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CENTRE FOR EUROPEAN REFORM

Letter from America: Europe is needed as never before

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Twenty years ago, Nick Butler and I conceived the CER as an antidote to the fustiness that we felt pervaded too much of the debate about the future of Europe – notably in London but also elsewhere. We felt that a new generation of Europeans, born after the war and ready to think in new ways about Europe, needed to make their voices heard. We were convinced that Britain could do better than fight a 'beef war', and that the EU would benefit from positive British engagement.

Fast forward 100 issues of the CER bulletin, and some things have changed. Enlargement has turned from dream into reality, and Europe is stronger for being wider. Just look at how policy on Russia is now much better balanced than it was 20 years ago. The euro has turned from dream into…well, into a huge challenge for millions of unemployed in southern Europe. Germany has moved from being a new country finding its feet to the first among equals.

The CER has proven itself to be ahead of its time, and ahead of the debate, on many issues, from economy to environment to crime to institutions. In 2000, its report 'EU 2010: an optimistic vision of the future' called for the creation of an EU foreign policy chief and an external action service, combining the resources of the European Commission and the Council of Ministers, to increase Europe's heft in the world – and now they exist. Whatever the complaints about the current set-up, they are at least there to be improved. Every year from 2000 to 2010, the CER published its 'Lisbon scorecard', analysing the progress – or lack of it – that EU governments had made in implementing their commitments on structural economic reform, undertaken in Lisbon in 2000; if governments had done more, the eurozone would be in a happier state today. In 'Will the eurozone crack?', in 2006, the CER forecast that the diverging competitiveness of northern and southern Europe would subject the eurozone to hugely painful stresses. The CER's friends dismissed this as doom-mongering or 'eurosceptic' but in fact it was prescient.

I now live in New York and perhaps distance does bring perspective. For the American political and economic elite, European co-operation may be a disappointment, and sometimes a puzzle, but it remains a necessity. And while British euroscepticism may in some quarters be considered understandable, the europhobia that leads some people to advocate British withdrawal from the EU is perceived to be bizarre and dangerous. In the same way that the threat of Scottish separatism crept up on Americans, producing genuine anguish, so the serious prospect that Britain might quit the EU is producing a similarly strong reaction. Across party lines in the US, the idea of a Europe without Britain is not attractive at all; and it must also be said, the idea of a serious Britain outside the EU is a non-starter.

Americans see that British membership of the EU has never been more fragile. It is striking how the frequent success of British negotiators over the past 20 years has gone side by side with polls showing that growing numbers of British people are alienated from the institutions of European co-operation. It is convenient for me to say that this is less about Europe and more about the economic and social challenges facing all mainstream parties in countries like the UK. However, the facts suggest that this statement contains much truth. After all, trust in national political institutions has fallen as fast over the last 20 years as trust in European institutions.

There are immediate crises to be addressed, from the euro to Ukraine. But the key long-term question is how the EU recovers its sense of purpose in the eyes of the people. This seems to me to require at least two things.

The first is that Europe needs to be about more than the euro. There needs to be an explicit and bold agenda for the Europe of 28 countries to pursue. This is not just for the obvious reason that it would be inclusive. An agenda for the 28 could soothe some of the divisions within the eurozone. It could link euro-outs like Britain, Sweden and Poland with euro-ins like Germany. It would foster new alliances.

The policy agenda for the 28 needs to go beyond the usual mantras of completing trade agreements and the single market in goods and services, important though they are. It is not my position now to advocate a comprehensive agenda, but there are some obvious candidates – a real energy union that integrates national systems, both boosting energy security and encouraging low-carbon power generation; a clampdown on tax avoidance; and a new neighbourhood policy that strengthens the southern and eastern neighbours – and thus Europe – without offering full membership.

In my own way, I see this opportunity for co-ordinated action among the 28 in the world of humanitarian relief which I now inhabit. The EU is the second largest humanitarian donor in the world after the US. It speaks for all its member-states, and augments bilateral assistance with institutionally powerful multilateral aid. It gives a voice to people and crises that otherwise get forgotten – like the Central African Republic. And it backs aid with diplomatic, economic and in some cases military muscle. Europeans should be proud of this under-sung success story.

"Europe was most popular and effective when both centre-right and centre-left voters and leaders saw something of themselves in the EU project."

There is a second imperative, which is in some ways paradoxical, since we currently need to maximise support for Europe from across the political spectrum. The imperative is that we should not see European politics only in terms of pro-European and anti-European. There needs to be a pro-European politics of the centre-left, and one of the centre-right. They would be united in supporting an expansive vision of the role of the EU in big global challenges, but advocate different recipes on economic and social questions.

