POLITICS

On the Need for Political Union in Europe

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THE SCEPTICS OF EUROPE'S COMMON currency believe that its measurable benefits are negligible. Even if they are right, the sustainability of the current system of semi-fixed exchange rates will increasingly be threatened by the rapid growth in the volume of international financial transactions. As the 1992-93 currency crisis and similar episodes elsewhere demonstrated, central banks are struggling to preserve an effective defence against speculative attacks. European governments have realised that they will eventually be confronted with the choice between either a common currency launched in a pre-emptive strike against disruptive currency turmoils or a return to a pre-1979 system of flexible exchange rates. Fixing currencies without eliminating exchange-rate risks has few, if any, advantages.

What Comes After the Euro?

Criticism of the Maastricht blueprint for the euro has swept from the British isles over to the continent. It would be misleading, however, to interpret these objections as a general desire to untie currencies from EMS-constraints, just too intertwined are the continental European economies. Rather, the institutional consequences of the euro are looked at with some degree of nervousness. In the discussion about the single-currency project, two fundamentally different directions of attack have emerged and are intermingling in a confusing way. One strand of euro-sceptic arguments culminates in the concern that the common currency will prove unsuccessful without a political superstructure—that EMU will remain reversible unless it is accompanied by further institutional integration. The controversy over whether Maastricht's deficit target means *somewhere around* 3% or *exactly* 3.0% would be a pointless exercise in political shadow-boxing if it were not for the doubts regarding insufficient political fora for fiscal co-ordination in the post-1999 euro era. The alternative strand of anti-Maastricht arguments is motivated by the fear that the euro is only an intermediate step toward a European federation, which is likely to blur already threatened national identities. Much of British and Scandinavian euro-scepticism is driven by this concern.

Both strands of anti-Maastricht arguments invite a couple of interesting questions regarding the relationship between monetary and political unions. First, is political integration likely and inevitably to follow EMU? Second, is a political union, should it then occur, a desirable outcome? Both questions can be examined by placing Europe's process of monetary unification in the context of the only relevant example in history—the economic, monetary, and political unification of 19th-century Germany.

A Little History

The prospect of prosperity reduces the propensity for war and conflict. The economic unification processes in 19th-century Germany and in 20th-century Europe were both driven by this belief, with the latter being modelled after the experience of the former. The Vienna Congress of 1815, sorting through the rubble of the Napoleonic wars, left 35 sovereign principalities and four free cities on German soil. Each of these 39 states possessed complete control over fiscal matters, customs, weights, measures, coinage and monetary systems. The resulting chaos that existed in trade relations denied Germans the industrial take-off observed in England or France. The emerging industrialists, restricted in their ability to exploit the growing opportunities in trade, production, and finance, pressed the aristocratic élites ruling the principalities to rescind their remaining fiscal privileges—primarily the revenues from customs and the seigniorage from the coinage of money—for the greater good of a common German market.

For reasons of economic dominance in Germany, the Prussian government supported the pan-German business community in its endeavour to overcome regional protectionism. Their combined efforts, after several preliminary stages and failed attempts, culminated in the customs union of 1834 (*Zollverein*), which included a large majority of the German states. The agreement on the elimination of internal tariffs and the adoption of Prussia's external customs—which were very low by the standards of the time—unified the internal market and allowed for the rapid catch-up of Germany's developing industries over subsequent decades. Incidentally, Europeans were able to exploit a similar institutional impetus when they signed the Treaty of Rome 123 years later.

In addition to forming a German customs union, the *Zollverein* agreement called for a harmonisation of its members' various currencies. Though all German states at the time used the silver standard (except for Bremen), the coins minted by German states differed widely in their monetary standards, weights, denominations, and metal values.

In contrast, paper money played only a minor role in the 19th century, in part as a result of the free-banking movement of the time, and it did not possess any legal-tender status until 1909. As Carl-Ludwig Holtfrerich has recently argued, bank notes "were generally considered as credit instruments for the purpose of facilitating payments among businessmen, like checks or remittances." The standardisation of the coinage system used in intra-German trade was therefore the key event in the unification of monetary standards in Germany. In the Dresden and Vienna Coin Treaties of 1838 and 1857, respectively, the *Zollverein* governments agreed initially to specify the metal content of their coins and later to adopt a common

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currency. By 1857, Prussia's thaler had effectively been accepted as German money. Even more important in today's context is the fact that these treaties allowed the money-supply process to be separated from any undue political influences, as did the Maastricht Treaty with the European Central Bank.

