

Trouble in
Paradise?
Europe in the
21st Century

*Steven Philip Kramer
and
Irene Kyriakopoulos*



***A popular Government,
without popular information or the means of
acquiring it,
is but a Prologue to a Farce or a Tragedy; or
perhaps both.
Knowledge will forever govern ignorance;
And a people who mean to be their own
Governors,
must arm themselves with the power which
knowledge gives.***

**JAMES MADISON to W. T. BARRY
August 4, 1822**

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TROUBLE IN PARADISE? EUROPE IN THE 21st CENTURY

*And that this place may thoroughly be thought
True Paradise, I have the serpent brought.*

Donne

PROLOGUE

THE CHANGES

When political observers talk about European security, they invariably refer to the challenges Western Europe faces on its peripheries from a renationalized Russia, conflicts in the Balkans, and Islamic fundamentalism in North Africa. Rarely do they imagine that the greatest dangers to the new Europe may come from within, that the kind of stability Europe has enjoyed since World War II could be merely a passing chapter in history, not a transcendence of history. Without suggesting that there is necessarily a worst case ending, this study will argue that there is indeed a series of crises converging on post-Cold War Europe that threaten its stability and that need to be addressed by European policy makers and taken into account by Americans.

The unparalleled stability of post-war Western Europe was based on several major factors:

- A powerful external threat, the USSR, which unwittingly fostered European cooperation and cohesion
- The United States, a willing and indispensable ally that guaranteed West European security
- Economic prosperity
- The success of a welfare state cum mixed economy, which brought to term the political and social polarization that characterized the interwar era and facilitated the consolidation and universalization of democracy all over Western Europe
- The existence of a divided Germany and a Federal Republic that chose to tie itself to western institutions
- Franco-German cooperation, which led to everwidening and deepening European integration that made unthinkable the prospect of renewed conflict among the states of Western Europe.

But can these achievements, which seemed so secure, survive the end of the Cold War? This study suggests that there are serious reasons for doubt.

The search for the sources of instability in Europe (if not throughout the world) should begin with a re-examination of the European political and economic map and its transformation over the last 6 years. During this period, the Berlin Wall was dismantled, a unified Germany emerged, the Warsaw Pact dissolved, and the Soviet Union ceased to exist. These events generated great public euphoria and created high expectations for a large political, social and economic peace dividend to be reaped by the whole western world. The fast pace of the civic revolutions that proceeded unopposed in all of Europe was taken as a sign that the potential for significant near-term economic gains could soon be realized. This would be the result of large-scale demobilization and wholesale conversion of resources from the military to the civilian sector; indeed, credible

estimates show that the Soviet threat had accounted for about half of defense expenditures in NATO countries. It was thought that in the absence of such a threat a dramatic reallocation of resources within and across countries could easily follow.

THE MYTH OF STABILITY

In contrast to popular expectations, the end of the Cold War did not generate an immediate peace dividend or stability on the European continent. Ironically, it helped to highlight and intensify preexisting economic problems—but it did more than that. It created new political and economic uncertainty. Since the 1940s, the welfare state embodied postwar social peace. It came increasingly under attack as one impediment to Europe's ability to compete effectively in a truly global economy. Now, however it could be criticized for another reason. Once it ended, the Cold War might no longer be deemed politically and ideologically necessary as a means of promoting inter-European cohesion. This is even more so since political leaders on the national level have been unsuccessful in curing long-term economic stagnation. The result of their failure has been a crisis of the political system. This crisis is unlike any other, because it has been deeply affected by a revolution in information technology, especially television, and by the decline of the nation state. Weakened by this multiple crisis, European states also find it difficult to act collectively at the supranational level. The economic and social problems that have not been successfully resolved in Paris, Bonn, and Rome have proved just as intractable in Brussels, thereby casting doubt on the future of the European Union (EU) as a source of stability. Preoccupied by their own problems, the West European states individually and the EU as a collective body have been distracted from their main task of deepening European integration. If these trends continue, Europe's ability to contribute significantly to

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international stability will be diminished. The implications would be negative for the shape of the post-Cold War world order and particularly adverse for the European continent.

1. THE WELFARE STATE IN TRANSITION

Political philosophers once claimed that the basis of political democracy is virtue; today it is fashionable to think it is economic prosperity. Europe has been prosperous for centuries, a commercial and economic powerhouse commanding resources and capital and expertise to maintain its primacy. Following the devastation of World War II, political decisions were made that, unlike those of Versailles, encouraged Europe's recovery, with the Marshall Plan leading the way. Excessive reparations and beggar-thy-neighbor economic nationalism were avoided. The reach of modern industrial society penetrated into the rural world of most of Western Europe, creating a mass market. The rising tide lifted all boats: the war was followed by 30 years of growth.

In the wake of World War II, Western European countries sought ways to rebuild their domestic social and industrial infrastructure and mechanisms to integrate their economies. These developments went in parallel, largely complementing one another. Domestically, West European governments adopted a variety of economic intervention measures that helped shape the modern comprehensive "welfare state." National leaders, often coming from the anti-Nazi resistance, formulated plans for a social order that could resolve the bitter ideological conflicts of the 1930s. Socialists, liberals and conservatives agreed on the creation of a uniquely European mixed economy, blending the rules of the market system with the principles of distributive justice. This was to usher in a period of social peace, facilitating economic recovery and growth on the continent. European workers earned

and then became accustomed to high wages, excellent social benefits, long vacations, and munificent unemployment benefits. These conquests were deemed *acquis sociaux*, permanent gains. At the same time, the stage was set for economic and political cooperation across national borders. As a first step, six states agreed to place national industrial resources under a common European authority so as to deter future conflict.¹ The process that began with the formation of the European Coal and Steel Community, the European Atomic Energy Agency and the European Economic Community eventually led to the historic Treaty of Rome in 1957, formally creating the European Communities. In this way, just as the welfare state was meant to foster social tranquility at home, so would increasing economic integration promote peace across Western Europe. A stable Europe became an affluent Europe.

The evolution of the European welfare state has been accompanied by a long series of economic achievements, leading Western Europe into great affluence and prosperity. By the early 1990s, Western Europe had at its command more resources held by its 12 member states than the United States, in terms of gross domestic product (GDP); after the admission of three more members in 1995, the European Union of the 15 enjoys an even larger aggregate income, twice the size of Japanese GDP. Per capita incomes in Western Europe have reached, and in some cases surpassed, the American one. The Europe of the 15 constitutes the largest single trading bloc, accounting for over 25 percent of total world trade; by comparison, the United States share stands at one-fifth, while Japan's remains much smaller at about 12 percent. The collective economic prowess of the member states of the European Union is represented by a single entity in international trade fora and negotiations. In the world of finance, the European Currency Unit (E.C.U.) has become much more than an administrative accounting convention; financial assets of

all kinds are now denominated in ECUs and the EU's planned monetary union will solidify the position of the ECU as a premier international currency.

But there is cause for concern. Unlike the welfare system in the United States, Europe's welfare state has not been faulted for perpetuating poverty or for contributing to social ills. Rather, the viability of Europe's welfare state has been called into question in recent years as the extent and intensity of demographic change and population movements across Europe increased. A perception has formed that in financial as well as in political, social, and ideological terms, the European welfare state has begun to cost too much.² In absolute levels of spending as well as in relative proportion, the resources required to sustain the welfare state in its present form can no longer be easily reconciled with emerging European policy priorities. The causes are domestic as much as international.

BUDGETARY COSTS

Internally, the European welfare state has been characterized by high and rising expenditures on social protection. The budgetary implications of this trend are revealing and disturbing. The cost of expenditures on social well-being may be approximated by public outlays on health, education, income security, housing assistance—namely, expenditures on a variety of social services. By the mid-1980s, the cost of social protection spending was claiming about 17 percent of the gross domestic product (GDP) on average throughout the European Community (European Union since 1993); the highest relative proportion, close to 28 percent of GDP, was in the Netherlands, the lowest, about 13 percent, in the United Kingdom. By contrast, public spending on social protection services accounted for only 11 percent of U.S. GDP and even less (just over 10 percent) in the case of Japan.³

Since then, the cost of social protection has risen even more. In one of the newest EU members, Sweden, public outlays allocated to social protection amount to almost 35 percent of GDP. The Dutch share is a close second at 32 percent. Even in the least generous budget, that of the United Kingdom, the one with the lowest spending, in relative terms, expenditures on social protection services have risen to almost one quarter of GDP. Similar cost pressures have been evident in the United States, but U.S. spending on social protection has not exceeded 18 percent. Japan's share, by comparison, has been held in check.⁴

Without doubt, the most significant cost pressure is the result of demographics in conjunction with social norms and preferences. Across the board, Europeans place a high value on old age security; over a third of public spending on social benefits takes the form of payments to provide for such protection. Next, the cost of medical care amounts to about a quarter of total public spending. These two categories, old age protection and medical care, together account for nearly 60 percent of social protection payments.⁵ As matters stand, the demand for social protection can only increase. Improvements in health technology, universal access to health care, and low fertility rates have contributed to the aging of Europe's population, thereby increasing the tax burden associated with higher pension and medical care costs. As a result, Europe's senior citizens have become major beneficiaries of the welfare state, a situation very much resembling budgetary realities evident in the United States as well. But while demand for social services is increasing, the sources of revenue to finance expansion are becoming more scarce.

DEFICIT SPENDING AND INDEBTEDNESS

European governments have resorted to borrowing in order to bridge the gap between public expectations and resource constraints. Large fiscal imbalances have generated additional longer term economic costs associated with deficit spending, now practiced by virtually all members of the European Union. Recent data on general government deficit reflect heavy economic burdens across all Western Europe. In some countries, deficit spending has been chronic and relatively high: in Greece, Italy, and Belgium, government deficits in the early 1990s reached 13, 10, and 7 percent of gross domestic product, respectively. Even Germany's public finances have been affected by the reunification process: the German government's deficit accounts for over 5 percent of the GDP. Moreover, the persistence of the imbalances between sources of revenue and claims on resources over time is reflected in overall government indebtedness: in the early 1990s, general government debt expressed as a proportion of the GDP exceeded 130 percent in Belgium, and was over 125 percent in Italy and Greece. France, Germany, and the United Kingdom have lower government indebtedness ratios, at 53, 59, and 52 percent respectively, but even these are high by contemporary standards.⁶ By way of comparison, the U.S. Government's indebtedness (the world's largest debtor nation in absolute terms since the mid 1980s) is reflected in a debt-to-gross domestic product ratio of around 70 percent.⁷

LIMITS OF DEMILITARIZATION

In the face of these realities, the end of the Cold War and the re-emergence in Europe of a common economic and political space were greeted with enthusiasm and euphoria for their implications on public finances. The

long-standing anticipation of the European left for a peace dividend associated with demilitarization of the economy was joined by the expectation of the right that expansion of capitalism would generate profits, jobs, and economic growth. So far, however, the financial benefits of the peace dividend and of capitalist expansion into east and central Europe and Russia fall short of earlier predictions.

Demilitarization is proceeding apace, but defense spending was never as important an element of the public budget, especially the budgets of the larger European economies, as in that of the United States. During the buildup of the 1980s, expenditures on defense claimed about 6 percent of American GDP; in most of Western Europe, 3 percent was close to maximum. As a result, defense cut-backs would be expected to release more resources to the civilian economy, in relative terms, in the United States than in Europe. Thus, the potential to finance the expansion of the welfare state through demilitarization of the West European economies was always much more limited.

As to capitalist expansion through the creation of market economies in Europe as a whole, it will take place over a much longer period of time than initially expected. At present, it is the lack of economic expansion together with high unemployment rates that is the main economic and political problem on the European scene.

TAXATION

Europe's welfare state could continue to be financed by greater reliance on taxes. Taxation, however, seems to be ranked worse than a solution of last resort. West European citizens bear a tax burden that is already perceived to be high. While international comparisons of tax burdens should be approached with caution, it appears that taxes constitute a much higher proportion of national income in Western Europe than in both the

United States and Japan. In the latter two, taxes equate to about a third of aggregate economic activity. Among members of the European Union, by contrast, taxes can claim a much higher proportion of national income, in some countries (such as the Netherlands and Sweden) amounting to around half of total income. Thus, proposals for additional increases are bound to be unpopular.

Even if there were less political resistance to higher taxes, increased taxation would be counterproductive during the present period of low growth unless its recessionary effects could be offset by more expansionary monetary policy. However, membership in the European Union in effect subjects monetary policy to constraints imposed by the EU's exchange rate mechanism. This means that member states cannot choose their monetary targets to meet domestic concerns; instead, domestic monetary policy is made within the larger context of the European monetary system.

