Historicizing the Unique:
Why the EMU Has No Fiscal Authority and Why it Matters

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ABSTRACT

Why does EMU not have a consolidated fiscal authority at the European level? Does it matter? This paper answers these questions through an examination of the history of single currencies, specifically the nineteenth century US case. The euro is historically unique, in that it has occurred without the usual deep political integration and statebuilding of which a single currency is only one part. Single currencies have most commonly been created in times of war, as a way to consolidate the fiscal power of the state rather than as a purely monetary exercise. Currencies have generally been introduced by political actors who need to federalize the raising of revenues and payments necessary for warfighting. The European Union’s historically unique brand of political development, a peace-time, voluntary one that leaves the prior form of political organization (the nation-state) intact, has not created the political conditions necessary to move to a robust fiscal authority at the European level. Whether the current eurozone debt crisis will provoke the political will and coalitional support to create fiscal federalism at the EU remains an open question. Nonetheless, evaluating the political economy of the euro through the lens of history, with the help of theories of comparative political development, can take us a long way in understanding the currency crisis and its potential for resolution.
INTRODUCTION

Why does Europe’s monetary union lack a consolidated fiscal authority at the European level? Does it matter? High levels of sovereign debt have brought on many months of attacks on the national bond markets of the EU’s Economic and Monetary Union (EMU). As the political and economic costs of the crisis keep mounting, the casual observer would be forgiven for thinking we are watching no less than the implosion of the entire European project. While the global financial meltdown has played a role, most experts agree that the basic institutional set up of EMU, namely the lack of fiscal authority and true economic governance at the EU level, has severely worsened the crisis. This paper addresses the question of why EMU looks and acts like it does, through an examination of the history of single currencies, specifically the nineteenth century US case.

The key takeaway from this analysis is the following: the euro is historically unique because it has occurred without the usual deep political integration and statebuilding of which the creation of a single currency forms only one part. Single currencies have most commonly come about in times of war, as a way to consolidate the fiscal power of the state, rather than coming into being as a purely monetary exercise, as was the case in the EU. Currencies have generally been introduced by political actors who need to federalize the raising of revenues, borrowing and the many payments necessary for warfighting. The European Union’s historically unique brand of political development, a peace-time, voluntary one that leaves the prior political form (the nation-state) intact, has not created the political conditions necessary to move to a robust fiscal authority at the European level. Whether the current eurozone debt crisis will provoke the political will and coalitional support to create fiscal federalism at the EU remains an open question. Nonetheless, evaluating the political economy of the euro through the lens of history, with the help of theories of comparative political development, can take us a long way in understanding the currency crisis and its potential for resolution. More generally, scholars of political economy should not forget the usefulness of historical comparison despite the attractions of the more microeconomically oriented work.

The rest of this essay explores these ideas as follows. I first briefly discuss the current crisis in the eurozone, and outline the theoretical contention that political dynamics are critical for understanding the workings of any financial system. I then turn to the comparative political development approach, and generate from this literature a preliminary template for understanding the links between currency and statebuilding. I offer a brief history of the drive towards a single currency in the US, highlighting the role of war and market integration, and demonstrating the importance of linkages between currency and fiscal policy capacity in transforming political authority. I apply the analytical lessons learned from the theory and the historical case to the contemporary situation of the Euro, and conclude.

THE EUROZONE IN CRISIS
When the European Union’s Economic and Monetary Union (EMU) began in 1999, it was a bold step forward for European integration. Melding the currencies of the core countries of the EU together fulfilled a long dream of early founders and advocates of the European Union, who saw a single currency as a critical milestone in the political integration of Europe. The hope was that if the countries of the EU pooled their sovereignty into one single monetary authority, the European Central Bank, and one single currency, the euro, these functional ties would tightly bind the formally factitious and warring states of Europe together once and for all (Sandholtz 1993, Jabko 1999, McNamara 1998). Although these political ends were the most important motivator, the hope was also that a single currency would promote more internal trade and investment in Europe’s single market (Emerson and Gros 1992).

As EMU neared its first decade of existence, it seemed to be an astonishingly successful, bold and unprecedented project. In the run up to the euro in the 1990s, member states that had previously struggled with inflation and financial instability reduced their deficits, debts and inflation levels, guided by the Maastricht convergence criteria. Once created, the euro spurred deeper financial integration, previously the most elusive part of the European single market program. EMU also allowed member states such as Italy to borrow money at rates closer to more financially sober states like Germany, rather than the more expensive rates they were charged before the euro’s good housekeeping seal of approval. Despite some unhappiness with perceptions of price gouging on the initial switchover, the euro was domestically generally viewed as a success inside Europe. Externally, the euro quickly gained a toehold in the international system as a strong, stable currency with some chance of rivaling the dollar as the hegemonic currency of choice. While the dollar remained the most frequently used currency for international invoicing and the most important foreign exchange reserve currency, the euro made serious inroads in other areas, particularly in international bond issues.

Bonds are notes issued by public bodies (national and subnational governments), private companies, and financial institutions for the purpose of borrowing money on international financial markets. In 2006, such Euro-denominated bonds made up 45 percent of total outstanding global debt in international markets, surpassing the level of dollar denominated debt, which was at 36 percent (International Capital Market Association data). This development seems in part due to the deepening of European capital markets, promoted in part by a move away from the traditional European model of bank financing, and more stable interest rates in the eurozone than in the US. Much of the gains in euro denominated debt were not in public bond issuance, but in the use of euro denomination by private companies and financial institutions around the world, not just in the EU. The European debt crises have shaken bond markets however. In 2011, the euro denominated debt had fallen relative to the dollar, to 27 percent (European Central Bank, 2011). However, this trend of interest in Euro-backed financial instruments was one important indicator of a growing confidence in the EU, relative to the US, on the part of investors, a trend that has not been as far rolled back as we might expect given the debt crisis in Europe, and the dithering on the part of European leaders in achieving a credible stabilization of their financial and political situation.
Perhaps most remarkable for the international status of the euro has been the strikingly robust value of the euro relative to the dollar, even despite the European sovereign debt crises. When the participating EU national currencies locked their rates together in January 1999, their new combined currency began trading on exchange markets as the euro at a value of one euro to $1.18 dollars. The euro then sharply declined down to .86 cents before it rose within a few years to substantially exceed its opening value. The trend for the Euro in the years after its fifth birthday has been extremely strong: in August 2011, those paying in dollars had to hand over the relatively princely sum of $1.42 for the European Union's (EU) single currency. Most economists view this rate as overvalued vis a vis the fundamentals, as the purchasing parity price of the euro to the dollar currencies should be closer to 1 to 1. One can interpret this data in several ways: economically, a weaker currency generally helps exporters, although international investors tend to prefer a stronger home currency. In prestige terms, however, it is clear for the moment at least that the euro is a much stronger currency in international markets than the dollar.

