A Keynesian Perspective on the European Union:

Economic Implications Now and in the Future

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The European Union is the collective effort of twenty-seven member states to promote diplomacy and prosperity throughout continental Europe. The inclinations for European integration in contemporary times stem from the prevailing fear that encompassed Europe after World War II, an unrelenting system of mechanized warfare bringing levels of destruction Europe had never before seen. After experiencing the implications of resolving inter-state issues by means of brute force, European countries sought to settle disputes through peaceful, diplomatic methods. The future ramifications of these Euro-concentric tendencies extend far beyond the diplomatic stage. The European Union has created a supranational parliamentary system of government, spanning all member states, along with a free trade area, and for many, a common currency: the euro. Along with the increasing influence that the EU gained in member states came a plethora of economic and political regulations, requiring the countries to conform to such measures. John Maynard Keynes, a British economist from the twentieth century, was one of the pioneers of the concept of governmental economic intervention similar to what the EU regulates. Keynes was greatly influenced by the atrocities that plagued the twentieth century such as the Great Depression, and like most other Europeans, the Second World War. Accordingly, his policies embody a motivation to give more economic control to a higher entity in order to avoid future economic downturn. Keynes' ideas can be applied precisely to the contemporary problems that persist with the EU. The first of these is a wide range of inequalities between the different economies, the second, unemployment and the third, bureaucratic inefficiencies. Following Keynesian thought, the vast majority of issues in the European Union stem from a lack of fiscal coordination, which can be remedied by creating a unified fiscal policy throughout the European Union.

The European Union as it stands today is a reflection of the integratory sentiments stemming post WWII. The first formal steps taken toward the creation of the entity known as the EU today was the signing of the Paris Treaty which created the European Coal and Steel Community, which was established on July 23, 1952. The first six signatory countries were Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany (Vataman, 2010). The signing of the Paris treaty established a common market for coal and steel. Five years later, the same aforementioned countries signed and put into effect the Treaty of Rome in 1957 which renamed the ECSC to the European Economic Community and thereby expanded the common market to include other goods. Harkening back to its main purpose as a free trade area, the first point listed on the treaty elaborates on “the elimination, as between Member States, of customs duties and of quantitative restrictions in regard to the importation and exportation of goods, as well as of all other measures with equivalent effect” (1957). Over the following two decades in the 1970’s, Denmark, Greece, Ireland, Northern Ireland, and the United Kingdom joined the EEC as well, expanding membership to eleven countries in total. This trend continued through the eighties with the addition of Spain and Portugal. Throughout the nineties to the early two-thousands, the EEC sustained this pattern of enlargement; however, a fundamental change occurred in 1992 which marked a turning point for the EEC. In the growing wave of European integration, the Maastricht Treaty was signed on February 7, 1992. This “merged with the Union's political and economic and monetary union,” (Vataman, 2010) creating the European Union as it is recognized today.

An important outgrowth of the creation of the European Union was the creation of the euro area, or the Eurozone. The Eurozone is made up of nineteen countries that have taken on the euro, the common currency of the EU (European Commission, 2018). Preceding the launch of the euro as a formal currency on January 1, 1999, the European Central Bank was established on June 1, 1998. The European Central Bank is responsible for the centralization of the EU's economic and monetary policy, located in Frankfurt, Germany. At its inception, the euro was only kept as a unit for accounting; however, in 2002, the physical currency of the euro was issued on January 1, 2002 to the following countries: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. This common currency successfully unified monetary policy throughout Europe amongst many countries, but the fiscal repercussions show that this unity may be more complex than previously believed.

John Maynard Keynes was born in Cambridge, England on June 5, 1883. He received his formal collegiate education from the King's College in Cambridge, where he specialized in mathematics. Growing up alongside the industrial revolution, Keynes observed the world evolve directly before his eyes (Harrod, 1951). He witnessed firsthand the economy's shift in activity from primarily agricultural to predominantly mechanized. His birth date also places him in a special position to see momentous events that shaped his ideology along with many other Europeans –World War I, the Great Depression, and World War II.

