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## **Business and the future of Europe**

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The original European project, as is well known, was an economic plan with a political purpose. While the economics of the Coal and Steel Community may have made sense in themselves, the apparatus was also designed to bind the former enemies of France and Germany together.

And so it has remained ever since. The European Union is still essentially an economic construction. Its limited budget is almost entirely spent on economic supports of one kind or the other. Most of it goes into agriculture, of course, and it can be argued whether this is a sensible use of resources. But again, the purpose is largely political.

The most dramatic example of these “political economics,” at least until the creation of the euro in 1999, was the development of the internal market in the 1980s. Unlike many European initiatives, this appeared to make clear economic sense. Cross-border trade and investment were curtailed by different national regulations, professional qualifications, taxes and duties, and by straightforward prohibitions such as exchange controls on movements of money.

There is a sharp Irish example here which is often forgotten. Before the single market, it could take a truck five hours to clear customs at the border. If a truck was not cleared before the customs officers went home for the evening, it had to park overnight. Despite Ireland’s commitment to free trade for the previous 20 years, never mind the rhetoric of a united Ireland, domestic political and fiscal considerations maintained this costly regime – and presumably still would.

The economic gains from the single market have been huge, not least for Ireland, but there was a political programme behind it too. It was felt that Europe needed another push towards the “ever closer union” enshrined in its founding Treaty. There seemed no realistic prospect of actual political integration on any meaningful scale. But a single market would tie the member states closer together and reinforce their mutual interests as compared with their national interests.

This has succeeded to a considerable degree. In particular, the free movement of people gives citizens of EU countries a unique relationship with their fellows. When Dublin was “hip” in the 1990s, the bars and cafes were full of young French, Spanish, Swedish people working or just enjoying themselves. They take the freedom to do so for granted, but it is easy to forget how remarkable it is. The citizens of the new member states will certainly think it remarkable; at least until the novelty wears off.

The internal market is still not complete. One reason is that those areas which remain to be opened to market forces impinge more on national interests, and perhaps on nationality itself, than the mutual recognition of standards for light bulbs, or even broad harmonisation of VAT. In Ireland, there is much more alarm about the opening of markets for electricity, postal services and air traffic than there was about any of the earlier changes. The threat to our low corporation tax is well recognised. Behind the scenes, there is also some concern about the effects of free capital movement and the consequences, for example, of the Irish banking system falling entirely into foreign ownership.

Such concerns are understandable. The European “method,” where economics leads the way and politics is meant to follow gives the EU a strange “upside-down” feeling compared with a federal nation state. In such states, matters such as defence and foreign policy are conducted by the federal government. Most economic matters, along with business regulation, tend to be handled by the states.

Sometimes the range of differences can be remarkable, especially in

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the USA. The idea of the joint stock company – one of the cornerstones of modern capitalism, was invented in New York in 1811. But California did not pass joint stock legislation until 1931. Even today, there is no personal income tax in Texas and Florida (what else have they got in common?), or in some other States, while the citizens of Massachusetts pay tax at almost European levels.

In the Europe Union, things tend to be the other way round. Member states deal with defence and foreign affairs, but more and more, the detail of business regulation, environmental protection, labour rights and social inclusion are decided by the Union.

One reason for this strange approach is that, despite having created the single market, member states fear the competition which it may bring. In particular, the richer states, with the most elaborate social and environment protection systems fear the cheaper costs of poorer states which do not carry these overheads.

Thus it is that all new members must accept the entire *acquis communautaire* of regulation developed over more than 50 years in the Community. This will be a major burden on the new members from the east, who will also be pressured into tying themselves to the euro as soon as possible, in case they might try to gain an advantage from having a cheaper currency.

The euro itself is the most dramatic example of the thinking which lies behind the EU model – the attempt to create a single economic, and perhaps social, entity without a central government. As has been said, while there are many examples of countries which got along fine without a central bank; there was, until the euro, no example of a central bank without a country.

