included: the free movement of capital, the full participation of all European Member States in the EMS, a programme of economic convergence, the creation of a European Central Bank, supported by a federal system of the central banks of the Member States, and increasing use of the ECU which, it was argued, would be driven by market forces eventually to displace national currencies.

Mitterrand, for his part, was playing his cards close to his chest, refusing to be drawn publicly on whether he intended to bid for a second Presidential term. His key concern over the Winter of 1987–88 was to gauge whether, if he were to run for a second term, he stood a realistic chance of persuading Kohl to make bold joint moves on European policy. From a political perspective, Mitterrand regarded it as essential, if the move to a liberalised European single market was to be acceptable in France, that it should be presented not as an end in itself, but rather as the first step towards France's longstanding ambition of creating a European economic and monetary union, with all the implications for social and political solidarity that that entailed.[9] So the success of any second term would crucially depend on his ability to persuade Kohl to make a bold European initiative in this area.

Keeping Chirac's government in the dark, Mitterrand quietly asked his diplomatic and economic advisers Hubert Védrine and Jacques Attali to explore privately with their German counterparts ideas for future bilateral initiatives on both defence and economic and monetary policy. Kohl was keen to work with France towards the creation of new European defence structures, and in July 1987, his office suggested the setting up of a Franco-German Defence Council to work up proposals. French counter-proposals to match this with a Franco-German Economic and Financial Council initially met with German reluctance, and despite Attali's enthusiasm to press the point, Mitterrand remained pessimistic

throughout 1987 that Kohl would endorse any move which might threaten the existence of the deutschmark.

Underlying Mitterrand's pessimism, according to Attali, was the suspicion that, since Germany's economic and monetary strength was a deep-seated source of national pride – rather as the independent nuclear deterrent was to France – Kohl would be as unlikely to share it with France and with Europe as Mitterrand would be to share with Germany France's independent deterrent.[10] However, he continued to appeal to Kohl's longstanding desire for European integration by promoting the idea of a joint sharing at European level of the respective monetary and military strengths of Germany and France. In October 1987, he made a speech in Aachen which included a call for a common European currency, along with a strengthening of European military co-operation.

Not to be outdone in the run up to his own Presidential bid, Gaullist Prime Minister Jacques Chirac jostled with President Mitterrand for Kohl's attention, making use of political links between European parties of the Right to try to develop his own dialogue on defence and monetary issues. In September 1987, having uncovered the secret preparatory work by the President's office on a Franco-German Defence Council, he wrote to Mitterrand to protest at being kept in the dark and to insist that any such joint initiative should be matched by German concessions on monetary policy.

Chirac's Finance Minister, Edouard Balladur, separately told his German opposite number that it would be unacceptable for a Franco-German Economic and Financial Council to meet at a level higher than Finance Ministers. Gerhard Stoltenburg, who had been kept out of the loop on the bilateral talks by Kohl, was taken aback. This episode was followed by an unseemly scramble between the President's and Prime Minister's press spokesmen at the 50th Franco-German Summit in November 1987 to take public credit for announcing the plans to set up the Defence Council and the Economic and Financial Council at the following January's 25th anniversary of the 1963 Franco-German Elysée Treaty.

In late 1987, Chirac encouraged Balladur to work up new proposals for strengthening European and international monetary co-operation. Balladur asked the Head of his Private Office, Jean-Claude Trichet,[11] and the Governor of the Central Bank of France, Jacques de Larosière, to help draft a paper for him, building on measures the G7 group of the most industrialised countries had introduced in the February 1987 Louvre agreement to help manage destabilising financial flows and also on the Basle-Nyborg agreement drawn up by European central bankers later

that year to improve the effectiveness of the Exchange Rate Mechanism (ERM) of the EMS.

Balladur circulated the paper, a seven-page memorandum on 'European Monetary Construction', on a personal basis to his fellow European Finance Ministers on 8 January 1988. In it, he argued that the joint efforts made to strengthen the EMS under the Basle-Nyborg agreement had proven their worth in resisting the turbulence which had swept through financial markets in October 1987 and should now be taken further, but they should also prompt reflection on more ambitious forms of European monetary construction. Pointing to the shortcomings of the existing EMS, notably that currencies of countries whose policies were too lax were penalised by having to make costly adjustments, whereas a country whose policy was too restrictive (understood: Germany) was under no pressure to adjust, Balladur argued that lifting capital controls and completing the single market would create a new situation in which such weaknesses in the current EMS would be exposed. Yet, since the creation of a single market for financial services was in Europe's interest, 'the rapid pursuit of European monetary construction is the only possible solution'.[12]

Ahead of the creation of the European Single Market, Balladur called for the creation of a European 'single currency zone', by which he explained he meant a zone in which the same currency could operate across all the countries, overseen by a 'common central institution and "federal" banks in each country'. The memorandum fell short of calling for the setting up of a European Central Bank (which, since it involved pooling French sovereignty, would have been sharply contested within Chirac's Gaullist Party). Instead, it listed a number of questions which needed answering before such a proposal could be made, including how a European Central Bank would relate to European political institutions as well as to national monetary bodies.

Balladur's memorandum, which he followed up with a major interview in the French right-wing daily 'Le Figaro', made quite a splash in the opening days of the January–June 1988 German Presidency of the European Economic Community (EEC). Ironically, it was these high-profile efforts by Mitterrand's political rivals to outflank him on European monetary union which finally prompted the Germans to propose a bold new European monetary initiative of their own, going beyond even Mitterrand's expectations.

The Germans reacted frostily to Balladur's proposals and were equally uneasy about many of the ideas emanating from the Giscard-Schmidt Committee. In particular, Germany's Bundesbank strongly opposed

the idea of the gradual creation of a European reserve currency and its oversight by a new European institution which would share monetary authority with national central banks. Unlike the Bundesbank, most other European central banks were still subject to political control. In both the Giscard-Schmidt and the Balladur proposals, the Bundesbank saw France trying to create an opportunity for political meddling in monetary policy, undermining its own mandate to maintain monetary stability.

Kohl publicly dismissed Balladur's proposals in a speech on 14 January 1988. However, with Germany holding the European Presidency, the pressure was now on Kohl to come up with alternative ideas on an issue which had been identified in the Padoa-Schioppa Report as crucial to the success of the single market and which was clearly a high priority for Germany's closest European partners.

At the beginning of March 1988, a German riposte to Balladur's memorandum appeared, but in such a way as to raise questions about whether it was a purely personal initiative or an official German Presidency proposal. Rather than coming from the German Finance Minister, to whom Balladur had circulated his memorandum, it took the form of an initiative by Germany's Foreign Minister and Vice-Chancellor, Hans-Dietrich Genscher. He promoted it in a low-key way, arranging for a personal discussion paper[13] to be circulated to Private Secretaries in the margins of an informal meeting of EEC Foreign Ministers. In the paper, Genscher picked up some of Balladur's points about the need for further progress in developing the EMS but then made a far bolder European proposal: the creation of a single currency, not only for commercial transactions but to replace national currencies altogether, under the supervision of a fully independent European Central Bank strictly modelled on the Bundesbank. He suggested that the June 1988 Hanover Summit should set up a committee of 5–7 'wise men' to elaborate this proposal and report back within a year.

By circulating his ideas on monetary issues to European Foreign, rather than Finance, Ministries, Genscher was bypassing not only Balladur but also his own Finance Minister, Gerhard Stoltenberg, and the Governor of the Bundesbank, Karl-Otto Pöhl. The key questions for Germany's partners were: did Genscher, who was not from Kohl's CDU Party but a veteran liberal democrat politician and CDU coalition partner, have the Chancellor's backing to do this? Was this a significant new German proposal?

The French Foreign Ministry, closely analysing the Genscher paper, concluded[14] on 3 March that the answer to both these questions was

'yes'. The French noted that the paper contained ideas similar to those Genscher had set out a few weeks earlier in a speech, after which it was known that the Bundesbank had called upon Kohl to disavow Genscher's proposal for a European Central Bank. The Chancellor had not done so, and therefore this proposal must have his tacit support. As for whether the Germans really meant business on replacing the Bundesbank with a European equivalent, Foreign Ministry officials thought it highly significant that, in Genscher's proposed mandate for the Committee of Wise Men, there was a reference to the German law setting up the Bundesbank. This, they believed, implied that the Germans were ready for the EEC to take a legally binding step.

The Director of the Foreign Ministry's Economic and Financial Division, Pierre de Boissieu[15], wrote a passionately argued Note, covering this analysis, which reached President Mitterrand's Diplomatic Adviser Hubert Védrine. In it, he stressed that Genscher's paper marked 'an important turning point' in German policy. France should take it seriously: 'Caught in the infernal turbulence of the dollar, fearing for her export markets in Europe, anxious both for her economic security and to affirm the identity of a monetary Europe which, steered by Germany or by the Franco-German partnership, would facilitate relations with the US as well as the opening to the East, Germany is setting a course towards monetary union. I am convinced of it'.

Boissieu asserted that Genscher's ideas were better than those in the recent Balladur memorandum, since they adopted a better balance between monetary stability and growth. Although they meant France conceding national sovereignty over monetary policy to an independent European Central Bank, the EEC already, Boissieu pointed out, accounted for half of France's economic activity. Moreover, in the current international monetary context, national governments and parliaments had already lost half of their real powers. He argued that closer institutional integration at European level could in fact enhance France's external power and strength, and concluded: 'we should not only return this ball but also co-direct the operation with the Germans'.[16]

By 15 March, Chancellor Kohl had dispelled any remaining doubt about German intentions. In a wide-ranging speech to German industrialists on the European Single Market, Kohl pointed out that the independence of the Bundesbank had been an important reason for the Federal Republic of Germany's economic success. Similarly, the proposed European Central Bank should be independent of governments and should take on responsibility for a European currency, controlling its circulation and guaranteeing its stability.

It was clear from this speech, and from soundings which British diplomats undertook at this time in Bonn[17], that – quite apart from the longer term political considerations in Kohl's mind – Genscher's ideas on a single currency had immediate appeal in German business circles as a means of reducing the dominance of the dollar, whose erratic but essentially downward trend since the mid-1980s had created upward pressure on the deutschmark, damaging German exports.

A week after Kohl's speech, on 22 March, Mitterrand finally put an end to months of speculation about whether or not he would run for President again by casually confirming his candidature in response to a question from a TV journalist. Soon afterwards, he published a 30-page 'Letter to All the French People', which he had carefully drafted himself. In contrast with the detailed programme of 110 Socialist-Communist pledges for changing France which had launched his first term, the letter contained few specific economic and social policy proposals. Instead, Mitterrand loftily set out the big future opportunities and challenges for France, focussing on the advent of the single market and his determination to devote himself to promoting new European social, environmental and cultural policies, an internationally powerful European reserve currency overseen by a new central bank, and tax harmonisation to ensure that Europe did not become just a free-trade zone.

In a cleverly judged appeal to the centre-right voters who had traditionally supported Giscard d'Estaing, Mitterrand signalled his willingness to open up politically to moderate pro-Europeans and to civil society. On the back of rising confidence from the strong recovery of the French economy, this was enough to clinch him a convincing victory over Jacques Chirac on 8 May, with 54 per cent of the second round votes, making him the first President of the Fifth Republic to be elected twice by universal suffrage.

Mitterrand at last had the serious prospect of working with Kohl as an equal partner in negotiating European integration. He had long seen it as vital to French interests that Germany should be ever more integrated into shared European structures, to strengthen Europe's security and to give France a say in how its neighbour's growing economic power was deployed. In conversation on 27 August 1987[18] with Spanish President Felipe Gonzalez, Mitterrand had described his over-arching objective on European defence as 'bringing to an end what I call the Europe of Yalta', adding 'it is important to offer a European perspective to the Federal Republic of Germany'.

Mitterrand knew Kohl well enough by now to believe that he too wanted Germany firmly embedded in a peaceful, stable and prosperous

Europe. As early as their first meeting on 2 October 1982, Kohl had evoked a future in which Europe would look very different and East and West Germany would be reunited. He firmly believed that, to achieve this objective without reawakening new forms of nationalism at home and fears among Germany's neighbours of the new country's political and economic strength, he needed to ensure before he left office that Germany was irrevocably embedded into a peaceful federation of European States. Claiming: 'I am the last pro-European German Chancellor'[19], he had appealed to Mitterrand to work with him to build this new Europe. The two men had decided that their Foreign and Defence Ministers would work together on this agenda, leading to a series of bilaterally driven European defence and security initiatives. Now at last, the opportunity was opening up to engage Kohl bilaterally in a second area vital to French interests, the creation of jointly managed economic, social and monetary policies, capable of making Europe into a new global economic model.

Opening Gambits

On 2 June 1988, just weeks after his re-election, Mitterrand met Kohl for a bilateral summit in the French Alpine resort of Evian which was to trigger the intensive negotiating process leading to the historic agreement in December 1991 on the Maastricht Treaty. Both leaders were agreed that the 27–8 June Hanover European Council should, as Genscher had proposed, decide the setting up of a study group on a new European currency. As a *quid pro quo*, the Germans looked to the French to drop their traditional hostility to the lifting of all controls on the free movement of capital. This was a big demand, since France at this time taxed domestic savings at the rate of 47 per cent and had hitherto relied on administrative controls to protect the franc against speculators. The French judged, for the reasons already outlined, that they could now afford to take this step if it secured German willingness to share control of European monetary policy.

Ahead of the Evian summit Mitterrand had, however, been lobbied hard by his Finance Minister Pierre Bérégovoy to ensure that any French agreement to lift capital controls and to move to a European single currency was accompanied by agreement to introduce Europe-wide tax harmonisation, without which Bérégovoy foresaw[20] a significant flight of capital from France to low-tax countries like Luxembourg and the UK. French officials were aware that capital flight would affect revenue to France's State budget far worse than to Germany's, since French

provisions to collect tax on savings were far more efficient than in Germany, where the French believed 80 per cent of comparable income was undeclared and thus untaxed.[21]

Mitterrand duly pressed Kohl on European tax harmonisation at Evian, and the Chancellor undertook, in principle, to support a Franco-German initiative. Nonetheless, with his eye on the prize of securing German agreement to a European currency, the President stopped short of making it a precondition, as Bérégovoy had wanted, for French agreement at the EC Finance Ministers' meeting on 13 June 1988 to lift capital controls.

As Mitterrand had hoped, Kohl agreed at Evian that the 27–8 June Hanover Summit should mandate an expert committee to propose concrete stages towards economic and monetary union. He also suggested it should be chaired by Jacques Delors, Mitterrand's former Finance Minister who, with Kohl's help, had in January 1985 secured the key post of President of the European Commission. From Mitterrand's point of view, Kohl's proposal of Delors to lead this work was a double-edged sword. Delors was keen to strengthen the role of the Commission and held firmly federalist views, which had helped him to foster good relations with Kohl. Kohl was adamant that the creation of a single currency required significant convergence of European economies which could only be achieved if there was equally clear political convergence under European democratic mandate. For Germany, it thus implied, not decision-making through inter-governmental co-ordination, but rather through a pooling of sovereignty, both economic and political (hence the choice at the Hanover Summit of the word 'union' for the mandate of the expert committee chaired by Delors, whereas the text in the 1986 Single European Act had referred only to economic and monetary 'co-operation').

Mitterrand was considerably less ready to accept a federalist approach, being firmly convinced that political power was vested by the French people in their President and Ministers. So, while he was happy to accept Kohl's proposal, knowing that appointing a French chairman would play well domestically, he remained wary of Delors and took steps to limit his room for manoeuvre, including agreeing with Kohl (and UK Prime Minister Thatcher) that his committee should include all EEC central bank governors, whereas Delors had wanted to create a group of 'wise men'. The Hanover European Council duly endorsed this decision, adding only three experts to the central bank governors, and asked the 'Delors Committee' to report back a year later to the Madrid European Council.

The decisions of these few months in early 1988 were crucial for the future course of the European project on monetary union. Already Mitterrand and Kohl had each made politically risky concessions, overruling close political allies, to set up a process which would lead to a new European Treaty pooling national currencies and committing Europeans to go further even than the United States in legalising free capital flows. Looking back today, both leaders were remarkably sanguine about lifting all capital controls. Certainly, from a political viewpoint, it was fortunate for Mitterrand that he resisted pressure from his Finance Minister to make tax harmonisation a precondition for lifting controls. Less than a year later, in Spring 1989, Kohl was to drop his commitment to support a European tax initiative, once the extent of German savings stashed away in accounts in Luxembourg and the political difficulties in Germany of introducing any new tax on capital became clear. Had Mitterrand taken Bérégovoy's advice, Franco-German bilateral relations would have been in crisis at a critical stage of the Delors Committee negotiations. As Mitterrand knew, achieving European agreement on tax harmonisation would in any case have been politically difficult, since any change on tax required unanimity, and the UK and Luxembourg were resolutely opposed. In other respects, though, the unconditional lifting in 1990 of EEC capital controls would – as we shall explore in later chapters – have negative consequences for European social, economic and fiscal policies as well as for maintaining stability in the EMS.

For the next two years, however, the main preoccupation for Mitterrand and his closest advisers would be to ensure that Kohl kept his side of the Evian deal and signed up to a legally binding commitment to replace the Bundesbank-controlled EMS with a shared European currency and monetary policy. Their task was to be complicated by the political changes which were about to convulse Europe.

3
1988–90: German Unity and European Union

The Delors Committee: German and French opening positions

As the Delors Committee began work in Autumn 1988, the international context which had helped to create favourable conditions for a high-level European drive for economic and monetary union was shifting. Political leaders in Europe became increasingly preoccupied with rising instability in the Soviet Union and Eastern Europe. The US dollar which, to the dismay of German exporters, had since early 1985 been losing value against the deutschmark, falling especially sharply after the October 1987 mini Wall Street crash, began in 1988 to climb again, in anticipation that the November 1988 US Presidential elections would mark the end of the Reagan era and the advent of tighter monetary conditions. It continued to strengthen through the early months of George H.W. Bush's Presidency. As business pressure on Kohl eased and as European central bankers began thinking through the practical implications of creating a new monetary institution, the more cautious attitude of the German Bundesbank and Finance Ministry reasserted itself over the European idealism of Genscher and the German Foreign Ministry.

The President of the Bundesbank, Karl Otto Pöhl, had already argued in a major article[1] published on 28 May 1988 that Central Bank Governors, however tempted to succumb to the 'charm of European visions', needed to ask a few critical questions about the vision of a European currency area. He had explained in detail why, although a European EMU was a desirable longer-term political and economic objective, many conditions first needed to be met, including the creation in 1992 of the European internal market and the economic convergence

which it would promote. He had been scathing too about ideas being floated by the Giscard-Schmidt Committee and others for developing the ECU as a 'parallel currency' competing with national currencies. In his view, such a halfway house to monetary union would lack credibility with markets unless supported by 'costly' central bank intervention. He followed this up in the Delors Committee by circulating a paper[2] arguing that 'monetary union cannot precede economic union' and that, prior to the creation of a single European economic area, 'key policy areas such as monetary, fiscal and incomes policy must be addressed…' Pöhl dismissed the argument advanced by the European Commission, with French and Italian support, that the creation of a European single market required the creation of a monetary union, arguing that it was possible instead to have what he called a 'soft' economic union, with fixed but adjustable rates, at least until economies had converged.

Having already conceded full capital liberalisation, the French foresaw the danger that the Germans might be tempted to allow the creation of full European monetary union to roll forward indefinitely. France's key negotiating objective from late 1988 onwards, therefore, became to establish a specific timetable, irreversibly enshrined in a European Treaty, for the transition to full economic and monetary union. This required repeated initiatives to keep up the political pressure on Germany and to counter the technical objections of the Bundesbank and the German Finance Ministry.

In an attempt to regain the initiative from Pöhl in the Delors Committee, the French Central Bank Governor, Jacques de Larosière, circulated a paper ahead of the Committee's 8 November meeting on the 'first stages towards the creation of a European Reserve Bank', proposing amending the Treaty of Rome to map out the stages leading to the creation of a European Central Bank. The first stage would be the establishment of a European Reserve Fund.

The proposal built on the provisions in the 1970 Werner Report,[3] which the Committee had taken as its starting point and which had set out a three stage approach to monetary union, with a 'European Fund for monetary co-operation' in the first or second stage as a forerunner to the creation of European System of Central Banks. The establishment of a commonly managed European Fund capable of intervening to stabilise the value of a European currency against the dollar and the yen was, for France, a longstanding ambition and constituted an important element of monetary union. Although Larosière described his paper as 'personal' (and the Director of the French Finance Ministry, Jean-Claude Trichet, had opposed it, arguing that Finance Ministers should retain control of

such intervention decisions and of economic policy co-ordination), the Bank of England, reporting on it to the UK Chancellor in early November 1988, believed[4] it to have Finance Minister Bérégovoy's support.

Overcoming German opposition: French diplomatic signals

The French were aware that there would be strong resistance in Germany to their proposals, just as the original Werner Report had been shelved following German objections. The Germans' fear was that a European Reserve Fund, ultimately still under the joint political control of national Finance Ministers, would lead to political interference in the Bundesbank's mandate to maintain price stability and result in the Bundesbank – and eventually German savers and taxpayers – having to 'bail out' less efficient and less rigorously managed European Member States.

To be credible in pressing for treaty change on economic and monetary union, the French knew they first had to demonstrate that their own economy was at least as resilient and well-managed as Germany's. In this respect, the Socialists at last had a good story to tell since the rigorous policies they had introduced since 1983, later dubbed 'competitive disinflation', were by December 1988 keeping inflation under 3 per cent (now only 1.4 per cent above Germany's, compared with 6.9 per cent above in 1979). Meanwhile, annual growth at 3.5 per cent (later adjusted upwards to 3.7 per cent) turned out to be France's best performance since 1976.[5] Although economic performance was boosted by cheaper oil prices and dynamic world demand, France was also benefitting from strong domestic consumption, thanks in part to improved purchasing power from some of Mitterrand's first term stimulatory policies, such as raising the minimum wage.

In early 1989, Bérégovoy decided that the time had come to demonstrate publicly to Germany and to markets that France had full confidence in the convergence of its economy with Germany's, and in the inexorable momentum towards European monetary union. In January, at a major economic forum of business leaders and the media in Paris, Bérégovoy agreed to answer journalists' questions. Asked what he would do if the deutschmark was revalued, Bérégovoy confirmed that, if that were to happen, then the franc would be revalued too.[6] In effect, he was announcing that the franc's value would, from that point onwards, be firmly fixed to the deutschmark at its then rate of 3.35 francs to the deutschmark (last adjusted in January 1987), anticipating a key condition of monetary union. It was a historic commitment which France

never subsequently broke, and indeed, became the rate at which the two currencies definitively locked together in the European single currency. Maintaining this commitment became known as France's 'strong franc' policy.

Soon afterwards, France gave another important political signal to Germany on economic and monetary union, although this time it was one that Bérégovoy was much less happy with. It had become clear to Larosière during the Delors Committee discussions that Germany would not accept his proposal for a European Reserve Fund, nor would they ever agree to give up the Bundesbank for anything less than a fully independent European Central Bank closely modelled on the Bundesbank. He decided to put the case for a change in French tactics directly to the President.

Mitterrand, with an eye to the French European Presidency and to celebrations for the Bicentenary of the 1789 French Revolution, both in the second half of 1989, needed an early political success in the European negotiations. Above all, he wanted to secure German agreement to a legally binding move to monetary union, which he hoped would open the way to German support in promoting politically popular European social policies to counteract fears inside France over the negative effects on employment of opening the single market. If allowing Larosière to accept the principle of a fully independent European Central Bank was the only way to achieve this, he was prepared to ignore his Finance Minister's objections to conceding political control over monetary policy.

Nodding through a key European report recommending the transfer of monetary power to an unelected European body made up of central bankers was a significant concession for France, whose own central bank had never been independent. Given France's strong republican tradition of maintaining central political control over, and Ministerial accountability for, economic and monetary decisions, it was also politically risky, as Bérégovoy would repeatedly argue in the months to come. So soon after his second-term victory it was, however, a risk Mitterrand was confident enough to take.

Mitterrand's overruling of his Finance Minister[7] once again paved the way for progress on the substance of economic and monetary union. By 12 April 1989, unanimous agreement had been reached within the Delors Committee on a report advocating a three-staged move towards economic and monetary union, leading in the final stage to the creation of a European currency overseen by an independent European Central Bank.

The first stage, which did not require treaty change, would begin on 1 July 1990 with the lifting of capital controls and closer co-operation within the European Monetary System. The transitional second stage would involve the creation of a new European body in the form of a federal-style European System of Central Banks (ESCB), made up of a European Monetary Institution with its own Council and Board (an embryo European Central Bank but without, as yet, independent control over monetary policy) and the national central banks of the participating countries. The report envisaged that responsibility for monetary policy would, at some point, be transferred from the national to the European level but did not specify when or how. In the final stage, exchange rate parities would be irreversibly fixed, a common or single currency would be created, and monetary policy would be independently managed by what would now have become the European Central Bank (ECB).

Decisions on stages two and three, requiring amendment of the Treaty of Rome and probably the drafting of a new treaty, would be remitted to an Intergovernmental Conference (IGC). At German insistence, no dates were set for the second two stages or for the IGC. The Larosière proposal for a European Reserve Fund as a halfway house to an independent central bank was quietly dropped.

A French diplomatic setback: the June 1989 Madrid European Council

The Delors Report was sent for endorsement by European Finance Ministers in May 1989 and by Foreign Ministers and Heads of State and Government at the 26–27 June European Council meeting in Madrid. French Ministry of the Economy, Finance and the Budget briefing on France's negotiating objectives ahead of Madrid[8] underlined that, given the success of its policy of competitive disinflation, France could contemplate European monetary union in a completely different light, discussing it with Germany 'without any complexes'. There were, French officials claimed, no longer any differences with Germany either over economic policy or over the independence of the central bank 'which we accept in principle, our only condition is that one should take into account the interdependency between monetary and economic policy'.

This latter statement was somewhat disingenuous since 'our only condition' was a significant one, implying that the powers of the Council of Ministers of Economic and Financial Affairs (ECOFIN) should be reinforced in parallel with the power given to the ECB over monetary policy, to ensure that economic policy did not escape from political control.

This, and French insistence that external monetary policy should remain with Ministers, would effectively give Ministers the power to set objectives – such as promoting growth and employment or influencing the dollar exchange rate – other than those in the ECB's mandate to promote currency stability. As such, they were anathema to the Germans.

The French brief concluded that France's aims for Madrid should be that Heads fully approved the Delors Report and decided to start work on the whole of stage one, including preparations to call an IGC to draw up a new treaty. France should resist British amendments, which sought to de-link the first stage of the Delors Report, on strengthening the European Monetary System, from the next two stages requiring a decision to negotiate a new treaty.

German political signals ahead of Madrid were mixed. The ever-helpful Genscher made a speech in May[9] calling for endorsement of the Delors Report, for all EC Member States, including Great Britain, to join the European Monetary System in stage one and for the three stages of the report to be regarded as 'integral parts of a single process', which implied that preparatory work should begin immediately for negotiations on a treaty 'so that an Intergovernmental Conference can be convened and the Treaty of Rome revised'.

By contrast, in early June, Pöhl insisted in a speech[10] (which he privately asked the Bank of England to make sure was seen in London) that 'it would be a serious mistake' to begin intergovernmental negotiations on treaty change at an early stage, and that 'The British Government is not the only one which has difficulties in accepting transfer of sovereign rights to supra-national institutions. That goes for the Federal Republic too. For example, the creation of a European Central Bank System ... would require far-reaching changes to the Bundesbank Act and I do not know whether there would be broad agreement for such changes in the Federal Republic for the foreseeable future'.

At the Madrid European Council, to French dismay, Pöhl rather than Genscher appeared to have the ear of the Chancellor, who resisted all attempts by Mitterrand, supported by Spain's President Gonzales, to press for the immediate calling of an IGC. Behind the apparently technical debate over the timing of the IGC lay deep-seated French concern over whether Kohl was serious about creating the single currency or whether, instead, the Germans' tactical aim was to spin out the process, extracting French concessions on market liberalisation and economic reform without delivering their side of the deal.

Germany's reluctance to be pinned down to dates for the second and third stages of the passage to monetary union was far from reassuring. At

Madrid, Kohl argued[11] that the competent authorities should take decisions on stage one and should make concrete proposals for stages two and three. An IGC should be set up after the start of stage one in July 1990, and after sufficient work had been done on the last two stages to give an IGC a chance of success. Mitterrand pressed again on the second day of the Council for a decision on timing, suggesting at one point that all three stages should be completed by 31 December 1992, but found himself isolated. Kohl's open-ended approach was agreed, and France was left to make a unilateral declaration that an IGC should meet as soon as possible after 1 July 1990.

The Madrid European Council also marked the shelving of the Franco-German initiative, launched a year earlier, to harmonise taxation of savings by creating a European withholding tax. A German move in January 1989 to introduce a 10 per cent withholding tax inside Germany led to flight of capital on such a scale that, by Spring 1989, the law was withdrawn. Kohl's newly appointed Finance Minister Theo Waigel, leader of the ultra- conservative Bavarian CSU Party, had insisted on its withdrawal as a precondition for joining the coalition government.

July–December 1989: The French EU Presidency

Despite this inauspicious prelude to France's European Presidency, Mitterrand announced at Madrid that France would use the second half of 1989 to begin preparatory work for an IGC. He appointed his European Affairs Adviser, Elisabeth Guigou, to chair a European High-Level Group with a remit to produce a report in the Autumn on the key questions an IGC should address, thus answering Kohl's demand for more work on stages two and three. Overcoming initial UK resistance to elevating work on EMU to a more 'political' level by the involvement of Foreign Ministries, this group, consisting of senior Finance and Foreign Ministry officials, succeeded after just five meetings in presenting to European Foreign Ministers on 30 October an agreed list of questions for future negotiations to address. French Archives show[12] that the coherence of the final report owed much to the backstage intervention of Italian economist Tommaso Padoa-Schioppa, who passed drafting suggestions to Elisabeth Guigou designed to circumvent dissenting views, as well as to a late decision by the Group to omit two UK questions calling into doubt the need for an EMU Treaty at all.

In parallel, the French stepped up their bilateral efforts to overcome German resistance to calling an early IGC. At the Franco-German Economic and Financial Council meeting on 24 August 1989, Bérégovoy

sought to disarm France's toughest German critics in the Finance Ministry and Bundesbank by convincing them that France's restored economic strength meant that Franco-German economic and monetary objectives in Europe were now closely aligned. Bérégovoy announced[13] to Waigel, his new German counterpart, and to Bundesbank Governor Pöhl that France now favoured early removal of all capital controls and would lift all its own remaining controls earlier than the Delors Report deadline of 1 July 1990. He confirmed that France would no longer change the franc-mark parity, which he stressed was underpinned by the French economy's fundamental strengths: an inflation level now stabilised at only 0.5 per cent above the German rate and a budget deficit down to 1.4 per cent of GDP. He argued that, with capital liberalisation imminent and France effectively already in the first stage of monetary union, more rapid progress was needed towards European economic and monetary union. France, like Germany, wanted a Europe of stable currencies although, once stability had been achieved, European countries should aim for growth and job creation.

French Finance Ministry officials recorded[14] that Bérégovoy's announcement on capital controls surprised and impressed the Germans and had a positive effect on the bilateral discussions on economic and monetary union, which produced a substantive agreed text on some of the technicalities of moving through the three stages in the Delors Report. Negotiations on where responsibility for economic policy should lie had, officials admitted, been 'very laborious'.[15] Pöhl and Waigel undoubtedly remained reticent about work on the last two stages, warning that calling an IGC as France wanted might raise expectations that could not be fulfilled. They had stressed full independence for a future ECB as a key condition. The French concluded, however, that, if the Germans secured this latter condition, then their reticence over calling an IGC could be overcome.

In his Presidency speech to the European Parliament on 25 October, Mitterrand staked out his objective at the December Strasbourg European Council of securing agreement to open an IGC concluding in the Autumn of 1990, to allow national parliaments time to ratify the new EMU Treaty before 1 January 1993.

The Fall of the Berlin Wall

By this time, momentous changes were afoot in Europe which would sweep the negotiations on European economic and monetary union away from the Central Bankers and Finance Ministers and back into

the realm of high politics. On 19 August 1989, Hungary had opened its borders to East Germans fleeing their teetering regime and making their way to West Germany in the hope of a better life. By early November, the pressure for political freedom had become unstoppable, and on 9 November, East Germany opened the crossing points in Berlin, and the Berlin Wall was breached forever. Now it was up to Chancellor Kohl to manage the historic change he had long foreseen and hoped for and to meet the aspirations of East and West Germans for a new life together.

Mitterrand had often discussed with Kohl the eventuality that West and East Germany would, at some future date, become reunited, but the speed of events took him, like everyone else, by surprise. His concern now became acute that Kohl's reluctance to commit to a new European Treaty meant that he would forsake his earlier European commitments on monetary union to focus on the more immediate prize of reuniting Germany.

France's efforts to keep the Germans under pressure to agree to European treaty change were not helped by UK attempts to argue that such moves were unnecessary. On 1 November 1989, the UK Treasury circulated to EC colleagues a paper by the Chancellor of the Exchequer, John Major, drafted by his predecessor Nigel Lawson, entitled 'An Evolutionary Approach to Economic and Monetary Union'. In place of early treaty change, it proposed after stage one of the Delors plan a gradual, market-driven approach involving closer economic and monetary co-ordination to strengthen the existing European Monetary System, whose exchange rate mechanism should include all European currencies. The paper included a UK commitment to bring sterling into the mechanism once inflation was sufficiently reduced to allow this. The paper argued that an evolutionary approach was sufficient without treaty constraints since, once capital controls were lifted, 'markets' would exert enough pressure on Member States to keep budgets under control and to ensure monetary stability.[16]

On 18 November, Mitterrand convened a meeting of European Community Heads of State and Government in Paris to discuss the latest political developments in Europe. His aim was to raise discussions on the future shape of Europe to the highest political level, and to create a common political framework between European support for German objectives in Eastern Europe and German support for European political and economic integration. Although there was no specific discussion of EMU, Mitterrand claimed in his press conference afterwards that there had been broad agreement that political evolution in Eastern Europe should be balanced by deeper integration in Western Europe. The UK

record[17] of the Heads' discussion denies that such an agreement was ever reached but does confirm that Kohl reassured EC colleagues that Germany's commitment to the European Community was in no way diminished by events in Eastern Europe.

On 27 November, however, Kohl told Mitterrand that he could not agree at the 8–9 December Strasbourg European Council to set a date for an IGC in 1990 on European monetary union, arguing instead that the summit should commission a report by the end of 1990 on 'the principles preparing a conference'.[18]

The next day, without warning any of his European partners, Kohl set out in a speech to the German Parliament a detailed plan for moves towards the eventual 'federation' of East and West Germany. According to Mitterrand's adviser Jacques Attali[19], the President, furious at having heard about this announcement via the media, promptly rang Kohl to make clear that French political support for his proposals for German reunification would be conditional upon him committing to: first, launch negotiations on a European Union; second, recognise Germany's borders with Poland and third, confirm the denuclearisation of Germany.

There is no direct corroboration in the Presidential archives for this account of Mitterrand proposing a bilateral trade off, including between the IGC and political support for German reunification, and a linkage was always formally denied. There is, however, ample evidence of intense high-level French concern in Autumn 1989 over the possible risks to EMU from German reunification and of sustained French pressure on the Germans to agree to hold treaty change negotiations on EMU.[20]

On 1 December, Mitterrand insisted to Kohl that he would ask the Strasbourg summit to fix a specific date for the start of the IGC. The French were nonetheless aware[21] that Kohl was reluctant to hold European negotiations on sensitive monetary issues in the run up to the first all-German Parliamentary elections in late 1990, elections which he regarded as crucial to endorsing his approach to the reunification of East and West Germany.

December 1989 Strasbourg European summit: a Franco-German deal

On 6 December, German news agency reports began to circulate that Kohl had written to Mitterrand a day earlier to argue that the Strasbourg summit should avoid setting a date for an IGC but instead agree a date for completion of the necessary treaty change, in 1994; and that it should also propose increased powers for the European Parliament.

Although the German Chancellor's office refused officially to confirm the existence of this letter, the UK Representation in Brussels reported confirmation[22] from a German Foreign Ministry source that the press reports were accurate, and that Mitterrand had immediately made his views clear to Kohl by telephone. Mitterrand's spokesman at this time, Hubert Védrine, does not mention the letter in his memoirs but does record that the prolonged stand-off between Kohl and Mitterrand was finally resolved just three days before the Strasbourg summit when Kohl's adviser Joachim Bitterlich rang Elisabeth Guigou to give Kohl's consent to fixing a date at Strasbourg to open the IGC a year later, at the December 1990 European Council.[23]

On 8 December, the opening day of the Strasbourg summit, Mitterrand duly proposed to his European partners that the process towards European EMU should be accelerated and that an IGC should be convened at the end of 1990. Kohl immediately supported the proposal, ignoring UK arguments that it was premature. The conclusions of the Strasbourg European Council[24] recorded that the necessary majority existed for the convening of an IGC 'charged with preparing an amendment to the Treaty with a view to the final stages of EMU' and that it would meet 'before the end of 1990', setting its own agenda and timetable. The summit also concluded that the first of the three stages of EMU should begin on 1 July 1990.

Heads at Strasbourg separately declared their political support for 'the strengthening of the state of peace in Europe in which the German people will regain its unity through free self-determination', a process which they stressed 'has to be placed in the perspective of European integration'.

Just after the Strasbourg summit, a senior German Foreign Ministry official told the British Embassy in Bonn[25] that the Chancellor's 5 December letter, which Foreign Minister Genscher had seen only after dispatch, had been the result of a four-hour meeting between Kohl and Finance Minister Waigel. He confirmed that the French had responded angrily but added that, although the German Foreign Ministry had considered the dispatch of this letter unacceptable at the time, they believed that the eventual summit outcome represented 'the best of both worlds. We have maintained momentum, but the conference will not start until after the Federal elections'.

For the German government, this was indeed the best of both worlds, since Kohl's brinkmanship with Mitterrand in the end secured European public endorsement of German reunification and maintained the political momentum towards European integration – but on a timetable

which delayed the start of the IGC on EMU until after the first parliamentary elections of a reunited Germany, due in early December 1990. From the French perspective, it was also a good outcome – Mitterrand's diplomatic brinkmanship, culminating in his angry private reaction to Kohl's Waigel-inspired letter, had produced a commitment from the German Chancellor to a fixed date to negotiate a new European treaty.

Despite having conceded negotiations concluding a year later than they originally wanted, the French were relieved with the outcome of the Strasbourg summit – which they saw as enabling preparatory work to start in 1990 ahead of an IGC launch in December under the Italian Presidency – which would be broadly supportive of French aims on EMU. The British had refrained from directly opposing the IGC, aware that a decision could be taken by majority vote. Nor had they been able to prevent the adoption by the other 11 Member States of a 'Community Charter of the fundamental social rights of workers', which the French regarded as a basis for developing future European social legislation.

Moreover, with the French economy continuing to grow at a healthy 3.5 per cent (later revised up to 3.7 per cent) and France's inflation differential with Germany below 1 per cent, Bérégovoy had been able confidently to confirm to European partners France's intention to lift remaining capital controls at the beginning of 1990, six months ahead of the Commission's deadline, and his determination to maintain the franc's fixed link to the deutschmark.

How German Reunification Affected French European Priorities

By now, however, a few dark clouds were appearing on the horizon for France's economy. One was a steadily worsening trade deficit as rising French purchasing power, which should have boosted domestic industry and employment, again primarily sucked in more imports. Another was a decision on 18 December 1989 by the French Central Bank to raise interest rates by half a percent (making its intervention rate now 10 per cent, as opposed to 7.5 per cent at the beginning of the year) to support the franc against a strengthening deutschmark (up from DM 1.95 to the dollar in September to DM 1.70 by the end of the year) and rising German short-term interest rates. This was the first sign of monetary policy tensions ahead, as Germany's consumer spending boom gathered pace following the opening of the border between East and West.

Politically, the tough Franco-German exchanges which had preceded the summit did nothing to allay French fears that Kohl would lose interest

in European integration as he became preoccupied with the reunification of the East and West Germany. Behind that fear lay deeper ones that the much larger and economically stronger Germany which would emerge would not only no longer regard France as an equal bilateral partner in Europe but might one day even once more threaten its peace and security. As the old Soviet Empire broke up, might a reunited Germany not look eastwards for economic and political allies, realising an old German dream of creating a *'Mittel-Europa'*, a central European power bloc and rekindling tensions with an unstable and unpredictable Russia?

While Mitterrand by now reluctantly accepted German reunification as inevitable, he believed it crucial to French interests that a future, more economically powerful, Germany should be legally constrained within a strengthened European political and economic framework, including an irreversible German commitment to full European economic and monetary union, negotiated through an equal Franco-German partnership. As the Cold War order in Europe broke down, France's aim was thus to ensure that the 'deepening' of European integration took priority over its 'widening' to admit new members from Central and Eastern Europe, whose commitment to the Community's founding principles the French considered at best untested. Once Europe had deepened its integration enough to cope, then countries emerging from Soviet domination could join, provided their economies were ready and they were willing to accept the political, legal and social obligations of membership.

In his New Year wishes to the French people for 1990, Mitterrand advocated that Central and Eastern countries should, meanwhile, become part of a 'European Confederation', a kind of political waiting room for EC membership. As France was about to find out, however, the drive towards a new political order in Europe could not so easily be contained.

German monetary union and European political union

When Kohl and Mitterrand next met on 4 January 1990, at Mitterrand's family home in Latché, South-west France, Kohl reiterated German concerns that a new treaty on European economic and monetary union would be unsustainable without a parallel process on European political union to clarify political accountability between the Member States and the EC institutions. Mitterrand was initially reluctant to make any public moves towards strengthening the power of European federal institutions, conscious that this would be unpopular with French nationalist opinion, most critically within the Socialist Party at a time when he was

trying discreetly to manage the shift to a new generation of leadership at the Party Congress in March.

Again, the speed of events in Germany ultimately forced his hand. On 6 February, ahead of elections on 18 March in both East and West Germany and once more without forewarning European partners, Kohl proposed the creation of monetary union between the two German States, a bold political move which greatly increased the appeal of his CDU Party, and his own personal authority, inside East Germany ahead of its first free elections on 18 March.

Taken aback, the French pressed Germany for a comparably swift move towards European monetary union, with Dumas urging his European colleagues in the February Foreign Affairs Council to agree to advance the start of the IGC on EMU from December to July, but to no avail. Meanwhile, at a bilateral lunch with Kohl on 12 February, Mitterrand privately agreed to Kohl's proposal for a second Intergovernmental Conference on Political Union, to be prepared in secret bilateral talks led by their European advisers, Bitterlich and Guigou.

Inside France, the surprise German move on national monetary union heightened public perceptions that Kohl was prioritising German unity over European union and fed rising hostility in the Gaullist Party to ceding sovereignty to the European level over national economic and monetary policy. In early April, Gaullist Party leader Jacques Chirac declared 'no' to a single currency, arguing that 'in the current uncertain European situation France should keep control of the instruments of her own destiny'.[26] The Socialists, meanwhile, were in disarray as their Rennes Congress in March blocked the leadership candidature of Laurent Fabius, widely regarded as Mitterrand's favoured successor, effectively wresting control of the party away from the President.

On 29 March 1990, in the wake of sweeping gains for the CDU Party in the 18 March East German elections, a confident Chancellor Kohl gave a speech to mark the 40th anniversary of the Königswinter Conference welcoming the 'overwhelming victory for those who advocate freedom, democracy and the social market economy'. He announced that at the Special European Council called by the Irish EC Presidency for 28 April to discuss the European Community's response to political change in Europe, 'I shall again propose, as I did in Strasbourg, that a further inter-governmental conference be convened this year with a view to making faster progress towards political union'.

