

Comment on “Prospects for the European Union” \*

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It's a great pleasure to be able to comment on this wonderfully comprehensive overview of the European Integration.

I concur the conclusion: “EU remains a historically unique political and institutional experiment”.

As a consequence, it will have major challenges as well as opportunities.

I will try to illustrate this double nature by picking up two issues: (1) Euro and (2) Democratic Deficit.

(1) Euro

Is Euro helping the stability of EU?

It has a major drawback as well as an advantage in this regard.

*Drawback:*

Various economists have already pointed out the negative sides of Euro. From my perspective, Euro somewhat resembles the Gold Standard of old times. First let me put a question:

How can a Euro member country obtain Euro, at all?

There are basically two ways:

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The *North* Model: By running trade surpluses.

The *South* Model: By borrowing from the North which accumulates Euro through trade surpluses.

The South model produces no problem as long as the borrowings are used profitably and the financial market functions smoothly. In fact, prior to the Euro crisis, Spain experienced a much higher average growth rate than Germany.

The South experienced serious difficulties, however, with the advent of the financial crisis.

This produced, and is still producing, repercussions in the monetary policies pursued by ECB.

In order to stimulate lending and for the sake of lowering the interest costs, the South prefer ECB to pursue a low interest policy whereas the preference of the North lies otherwise—the perennial source of conflicts between Germany and Southern countries.

*Advantage:*

Greece (or perhaps Yannis Varoufakis alone), at one point, seriously considered leaving Euro and some major political leaders such as Le Pen and Salvini, as are quoted in the main presentation, considered that option at some point.

Yet, at the end they all changed the idea because leaving Euro and readopting the old national currency will result in a decline in the real values of people's assets.

Thus, Euro acts as the barbed wire fence to prevent the prisoners' escape!

It is no coincidence that Britain which does not belong to the Euro area could leave EU whereas in the case of a Euro member country, there will be insurmountable difficulty in leaving EU because it has to leave Euro at the same time.

(For Germany, which will experience a rise in the real values of people's assets in the event of re-adoption of German Mark, the incentive may be the opposite)

## (2) Democratic Deficit

The paper discusses the disparity between the population and the number of seats in the European Parliament.

But a more serious problem may lie elsewhere:

Say, there is a group characterized by the ethnic and linguistic homogeneity.

Suppose also that the major policy decisions are entrusted to this *homogeneous* group.

Let's call this group "the Nation-State".

Viewed from the Nation-State, EU is a strange animal.

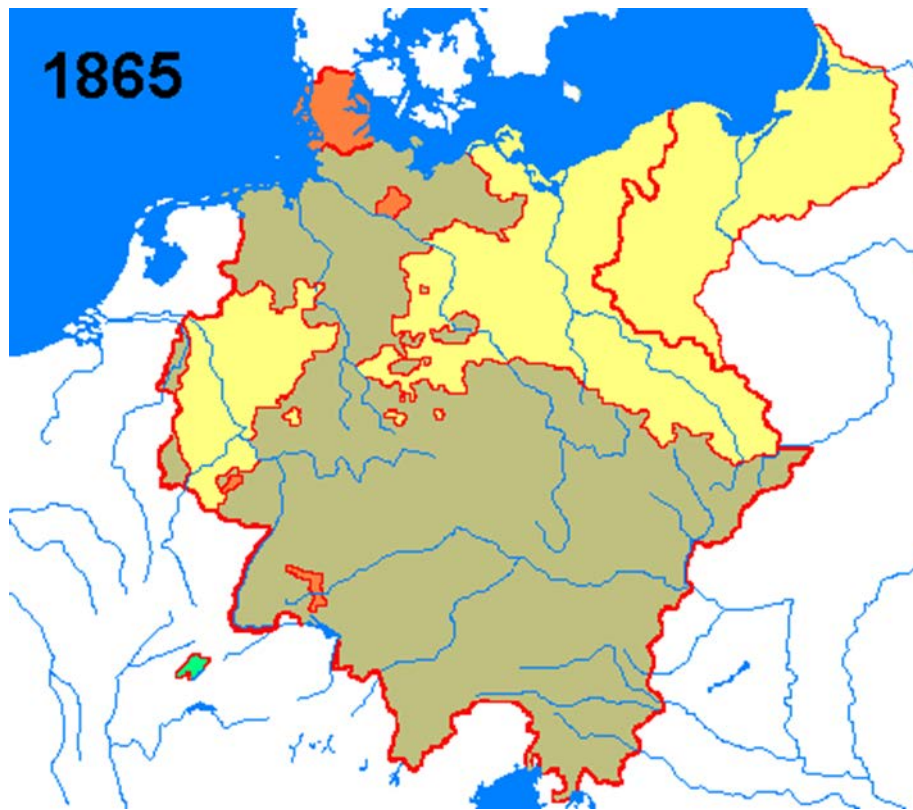
It is so because the important prerogatives of the Nation State, such as Rule Making (and Monetary Policy in the case of Euro) were entrusted to the Super-Structure, a foreign body from the standpoint of a Nation State, standing above the Nation-States. The Populists political parties, most of which are also Nationalist, are currently attacking this foreign body standing above their Nation-State.

