Chapter Four
Monetary Crisis in a Less Than Perfect Union

David Calleo

A decade ago, it was still commonplace to write optimistically about the future of the European Union. My own book at the time, *Rethinking Europe's Future*, some critics thought remarkable merely for observing that no ineluctable process made a European federal union inevitable.[1] My caution was long-standing. I had begun writing about Europe's integration in the 1960s, in the heyday of Monnet's "spillover" theory. Although I did my best to present the Brussels pioneers sympathetically, I thought their vision, a centralized "supranational" Europe, unrealistic. And while it was only natural for an integrating Europe to seek inspiration from the American model, I found the parallels treacherously misleading. Europe is far more diverse than the U.S., culturally, linguistically, and institutionally. Throughout modern history, the continent has been resolutely divided into separate states. Since the nineteenth century, these have mostly been nation-states, which has made them even more distinctive and divided. Their economic policies have frequently been dominated by mercantilist ideas—featuring histories of protectionism, with separate national currencies, sometimes manipulated as weapons in trade wars conducted as a zero-sum game. Given this past, not much seemed to me inevitable about European economic integration. Certainly a union could not be imposed on Europe simply by erecting a "supranational" federal authority. But I had found de Gaulle's vision for European Union—a confederal "Europe of States"—a richer and more persuasive model.

---

[1] David Calleo, *Rethinking Europe's Future* (Princeton: Princeton University Press, 2000, 2003); "European Unity: But Can it Last?" *The Economist*, November 1, 2001.

As de Gaulle saw things, Europe's national states remained the political structures able to mobilize public consensus and legitimacy. The traditional states were therefore the proper stakeholders and players for the new Europe. They would participate in a union insofar as doing so enhanced their own national aims. Common European policies would have to be bargains thrashed out among these states. They could not be imposed by a technocracy without national roots, no matter how skillful and dedicated. A federal state with a supranational government stretching across the continent would be unable to generate and sustain a coherent general will. Internal and foreign-based pressure groups might flourish, but such a system would perpetuate Europe's disunity and impotence rather than cure it. Only a confederal constitution—one based on a durable and active consensus among Europe's states—could provide a European Union in conformity with the continent's political realities. Logically, de Gaulle could probably not have denied that his confederacy, to succeed, would itself require the makings of a "European" general will. But he would have insisted that such a collective will was most likely to be reliably discovered through the bargaining of states, and could only be given legitimacy by their agreement.

Convinced by de Gaulle's eloquence, and despite the intense quarrels of the 1960s, I thought Europe's project for confederal Union would go forward. All through the Cold War, three great impulses continued to favor it. One was historical memory. Postwar West-European elites—in France and Germany above all—were determined to build an institutional structure that would prevent the fratricidal wars of the past. Another unifying impulse was fear of the Soviets, which bound the West European states not only to their American protector but to each other. A third was widespread determination to escape from the economic stagnation of the interwar years, a goal believed to require a European Economic Community, which continental Europeans saw as their natural counterbalance to the American colossus.

De Gaulle's "nationalist" view of European unification also carried a critical practical lesson—the European project's continuing need for broad political support from the public at large. De Gaulle was particularly sensitive to the danger of popular disaffection if European integration began to seem an elite project aiming to install a Mandarin government. Hence his notorious dislike of the supranational rhetoric of the Brussels bureaucracy. A European Union, he insisted, could not be governed effectively by an "*aeropage*" of experts installed in the glass palaces of Brussels.

While I believe de Gaulle had the better arguments, it would be foolish to deny the vital role Monnet's vision played in launching and continuing to energize the European Community. That vision is particularly enshrined in the European Commission and Court. But even the European Council—the most Gaullist of all the Brussels institutions—is seeded with Monnet-like functionaries—European and national—who ceaselessly propose the policies of confederal Europe. Given France's bureaucratic traditions, not to mention his own career, de Gaulle understood how the new European system would work. He took care to install France's own best and brightest throughout the Brussels bureaucracy, a practice continued by his successors. Brussels bureaucrats, in turn, have carefully cultivated ties with the national bureaucracies of member states.

