

# **Europe Fails to Learn the Lessons of History: Notes on Political Union for Barry Eichengreen's "Future of the Euro" Conference, as Delivered**

**J. Bradford DeLong**

U.C. Berkeley  
April 18, 2013

## **Starting Points**

What is the best starting point? The problem is I really have four starting points, or perhaps I have five starting points—fear, surprise, ruthless efficiency, etc....

## **"Political Union" Vague**

First, I would have to be even more rash than Charles le Temeraire, last duke of sovereign Burgundy, to opine about classical Dutch history with Jan de Vries in the room, but let me do so to point out that this session's topic, "political union", is a vague and sketchy concept. The political union of the strongest power in 17th century Europe, the seven United Provinces of the Netherlands, was made up of three components. First, there was a talk shop in the Hague—which had rather less power than is currently assembled in Brussels and Strasbourg. Second, the same guy, the Prince of Orange, was nearly always the *stadthouder*, the chief executive, of all seven provinces. Third, one of the provinces, Holland, was 60% of the total, and so if consensus was not reached could threaten to go it alone and do what was necessary—but when it did so take down names and have a long memory of who had played ball and who had not.

Nevertheless, that was enough of a political union to transform seven provinces into a 17th century European great power, powerful enough to rule the seas and make everyone—including Louis XIV—fear it on land. The most memorable piece of Samuel Pepys' diary about Restoration London is his lament one night, as he watched the fleet he had spent so much time trying to build burning on the Thames Estuary, that it seemed to him that: "the Devil shits Dutchmen". That was enough political union for the seven United Provinces of the Netherlands. Would that be enough for Europe today? I don't know. But I do know that a "political union" is a very elastic concept.

## Dilemmas of Large-Scale Democracy

Second there are the worries in the classical political tradition that a democratic political union on the scale of Europe is impossible. Aristotle believed there were no good democracies. Democracies were ridden by faction—so much so that politics devolved into a combination of street fights and purges. And if you did manage to get everyone together in the Assembly without their maiming each other beforehand, they would act fairly randomly, and fairly irrationally. They would decide today that they should execute every adult male in the recaptured city of Mytilene—even the demos—because the demos had been unwise enough to follow the *aristoi* when they had rebelled and tried to join affinity with Sparta during the Peloponnesian war.

Then, after what must have been an incredibly furious night by the Mytilenian ambassadors in Athens accompanied by lots of bags of gold to make sure the right people spoke in the Assembly on the following day, they reverse themselves. They promptly send off another trireme with an order not to kill every adult male in Mytilene. Faction-ridden, irrational, prone to aggressive militaristic war (because the demos would vote for a raiding expedition—you had the promise of plunder if you were in the fleet, plus regular wages while you were in the fleet). Democracies, Aristotle and company said were very bad news.

What you had to have instead was, ideally, *politeia*: a republic of mixed governmental principles with a strong aristocratic admixture in which, if I may give a Montesquieuian reading to Aristotle, the ruling passion was

virtue. But a republic has to be small: people have to see and be seen as practitioners of the kind of virtuous public-spirited behavior that you can get in a well ordered, not-very-democratic-but nevertheless-free, city-state politeia. Aristotle said you can keep this going—for a while, if you’re lucky to have a good starting setup—but only at the level of a city-state, nothing larger.

If you want a larger polity, you are stuck.

If, in the Aristotelian cosmos, you want a larger polity, then your options are limited to some sort of monarchy where the ruling principle is honor—if I may continue the Montesquieuian reading of Aristotle—or a despotism where—if I may switch to a Hobbesian reading—the ruling principle is fear. Perhaps your despotism can be a soft despotism, maintained-order rather than terror-based. But those are your choices, as Aristotle must have reflected many times during his years as tutor to Alexander the

So the classical tradition says that a democratic European political union on a continent-wide scale has got to be nearly impossible. James Madison, writing in the Federalist, then says: “Not so! Let’s look at the Aetolian League”—which I doubt very few people had thought of before James Madison went trolling in the historical record for possible examples of the United States—“It’s true that democracies tend to be faction ridden. It’s true that politics tends to be irrational, but add enough cooling constitutional elements to the orrery of a rationalistic constitution for an 18th Century Enlightenment system of political order (that curiously just happens to mimic the division of power between king, lord and commons at the accession of George III in its division of power between president, senate and the house) and you can tame the irrationalities of democracy if you have a broad extent of territory, so that your factions have a hard time organizing and communicating across space.”

So Madison raises at least the possibility of a large democratic political union—if your factions are of the right kind. But I think it is clear that, as Eric Rauchway has just twittered from 100 miles inland of here, the major faction of the pre-Civil War US, the slavepower, was of the wrong king. And I think it is clear that the major factions in Europe today are the wrong kind for Madison.

