

The EU's political impasse

New economic opportunities



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Every European country, including Turkey, could benefit greatly from the current impasse in the discussion on Europe's future. The period of contemplation that followed the rejection of the European Union's Constitutional Treaty by the French and Dutch electorate has yielded nothing. The plan to start a new process to build consensus by 2008, relying heavily on the German EU presidency during the first half of 2007, only demonstrates how desperate the situation is. This apparent lack of ideas provides fertile ground for a politically and economically attractive combination of four interrelated initiatives: accelerating and not delaying the expansion of the EU, shortening of the timetable for the complete integration of the 10 new members, completing the internal market with an even higher degree of urgency and establishing much closer co-operation between the countries that have adopted the euro.

The lay of the land

During the early 1990s, the long-running debate on broadening or deepening European co-operation came *de facto* to an end with the rise of the democratic movement in Eastern Europe and the disintegration of the Soviet Union. Suddenly, conditions were in place for Western European democracies to extend their influence to the borders of Russia, create peace and stability at their eastern borders and offer millions of people a new economic, political and cultural perspective. EU membership was

by far the most efficient instrument to achieve these political objectives.

Time was of the essence to make the political changes irreversible, and this meant the criteria for EU membership could not be too ambitious. Moreover, the Eastern European countries had to be admitted 'en bloc'. The inclusion of Poland was of paramount importance, given its size and its fraught relationship with Germany, so even well-founded objections against its membership had to be ignored. Only Rumania and Bulgaria, countries that could not demonstrate fast-enough progress in reforming their political system and judiciary, had to accept a few years delay.

Today, further expansion of the EU is again driven by laudable political objectives: stability in the Balkans and the need to ensure a secular Turkey. History would have judged European leaders very harshly had they not seized the opportunities provided by the fall of the Soviet empire, but everything has a price, and peace and prosperity for Europe is no exception. In this case, the price consists of political and economic sacrifices.

For example, the notion of a single European foreign policy has been abandoned. Nobody could have seriously believed that Eastern European countries, whose relationships with the world were determined by Moscow for decades, would accept Brussels as the new centre of gravity. Looming conflicts among the Eastern countries were a second

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insurmountable hurdle for any transfer of sovereignty in this area. On top of this, Europe has had to accept that it will take decades to roll back the impact of a US foreign policy that is actively wooing Eastern European countries to strengthen its own position in the world.

Economically, a price had to be paid in the form of likely further delay in fundamentally reviewing the EU common agricultural policy. This seems inevitable, given the economic structure of the new members, and an unholy alliance between the new members and France. An unnecessarily high price for peace was demanded in the form of the revision – or rather the lack of revision – of EU decision-making, as foreseen in the Constitutional Treaty. The French and Dutch voters, most of them unwittingly, prevented the introduction of a very poor system.

The Constitutional Treaty reflects total lack of trust. Lack of trust between large and small countries, between advanced and less advanced economies, between old and new members, between federalists and defenders of the nation state, and between the European Commission and the general public. What other explanation is there for the agreement that the EU Commission would have 25 members up to 2014? How else can the highly complicated interplay envisaged between the European Council and European Parliament for agreement on new legislation, based on proposals from the European Commission, be accounted for? How else can the different levels of authority enjoyed by the Council, Parliament and Commission (depending on the policy area) be justified?

All these 'safeguards', and still the need was felt to endow national parliaments with new powers to return Commission proposals for reconsideration. On top of all this, national veto rights remained in important areas, such

as fiscal and social policies, and many countries negotiated exemptions and procedures to protect specific national interests. Finally, implementation of the Constitution would enhance the role of European courts to set policy priorities and settle conflicts in the many areas that proved to be too difficult for inclusion in the Treaty.

At the very moment that Europe had to make major and far-reaching commitments, the new Constitution would have set inferior decision-making in stone. In contrast to the previous occasions on which Europe has made small steps to streamline its organisation and procedures, the new Constitution would rob member states of the opportunity to achieve a great leap forward at some point in the future. The procedures outlined in section IV of the Treaty give little hope that European decision-making could ever meet the requirements of a changing world. In this context, it is telling that the Chairman of the Convention that produced the Constitution reckoned it would prove its value for the coming 50 years.

The highly uncertain prospects for the Constitution are already forcing the European Commission to seek more joint decision-making in specific areas such as the fight against crime and terrorism. It is also encouraging that Germany is increasingly demonstrating a pragmatic attitude to the future of Europe and appears unwilling to go on spending political capital to save the Constitution. It has to be hoped that the Constitutional Treaty will die a quiet death.

Re-emphasising the economy, and the merits of a fourth track

The discussions on the future of Europe are taking place against the background of an ever-increasing need to bring sustainable economic growth to a higher level. Only when this is

achieved can Europe hope to get closer to finding solutions for its formidable strategic problems. By putting the economy at centre stage again (and the EU has an impressive track record here), and given the clear and growing inter-dependency among European economies, it should be possible to break the impasse.