I am a strong supporter of the agenda and positions set out by the Labour leadership. They are right that we need to be able to translate our values of social justice, economic empowerment and environmental sustainability into an agenda for the European level that brings hope to people. Such an agenda needs to be able to speak against austerity, for social norms, against discrimination, for equality of opportunity, and for a European role in helping bring these things about.

One can see the counter-narrative. It is that a retreat into nationalism is the best way to defend social norms. But it is false to pit patriotism against internationalism. We need to be able to make the opposite argument: that it is international engagement which makes national advance possible rather than defence necessary.

It has always struck me that Europe was most popular and effective when both centre-right and centre-left voters and leaders could see something of themselves in the European project. It would help to halt the decline of support for the European project if we could bring political values back into the debate. There always has to be an alternative, and Europe needs to be able to offer it.

David Miliband
is co-founder of the CER. A former British foreign secretary, he is now President and CEO of the International Rescue Committee.

The bulletin at 100

by Charles Grant

We have published a bulletin every two months since the CER started up in 1998. Re-reading numbers 50-99, I am struck by how different the world was in October 2006, when the 50th bulletin appeared (including my own take on the first 50 issues).

The EU had momentum: the euro was widely viewed as a success; the EU's leaders were working to save its constitutional treaty; and Bulgaria and Romania were preparing to join, while Turkey – then a shining example of a successful Muslim democracy – was negotiating seriously to follow them. With Tony Blair as prime minister, few questioned British membership of the Union.

Ukraine was an exasperating neighbour but a sovereign state. And though Russia's creeping authoritarianism was somewhat worrying, it seemed to understand that it needed to work with the West. The Arab world was dominated by stable, autocratic regimes. The US was fighting difficult wars in Iraq and Afghanistan, with sometimes reluctant European support, but was undoubtedly the dominant global power. And China was rising.

So much has changed since then, though China is still rising. Europeans have stopped believing, with Voltaire's Pangloss, that they live in the best of all possible worlds. Hugo Brady captured the shift in bulletin 79 (August 2011): "The EU in its current form and the euro were born during a unique period between 1989 and 2008. This was a time of steady economic growth and freedom from existential threats. Agreement on European integration was relatively easy against this benign background. It no longer is."

The West as a whole is now less confident about its ability to shape global events. Barack Obama's insight that since the US could not run the world it should become a more modest super-power was correct. But unfortunately Obama has sometimes handled foreign policy in ways that make the US look weak. Neither the US nor the EU could prevent the failure of the 'Arab Spring' (Tunisia excepted), the growth of authoritarianism in Turkey, the dismemberment of Ukraine or the resurgence of militaristic nationalism in Russia. As for the EU, enlargement is off the agenda, almost nobody (outside the European Parliament) wants a major new integrating treaty and the euro is widely viewed as having been economically ruinous for several of its members. Anti-EU populism is surging in many countries and British membership of the club is now precarious.

The mismanagement of the euro accounts for several of the EU's current difficulties. As Simon Tilford wrote in bulletin 71 (April 2010): "In order for the eurozone to become stable, three things need to happen: South European member-states must boost productivity growth; northern ones – notably Germany – have to strengthen domestic demand and reduce their current-account surpluses; and there should be greater institutional integration." We have had a little, though not much, of the first and third things, enabling the euro to endure. But the CER has argued again and again that without quantitative easing (QE), more flexible fiscal rules, greater sharing of risk, structural reform and more public investment, the eurozone would stagnate and trust among governments would erode. Sadly – though QE is now, belatedly, on its way – we have been proven right.

We also read the political consequences of the euro crisis correctly. As Katinka Barysch wrote in bulletin 74 (October 2010), these were "a Union in which governments are in the driving seat, large countries matter more than small ones, and more decisions are taken by subsets of member-states. The crisis has also weakened the Franco-German alliance and revealed a growing sense of German euroscepticism." I added in bulletin 81 (December 2011) that "France and Germany make no secret of wanting less Monnet and more de Gaulle", and that this weakening of the European Commission vis-à-vis the member-states was dangerous for the EU. I noted that "Germany is emerging, for the first time in the EU's history, as the unquestioned leader. France is having to adjust to a subordinate role."

Germany is now central not only to EU policy on the euro, but also Russia. After Russia invaded Georgia I argued in bulletin 62 (October 2008) that its economic weakness would stop it becoming a serious threat to the West: it could not overcome its dependency on hydrocarbon exports or improve its lacklustre services and manufacturing industries. I also noted its strategic isolation, citing George Kennan's ever-valid dictum that Russia's neighbours had to choose between becoming its enemies or its vassals. I urged Western leaders to make clear to Russia that it would pay a price if it compromised the territorial integrity of its neighbours. The current sanctions over its actions in Ukraine are making it pay that price. And the impact of very cheap oil on an undiversified economy will prove extremely painful.