## **Keep Armies from Crossing the Rhine**

Third, there is the absolute necessity of political union in Europe today. Dieter, was it in 111 B.C. that the Cimbri, having moved down from Jutland to Austria, decided they didn't like Austria, and would rather cross the Rhine and eat feta cheese and olives in the Rhone Valley than eat sauerkraut and sausage and auroch jerky in Noricum?

They crossed the Rhine, and ate feta and olives—burned, looted, raped, and killed—until they were broken and defeated by the new model army of the Roman Republic under Gaius Marius g.f. seven times consul, etc., etc. Ever since then, at an average of once every 37 years, an army has crossed the Rhine bringing fire and sword—whether it's the Helvetii, Julius Caesar and all of his adopted relatives, Goths and Huns, Louis XIV because he doesn't think he'll be able to conquer Holland unless he can first ensure that no supporting Protestant army can move onto the left bank of the Rhine without starving, on up to Remagen Bridge in 1945.

The destructiveness of these Rhine-crossing armies has only increased as time has passed.

37 years after 1945 was 1982. We have been, thankfully, late—31 years late so far. We really want to stay that way.

Thus we desperately need political union in Europe lest we fall victim to the tragedy of great-power politics. It is absolutely essential that European politicians find some way that their disagreements are thrashed out at conference tables in Brussels and Strasbourg rather than settled in some other way, by some other mode, than political discussion and debate—there are better ways of deciding whether it should be spelled "Strasbourg" or "Strassburg" than killing hundreds of thousands of people.

## **Can a Hegemon Substitute?**

Fourth, suppose you need to avoid the tragedy of great-power politics but do not have the natural affinity across regions and the parcelization of po-

tential faction that Madison thought necessary for a democratic republic of large extent. Suppose you don't have that. Suppose you have to do something else —have to jury-rig something, much like the jury-rigged "political union" of the classical Dutch Republic.

The road then is the Kindlebergian "hegemon" route. Find some large state actor large enough to claim the role of first mover, of Stackelberg leader: to set the policy and give everyone else the choice of our way or the highway. Now a soft hegemon would much rather that it would be our way, and will allow peripheral countries in one way or another to free-ride to ensure the system is strongly win-win and thus stable. The hegemon will do this because it has an overarching interest in making the whole thing work peacefully, and because there are long-run benefits to being the hegemon—various forms of "exorbitant privilege" as Pierre-Olivier Gourinchas informs me it was Valerie Giscard d'Estaing and not Charles de Gaulle said.

Kindleberger's theory explains the tragedy of the North Atlantic economy between 1919 and 1939: Britain no longer and the United States not yet the hegemon. The Kindlebergian perspective would lead one to think that the problem of Europe today, at some fairly deep level, is that it is no longer part of a North Atlantic alliance—with the United States as a Cold War hegemon—and that Germany does not want to assume the burden, or assume the role, or is not wanted by the rest of Europe to assume the explicit role on terms that Germany wishes to exercise it.

## **Unifying External Threat?**

That brings me to the last possible starting point, which is what Madison left out in his praise of the Aetolian League. The Aetolian League was remarkably stable, for a slightly-more-than-confederation of poloi in classical Greece. They actually had an executive! With powers! That could command city states to actually do something rather than simply make requests!

But the Aetolian League as it was formed was impossible to imagine without Macedon, without a potentially—nay, an actively—hostile great power to the north.

The deal that struck the United States constitution—especially Rhode Island’s demand for equal suffrage in the senate, it’s hard to imagine that Virginia and Massachusetts would have agreed to such a disproportionate representation of the upper house of the legislature without the implicit and perhaps explicit threat from Rhode Island that if you don’t give this to us, we will go our own way, and Britain will spend money like water to have Newport as a naval base as we become the most loyal subjects of the Hanoverian dynasty you’ve ever seen.

There is a story—I don’t know whether it’s apocryphal or not—that when Paul-Henri Spaak was asked if it wouldn’t be a good idea to set up a bunch of statues to the founders of the European Union, he answered: What a wonderful idea! We should erect a 50-foot tall statue in front of the Berlaymont! Of Joseph Stalin! It was the Group of Soviet forces in Germany and the presence of the tanks of the Red Army at the Fulda Gap that most concentrated everyone’s mind on how much they wanted the Coal and Steel Community, the European Economic Community and then the European Union to succeed.

All that vanished, all that vanished at the start of the 1990s.

## **Four Lessons from 1919-1939**

Where does that leave us? Well, it ought to have left us, when we started the Euro, concentrating our minds on the four lessons that history taught us during the 1919-1939 period:

### **Symmetric Adjustment a Necessity**

In order for the world economy to be prosperous, adjustment to macroeconomic disequilibrium needs to be undertaken by both “surplus” and “deficit” economies—not by “deficit” economies alone.