The economic integration of Europe already has three tracks: the admittance of aspiring countries; negotiations with new candidates; the implementation of agreements with the 10 new members; and the completion of the internal market. It is now proposed to add a fourth track: the formalisation of the, at present informal, co-ordination of economic, fiscal, budgetary and social policies of the countries belonging to the euro zone by means of a complementary treaty.

Obviously, the first beneficiaries will be the countries that have adopted the euro. The stature of the euro on world financial markets will be significantly enhanced. The potential of the Monetary Union will finally be fully realised. All things being equal, interest rates will come down. In addition, it is likely that Denmark and Sweden can no longer afford to stay on the sidelines and will apply for membership. Norway and Switzerland will have even more reason to bring their monetary, economic and fiscal policies in alignment with the euro countries, and aspiring members will have an additional incentive to work hard towards meeting the euro zone criteria as quickly as possible.

As always, smaller countries benefit more than proportionally from international treaties. The voting rights for the Benelux countries, Austria, Finland and the others will be biased in their favour; informal influence can be substantial and the risk of being subjected to the power politics of larger neighbours recedes.

The benefits for the large countries –

Germany, France and Italy – are greater. Tying in their economies structurally to the innovative and rapidly growing economies of the smaller countries (the same countries that, by and large, have already restructured government spending and pension and healthcare systems), will provide new impetus for reform at national level.

The combination of the advantages of integrated policymaking and the acceleration of reform will simulate economic growth, which is very much in the interest of Europe as a whole.

Cohesion guaranteed by economic advance

Other EU countries will be admitted to the euro zone on an individual basis after meeting transparent and stringent conditions. This will guarantee that the cohesion of the euro zone will not come under pressure as the by-product of politically opportune, but economically premature, admissions.

In this new world, Rumania and Bulgaria and all the other potential EU members in their wake will be signatories of the Treaty of Nice. They will enter into what is, in effect, a common market of democratic countries, with heavy interventions in the markets for agricultural products, a common competition authority and a joint trading policy with the rest of the world. In addition, the Treaty of Nice fulfils the function of an umbrella treaty for the Treaty of Schengen, and present and future treaties and agreements to fight organised crime and terrorism. This umbrella function will increasingly come to the fore as the solutions to different problems require different coalitions of EU members.

When the euro countries build a separate identity by integrating their economies further, it is likely that resistance to the admission of

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Turkey to the less far-reaching Treaty of Nice will subsidise. This will make it possible to accelerate the entry of Turkey to the common market, which will be highly beneficial economically. More importantly, unequivocal admission will also resolve a politically and socially highly inflammable situation, in which Turkey is being held at bay by countries like France and Austria, despite signed and sealed agreements to the contrary.

All this holds *mutatis mutandis* also for countries such as the Ukraine, Belarus, Georgia and, in the future, Russia. The entry of Russia is, of course, important to help restart, support and sustain Russia's move towards democracy and to retain access to Russian oil and gas.

Capitalism deserves better

Important as all this may be, the overriding consideration should be that the euro countries would be able to preserve and improve their own, highly competitive form of capitalism, including the preservation of social cohesion and equal opportunities for all. The relentless attack on the economic performance of Europe is ill-founded. Few are able to accept that, during the second part of the nineties, the EU's GNP growth was on par with the US, if one makes corrections for statistical anomalies and differences in population growth rates.

Few can face the fact that a consumer boom has only been kept going in the US since 2000 by a sharp increase in government spending, tax reductions to the tune of four per cent of GDP, a housing boom fuelled by artificially low interest rates, and the American consumer himself, who stopped saving altogether and increased his debt by 50 per cent. All this at the expense of the future, when lenders to the US government and the nation as a whole will want to be repaid, or at least compensated for the higher risks of holding dollars.

For companies operating in the euro zone, it will become easier to resist pressure to focus on the pursuit of shareholder return on investment, simply realising the greatest increase in share price over the shortest possible time. Creation of economic value can take centre stage, which implies the optimisation of free cash flows taking appropriate rewards for the providers of capital into account.

These two objectives – shareholder return on investment and the creation of economic value – lead to very different corporate policies. Popular policies in pursuit of the first objective are buying in shares, cutting costs, and takeovers to cut more cost – anything to improve profit per share, as the presumed route to a higher share price. Concentration on economic value is more likely to lead to investments in products, markets and partnerships.

In a broader context, companies in the Euro zone will find it easier to escape the web of expectation that Anglo-Saxon investors, bankers, financial analysts and journalists spin around listed companies. Their preferred approach to business includes very specific views on the way to govern and manage companies. European companies are bound to do better if they sidestep the unaccounted cost and unintended consequences of this straightjacket. In addition, European companies will do better because they can choose from a variety of entrepreneurial and legal models: from the Dutch private limited companies to French co-operatives, and from German family-run firms to Spanish public/private partnerships.

