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"The Euro and the Future of the European Union"

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by

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1. Introduction

At the beginning of the year 1998, it looks as if European Monetary Union will become a reality. The leaders and political elite in many European states, most notably Germany and France, are determined to accomplish monetary union, a project of essentially political nature, and they are likely to succeed in the short term. But how long is monetary union going to last? My answer is: "Not very." Monetary union carries the seeds of its own undoing, and it will ultimately cause the collapse of the house of cards that we know as the Europe of Brussels.

At the present time, monetary union is bad economics. It will also expose that the Europe of Brussels is bad politics. The political and administrative structures of Europe were established for the postwar era, and they are not suited for the post-postwar era. The Europe of Brussels is essentially unbalanced: First, the Union is still lacking democratic legitimacy. Important decisions (such as monetary union) are made in the European Council, not in the Parliament or the national Parliaments. Second, the whole structure of Europe reflects the fears and bargains of the past rather than shared visions of the future.

The collapse of the institutions of Brussels, however, will leave the European idea intact and may even strengthen it. After Europe will have been freed from the illegitimate and undemocratic structures of Brussels, it will become clear that the post-national states of Europe have moved to higher level of cooperation and integration than may fear.

Europe *is* a unique network of states. The European nations by and large do trust each other and do know that there will only be a common future ore none at all. This network will achieve all and more than the Europe of Brussels. The level of trust and cooperation will actually *grow* with the demise of the current unhealthy and unbalanced structures. States will be free to address issues dearest to them in an atmosphere of trust and openness and actual progress on crucial issues is more likely than it is today.

In my paper, I will argue three points: First, I will recount and criticize the political and economic rationale for monetary union. Second, I will outline how bad economics will bring about the collapse of the EMU and the Europe of Brussels. Third, I will argue that this is actually a healthy development, providing Europe with the freedom to find a more suitable approach to face the real problems confronting it: Eurosclerosis (once again), unemployment and lagging economic dynamics.

2. The Rationale for Monetary Union

In essence, there are five reasons for monetary union: the strengthening of political integration, the strengthening of European financial power in the world markets, the acceleration of the convergence of monetary and fiscal policies and the creation of an optimum currency area to reduce transaction costs in the Common Market.

2.1. Political Integration

The most important reason for monetary union is a political one. It is argued by many of the current generation of European leaders that monetary union will document the „irreversible political will"[2] to create a unified Europe. Those leaders – most prominently Helmut Kohl and the late Francois Mitterrand - hoped that the Euro would become a symbol of a new European identity and enable a quantum leap toward the creation of a truly unified Europe.

Taken by itself, this hypothesis is as valid as any. The whole argument of this paper, however, is that the current thrust of political integration is a bureaucratic and invalid one, and that monetary integration, as the ultimate symbol of that thrust, will be the beginning of the end of the Europe of Brussels.

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[2] Thus German chancellor Helmut Kohl in defending the ratification of the Treaty of Maastricht before the German parliament.

Three fundamentally different positions on the future have yet to be reconciled. The prevalent German post-war notion was that the nation-state would be superseded by an ever-closer European Union. European institutions were to be equipped with genuine democratic legitimacy, creating the United States of Europe. Far-reaching supranational integration in all areas was to take place, supported by a democratically legitimized European Parliament with far-reaching powers. Italy, Belgium, the Netherlands and Luxembourg supported that position. That position has been shaken even in Germany, but it is still holding.

The French position, on the other hand, is one of a Europe of fatherlands, where the heads of government decide in the Council of Ministers – the technocratic and dirigisté European structure that currently dominates high-level EU decision-making. Europe is seen as a lever to increase France's geopolitical weight, not as a structure to supersede the French state. Monetary union will utilize the German economic potential, and closer intergovernmental cooperation in security and foreign affairs will raise France's standing in Europe, and Europe's standing in the world.

Third, the British position emphasizes intergovernmental cooperation, weak central powers, deregulation, free trade, openness to new entrants and the maintenance of strong transatlantic ties.

