Europe 1914 *vs.* Monetary Union Today

The difference is that World War I was a tragedy, not a crime. "Monetary union is a tragedy and a crime."

BY BERNARD CONNOLLY

The wonderful book *Sleepwalkers: How Europe Went to War in 1914* by Cambridge historian Christopher Clark has rightly received great praise. It provides an illuminating and tremendously well-written disentangling of the multiple forces—constraints, aspirations, misperceptions, paranoid delusions, and, in some ways most important of all, miscalculations that via the system of European alliances produced an appalling conflagration which killed, maimed, widowed, or orphaned tens of millions, destroyed the economic basis of the lives of many millions more, and effectively obliterated what had been European civilization. Clark describes the authors of the tragedy—the "statesmen" of Europe—as being "like sleepwalkers, watchful but unseeing, haunted by dreams, yet blind to the horror they were about to bring into the world."

A century later that same description might seem, to the generous in spirit, to fit the policymakers who created and now sustain the malignant lunacy of monetary union in Europe. Not everyone will find it possible to be so generous-minded; for most of the policymakers who imposed the present-day catastrophe were wide awake. They either knew, in outline if not in

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France Will Soon Be the Trimmings

The perverse economics of the euro are all too straightforward. Monetary union, everyone who was allowed to look beyond of his nose could always see, meant that divergences between the rate of return on capital between member countries could not be matched by appropriate divergences in *ex ante* real interest rates. Thus, without some Soviet-style attempt to suppress rate-of-return divergences—and to keep the poorer countries of the area poor—monetary union would inevitably create economic and financial instability, with the politically unimportant peripheral countries having no instruments available to cope with that instability. "Europe is France and Germany; the others are just the trimmings," as Charles de Gaulle put it.

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French general and president **Charles de Gaulle**

detail, what horrors were coming and sought to inflict them for their own purposes, or deliberately shut their eyes to them.

In his summing-up, Clark attempts a compare-and-contrast exercise between the descent into the abyss in 1914 and the euro crisis of 2011–2012. In both episodes, he writes, the problem was one of baffling complexity. As in 1914, the political actors were aware of the possibility of a general catastrophe—in 2012, according to Clark, the failure of the euro—and, although all of them hoped it would not happen, many were prepared to evoke its possibility in order to extract advantage for their own countries, polities, entities, or patrons.

The two great differences, in Clark's view, are that in the euro crisis all the actors have agreed on what the problem is, and that Europe now has "powerful supranational institutions that today provide a framework for defining tasks, mediating conflicts, and identifying remedies that were conspicuously absent in 1914."

Monetary union has meant that "Europe" is no longer France and Germany: Europe is now Germany, with France among the trimmings.

Although it does not vitiate the great achievement of his book in helping understand the past, Clark's excursion into the present is wrong in all its key respects. The euro problem is not one of baffling complexity. It is analytically straightforward but, unfortunately, incapable of benign resolution. The ultimate catastrophe would not have been the failure of the euro: the catastrophe was the creation of the euro. The present existence of "powerful supranational institutions" is not something that helps avert disaster and preserve stability, but the feature of the European present that has extinguished those elements of European civilization briefly resurrected in the 1950s and 1960s, already destroyed prosperity, and puts peace and stability in great danger.

The perverse economics of the euro are all too straightforward. Monetary union, everyone who was allowed to look beyond of his nose could always see, meant that divergences between the rate of return on capital between member countries could not be matched by appropriate divergences in *ex ante* real interest rates. (Indeed, it would, in an analogue of the famous Walters critique of the ERM, produce *ex ante* real interest rate movements in the wrong direction). Thus, without some Soviet-style attempt to suppress rate-of-return divergences—and to keep the poorer countries of the area poor—monetary union would inevitably create economic and financial instability,

The Future of Europe

The external debt ratios of peripheral countries will increase without bound.

The ineluctable implication is twofold: that the external deficits of the periphery will eventually absorb all world savings, and that the claims represented by those savings will become worthless—a financial Armageddon which one would, unless one were deranged, have to expect to introduce the Four Horsemen of the Apocalypse into the world. Of course that is far-fetched—it is not going to happen. But how will it be prevented? What mechanisms are available to escape from the choice between depression, deflation, banking system collapse, and probable social and political breakdown in the periphery on the one hand, and the resumption of an unsustainable trajectory of external debt on the other?

