



## Covalization: Europe on the Rack Between Globalization and Covid

### A Historian's Perspective on the European Union: Europe and Globalization

By Harold James  
Princeton University

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The European Union is often thought of as a manifestation of the phenomenon of globalization (understood as the mobility of capital, goods, people, but also as a demonstration of the limits of the nation-state). Populist critics often simply lump the European Union and globalization together as eroders of national sovereignty; while defenders of the integration project emphasize the way in which the EU can harness or tame globalization, and Europe's population from its wildest and most dangerous excesses. At a moment when the corona virus is thrusting globalization into reverse, the EU might be particularly vulnerable.

Globalization has often been strained. We can trace this history of questioning globalization in phases:

- In the 1930s, there was a complete collapse of globalization with the Great Depression (what I termed "The End of Globalization" in a 2001 book).<sup>1</sup>
- In the 1970s, oil price shocks, the perception that the geography of power in the world was shifting, and inflationary pressures led to a discussion of a New International Economic Order.

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<sup>1</sup> Harold James, *The End of Globalization: Lessons from the Great Depression*, Cambridge Mass.: Harvard University Press, 2001.

- In the 1990s, in the wake of the collapse of communism in central Europe, and with very large capital flows threatening financial and economic stability, the question of global governance in a post-Cold War world gave rise to fantasies of an “end of history,” the overcoming of all traditional divisions and hostilities.<sup>2</sup>
- In the 2010s, the aftermath of the global financial crisis prompted a wave of populism, and a backlash against mobility of labor and capital.

At the beginning of the postwar era, Europe needed to be rethought and remade in the wake of the political, economic, social, and moral catastrophes of the 1930s and 1940s. The European Economic Community provided a specific way of insuring against a repetition of the 1930s. Trade integration would prevent a repetition of trade wars and beggar-thy-neighbor policies. The spending activities of the EEC were also in line with the political priority of preventing a repetition of interwar failures. In particular, the large farming populations had been hit by the crisis of interwar globalization, the drying up of bank credit, and the collapse of raw material and food prices. Farmers, mostly as a result of economic misfortune, moved to support the radical anti-system parties, including the Italian fascist party, the French fascist leagues, and National Socialism in Germany. From the 1960s, the Common Agricultural Policy was designed as a mechanism for protecting farmers from price collapses, and more generally of managing the gradual decline of agricultural activity without provoking the radical populist backlash of the interwar years.

There was an explicit learning from the past, that still seems relevant. Pius XII spoke to a meeting of European federalists in his palace at Castegandolfo in November 1948: “There is one danger which cannot be overstated: the abuse of postwar political superiority in order to eliminate economic competition. Nothing could better succeed in irreparably poisoning the work of rapprochement and mutual understanding. The great nations of the continent, with their long histories filled with memories of glory and power, can also thwart the

constitution of a European union, exposed as they are to the temptation of measuring themselves on the scale of their own past rather than on that constituted by the realities of the present and predictions of the future. This is precisely why we should expect them to disregard their greatness of yesteryear in order to align themselves with a higher political and economic unity. They will do it all the more willingly because they will not be forced, for the exaggerated concern of uniformity, to a forced leveling, while the respect for the cultural characters of each of the peoples would cause, by their harmonious variety, an easier and more stable union.”<sup>3</sup> It is striking that there is some ambivalence: does the phrase about “the abuse of postwar political superiority” apply primarily to the Soviet Union, which was extending its grip over central Europe, and was frequently a target of heavy criticism by the Pope, or also to the United States, in whose image a great deal of west European politics was being reconstituted? Or to the war-ravaged countries of Europe as well?

The early phase of European integration gave rise to a peculiarly self-confident doctrine: that Europe would always learn from crises. So it did not matter if the European construction was half complete, jerry-built. Political scientists sometimes describe this approach to institution building as “failing forward,” in imitation of a self-help psychology book of John C. Maxwell. Jean Monnet formulated this view in the often cited formula that Europe is driven by crises. In his *Memoirs*, he provides an eloquent account of the characteristic frenetic all night discussions to establish the European Coal and Steel Community, the antecedent of the European Economic Community and hence of the European Union. As he left the French Foreign Ministry on the Quai d’Orsay, the sun was rising, and he spoke to a French official:

“Now we have a few hours to test and a few months to succeed.