While it is difficult to overestimate Monnet's influence in the early days of the European Community, it nevertheless seems true that the constitutional structure that emerged from the 1960s and 1970s was essentially Gaullist. The European Community remained an assemblage of sovereign states. But those states increasingly found it in their interest to "pool" sovereignty in a European Union. Paradoxically, this seemed the only way to give reality to their formal sovereignty, and was the most effective way to establish some degree of practical control over their own regional environment. As a result, that Union developed as a hybrid—part supranational and part confederal—each part necessary to the other.

This evolution naturally gave rise to a fundamental constitutional issue, which has kept recurring in Europe's evolving Union: Is a structure that remains confederal in so many respects a distinctive model on its own, or does it merely indicate the European Union's incomplete development? In other words, is today's hybrid confederacy a form appropriate to the durable political realities of continental Europe? Or must the EU, to succeed, move on to something approximating America's centralized federation?

Reviewing these issues three decades later, as I wrote *Rethinking Europe's Future*, I found the European project even more necessary than during the Cold War. But I also found de Gaulle's political arguments about the nature of that Union still convincing. In many respects, the opening up of Eastern Europe was making the General's ideas more compelling than in the 1960s. Moreover, given Europe's stubbornly pluralistic nature, its hybrid superstructure had, in my view, been a great strength. But it was obvious that it could, on occasion, also be a dangerous weakness. Reaching agreement among bargaining states is inevitably a lengthy and delicate process. In some truly severe crisis it could prove a fatal disability. Of course, Europe's decision-making had been greatly refined over years of practice. Governments had grown used to discussing their problems patiently within the confederal structures until solutions were found. Monnet's experts, often consulting closely with the bureaucracies of the member states, were on hand to point discussion away from intractable confrontations and toward common interests. The process worked best in economic matters. It was far less impressive for security issues. But the Cold War had shielded the European Community from its shortcomings in the defense field. NATO greatly reduced Europe's need for any serious defense run collectively by the Europeans themselves. And whenever transatlantic differences over defense grew acute, the looming Soviet presence discouraged demands that could not be reconciled. In effect, the European Community had adapted successfully to the geopolitical realities of the bipolar strategic system. The U.S. protected Europe against Russia, but Russia also provided leverage for Europe in its relations with America. In many respects, the European Community had made the postwar Euro-Atlantic system tripolar rather than bipolar. This, I came to believe, was probably what de Gaulle had always intended.

The Soviet collapse ended Europe's Cold War shelter. Understandably, the Soviet contribution to European and transatlantic stability was not fully recognized during the Cold War. As a result, the Soviet Union in dying posed a greater threat to the West than in the Cold War. Deprived of its Soviet rival, the U.S. fell into a state of geopolitical and financial euphoria, and soon was enchanted by a unipolar vision of itself as the world's hegemon. NATO was enlarged to assume responsibility for much of the old Soviet sphere. The atrocities of 9/11 inspired America to undertake a global War on Terror, with its proliferation of new enemies and threats. War in Afghanistan was soon followed by war in Iraq. Fiscal discipline collapsed as taxes were cut and absolute military spending returned to or, by at least one estimate, exceeded Cold War levels.[2] Meanwhile, America's huge external deficit kept growing, while the dollar's exchange rate fitfully but relentlessly declined following September 11th.[3] Starting in the mid-1990s, the American economy began experiencing a series of speculative bubbles and crashes, a propensity which by now has gradually matured into an endemic financial and monetary crisis, reminiscent of the 1930s.[4]

Europe, meanwhile, experienced its own post-Soviet crisis. The disappearance of the Soviet threat reanimated geopolitical problems well-known in Europe's past. The reunification of Germany threatened to restore the familiar "German Problem"—a country too big for any internal European balance. Fear of a revived German threat was compounded by the opening up of the rest of Central and Eastern Europe—a region of relatively weak states intrinsically dependent on Germany. To guard against conflict, Europe needed to construct a new relationship with Russia. But West European states and newly liberated East European states had quite different notions about what this new relationship might be. Europe's collective reaction to the Soviet demise was therefore contradictory. The initial member states of the European Community believed the best way to meet the challenges of the Soviet collapse was to accelerate Europe's political and economic integration. Accordingly, they proposed the Treaty of Maastricht (1993), which renamed the European Community the European Union and was, on balance, a militant reaffirmation of Europe's federal aspirations. A radical upgrading of collective European tasks and institutions was designed to master the new situation.

