Europe’s Internal Dynamics: Absent Without Leave?

Less than a year after the rejection of the European constitution, Otto Graf Lambsdorff, honorary European chairman of the Trilateral Commission, warned that European integration has entered a crisis of leadership. Noting how long-term members of the European Union have started taking for granted the benefits of economic integration, he called for a renewed attempt to strengthen the EU and address its weaknesses. The session was moderated by former Polish foreign and finance minister Andrzej Olechowski.

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Europe stands before a crisis. But it is not a crisis of real substance; it is one of attitudes, of ideas, and most of all, of leadership. It is, therefore, a lack of internal dynamics that we confront in Europe these days.

Europe continues to be a paradox. The European Union and especially its common market—the biggest in the world—is the envy of its neighbors. The possibilities and benefits afforded to those states which are part of the Union are great, in both an economic and a social sense. This is reflected in the wish of many to be party to these benefits. Membership is aspired to by almost all those within its geographic reach—the only exception is our common neighbor Russia.

And yet one would not guess it to observe present events in the EU. A culture of fear, skepticism, and national protectionism has spread inside its borders among political elites and the wider public.

The EU Constitutional Treaty has stalled after the referendums in France and the Netherlands; economic growth in the continental heart of Europe is slow and in some cases stagnant; and the nasty row over the 2007–2013 budget was only defused by some compromise-seeking mediation by Chancellor Merkel and some very traditional German “checkbook diplomacy.”
But more worrying is the resurgence of nationalist protectionism inside the common market. Moves by national governments to prevent takeovers of national energy companies by other companies from inside the EU illustrate this new nationalist protectionism.

The reason for the current state of affairs in Europe is the lack of political leadership, which is called on to add force to the European idea and integration process. It is decidedly lacking in current political affairs, especially from two of Europe’s largest countries, where leadership should be expected to be forthcoming.

In England, Tony Blair is now a political lame duck who will not stand for office again. Instead, he keeps watching his political capital both at home and abroad being sapped away slowly but surely as all wait for Gordon Brown to take the reins.

In France the situation is not any rosier. President Chirac is on his back foot politically after the referendum on the Constitutional Treaty. Many Frenchmen took it to be a referendum on the French president, and therefore answered in the negative. His poll numbers continue to be disappointing and the campaign for his successor has begun in the open. The recent dispute between Prime Minister Dominique de Villepin and the Minister for Home Affairs, Nicolas Sarkozy over modest labor market reforms show that the current French leadership is disintegrating. The reforms as such concern an employer’s right to fire someone who is on his or her first working contract within 24 months of the signing of such a contract.

Now, this does not seem revolutionary and in fact, in Germany, this is precisely what socialists and conservatives have agreed to introduce during their term of office. However, in France it has sparked pseudo-revolutionary demonstrations, further damaged the Villepin government, and breathed new life into the Socialist Party that may field a very attractive female candidate, giving them a real chance at victory.

So, on balance, any real direction or drive from either Britain or France is now really out of the question in European matters. Great Britain is out until Gordon Brown steps up as the new prime minister. There, we know who the new person will be; it is unclear, however, when he will take over. In France, we know that the election will take place in the spring of 2007 and that a successor to Chirac will be chosen. Here we know when to expect a new face; we just do not know who that new face will be.

This has bad consequences for Europe: the lack of political leadership has led to stagnation in European political affairs and thus to the emergence of dangerous protectionist tendencies.
Let me say a word about Poland, the most important of the new EU member states. It was understandable that the Poles threw out their socialist government in the last elections. The alternative, however, does not look promising. The dominant force in Poland, the very conservative Law and Justice Party, has teamed up with two groups that are described as radical right-wingers: one is a party made up of Catholic fundamentalists, the other of agricultural populists. It is hard to conceive of a democratic party more conservative than Law and Justice in the first place, but two of them? The other Europeans have been bitterly disappointed by the failure to form a center-right government in Warsaw between Law and Justice on the one side and the Civic Platform on the other. Sometimes it appears that the Poles themselves do not really seem to know where they are going. What is clear in such a situation, however, is that one should not expect any substantial contributions from Warsaw that might be helpful for Europe as a whole.

There is, however, not all bad news on the leadership front. In Germany, things may look up a bit. Now, you may say that it is a little undiplomatic that I first deliver a criticism of the situation in three neighboring countries and then go on to exalt my own. Remember, however, that I belong to the opposition in Germany and I am not inclined to give the current government more than its due.

Up until now, nothing meaningful has been done for tax reform, reform of the labor market, our health insurance system, and our underfinanced social security systems. These are the issues which will decide whether Ms. Merkel will be a successful chancellor. With the existing grand coalition, her chances are very small.