Germany will also play a pivotal role in any British attempt to renegotiate EU membership. In bulletin 88 (February 2013) Philip Whyte shot down a major canard of the eurosceptics, that the EU holds back the UK economy. Using OECD data, he showed that "despite the alleged shackles of EU membership, the UK's product and labour markets are among the freest and least regulated in the developed world." He also pointed out that none of the main supply-side constraints on the British economy – poor infrastructure (notably transport), skills shortages (reflecting high drop-out rates from secondary school and poor vocational training) and rigid planning laws (distorting land use and pushing up rents) – were the fault of the EU.

"Governments are in the driving seat and large countries matter more than small ones. The crisis has revealed a growing sense of German euroscepticism."

Philip often refuted conventional thinking. In bulletin 59 (April 2008), he asked whether liberal economic reform really caused social problems. He demonstrated that the member-states with the most regulated markets – in Southern Europe – had the highest levels of poverty, inequality and long-term unemployment in the EU. And "the reason the Nordics and the Dutch are the most egalitarian societies is that they provide the best education".

When the financial crisis struck, Philip wrote in bulletin 65 (April 2009) that "many Europeans were quick to treat the event as a morality tale. Americans were paying for their profligacy and for their heartless model of capitalism". But Philip explained that the crisis was rooted in poor financial regulation and global imbalances rather than Anglo-Saxon capitalism and liberalising reforms per se. "The US was mistaken to allow parts of its financial sector to thrive with little regulatory oversight. But it does not follow that there is nothing in the US worth emulating." For instance, the US easily out-performs Europe on productivity.

Outside contributors wrote some of the most original pieces. Nick Butler, who co-founded the CER, explained in bulletin 64 (February 2009) that the high volatility of oil prices in 2008 had damaged much-needed investment in new hydrocarbon production and in renewables. He called for global governance in oil markets: a new institution should curb volatility by "holding a cushion of reserves. These stocks would be augmented as prices fell and released gradually as they rose." The halving of the oil price since mid-2014 has strengthened the case for such mechanisms.

The EU certainly faces bigger challenges than it did when the CER was founded or when the bulletin completed its half-century. But the CER will not flinch from continuing to provide both rigorous and sober analysis, and innovative policy proposals.

Charles Grant
Director of the Centre for European Reform

Hubris, realism and the European project

by Adair Turner

The CER was born in optimistic times. It seemed that the European Union, by completing the European single market, could deliver increased prosperity. The EU seemed to underpin peace in a once war-torn continent. And membership was the vital aspiration of Eastern European countries freed from Soviet domination. Even within a British political culture ever wary of grand visions, many saw noble purpose in the European project.

In one crucial way the hopes of 1995 have been achieved, with 11 countries of Eastern Europe now peaceful, democratic members of a united Europe. There must still be much good in a Union so many have wished to join, and which others still aspire to. But the optimism of the 1990s is gone. Europe is mired in low growth, and beset with increasing political tensions. Few in Britain now talk of the EU's noble purpose without fear of derision.

Economic and Monetary Union (EMU) obviously played an important role in creating today's tensions. Many people close to the CER, myself included, initially supported that project. We must understand what went wrong. Paradoxically, the problems derived both from too much grand political vision and too much faith in free markets.

The euro was in part a political project, a 'next step' in the creation of an ever closer Europe, justified at times by economically meaningless rhetoric about the need to 'stand up to the dollar' or contain the Bundesbank's power. But EMU also seemed justified as an impeccably free-market project, driving forward completion of the single market and supporting in particular the free flow of capital. The European Commission confidently asserted in its 1991 report 'One market, one money', that the single currency, by eliminating exchange rate risk, would unleash capital flows across the currency union, allocating capital efficiently to the highest-return projects, and driving faster convergence in productivity and income levels.

Part of that story certainly came true: we saw hugely increased capital flows, the flipside of massive current account surpluses and deficits. But far from fostering the efficient capital investment which free market theory predicted, these flows supported wasteful real estate investment in Spain and Ireland, and unsustainable public deficits in Greece. Just as in the US's subprime mortgage boom, more complete financial markets produced inefficient capital allocation and left economies facing severe debt overhangs after the bubble burst in 2008.

So the eurozone crisis is in part rooted in the same hubris which gave us the global financial crisis. Before 2008, too many economists were confident that financial market liberalisation was bound to deliver microeconomic efficiency. They also believed that macroeconomic stability was assured as long as central banks delivered low and stable inflation. Robert Lucas, the doyen of new classical economics, even claimed that the essential problem of macroeconomics – how to prevent major recessions – had been definitively solved.

