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THE EUROPEAN JOURNAL

The Journal of the European Foundation



Matthew Taylor
Racing to a Crisis

Moving On Up – Exposing EU Tax Plans

and Lord Owen, Bob Worcester & Dr Bernie Moss

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Contents

For reference, numbers on pages are as in the printed copy Articles below are hyperlinked – use the hand icon, point and click	Original Page	PDF Page
Editorial *Bill Cash, MP*	2	3
Aiming for the Heart of Europe: A Misguided Venture *John Bercow, MP*	3	4
Racing to a Crisis *Matthew Taylor*	5	6
EU and EMU: Why the experts invariably get it wrong *Dr Bernie Moss*	7	8
Regional Chambers *John Walker*	8	9
Constitutional Government *David Radlett*	9	10
Will the Euro be a Global Safe Haven? *Jeremy Stanford*	11	12
Moving On Up: Extracts from the European Foundation Pamphlet *European Foundation Staff*	13	14
Down which road? *Jason Groves*	15	16
Why the Tories lost the 1997 British General Election *Robert M. Worcester*	18	19
The Retreat of the State in International Affairs *The Rt Hon. the Lord Owen, CH*	20	21
Mr Blair's European Army *Keith Simpson, MP*	23	24
The UK, the Euro and the Treasury Tests *Brian Burkitt*	25	26
Eurodata	26	27

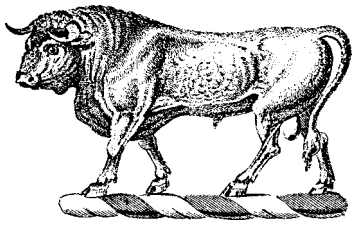
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It's Taxation, Stupid

No one can possibly doubt that tax harmonisation in the EU is with us and not just a slippery slope. The European Foundation pamphlet, "Moving On Up", was published in mid-October and is reproduced in this edition. It was foreshadowed in my pamphlet, "British and German National Interests", published at the end of September. They were at the forefront of the hue and cry which has dominated the British press since then and which was the first comprehensive analysis of the subject. We circulated "Moving On Up" to the Chairman of the FTSE 100 and to editors of newspapers, the media and MPs even before the dramatic speech by the German Chancellor which he made to the Bundestag on his inauguration. On 2nd October, Wilhelm Henkel, the celebrated German economist and member of our international advisory board, predicted in *Die Zeit* that the European Union would now introduce a wave of Keynesian policies stimulated within Germany under its new government and driven by the new German Finance Minister and Leader of the SPD, Oskar Lafontaine. The new Keynesian framework in Germany was the natural (or unnatural) consequence of the outcome of the German elections. Germany has decided that it cannot afford to carry the burden of financing most of the rest of the European Union, that it will insist on a rebate of its massive contributions and press for a "full union" and "a common constitution to turn the EU into an entity under international law", "the decisive task of our time" (the German Foreign Minister, Joschka Fischer, on 25th November), which means a single state, one country called Europe. The only way the new expansionary policies can be funded is by spreading tax revenues across the whole of the European Union in a desperate attempt to reduce not only unemployment in Germany (now at about 4 million), but also its exposure to debt in Russia which represents 40% of money owed to it in that country. In other words, this is not a technical matter but is at the heart of the fundamental agenda of the EU and Germany – a superstate.

The Prime Minister and the British Chancellor of the Exchequer have collaborated with this policy as part of the New Way for Europe which is the blueprint for a federalist Europe. They have insisted with breathtaking naïveté that the United Kingdom can put the brakes on tax harmonisation, but in the full knowledge that they have already agreed to European proposals to eliminate so-called harmful tax competition. The full implications of this policy are now clear and they will hit the British voter and British business with gravely damaging results, including loss of jobs, of investment and reduction of British business elsewhere in the world. One of the prime objectives of Oskar Lafontaine, as Josef Joffe of *Suideutsche Zeitung* made clear in the *Sunday Telegraph* on 29th November, is "to Germanise European economic and fiscal policy. Hence his quest for tax harmonisation across the EU, which really means hiking them up to the towering German level so that tax weary German businessmen won't escape into Holland or Britain where corporation taxes are much lower." It is not only to reduce the overall burden on Germany but also to establish a common tax regime for the EU which, as anyone can see, will lead to a single state. As Chancellor Kohl made clear in his speech at Louvain in February 1996, "European integration and German national interests are both sides of the same coin" – the euro. The policy of the former German government is being pursued with relentless force. As I pointed out at the German–British Industry Forum on 13th October (and now confirmed by Josef Joffe), the first victim would be the Stability Pact which was fostered by Kenneth Clarke and John Major and born out of the disastrous Maastricht Treaty.

When I put this to the Conference, which was held in the fateful Locarno Rooms in our own Foreign Office, and demanded a full renegotiation of the Maastricht Treaty, I was told in no uncertain terms by the German ex-Ministers who were present that this was off the agenda. Yet the German policy cannot be clearer and British voters and businessmen will foot the bill, including the cost of equalisation of pensions throughout Europe.

The British Government cannot escape the misery imposed by Maastricht without a clear policy of renegotiation. Far from it, they pursue the same Keynesian policies under the so-called New Way framework. Yet at the same time they claim they can veto the tax harmonisation programme which is the means to pay for that very same framework. They must also know that the Court of Justice is engaged in bypassing the unanimity rule on tax. The contradiction stares us in the face, as does the contradiction between the European Central Bank and the New Way.

This is not scaremongering, any more than the superb campaign being mounted by the *Sun* when they ask if Oskar Lafontaine is the most dangerous man in Europe and if Tony Blair is the most dangerous man in Britain. The two questions run together – for the same reason. The losers are Europeans and the British people, as I have indicated in several recent letters to the *Daily Telegraph* and *The Times*.

The Conservative Opposition must take heed. The single currency means tax harmonisation. The single currency is the Maastricht Treaty, which is now back at the top of the agenda. We put ourselves in the hopeless position of allowing Maastricht and EMU to go ahead and the Conservative Opposition must now call for its renegotiation and apologise for it as it did over the ERM. Saying 'Never' to the single currency would increase the 'No' Referendum vote.

The tax harmonisation programme is a practical matter of vast consequence to the British people. It is also a political and constitutional question and I call again on the Prime Minister to give the British people a White Paper on the issue. In his reply to me on the 21st October this year he said he had no plans to do so. Will the Opposition insist?

Bill Cash, December 1998

Aiming for the Heart of Europe: A Misguided Venture

Extracts of a lecture to the University of Buckingham
*by **John Bercow**, MP, on 15th September 1998*

I believe that for Britain to aim to be at the heart of Europe is a misguided venture. Tonight I shall attempt to justify that view by considering five factors: the conflicting views between Britain and her continental partners of the aim of the EEC, now the EU; the impact of the European Treaties upon this country; the political motivation for the single currency; the application of subsidiarity; and the cost to Britain of her membership of the EU. On the strength of that analysis, I shall suggest that there are alternatives to deeper European integration which all democratic political parties should contemplate.

The political motivation for the single currency

This is not the occasion for a detailed study of the arguments for or against Britain's entry to a single currency. However, as support for entry is high on the agenda of most of those who advocate that this country should be at the heart of Europe, it is as well to look at some of the economic and, in particular, the political considerations.

A Economic

British membership of a single European currency is not an obviously sensible economic proposition. Our business cycle has long been out of step with that of continental Europe and there is no evidence that convergence, if it happens, will be more than a meeting of ships which pass in the night. The start up costs for business will be enormous, hitting small firms and retailers the hardest. We could no longer use the exchange rate to absorb shocks, be they rises in prices or the impact of natural disasters. Moreover, membership of a single currency will prevent member states from taking policy decisions to react to asymmetric shocks, e.g. the collapse in confidence in the Russian economy. The UK's pattern of trade is global, not continental, and that pattern is set to continue. Sterling does not move with the European currencies but is influenced also by the US dollar. Changes in the European interest rate would affect this nation of home owners far more directly than those of other EU member states. This country has funded its pension arrangements – others have not funded theirs. A single monetary policy will need to be accompanied by a single fiscal, i.e. tax, policy, as the President of the Bundesbank has freely acknowledged. Unlike the United States, the European Union does not have the labour mobility that is a prerequisite of a successful currency union. The unemployed of Lewisham will not shift to Luxembourg to get a job. As the Governor of the Bank of England, Eddie George, has observed, "it's less likely that people will be able to move to where the work is because of language and cultural differences". Above all, the single currency entails a 'one size fits all' policy. A single interest rate would apply to every member of EMU whatever its economic situation. That rate would usually be either too high or too low. The single currency would be the permanent form of the Exchange Rate Mechanism of which Britain was a member from October 1990 until September 1992. In barely 23 months, unemployment went up from 1.67 million to 2.85 million, interest rates were artificially high for too long and rose briefly to 15 per cent, thousands of people saw their homes repossessed and many others were driven into bankruptcy.

The UK's pattern of trade is global, not continental, and that pattern is set to continue.

I hope the ten economic considerations cited above give cause for thought.

B Political

For me, the political objections to British entry to a single currency are the most compelling. Yet I was reminded recently that the political implications are not always recognised. An intelligent lady, whom I like and respect, came up to me and advanced the most common 'economic' argument for the single currency. "I would like such a currency", she said, because I wouldn't have to change money when I go abroad in Europe." I said that if that was all the single currency were about, I would agree with her. "Isn't it?", she replied.

