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France's Broken Dream
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By MARTIN FELDSTEIN

CAMBRIDGE – The crisis in the eurozone is the result of France's persistent pursuit of the "European project," the goal of political unification that began after World War II when two leading French politicians, Jean Monnet and Robert Schuman, proposed the creation of a United States of Europe.

Monnet and Schuman argued that a political union similar to America's would prevent the types of conflict that had caused three major European wars – an appealing idea, but one that overlooked America's horrific Civil War. A European political union could also make Europe a power comparable to the United States, and thereby give France, with its sophisticated foreign service, an important role in European and world affairs.

The Monnet-Schuman dream led to the 1956 Treaty of Rome, which established a small free-trade area that was later expanded to form the European Economic Community. Establishing the EEC had favorable economic effects, but, like the North American Free Trade Area, it did not reduce national identification or create a sense of political unity.

That was the purpose of the 1992 Maastricht Treaty, which established the European Union. The influential report "One market, one money," issued in 1990 under the leadership of the former French Finance Minister Jacques Delors, called for the creation of a single currency, relying on the specious argument that the single market could not function well otherwise. More realistically, advocates of a single currency reasoned that it would cause people to identify as Europeans, and that the shift to a single European Central Bank would herald a shift of power away from national governments.

Germany resisted the euro, arguing that full political union should come first. Since there was no chance that the other countries would accept political union, Germany's position seemed like a technical maneuver to prevent the establishment of the single currency. Germany was reluctant to give up the Deutsche Mark, a symbol of its economic power and commitment to price stability. Germany eventually agreed to the creation of the euro only when French President François Mitterrand made it a condition of France's support for German reunification.

Moreover, under pressure from France, the Maastricht Treaty's requirement that countries could introduce the euro only if their national debt was less than 60% of GDP was relaxed in order to admit countries that were seen to be "evolving" toward that goal. That modification allowed Greece, Spain, and Italy to be admitted.

The pro-euro politicians ignored economists' warnings that imposing a single currency on a dozen heterogeneous countries was bound to create serious economic problems. They regarded the economic risks as unimportant relative to their agenda of political unification.

But the creation of the euro caused a sharp fall in interest rates in the peripheral countries, leading to debt-financed housing bubbles and encouraging their governments to borrow to finance increased government spending. Amazingly, global financial markets ignored the credit risks of this sovereign debt, requiring only very small differences between interest rates on German bonds and those of Greece and other peripheral countries.

That ended in 2010, after Greece admitted that it had lied about its budget deficits and debt. Financial markets responded by demanding much higher rates on the bonds of countries with high government debt ratios and banking systems weakened by excessive mortgage debt.

Three small countries (Greece, Ireland, and Portugal) have been forced to accept help from the International Monetary Fund, and to enact painful contractionary fiscal cuts. The conditions in Greece are now hopeless, and are likely to lead to further defaults and a withdrawal from the eurozone. Spain, too, is in serious trouble, owing to the budget deficits of its traditionally independent regional governments, the weakness of its banks, and its need to roll over large sovereign-debt balances each year.

It is already clear that the EU's recently agreed "fiscal compact" will not constrain budget deficits or reduce national debts. Spain was the first to insist that it could not meet the conditions to which it had just agreed, and other countries will soon follow. French President François Hollande has proposed balancing deficit limits with growth initiatives, just as France had earlier forced the EU's Stability Pact to become the Stability and Growth Pact. The fiscal compact is an empty gesture that may be the last attempt to pretend that EU members are moving toward political unification.

The European project has clearly failed to achieve what French political leaders have wanted from the beginning. Instead of the amity and sense of purpose of which Monnet and Schuman dreamed, there is conflict and disarray. Europe's international role is shrinking, with the old G-5 having evolved into the G-20. And, with German Chancellor Angela Merkel setting conditions for the eurozone, France's ambition to dominate European policy has been thwarted.

Even if most eurozone countries retain the single currency, it will be because abandoning the euro would be financially painful. Now that its weaknesses are clear, the euro will remain a source of trouble rather than a path to political power

Martin Feldstein, Professor of Economics at Harvard, was Chairman of President Ronald Reagan's Council of Economic Advisers and is former President of the National Bureau for Economic Research.