ECONOMIC GROWTH

In the past, Western Europe used economic growth to finance expansions and extensions of a variety of social protection programs. Economic growth is, by far, the most effective antidote to most economic problems. But economic growth is no longer what it used to be. During the 1960s, Western Europe's real gross domestic product grew at rates approaching 5 percent annually. In the 1970s, rates were closer to 3 percent per year. During the 1980s, real growth fell below 3 percent. Since 1990, economic growth has been around 1 percent.⁸ Western Europe's economic performance has deteriorated and has remained below potential for a considerably long period of time, with adverse implications for living standards in general and public spending in particular. If economic growth remains low, European governments will be extremely limited in their

ability to find sources of revenue to finance expansion, or even to assure maintenance, of social services.

UNEMPLOYMENT

But the most fundamental and visible threat to Europe's welfare state is high and persistent unemployment. The direct, accounting cost of rising joblessness is reflected in increased outlays on unemployment insurance. In 1992, about 6 percent of social protection funds were spent on unemployment compensation.⁹ Of course, the indirect economic costs of unemployment are much larger in terms of output foregone. As to social and political ramifications, unemployment remains the most explosive public policy issue in all of the EU's member states as in all advanced industrialized democracies.

Europe's difficulties with job creation became evident in the early 1980s and have worsened since. The prospects remain bleak and have significant political implications. Unemployment rates of over 10 percent persist across the European Union; for Europeans under 25 years of age, the rate is over 20 percent. In Spain and Ireland, close to a fifth of the labor force is without work, according to official statistics. Among the larger economies, Germany's unemployment rates were close to 9 percent at the end of 1995, edging upward since then. In France and the United Kingdom, unemployment has exceeded 10 percent of the labor force since 1992. The situation in Italy is similar, if not worse.¹⁰ This picture is the reverse of what prevailed in the 1970s and early 1980s, when unemployment was an American problem; today, it appears that the U.S. economy is operating much closer to full employment, while Europe's workforce is significantly underutilized.

Why has European unemployment increased so dramatically? There are no clear answers, but among competing explanations some deserve greater attention than others. Economic conservatives on both sides of the Atlantic blame labor market rigidities, which are the

result of social practices and legislation that make entry into and exit from the employed labor force very expensive for employers. Flexibility in terms of employment (and labor market) is high, according to this view, if employers can fire and hire to meet production needs (more hours or more employees during booms, fewer during recessions). Since the cost of hiring and firing is high (because of the social protections afforded workers), employers try to minimize changes to their payroll. For their part, European workers have a high reservation wage, counting on generous unemployment benefits, and choose to wait out a recession. But the waiting has been too long. Long-term unemployment has gone up, indicating that structural change rather than temporary or cyclical adjustment may be at work.

A more powerful explanatory factor has to do with the limits of national fiscal and monetary policies. In part, the current unemployment situation may be the result of European anti-inflation measures of the last decade, particularly in connection with the exchange rate mechanism of the European Monetary System (EMS). To maintain EMS parities, member countries essentially gave up control of domestic monetary policy and followed the anti-inflation monetary policies of the German Bundesbank.¹¹ Since national governments could not and would not use exchange rate adjustment to address domestic imbalances, economic expansion could be pursued only through fiscal policy. This course of action has led to high budget deficits, as discussed above. As a result, traditional macroeconomic policy is no longer powerful.

The European monetary crisis in the fall of 1992 demonstrated the nature of the dilemma faced by national governments: policies consistent with the European exchange rate mechanism can be at odds with national (that is, internal) priorities. This time, domestic considerations had to be weighed against pan-European monetary imperatives. Unwilling to pay the price in the form of higher interest rates, the U.K. Government

decided to opt out of EMS, triggering a series of similar decisions elsewhere that eventually led to reforms in the structure of the exchange rate mechanism.

While the search for measures to address joblessness continues, the range of policy options seems to become more limited. Thus unemployment remains a problem without easy or even apparent solutions, economic or political, and consequently is a major challenge to the very existence of the European welfare state.

WINDS OF PRIVATIZATION

The ideological premise on which the European welfare state has been erected has become much less solid in the post-Cold War era. Strength in unity, a *sine qua non* during the period of East-West antagonism, implied (indeed, required) economic measures to promote collective well-being. In Western Europe, the tradition of state intervention to achieve this goal has encompassed active government participation in industrial enterprises as well as direct spending by the public sector on a variety of social services. But the end of military, political, and economic bipolarity has generated strong winds of privatization on a global scale.

The evolution and future course of privatization in Europe are larger and much more complicated issues than perhaps anywhere else in the industrialized world of advanced democracies. State intervention in economic activity to attain specific goals enshrined in national legislation has been part of the European policy landscape for a long time. In the post-World War II era, the most comprehensive approach to state intervention was developed in France through *planification*, best known as "indicative planning:" economic goals such as growth rates, investment priorities, and other macroeconomic aggregates formed de facto policy targets; targets were quantified and often made explicit for policy implementation purposes; and an apolitical agency, the *Commissariat General du Plan*, was in charge

of execution. This approach was itself based on the foundations of "colbertist" practice and St. Simonian theory. Scandinavian countries have also developed their own brand of state intervention in economic activity, characterized by centralized control, numerical economic targets and implementing legislation. But other countries in Western Europe, including the United Kingdom, have followed similar approaches. The fundamental premise on which European economic "statism" has been based combines centralized government policy to achieve democratically derived economic targets. As a concept, privatization is at odds with European economic tradition in so far as it involves substitution of market forces for state direction.

In Europe, privatization of government-controlled organizations or enterprises is conceptually similar to deregulation as defined and implemented in the United States (e.g., in telecommunications, banking, and airlines) but may also entail outright sale of state-owned assets (British Airways, France Telecom, etc.). To the extent that state ownership of industrial enterprises is more common in Europe, the potential revenue from the sale of such assets is also greater. Given the budgetary situation of many West European governments, it is not surprising that privatization is now held to be the solution of first choice. Gauging the potential for deregulation in Western Europe is a complicated matter; however, if one considers that the public sector accounts for about 45 percent of economic activity in the larger European countries (and may exceed that figure in some cases), then the possibilities seem large. By contrast, the U.S. and Japanese public sectors account for about one-third of total economic activity. For this reason, privatization is a much more powerful policy concept in the European context than across the Atlantic.

Some government functions and activities are contracted out; many others can simply be eliminated. Such outright abandonment of traditional services to the dicta of the market offers ways to create public savings.

In a larger sense, however, the result may simply be shifting the resource cost to the private sector. The extent to which a net gain is realized depends on whether efficiency is improved without impairing income distribution. But with the focus on cost reduction, less emphasis is placed on the distributional consequences, even though they can be significant. If the national health service can be privatized and thus run at a lower cost to the public budget, there seem to be fewer reasons left for not doing so; after all, there is no competing economic system to which the dissatisfied could turn. In this climate, the ideological foundation of the welfare state is not only open to question but subject to stringent cost-benefit analysis. A new, post-Cold War era calculus reveals costs that are growing continuously just as benefits are perceived to be falling.

The European welfare state may have become a victim of its own success. Conceived and put in place to promote social peace and solidarity in one-half of a divided continent, it succeeded in distributing prosperity in a socially acceptable manner throughout Western Europe and also within each nation state. But the generation most responsible for developing and installing the socioeconomic structure now taken for granted in Western Europe is being replaced. The average West European, about 35 years of age, has not experienced the conditions that led his grandparents to demand a comprehensive social safety net. Just as the end of the Cold War has erased the East-West division of Europe, so has time erased the memories of political turmoil accompanying the Great Depression and east-west socioeconomic antagonism of the 1930s, '40s and '50s. Why hold on to notions and norms of distributive justice formed in an era that has gone by?

Instead, the average West European (affluent, well educated and much traveled) sees that the cost of maintaining traditional social services and programs continues to grow for reasons that seem less and less intellectually defensible. In fact, some of the reasons are

totally obscure, such as the reality that the national government's control over fiscal and especially monetary policies is slowly eroding; worse yet, expensive social services are claimed by increasing numbers of foreign nationals and political or economic refugees. In this setting, the plight of unemployment is accentuated. The most visible and politically explosive problem in Europe, joblessness, continues to be viewed by voters as a domestic problem, even though it now a pan-European problem, best described (and often explained) in regional rather than national terms: eastern versus western Germany; southern versus northern Italy; southern versus western Spain. Unable to rely on aggressive fiscal or monetary policy measures, national governments increasingly look either to the private sector or to Brussels for help.

END OF ECONOMIC SOLIDARITY?

Problems of uneven economic development and economically depressed areas of countries and regions within the European Union have been targeted through a variety of economic development funds and programs. An extension of the notion of distributional equity in the domestic setting, social solidarity across regions and within member states of the European Union was deemed imperative for social cohesion. This principle was firmly embodied in the Single European Act of 1987. In the commercial sphere, the Act formed a visionary blueprint for complete market integration before the end of the 20th century. In the political sphere, the Treaty of Maastricht was meant to establish a framework for a European Union into the 21st century. The common denominator was a "Peoples Europe," eventually to be governed by a Social Charter spelling out the rights of European citizens across national boundaries. The fundamental principle on which the People's Europe was to rest was social and economic solidarity. The financial dimensions of solidarity, or social cohesion, were

concrete and quantifiable. In the preamble of the EEC Treaty, the member states had declared their aim of "reducing the differences existing between the various regions and the backwardness of the less-favored regions."¹² The gulf between the poorest and most prosperous areas was to narrow. This would be achieved through the so-called Structural Funds, including the European Social Fund and the European Regional Development Fund. Between 1987 and 1993, outlays for these purposes exceeded 14.1 billion ECU. Since 1989, the target of this assistance has been the stimulation of investment and job creation in the less developed (and least prosperous) regions of the European Union.

But the costs of inter-European solidarity are also subject to review in the post German reunification era. Most EU members, Germany among them, are balking at increased spending for solidarity purposes. To be sure, the admission of three rich states (Austria, Sweden, and Finland) will slightly ease the burden of the 12, but the financial burden to the EU is likely to increase dramatically in the future. France, Italy, and Spain strongly advocate efforts to increase EU involvement in the south in order to stabilize the Maghreb countries and prevent the spread of the kind of Islamic extremism now affecting Algeria. At the November 1995 Barcelona meeting, the EU agreed to such a program. Association agreements and eventual membership for the countries of Eastern Europe will involve immediate economic sacrifices by the Union in exchange for future economic and political gains.

Yet, to maintain the status quo promoting distributional equity within the European Union, member states are currently considering cutting back aid to the developing world. This represents an additional policy dilemma: the cost of spreading the wealth internally within the Union could mean a lower European profile externally. Traditionally, the European Union (and its predecessor, the European

Community) has been, through its member states, the most generous donor of aid to the Third World, especially African countries; Europe's official development assistance is much higher than aid given by the United States. For the period 1990-1995, the European Union had pledged some \$15 billion in financial aid,¹³ but now some member states are considering reducing their contributions. Key among them is Germany, burdened by the high costs of absorbing its eastern regions. On the other hand, Britain (never quite committed to pan-European social welfare measures) prefers to reallocate aid toward bilateral commitments, such as with India. France is the only country to have voiced concern about the proposed cutbacks, pushing instead for a higher amount of aid toward African countries.¹⁴ This is an indication, if not evidence, of diverging policy priorities and increasing inability to reach consensus on the allocation of scarce resources. Here, too, the implications for continued collective pursuit of West European well-being are troubling and bound to become more serious as the domestic (that is, national) claims on scarce resources multiply while, in the meantime, countries of the non-EU Europe are also seeking a share of Europe's wealth.

In summary, the viability of the European welfare state into the next century, while still probable, is no longer certain. The gap between prevailing economic conditions and sociopolitical expectations is growing wider as a result of rising budgetary costs, growing fiscal indebtedness, a lower than expected peace dividend, anemic economic growth and weakened economic solidarity. The most immediate and acute problem, unemployment, is also the most explosive. The future of the European welfare state will depend on the extent to which the gap between expectations and reality can be narrowed.

NOTES

1. A recent brief history of European integration notes: "The notion of a [united] Europe was part of a humanist-pacifist dream which was shattered by the conflicts which brought so much destruction to the European continent in the first half of this century. . . . In [the] postwar period, the Community was primarily seen as a way of securing peace by bringing victors and vanquished together within an institutional structure which would allow them to cooperate as equals." See Pascal Fontaine, *Europe in Ten Lessons* (Luxembourg: European Documentation, Office for Official Publications of the European Communities 1992), 5.