Despite all of this, however, the fact remains that many of the member states of EMU have been suffering severe financial crises. In the wake of the global financial crisis, tensions in the construction of the eurozone previously papered over broke out into view. The EU suffered a series of serious budget challenges, either driven by public sector debt as in Greece or brought on by problems in the banking systems of many EU states such as Ireland and Spain. Overall national debt to GDP figures have ballooned in some states. Overleveraged banks damaged public finances as national level bailouts of insolvent financial institutions have sent interest rates demanded for bonds soaring and made spreads between German bonds and Italian, Spanish, Irish and Portuguese debt dramatically widen. The overall position of the eurozone is quite sound, as the 17 states of the euro area had a public deficit (deficit to GDP ratio) of 6 percent in 2010, and the EU 27 states as a whole were at 6.4 percent. In comparison, the US’s federal deficit in 2010 was 12 percent of GDP, the largest share since World War II. The projected deficits for 2011 are 4.5 percent for the Eurozone and 10 percent for the US. Markets, however, are skeptical about the political unity of the EU, and do not see the EU as a true nation-state. This means that the relatively low overall EU and Eurozone deficits do not seem to matter in shaping outcomes in markets, rather the individual problems of member states like Greece seem to be the drivers.

EVERY INTERNATIONAL MONETARY REGIME RESTS ON A PARTICULAR POLITICAL ORDER

How should we interpret the disjuncture, tensions, innovations and realities of the euro and EMU? The root of the problem is the fact that the single currency has come about without full political integration, and is not embedded in a larger institutional setting as with every other single currency in history, as will be detailed below. Most immediately, monetary unification without concurrent fiscal unification has made it

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1 The quote is from Robert Gilpin (1987).
extremely difficult to stabilize the European economy and financial markets in the face of the debt crises and global recession after the subprime mortgage debacle.

So why does EMU not have a consolidated fiscal authority at the European level? The answer lies in the political unwillingness to move forward with such a dramatic break from national sovereignty. Money and currency do not have the same interest group dynamics, and the move to monetary union in Europe was gradually framed over time in neoliberal ways to be seen as the realm of technocrats, not politics, where independent central banks could legitimately appear to be left out of the fray of politics (McNamara 1998). Of course, this is a socially constructed view which is subjective and contested, but it was very successfully promulgated and widely held by European elites and their publics (McNamara 2002b). In contrast, there has been no such public consensus on the delegation of fiscal authority to the EU, even if some economists have long argued for the removal of fiscal policy discretion to the hands of technocrats in independent bodies (Blinder 2006).

The EU is an anomaly in history for disembedding, at least rhetorically, the single currency project from these larger, explicitly political dynamics. While the consensus around the need to delegate monetary policy to a hyper independent European Central Bank was crucial in getting the currency off the ground, as it sheltered the integration process from visceral debates over the distributive consequences of the euro and the longer term federal implications of a consolidated, sovereign currency, the clock seems to have run out on the euro as the unique case of a single currency without a broader fiscal, and political, union. Historically, currencies are coterminous with nation-states, not the optimal currency areas hypothesized by economists (Cohen 1998, Helleiner 2003, Gilbert and Helleiner, 1999). Only by comparing the euro with other historical examples of single currency creation can we understand what is, and what is not, likely in the future development of the EU.

One such fruitful illustrative historical case can be found in the antebellum United States (US), which provides a striking analogy to, and some striking differences with, contemporary Europe. The Greenback we carry in our wallets did not automatically appear with the initial founding of the US. Rather, its creation during the civil war was part of a broader monetary consolidation that coincided with the gradual transformation towards a more centralized and unified sovereign state. If indeed the Euro’s creation and the EU’s broader political unification has historical precedent in the US case, we may learn something from an analysis of the parallels, and differences, between the two cases. Most centrally, the historical anomaly that is the euro is likely facing real and permanent challenges because of its historical formation as a creature of peace, not of war. Without the fiscal authority that paralleled, supported and gave impetus to the single currency consolidation in the past, as in the US case, the EU is severely hobbled in its ability to govern over a stable, integrated economic system. Monetary systems can’t be disembedded from the “particular political orders” that support them, and financial markets will continue to test the odd historical anomaly that is the EU until it either falls apart or moves towards something much more statelike in form.
MODELS OF POLITICAL DEVELOPMENT

My broadest theoretical contention in this essay is that the dynamics of political economy in the EU today can be fruitfully analyzed using theories of comparative political development. Fortunately, such an exercise can draw on an extensive literature from the fields of comparative and American politics on the long history of statebuilding. Below, I sketch out the basic premises of this approach and develop a template to understand the potential causal linkages between currency consolidation and broader political development dynamics.

Simply put, scholarship on statebuilding examines the process by which power is consolidated and institutionalized through policymaking capacity at the center of a bounded geographical territory and population, resulting in a sovereign state. For most theorists, components of modern states generally (but not always) include a unified fiscal system; a common, often imposed, national language; a unified legal system; and, critical for our purposes here, a single currency (Poggi, 1978, 93). Statebuilding is related to but distinct from nation building: the latter implies the creation of a political community and common identity and is a critical enabling foundation for state power and capacity.

How does the process of statebuilding unfold, and, most importantly for understanding the experience of the EU today, how might we know it when we see it? Scholars have attempted to offer a generalized trajectory of political development which identifies the sequence and timing of the stages of statebuilding. The fact that this phenomenon is always historically contingent has prompted divergent models, making it easier to identify a process of political development in progress than to predict its outcome. From the European experience, Huntington proposed a three stage stylized description of statebuilding: it begins with the centralization of state power, continues with the development of specialized bureaucracies, and finally spreads to increased political participation at the new level of government (Huntington, 1968). Political development in the US case is generally agreed to have evolved differently: the

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2 EU scholars have wrestled with questions of political development more generally: see Sbragia (1992), Caporaso (1996, 2000), Banchoff and Smith, (1999), Marks (1997) and Hooghe and Marks (2001); none have specifically focused on currency, however. Nicolaidis and Howse (2001) offer a comparative survey of federalism in the EU and the contemporary US. Analyses of the general relationship between money and political order include Bensel (1990), Helleiner (1998), Gilbert and Helleiner (1999), Woodruff (1999), and Cohen (1998). In particular, Helleiner (2003) offers an extraordinarily rich and sophisticated analysis of the historical creation of territorial currencies.