European Monetary Union is a French-German idea. France has always seen monetary union as a means to harness German economic power and to strengthen the international financial power of Europe. During the economic turbulence of the late 1970s and early 1980s, French and German interest briefly converged: both nations wanted to be more independent from the Dollar. Since then, the political interests in Monetary Union have moved away from each other again. France still wants to harness German economic power, and Germans have increasingly returned to a strictly monetarist interpretation of international financial policy – if they ever diverged from it.

In December 1989, shortly after the fall of the Berlin Wall, Mitterrand pressed strongly for the advancement of monetary and economic union. Kohl went along, but added Germany's objectives: a strengthening of the European parliament as well as a deepening of political integration. The ensuing negotiations were the last bargains in Europe based on the post-WWII-structure. Out of all initiatives proposed, only European Monetary Union survived. Germany viewed EMU as a concession to achieve objectives much closer to German objectives: the strengthening of the democratic legitimacy of European Institutions and the promotion of supranational integration in the form of three pillars of the European Union: Monetary Union, Common Foreign and Security Policies and Common Interior Policies. With the exception of monetary union, none of these objectives was significantly promoted. Today, despite the Common European Act and the Treaty of Maastricht, the constitutional and institutional unification of Europe has not progressed much further than, say fifteen years ago.2.2. Prestige and External Power: the Euro as a Major Reserve Currency

There are those, mostly in certain Mediterranean countries of the EU, who also want to create a European Currency to rival the dollar as a major global reserve currency.[3] Reserve currency countries have a number of advantages over other nations – they can issue currency held by other central banks, thus enjoying gains from issuing currency. Countries with reserve currencies can also issue international debt denominated in their own currency, thus having the option of devaluing their own currency and reducing their debt.

These advantages can be explained by looking at the central bank balance sheet. Central banks hold two types of assets, claims on future payments by their own citizens and governments, mostly in the form of government bonds and loans to banks, and foreign assets, mainly foreign currency bonds.

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[3] See, for example, C. Fred Bergsten: „The Dollar and the Euro," Foreign Affairs, July/August 1997, pp. 83-95.

Central Bank Balance Sheet			
Assets		**Liabilities**	
Foreign Assets	FF 1000	Deposits held by private banks	FF 500
Domestic Assets	FF 1500	Currency in circulation	FF 2000

Central banks mainly incur two types of liabilities – deposits held by private banks and currency in circulation. Both are claims to payments by the central bank. The reserve currency country is in international demand. Other central banks will buy the bonds of that country and hold those permanently as „foreign assets". The central bank makes a profit in the amount of reserve currency that foreign countries are holding.

So far, the dollar is still the dominant reserve currency, accounting for 40% - 60% of world finance as opposed to 10% - 40% for the European currencies combined. According to some calculations, Monetary Union would bring a portfolio shift of $ 500 billion to $ 1 trillion dollars into Euros.[4] This shift, even if extended over a number of years, would put pressure on the dollar and further strengthen the European currencies, exacerbating the economic problems in Europe. Moreover, while the exchange rates within the European Union will be fixed, exchange rate instability between the Dollar and the Euro is likely to increase.

Yes, the Euro might briefly rise to the status of a major reserve currency and even rival the dollar. Any reserve currency, however, is only as good as the underlying economy and the underlying political constitution. Any shift from the Dollar into Euros will put upward pressure on the Euro, worsening the European trade balance and depressing economic income. Large external fluctuations will also put a considerable strain on the European institutions and will sooner or later reveal how fragile the consensus is between the nations that make up the EMU.

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[4] Bergsten, „The Dollar and the Euro", p. 90.

2.3. Economic Convergence: Enforced Monetary and Fiscal Discipline

Monetary union does force countries to coordinate their monetary policies, that is, maintain a fixed relationship of interest rates in order to keep exchange rates stable. It is argued by many, including Chancellor Kohl, that this enforced coordination of monetary and economic policies will also promote political integration.

To prepare for Monetary Union, the participating countries have to freeze exchange rates. This automatically implies that interest rate differentials, given no changes in capital flows and the real economy, will also be frozen. Member states' monetary will now be determined by the need to maintain set exchange and interest rates.