2. In a recent work dealing with the larger dimension of European economic (and political) integration, the cost issue is raised in a profound, almost apocalyptic title. Patrick Minford, editor, *The Cost of Europe* (Manchester University Press, 1992). In such a context, the cost of the alternative merits equal attention, even though it remains considerably more difficult to derive. What would have been the stream of net benefits accruing to Europe had it gone through the post World War II period without the welfare state? This is not merely an artificial but also a counterfactual question (if Europe did not exist what would be in its place?). A more interesting and narrowly focused question was treated in a White Paper published in 1985 by the European Commission on the "cost of non-Europe": strictly defined as the cost of border delays, technical barriers and protectionism in the form of public procurement, it was put at almost ECU 200 billion. In the same paper, it was estimated that a single market would add five percentage points to economic growth rates and create 5 million new jobs (Fontaine, 12). If account is taken of indirect costs as well as of net positive spillovers, the "cost of non-Europe" rises even more.

3. Estimates are for 1986. *A Guide to the European Community*, E.C. Delegation to the United States, Washington, 1991, 17.

4. Data from *Facts Through Figures: A Statistical Portrait of the European Union*, Eurostat (Brussels and Luxembourg: Office

of the Official Publications of the European Communities, 1994), 16-17.

5. *Facts Through Figures*, 16-17.
6. *The Economist*, April 8th, 1995, 45.
7. *Economic Report of the President*, February 1994, 362.
8. *Economic Report of the President*, February 1988, 374 and *Economic Report of the President*, February 1994, 395.
9. *Facts through Figures*, 16.
10. *Facts Through Figures*, 8-9 and *Economic Report of the President*, February 1994, 393.
11. For a critique of European monetary and fiscal policy under EMS, see Paul Krugman, *Peddling Prosperity* (W. W. Norton & Company, 1994), 182-194.
12. *The European Community in the Nineties*, E.C. Delegation of the European Communities, Washington, 1992, 17
13. *Ibid.*, 21
14. "EU Aid Program in Dispute," *The Washington Post*, 17 February 1995, A29.

2. CRISIS OF THE POLITICAL SYSTEM

The solidity of postwar European democracies was based on two major factors: their success in achieving consensus on a new and successful model for economic prosperity and social welfare, and the requirements of maintaining solidarity during the Cold War. Neither of these factors is still fully relevant. European political leaders have been unable to find solutions to the problems of the economy and the crisis of the welfare state. There is no real programmatic difference between governments and opposition, between mainstream left and right. Politics reduces itself to the battle of ins versus outs, and alternation of power does not necessarily change policy or improve the situation.

DECLINE OF IDEOLOGY

One apparently great success of postwar European politics was the end of the harsh clash of ideologically based adversarial parties that characterized the interwar world. Agreement on the basic contours of the welfare state and mixed economy led to the appeasement of rancorous and sometimes violent conflicts over first principles; liberals, conservatives, and socialists differed only over nuance and tried to work the system to maximize the benefits to their constituent groups (which in any case had become broader as catch-all parties replaced class-based parties). "Acceptance of the mixed economy cum welfare state thus represented an ill-founded act of faith that . . . [they] represented an end to history; that the economic system would continue to deliver the goods, which could then be redistributed to

promote 'equality.'¹ By the 1980s, communism had either become Euro-Communist or had been discredited. The end of the USSR and the collapse of its Communist party was the culmination, not the cause of this phenomenon. Socialists in most of Western Europe had long since made their peace with the new economic order (witness the Bad Godesberg platform of the SPD in 1959). In the 1980s, some of the socialist parties found themselves in an "identity crisis." They attempted to find a *raison d'être* in their foreign policy, by criticizing American conduct of the Cold War and occasionally glorifying Third World radicals, but this was not very meaningful then and would be even less so now. The French socialists, who had been out of government since the onset of the Fifth Republic in 1958, cherished the belief that they constituted a genuine alternative to the right and could make a "break with capitalism". It took only a few years of power (from 1981 to 1984) to dispel this illusion. Thus, socialism and communism, which had once constituted a kind of religious faith for their adherents lost their special identity. Socialist parties became simply parties of government and perhaps for this reason, no more immune to corruption than other parties.

So long as the new sociopolitical framework of Europe guaranteed unlimited prosperity, the end of ideology seemed a blessing. Unlike the 1930s, the crisis of the last decades has been a slow, incremental process. The rub was that once the system began to sputter, there was no real policy alternative presented by mainstream parties. The resulting crisis of political systems was a slow one, and this slowness and the tenacity of existing political institutions are as noteworthy as the existence of the crisis. Popular discontent with governments in a democratic regime usually leads to alternation of power, but alternation of power will not produce relief if the new government follows policies similar to those of the old. When that happens, citizens increasingly tend to abstain from the political process, look to extremist

parties or support new or nonestablishment political parties and movements, and may even go to the street. Ideology, which appeared to depart from politics through the front door, returns through the back door. In the last analysis, established parties can founder and the system can even collapse.

There is a widespread unhappiness with governments and politics throughout Europe, with political crises at varying stages of development in different countries:

- In the United Kingdom, the Conservative Party held on to power in 1992 only because of residual fear of the policies of a Labour government. In-fighting in the Conservative Party, much of it based on opposition by hardened Eurosceptics to even a tepid commitment to EU deepening, a series of embarrassing resignations of Tory ministers tainted by scandal and a devastating defeat in local elections in May 1995 have left the Major government gravely weakened.
- The Socialist Party in Spain is in a similar situation. Felipe Gonzalez' charisma has been tainted by unemployment of over 20 percent and a long series of scandals touching the PSOE; only the lack of a credible alternative has enabled that government to survive. The 1995 victory of the Popular Alliance in local and regional elections demonstrated the PSOE's unpopularity. Charges that Gonzalez must have been aware of government-inspired death squads directed against ETA terrorists ended Catalan support for the government and foretells opposition victory in general elections to take place following the conclusion of the Spanish presidency of the EU.
- In Germany, the CDU/CSU-FDP coalition under Helmut Kohl was barely reelected in 1994. In that election, the voters of the former GDR gave the ultimate slap in the face to West German political leaders by voting heavily for the PDS to protest how unification was taking place. Since that time, the CDU as well as its SPD rival have both done badly in state

elections, while the FDP has fallen below the 5 percent threshold in many state elections, thereby losing its representation. Both CDU and SPD are forced to think seriously about coalitions with the Greens, who have become more credible since the expulsion of their extremist wing. Disarray within the SPD, however, reduces its chances of winning a national election.

- The "end of French exceptionalism," which occurred when the "end of ideology" finally hit France in the mid 1980s produced a remarkable convergence of the political class not only on defense and foreign policy but on economic policy as well. France developed a strong franc and worked to make EMU possible by meeting the strict standards outlined in the Maastricht Treaty. Unfortunately, the political leadership did not succeed in resolving the problem of unemployment and economic stagnation. This failure eroded the credibility of the political class which had already been undermined by a long line of political scandals. The French magistrates, like their Italian counterparts, have gained prominence by attacking corruption in the political class. They helped discredit the socialist government and then turned on its conservative successor.

One consequence of this process was the rise of non-mainstream political movements and leaders. Le Pen, Villiers, and Tapie owe their success to the unpopularity of traditional politics and politicians and to their own effective use of television to support an antisystem, populist and personalist message, of either the left or right. Legislative elections in April 1993 may have prevented a reenactment of May 1968; they provided catharsis by virtually annihilating the governing Socialists. The fact that the referendum on the Maastricht Treaty barely passed despite support from virtually all major leaders constituted a vote of no confidence in the political class (though even more so of

Mitterrand). The Maastricht vote also indicated a reinforced tendency for much of much of the population to blame Europe for France's economic problems. For many French people, Europe has become equated both with the future and unemployment. Euroscepticism has become a tempting electoral ploy for ambitious French politicians looking for a way to break into the big time, not just for demagogues like Le Pen. As a result, especially in the year preceding presidential elections, France's mainstream politicians became far more reticent about European integration, so that the French presidency of the EU seemed like a caretaker operation.

The election of Jacques Chirac as president was a result of the public's unhappiness with the status quo. Candidate Chirac succeeded in painting both the socialists and his RPR rival, Balladur, as part of the problem and ran a brilliant campaign which stressed voluntarism and the determination to deal with unemployment and the forgotten man. He marginalized Villiers; both he and Jospin benefited from Tapie's legal troubles and temporary exclusion from political life.

The problem is that President Chirac could not fulfil the promises of candidate Chirac. Bringing French unemployment below 10 percent would have been difficult even if Chirac had a free hand to follow a purely French economic policy. But he did not have a free hand; he was committed to achieving EMU in 1999, which requires halving, rather than increasing, France's 5.7 percent public sector deficit by that time. Chirac could abandon the strong franc policy and call on the Seguin team, which is waiting in the wings to replace Juppé. But the consequences of breaking with France's long-term goal of EMU on domestic politics and on the Franco-German relationship are daunting.

Pursuing the policy of the strong franc and EMU, however, is extremely risky, since it requires immediate and drastic cuts in the deficit of the French social security system. After a government reshuffling in fall 1995, Prime Minister Juppé presented a program for

social security reform, accompanied by reforms of public service pensions, which raised the years of service required for retirement by some favored groups, like railroad workers, to match the rest of the public sector. The reforms were announced in a highly technocratic way; those affected were not consulted, not even Juppé's political and trade union allies were included in prior discussion. The result was a wave of strikes in November-December 1995, spearheaded by railroad and Paris Metro workers, which paralyzed the capital and eventually the country. Although the strikes were "led" by antigovernment unions, with their own agendas, the great majority of the general public supported the strikes, feeling that the strikers represented their cause as well. These strikes demonstrated the opposition of the French people to giving up the social benefits they had acquired in the course of the last 50 years without a convincing case having been made by the government. Unlike May 1968, this was a revolt by middle-class France anxious to protect its *acquis sociaux*, not by radicals. It demonstrated that the gap between the French elite, aware of the paramount necessity of succeeding in EMU, and the French public, concerned by unemployment and uncertain about the future, was even greater than at the time of Maastricht. The end of the strikes did not resolve underlying issues and the road to EMU remains full of obstacles. Yet without France, EMU would be meaningless and if EMU is postponed it may never take place. In short, Chirac may be caught in a box. He can only hope that movement in the right direction and the appearance of activism will suffice to avert a social crisis.

The country most affected by the combined impact of long term economic problems and the end of the Cold War is Italy. The end of the Cold War had a special impact there. Whereas for most of Europe containment involved an external foe, in Italy it was also internal. The *raison d'être* of Christian Democracy and its coalition partners was to keep the powerful Italian Communist Party out of government. "Hold your nose

and vote Christian Democrat!" The lack of alternation of power led to the corruption of the DCI as well as the other "democratic" parties which joined the governing coalition and shared the spoils. The main non-Communist opposition party, the Socialists, lost their ideology and integrity in the process. With the end of the Cold War, the justification for the government coalition disappeared. Italian magistrates began an unprecedented exposure of the corruption of the political system which led to the disintegration of all the major government parties and the discrediting of their leaders.

Italian communism was not the inheritor, for although the threat it represented to the right declined so did its own appeal. The initial beneficiary was television magnate Silvio Berlusconi, who filled the vacuum in the center by creating the Forza Italia political movement out of nowhere, until he was undermined by magistrates raising uncomfortable questions about his own business.

Italy had been famous for its *partitocrazia* and the dominance of its political class. It is now a country with undefined political structures, between elections and perhaps constitutions, with at best a temporary government of technocrats. During the "First Republic," governments survived only by not challenging the forces of organized crime and the underground economy. They subordinated foreign policy to their allies, economic policy to Brussels and defense policy to NATO. The old regime survived and then failed because Italians had few expectations concerning their government and politicians. Now that the Italian state has virtually withered away, how can government act and reform take place?

Japan constitutes an interesting analogue to the collapse of the Italian party system. The Liberal Democrats held onto office for just as long as the Christian Democrats and for much the same reason—to keep the left out of power. The end of the Cold War led to a "revolution of contempt" directed against the

LDP—as well as against its fossilized Socialist opposition. Perhaps the most telling testimony of public disgust at the entire political class was the April 1995 selection of a movie scriptwriter and a comedian as governors of Tokyo and Osaka respectively. Both ran against a single candidate backed by all five major political parties. The growth of fanatic religious cults also indicates disaffection with establishment politics.