3 On the development of states in Western Europe, see Tilly (1975); Poggi (1978); and Evans, Rueschemeyer, and Skocpol (1985). The US experience is explored in the American Political Development literature: see Burnham (1970); Skowronek (1982); Bensel (1990); and Friedberg (2000). I use the terms statebuilding and political development interchangeably in my analysis to refer to the consolidation of political authority.
broadening of political participation came first, not last, in the American case, before the development of a consolidated central state, and the creation of an extended and highly differentiated bureaucracy occurred more slowly. In addition, the role of the courts is different across the historical European and American cases: in the nineteenth century European statebuilding, the state itself was the fundamental source of political authority, whereas in America, the law was often the ultimate arbitrator.

What causes statebuilding? A central cause is war, as summed up in Tilly's succinct phrase, "War made the state and the state made war" (Tilly, 1975, 42). The need to survive warfare has historically prompted political leaders to centralize and strengthen the state, and encouraged courts to uphold such concentration of power. Effective mobilization for war requires an expanded state bureaucracy, a deepening of revenue extraction, and government involvement in a wide array of activities within the economy (Hintze, 1975; Downing, 1992; Porter, 1994). Just as important, the perception of crisis and a security imperative has often been crucial in overriding the normal objections of societal groups and local officials to such statebuilding.

In addition to war, theorists also have emphasized the linkages between statebuilding and the development of capitalist markets (Poggi, 1978; Skowronek 1982; Spruyt, 1994). As economic activity becomes more integrated and complex, societal actors make claims on the state to stabilize and regulate markets against the volatility inherent in their growth. Rules are drawn up, often by federal level courts, to enable markets to function. The creation of a market system, accompanied by the establishment of legal institutions and an administrative bureaucracy, centralizes authority over time as a newly deepened polity is constructed alongside the newly enlarged market. Currency consolidation is part of this market and polity construction: a single money may reduce uncertainty and bolster market integration at the same time as it creates a new authoritative political institution to regulate money. The historic reciprocal relationship between market construction and polity construction has been identified by authors as emblematic of the need for authoritative governance structures to sustain markets (Polanyi, 1944; Ruggie, 1983; Fligstein and Stone Sweet, 2002).

Figure 1: The Causes of Political Development

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<th>The Threat of War</th>
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Figure 1, above, provides a heuristic illustration of the potential relationship between statebuilding, war and market integration. In this conceptualization, statebuilding is most likely when both factors pushing statebuilding, war and market integration, are present and least likely when they are not. When one but not both factors are present, statebuilding is likely to occur, but only unevenly.

WHAT ROLE FOR A NATIONAL CURRENCY?

Where does currency fit into the rubric of political development? Monetary consolidation and the creation of a national currency have been assumed to be a component part of the state building process, yet few authors writing on political development have explicitly focused on currency. This is curious, for currency consolidation institutionalizes the power to rule and control, and is generally "hard-won, the culmination of a process of organized coercion and political negotiation similar to those that resulted in the other powers defining the modern nation-state" (Woodruff, 1999, 3). Nonetheless, a template can be drawn from this literature to pinpoint the factors that provoke currency consolidation as well as to suggest how a national money can bolster statebuilding by increasing administrative and bureaucratic capacity and providing a crucial foundation for a national fiscal regime.

Just as the broader statebuilding literature suggests, the causal factors of war and market integration can be vitally important for currency consolidation and its consequences. A national money can be a crucial component of state capacity in times of warfare, facilitating the collection of revenues, payment of federal expenditures, and organization of debt. A single currency can also aid in the development of a national single market, simplifying transactions and lowering uncertainty across economic actors. If motivated public actors are able to seize the opportunities presented by a period of security threats or the political demands of an enlarging market, they may successfully move governance towards the center of a political system. Societal groups may be more likely to support currency consolidation (or at least not mobilize in opposition), as the fact of war or economic instability may cast a legitimizing light on government reorganization and power centralization.

Once created, how can a single currency contribute to political development? A single currency most directly and prosaically may promote the development of administrative and bureaucratic power and capacity on the part of the central state, as responsibility for management of a uniform money moves to the national level. This task is often initially housed inside preexisting treasury or finance departments or ministries and then may produce new and more highly differentiated bureaucracies in conjunction with a national bank system, and, ultimately, a national central bank. In so doing, policymaking capabilities come under purview of central authorities, moving power to the national level government and providing the instruments for its effective use, in line with the description of political development described by Huntington and others.

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In particular, a national currency is important for political development because of its ability to serve as a facilitating factor for a national fiscal system. First, a national currency makes it easier both to raise and organize public debt, particularly through the issuing of federally backed bonds. Second, the creation of a single currency also significantly reduces the transaction costs of designing and running public fiscal systems, for example in allowing authorities to collect taxes and make payments more effectively. Third, nationalizing the currency can enhance the growth and efficiency of private financial markets. Finally, a single currency can have direct and important impact on national revenues through seignorage gains (the difference between the cost of minting money and its face value). While these four effects seem to accrue benefits to political elites at the center seeking to extract revenues and finance state activities, they also may benefit particular societal actors, such as well situated finance capitalists.

In summary, national currencies may arise from the same political sources that push forward statebuilding, and a single currency has the potential, in turn, to reinforce governance from the center through its effects on administrative and fiscal capacity. The next section examines the antebellum US case to illustrate and refine this conceptual framework.

COMPARING ANTEBELLUM AMERICA AND TODAY'S EU

How is a historical comparison of the Euro possible, given the claims of certain scholars that the EU is a unique, *sui generis* phenomenon? Such a comparison is valid if we set aside our assumptions about our overall understanding of the unit of analysis of the EU and the US today, and instead weigh the comparability of the antebellum US and today’s EU by unpacking and disaggregating their dynamics across a variety of dimensions likely to be important to the path of currency consolidation and political development. These dimensions include the process of currency evolution itself, political culture, formal political structures, and the nature of the economic environment. Both parallels and differences between the EU and the antebellum US can be found, making such a comparison potentially instructive.