Economic convergence as necessitated by monetary union causes a problem called the **„n-th-currency problem".** Under a system of fixed exchange rates operating with a reserve currency, one country is free to set monetary policy according to its own preferences, while the others must follow. With n currencies, only n-1 exchange rates vis-a-vis the (central) n-th currency need to be determined for the system to be fully determined. This leaves the n-th country free to set its own monetary policies. The other countries must then follow those policies to maintain their exchange rates.

The n-th-currency problem has frequently led to controversies between Germany – generally favoring a tighter monetary policy – and other European countries (e.g. France). These debates were as much political in nature as they were economic.

Between countries, where the coordination of monetary policies made obvious sense, virtually fixed exchange rates have been established and maintained by the governments without much notice and any formal agreement. Thus, fixed exchange rates have been a reality between Austria, Holland, Belgium, Luxembourg and Germany for many years.

In preparing for monetary union, the European nations actively embraced the coordination of monetary policies and agreed on criteria for membership in the European Monetary Union. In the 1970s, Richard Nixon mentioned that "we are all Keynesians now." To modify Nixon's dictum, in the 1980s and 1990s, "we are all monetarists." Accordingly, the criteria for membership in the European monetary union rely heavily on fiscal and monetary prudence.

Convergence Criteria for Inclusion in the First Round of Participants for European Monetary Union

1. The inflation rate must be no higher than 1.5 percentage points above the average of the three lowest-inflation countries in the union.
2. Long-term interest rates (as a measure of inflationary expectations) must not exceed by more than 2 percentage points those of the three best-performing countries.
3. The budget deficit must be below three percent of GDP.
4. The ratio of public debt to GDP must be below 60 percent.
5. Candidates must not have experienced a devaluation of their currencies for at least two years.

So far, the process of economic convergence has operated much better that most would have predicted.[5]

- Inflation rates, for example, have converged markedly. This convergence in inflation rates started in the mid-eighties and seems to be of a permanent nature.[6] Especially the more inflation-prone countries succeeded in reducing inflation rates. At the end of 1996, the inflation rate was down to 1.3 % in Italy and 2.1 % in France versus Germany's 1.3 %, for example. By the end of 1996, 10 out of 15 member states fulfilled the convergence criterion.

- Long-term interest rates, too, have entered into a process of long-term convergence, though countries with a traditionally loose monetary policy still have

[5] See, for example: „Report on the convergence in the European Union in 1996, according article 109j, paragraph 1 of the Treaty on the European Union", Europäische Wirtschaft, Europäische Union, Generaldirektion Wirtschaft und Finanzen, January 1997.

[6] Ibid., p. 9, see also Krugman/Obstfeld, p. 623.

higher interest rates. By the end of 1996, 11 of 15 of the member states fulfilled the respective criterion.

- Only four states had a public deficit below 3 % of GDP by the end of 1996. However, the EU nations have made enormous efforts to consolidate their budgets. Belgium's budget deficit dropped from 7.5 % of GDP in 1993 to 3.3 % in 1996, Italy's from 9.9 % to 6.6 %, Finland's from 8.0 % to 3.3 %. The same consolidation is true for most countries – except Germany. In Germany, the deficit was relatively low in 1993 at 3.5 % and rose slightly to 4.0 % in 1996.

- Most states did not meet the total deficit criteria (e.g. Belgium, with a debt-GDP ratio of 130 %, Italy with a similar ratio and Ireland with a ratio of 110 %).

- After the crises of 1992 and 1993, the stability of the exchange rates increased markedly. The most important reasons were fiscal and monetary discipline in anticipation of Monetary Union, a strengthening dollar which tended to strengthen the weaker European Currencies and similar business cycles in the countries of the European Union.

As a consequence, 11 candidates were informally selected in 1998 to be included in the first round of European Monetary Union: Luxembourg, Ireland, Finland, Holland, Belgium, Portugal, Austria, Spain, Germany, Italy and France.