Let us be clear. We are not talking about a common currency, but about a single currency. Whilst some opinion polls have been seemingly ambiguous on the subject of the single currency, these polls, without exception, have not mentioned that Britain's joining the single currency will entail the abolition of the pound and the re-calculation of everything into euros, from shop prices to pension entitlements. Those polls that have mentioned the obligation to abolish the pound have all recorded a significant majority against Britain joining a single currency. The most recent Gallup poll, for example, showed that 65 per cent of respondents were against British entry to a single currency on this basis and only 33 per cent in favour. Amongst Conservatives, the figures were 76 per cent and 23 per cent respectively.

The legal framework is clear. Under the single currency, the European Central Bank will be responsible for monetary policy. It is prohibited by Article 108 of the Treaty of Amsterdam from seeking or taking instructions from any other body, even a democratically elected body, about its conduct of monetary policy. Equally, member states undertake not to seek to influence the Bank. So the Bank, comprised of people whom we will not elect and cannot remove, will be empowered to make decisions affecting millions of British people. Yet their elected representatives have forsworn any attempt to influence those decisions. Stripped of the verbiage, that is the brutal reality of the single currency project. It will be no use electors complaining to the Government, let alone their local MP, about the effect of the ECB's policies. We should be mindful too that the Bank intends to regulate member states' borrowing and deficit levels and to bring about economic, as well as monetary, union. In short, a single currency means a single monetary policy, a single budgetary policy, a single fiscal policy, a single economy, a single Government and a single state. This is the federal European state which many member states want, which has long been developing by stealth but which virtually every British democratic politician except Sir Edward

Heath and the Liberal Democrats claims to oppose. Politics has long been the driving force of the architects of the single currency. That is why the convergence criteria have been fudged – economics plays second fiddle to politics.

Let the politicians speak for themselves – Chancellor Kohl, speaking in the Bundestag on 13th March 1991, said pithily, "however important the completion of economic and monetary union it would remain mere patchwork unless political union were established simultaneously. These two undertakings are, in our opinion, inseparable."

Yet the prize for candour must surely go to the former Prime Minister of Spain, Felipe Gonzalez, who wrote in May 1998, "The single currency is the greatest abandonment of sovereignty since the foundation of the European Community… It is a decision of an essentially political nature… We need this united Europe… We must never forget that the euro is an instrument for this project."

The reality is that Britain is a global trading nation. We sell our wares wherever we can and our success, especially since our economy was restored to health under Conservative Governments, has been conspicuous. That success is not contingent upon the EU. Our trade surplus until recently with every other continent but Europe is testimony to the fact that we provide goods and services of a quality people want and at prices they can pay. That is why in telecommunications, in oil, in civil engineering and in financial services, to name but a few, our trade is soaring. Politics forms no part of the equation save insofar as it creates a framework of open markets.

The political argument for our EU membership is that we carry more weight as part of a block of countries than if we act alone. This is what might be described as a political economy of scale. Yet it is persuasive only if and insofar as club members share a common goal. In the recent round of trade negotiations Britain had to play along with the French line which was much more protectionist than our own. A prime example is trade in the audio-visual sector in which French brinkmanship put up barriers to United States products. Given a free hand, and taking account of our strong trade relationship with the United States, it is doubtful that we would have pursued such a course. We were, in other words, obliged to uphold a position directly in conflict with our own national interest. This is an inevitable consequence of being jammed into a common position – a consequence met especially often by Britain, whose interests tend to diverge from the continental mean far more than do those of other states.

Conflict situations do not make a cogent case for the EU's indispensability to us either. In the Falklands, we gained practical help from the United States and much vacillation from a number of our European partners. In the Gulf, the meeting of minds with our American allies was palpable and the prevarication of the EU equally so. As for the imbroglio in Bosnia, the less said about how the EU acquitted itself the better.

De Gaulle long ago pinpointed the Franco–German relationship as the key fact in European politics. He said, "*There is an interdependence between Germany and France. On that interdependence depends the immediate security of the two peoples. One has only to look at a map to see this. On that interdependence depends the destiny of Europe as a whole.*" The partnership between France and Germany is akin to what is known as an open marriage. The partners row and are sometimes unfaithful but they always return to each other because they need each other.

It is a rarely observed fact that some of the most fervent advocates of closer European integration pride themselves on being traditional Conservatives or, as they often prefer to be called, Tories. A hallmark of a tradition Tory is an innate suspicion of grand schemes, overarching theories and elaborate constructions of any kind. He is more comfortable with institutions and power that are rooted closer to home. He is a pragmatist who wants to see that an idea works. His is a natural scepticism which befits a Tory but there is sometimes scant evidence of it in the attitude of a number of my Euro enthusiastic colleagues. The mantra that 'there is no alternative' to the ratchet of Euro integration will not wash. Neither will the attempt to induce the public to sleepwalk to federalism by telling them that it is 'inevitable'. Such an approach is disingenuous and a counsel of despair. There are alternatives. Parliamentarians owe it to their constituents honestly to address them.

The people of Britain will never knowingly consent to be governed by those who do not speak their language, live in their country or depend upon their votes. The power of self-government, the right to hire and fire our rulers and the capacity to chart our own destiny are inalienable birthrights. They should not be traded in for a mess of pottage otherwise known as a back row seat at a show called 'The Heart of Europe'. Our destiny is surely as a self-governing nation which trades freely with the world. The future is bright; the future is global. Our success in it is dependent upon the vision, self-confidence and calibre of our leaders, our businesses and our workforce.

John Bercow is Conservative MP for Buckingham and a member of the European Foundation Advisory Board. He was voted one of the Spectator's *'Backbenchers to Watch' at their annual awards on 25th November. His article 'EMU – Labour's Achilles Heel' appeared in the March* European Journal. *The full text of this speech will be published by the Bruges Group. [see page 27] For further details please telephone 0171 287 4414.*

The staff of the European Foundation wish all *European Journal* readers a happy Christmas and a prosperous new year.

Tony Lodge, Editor

Racing to a Crisis

by Matthew Taylor



The past 12 months have been an *annus horribilis* for the sport of kings. Last December Sheikh Mohammed, flat racing's most wealthy patron, issued an ultimatum that unless British prize money levels increased dramatically in the near future, he and his family – the ruling Maktoum brothers of Dubai – would relocate their horses elsewhere.

A month later public confidence in the sport was rocked by the arrests of three leading National Hunt jockeys as part of a Scotland Yard race fixing and doping investigation. In April the animal rights lobby were up in arms following the deaths of three horses in the Grand National and a month later the *Sporting Life,* for so long the public voice of racing, ceased publication after 140 years.

In July a senior Press Association Starting Price reporter was arrested in relation to racing related fraud, and Sheikh Mohammed gave the sport's rulers a reminder of his threats by announcing that next year the majority of his Godolphin two-year-olds will be trained in France.

Yet despite all of this damaging publicity, a far greater danger to the future of horse racing in Britain lurks in an innocent looking item of European Union legislation – a directive on agricultural feedingstuffs preventing the use of certain drugs on animals which may be used for human consumption (Directive 74/63/EEC).

Phenyl Butazone, more commonly known as Bute, is an anti-inflammatory painkiller commonly used on racehorses to treat lameness, sore shins and a wide range of tendon and muscular injuries. It is the most effective and efficient painkilling drug on the market and is used on the majority of racehorses from selling platers to world class champions. The EU would like to see it banned on racehorses.

The reason for this is that the EU classifies the horse as a food producing agricultural animal and would like to prevent the drug from ever entering the food chain, along with other substances such as Dipyrone or Buscopan, regularly used to treat colic, an illness potentially fatal in racehorses, and several anaesthetics.

Prohibiting such widely used drugs could transform Britain from a premier league racing nation into a third grade scaled down industry which can only hark back to a never-to-be-recaptured golden era.

The implications are that Sheikh Mohammed would be forced to take his horses elsewhere – probably away from Europe altogether – leading to a mass exodus of owners from racing in this country. Those that remain would face considerably higher training costs and – with Bute no longer available – a much greater risk of their horses picking up career threatening injuries.

The worrying point is that the legislation has already been passed and is in position. The only thing which prevents Bute from being banned on racehorses is a flimsy agreement allowing the use of the drug if the horse's owner signs a declaration promising it will never be sold for human consumption.

Mark Collins, chairman of the British Equine Veterinary Association's Scientific and Welfare Committee, is campaigning for a more solid agreement from the EU. He explains: "We really want a more permanent arrangement with Brussels that they will not simply change their minds at the drop of a hat and enforce the legislation. At the moment all we have is a weak promise which is not satisfactory for anyone. We are trying to come up with ways to prevent any more confusion, but the EU are not very accommodating and we are just coming up against a brick wall.

"It is a similar situation in France, Ireland and Italy, where racehorses can obtain special dispensation, but that is seen as a one-off rather than as a hard and fast item

of legislation. Other European countries where Bute and Buscopan are banned have no real racing industry any more.

"The drugs which the EU is trying to prohibit are essential. Nearly every racehorse is treated with Bute at some point during their career, some of them even live half of their lives on it. It is a successful and harmless painkiller but there has been very little research conducted on what it could do if it enters the food chain and the EU seem to be terrified of a BSE-like scare.

"It is understandable to put humans before horses. But the vast majority of horses which race in Britain do not enter the food chain and it seems ludicrous not to treat them with drugs such as Bute or Buscopan if they need it. The thought of a Derby winner being denied essential treatment because he might in theory be used for human consumption is laughable."

Collins, who works as a vet in York, is BEVA's representative on the British Horseracing Board's Industry Committee, and Annie Dodd, the BHB's Political Officer, is well aware of the potential disruption EU legislation can cause. She says: "There has been very little research into Bute and the constant threat of the drug being prohibited means that there is little chance of obtaining funds for further research and development."