For a start, the EU was to extend its functions to include common defense. Eventually, it was to take the leading role in dealing with

---

2 World Bank Databank, accessed on November 8, 2011. See also Heritage Foundation Report by Mackenzie Eaglen, "U.S. Defense Spending: The Mismatch Between Plans and Resources," June 7, 2010.

3 The U.S. Dollar index, DXY, is used as a proxy for global dollar strength.

4 Jon Hilsenrath, Serena Ng and Damian Paletta, "Worst Crisis Since '30s,With No End in Sight," *The Wall Street Journal*, September 18, 2008.

security challenges within its own regional space. European states, however, were deeply divided over these security arrangements. Some wished to go on depending heavily on America's Cold War guarantees; others looked for a more indigenous, inclusive and collaborative European security system—one that united the European states rather than divided them into opposing camps.

NATO, meanwhile, was busy reinventing itself as a global intervention force under traditional American leadership. This had particular appeal for East European states. In general, they were fearful of Russia and eager to join the EU, but skeptical of plans for a more European-based security system, and desperate to cling to American guarantees.

Maastricht also called for European states to collaborate more closely over border controls and immigration. The European project asserted its primacy by setting in train a major enlargement of the EU's membership. Joining the Union was seen as a process for transforming East European states into successful participants in Western Europe's liberal capitalism. Along with enlargement of EU membership, Maastricht's most striking initiative was the euro, the Economic and Monetary Union in Europe (EMU). This was a bold assertion of Europe's collective identity as well as a forceful response to the dollar's frequent gyrations, and the disruptive reactions that followed among Europe's national currencies.

In due course, Maastricht's bold ambitions began to seem contradictory. Enlargement of membership was working at cross-purposes with enlargement of functions. On the one hand the EU was taking on more challenging tasks, presumably requiring firmer and more centralized leadership. On the other hand, enlarging the membership seemed fated to weaken the capacity of a still confederal system to reach any central consensus. Extending the membership to countries emerging from lengthy communist dictatorships would inevitably change the political dynamics of the Union and make the already lengthy decision-making processes still more dilatory. To be sure, the reformist criteria imposed on the new members helped to bring about an impressive transformation in their political-economic systems. Arguably, the new members had to be absorbed into the new European system. Taking them into the EU was the best and perhaps the only solution. Nevertheless it came at a heavy cost to the efficiency of the confederal institutions at precisely the moment when they were confronting their most severe challenges. Under these circumstances, the Gaullist hybrid constitution inherited from the 1960s began to seem inadequate for the ambitions of the 1990s. Half-hearted efforts at constitutional reform undertaken at Amsterdam (1999) and at Nice (2003) seemed inadequate. Events seemed to be presenting the enlarged European Union with a potentially fatal dilemma: Either abandon Maastricht's ambitions or abandon the Gaullist confederal model and move on to a more centralized federation. The first course meant giving up goals thought necessary if the EU were to meet the historic challenges posed by the Soviet collapse. The second course risked shattering the consensus upon which the Union's survival and advancement had come to depend. As Europe continues to struggle, events grow more and more challenging.

Europe's constitutional dilemma is well illustrated in the current crisis of its Economic and Monetary Union (EMU). A cacophony of expert advice explains how to deal with the immediate emergency, and presents a far greater knowledge of markets and banking than I can offer. Nevertheless there are some larger political and geopolitical dimensions to the present crisis that might be useful to consider—at least as questions if not as answers. For a start, it is important to notice that, strictly speaking, it is not the euro that is in crisis. The eurozone and the EU as a whole are in rough equilibrium with the rest of the world economy. The euro has kept its value remarkably well. The actual crisis is inside the eurozone itself—among the European states that compose the EMU. The danger is not that the euro will lose its value for economic reasons. Rather it is that the EMU, or perhaps the EU itself, will disintegrate.

