The Role of State History on Current European Union Economic Policies

Introduction

France, Germany, and the United Kingdom (UK) are the three largest economies in the European Union (EU). Combined, the Gross Domestic Product (GDP) of Germany ($3.25 trillion), the UK ($2.38 trillion), and France ($2.29 trillion) totaled 50 percent of the EU economy in 2012.\(^1\) As a result of their relative economic power, these three states are relied upon heavily to fund the EU. In fact, in 2011, 47.5 percent of the EU budget was paid by these three states.\(^2\)

Although their histories are linked and their economies are heavily intertwined, the domestic economic policies of these three states are quite dissimilar. Most of the differences in domestic economic policy can be traced to their separate social, political, and economic histories. French economic policy is still based on the guiding principles of the French Revolution; the French establish “equality before the law and the undermining of aristocratic privilege” with a large, encompassing social security system.\(^3\) The German economy has developed into a system of organized competition and strict monetary policy as a “conscious intellectual resistance movement to Hitler’s nationalist socialist regime” and to avoid the hyperinflation of the Weimar Republic.\(^4\) The UK, the country to first experience a major industrial revolution, was a preeminent global economic power until the beginning of the twentieth century. The economic policy of the past century has been focused on improving worker conditions, managing limited resources, and, in the last thirty years, driving foreign investment into the UK.\(^5\)

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The domestic policies of France, Germany, and the United Kingdom are affected by their histories, but do their historical experiences still affect their positions on key, current EU economic issues? This article argues that the positions of France, Germany, and the United Kingdom on EU economic issues—in particular, their approaches to the Economic and Monetary Union (EMU) and the Common Agricultural Policy (CAP)—illustrate the strong relationship between their economic and political histories. Given their huge role in the EU’S economy, one must therefore explore these states’ histories to understand current EU policy outcomes.

In order to understand each state’s motivations to join the European Union and positions towards current EU economic programs, analyzing the economic histories of France, Germany and the United Kingdom is critical. This paper reviews the history of the EMU and the CAP, from inception to the current year. After presenting the history of these programs, this study explores the history of each state, in detail, as it pertains to each issue. My analysis will then expand to the ways that the history of each state impacts their current view on the policy. Although the historical study of each country covers roughly the last two centuries, there are specific starting points for each state’s historical review. The study of France begins at the end of the eighteenth century, during the French Revolution; the late nineteenth century, the beginning of Otto Von Bismarck’s reign, for Germany; and the early nineteenth century, the start of the British Industrial Revolution, for the United Kingdom. The discussion is followed with a conclusion that summarizes each state’s position on these policy areas, and the effect that the state’s history has on its positions.

The EMU

EMU- Background

The EMU refers to the group of EU states that share a single monetary policy. More specifically, the states in the EMU share one currency, the Euro, and rely on one central bank, the European Central Bank (ECB), to print that currency. The Maastricht Treaty was formulated in 1991 and created the ECB in conjunction with the EMU. The Maastricht Treaty did not eliminate national central banks; they simply became branches of the ECB. Monetary policy is a complex matter and requires a certain amount of homogeneity amongst the currency-holders. This requires the EMU to enforce strict economic policy standards. The Stability and Growth Pact (SGP) does just that; it gives the EU the ability to apply financial sanctions to any states in the EMU that run a budget deficit of over three percent of GDP.6

Monetary policy, in its current form, is a relatively new and inexact science. Until World War I, almost all states, including France, Germany, and the UK, were on a strict gold standard. This meant that one piece of currency was tied to a certain

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weight in gold. This accomplished two things. First, it made international trade simple. If a British pound was worth an ounce of gold and the French franc was worth two ounces of gold, an item that cost two pounds could be bought with one franc. Second, it limited spending. Given that currency was essentially a promise of gold, when a central bank handed out a piece of currency, the currency was redeemable for a certain weight in gold. If a central bank printed too much of it, promising more gold than it had, market observers would eventually sniff this out. At that point, the currency holders might run on the bank, draining the vault and leaving the bank in debt to unpaid currency holders.7

Starting in the mid-nineteenth century, the British central bank, the Bank of England, realized it could gain advantageous trade position by not strictly adhering to the gold standard. Most countries, however, remained on the strict gold standard until World War I. The high cost of both the war and the subsequent rebuilding effort combined with the large number of casualties to create insurmountable debt for most of Europe, including France, Germany, and the UK. Under the gold standard, states had two ways of paying their bills: taxing and borrowing. While under normal circumstances choosing between taxing, which cuts productivity, and borrowing, which accrues more debt, is tough, it was a gargantuan feat after World War I. Instead of doing either, these states chose a third option, devaluing their currency and abandoning the tenets of the gold standard.8

Though states still tied their currency to gold, they began adjusting their exchange rates to devalue their currency, which violated a fundamental principle of the gold standard. For illustrative purposes we will create a hypothetical scenario using Germany’s currency. In the interest of simplicity, we will set the value of both the German mark and the United States (US) dollar to one ounce of gold. If Germany acquired a zero interest loan of one million dollars from the US it would promise to pay the US one million marks. Under the strict gold standard, Germany would, basically, receive one million ounces of gold to pay back one million ounces of gold. Under the new system, if Germany could not pay back the loan it would simply set the value of the mark to one millionth of an ounce of gold. The Germans technically repaid their loan but actually left the US short $999,999 worth of value, destroying its own economy in the process.9

