A Political Union *Skeptic*

One of European monetary union's premier architects argues that centralization per se will not lead to prosperity.

BY OTMAR ISSING

There now seems broad consensus that the eurozone crisis has shown not only that we need more Europe, but also how to achieve this. Political union must now be seen as the end goal.

Against the background of two world wars, Europe's division by the Iron Curtain, and all the challenges of globalization, it would be hard not to support the project of a strong and prosperous Europe that guarantees peace and asserts its international position. But agreement on this goal doesn't necessarily mean agreement on how and with what tools it can be achieved.

Chancellor Angela Merkel's dictum has been "if the euro fails, Europe will fail," but I'm not so sure. It's not the euro that's at stake, but the eurozone, meaning the eurozone's composition rather than the eurozone itself. An argument that's frequently advanced is that this is a crisis confronting "Europe"—which is to say the economic and monetary union—with a choice: either deepen political integration, which would eventually be strengthened by the finalité of political union, or stay only with a monetary union, which would be doomed to collapse.

This turns upside down the initial idea, which was that a flourishing monetary union would pave the way for political

Otmar Issing is President of Frankfurt University's Center for Financial Studies and former chief economist at the European Central Bank. This article previously appeared at Europe's World *(http://www.europesworld.org).*

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E.
Suite 200
Washington, D.C. 20002
Phone: 202-861-0791
Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

union. Back in the 1950s, French economist Jacques Rueff, who was a close adviser to Charles de Gaulle, had as his slogan: “L’Europe se fera par la monnaie, ou ne se fera pas.” And almost half a century later, Germany’s President Richard von Weizsäcker would claim that only via a single currency would we Europeans achieve a common foreign policy. He acknowledged that this avenue would be anything but cheap, so on that point at least he was proved right.

Chancellor Angela Merkel’s dictum has been “if the euro fails, Europe will fail,” but I’m not so sure.

But the question is whether greatly intensified efforts to keep the monetary union together have brought us any nearer to that common foreign policy. Or has the crisis instead sparked the sort of resentments in almost all EU countries—irrespective of whether they receive or give financial aid—that we had hoped would no longer exist more than sixty years after World War II?

With this in mind, should the conclusion we draw from the European monetary union crisis be that integration has not gone far enough? Politicians took the courageous decision to launch monetary union at the start of 1999, even though the heterogeneity of the eurozone’s members had already provoked strong warnings. Nor did the last of the risk-taking end there, because the fundamental principles on which monetary union was based were also violated time and again, notably by the flouting of the Stability and Growth Pact and then the abandonment of the no-bailout principle. Put another way, just because sovereign states didn’t deliver on their commitments, does that mean their sovereignty has to be ended now? It’s hardly a convincing argument.

The idea that taking intermediate steps to ensure crisis management is more efficient and conducive to closer political integration, such as creating a “European finance minister,” or an EU commissioner who would have far-reaching new powers, looks like a dangerous illusion. The power to determine taxes and public spending is a fundamental prerequisite of national parliaments in a democracy, and of the sovereignty of EU member states.

In short, all the measures that would implicitly anticipate further elements of political union turn out to be inconsistent and dangerous. They involve huge financial risks for some eurozone members and could not only undermine the effort towards political union but could also destroy the basis on which the whole process of EU political union rests—getting the people of Europe to identify with the European idea.

In the eyes of public opinion, the attractiveness of “Europe” rests to a large degree on its economic success, on growth and employment. This is also the basis on which Europe has been developing a political role in the world. Yet the current crisis has produced convincing evidence that those countries that perform best economically are those with the most flexible labor markets and which are not overly protective of business and the professions while also having modest levels of taxation.