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with the politically unimportant peripheral countries having no instruments available to cope with that instability. "Europe is France and Germany; the others are just the trimmings," as Charles de Gaulle put it.

The real-side effects of monetary union would have been devastating for the peripheral countries in any circumstances. But things were made even worse by the fostering of the illusion that monetary union, rather than transforming currency risk into credit risk, somehow eliminated risk entirely. (Jean-Claude Trichet's 1994 assertion that "monetary union will permit the elimination of risk premiums" will surely be seen by future historians as one of the most misleading and damaging statements ever made by a financial policymaker.) The result of the illusion was that monetary union became the biggest credit bubble in history, threatening to bring down the global financial system.

At least the countries that were being tortured on the rack of the ERM twenty years ago were allowed (and even encouraged by the Bundesbank) to devalue or even to leave the system. The French griped about "disloyal" devaluations by other countries, but in the end it was apparent to everyone that such was the right answer.

But monetary union is a much bigger problem. Once the size of the credit losses to be distributed as its result became apparent even to the more dim-witted policymakers, that union became an international financial battleground as well as a theater of pain for residents of the peripheral countries. The prospect that creditor countries and their banks might have to share the pain with the periphery brought it home to the political "core" that their manoeuvring to achieve political hegemony (and ultimately not to prevent a third "European civil war" but to reverse the result, as they perceived it—a supposed triumph of the despised "Anglo-Saxon" model—of the Second World War) might cost just as much in treasure if not in lives as wars of the past. Their reaction over the course of the crisis has been to try to make the peoples of the periphery pay virtually the whole cost of the mess. And thus Klaus Regling claims, with whatever degree of accuracy, that the operations of the European Financial Stability Facility and the European Stability Mechanism have so far made a profit for Germany. That cannot remain the case, however—no benign outcome is available.

The crux of the euro problem as it stands is that the peripheral countries have unsustainable external positions encapsulated in huge full-employment current

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account deficits and rocketing external debt ratios. Depression in the periphery has reduced or eliminated actual current account deficits but has created massive, prolonged unemployment. And it has made the notion of "structural improvement in competitiveness" a sick joke. Just look at the vertiginous falls in capital investment in the peripheral countries and realize that recorded "improvements" in productivity there are merely the statistical effect of the outright disappearance of much economic capacity. Deflation must follow, and the combination will destroy the banking systems of the peripheral countries. The ominous leap in mortgage arrears in Ireland and Spain, for instance, is a warning of a crippling "second wave" of bank losses.

Philippe Maystadt

Awkward Truth?

One should not forget the statement in the mid-1990s by Philippe Maystadt, then Belgian finance minister and one of the "Fathers of the Euro," that "The purpose of the single currency is to prevent the encroachment of Anglo-Saxon values in Europe."

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Perhaps more important, the patience (or the bamboozling) of ordinary people in the face of the quite extraordinary suffering inflicted on them by monetary union will not persist forever. It is one thing to sell one's independence and national heritage for a mess of potage; but to be expected to pay an enormous tribute to the forces extinguishing that independence is a fate that was not enforced on vanquished nations even by the reviled Versailles Treaty.

But if "adjustment" efforts in the periphery slacken in order to ease the scourge of unemployment and to fend off or mitigate a deadly fall in the price level (a fall which ECB President Mario Draghi claims, staggeringly, would not constitute deflation there!), current account deficits will explode again. The external debt ratios of peripheral countries will increase without bound.

The ineluctable implication is twofold: that the external deficits of the periphery will eventually absorb all world savings, and that the claims represented by those savings will become worthless—a financial Armageddon which one would, unless one were deranged, have to expect to introduce the Four Horsemen of the Apocalypse into the world. Of course that is far-fetched—it is not going to happen. But how will it be prevented? What mechanisms are available to escape from the choice between depression, deflation, banking system collapse, and probable social and political breakdown in the periphery on the one hand, and the resumption of an unsustainable trajectory of external debt on the other?

Proponents of eurobonds seem to imagine that "mutualization" of existing peripheral debt could provide an escape route. That is deluded.