The global economy was in chaos between the world wars, with constant adjustments to the exchange rate, which made any sort of trade more of a challenge because one country could not trust the value of another country’s currency. Among many things, bad monetary policy led to the Great Depression, lengthened it, and deepened it. One economic theory is that inflation, encouraged by undervalued currency, caused the Stock Market Crash of 1929. Inflation is the amount that

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8 Ibid.
9 Ibid., 277-279
price levels increase. For example, if 100 percent inflation were to occur between today and tomorrow, a five-dollar book today will cost ten dollars tomorrow, as the price increases by a factor of 100 percent (i.e., it doubles). Another way of describing inflation is the rate that the purchasing power of the dollar decreases. Using the book example again, today having a five-dollar bill means you can get a book, tomorrow your money will only get you half as far. Inflation is caused by an increase in the money supply, meaning that while prices are up there is also more money to spend. The issue with inflation is that the closer the value of a currency approaches zero the less stable the economy becomes, as actually having money means you own a depreciating asset.10

After the crash, countries tried to counteract the negative effects of inflation, which lead to deflation. Deflation is the inverse of inflation. There is too little money in the economy, meaning the price of goods drops. During the Depression, there was not enough money to buy goods, even at cheaper prices. Less consumption led to unemployment, which, in turn, led to less consumption. This cyclical economic effect both intensified and extended the Depression.11

After World War II, the Bretton Woods conference that spawned the IMF also created a new monetary system. The new system tried to fix exchange rates as a way to avoid the chaos from the interwar period. The Bretton Woods system tied currencies to the US dollar in a manner similar to how countries tied currencies to gold. It also gave central banks the additional power of adjusting currencies more easily, hoping that countries could act more swiftly to better account for economic shocks. The Bretton Woods system had many issues. Chief among them was the fact that these two policies were contradictory. The first told countries to value their currency the same, while the second told countries to revalue their currencies on their own. The Bretton Woods system was abandoned in 1971 as a result of such contradictions and has since been replaced by a fiat system, where currency is not backed by anything and the value of a currency is decided on the foreign exchange market. With the goal of a single European market it made sense to all the member states to tie their economic and monetary policies together in order to both facilitate trade and stabilize the region.1213

EMU- History- France

Among market economies, France has a unique perspective on the role of government, one that is important to understand to fully appreciate the evolution of French economic policy over the last two centuries. France is a “capitalist country with a socialist outlook,” favoring capitalist views on private ownership, while

10 Ibid., 112-114.
11 Ibid., 112-114, 283-285.
12 Ibid., 300-303.
maintaining the importance of state intervention in economic affairs. With the UK and Germany, as with much of the rest of the world, the role of the state in economic affairs has shifted based on the political climate. France, alternatively, has been remarkably consistent in favoring “big government.” Much of this can explained by the “historical sociology of France” that has always put great pride in their public sector.

The classic perspective of economics is a bottom-up one, meaning that the consumer drives the economy. Consumers, as a group, decide what they are willing to purchase. This tells retailers which products to supply, which informs manufacturers what to produce. The main assumption of this theory is simple: the market will provide people with all necessary goods and services, as long as they are willing to pay for it.

The French approach to the economy can be described as a top-down approach. This idea is a little more complex than the bottom-up approach. Basically, there are certain goods and services—like national defense and environmental protections—which have a positive, measureable effect on people but cannot be supplied by the market. It is up to the state to decide what these goods are and how to provide them.

A completely bottom-up philosophy would be a laissez-faire system with no government involvement, while a fully top-down philosophy would be a completely nationalized economy, without private property rights or the ability to seek profit. States that have a mainly bottom-up philosophy, like the UK before World War I, provide some of these public goods. They try to impact the market as little as possible, fearing that high spending will lead to high taxes, which would result in decreased production. The French have mostly employed top-down philosophy, believing that the “[State] has a major responsibility in economic progress,” resulting in a particularly large portion of the market being publicly managed in comparison to other market economies.” France’s top-down approach means that the government does not pick up where the market leaves off, but instead the government guides the market.