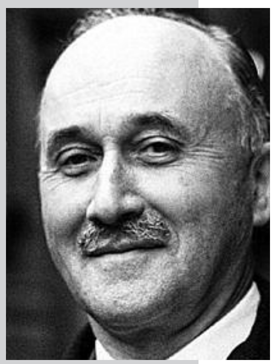
When in mid-1999 UK Prime Minister Tony Blair and German Chancellor Gerhard Schröder presented their joint paper on the “Third Way,” they proposed a method of benchmarking based on best practice. A few months later, in March 2000, the European Union’s Lisbon agenda was unveiled with its goal of making the European Union “the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion.” Right from the start, it was clearly doomed. So was its failure an argument for the European Union to try again with “more Europe,” or should it instead be seen as an argument for more economic governance by the European Union and for the harmonization and centralization of national policies? Many people think so.

Continued on page 80

Now He Tells Us

Jean Monnet, a founding father of the European Union, is said to have claimed, towards the end of his career, that if given the chance to start the process of European integration again he would have begun with culture.

—*O. Issing*



Jean Monnet

Continued from page 61

In September 2012, the European Commission's President José Manuel Barroso told the European Parliament in his "State of the Union" address: "A true political European Union means we must concentrate European action on the real issues that matter and must be dealt with at the European level." He then added: "To deliver lasting results, we need to develop a fully equipped community economic governance, together with a genuine, credible community fiscal capacity."

In other words, the Commission is asking for greater competences and more power. That's anything but surprising, but is the harmonization of taxes, a larger EU budget, and a new industrial policy the right avenue leading to higher growth and more and better jobs? When a decade ago, Chancellor Schröder outlined his Agenda 2010, it was a purely national initiative that turned out to be a major contribution to Germany's surprisingly good subsequent economic performance.

Economic theory and historical experience nevertheless tell a different story. In the footsteps of the Nobel Prize-winning American economic historian Douglass North, a number of studies have shown that it is competition between states and regions that lays the ground for progress and growth. On that basis, the Europe of centuries past became the most dynamic and prosperous region in the world. It's true that was also a time of wars, but that doesn't necessarily mean centralization is a guarantee for safeguarding peace.

The problem with so many of these approaches is that they are based on a mechanistic approach to economic policy. Harmonization and coordination, along with the centralization of decision-making, are seen a panacea for all kinds of problems. Yet would it not be better to start from the premise that appropriate institutions, property rights, and competition, together with a growth-friendly tax system and solid fiscal policies, are the basis of economic success? What might the European project look like if, instead of indulging in a seemingly ideological concept, we were to develop a framework that would really help to turn Europe into a dynamic and prosperous region? Rather than rising to this challenge, though, a constructivist approach now dominates mainstream thinking, even though it represents the sort of pretense of knowledge that Hayek denounced as a recipe for constraining freedom and ensuring economic mediocrity.

Jean Monnet, a founding father of the European Union, is said to have claimed, towards the end of his career, that if given the chance to start the process of European integration again he would have begun with culture. It's a dimension that's dear to us all, and where we neither need nor want centralization. Europe's cultural richness is its diversity, and the basis for Europe's finest achievements has been competition between people, institutions, and places. It's no accident that economic success reflects the same pressures.

All the measures that would implicitly anticipate further elements of political union turn out to be inconsistent and dangerous.

There is, meanwhile, another aspect of political union that needs closer attention. It is the relationship between the euro area's seventeen countries and the eleven members of the European Union, counting Croatia, that are outside it. There is a vast literature on different speeds or degrees of integration, but the basic idea of these various concepts has always been that "core" countries that wish to press ahead with closer integration would dominate future policymaking. Yet if this core is heading in the direction of centralization, and towards an institutional design that risks doing anything but foster prosperity, then the attraction of the eurozone towards the "outs" may strongly decline. Might this be a sign that institutional competition cannot be suppressed forever? If so, the kind of Europe that will emerge in such conditions is far from clear, although it's possible that the issue of the financial transaction tax will provide an interesting test.

I don't think I am obsessively opposed to the growth of European-level competence as opposed to national powers. Economists have developed concepts of externalities and spillovers, identifying fields in which only common action is appropriate to the implementation of efficient solutions, and environmental policy is clearly such a field. My criticism is instead directed against the notion that centralization per se is the solution to Europe's internal problems, and the basis for the European Union to play a more important role in the world. ◆