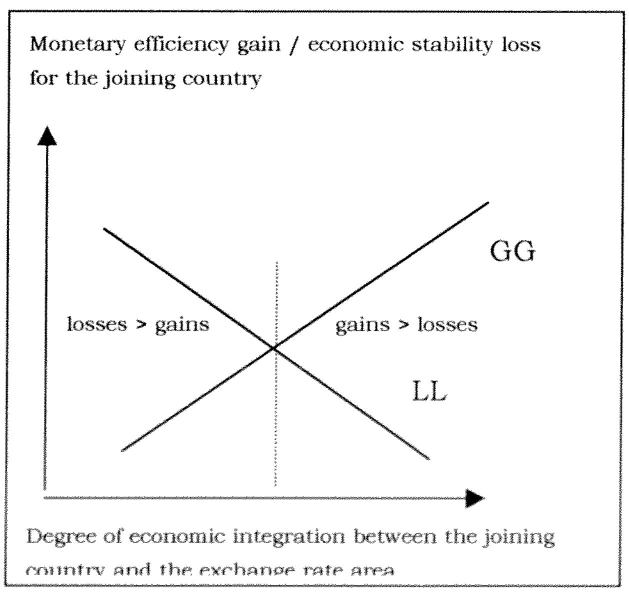
However, some states had to undergo enormous efforts to reach the convergence criteria. Italy, for example, had to cut its budget deficit in half. France went through an austerity program that helped to oust the bourgeois government. . Some of the changes may also have been window dressing. While the convergence to date has been an encouraging sign, this tour de force may not be sustainable for some states, especially in the face of a new global economic crisis.

2.4. The Economic Benefits of Currency Union

A currency union lowers the transaction costs between different areas and eliminates exchange risks. Countries do not have to exchange currencies anymore, if they want to trade with each other. The benefits derived from this fact increase with the amount of economic integration between two areas. The more two regions trade with each other, the greater the economic gain from monetary union.

This a positive correlation between the degree of economic integration and the monetary efficiency gain for the joining country is expressed in the upward slope of the curve below, also known as the GG curve. The GG schedule can be combined with a second schedule, the LL schedule, to describe the criteria for an optimum currency area.

Fixing exchange rates creates additional instability in the face of endogenous supply and demand shocks. In the case of strong domestic demand, for example, rising interest rates lead to an appreciation of the home currency, which, in turn, increases the demand for foreign goods, thus helping to avoid price pressures. In the face of strong domestic demand, the central bank could also tighten the money supply to further depress demand and increase interest rates. In a monetary union this is not be possible. Thus, the economy would be confronted with the full demand shock.



The LL schedule describes a relationship between the degree of economic integration and this economic stability loss. The larger the economic integration between two areas, the more interest rates, capital flows and trade balances can help to cushion economic shocks.

In short, the larger the degree of economic integration, the smaller the economic stability loss from joining a currency union.

There is a minimum degree of economic integration necessary for a currency union to make sense. Above that minimum degree, the gains from joining a currency union exceed the losses.

It is questionable whether Europe as a whole meets the criteria for an optimum currency area. A number of economic studies suggest that the European Union is split into various areas with a high degree of economic integration.[7] For some areas, the costs of monetary union are likely to exceed the gains. This could be the case, for example, if Northern and Southern countries are forced to have one currency.

A number of currency clubs would be a viable alternative to an all-encompassing European Monetary Union. The criteria for such clubs could be the degree of economic integration, the similarity of economic policies, the homogeneity of preferences, similar inflation rates, similar reaction patterns to external shocks, and high labor mobility. As already noted, the „D-Mark-block" (Germany, Holland, Austria, Belgium and Luxembourg) already constitutes such a de-facto monetary union with a high degree of economic integration.

Crises are likely to erupt in the event of regional economic booms and recessions. Let's say, there is a strong surge in domestic demand in an economically strong area, e.g. Germany.

Consider a demand shock. Demand is determined by consumption, investment, government purchases and the current account.