The fragility of long-established political systems and parties at a time of popular discontent was nowhere better illustrated than in the 1993 Canadian general elections. Although Canada is not on the European continent, its level of economic development is comparable to Europe; its party system and its brand of welfare state are also more similar to Western Europe than to the United States. Canada is suffering from a level of national and provincial debt higher than that of most of Western Europe, which limits its financial options. In 1993, Brian Mulroney's Conservatives, who had been in office since 1984, were expected to lose and the Liberals were expected to return to power. What was stunning was the magnitude of the loss. The Conservatives won only 16 percent of the popular vote and lost all but two seats in the House of Commons. Thus one-and-one-half of Canada's two-and-one-half party system were demolished. But the Liberals, although the winners, were not the only beneficiaries of the Tory defeat. In fact, they won only 41 percent of the vote. The "loyal opposition" in Ottawa was a new party, the Bloc Quebecois, the federal counterpart of the Parti Quebecois, and thus committed to Quebec independence. In the West, the Reform Party came out of nowhere to win 19 percent of the total national vote and only two fewer seats than the Bloq Quebecois. Thus, the governing Liberals were left—at least for the time being—as the only national party in a Parliament otherwise composed of regionalist parties. The life of both the Reform Party, a highly personalized grouping dominated by Preston Manning, and the Bloq

Quebecois, whose *raison d'être* is tied to Quebec independence, is precarious.

In summary, the decline of ideology in Europe led a growing consensus on basic policy issues between the mainstream parties of left and right. The fact that consensus thinking has proven inadequate to resolve basic economic problems is at the root of the vulnerability of these parties and of political institutions in general to growing public frustration. This has been all the more true because with the end of the Cold War, many long time governing parties are no longer indispensable as bulwarks against communism. The cases of Japan and Canada (to say nothing of the United States) suggest that the crisis of political parties and systems is not restricted to Europe but is a problem of advanced societies in general.

THE MEDIA AND THE CRISIS OF REPRESENTATIVE GOVERNMENT

The decline of the post-World War II European political system has been accentuated by the influence of the media. At the beginning of the postwar era, the typical West European government was essentially a representative government in which the autonomy of government was protected from the immediate pressure of the public. Between the citizen and the highest magistrates lay powerful institutions and organizations, including, naturally, the parliament and the institutions of the state, but also political parties and trade unions, all of which played a mediating role. These bodies had a sense of their corporate identity and responsibility and in no sense saw themselves as mere transmission belts of popular will. Even in the democratic era (one person one vote was attained in almost all West European states by 1945), government leaders also benefited from such attitudes and values, notably the deference accorded to public authorities.

In traditional parliamentary democracies, national leaders were elected indirectly. The prime minister was chosen by parliament, not the voters. The member of parliament himself was often chosen to stand for a particular district either by the national party or by the local party organization and had no personal relationship to the district. In many countries, conservative parliamentarians were members of local elites elected by virtue of their family standing. Where electoral lists were employed, national party leaders were especially powerful, since they ranked the list, in effect, deciding who would be elected. The prime minister was likely to be a politician's politician, chosen by virtue of his performance in Parliament or record in the party apparatus, rather than a people's politician. The physical distance between MP and constituent during parliamentary sessions prevented much direct contact. The voter was informed about public events through the printed media, mostly the newspaper, but only the well educated or politically involved tended to read a serious newspaper. Left wing voters often showed the same kind of deference to their party leaders (who rarely came from the working class) that they had shown previously, if reluctantly, to their "betters."

The development of radio, the first instantaneous form of mass communication, coincided with the rise of fascism, and Fascist leaders were quick to grasp the potential of radio to gain power and to continue to mobilize the population afterwards. Once they came to power, they destroyed the existing parliamentary structures and ruled as charismatic dictators. World War II ended their careers, but the rise of television after the war and the more democratic spirit that pervaded most European societies led to a slow transformation of political life.

Political leaders appealed increasingly to the public directly. They were chosen (or maintained) in part on the basis of their ability to reach a national audience. Their personality (above all, the trust they inspired or

failed to inspire) became a significant factor as to whether their party won elections. Many voters were voting for Margaret Thatcher as a person and not just as the Conservative candidate, and the same thing could be said of Felipe Gonzalez or Willy Brandt. Nonetheless, the existence of the parliamentary system and powerful national parties slowed down the process towards the kind of populist appeal found in American politics at that time. In multiparty systems where governments changed often, the development of leaders oriented to the public was slowest.

France developed in a somewhat different way. De Gaulle created a political system that favored the direct relationship between president and people (direct election of the President of the Republic after 1962, use of referenda by the President to go over the head of Parliament, etc.). France also had a heritage of weaker political parties than most other European countries. De Gaulle was quick to recognize the importance of television and retained firm control over it. Generally, however, especially after de Gaulle, the French president acted more like an elected monarch than a charismatic leader. The French public seemed to prefer presidents it could respect. The French State remained relatively effective, and the political class, despite a fair number of scandals, generally competent. The debate between Chirac and Jospin was conducted in a serious, almost technocratic way and avoided either *ad hominem* speech or discussion of sensitive areas of national security. On the other hand, the volatility of public opinion during the French presidential elections of 1995 (the rise and fall of Balladur, the rise of Chirac and his decline before the first round, and the rise of Jospin) cannot be explained without taking into account the role of the media.

The political system of the United States differs from that of all European nations. Nonetheless, it is instructive to note the impact of media on American politics. The primacy exercised by television in the relationship of citizen to government is evident in the

United States, with enormous implications as to why and how candidates are chosen, the simplification and personalization of the political debate, the demand for quick action and quick solutions, the aversion to long-term planning, the tendency to replace the institutional power of parties with the power of an individual's fortune. Ross Perot showed that someone with money and a telegenic personality (in this case, telegenic in an antihero kind of way), could score 17 percent of the vote in presidential elections. His very lack of political experience was translated into a special qualification for the highest office in the land. Bill Clinton's victory in the 1992 election was due largely to his effective use of the media during the campaign.

By personalizing politics, television has made the issue of "character" central. Distance and cynicism or irony are antithetic to the perspective of television. By providing constant close ups of political life, TV magnifies the importance of personal blemishes. The separation of political and private life disappears. Candidates and officials are held most accountable for personal behavior everyone understands (especially anything touching on the seven deadly sins) or issues on which everyone feels an equal right to an opinion (like abortion). Their positions on complex issues, understood by few but affecting many, become almost irrelevant.

By simulating the direct contact of leaders and the people (for the first time since early forms of social organization, where direct contact was possible because of the smallness of polity) television creates conditions for something approximating charismatic leadership as described by Max Weber. But unlike the days of yesteryear, there are no established patriarchal hierarchies to resist it. "The charismatic hero does not deduce his authority from codes and statutes. . . . The charismatic leader gains and maintains authority solely by proving his strength in life . . . his divine mission must 'prove' itself in that those who faithfully surrender to him

must fare well. If they do not fare well, he is obviously not the master sent by the gods." ²

Will Europe resist "americanization" in this domain? Clearly the weight of traditions and culture and the power of existing institutions should present—and in many countries has presented—powerful obstacles to this trend. Yet Italy, where old and entrenched institutions have collapsed, has gone even further than the United States towards "mediatization" of politics.

Italy provides an instructive lesson about the inherent weakness of the old model in a time of rapid change. Within a short time, Italy went from being a *partitocrazia* to a state in which a charismatic media personality, Silvio Berlusconi literally created out of thin air a "political party" simply to provide him with enough seats in parliament to govern. To be sure, Berlusconi was familiar with television, owning three of Italy's major networks (of which he was very loathe to divest himself when named Prime Minister). In the past, Italian leaders were creatures of a party; now at least one party is the creature of an individual. A referendum in June 1995 aiming to divest Berlusconi's company, Fininvest, of two of its three national television channels was defeated. Fininvest, which gained its powerful place through 1991 legislation that ended the state monopoly, even today controls about half of Italy's TV programming. Berlusconi pushed hard for June 1995 parliamentary elections because "fresh elections would postpone the referendum, and he has hedged his bet with frequent commercials on his channels telling Italians how to vote if the referendum goes forward." ³ The referendum resulted in a victory for Berlusconi, perhaps because some voters took seriously the threat that they might lose some of their favorite television programs.

The importance of the telegenic personality is made apparent also by the rise of Gianfranco Fini. Fini's winning telepersonality has eclipsed the fascist past of the National Alliance and has made it acceptable to a larger number of voters even as a party of government. Forza

Italia's weakness is that it is based almost entirely on one man's charisma (and wealth) but lacks organizational strength. Fini clearly believes that he and the National Alliance have the organizational base needed to expand and can inherit the Forza Italia constituency when and if Berlusconi falters. The key to success is to appear to be Berlusconi's loyal supporter. With Italian politics divided between coalitions of the left and right, Fini will be well placed to become Prime Minister.

It is not clear what Italian "postfascism" means today. Traditional fascism was nationalist and militarist; despite a few comments about Istria irredenta by National Alliance extremists, the movement does not talk about expansionism or the renationalization of defense. If anything, it shares the wider public fear of immigration (but unlike similar parties in other countries, Italian fascism and neofascism has never been especially racist). Fascism was strongly anti-Marxist but replicated many of the techniques of communism; today it is hard to be anti-Marxist when there is virtually no more Marxism. The National Alliance wants to keep the left out of power, but has not elevated that desire to the level of a crusade. Above all, neofascism generally reflects a loss of moorings of many strata of society, a desire to preserve the nation state and national culture against the encroachment of supranational Europe and regional loyalties. But what does that mean in practice? What policies would a Fini-led government follow? Italy could refuse to proceed further toward European integration, but such a position, although it might gladden some members of Fini's old party, would not please most of the center right. Already Italy runs the risk of being relegated to the second circle of a multispeed Europe; to leave the EU entirely seems an economic impossibility for Italy. Increasing acceptance of the National Alliance as a party of government and of Fini as a minister and potential head of government have consequences outside of Italy, by providing an aura of respectability to similar parties in other countries, like

the Freedom Party in Austria. Its leader, Georg Haider, must be taken seriously as a potential chancellor; the party received over a fifth of the vote in 1995.

It is clear how politicians can use television to gain power. What is less clear is what it means for the process of governing. At a time when the public is irascible and volatile, opposition figures find it an ideal instrument for taking on the existing leadership, but they, too, are quickly used up by the media when they in turn come to power. The same accessibility to the talk shows that helped elect Clinton seems to have undermined his stature; Newt Gingrich has become old very quickly. If radio contributed to the rule of Fascist strong men, television may contribute to the weakening of all political leaders and leadership.

Thus, television has greatly altered the nature of political life. It has eroded traditional institutions of representative government and the values that supported them and has personalized politics. It has made the pursuit of long term policies more difficult. The best guide to the relationship of leader and public may be *mutatis mutandi*, Thucydides' depiction of Athenian democracy after the death of Pericles. In that case, popular willfulness may replace political will, and continuity and rationality are at risk.

NOTES

1. Steven Philip Kramer, "Socialist Identity, Labour and the SPD," *SAIS Review*, (Summer-Fall 1987): 38.
2. From *Max Weber: Essays in Sociology*, Garth and Mills, eds., 248-49.
3. *The New York Times*, March 25, 1995, "Italian TV Empire Resists Breakup at Polls."

3. THE DECLINE OF THE NATION-STATE

The 20th century has witnessed the ebb tide of European dominance in the world. The great European overseas colonial empires, notably the British and French, have dissolved. Many of the states they created in Africa are being torn apart by ethnic, tribal, or clan conflict (no longer rationalized by the veneer of Cold War ideology). Multinational continental empires like Austria-Hungary, the Ottoman Empire, and the Soviet Union have failed. The end of the Cold War has led to the demise of several multinational states, like Yugoslavia and Czechoslovakia. The collapse of empires and multiethnic states is part of a broader process. In its heyday, Western Europe created a world in its own image, imposing artificial boundaries and often alien political regimes on Third World peoples and sometimes on East European peoples as well. The Cold War tended to preserve these structures. The end of the Cold War has unleashed centrifugal forces that tend toward the disaggregation of multiethnic or multireligious states where a sense of nationality did not gel.

There is nothing astonishing about the decline or breakup of artificial states, but what does that imply for old established nation-states? Presumably, there is some reason for complacency in historic European nation-states, but where is the nation-state that does not show fault lines in its historical past? What nation-state did not assimilate heterogeneous groups? In what state was this process not incomplete or somewhat defective? What nation-state is truly "natural" living within "natural" borders? In the last decade, many European states have

felt the pain of history mercilessly probing along their developmental fault lines. This is not all. Each former imperial state received immigration from its former colonies, which was welcomed when cheap labor was needed, but which is certainly not welcomed now. The existence of large populations of Third World immigrants, especially Moslem, tends to raise feelings of vulnerability about national identity at a time when other factors have also called into question the model of the nation-state.