The cautious three-step fashion through which Germany had created the economic foundation for a political union—the 1834 customs union, the fixed exchange rates of 1838, and the common currency of 1857—served as a model for the future European governments to agree on the Treaty of Rome in 1957, the EMS in 1978 and finally on the EMU to be in place by 1999.

Both the economic and monetary union proved sufficient for Germany's economic ascent, despite the fact that, with the commercial crisis of 1857, the shortage of raw cotton following the American civil war, and Prussia's wars against Denmark, Austria, and France, the external factors were far from optimal. The customs and monetary unions, combined with the rapid construction of railways, allowed for an active trade across the different economic regions of Germany. The foundation of the German Empire in 1871 merely sealed what had already become an economic reality. The political co-ordination among German states (in customs and monetary matters) had created an economic unity that, in turn, further strengthened the movement toward political union. As Holtfrerich concluded, the 1876 foundation of the Reichsbank that accompanied the introduction of the mark and the switch from a silver to a gold standard was cosmetic and represented a monetary unification process with other gold-standard countries.

Conscious Designs and Implicit Goals

Though customs unions generate benefits from increased trade among the member countries, they often also lead to trade discrimination against third countries. Given the trade-off between beneficial trade creation and harmful trade diversion, economists tend to favour a unilateral tariff reduction to customs unions that are frequently characterised as being protectionist devices. One feature of customs unions that economists usually view as undesirable is the inherent necessity for political co-operation among the member countries. Yet this feature appears to have been the ultimate motivation for the German and European customs unions. Both in 1834 and 1957, signatories had an implicit understanding to increase the degree of co-operation at a time when the explicit statement of the goal of political union would have been detrimental, from the perspective of third countries as well as one's own citizenry. Calling instead for monetary unions, as explicitly done in both the *Zollverein* agreement and the Treaty of Rome, has proven a much less controversial way of achieving the same goal.

Once the euro has been introduced and the participating countries have surrendered their ability to run their own monetary policies, the importance of co-ordinating fiscal, social, and labour policies will increase accordingly. Any single country's costs associated with large fiscal deficits, for instance, will now be dampened since greater integration of capital markets implies that the resulting rise in interest rates will be less pronounced. But that rise will also spill over onto the other member countries. Though the monetary union requires harmonised fiscal policies, the common market already mandates a large degree of conforming social policies as it is neither in the governments' nor in the voters' interests to engage in intra-European competition over location by reducing corporate taxes, labour standards, and environmental regulations. Such a competitive outcome would generally be undesirable.

Since the only alternative to closer political co-ordination would be economic adjustments through the member countries' unemployment rates, a hesitant public's reservation toward closer political ties will much more easily be overcome. Even though direct historic comparisons are fraught with dangers, several factors clearly support the expectation that the euro will indeed force pan-European political institutions to evolve even further.

Safeguards Against a Harmful Political Union

Democratic constraints will ensure that economic and political integration will not proceed unless it brings additional benefits to Europeans. Further economic integration—which is a purely political process as it results in a change in jurisdictions—will have to be justified by demonstrating that "Europe" rather than the nation-state represents the optimal size of government for the provision of certain goods and services.

For the *Zollverein* states in 1834, the benefits were immediate. Not only did it facilitate the unification of the economic area and the important task of customs collection, but it also allowed the combined region to fully exploit the new technologies (particularly railways) and gave it the political weight to negotiate favourable trade deals with the technologically superior neighbours to the west and across the English Channel. Had sovereignty not been gradually transferred to the *Zollverein*, which allowed for the industrial take-off to become apparent by the late 1830s, the princes and dukes might have been successfully swept off their thrones during the revolution of 1848.

Whether it is globalisation or the dynamic innovations in the information sector, businesses are again pressing for a unification of the economic region. With North America and Japan seen as the economic and technological powerhouses, the acceleration of the integration process has been vociferously demanded by the European business community. In that sense, the situation is actually very similar to the one in 19th-century Germany. The narrowness of the domestic markets in Europe has kept a lid on many potential productivity gains. The increased degree of intra-European competition alone, which follows the introduction of a common-currency area, will create economic dynamics that should find its ultimate reflection on the labour market, the Achilles' heel of the European economies. With success comes confidence, and with it acceptance. Periodic elections to national and European parliaments ensure that the integration process will occur at an acceptable speed and only if the economic benefits justify this process. And the more the benefits of this process become apparent, the more willing the electorates will be to support a political union in Europe. Time will not end with the arrival of 1999. ◆