After that - ”

‘After that,’ said Fontaine, smiling, ‘we shall face great difficulties, and we shall use them to make further progress.

<sup>2</sup> Francis Fukuyama, *The End of History and the Last Man*, New York: Simon and Schuster, 1992.

<sup>3</sup> [Allocution de S.S. Pie XII aux congressistes de l’Union Européenne des Fédéralistes](#) (Castelgandolfo, 11 novembre 1948).

That's it, isn't it?"

'It is indeed,' I said. 'You've understood what Europe is all about.'"<sup>4</sup>

There is always a possibility of failing to resolve a crisis. In the 1940 film of Géza von Bolváry, *Wiener G'schichten*, there is a running gag in which the waiter in a Vienna coffeehouse repeatedly stumbles with a heavily laden tray and almost lets them fall, but recovers at the last moment: but at the end he crashes, and the glasses all break. There is also a broader problem: this method is not very appealing to people outside the limited circle who enjoy the logic of late night discussions sustained by cold Belgian sandwiches – the *demos* neither likes or understands the process. Vaclav Havel castigated “the erroneous belief that the great European task before us is a purely technical, a purely administrative, or a purely systemic matter, and that all we need to do is come up with ingenious structures, new institutions, and new legal norms and regulations.”<sup>5</sup>

There is a need for a countervailing motivation, emphasizing fundamental values rather than a technocratic fix, but Europeans find this very hard to think or speak about this. They – like the population of the US – are deeply polarized, with very large differences of vision and outlook. Speaking at the shrine of Santiago di Compostela, John Paul II urged: “Do not become discouraged for the quantitative loss of some of your greatness in the world or for the social and cultural crises which affect you today. You can still be the guiding light of civilization and the stimulus of progress for the world. The other continents look to you and also hope to receive from you the same reply which James gave to Christ: ‘I can do it.’”<sup>6</sup>

In the 1970s and 1980s, there was a widespread sense that European integration had lost momentum and credibility. The initial euphoria of the 1950s faded. But there was a new crisis of globalization, driven by the oil shocks and the monetary instability of the 1970s, and by the belief that the US dollar had lost its role as the central anchor of global monetary

stability. When the dollar was soaring from 1981 to 1985, when American manufacturing was threatened and when there appeared to be the possibility of a protectionist backlash, the finance ministers of the major industrial countries pushed for exchange rate agreement. The G-7 finance ministers Louvre meeting in 1987 agreed to lock exchange rates into a system of target zones. In practice, nothing came of that global plan, but then Edouard Balladur, the French finance minister who had largely been responsible for the Louvre proposal, came up with a tighter European scheme. When German foreign minister Hans Dietrich Genscher appeared sympathetic, Europe's central bankers were asked by the president of the European Commission, Jacques Delors, to prepare a timetable and a plan for currency union.<sup>7</sup>

In the 1990s, a new source of crisis appeared. Would the collapse of the Soviet Empire generate geopolitical instability? Just as in the 1950s, the EEC had been a way of consolidating democracy in states such as France, Germany, and Italy, which had all had their recent experiences with failed democracy and dictatorship; and just as in the 1980s the European Community had been seen as a way of building a solid democratic order in Greece and then Spain and Portugal, all also emerging from the legacy of authoritarianism and dictatorship, the EU looked like an answer to the aspiration of former communist countries to become European and democratic. Poland's Lech Walesa and Czechoslovakia's Vaclav Havel heralded their country's “return to Europe.” The problem was, however, that the big west European countries had no possible plans for a bold vision – say a military or security union – and that in consequence the only ready-made or shovel-ready project in Europe's conceptual drawer was ... monetary union.

The 2008 Global Financial Crisis generated a new European uncertainty. The initial response was complacency: after all the crisis seemed to demonstrate the weakness of the American, not the European, model. German Finance Minister Peer Steinbrück called the financial collapse “above all an

<sup>4</sup> Jean Monnet (transl. Richard Mayne), *Memoirs*, London: Collins, 1978, p. 371.

<sup>5</sup> Vaclav Havel, “How Europe Could Fail,” *New York Review of Books*, November 18, 1993.

<sup>6</sup> John Paul II, Declaration to Europe in Santiago de Compostela, November 9, 1982.