As will be detailed in the case study below, the most striking similarity is in the processes of currency consolidation at work in the two cases. Foreign currencies and multiple versions of the dollar circulated widely throughout the antebellum US, and state-

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5 A second, more subtle way a single currency may promote statebuilding is through its impact on the creation of national identity. See Helleiner, 1998; 1999; Risse et al, 1999, Hymans, 2002.
7 Although political scientists have not yet made much of this comparison, Bordo and Jonung note that American monetary history “...is commonly used as a benchmark by economists when examining various issues of the process of European Monetary unification.” (Bordo and Jonung, 1999, p. 27). See for example, Sheridan, 1996, Eichengreen, 1990; Bordo and Jonung, 1999; and Hefeker, 1995.
based banks issued notes that functioned as paper money. There was no permanent national central bank and little in the way of federal mechanisms for control over the monetary order. While the dollar was the standard unit of account, state dollars floated at different rates within the antebellum US, similar to the floating of European national currencies prior to EMU. Just as in the EU today, the American states followed independent fiscal policies with few interstate fiscal mechanisms to promote redistribution or encourage political solidarity across the union. The antebellum states could even borrow directly from foreign capital markets in pursuit of their own goals.\(^8\)

In the US case, a national money was finally consolidated and competing paper currencies abolished; likewise, multiple national European currencies previously circulating across Europe have been unified, through an exercise of immense political will, into a single currency. Thus, the US and the EU cases may be viewed as examples of currency consolidation in the context of contested political authority. The analogy is not exact: for example, the Euro replaced twelve national currencies and is issued by a European Central Bank, whereas the US change involved a move from a chaotic situation of thousands of private and public currencies to a single legal tender currency, although several other forms of currency continued to circulate, and there was no national bank for many decades. Such differences, as well as the parallels, in the currency realm have implications for outcomes across the two cases and thus provide leverage on the question of currency and statebuilding.

Another dimension of relevance to our study of currency and political development might be the nature of the political cultures of the antebellum US and today’s EU. Conventional wisdom might assume that the high degree of cultural heterogeneity and strong national-level political identity in the EU constitutes a key difference with the US case. It is undeniable that while the American states began with a shared language and national political tradition, Europe today is composed of states with longstanding and diverse cultures, languages, and political histories. This may overstate the differences in the two cases, however. Although the American colonies did have a shared political history in the war of independence, and a largely (but not completely) shared common language, the bonds across the colonies and with the new states of the union had by no means assumed inevitability in the period before the civil war.\(^9\) Instead, the antebellum US was marked by deep cultural and political divides, violently expressed in the war but felt long before and afterwards. These divides extended beyond the North-South cleavages to secessionist movements in the mid-West region and Western expansion states (Bensel, 1990, 62).

Language of the time reflected this felt sense of separateness: the US was referred to in the plural, as in 'these United States are' and usage changed to the contemporary 'the United States is' only after the civil war (McPherson, 1991, viii).

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\(^8\) I thank an anonymous reviewer for this point.

\(^9\) Indeed, even the shared memories of fighting the British were a double edged sword for advocates of a more centralized US state, as this memory also contained in it the cultural tradition of resisting centralized authority and an emphasis instead on local level control.
James Madison, writing in the Federalist, No.46 about the US states, stated "Many considerations... seem to place it beyond doubt that the first and most natural attachment of the people will be to the governments of their respective states." Other prominent observers echoed similar sentiments. For example, after visiting America, Chateaubriand wrote: "It is immensely difficult to create a country out of states without any community of religion and interests...how many centuries will be needed to make these elements homogenous?"¹⁰ Likewise, in Democracy in America De Tocqueville wrote of the ‘distinct nations’ formed by the US states. It can be argued therefore that American cultural and political identity, and its links to nationhood, were constructed over a long time period, not fixed by the nineteenth century. If this is true, the US before the civil war might be a reasonable comparative case with the EU today.

Comparing their formal political structures and institutions, prior to the creation of the single currency, both today's EU and the US of the nineteenth century can be described as loose federal structures with central control limited to a few key areas.¹¹ At the founding of the US and the EU, the political structure of both was based on a unified customs union with a rapidly integrating single market. The constitutional hierarchy of political authority was fiercely contested in the antebellum US; recently, compliance with European level (European Court of Justice) law has been higher than antebellum compliance was with federal US law (Goldstein, 1997, 2001). Of course, important differences in the concentration of federal power remain: the foreign policy capacity of the US was much greater than it is in today’s EU. Political parties were also more organized at the federal US level than they are in the EU, where parties have yet to have a European-wide identity. Nonetheless, the hierarchy of political authority in nineteenth century America had certain parallels with today's EU.

Finally, a comparison of these two cases should also take into account the similarities and differences in the overall economic environment of the period. Here we may find the starkest differences between the two eras. While both the antebellum US and the EU were integrating single markets with states at varying levels of economic development, today’s EU is highly industrialized, whereas the nineteenth century US was industrializing but still significantly agrarian. In addition, the meaning of government control over money differs today, with higher expectations about macroeconomic management over the economy, in contrast to the more limited expectations of the nineteenth century. These differences may influence the move to a single currency and its subsequent impact on political development.

As Europe today is a collection of divergent polities and economies seeking some balance between collective governance and local sovereignty, so was the antebellum US. The act of consolidating monetary authority over a single paper currency may be consequential for this precarious balance of power in both cases. Understood in this way, comparisons of political processes across these two cases is helpful for understanding the

¹¹ See Kelemen (2003) for a systematic comparison of the EU to other federal systems.
broader implications of the Euro for the institutionalization of political authority in the EU.

THE DEVELOPMENT OF A SINGLE AMERICAN CURRENCY

To create a template with which to understand the contemporary European case of currency consolidation, I ask two questions of the American historical record. First, what conditions prompted actors to seek the consolidation of monetary authority? Second, how did this process of consolidation relate, if at all, to fiscal consolidation and statebuilding in the United States? In line with the literature on comparative political development, I highlight the role of war and market integration in stimulating certain public and private interests in monetary reform and in creating the conditions under which actors desiring a single currency might prevail, and then draw out the connections between the consolidation of the monetary system and American statebuilding. In particular, I highlight the currency’s link to fiscal capacity as a crucial variable that ultimately shaped the degree and quality of statebuilding.

*From Many Currencies to One: Antebellum Monetary History*

The road to the American Greenback was long and contentious. The US Constitution provided Congress with the power to coin money and regulate its value, but contained no specific legal instructions for a single American currency or central bank (Hurst 1973). The assumption was that a self-adjusting metallic standard would suffice, however, the logistics of using gold soon provoked a demand for paper money, which in turn implied the need for active oversight and public regulation. Paper monies began to be used in earnest in the late eighteenth century with the development of a commercial banking system, with three state banks, issuing their own local notes, chartered by Congress along with a national level First Bank of the United States in 1791. Federal control of the monetary system remained weak, however, as hostility to national control sunk the renewal of the First Bank’s charter (Timberlake 1978, 10). After a period of state oversight over banking, a Second National Bank was established in 1816 but it too struck only a temporary and precarious balance between federal power and state sovereignty. Its charter ended without renewal in 1836 after becoming a central issue in Andrew Jackson’s 1832 anti-federalist campaign for presidency.