If the euro area retains all its current members, the depreciation of the currency required to allow, say, Spain to escape the dilemma would be enormous. Work which I directed five years ago, using standard models, suggested that the euro would have to go to about U.S.$0.35 (from a level at that time of $1.57). That would be totally unacceptable to the rest of the world. And its probable impact on the German price level would be to raise it by 70 percent over five years. Given that massive euro depreciation could probably be achieved only by reducing euro-area yields effectively to zero, that would imply an expropriation of 70 percent of the value of German savings—a prospect surely unimaginable to anyone who has the slightest interest in avoiding a social and political explosion in Germany and thus in Europe.

Could full-employment current account adjustment in the periphery be achieved without trade adjustment and thus without a need either for depression, deflation, default, and political goodness-knows-what in the periphery, or for a violent inflation and a risk of political violence in Germany? Proponents of eurobonds seem to imagine that "mutualization" of existing peripheral debt could provide such an escape route. That is deluded. Even if the present external debt burdens of peripheral countries were reduced to zero, their full-employment trade deficits are so enormous that any recovery of demand and employment sufficient to mitigate depression and deflation would again set their external debt ratios on the unbounded path to infinity.

It is true, though, that in the almost-certain absence of such "mutualization" of existing debt, the peripheral

countries would have to achieve significant full-employment trade surpluses to avoid exploding debt ratios, but that is irrelevant given their evident inability even to substantially reduce their full-employment trade deficits.

In contrast, it is theoretically possible that the need for trade adjustment could be avoided if full-employment trade deficits were offset by equivalent receipts of unrequited transfers from abroad—monetary union could, in theory, work if it became not just a debt union but a complete transfer union. But the implications of such transfer union would again be unthinkable for anyone having the slightest interest in maintaining social and political stability in Germany and even for German governments which owed fealty to a "permanent coalition" of bankers, exporters, and euro-imperialists. Even if one heroically excluded the possibility of the moral hazard which in fact attends all welfare dependencies, the cost to Germany (the only feasible provider of transfers) would amount to 10 percent of its GDP every year forever (the transfers would have to be perpetual since by construction their purpose would be to avoid a need for adjustment). Once again, the Versailles Treaty springs unbidden to mind: not even the reparations imposed on Germany constituted a stream of payments—even had it been possible to pay them—with such an enormous present value. Importantly, part of the reason why the cost to Germany of a transfer union would be so high is that France has a large and worsening full-employment current account deficit; the implications of that are more than merely financial, as we shall see in a moment.

All roads now lead to disaster—political as well as economic, financial, and social. The "failure of the euro" would involve a financial crisis; that is why the creation of the euro was an act of stupendous irresponsibility. That financial crisis could be managed without destroying civilization, European or global—especially if it took the form of German withdrawal. Performing such management would require a better performance from policymakers than was evident in the descent into war in 1914 and in what have so far been merely the preliminary phases of the euro crisis. But the global financial crisis of 2008–2009 was eventually managed. The crisis created by the euro will be worse, but it will worsen further the longer it is delayed. The present efforts of the European Central Bank to re-create a credit bubble (not least by pretending, ludicrously, that a "banking union" could make the slightest contribution to resolving the dilemma outlined here) can be seen as an effort to distribute the eventual enormous credit losses more widely by sucking non-euro-area investors back into buying peripheral debt. The authorities of countries such as the United States, which has problems enough of its own, should be discouraging such behavior. Instead, they will probably applaud and support it. And that tells us much about the motivation for monetary union and indeed for the European Union.

One should not forget the statement in the mid-1990s by Philippe Maystadt, then Belgian finance minister and one of the "Fathers of the Euro," that "The purpose of the single currency is to prevent the encroachment of Anglo-Saxon values in Europe." He and his like have been aided in their obstructive purpose by developments in the United States, where policies have long been almost the antithesis of the "Anglo-Saxon" model, pursuing instead what economist F.A. Hayek called the Socialism of the Right under Bush the Younger and the Socialism of the Left under Obama. Spreading the tentacles of the euro ever further via recreating a global bubble in the debt, private and public, of the peripheral countries is a way of encouraging American support for the ambitions of the euro elite and arguably of a global elite.