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[7] Gunther Tichy: Theoretical and Empirical Considerations on the Dimension of an Optimum Integration Area in Europe, Aussenwirtschaft, 1992, pp. 102-37. Paul de Grauwe, Wim Vanhaverbeke: Is Europe an Optimum Currency Area? Evidence from Regional Data, in: Paul R. Masson, Mark P. Taylor (Eds.): Policy Issues in the Operation of Currency Unions, Cambridge 1993. Atish R. Ghosh, Holger C. Wolff: How many Monies? A Genetic Approach to Finding Optimum Currency Areas, National Bureau of Economic Research, Working paper 4805, 1994. Tamim Bayoumi, Barry Eichengreen: is there a Conflict between EU-Enlargement and European Monetary Unification?, National Bureau of Economic Research, Working Paper 3590, 1992.

(1) $D = C(Y-T) + I + G + CA$

Under a system of floating exchange rates, a demand shock would entail higher interest rate, which would in turn lead to an appreciation of the domestic currency and a deterioration of the trade balance. This would depress national income, which in turn would help to mitigate the demand shock and reduce inflationary pressures.

(2) $D = C(Y-T) + I + CA$

In summary, a demand shock would have the following effects in a system of floating exchange rates:

1. A demand for capital investments would force interest rates up, leading to an appreciation of the domestic currency. Moreover, a rise in interest rates would somewhat decrease the demand for capital investments.

2. The region would have a strong demand for goods, not all of which could be produced within the region. Due to rising exchange rates, the region would import more, thus also benefiting other areas.

3. Labor shortages might develop, leading to wage and salary rises. This, in turn, would make other economic areas more attractive, leading to a renewed interest in other areas.

All of those corrective mechanisms would contribute to a more even distribution of the benefits of economic growth between the regions. In a currency union, most of these corrective mechanisms do not work:

1. States are force to maintain more or less fixed interest rate. There would be no corrective mechanism on investment, thus prolonging the boom.

2. Exchange rates would remain fixed, ensuring that relative imports of the region would not rise significantly. The spillover effect to other regions would be much smaller.

3. Over time, labor might indeed become more expensive, leading to a slow adjustment between regions. In the meantime, however, there would be prolonged periods of widely divergent prosperity between regions.

Let's assume, Germany faces a strong rise in domestic demand. Let's also assume that Germany pursues loose fiscal policies and that it strictly controls the money supply to counter inflationary pressures. This scenario inevitably puts pressures on the interest rate.

Under fixed exchange rates, other countries will have to tighten monetary policies to maintain exchange rates. Thus, while Germany enjoys a growing economy, other countries may be thrown into a recession. This is of course precisely what happened after unification, when Germany experienced the domestic "reunification boom".

Many of Germany's European partners complained about Germany's policy mix – tight monetary and loose fiscal policy – in 1992-93. However, they went along with the monetary discipline imposed by Germany in order to defend exchange rates. At the same time, popular opinion became increasingly critical of the Treaty of Maastricht. Speculative pressures against the weak currencies continued to build. In September 1992, the lira and the peseta were devalued and the British pound was allowed to float again. The monetary crises of 1992 and 1993 severely damaged the European monetary system.

In the long run, the need to synchronize fiscal and monetary policies cannot be appropriate for an economic area as diverse as the European Union. In order for fully synchronized fiscal and monetary policies to work, most nations should be exposed to the same economic shocks and their economies should react similarly.

3. How monetary Union will Expose the Weaknesses of – and Eventually Destroy – the Regime of Brussels

Overall, we can think of six variables that can cushion endogenous supply and demand shocks:

1. Exchange rates
2. Interest rates
3. Trade
4. Capital movements
5. Fiscal policy
6. Labor mobility between economic areas.

In section 2, I have discussed the role of exchange rates, interest rates and trade, concluding that those factors are not likely to smooth diverging economic developments.

Factor movements are movements of the factors of production, i.e. capital and labor. **Capital movements** play an ambiguous role in the case of asymmetric demand shocks. Let's assume, Germany faces a strong surge in domestic demand. Since its relative exchange rate cannot appreciate in a monetary union, this demand benefits the "home" area more than would be the case under floating exchange rates. Investment would also increase, further strengthening the economic boom. Interest rates cannot move up, and thus there is not much of a dampening effect on investment.