France has been “a very centralized country, from, say, the fifteenth century (with an acceleration in the seventeenth century).” The French Revolution, which occurred in the 1790s, overturned the rule of the aristocracy and the Catholic

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18 Ibid.
Church. “The great financial trials and tribulations” of the Old Regime in the second half of the eighteenth century certainly helped push the revolutionary movement forward.\textsuperscript{19} Although the French were upset with the current financial policies of the state, the economic focus of the revolutionaries was mostly on the exploitive tax policies of the Old Regime, especially the injurious taxes on farmers. In fact, “three days before storming the Bastille, Parisian rioters took out their wrath on state tax policies by attacking the customs gates surrounding Paris.”\textsuperscript{20} The blame for the economic woes of France fell solely on the corruption of the aristocracy and the Catholic Church. A combination of that sentiment and the longstanding respect amongst the French people toward public servants allowed for a continuation of heavy state intervention in the economy of the First Republic.\textsuperscript{21}

The continuation of French faith in government and planning persists and is wholly represented by the establishment of \textit{dirigisme}, a government-guided market system, almost 80 years ago. \textit{Dirigisme} was not socialism. The French still believed in private property rights and profit seeking, but \textit{dirigisme} had socialist elements in its emphasis on planning, in contrast to the spontaneous order of a free market.\textsuperscript{22} The increase in government control of the economy began with the election of the “Popular Front” in 1936, as an attempt to plan a way out of the Great Depression, and expanded after World War II, during the process of reconstruction.\textsuperscript{23} \textit{Dirigisme} included heavy state investment in industry, state ownership of firms, certain limits on production, price controls, and other forms of government oversight. While \textit{dirigisme} was scrapped in the 1980s because the economy was performing poorly, many of its old vestiges remain in French economic policy.\textsuperscript{24} In fact, recently, France is still implementing a fiscal stimulus package in an attempt to use government funds to jump-start the economy.\textsuperscript{25} The heavy government influence can also be seen in the labor market. Currently, 22% of the French labor force works for the government, which is over 7% higher than the average for Organization for Economic Cooperation and Development (OECD)

\textsuperscript{19} Ibid.
member countries.  

EMU- Policy Position- France

France, currently and historically, has had a large, active government. In other words, France spends a lot of money. While it is certainly expensive, there are a couple reasons why the French prefer having a large government. First, the French view liberal government spending on welfare policies as a way to preserve the traditional values of the Revolution: liberty, equality, and brotherhood. France also enjoys an expansive civil service sector, which plays both a prominent historic role in French culture and a pivotal current role in the French economy.

France is very happily a member of the EMU, but its membership has created two interesting conundrums. The first is that France is not currently meeting the requirement mandated by the Stability and Growth Pact (SGP) that it limit its deficit to three percent of GDP. However, they are attempting to meet this requirement and reach a balanced budget by 2017, instituting major tax hikes in lieu of making significant budget cuts. This program challenges some aspects of conventional economic theory. For instance, according to the some economists, an increase in the tax rate does not necessarily represent an increase in tax revenue; simply put, if the tax rate is high enough, it will be more profitable for people to either leave the country or turn to some sort of black market, effectively eroding the tax base. Therefore, the French approach to balancing the budget will prove interesting if it succeeds.

The second conundrum is the fact that the ECB controls the money supply. As a result of all this spending, France’s public debt rose to 90.2 percent of GDP last year. While France is not currently facing steep interest rates on its debt, “public debt is approaching a level that leaves it vulnerable to a rapid loss of investor confidence, with the risk that higher interest rates would make ensuring debt sustainability even harder.” While inflation is neither a good thing, nor a smart long term funding plan, being part of the EMU forces France to fund their debt with taxes and borrowing, essentially taking any monetary option off the table. In fact the “average euro zone inflation fell to a provisional 1.7% in March 2013, in line with the official target of ‘close to but below 2%.”

A country’s deficit is different from its debt. Debt is simply the total money

30 Ibid.
the country owes and has not yet paid back. The deficit is a yearly phenomenon that occurs when a country spends more than it takes in for the current year. In order for a country to rein in its debt it must first stop running deficits. This is where France’s situation gets interesting, as ballooning debt resulting from continual deficits will eventually cause investors to lose confidence in the nation’s ability to pay off its loans. Once that occurs, interest rates will skyrocket, meaning that France would be paying more to lenders than it would be spending on actual government programs.

To slow debt growth, the French know they need to cease running deficits. Because the French are so agreeable to public spending, any major budget cuts would be wildly unpopular. The only options for the French government are to increase taxes or to print more money. Raising taxes increases revenue but, as stated earlier, erodes the tax base and shrinks the economy by disincentivizing production and encouraging cheating. Printing money effectively pays off debt and avoids any cut to spending, but in the long run leads to the possibility of hyperinflation.

Being a member of the EMU forces the French government to make tough decisions in the present, preventing them from “kicking the can down the road.” Because the remedies are often politically untenable, countries often fail to act on their debt and allow the issue to fester. This ultimately makes the problem more difficult to resolve. The EMU is not only protecting the French by forcing them to deal with their debt, but it also ensures that the French will not make a shortsighted decision—to print more currency—that hurts its economy in the long run. France is doing the right thing by addressing the issue now. While it would make more sense to cut spending and lower taxes, to prevent an erosion of the tax base, it would be difficult in political terms for the French government to push for a cut in spending. Due to the political problems resulting from austerity and the economic problems associated with printing more currency, France’s current course seems like its best option.

Not only does the EMU provide France long-term protection, it also provides short-term incentive to stay in the EMU. While France is rapidly approaching a debt crisis, being a member of the EMU provides an added layer of stability. While France by itself could face lower investor confidence due to high spending, its involvement in the more fiscally conservative EMU makes it a more stable investment.