Companies operating in the euro zone can distance themselves from the Anglo-Saxon business world, in which everything is allowed that is not explicitly excluded by law or by

contract. As a result, transaction costs in the euro zone are at a structurally lower level. Contracts can be less detailed, and litigation plays only a moderate role in settling conflicts. More importantly, European companies do not need to be as risk averse as their Anglo Saxon competitors when engaging in partnerships. This is a major competitive advantage in a world in which technology and market fragmentation force companies to specialise. In turn, specialisation helps to explain the explosion of joint ventures and other forms of co-operation across corporate boundaries that modern economies are witnessing.

Finally, the euro zone can still opt for principle-based private sector regulation, with genuine accountability, and avoid US-style rule-based regulation, which is inevitably accompanied by legally driven enforcement of compliance.

The road to policy integration

All these advantages can be obtained by making use of the organisational infrastructure based on existing treaties. The legal basis, the European Monetary Union, was created by the treaty of Maastricht. The council of finance ministers of the euro zone countries enjoys a robust mandate. To facilitate decision-making and enhance their influence, the finance ministers have already elected a permanent chairman. Since its inception, and given the many policy inter-dependencies, its formal agenda has already the tendency to go beyond pure financial matters. Informal consultations on every policy area are already a fact of life. The impact of the finance ministers on European affairs contrasts sharply with that of the Competition Council, the co-ordinating body of the economic affairs ministers, which has to operate without the benefit of a more far-reaching treaty.

The road to increased co-operation among the member states is laid out in some detail in the Treaty of Nice. Each group of eight countries that has a qualified majority in the Council of Ministers can work more closely in any field of policy identified in the Treaty. Interestingly, the Treaty does not impose any limits on the intensity of the co-operation.

Obviously, member states that want to intensify co-operation have to meet certain conditions. All existing treaties, agreements and regulations need to be respected, no member state can be excluded and all additional costs have to be absorbed by the participating member states. There are also procedural requirements. Plans to intensify co-operation are subjected to EU decision-making procedures and have to be submitted to the Council of Ministers.

Up until now, many politicians have seen closer co-operation between some member states as a measure of last resort when all attempts to move the EU forward as a single unit have failed. This moment has now come. The case can and should be made that the economic, political and cultural diversity of the EU has increased to the point where new directions are warranted. Formalities aside, there are also many informal political routes for bringing about the desired change, if and when the euro countries decide to move forward.

The fundamentals are in place

Very important economic conditions for going ahead with such an initiative have been fulfilled. The mutual dependence of the world's large economic regions is much more modest than generally assumed. Trade between the US and the EU is only seven per cent of GDP, a level that has not changed for decades. Foreign direct investments are only a fraction of total

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investment, and mostly concentrated within the region. Outsourcing is largely concentrated to countries inside the region and still confined to assembling and front and back office services. As far as the competitiveness of regions is concerned, the EU is the clear winner. It holds the largest share in world trade, enjoys a large and persistent surplus in the balance of trade with the US (its largest competitor) and has made the largest inroads in Eastern Europe, Russia, India and China, despite the substantial rise of the value of the euro versus the dollar.

In addition, the political stars are properly aligned. A new generation of politicians is taking over in France and the Netherlands. Avowed Europeans already lead Germany, Spain and Italy. Survey after survey shows that the majority of Europeans, apparently aware where their true interests lie, still support the EU, despite the incredibly inept handling of the European Project over the past 10 years.

Moreover, it has to be accepted that the divide between the UK and the European continent has become unbridgeable. With falling public support for British Prime Minister Tony Blair's ambitions, the last slim chance that the UK would embrace the euro has now gone. The possibility that the UK would divulge more of its sovereignty to Brussels in other fields has also disappeared. The Constitutional Treaty was already a bridge too far for the UK, despite the considerable achievements of Blair in clipping its wings in

the months before its approval by the Council of Ministers.

The viability of the proposal to integrate economic policymaking in the euro zone is greatly served by the fact that the UK would benefit substantially from such a step. Acceleration of the expansion of a common market, which is part of the package, is a long-standing British foreign policy objective. Given its economic dependency on the euro zone, the UK would benefit directly from the foreseen increase in economic growth in the area. With British trade with the euro zone growing, and the strengthening of the euro, comes more stability for the pound and lower interest rates. In many respects, the position of the UK would become comparable with that of Norway, a country that benefits from European integration without having to shoulder the cost or responsibility.

Last but not least, the split between the UK and the euro zone would free the UK to become a constructive participant in the common market and bring to a close an issue that has poisoned British and EU politics for at least 40 years.

Acceleration of the economic integration of the euro zone countries, under new leadership, acting as a core of a rapidly expanding free-trade zone, will create the surpluses required to meet the social and political demands of European citizens. It is also a way to restore confidence in the European Project.