Despite the lack of a national bank, the American economy developed and modernized in the period before the Civil War; unsurprisingly, however, its monetary system was highly decentralized and often chaotic. The federal government issued specie money, gold and silver coins, which were used to settle accounts, while a variety of paper currencies, not created by the federal government, also circulated alongside foreign coins (Sheridan, 1996, Ritter, 1997). Although estimates differ, before the Civil War,

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12 McNamara (2002a) examines the American case in detail.
approximately 7000 different kinds of bank notes were used as currency and, to further complicate matters, a good portion of those in circulation were counterfeit (Hepburn, 1924; Timberlake, 1978, 84; Rockoff, 1974, 151, 143). Moreover, "To cope with this chaos, merchants were forced to consult monthly bank note 'detectors' which informed them of the relative value of each note" (Helleiner 1999, 320). State governments were charged with overseeing local banks after the demise of the Second National Bank, but a considerable variation existed in the extent and effectiveness of their oversight. A series of banking crises prompted debate over the need for reform of this chaos, but there was little consensus on how to do so (Timberlake, 1978, 65-74).

To further the confusion, local bank notes also were traded across state borders, like national currencies today, and these paper currencies would rise or fall in value based on the assessment of the credibility of the commitment to exchange the note for specie. While some state bank systems were sound, such as those of New York and Louisiana, "others, particularly those along the Western frontier, were unstable and poorly managed. Since bank notes were often of uncertain value, they were heavily discounted by eastern banks." (Ritter, 1997, 66). Financial intermediaries tested the willingness of the banks to redeem notes at the stated value, and by the mid-1860s, clearinghouses were set up in major cities to facilitate this process. In effect, the antebellum US had a system of floating exchange rates and multiple currencies not unlike the European exchange rate system before EMU, as Sheridan (1996) has argued, although more chaotic and costly.

A standardized American currency system finally became a reality only with the onset of the Civil War. A series of reforms, described more fully below, centralized the monetary system at the federal level by outlawing local currencies and largely transferring monetary power to the center. A central part of these reforms was the introduction of large quantities of Greenbacks or “United States notes”, which were issued by the federal government as fiat money, full legal tender for all debts public and private. Although several types of national level monies continued to circulate as currency after the early 1860s, the overall consolidation of federal control over money during the civil war was dramatic.

The Causes and Consequences of the Single American Currency

What were the dynamics that produced these changes towards a more centralized monetary system and single currency in the antebellum United States, and what were their effects on the overall governance system that supported the single currency? As outlined in the theoretical discussion of currency and political development above, two factors were important in motivating actors to seek currency consolidation. The most immediate and proximate cause was war, specifically public officials’ need to rationalize the monetary system and increase federal revenues to prosecute the American civil war. The second factor setting the stage for a single currency was the creation of a single American market, spurred on by the federal courts, which created rising societal pressures for regulation of the monetary regime. The political processes set in motion by these factors impacted not only the creation of the American single currency, but
governance structures and political authority more broadly as well. I treat each factor in turn.

*War*

The creation of the American Greenback clearly illustrates the relationship between war fighting, the development of national currencies, fiscal consolidation and statebuilding. Even prior to the civil war, some political elites had linked monetary control to security concerns. The Second National Bank's founding was spearheaded by Congressional members concerned with strengthening the union and national capacities in the wake of the War of 1812 (Hammond, 1957). As the pressures of war faded, Congressional mistrust at the centralization of power within the executive reasserted itself “reflecting the general antipathy in Congress to discretionary executive control” (Timberlake, 1978, 48), and ending debates over granting legal tender status to Treasury notes (Hurst, 284, note 221).

The role of war in federalizing currency control reappeared with a vengeance in the 1860s with the secession of the South from the union and the fragmenting of the American political union to the West and Midwest. President Lincoln and the congressional Republicans pushed through a series of critical monetary reforms that significantly strengthened the ability of the North to wage its military campaign (Bensel 1990, 14; Hurst, 1973, 64, 176-181).

First, Congress created a single currency by conferring legal tender status on Greenbacks, the new dollar paper currency issued in the winter of 1861-2. As the Greenback was fiat money (i.e., money not redeemable for a specific amount of gold or other valuable commodity), it gave greater leeway to the government to print money to raise revenues, as long as authorities could maintain credibility over the worth of the paper currency. This significantly increased the Union government's policy flexibility in financing of the war. Between 1862—64 Congress authorized the issue of $450 million in Greenbacks. The Greenback was the only currency with legal tender status, although it continued to coexist with several other forms of currency, namely newly standardized national bank notes, as well as silver and gold certificates. Nonetheless, the new federal paper dollar heralded a simplified and standardized monetary order ruled over by the US Treasury and the US Congress instead of the US states.

Second, the reforms created a national bank system that abolished locally chartered banks and replaced them with federal chartered banks. The national bank notes issued by these banks now had to be uniform in design and accepted at par throughout the US. This centralization of monetary power was matched by a comprehensive effort in on

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14 This pure greenback standard lasted until January 2, 1879 with the resumption of the greenback's link to gold.

15 Southern states issued their own confederate dollar during the war, and only adopted the Greenback after the Union’s victory. Congress finally retired national bank notes in 1935.
the part of the federal authorities to remove foreign currencies from circulation, begun in 1857 and largely completed by 1861. In addition, federal initiatives in the 1860s cracked down on counterfeiting, with new policing mechanisms that further enhanced the control of the national government over money. Since the collapse of the Second Bank of the US, the government had conducted its operations in coins and specie, a logistical nightmare. These currency reforms facilitated the collection of tax revenues and payment of government bills, one of its chief advantages in the eyes of government officials such Treasury Secretary Salmon P. Chase.\textsuperscript{16}

Finally, as part of these reforms, the Union permanently placed a large part of the national debt with finance capitalists through the newly nationalized banking system. The federal government did this by forcing private banks which issued the newly standardized 'national bank' notes to hold government bonds and "thus created an instant market for these bonds which could finance its spending requirements" (Helleiner 1999, 325). Essentially, the state banks became fiscal agents of the Treasury, extending the capacity and reach of the federal government.

In sum, the need for an effective state apparatus to prosecute and finance the civil war was a key spur for currency consolidation by Lincoln and his party. The war was also instrumental in enabling the Republicans to achieve this goal despite the tradition of states rights, and in no small because the departure of southern representatives from the US Congress meant that legislation moving more powers to the federal level could go through. The impact on statebuilding was significant, as currency consolidation carried with it a series of new administrative and organizational powers located at the center of the union. The reforms enabled the expansion of fiscal authority while co-opting new social groups into a national level financial system, part of the gradual transformation to a consolidated federal political system.

