

Challenges for Europe* **

Willem H. Buiter

Chief Economist, European Bank for Reconstruction and Development
and Visiting Professor, LSE

6 December 2004

The book whose launch we are celebrating here “Challenges for Europe”, is a most valuable addition to the rather limited literature that approaches this issue with an open mind and in the spirit of readable but scholarly enquiry. Hugh Stephenson did a great job editing the volume, as those of you who saw my contribution in its original shape can confirm.

Each of the economic and social challenges for Europe considered in the volume is important: the Economic and Monetary Union, inequality, education, the boundaries between public and private economic activity, demographic issues and the role of Europe in the global economy. In the few minutes allotted to me, however, I will not focus on these economic issues. I will even resist reflecting on the euro, other than pointing out that, despite some obvious design errors –lack of procedural transparency, lack of individual accountability and an unsatisfactory and asymmetric inflation target – EMU has been a resounding success. Indeed it has been a success to the point that the performance of the Bank of England as regards inflation fits the ECB’s inflation objective (less than but close to two percent HICP inflation) rather better than it fits the Bank of England’s symmetric inflation objective and rather better than the ECB’s inflation performance fits its own inflation objective.

My only other reflection on economic issues is to note that there is a wide range of real economic performance in the EU. To study real economic behaviour, the natural unit remains the national economy, not the EU or EMU area as a whole. The UK is a good performer, but by no means the best. As regards growth of real GDP, Spain has outgrown the UK every year since 1997. So has Greece (but only after wasting its first decade of EU membership). Ireland has consistently outgrown the UK for more than 20 years. Austria, Ireland and the Netherlands have lower

* Remarks made at the launch of the volume *Challenges for Europe* edited by Hugh Stephenson on Monday 6th December 2004 at the LSE. The views expressed are those of the author and should not be taken to represent the views of the European Bank for Reconstruction and Development.

** © Willem H. Buiter 2004.

standardized unemployment rates than the UK. The poorest performers in the EU for at least the past decade have been Germany, Italy and France. There is no reason why any country would choose to or be compelled to follow their examples simply because it too happens to be an EU member. The UK has much to learn from and much to give to the other EU members (labour market flexibility); the other EU members have much to learn from and to give to, the UK (how to finance, build and maintain transport infrastructure; how to provide good quality primary and secondary education to the vast majority of children etc.; how to finance and provide a decent quality health care for the bulk of the population).

Economic success and failure are overwhelmingly ‘home-made’, not made in Brussels. The ‘acquis’, with the notable exceptions of the CAP and things like the Working Time Directive, which are both inefficient and inequitable, is consistent both with a flourishing dynamic economy and an ossified and stagnating economy. Prosperity and success, like decline and failure overwhelmingly reflect national institutions and policies, not EU-level institutions and policies.

The remainder of my comments will focus on the wider issue of what defines the boundaries, now and in the future, of the European Union.

The EU is more than the single market, important though the single market undoubtedly is. It is not just an economic union, it is also a political union. Its political dimension is, for me, even more important than its economic dimension. The EU is a union of European nations committed to and practicing the rule of law, respect for human rights and civil liberties, and political pluralism, through multi-party political systems and democratic, free and fair elections. Checks and balances, including an independent judiciary and a vigorous civil society, ensure that government too, including the executive branch, is under the law, not above it. The Union is secular, in the sense that de facto, if not always de jure (after all, England and Scotland have established churches) there is separation of church and state, temple and state, synagogue and state and mosque and state.

How important this political dimension of the EU is has been illustrated by developments in the former communist and centrally planned nations of Central and Eastern Europe since the fall of the Berlin Wall 15 years ago and the demise of the Soviet Union in 1991.

The need to satisfy the political Kopenhagen criteria has been a key driver of improvements in human rights and democratic governance in the 8 new EU members from Central Europe. There can be little doubt that the plight of the ethnic Russian minorities in Estonia and Latvia would have been worse without constant EU pressure. Likewise, the conditions of the Roma in Hungary and the Czech and Slovak Republics would be worse today but for the need to meet the standards set by the EU.

Indeed when one plots broad indicators of either the degree of freedom and fairness of the electoral process (such as the Freedom House data on nations in Transition) or on the rule of law, protection of property rights, civil liberties and corruption (such as the EBRD's own Constitutional Liberalism index), there are some very clear patterns. Contrast 4 groups. The 8 new EU members, the 3 in the waiting room of the EU (Bulgaria, Romania and Croatia), the other pre-ins from the West Balkans (Serbia-Montenegro, Albania, Macedonia, Bosnia-Herzegovina), and the 12 CIS countries. Starting in the early or mid-90's, the 8 new EU members start off at the highest level of the 4 groups and improve steadily. The 3 countries in the waiting room start off at a lower level, but improve at a faster rate, and are catching up with the eight front runners. Interestingly, a similar pattern applies, albeit from a much lower initial level, for the 4 countries in the Western Balkans.