*EMU- History- Germany*

The roots of current German monetary policy can be traced directly to the hyperinflation of the early 1920’s. As noted in the background for the EMU, inflation was out of control in Europe following World War I. No country experienced

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worse inflation than Germany. As a result, the Weimar Republic is tied to the issue of hyperinflation more than any other political regime.

Following World War I, the German government was struggling with its economy. Production was down due to the high number of casualties from the war. It could not afford to rebuild while coping with payment of reparations. As a result, like many other European countries, Germany allowed their currency to inflate to lessen their debt burden. Significant price increases were the resulting effect. To cope with this difficult issue Germany could have stopped printing money, curbing inflation but harming debt holders in the process. The second option was to continue printing money, moving the value of the currency closer to zero. Germany picked the latter course of action. Combined with the depressed global economy and a lack of resources due to the war, German inflation turned into uncontrollable hyperinflation. In turn, the hyperinflation resulted in a German economic collapse in 1923. When developing economic policy after World War II, German planners cited the economic issues of the Weimar Republic as a major reason for Hitler’s rise to power. 

Contrary to popular opinion, the Weimar Republic did not fall because of hyperinflation; the economy actually rebounded during the twenties. Many of Germany’s post-World War II economic planners blamed the policies of the Weimar Republic at the beginning of the Great Depression for the Nazi takeover. Like US policy during the Great Depression, the Weimar Republic cartelized industries and restricted output in an attempt to raise the prices of goods, failing to realize that lower production caused shortages while higher prices exacerbated issues for those who were unemployed.

The economic blunders of the Nazi economy, like the mistakes of the Weimar Republic, still loom large over German economic policy. The Nazi economy is remarkable because there was never really a discernable economic plan. It is clear that Hitler favored a planned economy similar to that of a wartime economy. The German government under the Nazis regulated “everything from banking and insurance to public utilities.” The Nazis issued price controls and production quotas, yet “rather than relying on Soviet style central planning, these laws remodeled Germany’s economy in a blend of corporatist and market elements.”

33 Ibid.
Determined after World War II to avoid a repeat of the Nazi takeover, German economic experts tried to formulate a policy that prevented hyperinflation and cartelization—the two main blunders of the Weimar Republic. The resulting policy, known as Ordoliberalism, created a market structure with limited spending and monetary growth to avoid inflation along with stringent antitrust policies to foster competition in industry. As a result of these policies, Germany’s economy was the fastest growing economy in Europe for the decades following the War, growing at 5% per year, compared to 4% for France and 2.4% for the UK. The revitalization of the German economy is commonly referred to as the Wirtschaftswunder, or “miracle economy.” Germany is currently Europe’s largest economy, which is even more impressive considering that it had undergone the reunification of the West German state with East Germany after the collapse of the Soviet Union. This was a major economic shock characterized by West Germany having to fund the development of the East German economy from top to bottom. While Germany survived the initial impact of reunification, the long-term cost of such a development project continues to grow.

**EMU- Policy Position- Germany**

Germany favored the creation of the EMU and definitely favored the implementation of the SGP. While there is not a single theory that fully explains why Germany joined the EMU, there are several intriguing ideas that adequately explain parts of the issue. These include theories on the trade benefits of a shared monetary policy and the pressure that reunification put on Germany.

Germany is currently the world’s second largest exporter, behind only China. By cutting the transaction cost of trade, Germany is able to push more goods on its neighbors. The trade theory certainly has merit, but it would be hard to argue that the benefits of lower transaction costs are greater than the potential harm

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of tying its economic fortunes to countries like Greece. Because of its position as the strongest economy in Europe, the peripheral EMU countries have relied on Germany for financial aid during the sovereign debt crisis. “Economic distress in the weaker members of the euro zone are likely to impact Germany both in terms of its exports as well as its participation in international assistance efforts that have been and will be required in the future.”

A theory that includes a more historical and sociological perspective argues that Germany, knowing the additional stress that might be put on its economy, joined the EMU as a way to prevent dangerous, inflationary policies by its neighbors. A “closer European monetary integration implies sharing the authority to set monetary policy with states that placed a lower value on financial austerity and central bank independence.” Germany is so set on avoiding inflation and repeating the monetary mistakes of the Weimar Republic that they are willing to weaken their own economy to ensure good fiscal policy by their neighbors. While the extent to which Germany fears inflation may seem overstated by this work, it is noteworthy that “Germans were recently asked to rank their anxieties in order of intensity. Their foremost fear, it transpired, was of helplessness in old age. Second – taking precedence over cancer, or terrorism, or unemployment – came the fear of inflation.” This suggests that one of Germany’s greatest economic motivators is avoiding inflation—for itself and its neighbors—by any means.

EMU- History- UK

So far, the focus of this study on monetary policy has been on the negative aspects of inflation and deflation and the concern that they inspire among policymakers. While there certainly is no consensus on this, monetary policy can theoretically be used by a crafty central bank for advantageous reasons. The British were the first of these three states to adopt a central bank and, as such, were the first to utilize monetary policy to manipulate trade and ride out shocks.