\textit{A Single American Market}

While war provided the immediate motive and means for federalizing monetary control and building fiscal capacity, less dramatic but consequential societal changes brought on by market integration also provided ripe ground for currency consolidation, although less so for fiscal integration. The construction of an American single market in the mid-nineteenth century, crucially aided by the federal courts, had been steadily transforming societal and public interests in national governance. Political leaders faced new pressures to develop the American political infrastructure to stabilize and regulate the growing national market and its increasingly industrial nature. Secretary of the Treasury Chase, whose "stubborn persistence" was key to the passage of monetary reform legislation, was keenly supportive of the need to facilitate market exchange through currency uniformity, although the more public justifications centered on the civil war imperative and reasons of state (Hurst, 1973, 79).

\textsuperscript{16} I thank an anonymous reviewer for bringing this point to my attention.
The American single market was the result of a combination of economic, technological, and political factors. Trade across the U.S. states had begun to rapidly increase in the first part of the nineteenth century, with an integrated national market emerging in the 1840s and 1850s. Increasing revenues from Southern cotton exports financed the demand for western foodstuffs and Northeastern services and manufactures in the latter years of the antebellum period (North, 1966, 68). Technological advances in transportation, both waterways and rail, further promoted the expansion and integration of the US economy.

However, government intervention and the exercise of political authority also shaped the new market. A key role in this increase of interregional trade was played by the US federal courts, who promoted an integrated market through their interpretation of the Interstate Commerce Clause (ICC), which barred state discrimination in commerce with other states. Although the ICC did not expressly implicate money, the integrating national market made more salient the need for the reorganization of the chaotic monetary system of thousands of currencies, and the courts upheld the view that federal currency regulation was linked to successful commerce across state borders, and therefore appropriate (Hurst, 1973, 72). Federal judges used their independence and authority to create laws that reduced the uncertainty of interstate business by more clearly specifying the rights and obligations of parties to contracts, particularly regarding the negotiability of bills of credit (Freyer, 1979).

The law was also important more directly in questions of how to stabilize expectations and confidence in the monetary regime. After all, 'legal tender' is made such by law, and the US courts actively concerned themselves with the question of the authenticity of the paper currency's source and form. A central practical concern was how the law could promote the day to day acceptability of a national system of money, and the Supreme Court sided with the federal government on the question of monetary authority, stating that "promoting popular acceptance of the currency was one proper purpose for congressional action." (Hurst 1973, 44). Significantly, when Congress imposed a severe tax on the notes of the state banks as part of its civil war era reforms this tax was upheld by the courts, who “accepted this claim of authority, apparently as a ‘necessary and proper’ incident to the [constitutionally] granted power to coin money.” (Hurst, 1973, 37).

The courts were able to shape the path of the national monetary system in part because societal dissent was relatively muted on these issues. Hurst argues that the rulings did not bring into play a wide variety of battling interest groups but were commonly perceived as being functionally necessary to the fundamental goal of market exchange (1973, 39). The courts also drew on common custom and prevailing business practices, strengthening societal support for its decisions. For example, “recognition of the utility of legal tender requirements generated substantial banker support" for currency reforms as bankers worried about enforcing contracts with appropriate payments absent a common monetary standard (Hurst 1973, 45).

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17 See North (1966, 32-36 and 101-121), and Schmidt (1939).
In sum, the courts promotion of a single market, the confluence of interests on the part of commercial coalitions in society who wanted to simplify and stabilize the currency system, and the Lincoln administration's desire to exert its authority and policy capacity in wartime created the right conditions for the single currency, despite the historically strong antagonism to federal control over money throughout the antebellum years. The immediate monetary reforms of 1862-63 may have been accomplished by virtually by edict, but societal ground was prepared because of the growing single market and its political repercussions. Note, however, that the standardization of money promoted the single market, but no such efforts were made to link the federalization of fiscal capacity to the workings of the American single market.

Currency, Fiscal Authority and US Political Development

Because the civil war moved policymaking to the federal level along a variety of policy areas, it is viewed by some scholars as "the true foundational moment in American political development." (Bensel, 1990, 10; McPherson, 1991). The long-term political consequences of the creation of a nationalized monetary system bear this out, as currency policies evolved from a Madisonian ideal of local control towards a Hamiltonian vision of a strong centralized government, ultimately with the potential to raise revenues and float debt with fiscal consolidation. However, just as the American state continued to develop in fits and starts even after the critical moment of the war, monetary and fiscal reform was far from complete. Several forms of currency continued to circulate and a national central bank or Federal Reserve was not established until 1913. Nonetheless, the centralization of state power and the development of a differentiated bureaucracy as outlined in the statebuilding literature were certainly found in the process by which the American currency was consolidated.

The centralization of money also had more subtle institutional effects, as it forged important new links between the state and powerful societal actors in ways that shaped subsequent American political development. Substituting Greenbacks for gold redeemable bank notes "effectively nationalized the payment clauses of private and public contracts in the northern economy and tied these agreements to the future financial policy of the central state." (Bensel 1990, 162). In other words, the explosion of government bonds served to create a client group and social base of support for the federal government by giving certain private actors an enduring interest in the health of the central state. The creation of federal level policy capacity thus meant the gradual organization of societal interests at the national level, transforming the American polity towards new set of authority structures.

18 Timberlake, 1978, p. 5; see also Savage 1988, p.70.
19 On a symbolic level, as well, the greenback may have impacted statebuilding by promoting a more homogenous, unified and collective vision of the American state. See Helleiner (2003, 1999) and Helleiner and Gilbert (1999).
THE CAUSES AND CONSEQUENCES OF THE EURO\textsuperscript{20}

Armed with the theoretical insights from the comparative political development literature and the empirical insights on currency's role in American development, we now can begin to generate theoretical claims about the causes and consequences of the Euro for broader fiscal and political integration. To do so, I analyze the similarities and differences between the two cases, focusing on the role of war and the role of market integration and the ways in which differences in the sources of currency consolidation may shape broader political development in the EU.

The Role of War

War clearly has played a very different role in the creation of the Euro than it did in the US case. It was the shadow of war, not in its crucible, that brought forth the Euro, and therefore the consequences for European political development through monetary reform have been fainter and more attenuated than in the US case. In Europe, the desire to minimize the potential for a revival of hostilities among the great powers was a critical original motivation for European integration more generally, expressed in the European Coal and Steel Community (ECSC) in 1952 and the signing of the Treaty of Rome in 1957 (Dinan, 1994, 9-38; Trachtenberg, 1999). The continued deepening of the EU project over the following decades has been understood by many as an attempt to solve the 'German problem' by binding Germany tightly together with its former enemies in a quasi-federal union. To further this end of stabilizing political relations, a single money was promoted by various political actors and agreed to as a goal by European leaders as early as 1969 (Tsoukalis, 1977).