<sup>7</sup> See Harold James, *Making the European Monetary Union*, Cambridge Mass.: Harvard University Press, 2012.

American problem.”<sup>8</sup> Then the economic downturn seemed to indicate all the vulnerabilities created by globalization: vulnerability to trade, in that many European areas affected by the “China shock” turned to populism; vulnerability to capital movements, as the sudden stop of flows to eastern and southern Europe created a financing gap; and vulnerability to flows of people. The latter, always a latent fear of Europeans, erupted after the 2015 refugee crisis.

What is the European response to such challenges? Angela Merkel is good for surprises. Her long Chancellorship has been marked by dramatic changes of policy orientation: in 2010, in bringing the IMF into a rescue plan for Greece that she presented as “without alternative,” in 2011, in taking German out of atomic energy production after the Fukushima disaster, in 2015, in accepting Syrian refugees moving into Germany, and in 2020, in agreeing to the new joint €500 billion rescue mechanism after the corona crisis. Each produced a howl of outrage from Germans worried about the costs of integration, and from Europeans frightened about German leadership in Europe. Each time the Chancellor insisted there is no alternative.

The latest step is by far the boldest. “The nation state on its own has no future,” she said in a joint video press conference with Emmanuel Macron on May 18, 2020.<sup>9</sup> Many Germans are now debating whether they are at a “Hamiltonian moment,” equivalent to the key constitutional move when Treasury Secretary Alexander Hamilton worked out a passage for the federal government to “assume” the debts of states from the war of independence. During the long drawn out European debt crisis, American economists and policy-makers repeatedly urged Europeans to learn from Hamilton: now the moment seemed to have come.

Integration follows from an emergency, but it is wrong to think that just any crisis produces a new moment of integration. There have been plenty of challenges and crises to Europe over the past twelve years: they come thick and fast. European federalists first hoped that the Euro crisis would work that way; but debt meant a larger divide between northern Europe and a southern European periphery. Then Putin and the attack on Crimea and eastern Ukraine?

But Russia skillfully drew more and more members of the EU into its orbit. Then Brexit, or Trump? But by that time the refugee crisis had prompted new lines of division, between eastern and western Europe.

So far the key historical conditions for a bold move to end Europe’s attachment to the nation-state have been missing. Why should covid-19 do what Putin, Trump, Brexit and debt could not do? There are two reasons: one is concerned the world, the other with political competence and effectiveness.

The pandemic demonstrates more clearly than the other crises the dilemmas of globalization. Macron at the press conference began with the statement that the “virus is global”. But that does not mean that every bit of globalization has to be reversed, or that it even can be. Effective combatting of the virus requires global cooperation.

Second, the corona virus is by itself not a catastrophe on the level of many previous episodes of pandemic mortality, but the economic fallout is terrifyingly dramatic. Fighting both the virus and the economic shutdown is a task that requires highly competent governments.

Mortality data and rates of infection are already being politicized in order to score points about relative competence. The comparisons occur between countries, but also between regions. Why is the devastation worse in the United States, the United Kingdom, Brazil? It is an easy exercise to connect the dots between incompetent, ideological and uncoordinated government responses and poor health outcomes.

Neither Merkel nor Macron is really good at doing political emotion, but both – and especially Merkel – pride themselves on being skillful managers, who make evidence-based decisions. The covid crisis demonstrates terrifyingly that the nation state cannot do many things. Many effective interventions have to be local, and not national; but many others depend on the international provision of public goods.

This lesson about “necessary responses” is especially poignant in the case of Germany. Like Italy, it was a creation of nineteenth century nationalism. Before

<sup>8</sup> <https://www.spiegel.de/wirtschaft/finanzkrise-steinbrueck-wirft-usa-massives-versagen-vor-a-580331.html>, September 25, 2008.