The UK was the first state to experience industrialization and owned a giant market share in industrial goods, especially textiles. Competition in the marketplace from the United States and Germany began in the 1850s, although the UK held on to the mantle of the world’s strongest economy until the beginning of the twentieth century. Unlike France, the UK had few trade barriers because it needed as large a market as possible to sell its goods. Despite the major increase in economic

productivity, social quality indicators such as life expectancy remained low in the UK. This was primarily due to widespread pollution and little investment in infrastructure.49 50

The Bank of England was established as the Central Bank of the UK in 1844. While under the gold standard, it was not allowed to change the value of the currency in the long run, but it could change the interest rates by temporarily overprinting or underprinting currency. In general, a high interest rate benefits lenders and a low interest rate benefits debtors. Extra currency meant that banks had more money to lend, which lowered the interest rate, and increased investment by entrepreneurs because lower interest rates simultaneously lower the amount an investor owes on a loan and lowers the return on savings. More money in the market, assuming no change in the amount of goods, meant increased spending. This spending surplus slightly raised the price of goods in relation to the rest of the world, which in turn increased the flow of artificially cheaper foreign goods into the UK. Less currency meant higher interest rates because banks had less money to loan and lower prices for British goods since people could not consume as much. Gold flowed in as foreign investors were more willing to invest in British companies and foreign consumers desired the artificially cheaper British products. The Bank of England used this power as a way to continually maintain a beneficial trade position. 51

**EMU- Policy Position- UK**

The British are associated with a long history of monetary policy and a strong belief in monetary independence. Reluctance to join the EMU and allowing the ECB control over monetary policy could be attributed to the historical relevance of the Bank of England, as “much of the history of the Bank [of England] runs parallel to the economic and financial history, and often to the political history, of the United Kingdom.”52 This history has created a sense of faith in the Bank of England that the British lack in the ECB.53 The British unwillingness to join the EMU also has to do with the fact that the British have more trust in their institutions to handle financial issues than they have in the EMU/ECB.54

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53 Ibid.
In an EU poll from the spring of 2013, the question was asked, “Who is best able to effectively deal with the monetary crisis?” Overall, 22 percent of EU citizens thought that the EU, as a body, was best equipped to handle the crisis. Similarly, 22 percent of French citizens and 23 percent of German citizens agreed. Only 11 percent of British citizens thought that the EU should be the entity to lean on during the financial crisis. In fact, that number was actually up from the last poll. French and German citizens had faith in their own country to pull them out of the crisis at 19 percent and 20 percent respectively. Those numbers were a little less than average for the EU, and were somewhat odd considering the strength of the two economies relative to the rest of Europe. Demonstrating faith in their sovereign institutions, 36 percent of British citizens—nearly twice the percentage of French or Germans—believed that their national government is best equipped to implement economic policy. The faith that the British have in their own government’s ability to manage the economy is reinforced by observing the struggles of other European countries to implement fiscal policy successfully.\(^{55}\)

For a state like the UK, there is little motivation to join the EMU. Joining a monetary union is ideal for countries that need an artificial boost in trade, need their currency stabilized, or are in a unique situation (like Germany) and use the union to keep neighboring economies stable. The second and the third point are not applicable to Britain, as its economy is relatively strong and they are not in Germany’s unique situation. The first does not fit either, but it requires further explanation.

Implementing the Euro would cut transaction costs associated with trade between the UK and other EMU countries, but it could potentially hurt Britain’s trade position with other countries. While commerce with EMU countries represents a huge chunk of British trade not all of their trade partners are EMU members. Adopting the Euro would restrict Britain’s ability to adjust their currency to the market and also would bring an unnecessary risk of economic collapse by another EMU member (like the recent situation with Greece) – a not entirely improbable outcome, even for large economies like France or Germany. This reality is reflected in a 2013 EU poll, in which 80 percent of French and 84 percent of German citizens answered that they wanted stronger economic coordination amongst EU countries, while only 58 percent of UK citizens agreed. The results were similar with questions about stronger EU regulations in finance (Germany, 75%; France, 76%; UK, 53%) and a strong EU central banking system (Germany, 83%; France, 73%; UK, 49%). To summarize, the British tend to feel that being more closely tied to EMU member countries would bring major risk for the guarantee of minor economic gains. For those reasons, Britain joining the EMU seems unnecessary and politically infeasible.\(^{56}\)

\(^{55}\) Ibid.
\(^{56}\) Ibid.
EMU- Summary

There are many tangible benefits to joining the EMU. The decreased transaction costs and long shadow of the future produce stronger trade cooperation and the EMU/ECB also give states a platform to influence their neighbors’ monetary policies. There are also substantial drawbacks to being a member of the EMU. The SGP limits a state’s economic independence, and fails to adequately reduce the economic independence of neighbors. The ECB limits monetary independence, limiting a country’s ability to deal with monetary shocks by themselves. Although there are economic benefits to tighter fiscal relations with neighbors, there is also a real economic cost created by the greater responsibility to help struggling peripheral countries.57

