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The European Union's Icarus Complex

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A very long time ago, Ludwig Erhard, German Minister of Economics in Germany's first post-war democratic government, asked Wilhelm Röpke what he thought about the Schuman Plan. Wilhelm Röpke replied unhesitatingly: it's a revival of the 1927 continental steel cartel[1] – you should have nothing to do with it! Erhard answered: I'm afraid we must accept – it's the first time the French have approached us with a request since the end of the war…

I tell this story because it illustrates Röpke's profound scepticism regarding the European integration project, right from the start. When the European Coal and Steel Community evolved into the European Economic Community, Röpke's opinion of the venture did not improve. Let me quote:

> « International organization goes by many an attractive name, such as « Europe », « supranational sovereignty », « international harmonization »… The latest stage in this development is the so-called European Common Market… The economist has reason to be very critical of this project (but) the decisive argument is that it implies a considerable amount of international economic planning and the prospect of more and more concentration and organization in the European economy and is therefore bound to provide a new and powerful

[1] Uniting the principal steel producers of France, Germany, Belgium & Luxembourg under the approving eye of their respective governments.

stimulus to international centrism… and all this in the name of Europe and the European tradition, which owes so much to freedom, variety and personality. »

(Wilhelm Röpke, *A Humane Economy, The Social Framework of the Free Market,* ISI Books, Wilmington, Delaware, 1998 (English version first published in 1960), p. 243.

Thus Röpke would be distressed, but not at all surprised, at the way the European Common Market has developed since then. It has fulfilled, at least in part, his gloomy expectation that centralization and bureaucracy – « economocrats and technocrats » at work! – would « do away with the last sound remnants of national decentralization … the shining peak in the distance is the international welfare state » (id.)

My purpose in this short essay is two-fold. I first would like to develop a classification system to describe different attitudes to competition and then use it to explain why the European Union project to harmonize social and fiscal policy commands a sort of instinctive, unthinking support on the part of the general public, until its true nature is revealed. Or why, to use Röpke's terminology, people tend to support "centrism" and fear "decentrism" – until they discover its dire results in practice.

Classifying attitudes to competition

People do understand the benefits of competition when they are experienced first-hand. For example, most people can see that to have retail businesses competing with each other is better than if there were only one giant retailer and no choice.

On the other hand, many people (indeed, often the very same people who can see that a duopoly is better than a monopoly) accept the idea that the State should provide major public services in a monopolistic manner. Of course not everyone thinks so, but the National Health Service in the UK, for example, commands such widespread love and respect that no government dares to touch it. The *Education nationale* in France is widely criticized, but it is a national monument all the same. Neither health nor education are public goods in the strict sense of the term, but they are much loved and valued public *services.* I suspect that one reason they command such strong public support is Frédéric Bastiat's well-known observation that the beneficiaries believe that they are free-riding on others (as they often are). No matter how poor the service actually is, it at least does not cost *them* much, and anyway it costs much less than if they really had to pay for it themselves out of their own pockets.

Indifference to the benefits of competition and acceptance of monopoly extends quite naturally to non-economic areas, such as the making of laws and regulations, taxation, social welfare and the management of money – areas to which in recent years economists have applied economic theory in order to gain insight into what are, after all, political questions. This area of intense academic research is known as institutional or jurisdictional competition.

Thus I would like to suggest a taxonomy of attitudes to competition which ranges from the "competition minimalist" who sees virtue in competition if applied to supermarkets, but does not believe that it is useful, or even exists, in other areas, to the "competition maximalist" who believes that competition is a general organizing principle upon which most observable living phenomena are based and that applies most definitely to different laws and institutions issuing from different societies in a global world. The "competition conservative" lies somewhere between these two extremes and believes that competition applies only in special circumstances and needs a lot of public intervention (with the help of trained experts) to make it work properly.

With these definitions in mind, I should now like to turn to how the EU has developed since Röpke's sceptical comments.

An "ever closer union" of European peoples?

Jean Monnet's theory of European integration, known as the "functional approach", was based on the gradual whittling away of sovereignty through international functional agreements. Although each agreement, by itself, would not constitute much of a challenge to sovereignty, the gradual accumulation of agreements would in due course so bind States that they would be unable to resist further steps, until one day full union (of an unspecified type) would be achieved. With this theory at its inception, and given a natural tendency towards "mission creep", the European Economic Community had little difficulty being drawn first towards planning coal and steel markets, then the entire agricultural sector, then development aid, then regional policy, then health and safety regulation and (skipping a few) - finally, to a single currency and what is now known as "fiscal union".