Capital moves from economically weaker areas to the area with the economic boom. Those capital movements, under floating exchange rates, would once again increase the exchange rate of the area with strong demand, increasing imports and smoothing the business cycle. Not so here. Interest rates must be maintained throughout the area of the currency union. Investment therefore concentrates in the economically strong areas.

Another potentially corrective mechanism is the **movement of labor.** In a truly unified economic area with high labor mobility, labor would move to the strong areas. This was the case in California in the early nineties, when the closing of military bases threw the state into a recession. Californians left the state for greener pastures. In an economic area with low labor mobility, labor would not move as easily, even if there was surplus of jobs in area A and high unemployment in area B. Area B would have to go through a prolonged period of declining wages and high unemployment before the investment cycle would turn. This, mechanism, however, would depend on economic differences between areas rather that promote integration.

There is ample evidence that Europe as a whole is an area with low labor mobility as compared to other countries:

People Changing Region of Residence in 1986 (% of total population)[8]					
Britain	*France*	*Germany*	*Italy*	*Japan*	*U.S.*
1.1	1.3	1.1	0.6	2.6	3.0

Americans, for example, were almost three times as likely to change their region of residence, than were Germans or British. Any pronounced differences in economic conditions in Europe cannot be corrected easily through labor mobility. The immobility of Europeans may be deeply rooted in cultural factors – Germans, for example, are rather unlikely to change areas even within the country. There is little reason to believe that a common currency will change this situation.

This leaves fiscal policy as the final corrective mechanism in the case of divergent economic developments. Fully integrated economic areas should have *one* fiscal policy, because it provides an insurance policy against divergent economic

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[8] OECD data, cited in Krugman/Obstfeld, pp. 633.

developments. Booming areas will pay higher taxes, because of rising corporate and individual incomes. Depressed areas will pay lower taxes. Moreover, depressed areas will receive certain subsidies and benefits – unemployment and welfare benefits, adjustment subsidies, and regional development funds. This mechanism, to a certain extent, will smooth the effects of divergent developments. The German constitution, for example, even makes it a task of the government to guarantee the "unity of living conditions" within the state. (This fateful clause, of course, prevented adjustment in East Germany by providing for large salary raises in the face of low labor productivity and a depleted capital base. The result: a deepening of the economic problems in East Germany and a massive move of East Germans to the West.)

In modern economies, where up to 50 % of gross GDP passes trough public budgets, the effects of this insurance policy can be substantial. One study concludes that in the U.S. at least one third of regions' economic problems will be offset by this mechanism.[9]

The European nations, of course, saw the need to provide for a similar insurance policy. During the negotiations for the Treaty of Maastricht, the size of the regional funds for structural adjustment was significantly increased.[10] And the Common Agricultural Policy, which until today devours two-thirds of the EU budget, is itself a structural policy benefiting economically weaker regions. However, with only about 1.3 % of member nations' GDP passing through EU funds, any attempts of providing for an exchange between strong and weak regions are rendered useless by the insignificance of the available funds.

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[9] Xavier Sala-i-Martin and Jeffrey Sachs: „Fiscal Federalism and Optimum Currency Areas: Evidence for Europe from the United States," in Matthew Canzeroni, Vittorio Grilli and Paul Masson: Establishing a Central Bank: Issues in Europe and Lessons from the U.S. (Cambrige, U.K.: Cambridge University Press, 1992), cited in Krugman/Obstfeld, p. 635.

[10] See Max Otte: „The Loss of Utopia: Germany and European Integration, 1988-1994", in: A Rising Middle Power? German Foreign Policy in Transformation, 1988-1995. Dissertation, Princeton University, January 1997, pp. 177-265.