That said, the limitation of the prerogatives of the Nation State (the supposedly ethnically and linguistically homogenous group) is not new in Europe at all. Indeed, such limitations are the history of European Integration itself!

The history dates back, at least, to the system created by the Conference of Vienna in 1814-1815—the so called Metternich system.

This arrangement was based on the rigorous application of balance of power concept, which explicitly precluded unification of Germany based on the ethnical and linguistic homogeneity, for the simple reason that a unified Germany will pose an insurmountable security challenge to the European stability.

This idea is clearly reflected in the German geography around 1865, especially unnatural territory arrangement of Prussia.



(Yellow is Prussia and gray is the German Confederation)

The idea was prescient because after the German unification in 1871, two tragic great wars ensued.

Thus, after WWII Europe started the initiative of creating a Super-Structure standing above the Nation-States.

Conveniently enough, Germany was divided in two parts, at first, so that the EU political leaders needed not worry about a dominant country problem.

The reunification of Germany (1990) was, therefore, a great challenge to the European Stability and the EU reacted with the Maastricht treaty (1992) and the creation of Euro (1999).

*Summing up:*

Although the democratic deficit problem as well as the dominant player (Germany) problem may continue to haunt EU, this institutional arrangement and, especially, the EU's ability to produce rules applicable to diverse and heterogeneous members have a great relevance in meeting the challenges of the modern world.

Consider these challenges: *Digital Technology, China, Trump, and the global climatic change.*

One country solution will be ineffective for any of these!

On the other hand, the rules which were initiated by EU are already transforming the global business landscape.

Thus GDPR (General Data Protection Rule) is affecting the digital industry globally.

The strengthening of the CO2 emission regulation is changing the landscape of the global automobile industry.

Now that the trade war, which was unilaterally initiated by US, has produced only limited positive results vis a vis China, a rule based approach carried out multilaterally will be required to deal with the China's state subsidy problems.

Currently, Asia does not have a Super-Structure comparable to EU: I want to ask the Japanese audience today: *How would you characterize the current relationship among Japan, China and Korea?*

One final word: There is an excellent recent book by Thomas Philippon, the Great Reversal.

His conclusion is that EU, which abhor the idea of an industry dominated by a single firm, enforced Anti-Trust law more vigorously than the US.

In fact, competition policy became a key component of the EU policies.

As a result, the EU market is today much more competitive than the US.

I was so impressed by the book that I asked my friend at the Cabinet Ministry to insert the Japanese data in some diagrams of his book.

Take these as souvenir.

Thank you!

Fig.6.2 Profit margins in the US, EU and Japan

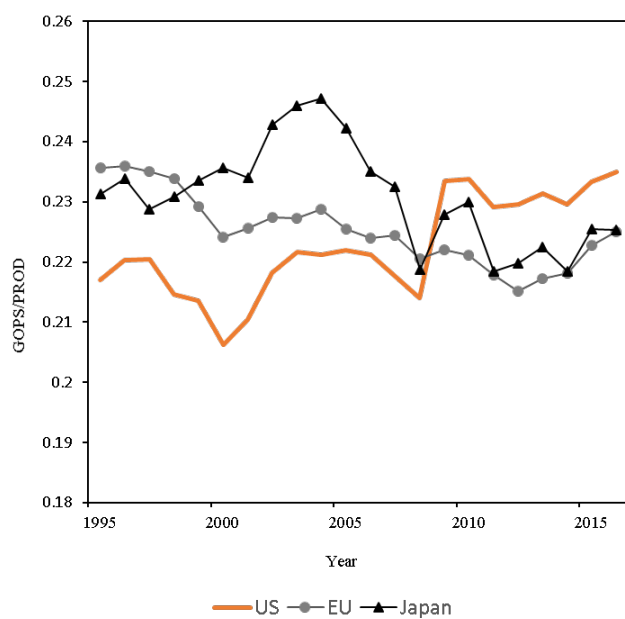


Fig.6.5 Labor shares