Mitterrand was by now acutely aware that, if he were to counter the risk of his EMU strategy unravelling and to allay public fears in France that Germany was forging ahead unilaterally, he needed to move quickly

to make clear publicly that Kohl's proposal was a Franco-German initiative and use it to secure a firm date for the start of EMU negotiations. The result was a carefully worded joint letter to the Irish EC Presidency, dated 19 April, from Kohl and Mitterrand, copied to their European colleagues, announcing that the moment had come, as set out in the Single European Act, to 'transform collective relationships between the Member States into a European Union and to grant it the necessary means of action', and proposing the convening of an IGC on Political Union, in parallel with the one on EMU. Both would begin 'before the end of 1990 at the invitation of the Italian Presidency', with the aim of enabling reforms to enter into force on 1 January 1993. These proposals were agreed at the 28 April Dublin Special Summit and formally adopted at the June Dublin European Council.

The political imperatives for European economic and monetary union

By Summer 1990, the European project to create an economic and monetary union had left the technical realm of the Single Market preparations to become a process fraught with politics on multiple levels.

First, with the fall of the Berlin Wall, EMU had in French eyes become the key political test of whether Kohl was willing to commit irrevocably to sharing a reunited Germany's new strength with its European neighbours inside a legally binding union. This was now more important to France than the bilateral links on defence and security that had been so carefully nurtured during the Cold War.

Second, Kohl's linkage of EMU to a parallel European process on political union risked exposing deep differences over how political decisions on economic and monetary policy should be taken and accounted for, not only between France and Germany with their very different political traditions, but also between different strands of political thinking inside France itself and inside each of France's mainstream political parties. French hopes to create a European currency underpinned by a shared monetary policy while keeping economic, budgetary and external monetary policies under national control would now be challenged by Germany, the European Commission and others such as the Netherlands who wanted a more federalist approach, giving the European Commission and Parliament more oversight of these policies to ensure that they supported stability of the future European currency. How to reconcile the French and German models of political accountability would become a central dilemma for the EMU Treaty negotiators.

Third, by making the political choice to move at breakneck speed towards a monetary union of the two Germanys (which went ahead on 1 July 1990), Kohl had at a stroke destroyed the credibility of the long-standing German argument, much deployed by Bundesbank Governor Pöhl, that a monetary union could not result from an act of political will but needed to be the culmination of a process of convergence between participating economies. As the French Finance Ministry pointed out in a public briefing note[27] on EMU in June 1990, 'the realisation of monetary union with East Germany removes the German argument whereby strict economic convergence is regarded as an absolute precondition for European monetary union'. What the French had long suspected had in their eyes been proven: Kohl could bend the Bundesbank's much vaunted independence when it suited him politically to do so. This being the case, what mattered most for French negotiators now was to avoid getting caught up in prolonged technical discussions over how to make a European monetary union work effectively. Instead, their tactical aim was to obtain Kohl's earliest possible political commitment to a legally binding treaty.

The politicisation of the EMU negotiations had the consequence inside the French negotiating team of strengthening the hand of the Foreign Ministry, responsible for leading on preparations for the IGC on political union, as well as for ensuring coherence between the two parallel negotiations, at the expense of the Finance Ministry which had jealously guarded its role in preparing the IGC on EMU. Mitterrand trusted the discretion of the Foreign Minister, his old friend Roland Dumas, rather more than he trusted that of Pierre Bérégovoy, whose opposition to giving up any national decision-making powers to European federal bodies had already led to several heated exchanges. At one point, ahead of the previous March's Socialist Party Congress in Rennes, rumours had even begun to circulate that Mitterrand was planning to remove Bérégovoy from the Finance Ministry, but it quickly became evident that Bérégovoy's popularity in business circles as the champion of the 'strong franc', and architect of key reforms to France's financial markets, could make that a damaging move for France's international financial credibility. After the disastrous outcome of the Socialist Party Congress, Mitterrand could certainly not afford to take such a risk. His only hold now over his Finance Minister was to keep alive Bérégovoy's long-standing hopes of becoming Prime Minister.

Bérégovoy's strongest card in the forthcoming negotiations was his Director of the Treasury, the formidable Jean-Claude Trichet who, despite having headed the office of his Gaullist predecessor Balladur,

had quickly impressed the Minister by his resourcefulness and loyalty. The Foreign Ministry, however, had at its disposal the comparable intellectual fire-power and immeasurable self-confidence of its Director of Economic and Financial Affairs, Pierre de Boissieu, and Dumas placed him in charge of the negotiations on political union, with oversight too of the institutional aspects of the EMU negotiations. These two were to become France's official level negotiators in a tightly controlled strategic operation of immense political sensitivity.

Preparing the two intergovernmental conferences

Over the Summer of 1990, in preparation for the two IGCs, Boissieu wrestled with the Franco-German differences over political accountability which would inevitably arise. How could the future European Treaty square the circle of Germany's need for a federal-style Europe with France's Republican values, based on central control and the accountability to the people of nationally elected politicians? In a briefing note[28] for the President ahead of the Franco-German Summit on 17–18 September, Boissieu argued that France needed to clarify what Germany really understood by political union and to try to reach a common understanding. In his view, the European Community currently had two models: one fully integrated, as for the Common Agricultural Policy (CAP), with the European Commission making a proposal, the Council deciding and the European Parliament overseeing the process; and another involving only intergovernmental co-operation, as for common foreign and security policy issues (CFSP). It would be politically unthinkable to attempt to remodel CFSP along the lines of the CAP, so some kind of compromise needed to be worked out whereby the European Council, which through its nationally elected leaders constituted in French eyes the only legitimate European body, retained responsibility for the big strategic decisions, even as the other European institutions were gradually strengthened.

Summing up the latest state of the bilateral understanding with Germany on economic and monetary union, Boissieu noted that there was agreement on the independence of the ECB and on the need for budgetary discipline, but still no common view on what form a future currency would take (the Germans did not want a French-sounding 'écu', and the French did not want the deutschmark to become the single currency), on how the transition to a single currency would happen or on the political institutions of EMU, in particular how economic policy would be managed and by whom. The key problem with the latter

was how to define the respective roles of the European Council and of European Finance Ministers. Finance Ministers did not want to have the European Council overseeing them, and Foreign Ministers did not want to allow Finance Ministers to sit in the European Council.

In Boissieu's view, France should insist on a role for the European Council because, while Germany was used to conducting economic policy based on rules and discipline, in other countries like France, Spain and the UK, economic policy decisions were only politically acceptable to people if endorsed by Heads of State and Government. The French should also clarify the relationship between European and national parliaments. On the transition to a single currency, Boissieu flagged up to the President the risk that the second stage of the Delors process would turn into a long waiting room, adding rhetorically: 'and we'll wait for what? Eternity, before convergence is perfect (that's what the Germans want)'. He concluded that the best way to counter this was by embedding a specific timetable for each stage within the new treaty.

In the end, both Mitterrand and Kohl were too preoccupied by the consequences of Iraq's 2 August invasion of Kuwait to spend much time on European questions. The 56th Franco-German Summit declaration simply pointed forward to decisions to be taken at the Rome European Council on 14–15 December 1990 to launch the two Intergovernmental Conferences. Boissieu's ideas were, however, later reflected in French negotiating positions in both IGCs.

Technical work on EMU by Finance Ministers and Central Bankers made rather better progress, resulting in a substantive set of conclusions agreed by 11 Member States (the UK dissenting) on a framework for future treaty negotiations at a Special European Summit in Rome on 27–28 October. The framework included key points agreed bilaterally in the Economic and Financial Councils between France and Germany, notably that treaty change should allow for the setting up of a new European Monetary Institution from the beginning of the second stage of EMU, made up of a central body plus the national central banks, to take on full and independent responsibility for monetary policy by the start of the third stage. It was also agreed that not all European currencies needed to be in the narrow band of the European Monetary System to enable stage two to be launched on 1 January 1994. Thus, there would be no coercion to join the single currency, but nor should any country be able to veto the process.

On 6 December, ahead of the Rome European Council, Kohl and Mitterrand sent European colleagues a joint letter attempting to create a similar negotiating framework for the IGC on Political Union.

This framework comprised: enlarging the roles of both the European Parliament and the European Council, extending majority voting, including for operational level decisions on foreign and security policy once the policy itself had been agreed unanimously, and enhancing democratic legitimacy by promoting the concept of European citizenship. The proposal for this initiative had come from Kohl who, following the first free parliamentary elections of a reunited Germany on 2 December, had emerged with a convincing mandate for a third term and was now keen to press on with negotiations on the future shape of Europe.

As so often happens in summits, however, more immediate political events overtook the Rome European Council's discussions. The French found themselves fighting to keep the European Parliament in Strasbourg, against the wishes of most of its members who preferred to work in Brussels, and endorsing a Dutch-brokered US ultimatum to Saddam Hussein to get his troops out of Kuwait by 15 January or face the consequences. Nonetheless, immediately after the summit, the two IGCs formally opened as planned, with a mandate to conclude by end 1991, and European Member States were invited to appoint one official representative for each. France duly appointed Pierre de Boissieu to lead on Political Union and Jean-Claude Trichet on Economic and Monetary Union.

For the French leadership, there was an urgent need to secure a European deal as quickly as possible. Rising oil prices and a slowing global economy in the wake of the Gulf crisis were already perceptibly dampening French growth, a sign that the political window opened up by Mitterrand's convincing re-election would soon close. By contrast, the German economy was still growing. This only served, however, to increase tension between French and German monetary policy, as the Bundesbank continued to put up interest rates to counter inflation and to attract finance for sharply rising budgetary costs in the wake of German monetary union. The French and German economies were now diverging, with unpredictable consequences. A critical year of intensive negotiations lay ahead.

4

1991: The Maastricht Negotiations

The parallel IGCs: Mitterrand's priorities

Negotiations in the two parallel Intergovernmental Conferences (IGCs) on Economic and Monetary Union (EMU) and on Political Union began in January 1991 under Luxembourg chairmanship, with the aim of concluding under the Netherlands Presidency at the European Council in Maastricht in December 1991, to allow time for a Treaty on European Union to be ratified by national governments before the European Single Market was launched on 1 January 1993.

For Mitterrand, a successful outcome on EMU was what really mattered. The Political Union negotiations, though necessary for German agreement to a single currency and an opportunity to promote a more autonomous European defence and foreign policy identity, were of secondary importance. Moreover, they carried risks of a nationalist backlash inside France if shared decision making went too far.

The EMU negotiations opened with the German and French positions still far apart on the design, governance arrangements, membership qualifications and timetable for the future single currency. French Finance Minister Bérégovoy, anxious to seize the negotiating initiative, had worked throughout late 1990 to draft detailed French Treaty proposals, which received the backing of the President and government in early December. However, by mid-January 1991, French troops were deployed alongside the US and its allies in the Gulf War, taking up Mitterrand's attention during the first three months of the IGC. The President took care, however, to insist that Foreign Ministers should be fully involved, given the institutional aspects of the negotiations and their read across to the negotiations on Political Union. He had made clear his views on the dangers of leaving Finance Ministers in charge

of the EMU negotiations in a speech to a Franco-German audience the previous Autumn:

> If you want to conclude a Treaty on agriculture … don't leave it to the Agriculture Minister. If you want to conclude an economic and monetary Treaty … well, you get the idea. Only political will can overcome the opposition and reservations of specialists[1]

The French 'Temple' and the German 'Tree'

If Mitterrand could be confident that he and Kohl between them could resolve disputes between Finance Ministers on the technicalities of creating a single currency, this was much less true of the negotiations straddling both IGCs on the future shape and powers of European political institutions, including how to ensure the democratic legitimacy of the strategic decisions on economic, budgetary and monetary policy needed to support a European currency. Here, the differences between the two countries ran deep.

Mitterrand understood that Kohl needed to show German public opinion that his decision to share Germany's strong currency with its European partners was an essential part of a wider political process of restoring Germany to the heart of a stable, democratic Europe. Nonetheless, France's republican tradition, the nationalist principles of De Gaulle's Fifth Republic and Mitterrand's own instincts baulked at the idea of transferring power over decisions in politically sensitive areas like economic policy and foreign affairs to the Brussels-based technocrats in the European Commission, or to the European Parliament whose democratic legitimacy was still largely unrecognised by the French electorate.

For French negotiators, the art of managing these risks lay in finding ways to maintain the momentum towards European political integration without losing the capability of nationally elected Heads of State and Ministers to take the big strategic decisions. Their way of squaring this circle was to propose a structure for the future European Union which would enhance the overarching role of the European Council and of the Ministerial Councils in deciding on policies, while also extending qualified majority voting in implementing policies once agreed, and creating new common initiatives in areas that France wanted, such as social, industrial and environmental policy.

The French thus saw the future European Union as taking the shape of a 'temple': each broad field of activity – economic issues, foreign and security matters or justice and home affairs – would constitute a 'pillar'

of the temple, and sitting on top of the pillars would be the European Council which would decide the Union's strategic priorities and issue policy guidelines. Thus, the Union would remain under intergovernmental control, and indeed, its intergovernmental nature would be strengthened because the role of the European Council, which had been informally established in 1974 as a French initiative, would for the first time be legally recognised in the new Treaty.

Germany's conception of European Political Union was strikingly different, drawn from its own very different historical legacy. Unlike de Gaulle's blueprint for the Fifth Republic, which concentrated power in Paris and above all in the hands of the President, the Constitution of the Federal Republic of Germany had been designed at the end of the Second World War to prevent nationalist forces ever again seizing control of the country's strategic direction. Its governance structures were based on political balance and consensus, underpinned by clear legal safeguards, and a key federalist principle known as 'subsidiarity' ensured decisions were taken at the lowest political level efficiently possible. Institutions based on these principles, such as Germany's flourishing regional governments (Länder), its works councils (Betriebsräte), in which employees and employers reached consensus on wage levels and working methods, and its independent Central Bank (Bundesbank), which set monetary policy without political interference, had all contributed to the country's successful postwar political and economic recovery.

Germany wanted to see these principles, on which its stability had been achieved, translated to the European level. The Germans, therefore, saw the future Union in the shape not of a temple but of a 'tree', whereby policy initiative flowed out from the central trunk – the European institutions, whose democratic legitimacy and impartiality would be assured by giving the directly elected European Parliament oversight of the Commission and Council – and then passed along the branches to be decided upon and implemented at the most appropriate level, be it European, national or regional. In seeking impartial European institutions under pooled democratic control, Germany had the support of some smaller European Member States, including the Netherlands, who were concerned that France's intergovernmental approach would undermine the political balance of Community policies under the Treaty of Rome and would lead to larger countries dominating the Union.

This political tension between the desire of the Germans and Dutch to create strong federal European institutions and the French desire to create strong European policies under the top-down control of nationally elected politicians was to dominate the two sets of European negotiations.

The EMU negotiations: the first six months

French and German opening positions

Bérégovoy and his Foreign Ministerial colleague Dumas jointly tabled France's full draft EMU Treaty proposal at the first Ministerial IGC Meeting on 28 January 1991. Although it was based on the negotiating framework agreed at the first Rome European Council in October 1990 and included provisions to reassure the Germans that France endorsed a single European currency overseen by an independent European Central Bank, the draft also embodied a number of French priorities which were less welcome to Germany, notably:

- a role for the European Council in defining the broad guidelines of economic policy and for the Council of European Economic and Finance Ministers (ECOFIN) in co-ordinating the economic policy of the Member States, giving them powers, in consultation with the European Parliament, to apply budgetary sanctions to those failing to follow its recommendations;
- the European System of Central Banks to be operational from 1 January 1994 (that is, at the beginning of the second stage of the Delors process and before the ECB had been granted full independence) and able to strengthen monetary co-operation inside the EMS, including through the development of the ECU;
- a lead role for the ECOFIN Council, voting by qualified majority and in consultation with the ECB, in determining a single foreign exchange policy, with day-to-day operations carried out by the ECB;
- no Member State to have a veto on the move to full economic and monetary union in the third stage, but none to be excluded either (France insisting that the aim should be for all twelve Member States to join the single currency).

The German Finance Ministry was highly suspicious of Bérégovoy's motives. Its State Secretary, Horst Köhler, who was also Germany's EMU IGC negotiator, confided to his British colleague Nigel Wicks[2] in late December 1990 that he believed that Bérégovoy was seeking to undermine the concept of an independent ECB through his proposals. He suspected in particular that, by proposing the early establishment in stage two of the European System of Central Banks, the French had ambitions to direct the ECB to intervene on the foreign exchange markets against the dollar and the yen, thereby cutting across its mandate to maintain stability before it had achieved independence.

Germany's own Treaty texts, tabled at the next Ministerial Conference on 26 February, constituted according to the UK negotiator 'an attempt to reassert German orthodoxy on EMU'.[3] Like the French, a month earlier, they started from the negotiating framework agreed at the Rome European Council but remodelled it to suit their own priorities, for example, by stressing the overriding priority of price stability and the need for economic convergence as well as by putting back the establishment of a European System of Central Banks until the end of the second stage. On the move to full currency union in stage three, they stressed the need for the economies of all participants to have converged beforehand and included provision for a limited group of countries to move to the final stage without those whose economies were not ready.

A tactical alliance with the UK?

With such wide divergence between their own and German negotiating positions, the French were at first tempted to turn to the UK for support in policy areas of mutual interest. By early 1991, the UK looked more credible as an eventual participant in the single currency, sterling having joined the Exchange Rate Mechanism of the EMS in October 1990. Moreover, Margaret Thatcher had shortly afterwards been succeeded as Prime Minister by John Major, who was known to be more willing to consider taking the UK into EMU.

On some aspects of EMU, UK Treasury thinking was close to that of Bérégovoy's Finance Ministry, in particular on the need for a strong role for ECOFIN in economic policy co-ordination. Bérégovoy also still shared much of UK dislike of the Delors Plan with its federal-style proposal for an independent ECB. In Summer 1990, while still Chancellor of the Exchequer, Major had circulated UK proposals for a 'hard ECU'. These were intended as a market-driven alternative to the ambitious Delors Plan. Instead of a politically managed, staged move to a single currency, Major proposed developing a fixed version of the existing ECU, backed by a 'European Monetary Fund', which would compete with, and if successful replace, national currencies within the European Monetary System. These proposals had replaced the paper by Major's predecessor Nigel Lawson on 'An Evolutionary Approach to EMU', which had been criticised by Germany, France and others on the grounds that an evolving rather than a fixed currency risked becoming a target of financial speculation and thus fundamentally unstable.

The UK Treasury had shared their Treaty drafts on a 'hard ECU' in advance with Bérégovoy, who had found them appealing since they fitted well with his own ideas on establishing a functioning set of

monetary institutions during the second stage of EMU and using them to develop the ECU and actively to manage exchange rates. Furthermore, in the early negotiations on the Delors Plan the French themselves had proposed setting up a European Fund to support the new currency, but Delors had dropped the idea, well aware that this was the aspect of the original Werner proposals that the Germans had most opposed and could kill his Plan.

When Bérégovoy had presented his own draft Treaty proposals to Mitterrand in December 1990, he had obtained the President's permission to explore UK ideas further, provided that they did not hold up progress towards a Treaty deal with Germany. Mitterrand himself could see some advantages in having the UK in EMU as a counterweight to Germany, not least since the UK shared French wariness towards federalism and was opposed to strengthening the powers of the European Parliament. In his first bilateral meeting with the new UK Prime Minister in Paris on 14 January 1991, Mitterrand told Major that he saw some merit in the UK's 'hard ECU' ideas for the medium term before convergence had taken place and that the French would study them, warning, however, that Germany opposed them, and that a single currency had to remain the ultimate goal. Mitterrand reassured Major that he would like to see UK fully involved in the European negotiations. He suggested that France and the UK had interests in common not shared by Germany, for example strengthening the European Council and avoiding giving more powers to the European Parliament which, he stressed, was 'not a real parliament'.[4] He proposed official level bilateral talks to work up joint positions.

The French and Germans meanwhile intensified their own bilateral discussions between Finance and Foreign Ministries to try to bridge their disagreements. Mitterrand's intention in engaging the UK was never to displace the Franco-German relationship but merely to strengthen France's negotiating hand. In a meeting with his Ministers and advisers on 26 January to discuss French EMU proposals and whether, as Bérégovoy wanted, France should explicitly support the UK's approach, he sharply called his Finance Minister to order: 'No reversal of alliance! The ally is Germany. The British are allied to the United States!'[5]

The French were, moreover, soon to be disappointed by the UK position on the European Council. Far from agreeing that its oversight role should be strengthened in the new Treaty UK officials, in particular the Foreign Office, were concerned that formally recognising the European Council in the Treaty would make its actions legally answerable to the European Court of Justice, which they saw as an unacceptable limitation

on UK sovereignty. In the first IGC Ministerial meeting, the UK took a hard line, opposing making any reference to the European Council in the Treaty texts. Officials confirmed to the French negotiating team in late February[6] that they were unconvinced that the European Council should have a deciding role on EMU. Although Bérégovoy continued for some months to nurse hopes of an alliance, for the French Foreign Ministry and for Mitterrand the brief UK flirtation had now ended.

Stage two of EMU – German design, French timetable

In the first six months of the negotiations French and German bilateral talks remained stubbornly deadlocked over the role of the European Council and over German demands to extend new powers to the European Parliament. They did, however, achieve a breakthrough in Spring 1991 on the creation and powers of the new European monetary institution during the second stage of the move to a single currency.

The Franco-German Economic and Financial Council met in early March to try to iron out the differences between the two countries' draft Treaty proposals, followed by further intensive talks. The Germans were adamant that they could not accept French proposals to set up in January 1994, at the beginning of stage two, an ESCB with substantive monetary power to develop the ECU and to intervene on currency markets, suspicious that this would lead to political interference in monetary policy. Nor could they agree to the UK 'hard ECU' proposals, which they regarded as similarly threatening the Bundesbank's ability to keep the deutschmark stable. They insisted they would only transfer monetary authority to a fully independent ECB in stage three.

France's Central Bank had its own concerns about the 'hard ECU'. Like the Bundesbank, it believed that, under the UK's market-driven approach of competing currencies, the volatility in the exchange rate mechanism would be hard to manage. It worried that instability would accelerate the flow of monetary power towards Germany as holding the dominant currency and became convinced that only an agreement negotiated politically to share this power would secure French interests. Bérégovoy, however, held doggedly to his belief that Finance Ministers needed to play a role in setting up the new institutions and developing European monetary policy in a long, substantive, second stage. As the Germans were well aware, he had not given up hope of counterbalancing the ECB's independence with a political role for Ministers in setting external exchange rate policy.

The French Foreign Ministry judged that Bérégovoy was simply pursuing narrow Finance Ministry interests, and that monetary stability

was such a critical issue for Germany that Bérégovoy's approach risked undermining the wider political deal. They accordingly resolved to outflank him by taking matters to the President.

By early March, the Gulf War was over and Mitterrand could again focus on domestic affairs and on the political handling of the IGCs. Both gave him cause for concern. On the domestic front, France's economy, affected by a US downturn in the wake of the Gulf crisis and hobbled by Germany's high interest rates, was by now in trouble and, with it, the Socialists' prospects for the 1993 Parliamentary elections. As the Socialist party quarrelled between competing factions and the Communist vote dwindled away, Mitterrand faced the unpleasant likelihood of ending his political career in a second 'cohabitation' with a Right-led government. He badly needed a successful outcome to the European negotiations, both to leave a lasting historical legacy from his second mandate and to increase his own political room for manoeuvre inside France.

Yet the EMU talks were getting bogged down over technicalities, and Kohl was reluctant to commit to dates for the second and third stages of the move to a single currency. Germany's own internal monetary union had already created a 5 per cent budget deficit, sapping German political support for a European currency union and raising question marks over whether Germany would even qualify to participate. The political window of opportunity for a deal appeared to be closing and Mitterrand realised he needed new initiatives to change the dynamics if he was to avoid being boxed in.

As in 1989, when he had overruled his Finance Minister's objections to Genscher's proposal for an independent ECB, Mitterrand perceived the need for a strong political signal to renew momentum. He was receptive to the advice of his Foreign Ministry that what mattered above all was to secure a clear timetable for moving quickly to a single currency. In practice, this meant conceding to Germany that the ECB should have no substantive power until it became fully independent in stage three, keeping the second stage as short as possible and stepping up the diplomatic pressure to write specific dates into the Treaty.

Mitterrand's former adviser, by now European Affairs Minister, Elisabeth Guigou explained to UK Financial Secretary Francis Maude on 16 April,[7] that France had decided 'at the highest level' that it was in its interest to secure full EMU as soon as possible, since Germany's growing economic power would one day lead it to want to be more assertive in other policy areas. So France's overarching interest in the negotiations was, she stressed, political, although it was necessary to work on the technical issues.

Political factors were also uppermost in Chancellor Kohl's approach to the negotiations. He understood Mitterrand's concerns about Germany's growing strength, and despite the economic difficulties at home, he and his Christian Democratic Party (CDU) had their own reasons for wanting to lock Germany into an early European deal, as the British Ambassador to Bonn, Sir Christopher Mallaby, explained in two despatches[8] assessing German views on EMU:

> Many in the CDU do not trust those who come after them ... to be as European, so, as Kohl often puts it in private, they want to make the creation of European Union "irreversible" ... 'Some even fear that a united Germany with the largest economy in Europe, could begin to exercise its muscle in a way which would cause such tensions that integration could unravel.

This, the Ambassador judged, 'reflects a deeply-rooted sense of guilt about the Nazi past'. In his view, it explained why, although the Germans were becoming less keen on EMU as the size of the task facing them in East Germany became clear and would want to set tough conditions, their motives for wanting EMU still remained valid: 'they see it as a logical extension of the Single Market which will help their manufacturing industry to export; and more importantly they think that long term a Europe dominated by the deutschmark would be politically unhealthy'.

It was this fundamental coincidence of political interests between Kohl and Mitterrand which ultimately made a European Treaty deal possible, despite all the technical and political difficulties. Whenever the French and German Finance Ministries reached deadlock, the political impulsion would come from the Foreign Ministries and from the two Heads of State to find a solution.

So it was that, on 22 March, the French and German Foreign Ministers issued a joint statement on the IGCs which included what initially looked like a bland restatement of the October Rome Council framework on EMU but which, in fact, confirmed that they had reached a new political understanding. This was that the proposed new European monetary institution would be set up on 1 January 1994, at the beginning of stage two of the Delors Plan (contrary to the German Finance Minister's view that it should only be set up at the end). However, (contrary to the French Finance Minister's view), it would not be an operational entity but simply an 'institutional premise' which would only take on monetary policy in the third and final stage.

British Embassy Paris contacts with the French Foreign and Finance Ministries in late March confirmed that France had privately conceded to Germany that the new institution created in the second stage should have only nominal powers, effectively ruling out the UK's 'hard ECU' proposals. Without revealing any details of French concessions, Mitterrand simply confirmed publicly when he and Kohl subsequently met in Paris on 24 April that they had agreed that the 'new monetary institution' would be set up in January 1994. He and Kohl also confirmed they had agreed on a calendar for the negotiations, which should be brought to a successful close at the end of the year. Once again, the Germans had succeeded in shaping the content of the future monetary union deal, while the French focussed on the timetable.

Stage three: Who should join a single currency and who decides?

France's ability to secure a swift deal on an early move to a single currency appeared at first to hinge on accepting that only a limited number of countries should participate, at least in the first wave. The view of Bundesbank President Pöhl, shared by German Finance Minister Waigel, was that, if EMU had to happen, better that it should happen quickly with a limited number of countries already politically and economically close to Germany, so as to ensure a strong, stable currency. Better too that the decision on who could join should be based on a set of objective convergence criteria, rather than being agreed by Ministers, since this would circumvent political pressure from those who were not yet ready. In 1991, this implied a relatively limited number of initial participants: France, Germany, Benelux countries and perhaps Denmark and Ireland but certainly not Portugal or Greece and probably not Spain or Italy, whose economies were still far from convergent.

A rapid but limited EMU, with others able to join automatically when they met the criteria, also had the advantage for Germany of disciplining countries to put their own house in order, thus avoiding collective efforts having to be made to promote economic convergence between European economies, a process which they saw as carrying a number of risks. First, France would be able to use such efforts to justify the creation of a European 'economic government' to co-ordinate policies and thus to set political objectives for growth and employment, cutting across the Bundesbank's mandate to control inflation. Second, close scrutiny of Member States' economic policies would draw unwelcome attention to, and calls to curb, the rapidly spiralling costs of German reunification. Third, poorer southern Member States would step up pressure for additional funding from the European Community budget to help their

convergence, and this Germany was determined to resist, not least to avoid further adding to its costs.

French views on going ahead rapidly with a small group were, however, divided: Bérégovoy was utterly opposed, not only because it would undermine his plans for stage two, but also because EMU would effectively then be little more than the current deutschmark zone, and would tie France into a German-dominated northern European economy, while its major trading partners across the Channel and in southern Europe were able to compete by devaluing their currencies. In the Foreign Ministry, the federalist-minded European Affairs Minister Elisabeth Guigou could see some advantage in joining a smaller yet more politically integrated European monetary area if it secured a swift deal as the President wanted; while in Mitterrand's office, the influential Hubert Védrine, at this time Presidential Spokesman but soon to be promoted Secretary-General of the Presidency and thus responsible for external relations, saw such a move as undermining French sovereignty by reducing France's ability to counterbalance German power in Europe.

For Mitterrand, the key objective was to contain German economic power. He saw the force of Védrine's argument that a single currency limited to Germany's northern European allies would dangerously limit France's clout. Italy in particular had always been a close European ally of France. Moreover, he realised that Kohl himself was unhappy at leaving out Italy, a founder member of the European Community. At the Franco-German bilateral summit in Lille on 29–30 May, Mitterrand and Kohl reached a broad understanding that in principle all twelve countries should be able to proceed to the single currency according to the Delors Plan timetable, and that Bundesbank President Pöhl's ideas on creating a smaller group were unacceptable.

The only complication lay with the UK whose economy could soon be convergent enough to join a single currency but whose Prime Minister opposed a Treaty-based political process to create it, arguing that a European currency would only be economically viable, as well as politically acceptable in the UK, if it was allowed to emerge naturally over time from the pressure of market forces.

From a French perspective, while it would be preferable to have the UK in EMU, allowing such an open-ended currency experiment to run would create political and financial uncertainty and would waste a historic window of opportunity to secure a deal with Kohl. Once Mitterrand had decided that speed was of the essence and that the 'hard ECU' would not run, it became clear that a way had to be found of dealing with British objections to a single currency, one which also avoided allowing them

to veto a Treaty, yet kept open their option of membership. Mitterrand and Kohl agreed in Lille jointly to support the principles that, first, no Member State should be forced against its will to join the single currency, second, that no Member State should be allowed to veto a move to adopt it by others, and third, that no Member State would be 'locked out' from joining once it met the economic and institutional membership criteria. These ideas became known to EMU negotiators as the three golden rules: 'no imposition, no veto, no lock-out'.

The parallel intergovernmental conferences: mid-year stock-take

By early June 1991, there was a general mood of optimism among negotiators in the IGCs that, under the Luxembourg Presidency, they had managed to overcome some of the biggest obstacles to a deal. In the Intergovernmental Conference on Political Union, despite the stand-off between France and Germany, whereby France was reluctant to grant new powers to the European Parliament (EP) and Germany was reluctant to recognise the European Council as having overarching responsibility for policy decisions, some progress had been made. France was beginning to accept a shared role between the EP and the Council on legislative decisions in some policy areas. Kohl in return, while insisting that he could not put a Treaty on European Union to the German Parliament which did not balance progress on EMU with progress on political union, was signalling that the direction of travel was more important than achieving everything at once. The French remained hopeful of achieving a Treaty that preserved their intergovernmental 'temple' structure.

On EMU, the mood was even more positive. An FCO brief for the Foreign Secretary, dated 12 June,[9] on progress in the EMU IGC stressed the delight among negotiators that a Treaty acceptable to all twelve Member States now looked achievable by the December European Council in Maastricht. It flagged up key areas of agreement:

- stage two was to begin on 1 January 1994 with the setting up of what the Dutch had proposed should be called the 'European Monetary Institute'. This would not be the bank that the French and Italians had wanted, so there would be no encroachment on national monetary policy. In stage three, the ECB would be independent, which the UK now agreed best served the key objective of price stability. The Treasury were still persisting on the 'hard ECU' (but according to the brief, 'without much conviction');

- on the transition to stage three, broad consensus was that the timetable set out in the October Rome Council Conclusions should only be indicative and should be linked to, but not fully dependent on, a specific set of convergence criteria;
- there was wide acceptance that participation in stage three would be subject to the 'no veto, no imposition, no lock-out' principle. The Dutch had already proposed to meet UK concerns on 'no imposition' with a Treaty clause of general applicability to come into effect once a date had been set for the move to the final stage, although the UK would still like to strengthen this further.

When Kohl came to lunch with the British Prime Minister at Chequers on 9 June[10], he told Major that he was feeling more motivated than he had for many years, as events were now moving in the European Community. He had decided to stand again for election as Chancellor in 1994. He said he understood the anxieties felt by Germany's neighbours about its economic power, which was why Germany should be fully integrated into Europe. He explained that he wanted new powers for the EP, but hinted that at Maastricht he would settle for a modest move, since 'direction was more important than speed'. Both leaders agreed to work towards a positive outcome to the two IGCs in December and that the June Luxembourg Council should not take any premature decisions on EMU, but merely take stock of progress.

Major's concern was to persuade Kohl that real economic convergence should, as Germany had always earlier argued, take priority over the political timetable, despite French pressure to fix dates. The two leaders agreed to do more work bilaterally on how economic convergence could be translated into specific criteria. On the UK's concern to make its own separate decision on joining the single currency, Kohl stressed that, provided that the UK genuinely needed more time to decide for itself and would not act as a brake on others, Germany would help find a way of accommodating it.

Unfortunately, initial optimism that a mutually acceptable Treaty opt-out for the UK could easily be found proved short lived. Although political leaders in early June had not yet realised this, the seeds of discord had already been sown between Finance Ministers at an informal ECOFIN meeting on 11 May. At the end of a routine discussion on convergence arrangements, Bérégovoy suddenly floated the idea of accommodating the UK's need for a separate decision on joining through particular language in the Treaty, in exchange for language to

the effect that no country could prevent others from going ahead. His Dutch colleague Wim Kok promptly insisted that language giving the right to decide if and when to join stage three should be available for all, not just for the UK. Commission President Delors then tried to claw back the idea of a Treaty clause applying to any Member State, arguing instead for a unilateral political 'declaration' by the UK. This private, informal debate would have remained within Finance Ministries had not Delors' views on the need for a unilateral UK declaration leaked some weeks later, causing speculation in the UK press and putting pressure on the UK government to clarify its position ahead of the 28–29 June Luxembourg European Council.

In a speech in Swansea on 14 June, Prime Minister Major gave a public undertaking that, before signing a Treaty on EMU, he would insist upon a clear provision allowing the British Parliament to take a further and separate decision on whether or not the UK would join a single currency. He followed up by pressing European partners that this provision should take the form, not of a unilateral political declaration, but of a Treaty clause applicable to all countries.

As Delors no doubt realised when he had tried to reformulate Bérégovoy's proposal on 11 May, a generalised Treaty clause created the risk that other Member States would follow the UK in demanding a further national decision. Above all, it could allow those in Germany who opposed giving up the deutschmark to insist that the German Parliament, the Bundestag, should have a right to say 'no' just before the third stage in 1997 or 1999. Moreover, as the German Chancellor's office pointed out[11] to the British Ambassador on 18 June, a 'no imposition' clause would almost certainly need to be balanced by a clause preventing countries which were unready or unwilling to join from vetoing the process for others, whereas the existing draft spoke of moving to stage three by consensus. Yet, the German Parliament might well refuse to ratify a Treaty which, technically, allowed Germany to be voted into a single currency against its will.

In short, accepting the UK demand for a generalised opt-out clause would undermine the overriding political aim of both Kohl and Mitterrand to make the move to a single currency irreversible during their time in office and thus irrevocably to bind Germany into the European Union. This was an issue that would bedevil the high-level discussions on EMU in the coming months. It was made worse, from a French perspective, by the fact that the incoming Netherlands Presidency supported a generalised opt-out clause and had tabled a draft text.

The last six months of negotiations: France versus the Netherlands Presidency

The Dutch were concerned by France's approach to the IGC negotiations across a range of issues and had decided to use their June to December 1991 EC Presidency to table their own ambitious new proposals, initially as working papers to be considered over the Summer. They were unhappy with the very notion of moving away from a European 'Community' of pooled sovereignty towards a more intergovernmental 'Union' of States. Above all, the Netherlands objected[12] to France's proposed 'temple' structure for the Union, with the European Council overarching even existing Community policies. The Dutch saw it as a retrograde move, undermining the federalist vocation of Europe and giving the political leaders of the big countries decision-making power over issues on which, until now, small Member States had had an equal say. They feared it could lead to a Franco-German political directorate at the heart of Europe. Their response was to appeal to Germany for support in restoring a federalist structure to the Treaty, with EMU based on strict economic convergence criteria, more powers for the Commission and EP and national politicians kept at arms' length. They were encouraged and supported by Commission President Delors, whose federalist ambitions Mitterrand by now distrusted.

For French negotiators, Dutch federalist zeal could not have come at a worse time. Following German reunification and the economic downturn, the mood inside France throughout 1991 had become steadily more defensive and nationalistic. Mitterrand had sensed the change and resolved to get ahead of public opinion by demonstrating that France's leadership was taking decisive action. With unemployment rising and French industries warning of further job cuts ahead, Mitterrand had become impatient with the consensual, market-friendly approach of Michel Rocard's government. On 15 May 1991, he had surprised the French public by replacing the still-popular Rocard with France's first-ever woman Prime Minister, Edith Cresson, a political bruiser from the nationalist left of the party who believed in social and industrial modernisation through state-driven initiatives. Mitterrand had given her a mandate both to speed up the pace of domestic social, industrial and administrative reform and to prepare France for the 1993 Single Market by leading a high-profile drive for European strategic industrial policies.

By Autumn 1991, however, the new Prime Minister had made enough gaffes[13] to damage her political credibility and to unsettle the financial

markets. It was also an open secret that she and Bérégovoy, who had hoped Mitterrand would appoint him in her place but was still Finance Minister, were at loggerheads over how best to revive France's flagging economy. Mitterrand's popularity rating, which had reached 75 per cent during the Gulf War, had by now slid to around 30–40 per cent. France's Socialist leadership badly needed a diplomatic success in the Maastricht negotiations.

French concerns with the Dutch Presidency proposals on EMU went much wider than their formulation of the 'no imposition' clause to deal with the UK. Dutch federalism ran contrary to the French belief that, while an independent ECB should manage day-to-day monetary operations, nationally elected Ministers needed to be fully involved in politically important strategic decisions on the single currency. Despite persistent lobbying, Bérégovoy had made little headway with two key French draft Treaty proposals: first, that the Council of Economic and Finance Ministers (ECOFIN) should be responsible for determining broad guidelines for the future currency's external exchange rate policy; and second, that an 'economic pillar' should be set up alongside the monetary one to co-ordinate European economic policies and promote convergence. Instead, on economic convergence the Dutch had come up with a set of specific, objective criteria to determine who could move to stage three that were so strict as to exclude all but a small group of countries. They also proposed that these qualifying countries would then be able to make their own decision to move to the final stage. It was essentially Pöhl's idea of a small avant-garde, presented in a different guise.

Driving the Presidency's rigour was deep scepticism, especially in the Dutch Central Bank, about the capability of European governments to manage economic convergence through the kind of political process of 'economic government' by the Council of Ministers, that the French had been arguing for. In an International Conference on the issues and priorities for the Dutch Presidency, held on 21–22 March at the Dutch Ministry of Foreign Affairs, one of the Netherlands Bank's Executive Directors, Dr Szasz,[14] had pointed out that Finance Ministers in the Council shied away from political confrontation and were not well placed to hold colleagues to account over their commitments. He cited the example of Greece, which had been granted Community support in 1985, had failed to fulfil the policy conditions attached and was in 1991 again being bailed out. He argued that a combination of this episode and the effects on Germany's neighbours of the high interest rates introduced to cope with a budget deficit which had gone from zero to 5 per cent in under two years had now created a climate more

conducive to introducing strict convergence criteria, especially on the size of budget deficits. In conclusion, he had stressed that only those countries that complied with all conditions should participate in EMU's third stage.

For France, the Netherlands Presidency risked undoing much careful work undertaken by Luxembourg during its Presidency to achieve consensus on EMU, especially since the June Luxembourg Council had by general agreement taken no decisions, referring in its conclusions only to 'broad areas of agreement' which needed to be finalised at the next European Council in December. In a Note of 8 September[15] to French European Affairs Minister Guigou, one of her advisers warned that the strictness of Dutch conditions for moving to stage three risked undermining French negotiating gains under the Luxembourg Presidency and potentially resulting in as few as six countries joining the single currency. The Italians in particular were furious and had been lobbying France hard to fight the proposals and publicly to support Italian membership.

In the 9 September EMU IGC Ministerial meeting, the Dutch Presidency proposals on the move to stage three came under sustained attack, led by Italy and supported by France. Italy argued for a return to the Luxembourg text which provided for a Community decision by consensus, insisting it was unacceptable that a small sub-group of Member States should be able to decide to move to a single currency. Bérégovoy agreed that a single system was preferable to allowing a small group to move forward and argued that there could be derogations for those unready or unwilling to join. It should be for the European Council to decide by consensus on the timing of the move. Only the UK and German Finance Ministers broadly supported the Dutch approach, with the UK adamant that Bérégovoy's proposal for derogations was unacceptable.

Soon the Dutch Presidency had lost the support even of their traditional German allies. In a meeting of Foreign Ministers on 30 September to discuss the Netherlands proposals for a Community-based structure to the Treaty, the Presidency found itself effectively isolated, with only Belgium and the European Commission supporting its ideas, and had to admit defeat. From this point onwards, they loyally supported the majority view in favour of a 'Union' and the French 'Temple' structure became the broad consensus, with only Delors still objecting. By overplaying their hand, the Dutch had ironically helped France to rally German and wider support for their intergovernmental approach. In his history of the genesis of the European Union, the Dutch writer (and

speechwriter to the first permanent President of the European Council, Herman van Rompuy) Luuk van Middelaar attributes what he refers to as the 'Black Monday' of Dutch diplomacy to having underestimated how far the fall of the Berlin Wall had changed political attitudes: 'Initiating proposals relative to a Common Market was one thing; deciding on war and peace another altogether. A responsibility of that kind could not be left to civil servants in Brussels or Strasbourg, such was the view in European capitals'.[16]

A majority of capitals also supported France's view that decisions on state budgets, employment and debt could not be delegated either. In early October, in response to overwhelming criticism from other Member States, the Presidency produced a new proposal on the move to a single currency: a joint Commission and European Monetary Institute report would be produced by the end of 1996 on compliance with the convergence criteria, ECOFIN then deciding by qualified majority which Member States met the conditions and recommending its findings to the European Council for final decision. If conditions were not in place for a viable number of countries to go ahead, the process would be repeated two years later. As for the UK opt-out, having earlier wobbled and argued at the informal ECOFIN meeting in Apeldoorn on 20–21 September for a solution based only on derogations, on 3 October after intensive UK lobbying, the Dutch reinstated a generalised 'no imposition' clause.

Although the latest EMU proposals marked a significant concession to French demands for the European Council to take the final political decisions, it was still an open-ended process which, taken with the generalised 'no imposition' clause, fell well short of their – and Kohl's – requirement to bind Germany into an irreversible legal commitment. Once again, it became clear to the French negotiators that the only way out lay in a high-level political deal with Germany.

The last lap – making the EMU Treaty irreversible

France's need for an irreversible Treaty commitment: the monetary and political drivers

If the French needed a reminder of the crucial importance to their economy of securing a Treaty giving France an equal share in deciding on European economic and monetary policy, the Germans obligingly offered one through 1991 by their handling of the fallout from reunification. The integration of East and West Germany acted as an asymmetric shock to European economies as East Germans bought West German consumer goods, causing Germany's economy to boom, while

neighbouring economies were experiencing a downturn. At the same time, as integration costs escalated, Germany's budgetary deficit rose sharply above the 3 per cent level by now accepted as the appropriate ceiling for a country wishing to join the single currency. For political reasons, the German government was reluctant to cope by increasing taxation and instead the strain fell on monetary policy. Pöhl had resigned in June, many believed in protest at Kohl's forced handling of German monetary unification. His successor, Helmut Schlesinger, was even more relentless in raising German interest rates to counter inflation and to attract finance to cover borrowing costs, regardless of the impact on other European countries. After all, the Bundesbank's mandate only covered Germany.