Keynes wrote in a variety of disciplines; however, he is most noted for his work in economic philosophy. His economic philosophy takes the principles laid out by previous Capitalists from the nineteenth century, Adam Smith and David Hume, and slightly develops them, putting them on a different premise. The free market capitalism that Smith and Hume write about hinges on the fact that the invisible hand, the result of natural market forces acting on the economy, will do the necessary regulating with no outside entities needing to be involved (Heilbroner, 1999). While Smith fully supports the free market economy and cites it as the most efficient economic system available (Heilbroner, 1999), Keynes, on the other hand, counters that there must be a governing force overseeing the free market, otherwise it will fail. Keynes believed that such market failure lies on the fact of deficient aggregate demand:

> "When the business outlook is poor, whether because of "gluts" in particular markets, or because the international situation is alarming, or because businessmen are nervous about inflation, or for any other reason, the impetus to invest will wane" (Heilbroner, 1999, p. 266).

In essence, when various externalities effect the behavior of businesses or the people, one will begin saving more which will cause the other to cut back as well, creating a downward spiral into a depression. This is what happened in the late 1920's when the Great Depression began due to deficient aggregate demand, meaning consumers did not want to buy products, so employers paid lower wages, inciting fear in the consumers, causing them to save what they had, decreasing overall economic stimulation. It is where an overarching organization, such as the government, can increase aggregate demand through governmental spending on programs and projects which will result in a net increase in price level and quantity output negating the effects of the depression. This commentary that Keynes provides on governmental intervention proves useful in analyzing the effects of the common currency and unified monetary policy of the EU.

Looking at the contemporary European economic system, many of Keynes' ideas are employed in full force. The primary instance where Keynes' philosophy of stabilizing the aggregate demand lies in the increased inclinations towards the welfare state in many European countries. In Germany, one of the most economically stable countries in the EU, governmental spending on welfare accounted for 25.3% of its GDP in 2016 (OECD, 2018). In a relevant comparison, in the United States, spending on welfare as a percentage of GDP was only 3% (Chantrill, 2018). The effect of this generous welfare spending on the part of Germany results in micro-fluctuations in price level, but in the long run, the total change in price level remains constant (University of Pennsylvania, 2012). Juxtaposed with the United States, who also runs a similar price level but to a lesser degree than Germany, the US price level will go through periods of drastic change, which becomes the impetus for congress to pass legislation which will take one to two years to come into effect. This action will bring the real price level back up to previous levels, as seen with the effect of President Obama's signing of the Stimulus Package in 2009 as a response to the Great Recession of 2008 (Meckler, 2009). Here, it is at the root a fundamental dichotomy in understanding of the role of welfare spending. More in line with Keynesian beliefs, Germany views welfare spending as a necessary economic stabilizer and implements it as such. The United States, on the other hand, is much more reluctant in the use of welfare spending as an economic regenerator, only increasing it when circumstances make it absolutely crucial to do so.

Another contemporary facet of the Keynesian-influenced European economic system can be found once again in Germany's budgeting process. Keynes strongly supported running a budgetary surplus in times of an economic boom so that during economic recessions, the government would have adequate funds saved to be able to boost the economy through government spending (Karakas, 2015). True to this principle, Germany has run a budgetary surplus since 2014 (World Bank, 2016). Increasing the country's surplus requires an increase in the tax rates which has successfully worked for the German model. In increasing tax rates to augment the budgetary surplus, the price level and would theoretically decrease. In practice, however, due to the crowding out effect and the reinvestment of funds collected by taxes into public programs, this actually ends up increasing the price level by contributing to the aggregate demand. When this happens, the ECB can complement this with a contractionary or expansionary monetary policy depending to reduce or increase the money supply, which will manipulate the price level on a larger scale so that it is within the necessary bounds of inflation as dictated by the euro convergence criteria (European Commission). Though Germany maintains a productive relationship with the ECB, the whole of the EU is not quite as prosperous as Germany.

The primary problem that lies at the root of the modern day Eurocrisis is that several countries in the EU possess extremely large debts, some even running the risk of having to default. A perfect illustration of this concept is the Greek economic crash of the 2000's. "Since 2007, the Greek economy has contracted by nearly twenty-five percent." (US Senate, 2015). Because of this lack of production and growth in GDP, Greece is accruing the same amount of debt had its economy remained unchanged. A more stringent fiscal policy would prove to be the remedy in this instance. A tightening of Greek fiscal policy would take measures into account including but not limited to increasing taxes, reducing public benefits, and even increasing the retirement age. These measures would serve to increase productivity and generate more money within the Greek economy. Many movements to implement these measures into public policy have been brought forward by Greek elected (House & Teasar, 2015); however, all of them have been defeated in the early stages of its legislation.

