

20th Century European Policy Making

This document is based on my notes from a lecture entitled “20th Century European Policy Making” which I delivered at the IES Europe seminar in Leuven, Belgium in July 2007.

For the purposes of this lecture I have divided the period into four periods. The periods are these:

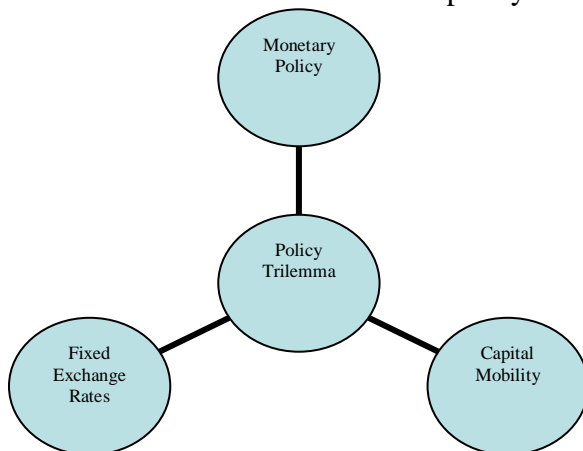
<u>Period</u>	<u>Important Issues of the Period</u>
Pre WWI	Gold Standard
Interwar Period	Depression
WWII	Government Controlled Economy
Post WWII	Welfare State EU and its Predecessors

Period 1 – Gold Standard Period

Before the outbreak of WWI most European countries had fixed their currencies to the price of gold. This means that central banks gave up their ability to independently set monetary policy. In exchange for the ability to set monetary policy central banks took the benefits of free capital mobility and fixed exchange rates.

Policy Trilemma:

Countries and central banks generally seek three policy objectives. They are only able to achieve two of these three. This is called the policy trilemma. The three objectives are below:



Dates that countries joined the gold standard:

1821 Britain

1871 Germany

1873 Belgium, Italy, Switzerland, France, USA

1875 Denmark, Norway, Sweden, Netherlands

By 1900 these countries had joined: Spain, Austria, Russia, Japan, and India

Countries which had joined the gold standard benefited from stability and the trust of other countries. Bordo and Rockoff called this the “good housekeeping seal of approval.”

Weaknesses of the system included that only a few affluent voters determined policy and thus as prices increased, the “common man’s” purchasing power decreased. This period saw general stability (1870-1914) and financial flows to the new world where money sought higher returns.

WWI & WWII

This period was one of tremendous change and experimentation. I have not focused on the policies of this period but rather its impact on the subsequent periods. Of course the depression occurred between the wars and there was great government intervention in this period.

Two major economic thinkers were both in England between the wars. John Maynard Keynes (Cambridge) advised the British government off and on throughout the period. When he left the negotiations of the peace after WWI, he wrote the book, “Consequences of the Peace” which foretold the ruin of the German economy. Keynes is considered the father of macroeconomics and advocated government management of the economy. During the raids of London, Keynes housed Friedrich von Hayek (London School of Economics) at Cambridge. They were intellectual rivals. Hayek emerged later in the century as a leading economic thinker. He advocated free markets and minimal government management of the economy.

World War II devastated the economies of most of Europe. Life, family structures, industry and infrastructure were all changed or demolished by the end of the war. Caloric intake by residents of most countries decreased to around 15% in the worst affected countries (i.e. Germany).

The countries of Europe followed a policy of “taking care of their citizens” after the war which enforced the notion of the nation state and preferred the “common man.”

Post WWII Rise of the Welfare State

This section focuses on welfare policy and integration. The welfare systems which were put in place were geographically distinct because of their different situations and goals. The three welfare models which I will mention are not the only ones. They are the Scandinavian, British and Continental models. These are briefly discussed below.

Scandinavian Model – the goal of this system is to equalize citizen’s welfare regardless of employment or family conditions. The policy is pursued by providing “basic security” and “income security.” Basic security is satisfied through many in-kind services such as childcare. Income for unemployed workers is replaced by the state at 90-100% of previous levels. These countries support this system by keeping employment low through excluding foreign workers and keeping women in the workforce.

British Model – This model originated when private clubs provided insurance for their members. These clubs were taken over by the state. After WWII the government sought to fight the “evils” of want, disease, ignorance, squalor, and idleness. Few in-kind transfers are used. 40% of this system is funded through employee and employer taxes and the rest is funded by general taxation.

Continental Model – Very few in kind transfers are used. Child care is provided but at much lower levels than Scandinavian countries. (DE 2%, IT 5%, FR3.7%) Benefits are tied to employment and they usually go to families rather than individuals. This decreases the incentives for women to enter the workforce.

Integration – Two aspects of European integration will be discussed herein. The European Coal and Steel Community and the Common Agricultural Policy will be shortly discussed.

ECSC – The European Payments Union (1950) brought governments to the realization that they needed a regular flow of income. To accomplish this, the governments sought to stabilize and solidify business in their respective countries. This stabilization was done to the detriment of market operations. France needed coal and export partners for steel. West Germany had restrictions on steel production and wanted to re-establish its reputation. Belgium employed 12% of its workforce in the coal industry and wanted to ensure that those jobs were secure. These are three of the six countries which joined the ECSC.

Each country’s policy makers satisfied its goals by joining the ECSC. France was able to monitor Germany’s production, Germany was able to increase production and regain some integration into European trade, and Belgium was able to sell coal at above market prices and thus sustain its welfare and employment levels.

Therefore, these countries all entered for self-motivated reasons. The common market (1957) was based on the success of the ECSC and can therefore be seen as one of the triggers for the integration of Europe which lead to the development of the EU to present.

CAP – the common agricultural policy was similarly entered into for political reasons to the neglect of the market. In the 1950s most governments needed farmer’s electoral support. France’s electorate was composed in 25% by farmers and their dependents. In the face of increased international competition, the CAP protected producers in Europe from decreasing prices and kept European consumers buying agricultural goods at above market prices. Nevertheless, this policy was put in place by governments in their self interest as a result of their “democratic” processes.

1973 – Now

The period from 1973 to now is not dealt with in this lecture other than to point out some critical events. Privatization schemes were undertaken by several governments to varying degrees. In Britain this was done under Margaret Thatcher (informed by Friedrich Von Hayek and his book “the road to serfdom”). Britain’s privatization included 48 large businesses and many smaller

ones. Perhaps more importantly her policies “broke” the power of the unions which allowed more market activity in labor and commerce. In France Jacques Chirac came into power in 1986 with big plans for privatization but stopped in 1988.

Other major events which occurred were the reintroduction of more normal relations between eastern and western Europe after 1989 and the fall of the USSR. In 1999 the Euro was launched as a currency in many western European countries.

Summary:

These periods are very distinct in their ways. The path for the future is yet unclear but integration seems to be continuing. Some cracks are surfacing in the integration movement as countries opt out of different policies and schemes and encounter domestic resistance. Tax competition also appears to be coming to the EU.

Recommended Reading

A. S. Milward's The European Rescue of the Nation State and The Frontier of National Sovereignty: History and Theory 1945-1992

Krueger, A. O. (1998) Why Trade Liberalization is Good for Growth, Economic Journal 108

The Commanding Heights by Yergin and Stanislaw
<http://www.pbs.org/wgbh/commandingheights/>