There is no mystery about the primary reason for the decline of the nation-state in Europe—it has gradually ceased to be a largely independent unit for the economic life and security of its populations. What was once true for smaller states is now true for all European nations. After World War II, West European states, with the exception of France, abandoned their independence in matters of defense and relied on the United States via NATO. The rise of the European Union has meant that basic economic decisions are made in Brussels and financial decisions made de facto in Frankfurt.

With the decline of the nation-state as a self-determined economic unit, the rationality of economic cooperation among regions of contiguous European states becomes greater, further undercutting the economic necessity underlying the nation state. Economic geography regains priority over old political geography. At a time of economic stagnation, prosperous regions may also become unwilling to subsidize poorer ones within their own country especially when there are ethnic or cultural or linguistic differences or where they feel that these poorer regions are simply on a permanent dole.

Even in the important domain of cultural life, the autonomy of each nation has been overwhelmed by the flood of sounds and images from abroad, either from European neighbors or from the U.S. The rise of popular culture has contributed to the loss of self-confidence and prestige of national cultures that were

traditionally elitist and based largely on the printed word and unique object.

At the very moment when national cultures are thus at risk, they are in turn challenged by immigration, which raises questions about the validity or feasibility of former models of assimilation. The industrial economy, which assimilated workers to a common national culture, has been replaced by a service economy, which emphasizes individuation. The growth of consumerism is bolstered by a more sophisticated advertising approach no longer directed at everyman but appealing to particular interests. At the very minimum, the result is a widespread sense of anxiety concerning the relevance of national identity.

At the same time, the end of the Cold War eliminates the national mobilization against the Soviet threat, which had tended to freeze sociocultural change and around which political life had focused. The decline of other traditional sources of political conflict, namely class and religion, spotlights latent ethnic and national issues. The result is a "return of history" in Western Europe.

What is striking, however, is that while the development of the European Union and what it represents has undermined the economic reality on which the nation-state is based, that very devaluation of the nation-state has also undermined separatism. It is one thing to seek independence from a powerful state that refuses to accept your "difference" and ties you to its institutions. Such an independence was meaningful when states were really autonomous. It is quite another to seek independence from a state whose role is continually being undercut, where you have access to a European market and often to structural development funds and where, to an increasing degree, you think of yourself as European. Thus the existence of the Europe of Regions may simultaneously increase regional consciousness and defuse separatism.

Belgium is an excellent example. If the European Union did not exist, it is easy to imagine that the loveless

marriage of convenience between Flemings and Walloons could lead to a divorce, nasty or otherwise. Belgium was an artificial state created in 1830 and eventually given its international statute by the Great Powers. It was created as a marriage of convenience by two groups both on the rebound from a divorce with the Netherlands: French-speaking liberals who resented the dominance of the Dutch language, and Dutch-speaking Catholics who opposed the Netherlands' Protestant orientation. The former dominated the latter until after World War II, when the balance shifted. Belgium could have found itself in a civil war and been divided in two, were it not for the phlegmatic temperament of the population, the good sense of its politicians, the impossibility of dividing Brussels, the slow but inexorable process of devolution, and finally the rise of the European Union. Why divorce when the power of "Brussels, capital of the Belgian State" was being eclipsed by the growth of "Brussels, capital of the European Union?" Why divorce when the many powers of the state were being devolved on the Walloon and Flemish regions and the linguistic communities?

Recent progress toward a beginning of a solution to the Northern Ireland question may not have been possible without the rise of Europe. The Republic of Ireland, by becoming part of Europe, has become less distinctively a provincial Irish Catholic state. It is unlikely, for example, that without EU membership the Republic would have enacted divorce in 1995. Ulster and Ireland can no longer be defined purely in terms of opposition to each other, since each is also part of the EU. Devolution for Scotland and Wales may happen if Labour comes to power. Spain, now a member of NATO and the EU, has been far more successful in containing Basque separatism than the Franco regime; moreover, giving autonomy to the Basques and Catalans has isolated the violent extremists. Of course, the rise of democracy after Franco's death was probably the key

reason why accommodations between Madrid and the regions could be found.

The end of the Cold War not only produced a crisis in Italian political institutions but reopened the question of Italy's existence as a nation state. Italy came into existence between 1859 and 1870; just after unification, one Italian political leader declared, "We have created Italy, now we must create Italians." This enterprise has only partially succeeded. As Metternich said, Italy was only a geographic expression. It had never existed as a political entity, because the Roman Empire was a world empire based on a city-state and one of the last things the Roman Catholic Church wanted in the 19th century was an Italian state. Throughout the Middle Ages and Renaissance, the focus of patriotism in Italy was the city-state. The *risorgimento* was an ideal of the intellectual elites, but was given faint support by the masses. In the end, southern Italy was taken over by the kingdom of Piedmont-Savoy just as the GDR was taken over by the FRG. Italian unification produced some enthusiasm, but the aftermath witnessed reactions similar to those in East Germany today—only they have persisted for almost 150 years. The north complained about the burden of the Mezzogiorno, the south retorted that unification had undercut its own industrial development.

The collapse of the Christian Democratic Party in the elections of 1994 allowed the Northern League to receive 117 out of 630 seats in the Chamber of Deputies and the neo-fascist National Alliance to win large numbers of votes in the South. The Northern League opposes the unitary Italian state but was divided between those who wanted a federal Italy and a minority who wanted independence. The main complaint of League voters was that a prosperous north was forced to finance an expensive central government in Rome and support a backward, mafia-ridden south.

It is ironic but true that the same governing coalition that included a party that is not sure whether it believes in Italian unity (or at least whether it believes in a unitary

state) also included a party some of whose leaders have unfurled the banner of irredentism. For example, National Alliance leader Mirko Temaglia, president of the Italian parliament's foreign affairs commission, raised irredentist claims with regard to Istria, Dalmatia, and Fiume. Other Alliance members do not support changing boundaries but raise questions about the treatment of Slovenia's Italian minority. The two are consistent in the sense that the end of the Cold War has raised basic questions about Italy's identity as a nation-state.

In a curious way, both the League and the National Alliance are regionalist parties. The League, as a regional party of the rich north, objects to Rome's redistributing of its taxes to the south. The National Alliance, which receives most of its votes from the south, and which is the *de facto* regional party of the south, must support the unitary state to maintain the flow of largesse from Rome.

The end of the Cold War has also raised new identity questions for Germany. Germany had a unique history in the early modern period, in which sovereignty was shared between princes and the decentralized institutions of the elective Holy Roman Empire. The empire declined for centuries but did not disappear until 1806. From 1806 to 1866, the German Confederation maintained some of the supranational aspects of the old Empire. Following 1866, Prussia unified Germany "by blood and iron"; Bismarck's *Kulturkampf* was an attempt to impose Prussian Protestant rule on an ambivalent Catholic south. But even the Wilhelmine Empire was not a unitary state, because the old princely rulers reigned in Bavaria and elsewhere. The only experience of a truly unitary state in Germany occurred under Hitler. This explains why the democratic successor state in the West rejected that model and returned to a non-Prussian, federal tradition, almost as if it were determined to replay the Revolution of 1848 and produce a happy outcome to the Frankfurt Parliament.

Postwar Germany's willingness to abandon many traditional attributes of national sovereignty to Europe may thus be based in part on a residual tradition of divided sovereignty dating back to the experience of the Holy Roman Empire and German Confederation. It is certainly also based on the experience of reconciling German interests and European interests in the postwar era. Since after World War II, Germany recovered only some of the attributes of sovereignty as a member of the WEU, NATO, and the EU rather than as a nation state, Germany has greater experience than more traditional nation states in functioning successfully in the new European environment.

With the end of the Cold War, the FRG acquired the old GDR. Ironically, the FRG is now engaged in a kind of *Kulturkampf* in reverse, attempting to impose its postwar culture on an east that retains aspects of Prussianism and communism! The old FRG showed more sensitivity to the other European states than it is showing to the former GDR, perhaps because it wants to deny repressed aspects of itself incarnated by the latter. In any case, the cultural/psychological question of German identity will continue to trouble Germany far longer than the problem of economic integration of the two Germanies.

It may be useful to compare the crisis of the federal system in Canada with what we have seen in Europe. Since the rise of modern Quebec consciousness during the 1960s, there has been a series of efforts to resolve the uncomfortable relationship of Quebec to English-speaking Canada. These have included Jean-Pierre Trudeau's efforts to create a bilingual Canada with its own repatriated constitution, subsequent attempts at negotiating a new constitutional accord between Quebec and the rest of Canada (which has become further complicated because of the rise of other forms of regionalism and ethnic identities); and finally, the Parti Quebecois' two unsuccessful efforts to initiate the process of Quebec independence through referendum.

But differences of opinion both within Canada and within Quebec have thus far stymied all these projects, with the result that Canada's energies are being sapped by continual constitutional crises. It can be argued that if Canada were part of the EU, a solution closer to that of Belgium would have been worked out between Quebec and anglophone Canada. If the Quebecois were less modern in their outlook, less secure about their identity and less concerned about their standard of living, perhaps they would have taken the same route as Slovakia.

In conclusion, then, the development of the European Union has been a major factor in undermining the traditional nation-state. At the same time, it has provided a soft landing for the nation-state by providing a place for regional identity within European institutions. Without the European Union, and given a high level of economic distress, especially if unevenly experienced within European states, the problem of regionalism could become acute. Even with the existence of the EU, serious economic difficulties could exacerbate separatist or extremist sentiments. At the same time, the growth of regionalism has complicated the already complex equilibrium of a Europe that has ceased to be a Europe of States without arriving at a federal Europe (and which may never arrive there), thereby making decisive action even more difficult.

4. PROSPECTS

The decline of the welfare state, the crisis of the European political system, and the erosion of the nation-state are trends that could be largely independent of economic conditions and that have their own momentum. If they converge, they could herald an era of great but unhappy political and social change and therefore unwelcome instability.

A truly apocalyptic scenario for Europe could unfold as a result of failure to arrest the processes described so far in this study. The implications of each of these crises would be sufficiently adverse to warrant action, but taken together, they could produce a negative synergy with overwhelming consequences. At some point, cumulative quantitative change could become qualitative and visible. The pressure to cut welfare state programs at a time of increasing unemployment would certainly undermine social stability, intensifying the impact of joblessness. A conflict of "haves" and "have-nots" could result, either along new, perhaps unpredictable, dividing lines or taking the old forms of class conflict. Massive labor unrest not witnessed for decades could reappear; the resulting economic and social friction might spread to several of Europe's regions, especially those burdened by persistent, long-term unemployment and continuous flows of political and economic refugees. The failure of mainstream political parties to manage problems of such magnitude could eventually lead to elections of extremist leaders as heads of government with unpredictable consequences for Europe, both internally and externally.

The void created by a deep crisis of the nation-state and its political system would not contribute to the development of the European Union and might actually threaten its survival. At a time when power is divided

between the nation-state and Brussels, the vitality of nation-states is indispensable to the further development of European institutions. Only strong and healthy democracies can negotiate the complex process of transferring power from the nation-state to the EU; a large-scale crisis affecting Western Europe could lead to the collapse of the EU.

While such a scenario may not be likely, it is certainly not improbable. If the existing economic, financial, and political trends were to continue unchecked, they could undermine European cohesion and thus erode popular support for further integration in the areas of social, economic, and foreign policy. Most importantly, the implications for European monetary union could be catastrophic. The single market would remain incomplete because the benefits likely to accrue from monetary union would not be realized. Monetary policymaking would continue to be exercised *de facto* by Germany's Bundesbank, further delaying collective decisionmaking on financial matters and the formation of the system of European central banks envisioned in the Union Treaty. Such a development would exacerbate the perception (and contribute to the development) of yet another form of democratic deficit, this time associated not with the European Parliament (a relatively weak institution) but rather with the vital task of management of European financial resources. As a consequence, political friction might ensue: Franco-German cooperation, a necessary condition for European integration, could be endangered; if so, Germany's mooring to Europe could become less secure while France's willingness to strain its resources for the sake of monetary union might weaken. In the final analysis, failure to arrest the convergence of economic and political crises could conceivably rock the very foundations of the EU and of the Franco-German partnership on which postwar European arrangements have been based.

It would be tragic indeed if these were the prospects for Europe's future following the end of the Cold War. Fortunately, under a set of less extreme but more realistic assumptions, the future course of European integration into the next century may be much more positive and could become promising.

The depth, extent, and intensity of Western Europe's integration and interdependence achieved over the second half of the 20th century suggest that the EU has reached a stage of considerable institutional and social maturity. The end of the division of Europe has brought with it tremendous change in the composition of demand for and supply of scarce resources. As an overwhelming exogenous shock, the end of the Cold War has upset traditional economic patterns, caused a reordering of trade and commercial alliances, and been accompanied by new population movements. If the impetus behind the current crises is economics, then it may be cyclical and temporary. In that case, a general unravelling of European society can be avoided and there may be time for Europe to adjust to new realities.