John Maynard Keynes tried to teach Harry Dexter White this lesson at Bretton Woods. He failed. But just because Harry Dexter White did not

learn it does not mean that we should not have. Christina Romer used to stand up at OECD meetings and say that Europe needs both a shift to sound finance and austerity in the south but also pro-growth policies in the north, by which she meant: “4%/year inflation in Germany”. Everyone nodded, but did not do.

## **Integrated Regulation a Requirement**

If the world economy is to have any chance of avoiding or limiting crises, an integrated banking system requires an integrated bank regulator and supervisor. Either you have to cut banking systems off from each other and run credits and debits through sovereigns. Or if you let banks take up liabilities from everywhere and loan to everywhere, there needs to be a common regulator and supervisor to look at the system as a whole.

## **True Lender of Last Resort a Prerequisite**

In order for crises to be successfully managed, the lender of last resort must truly be a lender of last resort: it must create whatever asset the market thinks is the safest in the economy, and must be able to do so in whatever quantity the market demands. And it must not get hung up on, say, Pierre Laval’s desire to win points for himself in French politics by blocking the possibility that Germany’s Central Bank can come to the rescue of Austria’s Central Bank when Austria’s Central Bank has overcommitted itself in coming to the rescue of the credit [0:16:38] [Indiscernible] which had over committed itself in trying to maintain prosperity in the Danube Basin.

## **Fiscal Transfers Essential**

In order for any monetary union or fixed exchange rate system larger than an optimum currency area to survive, it must be willing to undertake large-scale fiscal transfers to compensate for the exchange rate movements to rapidly shift inter-regional terms of trade that it prohibits. So that monetary union on a scale as large as the Euro zone requires large fiscal transfers. And those are unthinkable without, in turn, something that is for enough intents and purposes a political union.

## **Why Were the Lessons Not Learned?**

I, at least, thought that everybody—or everybody who mattered in governing the world economy—had learned these four lessons that 1919-1939 had so cruelly taught us. I do know that that back at the start of the 1990s those of us in the US Treasury working on international affairs thought that everybody or at least enough of us with PhDs in economics had learned these lessons that history had taught us.

Now it turns out that the princesses and princes of Eurovia do not appear to have learned these lessons.

But what were the princes and princesses of Eurovia doing? How did this come about? Why didn't Maastricht set up a single Eurovia-wide banking regulator and supervisor to align financial policy with monetary policy? Why didn't Maastricht set up the fiscal-transfer funds that would be needed when—as would inevitably happen—some chunk of the future Eurovia went into recession while other chunks were in boom? Why did Maastricht leave a good chunk of lender-of-last-resort authority in the hands of national governments that could not print money and so fulfill the lender-of-least-resort function rather than placing all of it in the European Central Bank, which could?

And why—given that one country's exports are another's imports—does the adoption of policies in deficit countries to reduce their imports and boost their export not automatically trigger the adoption of policies in surplus countries to boost their imports and reduce their exports?

Some of it was a belief that specifying details at Maastricht would postpone the project for years or decades, and that the logic of events would inevitably lead to the organic growth and development of the missing pieces. The first large regional recession in the monetary union would call forth fiscal transfers. The first major banking crisis would see the European Central Bank immediately adopt the lender of last resort function, and would be swiftly followed by banking union. And when have politi-

cians ever turned down an IMF-blessed demand that they expand their economies? Underlying everything was a background gestalt that Maastricht was in large part Germany renewing its commitment to the closer integration of Europe in the aftermath of the rest of Europe's strong support of the Bundesrepublik's absorption of the German East, and that if it turned out that somebody need to pay somehow for not clearly foreseen consequences of Maastricht, then Germany would step up and pay.

It may well work out. 50 years from now historians may well be writing that Maastricht was a gamble, but a gamble that turned out well.

Historians may say 50 years from now in 2063 that it has now been 108 years since an army crossed the Rhine in fire, in swift fire and sword, and that differences between core and peripheral Europe are still annoying and a source of trouble and distress, but Europe as a continent as a whole is so rich that they have reverted to second-order concerns.

Northern Europeans still rumble that southern Europeans don't have a proper work ethic. But northern Europeans will be very eager to go and visit the periphery. Then the descendants of the poor Cimbri will finally get to eat the feta and olives that their ancestors never got to enjoy as they were driven back out from their own valley up north back into the Netherlands and Jutland.

Perhaps.

Perhaps not.

And surely most of it right now is the consequence of the fact that, while history taught the lesson, the princesses and princes of Eurovia were indeed looking out the window and gossiping on Facebook.

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2013-04-18

2983 words