<sup>9</sup> <https://www.bundeskanzlerin.de/bkin-de/aktuelles/pressekonferenz-von-bundeskanzlerin-merkel-und-dem-franzoesischen-praesidenten-emmanuel-macron-1753844>

Otto von Bismarck (and his Italian equivalent, Camillo Cavour), there were multiple small states, which were quite beautiful in giving a sense of local identity. But they were not good at responding to the technical and economic challenges of the world of increased globalization, where markets were quickly developing as communications and transport became cheaper. One leading commentator, the liberal journalist who invented the term *Realpolitik*, Ludwig August von Rochau, concluded that nation-state was “nothing more or less than a simple business transaction [*eine reine Geschäftssache*], in which no one wants to lose, but everyone wants to extract as much as possible for themselves.”<sup>10</sup>

It was in that spirit of simplifying state structures to make them more effective that the national project was driven forwards. It is even possible to think of some kind of law of history: before the Treaties of Westphalia in 1648 there were between three and four thousand independent territorial units, subject only to a loose imperial jurisdiction. By the eighteenth century there were three or four hundred. After 1815, there were only members of the German Confederation. By the end of the nineteenth century, there were just three countries that had a large number of German speakers, the German Empire, the Austro-Hungarian Empire, and the Swiss Confederation. An arithmetically focused historian might conclude that the number of states in central Europe fell every century or so by a factor of ten.

Does that mean that soon there will only be 0.3 states in central Europe, because of a process of federation? History does not move that simply, in neat arithmetic lines. But it is clear that old-style nation-states are having to rethink where, and how, they stand in the world.

The ruling of the German constitutional court on May 5, 2020, apparently setting a limit to the participation of the German central bank in the ECB’s bond buying programs was the final push to the new integration. Far from stopping a process of Europeanizing crisis responses, however, the ruling called for a legal and political backing for a new orientation. In fact, no country has in its constitution as much emphasis on Europe as does Germany. The 1949 Basic Law (the equivalent of a constitution) for a Federal Republic that was then part of a divided country explains that the German people is “inspired” by “determination to

promote world peace as an equal partner in a united Europe.” And reference to European unification occurs in other substantive parts of the constitution: Article 24 specifically refers to the abdication of sovereign rights for the sake of “a peaceful and permanent order” in Europe.

It is worth thinking more precisely about what makes the covid-19 challenge so unique, why the challenge is not a simple repetition of the Global Financial Crisis, and why the uncertainties it has created about the globalization process are so peculiar. The consequence of covid-19 has been a simultaneous shock to demand and output, as governments imposed lockdowns. Governments responded with stimulus measures, as well as targeted spending on health equipment and research, at a time when the reduction in economic activity drastically cut tax revenue. The result has been the sharpest ever increase in fiscal deficits outside wartime. Monetary authorities all over the world, including the ECB, responded with accommodative measures. A European peculiarity has been the extent of the support given through loans and guarantees to businesses hit by the lockdowns. The total volume of the German guarantees amounts to at least €757 billion (23 percent of GDP), that in Italy to €400 billion (25 percent of GDP), and in France there are bank loan guarantees and credit reinsurance schemes of €315 billion (close to 14 percent of GDP).

There are two major uncertainties. The first concerns the timing and speed of recovery. Even if there is a successful combination of vaccination and antiviral treatment, it is unlikely that some areas of activity will recover for a long time. Some of the crisis-era shifts are likely to be longer term: for instance, the move to remote office working and internet conferencing. Cruise ships, tourism, restaurants and hospitality, trade fair and conference business are all likely to take a longer term hit. Fashion and clothing may suffer with fewer opportunities either to socialize or meet in offices. Universities and hospitals have seen their business model shaken. If the longer term alterations materialize, it is likely that a very large proportion of the loans will never be repaid, leaving a substantial fiscal burden. High levels of unemployment are also likely to remain, with pressure for more permanent support mechanisms once the very widespread (and successful) short term support (*Kurzarbeit*) expire.

<sup>10</sup> August Ludwig von Rochau, *Grundsätze der Realpolitik*, Vol. 2, Stuttgart: Göpel, 1869, pp. 26-27.

The second uncertainty concerns the monetary consequences of the new environment. The ECB has embarked on a wide range of asset purchases, collateral easing, as well as the new low-interest liquidity facility (Pandemic Emergency Longer-Term Refinancing Operations, PELTRO); other central banks are taking similar measures, and the Bank of England is reflecting on negative interest rates. Since February 2020, in every industrial country broader monetary aggregates are rising.

Measuring the effects in terms of inflationary/deflationary impact is extremely hard at the outset. The collapse of demand has unsurprisingly led to major price falls for a range of consumer goods, including textiles and automobiles. Petroleum prices fell by record amounts (with negative prices for forward contracts because of the shortage of storage facilities). On the other hand, the collapse of supply chains and a politically driven reversal of globalization is likely to make many goods more expensive, including many food products. Consumers are accumulating large cash balances, that one day will be spent. Europeans are historically highly sensitive to inflation, and many see inflation as a process that destroys democracy (as it encourages groups to organize and fight for their interests).