Much contemporary commentary links the EU's monetary crisis with what I have called its constitutional dilemma. In theory, it might be easier to resolve the crisis if the EU had some sovereign authority capable of deciding the issues rapidly and suppressing opposition thereafter. But if the EU is to remain a liberal construction of liberal states, where legitimate leadership remains based on consensus, it is not clear that a different constitution could have produced a different result. It might be worth noting that the American federation has not been any more successful at generating a clear and decisive solution to America's long-standing fiscal crisis. America's constitutional parts simply do not agree on what course to follow. In Europe's case, not only are the member states divided, the issues themselves are far from amenable to a straightforward solution. There is no indisputably correct answer waiting to be proclaimed. A substantial body of professional opinion believes, for example, that Europe's monetary union was a mistake from the start. They argue that states like Greece, Spain or even Italy would be better off outside the EMU. It is therefore not easy to argue that the outcomes currently championed by Germany, France, the European Commission, the European Central Bank or the International Monetary Fund are self-evidently correct, or equally in the interest of all parties concerned.

The heart of the problem is often said to be that Europe's monetary union lacks a fiscal union. What is usually meant is that fiscal policy is not subordinated to monetary policy. It is relatively easy to make the case that countries whose fiscal spending shows a large and persisting deficit will have growing difficulty financing that fiscal deficit in bond markets, especially if monetary policy is primarily concerned with preventing inflation.

A sovereign state not in the monetary union would have the option of printing more money—inflating the money supply to cover its swelling deficit. Inflating the currency would presumably put downward pressure on the exchange rate. In due course the currency would devalue which, hopefully, would restore its competitiveness by boosting exports and discouraging imports. Greater growth should then follow. In considering these scenarios, it is worth remembering that devaluations were frequent through the 1950s, 1960s and 1970s, often with unhappy longer term consequences.

In any event, a state in a monetary union cannot follow its own inflationary course unless it can persuade whoever controls monetary policy to inflate the common currency. If the errant state defies the fiscal discipline appropriate for the reigning monetary policy, and others resist financing its rebellion, sooner or later it will very likely face a financial crisis. Then banks, and others who hold its debt, will fear for their capital.

One commonly advanced solution is constitutional, a more robust Stability and Growth Pact, one that effectively limits debt and deficits. The issue is whether publics will be willing to endure the regime of prolonged austerity that the current anti-inflationary bias of the European Central Bank (ECB) requires from states like Greece. Of course, the adjustment of such states would presumably be easier if the ECB permitted more inflation. In the end, some greater inflation seems likely to be part of any successful resolution of the present debt crisis. At the moment it is said to be unacceptable to the more virtuous core states, Germany above all. Germans are commonly said to be traumatized by their own Great Inflation of 1923—a hyperinflation provoked and sustained by their own government. The present ECB policy very much reflects the hegemony of the "German model." At Maastricht that model enjoyed an intellectual predominance among the French as well as the Germans and their traditional allies. By now, however, it is unclear that the model is compatible with the political-economic cultures of all European countries, or indeed suits their actual economic situations. Italy, for example, followed a model of frequent depreciation for several prosperous decades. It seems unlikely to remain yoked to a Germanic monetary regime if Italians come to believe that doing so condemns them to a long period of high unemployment and mediocre growth.

It would be easier if it were possible to dismiss revolts against Germanic monetary discipline simply as populist uprisings against a self-evidently correct economic discipline. Critics of EMU and its Germanic discipline, however, are not so easily dismissed. Today's populist agitation against austerity comes armed with a powerful and persuasive Keynesian economic tradition of its own. That tradition, forged in the Depression, is still out of fashion but unlikely to remain so during an era that more and more resembles the 1930s themselves. Keynes' basic message was that deflation is worse than inflation. He admitted that hyperinflation was still worse, but was unlikely without the positive connivance of the monetary authorities themselves. A strong fear of inflation nevertheless remains lurking in today's markets and reinforces the hegemony of the German model. What helps give that fear credence is the explosion of footloose liquidity in the global economy over recent decades. Here the principal culprit is the central bank of the postwar global hegemon—the U.S. Federal Reserve. The story of the euro is inseparable from the story of the dollar.