At the moment racehorses can be identified by an equine 'passport', and the BHB is currently looking at implementing a new programme whereby the horse has a microchip inserted in its neck, allowing vets to use a scanner to distinguish the horse and read its medical record.

Mrs Dodd continues: "Microchipping would allow us to immediately identify which horses had used Bute and the amounts which they had taken, but the EU have done little to encourage us." She continues: "Every time we come up against the EU we get so many conflicting responses. No one seems to know exactly how the Working Time Directive will affect our stable and stud staff, but we have already had to take legal advice to make sure that the racing industry will have a case.

"Some horses require treatment and attention 24 hours a day and many stable lads want to earn extra money through overtime. No one decides they want to work in a racing stable if they expect a nine to five job and it seems unfair for Brussels to dictate who works when."

The Working Time Directive lays down rules regarding daily and weekly rest periods, the maximum working week, annual holiday and certain aspects of night and shift work.

Another reason for the confusion is the Directive's ambiguous wording. The WTD states that "employers [should] organise work … with a view, in particular, to alleviating monotonous work." A job that is monotonous to one person may be interesting to another. How should employers implement this aspect of the Directive?

Richard Wilson of the Institute of Directors believes that, "In some areas the regulations are not clear; therefore a danger exists that an employer might inadvertently infringe the Working Time regulations and thereby risk being taken to an employment tribunal." Trainers and owners, beware!

It is no exaggeration to say that the future of the sport now lies out of our hands; the only hope is that those in Brussels handle one of our most ancient and beautiful sports with the same compassion and care they have for the standard of their horsemeat.

Matthew Taylor is a racing journalist with the Daily Mail *and the* Independent. *He was formerly with the* Sporting Life.

The Working Time Directive (93/104/EC)

- maximum working week of 48 hours (averaged over 4 months)
- minimum of 3 weeks' holiday per year (rising to 4 weeks in 3 years' time)
- maximum of 8 hours' work on night shift
- maximum of 13 hours work in one day
- maximum of 6 days' work per week
- designated rest breaks

… news in brief

An ulterior motive?

47 German Christian Democrat MEPs have called for the resignation of the entire European Commission in the wake of the unfolding scandal over the corrupt misappropriation of funds from the ECHO scheme. They were joined by the former president of the European parliament, now leader of the Social Democrat group, Klaus Hensch, who said, "If the Commission has the slightest spark of honour left in its body, then it must resign".

This was all carried as news, backed up with outraged editorials, in the arch pro-European newspaper, *Frankfurter Allgemeine Zeitung.* "The 20 Commissioners reign like princes in a court, without public opinion being able to get a look in. It cannot be overlooked that the Commissioners and the 24 Directors-General lead a practically uncontrolled life. Since this system also uses numerous advisers who are rewarded with fat fees, the temptation to abuse is omnipresent." [18th November 1998] The overall budgetary arrangements have also been attacked by the prime minister of North-Rhine Westphalia. But how can one explain these sudden outbursts of German anger? After all, although the corruption surrounding ECHO is indeed shocking, the reports of the Court of Auditors which reveal that between 5% and 10% of the EU's spending is wasted or stolen, are an annual event – as regular as the autumn leaves that strew the brooks in Vallambrosa. A possible explanation for the Germans' protest, therefore, is that it is a cynical political move designed to bolster Germany's demand for a reduction in her budget contribution and an end to the British rebate.

"Tax harmonisation within six months"

At a meeting between Finance Ministers and Central Banks chiefs, France and Germany agreed to strengthen their co-operation in economic, social and fiscal policy. They also agreed that a proposal to harmonise corporate tax within the EU would be decided on during the German presidency of the European Union in the first half of next year. France supported that proposal. Lafontaine said that a common European economic and financial policy was necessary. "Europe must learn to speak with one voice", he said. [*Handelsblatt,* 19th November 1998]

EU and EMU: Why the experts invariably get it wrong

by Dr Bernie Moss

The book that I have recently published with Macmillan *The Single European Currency in National Perspective: A Community in Crisis?* is arguably the first serious study of the EU from that perspective. It is also one of the first scholarly books – there are several estimable political ones[1] – among literally thousands devoted to the subject that is critical of the European project. Most university texts tend to look at the EU as a *sui generis* phenomenon, cut off from foundations in nation states and economies. The prevailing narrative is Whiggish, that of the decline of the nation state and growth of the EU towards prosperity and ever closer union.

The reasons for satisfaction are few. It is argued that the EC ended the threat of war between France and Germany, but that was really a function of American hegemony and the Cold War. As to promoting prosperity through trade, the performance of the EC, except for the start-up period, 1957 to 1973, has been mediocre compared to that of other OECD or Asian countries.[2] Manufacturing trade interdependence among the original six countries has actually declined since the 1970s and stagnated among the others since the 1980s.[3] The single market which the Commission's experts predicted would add five million more jobs and seven per cent growth – 'how could so many leading experts be so wrong?'[4] – produced the opposite: 7 million more jobless and five per cent lower GNP.

The single market created greater disparity in unemployment and trading and business structures.[5] It stimulated national and trans-Atlantic rather than European mergers.[6] Except in the realm of agriculture where consumers paid a price, European industry became more dependent upon US and Japanese multinationals, particularly in the area of high tech.[7]

The policies of monetary union have been particularly destructive. A new econometric study of developed nations finds EU membership associated with twenty per cent reduction of annual per capita income, high interest rates, and four per cent increase in unemployment.[8] The worst performance began in 1979 with the ERM by which members were forced to allign themselves at a high rate with the Germans whose interest rates were unresponsive to unemployment. The German economy worked only so long as there were loose spending nations able to buy its capital goods. Once all members adopted hard money polices Germany too went into decline. The convergence criteria for the single currency imposed a deflationary straitjacket that reduced growth and increased unemployment in the EU from nine to twelve per cent.

Why then the one-sidedness of academic and expert opinion? Without undertaking a sociology of academic knowledge I would propose a few simple explanations. In the US where most of the early literature originated the issue was framed in the context of the Cold War which required a strong, economically united prosperous Western Europe to serve as a bulwark against the Soviet bloc and threat of internal subversion. American thinking about Europe reflected US experience with federalism and the absence of a strong state tradition. The neo-functionalists saw a federalist European state emerging automatically out of market and interest group links much as did Jean Monnet, the 'American' in Paris.

British academic literature remained more descriptive than American, but it became even more apologetic of the EC for both institutional and ideological reasons. At a time when traditional disciplines were under challenge as lacking in relevance, European studies became a growth industry. The European Commission funded over one hundred Jean Monnet professorships in British universities. Teaching and research shifted from traditional disciplines and national studies to interdisciplinary or undisciplined European studies. Students became more conversant with the life of Monnet than that of Cromwell, Garibaldi or Bismarck.

Given their social background and situation, most academics were naturally inclined to the soft left with a cosmopolitan penchant for the continent, but they received a jolt from Mrs Thatcher, who challenged both the assumptions of the welfare state and of the EC. The traditional left which had defended the welfare state collapsed. The European enemy of Mrs Thatcher, social democrats reasoned, must be our friend. Hopes for a caring society were transposed to Europe where Jacques Delors promised a social dimension. The fact that Delors produced almost nothing in the way of social reform did not seem to matter because Europe had by now become a substitute for the welfare state.

EMU is a monetarist arrangement for an independent bank floating free of democratic control, pursuing the single deflationary aim of price stability and requiring strict budgetary discipline from member states. It is currently being challenged by Socialist governments working in tandem in France, Germany and Italy.

They are calling for lower interest and exchange rates, relaxation of their deficit limits and their control of the European Bank, all of which are breaches of the Maastricht Treaty. They are also negotiating in the euro council provisions for minimum wage, tax harmonization and binding employment objectives and reviving Delors' 1993 plan for investment in trans-European networks.

At the same time neither France nor Germany is willing to concede to the EU more resources or sovereignty; the Germans, who keep it all afloat, are demanding their money back. Popular satisfaction with the EU is at an all-time low. Members confront intractable problems of reforming the CAP and structural funds and preparing for enlargement. They think they are building Europe, but in the midst of deepening economic crisis they are actually rehabilitating the welfare state and thus destroying EMU.

Bernard H. Moss is a professor of history associated with the Institute for European Studies. He was recently a candidate for Labour Party MEP selection in London.

1 On the right see W. Cash, *Against a Federal Europe: The Battle for Britain,* 1991, and left S. Holland, *The Uncommon Market,* 1980.
2 C. van Paridon, 'European Economic Integration: Did it matter in the past, will it matter in the future?' *European Economic Integration as a Challenge to Industry and Government,* eds R. Tilly and P. Wolfens, 1996.
3 G. Lafay, *L'Euro contre l'Europe,* 1997, p. 133.
4 P. Cecchini, *The European Challenge, 1992: The Benefits of a Single Market,* 1988, p. 116 and *inter alia.*
5 M. Pivetti, 'Monetary versus Political Unification in Europe,' *Review of Political Economy,* 10(1998): 5-25.
6 Y. Salesse, *Propositions pour une autre Europe: construire Babel,* 1997, p. 172.
7 C. Berry, *Existe-t-il une industrie europeenne?* no. 131, ISERES, C.G.T.
8 Gerald Friedman, Dept. of Economics, U. of Mass. Amherst.