There is likely to be a rapid increase in “felt inflation,” in that trips to the supermarket are already becoming much more expensive. Asset prices already look as if they are being driven by a monetary overhang, as the initial post-covid losses are reversed. For at least a few months, or even a few years, however, the tug of war between inflation and deflation may be unresolved, and policy uncertainty will prevail.

If and when the inflationary scenario materializes, there will be a rapid move away from fixed yield instruments, and government financing will become much more expensive. That outcome would see a return to the Euro debt crisis of the early 2010s. The environment surrounding the EU is likely also to be more unstable, as a return to inflation fears is likely to occur earlier and faster there.

If this scenario is realistic, it changes the policy incentives, and creates in particular a great attractiveness to fund as much debt as possible quickly, including very long term maturities, or even as suggested by Francesco Giovazzi and Guido Tabellini and by George Soros non-maturing permanent debt, modelled on the very successful British “consols” launched in the eighteenth century.<sup>11</sup> Such instruments can however only be issued by very secure borrowers. An enormous amount of constitutional design was required for the framework for eighteenth century British public finance.

If there is any doubt as to the credibility, such long term bonds would not be likely to find much of a market. The ECB without an adequate long term fiscal arrangement would simply look like a version of the post-World War I German central bank, desperately selling loans at grotesquely negative real interest rates, and mopping them through monetary expansion. Already it is clear that small European countries, or emerging markets, will not be able to access this type of instrument.

The consol proposal thus depends on a very radical move to debt mutualization in Europe, a move much more radical than the limited €500 billion ESM facilities recently set out by Chancellor Merkel and President Macron. Already that proposal has provoked a pushback. There is perhaps no political appetite for a broader scheme, which would have to be implemented very quickly, with all the constitutional mechanisms of eighteenth century Britain to ensure that debt is serviced and taxes collected.

If the moment of opportunity is brief, Europe may well be about to give up a very substantial free lunch. This will be the great last chance, the moment when retrospectively historians conclude that Europe was lost – or saved. As advertisers like to say, this is an offer that cannot and will not be repeated. In the nineteenth century, nation-states were created out of blood and iron. Now something new is emerging as a necessary medicine for a political fever. ■

<sup>11</sup> Francesco Giovazzi and Guido Tabellini, Covid Perpetual Eurobonds: Jointly Guaranteed and Supported by the ECB. VoxEU, 24 March 2020; <https://www.project-syndicate.org/commentary/perpetual-bonds-are-essential-to-european-union-survival-by-george-soros-2020-05>.

## About the author

**Harold James**, the Claude and Lore Kelly Professor in European Studies at Princeton University, is Professor of History and International Affairs at the Woodrow Wilson School. His books include a study of the interwar depression in Germany, *The German Slump* (1986); an analysis of the changing character of national identity in Germany, *A German Identity 1770-1990* (1989); *International Monetary Cooperation Since Bretton Woods* (1996), and *The End of Globalization* (2001), which is available in 8 languages. He was also coauthor of a history of *Deutsche Bank* (1995), which won the Financial Times Global Business Book Award in 1996, and he wrote *The Deutsche Bank and the Nazi Economic War Against the Jews* (2001). His most recent books include *Family Capitalism*, Harvard University Press, 2006; *The Creation and Destruction of Value: The Globalization Cycle*, Harvard University Press, 2009; *Making the European Monetary Union*, Harvard University Press, 2012; *The Euro and the Battle of Economic Ideas* (with Markus K. Brunnermeier and Jean-Pierre Landau), Princeton University Press, 2016; *Making A Modern Central Bank: The Bank of England 1979-2003*, Cambridge University Press 2020. He is the official historian of the International Monetary Fund. In 2004 he was awarded the Helmut Schmidt Prize for Economic History, and in 2005 the Ludwig Erhard Prize for writing about economics.

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c/o OeNB  
Otto-Wagner-Platz 3  
A-1090 Vienna, Austria  
Phone: +43-1-40420-7206  
www.suerf.org • suerf@oenb.at