But truth be told, Germany’s new chancellor may yet turn out to be a beacon of hope, a leader with a European vision, a healthy stock of still-fresh political capital and drive, and, most importantly, a willingness to strike deals. Ms. Merkel is said to have learned a lot from Helmut Kohl. She served in his cabinet as minister for the environment in the 1990s. She has already changed one tenet of the inept red-green government’s foreign policy and returned to the tradition of Kohl and Genscher. I would like to add, “pay attention to the smaller ones.” Inviting and listening to smaller neighbors pays off. A broad basis of support for the EU’s new direction will be vital. Merkel can play a crucial role in the further success of the European project if she can ensure the support of the smaller member states. This is a mission that she has already begun, thus laying the groundwork for the German EU presidency in the first half of 2007. She also had a very good start with her role in the recent European budget negotiations; in the mold of ex-Chancellor Helmut Kohl, she stepped in and brokered a compromise
between the British and the French, and thus a solution to the problem. It cost a little, as Germany threw in €100 million for Poland, but on balance it was worth it as another festering crisis could be avoided.

However, while haggling over how much money Europe wants to spend, another problem was not addressed, and that is the manner in which we should spend our money. The EU budget is a relatively modest €100 billion per year, or about US$120 billion. Nearly half of that is spent on agricultural subsidies. Now, it is true that this is also due to the fact that national agricultural subsidies are outlawed in Europe and that therefore all such money has to come from the EU. That does not explain, however, the fact that Europe continues to spend tens of billions of euros on agricultural subsidies in the first place. This, unfortunately, had not changed with the recent budget deal and Ms. Merkel could not do anything about it in the face of staunch opposition from France. A modern, progressive attitude toward the future of Europe’s economy, however, would require a structural change in the way we spend our money.

At the national levels, it is social welfare spending that constitutes the bulk of the budget plus interest on debt, which has spiraled to a level unheard of in earlier decades. And on the European level, we spend nearly half of our money on agriculture. Combined, these show that we invest way too much in consumption and in repaying past debt while neglecting investment in the future. That is bad enough and it is a structural problem that will require courage on the part of all national and European leaders if it is to be overcome anytime soon.

A much more current problem that is just as serious is the recurrence of economic nationalism in Europe. There is no question that the European internal market is both the foundation of Europe’s wealth and one of the core pillars of Europe’s postwar political construction. After enlargement, the EU has become the world’s biggest internal market. The 10 countries that joined the EU on May 1, 2004, brought with them 75 million new citizens. The total EU population now is approximately 455 million. Moreover, the combined economic weight of the newly expanded EU has increased 5 percent in monetary terms and 10 percent in purchasing power parity as compared to the economy of the “old” EU. The EU now accounts for 19 percent of world trade and a quarter of the world’s GDP. In addition, it is the source of 46 percent of the world’s outward FDI and is host to 24 percent of inward FDI. For the people, it means that they find new markets, can choose from a larger range of goods, and probably pay less for these goods than they would otherwise have to. It also means more and better possibilities for European companies to do business. All in all, therefore,
enlargement is a success story. But the market encompasses the famous “four freedoms”— the freedom of people, goods, services, and capital to move freely inside the EU. Three of these are in danger. Limitations on labor mobility so far as workers from the new member states are concerned have just been extended by countries such as Germany, Austria, and others.

As far as services are concerned, the plan to pry open the sector in the way Frits Bolkestein envisioned has regrettably been abandoned. Services are responsible for about 70 percent of Europe’s GDP, but the market is still fragmented. Achieving a truly free internal market for services would have meant a big boost for growth and jobs in the EU. It does not look good right now, though. The heads of state and government have accepted a bad proposal from the European Parliament that will leave the situation more or less unchanged. The leader of the Socialists in the EU Parliament called the decision against the service directive a victory for the social model. That model includes 17 million unemployed!

The most worrying development, however, is taking place in the area of the free movement of capital. National governments have erected hurdles against such free movement in a number of important cases. In Luxembourg and France, there is great agitation about Mittal Steel’s offer to buy Arcelor. Mittal is registered in the Netherlands, so qualifies as European. Luxembourg’s Prime Minister Jean-Claude Juncker, an otherwise reasonable man, has spoken out against hostile takeovers altogether. In Germany, we still have the so-called “Volkswagen Law” lest our carmaker fall into foreign hands the way Nissan has been bought by Renault. And Italy has thwarted attempts to acquire Italian banks. Most absurdly, Poland was opposed to the merger of Italy’s Polish Unicredit affiliate with the Polish affiliate of Germany’s HVB, even though Unicredit has already acquired HVB in Germany in what was an encouraging exception to the rules of late.

