

# **EU Today: Challenges and Priorities**

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**presentation at the international conference**

**European Integration at the Crossroads**

**Session 1: EU Governance – How the European Union Is and Should Be Governed?**

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# **1. Introduction**

# **Are we at the crossroads?**

- **A very proper conference title**
- **Yes, EU is at crossroads**
- **Not so much because of particular problems, even not because of refused Constitution in France and Germany**
- **Two reasons**
  - **It overstepped its own shadow**
  - **Generational change**

# Overstepping its Shadow

- **Treaty of Rome: “an ever closer union among the European peoples” ...**
- **... but not an European federal super-state**
- **There were the basic cornerstones**
  - **freedom and democracy, market economy, rule of law and – yes – social solidarity**
- **After 50 years**
  - **EU is rather perceived as entering into too many facets of everyday life, the cornerstones are sometimes forgotten**
  - **Social solidarity became more a burden than an achievement**
  - **Bureaucracy and “élites” seem to control the process without proper feedback with the people**

# Generational change

- **EU project achieved some amazing results since its inception**
  - **Peace and disappearance of Franco-German historical hostility**
  - **Post-war reconstruction and prosperity**
  - **Internal market (even if some issues remain)**
  - **In some cases (e.g. anti-trust policies) leading the pro-market policies (over-regulation in many other cases)**
- **On the other hand: an excessive European social model became –for 2, maybe 3 generations – a basic, definitional feature of EU**
  - **And present generations are not prepared to give it up**

## **2. Challenges**

- **What is Europe?**
- **Relevance**
- **Productivity, economic growth and social model**
- **Euro and macroeconomic policies**
- **Energy security and Russia**

**No pretension as to completeness**

**Do not mix it with global challenges**

## **2.1 What is Europe?**

# Roots and definition ...

**Based on**

- **Common history?**
- **Common values?**
- **Political power?**



# **... and extent?**

- **Enlargement and definitions**
- **Was there a popular, democratic discussion about Turkish membership?**
- **Europe of 35?**

## **2.2 Relevance**

# **Do people care about EU?**

**... not very much. Why?**

- Genuine European achievements are taken as given by present generation**
- EU is neither seen as a problem generator, neither as a guarantee for their solution**
- Top-down approach of EU**

## **2.3 Productivity, economic growth and social model**

# Basic proposition

- **Obvious truth: productivity growth → growth in standard of living**
  - since the beginning of 1990s: European productivity growth lags behind both US and emerging markets
  - **Vis-à-vis US mainly in retail and wholesale trade and financial services, emerging markets across the board**
- **Proposition: the European model, as it has been established in past decades, is the principal cause of lagging productivity and growth**

# **Competitiveness crucial**

- **More important than access to technology, capital and skilled labor**
- **Competitive environment as a major driver of productivity growth**
- **European competitiveness suffers from**
  - **Problem of reallocation of labor**
  - **Excessive regulation**

# **Reallocation and social model**

- **European (social) model: too many shortcomings in too many countries**
  - **Protection of jobs, not of workers**
  - **Weak incentives towards job searching**
  - **Abundant minimum wages**
  - ...
- **Labor mobility and reallocation power quite limited**  
→ **high efficiency costs**

# Scandinavian attempt?

- **Nordic countries (Denmark, Sweden) – more promising approach**
- **Combination of low employment protection with relatively high degree of social equitability, that**
  - **is consistent with low unemployment and solid growth**
  - **does not generate excessive efficiency costs**
- **Critical evaluation**
  - **not time long enough**
  - **is it transferable?**



## **2.4 Euro and macroeconomic policies**

# **Euro so far – success on the surface**

**On the surface, Euro looks promising**

- **Firm control of inflation**
- **Long-term interest rate lower than in US**
- **Strong at international currency markets**
- **Displaced USD at international bond markets**

**But, when launching Euro, optimistic expectations**

- **In the absence of exchange rate policies to restore loss of competitiveness**
  - **countries forced to reform labor market**
  - **deregulate and liberalize other markets**

**These expectations did not materialize so far**

# **Weak southern flank (as before Euro)**

**Greece, Italy, Spain, Portugal**

- **Continued relaxed wage policies**
- **Loss of 30-45% of their competitiveness to Germany**
- **Current account deficit of 8-10% of GDP (not in Italy)**
- **Difficult state of public finance, with Italy standing out even in this group**

**All this at favorable global economic environment**

# **Macroeconomic policies**

**Euro  $\leftrightarrow$  policy constraints:**

- **Loss of monetary and exchange rate policies**
- **Only fiscal policies left**

**Conditions for Euro to be efficient:**

- **Limited size of country specific shocks**
- **High labor mobility**
- **High nominal wage flexibility**

**These conditions are far from being fulfilled**

# Rotating recessions

- **Different shock to different countries**
  - “Laboratory” experiment: German unification
  - Portugal: pre-Euro demand boom → appreciation, nominal wage increase, loss of competitiveness
  - Italy – no need to elaborate
  - Next candidate: Spain
- **Lessons for new countries?**

# Political feasibility?

- **Recession will rotate**
- **EC and ECB will exercise “panEuropean policies”, that might be counterproductive just to countries in recessions**
- **On national levels - only fiscal policies left, i.e.**
  - **Fiscal transfers**
  - **Nominal wage adjustment**

**How long will that be politically feasible?**

## **2.5 Energy security and Russia**

# **Understanding Russian reality**

- **Law and order according Putin**
  - but more than 70% of population supports him
- **Strong growth and improvement of economic fundamentals**
  - But based on extremely favorable prices of oil and gas
  - Is the windfall efficiently used ?
- **Strong and powerful top companies, second generation of top owners/managers**
- **Revival of Russian national/economic interest even among most ardent Putin adversaries**



# **Inconsistent European interests**

**What do we want?**

- **Political and trade cooperation**
- **European companies entering Russian markets, including energy**
- **Secured energy supplies to Europe**

**What do we also want?**

- **No Russian companies in major European energy firms**
- **Improve democracy in Russia**
- **Capture part of the windfall profit from energy prices boom**

# The result?

- **To much straddled approach**
- **Pro-democracy Russian policies inefficient**
- **Large European companies have their own Russian interest and leverage over European politicians**
- **Uncertainty for close Russian neighbors**
- **Inconsistency between political and economic European interest makes us weak**

# **3. What to do?**

# Select the priorities well ...

- **Diversity as one the main assets → return of powers to national levels**
  - respect subsidiarity principle
- **Core of needed reforms is on national levels**
  - In search of different social models
- **Do perform the truly European policies**
  - Complete internal market, including financial services
  - Defense, some facets of foreign policy
  - Energy and Russia
- **Do ask about relevancy of what we do on European level**

# **... and slow-down**

- **Remember the cornerstones**
- **Forget about the Constitution – we do not need it**
- **Contemplate more ... what we are and we want to be**
  - **Core values**
  - **Internal market and free movement of labor**
  - **Future enlargement – where is the end?**
  - **Are we happy with “second best”?**