A "competition minimalist" would, I think, applaud these developments as proof that international cooperation was imposing order upon chaos, preventing another war from breaking out and generally making States bow to international law. He would not realize, I think, that nothing really makes States bow to international law unless they see their own interest in doing so, or that the last 70 years of peace that Western Europe has enjoyed is perhaps not the result of the EU but rather that the nations composing it have enjoyed (along with others) a wonderfully long stretch of peace under the Pax Americana.

A "competition maximalist" on the other hand, would deplore the way the EU is claiming the right to set Europe-wide minimum standards in most areas of government and the fact that European Union law must, logically, take precedence over municipal law in all areas where the EU is allowed to act. Its spreading tentacles and top-down approach to integration means that there are by now very few spaces left free for national democracy or institutional competition to flourish.

The "competition minimalist" on the other hand applauds and thinks that this is Jean Monnet's theory at work. Some Member States may object from time to time (the UK is a regular stone in the functionalist shoe) but in the end, they toe the line. According to the functionalists, events like the Greek sovereign debt crisis are a good thing – they force the Union to take yet further steps towards "ever closer union".

Why I am a "competition maximalist"

Economists have always poured scorn on the idea that one had to unify the price of milk *before* allowing milk to trade freely within the Common Market. It is even hard to believe that this was, indeed, the governing principle behind the Common Agricultural Policy. We all know that competition drives prices down to a "single" market price. Governments agreeing to the price of milk at 3 a.m. is not at all the same thing! This is by definition a cartel. If prices are harmonized *before* trade is freed and *before* competition does its work, very little trade and competition will occur. But of course, that was the intention – a giant cartel of milk producers on a European scale was what was in mind. You cannot have free trade in milk! That would be unfair to farmers! The competition minimalist considers most forms of competition to be "unfair" and his solution is a maximum of harmonization at European level, like a giant Common Agricultural Policy.

Now I believe that this kind of thinking also lies behind the proposition that you cannot have free trade between countries that practise different levels of social welfare, or different levels of taxation. The EU has (naturally) always been an enthusiastic supporter of a European social policy and European tax harmonization. The Commission has proposed numerous "initiatives" in this, while Member States are understandably reluctant to hand these two sensitive areas over to the Commission, however much industrialists plead for a "level playing field" and trade unions complain about fiscal, social or wage "dumping", all code words for unfair competition.

Of course to achieve the EU's famous "four freedoms" (free movement of goods, services, labour and capital) *without* first harmonizing taxes and social welfare might drive European standards down to a (low) common denominator – the famous "race to the bottom". Unfortunately there is little sign of this happening. The reasons are the same as those that allow developed countries to trade peacefully and for great mutual benefit with emerging nations like China, India or Brazil:

- trade flourishes on differences, not similarities
- trade opens as many opportunities as it provides challenges
- trade encourages firms to seek new and different markets
- trade is hugely dynamic and profitable.

So, in the end, the gains from trade pay for high wages, high taxes and high social welfare and there is remarkably little evidence of any "race to the bottom".[2]

[2] For example, the last 30 years have seen a world-wide reduction of high marginal rates of personal taxation, and some easing of corporate tax rates. However not only is the result of global tax competition far from zero, the downward trend is currently being reversed. Furthermore, tax revenues have *risen* during this period – further evidence that while fiscal competition may exist, it does not result in a « race to the bottom ».

It is important to note in this context that competition does not result in a single outcome, quite the contrary. Take the market for socks, yogurt or even an industrial commodity like steel. Leaving aside the thousands of different types of socks you could choose from, note that there are at least 200 different types of basic steel quoted on the Chicago metal exchange. Competition is a dynamic process that leads naturally to the exploration of every possible outcome, the occupation of every environmental nook and cranny, with greater or lesser success. The result is diversity, not uniformity[3].

One would not, therefore, *expect* institutional competition to result in a "race to the bottom", but rather in a flourishing of institutional experimentation.

Fiscal and welfare competition indeed exists between members of the EU, and between them and the rest of the world. A competition maximalist like myself would say that it has to be encouraged at all costs.

The process is as follows:

a) "Foot voting", according to which people, firms and capital are free to move from one fiscal/institutional/regulatory jurisdiction to another, forces governments to be attentive to local voters' real *needs in terms of public goods supplied.*
b) "Foot voting" encourages governments to keep taxes as low as possible, for a given mix of public goods supplied.
c) Result: better government services at a lower cost!