Both beliefs were wrong. Free financial markets can allocate capital inefficiently and can cause massive financial instability: they have left US GDP more than 10 per cent smaller than it would have been had it grown in line with its pre-crisis trend, and the eurozone still below its 2007 level. But while the path to disaster in both economies lay in the same free-market excess, the eurozone's route out of it has proved far more difficult because of its flawed political structure.

With one government and one central bank, it is politically easy to use large public deficits to offset private sector deleveraging, and to use quantitative easing to avoid public borrowing crowding out private. If needed, it is possible to go even further and permanently monetise government debt, as Japan undoubtedly will. But in the eurozone, where there are multiple national debt issuers, distributional disputes make it difficult and perhaps impossible to deal with the problems which inadequately controlled finance has left behind.

Those of us in Britain who supported the EMU were therefore doubly wrong – both in our failure to foresee the risks as well as the potential benefits of financial market completion, and in our assumption that the problems of macroeconomics had indeed been solved, allowing us to safely ignore the obvious deficiencies of the eurozone's political structure.

The eurozone now faces a chronic problem of deficient demand, to which the ECB's quantitative easing programme will be only a partially effective response. Without progress to a more complete economic union, with some federalisation of public debt, and some write-off or monetisation of existing debt, the currency union risks another lost decade of weak growth and low inflation. This would mirror Japan's experience in the 1990s and 2000s, but with far worse potential social and political consequences than in that ethnically and culturally homogeneous nation. If such progress is politically unachievable, a controlled breakup of the eurozone might be the better – though still risky – path forward.

In 1995, the year of the CER's conception, many of us saw market integration as the route to economic efficiency, while some European elites believed currency union a desirable political project in itself, independent of its concrete economic implications. The subsequent years have taught us painful lessons. Future policy needs to be based on a more realistic assessment of both market and political imperfections, if we are to preserve what is truly valuable and noble in the European project: a shared commitment to peace, co-operation, democracy and liberty.

Adair Turner
Former Chairman, Financial Services Authority

CER in the press

The Financial Times
20th January 2015
"The stability of the euro and the futures of the participating countries will continue to be vulnerable to the short-term exigencies of German domestic politics," wrote Simon Tilford, deputy director of the **CER**.

El País
19th January 2015
"The Schengen Information System allows member-states to track persons susceptible of committing terrorist attacks, but is being under-used. This is closely linked to the lack of trust among intelligence services, who are reticent to share information" said Camino Mortera-Martinez , a research fellow at the **CER**.

The New York Times
4th January 2015
"The Greek situation makes it much more difficult to announce a QE program where the risks are shared out," said Christian Odendahl, chief economist at the **CER**.

The Telegraph
20th December 2014
[On Russia's escalation options] Ian Bond of the CER commented "The nightmare scenario is if 'little green men' appear in one of the Baltics, and it then invokes Nato's Article V [mutual defence clause]".

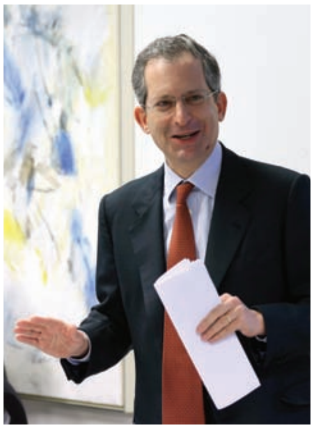
The Economist
5th December 2014
Charles Grant, director of the **CER** says some Conservatives have been too optimistic about the prospect of treaty change, partly because Wolfgang Schäuble, Germany's integrationist finance minister, tells them he is in favour – though many other senior figures in Berlin are not.

Recent events

Jyrki Katainen

20 January 2015
Breakfast on 'How to stimulate European investment', Brussels
With Jyrki Katainen, vice president, European Commission

16 January 2015
Breakfast on 'Prospects for TTIP', Brussels
With Anthony Gardner, US ambassador to the European Union



Anthony Gardner

Pier Carlo Padoan

21 November2014
Roundtable on 'Reforms and growth in Italy and the EU', London
With Pier Carlo Padoan, minister of economy and finance, Italy

17 November
Lunch on 'Reform in France and in the eurozone', London
With Emmanuel Macron, minister for the economy, France

Emmanuel Macron

Forthcoming publications

State aid and energy
Stephen Tindale

The strategic implications of a deal with Iran
Rem Korteweg

The EU, Russia and sanctions
Ian Bond, Christian Odendahl and Jennifer Rankin

The impact of Brexit on the UK's regions
John Springford

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