Regional Chambers

***John Walker** reports on further Euro Region developments as Chambers in the English Regions are due to be set up this autumn and in the process lay the framework for directly elected Regional Assemblies within a matter of years. He cites the administration of the Single Market and its currency as a leading factor in this regionalisation across the EU, leading ultimately to a single government for the whole of the EU.*

Another key step towards the break up of England into Euro Regions will unfold this autumn with the setting up of Voluntary Regional Chambers in eight of the nine English Regions, with London having its own elected authority next year. These Chambers, not to be confused with Chambers of Commerce, will have representation from both the local authorities in the their Regions and 'Regional Stakeholders', which include business, educational establishments and trades unions. Should Labour be re-elected at the next General Election, it is committed to setting up directly elected Regional Assemblies, where there is a demand for them although it is unclear how the demand will be judged as this does not seem to include a referendum. One prerequisite for these Assemblies will be that the Regions concerned must have Unitary Local Authorities and no County Councils, so the need for another Local Government Review would come into play and to some extent this explains why there was one in 1993/4 and the resultant Unitary Councils in some areas.

On the 16th September in London, representatives of the 74 local authorities in the South East, under the auspices of the year old South East Regional Forum, met to discuss the format of the new Voluntary Regional Chamber. Also present were non-voting representatives of Regional Stakeholders. The Government, through the Department of Environment, Transport & Regions (DETR), is the driving force behind these Chambers as they are an integral part of the Regional Development Agency (RDA) project which are due to start in April 1999, making the word 'Voluntary' rather misleading.

The South East Chamber will have one representative from each of the 74 local authorities in the Region plus 33 representatives of Regional Stakeholders to reflect the DETR formula of 70% local authority and 30% stakeholders. The proposed voting system however will give County and Unitary authorities weighted votes and therefore the influence of stakeholders will be much reduced from the 30% intended. A similar process to the South East is taking place in the other English Regions and any reader wishing to find out the position outside the SE can ask their own local council or Government Regional Office. These eight Regional Chambers are expected to be fully operational by the end of the year.

So what is their purpose, both stated and unstated? These Chambers are portrayed as meeting the 'Democratic Deficit' occasioned by the Regional Development Agencies, which themselves were a response to a perceived 'Economic Deficit' at regional level. Add to that 'A voice for the Region in Brussels' and 'Devolution', and the agenda starts to become far clearer. The European Spatial Development Perspective (ESPD) and funding out of UK contributions to the EU budget acquiring its own regional agenda will both become leading issues for the RDAs and Chambers. Spatial Planning includes: economic development, land use planning, house building requirements, waste disposal, integrated transport and the environment. Whilst ESPD is still intergovernmental, next year discussions with member states could see the EU become the lead body for all the policy areas within spatial planning. Even if no agreement is reached, the development of the Single Market would make one necessary in time. Far from the devolution of policy making being taken closer to the people, it could actually be centred in Brussels with only its administration and implementation being devolved to the Regions.

Key to this centralised administration by Brussels through the Regions is the single currency. The RDAs and the equivalent Regional Authorities in other member states, will undoubtedly be charged with the very close monitoring of the economies in their regions so that any problems which could undermine EMU can be identified at an early stage. Remedies would no doubt include structural funds, subject to availability, and could stretch the ability of taxpayers to fund. The excellent article by Jeremy Nieboer in the June *Journal* referred to the Commission in the 1970s suggesting that 7.5% of EU GDP would be needed to deal with structural problems in EMU; and that was before Greece, Portugal and Spain joined. The link between centralising VAT collection in Brussels and funding these structural problems inside EMU should not be discounted, as the 1.27% of GDP currently paid in contributions may woefully low.

At the London meeting, referred to above, it was stated that Government sees a widening of the policy areas to be administered by the Regions. Whilst no specifics were given, this is likely to include Education which is touching the Government Regional Offices and already administered by local authorities. Add Education to the spatial planning policy areas, and there is not much left that could be devolved downwards. In or out of EMU, the centralisation of most tax setting and collection to Brussels cannot be ruled out and when combined with the EU taking a more prominent role in Foreign Affairs, and by implication Defence, Westminster will have little left in the coming years to involve itself. In fact, the UK's current places in the UN, G7, IMF and the Commonwealth must all come under scrutiny as the EU continues to develop its own international status, and this would gather additional momentum inside EMU. The external representation of the euro on the G7 is already a live issue for France, Germany and Italy, plus of course the Commission keen to be promoted from 'Attendance Only' status to full member.

The constitutional changes being implemented to satisfy the requirements of both a Single Market with a single currency and the subsidiarity sections of Maastricht, are potentially so far reaching that there will come a time when Westminster's very

existence will be questionned due to it having little or no legislative power left. This is being achieved by a combination of downward devolution to the Regions for administration direct from Brussels and upward devolution of other policy areas to EU Institutions. The fact that the boundaries for the RDAs, Government Regional Offices, the 1999 Euro Elections and the Regional Chambers are the same is no coincidence. These Chambers are but a staging post towards directly elected Regional Assemblies and in turn all but complete the project of having a European Union of 111 Regions administered centrally from Brussels. The continued existence of national parliaments and general elections might maintain the illusion of statehood and the ability to make our own laws, but for how long ?

John Walker attended the London meeting referred to in this article as a representative of a small business organisation or 'Regional Stakeholder', and has been closely following these issues as they unfold.

Constitutional Government

by David Radlett

The origins of constitutional government lie in the marked and amply justified distrust of human beings in human nature. Constitutional government recognises the recondite certitude, born of experience, that the people in whom we vest authority over ourselves require restraint by something more potent than their own discretion.

This restraint is generally labelled 'constitutionalism'. Two views can be taken of this concept. The first is that the government of a nation state (like anyone else) can do anything that is not prohibited by law. At the moment, this sums up the constitutional position regarding the United Kingdom. The second view is that a government (unlike anyone else) can only do those things which are permitted by law. This view represents the position in countries like the United States, and most other federal states. A common feature of both views is that 'the law' includes certain basic precepts, like the principles of natural justice, that create additional fetters on freedom of government action.

It is the second view that has prevailed in the context of international law regarding bodies created by treaty. As the International Court of Justice observed in an advisory opinion on the scope of its powers in the *Interpretation of Peace Treaties Case* (Second Phase) (1950) ICJ Reports 221:

"It is the duty of the Court to interpret the Treaties, not to revise them."

This is a natural fetter on the discretion of an international, governmental body. The restraint shown by the apolitical International Court of Justice is admirable. Such is not the case, it is feared, with another international, governmental body, the Court of Justice of the European Communities. The Court is undoubtedly a creature of international statute, namely the EC Treaty 1957. It is therefore extraordinary that, with each turn of the ratchet towards establishing the European Federal State, there is very little concern amongst writers and academics about the absence of restraints on the operation of that Court. In fact, there appears to be tacit, if not outright approval of their many assumptions of power in ways not obviously authorised by the EC Treaty. This is amply demonstrated in the growing literature on the operation of the Court. Take as an example the following passage from *Brown & Jacobs on the Court of Justice of the European Communities*:

"[The ECJ] has a legislative function, inasmuch as it often falls to the Court to fill gaps in the legal system arising from the political impotence of the Council …" (Brown & Kennedy, Sweet & Maxwell, 4th edition at p 101).

The desire of the Court to 'fill in gaps' in the Treaty was seen in the *Cassis de Dijon Case [1979] ECR 649*. The Court had to tackle German reluctance to admit French alcohol to its domestic market. The Court set out an intellectually pleasing test against which national restrictions to free movement of goods can be justified. It ruled that such restrictions were in accordance with EC law if they were necessary to promote effective domestic tax regimes, or public health, or the fairness of commercial transactions or consumer protection, but not otherwise. The difficulty is that the EC Treaty appears to set out the full extent of Community law on the point. Both before and after *Cassis* there is ample evidence to suggest that free movement of goods remains a chimera (see, for example, chapter 10 of *The Castle of Lies* by Booker and North, Duckworths, 1996). The point here, though, is that another leading authority on EC law, Stephen Weatherill, could note, without criticism, that:

"The Cassis de Dijon formula is merely a particularly high-profile example of [the] gap-filling function," (*Law and Integration in the European Union,* OUP, 1995 at p. 236).

Needless to write, the EC Treaty mentions no 'gap-filling' function to be carried out by the Court. Therefore the question is whether this 'gap-filling' function is constitutional. The basic role of the Court is set out in Article 164 of the EC Treaty, which provides that:

"The Court of Justice shall ensure that in the interpretation and application of this Treaty the law is observed."

What is 'the law'? This question poses some difficulty. The word "law" in the English translation comes from the French word *'droit'* – as in *'principes generaux du droit'* (general principles of law) – used in the official text of the Treaty. The authors of the Treaty could have used *'lois'* (also capable of being translated as 'law'). It is argued that this matters because, in French jurisprudence, *'lois'* is essentially written law and *'droit'* comprises general principles. Wyatt and Dashwood write that the use of *'droit'*:

"suggests a *corpus juris* transcending the treaty texts," (in *European Community Law,* Sweet & Maxwell, 1993 at p 89).

Some of the arguments regarding this issue were rehearsed in the article 'The Myth of Supremacy' in this *Journal* at (1997) Vol 4 No 4 (page 29). Yet the *lois/droit* conundrum continues to trouble, as a governmental power may be impliedly constitutional, even if not expressly constitutional.

Lord Mackenzie Stuart clearly thought so. In his Hamlyn lectures on 'The European Communities and the Rule of Law' he noted that:

"[I]n our search for the underlying concept of [the] court … [t]here are two

sources to be considered. First, the background to the Treaty itself and secondly the tradition of legal control over administration which has been developed in each of the six original Member States," (Stevens, 1977 at p 8).