France, Germany, and the UK approach the EMU in much different ways. Their approaches to the EMU have as much to do with the successes and failures of economic policies from over a century ago as they do with anything else. The main focus of the French is reconciling the major spending that comes with the sort of big government France has employed since the French Revolution with the strict limits of the SGP. Being a member of the EMU has discouraged any policies that might foster inflation but has forced them to increase taxes, as borrowing has also become less of an option. Germany has actually accrued more debt than usual, and is also struggling to meet the fiscal constraints of the SGP. While Germany seems to be feeling the negative effects of belonging to the EMU, its firsthand experience with hyperinflation is likely to ensure continued membership. Germany is free to exert more influence on its neighbors through monetary policy than it could through any other channel, to prevent inflationary tactics by Eurozone countries which could lead to a damaging economic collapse. While joining the EMU could reduce transaction costs with some of its biggest trade partners, the UK is unlikely to join the EMU. The British have a much better track record with their own monetary policy than other EMU countries, which has led to tremendous public support for British monetary independence. 58

The CAP

CAP- Background

After the “horrendous hardships of the Second World War and of the starvation, scarcity, and humanitarian crises of the early postwar period,” Europe turned to the Common Agricultural Policy (CAP).59 The CAP was created by the Treaty of Rome in 1957, but was not operational until 1962.60 The CAP was a policy

58 Ibid.
60 Michelle Cini and Nieves Pérez-Solórzano Borragán, European Union Politics (Oxford University Press, 2013), 310.
that promoted the movement of agricultural goods between states, which stood in stark contrast to the protection and intervention dynamic of most states’ agricultural policy after World War II. Instituting supranational control of agricultural policy decreased the competitive state dynamic and created “a greater degree of freedom of movement of agricultural products.”

Given that competition from the global market put European farmers out of work, the CAP was a way to encourage trade among states while encouraging the development of the European Agricultural industry by limiting any price-gouging from non-European competitors. The CAP was supposed to be a win-win for Europe, as increased trade amongst European countries should lower prices and increase variety, while ensuring that European farmers received fair compensation. It also “cushioned [Europe] from the instability of world prices and supply.” The CAP was also thought to be an “indispensable element of economic recovery”; at its inception, the primary goal of the CAP was to prevent European food supply from dropping. The accompanying economic growth and emergence of a globally competitive farming industry was a major plus, but preventing a repeat of the horrors caused by starvation after each World War was the major motivating factor.

There continues to be major support for the CAP at the European level. Analogous to how the fear of hyperinflation drives German economic policy, fear of starvation drives European agricultural policy. In order to keep food prices competitive, while making sure that farmers are making enough to earn a living, the CAP pays farmers through subsidies. It is also important to note that not every state receives equal benefits, in the form of funding through the CAP. A country’s perspective on the CAP is to be judged not only on their agrarian history, but also by the size of the current benefits they receive under the CAP. For example, France, a supporter of the CAP, receives almost three times as much direct aid from the EU as the UK, a country in clear opposition to the CAP. The differences in funding can be attributed to differences in the structure of the two countries’ economies, as France continues to be fairly agrarian while the United Kingdom does not.

**CAP- France**

Immediately before the revolution, the chief issue that propelled much of the lower class toward revolt was access to food. People “lived with constant hunger and malnutrition; people commonly fell ill or even died due to starvation.”

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62 Ibid.
64 Ibid., 321.
After the revolution, there was a movement to build the agrarian sector, for social reasons and for practical reasons. Socially, a move from the Old Regime’s harsh tax farming system that exploited the peasant farmer signified a move in the right direction for the populace. Practically, France needed to put its bountiful natural resources to work and begin to feed its people. 66

The Napoleonic Wars of the nineteenth century required a lot of productivity, capital, and labor. This tax on resources bankrupted France. In the late nineteenth century France had the natural resources, labor, consumer base, and technological knowledge to stage its own Industrial Revolution. Unfortunately several factors, including the misappropriation of resources of the Napoleonic Wars and heavy-handed government intervention, led to much slower industrial growth than both the UK and Germany experienced. In response, France enacted protectionist policies, including tariffs on imports and quotas that limited the number of goods imported from other countries. The protectionist policies were an attempt to stem the competition that France’s domestic industry was facing during a time when they could not compete internationally. Another goal of these protectionist policies was to protect the employees in those industries, arguing that less industrial production at home would lead to higher unemployment. France’s protectionist policies actually backfired, stunting industrial growth in two ways. First, it weakened international trade relations, leading to similar reactionary policies by other states. Second, choosing to protect a less productive industry reduced competition from outside sources (which decreased the major incentive to become more productive and/or cheaper) and tied the fate of that segment of the economy to the domestic industry (which had already proven to be less successful than the foreign competition and, after the policy was put in place had even less incentive to improve). With a relatively weak industrial sector, France had less industrial jobs available and less finished goods to purchase than Germany and the UK. That combined with the abundance of fertile land, and farming remained an attractive opportunity for French citizens. In many ways, the French before World War I were still an Agrarian society. 67 68

The French position on the CAP is tied into two distinct historical phenomena. The first has to do with the important role agriculture has played in French history. Profitable farming represents a shift from the Old Regime to a freer, more idealistic society. However, because the industrial sector in France was so slow to grow relative to other countries, the French before World War I were largely an agrarian society. WWI is only a few generations past, leaving a much stronger bond to the land and the profession of farming than in those countries where the workforce shifted to industrial labor more than a half century before. In France, the CAP is

67 Ibid.
seen as a protection of a historically-grand French industry, the connection to which France is not ready to give up.  