The decision to finally go forward with the Euro in 1992 at Maastricht was influenced by similar concerns, but there was little security imperative to the single currency. The fall of the Berlin wall in 1989 and the reunification of Germany have been argued to have prompted French President Mitterrand and German Chancellor Helmut Kohl to seek the binding of European nation-states to Germany through the Maastricht Treaty and the single currency (Sandholtz, 1993; Dyson and Featherstone, 1999).\textsuperscript{21} Thus, while EU leaders sought to lock-in cooperation in the EU and the Euro was seen by some as potentially making secession from the EU less likely, the level and immediacy of threat was not the same as in the American case. Europe faced the end of an external cold war in partnership with a reformed Germany, not the mobilization for a bloody civil war. While the Greenback was imposed on the South in an exercise of power by the winning Northern states, in Europe, EMU was agreed to, not coerced, among states of legally equal status.

The difference in the levels of threat between the two cases may account for the differential effects of monetary consolidation on statebuilding. Most importantly, the

\\[\textsuperscript{20}\text{Detailed accounts of the creation of the Euro are found in Dyson and Featherstone (1999) and Moravcsik (1998).}\]

\\[\textsuperscript{21}\text{See Moravcsik (1998) for an opposing view.}\]
pragmatic and pressing need to finance war fighting expenditures is missing from the contemporary European context. The Greenback had decisive impacts on statebuilding in part because it was intimately linked to the need for public financing of the civil war and the development of new revenue extraction capacities on the part of the federal state. In contrast, the low level of threat has prompted little in the way of transfer of fiscal capacity at the EU level. Thus, the end of the Cold War can be argued to be a catalyzing event for a longstanding interest in monetary integration in Europe, but in a much less immediate and salient way than the civil war was for the US. As will be discussed further below, this translated into very different consequences for the development of fiscal linkages and further economic policy capacity at the European level.

The Single European Market

Market integration, not war, is the causal factor that appears in both the US and EU cases, with important consequences for the way EMU has evolved. A key goal of the EU's founding constitution, the Treaty of Rome, was the creation of a single European market with the protection of the 'four freedoms'—the free flow of people, goods, capital and services. The 1985 Single European Act, which strove to remove all barriers to commerce across the EU by 1992, was a milestone in the achievement of this goal (Sandholtz and Zysman, 1989). While certain private commercial interests actively promoted the European single market (Cowles, 1995), the European Court of Justice was also critical in the creation of the European wide market through its interpretation of the EU’s treaties. Decisions such as the 1979 Cassis de Dijon judgment, which reinforced the principle of mutual recognition of national product standards across the EU member states, gave political ammunition to supporters of integration, rejuvenating EC harmonization policy and spurring the development of the Single European Act (Alter and Meunier-Aitsahalia, 1994; Burley and Mattli, 1993).

The ECJ did not, however, create the single market whole handedly, rather, as with the American case, the court's decisions sparked political responses on the part of political elites in the European Commission, and in the member states, to move forward integration and triggered the mobilization of various interests groups, for and against the further federalization of economic activity and governance. The ECJ has also used a broad interpretation of the legal reach of the 'four freedoms' of market integration to create a constitutional framework for a European level legal order that has promoted deeper integration, even in areas not directly under the Treaty of Rome (Ball, 1996; Pierson, 1996). In this way, the political dynamics of the single market seem to parallel that of the political and legal uses of the Interstate Commerce Clause in the creation of the American single market.

The ECJ has not, however, promoted monetary integration directly through legal rulings as the American supreme court did. Rather, EU and national officials have made the linkage through political rhetoric and action, as the single market was widely cited by political elites as a key reason for the drive to a single currency in the run up to EMU. The European Commission actively promoted this policy linkage between market integration and monetary integration, as codified in an influential report, One Market,
One Money (Emerson and Gros, 1992). Similar dynamics had been in play for some time: the difficulties of having a single market for agriculture combined with a federal subsidy system in the Common Agricultural Policy (CAP) prompted interest on the part of policymakers fixed exchange rates in the 1970s and 1980s (McNamara, 1992) similar to the antebellum American Treasury’s interest in rationalizing receipts and payments. As more widespread market integration gathered steam in the 1980s and 1990s, the idea of a single currency gained a certain political logic.

However, EU market integration alone did not necessitate the creation of the Euro: different societal, legal and governmental actors varied in their preferences for monetary union and for a more federalized market and governance structure (Oatley, 1997; Frieden, 1991; Henning, 1994). The single market-Euro linkage was created in part as a political strategy by those in the Commission and national capitals interested in the goal of further integration (Jabko, 1999), just as in the American case, the political linkages between the single market and the Greenback gave a push to statebuilding.22

Figure 2: Comparing Historical Outcomes of Currency Consolidation

<table>
<thead>
<tr>
<th>Threat of War</th>
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<th>High</th>
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<tr>
<td>Market Integration</td>
<td>INTERNATIONAL SYSTEM</td>
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</tr>
<tr>
<td>Low</td>
<td>Multiple Currencies, Multiple Fiscal Authorities</td>
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<tr>
<td>High</td>
<td>EU</td>
<td>US</td>
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<tr>
<td></td>
<td>Single Currency &amp; Multiple Fiscal Authorities</td>
<td>Single Currency &amp; Centralized Fiscal Authority</td>
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Generalizing from our comparison across the US and EU cases allows for a characterization of a simple relationship between market integration, the threat of war, and currency and fiscal consolidation. Both war and market integration may present opportunities for political actors to move forward with statebuilding, but such an impetus needs to be filtered through specific private and public actors for these outcomes to be

22 Others rejected this perspective and viewed the single money as an end in itself, for example, to lock in price stability policies (Moravcsik, 1998; McNamara, 1998).
realized. As shown in Figure 2, above, high levels of both market integration pressures and the threat of war may produce the most likely scenario for the creation of a single currency and fiscal authority at the federal level, as in the US, whereas low levels on both are likely not to produce such effects. The EU case illustrates the ways in which high levels of market integration without a pressing threat of war may produce currency without fiscal power. The final cell is left indeterminate until further research can determine what a high threat of war alone produces, absent market integration.

Currency and Statebuilding in the EU

The US and EU cases share the impetus of market integration for statebuilding, but while the civil war may have been the “true foundational moment” of the American state, the EU has yet to experience such a singular, consequential episode in political consolidation. After the initial burst of institutional creation after WWII, European level political development has been characterized by an incremental, endogenous evolution. The EU’s development has appeared more voluntary in nature than those historical cases where statebuilding is an immediate imperative of warfighting.