It is now common knowledge that the founding fathers of the Community intended to bring about a federal state of Europe. There is a dispute is the extent to which they were honest about this, with the current trend being to claim (contrary to all the evidence) that there was never a secret. For an honest account of these matters, Brigitte Boyce's article on 'The Democratic Deficit of the European Community' (to be found in *Parliamentary Affairs* (1993) Vol 46 No. 4) is hard to beat. On the assumption (supported by Boyce) that the federalists 'went underground' after the failure of the European Defence Community in 1954, the background to the EC Treaty of 1957 would suggest that federalism was not on the agenda. Mackenzie Stuart's attempt to take succour from the earlier Coal and Steel Community Treaty appears ill-founded. Accordingly, the legal background to the EC Treaty suggests that the Court of Justice should regard itself as confined to the matters in, and the law of, that treaty. The comparison with the International Court of Justice is obvious.

To what extent, them, might support for implied powers to the Court be found in the existence of a common tradition of legal control over administration amongst the Six? Mackenzie Stuart focused on the position in France. He claimed that French jurisprudence showed a:

"development of a body of case law setting forth a coherent group of rules by which the executive must regulate its affairs in the interest of good administration and for the protection of the individual," (at p 12).

These are the rules labelled *'principes generaux du droit'*. Certainly, much of the hot air emanating from the Court of Justice suggests that it is applying its version of these rules in the context of the Community, and that it has the right to do so. However, these arguments are based on a fundamental misapprehension, deliberate or otherwise, as to the status of *'principes generaux du droit'* in (French) constitutional and administrative law.

The French parliament (consisting of a National Assembly and a Senate) is empowered to enact statutes under Article 34 of the 1958 constitution. These statutes are properly referred to as *'lois'*. They must address matters reserved to the parliament, which include civil rights and public liberties, national defence, personal status, education, employment and the electoral system. Outside these areas, government ministers are empowered to legislate by way of 'reglements autonomes'.

The French judiciary has asserted the right to apply *'principes generaux du droit'* in assessing the validity of *'reglements autonomes'*. However, there is no power to judicially test the validity of a French statute, so *'principes generaux du droit'* have no application. For the French lawyer,the ordinary legal hierarchy consists of statutes, *'principes generaux du droit'* and *'reglements autonomes'* in that order. The 'general principles' do not authorise the French judiciary to engage in far-reaching constitutional innovation.

It follows that the use of the word *'droit'* for 'law' in the EC Treaty has no mystical meaning derived from French law, and cannot be used as a valid excuse for the naked assumption of power that the Court has undertaken.

Oddly enough, it could have been different. French law recognises a system of general principles covering some similar ground to the *'principes generaux du droit'*, but which fall to be applied by the *Conseil constitutionnel* (Constitutional Council). The tasks of the *Conseil constitutionnel* include the supervision of presidential and other elections, and ruling on the conformity of proposed new laws affecting the French constitution with that constitution.

The interested observer will note that this is exactly the role that the Court of Justice purports to perform. It dearly wants to be the collective king of the Euro-castle. Several articles in the EC Treaty, most notably articles 169, 173 and 177 authorise it to pronounce on the meaning and impact of an item of Community law. These articles do not, on their face, permit the Court to make up new law as it sees fit in order to reach what Mackenzie Stuart and others refer to as a 'Community solution' to a legal problem. Indeed, in keeping with international law current at the time of the EC Treaty, it would have been expected that the Court would interpret the Treaty, not revise and extend it

To achieve legitimacy, the Court of Justice needed to imitate the *Conseil constitutionnel* in that body's development of a system of rules which it labelled *'principes fondamentaux reconnus par les lois de la Republique'* or 'acknowledged fundamental principles of the laws of the Republic'. Such broad concepts are, perhaps, apt to include the New Legal Order proclaimed by the Court of Justice, the Supremacy of Community law and principles of direct effect. But, note the word used by the *Conseil constitutionnel* to describe the basis of its general principles – not *'droit'* but *'lois'*!

It is too late, after 40 years and thousands of words to the contrary, for the Court of Justice and its apologists to claim that the use of the word *'lois'* in Article 164 of the EC Treaty gave that Court the right to invent new roles and new doctrines. Such an argument would simply expose further the Court of Justice for the bogus apology for a court of law that it really is. The early American cleric, William Ellery Channing, once wrote that:

"False theories, though held by the greatest and best of men, and though not thoroughly believed, have wrought much evil."

The falsity of the theory of judicial powers outside the EC Treaty has been demonstrated. The evil that the citizens of each of the Member States face is the untrammelled exercise of illegitimate political power by the Court of Justice. Sir Patrick Neill (as he then was) described the Court of Justice as:

"… a legislative body over which there is no control of higher authority. We have an extra wheel on the coach, which is not only deciding but directly legislating, when it finds gaps [in the Treaty or] things it does not like," (*The Times* 19th September 1994).

The legerdemain of the Court and its apologists dazzles both their audience and themselves, it bestows dignity to meanness and magnifies the small-mindedness of the whole project. It gives authority to the despotism that would otherwise be regarded as contemptible. It exalts in the name of freedom that which is but base servitude. If the idea of constitutional government requires the restraint of governmental power, then the antics of the Court of Justice demonstrate that it is, at heart, unconstitutional.

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Will the Euro be a Global Safe Haven?

by Jeremy Stanford

The European Central Bank's Nero-like statements on world economic events – "Crisis? What crisis?" – stand awkwardly beside those of the EU's new centre-left political leadership who, alarmed at the environment of global economic downturn into which the euro is being launched, appear ready to bury the Maastricht rulebook and reflate the euro-economy by pumping money into it until it bursts.

Further confirmation, if needed, of the confused political nature of the project. And the certainty that little reality will come from the bureaucrats in Frankfurt or Brussels until after the euro is launched – as they stoically try to contain the tensions within the project, while isolating it from the real world of currency crises without, at least until after January 1st.

Yet, with the unerring EU instinct to turn a crisis into a platitude, the relentless euro propagandists suggest there could be no better time for launching the euro: that at a time of turmoil in financial markets the euro will offer investors security and stability that will rival the global dominance of the dollar's 'safe haven' currency status. But on what basis do they make such claims?

Can they be serious?

Those looking for a country or currency zone with which to trust their future wealth seek out basic fundamentals: rising growth; expanding employment; stable politics; an open economy; low tax rates; low business regulation; and low inflation.

Inflation in euroland, though satisfactory up to euro entry, looks set to be a major victim of the changing political philosophy. On the checklist above it is clear that continental euroland scores zero on all seven fronts.

Furthermore, in contrast to national central banks the ECB will be dependent on pooled financial resources. It will lack the reassurance of the sovereign authority to act independently as a lender of last resort.

And while the ECB is charged with independence in setting the euro interest rate it is, paradoxically, to share exchange rate policy with euro finance ministers. The tensions inherent in this Achilles' heel for the ECB can only create policy instability. A recent report by the Centre for Economic Policy Research warns that the ECB suffers from serious design flaws "and the consequences of these are likely to surface when the world financial crisis hits euroland".

Global crisis and the euro zone

And the euro is indeed being born into a world of economic crisis: collapsed economies and currencies; massive unrecoverable debt; the contraction of global investment and forward credit by institutions no longer willing, or able, to get their fingers burned. Could the euro offer the investor a stable currency option in such troubled times?

Consider these disturbing facts:

• European bank lending to developing countries stands at £530 billion – two-thirds of all bank lending to emerging market economies.

• Euroland exposure to crisis-hit economies is larger in both amount and % of GDP than either the US or UK. Current estimates of defaults to European banks total $185 billion.

• Massive "risk-country" loans by German banks to former Soviet states were guaranteed by the Bundesbank. The cost of meeting defaults is expected to increase Germany's fiscal deficit by 1% of GDP next year – challenging the fragile 'Growth and Stability' Pact.

• Limits on future business lending by Germany's leading banks may, of themselves, reduce German GDP growth by 1.9% next year.

• Euroland GDP growth forecasts for 1999 have dropped from 3.2% to under 2%. In Italy the fall is from 2.5% to 1.6%. In Germany and France growth is marked at 1.5% to 2%.

• The managed devaluation of the US dollar, and corresponding rise in the DM, exposes glaring unwillingness by euroland central bankers to act upon these recessionary facts. Market response to such euroland stoicism has produced the stock market 'crashes' in Frankfurt, Paris and Milan.

• If the Growth & Stability Pact is adhered to, borrowing next year will be restricted as a result of lower GDP growth. Responding to the social costs of deflation could trigger massive 'fines', or further public spending programmes will need to be cut. Alternatively, more taxes must be imposed on already depressed euro-economies.

• Such spending restrictions are already being challenged by political leaders. The prospect is being offered of euroland economic and monetary policy being targeted in opposing directions, with open warfare developing between extravagant politicians and the rigid mandate of the central bank.

Such is the environment that some would persuade us marks the birth of a stable global currency!

The long term view

But suppose the euro survives this baptism of fire: could it establish itself as a "safe haven" currency in the longer term?

The eleven euro member countries' economies are far from structurally, or even cyclically, homogenous. In the absence of convergence, the single interest and exchange rate can never be the optimum rate for most. The individual effect will be either to restrict growth or encourage inflation. But with a single ECB remit to control inflation, the collective effect must be towards lower growth.

Yet while the euroland economic zone may be compared to that of the United States the only way for its currency to acquire similar status would be for the region to surpass the US record for sustained growth and creation of jobs. The growing demands for Keynesian intervention contrast with the successful liberal policies of the United States and bode ill for investor requirements of a low-inflationary currency.

The further disincentives of high social costs attached to euroland employment and retirement, endemic restrictive regulatory practices, and the increasingly crushing weight of Commission regulations deterring both labour and entrepreneurial flexibility, must further count against investor expectations of long-term euro-land growth.