France regarded this policy as effectively dumping Germany's reunification costs onto its European trading partners who were forced to maintain high interest rates to defend their currencies in the EMS even though their own economies were now facing recession. On 17 October, Bérégovoy had attempted[17] to give French industries some relief by (for the first time since the 1970s) cutting French short-term interest rates to below German levels. Only weeks later, after the US had again cut interest rates and money had rushed across the Atlantic to benefit from Germany's high rates, the franc – as so often before – found itself caught in the crossfire and sharply lost value, forcing Bérégovoy into a humiliating policy reversal. The only protection for the French from the unequal monetary battle lay in securing a pooled European currency under shared management, which at least gave them some say in setting policy.

Germany's high deficit was not only an economic threat to its neighbours, but also a potential threat to the political credibility of Germany going ahead with the European single currency. In a debate on EMU in the German Parliament on 18 September, France's Central Bank President Jacques de Larosière warned publicly that Germany's deficit constituted a risk not only for the country but for the whole of the European Community. This Parliamentary debate provided evidence too that Kohl's office had been right to be concerned that, if a generalised opt-out was written into the EMU Treaty as the UK wanted, there was a risk that a future German government and parliament might well want to opt-out too. The British Embassy in Bonn picked up confirmation of this possibility from both Bundesbank and German Finance Ministry sources,[18] and Elisabeth Guigou's office warned[19] that Germany, whose Parliamentary elections fell in 1998, might then judge it politically inopportune to 'sell its deutschmark for the ecu' and decide instead to make use of the opt-out clause.

It was critical that France should avoid these dangers by finding a way to make the EMU Treaty decisions irreversible.

Engaging German support

French EMU negotiators wrestled throughout Autumn 1991 with how to make the EMU Treaty binding on all future German governments. By the time of the 14–15 November Franco-German Summit, Elisabeth Guigou and her advisers were coming to the view that the only legal guarantee lay in writing a specific date for the start of the third stage of EMU into the Treaty. They concluded that the Dutch generalised 'no imposition' clause had to go, with the UK's need for a further decision being dealt with by a UK-specific opt-out. They now needed to persuade the President to secure a bilateral deal with Kohl on both these points.

The second point on the opt-out was more straightforward to negotiate, both with the President and with the Germans. Although the Bundesbank and the German Finance Ministry were attracted to a generalised Treaty clause, which could offer a way out of EMU should economic convergence prove unsatisfactory, Kohl had no wish to see his European policy scuppered by parliament and was just as concerned as Mitterrand to make his signature of the future Treaty binding upon future German governments. Already in mid-October, his office had warned UK negotiators that Germany could not accept a generalised opt-out, and by the end of October this was the agreed German position[20]. On 10 November, Kohl told Major[21] that he believed that a unique opportunity now existed to make progress both on German unity and on European unity. If it did not happen now, it would not for years to come. It was essential to fix the principles 'irreversibly'. Kohl warned that the kind of widely applicable opt-out Major was asking for would be very difficult, although if the UK needed more time to decide, he would be willing to help.

Soon afterwards, Kohl and Mitterrand, at their November bilateral summit, succeeded in reaching a broad understanding on EMU and on key aspects of European Political Union. On decision making under Political Union, Kohl, as he had earlier hinted to Major, would content himself at this IGC with modest progress rather than pressing significantly to strengthen the European Parliament's powers, while Mitterrand conceded that the EP should have co-decision with the Council in a number of policy areas. Germany accepted that the European Council should have an overarching role on policy decisions. On EMU, Kohl claimed in the joint summit press conference that there was now complete bilateral agreement. Certainly there was a clear Franco-German accord that the decision to move to a single currency should be made

irreversible, and that, rather than the Dutch generalised 'no imposition' clause, the UK should have an annexed declaration or protocol.

Some issues did, however, remain to be clarified. These included the key point for France of precisely how the final move to EMU could be made irreversible. The French Foreign Ministry concern was that the latest Dutch Treaty text proposed that a first report and decision on whether the move to the single currency should go ahead, and with whom, would be taken in 1996, but that if a 'critical mass' of at least seven countries did not qualify, then the decision would be put off for another two years, a process which, in the initial Dutch draft, could have repeated itself *ad infinitum* – a real risk, since in 1991 only France and Luxembourg actually met the qualifying convergence criteria. In early November, when one of Guigou's advisers, with Boissieu's support,[22] proposed negotiating a fixed date by which all qualifying countries would automatically adopt the single currency, the President's office expressed keen interest.

Bérégovoy, however, opposed the idea, arguing that it would be unlikely to be agreed, as a number of Member States would object. Italy and other southern Member States in particular were vehemently opposed to a smaller group automatically going forward without them. It was at Italian insistence that a minimum number of seven qualifying countries had been stipulated in the latest draft, the Dutch and Germans having earlier suggested six.

Italy's chances of qualifying any time soon looked remote. In 1991, Italy had inflation running at 6 per cent, a deficit of 9 per cent and a debt level of over 100 per cent. In October, the Finance Ministry had briefed Mitterrand to reassure Italian Prime Minister Andreotti that France opposed a two-speed Europe and would insist that the final decision on who would join the single currency should be taken at a political level in the European Council. The President had been briefed to point to French efforts to create a consensus that qualification to join should be based, not automatically on the convergence figures, but also on 'political' judgement of the effort made and the overall trend, and to press Italy to use the intervening period to get its economy on a virtuous path. Mitterrand, in return, was to seek Italian support for French proposals for an 'economic government' and for decisions on exchange rate issues to be taken by the Council of Ministers, two issues of keen concern to Bérégovoy. Now, by proposing an automatic rather than a political decision, France risked alienating Italy and other southern European allies.

The real question, though, was whether Kohl would agree to fixing an automatic date. The Bundesbank and German Finance Ministry,

supported by the Dutch and British, were adamant that the move to a single currency should strictly be based on objective economic criteria to ensure the credibility of the new currency. Would Kohl be willing to overrule them, given the risk that, without their endorsement, Germany's Parliament and Constitutional Court might oppose ratifying the Treaty?

In the end, it was a political judgement and one that only the President could make.

Mitterrand's negotiating priorities for the Maastricht Summit, 9–10 December 1991

On 27 November, ahead of their final meeting with President Mitterrand before the Maastricht Summit, French Ministers[23] listed three remaining key negotiating points to resolve on EMU:

> First, although agreement existed between France and Germany on the second stage of the Delors process and the role of the European Monetary Institute, one outstanding difference remained over the management of exchange rate policy, which Germany argued should remain in national hands during stage two.
>
> Second, question marks remained over the complex process for moving to stage three. There was, however, agreement between France and Germany to rule out a generalised exemption clause for the UK, also that the Dutch proposal of a necessary 'critical mass' of countries needing to qualify before the move to stage three unhelpfully revived the threat of a two-speed Europe.
>
> Finally, on the balance of powers between the institutions, France, backed by the German Finance Ministry, supported a proposal that the right to make policy proposals should not be the exclusive right of the European Commission but should be shared with the Council of Ministers.

For France's Foreign Ministry negotiators and for European Affairs Minister Guigou only the second point mattered, and the only question the President needed to decide was whether or not to press for a fixed date. As Foreign Minister Dumas' technical adviser put it bluntly in his Ministerial brief[24]: 'it is essential to prevent M. Bérégovoy from diverting attention onto peripheral issues and to make him speak about the key point: the move to stage three'. Bérégovoy, perhaps suspecting the Foreign Ministry would try to clip his wings, lobbied the President ahead of the meeting in two long personal notes covering all three EMU points. Mitterrand simply marked them, unread, 'For Maastricht'.

The 27 November French Cabinet meeting[25] with the President was attended not only by the relevant Ministers and by Hubert Védrine and Caroline de Margerie from the President's office but also, as a special honour, by Foreign Ministry official IGC negotiator Pierre de Boissieu. Védrine had recommended that the President meet Boissieu and his Finance Ministry colleague Jean-Claude Trichet, since both 'for years have played a key role in the European negotiations' and were 'of exceptional quality' (Trichet, in Japan on business, was unable to attend).

Invited by the President to speak first, Elisabeth Guigou stressed that the only issue on EMU still to be settled was the move to the final stage. She explained the possible procedural alternatives to a generalised opt-out clause for the UK and also how, to prevent a veto by any country, a decision to move to stage three by qualifying countries could either be taken by consensus, with a provision to revert to a qualified majority vote if consensus could not be reached, or else a decision could be taken only by the countries who qualified. She concluded, however, that the only safe way to be certain that a commitment to move to stage three was irreversible would be to include a fixed date in the Treaty. Bérégovoy immediately intervened against Guigou's proposal of a fixed date, arguing that a number of countries would object.

Overruling Bérégovoy's objections once again, the President gave his approval to negotiating a fixed date. He commented that, on many areas in the two IGCs such as social policy, industrial policy, powers for the EP, and qualified majority voting on foreign and security policy, France could not, if it was to meet its objectives, avoid a ' trial of strength' with the UK at Maastricht.

In the last days before the Maastricht Summit, Mitterrand had meetings with leaders of the main French political parties, as well as with major European leaders. In parallel, French negotiators used the final ECOFIN and EMU IGC Ministerial meetings in early December to try to clear the deck of all remaining issues to allow the President to concentrate at Maastricht on securing a fixed date for the single currency.

On 1 December, French and German Finance Ministers achieved majority support in ECOFIN for a UK-specific opt-out to replace the Dutch generalised 'no imposition' clause. When Mitterrand met the UK Prime Minister in London the next day, Major was appalled at the turn of events, stressing[26] that a UK-specific opt-out would significantly reduce the chances of sterling entering the single currency, since the UK would by stage three have been singled out for so long. Without one of Europe's three big currencies, the single currency would not be successful; there was, moreover, the risk of turbulence in the European

Exchange Rate Mechanism if one of its currencies was treated differently. Mitterrand retorted that a generalised opt-out clause would have risked reopening Treaty decisions. There came a time when one had to draw the line. There might be some small room for manoeuvre left on the final date of the move to a single currency, but the UK could not be allowed to put the whole enterprise in peril. Major pointed out that removing a generalised opt-out clause would not prevent a Member State from taking a political decision in future not to participate. Mitterrand conceded this was true but argued it only convinced him he was right not to trust the decision to the discretion of others.

Privately, Mitterrand had already concluded that only a fixed date in the Treaty would remove the political risk of a German change of heart.

At the final EMU IGC Ministerial meeting on 3 December, all outstanding issues were resolved, except for certain aspects of the move to stage three that Finance Ministers needed to resolve in the margins of the Maastricht European Council itself. The Germans in principle supported a new French proposal that, if a second decision had to be taken in 1998 on the move to stage three, it should no longer be by consensus but by simple majority, although they sought more guarantees that only countries meeting the convergence criteria would be allowed to go ahead. This was less watertight than a fixed date but still an encouraging sign that Germany might in the end be willing to make the decision in 1998 automatic rather than discretionary, provided those joining met the agreed criteria.

On France's other outstanding issues, Bérégovoy failed in his efforts to persuade the Germans to give the European Monetary Institute the power and the financial means to intervene to manage external exchange rates in stage two while still under national political control. In stage three, Germany had wanted to remove external exchange rate policy totally from political control and give it to the independent ECB, whereas for France exchange rate policy was, as Bérégovoy had argued to Mitterrand in his personal notes, 'an integral part of the external action of States'[27]. In the end, it was agreed that, although day-to-day exchange operations would be managed by the ECB, overall exchange rate policy should remain with the Council, under national control. The French also made a modest advance on their third key point on institutional balance. Having pressed in vain for the European Commission to be made to share its power of policy initiative with governments, Bérégovoy managed in the closing moments of the meeting to secure agreement on a new Treaty article whereby Member

States could request the Commission to make a policy recommendation; the Commission would then consider it and give its opinion to the Council of Ministers.

This article was as close as Bérégovoy would get to his cherished vision of a European 'economic government' to take the difficult economic and budgetary decisions he foresaw would be needed to underpin the new currency. The French Foreign Ministry saw Bérégovoy's vision as simply the Finance Minister trying to enhance his own power. Bérégovoy himself saw it as a crucial aspect of democratic accountability, which for him had to lie with nationally elected Ministers, as he had tried to convince Mitterrand:

> 'the creation…of a monetary 'federation' with a single currency and single monetary policy will be an event of immense significance. How can we but conclude that the Member States will end up sharing not only monetary but also economic policies? A major shift in the political debate inside the States making up Europe is thus foreseeable. And we shall then be in the curious position – despite not having formed a federal government – of finding that most of the debate on our own economic policy is taking place in Brussels.' In Bérégovoy's view this situation was not politically tenable over the long term. Meanwhile, 'it is imperative that governments…the only democratic bodies…should exercise their responsibilities in the Council.'[28]

Yet, Mitterrand knew that, in Germany's eyes, giving new economic policy powers to Finance Ministers risked undermining the independent ECB's ability to make the new currency as credible and stable as the deutschmark, for nationally – elected Ministers would have other political priorities such as jobs and growth. Before he could irrevocably sign up to the single currency, Kohl needed to be able to reassure his electorate that the new currency would be just as well-managed as the deutschmark. Mitterrand's sole negotiating objective was to make Kohl's signature irrevocable.

Mitterrand in Maastricht, 8–10 December

The President's Brief

The French Maastricht Summit brief[29] began with the triumphant declaration: 'the draft Treaty submitted (to Heads) suits France in its current state. Of the twelve Member States only France could sign the text exactly as it is'.

The chief threat at the summit, the President's advisers warned, came from the Treaty's opponents, above all the UK but also Spain, whose opposition was regarded as essentially tactical, to extract more financial support. Others to watch out for were Delors, who strongly opposed the structure of the Treaty on Political Union, the Netherlands Presidency, which might yet try to reintroduce a generalised opt-out clause on EMU, and Finance Ministers who were trying to ensure that the European Council was prevented from taking any decisions with financial consequences which had not first been approved by Finance Ministers!

Mitterrand's brief on EMU did, however, identify one fly in the ointment. The current Treaty wording on the move to stage three was an uneasy compromise between France's desire for a rapid move to full EMU and the southern Member States' fear of being left behind and hence insistence on as large a minimum number of participants as possible. It provided that if seven states by 1996 met the criteria and wanted to go ahead no other state could object; but if this condition was not met in 1996, the decision was put back to 1998, when there would be no conditions about a minimum number. The decision would be taken by the 'Heads of State and Government meeting in Council' by unanimity in 1996 but by simple majority in 1998. The formula of having Heads meet in Council was clumsy and risked weakening both the Council and the European Council. It implied moreover that, for the first time, Heads could meet in a formation under control of the European Court of Justice and that one of them could be defeated on an important question. France should insist that the decision was taken by the European Council.

These institutional complications were yet another reason, if Mitterrand needed one, to ensure that the final move to the single currency should happen automatically by a fixed date. The question was how, since the German Bundesbank and Finance Minister were insisting to Kohl that the final move should depend on assessment of progress against the convergence criteria and opposed setting a fixed date.

A deal with Andreotti

Soon after arriving in Maastricht on 8 December, Mitterrand dined alone with Italian PM Andreotti. His European Affairs adviser's record[30] of the discussion is sketchy but indicates that Andreotti took the initiative of offering to support Mitterrand if he were to propose in the next morning's plenary session on EMU a fixed date for the move to the final stage. On the face of it, this was a surprising offer since Italy's budgetary situation made its qualification for the single currency any time soon

appear unlikely. Andreotti is, however, recorded as telling Mitterrand that he had decided to demand more direct oversight of Italy's national budgetary policies. Clearly, he believed that, one way or another, Italy would be able to join the single currency by 1 January 1999, the date the two leaders agreed to put forward next day.

At 10 a.m. the following morning, as EMU talks were about to begin, Elisabeth Guigou passed Mitterrand a handwritten note[31] warning him that the previous evening Finance Ministers had discussed the decision-making procedure for moving to the single currency in stage three but continued to be at odds over how the European Council would take the final decision. She recommended that Mitterrand propose fixing a date for the move to a single currency: 'as you proposed to M. Andreotti', adding that: 'M. Kohl will need to agree (it would perhaps be useful if you could forewarn him of this). In this eventuality, the whole subtle construct devised by Finance Ministers becomes otiose. It is enough to write in the Treaty: "Stage three begins on 1 January 1998".' Guigou warned of the risk that Andreotti would propose putting the date in a political statement, which would have 'no value and no interest'. The passage in brackets about warning Kohl is sidelined by hand in Mitterrand's brief, and indeed he and Andreotti did tip Kohl off just in advance of the morning session.

When the EMU session[32] opened, Kohl spoke first after the Presidency's introduction of the latest text on the move to stage three. He stressed that the decision on stage three should be irreversible. He did not want to discriminate between first and second class countries but convergence was fundamental, since if the convergence criteria were diluted the process would not be credible. The balanced approach agreed by Finance Ministers should not be altered. He was ready to move to the final stage in 1996 or 1997 if a critical mass of Member States fulfilled the convergence criteria. However, in 1998, the critical mass should not apply, only the convergence criteria.

Major dismissed the latest text as a backward step. It was essential to have a 'no imposition' clause allowing each Member State to decide whether or not to participate. As for the transition to stage three, convergence was the crucial issue. The decision should be taken by all, or there would be a risk of a two-speed Europe.

Others could support the Presidency text, although Belgium was worried that going ahead without fiscal harmonisation would lead countries to compete to reduce taxes and thus erode state budget receipts, while Spain, Portugal and Greece wanted more Community financial support to help their convergence.

Mitterrand said that the Community needed to take an irreversible decision on a single currency. The convergence criteria had to be met. A date should be fixed for the start of stage three, probably the beginning of 1999. Any opt-out should not take the form of a general 'no coercion' clause. Andreotti said Italy could also agree to a compulsory transition to stage three at a fixed date.

The Presidency concluded that there was a divergence about whether to take an irrevocable decision on stage three. Finance Ministers should discuss this and also whether or not there should be a 'no coercion' clause.

Early on 10 December, a delighted Guigou reported back in a handwritten note[33] to Mitterrand that: 'following your intervention, the date of 1 January 1999 is fixed as the date of transition to the third stage. It is an irrevocable target, written into the Treaty.'

She went on to explain that stage three could still happen earlier, in 1996, if the European Council so decided. There would need to be seven countries that met the criteria, decided by qualified majority. If there were not, then the single currency would go ahead anyway on 1 January 1999 with however many countries were ready. This had all been in a new Presidency draft produced after the previous day's discussion, was now agreed by Finance Ministers, and would be put to the European Council later that day for approval.

In the final EMU session, the new Protocol on the move to stage three was agreed. The UK circulated amendments to another Protocol on its opt-out, which was then also agreed. The EMU Treaty text was complete.

5
The EMU Deal: French Ambition; German Design?

The Treaty on European Union, or ‘Maastricht Treaty’, was signed by all twelve European Member States in a special ceremony in the Dutch border town of Maastricht on 7 February 1992. In the light of currently available archive material, this chapter assesses how far France had achieved its negotiating objectives on EMU by the time of the signature of the Maastricht Treaty. How satisfied were French negotiators at the time over the outcome? With the benefit of hindsight, what questions do those contemporary judgements now raise? What compromises had France made along the way to Germany and to others? Can one argue that significant flaws in the design of European Economic and Monetary Union were plastered over in Mitterrand’s anxiety to secure a deal with Kohl?

Contemporary assessments

In December 1991, both Kohl and Mitterrand publicly presented agreement on the Treaty as a historic success. While both leaders admitted that more might have been achieved on European Political Union, both also pointed out that European construction was a work in progress and were confident that deeper political integration would be possible in future. Kohl told the German Parliament[1] that there would be no going back: a process was now in place which would so bind together Europeans as to make disintegration or a resurgence of the old nationalist mindset impossible. German unity and European Union were now ‘two sides of the same coin’. The outcome on EMU, he insisted, reflected German positions on all important points, especially the agreement on specific economic convergence criteria. The European Central Bank

would be modelled on the Bundesbank, giving priority to price stability and would be fully independent.

In his press conference immediately following the conclusion of the Maastricht negotiations, Mitterrand hailed agreement on an irreversible process towards a European single currency by a fixed date as 'a real success'[2] for France. Next day, after the French Cabinet had met to assess the Summit outcome, the President's statement[3] to the French public was even more triumphant:

> 'France clearly met her objectives, which were: as swift a move as possible to a single currency, an 'economic government' in parallel with the monetary authority, a strong stage two to ensure economic convergence.
>
> The agreement reflects these elements. It is a great success for France and for Europe. Our country was able to ensure that our key positions prevailed in the negotiation, because our policies now afford us real credibility in Europe.
>
> The single currency will be a great step forward in the construction of a European Community, a pillar of stability and peace. It will also be an important factor for economic growth, by helping individual and business effort and by improving economic policy-making. Europe will be able to become the foremost global economic and monetary power.'

Interviewed on French television[4] on 15 December, Mitterrand called the deal on Maastricht 'one of the most important events of the last half-century, which prepares the way for the next century', adding: 'Our 20th century has seen the collapse of all the Empires – Turkish, Austro-Hungarian, Soviet Russian, two German Reichs, the colonial Empires – and now it witnesses the birth of a Community of 350 million people'.

Privately, Mitterrand's office[5] had stressed to the UK Ambassador in Paris, just before the President's 2 December meeting with Major, that a deal on EMU would be the overriding French priority at Maastricht, more important than their objectives on European defence or on social policy. Immediately after the Summit, a member of the French Foreign Ministry negotiating team judged[6] that the key success for France from the Treaty negotiations had been agreement on a fixed date for the move to a single currency, even though this was a later date than the French had initially hoped for.

With the benefit of hindsight

French achievements

Securing Kohl's irrevocable legal commitment to replacing the deutschmark with a European single currency by, at latest, 1 January 1999 was undoubtedly a remarkable diplomatic achievement. It would prove crucial in keeping the EMU process on track through the political and economic shockwaves from German reunification affecting European countries during the 1990s. The tactic of securing a fixed date, already foreseen by Boissieu in late 1990, had been finalised by Elisabeth Guigou and her advisers just ahead of Maastricht, and Guigou gave Mitterrand effective and well-timed advice throughout the negotiations. It is clear from French archives that Guigou briefed Mitterrand to raise the idea with Andreotti on the eve of the Summit, even though the short note recording[7] their meeting implies that Andreotti took the initiative of suggesting a Franco-Italian proposal in the next day's plenary session. It was a bold tactic designed to force Kohl's hand and to outflank the German Finance Ministry and Bundesbank, both of whom were adamant that Germany should only accept the single currency once European economies had met all the specific convergence criteria. France and Italy by contrast had a shared interest in ensuring that, ultimately, the move to full EMU was not held hostage to objective convergence criteria but rather decided politically.

The French tactic was, on the face of it, high risk. The proposal of a fixed date constituted, according to John Major[8] in his account of Maastricht, 'an exocet' which took the German Finance Minister totally by surprise. Kohl, though, tipped off by Mitterrand and Andreotti just in advance, could in principle have resented the bounce and blocked it.

In practice, it was a shrewdly calculated move based on Mitterrand's understanding of Kohl's motivation and political priorities, the culmination of almost a decade of bilateral discussions between them on the future shape of Europe which had begun with Kohl's first visit to Paris, as newly elected Chancellor, in October 1982. Mitterrand had from this first meeting been impressed by Kohl's profound commitment to peace and reconciliation in Europe, and by his prediction that he would be 'the last pro-European German Chancellor'.[9] He had immediately appreciated that here was a German leader with whom he could work to make historic changes in Europe.

Yet, important as the Kohl-Mitterrand relationship was in keeping the EMU project on track, Kohl's decision to commit irrevocably to EMU did not come about essentially because of Mitterrand's tactical skills or

because of the two men's personal rapport, but rather because both leaders recognised an unprecedented – and probably unrepeatable – coincidence in their diplomatic objectives and in their respective countries' political and economic interests. Each leader had his own reasons for wanting to see a reunified Germany fully integrated into a strengthened European Union. Both men saw in the creation of a single European currency the potential irreversibly to integrate European monetary, economic and political interests, such as to make unthinkable the extreme nationalism which so often before had led their countries to war.[10]

Mitterrand and Kohl also shared a sense of urgency: once the Soviet Union broke up, new counties would seek to join the European Union who, they feared, would not share their motivation to work together but would instead focus on asserting their newly rediscovered national identity. It was, they believed, essential to deepen European integration before opening the EU to new members. In Mitterrand's case, this apprehension was compounded by concern that France's influence in Europe would diminish as Germany's economic strength grew and the EU enlarged to include countries politically closer to Germany.

Looking beyond Europe, both Mitterrand and Kohl saw in EMU a means of creating, through economic and social integration, an alternative global political model, not only to Communism but also to the 'ultra-liberal' principles adopted in the 1980s by Reagan and Thatcher. The French had been trying in vain ever since the demise of Bretton Woods to persuade the Americans to return to a collectively managed global monetary order. In his first term, Mitterrand had devoted a succession of G7 Summits to this effort. The Germans too, for all their promotion of trade liberalisation and competition, were unhappy with the absence of global rules and the rise of speculative finance. When Kohl met Major on 10 November 1991,[11] he told the UK Prime Minister that Europe had to find its place in the world. In Kohl's view, US President Bush was paying the price of Reagan's 'Friedmanite'[12] policies, and 'Friedman had nothing to do with human beings'. Kohl drew a comparison with Ludwig Erhard, the founder of Germany's economic success, who he argued, although an advocate of market economics, 'would not have recognised Friedman as a fellow-thinker'. Erhard, Kohl insisted, had been aiming for a 'social market' and 'businesses needed a social conscience'. Kohl argued passionately that Europe now had a unique opportunity to make progress through EMU. If it did not happen now, the chance would not occur again for many years since, once East-West confrontation ended, nationalism would again become an important force. The principles of European unity needed to be fixed 'irreversibly'.

So, when faced with the choice of whether or not to support a fixed date for moving to a single currency, Kohl chose according to his deeply held political convictions. French diplomatic skill at Maastricht lay in placing him in a position where he had to make that historic choice explicit.

Although the launch of the single currency was still some years off, France had now secured European legal commitments to its key objectives on EMU. These were, firstly, that Germany would extend the stability and credibility of its currency to shield the whole European single currency area from speculative pressure. Even before the final stage of EMU, France expected that the Franco-German bilateral commitment to EMU, now enshrined within the Treaty, would send a political signal to the financial markets that Germany would support the French franc at its January 1987 Exchange Rate Mechanism (ERM) parity with the deutschmark, thereby giving France reliable access to international finance at much lower interest rates. Secondly, France would share in deciding monetary policy for the single currency: the new Treaty gave each participating country's Central Bank a seat and a vote on the Governing Council of the independent European Central Bank. Thirdly, and since Germany's reunification perhaps most importantly of all, Germany would in future be bound politically and economically into a stable and strengthened European Union where its growing power could help make Europe a global force to be reckoned with.

Finally, France was successful in imposing on the Treaty on European Union the overall 'temple' structure that it had sought from the outset. The European Council, which began in 1974 as an informal forum of Heads of State and Government, was now for the first time formally recognised in a Treaty as having the power to define strategic policy guidelines,[13] including on EMU.

French concessions

In exchange, France had made concessions in three broad negotiating areas to Germany. First, on monetary union, the French had accepted the design of the single currency and of the European Central Bank put forward by Genscher and by the Bundesbank. Mitterrand realised that, politically, Kohl could not make a deal on any other basis: the German people had to be reassured that the new currency would be as stable and as well managed as the deutschmark. This meant that the ECB's independence had to be respected, not only permanently from the final launch of the single currency, but also during the preparatory stages. Ministers would not be allowed, as French negotiators had first

hoped, to become involved in the management of monetary policy in the second stage, since the Bundesbank believed this could circumscribe the eventual decision-making authority of the new institution. No trace was left in the final Treaty of the provisions in the draft French Treaty text giving the Council of Economic and Finance Ministers (ECOFIN) a measure of influence over the European System of Central Banks, such as the power to delay its decisions for up to 15 days, or to amend its statutes. Thus, the French drew a line under a long domestic tradition of political involvement in the management of monetary policy.

Although full Central Bank independence was a concession, it was also in some respects a welcome constraint since it helped French Ministers to justify some tough decisions to reform France's economy: no longer could they be put under political pressure to use monetary policy measures as the easy way out. At the same time, it gave proof to financial markets that the pegged franc and later the single currency would be free from day-to-day political manipulation. The full independence of the ECB and the involvement of European central bankers in its design and in the management of its operations were to be crucial factors in establishing the credibility and stability of the new currency.

The second French concession was over the design of economic union. It was largely to preserve the credibility and effectiveness of the ECB's mandate to maintain price stability that the Germans resisted French negotiating attempts to draw up detailed provisions for European Economic Union in parallel to those for European Monetary Union. For France, and above all for Finance Minister Bérégovoy, an independent European Central Bank needed to be complemented by a European 'economic government'. Elisabeth Guigou defined[14] this term during the Maastricht negotiations as meaning that, while the ECB as monetary authority should be independent within its sphere, there should also be an economic authority which, given its democratic legitimacy, should ultimately be rooted in the European Council. The French envisaged that the European Council would meet occasionally to take the big economic decisions, for example, at what point sufficient convergence had been achieved between countries' economies to enable monetary union to go ahead. ECOFIN, meanwhile, would be more frequently engaged in co-ordinating day-to-day European economic, financial and fiscal policies. This economic authority was necessary, Guigou argued, not least to respond to the expectations of national parliaments and electorates.

For Germany, however, the key objective of a single currency was to maintain price stability, which had to be the sole mandate of the independent European Central Bank. Economic policy only needed to be

co-ordinated inasmuch as it would enable the pooling of sovereignty needed to set up the single currency and then to support its stability, for example, by preventing governments from running up an excessive budget deficit or taking on unsustainable levels of debt. Such co-ordination should ideally take the form of agreeing to follow objective rules or 'criteria', to ensure fairness and rigour but also to place responsibility for all measures and costs needed to meet those criteria upon the Member States themselves.

The French approach, aimed at balancing economic and monetary objectives and providing for Finance Ministers to take collective political decisions on economic policy, from Germany's perspective risked leading to political interference in decisions and pressure from the weaker Member States for financial support. It could, moreover, cut across the future European Central Bank's mandate to fight inflation. In an economic crisis affecting European countries differently should one, for example, raise interest rates to combat inflation or lower them to stimulate growth and employment? Clearly situations would arise in which European central bankers would want the first option and politicians facing an election, the second. Tension between the two would cause confusion and uncertainty, unsettling the markets and potentially damaging currency stability to the anger of German public opinion. Moreover, if collective decisions were to be taken about politically sensitive matters like budgetary policy then, for Germany, the European Parliament needed to be involved in the decision, to give it European democratic legitimacy.

From Mitterrand's perspective, however, public opinion in France, with its long tradition of strong national leadership, was unlikely to accept that decisions affecting growth and jobs should be taken by a European Parliament whose representatives, despite sitting in Strasbourg, carried almost no political clout in France. France feared too[15] that a reunified Germany would come to dominate the European Parliament and thus, ultimately, to dominate what had long been a Franco-German bilateral relationship of political equals in Europe. Germany had been pressing throughout the Maastricht negotiations for the number of EP seats allocated to each Member State to be amended to reflect population size, especially now that Germany had increased its own population through reunification, a decision which France refused to take at Maastricht.[16]

Thus, the tension between France and Germany over European economic policy-making reflected not only their differing concepts of where democratic accountability in Europe should lie but also, in the wake of German reunification, a bilateral power struggle as France tried

to hold onto the equal political relationship which had been at the heart of the Elysée Treaty since De Gaulle and Adenauer had signed it in 1963, ending centuries of rivalry. Unsurprisingly, given these high stakes, the issue of how political decisions on economic management of the euro should be taken was never resolved, despite intense private bilateral discussions in the run up to Maastricht.

Behind the Franco-German debate over the principles governing democratic accountability and Germany's concerns about the independence of the European Central Bank the French suspected another, less avowed, German motive for resisting European economic policy co-ordination. At the time of Maastricht, the Germans were conscious that their own economy was undergoing a particular economic shock because of reunification. They knew that this would take time to work through and were, the French believed, reluctant to agree to anything which would give the European Commission and their European partners a direct say in managing German economic policy decisions. For example, in 1991–92, the French were arguing that part of the spiralling cost of German reunification should be paid for through higher domestic taxes, rather than through high interest rates to attract external finance, since the latter forced French interest rates to follow suit and artificially depressed the French economy, then already entering a downturn. The French Finance Ministry saw German determination to retain a free hand in the management of their own economic difficulties as a major factor behind their reluctance to envisage a European economic government of the kind the French had proposed.[17]

The outcome of these complex Franco-German differences of outlook was that, ahead of Maastricht, Mitterrand came to a tacit understanding with Kohl to make a deal possible: Kohl would for now lower his ambitions on giving more powers to the European Parliament and Mitterrand would do likewise on giving nationally elected politicians in ECOFIN more powers to co-ordinate economic policy.

As a consequence, under Title VI of the Maastricht Treaty on European Union (TEU)[18] covering Economic and Monetary Policy, chapter one on economic policy was much sketchier and broad-brush than chapter two on monetary policy. It provided that Member States should regard their economic policies 'as a matter of common concern' and co-ordinate them within the Council, which could recommend to the European Council 'broad guidelines' for the economic policies of Member States based on monitoring of their economies and European Commission assessments (TEU, article 103). Other than, in extremis, the Council making the recommendations public, there were, however, no

sanctions should a Member State's economic policies risk jeopardising the proper functioning of economic and monetary union. Equally, it was made clear that the European Community, its Member States and its Institutions would not be liable for the financial commitments of any Member State or its public bodies (TEU, article 104, 104a, 104b – dubbed the 'no bail-out clause'). So, responsibility for economic policies essentially remained in national hands, leaving European Economic Union as work in progress.

The role of ECOFIN was left unclear in a number of areas. For example, in assessing when countries were ready to adopt the single currency, Ministers' powers were, at German insistence, circumscribed by the setting of specific qualification rules. Member States were to meet four fixed macroeconomic criteria:[19]

1. **price stability**: an inflation rate close to that of the three best-performing countries in terms of stability (inflation no higher than 1.5 percent above the best three EU countries);
2. **sustainable public finances**: a government deficit not exceeding 3 per cent of the country's GDP and a government debt level not exceeding 60 per cent of GDP;
3. **exchange rate stability**: a national currency remaining for two years prior to qualification within the normal fluctuation margins provided for by the ERM of the European Monetary System;
4. **durable convergence**: as reflected in long-term interest rates averaging in one year not more than 2 per cent above that of the three best-performing Member States.

Nonetheless, ambiguity remained in the wording and interpretation of the Treaty about how absolute these criteria were. Would it, for example, be enough for a country to have set a course to meet these conditions? Was it sufficient to have met the criteria in the qualifying year or should the performance levels be sustainable? At their informal meeting in Apeldoorn in September 1991, after prolonged wrangling between Germany and its northern allies and Italy and the Mediterranean countries, European Finance Ministers had agreed a compromise whereby, although precise qualifying criteria would be set, a margin of political judgement would be allowed, so as to take account of the direction travelled and the effort made. Here was scope for Ministers to carve out a more political role and to bend the strict Maastricht rules, scope which a number of countries would later exploit to the full.

Then again, what constraints would there be on countries to remain virtuous once they were part of the single currency? The absence of enforceable budgetary constraints on countries once inside EMU or of rigorous legal sanctions against 'free-riding' behaviour[20], given that joining was irreversible, was a significant shortcoming of the Maastricht Treaty. How best to ensure the credibility and stability of the euro in the absence of direct political engagement through European economic policies became the biggest bone of contention between Germany and France in the years following Maastricht. It was only partially resolved by agreement in December 1996 between Kohl and Chirac to establish a 'Stability and Growth Pact' with rules and sanctions to constrain the budgetary policies of participating countries, which became part of the 1997 Amsterdam Treaty.

Economic and monetary union thus became a dual system. Monetary union was established along federal lines with a strong, independent ECB and equal representation for Member States in deciding on monetary policy, regardless of their political weight. Yet in the Maastricht Treaty, this was something of an anomaly. With its 'temple' structure, the Treaty overall took Europe back in a more intergovernmental direction, giving greater weight to the larger Member States. Economic policy, remaining intergovernmental with decisions (apart from those on the convergence criteria) under national political control, thus became gradually more dominated by political power-broking. So, in one sphere, there was the day-to-day management of monetary policy by the independent ECB and, in another, the day-to-day management of economic policies by Ministers in the Council. Article 109b did, however, make some provisions for the two spheres to meet. For example, the Chairman of ECOFIN could be present as observer at ECB Governing Council meetings and, thanks to Bérégovoy's last-minute Treaty addition, could propose an issue for the ECB to debate. Likewise, the ECB Chair could be present at ECOFIN meetings when issues relating to the ECB were discussed. The ECB also presented an Annual Report to the European Council and Parliament.

What was less clear was how the two parts of this system would communicate with one another if the system was hit by a shock, such as a major financial crisis. For while, in calm conditions, it might be enough to have a rules-based part of the system operated at arm's length by experts, in a major political or economic crisis Ministers would find themselves in the eye of a media storm and would need to be willing and able publicly to defend and support the system as a whole.

With the benefit of hindsight, it seems evident that serious consideration should have been given to building a crisis management system

for the euro area which, while upholding the ECB's decision-making independence, would have engaged high level European political support behind co-ordinating the different roles of the monetary and economic spheres, enabling them to take critical decisions quickly and to reinforce one another. This would have required establishing a clear understanding among European leaders about how the system was to be managed under stress and willingness by those leaders to assume public accountability for it. Instead, in France's concern to ensure that the move to a single currency was secured irreversibly, and in Germany's concern to establish a fully independent European monetary policy and to keep a free hand in managing the economic consequences of reunification, Maastricht quietly shelved this critical issue.

In part, this absence of crisis contingency planning was intended to signal political confidence in the robustness of the system itself – after all, if the move to a single currency was irreversible then participating countries would simply have to find a way of managing any shocks. There would not be any alternative. This was a reflection of French 'monetarist' thinking that agreement on a single currency would drive economic convergence, rather than the other way round. Germany, by contrast, had traditionally been much less sanguine that economic convergence would automatically follow political commitment. Although the Single Market was expected to drive competition, the Germans appreciated that full convergence would require tough political decisions, for example, on labour market reform, which in turn required a clear system of political accountability, hence Kohl's insistence on parallel negotiations on political union. However, the bilateral differences which emerged with France over how political accountability should be structured at European level, combined with reluctance following its own problems in managing reunification to commit to costly and potentially intrusive European structures to manage economic shocks, led Germany to scale back on European economic convergence.[21]

The third French concession to Germany was one which, in retrospect, made the risk of significant financial shocks to European Economic and Monetary Union much more likely. This was the free movement of capital, a key German condition in 1988 for opening negotiations on a single currency. The full lifting of capital controls inside the European Single Market was agreed that year as part of the Single Market programme. The Maastricht Treaty in addition provided under article 73b for the lifting of capital controls involving third countries.

There was concern at the time in France and other European countries with higher social spending that liberalised private capital flows would

lead to loss of state revenue as savings migrated to the lowest tax regime. The French, supported by Belgium and Italy, argued that the effects of full capital liberalisation should be mitigated by European agreement on harmonising taxation of savings. This was not to be, especially with founder EC member Luxembourg offering a tax haven to savings on Germany's border. However, the French were aware by the time they made this concession that the cat was already largely out of the bag, even before the completion of the European Single Market. Major economies like the US, Germany and the UK had already lifted all capital controls by the late 1980s and Mitterrand had decided in 1983 that France could not afford to put up the barriers against capital flows.

Instead, Mitterrand saw in European level collective action the best available strategy to cope with the disadvantages of capital liberalisation, a process he believed was unstoppable, that also had the advantage of driving modernisation in France by giving the state and industries access to cheaper finance. Thanks to the tough economic reforms of the 1980s, the French believed that their economy was now more competitive and resilient to cope with the pressure of open capital markets than that of their main European trade competitors. They had developed sophisticated and effective operations for packaging and selling government debt.

The only intractable issue was how to cope with rising unemployment. Mitterrand hoped that, over time, collective European action would create an alternative model of economic and social co-operation to mitigate the impact of market liberalisation on the more vulnerable. This was important to France, not only for economic and social reasons, but also in order to sustain domestic political support for European construction, as the Secretary-General of Mitterrand's office, Hubert Védrine, explained[22] to his UK counterpart Sir Robin Butler just before the Maastricht Summit. He stressed that, while Mitterrand had initially succeeded for his second Presidential mandate in lifting the French mood on Europe from indifference to enthusiasm, more recently a new nationalistic strain was evident, alongside a rising fear for French identity. This, Védrine argued, made the need for a social dimension to European policy all the more urgent.

Kohl too, as we have seen, aspired to a European 'social market' model to challenge the 'Friedmanite' one, combining efficient, competitive markets for wealth creation with social solidarity in the form of state support for welfare, training and research. This shared Franco-German aspiration was reflected in the 'Common Provisions' of the Maastricht Treaty: 'to promote economic and social progress which is balanced and sustainable, in particular through the creation of an area without

internal frontiers, through the strengthening of economic and social cohesion and through the establishment of economic and monetary union, ultimately including a single currency in accordance with the provisions of this Treaty.'

Yet, in the final text of the Maastricht Treaty, despite Mitterrand's and Kohl's best intentions, European action to promote social cohesion – like action on economic cohesion and tax harmonisation – remained essentially an aspiration. Germany in principle supported French efforts to include a new social policy chapter in the Treaty. There was a bilateral understanding that, in exchange for French support for giving the European Parliament, in certain specified legislative areas, the power to co-decide with the Council, Germany would be willing to include among those specified areas the issues on which France wanted to see collective European action, in particular social, industrial and cultural policy. In the end, however, at Maastricht the UK blocked including in the body of the Treaty a substantive new social policy chapter on the grounds that it would impose an unacceptable competitive disadvantage on businesses. Instead, 11 Member States agreed in a Protocol to work together outside the Treaty to take forward the ideas set out in the 1989 Social Charter. There was also widespread opposition at Maastricht to moving away from unanimity on industrial and cultural policy.

As Védrine had predicted, the omission of provisions for European economic and social policies to help manage the impacts of capital liberalisation, particularly on state revenue and on employment, was to become a key factor, alongside other concerns such as the free movement of people and their employment and voting rights in France, behind rising scepticism in French domestic opinion towards the Maastricht Treaty and its successor European Treaties.

Conclusion: EMU – A work in progress?

In the end, while the Maastricht outcome on economic and monetary union was in large part the result of an extraordinary process of bilateral deal-making between Kohl and Mitterrand, bringing together German-led design of the single currency and its governance with French ambition to secure a clear timetable, the overall EMU package did not turn out exactly as either leader had intended.

In the European single currency provisions of the Maastricht Treaty France and Germany had made an historic commitment to arguably the most ambitious shared project ever devised between independent and once hostile nation states.

Yet, while the route map towards, and design of, the single currency was clear, and the lifting of Europe's internal frontiers was imminent, these were only two elements of the union which needed to be created to meet the declared goal in the Treaty of 'economic progress which is balanced and sustainable', and thus to create the European social market model to which both Kohl and Mitterrand aspired.

At the time of the Treaty's signature, France and Germany both saw Maastricht as only a first stage in the process of European integration, and expected there to be other opportunities to overcome Franco-German differences: France, Germany and the Commission had successfully pressed for another Intergovernmental Conference to be held in 1996 to agree further moves towards political integration. It was believed that, by then, with German reunification complete, there would be more scope for bold moves on economic and political governance at the same time as a decision was due on the move to the final stage of EMU.

A second assumption at the time was that the lifting of capital controls would eventually help overcome such differences anyway, by assisting economic convergence between European countries. Financial markets were considered 'efficient' and capital was expected to flow to where it was most needed,[23] provided that countries' economies were themselves well enough managed to reassure investors. Thus, 'market discipline' would create a virtuous circle whereby capital would flow to the best-managed economies and tensions built up in exchange rate parities would be eliminated. To promote economic efficiency and convergence, therefore, the focus in the Maastricht Treaty was on imposing discipline on state finances through the setting of convergence criteria and through the process of multilateral economic surveillance of government economic policies. Private finance, it was assumed, could be left to take care of itself.