Is this "unfair competition"? Surely not! If our governments think they are in a natural monopoly position, then it is time they woke up to the reality of global competition. It is not just the EU which obliges them to do so, it is the entire world. One of the reasons for Switzerland's economic and political "success story" is surely flourishing inter-cantonal jurisdictional and fiscal competition.

Health and safety regulation

Health and safety regulation by the EU is a vast and growing domain, and one over which it has undisputed sovereignty (unlike taxation and social welfare). The EU may not have to power to tax, but it has the power to regulate, and regulation is another form of taxation (the public authority achieves its policy objective directly, by imposing costs on the public). It is the area of EU regulation that is at the root of its growing unpopularity. The public (at least in the UK) tends to see it as unnecessarily detailed, intrusive, expensive and even ridiculous. But the business sector loves it. Firms like a "level playing field", so that cheap products from Greece, Romania or Bulgaria are in no danger of coming in to spoil their markets.

[3] This diversity of course does *not* violate the « law of one price »: the market for socks *in general* comprises high-quality, expensive socks, medium-quality socks and frankly awful socks – and different prices reflect these quality differences. One must compare like with like: in a given market, for a given product, competition will drive prices down to the lowest possible level, forcing markets to serve consumers rather than producers.

There was a brief moment in the 1980s when the European Community (as it was then) adopted the principle of "mutual recognition" in order to by-pass the difficulty of harmonizing standards by unanimous vote, thus creating a single market almost overnight. But it was quickly over once the Maastricht Treaty (1992) introduced Qualified Majority Voting (QMV) for such matters. Since then harmonized health and safety standards and directives have been pouring out of Brussels in an uninterrupted flow, a phenomenon that the competition maximalist deplores.

Imagine briefly a world without QMV making harmonization easy in the EU. Mutual recognition of competing health and safety standards would have established a unique and fantastically efficient and dynamic way to cope with regulation in a globalized world. Each Member State establishes its own standards, according to its own lights, and items produced under different standards meet in a common market place. Consumers choose – cheap and nasty, nice and expensive, whatever they like. Nasty and expensive items are not likely to find many buyers, but consumers will soon discover the nice and cheap ones – jurisdictional competition again! After that, parliaments or regulators have but to adopt the most efficient standard as revealed by competition, or even, if they are particularly gifted, they might develop an even better standard. Result: ever nicer, cheaper goods. What's to complain? Is this unfair competition? No – it would have been a sure way to make European products desirable worldwide! Sadly, the EU's Icarus Complex has turned this entirely practical system of natural competition into an unattainable utopia.

Democratic accountability

As we have seen, different social groups have different needs and tastes in terms of public goods and services. Some social groups might prefer (and be able to afford) a high-tax, high public goods environment, others might prefer the opposite, or a different mix of public goods. In democracies the actual mix of public goods and the taxes that are voted to pay for them are supposed to be determined in bottom-up manner, according to voter preferences expressed in elected parliaments. We know that the process is not perfect, but that is what politics is supposed to be about: no taxation without representation!

It is amazing that the EU should have got as far as it has in hijacking the parliamentary prerogatives of its members. But it is in serious danger of overreach – hence the title of this essay: the EU's "Icarus Complex". It is *inconceivable* that the tax/public goods mix should be identical across the whole of EU's 28 members, if only because they are at very different stages in economic development, let alone their cultural diversity and historical specificities. Yet that is what is assumed when the EU regulates blithely (remember: regulation is just another form of taxation). In doing so it does several things simultaneously:

a) it is rightly accused of a "democratic deficit" and is therefore becoming increasingly unpopular;
b) it is depriving itself of the many benefits of jurisdictional competition outlined above;
c) it prevents entrepreneurs in less-developed Member States from accessing the rich markets of Western Europe, where industrialists have

successfully lobbied for high harmonized standards, i.e. it has built up an insurmountable walls of non-tariff barrier protection within the Common Market;

d) it limits the full range of products and services that competition would naturally supply to those at the higher end of the price/quality trade-off line, thus depriving the poorer members of society from access to the cheaper range.

Indeed, the EU needs urgently to unstitch a lot of the harmonization it has already painstakingly built up over the years and let member states regain much of the territory they have unthinkingly ceded to the Union during the past.

Unfortunately, this is a most unlikely outcome. So the ranks of Euro-sceptics will continue to grow until they become a majority and a breaking point occurs at some point in the future. Wilhelm Röpke will have a growing number of disciples!