Considering the lingering fear of global inflation should remind us that Europe's modern crisis is more than a contest between rival economic theories or cultures, but takes place within a global framework that is undergoing revolutionary changes. It may be worth speculating on how these changes affect Europe's monetary crisis. Today's geopolitical scene presents a clash between multiple emerging and declining superpowers and their geo-economic blocs. Of particular significance for Europe's future are the roles of the U.S. and China. Each poses distinctive challenges, opportunities and threats for Europe.

Arguably, it was the threat to Europe posed by the U.S. dollar that was the principal inducement for the European states to create the euro. The dollar has been unstable since the middle of the 1960s. Fear of the inflated dollar and calls for European monetary solidarity were linked explicitly in 1965 by no less a figure than General de Gaulle. It was in that year that de Gaulle issued his famous warnings about how the monetary abuses permitted by the Bretton Woods system were not only politically unjust but were building up inflation for the future, and pointing toward the collapse of the dollar's value. In raising these charges he was resurrecting French grievances of the 1920s, given their classic statement in the writings of the French economist who served as de Gaulle's economic adviser, Jacques Rueff.[5] Rueff's complaints centered on the "gold-exchange standard" for according an "exorbitant privilege" to the so-called "reserve currencies"—the dollar and the British pound. That privilege was the right to use dollars or pounds, which American and British governments could themselves create at will, as money that other countries were expected to accept in place of gold. In the French view of monetary history, it was this diseased system, installed in 1923, that had paved the way for the inflation of the later 1920s and the financial collapse of the 1930s. That same system had been re-installed at Bretton Woods. As a result, de Gaulle warned, the world economy was set on the same path as in the interwar years. De Gaulle's objections were partly economic: the system encouraged the U.S. to spend and invest freely around the world and to consume imports at home. De Gaulle admitted that this had been highly beneficial to the world economy initially, but claimed it was now exporting inflation to Europe. As de Gaulle had implied, within a few years world currency markets were refusing to support

[5] Christopher Chivvis, *The Monetary Conservation: Jacques Rueff and Twentieth Century Free Market Thought* (DeKalb: Northern Illinois Press, 2010).

the dollar's official exchange rate. In theory the Americans were supposed to back up their exported dollars with gold. U.S. gold reserves dwindled and by 1971, they were no longer able to do so. Accordingly, the Nixon administration abandoned Bretton Woods for a floating dollar. In effect, the gold-exchange standard of Bretton Woods was replaced by a simple dollar standard. The dollar continued its role as the world's principal reserve currency. The U.S. continued its global free-spending, but abandoned any obligation to support the exchange rate. The American current-account deficit grew steadily worse, despite continuing depreciation. The dollar's exchange rate grew more and more unstable, depending mostly on the vagaries of domestic American politics. The dollar's instability fell unevenly on Europe's diverse national currencies, with distorting consequences on prices, savings, and investments within the Common Market. Not surprisingly, plans for European Monetary Union date from this period.

De Gaulle's critique of Bretton Woods was, above all, geopolitical. The right to spend abroad as it pleased encouraged the U.S. not only to buy up the industries of others but to intervene militarily around the world. The 1960s and early 1970s were, of course, the time of *le défi américain* and of Vietnam. Half a century later, the U.S. deficit with the world economy had reached levels unimaginable in the 1960s. De Gaulle would doubtless be surprised and horrified to learn how good a prophet he had been. The U.S., no longer defending the world against communism, was now presenting itself as the unipolar keeper of world order—the indispensable foe of terrorism and nuclear proliferation wherever it was suspected. Accordingly, U.S. defense spending was greater than that of all the rest of the world combined. The fiscal consequence was a huge budget deficit. Europeans today doubtless have ambivalent feelings about America's role as hegemon. They are nevertheless glad to have the Americans around as a balancer against Russia, China and Iran. It allows them to play both the role of faithful but limited ally, as they are continuing to do in Afghanistan, but also to distance themselves from unpopular American moves that alienate Europe's strategic neighbors, like Russia, Iran or the Arabs. Europeans must also wonder how long the U.S. will be able to sustain the huge deficit that goes with its world role. Hence the continuous, if not very compelling, pressure for the EU to develop its own capacities for collective defense.