Unelected Functionary

Read the highly offensive—in both senses of that word—speech, "A More Perfect Union," given by Mario Draghi at Harvard in October. Few things could be more plainly indicative of the breathtakingly illegitimate implications and ambitions of monetary union than that a mere central bank governor, an unelected functionary, should presume to demand the imposition of his vision of the constitutional structure of a continent.

—B. Connolly

Mario Draghi

Clark's argument that European policymakers have a common understanding of the problem is right only to the extent that those policymakers form a self-interested and self-serving *nomenklatura* bent on using the euro to erect an unaccountable, irresponsible, illegitimate, and effectively lawless superstate. In attempting to do that, the *nomenklatura* has undermined the foundations of a Europe—at least the democratic part of Europe—that in the 1950s and 1960s was more stable, more cooperative, and more genuinely amicable than at any time in modern history.

The first of those foundations was economic prosperity. That has simply been vaporized by monetary union. The second was democratic legitimacy and the rule of law. That too has been vaporized by monetary union and by the wider operation of the European Union and its law-destroying so-called Court of Justice (just look at the enormous pressures being exerted on the Constitutional Courts of Portugal and Germany to ignore constitutional and democratic precepts in "the wider interests of the eurozone": *une certain idée de l'Europe* trumps political decency, democracy, legitimacy, and law).

The third foundation was the principle of non-interference by one country which respects natural law in the domestic affairs of another such country. The whole notion of the European Union is antithetical to that principle, and monetary union has very obviously been the most effective weapon used against it. Read the highly offensive—in both senses of that word—speech, "A More Perfect Union," given by Mario Draghi at Harvard in October. Few things could be more plainly indicative of the breathtakingly illegitimate implications and ambitions of monetary union than that a mere central bank governor, an unelected functionary, should presume to demand the imposition of his vision of the constitutional structure of a continent.

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No one outside the self-serving *nomenklatura* (which includes financial and "intellectual" elites as well as the overtly political ones) shares the ambition of replacing legitimate, democratic sovereign states with Leviathan. One of the things which Clark's book confirms (it should have been obvious to everyone) is that World War I was not the outcome of "nationalism" in the various Powers: popular national antipathies were largely the result of the war, not the other way around. The bringers of war were the "statesmen," with their machinations, manoeuvrings, presumptions, and miscalculations. They were the diplomats, whose successors again affect to determine the destiny of Europe. Their aspirations and attitudes, shared across Europe, were those of a caste in which imperialism, Social Darwinism, and, at least in Germany, economicism (the belief that the legitimacy of the state derived from its power in delivering economic outcomes) were important driving forces. (Draghi's Harvard speech is redolent of a modern-day version of such attitudes and particularly of economicism: perhaps the gift to him of a Wilhelmine Pickelhaube was entirely appropriate!)

The imposition of "Europe" and, particularly, monetary union has, like the First World War, kindled in almost every country widespread feelings of antagonism and of attribution of blame for suffering to "the Other." "The Other" has two faces. In most countries one of those faces is, thanks to monetary union, Germany. That has been most remarked in the case of Greece. But over the next few years it will, very importantly, increasingly be the case of France. Monetary union has meant that "Europe" is no longer France and Germany: Europe is now Germany, with France among the trimmings.

The emergence of antagonism towards a second face of "the Other" has been equally predictable and equally worrying. "Europe," by attempting to eliminate sovereignty and to destroy a political sense of national identity, has opened the door for loyalty to be given to other, more anarchic, sources of identity: race, ethnicity, language, class, and religion. When these trends are combined with the bitterness and despair created by the reality of a cruel monetary union and by perceptions of a harsh and dictatorial Germany, they will inevitably produce political reconfigurations that will alarm the *nomenklatura*. In particular, they may deliver a President Le Pen in France in 2017: the *nomenklatura* will deserve no less.

The truth about monetary union I wrote in my 1995 book, *The Rotten Heart of Europe,* is now painfully evident: it is a threat not only to our wealth but to our stability and ultimately to our peace. Clark's conclusion about 1914 is that, "the outbreak of war was a tragedy, not a crime." It is hard not to believe that monetary union is both a tragedy and a crime. ◆