The EU, while having a coordinated monetary policy, has no control over the fiscal policies of the individual member states. Those decisions are left up to the countries themselves.

The inability for the EU comes to be problematic in instances such as this where a country with full fiscal autonomy is able to become a drain on the overall economic activity of the EU. This is the case with not only Greece, but other member states such as Italy, Portugal, and Spain. In addition to having a weak economy overall, many of the economically inferior countries also have an unemployment rate above the EU average.

Standing at the center of the Eurocrisis is the high rates of unemployment spanning the entirety of the EU, from Spain to Croatia. Member states in the EU maintained an average of 7.3% of January 2018; whereas the Czech Republic, held an unemployment rate of merely 2.4% at the same time (Eurostat, 2018). This wide degree of variation in unemployment rates throughout the EU demonstrates the inefficiencies of the economy on a macro scale. In the market for labor in the EU, countries with high unemployment rates shift the demand for labor leftwards, thereby decreasing the quantity of jobs in addition to the wages that are being paid. This is a perfect example of Keynes' principle of deficient aggregate demand. There is not sufficient demand for labor; therefore, according to Keynes, it is the government's responsibility to increase spending to create more jobs to shift the aggregate demand curve for labor to the right. This is unable to come to fruition on a large scale because there is no central coordination of fiscal policies such as this in the EU, meaning that it is left to how the countries see fit to remedy this situation which in practice, has not necessarily been effective.

Another issue that is distinctly trademark of the European Union is the excessive bureaucracy. While not an issue in itself, rather, bureaucratic inefficiencies cause an overall decrease in the ability for governmental funding to be responsive to any externalities or stimuli to which it must regulate the economy. For example, in the Czech Republic, Czech physicists in 2008 were charged with spearheading the management of €18 billion of government funding into physics experiments. What could have been an opportunity for a rapid response to the declining market conditions of the Global Financial Crisis took an exorbitant amount of time. Physicists lament: “The process of applying for money from the Framework programme of the European Union (EU) is a “stain” on the EU’s reputation and a “radical overhaul” of the administration is needed” (Banks 2009). A large component of this bureaucratic inefficiency is due to the fact that the individual member states are required to coordinate the fiscal measures the various national legislative bodies while at the same time with the EU Parliament as a whole.

Since the foundation of the primary issues that plague the EU causing the Eurocrisis is a result from a lack of coordinated fiscal policy amongst member states, Keynesian policies should be further implemented within the policies of the EU. The most crucial policy would be to unify fiscal policy in all member states of the EU in its entirety, similarly to the EMU’s (European Monetary Union’s) approach to monetary policy. A central body for spending and taxation, such as the ECB stands for authoritative regulation for monetary policy, would allow consistent control over unemployment, budget deficits, and variances in neighboring countries’ economies.

The disadvantage of this approach is that it greatly curtails the autonomy of the member states. In relinquishing power of this degree to the EU functionally diminishes the individuality of the member states. This is an unintended consequence of Keynesian policies. This notion is still in line with his policies, however, because it greatly reduces the statistical probability for risk. In his book, *A Treatise on Probability*, Keynes records a strong disdain for the possibility of chance, “Yet on that evidence alone we should hardly assert a generalization (1921, p. 487). Though a unified monetary and fiscal system coupled with the current political control that the EU has over countries would strip member states’ national autonomy to a great degree, Keynes would see the reduction of chance as a greater advantage than the disadvantage on the national level.

The main issues with which the EU struggles lie mainly in the inadequacy of fiscal control throughout the EU. Keynesian thought promotes greater measures to centralize fiscal control to guarantee stabilization of the economies of the member states; however, due to the nature of the EU, in doing this, unifying would lead to one central body for fiscal, monetary, and political proceedings, functionally devaluing the country as an entity. This consequence is not accounted for in Keynes' writings simply because there is a temporal disconnect. In Keynes' time, he was just beginning to see the increase of technology in the governmental and consumer realm. He would have had no way of fully grasping the effects that globalization would have on the EU and on European society as a whole. If isolated in time, a Keynesian solution may have worked without issue, but the complexities of the globalized society obscure the true answer to which Keynes came. Through fear and uncertainty, success and defeat, circumstances are constantly changing, allowing for the progress of society and the evolution of thought.

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