Both of these assumptions, though widely shared at the time, were to prove misguided, making the economic and political management of the future European single currency area much harder than anyone could have predicted. The next part of the book explores why this was the case, and it looks at how France's political commitment to the deal on EMU achieved at Maastricht was put to the test, both in the run up to the launch of the single currency in 1999 and afterwards, as European Governments were hit by a sharp downturn in public support for European construction and by a series of external shocks, culminating in 2008 in the worst global financial crisis since 1929.

Part II 1992–2014

Putting the Treaty Deal into Practice: French Political Management of EMU

6
1992–96: The Years of Turmoil and Disarray

Despite the declared 'irreversibility' of the EMU process and the fixed date for its completion, both enshrined in the Maastricht Treaty, by the mid-1990s, many were predicting that the European single currency would never go ahead or that, if it did, it would involve only a few of Germany's close neighbours.

The change in expectations occurred over only a matter of months. In Summer 1991, Kohl had confided to John Major his sense of optimism that things were moving in a positive direction in Europe. Even the spat between France and the Netherlands Presidency over the future shape of European institutions seemed to be quickly resolved and at Maastricht the Franco-German alliance held firm. Yet, barely was the ink dry on the Treaty signatures than a mood of scepticism and uncertainty began to take hold in Europe. The political changes sweeping across the continent in the wake of the fall of the Berlin Wall and the break up of the Soviet Union, combined with the imminent lifting of barriers within the European Single Market, may have delighted many Europeans in the early 1990s but, for those less equipped to cope with rapid change or at risk of losing their jobs, they meant rising uncertainty and anxiety. In France, the comfortable pro-European political consensus, which had prevailed before the Maastricht deal, suddenly began to erode. The effect was exacerbated in the second half of 1992 by a sharp downturn in the French economy.

Shockwaves of German reunification

Europe was by now experiencing the first big economic and political shockwave from Germany's reunification, made worse by a mismatch between German and US monetary policy. As the Bundesbank steadily

raised rates in 1991–92 to damp down an overheating German economy, the US Federal Reserve moved in the opposite direction, trying to pull the US economy out of the downturn it had suffered at the time of the Gulf War. Money flowed across the Atlantic to Germany towards the higher rates, where it was welcomed to help cope with the rising costs of reunification. The French were furious, arguing privately that Germany should do more to raise finance through domestic taxation rather than putting all the effort onto attracting external finance through monetary policy, effectively making other countries, whose currencies were anchored to the deutschmark absorb some of the pain through artificially depressed economic activity and higher social costs.

The early signs of the strains in the French economy from the rise in German interest rates were already evident by November 1991 in the humiliating reversal by Finance Minister Bérégovoy of the cut in French interest rates he had made only a few weeks earlier. In December 1991, just a day after the conclusion of the Maastricht Summit, Germany put up its rates again. It was a tightening which would continue relentlessly until 14 September 1992, by which time Italy's currency would have been forced out of the Exchange Rate Mechanism of the European Monetary System (EMS), sterling would be teetering on the brink and no one could be sure that France's referendum two days later would secure a majority in favour of ratifying the Maastricht Treaty.

Inside Germany, the initial euphoria over reunification was giving way to a more sober appreciation of the costs, not only to state finances, but also to the competitiveness of German businesses from absorbing East German workers whose wages, thanks to the rate at which the deutschmark had been introduced into the GDR, had been kept artificially high. The result had been to depress the East German economy and push up unemployment. Reunification thus served as a public lesson in the effects of creating a single currency, at an arbitrary rate, between countries whose economies were far from convergent. For West Germany, the only way to remedy the situation was through large budgetary transfers to the East. It was a price that Germans were, at a push, ready to pay for their national unity, but the experience suddenly began to make the prospect of undertaking a similar experiment on a European scale far from appealing.

For all that Kohl had presented Maastricht as a success for Germany, the German press had criticised him sharply for giving up the deutschmark for so little to show on European Political Union. The Bundesbank too, already worried about the effects of reunification costs on its monetary stability policies, stepped up its warnings against rushing into EMU at the expense of strict observance of the convergence criteria.

In a speech in Frankfurt on 26 February 1992, Bundesbank Vice-President Hans Tietmeyer asked rhetorically why, given that the blueprint agreed at Maastricht for the single currency and European Central Bank was satisfactory and largely reflected German views, had there been such a wave of criticism in Germany? His answer was that this largely reflected German concern that the final decision on EMU would be a political one and yet agreement on a European Political Union was still a long way off. In the Bundesbank's view, EMU could not be effective without a common political will and effective political structures to express it. All member countries would have to work to make their economies meet the convergence criteria. Germany could not afford to make transfer payments to other European countries. Moreover, German monetary union had shown that a single currency led to high wages in low productivity regions.

Tietmeyer's public warning about German views on EMU chimed with a post-Maastricht decline in support in opinion polls, one of which by June 1992 showed West German opinion at 52 per cent against and only 42 per cent in favour of a European Union with a single currency.[1]

In France, 1992 began with mixed economic news: inflation was well under control, as were public finances, and the economy seemed at first to be picking up as French exporters benefitted from the surge in German demand. By Spring, however, a combination of high interest rates and a sharp downturn in the German economy was stifling this growth. Rather than investing and creating jobs, businesses focussed on reducing their debts and cutting their workforce, to prepare themselves for a more competitive European Single Market in 1993.

With unemployment rising steadily, the mood of the French public became increasingly critical both of the government and the President. In the March 1992 Regional elections, the Socialists made heavy losses and Mitterrand had little option but to dismiss the Cresson Government. At last, Pierre Bérégovoy achieved his longstanding ambition of becoming Prime Minister – but in deteriorating economic circumstances and with less than a year to run before the March 1993 parliamentary elections, which the Socialists were widely predicted to lose.

Rising political dissent and the campaign to ratify the Maastricht Treaty

For Mitterrand, in failing health and facing the likelihood of spending his last two years in office in cohabitation with a Right-led government, 1992 was critical to securing the future of European Economic and

Monetary Union – and his own historical legacy – through ratification of the Maastricht Treaty. It was clear soon after the Treaty was signed, however, that the public mood was shifting and the President could no longer afford to take popular support in France for granted.

In April 1992, the French Constitutional Council complicated Mitterrand's task by ruling that the Maastricht Treaty was against the national sovereignty provisions of the French Constitution on three counts. First, in providing for any EU citizen residing in France to vote or run for office in municipal elections when the constitution only accorded this right to French nationals; second, on EMU where several articles and protocols were at odds with French economic and monetary sovereignty; and third, in the common visa policy where France could be overruled over decisions on the free movement of third country nationals which would be taken by majority voting. Of the three, the issue of allowing foreigners to vote in French local elections was politically the most sensitive, not least since some believed that it would pave the way for allowing France's North African immigrant population similar rights without taking on French nationality, thereby undermining France's rigorous social integration policies. Amending the constitution could create an opportunity for Jean-Marie Le Pen's extreme-Right National Front Party to play on people's fears about national identity, drawing the Gaullists down the same path. It would also be the first time that the French Constitution had to be changed because of European legislation. In a parliamentary election campaign year, it placed European issues, and Maastricht ratification in particular, at the heart of French domestic politics.

Quick to see the danger, Mitterrand gave a long TV interview on 12 April[2] in which he explained that he saw the Maastricht Treaty as 'a project for France' and had no wish to make a divisive internal political issue out of the constitutional revision and ratification processes. He announced that he would take the constitutional amendments through parliament, rather than taking up the option in the constitution to hold a popular referendum in place of the second leg of the parliamentary process. In an attempt to calm fears on the nationalist Right, he hinted that he might consider, within the terms of the Treaty, imposing tougher restrictions on EU citizens voting in local elections. He warned, however, that he would stop at nothing to prevent any attempt by the Right to block the constitutional changes, even if it meant holding a referendum after all, regardless of the political consequences. He kept open his options for the subsequent ratification process.

Mitterrand's declared preference to avoid a referendum on the constitutional changes showed that, in the current political climate, he judged

it to be a high risk strategy. Equally, failure to ratify Maastricht would be the end of everything he had fought for since he took the decision in 1983 to anchor France to Germany in Europe. His tactic was, first, to create a left-right parliamentary consensus around the – politically more controversial – constitutional amendments, before showing his hand on whether or not to hold a referendum on ratification of the Treaty itself. Already, he was hinting that, if the Opposition created difficulties – or if he judged it politically opportune – he would take the political gamble of putting the Maastricht outcome to a popular referendum.

It would not be long before he had to take this gamble, not because of Opposition obstructionism in parliament over the constitutional amendment process, which was running smoothly, but because, unexpectedly, on 2 June in a referendum, Denmark narrowly voted against ratifying the Maastricht Treaty. It was the first time that an EC member had voted to reject a European Treaty proposal, and it came as a great shock. What until then had seemed to most Europeans as a natural process of ever closer political and economic union was suddenly open to doubt.

For Mitterrand and the French Government, the only possible response to the crisis was a swift and determined reassertion of European political will to carry on regardless, even at the expense of leaving Denmark behind and creating a two-speed Europe, something France had until now refused to contemplate. On 3 June, Mitterrand announced his intention to put ratification of the Maastricht Treaty to the French people that Autumn in a referendum. The same day, Prime Minister Bérégovoy told the French Senate that what could not be done by 12 Member States would simply be done by a smaller number, and French and German Foreign Ministers issued a joint statement stressing their determination to press ahead with Maastricht. Only at German insistence[3] did the statement contain a reference to the importance of helping Denmark to catch up later.

Mitterrand now stepped up his public campaign to explain to the French people why they should support European construction and the Maastricht Treaty. French opinion polls taken immediately after the Maastricht European Council had shown that a comfortable majority believed the Treaty outcome was positive for France. By Spring 1992, however, as the economy faltered and the effect of the new Treaty on French national sovereignty became evident in the Constitutional Council ruling, the mood had turned more sceptical. In his 12 April television interview following the decision of the Constitutional Council, Mitterrand had stressed the need to 'inform the French people and not cease in the weeks and months ahead to demonstrate to them the

importance of these agreements, for France and for Europe'. Throughout the months leading up to the referendum, fixed for 20 September, Mitterrand multiplied his public appearances and, abandoning his usual caution and ambiguity, argued passionately in favour of a 'yes' vote.

His key arguments were: first, to reassure that Maastricht was not a new departure but part of 'an extraordinary continuity in French policy',[4] a vision of Europe which had been supported by all French leaders since the war. Second, to warn that the choice ahead was between war and peace, between on the one hand, building a peaceful Europe based on contract, negotiation and mediation and, on the other, the return to the clash of national ambitions and ideologies, which had already twice that century destroyed France. Third, to stress that France would not be choosing between the nation and Europe, but rather the French nation would be choosing between two global models, one based on 'Anglo-Saxon' free market principles and run purely on an economic logic of profit and another following European principles of building a community based on solidarity and popular political will. By choosing the latter model, France would bind Germany and future members of the European Union into a structure based on peaceful co-operation, which France had helped to shape.

Mitterrand's personal public engagement in the referendum debate was crucial in a country that looked to its President to show strong political leadership. Yet, in a parliamentary election year and so close to the end of Mitterrand's time in office, it also had two unfortunate offsetting effects. First, it had the inevitable effect in the public mind of linking his personal political reputation and fate to the referendum outcome. In a sense, for all his protestations that he did not want to turn Maastricht into a domestic political issue, Mitterrand himself had chosen to align his own political survival with the success of the Treaty, judging it an issue sufficiently critical to all he had fought for in office to be worth ending his career on if need be. As the economic outlook worsened, however, and the public mood turned against the Socialists, the referendum increasingly risked turning into a popular vote, not on France's European strategy as Mitterrand had intended, but rather on the President himself and on his government's domestic policies.

Mitterrand's high political profile on Maastricht also had the effect of prompting his political adversaries on the Right to withhold their public support during the referendum campaign. Former President Valéry Giscard d'Estaing, heading the Centre-Right UDF, and former Prime Minister Jacques Chirac, leader of the Gaullist RPR and Mayor of Paris, both favoured the 'yes' camp and had been prepared quietly to

support the parliamentary process, but a high profile public referendum campaign directly affected their grassroots support. So long as a positive referendum result seemed easily achievable, each judged the smartest tactic to be to keep his head down to avoid appearing to give Mitterrand political endorsement.

Both leaders saw Mitterrand's strategy as calculated to deepen divisions on the Right ahead of the 1993 parliamentary and 1995 Presidential elections. Chirac in particular had the dilemma of knowing that internal polls showed that, within his own RPR Party, a significant majority opposed ratifying Maastricht; yet, he could not be a credible Presidential candidate in 1995 if he took an anti-European stance. This political vacuum, however, tempted Chirac's opponents on the nationalist wing of the Gaullist Party, led by Philippe Séguin and Charles Pasqua, to try their hand at seizing control of the Gaullist movement by campaigning for a 'no' vote on Maastricht. Throughout the Summer of 1992, Séguin travelled across France putting the nationalist case against ceding sovereignty over France's economy and the treatment of foreign residents to 'Brussels-based technocrats'.

By late August, what had started out just months earlier as around two thirds national majority in favour of Maastricht had turned into a roughly equal split between 'yes' and 'no' voting intentions, with around 40 per cent still undecided, and the trend edging towards 'no', provoking alarm across the moderate political leadership in France and among France's European partners.

Belatedly, Giscard and Chirac decided to add their weight to the government's now struggling 'yes' campaign. On 25 August, Giscard gave a major TV interview in which he warned the Right's electorate against turning the referendum into a plebiscite on Mitterrand, asking them to save their fire instead for the following Spring's elections. Like the President, he argued that a 'no' vote would put peace in Europe at risk. At the risk of annoying Kohl, who was due to appear on 3 September on French television in support of Mitterrand's Maastricht campaign, Giscard cheekily also claimed that France risked missing a great opportunity, since the Germans would never again be prepared to agree to abandon the deutschmark. Two days later, Chirac followed suit with an interview in which he argued that if the 'no' vote carried the day, 'Europe would be shattered'.[5]

Mitterrand's decision to confront Philippe Séguin in a three hour-long television debate on Maastricht on 3 September was courageous, given that by now – although his audience did not yet know it – he was suffering from a severe relapse into the cancer which he had secretly

been fighting for the past 11 years. The television debate involved the President, seated in the great amphitheatre of the University of the Sorbonne, holding a friendly conversation with Kohl and answering questions about the European Treaty from a cross section of the public, as well as from Séguin. Throughout the debate, Mitterrand gave a calm, professorial performance, presenting the Maastricht Treaty as necessary to protect France from *laisser-faire* capitalism ('no Single Market without a single currency'), as well as from uncontrolled immigration, crime and terrorism. He pleaded against turning the referendum into a verdict on his own record ('Europe…is a matter which is so important, so decisive…that to turn this into a personal plebiscite would be absurd.') and carefully avoided repeated questions about whether he would resign if the outcome went against him.

Séguin, hamstrung by the need to show a proper Gaullist respect for the role of the President, pulled or missed most of his punches. Mitterrand loftily dismissed Séguin's accusations that Maastricht would hand French sovereignty to Brussels technocrats as 'outdated', pointing out that the Treaty's provisions on the European Council would in fact make it more intergovernmental than the Single European Act. Kohl's brief intervention reassured his French audience that Germany was not seeking to dominate Europe ('Maastricht will not be a German Europe but Europe of the French, the Germans, the Dutch…we shall all keep our history, our identity, our culture.'). The programme reached an audience of over 22 million and, according to one opinion poll[6] taken the following day, gave at least a brief fillip to the 'yes' camp. Fifty-five per cent now indicated they would vote positively whereas a week earlier the same poll had indicated only 47 per cent of positive intentions.

Shortly afterwards, a brief factual announcement at the bottom of the front page of *Le Monde* informed the French public that the President would undergo treatment for prostate cancer, the first time his illness had been officially mentioned. Mitterrand returned to work just two days before the referendum, breezily dismissing media questions about his fitness for office ('they didn't take away any of my brain, it wasn't that end they operated on…').

Although by now public polls were no longer allowed, secret polling by the French authorities showed the referendum balanced on a knife-edge right up to polling day. Exit polls on the day showed a tendency towards 'yes' in the Paris area, Brittany and the North-East but a majority for 'no' across the economically less well off regions of the North-West, Centre and South. At the time the final results were scheduled to be announced by the Minister of the Interior, there was an agonising delay while the

votes in Paris, where polling stations had closed later, were counted. Only then could the government confirm that the 'yes' vote had secured over 50 per cent (the votes arriving in next day from France's traditionally loyal overseas constituencies tipped it over 51 per cent). Thanks to Paris (62.5 per cent yes)[7], and by a hair's breadth, the Maastricht Treaty had been saved.

Financial turbulence and the fight to save the EMS

Mitterrand may have salvaged the Maastricht Treaty, but by the time the referendum result was clear, the uncertainty about the outcome had already led to unprecedented speculation in the international currency markets and significant damage inside the EMS. If the country which had pushed the hardest of all for European economic and monetary union were to reject the Maastricht Treaty then EMU would, a number of foreign exchange traders calculated, be dead in the water and the EMS would break up. The result would be appreciation of the deutschmark and devaluation of a number of other European currencies, leading potentially to huge profits or losses depending on the currencies held by their funds on the day. Traders scrambled in early September to sell the weakest currencies pegged to the deutschmark. Over the Summer, relentless German interest rate rises had combined with a sharp downturn in the dollar to make this look like a safe bet.

In the last fortnight before the referendum, as some private polls circulated putting the 'no' vote ahead, pressure inside the narrow band of the Exchange Rate Mechanism (ERM) of the EMS began to reach a critical point, first affecting the Italian lira as the weakest currency in the ERM. Over the weekend of 11–13 September, there were intensive contacts between ERM countries about German ideas for a possible broad realignment of currencies, but France, determined to defend the credibility of its 'strong franc' policy, would not agree to devalue the franc. On the evening of Sunday 13 September, the Bundesbank and Italian Central Bank gave up the struggle to defend the lira inside the ERM's narrow band and announced a realignment of currencies involving a 7 per cent devaluation of the lira and 5 per cent devaluation of the Spanish peseta, ending a long period of ERM stability since January 1987.

Next morning, the realignment was followed by the first cut in German interest rates for over a year, warmly welcomed by France. It surprised the markets[8], coming less than a week after Bundesbank President Schlesinger, despite having repeatedly come under pressure from European Finance Ministers to cut German rates, had said publicly

that there was no justification for any change. At only a quarter point, it also looked grudging, sparking speculation in markets that the – supposedly independent – Bundesbank's hand had been politically forced.

On Tuesday 15 September, Schlesinger attempted to set the record straight in a wide-ranging interview on the currency crisis with the German business newspaper, the Handelsblatt, and the Wall Street Journal. Instead of highlighting his insistence that the decision to cut interest rates had been taken by the Bundesbank alone, the subsequent article[9] – advance copies of which circulated on 15 September – led on his reported view that 'EMS tensions had not yet completely eased', that 'problems had not been completely solved' but 'could have been further eased if there had been a more comprehensive realignment', which 'had not been possible'. On 17 September, Handelsblatt published a corrected version of the article focussing on the Bundesbank decision to cut interest rates and quoting Schlesinger as judging that 'the measures taken last weekend have strengthened the EMS'. By then, however, on what came to be known in UK as 'Black Wednesday', sterling had been forced out of the ERM, despite substantial Bundesbank interventions in its support. The episode led to angry UK-German exchanges, the UK believing that sterling had been undermined by a series of rumours and half-leaks and the Bundesbank insisting that it had acted in good faith and been misquoted.

In an article[10] appearing in *The Times of London* a month later, George Soros, a major international investor, admitted that his 'Quantum' hedge fund had made a 950 million dollar profit from its part in forcing sterling out of the ERM and a similar amount from other currency trades involving the ERM. His calculation had been based on the weakness of the UK economy in relation to sterling's deutschmark parity, the political difficulty of raising UK interest rates and the unlikelihood, given the public stance taken by Schlesinger, that Germany would cut interest rates further to help sterling. Quantum had by mid-September quietly assembled around 15 billion dollars to bet against the UK currency, easily matching what it believed the Bank of England had been able to muster in its defence[11]. More recent interviews[12] with Soros have revealed that Quantum and a number of other traders had taken the decision to attack sterling well before the Handelsblatt article, which had, however, acted as the trigger on 15 September.

Soros' success sent a signal to other traders and to governments alike that the financial firepower of global currency markets (which had tripled in size since the early 1980s) could now outstrip that of State Central Banks, making all but the most economically credible pegged

currencies look like sitting ducks. Moreover, the lifting of EC capital controls in 1990 had removed the last restrictions preventing the swift, cheap and largely untraceable flows of speculative money.

Flushed with success from the 14 per cent devaluation of sterling, a number of traders[13] turned on the franc. On 18 September, the French Central Bank spent almost 8 billion dollars defending the franc. On 21 September, in the wake of the French narrow 'yes', renewed speculation cost France another 2.2 billion dollars before turning in to an all-out attack on 22 September after (false) market rumours spread that Germany was preparing an ERM realignment revaluing the deutschmark by 7 per cent and the franc by 5 per cent (effectively a 2 per cent franc devaluation).[14]

At this point, by chance, French and German Finance Ministers and Central Bankers were all in Washington for an IMF meeting. By another remarkable coincidence Kohl was in Paris for one of his regular bilaterals with Mitterrand. Alerted to the crisis by Prime Minister Bérégovoy, who had warned that if the franc was forced to devalue he would hand the President his resignation, Mitterrand confronted Kohl with a graphic description of the historic consequences of allowing the speculators to win: collapse of the EMS, end of the European Single Currency and very likely also of the Single Market. Only high profile concerted action by France and Germany could save the situation.

Unaware of the crisis, Kohl was taken aback. He telephoned the German delegation in Washington, only to hear the French account confirmed. Seeing Kohl still hesitating, Mitterrand returned to the charge, insisting that he would not devalue the franc against the deutschmark, pointing out that the French 'fundamentals' (inflation level, public deficit, trade and payments balances, growth) were all in a better state than Germany's. Accepting the truth of this, Kohl telephoned Bundesbank Deputy President Tietmeyer in Washington and told him he wanted a joint public statement by the French and German Central Banks supporting the franc-deutschmark parity at its current level.[15] Even after Kohl's order, Bundesbank President Schlesinger held out against signing for several hours, telling the French delegation: 'I won't sign. A country in France's situation devalues. Anyway, France has done nothing serious to defend the franc.' Finally, after another conversation with Kohl, he agreed to sign. The Bundesbank also agreed to intervene on the money markets on France's behalf – but only on condition that France covered the costs.

The Franco-German joint statement was released early on 23 September, and the Bundesbank surprised markets further by buying francs even

though, given that the franc had not yet reached the ERM floor, it was not under ERM rules obliged to do so. To drive home the point, French Finance Minister Michel Sapin berated the franc's attackers on the morning news bulletin: 'When you have speculators the only answer is to make them pay. At the time of the Revolution, they were called 'traffickers' (Fr. 'agioteurs') and we used to cut their heads off'.[16]

That afternoon, with French reserves just about to run out, the markets turned, and the franc began to rise.

Between 18 September and the end of the month, the net level of French Central Bank currency reserves had gone from plus 20 billion dollars to minus 15 billion dollars, and interventions in support of the franc had required an outlay of 34.7 billion dollars, including 19 billion dollars borrowed from the Bundesbank. The following month, however, once the franc had rebounded, the Bank retrieved the funds deployed, repaid the Germans and made an overall profit of 2 billion dollars from the speculators. This time, the attacking traders had had their fingers burnt, instilling some political awareness of the determination of Kohl and Mitterrand to defend their joint European strategy, but also making them more alert to any sign of Franco-German political differences.

The French might have won one battle against the speculators but financial turbulence risked inflicting serious damage on the longer-term prospects for European economic and monetary union. A confidential internal French Foreign Ministry Policy Planners' assessment[17] sent to Hubert Védrine, Head of Mitterrand's Presidential staff, in October 1992 on the implications of the currency crisis for the future of the EMS concluded that, now that most capital controls had been lifted, 'the days of the EMS are numbered'. The assessment argued that the EMS had become inherently vulnerable to attack and that, after 1987, currency stability had been preserved only by the prospect of European monetary union, combined with the political determination of countries to make their economies converge. This had been undermined by the Danish 'no' vote and by the French ratification debate. Once doubt set in, currencies like UK sterling and the Italian lira, which had failed to make the necessary economic adjustments and were thus overvalued, quickly came under speculative attack.

For the future, planners argued, it would be impossible to reinstate capital controls, not least since technological innovation meant that they could easily be bypassed. Equally, to move to greater exchange rate flexibility would undo all that had been achieved in the 1980s and would damage the Common Agricultural Policy. There was no alternative to the current EMU policy. Yet, how could France repair the doubts

about the future of French economic policy created in investors' minds by the September currency crisis? The only answer, Foreign Ministry Planners argued, was to move as quickly as possible towards full EMU by completing Maastricht ratification and overcoming the Danish 'no' and, meanwhile, to take 'spectacular measures' to impress the markets. It was crucial to avoid letting the impression take hold that a 'two-speed Europe' was now emerging, with a hard core EMU created around Germany and other European countries excluded. So such measures might involve promoting instead the idea of a 'convoy', with low inflation 'core' EMS countries, including France, Germany, Benelux countries and perhaps Denmark and Ireland, moving ahead faster, with others able to catch up later. Meanwhile, since the franc remained open to speculative attack so long as monetary policy was seen to depend on domestic political decisions, France should, the planners argued, strengthen the franc's credibility by moving now to make the Bank of France independent.

In line with this analysis, the French Government drew the broad lesson from the turmoil of September 1992 that, however important the fundamentals of the economy might be in maintaining a currency's credibility, this was not enough in itself since financial markets were not basing their decisions primarily on current economic realities but on psychological factors, including impressions of future political risk. It was crucial for Europeans to send the right political signals to the markets. As Finance Minister Sapin pointed out in a speech on 20 November 1992 at Chatham House in London, 'the serious tensions we witnessed resulted mainly from the uncertainties bearing down on European construction…we must therefore prove our resolve to move ahead together'. He attributed France's ability to see off the speculators partly to the fact that France's economy had higher growth, lower inflation and more tightly controlled public finances than Germany's and partly to the French government's demonstration of political determination. In France's view, the turbulence had demonstrated that Europeans had been right to commit to a single currency since retaining too much exchange rate flexibility led only to instability, inflation and disruption to trade and investment. Indeed, he admitted, France now needed to give more thought to how to manage the EMS's fixed-but-flexible rate mechanism ahead of the move to a single currency.

French fears that neither the EMS nor the franc was yet out of the woods proved well-founded. From the end of November 1992, as soon as it became clear that the Socialists were about to lose the Spring 1993 parliamentary elections, the currency traders began quietly selling the franc again in anticipation that, as the French economy continued to

suffer from high German interest rates, a Right-led government might be less resolute in pursuing the 'strong franc' policy. A poll of 402 French business leaders published in *Les Echos* showed 71 per cent were looking to the next government to 'promote growth by cutting interest rates' rather than pursuing 'a policy of rigour and the strong franc'. Political heavyweights inside Giscard's UDF Party, such as Vice-President Alain Madelin, and supporters of Philippe Séguin inside Chirac's RPR were of the same view. Giscard and Chirac themselves, however, had set their sights on the 1995 Presidential elections and knew they needed to maintain France's historical pro-European consensus. Moreover, Chirac's Gaullist colleague Eduard Balladur expected to become the next Prime Minister, and knew he would need to 'cohabit' with President Mitterrand. So, all three were prepared to take a firm public stance in favour of maintaining the franc's parity with the deutschmark.

For the French Government, though, the greatest threat to the EMS came not from political divisions inside France but rather from 'the scandalous attitude of the Bundesbank', as Mitterrand's economic adviser at the time, Guillaume Hannezo, put it in a briefing note[18] dated 3 December 1992, ahead of Mitterrand's latest bilateral meeting with Kohl. Hannezo warned Mitterrand that the Bundesbank's market interventions in defence of the franc were being undermined by its highly damaging public statements casting doubt on the political will behind the EMU project. He insisted that 'the Bundesbank wants the EMS' hide before German interest rate cuts can put it back on its feet'. With support from Finance Minister Sapin, Hannezo recommended that Mitterrand protest to Kohl about the Bundesbank's tactics, insist on publication of another joint statement reaffirming the two countries' commitment to the franc-deutschmark parity and agree with Kohl a mandate for the two Finance Ministers to look at how to reinforce economic and monetary co-operation. If need be, Hannezo argued, France and Germany should accelerate the timetable for irrevocably locking the two currencies, perhaps even 'if we have no other choice', creating a 'hard core' of countries and announcing an early move to make the Bank of France independent.

French and German Finance Ministers and Central Bankers duly met on 21 December and privately agreed[19] on a joint strategy to defend the franc. This included drafting legislation to make the French Central Bank independent well in advance of the second stage of EMU. Rumours (false, but studiously not denied by French Ministers) began to circulate that France and Germany might secretly be working to move faster to create a single currency with a small group.

The Franco-German show of unity and determination worked. Speculation on the franc faded away in early 1993. As the German economy slowed, market pressure was further relieved, as Hannezo had anticipated, by German interest rate cuts. In the end, the Bérégovoy Government's legislation on bank independence was shelved ahead of the March 1993 parliamentary elections.

It was a short respite. Just a few months after the Centre-Right electoral victory and Balladur's appointment as Prime Minister, the attacks on the franc came back with renewed intensity. They were stirred up in part by a deteriorating economy but, above all, by evidence of political disarray on the Right. Despite a 4 per cent reduction in interest rates over the two months following the election, the French economy slid deeper into recession. As unemployment rose towards 11 per cent of the working population, the voices favouring an end to France's longstanding policy of economic rigour and monetary stability grew more strident. On 16 June, the former leader of the dissident Gaullist campaign against Maastricht, Philippe Séguin, now President of the French Parliament, argued publicly for a reversal of French economic, social and European priorities. He claimed that France had lived too long under what he called a 'social Munich' – inflammatory language implying that accepting the social costs of German monetary policies by maintaining the strong franc was akin to a form of appeasement.

Two days later, Balladur ruled out a change of policy. But the government, anxious to demonstrate to critics France's independence from German monetary policy, prompted the Central Bank on 21 June to cut French interest rates to a level just below Germany's. On 24 June, interviewed[20] on 'Europe 1', a radio news programme, Balladur's Economy Minister Edmond Alphandéry argued that Europe was suffering from Germany's over-restrictive monetary policy, called upon Germany to lower its interest rates and announced that he and the Governor of the Bank of France had invited their German opposite numbers, Finance Minister Theo Waigel, and Bundesbank President, Helmut Schlesinger, to Paris the next day to discuss a concerted lowering of the two countries' interest rates. Informed by media reports that what they had thought was the next routine meeting of the Franco-German Economic and Financial Council had turned into a negotiation on interest rates, Waigel and Schlesinger promptly cancelled the meeting, throwing the bilateral relationship into public disarray.

Soon afterwards, on 7 July, the official French economic forecaster INSEE[21] predicted that the French economy in 1993 would contract by 1.2 per cent, making clear the lack of economic justification for

continuing high interest rates in France and triggering a steep fall in the franc. Speculative attacks, which soon widened out to affect other European currencies, continued throughout July, despite public statements by Balladur, Mitterrand and Kohl in support of the franc-deutschmark parity and despite the release of a Franco-German joint statement comparable to the one in September 1992. By the end of July, the Bank of France had, since the onset of the crisis, deployed around 350 billion francs (then almost 70 billion dollars) in the franc's defence. Yet, the French currency was stuck at the lowest rate possible within the ERM's narrow band, which permitted no more than 2.25 per cent fluctuation in value either side of a pivotal rate. From this point, it was futile to resist further.

Meeting in emergency session over the weekend of 31 July – 1 August, the EC's Monetary Committee debated and ruled out a number of options to stem the crisis before finally announcing that, henceforth, the ERM's margins would be widened to allow European currencies inside to fluctuate by up to 15 per cent. It was a desperate move[22], which for now effectively removed one of the four disciplines laid down in the Maastricht Treaty for judging that countries were ready for full economic and monetary union (the ability to maintain the currency within the narrow band of the ERM for at least two years).

However, it worked remarkably well. Keeping a margin in place saved face for the EMS but, at 15 per cent, it was hardly more constraining than a free float, with the effect that traders could no longer guess at what level the Central Banks would decide to defend their currency. The speculation melted away, and given that the Balladur Government announced it would maintain a policy of economic rigour, the franc dipped only briefly before stabilising at its earlier value against the deutschmark. Once again, the French Central Bank eventually recouped its losses and repaid its loan from the Bundesbank.

In October, Schlesinger was replaced as Bundesbank Governor by his more European-minded Deputy, Hans Tietmeyer. Jean-Claude Trichet, former Maastricht Treaty negotiator on EMU, became Bank of France Governor around the same time. Trichet and Tietmeyer knew and liked each other, and the two began quietly to work together on the technical preparations for the European single currency during the second stage of EMU, due to begin in 1994. The law making the Bank of France independent, drafted but not tabled in the last months of the Bérégovoy Government, was finally voted through by the Balladur Government in late 1993, soon after the Maastricht Treaty's entry into force on 1 November.

The franc's recovery was also helped over Autumn 1993 by external factors. The US dollar strengthened, and the Bundesbank continued to cut interest rates as the German economy slowed sharply and inflation peaked, bringing some relief to the French economy. By the end of the year, Germany's economy had plunged further into recession than France's (according to INSEE, the final GDP outturn for 1993 was –0.8 per cent for France and –2.3 per cent for Germany). This created its own problems, but at least the two economies were no longer moving in opposite directions under the exceptional shock of German reunification which, exacerbated by the effects of capital liberalisation, had placed the EMS under what finally proved to be an impossible strain.

Political Fallout

The technical competence of the central bankers, quietly preparing EMU throughout the 1990s, was overshadowed by the disarray and divisions over the European single currency in the political arena. In France's political mainstream, on both the Left and Right, the years of turmoil following the end of the East-West divide in Europe and the lifting of barriers to capital flows had seriously damaged the consensus over domestic and European economic policy which had held since Mitterrand had made his historic policy U-turn in 1983.

On the Left, the slender 'yes' vote on Maastricht, the economic downturn from 1992 onwards and relentlessly rising unemployment all made the optimistic pro-European vision Mitterrand had set out in his 1988 re-election campaign look hollow. After the humiliating Socialist Party defeat in the Spring 1993 parliamentary elections, a bitter debate began in Left circles over whether the 'strong franc' policy had in effect destroyed all that the Socialists traditionally stood for. Former Socialist Prime Minister Laurent Fabius, in a book published in 1995[23] looking back critically over Socialist policies of this period, asserted that the 'strong franc' had only been possible at the cost of high interest rates limiting economic activity and thus employment. Pierre Bérégovoy, who had always been proud both of his working class roots and of the defence of the franc he had pursued over many years, became enmeshed in accusations of financial impropriety and was overcome by despair after the Socialists' defeat in March 1993. A few weeks later on Labour Day, tragically, he took his own life.

In his final New Year speech[24] to the Press Corps before leaving office in May 1995, President Mitterrand reflected on the 'historic contradiction between the arrival in power of a Socialist and the greatest ever opening

up of France to the rest of the world'. He told journalists frankly that the liberalisation of capital movements had created for him a stark choice between total isolationism and the pro-European 'strong franc' policy he had finally adopted: 'Money goes wherever it wants. Of course, you can try to stop it (without any guarantee of success, or else you would need to have a completely isolationist policy, as if that would be possible for a country like France!) and thus renounce all European construction, or even any kind of normal relations with neighbours and trading partners. You have there an extremely difficult problem ... ' Half-apologetically, he went on to defend his policy choice but acknowledged that it had been taken out of realism and against his Socialist principles: 'I believe that the choice which I had to make was the right one; ... I haven't renounced, I am still a Socialist, but I took account of reality and made the necessary choices ... ' A year later, on 8 January 1996, Mitterrand died – without knowing whether the European economic and monetary union he had fought so hard for would become a reality.

On the Right, the divisions within the mainstream parties between those who had voted for and those who had voted against Maastricht ratification resurfaced in the run up to the 1995 Presidential elections. Within the Gaullist RPR Party, Balladur decided to run against Chirac on a pro-European, pro 'strong franc' ticket, whereas Chirac attempted to widen his appeal to include the nationalists and euro-sceptics within the Party. He argued during his campaign that employment was at least as important as defending the currency, fighting inflation or reducing the public deficit. He suggested at one point[25] that, if elected, he would hold a referendum on the European single currency, only to backtrack a few weeks later and to insist instead that his priority would be to reduce the deficit and debt and stabilise the currency so as to meet the Maastricht criteria. The tactic of a broad populist appeal succeeded, and in May 1995, Chirac became President, only to discover that his mixed public messages had unleashed a wave of rumours about a change of policy and a run on the franc.

The attacks continued throughout the Summer and early Autumn, placing Chirac under pressure to make clear whether or not he intended to maintain the policies which had supported the franc's peg to the deutschmark. Like Mitterrand in 1983, Chirac hesitated and privately explored other options, including – encouraged by a number of prominent business leaders – taking the franc out of the ERM[26]. Finally, on 26 October, a day after intense discussions with Kohl in his first bilateral visit to Germany, the President gave a television presentation in which he finally made clear to the French people and to the financial markets

that his overriding priority was to tackle the French public deficit and support the stability of the franc.

On 15 November, his Prime Minister, Alain Juppé, drove the point home by announcing in parliament the most ambitious reform of the French social welfare system since the Second World War, with the aim of balancing the French budget by 1997. Despite the wave of public sector and trade union protest which followed over the next few months, the Gaullist Party leadership's show of political determination had the effects of calming the financial markets and of bringing the Gaullist dissidents back into line. In his press conference after the December 1995 Madrid European Council, Chirac – like Mitterrand before him – made achieving a strong and stable European currency the key priority of his seven-year Presidency.

1996: A watershed year for EMU?

The December 1995 European Council had agreed that the European single currency would be called the 'euro' and set a clear timetable for creating it on 1 January 1999, with notes and coins in circulation by 2002. However, EU leaders also acknowledged that not all Member States' economies would be ready for EMU by 1999. For Europeans still affected by the worst economic downturn since the Second World War, the real question, still publicly unavowed, was whether EMU could go ahead by 1999 at all, at least on the basis of the rigorous qualifying criteria laid down in the Maastricht Treaty. In the early months of 1996, the economic realities in both France and Germany[27] seemed to belie the optimism Kohl and Chirac had demonstrated at the Madrid European Council that their countries would be ready to lead the first wave.

In Germany, it was by now clear that industrial production had begun to decline in 1995, and unemployment was rising sharply, knocking the government's budget plans off course. Soon after the Madrid Summit, German Finance Minister Waigel announced a worse-than-expected German deficit for 1995 of 3.6 per cent, significantly above the 3 per cent Maastricht limit, and admitted that it was unlikely to fall in 1996. Kohl, with his eye on running for another term in 1998, initially responded by pledging to halve unemployment by 2000 and embarked on a consultation with Germany's trades unions. In France too, unemployment was rising again towards the historic high it had reached in 1994 of 12 per cent. Moreover, a winter of public sector strikes and protests against Juppé's social welfare cuts had forced the government to retreat on a number of key reforms (although they stuck to their guns on

the most important one of tackling France's burgeoning health costs), calling into doubt their ability to cut France's deficit to 3 per cent by 1997, as Juppé had promised.

In January 1996, The British Ambassador to Paris, Sir Christopher Mallaby, sent to London, on a personal basis, an informal paper[28] by Embassy staff summarising French arguments on EMU and assessing whether the single currency looked likely to go ahead on the terms set out in the Maastricht Treaty. It concluded that: 'present economic circumstances suggest that the conditions for a successful monetary union of the kind envisaged when the Treaty was drafted are most unlikely to have been established by 1999 ... ' A minority of EU members 'might well be able to create a single currency in 1999 if they wished, but their single currency zone would damage the cohesion of the European Union'. In January too, the UK Representative to the EU in Brussels, while stressing that 'the character of public utterances has not changed', judged[29] that, for economic reasons, postponement of the 1999 date 'now looks more likely than it did six months ago'.

Yet, within months, both assessments were radically to change. By late 1996, reporting from the UK Representation in Brussels and from British Embassies in Paris and Bonn indicated that the private expectation of EU political and business leaders was that EMU would happen on time, in accordance with the Maastricht Treaty, and most likely with a majority of EU members in the first wave. The next chapter analyses how this shift came about.

7
1996–99: Recovery and Launch of a Wide Eurozone

Shifting expectations: how a 'virtuous circle' formed for the single currency

Like the rapid loss of confidence in EMU in 1992, the return of confidence in 1996 that the single currency would go ahead as the Maastricht Treaty had laid down happened over only a matter of months and involved both economic and political factors. It began with financial markets reacting to signals from key politicians and central bankers, was reinforced by changing economic and business expectations, which by Summer 1996 had in turn bolstered confidence among EMU policymakers. Finally, in 1997, as the economic recovery became discernible, the positive outlook fed through to public opinion.

Chirac's public confirmation of his backing for the euro project on 26 October 1995, which he reiterated at the December Madrid European Council, was the first catalyst of the return of confidence. Foreign exchange traders, who since the Presidential election had repeatedly tested Chirac's resolve on the franc's peg to the deutschmark, finally began factoring in that France's monetary policy was not about to change. They also picked up the positive signals sent out by the Madrid Summit's clear EMU timetable and by the European Monetary Institute (the forerunner of the European Central Bank (ECB)) and Central Banks in European capitals making technical preparations for the launch of the euro. Private banks and businesses began investing in their own preparations.

By Spring 1996, despite continuing scepticism among many European politicians and officials, markets were already anticipating that EMU was going ahead: 10 year bond yields on sovereign debt in countries likely to join the euro were converging towards Germany's, indicating

market confidence that the single currency would be created on time. Indeed, French 10 year bond yields by end 1996 had, for the first time, fully converged with Germany's. Even Italy's long-term bond rates, despite continuing high public deficit levels, had fallen below those of the UK. Rising market confidence meant lower borrowing costs for countries deemed likely to join the euro, which in turn helped governments' efforts to meet the Maastricht criteria. It also meant that political leaders in European capitals realised that failure to set a clear course towards EMU, particularly in their budgets for 1997 (the year whose outturn would decide in 1998 who would qualify to join the euro) would be heavily penalised by the financial markets, leading to sharply increased borrowing costs and currency instability. This was the beginning of a political and economic 'virtuous circle' reinforcing the move to the single currency.

Kohl's political commitment was also critical. In April 1996, despite his ambition to run again for Chancellor in October 1998, Kohl realised that tackling Germany's public deficit had to take priority over his earlier promises to cut unemployment if he was to deliver his Maastricht commitment to achieving EMU. He broke off tripartite talks with trades unions and management on employment measures and announced a 70 billion deutschmark (2 per cent of GDP) package of budget cuts, setting a clear course to meet the Maastricht deficit criterion.

Kohl was further encouraged to keep to the 1999 EMU deadline by Germany's major industrialists, who were becoming markedly more pro-euro.[1] After the currency upheavals of 1992 and 1993, they faced increased trade competition from the European countries whose currencies were now outside the former constraints of the Exchange Rate Mechanism (ERM). Moreover, rising wage costs since Germany's reunification and an overvalued deutschmark[2] had exacerbated their problems, causing German exports and production to slump. Before German reunification, German businesses had long benefitted from Germany's lower inflation rate compared with its European trade competitors. After 1992, however, inflation levels globally came down sharply, but German inflation increased, eroding German price competitiveness. Over the Winter of 1994–95, in the wake of the Mexican debt crisis, the US dollar fell sharply against the deutschmark, adding to the difficulties faced by German exporters.

Germany's export-oriented businesses began to see advantage in joining a European single currency likely to be weaker, and thus more competitive, than the deutschmark, especially if membership went wider

than just the strong currency countries of Northern Europe. They were, moreover, keen to bring trading competitors like the UK, Italy and Spain back inside a reformed ERM and thus to limit their scope to engage in competitive devaluation.