The second historical factor is France’s protectionist history. France adopted protectionist policies in the late nineteenth century, which hurt trade and coincided with a long and turbulent economic period from the late nineteenth century until right after World War II. The CAP gave France a chance to engage in more open trade, which was seen as a major step up from the ardent protectionism of the last several decades. Through its structure, however, the CAP was a protection for the European farmer, allowing France to provide protection to citizens engaged in agriculture. 

Protection of French agrarian history and a turn toward free trade were definitely the motives for joining the CAP, and are reasons why France remains on the CAP. There are also contemporary motivations France supports the CAP. According to Cini, France receives the largest contribution of CAP subsidies. Moves away from the CAP or efforts to defund the CAP would be incredibly unpopular in France.

**CAP- Germany**

Though German history from the mid-nineteenth century to the end of World War II is often characterized by militarization and far right politics, Germany is credited with inventing one of the most far-left, charity based, and socially responsible tools of government: the welfare state. The welfare state recognizes the concept that the state is responsible for the well-being of its citizens—meaning the state has a responsibility to provide a citizen with a standard quality of living. Oddly enough, Otto von Bismarck—nicknamed the “Iron Duke” for his tough, heavy-handed style of rule—originally implemented the program. Bismarck’s goal to create a stronger, more unified Germany led him to implement “uniform systems of law, currency, banking and administration . . . [and] restrictions on trade and labor movement were lifted.” One reason for the implementation of the welfare state was that it provided a political tool for Bismarck to undercut opposition from Catholic political groups. Since its inception, especially because it was implemented by such a far-right figure, German politicians on both

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73 Ibid.
the left and the right have generally supported the idea of a strong welfare state.\textsuperscript{74}

While ordoliberalism is rooted in competition and fiscal responsibility in order to avoid the mistakes of the German economy in the interwar period, it also has many of its roots in the historic German ideal of the welfare state. One of the main tenets of ordoliberalism is the “stakeholder” system, which differs from the classic “shareholder” system. The “shareholder” system focuses on the payouts to the owners of the company. A company will engage in whatever the profit-maximizing strategy is without any thought toward the impact of externalities—like pollution or property displacement—on employees, customers, or neighbors. The “stakeholder” system charges companies to consider the effect than an action will have on everyone that has something at “stake” with the company. In a sense, it creates a metaphorical “moral bottom-line” for companies to meet. In theory, if a company under the “shareholder” system thought it would increase profits, it would cut corners on employee safety, sell a product of low quality, and dump huge amounts of polluting material. While the “stakeholder” system is a better process for society as a whole, the additional cost of the safety regulations, better quality product, and clean environment are pushed onto the consumer.\textsuperscript{75}

The German reason for joining the CAP was similar to that of the French: they needed to find trade partners. Germany was protectionist towards the end of the Weimar Republic and under Hitler, but there was also a fear that no one would trade with it because Germany bore the blame for both World Wars. Germany’s economy was more adept at finished manufacture goods than it was at farming; simply put, German society needed access to both cheaper food and more consumers to sell their manufactured goods. The CAP successfully met Germany’s general need for food, while providing it with new markets to sell manufactured goods.\textsuperscript{76}

Even without the trouble caused by the two World Wars, Germany’s “stakeholder” system, despite societal benefits, makes products more expensive and weakens its trade position. The stakeholder system necessitates some sort of trade alliance, so that German companies are not undercut by companies from countries with less demanding regulations. The CAP was one of the first major economic agreements of the EU and, based on budget commitment and timing, was arguably the most important economic policy of the EU. While supporting reform of the CAP, Germany would not advocate dissolution of the CAP.\textsuperscript{77}

\textsuperscript{74} Ibid.
\textsuperscript{75} Ibid., 518; Lawrence White, \textit{The Clash of Economic Ideas: The Great Policy Debates and Experiments of the Last Hundred Years} (New York: Cambridge University Press, 2012), 236-238.
CAP - UK

The UK’s position toward the CAP can be traced back to British Labor policy in the nineteenth century. Despite being one of the most powerful economies in the world, known for its innovation and utilization of technology, the life expectancy and quality of life in the UK was much lower than in the less economically-developed France and Germany. While life expectancy and quality of life were improving in the UK, they were improving at a much slower rate than the economy grew. The main economic focus of the pre-World War I British government was trade dominance. The era before World War I also marks the beginning of greater labor organization as a response to the poor living conditions and the emergence of the Labour Party.78

World War I initiated the end of Britain’s elite economic status. Unlike France and Germany, the UK experienced an economic boom during the First World War. Industrial productivity increased as the demand for all war-related goods exploded. Like almost all combatants that needed to fund World War I, the British temporarily went off the gold standard in order to print more money and cover the costs of the War. 79

After the War, the British had to deal with a massive number of casualties, which lowered productivity at the national level. Britain had to operate under conditions of decreased production while simultaneously dealing with massive inflation, which made all goods more expensive for consumers. This combination forced the British economy into a terrible economic downturn that lasted throughout the 1920s. The rough twenties led right into the Great Depression, during which the government enacted trade barriers, tariffs and quotas, in an attempt to protect domestic industry.80 This program was contrary to the successful economic policies of the late nineteenth century.