Europe's American Problem is, of course, closely related to its China Problem. Not only does the U.S. spend freely everywhere but it has proclaimed itself the world's 'consumer of last resort.' Inevitably great pools of exported dollars have accumulated around the world—above all in China. This has made China the guardian of the dollar's exchange rate. Should China cease to hold its huge annual dollar earnings in its reserves, the dollar's exchange rate would likely collapse. Given America's huge current account deficit, the dollar has no real support. What the Chinese do with their dollars must therefore be of great concern to the Europeans. Successive American governments have been pressing the Chinese to let the dollar fall. But it would fall not just against the Chinese renminbi but also against the euro. China, with its still drastically cheaper labor costs, would remain highly competitive. Europe would presumably be more vulnerable—to American as well as Chinese competition, at home as well as overseas.

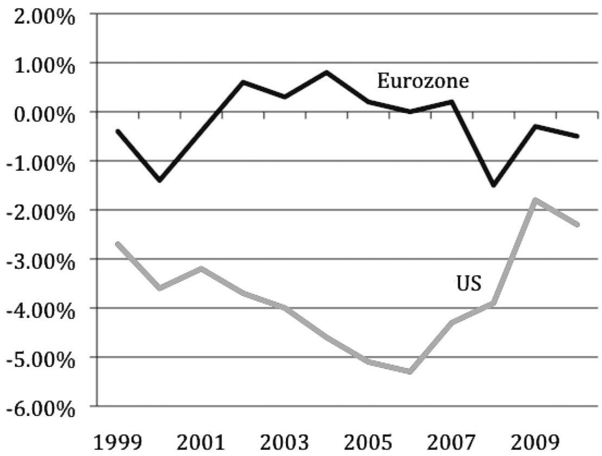
Retaining a competitive exchange rate is important for a Europe competing with America for the high end of manufacturing and services. A dollar depreciating rapidly is something Europeans have to take seriously. Meanwhile, their own trade relations with China have been growing increasingly important. Europe is already China's largest export market, and China is Europe's second-largest trading partner after the U.S.[6] Europe's trade deficit with China has been growing rapidly over the past few years, although its external trade with the rest of the world remains roughly in balance overall [Figures 1 and 2]. This distinguishes the EU from the U.S., which has run an increasing deficit with China as well as a steady current account deficit with the world in general.

A more detailed breakdown of EU trade suggests the complex interdependency among EU states. Europe's overall balance with the world depends heavily on the bilateral surpluses of a few major exporting countries—Germany in particular, which is the 2nd largest exporter in the world.[7] However, the better part of Germany's exports

[6] Eurostat news release, "Strong Increase in EU27 exports to China in the first half of 2010," October 5, 2010.

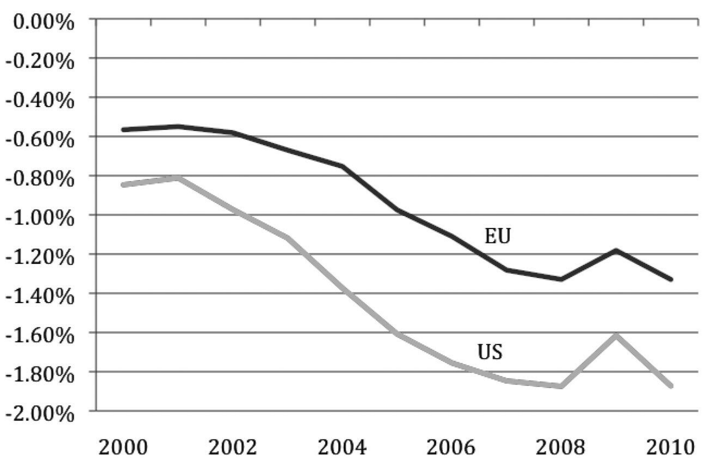
[7] CIA World Factbook.

Figure 1. Current Account as a Percentage of GDP



Source: ECB Statistical Data Warehouse, World Bank World Development Indicators, U.S. Bureau of Economic Analysis International Transactions Accounts Data. Note that eurozone figures are for external trade, and the index changes based on adoption of the euro.