The return of higher rates of economic growth for the remainder of the decade of the 1990s could be the single necessary and sufficient condition permitting a soft landing for the social and political status quo in all of Europe: economic growth would create jobs, boost income levels and generate tax revenues. What are the prospects for reinvigorating economic growth by means of trade, technology, EU enlargement and monetary union?

GROWTH THROUGH TRADE

Growth through trade is very much a European tradition; it has been tried and it has worked. Indeed, for the members of the European Union, growth through trade has been a key objective of the European Economic Community and, later, of the single European market. The original creation of a customs union

followed by the elimination of trade (and many nontrade) barriers has given rise to the present situation where intra-European trade among European Union member states is larger than trade between all of them and the rest of the world.

External trade (between the EU and the rest of the world) has also grown significantly. The European Union is the world's biggest exporter, accounting for over one-fifth of total world trade. By comparison, trade represents a much lower level of economic activity in other regions. Exports from the United States and the whole Western Hemisphere combined account for less than half as large a share of world trade; intraregional trade across all of North and South America amounts to less than a third of the region's external trade. Even countries of the Pacific rim, with their exports combined, cannot challenge the EU's primacy as an exporter with global reach.¹

Trade is what the Europeans do very well and they would like to do more of it—but so does everybody else. The creation of the North American Free Trade Area (NAFTA) was undertaken in the belief that it would expand trade. The APEC agreement aims in the same direction. At the same time, European countries that are not yet beneficiaries of EU membership also look to trade as the best means of promoting economic growth. And "trade, not aid" is a political phrase with significant economic content for all less developed countries. But at all times, one country's exports automatically constitute other countries' imports. Even under the most favorable conditions of worldwide and widespread economic growth, not all countries can enjoy export-led expansion at the same time. In the real world, increases in export shares by one region or bloc will be at the expense of the export share of another, at least initially; in the short run, the EU can increase its share of world trade so long as no one else can do likewise.

If trade is conducted under zero-sum conditions, real or perceived, then friction is likely to ensue. Some

evidence of friction between the EU and non-EU European member states has already surfaced, largely with respect to agricultural products, as might be expected. Trade friction between the EU and the United States has a longer history and is not unexpected, especially for annual trade flows in excess of \$1 billion. But there is a widespread feeling in Europe that the Clinton administration is making economic policy the essential element of its foreign policy and has recently been engaged in something tantamount to economic war with Europe.

Until recently, one source of the trade friction between the EU and its trading partners had been the complex system of European agricultural support policies (known as CAP, for common agricultural policy). Funded mainly through the EU's central budget, the CAP had been the largest expenditure component; in the late 1980s, agricultural support claimed almost 70 percent of the EU budget.² Since then, partly in response to trade-related pressures and the outcomes of the Uruguay round, and partly as a result of other internally competing claims, the EU is reducing its emphasis on agricultural subsidies. It has adopted a more restrictive pricing policy and is scaling down financial support for farm products; by 1992, the CAP absorbed less than 60 percent of the EU's budget and this proportion will further decrease.

In terms of EU-U.S. trade, major areas of disagreement have involved procurement in telecommunications goods, services and construction; extension of the 1992 U.S.-Airbus decision to other aircraft parts; development of technical standards (for software, gas connectors, blood products, outdoor power equipment) and testing and certification procedures; broadcasting; public procurement (including buy-American legislation); air transport services; eco-labeling; fisheries; and meat hormone ban, third-country meat certification and labels on the use of BST (a drug to promote cow milk production). In most

of these disputes, negotiations between the EU and the United States have resulted in interim arrangements satisfactory to both parties, subject to further negotiation and compromise. However, there persists a difference between the two partners in their overall approach to trade disputes.

There has been a persistent tendency on the part of the United States to prefer and attempt to resolve trade problems through bilateral agreements rather than through U.S.-EU dialogue exclusively. In addition, the Congress has intervened quite actively in trade matters in recent years, with initiatives ranging from adoption of a new and tougher "Super 301" procedure to proposals seeking to expand the scope of U.S. antitrust law. Such measures are unilateral in nature and not in harmony with multilateral rules adopted by GATT and OECD; in fact, Congress is generally reluctant to accept GATT panel rulings and to modify existing U.S. law accordingly. By contrast, the European Union places emphasis on the management of external trade problems at the level of the Commission; even though individual member countries may have particular preferences or prior experience in specific trade issues, they have subordinated national trade policy to the Commission, which speaks for all of the EU members.

This difference in approach explains only part of the trade friction. A more significant factor has to do with perceptions of protectionism prevailing on each side of the Atlantic. In the American view, Europeans are more interventionist and thus willing to subsidize industrial or commercial enterprises, products or services to overcome trade barriers and gain market share. Europeans, on the other hand, point out that the U.S. Government intervenes for the same purposes as a matter of course, except that it does so most often in the name of national security, broadly (and loosely) defined. These analogies have been relevant, for example, in comparisons of European "subsidies" to Airbus with U.S. "subsidies" to military (and then civilian) aircraft

production; in discussions about national laws controlling foreign ownership of broadcasting and telecommunications organizations; and in debates on the nature of "buy American" versus "buy European" practices in public procurement. Because both sides have a point, the key issue concerns the ability to prevail in negotiation of particular disputes in the future.

To the extent that America's trade position in general has deteriorated and its trade orientation is still much lower than that of the EU, it appears that the tendency toward unilateralism is likely to grow stronger in the United States. This has been the case already in the context of U.S.-Japan trade and could trigger anti-European trade sentiment even though U.S. trade with the EU is still well balanced. If that happens, trade conditions would continue to favor the EU, not because of her "Fortress Europe" behavior but because of her "Exporter Europe" tradition. However, trade flows could be adversely affected for both the United States and the EU. Should the United States decide to take a more aggressive, protectionist stance vis-a-vis its trade with Europe in response to such a development, it might do so at the expense of its political cooperation and dialogue with the EU. In the worst case, it is possible that the perception of the tradeoff between trade and the whole trans-Atlantic relationship as a zero-sum solution might be reinforced. In conclusion, Europe can expect to make some—perhaps limited—economic gains through trade expansion, but at the risk of increased economic conflict with the United States with possible political and security spillovers.

GROWTH THROUGH TECHNOLOGY

Can Western Europe overcome its current economic problems by placing greater emphasis on technological innovation and greater diffusion of technology in all sectors of its economy? This question raises several controversial issues that tend to obscure a central fact:

namely, that technological advancement is not sought as an end in itself but rather as a means to improved well-being and greater material prosperity. The real problem, from a policy perspective, is whether technological progress can be fostered in a climate of low economic growth.

In an economic sense, meaningful (that is, efficient) technological progress leads either to falling per unit prices, over time and in real terms, of established product lines or services, or to development of new forms of output. These phenomena have been observed in a great number of industries, primarily goods-producing (agriculture, construction, manufacturing) but also in several sectors of the service-producing industries (especially communications and transportation). In both its manifestations, technological progress results in significant, often revolutionary, productivity improvements leading to permanent reductions in cost of production over time. Technological progress has, as a rule, transformed highly labor-intensive operations to fully automated processes. In releasing labor from onerous or deadend jobs and boring tasks, technological progress (as opposed to mere application of technology)³ can lead to economic expansion that raises living standards. Europe's record in this respect is impressive. Under what conditions can it be improved?

Pessimistic assessments of Europe's potential to channel technological innovation into the production process are based on several trends: erosion of Western Europe's comparative advantage in some high-technology sectors (notably consumer electronics and related apparatus, computing equipment and office supplies), its low ranking in patent awards (behind Japan and the United States), lagging spending on research and development and not sufficiently large numbers or proportion of researchers. (In R&D spending as well as in numbers of researchers, Western Europe is behind Japan and, by some measures, behind the United States as well, in both absolute and relative terms.) In addition,

some evidence can be read to suggest that de-industrialization has affected not just the United States but also Western Europe (as indicated by the ascent of its service-producing industries at the expense of manufacturing).

But another set of factors deserves equal attention, for it is tempting to overlook important structural differences when making broad international comparisons. First, with respect to secular changes in comparative advantage, trade balances matter a lot. If a technology gap exists, it has not affected the robustness of European trade, as discussed earlier. In fact, trade data lend support to a more optimistic assessment of Europe's international competitiveness position vis-a-vis the United States and Japan. Thus, even though by some technological indicators (i.e., number of new patents and researchers) the United States has been a longtime leader, this position has not prevented it from becoming also the world's largest debtor nation. In its trade balance and among broad end-use categories of merchandise traded, the United States usually has a surplus in only two (and these are overshadowed by larger deficits in most other categories). Of these, the more significant surplus is in foods, feeds, and beverages, not normally classified as high technology sectors; a much smaller surplus is shown under industrial supplies and materials. By contrast, the EU (ranked third in terms of technology orientation) has a balanced trade with the United States and a much smaller trade deficit with Japan than does the United States. Thus, the connection between technological supremacy measured in factor inputs and production efficiency or productivity gains may be much more roundabout (and certainly less obvious) than normally assumed.

In gauging the potential for greater technological advancement in Europe, the following advantages stand out:

- Europe's human capital stock is impressive in scientific and technological know-how as measured

by the share of engineering and natural science graduates in terms of total population of university students (EU: 28 percent; U.S.: 17 percent; Japan: 25 percent).⁴

- Europe is ahead of the United States in terms of investment orientation, a condition commensurate with high savings rates; European gross savings rates, at 20 percent of GDP, are now lower than Japan's (at 30 percent) but have historically been higher than those of the United States (at 14 percent).
- Western Europe's traditional exposure to the competitive pressures of international trade has been and remains singular; by comparison, the U.S. economy still retains a strong domestic focus while Japan's size has yet to confer on it a role larger than Europe's or America's in world trade.

All in all, Europe has the potential to push forward in terms of technological advancement. This will be good for its international competitiveness position, although its overall gains through trade may become more limited for reasons discussed earlier. It is even more likely that technological advancement will eventually create conditions favorable to higher economic growth in general, as it always has in the past. However, technology per se will probably not be an important factor for short-term turnaround in European unemployment. Thus, while technology remains essential for the preservation of high living standards in the future, it cannot serve as a substitute for countercyclical macroeconomic policies aimed at joblessness. For this reason, it is possible that fewer resources will be diverted toward technology-related investments and more toward job creation schemes. If so, the role of technology could become even more limited.

GROWTH THROUGH ENLARGEMENT

Europe can also grow by expanding its membership wisely. The club of 12 added three new members in 1995: Austria, Sweden, and Finland. These affluent, industrialized democracies bring with them higher than average per capita incomes, well-developed market economies and strong export orientation; such attributes change immediately the economic statistics of the EU as a whole and in the right direction. The financial benefits are especially visible because these new members will be net contributors to the EU's budget and thus enhance EU-financed projects. At the same time, potential costs to political cohesion in the European Union are minimized because the new members are, in reality, old and established partners of the EU through EFTA. Their political, social, cultural, and economic institutions are mature and in harmony with those of EU member states. Thus, Europe's most recent enlargement may actually represent a win-win outcome and one that stimulates economic expansion for the union as a whole. Nonetheless, this enlargement does present some problems. It reinforces the need to overhaul the cumbersome institutional structure of the EU at the 1996 Intergovernmental Conference (IGC). The three new members' security identity is marked by a long tradition of neutrality: they may be less willing to support the idea of robust European security cooperation. Finally, these nations seem less committed to the Monnet ideal of Europe; Swedish public opinion is already showing reservations about the likely benefits of EU membership.

But what are the limits to the EU's enlargement? In theory, Europe could have and should have become whole again after the end of the Cold War. Instead, there is now a new divide, the result of the de facto separation between two groups of countries: those that are members of the EU (industrial democracies with developed political institutions and mature market economies) and those that are not (former Communist

countries facing serious problems of political and economic adjustment). The success and speed with which Western Europe can integrate the states of Central and Eastern Europe, as well as Russia, into its political and economic structures will be critical determinants of this process. If true integration can be achieved, the single market will expand immensely. The benefits associated with economies of scale will be considerable and, if past trends are a guide, trade flows will grow significantly as well.