During World War II, planning was necessary in order to properly allocate natural resources. “World War II marked a watershed for the British economy. The market mechanism was replaced by central planning as all natural resources were directed toward the war effort.”81 After World War II there was a major political shift as the Labour Party celebrated a “landslide victory” in the general election. Policies of the newly-elected Labour Party included economic planning and nationalization

80 Ibid.
81 Ibid.
of private companies after the war. “The government was forced to continue with rationing and production controls” in an attempt to avoid the hyperinflation and inefficient production that followed World War I.\(^8^2\) The main focus of the Labour Party after World War II was decidedly more domestic than it was external.\(^8^3\)

In the late 1970s political and economic change was called for, as the “British economy grew at 2.4% per annum, compared with 4% in France and 5% in Germany.”\(^8^4\) In 1979, “the Conservative government introduced reforms to make the UK one of Europe’s freest economies”, although “many policies of the subsequent Labour government continued.”\(^8^5\) Results have been mixed; the United Kingdom has a high level of foreign investment, ranking third behind only the United States and China.\(^8^6\) This is mostly credited to the fact that labor is cheaper in the UK than the rest of Europe. One issue is that workers in the United Kingdom are generally less productive on an hourly basis than Germany or France, which is represented by a low GDP per hours worked. This discrepancy is frequently attributed to less government investment in education and technology.\(^8^7\)

Initially, joining the CAP was politically infeasible because British trade policy—like it has been for most of its recent history—was strongly liberal. The British viewed the CAP as too restrictive on their own trade, feeling that a more open trade regime would be an adequate solution. Although hunger affected England during World War II, like it had France and Germany, Britain’s response was very different. Simply put, a program like the CAP threatened the principles of post-war Labour Party policy. The Labour Party came to power after World War II, after nearly a half century of political mobilization of the worker in response to poor living conditions. While the Labour Party supported limits on the domestic market, as a party representing workers’ interests it could not support a program that raised prices.\(^8^8\)

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\(^8^2\) Ibid.
After the economic liberalization of the UK in the 1970s, British opposition to the CAP continued. One economic policy engrained in British identity, that political regimes from both the left and the right have supported, is free trade. Under the tight fiscal policy of the new British regime, opposition to the CAP intensified. There was concern that the British, who farm very little compared to countries like France, would pay to fund those countries agricultural sectors while also having to pay more for food. A rebate was agreed upon, giving the British a 66% return on any money it supplied to the EU budget that did not directly impact the UK.\textsuperscript{89}

Observing the separate histories of France, Germany, and the UK, the differences in trade policies and outcomes for France and Germany in comparison to the UK are apparent. While the CAP represented a major move toward free trade for both France and Germany, joining the CAP would have been antithetical to British trade policy. The CAP illustrates exactly how historical experiences lead to economic position preferences.\textsuperscript{90}

\textit{Conclusion}

The past 200 years for France, Germany, and the United Kingdom serve as the basis for a fascinating comparative economic study. For the first half of that period, the UK and Germany were powerful industrial economies and thereby understood the considerable benefits of free trade, while the less-industrialized state of France turned to protectionist policies. Each country’s trade position changed during and after the war. The French and Germans, who had burned many bridges as a consequence of World War II, needed trade partners and looked to the EU and the CAP. Alternatively, the British relied on self-motivated trade with other nations.

The British reliance on trade, in the nineteenth century, also encouraged the development of a central bank and national monetary policy theory much earlier than other countries. This created a strong sense of faith and pride in the Bank of England. In contrast, Germany’s terrible mismanagement of monetary policy over the early part of the twentieth century is now used as a guide for the current German economy.

While the EMU has issues, the French prefer the stable monetary policy because it provides them with the ability to balance their budget without the threat of dangerous inflation. The German fear of hyperinflation provides Germany with the motivation to remain a member of the EMU and provide guidance to its neighbors, while the faith the British have in the Bank of England keep them from embracing the ECB.

\textsuperscript{90} Ibid.
Overall, it appears that economic theories and policy prescriptions are based on avoiding the mistakes of history while attempting to replicate the successes. In that sense, the economic policies of today cannot be separated from the policymaker’s view of economic history. Considering the strong relationship between social, political, and economic events, one can argue that economic policy is based as much on the policymaker’s historic social and political understanding as on his or her economic views. The results of this paper show that the positions of France, Germany, and the United Kingdom on EU economic issues are indicative of a strong relationship between economic and political history. In order to understand current EU policy outcomes, one must also understand the histories of these states.
Bibliography