Figure 2. Trade Deficit with China as a Percentage of GDP



Source: ECB Statistical Data Warehouse, World Bank World Development Indicators, U.S. Bureau of Economic Analysis International Transactions Accounts Data. Note that the EU index changes on accession.

are sold within the eurozone and the EU itself.[8] Therefore, in brief, the EU is a large collective economy whose member states trade mostly with each other. EU trade is, however, so large that its member states collectively are also the world's leading exporters and importers for trade beyond Europe.[9] Prowess in maintaining these internal as well as external exports is of particular important to many of several of the EU's member states—including France, Italy and, of course, Germany. These big continental countries continue to have a large industrial segment to their economies, a section that employs a significant proportion of the workforce. In 2007, before the crisis, the industrial base of the EU27 accounted for 37.1% of its GDP and 39.6% of its employment.[10] The need to protect the competitiveness of its industrial sector helps to explain Germany's historic aversion to domestic inflation, an aversion enshrined in the policies of the ECB. It also highlights Europe's vulnerability to the huge dollar overhang, which could easily cause the dollar to depreciate sharply.

The interesting question for our purposes is whether America's dollar's potential crisis promotes or weakens European solidarity. Whereas the EU on the whole and the eurozone in particular form a large integrated and relatively closed economy, individual member states can nevertheless continue to see themselves as relatively small and open economies, searching for a niche in a global market. Does the dollar threat thus work to set the European states against one another? The weaker exporting Europeans might want a weak euro that follows the downward path of the dollar. The stronger exporters, like Germany, are traditionally more fearful of inflation and want a stronger currency. Of course, it might be argued that the stronger European states, with their outsized trade surpluses, are protected by the weaker with their big trade deficits. Without that protection, the euro might very likely be extremely overvalued in relation to the

[8] Germany's exports to the EU as a percentage of total exports accounted for 71% in 2010. Statistisches Bundesamt Deutschland, "Foreign Trade: Ranking of Germany's trading partners in foreign trade."

[9] The World Trade Organization, http://www.wto.org/english/news_e/pres10_e/pr598_e.htm, accessed on August 11, 2011.

[10] Figures derived from the European Commission for Enterprise and Industry, "EU Manufacturing Industry: What are the Challenges and Opportunities for the Coming Years?," April 26, 2010.

depreciation-prone dollar. Should a severe dollar collapse lie in the future, the advantages of a closely integrated European political and economic bloc are not difficult to imagine.

To see this putative harmony of interests, however, Europeans probably need a constitution that permits them to visualize themselves less as separate states and more as the union they are, and presumably wish to be. But reinforcing this shared interest and identity calls for either a better balance of trade and investment among the EU states, or for an arrangement whereby the surplus states, recognizing their interdependence, share their bounty with the deficit states.

Along with the decline in America's trade balance, probably the most dramatic event in the world economy has been Asia's rise. How will Asia's rise affect Europe's federal experiment? This topic is vast and elusive, but a few observations may be useful. "Emerging" Asian economies, China above all, but also India and several others, are highly competitive and have grown very rapidly. While all face serious problems with inflation, political dissension and environmental pollution, their labor costs, even if rising rapidly, will remain at a fraction of European and American levels for the foreseeable future. Given the world's environmental problems, together with the shortage of energy and raw materials, world growth seems unlikely to accommodate both a continuing Asian rise, together with enough growth to sustain customary postwar expectations in the West. As a result, the world will continue to witness a fundamental shift in wealth and income from the West to Asia. From a longer historical perspective, there seems nothing remarkable in this. For most centuries of recorded history China has been the world's richest and largest country. Its outrageous humiliation of the past two centuries is now being reversed. Given the high living standards that prevail in the West, China's rise hardly needs to end in catastrophe. But in addition to the daunting demographic and environmental problems that lie in store for the world in general, the West and Japan will also face an uncomfortable political, social and cultural adjustment to slow growth and arduous competition. Avoiding violent conflict will require imaginative structures for global governance. Indeed, Europe's experience with regional federation may have a good deal to offer the rest of the world.

Like the weak dollar, rising Asia presumably makes all the more desirable the development of a harmonious European region, able to reconcile and assert its interests. Will a more competitive world eventually require a more centralized federalism than the Gaullist model allows? It might. Much will depend on how China itself evolves politically and socially, or on how much West and East are disposed to accommodate each other, or are capable of carrying out their own good intentions. A world locked in combat over scarce resources may well require more authoritarian governments all around. Ideally, some enlightened combination of technology and diplomacy will deliver an environment where liberal governments based on consensus can survive. In any event the global dimension of today's economic crisis, while it may make Europe's federal aspirations more difficult to achieve, should also make them more self-evidently beneficial to pursue.