It would be a mistake to invoke economics as the singular driving force pushing toward EU expansion. A strong argument can be made that economic integration is a means toward a larger goal, that of political (and, by extension, social and cultural) unification. In contrast to other economic zones or free trade areas (including the largest and most recent one, NAFTA), the EU is composed of countries with a common collective conscience, heritage, and culture. Geographically, their boundaries and history tie them together on the European continent. Their political and economic institutions are similarly based on common conceptions of governance, from the birth of participatory democracy in the Greek city-states to monarchy to parliamentary democracy and from feudalism to contemporary political economy. Culturally, EU member states have created and share in the values of Western civilization, from Greek philosophy to the spread of Christianity to the Renaissance and the Age of Enlightenment. Indeed, the notion of a European identity (symbolized in the EU passport since 1985) has a far stronger cultural, sociogeographic content than the American one (in the sense of the North American or South American continent, and even less so in the case of both of them combined). These factors indicate that the current divide in Europe may be temporary, ephemeral, and artificial. The limits of the EU will most likely be expanded to include all the states professing a broadly based and genuine popular allegiance to a common

European ethos, culture, history and civic values. By these criteria, the European Union might eventually include all the countries on the continent of Europe all the way to the Urals; indeed, Russia is as much a European power on its western side as it is Asiatic on its eastern side.

There are grounds for optimism that such an accomplishment is possible: since 1989, the reunification of Germany has involved not just the absorption of the former GDR by the FDR but also the immediate inclusion, through Germany's membership, of the former Communist GDR into the EU. This has not been an easy process; in addition to major political, social, industrial, and other dislocations caused by the decision to reunify the two countries, the financial costs have been enormous and borne mostly by German taxpayers. But beyond the direct financial costs, the full economic costs of this inevitable task are incurred (directly or indirectly) by all citizens of the EU. It is inconceivable now that Europe would have room for two German states, one inside the EU, the other outside, because despite their differences in political and economic systems over decades, the two German states share common linguistic, cultural and historic traditions. The extent to which such traditions form a common civic denominator among the peoples of Europe will most likely define the limits of the post Cold War EU, its economic geography, ethnographic composition and new political identity. European history, after all, reflects a legacy of both centripetal and centrifugal forces. Diversity and unity are not contradictory. In the High Middle Ages, for example, there was a remarkable unity in cultural and intellectual life at a time of political fragmentation. Today it is possible to imagine political and economic integration together with enormous degrees of cultural diversity.

In the near term, enlargement of the European Union is constrained by serious political uncertainties. These, in turn, lead to calculations unfavorable to the

commitment of scarce resources outside of the EU. The issues, prospects and problems associated with future enlargement must be dealt with in terms of the economic calculus prevailing in Europe today. Further enlargement can take place in two directions: south and northeast.

Expansion to the south would mean simply opening up the EU to Malta and Cyprus. The economic benefits or costs would be minimal, given the small size of the economies involved. The political gains would be negligible, the potential dangers great. Malta has a long history as a maverick within international organizations. Giving Malta the existing right of veto could paralyze the operations of EU institutions, especially if the Maltese Labour Party returns to power. Entry of Cyprus is predicated on a solution of the Cypriot question, which depends in turn on a breakthrough in Greek-Turkish relations. Far more than expansion, there will certainly be greater involvement of Europe in the Mediterranean. The conflict in Algeria has focused the attention of Mediterranean states like France, Italy, and Spain on the importance of stabilizing the countries of the Maghreb to avoid generalization of instability and immigration because of Islamic fundamentalism, a high birthrate and economic backwardness. It is to conjure potential dangers emanating from the Maghreb rather than in pursuit of economic gains that the EU is likely to incur significant financial burdens.

Thus when EU enlargement is invoked what is usually meant is expansion to the northeast. The first tranche of candidates are the Czech Republic, Poland, and Hungary (Slovakia is often included in this group, but will be discussed separately). The political experience of these three countries since the end of Communist rule has been generally positive. Democratic elections, alternation of power, freedom of speech, and rule of law have prevailed. The process of democratization was based either on historical experience (the Czech Republic from 1918 to 1938), the

record of resistance to Communist rule (Solidarity in Poland), or the origins of a genuine multiparty system under Communist rule (Hungary). Neither Poland nor the Czech Republic is involved in any significant boundary disputes or national minority questions, although antisemitism persists in Poland. Hungary's differences with Slovakia seemed to have been resolved by a new treaty negotiated under the stability pact rubric but reemerged when Slovakia voted to make Slovak the official language of the country. A treaty with Romania remains to be negotiated. The left wing Hungarian government of Gyula Horn has been far more conciliatory on issues related to the large Hungarian national minorities in neighboring countries than was its conservative predecessor. Assuming that this issue is satisfactorily resolved, there is reason to think that the membership of these countries in the EU is at least as sound a proposition on political grounds as was Greek membership in 1981 and Spanish and Portuguese membership a decade ago. Including them in the EU would expand the zone of stability and security in Europe.

Slovakia has not gone as far in creating a free market and has weaker democratic credentials. Had it not been part of Czechoslovakia it is unlikely that it would be considered at this point for EU membership. Beyond this tranche of countries it is hard to see many likely candidates for EU membership in the next decade. Until peace reigns in the Balkans, incorporating any Balkan state could be risky, as it could be involved in a widened war. This certainly is the case of most of the republics of the former Yugoslavia. Nor is there much progress toward liberal democracy in other Balkan countries, although Bulgaria has shown good sense in dealing with its minority problems. Slovenia is economically developed, but it is not clear whether it should be rewarded for having pulled the plug out of Yugoslavia and unleashing civil war. Rumania seems not to have undergone much genuine reform at all. The Baltics

remain a problem because of the continuing problem of Russian minorities.

It is fair to say that EU membership can consolidate democracy. But affording EU membership to states not yet far advanced toward democracy or harboring territorial disputes with neighbors or unresolved national minority questions runs the risk of importing these problems into the EU. Even the admission of the strongest candidates poses serious risks if the decisionmaking mechanism of the EU is not reformed and until there is a consensus on the direction the EU is supposed to take. The more states are admitted, the more difficult it will be to change the institutional structure and the more dysfunctional the present structure will be. One danger is that once admitted, new states will immediately be relegated to the bottom tier of a multispeed Europe, which will have to be multispeed in part because of their admission. The upcoming IGC will have to resolve issues of institutional structure that logically should have been dealt with before any enlargement.

Beyond the political dimension, expansion to the east involves equally serious problems of economic integration. Both in terms of industrial development and income levels, a large gap exists between Western Europe and countries that stayed behind the Iron Curtain for decades. The least troubling and most optimistic case is the Czech Republic, the best economic performer in Eastern Europe: its per capita income is just over \$7,000, putting the country in first place among all non-EU states in Europe. Yet, compared to EU income levels, the Czech standard of living is very low: it barely reaches one-half of average EU income, significantly lower than that of Greece and Portugal, the EU's least well-off member states (both have average incomes around \$9,000).

The Czech Republic situation is similar to that of Slovenia (a new state but located in a region with a strong industrial tradition). Slovakia, Hungary, Belarus,

and Estonia may be grouped together in a tier below, with income levels around \$5,500. The former Yugoslavia might also have been placed in the same group; Croatia and, to a lesser extent, Serbia and Montenegro were relatively well off before the dissolution of the Yugoslav state. But all other former members of the now-defunct Warsaw Pact are countries of even lesser means, with average incomes inordinately low in comparison to EU levels. The economies of Poland, Ukraine, Bulgaria, and Romania show signs of improvement but will remain fragile in the transition to decentralization and open market rules. By any measure, these countries do not have the economic credentials to be considered candidates for admission to the EU any time soon. Nor are their evolving political institutions stable enough to contribute to inter-European cooperation in the realm of foreign policy and security. Admission to the EU would amount to virtual guarantee of significant income transfers (at high cost) from Western Europe in exchange for future (unspecified if not insignificant) political benefits.

However, the need to develop stronger ties between Western Europe and its eastern neighbors cannot be overlooked. Short of enlargement by formal expansion through admission of new states, it is possible to meet that need through interim measures such as association agreements. This course of action has already received policy priority, is feasible, and can benefit all sides. Greater economic integration can lead to political integration between east and west in Europe, in much the same way that it has facilitated political integration throughout the EU in the post- World War II period. Despite its cumbersomeness and slow speed, EU enlargement through economic integration has been successful for Europe. The recent admission of former EFTA countries adds to the body of strong evidence that long-term association agreements promote *de facto* economic and political integration, leading naturally to EU membership. Of even greater significance is the

success with which association agreements paved the way for admission into the EU of Greece, Spain, and Portugal in the 1980s. Not only were these countries relatively poor, but their political record had been marked by military dictatorships in the post-World War II period. By comparison, the countries to the east of the EU are less well off in material terms and significantly more burdened by the experience of Communist rule. Enlargement of the EU to the east may be out the question for now but could become possible in the future, even though it might require long-term association agreements.⁵

Political considerations will probably lead to the admission of the Czech Republic, Hungary, and Poland by early in the next decade. In the long term, inclusion of these states and of other states in the East later on will pave the way for enormous expansion of European trade and economic growth. Initially and for some time, however, the economic and financial costs to the EU will be far greater than the benefits. Enlargement to the East may help solve Europe's economic problems in the future but will certainly exacerbate them in the next decade.

MONETARY UNION

Europe's internal market has benefitted greatly from economic liberalization and integration processes at work since the implementation of the Single European Act. Economic union is to be complete when full monetary union is implemented, leading to higher economic growth across Europe.

The direct benefits of monetary union can be substantial. They include savings on currency conversion costs as a result of irrevocable locked exchange rates; sustainable price stability as a result of monetary policy coordination by a European System of Central Banks; savings on government finances through lower interest rates; and reduced costs on currency

conversion and forward exchange covers incurred by banks and other enterprises doing international business in ECUs (central banks will also economize on the costs of holding foreign currencies). Removal of restrictions on capital flows has already been achieved. Indirect benefits are difficult to quantify but could be even more profound, not just in terms of their economic effects but also because of their political ramifications.⁶

European monetary integration has a long history and is marked by several phases. An important phase began in 1978 when the European Monetary System (EMS) was conceived and, by one account, "sold to the rest of the Community by (then) West German Chancellor Helmut Schmidt and French President Valéry Giscard d'Estaing."⁷ In the late 1980s, not just academics but business leaders also would engage in speculative talk of the advent of a common European currency. The *Economist* featured a cover story on the Phoenix (a fictitious name for the European coin and paper that might be issued one day). In the meantime, the European Currency Unit (ECU) has achieved the status of a premier international monetary unit; even though it is not issued in paper or metal form, it has been traded in world currency markets as a key foreign currency and is used to settle official accounts and private invoices. In the last 10 years or so, many European government bonds have been denominated in ECUs. But the most ambitious phase of monetary integration began with the incorporation of European monetary union (EMU) in the articles of the Union Treaty in 1992. In December 1995, the EU baptized its future single currency "Euro."

The literature on the problems, crises, prospects and promises of European monetary integration is quite prolific. Beyond the theoretical issues related to the demand and supply of Euromoney, interest rates and effects on macroeconomic aggregates, there has been a lot of debate on the implications of monetary union for the distribution of political power within and among EU

member states. American observers, but also several European economists, have attached special importance to the meaning of EMU for national sovereignty and particularly for its effects on the distribution of political power among participating states: as control of the money supply is effectively handed over to a European central bank, the ability of the government of each sovereign state to control national economic activity is diminished or eliminated. For political conservatives who advocate devolution of power away from the center, EMU represents a most undesirable condition, threatening the very existence of democratic governance.⁸ On the other hand, interventionist economists and politicians have argued that monetary union will contribute to more effective management of the economy at a pan-European level, increasing the synergism between fiscal and financial policies in a truly single European market.

From a conceptual and even from a technocratic viewpoint, the evolution of EMU should be assessed with reference to parallels in the development of central banking in the United States since the 19th century. In contrast to all other major powers in the Western world, the United States did not have a central bank until just before World War I. The U.S. banking system was controlled and regulated by the states, not by the Federal Government. The creation of a uniform, single currency standard as well as the establishment of a U.S. central bank did not materialize until 1913 (with legislation creating the Federal Reserve System), after a long series of crises and years of financial chaos, especially after the turn of the century.⁹ The U.S. banking system is still unique as a two-tier system, with state banks chartered by state authorities and national banks licensed to operate as members of the Federal Reserve System. Using this analogy and applying it very loosely to the EU setting, it is evident that the EMU provisions of the Maastricht Treaty will create a similar two-tier banking system in Europe: in each EU member state, control of the banks

will be exercised by the national authorities, while a European system of central banks will set monetary targets and policies to achieve them.