The worst cases, however, can be observed in France and Spain these days, and they both relate to a strategic area in which competitiveness is paramount for Europe’s future in a changing world—energy. When an Italian company, ENEL, wanted to take over Suez, the French government went into overdrive to stop this. All of a sudden, Gaz de France was told to merge with Suez. That is easy as Gaz de France is state-owned. At the same time, Prime Minister Villepin pronounced a new “economic patriotism” that was henceforth to govern France’s attitude toward cross-border mergers. He identified a number of so-called strategic industries that were to be protected against immoral offers from the competition and called for the creation of “national champions.”
Apparently, that call was music to the ears of Spain’s government. Just after the announcement that Germany’s EON would bid for the Spanish utility Endesa, Madrid rushed through a law that gives its national energy commission new powers. The law not only enables the commission to veto or impose conditions on takeovers of national utilities by foreign investors, it also widens the agency’s mission to include national political considerations. This is clearly contrary to the principles of the internal market. So far, however, it is unclear whether the issue will be resolved in a reasonable manner.

It is deeply worrying that old nationalist fears are being allowed to reemerge and to put the continued prosperity and growth of the Union at risk.

French, German, Polish, or Italian “national champions” go against the very core of the vision of a united Europe. Compared to the market sizes of the United States, India, Japan, and China, these so-called national champions are “provincial champions” at best. They are nothing without the internal market. Therefore, the wellbeing of the entire union is what counts. In this context, “global champions” based in Europe are helpful, like Siemens, Accor, Airbus, or SAP. Talk of national champions, on the contrary, is not only shortsighted, it is outright dangerous.

Jacques Delors was right, of course, when he said that no one falls in love with an internal market. But you do not have to be in love in order to recognize that, these days, Europe must rediscover the concept of the internal market and must take it seriously.

And some countries actually feel a kind of love for that market—namely, the new member states who still remember what life looks like outside the EU and now feel that they are short-changed. This is especially true when the mobility of labor and services is hindered by the old member states. Therefore, a deeper sense of unity should be extended to nations in Eastern Europe, who feel somewhat excluded or relegated to part of a “second tier” of Europe. They must be included and seen as full and equal members of the European Union who are free to compete on the same level as other countries. Accusations of so-called “social dumping” directed against Eastern European countries and calls on them to raise their taxes are counterproductive. They also do little to add to a feeling of general purpose inside the EU.

In this context, a significant liberalization of the labor market is in order. First moves in this direction in France were a good start, but the opposition shown toward them there illustrates the need for unity and focus throughout Europe. The globalized economy is characterized by the
need for economic dynamism—the ability to move quickly to take advantage of new markets and opportunities. Europe will never succeed in this environment if it does not liberalize its labor laws to give companies and workers the ability to be flexible and adjust quickly to market conditions. A liberalization of unlawful dismissal laws would be a very positive step in this direction.

So, if 2006 is not the year of inspiration in Europe, where and when can we hope to see a more inspired leadership again?

For inspiration, I believe we can look to Japan, where three years ago the economy was only growing at about 1 percent per year. Today, continental Europe does not look much better with growth of under 2 percent. I think that European leaders can learn from Prime Minister Koizumi. His is exactly the type of courageous leadership that Europe needs, and that would lead Europe's economy back to growth and increased prosperity. Cutting back on red tape, reducing the role of the state in the economy, and privatizing industries that can be handled by the market are all moves in a direction that Europe would be well advised to emulate.

We can also look to the United States, as we heard earlier. They grow at almost 4 percent per annum. Contrary to conventional wisdom, the United States is heavily regulated in a number of areas, from environmental considerations to demands on product safety. But the ease and speed with which employees can be hired or fired lends a large degree of flexibility to the American economy, which is lacking in Europe. This essential element of economic dynamism needs to be brought to Europe as well. Both employers and employees must be quicker in addressing new challenges and making the most of new opportunities.

As to the timing of a new phase of leadership in Europe, we can look to 2007, when a number of factors will come together. There will be a new president in France and possibly a new prime minister in London. Some also point to the German EU presidency led by a new chancellor. I believe that this presidency will be very difficult, though, as it takes place at exactly the same time as the election campaign, and the election itself, in France. Heightened sensitivity is probably a euphemism to describe the situation in France one year from now. This will limit the room to maneuver for any EU presidency, no matter which country has the dubious privilege. What we can hope for, though, is a renewed attempt to overcome the problems of the Treaty of Nice. This can take place in the form of a new initiative concerning the so-called European Constitution or as a plan for the creation of a new, more modest treaty. Hardly anything, however, will be brought to a conclusion during that phase, as it would surely fall victim to French campaigning.
Instead, the German presidency should seek close cooperation with the Finnish presidency, which it will be succeeding, and lay the groundwork for some decisions to be taken during the second half of next year. This may well create a different political climate in Europe, bringing with it new opportunities for growth and progress.

So, it will be a difficult year ahead; that much is clear. But if Angela Merkel succeeds in laying the foundations for a renewed European impulse, we may see some real progress in the second half of 2007, as well as in 2008. This is important because the core goals and benefits of the EU are sound. We can see this reflected in the will of so many nations to join the Union. After all, if we did not have the European Union today, we would have to invent it. Now that we have it, we have to improve it. And with it, the lives and fortunes of Europeans and everyone else doing business with us. That is the challenge for the coming years.

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