Demographics are not on Euroland's side

Furthermore, in its report in March this year, the European Monetary Institute drew dramatic attention to the long term

economic effects of ageing populations now afflicting many euroland countries.

In Italy, where official GDP growth projections are predicated on continuous budget surpluses, the EMI points out that the marked ageing of the population – reducing the workforce and increasing the burden on unfunded state pensions – could negate any such budget surpluses as a proportion of GDP.

In Germany, it described the inescapable consequences of the country's ageing population as set to place an increasing strain on the economy, where the existing burden of social levies were "already unacceptably high."

In terms of value, present unfunded state pension liabilities in Germany, France and Italy exceed 100% of GDP. This compares to well under 20% in UK where a majority of pensions are funded. The gaps in pension contributions in Germany and France even today amount to nearly 3.5% of GDP a year. Borrowing to address this ever expanding deficit in the future will require the euroland interest rate to rise measurably; alternatively greatly increased corporate payroll taxes will need to be imposed. Either choice must have serious consequences for euroland's future economic growth.

The growing debt burden

But the 'pensions timebomb' is just part, though a central one, of euroland's destabilising future debt position. Despite Maastricht requirements for euro entry of a national debt limit of 60% of GDP: Belgium's current debt is 118%; Netherland's debt is 70%; Italy's debt is 118%; Germany's debt is 61.2%; and France's national debt has been heading inexorably upwards for the past eight years, from 36% to 58% of GDP.

FACT

The UK's trade deficit over 25 years with the EU exceeds £155 billion

According to the EMI this year, France's current fiscal position would "not appear to be sufficient" to stabilise the ratio below 60 per cent. In Germany, despite the annual deficit ratio "appearing" to fall last year, the EMI believed this to be insufficient to cut accumulated debt, "substantial progress in consolidation of the fiscal position is needed," it said.

Yet these forecasts were made at a time of expected up-turn for the euro economy; in which the final reward for years of painful stringency – creating unemployment levels not seen in Europe for 50 years – was to be the launch of the new euro currency at a time coinciding with a cyclical upswing in continental growth.

Euro reality

Now such dreams have been shattered. The euro will be born at a time of financial crisis, when talk is of 'credit crunch' and 'global meltdown' in currency values. The euro currency venture has always carried serious risks: its concept is untried and it defies all theory on optimal single currency area economics. Now the contradictions within the project that were clear from the start are boiling over in tensions between regulatory purists at the ECB and the growing fear amongst Europe's political elite that their euro was designed for an economic era that has now passed.

The authorities though, one can be sure, will do all they can to maintain the euro's survival. And a common fiscal area for the euro seems certain to be claimed as a first necessity – to alleviate the unequal effects of euro policy and to bolster its authority. EU leaders may find themselves not only struggling to establish confidence in their hybrid currency in turbulent world markets, but forcing through controversial new political measures on common taxation, raising further divisions amongst EU members.

Will the euro offer a 'safe haven' in such uncertain times? It would likely be many years, and only following the establishment of a truly political dimension to the currency's authority – namely, its own sovereignty – that the euro might hope to establish for itself the credibility of a safe haven status to match the dollar. But as the many unsolved problematic issues listed above show, the naïvely-designed euro currency area will almost certainly prove unstable and therefore unsustainable (for political as much as economic reasons) and be forced apart before its grand ambitions can ever be reached.

… news in brief

Five wise men criticise Lafontaine

The five economists who advise the German Finance Minister have issued sharp criticism of the new government's economic policy. Although the group thinks that the economic recovery in Germany has stabilised despite the world's financial crisis, it predicts only 2% growth for 1999. Internal demand is predicted to fall next year and exports are also expected to fall. Unemployment is predicted to remain above 4 million. The plans of the government leave much to be desired, the group says. Above all, the economists have criticised Mr Lafontaine's tax plans, especially his failure to effect substantial cuts in income tax. [*Handelsblatt,* 18th November 1998]

Mr Schröder goes to Moscow

The new German Chancellor has paid a visit to Moscow, having said beforehand that he wanted "to put an end to the politics of the sauna" – a reference to the close personal friendship between Helmut Kohl and Boris Yeltsin. Accompanied by his foreign minister, Joschka Fischer, the Chancellor met the prime minister, Yevgueny Primakov, the presidential hopeful, Alexander Lebed, and the General Secretary of the Communist Party, Gennady Zyuganov. [*Le Monde,* 17th November 1998] Schröder was quoted as having told Mr Primakov that Germany's resources (for helping Russia) were exhausted but that the Russian government's programme for dealing with the economic crisis was "a good start". [*Handelsblatt,* 17th November 1998]

It is noteworthy that Schröder wants to distance himself from the chummy way in which Helmut Kohl used to conduct foreign policy. Although he said that he wanted to make Germany "the advocate of Russian interests", it has also been noted by commentators that Schröder believes that "people can have friends, but peoples have above all interests". [*Handelsblatt,* 18th November 1998]

Massimo d'Alema's little red book

"It is practically impossible to find as beautiful a name as 'Communist Party'" [*l'Espresso,* 5th August 1990]; "It is clear to all that the Italian Communist Party has made a decisive, democratic and majority choice to change itself into the Democratic Party of the Left. And it decided to do this without repudiating the history and the symbols of Italian Communism" [*L'Unita,* 22nd April 1991]. These are both declarations by the new "post" Communist prime minister of Italy, Massimo d'Alema.

Moving On Up

Extracts from the European Foundation Pamphlet

"Compulsory tax harmonisation is one of the most economically damaging ideas to come out of Europe. It is portrayed as ensuring fairness between member state. In fact we are all better off when governments are locked in competition, striving to be efficient so they can cut taxes and attract business. Harmonisation would merely make Europe uncompetitive relative to the rest of the world. Business is not going to stay here if it can get a better deal abroad. We must seize every opportunity to expose the fallacies of the harmonisers. *Moving On Up* is a valuable contribution to the debate."

***Richard Baron**, Policy Unit, Institute of Directors.*

The European Foundation pamphlet, *Moving on Up* analyses two issues:

- The current moves towards company and savings tax harmonisation in the European Union
- The effect of these developments on the UK's control of its tax policy, and so future levels of UK tax.

High levels of foreign direct investment in the UK, as a result of low corporate taxation and an attractive financial environment, already attract the envy of other EU member states. In short, tax harmonisation offers these states the opportunity to end the UK's self-made advantage.

The Single Market gives the European Court of Justice the means to, and EMU will, end the UK's autonomy in company tax matters. One member of the influential Ruding Committee which investigated company taxation in the EU in 1992, noted that "There was no doubt in the … Committee that a common currency requires at least minimum harmonisation of direct taxation." The result is that other countries will increasingly be able to decide Britain's tax strategy especially if the UK joins EMU. Any of EMU's economic benefits (no exchange rates, lower interest rates) would be cancelled by the significant increase in UK corporation tax to match the continental average of 43.8% (weighted to take account of population).

Whereas recent UK tax policy has lightened the burden and encouraged investment, continental taxes have risen (by the EU's own calculation, from 35% to 42% of GDP 1981–95). Harmonisation of EU member states' tax rates would mean higher taxes for the UK, since other states are unable or unwilling to reduce the tax burden on their voters and institutional developments inside EMU would end the need for unanimity among European Union members over tax matters.

Tax harmonisation – in the news

Although not a new issue, tax harmonisation has suddenly hit the news. The Austrians, who hold the EU Presidency until January 1999, immediately declared that harmonisation of corporation tax was an important item on their agenda. Several European countries, notably France, Germany and Belgium have expressed concerns that no action has been taken.