Theoretical considerations notwithstanding, the practical implications of a single EU currency to be used in daily cash transactions are overwhelming. The European Union of the 15 may now boast more currencies (exactly 15)¹⁰ than official languages (a total of 11). The proliferation of official languages has led some public officials to suggest that the total number of languages be reduced (in official EU communications including publications) by half, to, say, five or six.¹¹ The accounting logic may be flawless but proposals of this sort enraged the public in countries that might be affected (generally the smaller ones). Such proposals were quickly withdrawn for further study; language, after all, is the most powerful symbol of national culture and sovereignty in the multinational EU. By comparison, the lowering of the status of a country's currency (as would be the case when ECUs are minted) is viewed with much less sentimentality by Europeans. The complexities and costs of dealing with 15 currencies can be tremendous: from the policy demands of exchange rate adjustment to inconvenience and expense due to transaction costs, the multiplicity of currencies has been an obstacle to European monetary integration. This may explain why the movement toward a single currency has met generally with public approval.

European attitudes toward a single currency have been positive. According to a poll conducted in spring 1993, a majority of EU citizens would like to see national currencies replaced by a single currency by 1999. Opposition to a single currency is highest in the United Kingdom, Denmark, and Germany, lowest in Italy, Greece, and Belgium.¹² Similar attitudes prevail toward a European Central Bank.¹³

In the years following the signing of the Union Treaty, it seemed as though the evolution toward a single currency in Europe was inevitable, but monetary union

could take longer, might be more complicated and troublesome, and could create greater protracted adjustment problems than originally estimated. Time is an important element but hardly the most critical. As with economic union, which took over 40 years to reach its present stage in Europe, the optimal date for issuing a European currency is still open to debate. In the end, a single European currency can materialize at such time as the EU's economic power and political and social integration make it imperative.¹⁴ But what if monetary union proved to be more complicated and protracted than initially envisioned?

There have been obstacles along the way and more could emerge, however. In the post-Cold War era, there have been tendencies in Western Europe to resort to stratification in order to deal with current problems, as analyzed in earlier sections of this book. For all the reasons already listed, the EU is considering interim solutions that may be more divisive than cohesive. One example is a multitier approach to monetary unification, suggested as a means of keeping with the letter (but not the spirit) of the Union Treaty; a two-tier EU, with some countries in the top tier (or in a "hard core") and most in the bottom tier (or "soft core") may be technically possible but could prove politically dangerous. Would the increased commitment to monetary union of "hard core" countries be exactly offset by the (justifiably) diluted commitment of "soft core" countries? What would be the impact on the future of financial discipline within the EU as a whole? What signals would be thereby transmitted to prospective EU candidate-members concerning their monetary integration? And if there is something truly negative to be said about the convergence criteria for monetary union, it is that they were deemed irrelevant and unnecessary (at least by implication) for the monetary union between the Federal Republic of Germany (FRG) and the former German Democratic Republic (GDR). By any measure, the GDR's economy was in much worse condition at the

time of German reunification than the least well-off EU member state, now or at the end of the decade. If monetary union without any preconditions was feasible between the former FRG and GDR, why would it not be achievable by EU member states characterized by fewer economic disparities among them and with a 40-year history of economic and financial integration?

The events in France in December of 1995, in the form of public workers union strikes that paralyzed urban life, underscore the importance of answering the question posed above. Among the first to assess as paradoxical (and, perhaps, unacceptable) the nature of the tradeoff offered by the government, the French perceived that the benefits of EMU came at an exorbitant cost: higher unemployment and lower living standards. The government's insistence that its austerity measures are necessary for France to satisfy EMU criteria may be technically valid but politically explosive. This fact alone suggests that the application of the criteria as well as their interpretation warrant reevaluation as to their economic validity and political relevance. In many ways, the future of EMU may be hostage to a set of quantitative tests that have the virtue of being highly specific yet extremely arbitrary.¹⁵

In the final analysis, it is imperative that conditions for participation in the final stage of monetary union be observed and financial discipline enforced. Under any circumstances, the stability of a single currency will depend on sound public finances. This fundamental monetary principle is at the heart of the provisions of the Union Treaty. Its application will be a function of the technical tools with which the EU Council is already armed as well as of the manner in which they are used. But above all, monetary union will be determined ultimately by the Europeans' political will to bring it about. The fact that the Maastricht Treaty was ratified at all despite the obstacles encountered demonstrates Europe's underlying commitment to eventual monetary union by the end of the century. Monetary union once

achieved should provide an important impetus for faster economic growth.

In summary, of the four factors examined for their likely impact on Europe's growth and prosperity toward the next century, two seem to hold the most promise: monetary union and limited enlargement. It should not appear paradoxical that while these are the most difficult, riskiest, and perhaps most ambitious undertakings, they are also the ones that are likely to generate the greatest pay-off to Europe's prosperity. By contrast, Europe's near-term gains from continuing its tradition as a premier world trader or from maintaining its technological prowess are bound to be more limited. This does not mean that a choice to emphasize the bigger projects needed to truly unite Europe can or should be at the expense or exclusion of the more traditional options (trade and technological advancement). But it does mean that resumption of a course of strong economic expansion will depend mainly on Europe's successful pursuit of monetary unification and prudent management of EU enlargement.

BUT IS THE POLITICAL WILL THERE?

The above conclusions are based on relatively optimistic assumptions about the future: namely, that no political and security problems emerge that significantly threaten European interests and the European economy. Such threats might include revival of the conflict in Bosnia and spillover to other areas, such as the former Yugoslav Republic of Macedonia or Kosovo, perhaps leading to a regional war; the continued weakening of reformist forces in Russia, resulting in a nationalist and expansionist foreign policy; a war in the Middle East affecting oil supplies; or continued distancing of the United States from Europe to the point that American security guarantees lose their credibility. Clearly, such external factors could provoke a crisis in the European economy, making our predictions of future sources of

economic growth questionable. U.S. involvement in Bosnia and the Dayton peace accords have obviated the immediate threat of an aggravated Balkan crisis. The weak and divided response of Western Europe to the crisis from its outset, which in turn was partly a result of ambivalent European leadership and the domestic preoccupations already discussed, was a key factor for U.S. intervention. There is no guarantee, however, that the peace settlement will long survive the end of the NATO peacekeeping mission, and that, if it does not, Europe will be any better equipped to respond to a renewed crisis than last time.

But a far more obvious threat to Europe's economic future is whether Europe will have the political will to move resolutely toward EU institutional reform at the upcoming IGC meeting, on which economic growth depends. The European Union looks like the Ptolemaic system of the universe before the advent of Copernicus, with its ponderous system of circles within circles. Enlargement of the EU only makes it more cumbersome. Widening has preceded adequate deepening. The structure of the EU reflects the underlying ambivalence of European states about yielding sovereignty in areas particularly sensitive to them.

What is alarming is that expectations for the IGC are being cut back. It is not surprising that the British Government is wary about majority voting and "federalism" in general. France under Chirac is uncomfortable about the increasingly clear signals from Bonn that Germany will insist on additional movement toward federalism in exchange for EMU. The French seem to have forgotten that the primary purpose of their historical European policy was to irreversibly moor Germany to European institutions. Paradoxically, they are now resisting Germany's demand to be further tied down.

It is almost certain that the EU will come up with some kind of package addressing institutional reform by 1997; after all, the IGC cannot be allowed to fail. The

question is whether the politically acceptable package will also prove workable. The need to compromise between different visions of Europe may produce a Europe without vision. The states of Europe lack the reality of power they once possessed to act effectively on the national level, or the will to make Europe really succeed; the whole seems to be less than the sum of its parts. Europe awaits its Copernican revolution. Whether the leadership necessary to make that revolution presents itself—under the admittedly difficult economic and political circumstances just described—may be the critical factor in determining whether the EU will survive as a viable institution and whether Europe will play the kind of role to which its wealth, population, and history would seem to destine it.

NOTES

1. With a population exceeding 1.8 billion, they export about \$700 billion a year, or less than half the dollar value of exports sent abroad by 347 million Europeans, according to a recent estimate. *Strategic Assessment 1995* (Washington, DC: Institute for National Strategic Studies, 1995), 198.

2. Clifford P. Hackett, *Cautious Revolution: The European Community Arrives*, Praeger, 1990, 121.

3. For example, mere application of technology in U.S. defense production has resulted in rising, not falling, prices over time. Also, the application of technology has not been associated with reduced costs of production in less trade-exposed sectors of the economy, including services, medical care in particular.

4. Industrial Research and Development Advisory Committee of the Commission of the European Communities, *Skill Shortages in Europe—IRDAC Opinion* (Luxembourg: Office for Official Publications of the European Communities, undated), 34.

5. For Greece, the transition between an association agreement with and membership in the EU in 1981 lasted 20 years. Portugal's association with the EU began in 1959, through Portugal's membership in the European Free Trade Area; EU membership materialized in 1986. During the same year, Spain also joined the EU, following years of isolation from Europe (Franco's regime ended with his death in 1975).

6. A recent assessment concludes: "The Maastricht negotiations were initiated by a desire to have a less German-dominated, more equal currency system than the EMS. In other words, the initial catalyst for change was internal. But as time went on . . . a wider vision was raised in many minds of how a monetary union might change Europe's place in the world. This vision is set early in the twenty-first century. It conjures up the prospect that every central banker around the world might have to keep Ecus (rather than dollars) in his foreign exchange reserves, that every trader with the world's largest commercial bloc might have to invoice his goods in Ecus, that every broker of oil and basic commodities might have to mark his prices in Ecus, and that every prudent investor might never want to be without substantial Ecu assets in his portfolio." David Buchan, *Europe: The Strange Superpower* (Dartmouth, 1993), 25-26.

7. Steven F. Overturf, "The Economics of the Renewed Integration Movement," *Annals of the American Academy of Political and Social Science*, (Jan. 1994): 85.

8. See, for example, Murray Weidenbaum "Why Maastricht Will Fail," *The National Interest*, Summer 1993.

9. Until then, regulation and control of the American banking system was in the hands of state banks. In the absence of a central authority to monitor the quality of state bank assets and liabilities, currency in circulation consisted of bank notes often issued without regard to financial strength. High failure rates among banks resulted in substantial losses by depositors, leading to financial, economic and social turmoil.

10. The sheer inconvenience of changing currencies at each border crossing (exacerbated now that there are none) within

the EU can be approximated if one imagines U.S. citizens having to do the same when crossing state lines.

11. In the summer of 1994, European media reported on deliberations and proposals concerning the proliferation of official languages in the EU.

12. *European Union: Europe on the Move* (Luxembourg: Office for Official Publications of the European Communities 1994), 40.

13. *Ibid.*, 39. The Maastricht Treaty actually calls for a European System of Central Banks rather than a single bank.

14. By analogy, the post World War II international financial system was a natural outcome of prevailing economic and political power balances. The United States was the world's strongest economy and this prowess served as the backbone of the international financial system based on the gold standard. For a long time, this system could meet the needs of the United States and its partners. When it no longer did, it was undone (by U.S. unilateral action, announced in the summer of 1971).

15. The convergence criteria for EMU have been and remain controversial, particularly as to their relevance on technical grounds: "These criteria . . . taken at face value . . . made no sense whatsoever. The first criterion was that a country maintain a stable exchange rate for two years before joining . . . a country that showed that it was very good at living with an independent currency would be allowed to abolish it. The second criterion was . . . circular: a country would be allowed to join EMU if the markets thought it would. The third criterion required inflation to be close to that of the EC's best performance . [But] under fixed exchange rates...there was really nothing a country could do about [inflation] without violating the first criterion]. Finally, two criteria set limits on budget deficits and the size of government debt. These are reasonable things, but what do they have to do with monetary union? The Federal Reserve does not need to police the budgets of New York and California, because they cannot print money to cover their deficits. The same

would be true of national governments after EMU." Paul Krugman, *Peddling Prosperity*, Norton, 1994, 191.

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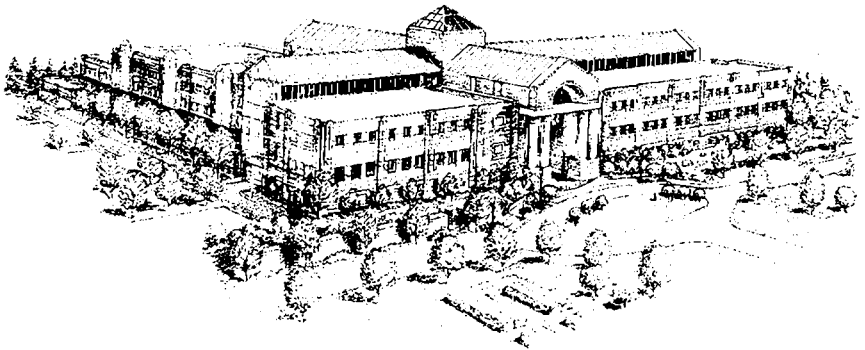
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