By Summer 1996, German Finance Ministry officials in Bonn and bankers in Frankfurt were privately confident[3] that the euro would go ahead with a first group of countries as scheduled in 1999, with Germany at its core, having either met the 3 per cent budget deficit criterion or at least come close enough to it to retain the Bundesbank's support for EMU (Bundesbank support for the government being regarded as essential to securing a positive vote in the German Parliament once the time came to give up the deutschmark). Bundesbank Governor Tietmeyer was now privately telling interlocutors[4] that he would not worry about a 3.1 or 3.2 per cent German deficit. No one in Bonn now saw Germany's breach of the Maastricht debt criterion as a problem either. Publicly too, the effort began to prepare German opinion. On 11 August, German Foreign Minister Klaus Kinkel predicted in a domestic press interview[5] that enough countries would meet the criteria for EMU to be launched on schedule in 1999, echoed later the same month by Chancellor Kohl: ' the euro must come'.[6]

The relaxed attitude in Bonn and Frankfurt over whether Maastricht criteria should be met 'strictly' was in striking contrast to pronouncements in earlier years by the German Finance Ministry and by successive Bundesbank Presidents that real economic convergence and a rigorous interpretation of the criteria were necessary for the single currency to go ahead. In part, the change can be attributed to the fact that German inflation was now at last under control, and Kohl had grasped the nettle of making significant cuts to public spending, making high German debt (forecast for the EMU qualifying year of 1997 to remain above the Maastricht limit of 60 per cent of GDP) less important now that the budget deficit was coming under control. Germany could thus afford, in order to signal its determination to be at the core of the first wave of EMU, to be more flexible in its interpretation of the Maastricht criteria while remaining within the terms of the Treaty. The Treaty itself was vague on several of the criteria. On debt, for example, it did not make 60 per cent of GDP the absolute limit, but merely required the debt level to be 'sufficiently diminishing and approaching the reference level at a satisfactory rate'.[7]

Germany's attitude was also shaped by proposals which its Finance Minister Theo Waigel had put earlier in the year to EU colleagues for a new 'stability pact' among countries participating in the euro to limit

their budget deficits once they joined the euro. The Maastricht criteria only effectively constrained countries while they were seeking to qualify for euro membership. The absence of effective legal constraints on participating countries' budgetary spending once they had adopted the euro was regarded, especially in Germany, as a serious oversight in the Maastricht Treaty. The German worry was that European countries without Germany's post-war political tradition of upholding a strong, stable currency and rigorous public finances might, once inside the euro area, succumb to popular pressure to spend, expecting Germany to help them out in order to preserve the credibility of the single currency. Although the Maastricht Treaty contained a clause[8] prohibiting the ECB, the European Community or any of its Member States from 'bailing out' any government or its public authorities who ran into budgetary difficulties, this had yet to be tested. Moreover, it did little to prevent countries getting into trouble in the first place. The German Finance Ministry and the Bundesbank both saw it as vital to put in place tougher legal safeguards before the euro was launched. Waigel's Stability Pact was to contain provisions for budgetary discipline, including the submission to Brussels by each eurozone country of an annual 'stability programme' justifying its budgetary plans and a process for the Commission and Council to impose sanctions on eurozone countries whose public accounts carried an 'excessive deficit', of 3 per cent or over.

European Economic and Finance Ministers (ECOFIN) agreed in June 1996 to begin work on Waigel's proposal and on 17 September, after the six-monthly Franco-German Economic and Financial Council meeting, French and German Finance Ministers announced that they had agreed that the proposed Stability Pact was an 'indispensable precondition' to EMU. For Germany, ensuring that the euro once launched would remain stable by putting in place legally enforceable eurozone budgetary discipline was, by now, more critical than insisting that countries strictly met the Maastricht criteria for entry (not least since Germany itself was unable to meet them all in strict terms). Bundesbank President Tietmeyer made this clear in a major interview published in *Le Monde* on 17 October under the headline 'The Bundesbank President wagers on the euro in 1999'.[9] In the interview, Tietmeyer accepted that 'margins of interpretation' existed over the Maastricht criteria but stressed that 'the determining factor is that the whole project should have great durability and solidity…one-off results are not sufficient proof of respecting the stability criteria'.

Qualifying for euro membership: Waigel's Stability Pact and the Maastricht criteria

Germany's shift in emphasis in 1996, from the need to achieve strict virtue before joining the euro to countries being able to sustain a virtuous budgetary position once inside the euro area, had consequences for eventual euro membership in 1999. In return for EU agreement on his Stability Pact proposal, Waigel was effectively signalling that Germany would, if not endorse, at least tolerate more flexible management of the immediate budgetary difficulties facing a number of European countries as they struggled at the end of a long economic downturn to ensure that their 1997 budget would qualify for the single currency. In so doing, he cleared the way for more countries than had earlier been anticipated to join the first wave.

A wider euro area was, as mentioned above, in the interest of German exporters keen both to have a competitively valued euro and to prevent trade rivals from engaging in competitive currency devaluations. At a higher political level, it sent a positive signal to new and aspiring EU Member States that Germany had no wish to create new economic divisions in Europe between rich Northern and poorer Southern countries but aspired instead to build a strong, inclusive political and economic union. In January 1995, Austria, Finland and Sweden had become EU members, and now, following the break-up of the Soviet Union and Warsaw Pact, ten more countries were waiting at the EU's door. If Kohl was to fulfil his longstanding political ambition of placing a reunified Germany at the heart of a united Europe it made little sense to create a euro area only as a small club for the richest EU members.

Purely on a practical level, Germany was also aware that in 1998 it would be difficult to decide whether or not countries were ready for the euro just on the basis of whether or not their latest budget met the Maastricht criteria. Judging whether or not countries' public accounts technically met the criteria would be far from an exact science. Behind Tietmeyer's allusion to 'one-off results' lay mounting Bundesbank concern that European countries would respect the Maastricht figures simply by bending the budgetary accounting rules. At this time, government accounting was not always rigorous[10]. Moreover, EU governments had yet to agree among themselves on a single compatible set of statistics that would have enabled the European Commission accurately to compare and monitor different EU countries' public accounts.[11]

The scope for individual creativity was therefore considerable and, given that the budgetary deficit level for 1997 was to be the key qualifying statistic for EMU membership, several governments were already applying themselves to finding specific measures to help reduce the 1997 deficit to the critical level of 3 per cent of GDP. It was France who led the way.

Qualifying for euro membership: Chirac's dilemma

Once President Chirac had publicly staked the success of his first term in office on achieving European economic and monetary union, he faced a dilemma. How could he both take the tough budgetary measures needed to ensure that France qualified to join Germany in launching the euro in 1999 and at the same time prevent those measures from irreparably damaging the Right's chances in the Spring 1998 Parliamentary elections and his own prospects of being re-elected President in 2002? The key challenge was cutting the public deficit. Although against three of the four Maastricht criteria France was in a comfortable position, the country's public finances had suffered from the post 1991 economic downturn and by 1995 were still, according to European Commission data, showing a deficit of 5 per cent, well above Germany's at 3.6 per cent and significantly above the Maastricht threshold.

The forced retreat by Chirac's Prime Minister and close political ally, Alain Juppé, from a number of promised social welfare reforms, in the wake of mass strikes and protests during the Winter of 1995–96, was a major setback to French efforts to reduce the deficit. Along with the need to tackle unemployment, at over 12 per cent and rising, and to encourage economic recovery, it meant that the scope both for tax increases and for spending cuts was limited. The Finance Ministry accordingly drew up an ingenious plan for a one-off receipt to its 1997 budget of 37.5 billion francs, in return for the state taking on long-term pension liabilities from the privatisation of France Telecom. This plan enabled France in September 1996 to table a draft 1997 budget projecting a deficit of 3.1 per cent, good enough to qualify for the euro. It included a historically large cut in spending but, since it was combined with tax cuts to please the Right's electorate and an overspend in the social security budget, this was not enough to bridge the gap without the planned France Telecom payment. The French Finance Minister had taken care in the 17 September Franco-German Economic and Financial Council to explain his budget to his German colleague Waigel and to reassure him that, despite the one-off measure, France would sustain its budgetary effort and support Waigel's Stability Pact.

Nonetheless, it was still far from certain that the French Government could deliver its forecast budget. Juppé's popularity rating had by November 1996 fallen to 22 per cent, an all-time low for a French Prime Minister, and further austerity measures were opposed even by many of the Gaullist Party's own parliamentarians. More worrying still for Chirac, he faced a decision on Waigel's Stability Pact, which was put to EU Heads at the December 1996 Dublin European Council. Chirac saw the danger of the pact being seen by the French public as a commitment to perpetual austerity and rising unemployment. He initially refused to endorse it, insisting that it should be reworked to balance price stability with job creation. In the end, though, in a Franco-German compromise brokered at the Summit by the Luxembourg Prime Minister Jean-Claude Juncker, he agreed to a (purely cosmetic) change to the title, and the renamed 'Stability and Growth Pact' was sent for final endorsement at the Amsterdam Summit in June 1997. Chirac is reported as having congratulated Juncker afterwards for achieving agreement on the pact, adding ruefully, 'thanks to you I'm going to lose the elections'.[12]

In the early months of 1997, Chirac became convinced that the Right would indeed lose the Spring 1998 Parliamentary elections if they had to put through all the tough budgetary measures needed by then to meet the 1999 euro launch date. The European Commission's latest economic forecast,[13] as the French were aware ahead of its publication in April 1997, would say that France, like Germany and Italy, would be unable to bring its deficit level sustainably below 3 per cent without taking more measures. Chirac's answer was to surprise everyone by calling unprecedented early elections for late May 1997, arguing that the government needed a new mandate to enable France to take difficult budgetary decisions for euro membership.

Did Chirac really believe that Juppé's Government no longer had the political support to deliver the measures needed to square France's public accounts? Did he perhaps also calculate that, even if he gambled and the Right lost these elections, it might do his own Presidential prospects in 2002 less harm if his Socialist rival Lionel Jospin was implicated in some of these unpopular decisions? Whatever the reason, bringing Parliamentary elections forward was highly unusual in France, and smacked of desperation. French voters were known not to like electoral manoeuvring of this kind.

Despite the Right starting out ahead in the polls, by the May elections Chirac had lost his political gamble, at least in the short term. The Gaullist Party lost control of the Parliament and Juppé resigned,

precipitating Jospin into power at the head of a Socialist-led broad coalition government, which included the Communists and Greens.

Yet, in the longer term, this forced period of 'cohabitation' did not harm Chirac politically. With a political opponent rather than a close Gaullist ally as his Prime Minister, the President could afford to step back from domestic policies – and even to express sympathy for those hardest hit by austerity – while leaving Jospin to take the tough economic decisions, much as Mitterrand had done to Chirac when the latter was Prime Minister in 1986–88.

Qualifying for euro membership: a new French cross-party consensus on EMU

Chirac's lost political gamble also turned out, in the wider game of the politics of the euro, to be a benefit for France. For Jospin's arrival eventually helped to restore public confidence in the single currency and to re-establish the left-right moderate consensus behind EMU so badly shaken by the economic and monetary shocks of the early 1990s. By the end of its Parliamentary term, Jospin's Government would have resolved Chirac's budgetary dilemma and successfully led France into the European single currency.

This outcome was far from self- evident when Jospin first took office in June 1997. A former Trotskyist who had joined Mitterrand's Socialist Party in 1971 and served as Education Minister in his second term, Jospin had increasingly opposed Mitterrand's economic policies. As the Socialist Presidential candidate in 1995, he had, with Communist Party support, come a close second to Chirac, helping to restore his party's credibility after its disastrous 1993 Parliamentary defeat. Jospin was openly sceptical about the euro project and publicly critical of Waigel's Stability Pact as putting jobs and recovery at risk.

Chirac's calling of early elections had taken Jospin by surprise.[14] When early polls made it appear unlikely the Socialists would win, Jospin hastily mounted an election campaign designed primarily to promote his longer-term Presidential prospects by appealing to his Communist allies, who opposed the euro, and to grassroots Left voters worried about persistent unemployment. Campaigning on a promise to 'change the future' (a nod to his party's 1981 promise to 'change our lives' (Fr. 'changer la vie')), Jospin said he wanted 'Maastricht, but not at any price'. His key conditions for the euro were, first, that it should have a 'wide' membership, including France's Mediterranean trading partners; second, that it should be accompanied by a 'social

Europe', with policies to boost growth and employment, rather than the Stability Pact in its present form; and third, that a European 'economic government' should be created to take political decisions on fiscal policy. These were familiar Socialist Party demands, similar to those already promoted by Bérégovoy in the run up to Maastricht. They had, however, been designed to rally the party faithful rather than as worked through policies for a future government. Now, unexpectedly, Jospin faced the challenge of negotiating as Prime Minister the changes he had been calling for.

On 5 June 1997, just days after the elections, Jospin tested out likely support for his EMU conditions from other EU Socialist leaders at their meeting in Malmo, Sweden. With unemployment rising across the EU, Left-wing parties had recently been winning elections in a number of EU countries and looked likely to take control of the next European Parliament. There was a broad Left consensus that more needed to be done at EU level to stimulate growth and employment. Was it enough to give France a chance of pushing through changes to the way economic policy would be managed inside a future eurozone?

Jospin explained the conditions in his manifesto for France's participation in EMU. He also explained French difficulties in meeting the Maastricht deficit criterion in the 1998 budget. Might it be possible, he wondered, to postpone EMU to allow for a renegotiation of some of the terms? According to one observer,[15] his question produced a 'frisson of horror'. No one supported delay. Luxembourg Deputy PM Jacques Poos pointed out that postponement of EMU could result in disaster on the money markets. Netherlands PM Wim Kok stressed that the Stability and Growth Pact had been agreed at the December 1996 Dublin Summit, and he could not see how it could be changed significantly. The Netherlands Presidency would not alter preparations for the Amsterdam Summit later that month, which was due to sign off on a resolution[16] and two regulations to implement the pact. In any case, Kok asked pointedly, would Jospin find it any easier to agree to the package in six weeks' time?

Back home, Jospin bit the bullet and decided he had no option but to accept the Stability and Growth Pact, along with the 'Amsterdam Treaty', amending the Maastricht Treaty, which had been negotiated in the 1996–97 Intergovernmental Conference (IGC) during his predecessor's time in office. Jospin's Minister for European Affairs at the time, Pierre Moscovici, is quoted[17] as commenting privately: 'We decided that the fight against Amsterdam wasn't worth the candle. We were in triple cohabitation with Jacques Chirac, the Germans and the markets'.

So Jospin shelved his conditions. He endorsed the Amsterdam Treaty and, with the addition of a face-saving resolution calling for co-ordinated EU action on growth and employment, agreed to the package on the Stability and Growth Pact. As some consolation to the French Socialists, the Germans agreed at Amsterdam to a Special European Council in the Autumn on employment, and the new UK Labour Government under Tony Blair agreed to re-integrate into the Amsterdam Treaty a strengthened version of the social policy agreement John Major had refused to sign at Maastricht.

The Amsterdam Treaty did, moreover, introduce one important institutional innovation that Chirac had been pressing for. This was to extend to all three 'pillars' of the EU a legal provision for 'enhanced co-operation', whereby the most ambitious Member States in a policy area could deepen EU co-operation among themselves, while allowing others to catch up at a later date. For France, this 'flexibility' in the Treaty was particularly useful in potentially allowing countries inside a future eurozone to deepen their economic co-operation, without needing the agreement of those still outside.

After Amsterdam, Jospin dropped his public criticisms of EMU and set his government's sights on achieving a successful launch of the euro in 1999. In September, Finance Minister Dominique Strauss-Kahn tabled a draft 1998 French budget with the deficit forecast at 3 per cent. It contained a carefully balanced package of tax rises and a freeze on government spending, combined with help for education and the unemployed. The Socialists had by now also decided to maintain most of Juppé's programme for increasing privatisation of French state-owned companies, including the France Telecom one-off payment into the 1997 budget.

With the Right still in disarray after their election defeat and the Communists and Greens constrained as government partners, the budget's announced austerity measures, which Chirac had so feared to take, were received with barely a whimper. Other political factors helped too. Jospin's focus on fighting unemployment (in 1997 his government introduced radical proposals for a 35 hour working week, intended to stimulate job creation) and his consensual style of government, holding regular public policy consultations, contrasted with Juppé's earlier attempts to force through reforms.

Above all, though, the government benefitted from France's surprise return to economic good health. French exports had been boosted by an exceptionally strong dollar in 1996,[18] and business investment had picked up thanks to low interest rates. By November 1997, with France's

GDP growth running at around 3 per cent, the public mood had lifted too, and Jospin was basking in popularity ratings of over 60 per cent in the polls.[19]

Economic governance of the eurozone and the Franco-German alliance

From Summer 1997, the Jospin Government made efforts to mend fences with the Germans, who had been shaken by Chirac's failure to secure a new mandate for Juppé's policies and by Jospin's campaign attacks on the Stability Pact. Jospin met Kohl in Bonn on 28 August and reassured him that France would do everything possible to ensure the euro could be launched on time with a large number of countries participating. By now, the Germans were as confident as the French of meeting the budget deficit criterion and Kohl was determined[20] to proceed with EMU in 1999. It had become clear too that most other EU countries were set to take the tough budgetary decisions – and whatever one-off measures they could find – to qualify for the first wave.

Almost all the technical preparations for the launch of the euro were by now in place. However, there were still unresolved issues between France and Germany over how, in a future eurozone, economic decisions would be taken and made politically accountable. Despite having signed up to the Stability and Growth Pact, the French remained adamant that the eurozone could not be run by pre-set budgetary rules alone but required some kind of 'economic government'. This would take the form of a politically accountable EU forum in which eurozone Ministers could co-ordinate their economic policies. At French insistence, the Amsterdam Summit Conclusions had included a mandate to the Commission and Council to consider ways of improving economic policy co-ordination and to make a report on its conclusions to the December 1997 Luxembourg European Council. Jospin stressed to Kohl when they met in Bonn in August that his government wished to see more ambitious EU institutional reform, including on EMU, and hinted that France might make this a precondition before agreeing to further EU enlargement.[21]

The Amsterdam Treaty embodied only limited progress in improving the EU's decision-making structures to cope with a much larger number of countries joining. Hopes which Kohl and Mitterrand had expressed at Maastricht that the IGC in 1996 would be able to agree much deeper European political integration proved ill-founded. The historic ending of the East-West divide in Europe in 1989–91 had opened up a political window for deepening of European integration which was not to last.

The long economic downturn after 1991 made it harder politically inside France to secure popular support for letting poorer countries join the EU, as well as for ceding further decision-making power to Brussels. Once again, EU reform negotiations foundered on the enduring constitutional differences between France and Germany over where political power in the EU should lie. This time they were sharpened by new Franco-German tensions over German demands that a – now much bigger – Germany should carry more voting weight in European institutions. At the Amsterdam Summit, important changes needed ahead of EU enlargement to rationalise the number of European Commissioners, reassess the relative voting weights of large and small countries and increase the use of qualified majority voting were put off to yet another IGC. This looked unlikely to conclude before 2000, after the euro's launch.

French demands for an 'economic government' of the eurozone were therefore, if anything, more unwelcome to Germany in 1997 than they had been in 1991. Polls showed that between 60 and 70 per cent of Germans, although by now mostly resigned to the euro, opposed giving up the deutschmark, largely because they feared French political interference would undermine the euro's stability. The Bundesbank and German Finance Ministry continued to refuse to contemplate any formal EU decision-making body which could cut across the authority of the ECB to preserve monetary stability. Nonetheless, Kohl realised that something needed to be done to meet French concerns.

Intensive Franco-German bilateral discussions followed in Autumn 1997 to agree a common position on EMU ahead of the December Luxembourg European Council. Out of deference to German sensitivities, the French dropped their earlier references to 'economic government'. In a major interview on France's European policy in September 1997,[22] Europe Minister Pierre Moscovici admitted that the Germans interpreted such a term 'as a resurgence of our traditional interventionism, if not as an attempt to claw back the independence of the European Central Bank'. Instead, he suggested, 'let us speak of…"economic policy co-ordination"…since this is more operational'. This would, he argued, require the setting up of a 'Euro Council', within which, France proposed, eurozone Finance Ministers would discuss the smooth functioning of EMU, especially budgetary and fiscal policies.

Following the 14 October Franco-German Economic and Financial Council, Finance Ministers Waigel and Straus-Kahn circulated to ECOFIN colleagues a joint Note on 'Economic Policy Co-ordination in Stage 3 of EMU', which they hoped could be agreed by ECOFIN and endorsed by the December European Council in Luxembourg. While stressing that

ECOFIN would remain the only EU body taking formal decisions, the Note set out a list of economic, budgetary and monetary topics which might be discussed separately, ahead of ECOFIN meetings, by a group (at German insistence, kept informal and dubbed 'Euro-X' rather than 'Euro Council') of eurozone Finance Ministers, joined where appropriate by the European Commission and the ECB. This proposal proved controversial, particularly with the UK, Denmark and Sweden who had decided against joining the euro in 1999 but who wished to be involved in all decisions affecting the European Single Market. Nonetheless, it was finally agreed by Heads of Government at the December 1997 Luxembourg Summit, politically clearing the way for the third and final stage of the Delors Plan on EMU.

Green light to a wide eurozone

It fell to the UK as EU Presidency to chair the Special European Council, held over the weekend of 1–3 May 1998, which gave the go ahead to full European Economic and Monetary Union. The Special Council also confirmed the currency conversion rates which would apply once the euro was created and decided that the ECB would be established in Frankfurt on 1 June 1998, preparing to run a single monetary policy from the launch of the euro on 1 January 1999. Over lunch, EU leaders reached political agreement on nominations to the ECB's Executive Board. The most difficult issue was the nomination of the ECB President, where Kohl supported the Dutchman Wim Duisenberg, and Chirac lobbied for the Governor of the Banque de France, Jean-Claude Trichet. Duisenberg was finally appointed, but in a confused discussion the French believed they had reached an understanding that Trichet would take over after four years (in the end Trichet took over in November 2003 and remained ECB President until November 2011).

Although the May 1998 Special European Council took the formal decision on who qualified to join the eurozone in 1999, the issue had effectively been decided earlier in the year by the publication of reports[23] from the European Commission and the European Monetary Institute (forerunner of the ECB). The Commission judged that the 'excessive deficits' of nine EU Member States, including France, Germany, Spain and Italy, had been corrected and that 11 Member States (Germany, France, Italy, Belgium, Netherlands, Luxembourg, Finland, Austria, Ireland, Portugal and Spain) now fulfilled the necessary conditions to join the euro in the first wave. Of the remaining four EU members, three – UK, Denmark and Sweden – were not candidates to join in 1999. Greece

was the only candidate assessed as not yet ready to join, having failed all the Maastricht criteria. However, even Greece's economy was on an improving trend and the drachma had rejoined the ERM in March 1998, a signal of the Greek government's declared determination to join in January 2001.

The Jospin Government welcomed the Commission and EMI reports. On 22 April, Finance Minister Strauss-Kahn told the French National Assembly: 'As the French Government has hoped for ten months, EMU is starting off with a wide euro, with all the countries who want to do it'. A Parliamentary resolution, approving the Commission's recommendations, was approved by a large majority.

The French had every reason to be pleased, especially that their major trading partners and competitors Italy and Spain had qualified for the euro, but also because a wide eurozone meant a stronger role for the 'Euro-X' group (now to become the 'Euro-11'). Economic policy co-ordination would be needed to promote economic convergence between the poorer countries in the south of Europe and richer ones in the north, with France potentially holding the balance between the two groups.

France, the euro and the global economy

For France, wide membership also gave the eurozone the political potential to carry more weight in international bodies like the International Monetary Fund (IMF), and even one day to challenge the supremacy of the dollar as the global trading and reserve currency, a longstanding French ambition. On 26 August 1998, in his speech to the annual conference of France's Ambassadors, President Chirac set out why, with Kohl, he had promoted 'the most ambitious European project to date'. EMU, he said, 'is the necessary complement to the Single Market … gives France back its monetary sovereignty … protects our people from crises and from monetary fluctuations … gives us the collective economic disciplines which best guarantee sustainable, healthy growth and thus employment … and finally, … it enables Europe to be the equal of America in the decisive monetary arena'. France, Chirac argued, should encourage the emergence of a 'multi-polar world', in which Europe would carry equal weight with other large regions, enabling the creation of new global relationships and the strengthening of international institutions.

On September 10 1998, in an exclusive think-piece in the weekly centre-Left French magazine *Le Nouvel Observateur*, Prime Minister Jospin set out an even more ambitious vision for EMU in the global economy.[24] He pointed out that global capitalism, like all capitalism, had an Achilles

heel: it led to financial accumulation for its own sake which, being neither economically productive nor fair, was ultimately destabilising. This inherent instability had been proven by the recent economic crises in Mexico, Asia and Russia. To succeed, the market economy needed stability, proper rules, and solid, democratic political institutions. One could not have a healthy economy without a healthy political structure, social protection and respect for people and their history.

In future, Jospin argued, the globalisation of economic activity needed to be managed through global policies. These should take the form, first, of a collective review of how capital markets worked, leading to new prudential and transparency rules, as well as new methods to combat abuses and to encourage healthy activity. IMF competences should be widened to cover capital movements and to tackle offshore financial centres. Secondly, a new international monetary system, a more flexible version of Bretton Woods, should be built around regional economic entities, linked by flexible but managed exchange rates. Europe should lead the way in establishing this international policy dialogue, building on its new-found credibility through the stability it had created by establishing its own monetary union. This stability, Jospin argued, had been proven by the success of European economic policy co-ordination in the new Euro Council, which had emerged strengthened from the latest global financial crises.

These French ambitions for the eurozone were further nurtured by the election in Germany in Autumn 1999 of a Social Democrat (SPD) government, marking the end of Kohl's 16 years as Chancellor. Chirac and Jospin were both wary of the new German Chancellor, Gerhard Schröder, who had campaigned as a pro-business economic moderniser, and as a pragmatist, rather than an idealist, on European integration. They had hoped to see the return of Kohl, whose European convictions were rooted in the war and had stood the test of time.

The French Socialists did, however, welcome Waigel's replacement as Finance Minister, SPD Chairman Oskar Lafontaine, a francophone with whom they had longstanding party links. From Autumn 1998 to Spring 1999, Strauss-Kahn and Lafontaine worked together to flesh out how best to promote the new European currency, producing a joint paper entitled 'Making the best of the euro'.[25] The paper set out a strategy to improve budgetary co-ordination and to co-ordinate tax policies, eliminating 'tax havens'. More controversially in Germany, it advocated an active exchange rate policy towards the US dollar, aimed at avoiding excessive appreciation of the euro and, in the longer term, negotiating with the US a more stable international currency regime.

The publication of the joint paper in January 1999 would, however, prove to be the high water mark of Franco-German co-operation over the euro's international role. It was unclear whether Lafontaine had secured Schröder's authority to agree the paper with the French. Two months after its publication, Lafontaine quarrelled with Schröder and left the government. Strauss-Kahn also quit his post in Autumn 1999. Franco-German co-operation on tax co-ordination subsequently fell apart in the face of stiff resistance from EU countries which depended on competitive tax rates to attract financial services, especially the UK, Luxembourg and Ireland.

Although the French later used their 2000 EU Presidency to raise the profile of the Euro 11 by holding regular press conferences, they did not succeed at the 7–9 December 2000 Nice European Council in extending its policy role. The Council was marked by long and difficult Nice Treaty negotiations[26] on the reweighting of votes and the extension of qualified majority voting to prepare the way for EU enlargement. France's main concern was to maintain its equal voting weight with Germany. When Franco-German bilateral co-ordination broke down, Chirac achieved this by forcing through, in protracted overnight negotiations, especially with Belgium, a political decision to reduce the voting weights of small and medium-sized Member States, while keeping the large ones at voting parity. It only delayed a decision on vote reweighting since, at German and Belgian insistence, the Nice Conclusions included provision for a new IGC in 2004.

Meanwhile, the Nice Summit outcome served to deepen political divisions between France and Germany, as well as between France and Belgium and the Netherlands. Whereas the latter sought to defend the principles of the original European Community against the power politics of the big Member States, the Nice Summit further reinforced the intergovernmental and political nature of EU decision making, in accordance with Chirac's vision of the EU as 'not a United States of Europe' but rather 'a United Europe of States'.[27] This politicisation of the EU would eventually rebound on France as Germany under Schröder became more concerned with its own competitiveness and less willing than Kohl had been to place German economic strength at the service of the EU.

Conclusions and forward look: France at the launch of EMU

The successful launch of the euro with a wide membership in 1999 marked the attainment of a strategic objective that successive French

leaders had pursued for over three decades. The political drive for EMU enabled France to recover from the economic policy mistakes of the 1970s and early 1980s, when it had struggled to reconcile the radically changed global environment after the collapse of Bretton Woods with the economic and political aspirations of its rising middle class. From 1983 onwards, the EMU project, and the anchor of the franc to the deutschmark that helped to achieve it, made possible in France a painfully achieved economic policy consensus, representing a difficult balance between conflicting domestic and international pressures.

As a French-driven project, seen inside France as enhancing French European and global influence, EMU also made possible the progressive modernisation and opening up of the French economy, despite deep-rooted popular assumptions about the need for strong, centralised state control, which otherwise could have stood in the way of France's integration into the European Single Market and the wider global economy.

When the euro came into being, France locked in a competitive advantage by permanently fixing its currency against Germany's at an exchange rate (3.35 francs = 1 deutschmark), which had not changed since the last EMS devaluation in January 1987, at a time when France's economy had been in worse shape than Germany's. The impact on Germany of reunification and the modernisation and reform process in France changed the relative performances of the two economies. By the time the euro was launched, the French economy was consistently growing more strongly than Germany's, wage costs were more competitive than Germany's, and France had a trade surplus. Although unemployment was still uncomfortably high, it had come down under Jospin's Government from over 12 to around 9 per cent. The public mood in France was optimistic, and all the pressure was on Germany to put its house in order.

Over the first decade of the euro's existence, that competitive advantage over Germany, for which France had fought so hard during the 1980s and 90s, was to be lost. Moreover, despite Waigel's Stability and Growth Pact and France's longstanding efforts to improve economic policy co-ordination, the eurozone would suffer after 2008 the full impact of the global financial crisis, losing in its wake both stability and growth.

The next two chapters explore how these changes came about.

8
1999–2007: French Competitiveness and European Reform

1999–2002: The 'good years': how France lost its competitive edge

Before the launch of the euro in 1999, the broad expectation in France had been that the new European currency would strengthen against the dollar. Many economic commentators[1] argued that governments and private investors would diversify assets away from the dollar and into the euro, which would grow to rival the dollar as a global currency. The main French concern was that the European Central Bank (ECB), modelling itself on the Bundesbank and keen to establish its credibility, would strengthen the euro still further by keeping interest rates relatively high, thereby depressing France's economic growth and trade competitiveness. In French eyes, it was crucially important that eurozone Finance Ministers should co-ordinate their economic policies, since effective budgetary control and economic reform would offset the need for the ECB to use monetary policy to bolster the euro.

In the event, the euro significantly lost value against the dollar between its creation as an electronic trading entity in January 1999 and the successful deployment of euro notes and coins in 2002. In large part, this was due to long-term capital outflows from Europe into the US, as French and other EU businesses seized opportunities for mergers and acquisitions, and European financial investors sought out higher returns. That a comparable amount of capital from the US and other parts of the world did not initially flow into Europe as expected can partly be ascribed to US interest rates being higher than those in the eurozone until 2001 (when the US economy turned sharply down and the position reversed). It also, however, reflected market uncertainty about the future governance and credibility of the euro, especially after

the surprise qualification of Italy and (in 2000) of Greece, countries whose financial discipline was known to be weak.[2]

The French response to the euro's unexpected weakness was mixed. In a joint assessment of economic policy co-ordination in the eurozone, published in January 2001,[3] two eminent French economists in Prime Minister Jospin's 'Council for Economic Analysis', Pierre Jacquet[4] and Jean Pisani-Ferry[5], continued to make the case for strengthened eurozone economic governance. They advocated optimising eurozone economic decision making and actively promoting stability by transforming the informal Euro 11 (renamed the 'Eurogroup' following Greece's membership from January 2001) into a collective executive body, an 'Economic Policy Council' of Finance Ministers to decide on strategies for dealing with structural problems or for responding to economic or financial shocks. This, they insisted, would build confidence in the euro and encourage inward investment.

Jacquet and Pisani-Ferry argued that it would be a mistake to assume that monetary policy conducted by the ECB was enough in itself to control eurozone inflation and to deliver competitiveness and growth. They pointed out that decisions by individual eurozone countries on public spending, taxation and structural reforms affected prices and thus overall inflation in the eurozone. Such decisions also had spill over effects on the competitiveness of other countries who shared the same currency. It was therefore essential to co-ordinate these individual policy decisions to maximise their positive impact on the eurozone as a whole and to ensure that decisions taken by the ECB on interest rates could take them into account. Moreover, by coming together at the European level to agree these politically sensitive decisions, Finance Ministers were taking collective political responsibility for them rather than pushing all responsibility onto the (unelected) ECB: 'It would be quite wrong for the ECB to be held accountable beyond the range of its responsibilities'.[6]

Jacquet and Pisani-Ferry foresaw, however, that the ideals of mutual co-operation and collective responsibility which were needed to optimise the economic benefits of a shared currency risked vying with the temptation nationally elected politicians faced of putting national interest above the collective European good. They warned that: 'Recent policy behaviour in most Member States – including France, despite its repeated insistence on the need to co-ordinate policies – highlights that in 'good times' co-ordination becomes a less urgent priority. (...) Furthermore, there is a temptation to 'nationalise' growth, by presenting it as the result of national, not European policies'.[7] It was a perceptive insight, for the political mood in France was shifting.

The euro's early weakness and the fact that continuing economic difficulties in the eurozone's biggest economy, Germany, meant that the ECB initially kept interest rates relatively low were an unexpected boon to the French economy in the last years of the Jospin Government, which enjoyed strong GDP growth, consistently above Germany's, and a healthy trade surplus. The French economy was also at last benefitting from the gains painfully achieved through the policy of 'competitive disinflation' in earlier years, when France had kept interest rates high to support the franc's peg to the deutschmark. Now Germany was facing the effects of having entered the euro at an overvalued parity, while France's currency had been undervalued, a significant advantage for French exporters. In these 'good times', the political and economic attractiveness to France of co-ordinating its budgetary and structural policies with European partners fell away.

Moreover, with an eye to the 2002 Presidential elections, both Jospin and Chirac chose domestic spending over their European promises to reduce the public deficit, disagreeing only over the spending priorities. After a decade of record high unemployment French political parties of both Left and Right were under political pressure to boost growth and employment. Jospin wanted to do this by reforming the labour market, especially through the introduction of a 35 hour week, which the Socialists expected to create new jobs, whereas Chirac favoured tax cuts.[8] So it was that, rather than using the good times to reduce its debts and to save for a rainy day, France, like a number of other eurozone economies, let out more slack (or, in the jargon of economists, adopted pro-cyclical expansionist fiscal policies, rather than making use of automatic stabilisers). Because of the Spring elections, spending continued into 2002 even when it became clear that the French economy was slowing sharply, following the rise in oil prices and the US economic downturn, accelerated by the 11 September 2001 terrorist attacks.

By the time that Jospin, following a lacklustre campaign, had lost the Presidential elections to Chirac, having been knocked out in the first round on 21 April 2002 by the far-Right 'Front National' leader Jean-Marie Le Pen, US interest rates were falling sharply, and the euro was beginning its long climb against the dollar. France's economic 'good times' were over.

The policy choices made in the period from mid-1997 to early 2002, when France economically outperformed its eurozone partners, while Germany found itself branded ' the sick man of Europe',[9] were to prove costly for French business competitiveness. While France under Jospin introduced from 2000 a 35 hour working week, pushing up overall

wage costs, Schröder confronted the need for tough domestic welfare and labour market reforms. He proposed a raft of measures, which he dubbed 'Agenda 2010', to help Germany recover from its loss of business competitiveness since reunification. Largely as a result of deep cuts in employers' costs and the introduction of more flexible working practices agreed between employers and trades unions during Schröder's time in office, especially in 2003–04, Germany transformed its economy and overtook France in the race for competitiveness.

Although the downward trend in French competitiveness was set under Jospin, the governments of the Right that succeeded one another over the next ten years did not reverse it. While German unit labour costs remained broadly the same between 2000 and 2008, those in France rose by almost 20 per cent over the same period,[10] and continued on an upwards trend thereafter. German exporters, competing mainly in high value markets, coped better than their French counterparts with a stronger euro and, over the euro's first decade, increased their global market share, particularly in China and other emerging markets, making Germany by 2005 the world's top exporting country. German car manufacturers also took advantage of the availability of cheap labour in an enlarged EU to outsource lower skilled assembly processes to central European countries while keeping overall production inside Germany. French exporters, by contrast, especially in mid-value markets such as car manufacturing, were slower to adapt to changing market conditions and consistently lost ground, accounting for 17 per cent of eurozone exports of goods and services in 1999 but only 12.9 per cent by 2011.[11]

Schröder's domestic welfare and labour market reforms in 2002–04 were made all the harder to push through by the continued sluggishness of the German economy (GDP growth in 2002 was 0.0 per cent; in 2003 – 0.4 per cent[12]), reducing state revenue and increasing the public deficit. As initial attempts to control spending and reduce the deficit seemed only to dampen Germany's economy still further, Schröder moved instead to limit the political damage his reform programme was causing to his government's popularity by maintaining relatively high state spending levels. In defiance of eurozone governance rules that Germany itself had insisted on putting in place, he allowed Germany's public deficit to exceed the 3 per cent Maastricht limit and, by 2003, to reach 4.2 per cent.

If Chirac had followed the published advice of his government's economic advisers, such as Jacquet and Pisani-Ferry, his response to Schröder's decision to prioritise German economic interests would have been to play the European card of pushing for improved eurozone

economic policy co-ordination to offset the impact of Germany's self-interested economic behaviour on its eurozone neighbours. Instead, he chose to collude with the German Chancellor in weakening the most binding instrument the EU had so far put in place collectively to manage economic policy: the Stability and Growth Pact (SGP).

Like Schröder, Chirac had domestic political reasons for defying European budget discipline. Unlike Schröder, however, these were not linked to a major drive for structural reform.

Chirac, Schröder and the destabilising of the stability and growth pact

Jospin's 2002 Presidential defeat, and the inevitable Socialist losses which followed in the Parliamentary elections soon after, ushered in a decade in which the Right governed France alone. Constitutional change had by now shortened the Presidential term from seven to five years, aligning Presidential and Parliamentary terms and putting an end to 'cohabitation' between Presidents and governments of different political colours. This was seen as giving the electorate clearer choices. It also, however, had the effect of putting the President under greater domestic political pressure, since he was more closely identified with the party of government. This shortening of the political time horizon, combined with the fact that Presidents and Prime Ministers of different political colours were no longer forced to work together as they had been in the 1980s and 1990s, made France's longstanding left-right moderate consensus on economic and European policies harder to sustain.

The effect from 2002 was exacerbated inside France by heightened concerns about Islamic terrorism, in the wake of Al-Qaida's attack on the US in September 2001, and, as the unemployment rate began to climb again, about the effect on jobs of the free movement of EU workers. After Le Pen's shock success in reaching the second round of the 2002 Presidential elections, Chirac was determined to weaken the far-Right's appeal to the economically vulnerable by focussing on French security and by hardening his own rhetoric where France's national interests were at stake.

Despite falling state revenues, as the French economy was increasingly affected by the rising euro and slowing world demand, the new Gaullist-led government under PM Jean-Pierre Raffarin persisted with the tax-cutting agenda Chirac had promised for his second term, along with increased spending on security and defence. Nor did Raffarin repeal the 35 hour week legislation introduced by Jospin, which commanded

broad political support, although his government did attempt to make its implementation more flexible and less costly. The biggest problem for the public deficit, though, was not the 35 hour week, whose costs were partially offset by a reduction in unemployment, but rather the failure of successive governments to control France's fast-rising pension and healthcare costs. From 1999 onwards, under both the Jospin and the Raffarin Governments French budgetary expenditure was consistently well above the government's own targets, the largest overspend coming from the social security budget.[13]

In Spring 2003, after months of over-optimistic forecasting on growth and the state of French public finances, Raffarin conceded in an interview with the economic newspaper *Les Echos*[14] that Eurostat had correctly assessed that France had exceeded the Maastricht 3 per cent deficit threshold in 2002. He revised down an earlier growth forecast for 2003 from 2.5 per cent to 1.3 per cent, which suggested that France's deficit over the year would increase from 3.1 to 3.4 per cent and looked unlikely to come back under 3 per cent before 2004 (in fact, according to Eurostat, it reached 4.1 per cent in 2003 and did not come back under 3 per cent until 2005).

Once both Germany and France were in breach of the Treaty requirement for Member States to avoid running an excessive deficit, as well as the requirement under the Stability and Growth Pact (SGP) to achieve and maintain budgetary positions 'close to balance or in surplus', the European Commission, as guardian of the Treaties, had little option but to take disciplinary action against them. A clash between the eurozone's biggest countries, France, Germany and Italy, and the European Commission now became inevitable.

Ministers in the ECOFIN Council from the larger countries had consistently shown themselves to be sympathetic to each other's national budgetary problems, each recognising that their own turn for censure might come next. Instead of backing the Commission's application of the EU legislation they had signed up to, they criticised the inflexibility of the SGP's rules, arguing that these forced countries to cut spending in a downturn, depressing their economies further. In February 2002, European Economic and Finance Ministers had already formally rejected Commission recommendations to issue early warnings to countries, including Germany, who were at risk of running an excessive deficit.

Throughout 2002, critics and supporters of the SGP attacked each other in the media. ECB President Wim Duisenburg and his expected successor, French Central Bank Governor Jean-Claude Trichet, both supported the pact, Trichet arguing publicly[15] that it was 'an essential

element for the credibility of EMU' and pointing out privately[16] that the larger eurozone members had created their own problems by failing to get their budget deficits down in the good years. By contrast, French Finance Minister Francis Mer was quoted[17] as saying that France had 'other priorities' than abiding by the SGP, such as boosting growth and raising military expenditure.

In Autumn 2002,[18] the Commission tried to find a compromise with the Council, recognising that the SGP needed to be implemented flexibly so as to allow for the economic cycle, enabling more spending by individual countries in a downturn while ensuring that they ran a tightened budget in good times. The Commission did not, however, advocate changing the SGP's core budget rules or objectives but rather proposed measures to improve the consistency and transparency with which they were applied. This pleased those countries, like Spain, Finland and the Netherlands, who had obeyed the budgetary rules. It did not satisfy those, like France, who had already failed to create budgetary headroom in the good times. Commission President Romano Prodi then undermined the Commission's own credibility by appearing publicly to throw his lot in with the SGP's critics, calling the pact 'stupid, like all rigid decisions', and arguing for 'a more intelligent tool and more flexibility ... '[19]

On 25 November 2003, after lobbying by Germany and France, and with Italian and UK support, a majority of EU Finance Ministers in ECOFIN decided against adopting the Commission's recommendations that France and Germany had not taken effective action to reduce their deficits and should thus face disciplinary action under the SGP's rules. Instead, they placed the Excessive Deficit Procedures for each country into abeyance, while setting out steps each should take to reduce the deficit. Spain and the smaller eurozone countries, who had taken painful decisions to abide by the SGP, were furious at this bending of the rules to suit the interests of the two biggest eurozone countries, and in 2004, the European Commission successfully challenged[20] the legal basis for the ECOFIN decision in the European Court of Justice.

The riposte by Chirac and Schröder came at the Spring 2005 European Council. Despite concerns expressed by the ECB and a number of Member States, France and Germany successfully secured agreement to dilute the SGP. The 3 per cent deficit limit was maintained, but now countries were allowed, in presenting their annual budgets for European Commission and Council assessment, to exclude from the balance a whole series of longer-term spending commitments such as state pension costs: in France's case, this included defence spending; in Germany's, the massive payments made since 1990 to support German reunification. Schröder

was cited after the Council as saying that 'Stability is important but growth is at least as important'. Italian President Silvio Berlusconi was quoted[21] as saying that 'Europe's job should not be to create difficulties for Member States but just the opposite' and as promising to contest Eurostat figures showing that Italy's deficit now exceeded 3 per cent.