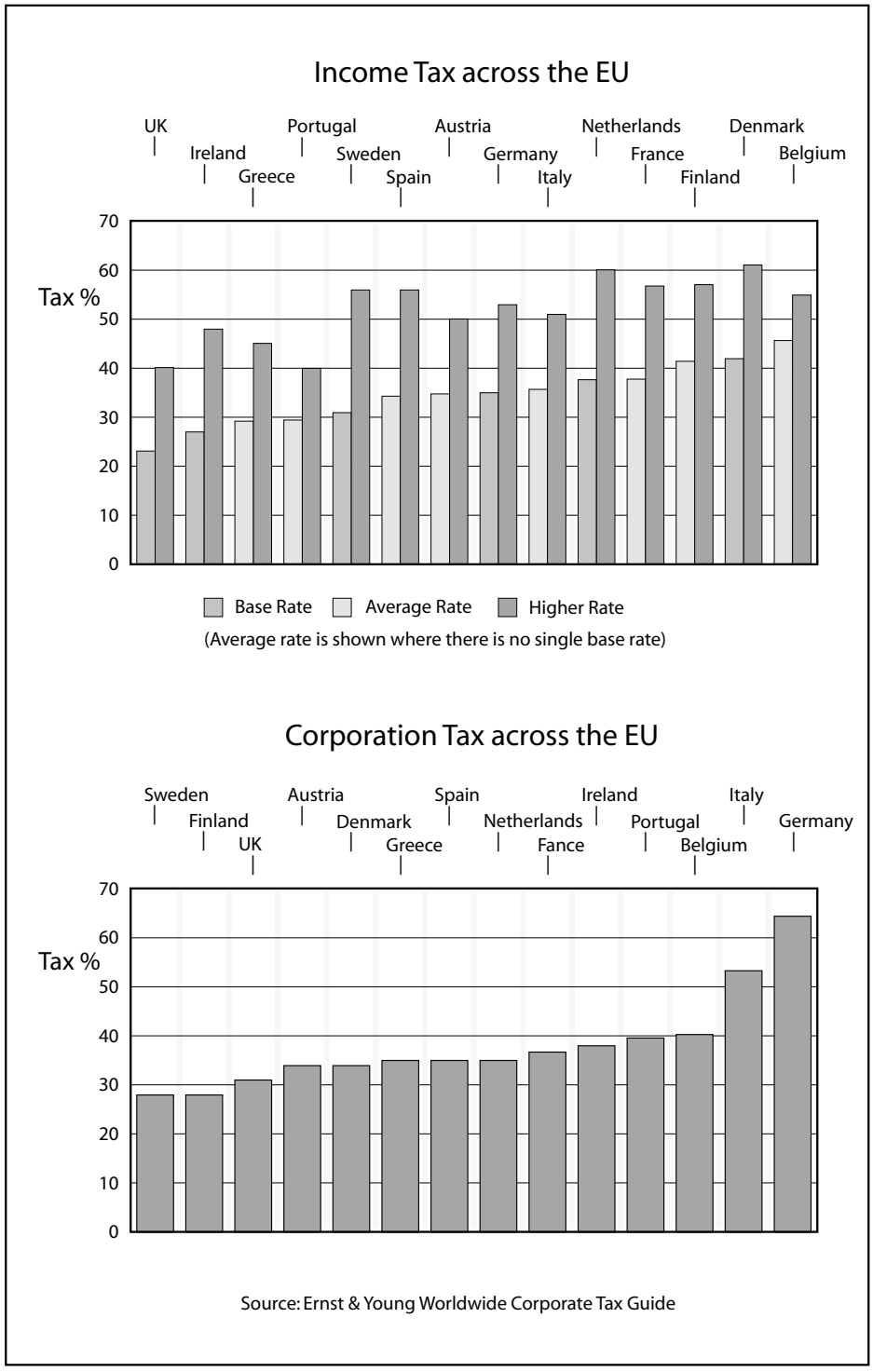
But late in 1997 the UK along with other EU states, signed a code of conduct pledging action on "harmful tax competition". The following day, Jean-Claude Juncker, leader of the European Parliament, announced that he expected the harmonisation of EU business taxes "within two years".

In March 1998, the European Commission proposed a directive to standardise tax on royalties and interest payments made between related companies operating in different member states.

By early summer, the Commission announced plans for an EU-wide 20% withholding tax on savings. This tax, designed to ensure that all investments in the EU are taxed, immediately attracted criticism, with several banking associations in the UK claiming that it would destroy the profitable Eurobond market by driving savers away from Europe in general and London in particular. A delegation sent by the City of London in November 1998 to canvas opposition to the tax had no effect; at the same time, the European Commission approved a draft report which advocated doubling the scope of the tax. In particular, the tax seemed to blur the significant distinction between illegal tax evasion and legitimate tax avoidance, in line with Article L of the 1997 code of conduct which lumped evasion and avoidance together. The code was especially significant because it made these national legal concepts a European political issue. On 26th September, the Commission announced that harmonisation of the withholding tax on savings should be achieved by the end of June 1999 at the latest. The recent 'New European Way', a document agreed by the socialists in the EP, moved towards "co-ordinating savings and corporate taxation". As we went to press, Mr Schröder made it clear that he backed calls for an end to the national veto on direct tax issues. It became clear that the German Government and the French Government are both now calling for the abolition of the veto and that the Finnish Presidency next year expects to call an IGC to amend the Treaty. The European Foundation was, therefore, right to predict calls to remove the veto six weeks ago.

Direct tax harmonisation would initially involve standardising company taxation across the whole European Union. On Day One of the Austrian Presidency, Austria's finance minister, Rudolf Edlinger, summarised the issue simply: "If the EU established minimum taxes, the countries where the level is lower than that will have to raise them. That is a problem." (*Electronic Telegraph,* 2nd July 1998) An effort to set an EU business tax rate would constitute an attempt to change the political philosophy of many national governments, especially in the UK.

Moreover tax levels reflect the ability of governments to collect taxation: the vicious circle of high taxation and a flourishing black economy in several European countries should be noted. A rate that reflected other governments' problems would discriminate against British taxpayers who have a good record of payment of tax. Higher taxes would drive business



and investment out of Britain, especially in financial services industry, where labour is highly mobile. Heavier industry on the continent would be less affected.

The story of VAT (indirect tax) harmonisation reveals previous tactics used by the Commission. Its publication, *A common system of VAT* (XXI/1156/96, 24th October 1996), insisted that 'the introduction of a single rate [of VAT] should not be set aside since this would be the only way of guaranteeing that the tax is entirely neutral'. One sign that the Commission fully intends to set a single rate came when the status of its VAT Committee abruptly changed from being 'advisory' to 'regulatory' on 21st January 1998.

It is unlikely that the VAT Committee will settle on a low standard VAT rate as it suits the European Commission to allow VAT to increase since a large part of the EU budget depends on VAT receipts, 42% of which go to the EU. The larger the VAT receipt, the more money the EU can spend independently. Since the end customer pays VAT, businesses have not opposed the increase.

The impetus for direct tax harmonisation

There are two major causes of tax harmonisation:

- The European Court of Justice
- Economic and Monetary Union.

The European Court of Justice

Since the early 1980s the work of the European Court of Justice [ECJ] has crossed into the field of direct taxation in supporting the freedoms of movement within the European Communities. Its activity has led KPMG's David Evans and Alastair Munro to conclude that "The possible impact of European Community law on United Kingdom direct taxation cannot be underestimated." (*Taxation,* 6th August 1998) Professor Frans Vanistendael of Leuven University explains the matter simply:

"Increasingly the ECJ is applying the non-discrimination principle, that has fully been accepted and implemented in the area of indirect taxation, to the area of income tax. This is only a logical extension of the basic principles on which the single market is based in the EC Treaty. A single market in which non-resident competitors from other member states would be treated less favourably for income tax purposes is in

effect not a single market." (*EC Tax Review* 1998/2 p.77)

The remit of the European Court of Justice has increased for two reasons, in line with its mandate to achieve the 'ever closer union' of Europe. As the Single Market has developed, to promote freedom of movement, loop-holes have been revealed in many EU member states' tax laws. Article 234 of the Treaty on European Union empowers the ECJ to judge these doubtful cases in the first instance. The Court also has jurisdiction in a final appeal (Article K7). David Southern, a tax barrister writing in *Taxation,* 16th October 1997, has commented that "Effectively the European Court of Justice has become a United Kingdom tax court", since the national courts are unwilling to pass judgements that might later be overturned by the ECJ.

The British Government has assured MPs on numerous occasions that the unanimity principle for matters of tax is 'sacrosanct' (the Prime Minister's word) but the evidence suggests otherwise. The European Court of Justice has just used a Single Market provision, Article 59 which prohibits restrictions on freedom to provide services in the EU, to attack Sweden's insurance company tax legislation (the *Safir* case, judgement delivered on 28th April 1998). Legislation on the Single Market requires only simple majority, not unanimity. The British Government is therefore wrong to trumpet the power of its veto: the Single Market has moved on, and now that varying levels of tax are deemed to obstruct its further development, the ECJ can apply Single Market law to end distortions. Once EMU starts, experts are agreed that a faster decision-making process will be necessary. This would involve majority voting on tax issues. In 1997 the European Parliament's Economic and Monetary Affairs Committee called for majority voting on tax matters three times. It noted that "harmonisation … will ultimately render the principle of unanimity superfluous."

Economic and Monetary Union

Once EMU has begun, it will remove one more barrier to international trade inside the euro-zone: variable exchange rates. The wide difference in corporation tax levels around Europe will become more obvious and there is likely to be political pressure within the EU's Council of finance ministers to harmonise tax at a single European rate so that no member of EMU can profit from lower taxation.

Thus Onno Ruding, the former Netherlands finance minister and now vice-Chairman of Citicorp, explained in the September 1998 issue of *EC Tax Review* that "There are clear links between corporate taxation, the EMU and the Single Market." He went on to say that "A successful EMU requires a high degree of policy co-ordination, on economic as well as political matters, and will unavoidably reduce remaining national autonomy, including on tax policies. It is unrealistic to assume differently."

Will direct tax harmonisation push British tax up?

Since EMU would lead to remote control of British tax policy, if the UK joined, it is vital to know to what level UK tax would be harmonised. Some supporters of tax harmonisation believe that it would lead to lower tax, stimulating higher inward investment. In theory tax could be harmonised at any level, but the practical situation in Europe means that the benchmark is most likely to be higher rather than lower than UK tax at present. The benchmark could fall in one of three broad areas.

- It could, if the UK joined EMU, reflect Britain's deregulated and low spending policy on tax. This is recommended by UNICE, Europe's federation of employers. **UK tax would stay the same.**
- It could find a middle way between the bulk of higher taxing and spending continental economies and the British model. **UK tax would rise (by about 5 percentage points).**
- Alternatively it could reflect the European average. This is the easiest option. **UK tax would rise significantly (10–15 percentage points).**

On the law of averages, it is unlikely that the current rate of British corporation tax, which is exceptional in Europe, would form the benchmark. This mathematical calculation is supported by investigation of states' political attitudes to the varying corporation tax rates around the EU.

'Harmful tax competition'

EU states have been preoccupied with the issue of 'harmful tax competition' which has been highlighted by EMU. Taxation deemed 'harmful', under a code of conduct published late in 1997 and agreed by the UK, concerns 'those measures which affect, or may affect in a significant way the location of business activity in the Community' (Article A).