Of course, next to the "automatic insurance policy" integrated fiscal policies would create states could also attempt discretionary policies, when faced with the prospects of a recession. A depressed country, for example, could attempt to administer a fiscal stimulus package, when the danger of chronically depressed incomes becomes imminent. The country could finance a government spending program by issuing government bonds. In the pre-EMU setting, the international capital markets would have punished such an attempt by placing high interest rate premiums on those government bonds. This would render most of the intended expansionary effect useless.

In the new EMU, states would be faced with a *public goods problem* – one country would issue bonds at its own discretion, while all other countries would guarantee the stability of the currency and the bond. The depressed country would benefit from the efforts of other countries.

The EU nations, did, of course, recognize this fact, if only belatedly. The initial convergence criteria described earlier in this paper only lined out the conditions for inclusion in the Monetary Union, but did not prescribe any standards for fiscal policy once a country was included in the Union. At the 1996 Dublin summit stated belatedly corrected this policy. Fiscal sinners would be required to hold certain non-interest-bearing deposits with the European Central Bank as a corrective mechanism. They might even have to pay certain penalties.

In theory, this should solve the problem. I am very skeptical, however. If a country faces a period of depressed incomes, it will be forced to do something by its electorate. This electorate is not likely to pack up and move to greener pastures within the Union, as Americans would do. It is much more likely that beyond a certain point of stress, countries will ignore the artificial rules and regulations of the union. This will not be a catastrophe. It will just happen – and all countries will have an interest in downplaying the even.

Not that it has not happened before. When the Pound, the Lira and the Peseta out of the exchange rate mechanism in 1992, the ironclad European Monetary Systems partially dissolved. In 1993, fluctuation margins between the currencies were widened from +/- 2.25% to +/-
15 %, the idea of the European monetary system was basically dead. Nevertheless, all European states downplayed the event and still foster the illusion that Europe does have a monetary system to speak of.

To sum up: political integration has to come before monetary integration in an area as diverse as Europe. Fiscal integration would be such an expression of political integration. Monetary integration, by contrast, has a high symbolic value but will mercilessly expose the lack of political integration.

The demise of the Europe of Brussels can come in many forms. Populist movements against the Euro may grow stronger, as nations realize how much economic independence their government have really forsaken. Economically depressed areas may demand higher subsidies, while those states with strong economies will point to the fact that their net transfers to the EU are already very high. The issue of net transfers to EU, for example, has become more prominent in the political discussion in Germany. A recent study has shown that the people in most countries know whether their country is a net recipient or payer of EU funds. This however, did not diminish disenchantment. Recipient and payers alike believe that their country should get out more of the EU.[11]

The deepening of economic asymmetries within the EU will be the root cause of the demise of the institutions of Brussels. Nations will rediscover their desire to develop their own way for dealing with economic problems –and this is appropriate in an area as diverse as the European Union.

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[11] Institute for Economic and Social Psychology, University of Cologne, March 1998.

The Amsterdam conference was not able to spur any significant progress in the political integration of Europe. Budgetary and policy decisions are still made by the Council of Ministers behind closed doors, that is, by delegations of member governments. The European Parliament continues to be without real powers and the workings of Brussels are as intransparent as ever to national populations. Moreover, the institutions of Europe still do not have any broad democratic legitimacy. George Soros writes:

> There is a Catch-22. People have lost their trust in European institutions because of the way those institutions work. They are less willing to delegate sovereignty, even if that might make the institutions more effective... But any further delegation of sovereignty should come directly from the people, not through the governments.[12]

Soros proposes bold steps by the European parliament, e.g. the creation of a constitutional assembly. Unfortunately, such a step is not likely to happen. Instead, the weaknesses of the current illegitimate bureaucratic structures will be exposed. The institutions of Brussels will collapse.

It is a myth that a currency union is "irreversible" once it is conceived. In fact, most currency unions we have seen in the past have been dissolved sooner or later. Yes, the EMU is based on a contract. But contracts can be broken and have been broken in the past. Why should the EMU fare differently, considering the enormous strains it will be facing?

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[12] George Soros: „Can Europe Work? A Plan to Rescue the Union", Foreign Affairs 75:5 (September/ October 1996), pp. 8-14.