The creation of the Euro, taking place not in the context of war but in its very long shadow, has brought new monetary policy capacity and thus new administrative and bureaucratic powers to the European federal level. It has also brought new responsibility to the European Parliament in monitoring the European Central Bank, notwithstanding the ECB's high level of independence, and deepened the activities of Commission officials in the monetary and financial sphere. In part because of the sources of the single currency, however, this transfer of political authority has not extended to fiscal policy, as taxing, spending and borrowing privileges remain overwhelmingly at the national level in Europe. The EU is severely constrained in the fiscal area and has relied on cooperation among national finance and treasury officials to coordinate fiscal positions. The EU is prohibited by its own laws from borrowing to balance its budget and must operate entirely within its revenues (Laffan, 1997). It cannot impose direct taxation on EU citizens and strict limitations are placed on EU expenditures as a proportion of the overall European GNP. Although such expenditures have grown over the 1990s, the current EU budget runs at less than two percent of total EU GNP, a fraction of the 30 to 50 percent spent by national governments as a proportion of their economies. Perhaps most significantly, the EU cannot at present issue federally backed, Euro denominated bonds, leaving it to individual member states to issue their own debt.

The truncated nature of EU revenue extraction and expenditure has meant that the EU must rely on administrative rule making as the chief means of policy development and on the European Court of Justice and the national administrations of the member

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23 The largest part of EU revenue itself comes from value added taxes, collected at a harmonized rate across the EU, which in 1999 was limited to 1 percent of EU GNP. The next largest source are national contributions to the EU budget determined annually as a proportion of national GNP. Finally, a diminishing amount of revenue is derived from agricultural levies and customs duties on imported products (Hix, 1999, 244-48).
states for implementation and enforcement (Majone 1993). The lack of an EU backed bond market has also acted as a deterrent for the Euro to become a true key currency, and has kept investors in US dollars instead. Until very recently, there has been little publicly voiced support for an EU fiscal institution, although privately many high level EU and national officials have long argued that the single currency can only function effectively if it is joined with fiscal policy capacity.

The US case implies that EU political elites are likely to wait until a severe crisis changes the publics’ perception of the value of moving fiscal capacity to Brussels. The critical question is whether the ongoing and dramatic crisis in the eurozone today might be provoking a political recalculation of whether a Eurobond, and substantially deepened fiscal authority at the European level. In the public discourse, the idea of a eurobond is gaining traction, despite German president Angela Merkel’s distaste for lumping her fiscally prudent nation together with much less trustworthy member states. Nonetheless, it is striking the degree to which the idea has gained traction in news reports, market commentaries, and among academic observers of the crisis. A parallel discussion has focused on the desirability of centralized decisionmaking over national fiscal policies, from strengthening the rules of the growth and stability pact to enhancing the power of the EU Council President, currently Herman Van Rompuy, to coordinate and direct national policies.

CONCLUSION

To better understand the nature of the political evolution that may be occurring in the EU today, this paper has argued for the value of using insights from the scholarship on comparative political development, and assessing the Euro in light of nineteenth century cases of monetary consolidation. While we know how the historical American case turned out, the institutionalization of authority at the European level is ongoing and unresolved in terms of its ultimate endpoint. Nonetheless, we can use existing literatures and cases to generate theories that address the broader consequences of the federalizing of power over money in Europe. The comparison with the antebellum American experience suggests a series of specific lessons about the potential path of political development in the EU. Most centrally, the comparison points to the importance not just of currency, but of a single money in combination with centralized fiscal capacity in the broader successful institutionalization political authority. Alexander Hamilton argued against his many skeptics in 1781 that "A national debt if it is not excessive will be to us a national blessing: it will be a powerful cement of our union" (Higginbotham 1977, 294, quoted in Savage 1988, 70). The lifting of the prohibition on a European federal debt would be a similarly critical element in the resolution of the current financial crisis, but also in the process of political unification in Europe, one which pushes beyond currency alone in statebuilding.

24 Author’s interviews with prominent European central bankers with longstanding involvement in EMU process. Many economists also argue that the single currency must be matched by EU level fiscal federalism, see for example Eichengreen (1990).
The seemingly endless financial crisis in Europe has policymakers, investors, and publics worried about the potential for even worse economic hard times and political tensions within the European Union, or even the collapse of the EU altogether. As this paper sketches out, to any student of history, the crisis is hardly surprising. No monetary union has ever succeeded without a robust political union and a centralized fiscal policy. The EU, impressive innovation that it is, is attempting to break the historical relationship between a single currency and the nation-state. The current crisis demonstrates that markets, to date, remain unconvinced.

The EU has been a stunningly successful experiment in governance beyond the nation-state. In seemingly Rube Goldberg-like ways, the EU has navigated the continued existence of its storied nation-states while pooling sovereignty in Brussels over key parts of its economy, society, and foreign policy, putting a rest to fears of a resurgence of the cataclysmic wars and fascism of the first part of the twentieth century. The Euro seemed a breathtakingly bold consolidation of vital economic and political power at the European level. Yet when creating it, national politicians did not venture even further into the toolbox of states and consolidate the fiscal policy side, which governs taxing, spending and the issuance of public debt. Instead, they left that very high profile, publicly sensitive arena to the EU member states. Unlike all historical cases of successful single currencies, where fiscal policy was part and parcel of the move to centralize political power, the EU relied on a series of rules (the Growth and Stability Pact) without teeth and without real functionality.

It is no wonder that financial markets are testing Europe’s resolve in the face of the global financial meltdown, and the debts and deficits of its members. The wave of attacks that began with Greece keep spreading through financial contagion to other states. Although the Greek economy is only about 2 percent of the overall GDP of the EU, markets cared less about the actual economic logic of a potential Greek default, than questions about the solidity of the political will under girding the Euro and the European project more generally.

Consider this. If an economically small US state like Alabama was on the brink of default on its bonds, markets would be unlikely to bet on a contagion to other US states, a crash of the dollar and the potential dissolution of the American federal system. Today, the fragile balance between the EU and the still vital nation-states creates plenty of opportunities for markets to probe potential weaknesses, and to jeopardize investor confidence in Spain, Italy and other large and thus more consequential economies. At present, the novelty of the EU is turning out to be a liability, one that is not likely to go away quickly. How Europe’s leaders deal with these historical challenges, and their willingness in particular to consider building fiscal capacity and introducing a true eurobond, will prove decisive for the future of the EU and the long term peace and stability of its members.
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