Europe's financial crisis is, at heart, political. It is the failure to control budgets and supervise banks—two fundamental tasks of government. What gives rational support to pessimism about the euro, if not any corresponding faith in the dollar, is the fear that the EU's confederal institutions are too weak to provide the timely and steady leadership required to steer through the rapids of today's financial crisis. Over the longer term, can the EU evolve institutions and habits strong enough to constrain states, firms and markets from the runaway accumulation of ailments characteristic of recent years? Many commentators have been highly critical of the EU's governing institutions in the current crisis. Not surprisingly, there have been heated and often confused disagreements among the partner states. New institutions and practices have evolved rapidly in the past few years. Policy has often stumbled. But it is not clear that Europe's performance has been inferior to that of the U.S. To see U.S. federal institutions as regularly more capable of successful market regulation or coherent macroeconomic policies seems a considerable exaggeration. Given our recent experience, it is not self-evident that appropriate regulatory, monetary and fiscal policies would be easier for Europe to achieve if it had a more centralized federal system, like our own.

There are, after all, other models for successful unions of sovereign states. One comes from the monetary sphere itself—the Gold Standard that de Gaulle celebrated in his press conference on the dollar. For several decades in the nineteenth century the major European states did collectively manage gold as a stable and successful common currency, without a federal government or, arguably, without even a single hegemonic power. The major financial centers of the world—London, Paris, Berlin, Vienna, and New York—collaborated to sustain rules that more or less automatically kept themselves in balance with each other—rules that amounted to an early Stability and Growth Pact. London, the biggest and most active center, nevertheless remained in equilibrium with the rest. In crises, the major centers did sometimes actively cooperate in the general interest—as when the Bank of France on occasion quietly bailed out the sometimes overextended Bank of England.[11] This collegial model of voluntary monetary cooperation died in World War I—a time when Europeans abandoned any pretension to impose on themselves rational self-restraint in the common interest. After the great madness of 1914 came the renewed insanity of 1939. Arguably, Europe has never really recovered from these two great wars of the last century. Instead, Europe came close to destroying its prosperity and civilization forever—a lesson that we can hope France, Germany, and the rest of Europe have not forgotten. Similarly we can hope that today's world offers ample evidence of how vulnerable a rich but divided and therefore weak Europe can be. We can hope that the dangers appear vivid enough to dampen any serious rebirth of narrow old-fashioned nationalism on the part of the Germans, the French, the British, or indeed the Americans.

Since the end of World War II Europe's states have been in the midst of a great experiment to reestablish and stabilize the relative order and comity that prevailed among them before 1914. Europe's experiment with federalism, of course, recalls our own but is in some respects very different. When we look at Europe's federal model, we cannot help but note its relative lack of a strong central power. As a result, we tend to see Europe's Union as an early, incomplete or perhaps failed version of our own. Our own history teaches us to see things in this way, whereas Europe's history suggests a different perspective. European states have struggled for centuries to prevent the rise of a dominant central power. That determination has continued, even as they set about building their Monetary Union. At the outset,

[11] Marcello De Cecco, "From Monopoly to Oligopoly: Lessons from the Pre-1914 Experience," in Eric Helleiner and Jonathan Kirshner, eds., *The Future of the Dollar*, (Ithaca: Cornell University Press, 2009).

most member states might have preferred to stop with a reinforced European Monetary System, rather than a single currency. They felt compelled to go on to a single currency because they lived in a world system dominated by the dollar. To protect themselves from the thrashings of the imperial dollar, Europeans had to go on to create the euro. Monsters, we might say, beget monsters.

Under the circumstances, we should perhaps try harder to avoid seeing the European Union as a continental nation state in the making, a primitive, incomplete or decadent version of ourselves. Instead, we might consider it a new political formula for a new world order—one that builds on the achievements of nation states and links them in a fashion that brings a stable peace to their relationships. For our own sake, we should wish them well.