The weakening of the SGP, the discrimination between powerful and less powerful European countries, and the disarray between the Commission and the Council left the eurozone's economic governance capability threadbare. The French had never liked Waigel's Stability Pact, preferring to give political responsibility for economic policy co-ordination to Finance Ministers in ECOFIN rather than to the SGP's arm's length, rules-based system overseen by the Commission. In that respect, Chirac could regard Schröder's collusion in diluting the pact as a political victory, potentially shifting European decision making towards the intergovernmental approach France had always favoured. It cemented a high-level Franco-German tactical relationship which had also been strengthened by both countries' critical stance towards the 2003 Iraq war.

Yet, the bending of the SGP rules left many other eurozone countries resentful and made intergovernmental economic policy co-ordination much harder. In practice, the outcome was to weaken the eurozone's ability to drive structural reform and the economic convergence of its Member States. It would leave the ECB's monetary policy to shoulder the burden of managing the euro's stability.

2002–07: shifting French public attitudes towards Europe, competitiveness and reform

As the EU struggled to absorb the combined impacts of massive political change in Europe and the creation of a Single Market, the political tension between large and small, older and newer European Member States affected French public attitudes, especially among those who saw themselves as most vulnerable to increased competition. French unemployment remained stubbornly high, and as evidence emerged after the 2002 Presidential elections of an economic slowdown and, from 2004, of slipping French competitiveness, the confidence of households fell steadily[22], reaching its lowest point in late 2005. The popular change in mood was revealed most spectacularly in the French referendum held that year on a new Constitution for Europe.

The Intergovernmental Conference establishing a Constitution for Europe successfully concluded in June 2004, and on 29 October, the EU Member States signed the new Constitutional Treaty, the result of more

than two years of work by a 'European Convention', chaired by former French President Valéry Giscard d'Estaing. The Constitution primarily clarified how existing EU Treaty powers related to those of Member States, but it did provide for a permanent President of the European Council and EU Foreign Minister and also proposed a new system of qualified majority voting in the Council which, for the first time and despite years of resistance by France, took account of Germany's greater population size.[23]

Under pressure from the euro-sceptics within his own party, Chirac had reluctantly followed the example of UK Prime Minister Blair in undertaking to have the Treaty ratified by popular referendum, rather than via Parliament. France's referendum was due to be held on 29 May 2005. After the hairsbreadth 'yes' in the last EU referendum in France, on the Maastricht Treaty, it was a high risk option. Although, according to the Spring 2005 Eurobarometer poll,[24] a slender majority of French opinion was still pro-EU, support had been gradually eroding as the far-Right 'Front National' attracted marginal voters on both Right and Left who saw their jobs or businesses as vulnerable to international competition. Around two-thirds of those polled in France by Eurobarometer cited unemployment and the future state of the economy as their two top concerns, making these issues, rather than the constitutional aspects of the Treaty, critical to their voting choice.

While polls showed French voters needed reassurance that the EU could offer hope of more jobs and prosperity, the messages coming from the French leadership about the EU hardly fitted that picture. Chirac's and Raffarin's public defiance of the EU's SGP had served only to reinforce the impression in France that national spending priorities needed to be protected against the demands of the accountants in Brussels.

More broadly, the tone of France's public discourse on Europe had changed under Chirac. On one level, this was inevitable since France had now achieved the European ambition that had driven Mitterrand's Presidencies – to share control of a stable European currency with Germany. A new European goal needed to be set to justify France's EU strategy and to sustain impetus behind the economic reform effort at home. Yet, Chirac (and his Presidential successors), while maintaining the same economic policy, struggled to offer that new strategic vision and to convince the French public that difficult domestic reforms would pay off in greater prosperity, higher employment and more global influence for France through its European role.

As the EU enlarged its membership, the French leadership's earlier public discourse on economic co-operation and on the creation of

common social policies in Europe became displaced by a discourse on competing actions between different groups of EU nation-states. Whereas Mitterrand had stressed the positive ability through France's EU role to reconcile patriotism and European aspiration (with slogans like: 'France is our homeland; Europe is our future'), Chirac's attitude towards Europe, especially in his second term, was increasingly confrontational. France's declared objective was no longer the 'ever-closer union' of the Maastricht Treaty preamble, but rather a 'refounded' Europe,[25] closer to its citizens' concerns, in which a 'pioneer group' of nation-states[26] (or possibly several different groups, all centred around France and Germany) could take policy initiatives to make the EU, once it had grown in 2004 from 15 to 25 members, more 'efficient' and better able to respond to new challenges like cross-border crime and terrorism.

Chirac's greater rhetorical emphasis on action by (large) nation-states was accompanied by increasing French criticism of the European Institutions, especially the Commission. Once regarded in Mitterrand's time as a potential ally of France, with Delors at its head, the European Commission during Chirac's time in office came increasingly to be seen as too 'Anglo-Saxon', promoting an economically liberal agenda at odds with French interests, especially once former Portuguese PM José Manuel Barroso took over as President from Romano Prodi in November 2004. Chirac did not hide his wariness of Barroso, who, as Portugal's Prime Minister, had given staunch support to the US and UK over the Iraq war. The Barroso Commission's strategic objectives for 2005–09, published in January 2005, were seen by the Gaullist Right in France, as much as by Schröder's Social Democrats, as a 'neo-liberal agenda', prompting Franco-German calls to limit the EU's budget and to introduce a single European tax base for businesses.

Above all, the tabling in early 2005 of Commissioner Bolkestein's draft Single Market Directive to liberalise services in the EU sparked anger in France and in Germany. For France, the timing, just months before the May Constitutional referendum, could not have been worse. In February 2005, French PM Raffarin told the French Parliament that the Bolkestein Directive was 'unacceptable', particularly the draft provision allowing the providers of a service to several EU countries to use the legislation of their country of origin – seen in France as a recipe for attracting EU services to set up in the lowest wage, lowest social provision countries.

Despite having strongly supported the drive to create a Single Market in 1992, both France and Germany now feared that unbridled competition from the ten Central and Eastern European Member States who

joined the EU in 2004 would affect jobs and living standards and foster political extremism. Addressing the European Parliament in March 2005, Schröder argued that EU enlargement was fuelling tax and wage competition across Europe. Barroso eventually signalled the Commission's willingness to reconsider the Directive and, at the March Spring European Council, Chirac and Schröder succeeded in formally sending it back to the drawing board.

Fears raised by the Bolkestein Directive nonetheless had a measurable impact on French opinion in early 2005. Eurobarometer recorded between Autumn 2004 and Spring 2005 an 11 per cent fall in confidence in the EU, a 10 point fall in confidence in the European Commission and a 16 point increase in concern over unemployment.

Voting in the French referendum was also affected by division on the Left. Whereas during Mitterrand's 1992 Maastricht campaign, the Socialist Party had remained united in calling for a 'yes', while Chirac's Gaullist Party had split down the middle, this time the effect was reversed. While the Right held together behind Chirac, former PM Laurent Fabius defied the Socialist Party's National Secretary François Hollande to campaign against the Constitution, on the grounds that it strengthened the 'neo-liberal' tendency of the EU and should have contained more social provisions.

Although the Right avoided a political split, its authority was much weakened and the popularity ratings of Raffarin and Chirac fell sharply in 2005. A belated television appearance by Chirac on 14 April 2005 to put the case for the Constitution barely registered on the succession of polls predicting a majority for 'no'. The final vote on 29 May was just under 55 per cent 'no', 45 per cent 'yes'. According to a French exit poll,[27] 56 per cent of Socialist Party sympathisers had voted 'no', compared with only 22 per cent who had voted negatively in the 1992 Maastricht Treaty referendum. Overall, only among older, wealthier and better educated voters was the 'yes' in the majority. Among all those who voted 'no', the most important reason cited was discontent with the economic and social situation in France. As also happened in the Maastricht referendum, many voters had used the occasion, not to answer the question asked, but rather to register a protest over domestic issues.

Nonetheless, there was evidence in the 2005 referendum of sharply rising discontent in France with the way the EU was developing and of heightened concern over the ability of France to influence this new Europe. This concern was not primarily directed against the introduction of the euro which, according to Eurobarometer[28], 66 per cent of French

people considered in late 2004 to have been beneficial, as opposed to only 41 per cent in Germany (although in the same poll a year later, as the economic recovery in Germany became perceptible, the gap had closed to 57 per cent in France and 47 per cent in Germany). Rather, it highlighted growing pessimism over the ability of France to compete effectively in an EU dominated by the larger Member States and to shape its economic development. In the 2005 Eurobarometer poll, 62 per cent thought that it was the large Member States who had the most power in the EU, but only 40 per cent thought that the EU took account of French interests, and only 34 per cent that France's influence would increase in future.

Chirac's new European vision of France, as part of a 'pioneer group' of large Member States shaping the EU's future, had failed to convince majority French opinion, which instead perceived France as losing jobs and competitiveness in a more open and competitive Europe. French pessimism was reinforced from 2005 onwards by evidence of German economic resurgence and of a power shift in France-German relations.

Markets, competitiveness and the Franco-German relationship

Alongside the impact of EU enlargement and of the changing culture and ethos of European institutions, France's policy towards the eurozone in its first decade was also shaped by the impact of capital liberalisation under the Single Market.

When capital controls were lifted in 1990, EU governments had paid little attention to the consequences, since the prevailing view was that capital liberalisation would drive efficiency and economic convergence between European countries.[29] Yet, once the euro was introduced, instead of going to the most efficiently managed places and to where most economically productive use could be made of it, as conventional economic theory suggested, most private capital was attracted to rapid, high returns from riskier assets in less-regulated countries in the eurozone's periphery. These countries could not counter the overheating this caused by putting up the cost of credit, since interest rates were set by the ECB for the whole eurozone and needed to take account of slow growth in Germany. Private finance flowed into Europe, fuelling property booms in several eurozone countries and prompting the ECB to warn[30] of the risks of unsustainable property price increases.

France did not experience an unsustainable property bubble[31] like those in Ireland, Greece or Spain, and French households and businesses

largely avoided the problems of private indebtedness encountered elsewhere in the eurozone. In France, however, the eurozone's credit-fuelled boom served to mask problems of rising labour costs and growing public sector indebtedness. As Xavier Musca, who in 2002–04 headed the Office of Francis Mer, French Minister of the Economy, Finance and Industry, and from 2004–09 was Director of the Treasury in the French Finance Ministry, points out: 'The early years of the euro seemed to confirm that all was for the best, whereas in reality events were taking a turn for the worst. Because strong GDP growth masked the increase in nominal wages, we did not pay enough attention to the loss of competitiveness'.[32]

In its search for higher yield, private finance paid little attention to the different political and economic risks in eurozone countries or to tensions in their political relations with each other. It is striking in retrospect that, throughout the public row in 2002–05 over the SGP and despite rising budget deficits in a number of eurozone countries, financial markets hardly reacted. The euro remained stable and strong against the dollar and eurozone countries' 10 year bond yields declined steadily and remained broadly convergent. When asked to comment on the row between the Commission and France and Germany, large investment banks like Goldman Sachs, HSBC and Merrill Lynch dismissed the budgetary overruns and the failure of the SGP as inevitable and unlikely to affect eurozone interest rates or debt overall.[33]

In part, this indifference to signs of strain in eurozone public account management could be ascribed to even greater market concerns over the sustainability of the US current account deficit, which made the euro appear a safer haven; in part too, it reflected the fact that government budgets were by now dwarfed by the massive international flows of private finance. Finally, large investment banks had long been dismissive of the effectiveness of the SGP and of the ability of EU countries to co-ordinate their economic policies. By contrast, they saw the Frankfurt-based ECB's performance as effective, drawing on Bundesbank expertise. Trichet, who took over as ECB President in November 2004, was a good communicator and the ECB's global figures for the eurozone highlighted its stability. So, for all these reasons, financial market operators tended to look at the eurozone as a whole, rather than at its component parts.

This sanguine collective market view was also evident in the wake of the European Constitutional crisis. After the French 'no' on 29 May 2005, and the Netherlands 'no' that followed a day later, the EU's Constitutional Treaty was effectively dead. Unlike the 1992 Maastricht Treaty referendum, which sparked months of financial turbulence, the

Constitutional Treaty crisis had no effect on how markets perceived the prospects for the euro or the stability of the eurozone or of its member countries. By September 2005, against a backdrop of higher oil prices following Hurricane Katrina in the US, eurozone long-term government bond yields had dropped to historic lows[34], indicating an all-time high in market confidence.

France had learnt from its experience of exposure to global financial flows that the financial markets, although potentially destabilising, could also be turned to advantage in helping the government manage its own budget priorities more efficiently, provided they were handled with care. France's longstanding peg to the deutschmark and Germany's track record of political and economic commitment to its special bilateral EU relationship with France were considerable market assets, placing France in a class of its own. France could now benefit inside the eurozone by borrowing from the financial markets at record low rates, much lower than for a comparable country outside the eurozone (French 10 year government bond yields in 2002–07 were, for example, consistently below the UK's – and remain so at the time of writing).

The French government debt agency 'Agence France Trésor' (AFT)[35], set up in 2001, worked skilfully through roadshows around the world and in consultation with market professionals to create a large, liquid market for French government debt (AFT's Strategy Committee, chaired by former French Central Bank Governor Jacques de Larosière, includes representatives from international investment banks and major funds and all market operations are conducted through a group of 'Primary dealers', made up of top international banks selected by a committee including French Parliamentarians, but with the French Finance Ministry holding the final say). The marketing operation was successful, perhaps too successful. Whereas in 1993, French public debt stood at the equivalent of just over 45 per cent of GDP; by 2003, it had passed the Maastricht limit at 63 per cent of GDP, and it continued to edge upwards to over 68 per cent by 2008. Almost half of French debt was foreign owned by 2003, rising to 70 per cent by 2010.

The cheap private credit which swept across the eurozone from 2003 onwards acted as an asymmetric shock, affecting eurozone countries differently, including France and Germany. Whereas, in the 1980s and 1990s, France's increased access to international finance through its financial market reforms had helped it to manage the introduction of much needed economic reforms; in the early 2000s, borrowing helped rather to manage the absence or failure of reform. With credit so cheap and plentiful, not only for the government but also for businesses

and individuals, there was little incentive for France (or most other eurozone countries) to make difficult structural changes. A study,[36] published in 2006 by the ECB assessing the impact of EMU on structural reform, found that, after the euro's launch, reforms had actually slowed overall inside the eurozone, compared to the qualifying period leading up to EMU.

Inside France, an official report,[37] published in December 2005, concluded that rising financial debt was a 'preoccupying' problem in France, made worse by the failure of successive governments to use the fruits of privatisation and the years of strong economic growth – especially 1997–2000 – to reduce state debt. It pointed out that, whereas post-war debt had been reduced by inflation, under the euro's anti-inflationary policies this was no longer possible, yet spending habits had not adjusted and debt was being used as an 'easy way out'. The report concluded that getting public expenditure back under control should be France's priority for the following five years.

The European exception to the pattern of debt-fuelled spending in the early years of the euro was Germany, because of its need to recover from the economic impact of reunification. Moreover, since the German housing market was not in these years given over to a speculative boom (although German investors were participating in the property bubbles in eurozone periphery countries like Spain and Greece), economic success was measured domestically in terms of Germany's export performance, rather than in rising house prices.

Economic conditions in Germany began to improve significantly from late 2005, as the Schröder labour market reforms fed through to the external competitiveness of Germany's businesses. German manufacturing exports rose (+ 6.7 per cent from 2004–05[38]), helped by strong demand in France and other EU countries, as well as rising demand from middle-income countries like China and Russia.

In France, by contrast, exports declined in 2003–04 (-2.5 per cent), and grew by only 1.6 per cent in 2004–05. French share of EU-27 exports slipped steadily from 2000 onwards, and businesses shed jobs, despite French real GDP growth continuing to outpace Germany's (+2.5 per cent in 2004, as opposed to +1.2 per cent in Germany).

To maintain competitiveness, France needed to do more to address business rigidities, on the side both of the employers and of the employed. Despite record availability of cheap credit, French management remained reluctant to invest in productive capacity (investment fell by 2.9 per cent in 2002 and by 2.4 per cent in 2003) so that, as Mitterrand had found in the early 1980s, higher demand could not

be met by French industries but simply sucked in more imports. This inflexibility pointed to the need for management to focus on growing the business to meet changing customer demand, but also to the need in some sectors to overcome the high costs and labour market rigidities making firms reluctant to take on new workers.

Structural reforms were, however, made harder by the rising pessimism and distrust of French opinion towards the policies of its own political leadership, as described earlier. Opposition often took the form of strikes and street protests, which in France were much less constrained by law than in Germany. Unlike in Germany,[39] moreover, where all employees in medium to large companies were represented on Works Councils, not always by trades union members, and where trades unions were apolitical, France had a long tradition of confrontation between employers and a competing and fissiparous array of trades unions, most of which had political associations. This made it harder to secure consensus for structural reforms affecting employment, pensions and social benefits. As traditional industries restructured, trade union membership in France was declining and in 2004 stood at only 8.2 per cent of the active population, one of the lowest levels in Europe, but the established, legally recognised trades unions (of whom the three largest were CGT, CDFT and FO) had seats on the joint management boards of France's massive public sector health insurance, pension and unemployment benefit funds. These established trades unions faced competition from newer, more confrontational, and as yet legally unrecognised unions (for example, SUD and UNSA), and were thus reluctant to make any concessions to the Gaullist-led government. Nor could they any longer be sure of controlling protests once they came onto the streets. Repeated government efforts to reduce pension costs, regain control of health insurance spending and to reduce social costs to employers, thus met with unpredictable mass protests and were watered down or abandoned, to be replaced by more debt.

Although the Raffarin Government did make limited progress in 2003 in reforming pensions to reduce longer-term costs, by 2007 public expenditure still accounted for around 53 per cent of French GDP, as it had in 2002 (compared with German public expenditure of 43.5 per cent, down from 48.5 per cent in 2003). In 2007, the French Finance Ministry calculated[40] that – despite 23 billion euros' worth of tax reliefs accorded by successive French governments since 2002 – contributions had still risen overall, because of increased social spending costs, and that French taxation remained significantly higher than Germany's.

The political effect of the change in relative economic competitiveness between France and Germany made itself felt in bilateral relations from 2005 onwards. Schröder himself did not remain in power long enough to reap the political benefit of his reforms. Germany's economic upturn came too late to prevent him from narrowly losing the Federal elections in September 2005, bringing to power CDU leader Angela Merkel at the head of a left-right 'Grand Coalition'. While Merkel was a protégée of Helmut Kohl, and so understood better than Schröder the vision of Europe Kohl had once shared with Mitterrand, she had her own European priorities and no longer saw any need, as Kohl had once done, to 'bow twice to the Tricolour'.

In France, Chirac's popularity ratings never recovered from the May 2005 referendum, which did not help him in establishing an effective bilateral and European working relationship with the new German Chancellor. Merkel's authorised biography[41] describes her, on coming to power, regarding Chirac as a head of government 'whose power was on the wane'.

It would be left to Chirac's political rival in the Gaullist Party, Nicolas Sarkozy, to take up the challenge, once elected President in May 2007, of restoring both French competitiveness and France's high-level relationship with Germany. Yet, by then, the eurozone was about to experience the first effects of the global financial crisis.

9
2007–12: The Crisis Years

French political and economic priorities at the onset of the global banking crisis

On 9 August 2007, an asset-management unit linked to France's largest bank BNP Paribas announced that it was ceasing its activity in three US hedge funds specialising in US mortgage debt. The same day, the European Central Bank (ECB) confirmed that it would provide as much funding as banks needed to counter 'tensions in the euro money markets'.[1] These moves sparked a realisation by banks around the world that, as US interest rates rose in the wake of high oil prices, the 'innovative' financial products they had been buying, interwoven with slices of US sub-prime mortgage debt, were far riskier than they once seemed; certainly riskier than the triple A ratings most of them had been awarded by the international credit rating agencies. Since no one knew how to disentangle these complex products or how many of them other banks were holding, the realisation quickly led to panic selling and a breakdown of trust between the banks, threatening a total banking market seizure. The first phase of the global financial crisis had begun.

Outside of investment banking circles, the significance of the collapse in the US sub-prime mortgage market was not at first evident and seemed largely confined to the US itself. In France, the Banque de France was quick to announce that French banks had very limited exposure to the sub-prime market, in the case of BNP Paribas less than 100 million euros. Only later did it become evident that many US and European banks had held back from declaring losses. Société Générale and Crédit Agricole, the next two largest French banks, finally declared in December 2007 losses running into several billion euros.[2]

As for the new Gaullist-led Government under Prime Minister François Fillon, elected in the wake of President Nicolas Sarkozy's arrival in power in May 2007, its priority over Summer 2007 was to introduce a raft of new laws to fulfil the promises in the President's election manifesto. The Presidential campaign had been run during a period of rising economic optimism. In January 2007 the ECB reported[3] a continuing favourable outlook for growth in the eurozone and a buoyant employment market, noting[4] that since 1999 the eurozone had created around 12 million new jobs. With France's GDP growth still looking comparable to the healthy 2.5 per cent it achieved in 2006, and unemployment down to around 8 per cent (its lowest level for 25 years),the focus of political attention during the Spring 2007 Presidential campaign had been on the remaining economic weak spot: France's growing commercial deficit.

Sarkozy 's campaign message was that he would vigorously address France's slipping competitiveness, and boost investment and job creation, by making hard work pay (slogan: 'work more to earn more'), relieving the tax burden on businesses, and helping middle class voters to get on and buy a home. He argued that the French economic and social model needed reform, beginning with the 'catastrophic'[5] law the Socialists had introduced limiting the working week to 35 hours. Only by rewarding ambition and excellence would France recover its export performance and match Germany's success: 'Our external trade, which has long been one of our strengths, is in a very worrying state not because of rising oil prices but because our products are not positioning themselves enough for quality. Germany, which has the same external constraints as us, with the same currency and a higher energy dependency, had a record trade surplus in 2005, the year that our trade deficit reached a historic high (26.4 billion euros, as opposed to 8.3 billion euros in 2004).'[6]

On 10 July 2007 Christine Lagarde, Economy and Finance Minister in the Fillon Government, presented to the French Parliament a major new tax reform bill, called the 'Work, Employment and Purchasing Power Law' or 'TEPA' ('**T**ravail, **E**mploi, **P**ouvoir d'**A**chat'). Designed to stimulate confidence, growth and employment, the law's four main provisions: removed tax on extra hours worked over and above the 35 hour weekly limit; created a 'fiscal shield' protecting anyone from paying more than 50 per cent overall on their taxable income/assets; provided partial tax relief on the cost of a home loan; and largely abolished inheritance tax. Lagarde estimated that introducing the law's measures would add 0.5 per cent onto French GDP growth in 2008, and that, although there would be costs, estimated at 15–20 billion euros overall, the growth in public expenditure could be brought down to one per cent of GDP in

2008. The bill, which was not put out to consultation with social partners beforehand, was rushed through parliament and passed into law on 21 August 2007, just weeks after the first tremors of the coming financial crisis ran through the French banks.

This tax-cutting law, which ignored the ECB's repeated advice to eurozone countries to use the economic good times to improve public finances, deprived the French state of revenue just as it was about to face unprecedented demands. By 2008, under the impact of the first phase of the global financial crisis, GDP growth had plunged to –0.1 per cent, leading to a loss of government revenue which by 2009 left the French public deficit at –7.5 per cent (from –2.7 in 2007). The TEPA law failed, moreover, to produce the promised boost to hard work and jobs: a 2011 Parliamentary Report[7] concluded that that law's flagship provision, to cut tax on supplementary hours worked, had had no measurable effect on the overall number of hours worked or on job creation. Its modest stimulatory effect on GDP of around 0.15 per cent per annum was far outstripped by its costs of 4.5 billion euros per annum (equivalent to 0.23 per cent of GDP), paid for by increasing the public debt.

The TEPA's other three provisions, disproportionately generous to the wealthy, came under public attack once the economic downturn began to bite. As happened elsewhere in the developed world, most of the wealthy beneficiaries of reduced taxes, instead of making longer-term investment in the productive sector as the government had hoped, sought rapid, high returns from speculation on capital assets, especially property. French business investment and export competitiveness continued to slip throughout Sarkozy's Presidential term. Moreover, if the aim had been to encourage businesses and wealthy individuals to keep and declare more wealth inside France there is no evidence this happened. Overall, tax revenue from businesses and from capital, as a proportion of GDP, declined between 2007 and 2009, whereas tax income from labour increased slightly.[8] By the end of 2011 all four major provisions of the TEPA law had been dismantled or amended.[9]

2007–9: Lehman Brothers: how governments became bankers

From Summer 2007 until 15 September 2008, when the US investment bank Lehman Brothers collapsed, Jean-Claude Trichet and his colleagues in the ECB led the eurozone in responding to the global banking crisis, since at this stage it was essentially a question of making more short-term funding available to banks.

The ECB's independence, and its clear mandate to sustain monetary stability, gave it a certain advantage over US and UK central banks, at least in seeing the danger coming a little sooner and taking responsibility for doing something. Trichet had presciently warned, in a keynote address at the Davos World Economic Forum in January 2007, that global financial markets were 'unstable' and that a sharp price correction was possible.[10] The first to react to the unfolding crisis in US sub-prime mortgage debt in early August 2007, the ECB moved quickly, alongside other European central banks, to make dollar funding available to European banks in the US dollar credit crunch which followed the admission by US mortgage lender Countrywide, in mid August, that its home loans portfolio was in trouble. This relieved a credit squeeze that would otherwise have affected Europe much worse than the US, given that the affected credit derivatives were traded in dollars and private European banks did not, unlike their US counterparts, have access to US bank deposits or to dollar funding from the US Federal Reserve.[11]

A few months later, though, events took the crisis into a new phase, which the central banks could not manage alone. The US decision in mid September 2008 to allow Lehman Brothers to go bankrupt forced governments to step in. Under US law, the decision was rational: Lehman Brothers was an investment not a retail bank and its bankruptcy forced sophisticated financial operators to take responsibility for losses. It did not, however, allow for the global consequences. The French, like many other Europeans, were horrified at what, to them, seemed an irresponsible refusal by the US authorities to recognise the third party effects of the collapse of a globally interconnected investment bank, thereby transmitting the damage to the rest of the global financial system. French Finance Minister Christine Lagarde was quoted[12] describing the decision as 'horrendous' and warning of the dangers for the equilibrium of the world financial system.

Once again, European countries were potentially more seriously affected by the unfolding crisis than the US. Whereas Lehman Brothers had been devoted only to investment banking and so in US eyes could be allowed to fail, most big European banks caught up in the ensuing panic combined investment and retail operations. As the panic spread, the ECB's provision of liquidity no longer sufficed and European governments were faced with the prospect of major banks collapsing, with terrible consequences for innocent retail customers, whose deposits could not be disentangled from the funds put at risk by the investment operators. Moreover, in European countries, credit flows to businesses and individuals were more dependent on the banking system

than those in the US, which had a range of non-bank financial intermediaries. According to the Institute of International Finance[13], at end 2009 banks accounted for only 24 per cent of credit intermediation in the US, whereas in eurozone countries they accounted for as much as 74 per cent. In France, Germany, the UK and other European countries, governments had little choice but to bail out the failing private banks, greatly increasing public debt levels.[14]

As the then Governor of the Bank of England, Mervyn King, is attributed with pointing out[15], banks which in earlier good times had seen themselves as international, once the 2008 crisis hit suddenly became national, needing help from the public purse. There was no EU or internationally agreed system for salvaging or winding up bank operations. Nor had a eurozone bailout fund been set up. Indeed the Maastricht Treaty explicitly prevented the ECB from taking on the financial commitments of any Member State or its public bodies. The Treaty negotiators, focussed only on the risks from public liabilities and never envisaging the possibility of a private banking crisis, had in fact not explicitly excluded action by the ECB to support Europe's private banks. Later, how far eurozone governments should exploit this omission would become a subject for intense debate, especially between France and Germany. In 2008, though, the urgent need was to stop the panic and only immediate action by national governments could do that.

Lead responsibility in Europe for managing the financial crisis effectively passed from the ECB to national governments. Since there were no provisions in place for national governments and technical experts in the ECB and Commission to manage the crisis jointly, this transition happened in a disorderly way, through a series of ill co-ordinated national and European-level responses. European governments scrambled to offer their own, differing, national guarantees to retail depositors and to rescue ailing 'national champion' banks.

French Presidency efforts to shape EU and eurozone economic and financial governance

The disarray in the EU and eurozone immediately following the Lehman collapse was a particular embarrassment for France, which in the second half of 2008 was holding the EU rotating Presidency. Determined to get a grip on the European response to the crisis, Sarkozy on 12 October called an emergency Eurogroup meeting in Paris to which, for the first time, the Presidents of the ECB and of the European Commission were formally invited, along with – exceptionally – UK Prime Minister

Gordon Brown, who presented his government's actions, subsequently emulated by the US, to recapitalise and stabilise the country's banking sector. The Eurogroup 'Action Plan',[16] which emerged from the meeting, consisted of little more than endorsement of the fire-fighting actions of the Commission, the ECB, and of various national governments, to make more funding available to banks. On the other hand, it did bring together in one forum nationally elected governments and the EU's technocrats in the ECB and European Commission, giving a much-needed public demonstration of unity and of national political support for European-level action.

Soon afterwards, the 15–16 October 2008 European Council agreed to the setting up of an EU financial crisis cell, formally consisting of the Presidency-in-office, the Presidents of the Commission, ECB (in conjunction with the other European central banks) and Eurogroup, and the governments of the Member States. This new body created the formal link that had been missing from the Maastricht Treaty between, on the one hand, the technical expertise of the ECB and European Commission and, on the other, the political accountability of democratically elected national politicians. For a crisis cell, though, it was a large, unwieldy group which would need to be drastically honed down once the crisis reached its acute phase.

It was still far from clear what the new cell's role would be or how policy to deal with the crisis would be formulated. Was action best agreed among all EU Member States or did the eurozone countries have particular interests requiring them to form a separate policy group? In some areas, such as financial regulation, it made little sense to omit a non-eurozone country like the UK, home to Europe's biggest financial services cluster. Yet the UK, with its floating currency and 'light touch' regulation, did not necessarily share the same interests as countries for whom the stability of the euro was paramount. Initially, though, the European Council aimed to be inclusive of the whole EU. It tasked the Commission with submitting proposals to improve future regulation and supervision of EU financial markets (a task delegated to a working group led by former Governor of the Banque de France Jacques de Larosière), as well as to help economic recovery.

Sarkozy, who throughout his Presidential campaign had called repeatedly for the creation of an 'economic government'[17] to manage the single currency, used France's EU chairmanship to press the October 2008 European Council for more ambitious action on eurozone economic governance. In his press conference afterwards[18] he commented: 'Do we need the same co-ordination for economic policy as we have for

the financial crisis? From the French EU Presidency's point of view the answer is "yes, yes, yes, yes".' He admitted, however, that he had yet to secure unanimity on this point. As always, the UK was determined to avoid being excluded from eurozone decisions which might affect the City's competitive lead in financial services; and the Germans had strong reservations about actions by eurozone Economy Ministers and the European Commission which might affect the ECB's independence to set monetary policy or create divisions within the European Single Market. When Sarkozy subsequently argued, in a Presidency speech to the European Parliament on 21 October 2008, that the ECB – whilst remaining independent- should be able to have a dialogue with a eurozone 'economic government', Commission President Barroso was reported as commenting that: 'one should not create the very dangerous illusion that…the idea might be to give instructions to the central bank'.[19]

This political stand-off inside the EU meant that the issue of further strengthening eurozone economic governance would not be revisited until 2010, by which time the eurozone would be in full-blown crisis.

France and the global response

At the global level, in his October 2008 press conference, Sarkozy flagged up unanimous EU support for convening, before the end of the year, an international conference to negotiate what he dubbed a 'new Bretton Woods' agreement. This proposal, which Sarkozy saw as building new international architecture for the governance of world capitalism, would, he announced, be put to the US President the following weekend during his joint visit to Washington with European Commission President Barroso. In fact, there had already been discussions among the G7 of how best in future to work with what became known as the 'G20', the 20 largest world economies, for the first time including in discussions on global economic issues fast-growing emerging economies such as China, India and Brazil. France was keen to shape the agenda of those discussions around its longstanding efforts to persuade the US to agree to a new form of global Bretton Woods system, not only to handle the immediate crisis, but also to create permanent global architecture to help jointly manage destabilising capital flows and to tackle global trade imbalances.

The US response would be the convening of a G20 conference in Washington on 14–15 November 2008 to co-ordinate the global response to the financial crisis. G20 leaders there agreed on broad principles for

future financial regulation, to be worked up in more detail at a London G20 meeting in April 2009. Yet, despite media speculation about the imminent creation of a 'Bretton Woods II', the US remained reluctant to commit either to new global financial architecture or to reforming existing IMF and World Bank governance structures in any way that might dilute its own dominant role or open up governance to emerging economies like China. Nor were Europeans willing to exchange their national seats on IMF and World Bank Boards for an EU or eurozone one. In practice, the G20 itself became the co-ordinating global body, but without formalised structures. This fell well short of French ambitions.

Like his Presidential predecessors, Sarkozy found that the G7 and other 'G' groupings did not afford France a viable alternative to the EU for promoting its longstanding ambition of a jointly managed world economy. The US was too determined to maintain its freedom of action. Only by matching US economic size and global impact as part of a European entity could France hope eventually to exert policy influence.

Merkozy: how the eurozone crisis drove France and Germany together

Nicolas Sarkozy and Angela Merkel were, as Merkel's authorised biographer Stefan Kornelius points out, 'like chalk and cheese'.[20] In his biography, Kornelius describes the protocol stand-off between the two leaders, as Sarkozy arrived in Berlin for his first courtesy call on Merkel soon after his election in May 2007. Since Merkel had been elected 18 months earlier than Sarkozy it was for him to approach her. But there was a long, awkward pause as Sarkozy waited in his car for Merkel to come to him along the red carpet. She held her ground and eventually he got out. This scene would be emblematic of their relationship.

The tensions between the two leaders were not only about personality, although Sarkozy's impulsive machismo certainly contrasted with Merkel's 'analytical, cautious, mistrustful'[21] temperament. During Sarkozy's first two years in office the two leaders also had very different political and economic priorities. Merkel, who had worked hard during Germany's EU Presidency in the first six months of 2007 to salvage the remains of the rejected Constitutional Treaty and to negotiate a repackaged version which in December 2007 became the Lisbon Treaty, had a carefully thought-through concept of her ideal Europe.

Merkel's vision of Europe, which she set out in 2007 in her EU Presidency speeches, was one where peace and freedom were won

through mutual respect and tolerance for its diverse peoples and cultures, involving 'the constant exchange of opinion and counter-opinion, idea and counter-idea, thesis and antithesis'.[22] Like Kohl before her, Merkel saw in these European values, balancing freedom and responsibility, a bulwark against the nationalism, racism and authoritarianism that had once overwhelmed Germany. Like Kohl too, she saw Europe in terms of the German Social Market model: 'The age of globalization makes one thing increasingly clear to us: the decision in favour of Europe is also a decision in favour of a certain way of life. It was and remains a decision in favour of our European model. It combines economic success and social responsibility. Only together can we continue to preserve our ideal of European society in future. Only together can we ensure economic and social standards also internationally'.[23]

For Merkel, building this European model required building mutual trust between Europeans, which in turn came from agreeing fair, transparent constitutional rules and sticking to them.

Sarkozy's vision, however, was based on power politics. For him, the importance of Europe lay in its ability to enhance France's global power: 'we want Europe', he said in his 2007 Presidential candidature speech, 'because, without it, our old nations count for nothing in a globalised world, without it, our values cannot be defended, without it, the clash of civilisations becomes more likely and the peril for humanity will be terrible'.[24] His early priority in office, as we have seen, was to restore France's trade competitiveness, by creating a eurozone economic government in which France could channel German economic power and by introducing inside France a costly tax-cutting package to help businesses. One of his first European actions as President was to accompany his Finance Minister, Christine Lagarde, to the July 2007 meeting of EU Economic and Finance Ministers to announce to them that France would no longer keep its earlier EU commitment to balance its public accounts by 2010, but would now require two more years. In so doing, he both undermined the authority of his newly appointed Finance Minister and showed his indifference to German sensitivities about abiding by the EU's budget rules.

The impact of the global financial crisis on the European economy and, above all, on the eurozone challenged both these concepts of Europe. It dramatically changed the relationship between the two leaders, forcing them to confront their differences and to find a way of working together or else witness the collapse of the euro project.

Neither leader saw the eurozone crisis coming. The Autumn 2008 collapse of Lehman Brothers appeared at first to affect mainly US and

UK banks and just a few, smaller, German, French and Benelux ones. In France, at the President's behest, the state and France's largest banks came together to devise a rescue plan, setting up public-private bodies to raise state-guaranteed funds and to recapitalise the banks. This kept the process low-key and avoided the need for high-profile nationalisation or state bailout of individual banks.[25] Once EU governments had stepped in to rescue the banks, their primary concern was to mitigate the impact of the financial turmoil on the real economy. The December 2008 European Council approved action to support the EU economies and in March 2009 agreed an 'Economic Recovery Plan', using unspent EU funds for a package of measures including the upgrading of energy and internet connections. In parallel, the Larosière Group put forward in February 2009 a set of proposals designed to strengthen EU financial supervision to avoid a repetition of the banking crisis. By the second half of 2009, as Barroso was appointed Commission President for a second term, the Lisbon Treaty was finally ratified to come into force by the end of the year, and Belgian Prime Minister Herman Van Rompuy was chosen as the European Council's first long-term President, the global economy seemed to be picking up again and the EU looked to have weathered the storm.

Behind the scenes, though, national debt was soaring, especially in the weaker EU economies. The worst private bank debts had been offloaded onto public accounts to be coped with by governments and taxpayers. European banks were, however, still holding more of the risky assets, including US sub-prime mortgage debt, than had first been publicly apparent. After the Lehman collapse, affected European banks began buying much more of their national government's debt to improve their balance sheets. This recycling of debt only increased eurozone vulnerability, as it became ever harder to disentangle where, between banks and governments, the risks lay. A crisis in one would immediately affect the other. The problem for state revenues was made worse by the economic slowdown and, especially in the southern European countries, by lost competitiveness due to artificial inflation of asset prices and incomes in the 'good times' when cheap credit had flowed freely. Now the cheap credit had flowed out again and, with low inflation and falling tax revenues, the debts were hard to shift.

Europe's mounting debt became a time bomb. Greek Prime Minister Georges Papandreou's public admission, following his election in October 2009, that the budget figures reported to Brussels since Greece supposedly qualified to join the euro had been falsified, and his request in April 2010 for European help with a debt pile equivalent to around

130 per cent of Greek GDP, finally sparked the crisis. That it was Greece which lit the touchpaper first was, in some ways, an accident of timing, but as the French economist Jean Pisani-Ferry points out,[26] it coloured public perceptions of the eurozone crisis, especially in Germany, because in Greece the damage caused by the bursting of a private sector capital asset bubble was compounded by endemic lax, often fraudulent, public administration. This was not true of other eurozone countries caught up in the crisis, such as Ireland or Spain, whose difficulties were primarily a result of private debt and the banking crisis. Essentially, the eurozone crisis was precipitated by the mismanagement of private, rather than public, finance, but Greece's dominance of the headlines between 2009 and 2011 did not make it look that way.[27]

Papandreou's request directly challenged a fundamental German principle behind the Maastricht Treaty deal: no government bailouts. Throughout the Treaty negotiations, the Bundesbank had warned that a single currency would tempt some governments to overspend, calculating that Germany's economic strength would underwrite the currency and come to their aid rather than put it at risk. Certainly, France would have liked to see more pooling of economic risk through the creation of a central reserve fund to help underwrite national accounts but realised that this was a bridge too far for Germany. The result had been a Franco-German compromise agreement that, although monetary policy would be centralised under the control of the ECB, economic policies would remain the responsibility of governments, within agreed limits on debt and deficit levels, and there would be no help given to profligate governments. This was legally enshrined in the so-called 'no bailout clause' of the Treaty.[28] Yet, no one had anticipated that government accounts would be swollen to breaking point by private sector banking liabilities built up as a result of another principle Germany had fought for: the free movement of capital across the EU.

The Franco-German Maastricht compromise now blew apart, as Sarkozy and Merkel reached opposing views on the eurozone's response to Greece's predicament. Sarkozy, with support from Trichet at the head of the ECB, argued that it was essential to move quickly to help Greece so as to reassure the private investors holding eurozone government bonds. The financial case was clear: Greece was a relatively small economy (just over 2 per cent of the eurozone), so helping it would not be too costly, whereas if the markets panicked and the contagion spread to other, bigger countries such as Italy or Spain, the costs could become unmanageable. A confident gesture of eurozone support now would send a strong signal to markets and forestall trouble later on.

If the market players who were betting against Greek bonds got their fingers burned, it should warn off other speculators.

Yet, this poker-player's logic, which dominated financial market perceptions, in German eyes rode roughshod over the legal principles underpinning the EU Treaties and over the moral aspirations to honesty, order and justice of the ordinary electorate. To resolve the crisis, Merkel was being asked to violate the Maastricht Treaty 'no bailout' clause and to overlook Greece's culpability in its own downfall, as well as to contribute German taxpayers' money to help protect private investors (including German banks) who had speculated in Greek capital assets. To reward such irresponsible, self-seeking behaviour flew in the face of the ideal of a socially just and democratic Europe; yet, not to do so signalled indifference to the euro's fate and courted financial disaster. It was a dilemma that Merkel and other eurozone political leaders would confront repeatedly throughout the crisis.

Merkel's initial response was that the Greeks, having mismanaged their finances, did not deserve European help. Greece should, like any other country whose public finances became distressed, seek help from the IMF, which would in exchange for financial support set draconian conditions for much-needed economic reform. For Trichet and Sarkozy, handing over to the IMF would be seen by markets as a clear signal of German repudiation of eurozone responsibility, likely to trigger a panic sell-off of eurozone government bonds.

In April 2010, Trichet travelled to Berlin to put the case to the German government and parliament that it was in Germany's, as well as the eurozone's, best interests to help Greece now rather than see the crisis spread. In May 2010, Merkel finally agreed to a rescue package worth 110 billion euros but only on condition that the IMF should participate alongside the eurozone and that Greece agree to a tough set of austerity measures. By then, however, the Franco-German policy dispute had become painfully apparent, undermining the credibility of the package as a deterrent to speculators.

Throughout Autumn 2010, as Greece's debts and borrowing costs continued to rise, despite a further rescue package in July, Merkel and Sarkozy worked desperately to agree a new joint approach which would both calm the markets and allow Merkel to sustain the political support she needed inside Germany to manage the European crisis, especially from the German Parliament and Constitutional Court. It had become clear over the course of 2010 that the crisis was not only about Greek budgetary mismanagement, but also the result of financial instability in a number of peripheral eurozone countries who had not previously

mismanaged their public finances, but whose sovereign debt was now vulnerable to speculation because of the cost of rescuing private banks. Private investors, including German banks, carried a large share of responsibility for reckless lending to these countries.[29]

By now, both leaders realised that the situation was far worse than they had first thought and that their own, and the eurozone's, political future would be defined by how they resolved it. The aims of the two leaders had at last converged, leading the French press to dub the pair 'Merkozy'. The first fruit of this new political alliance would, however, be a tactical error that only escalated the crisis.

Merkozy: resolving the eurozone crisis the hard way

In an entertaining and polemical book[30] analysing key decisions on Economic and Monetary Union (EMU) by successive French Presidents, *Le Monde* editorialist Arnaud Leparmentier recounts a secret bilateral meeting in the margins of the 4 October 2010 EU–Asia Summit between Sarkozy and Merkel, at which the two leaders clinched a deal on a legally binding package of eurozone budgetary reforms, to be announced at their bilateral summit in Deauville two weeks later. According to Leparmentier, the deal was a disaster for French diplomacy. Without French Treasury experts present to advise him and failing to appreciate how financial markets would react, Sarkozy ended up agreeing to Merkel's insistence that, in future, the private creditors of any eurozone country in difficulty should have to contribute to the cost of its financial rescue.