By contrast, the CIS countries as a group start at a level somewhat above that of SEE, but show steady deterioration over the past decade. As of now there are only 2, or at most 3 countries where when there is an election, the incumbent or the incumbent's hand-picked candidate isn't a shoe-in. The two countries are Georgia and Ukraine. If Moldova's next set of elections are reasonably free and fair, that would be number three. In the remaining 9 CIS countries, including Russia, we see deterioration in the electoral process and weakening of the rule of law – a steady drift into unaccountable autocracy. A number of countries, Belarus, Turkmenistan and Uzbekistan are already full-fledged police states. Others may not be far behind.

What can be the role of the EU here? Considering both political and economic reform processes across the 27 countries of the region, one common feature stands out: the prospect of EU membership, and the need to meet the political and economic Kopenhagen criteria and the demands of the 'acquis' combine to make a powerful driver of political and economic reform.

For countries that fall outside the dotted lines that Brussels has drawn on the European map, that powerful external driver of economic and political reform does not exist. That includes all countries that were part of the Wider Europe initiative, now known as the European Neighbourhood Policy. In the EBRD's region this includes Belarus, Ukraine, Moldova and the three South Caucasus countries: Armenia, Azerbaijan and Georgia. Note that the last three countries were not part of the Wider Europe initiative. Only after someone in the Berlaymont building looked at the map more closely did it dawn on the responsible parties in Brussels that Armenia, Azerbaijan and Georgia were indeed European countries.

The European Neighbourhood Policy is a polite way of saying to the countries it covers: "not now, not ever, never" will you be a EU candidate". It goes on to add insult to injury by adding: "Yes, you should adopt the 'acquis', even without any prospect of EU membership; what you will get in return is enhanced market access and possibly some cash (through the new financial instrument that is supposed to be part of the ENP)."

Recent developments in Ukraine make it clear just how short-sighted, shabby and cheap the ENP is. The cause of democracy and market reform would have been boosted significantly had there been a firm promise from the EU that Ukraine too could become an EU member, provided the same political, economic, social and other institutional conditions are met that had to be met by the 8 countries that joined the EU on May 1, 2004,. The hurdles that must be met are daunting. Qualifying may take decades - even a generation or more. But we cannot and should not pull up the drawbridge and try to define once and for all where the boundaries of the EU lie. The EU missed a historic opportunity to strike a blow for democracy and market reform when it designed the European Neighbourhood policy. It is not too late to change course, although not all the damage that was done can be easily undone.

Provided the Kopenhagen political and economic criteria and the demands of the 'acquis' are met, any European country should be able to become an EU member. In practice this means Ukraine, Moldova, Belarus and the nations of the Caucasus, although of these three, Azerbaijan often appears to be more Central Asian than European. There has never been, nor is there today, any effective desire in Russia for EU membership. Nor, I think, is there in the former Soviet Republics of Central Asia, although Kazakhstan at times emphasizes the 'Eur' in its 'Eurasian' status. Russia, because of its natural gas resources, is an

elephant in its own right and can negotiate with the Brussels elephant on equal terms. The same does not apply to the other CIS countries. They need our help.

In addition to a commitment that the ENP countries of the region can become EU members provided they meet the same criteria as the new EU members of the 2004 cohort, the EU should offer the following to these countries:

- Unrestricted market access for all sectors, including agriculture and 'sensitive sectors' like textiles, footwear, steel, shipbuilding, light engineering etc. There should only be political conditionality associated with this enhanced market access.
- A generous policy of (multiple) entry visas and work permits to compensate for the loss of employment opportunities in the enlarged EU as a result of the imposition of the 'Schengen curtain'.
- Generous scholarships for study at the best EU Universities.
- Generous financial support for capacity building in the legal, regulatory and general administrative fields.

Unless the EU meets these challenges, it could end up with a number of failing states on its new boundaries. The adverse external effects in the form of crime (money laundering, financing of terrorism, illegal arms trade, trafficking in illegal drugs, human trafficking, prostitution), terrorism and public health would be very serious. So enlightened self-interest and doing the right thing for once point to the same course of action. It is up to the EU to meet this challenge.