4. The Future of the European Union

Let me end on a positive note. The Europe of Rome, Brussels and Maastricht was a bureaucratic superstructure, created for various reasons. Germany was to be controlled internationally. Economic growth was to be jump started in war-ravaged Europe by creating a free trade zone. After the demise of Bretton Woods System in the early 1970s, Europe attempted to strengthen its autonomy in international finance – a macroeconomic and political objective. After 1987, the Common European act was an attempt to revive economic dynamism by focusing on microeconomics and the supply side once again.

The prevention of war is still very much in the minds of the current generation of European leaders, which is mostly the postwar generation. Fortunately, the fears of most of those leaders are unfounded. It is almost impossible that Europe will once again become a group of hostile nation states, eyeing each other with great suspicion (a little suspicion, here and there, is of course possible). The stakes within Europe are simply too low, and the stakes Europe is confronting as a whole are too high. All European states – Germany included – are too small to play a really global role.[13]

Popular distrust and rejection of the institutions of Brussels should not be confused with a rejection of the European idea. Most younger Europeans are just that - convinced Europeans. The knowledge about each other has increased to an extent that would have been inconceivable even 25 years ago. The younger Europeans instinctively know that Europe only stands a chance as a closely-knit network of states. They also instinctively recognize the deficits of the current institutions. Their view on cooperation among the European nations is relaxed and pragmatic.

Europe is confronted with a great number of economic challenges, most prominently the need to fight soaring unemployment, to regain economic flexibility and dynamism

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[13] Otte: „German Unification and Structural Changes in the International System“, in: A Rising Middle Power?“, pp. 33-105.

and the need for structural adjustment. Monetary union is at best neutral, and at worst detrimental, in dealing with those issues.

In Germany, for example, unemployment has risen to 5 million. At the same time, an encompassing tax reform is blocked by party politics, leaving the Euro as the most important economic initiative of the government. This flight into symbolic measures in the face of severe economic problems must be termed almost grotesque. The policy of Helmut Kohl is the policy of a postwar politician who wants to save something that is not threatened (cooperation and peace among European nations) while not seeing the real challenges of the new age.

The Europe of Brussels is a Europe of rent-receivers in two respects. On the one hand, many industries and companies receive monopoly rents, because they are protected from economic competition. On the other hand, many people toward the end of their work lives do indeed want to protect the status quo. The demise of the Europe of Brussels and Maastricht will do away with those unhealthy structures.

Sufficient opportunities for the new generation will only arise if Europe becomes an economy favoring the supply of labor – i.e. favoring work – over the reception of rents. The harsh realities of globalization must faced by giving Europe's regions enough flexibility and opportunities to react with innovative solutions, rather than tying them into a network of enforced monetary cooperation.

In a certain way the Great Britain of Tony Blair – and not Germany or France – is a model for the New Europe. Blair has given the regions more autonomy, a step that France will have to follow at some point. At the same time, British defense policy is rather traditional, a model that Germany will have to follow. Like Clinton, Blair continues the market-oriented reforms of his predecessor, but enhanced by a social dimension. Compared to the economic stagnation of the Christian-Democrat Free-Democrat coalition in Germany, Blair's policies look like pure market capitalism.

Great Britain rejects monetary union. And yet: Blair and his government know that the future of Britain lies in Europe, a Europe that will grow together ever closer. England is about to accustom itself to the European idea, proving that rejection of Monetary Union does not mean rejection of Europe, as most of the current proponents of EMU would want us to believe.

The Euro will come and go. A European defense identity will emerge fast, slowly, or not at all. Europeans should be relaxed about this. The European identity is much deeper within the young generation that many, even many of the old Europeanists like Kohl, believe. This identity will not be shaken, even by larger crises. Stop worrying about the Europe of Brussels and fearing the fears of yesterday. The really important questions – i.e., the preparation of the European economies for the year 2000 and the creating of democratic legitimacy for the European institutions - deserve more attention.

When and only when those issues are addressed in an appropriate manner, Europe will make real progress.