For Merkel, this was a moral issue: ordinary German savers would not see why they should have to keep paying to help Greece when the private creditors who had helped to create the problem did not. For Sarkozy, it was a political issue: criticism was rising inside France that his tax-cutting laws were only benefitting the wealthy; bailing out investors again would not go down well. Moreover, according to Leparmentier, he needed a German concession: Herman Van Rompuy, the European Council's recently appointed long-term President, was working up new proposals to create a euro rescue fund, along with tough new eurozone budget rules involving virtually automatic Commission sanctions for those who broke the rules. Sarkozy, who did not want to give up the option Chirac had in 2003 to create a blocking minority in the Council to override Commission sanctions, needed Merkel's agreement to weaken Van Rompuy's sanction procedure.

The market reactions when the Franco-German deal to involve private creditors was made public at Deauville, and then taken up by the 28

October 2010 European Council, are well documented. It is widely accepted to have triggered the most acute phase of the eurozone crisis, spreading the sell-off of government bonds over the following months beyond Greece to Ireland, Portugal, Italy and Spain and putting the continued existence of the euro into doubt. The longstanding market assumption that Germany would, despite the Maastricht Treaty 'no bailout clause', have to help out a fellow eurozone country suddenly appeared misconceived. Uncertainty about future potential losses for private creditors in any rescue package frightened away mainstream investors and gave a field day to speculators, who now saw taking positions against weaker eurozone countries as a safe bet. Even Merkel's authorised biographer considers this announcement, in retrospect, to have been a serious tactical mistake.[31]

From this point on, German and French leaders, along with the so-called 'Troika', made up of the Presidents of the ECB, IMF and European Commission, fought a desperate battle to contain the widening sovereign debt crisis, under the full glare of the media. They had no agreed crisis management procedures or precedents to help them, since no emergency of this kind had been foreseen either by the negotiators of the Maastricht Treaty or by the many economists who had purported to advise on how 'efficient markets' worked. For the financial market experts, the only way to win this war was to deploy what UK Prime Minister Cameron called[32] 'a big bazooka', in other words, to put together a eurozone bailout fund big enough to convince the speculators that they would lose out by betting against the sovereign debt of weaker eurozone countries. In practice, that, above all, meant Germany, as the largest eurozone economy, making large sums available to lend to Greece, Ireland, Portugal, Italy, Spain and any other country whose sovereign debt interest rates were being driven up to unsustainable levels by private investors selling or speculating against it.

In early November 2011, at the G20 meeting hosted by France in Cannes, US President Obama, with support from Sarkozy, pressed Merkel to agree to building just such a 'bazooka', by deploying European countries' gold-backed funds committed to the IMF, known as 'Special Drawing Rights', to make up a 1000 billion euro fund to underpin the single currency. If the fund looked big enough, they argued, it should not need actually to be deployed, as the speculators would back off.

Merkel refused, though, for two reasons. First, German gold was under the legal authority of Germany's independent Central Bank. For a political leader to override the Bundesbank's independence to deploy gold to back the euro would, as well as flouting the Maastricht Treaty provision

against state bailouts, be to ignore the German Constitution which, she reminded Obama, the US and its allies had drawn up after the war as a democratic deterrent to just such authoritarian behaviour by government. Second, the creation of such a bailout fund would be a signal to eurozone countries and private investors that those who spent and invested unwisely would always be helped out by taxpayers and savers. It created 'moral hazard', solving the immediate problem at the expense of building up worse trouble in future.

If Merkel had needed an illustration of 'moral hazard', she was given one by Italian President Berlusconi just before the Cannes G20 meeting. Over Summer 2011, Italy had been saved from a run on its sovereign debt by financial support from the ECB after Berlusconi had promised a package of economic reforms. Yet, no sooner did the ECB help calm the markets than Berlusconi went back on his reform promises. Summoned to explain himself to Merkel and Sarkozy in Cannes, Berlusconi was unrepentant.

In short, there were no easy or quick solutions to the eurozone crisis that would be sustainable. Instead, painfully and messily, eurozone leaders pieced together an approach aiming to balance financial solidarity against legally binding commitments to behave more responsibly. Eurozone *ad hoc* help to Greece in March 2010 was followed in May 2010 by agreement to tighten eurozone budgetary controls, improve economic co-ordination and increase financial market surveillance, while setting up a temporary 750 billion euro EU/IMF joint rescue fund. In December 2010, EU leaders agreed to a small change to the Lisbon Treaty to allow a permanent rescue fund to be created by 2013.

In 2011, as global economic conditions worsened and angry crowds demonstrated in Greece against what they saw as German-imposed austerity measures, Europe's leaders again seemed to be losing the battle to stabilise the eurozone. The markets were in turmoil again by late October as Greek Prime Minister Papandreou unexpectedly announced he would put the latest conditional EU/IMF bailout package to a national referendum. Merkel's subsequent rejection of a US-brokered deal at the November Cannes G20 summit to get Greece off the hook was widely seen at the time as emblematic of the eurozone's disarray. This impression was compounded on 8–9 December 2011 by deadlock inside the European Council between the UK and eurozone countries over the 'Fiscal Compact',[33] establishing a legally binding 'golden rule' to balance state budgets or face sanctions, which finally forced the 17 eurozone countries and five other EU countries to adopt the Compact as part of an intergovernmental Budget Treaty[34], outside the EU Treaties.

In retrospect, however, the second half of 2011 can be seen as a defining period in the eurozone's political handling of the crisis. Finally, 'Merkozy' began to reach a more balanced and effective approach. Under the pressure of events, German EU policy edged towards acceptance of the need to hold the eurozone together and to deepen its political and economic integration. Merkel who, before the crisis, had opposed creating 'divisions in Europe' between the EU single market and the eurozone, arguing in her 2009 Humboldt University speech against 'often ill-conceived demands for more intensive co-ordination of economic policies in the eurozone', now began to move closer to the French view that sustaining the euro would inevitably involve, alongside the creation of a permanent rescue fund, more harmonisation of eurozone financial, economic and social policies, even if this did result in a 'Two-speed Europe'. At the 16 August 2011 Franco-German summit, Sarkozy and Merkel announced a joint agreement on the creation of 'a veritable government of the eurozone', meeting regularly at summit level and headed by a President appointed for a two and a half year term, as well as moves towards eurozone tax harmonisation. Merkel justified her actions before the German Parliament on 26 October 2011 by insisting: 'if the euro fails, Europe will fail'.

Merkel remained adamant, nonetheless, that greater solidarity and cohesion should be matched by clear and binding responsibilities. The eurozone's shared structures should be transparent and rules-based, rather than politically managed by Ministers. Merkel also ruled out French-inspired proposals for the creation of 'eurobonds', continuing to insist that, to improve competitiveness and avoid moral hazard, eurozone countries needed to be responsible for their own public debt. France, for its part, accepted the tough budget rules and sanctions brokered by Van Rompuy as part of the 'Fiscal Compact', a concession to German rigour that Sarkozy knew would be difficult to sell at home.

Papandreou's announcement of a national referendum on a rescue package agreed just days before severely tested this Franco-German approach. In the margins of the Cannes G20 summit, Sarkozy and Merkel were reported to have told Papandreou bluntly that the question to the Greek people should be 'Do you, yes or no, want to stay in the eurozone?' In reality, though, both sides knew there was no legal provision in the Maastricht Treaty for a country to leave the eurozone, since Mitterrand and Kohl had wanted to make EMU 'irreversible' to commit their successors and to send a clear signal to markets. A Greek exit could only be achieved by Greece leaving the EU altogether. Moreover, the implication that the euro could be abandoned, even by one small

country, would destroy the Maastricht proof of irreversibility, fuelling speculation against other weakened eurozone countries and potentially destroying the whole EMU project. Papandreou's resignation, just days after the Cannes summit, and the abandonment of the referendum avoided the question having to be put but did nothing stem speculation over the break-up of the euro.

Although this was far from apparent at the time, the December 2011 Budget Treaty agreement was crucial in beginning to turn the tide of the crisis. It consolidated the painstakingly won Franco-German joint approach, reassured the markets that the Deauville decision to force private creditors to contribute to the Greek rescue packages would not apply to other eurozone countries and gave the ECB the political cover to provide more lending to stabilise eurozone banks. This in turn bought time for Van Rompuy, along with the Presidents of the Commission (Barroso), ECB (Draghi) and Eurogroup (Juncker), to prepare more radical political decisions on future eurozone policies, including moves to resolve the banking and sovereign debt crisis, which could only come in mid 2012 once Mario Monti, who had replaced Berlusconi in Italy as PM in November 2011, had had chance to take the tough measures his predecessor had ducked, and a stable leadership was in place in Greece.

May–October 2012: final moves to resolve the crisis

In late May 2012, Van Rompuy chaired an informal European Council meeting to brainstorm some of the ideas he and his three Presidential colleagues had been discussing. He secured a mandate from European leaders to present a draft report to the 28–29 June European Council on what, in the light of the crisis, should be done to fix the eurozone's architecture. The report, entitled 'Towards a genuine Economic and Monetary Union',[35] proposed the creation of a banking union, a fiscal union and an Economic Union, along with moves to make decision taking more democratic and accountable.

In the end, at the June European Council, eurozone leaders decided that the most urgent task was to create a eurozone banking union to break the vicious circle between sovereign debt and private bank debt. They reached agreement on the setting up of a single supervisor for eurozone banks (and for those in other EU countries wishing to participate) and on the ability of failing banks directly to access eurozone rescue funding. This agreement in turn enabled Trichet's successor as ECB President, Mario Draghi, to tell a financial conference in London on 26 July 2012 that the ECB would do 'whatever it takes'[36] to save the

euro and, on 6 September, the ECB underlined the message by pledging 'unlimited but conditional' support to any eurozone country which came under market attack.

On 12 September, the German Constitutional Court ruled that the eurozone's 500 billion euro permanent rescue fund, the 'European Stability Mechanism', was in accordance with the Constitution, removing the last potential obstacle to its deployment. By now, the tide of financial market opinion had finally turned. Van Rompuy recalls[37] that, although there were still problems ahead to resolve, he finally felt confident enough to tell a business audience on 25 October 2012: 'The existential threat to the eurozone is over'.

Strikingly, the initiatives of May to October 2012, which meant that – in Van Rompuy's words – 'Europe turned the corner', were steered by the Presidents of the European Council and the ECB, without political leadership from the Franco-German partnership. For, by then, Sarkozy had lost the French Presidential elections and 'Merkozy' was over.

A return to 'normality'? how the end of the euro crisis affected Franco-German relations

On 15 May 2012, François Hollande, who had defeated Sarkozy with 51.7 per cent of the vote, became France's first Socialist President since Mitterrand stepped down in 1995. Unlike Mitterrand, though, he had never held Ministerial office. After becoming a junior special adviser to Mitterrand in 1981 and winning a Parliamentary seat in 1988, he had risen through Socialist Party ranks to become its First Secretary (Chairman) in 1997, struggling to hold the party together behind a pro-EU line through the bitter divisions sparked by Fabius' opportunistic 'no' campaign against the EU Constitutional Treaty in 2005.

Hollande's 2012 Presidential campaign, which asserted that France needed a 'normal Presidency' after Sarkozy's hyperactivity, had attacked Sarkozy for putting the financial markets, big business interests and his close relations with Merkel ahead of French jobs and growth. The message struck home, especially when in January 2012, despite a series of domestic austerity packages and Sarkozy's acceptance of the eurozone Budget Treaty, Standard and Poor's decided to strip French sovereign debt of its triple A rating, a fate which Sarkozy had publicly vowed to avoid. Ironically too, the temporary lull in the eurozone crisis which followed the Budget Treaty deal and the ECB's market intervention seemed to remove the political need for Sarkozy's European activism.

Once elected, Hollande's European priorities were to fulfil his election pledges, first, to re-negotiate the Budget Treaty to turn it into what his manifesto called a 'Pact for Responsibility, Governance and Growth' and, second, to redefine the Franco-German relationship over the longer term, encapsulating it in a new bilateral Treaty. In his first bilateral meeting with Merkel on 24 May 2012, Hollande pressed the German Chancellor to amend the Budget Treaty, including a change to the mandate of the ECB, so as to balance low inflation with promoting growth, and the introduction of 'eurobonds' to mutualise part of the sovereign debt of eurozone countries at European level. These were not technical adjustments but rather a major shift in economic policy away from 'supply-side' reforms and monetary stability towards demand-led measures to stimulate growth. Moreover, it would principally fall to Germany to underwrite any eurobonds, which in German eyes created moral hazard as less responsible countries saw a low-risk way to overspend. Merkel refused to accept both demands, much as in June 1997 Kohl had refused PM Jospin's demands for a significant growth component to the EU Stability Pact. Like Jospin 15 years earlier, Hollande eventually had to accept a few cosmetic references to growth in the budget legislation and then persuade his own parliament to ratify it.

This time, though, the Franco-German clash was at a higher diplomatic level. It was also party political and personal. At the February 2012 Franco-German Summit, Merkel had gone out of her way publicly to support Sarkozy's Presidential bid 'on all fronts', pointing out that their political parties were allies. It was a tactical error which did not help Sarkozy's ratings in France. Yet, it put a cloud over her relations with Hollande right up to her re-election as Chancellor in September 2013 – the French Socialists inevitably supporting her Social Democratic Party opponents – which only partly lifted at the end of the year when she formed a 'Grand Coalition' with the Social Democrats after her old coalition partners, the Liberal Democratic FDP, were routed in the elections.

In the meantime, Hollande appeared to be putting more effort into building relations with 'southern' eurozone partners Italy and Spain than into helping Germany forge a stronger eurozone acceptable to 'northern' and 'southern' euro area countries alike. In 2014, Van Rompuy underlined that reforms, decided at the June 2012 European Council meeting which ended the acute phase of the eurozone crisis, were falling into place and that a full European banking union should be in place by the end of the year. Yet he also noted, with regret, that 'the Franco-German engine has sputtered during the last two years'.[38]

The next, concluding, chapter asks whether France continues to aspire to Franco-German leadership in Europe and, if so, whether its current economic difficulties still enable it to maintain an equal relationship with Germany and to influence the future shape of the eurozone. Does the state of the 'Franco-German motor' still matter? Or are the changes in Europe since the fall of the Berlin Wall such that what Kohl and Mitterrand might have aspired to at the time of the Maastricht Treaty no longer applies today? In the light of the financial crisis, how does France now judge EMU, its most ambitious European project ever?

10
Conclusions and Future Policy Challenges

French political grand strategy and its economic consequences

The launch of the euro on 1 January 1999, with wide European participation, marked the culmination of over three decades of French high-level diplomatic effort, from Raymond Barre's French blueprint for a European Economic and Monetary Union (EMU), incorporated into the 1970 Werner Report, through Giscard d'Estaing's agreement with Schmidt in 1979 to establish the European Exchange Rate Mechanism, Mitterrand's 1991 deal with Kohl at Maastricht and Chirac's decision to accept the Stability and Growth Pact in 1996. The ambition to achieve EMU survived a succession of economic and political shocks and, from a diverse country with a tradition of political unruliness,[1] demanded extraordinary consistency of purpose.

At the heart of this successful drive for EMU was a French realisation, as the US under Nixon withdrew from international monetary co-operation, that the country's global interests were best served by harnessing Germany's growing economic strength within a common European political framework. By the mid-1980s, under the pressure of global economic change and the imminent creation of a European Single Market, this conviction came to be shared by moderate politicians across France's political divide. In 1989, German reunification and the imminent collapse of the Soviet Union provided the sense of urgency and the coincidence of political interests between Kohl and Mitterrand which turned it into a shared European goal.

From that point until European EMU became a reality, France's diplomatic strategy, and its domestic economic implications, were consistently communicated, with full Presidential authority, to the French

people. Mitterrand's public statement after concluding the Maastricht deal in 1991 and Chirac's public justification for his support for the euro in 1998 chime with each other in emphasising the crucial importance to France of building a European shield, both against the threat of a return to political extremism and against the risks of unbridled global capitalism: EMU would be 'a pillar of stability and peace'...'an important factor for economic growth'...'Europe will be able to become the foremost global economic and monetary power' (Mitterrand, Chapter 5); 'A necessary complement to the Single Market...protects our people from crises and from monetary fluctuations...gives us the collective economic disciplines which best guarantee sustainable, healthy growth and thus employment...enables Europe to be the equal of America' (Chirac, Chapter 7).

These shared goals and commitments built political confidence in a France open to business with the world and made possible, over the last two decades of the twentieth century, the modernisation of the country's economy, enabling it to adapt to the 1992 creation of the European Single Market and to the enlargement of the European Union after the breakup of the Soviet Union. Throughout these immense changes, Europe's drive to open its markets and to achieve EMU did indeed, as Mitterrand and Kohl had promised, help the European Union to act as a beacon of stability, peace and prosperity for its continental neighbours, as they aspired to be part of its success.

The smooth launch of the euro in 1999–2002, and the early consolidation of financial market confidence in its independent management by the European Central Bank (ECB), were undoubted successes. Although the euro did not grow to rival the dollar as an international reserve currency, it did indeed, as France had hoped, bring much greater price and currency stability.[2] Gone were the days when France's Presidents had to negotiate humiliating currency devaluations. Gone too were the days when the Bundesbank set monetary policy only to suit Germany. Now, France had equal representation with Germany on the ECB Governing Council.

As promised too, the euro project acted as an important factor for economic growth in France. The monetary credibility of the Bundesbank, and then of the ECB, gave France's government, banks and businesses unprecedented access to market finance at low interest rates. This enabled France, from the mid-1980s onwards, better to manage the timing and pace of necessary domestic reforms so as to modernise and open up its economy, while maintaining political stability – vital in a country where

strikes and street protests in the capital by well-organised interest groups could, and often did, hold the government to ransom.

Structural reforms introduced by successive governments after 1982, tight control of public finances and the franc's fixed value against the deutschmark – which remained unchanged from January 1987 onwards – gave France's businesses a competitive advantage ahead of the euro's launch and led from 1997 to 2001 to a period of strong, low inflationary, growth. By this time, France's economy was significantly outperforming Germany's.

How then did France find itself a decade later seriously lagging behind Germany in both growth and competitiveness, and with public confidence in its political leadership at an all-time low?

The problems set in well before the 2008 financial crisis, from the launch of the euro, and were as much political as economic. It was the euro's very success, acting as a magnet for finance and driving low, convergent interest rates, which led to trouble. It encouraged complacency in France, as elsewhere, that EMU was essentially working well. Yet, the Maastricht Treaty negotiators had been well aware that more work was needed on economic convergence between eurozone countries and on how the decisions on reforming budgetary, tax, labour market and social policies, needed to make EMU more effective, should be made democratically accountable.

So, France's leaders missed the opportunity, during the years of strong growth, to put in place, and engage public support for, a new European political, economic and social strategy to strengthen EMU and to sustain France's domestic consensus for reform. Instead, like Schröder's Germany, France during the early 2000s became more narrowly focussed on its national interests, and later, under Sarkozy's Presidency, on domestic measures to restore its failing competitiveness. As Presidential messages became more critical of European policies on the Single Market and on budgetary discipline, and as the President, under a shortened mandate, became more identified with the party of government, the longstanding domestic political and economic consensus around EMU began to fray at the edges, and with it the ability of France's political leadership to sustain the momentum of reform at home and French influence inside the EU.

At first, though, the economic consequences of these political shifts were masked by credit-fuelled growth in France and across the eurozone. It was only when the credit bubble burst that the full extent of the damage became apparent.

What the eurozone crisis revealed about capital markets and the flaws in EMU's shield

Capital flows and financial stability

The 2008 global financial crisis and 2010–12 eurozone crisis came as a rude awakening. Failing banks, capital flight and rocketing interest rates for the sovereign debt of eurozone periphery countries jolted Europe's leaders out of their assumptions about the successful design of the single currency and the benign effects of capital flows.[3] It soon became clear that, even when supported by a single monetary policy and by rules limiting public spending, fixed exchange rates could not guarantee financial stability, once capital was able to circulate freely.[4]

Implicit government guarantees to bail out 'national champion' banks, and large holdings by these banks of national sovereign debt, created links between private and government debt and thus, for example, the risk that private asset bubbles created anywhere might become the responsibility of a bank's 'host' government. Private capital had the capacity to overwhelm government budgets and potentially also central bank reserves.

This was not a problem only for eurozone countries, but it was exacerbated inside the euro area by greater cross-border financial integration and by uncertainty over whether or not the ECB would act as a lender of last resort. Moreover, the central role of bank financing to businesses in Europe meant that any banking crisis rapidly affected European economies.

Yet, capital liberalisation was one of the four core freedoms of the EU Single Market and a key element of the deal struck between France and Germany over the move to a European single currency. As we saw in Chapter 3, France lifted its longstanding opposition to capital liberalisation in 1988 to make politically possible a German offer to create a European Central Bank, providing the shield against exchange rate pressures and the shared responsibility for monetary policy which France had long sought.

Looking back after the eurozone crisis, it seems extraordinary that all capital controls were lifted without any serious assessment and mitigation of the risks.[5] In part, the failure at the time of the Maastricht Treaty negotiations to put in place euro area crisis management mechanisms to deal with financial instability reflected the dominant economic orthodoxy at the time, widely accepted in US and European banking circles and in Finance Ministries, which saw free private capital flows as beneficial and self-correcting.

In the case of the French Socialists, however, who never converted to this orthodoxy, the reasons were more complex. By the time Maastricht negotiations began in 1988, French decision makers saw the global movement towards capital liberalisation as politically unassailable. They had already begun to adapt by reforming French capital and labour markets. Once Paris was established as a financial centre by the late 1980s, French leaders, on Left and Right alike, came to see access to global capital as something they could turn to France's economic advantage through lower borrowing costs. They knew that liberalisation carried risks of capital flight and tax avoidance and would put pressure on state budgets and on social and employment policies, but – after Mitterrand's failed political experiment of 1981–83 – regarded the creation of European level policies of monetary, economic and social solidarity as the only viable means of defending against these risks. So long as borrowing helped to support stability and reform France had as much reason as Germany to want to maintain the freedom of movement of capital.

By the mid-2000s, however, this was no longer the case.[6] While the excessive credit which washed across the eurozone from 2003 until the full onset of the financial crisis in 2008 did not in France create a property bubble on the scale of less regulated countries, it did, as in many other eurozone countries, contribute to loss of competitiveness through rising wage and benefit costs. It also led to deteriorating public accounts as authorities (especially local authorities) resorted to easy borrowing over politically difficult economic reforms, spending constraints or tax increases. When the crisis finally arrived, French government debt and deficit levels were already above the EU's Stability and Growth Pact limits, leaving no budgetary room to manoeuvre.

In some other eurozone countries, as the ECB has pointed out,[7] the sheer scale of private debt was by now enough anyway to overwhelm the capacity of government budgetary policy to counteract its destabilising effects, even where a country did keep public spending within agreed limits.

The most urgent lesson of the crisis, for the eurozone as a whole, was therefore the need to manage capital flows better, by breaking the dangerous links between private debt and government budgets and by authorising the ECB to supervise private banks as part of its monetary stability mandate. The 2012 European Stability Mechanism, the EU Banking Union coming into effect in 2014, and the European Commission's January 2014 proposals to limit, and to separate out from ordinary deposit-taking, the riskiest trading activities of Europe's biggest and most complex banks are all designed to address these vulnerabilities

towards financial market risk-taking and to ensure that, if European banks do fail, they can in future be wound up without involving taxpayers and damaging public finances.[8]

More needs to be done, however, to put in place incentives for capital to move from short-term recycling of existing assets into productive long-term investment. France favours reducing the dominance of the banking sector over European investment finance in favour of a more diversified and integrated financial market model, as in the US. Certainly, the dominance of banks was a factor in exacerbating the impact of the financial crisis on eurozone economies.[9] It remains to be seen, however, whether such a European move would improve financial stability and productive long-term investment, given the poor track record on both scores of US financial markets.[10] Much would depend on the tax and regulatory framework and on whether the incentives for financial intermediaries could be shifted from the short to the longer term.

Capital flows, sovereign debt and French competitiveness

For France, which coped relatively smoothly with the immediate impact of the financial crisis and has since largely recouped the costs of helping its banks, the most serious domestic effects of the financial and eurozone crises were not within the private banking sector. Rather, they were economic and social, arising from loss of business competitiveness and the impact of depressed demand in European markets, combined with the need to reduce its budget deficit and sovereign debt in line with its European commitments.

At the insistence of Germany and other northern eurozone countries, responsibility for coping with the overhang of sovereign debt remains with individual eurozone countries. In France, as in many other European countries, with inflation at historic lows and growth still sluggish, high debt levels will be hard to shift.

On the positive side, despite losing its triple A credit rating in 2012, France's borrowing costs have remained extremely low. France has the strong credit signature of a wealthy and stable country which has never, since the 1789 Revolution, defaulted on its debt[11] and which, since the 1980s, has built an effective debt management and marketing system. It continues to benefit, above all, from its longstanding political and economic ties to Germany, a reward for the 'competitive disinflation' policies successive Presidents and governments have pursued over many decades to underpin France's EMU strategy. As a result, while debt financing costs in Greece, Italy and a number of other eurozone countries soared during the crisis, the French government's interest payments

on its 10 year sovereign bonds remained only just above Germany's, as both countries were seen as safe havens for investors. In the absence of a large euro reserve fund and authority for the ECB to act as a lender of last resort, this gave France a significant advantage over more vulnerable eurozone countries, who were forced into drastic spending cuts to reassure creditors, at a time when their economies were still coping with the aftermath of the 2008 financial crisis.

The disadvantage of France's safe haven status has been that, without the external pressure of a crisis, it is harder politically to justify drawing a line under borrowing and moving instead to cut costs or raise taxes. Germany faced similar problems after borrowing to finance reunification, until Schröder faced up to the need for reforms in 2003. Some of France's eurozone partners, such as Ireland, Greece and Spain, are now beginning to see early benefits, in the shape of reduced deficits and improving competitiveness, from the drastic economic reforms and spending cuts forced on them during the sovereign debt crisis. For France, which did not face comparable public pressures on its finances, the biggest challenge now is: how to restore and maintain a strong domestic political consensus for the structural reforms needed to regain competitiveness and to lift the economy out of stagnation?

However good France's sovereign debt management may be, this challenge cannot be separated out from the need to improve public finances for, while a sustainable level of borrowing can give governments flexibility and make the reform process politically more manageable, excessive debt has the opposite effect.

Capital flows, debt and political authority

In some respects, the economic challenges which face France's political leadership today are again comparable to those facing President Mitterrand in the 1980s. How to create jobs for young people in a growing population (for France does still have the advantage over Germany of a relatively young and growing population)? How to ensure that savings are invested in business growth and that businesses create jobs? How to reform and modernise the economy to make France more competitive without making its society more unequal?

Yet, the competition from global markets is now more intense, as Asian, Latin American and African countries transform their economies, and businesses and capital can go anywhere in search of the best returns. Already in 1983, capital liberalisation made it impossible, without closing France to external trade, for Mitterrand to pursue the Socialist/Communist platform on which he had been elected. How to cope with

the impact on governments of financial speculation still exasperated him as the most intractable problem of his Presidency when he gave his farewell speech in 1995.[12]

Now that capital markets have grown far larger,[13] and European countries have become more indebted, those policy pressures on governments are today even stronger, as Pierre Moscovici, French Finance and Economy Minister from 2012–14, recently pointed out: 'over close on thirty years…I have seen the political field of action narrow down, its tools to intervene diminish, its capacity to propose a collective response retreat. In the Eurogroup… I have seen governments collapse in face of market pressure'.[14]

Moderate governments, in France as in other democratic countries, have seen their political authority steadily eroded, as their election manifestos promising growth, jobs and a more just society have come up against the stark realities of having to maintain their country's creditworthiness in the face of malfunctioning global capital markets focussed, not on longer-term investment for growth, but on short-term returns. At the same time, globalisation, migration and resource pressures have created new challenges which exceed the capacities of governments acting alone.

Populists on both the extreme Right and extreme Left of the political spectrum have increasingly exploited these constraints as apparent evidence of political hypocrisy, making the European Union the scapegoat for globalisation and offering apparently easy solutions in a national 'go it alone' protectionist agenda. They omit to mention that such an approach has been tried before, not only in France in 1981, but also across Europe in the 1930s, with disastrous results.

The financial and eurozone crises revealed the limits of what can be done to duck these challenges through government borrowing. They also showed the limits of an approach based on leaving the financial markets to drive economic and social convergence. If the original aims of the Maastricht Treaty to 'promote economic and social progress which is balanced and sustainable' are to be salvaged, the answers from now on will require political choices and strong, moderate leadership, at both national and European levels.

France and EMU: future policy challenges

How can France regain its economic health and political strength?

France's moderate political leaders are well aware of the challenges facing their country. A 2014 report on 10 year policy options for France,

commissioned by President Hollande from an expert group chaired by Jean Pisani-Ferry, French Commissioner-General for Strategy and Planning (a newly created government advisory role which harks back to that of Jean Monnet in planning France's reconstruction in the post-war years), takes a frank look at the dilemmas France faces in reducing its costs and regaining its lost competitiveness and points out that recovery will take time: 'Experience shows…that crises of public and private indebtedness can only be recovered from very slowly, above all in a context of very low inflation'.[15]

Hollande's dilemma is that political horizons are much shorter. The anaemic recovery of the French economy from the eurozone crisis is draining support from the political centre. An opinion poll in 2014 even indicated that Marine Le Pen, leader of France's extreme Right 'Front National' party, could defeat Hollande in the second round of the 2017 Presidential elections.

Yet, all the evidence of the past decades shows that, like Mitterrand in 1983 and Schröder in 2003, the only way ultimately for Hollande to help France recover its economic health and its political room for manoeuvre is by taking the hard and unpopular decisions which were skirted around over the past 15 years: reducing public expenditure (in 2013 running at 57 per cent of GDP) to bring down public debt; overcoming the vested interests preventing the labour market and service sector reforms needed to bring down unemployment and to improve business competitiveness and encouraging capital investment into new businesses, training and skills. As in the 1980s, a bold reform agenda would also be the best way for France to regain its credibility and rebuild its bilateral relationship with Germany.

Pisani-Ferry's 2014 Report recognises that structural reforms need to be accompanied by a reduction in public debt, pointing out that only then will France recover its political freedom.[16] It sets out a range of possible strategies for achieving these changes, and at the time of writing, the evidence is that, despite political pressures from both flanks, Hollande will seek to hold together a moderate consensus behind the reform agenda he set out publicly in September 2014.[17] One question mark will be over its pace – France has already delayed several times its promised timetable for reducing its budget deficit to 3 per cent, so how credible is the latest target? Another will be over the President's ability, despite his flagging popularity, to convince the French public that reform is not only inevitable but will also pay dividends for the many and not just the few. For that, Hollande has insisted, France needs to prioritise jobs and investment.

The particular difficulty facing France now is that, in the aftermath of the financial crisis, demand in its export markets remains subdued. The French President is therefore pressing for European support for France's supply-side reform effort, in the form of European initiatives to stimulate demand. These are in any case needed to help all European economies recover from the eurozone crisis. The French leadership recognises that restoring growth goes wider than the eurozone and will involve an effort by all Europeans to make the Single Market work better, for example, by opening up the energy and telecoms sectors, by making financial and other services support innovation and investment and by harmonising work-related social benefits to make workers more mobile. France is now as conscious as Germany of the need, while strengthening the eurozone, to avoid cutting across or weakening the Single Market. As the 2014 Pisani-Ferry Report stresses, this means keeping to the principle of doing 'everything necessary, but nothing more than necessary'[18] to make the eurozone work better.

So, after six years of ad hoc crisis management, France's leadership is asking itself what kind of eurozone economic governance would best optimise growth in France and across the wider European economy and whether France can influence its future shape.

Is an economic union still achievable?

For Mitterrand and Kohl, economic and monetary union, which began with the creation at Maastricht of a single currency, was intended over time to evolve into a new European political model, not sealed off from or totally rejecting the US free market model but adapting it to retain the benefits of fair and open trade and access to capital for innovation, while shielding against the worst effects of financial instability and unsustainable, ' beggar-thy-neighbour' competition for markets and resources. Only through co-operating to establish a level playing field and to provide mutual support in times of stress could European countries maintain peace and stability and realise their economic and political strength.

As we saw in Chapters 4 and 5, the Maastricht Treaty deal fell well short of these aspirations. The creation of a new form of European economic governance to co-ordinate eurozone taxation, budgetary, social and employment policies faltered between German insistence that such politically sensitive decisions should only be taken as part of a political union with new powers for the European Parliament and French insistence that genuine political authority lay with the nationally elected Council of Ministers rather than in Brussels or Strasbourg.

This uneasy standoff between France and Germany over economic policy co-ordination continued for as long as the ECB's independent monetary management of the single currency seemed to be enough to sustain the market credibility of EMU's design and market lending paid little attention to economic differences between eurozone countries.

The eurozone crisis revealed the flaws in this *laissez-faire* approach. Rather than co-operating to manage structural reforms, connect infrastructure and create incentives for investment into new technologies, European countries competed with one another to attract capital and businesses with low tax rates. Instead of being under continuous market pressure to reform and converge, eurozone countries were subjected to capricious capital market mood swings.

The sudden flight from peripheral eurozone countries' sovereign debt in 2010–12 seemed to present Germany with a stark choice: either underwrite this debt or allow the eurozone to break up.[19] To salvage the euro, France and Germany's leaders were forced at last to suspend their mutual suspicion and differences of political outlook to find a way of working together, and – after much trial and error – with the EU institutions, to make the kind of economic policy decisions they had earlier failed to confront. Financial traders betting on an 'all or nothing' outcome miscalculated the nature of the European political process.

Although negotiating a response was messy and subject to intense debate, and will no doubt go through many more twists and turns, the eurozone crisis demonstrated, at a political level, the deep-seated will in all the member countries to hold the European Monetary Union together. The determination of Kohl and Mitterrand to make the move to a single currency 'irreversible' paid off, as was evident in October 2011, at the worst moment of the crisis, when Merkel insisted to the German Parliament: 'if the euro fails, Europe will fail'.

The decisions reached during the eurozone crisis on financial and economic reform represented a hard-won political balance between, on the one hand, pressure from France and the southern eurozone countries for financial solidarity and, on the other, the determination of Germany and other northern countries that help in a crisis should not enable reckless private investors or complicit governments to escape responsibility for their actions. The Banking Union and budgetary reforms, for example, avoided the stark binary choice between unlimited guarantee and total rejection of support. Instead, they were designed to build a system of mutual trust and responsibility, advancing solidarity in exchange for transparency and better financial management.

Now the question is whether these same principles,[20] forged out of political necessity, can be translated into a more stable governance structure for the eurozone. Already the broad lines of a possible structure are emerging. One significant shift in German policy since Maastricht has been the burying of Kohl's argument that European political union should involve the creation of a federal decision-making structure, transferring political authority for economic policies to the European Parliament. As Merkel's authorised biographer points out, by the time of the eurozone crisis the German Chancellor was already convinced that 'the nation states are masters of the treaties'.[21] Germany had come to share Mitterrand's political instinct that, at times of stress, people looked to their nationally elected politicians for leadership.

The intergovernmental nature of European policy-making, already established in the Maastricht Treaty, has thus emerged from the eurozone crisis reinforced, with strengthened strategic roles for the European Council and Eurogroup. At the same time, at German insistence, the federal arm's-length EU bodies now have a stronger role in overseeing the execution of policy once agreed, with the aim of limiting the scope for day-to-day political meddling. So, for example, the European Commission has strengthened oversight powers from the 2011 Budget Treaty and the ECB has acquired responsibility for banking supervision. This approach is intended to avoid the kind of short-term political juggling for advantage which undermined the Stability and Growth Pact in 2004, while accepting that longer-term decisions on European policy need to be taken by nationally elected politicians, who then should[22] assume public responsibility for them.

French leaders have viewed Germany's policy shift with mixed feelings. On the one hand, it moves German thinking closer to the French political tradition under the Fifth Republic of strategic national leadership and to the decision-making approach which French negotiators advocated at Maastricht. On the other, they are aware that this new preference for intergovernmental political responsibility also reflects Germany's desire to retain national control over the management of its own economy and its determination to keep responsibility for budgetary discipline firmly with individual governments, rather than creating new structures for mutual support at European level where Germany, as the largest economy, would face pressure to help out more profligate spenders.

The Pisani-Ferry Report looks at different models for eurozone governance, ranging from a fully centralised federal system, with a separately elected eurozone Parliament and a central budget controlled by the

European Commission, to a fully decentralised system without any mutual budgetary support and only common rules governing budgetary discipline and the orderly crisis management of bankrupt countries, but comes down broadly in favour of a hybrid 'co-operative' model involving a graduated financial support mechanism to offer more assistance at increasing levels of conditionality, tough budget rules, a single European Finance Minister and Treasury, and a parliamentary assembly made up of representatives of national parliaments.

The first part of this model acknowledges Germany's need for a balance between mutual solidarity and individual country responsibility, on the basis of strict budgetary rules, which emerged from the eurozone crisis as Merkel's bottom line. More controversial, however, is the idea of moving from the Eurogroup, made up of national ministers, to a single eurozone minister (perhaps combining the roles of the President of the Eurogroup and the European Commissioner for Economic Affairs) and a eurozone treasury. This would go beyond what the French Finance Ministry has previously been prepared to countenance.

Pisani-Ferry argues that it is a necessary concession if the eurozone is to be effectively governed: 'Experience has amply demonstrated that simple co-ordination between independent governments failed to produce the (necessary) capacity to decide. If we want the eurozone to be governed, we have to accept to delegate to it certain limited responsibilities and to give it an executive capable of exercising them'.[23] While Merkel would undoubtedly agree with Pisani-Ferry's first point, the question is whether Germany would be willing to delegate economic policy to a European Minister. Pisani-Ferry admits his hybrid model could be difficult to negotiate with Germany, whose Constitutional Court has expressed strong reservations about further transfers of power.

These unresolved issues over governance, and the now much greater disparity in economic strength between France and Germany, have led some in France privately to argue against engaging Germany on European Economic Union, for fear of the political consequences of making France's weaker position apparent. This surely would be an abdication of responsibility and a strategic miscalculation, after the decades of high-level investment France's leadership has made in the EMU project. Germany's economic predominance in Europe is a reality, long foreseen. Yet, the eurozone crisis showed that, although economically more powerful, Germany still needs France's political partnership and its support inside the eurozone to manage the tensions between its northern and southern members. The 'Franco-German motor' has always drawn its strength from the ability of Germany to muster its northern

and eastern European neighbours, and France its Mediterranean partners, behind a Franco-German compromise. France can ill afford to be consigned to the southern camp.

Failure to confront the economic policy issues left in abeyance at Maastricht would, moreover, be letting the lessons of the 2008 financial and 2010–12 eurozone crises go to waste. The global financial model, which in the 1980s seemed so unassailable, has been found to be far from efficient and – although some economists still seem wedded to it – the political debate is now wide open about how to reform it. In a fundamentally unstable global financial environment, can a European pole of stability, responsibility and solidarity still be created? How can capital flows be stabilised? How can savings be harnessed to innovation, long-term business growth and job creation instead of gambled away by financial intermediaries? How can rising inequality be reversed?[24] These questions are not only being asked in Europe, and the debate will also need to be global, but surely the EU, with its diverse membership and long experience of strategic thinking and cross-border co-operation, is better placed than any other organisation to start looking for answers? While moderate politicians fail to confront these issues, the field is left open to the merchants of fear, greed and extreme nationalism.

Is a European 'Social Market' of the kind Mitterrand and Kohl dreamed of still desirable or achievable today? How can the European Union and euro area help build better, open societies which preserve peace, encourage productive investment and entrepreneurship and promote social justice? Rather than debating institutional models for the eurozone, perhaps these are the kind of questions France should begin by asking Germany and other European partners. Only by sharing a new ambition which offers people hope, and by charting a bold course for reform, will France's moderate leadership recover its political strength and the European project its ability to inspire a new generation.

Notes

1 Introduction: Why Did France Want EMU?

1. Steil, B. (2013) *The Battle of Bretton Woods*, Princetown and Oxford, Princeton University Press, gives a graphic account of the creation and demise of the Bretton Woods system (so named after the small town in New Hampshire, US, which hosted its founding conference in July 1944)
2. See Steil (2013), pp.334–9 on French involvement in the breakdown of Bretton Woods
3. Beckerman, G. and Saint-Marc, M., (1991), *L'euro*, Presses Universitaires de France, 4th edition, p.17
4. Hefeker, C., 'Germany and European Monetary Union', in *The Political Economy of EMU: France, Germany and the UK*, CEPS Paper, No 69, May 1997, p.42
5. Attali, J. (1993) *Verbatim I* (Paris: Fayard), p.619
6. 'Histoire secrète des trois dévaluations', Libération, 12 July 1983, cited in Aeschimann, E. and Riché, P. (1996), *La Guerre de Sept Ans : Histoire secrète du franc fort 1989–1996* (Paris : Calmann-Levy)
7. Attali, J. (2005) *C'était François Mitterrand* (Paris, Fayard), p.144
8. Idem, p.135
9. Idem, pp.156–7

2 1984–88: How the EMU Treaty Project Took Shape

1. Attali, J. (2005) *C'était François Mitterrand* (Paris: Fayard), p.157: 'François Mitterrand's obsession at that time was to make purchasing power grow ... no longer by raising salaries or unemployment benefits but by lowering inflation and taxation ... to reduce taxation, he encouraged the search for other financing sources for social security and for public and private enterprise. This was why he pressed for the organisation of capital markets ... ' (author's translation)
2. For a fuller account of the dramatic changes to French financial markets in the 1980s see Bacot, F., Dubroeucq, P-F. and Juvin, H. (1989) *Le Nouvel Age des Marchés Francais* (Paris: Editions Les Djinns)
3. Knapp, A. and Wright, V. (2006) *The Government and Politics of France* (London and New York: Routledge), p.174, p.178
4. For an analysis of the evolving socio-economic backgrounds of French Socialist Party members see Rey, H. (May 2011) *Les adhérents socialistes, permanences et changements*, 'La Revue socialiste', no 42. In 1985, only around 10 per cent came from the working classes, and by 2011 this had dropped to 3 per cent.
5. Whenever parities between currencies in the European Monetary System changed, it was necessary to adjust the single payments to farmers to ensure they received the same price regardless of the changed value of national currencies. This was done through a complex and costly system of 'monetary compensatory amounts'.

6. In the early 1960s, the Canadian economist Robert Mundell and his colleague Marcus Fleming argued that, to remain stable, an open economy or monetary area could simultaneously pursue two, but not three, of the following policy objectives: a fixed exchange rate, free movement of capital and independent national monetary policy. This theory became known as 'Mundell's trilemma'.
7. *Efficiency, Stability and Equity – A Strategy for the Evolution of the Economic System of the European Community*, Report of a study group appointed by the Commission of the European Communities and presided by T. Padoa-Schioppa, April 1987. In a speech on 9 November 2001, marking the award of the Jean Monnet Foundation Gold Medal to Helmut Schmidt and Valery Giscard d'Estaing, former European Commission President Jacques Delors commented: 'it is important to note the influence of the report that, as President of the European Commission, I had asked Tommaso Padoa-Schioppa to write ... since it underlined that, in a European Single Market, the essential function of stabilisation ... could not succeed without monetary integration'.
8. See e.g. Ministère de l'Économie, des Finances et du Budget, 'La nécessité de l'UEM', *Les Notes Bleues,* no. 493, 18–24 juin 1990, p.8: 'Germany's fear was that, for some of its partners, maintaining exchange controls served to shield their inadequate economic adjustment efforts. The convergence of economic policies inside the framework of the EMS, the moves by economies to converge ahead of the 1992 deadline, and capital liberalisation thus now make possible the lifting of the precondition set by Germany for advancing towards monetary union'. (author's translation)
9. In an interview with 'Time Magazine' on 9 May 1988, Mitterrand said (author's translation): 'The realisation in 1992 of economic Europe should not be limited to the creation of a large free-trade zone. It implies the reinforcing of existing common policies and the creation of new policies in the social, monetary and research fields so that the single market might become a unified space giving economic Europe its own identity'.
10. Attali, J. (2005) *C'était François Mitterrand*, pp. 298–9
11. Jean-Claude Trichet later played a major role in the development of Economic and Monetary Union, first as the key French negotiator on EMU in the run up to the 1992 Maastricht Treaty, then (1993–2003) as Governor of the Central Bank of France and finally (2003–2011) as the President of the European Central Bank.
12. *European Monetary Construction*, a memorandum circulated to European Community colleagues under a letter of 8 January 1988 by Edouard Balladur, French Minister of the Economy, Finance and Privatisation, p.3. This paper was followed by another to G7 colleagues on 22 February entitled 'Rebuilding an International Monetary System' arguing in favour of filling the void left by the demise of Bretton Woods with a new world monetary system modelled on the European one. Both papers in FCO Archives, MWF 100/9/88.
13. *Memorandum on the Creation of a European Monetary Area and a European Central Bank,* Hans-Dietrich Genscher, Bonn, 26 February 1988 (copy handed to Lyn Parker, Private Secretary of the UK Secretary of State for Foreign Affairs, at the EEC Foreign Ministers' meeting in Konstanz, circulated in FCO on 6 March), in FCO Archives (FCOA), MWF 100/8/88.