The dangers in such a system were foreseen – hence the creation of the Stability and Growth Pact which was designed to limit national borrowing. In a monetary union, the higher interest rates caused by excessive borrowing by one member are borne by all. In theory, it is in

everyone's interests to see that there is no such fiscal indiscipline.

In practice, it is a real temptation for individual states to take advantage of the single currency by borrowing for itself while sharing and diluting the pain of higher long-term rates with the other members. If only one or two states are fiscally reckless, the rise in rates will be small. In the case of small states like Ireland or Finland, it would make no difference at all. Ironically, this gives them a vested interest in fiscal prudence, because the large states' behaviour can affect their interest rates, but not vice-versa.

It is a kind of prisoner's dilemma. The difficulties may go deeper, however. There are clear signs that France, which was never keen on the Pact, does not believe that the rules are even sensible. Paris may well feel that the creation of the euro is an opportunity to run bigger national budget deficits than would be possible with small national currencies. It can point to the United States, which blithely ignores the external value of the dollar and take a remarkably relaxed view of deficits as well.

The big difference, of course, is that Washington does the borrowing. The individual States are supposed to balance their books. Right now, they are having to cut back vigorously in order to do so, offsetting much of the stimulus from the rising Federal deficit.

This is the norm in federal systems, including Germany, for precisely the same reason – to avoid “free-loading” by one state. But Europe has only states and no central Exchequer to determine fiscal policy. Once again, far from being a federal super-state, the EU is the exact mirror image of one.

In these circumstances, it is hard to argue against the proposition that euro zone states need more fiscal freedom than the Pact allows. The uncomfortable fact is that even the 12 present euro members differ considerably in their economic structure and potential. They require different fiscal stances. Ireland's infrastructure deficit is only one

example. Germany is almost certainly in a “debt trap” and literally cannot close its deficit with the normal mixture of spending cuts and tax rises. Other countries – France probably included – could run budget surpluses, and should do so, given their future pension liabilities.

These differences will increase with the arrival of members from the east. Because they are poor, they have the potential to grow much faster than existing members. Instead of welcoming that potential, EU leaders, including Ireland’s regard it as a threat – illustrating even more graphically the failure to think through how the European economic entity is to work.

Underlying it is a very dubious concept, but one which appeals instinctively. This is that economic growth is a zero sum game. If Ireland is growing faster and attracting more investment than, say, Austria, Ireland must be gaining at Austria’s expense, this thinking says. But wealth truly is created by economic growth; it is not a question of sharing a pie.

And Europe needs all the growth it can get. Despite the dramatic EU integration of the past 20 years, its economic performance has, in most eyes, been disappointing. In particular, comparisons with the USA are unflattering. This is particularly true of the boom years of 1994-2000, when the US recorded growth of around 4% a year in real terms, and the euro zone countries just 2.5%.

Within these figures, the differences between domestic demand and investment in the two economies is even more striking. The end result was that unemployment fell in the USA from 6% to 4% in the period, but from 11% to 8% in the euro zone. Because the US labour force is growing, the EU record in job creation is even worse than these comparisons suggest.

In fact, US unemployment is much more responsive in both directions. It has risen to 6% since the downturn – an increase of 50% in the level from its 2000 low point – but euro zone unemployment is up less than 10%. This may be seen as a microcosm of the much-vaunted flexibility of the USA over Europe. Unemployment is lower, but jobs are less secure. There are many in Europe who argue that their more secure system is a reasonable trade-off. They question the emphasis on economic growth in much media comment and political analysis, and regret the absence of wider measurements of living standards.

This was the theme of Will Hutton's most recent book, *"The World We're In."* *" Across Europe there is a profound commitment to the notion that all citizens should have an equal right to participate in economic and social life, and that the state is more than a safety net of last resort,"* he writes.