14. French National Archives (FNA), 5 AG4 /AH/19–4, Note of 2 March 1988 by Mlle Beracha, Economic and Financial Division of the French Foreign Ministry.
15. Pierre de Boissieu became an influential figure in the development of France's European diplomacy. Alongside Trichet, he was appointed in December 1990 as one of France's two top official negotiators on the 1992 Maastricht Treaty. He later (1993–99) became France's Permanent Representative to the EU and then served in the Council of the European Union as Deputy Secretary-General (1999–2009), then Secretary-General (2009–11).
16. FNA, 5 AG4 /AH/19–4, Note by P. de Boissieu, Director of the Economic and Financial Division of the Foreign Ministry, dated 3 March 1988, covering Mlle Beracha's Note of 2 March. The note does not have an addressee but is marked as having been seen by Hubert Védrine, President Mitterrand's Diplomatic Adviser.
17. FCOA, MWF100/30/88, Letter of 15 March from Pauline Neville-Jones, Minister, BE Bonn
18. Attali, J. (1995) *Verbatim II* (Paris: Fayard), p.380
19. Attali, J. (1993) *Verbatim I* (Paris: Fayard), p.491
20. Aeschimann, E. and Riché, P. (1996) *La Guerre de Sept Ans : Histoire secrète du franc fort 1989–1996* (Paris: Calmann-Levy), pp.46–9
21. Points Mitterrand's and Rocard's advisers stressed to UK officials during bilateral talks in Paris, 15 June 1988, record in FCOA, MWF 100/30/88.

3 1988–90: German unity and European union

1. According to FCO Archives (FCOA) MWF 100/30/88, PM Thatcher had read this article published in the Frankfurter Allgemeine Zeitung 'with great interest'
2. Paper dated 9 September 1988: 'Outline of problems connected with a European economic union', in FCOA, MWB 14/3/88
3. 'Report to the Council and the Commission on the realisation by stages of economic and monetary union in the Community', submitted in October 1970 by an expert group chaired by Luxembourg Prime Minister Pierre Werner
4. FCOA, MWF 100/49/88: Memorandum of 3 November 1988 to HM Treasury from the Bank of England, copied to FCO
5. French National Institute for Statistics and Economic Studies (INSEE), December 1988 Report
6. Aeschmann and Riché (1996), p.59
7. According to Aeschimann and Riché (1996), p.88, Bérégovoy objected to the Delors Report conclusions in a private meeting with Mitterrand but was told firmly that if the other Europeans could agree to it then so could France
8. FNA, AG/5(4)/TB/65
9. 'The Completion of the European Monetary System', speech to a conference organised by the Bertelsmann Foundation in Gutersloh on 5 May 1989
10. Speech to the Congress of German Savings Banks, Cologne, 8 June 1989. Extract in English with key passages underlined handed to the Adviser to the Governor of the Bank of England, who noted that 'the words underlined are those Pöhl thought important for London', FCOA, MWG 011/2/89

11. FCOA, MWG 011/2/89, telno 645 of 27 June from the UK Delegation in Madrid, record by David Hannay of discussions by Heads
12. FNA, AG/5(4)/EG/91: successive versions of the draft Report by the High Level Group, October 1989
13. FNA, AG/5(4)/TB/65, dossier2: Note of 24 August 1989 for the Minister of State by Jean-Claude Trichet, Director of the Treasury, on the Franco-German Economic and Financial Council, 'Key questions to raise with M. Waigel'.
14. FNA, Record by Guillaume Hannezo of the 24 August Franco-German Economic and Financial Council
15. FNA, AG/5(4)/TB/65, Dossier 2, Handwritten Note by Villeroy de Galhau, Ministry of the Economy, Finance and the Budget covering the final agreed text of the 24 August Franco-German Council
16. FNA, AG/5(4)/TB/65, 'Une Approche Evolutive de l'Union Economique et Monétaire', French version of a paper by the British Treasury, dated 1 November 1989, para 24: 'the pressures exerted by the vast European capital market and by multilateral surveillance will ensure that these (national) budgets do not undermine monetary stability. The discipline of the capital markets will have a beneficial effect'. (author's translation from the French)
17. FCOA, MWG 011/3/89: Record of 18 November by PS/Mrs Thatcher, based on the PM's own notes of Heads meeting alone Record of 18 November by the Private Secretary to Mrs Thatcher, based on the PM's own notes of the conversation between Heads of State and Government, meeting without officials.
18. Védrine, H. (1996) *Les mondes de François Mitterrand – A l'Elysée 1981–1995* (Paris: Fayard), p.430.
19. Attali, J. (2005) *C'était François Mitterrand* (Paris : Fayard), p. 318.
20. See also the account of this period by one of Bérégovoy's advisers at the time, André Gauron: 'The speech on 28 November 1989 by Helmut Kohl, which established German reunification, placed Franco-German relations in the balance…at the Elysée anxious questions were asked. Would the Chancellor distance himself from European construction? The French President demanded from his European partner a firm commitment on the single currency'. (author's translation) In A. Gauron (1998): *Le Malentendu Européen* (Paris: Hachette Littératures), p.153
21. FCOA, MWF 100/28/89, Letter of 5 December from the Prime Minister's Private Secretary to the Foreign Secretary's Private Secretary recording the PM's discussions with the Chancellor, Foreign Secretary and Governor of the Bank of England ahead of the Strasbourg European Council
22. FCOA, MWF 100/22/89, telegram 3911 of 6 December from the UK Representative to the EC reports his conversation with the German Permanent representative, who confirmed that the press report of Kohl's 5 December letter had been accurate and that Kohl and Mitterrand had spoken on the telephone on 6 December
23. Védrine (1996), p.431
24. 8–9 December 1989 Strasbourg European Council. Presidency Conclusions at: http://www.europarl.europa.eu/summits/strasbourg/st_En.pdf, accessed on 28 October 2014
25. FCOA, M100/65/89, Letter of 13 December 1989 from David Broucher, BE Bonn, to Michael Arthur, Head of European Communities Department

(Internal), covering a verbatim record of a conversation between Pauline Neville-Jones and von Kyaw, German Foreign Ministry

26. Interview in 'Les Echos', 6 April 1990
27. 'La nécessité de l'UEM' in 'Les Notes Bleues du Ministère de l'Économie, des Finances et du Budget,', no. 493, 18–24 juin 1990
28. FNA, AG/5(4)/AH/19, 'L'Avenir de la Communauté', Note by Pierre de Boissieu, 30 August 1990

4 1991: The Maastricht Negotiations

1. Mitterrand's speech closing the Franco-German Convention for Europe, Paris, 6 October 1990
2. FCOA, MWF 100/20/91, Minutes of 2 January 1991 by Nigel Wicks, Permanent Secretary, HMT, recording his calls on Horst Köhler, Secretary of State in the Finance Ministry and IGC negotiator (in Bonn) and Tietmeyer (in Frankfurt) on 21 December 1990
3. FCOA, Minutes by Nigel Wicks recording the 26 February IGC Ministerial
4. FCOA, MWB/20/4/91, Charles Powell (Private Secretary to the PM)'s record of 14 January of the discussion over lunch between PM Major and President Mitterrand
5. Aeschimann and Riché (1996), p.91
6. FCOA, MWE/12/22/91, FCO record of talks on Political Union on 21 February 1991 between Michael Jay, FCO, Brian Bender, Cabinet Office and Pierre de Boissieu, French Foreign Ministry, and Caroline de Margerie, President's Office
7. FCOA, MWF 100/19/91, Record by British Embassy Paris of a call on 16 April 1991 by Francis Maude, Finance Secretary to the Treasury, on Elisabeth Guigou, French European Affairs Minister
8. FCOA, MWF 100/20/91, Letters to FCO of 11 and 25 April 1991 from Sir Christopher Mallaby, British Ambassador to Bonn
9. FCOA, MWF 100/27, Minutes of 12 June from European Communities Department (Internal) to the Private Secretary
10. FCOA, MWF 100/20/91, Record by Stephen Wall, Private Secretary, of the PM's lunch with Kohl, 9 June
11. FCOA, MWF 100/20/91, Bonn telegram no 482
12. As expressed, for example, in a speech given on 21 March 1991 on behalf of the Netherlands State Secretary for Foreign Affairs at a seminar in the Foreign Ministry setting out the challenges and priorities for the Netherlands Presidency: 'The Netherlands' concern…is that this evolutionary process towards a federal Community should not be interrupted or blocked by introducing forms of intergovernmental co-operation which do not lend themselves to subsequent incorporation in a Community legal order.'
13. See, for example, Aeschimann and Riché, p.98
14. FCOA, MWG 011/17/91, Report dated 8 March 1991 by Prof. Dr A Szasz on 'The Politics of a European Currency', presented on 21 March 1991 at an 'International Conference on the EC and Priorities for the Dutch Presidency' hosted by the Dutch Foreign Ministry, reported by the British Embassy in the Hague

15. FNA, AG5(4) /TB /62, Note of 8 September by Nacer Meddah, Technical Counsellor to Elisabeth Guigou
16. Middelaar, L. van, (2012) *Le Passage à L'Europe, histoire d'un commencement* (Paris: Gallimard), p.296 (translated from the original 2009 edition in Dutch, Groningen, Historische Uitgevereij)
17. For a fuller account, see Aeschimann and Riché, pp.98–107
18. FCOA, MWF 100/20/91, Bonn telno 711 of 19 September
19. FNA, AG5(4)/TB/62, Note to Elisabeth Guigou of 3 November by Nacer Meddah
20. FCOA, MWF 100/20/91, Bonn telegram no 824 of 31 October
21. FCOA, MWF 100/20/91, Record by Stephen Wall of the PM's talks with Kohl, 10 November
22. FNA, AG5(4)/TB/62, Note for the President of 5 November by Boissieu, covering one of 3 November by Meddah
23. FNA, AG5(4)/CDM/14, Record by the Secretary-General of the Government of the 25 November Inter-Ministerial meeting
24. FNA, AG5(4)/CDM/14, Note of 26 November to the Secretary of State for Foreign Affairs by Jean-Michel Casa, Technical Counsellor
25. FNA, AG5(4)/CDM/14, Secretary-General's Record of the 27 November Restricted Ministerial Council, chaired by the President
26. FCOA, MWF 100/19, Record by Stephen Wall of the PM's lunch with Mitterrand, 2 December
27. FNA, AG5(4) /TB /62, Personal Note of 26 November from Bérégovoy to Mitterrand
28. FNA, AG5(4) /TB /62, Personal Note of 26 November
29. Note for the President of 7 December
30. FNA, AG5(4)/ PHB/8, Undated record by Caroline de Margerie
31. FNA, AG5(4)/ PHB/8, Handwritten note to the President by Elisabeth Guigou, timed at 10.00 on 9 December
32. FCOA, MWG 011/16, Record by the UK Representation of the European Council discussions, 9–10 December; and FNA, AG5(4)/ PHB/8, verbatim record of the same discussions by the French delegation.
33. FNA, AG5(4)/ PHB/8, Handwritten note to the President by Elisabeth Guigou, timed at 0800 on 10 December

5 The EMU Deal: French Ambition; German Design?

1. Chancellor Kohl's statement to the Bundestag, 13 December, as reported in Bonn telegram no 978, FCOA, MWF 100/20/91
2. President Mitterrand's opening statement at his press conference after the Maastricht Summit, 10 December, in French National Archives (FNA), AG5(4)/PHB/8
3. Public statement by President Mitterrand, issued after the meeting of the Council of Ministers, 11 December, in FNA, AG5(4)/ PHB/9
4. Interview given on 15 December by Mitterrand to the Programme '7 sur 7', on TF1, transcript in the documents of the Institut François Mitterrand (IFM), Paris
5. FCOA, MWE 12/22/91, Paris Telno 1245 of 28 November, Ambassador's call on Secretary-General of the Elysée Védrine

6. FCOA, MWF 100/19, letter of 19 December from the Counsellor Financial and Economic, BE Paris, reporting a private conversation with Boissieu's Deputy Lefas on the Maastricht outcome
7. FNA, AG5(4)/ PHB/9, Undated Note by Caroline de Margerie on private discussions over dinner between President Mitterrand and Andreotti, 8 December
8. Major, J. (1999) *The Autobiography* (London: HarperCollins Publishers), p.283
9. Attali, J. (1993) *Verbatim I*, pp.491–92.
10. Sylvain de Forges, former French Treasury official (see Aeschimann and Riché (1996), pp.77–78) who worked on international monetary issues before and after the Maastricht agreement, in conversation with the author on 17 September 2014 stressed the importance of understanding the depth of conviction of Mitterrand, Bérégovoy and Kohl, and of many others of their generation who had experienced at first hand the suffering and devastation of war in Europe, that they should do everything in their power to prevent it ever happening again.
11. FCOA, MWF 100/20/91, Record by Stephen Wall of Kohl's bilateral talks with Major, 10 November
12. 1976 Nobel Prizewinner Milton Friedman's arguments in favour of free capital markets became widely accepted in the US after the break-up of Bretton Woods, especially from 1980 when he became economic adviser to President Reagan
13. Treaty on European Union (TEU), Article D: 'The European Council shall provide the Union with the necessary impetus for its development and shall define the general political guidelines thereof.' The European Council was finally established as an EU Institution in the Lisbon Treaty (2009)
14. FCOA, MWE 12/22/91, Report by BE Paris of a call on Guigou on 12 March by the Minister, Michael Llewellyn-Smith
15. On 10 July 1991, French Opposition leader Jacques Chirac, visiting London following discussions with Kohl, told PM Major (record in FCOA, MWE 12/22/91) that the reason Kohl wished to increase the powers of the EP was because the Germans had calculated that the number of German MEPs in future Parliaments would enable Germany to make or unmake the EP majority on either the Left or the Right
16. A reweighting of votes differentiating between Germany and France to take account of the reunified Germany's larger size was only introduced, after prolonged Franco-German wrangling, in the 2007 Lisbon Treaty
17. Author's discussion with Sylvain de Forges
18. Text of the Treaty on European Union (TEU) (92/C 191/01) published in 'The Official Journal of the European Communities', No C 191/1 of 29.7.92
19. TEU, Articles 109j, paragraph 1, 104c(2) and associated Protocols
20. The 'free-rider' risk inside a single currency area is one whereby individual member countries might irresponsibly assume they can spend freely, while relying on others with stronger economies to underwrite their liabilities for the sake of preserving the integrity of the shared currency
21. By late March 1991, officials in Guigou's office and in the French Finance Ministry were picking up German signals that economic convergence was a lesser priority, at least for the next few years, given Germany's own economic problems (reports from British Embassy Paris in FCOA, MWF 100/19/91)

22. FCOA, MWE 12/22/91, Record of a call on Védrine by Sir Robin Butler on 12 November 1991
23. For example, German Finance Minister Stoltenberg in a paper to European colleagues of 15 March 1988 on 'The further development of monetary cooperation in Europe':

    'The freedom of capital transactions is of crucial significance for the continuing integration of European economies and for enhancing their growth potential. It enables the most efficient use to be made of scarce capital resources and at the same time eliminates the causes of distortions within the exchange rate system.'

    Or again, French Finance Minister Balladur in his Memorandum to European colleagues on a single European currency of January 1988 calls for the rapid liberalisation of capital in order to 'improve the European economy as a whole, and to prevent inadequate policies from hiding behind artificial barriers.'

6 1992–96: The Years of Turmoil and Disarray

1. FCOA, MWF 100/33/92, Teleletter from B.E. Bonn of 23 June 1992 reporting a poll in 'Der Spiegel'
2. IFM, Documents F. Mitterrand, transcript of an interview given by President Mitterrand to TF1, Antenne2, France Inter and RTL, 12 April 1992
3. FCOA, MWF 100/32/92, Paris telno 473 of 5 June
4. IFM, Documents F. Mitterrand, transcript of the President's intervention on 5 June 1992 at the Institut d'Etudes Politiques (IEP), Paris
5. FCOA, MWF 100/32/92, Paris telno 752 of 31 August commenting on Giscard interviewed on TF1 on 25 August and Chirac interviewed on Europe 1 on 27 August
6. Poll conducted by CSA-Le Parisien, results published in an article in 'Libération' of 5–6 September 1992, p.2
7. See http://www.interieur.gouv.fr/Elections/Les-resultats/Referendums/elcresult__referendum_1992/(path)/referendum_1992/, accessed on 28 October 2014
8. FCOA, MWF 100/26/92, Minutes dated 14 September to the Private Secretary from Neil Chrimes, Senior Economic Adviser, FCO
9. FCOA, MWF 100/26/92, HM Treasury Brief for the Chancellor, dated 1 October, attaching advance (15 September) and final (17 September) versions of the Handelsblatt article
10. Anatole Kaletsky, 'How Mr Soros made a billion by betting against the pound', *The Times of London*, 26 October 1992, quoted in Authers, J. (2010) *The Fearful Rise of Markets* (UK: Pearson), p. 58.
11. In the Kaletsky article cited above, Soros is quoted as saying: 'When Norman Lamont said just before the devaluation that he would borrow nearly fifteen billion dollars to defend sterling, we were amused because that was about how much we wanted to sell.'
12. Mallaby, S. (2010) *More Money than God: Hedge Funds and the Making of a new Elite* (UK: Bloomsbury), pp.152–71
13. Not including Soros who had decided he would make more money by buying francs and tipping off the French Treasury that an attack was imminent – see Mallaby (2010) for a fuller account

14. For a fuller account, see Aeschimann and Riché (1996), pp.142–57
15. Aeschimann and Riché's account of Kohl's instruction to the Bundesbank is corroborated by Mitterrand in his January 1995 farewell speech to the French Press Corps: copy of transcript in FNA, AG5(4) /TB /62
16. Interview with 'Europe 1' radio station, 23 September 1992
17. FNA, AG5(4) /TB/64, Confidential Note dated 19 October 1992 by Pierre Jacquet, Conseil d'Analyse et de Prévision, French Foreign Ministry, marked as seen by Hubert Védrine. Similar ideas were later incorporated into an article on *La crise monétaire européenne: quels enseignements*? by Michael Aglietta, Henri Delessy and Jean Pisani-Ferry in 'La Lettre du CEP II', no. 106, October 1992
18. FNA, AG5(4)/TB/65, Note for the President, dated 3 December 1992, by Guillaume Hannezo: 'Monetary situation: your meeting with Helmut Kohl': 'You are recommended to protest against the scandalous attitude of the Bundesbank which, not content to set exorbitantly high interest rates for internal reasons, also works to destabilise the currencies of countries who are paying this price…' (author's translation)
19. Aeschimann and Riché (1996), pp.157–64
20. Aeschimann and Riché (1996), pp.208–09
21. French National Institute of Statistics and Economic Studies (INSEE)
22. According to Aeschiman and Riché (1996), pp.232–33, UK Finance Minister Ken Clarke is credited by the French delegation with rallying his colleagues to save the EMS at the lowest point of the Council meeting
23. L. Fabius (1995) *Les Blessures de la Vérité* (Paris: Flammarion)
24. FNA, AG5 (4) /TB /62, transcript by the President's Office of Mitterrand's New Year speech to the Press, January 1995 (author's translation)
25. Interview with 'La Voix du Nord', 4 November 1994
26. For a fuller account, see Aeschimann and Riché (1996) pp.301–10
27. Analysis based on economic reporting by BE Bonn and BE Paris and assessment by the FCO Senior Economic Adviser Martin Williamson ('European Economies and EMU: Kohl grasps the nettle', note for the Private Secretary, 10 May 1996) in FCOA MWF100/35/96
28. FCOA MWF 100/34/96, Letter of 24 January from Sir Christopher Mallaby to FCO, covering an informal paper by Embassy staff
29. FCOA, MWF100/31/96, UKREP Telno 159 of 31 January 1996: 'EMU: What next?'

7 1996–99: Recovery and Launch of a Wide Eurozone

1. For fuller analysis of the shift in German business attitudes towards EMU, see 'Between Efficiency and Stability: Germany and European Monetary Union', Carsten Hefeker, in *Centre for European Policy Studies (CEPS) Paper* no. 69, May 1997, pp.39–71
2. The French Economist Patrick Artus calculated in an article published in 1996 ('la situation allemande n'est pas rassurante', April 1996 in 'Euro: Les enjeux pour la France – Points de vue recueillis par Reuters', *Economica*, 1998, pp.297–99) that the deutschmark had been overvalued by around 20 per cent since 1991
3. FCOA, MWF 100/35/96, Record by Martin Williamson, FCO Chief Economist, of FCO/HM Treasury talks in Bonn and Frankfurt on 17–18 June 1996

4. As reported, for example, in Peter Collecott (BE Bonn)'s letter to FCO of 8 July 1996: 'EMU: Can Kohl push it through?' in FCOA, MWF 100/35/96
5. Interview in the *Stuttgarter Zeitung*, 11 August 1996
6. Speech by Kohl at a reception on 28 August 1996 to mark the 65th birthday of Bundesbank President Tietmeyer
7. TEU Article 104c, 2b
8. TEU, Article 104, usually referred to as the 'no bail-out clause'
9. 'Le président de la Bundesbank parie sur l'euro en 1999', exclusive interview with Hans Tietmeyer in *Le Monde*, 17 October 1996
10. FCOA MWF 100/35/96: An economist working for Goldman Sachs told the FCO's Senior Economic Adviser, visiting Frankfurt in June 1996, that discrepancies in the official government statistics provided scope for 'technical' statistical adjustments to eliminate deficits worth 0.5 per cent of GDP or more if needed
11. The problem of comparable European statistics was highlighted by European Finance Ministers in an ECOFIN meeting in April 1998, and in September 2000 ECOFIN endorsed an 'Action Plan on EMU Statistics' which identified five priority areas for urgent work, including public finances. Thus, began a long process of improvement which is still continuing. On this, see the analysis by the Staff of the Directorate-General for Economic and Financial Affairs, European Commission in *Economic Papers* 328, June 2008, 'The Evolution of Economic Governance in EMU', pp.52–61
12. Leparmentier, A. (2013) *Ces Français, fossoyeurs de l'euro* (Paris: Plon), p.53
13. European Commission *Annual Economic Report* (COM (97) 27), published 23 April 1997
14. He told PM Blair as much in a private conversation in the margins of the Socialist leaders' meeting in Malmo, recorded by the PM's Private Secretary in a letter of 5 June, in MWE012/005/97
15. FCOA, MWF100/19/97, Record by the Private Secretary to PM Blair of the non-party discussions between EU Socialist leaders meeting in Malmo, 5 June 1997, based on an eyewitness account by the Foreign Secretary
16. Resolution of the European Council on the Stability and Growth Pact, Amsterdam, 17 June 1997, in the *Official Journal of the European Communities*, C 236 of 02.08.1997
17. Leparmentier (2013), p.55
18. The dollar peaked at DM 1.56 in December 1996 following the re-election of Bill Clinton and then declined steadily in 1997. For analyses by French economic commentators of the effects of the dollar's level in 1996–97 on the euro launch see: 'Euro: Les Enjeux pour la France-Points de vue receuillis par: Reuters', *Economica*, 1998
19. Assessments of PM Jospin and his policies based on political reporting from BE Embassy Paris, including by the author, in FCOA, WRF014/001/97
20. As confirmed, for example, to a UK Treasury official by Kohl's former close policy adviser, BMW Board Member Horst Teltschik, visiting London on 14 October 1997, record in FCOA, MWE012/006/97
21. Author's letter to FCO from BE Paris of 4 September on the French position on EU institutional reform, FCOA, MWE 012/005/97
22. Interview in *Le Monde*, 10 September 1997

23. *European Economy*, Report by the European Commission, no 65, Spring 1998 and the 1998 *Convergence Report* by the European Monetary Institute
24. Reported in Paris telno 908 of 11 September 1998, FCOA, WRF014/001/98
25. Published in *Le Monde* on 15 January 1999
26. FCOA, MWE012/083/00, Note of 11 December 2000 to Delegations and Representations by David O'Sullivan, European Commission, assessing the Nice European Council
27. FCOA, MWE012/083/00, PM's brief for the Nice European Council, quoting Chirac, interviewed on German television on 25 June 2000

8 1999–2007: French Competitiveness and European Reform

1. See, for example, C.F. Bergsten (1998): 'Weak dollar, strong euro?' London: Centre for European Reform (CER)
2. For example, the decision by European Finance Ministers in Spring 1999 to grant Italy a higher budget deficit target than had originally been envisaged in its Stability Programme was seen by markets as a sign that Waigel's Stability and Growth Pact would be weakened and the euro promptly slid 2 per cent in one month, to reach USD 1.04 on 2 June 1999
3. For example, see P. Jacquet and J. Pisani-Ferry (January 2001): 'Economic Policy co-ordination in the eurozone: What has been achieved? What should be done?' London: Centre for European Reform Essays.
4. Pierre Jacquet was a member of the French Prime Minister's Council of Economic Analysis from 1997–2006 and in 2012 became President of the Global Development Network.
5. Jean Pisani-Ferry headed the French Prime Minister's Council of Economic Analysis in 2001–02. In 2002–04, he was Senior Economic Adviser to the Director of the French Treasury. He then became (2005–13) Director of the Brussels-based think tank 'Bruegel', before returning to France as Commissioner-General of the Prime Minister's Policy Planning Staff.
6. Jacquet and Pisani-Ferry (2001), pp.7–8
7. Jacquet and Pisani-Ferry (2001), p.4
8. In a speech in Strasbourg on 6 March 2002, Chirac said: 'We need to lower our taxes, whilst of course still respecting our European commitments concerning public finances. (…) I understand the importance of solid, healthy finances. I can only thus deplore all the more that the fruits of the growth of these last years have not been used better to prepare the future of the French people. I should add that it goes without saying that our country will respect the stability and growth pact that it has signed.'
9. *The Economist*, 3 June 1999: 'As economic growth stalls yet again, (Germany) is being branded the sick man (or even the Japan) of Europe.'
10. Source: OECD Economic Outlook 2012
11. 'La compétitivité française en 2013', Document de Travail, no 44 du COE-Rexecode (Centre d'observation économique et de Recherche pour l'Expansion de l'économie et le Développement des Entreprises), p.3 file:///C:/Users/Public/Coe-Rexecode-Doc-trav-Competitivite-francaise-octobre-2013.pdf, accessed on 29 October 2014

12. Eurostat figures
13. European Commission Ecfin Country Focus Vol 1, Issue 5 of 12 March 2004: 'Expenditure Rules à la française: an assessment after five years' by Laurent Moulin, p.3
14. Interview on 17 March 2003, accessed on 28 October 2014 at: http://discours.vie-publique.fr/notices/033000984.html
15. Interview in *Le Monde*, 7 July 2002
16. FCOA, MWF 100/003/02, Telegram no 641 of 7 November 2002 from BE Paris reporting a call on the Governor of the Banque de France by the UK House of Commons Treasury Select Committee, 6 November 2002
17. For example in *The Guardian*, 22 October 2002, citing comments by Mer on 8 October following a meeting in Luxembourg of eurozone Finance Ministers and Central Bankers, explaining his reasons for dissenting from a decision by other eurozone countries to reduce budget deficits in 2003
18. 'Budgetary challenges in the euro zone', Communication of Commissioner Solbes in agreement with President Prodi, SEC (2002) 1009/6, Brussels 25 September 2002 and Communication from the Commission to the Council and the European Parliament: 'Strengthening the co-ordination of budgetary policies'. Document no 14997/02
19. Interview with *Le Monde*, 17 October 2002
20. Commission v Council, Case C-27/04, View of Advocate-General Tizzano, 19 May 2004
21. International Herald Tribune, 19 March 2005
22. INSEE chart of household confidence levels, based on CVS polling, between 1995 and 2007, in *L'Année économique, politique et sociale* (2007) (Paris: Moniteur)
23. In a double majority system requiring a 55 per cent majority of Member States plus a 65 per cent majority of the European population for a proposal to pass
24. Eurobarometer for Spring 2005 records that 51 per cent of French people polled considered French EU membership 'a good thing'. Thirty-nine per cent had confidence in the EU while only 24 per cent had confidence in the French government. Sixty-seven per cent gave unemployment as their top concern, up 16 points since the last Eurobarometer poll in Autumn 2004
25. For example, President Chirac's New Year's Greetings to the Diplomatic Corps, January 2003: 'The success of Copenhagen has spawned new ambitions for Europe and will ultimately lead to its refoundation. This is the mission entrusted to the Convention which will, next summer, propose a draft Constitution for Europe. Making a contribution to this process which will shape its future is a priority for France. We have already made numerous proposals for a more efficient and more democratic Europe, a Europe with which our citizens will more readily identify, a Europe with enhanced stability, visibility and influence.' Accessed on 28 October 2014 at: http://www.jacqueschirac-asso.fr/archives-elysee.fr/elysee/elysee.fr/anglais/speeches_and_documents/2003/fi005596.html
26. See, for example, a speech by President Chirac in Strasbourg, 6 March 2002
27. By IPSOS, accessed on 28 October 2014 at: http://www.ipsos.fr/ipsos-public-affairs/sondages/referendum-29-mai-2005-sondage-sorti-urnes

28. Flash Eurobarometer 165, 'The Euro, 3 years later', Report December 2004, p.39
29. For example, the UK Treasury's 1989 paper 'An Evolutionary approach to Economic and Monetary Union' (FNA, AG5(4)/TB/65) predicted that, once European capital controls were lifted, the open capital market would help ensure that national budgets did not undermine monetary stability: 'The discipline of the capital markets will have a beneficial effect.'
30. ECB Monthly Bulletin, January 2005, p.5: 'the combination of high excess liquidity and strong credit growth could in some countries become a source of unsustainable price increases in property markets.'
31. One reason for the moderation in French asset price rises was that lending rules are more rigid than in some other EU countries, depending on ability to repay rather than on collateral
32. Remarks made in conversation with the author, 16 September 2014
33. FCOA, EIR 100/002/04, summary of market reactions in HM Treasury Discussion Paper on the Stability and Growth Pact, March 2004, p.40
34. ECB Financial Stability Review, December 2005, p.64
35. See www.aft.gouv.fr for more details
36. 'The Effects of EMU on Structural Reform in Labour and Product Markets', by Romain Duval and Jorgen Elmeskov, ECB Working Paper, Series Number 596, March 2006, p.37
37. 'Rompre avec la Facilité de la Dette Publique', Official Report (December 2005) by a Committee chaired by Michel Pébereau (President of BNP Paribas), La Documentation Française, accessed on 28 October 2014 at: http://www.ladocumentationfrancaise.fr/var/storage/rapports-publics/054004454/0000.pdf
38. Statistics taken from Eurostat
39. For more on French and German trades unions, see http://www.france-allemagne.fr/Les-syndicats-en-France,2751.html, accessed on 28 October 2014
40. *L'Année politique,économique et sociale 1980–* (2007) (Paris: Moniteur), p.415
41. S. Kornelius (2013) *Angela Merkel – The Chancellor and her World*, trans. Bell and Moncrieff (London: Alma Books), p.88: 'The French were surprised that this Chancellor didn't immediately bow twice to the Tricolour – as had been the custom of her forebear, Helmut Kohl – but told the President that, with all due respect, she thought his European policy during the Iraq crisis had been divisive.'

9 2007–12: The Crisis Years

1. For a fuller account of these events, see Gillian Tett (2009) *Fool's Gold* (London: Little, Brown), pp.215–16
2. *L'Année Politique, Economique et Sociale* (2007)
3. ECB Annual Report (2006), published January 2007, p.20
4. ECB (2006), p.11
5. Nicolas Sarkozy (2006) *Témoignage* (Paris: XO Editions), p.142
6. Sarkozy (2006), p.132
7. Information Report no 3615 by Jean-Pierre Gorges and Jean Maillot, on behalf of the Committee for the Evaluation and Inspection of Public Policy

of the National Assembly (French Parliament), 30 June 2011, accessed on 28 October 2014 at: http://www.assemblee-nationale.fr/13/rap-info/i3615.asp

8. Eurostat: 'Taxation Trends in the European Union', 2013 edition, p.82. Accessed on 28 October 2014 at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-DU-13–001/EN/KS-DU-13–001-EN.PDF
9. For a fuller account, see *Le Monde*, 23 August 2011: 'There is almost nothing left of the TEPA law', by Samuel Laurent
10. This foresight prompted the *Financial Times* in December 2007 to declare Trichet its 'Person of the Year'
11. Tett (2009), p.220
12. For example, in *The Telegraph*, 16 October 2008, http://www.telegraph.co.uk/finance/financialcrisis/3212182/Financial-crisis-Christine-Lagarde-warned-Hank-Paulson-to-bail-out-Lehman-Brothers.html, accessed on 28 October 2014
13. Institute for International Finance, 2010, 'A Global Approach to Resolving Failing Financial Firms: An Industry Perspective,' IIF, Washington DC, May, at: www.iif.com. For an interesting analysis of the different approaches of the US and the Europeans to managing the 2007–09 banking crisis, see a draft paper presented by M. Goldstein and N. Véron: 'Too Big to Fail: The Transatlantic Debate', prepared for a conference in Washington DC, organised by Bruegel and the Peterson Institute for Economic Relations on 8 October 2010, at: http://www.iie.com/publications/papers/goldstein-veron20101008.pdf, both accessed on 28 October 2014
14. French government debt as a percentage of GDP jumped from 64.2 in 2007 to 82.7 in 2010. (By comparison over the same period: Germany: 65.2 to 82.5; UK: 43.7 to 78.4)
15. 'Global banks are international in life but national in death'
16. Accessed on 28 October 2014 at: http://ec.europa.eu/economy_finance/publications/publication13260_En.pdf
17. For example, in his inaugural speech as Presidential candidate on 14 January 2007: 'I want to be the President of a France which will say to fellow Europeans "we cannot continue to have a single currency without an economic government".' Accessed on 28 October 2014 at: http://www.lemonde.fr/societe/article/2007/01/15/le-discours-d-investiture-de-nicolas-sarkozy_855369_3224.html
18. Available verbatim at: http://discours.vie-publique.fr/notices/087003231.html, accessed on 28 October 2014
19. Reported by Agence France Presse on 21 October 2008: 'Nicolas Sarkozy veut un gouvernement économique pour la zone euro'
20. Kornelius (2013), p.221
21. Kornelius (2013), p.220
22. Extract from official translation of Merkel's speech to the European Parliament of 17 January 2007, marking the start of the German EU Presidency, at: http://www.eu2007.de/en/News/Speeches_Interviews/January/Rede_Bundeskanzlerin2.html, accessed on 28 October 2014
23. Extract from official translation of Merkel's speech on 25 March 2007 at the ceremony in Berlin to celebrate the 50th anniversary of the signing of the Treaties of Rome, at: **http://www.eu2007.de/en/News/Speeches_Interviews/March/0325BKBerliner.html**, accessed on 28 October 2014

24. Inauguration speech as UMP Presidential candidate, 14 January 2007
25. Except in the case of Dexia, a Franco-Belgian bank which needed to be bailed out in 2008 to the tune of 3 billion euros. For a detailed account of the French approach to rescuing the banks, see Nicolas Jabko and Elsa Massoc (2012) 'French capitalism under stress: How Nicolas Sarkozy rescued the banks', in the *Review of International Political Economy*, 19:4, pp.562–85
26. J. Pisani-Ferry (2011) *Le réveil des démons: La crise de l'euro et comment nous en sortir* (Paris: Fayard), pp.85–92
27. Between 1999 and 2007, according to ECB figures, eurozone public debt as a percentage of GDP declined by 7.4 per cent, whereas private debt increased by 26.8 per cent. Within this are considerable differences between Germany, where private debt declined by 13.4 per cent, and stressed eurozone countries like Greece (+ 217.5 per cent) or Ireland (+ 101.0 per cent). For further analysis of this point, see, for example, the speech on 'The European crisis and the role of the financial system' by Vítor Constâncio, Vice-President of the ECB, delivered to the Bank of Greece conference on 'The crisis in the euro area', in Athens on 23 May 2013, at: https://www.ecb.europa.eu/press/key/date/2013/html/sp130523_1.en.html, accessed on 28 October 2014
28. Maastricht Treaty, Article 104b, accessed on 28 October 2014 at: http://www.eurotreaties.com/maastrichtext.html
29. According to Constâncio, in the speech cited at xxvii above: 'A particular aspect of the process of financial integration in Europe after the introduction of the euro was a major increase in cross-border bank activity. Exposures of banks from non-stressed countries to stressed countries more than quintupled between the introduction of the euro and the beginning of the financial crisis.'
30. A. Leparmentier (2013), 'Ces Français, fossoyeurs de l'euro' (roughly translated: 'These Frenchmen who dug the euro's grave'), (Plon), pp.13–19
31. Kornelius (2013), p.231
32. In an interview with the *Financial Times*, 9 October 2011
33. Full details of the 'Fiscal Compact' in the Statement of 9 December 2011 by Euro Area Heads of State or Government, accessed on 28 October 2014 at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/126658.pdf
34. The intergovernmental Budget Treaty, formally known as the 'Treaty on Stability, Co-ordination and Governance (TSCG)' was signed on 2 March 2012 and came into force on 1 January 2013. It complements, and in some areas enhances, key provisions of the Stability and Growth Pact (SGP). Specifically, the Fiscal Compact requires signatories to enshrine in national law a balanced budget rule with a lower limit of a structural deficit of 0.5 per cent GDP, as part of its medium-term objective (MTO) as defined in the SGP. More details on eurozone budget reforms at: http://ec.europa.eu/economy_finance/economic_governance/sgp/index_En.htm, accessed on 28 October 2014
35. Full text accessed on 28 October 2014 at: http://ec.europa.eu/economy_finance/crisis/documents/131201_En.pdf
36. http://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html, accessed on 28 October 2014
37. H. Van Rompuy (2014) *Europe in the Storm. Promise and Prejudice* (Leuven: Davidsfonds Uitgeverij), pp.23–24

38. Van Rompuy (2014), p.119

10 Conclusions and Future Challenges for French Policy

1. How, De Gaulle once asked, can one govern a country which has 246 types of cheese?
2. As Jean-Claude Trichet, ECB Governor from 2004, noted in his farewell speech on 19 October 2011: ‘The achievements of the Euro as a currency have to be judged against its primary mandate. Over nearly thirteen years, and in spite of a series of major global economic and financial shocks, average yearly inflation has remained at 2.0% for 332 million fellow citizens. Despite the successive rises of the price of oil and commodities, it is the best result, over such a period of time, of the 50 last years in any large country in Europe. In Germany, with average yearly inflation of 1.6% over 13 years, it is a better result than before the Euro.’
3. Before the financial crisis data about cross-border financial flows within the eurozone was not even collected, let alone monitored
4. Mundell’s ‘trilemma’ theory, based on historical experience of the gold standard, did not anticipate the de-regularisation and massive growth of the global finance industry from the 1980s onwards, which became capable of destabilising governments and the monetary policy of central banks. For fuller analysis of the limits to Mundell’s logic see, for example, Andrew Crockett’s speech to the 1993 Jackson Hole Symposium on ‘Monetary policy implications of increased capital flows’, accessed on 28 October 2014 at: http://www.kc.frb.org/publications/research/escp/escp-1993.cfm
5. It is worth noting that, when negotiating the 1944 Bretton Woods system of fixed-but-flexible currencies, the US insisted on strict controls being put in place on capital flows for investment (as opposed to trade) with the intention of curbing the speculation and tax evasion which had affected economies in the inter-war years (see, for example, Steil (2013) pp.134–35)
6. See, for example, a speech by Vítor Constâncio, Vice-President of the ECB, at the Annual Hyman P. Minsky Conference on the State of the US and World Economies, Washington DC, 10 April 2014: ‘At reasonable levels, finance is essential for growth, but once it grows to an excess, the damage it can do can easily wipe out its positive contribution’. Accessed on 28 October 2014 at: https://www.ecb.europa.eu/press/key/date/2014/html/sp140410_1.en.html
7. Speech by Vítor Constâncio, Vice-President of the ECB, Athens, 23 May 2013, ‘The European Crisis and the Role of the Financial System.’ Accessed on 28 October 2014 at: http://www.ecb.europa.eu/press/key/date/2013/html/sp1305231.en.html
8. Details of the measures making up the Banking Union at: http://ec.europa.eu/internal_market/finances/banking-union/index_En.htm and a summary of all the banking measures taken in response to the financial crisis is available at: http://europa.eu/rapid/press-release_MEMO-14–57_En.htm, accessed on 28 October 2014

9. See Chapter 9
10. For example, according to US investment professional John C. Bogle (*The Clash of the Cultures, investment v. speculation,* New Jersey: John Wiley and Sons, 2012, p.xviii), while annual trading in stocks on Wall Street in recent years has averaged around 33 trillion dollars, 99.2 per cent of that trading was purely speculative and only 0.8 per cent represented capital formation, such as investment in new businesses, new technology and business growth
11. France last defaulted in 1788. Source: Reinhart, C.M. and Rogoff, K.S. (2009) *This Time is Different, Eight Centuries of Financial Folly* (Princetown: Princetown University Press), p.87
12. See Chapter 6
13. In a speech on 4 April 2014, Andrew Haldane, Chief Economist at the Bank of England, said that the value of capital assets under management had risen from an estimated 11 trillion dollars in 1990 to over 60 trillion dollars in 2006 and was expected in 2014 to reach 87 trillion dollars, the equivalent of a year's global GDP
14. Moscovici, P. (2013) *Combats Pour que la France s'en sorte* (Paris: Flammarion), p.40 (author's translation)
15. Pisani-Ferry, J. (2014) *Quelle France dans dix ans? Rapport de France Stratégie au Président de la République* (Paris: Fayard), p.277
16. Pisani-Ferry (2014), p.127: 'If we do not want to put ourselves at the mercy of financial markets then (tomorrow's growth) must be directed towards reducing our public debt'
17. Press Conference by President Hollande, 18 September 2014: 'I am proposing to reach the 3 per cent deficit in 2017. Will we convince (our European partners that we will do that)? Our economy must at the same time regain its competitiveness and reduce its public deficits, both at the same intensive rate. My priority is employment. That means that we must as a priority reduce our labour costs, and give businesses chance to invest so that the French economy can recover. The key is investment'. (author's translation)
18. See, for example, Pisani-Ferry (2014), p.287
19. Pisani-Ferry (2011) pp.170–01: 'The absence of a guarantee – implicit but certain – that the central bank will act if need be to block speculation against countries' debt makes them vulnerable, increases the risks of a vicious circle forming between a banking crisis and a sovereign debt crisis, and lowers the security threshold for public debt. No-one (when the euro was created) had fully appreciated this implacable logic'
20. See, for example, Chancellor Merkel's speech to the UK Parliament on 27 February 2014: 'we in Europe … will only have a history of our own in the age of globalisation and digitisation that is the 21st century if we move forward together and if we stay together and if, as European nations, we always adhere to two principles in our actions:
    responsibility and solidarity.'
21. Kornelius (2013), p.212
22. But often do not – an issue which deserves more attention
23. Pisani-Ferry (2014), p.294 (author's translation)

24. French economist Thomas Piketty recently made a major contribution to this debate in the US and UK with his book *Capital in the Twenty-First Century* (2014) first published in English translation by the Bellnap Press of Harvard University Press, Cambridge and London. The French original, published by Editions du Seuil a year earlier, made far less impact in France

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