Americans do not have that "profound commitment," and see society organised in a different way, based more upon the individual. The differences probably widened during the 1990s, with the economic boom and bubble, the end of the cold war and the rise of a new conservatism in the USA.

In Ireland, of course, these differences were crystallised in Mary Harney's famous comment that Ireland was closer to Boston than Berlin. The interesting thing is that the phrase became famous. That usually happens when a phrase touches a chord, captures an underlying concern, or even exposes a hidden truth.

One is not quite sure which it was in this case. Possibly the phrase did reflect an underlying concern. This ranges from fears that Europe threatens political and social values, from neutrality to abortion, to the more mundane worry that European developments will harm our economic growth.

As to the latter, one has to be careful about the comparisons between the EU and the USA. Dr Garret FitzGerald was one of the first to point

out that, measured per hour worked, Europeans are, if anything, more productive than Americans. But they do not work as much. It can reasonably be argued that this is a perfectly rational response in countries so rich that the necessities of life are more than taken care of.

But even when all these factors are taken into account, the EU – and the euro zone especially - seems to under-perform. But the performance is uneven. No-one could argue with the economic success of Finland or the Netherlands. The culprit is Germany which, unfortunately, accounts for 30pc of the eurozone economy and 90pc of media and market comment .

Why the difference? All three countries have high levels of social protection. There is, in fact, little evidence that such protection, per se, damages economic performance. The damage is done when the protection is of jobs, insiders and the status quo. This is quite different from a generous safety net for those who require one, and serious policies to get them out of the net if they fall in.

The danger which many commentators perceive is that the way in which EU legislation and regulation is framed favours the damaging protection of insiders rather than those in need. Insiders, whether they be employers stifling competition, trade unions protecting featherbedding, or politicians pleasing interest groups, usually have more influence than “outsiders” like the unemployed, immigrant workers, the young, or those who can only work part-time.

This combination means that business and economic agents are confronted, in a sense, by two Europes. Where the creation of the single market is concerned, the thrust has been for de-regulation, more competition and increasingly tight scrutiny of mergers and acquisitions. Were it not for Europe, it seems certain that nothing would have been allowed to disturb the tranquility of Telecom Eireann, the ESB and Aer Lingus. Where the single market does not apply, as with pharmacists or publicans, the status quo is indeed undisturbed. But at the level of the company, EU policy has tended to restrict the

free operations of the marketplace. The drive for minimum standards across the Union has had all kinds of effects, from making it difficult to run small food-processing companies, to restricting part-time work, to killing off the traditional Christmas turkey.

It is true that the single market could not function without standards. The difficulty is that too often they are set by reference to those of the richest countries. This may represent best practice in many cases but it too easily ignores the fact that standards are a cost and rich countries, like rich people, are better able to bear costs than poor ones.

Ireland is now in an ambiguous situation in this argument. Its income levels are high enough to put it in the rich club. But most observers would feel that its indigenous industrial – even service – development is still below average and that EU restrictions may damage its future prospects.

The evidence from bodies like the OECD is that many European practices, particularly restriction on labour flexibility, damage growth and employment. This issue will surely become more intense after the accession of the new members from the east, whose average income is around a quarter of the existing members'. EU Conventions and Constitutions notwithstanding, it is difficult to believe that the enlarged EU can function unless the model is changed to something which takes more account of national and regional conditions.

Finally, there is the question whether the old method of advancing political integration by economic integration has now run its course. As the EU becomes a more integrated economy, and as it tries to develop further as an economic entity, it moves ever more into areas which are acutely political within the member states. (This is even more the case as it moves into areas like foreign affairs and justice).

The question is whether the EU has the political structures or the democratic legitimacy to extend its remit much further, even in economic matters. If it does not, and does not find a way to create such

legitimacy, but still develops along the lines which many of its leaders wish it to do, its citizens will increasingly find themselves governed rather than governing - as citizens in a democracy are supposed to do.