Also defined as harmful are 'Tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the member states in question' (Article B). Parliament debated the code in late 1997, when questions were raised about the exact definition of 'harmful'. When an assessment of whether a country's system of tax is 'harmful' can be initiated by another member state, as the code allows, clearly whether Britain's low tax regime is deemed harmful depends on the political opinion of other EU members. It is a *relative* concept, as the German ex-finance minister, Theo Waigel, showed when he described London as a tax haven in late 1996, because low personal income tax in the UK had encouraged German financiers to move there.

Foreign Direct Investment

The UK benefits significantly from foreign direct investment. According to the OECD, in 1994 the UK received 34% of all inward investment into the EU; corresponding figures for France, Germany and Italy were 11%, 20% and 7% respectively.

One reason for the UK's success seems to lie in the significant difference between the tax regime in the UK and that on the continent. There is a close relationship between low corporation tax and high levels of investment, although the European Commission has tried to separate the two. It has claimed that varying tax rates obscure the 'intrinsic merits' of various 'investment alternatives' (Withholding tax proposal, 20th May 1998), when clearly the returns on investment are inextricably linked to the level of corporation tax. In October 1998, the telecommunications company Ericsson explained that its decision to move part of its business to London followed difficulties persuading executives to work in Sweden, because of high taxes.

Tax havens

Tax havens in Jersey, Guernsey and the Isle of Man also encourage investors to deal through London institutions with specific expertise in the opportunities available. These tax havens would fall foul of the Code of Conduct, because Article M requires that "Member States with dependent or associated territories … commit themselves … to ensuring that these principles are applied in those territories." The islands'

future position is also precarious because of the Commission is blurring the difference between tax 'evasion' and 'avoidance'. 'Avoidance' is defined in national terms as the manipulation of tax law against Parliament's intent, yet clearly the code of conduct and the aim to curb tax avoidance and evasion give this legal issue an international, political significance. It is entirely possible, given the widespread recognition of the need to attract foreign direct investment, that other member states will attack current British arrangements as 'harmful' or encouraging evasion or avoidance, since they could be portrayed as drawing investment away from other European countries.

Why don't other EU members lower their taxes?

There are six major reasons why British tax would rise because other EU states will prove unwilling or unable to reduce their tax rates.

• The Maastricht Treaty imposed deflationary policies and many European Union countries have no appetite for further spending cuts, now that they have qualified for EMU. Many experts, including Adair Turner at the CBI fear that EMU may increase unemployment, making welfare cost-cutting less attractive to governments. It would be easier to raise British tax, than to reduce continental taxes.

• Many other countries would like a more equal share of Foreign Direct Investment without having to make the tax savings Britain has. Few other countries have tax havens like the Channel Islands: ironing out the UK's advantage would be attractive.

• The increasingly leftward slant of the Social Democratic governments now controlling the EU makes tax cuts unlikely. Although deregulation and reform of the welfare state are long overdue, governments committed to old-style social protection are unlikely to support a reform of tax downwards. The Green Party/SPD coalition in Germany has agreed to increase taxes on energy as a means of financing growing pension liabilities (*FT*, 19th October 1998). The overall burden of tax, however, remains the same.

• Large unfunded pension liabilities shared by most European governments (but not the UK) make continued higher taxes to fund the mounting debt inevitable.

• The stability pact may also have an unforeseen impact on tax as well, making it imperative for governments to safeguard tax levels to avoid contravening the pact, which sets a maximum budget deficit for EMU members, and being fined as a consequence.

• Germany and France have already implied that they could not tolerate the British low tax regime inside EMU, as continental business would migrate to the UK. Already, some companies are taking advantage of the Single Market's Freedom of Establishment provisions to register their businesses in the UK – paying lower tax as a result. This is bound to enflame opposition to the UK's fiscal regime, when other governments lose tax revenue as a result.

The unspoken solution – lower government spending

Both the Ruding (1992) and Monti (1996) Reports to the Commission on taxation identified what appeared to be an intractable problem. Broadly, tax could either be raised from mobile (business, investment) areas of the economy, or immobile bases (labour, land, housing). Tax mobile elements and they leave, reducing revenue. Tax the immobile, and the effect is to reduce consumer spending and increase unemployment. Tax competition was identified in totally negative terms: it 'eroded' the tax base, was a 'beggar thy neighbour policy' or 'undermined' governments. Neither report addressed the possibility of reducing overall taxation.

Harmonisation would be an easy way to pay for Europe's pension liabilities, relying on the size of the European market as a means to guarantee continued investment despite higher average taxation. If Britain's taxation were raised she would be paying for a pensions problem she does not have. However it is just as likely that higher taxes would drive investment which might have gone to the UK to other locations outside the European Union.

Besides the threat to business, investment and private savings, harmonising taxes throughout the EU is profoundly undemocratic. Today tax levels in Britain broadly represent what the British electorate and businesses in the UK are willing to pay. Yet if UK tax increased due to cross-European harmonisation, the government would be powerless to do anything. voters would have no ability to influence the level of tax they pay.

At present the Government supports joining EMU when the time is right. It also supports international action to tackle tax evasion. It maintains that the UK will remain in full control of direct tax policy in the UK. The mounting legal evidence detailed above shows that the basis for the last argument is very unsound. As Ruding has made explicitly clear, "Monetary Union requires … a willingness to reduce national sovereignty over taxation as well." The role of the European Court of Justice and the European Central Bank will make British control over tax policy, and therefore low British taxation, a thing of the past.

Joining EMU is central to the issue of tax harmonisation since it would make the British advantage transparently obvious. Contrary to government claims, it would also give Europe power to determine Britain's tax in its collective interest. It is likely that the level of tax harmonisation agreed by the Central Bank or in the European Council would cancel out any of the marginal benefits EMU could offer the UK.

Tax harmonisation inside EMU would mean a net deterioration in the attractiveness of the UK as a place to site business and investment. British jobs and prosperity would suffer as businesses and international investment migrate elsewhere.

Suggested Further Reading:

Christopher Arkell, 'Another Hard Lesson', *European Journal* 1997 Vol.4 No.9

Christopher Arkell, 'Time for another tilt at the ECJ', *European Journal* Vol.6 No.2

European Commission, *Taxation in the European Union, Report on the Development of Tax systems*, 22nd October 1996

Parliamentary Debates, European Standing Committee B, 'Harmful Tax Competition', 26th November 1997

Onno Ruding, 'After the euro: corporation tax harmonisation?', *EC Tax Review* 1998 Vol.7 No.2

Frans Vanistendael, 'Redistribution of tax law-making power in EMU?', *EC Tax Review* 1998 Vol.7 No.2

UNICE, *Benchmarking Europe's Competitiveness: from analysis to action*, 1998

The European Foundation would like to thank Christopher Arkell for his considerable help in preparing this analysis.

The European Foundation regularly publishes research on topical European issues as well as the monthly European Journal. *For further details contact the European Foundation at 61 Pall Mall.*

Down which road?

***Jason Groves** reports that with the European Parliament on a spin doctored PR drive, motor insurers cannot afford to take their eye off Brussels*

The creeping tentacles of EU regulation does more than just change the shape of British scotch bottles – it also pervades the financial services industry. Prescriptive regulations governing the method of settling motor claims are looming. While UK insurers are by and large well prepared, the new red tape could prove costly.

The Fourth Directive on the motor insurance industry has been released by the European Commission and has gone for debate in the complicated structure that is the EU way of governance. While increased competition has been expected for some time with the introduction of the euro, the EU is developing processes it hopes will be both consumer and insurer friendly. What the new directive, anticipated to become EU law by the end of 2001, will do is allow a victim who has an accident in an EU country in which they do not reside to gain information about the offending vehicle and pursue the claim in their home country via the offending vehicle's insurers agent in that country. The victim will go to one of the newly created information centres, in either the country where the accident took place or their own home country.

One proposal that could prove costly will be the requirement to set up information centres that carry full details of every registered vehicle especially the name of the vehicle's insurer. The UK had already been planning something similar through the Motor Insurers' Bureau with plans well developed. The database will provide the name of the vehicle's insurer but problems will arise in the case of fleet vehicles. Insurers do not presently request registration details of all fleet cars but they may well soon have to.

Parliament knows best

When asked how difficult this might be to organise, Penny Coombs, manager-motor for the Association of British Insurers (ABI) said she hoped the final form of the directive would not be that prescriptive and was very optimistic that common sense would prevail. Ms Coombs' comments followed her presentation at a recent conference, where she said that while the Parliament had a clear goal in mind, by setting down exactly how it was to be achieved, it was stifling the process. The clear goal was to ensure that victims had speedy access to information. Rather than let the information centres devise the most effective means of making sure this happens, the European Parliament's current thinking is that it knows best. Ideally, the final form of the directive would not be prescriptive enough to require information centres to have full details, but rather only require a speedy means for them to be obtained. While the UK is not the only country setting up a database – the Dutch, for example, already have such a listing already compiled – many EU member countries will have much work to do.

> … additional regulation designed by the European Parliament to be pro-consumer will have the ironic effect of delaying any benefits, rather than enhancing them

According to Ms Coombs, proposals to allow the victim to use the information centre in any EU country are likely to be rejected. The directive will, however, require insurers to have agents in every EU member country ready to handle any claims made there. She added that the contact networks for agents are already largely in place as a result of the third directive dealing with motor insurance services. Ms Coombs thought it unlikely that insurance companies would have to employ full-time representatives, given the small number of claims that are likely to be filed. She believed that many companies would probably use their links with other insurance companies to act as their agents.

Don't expect a speedy outcome

With Parliament determined to have claims settled with a great deal of celerity, some problems in communication are likely to arise. The European Parliament, in a wish to appear more pro-consumer, is likely to apply additional pressure. The European Council of Ministers will simultaneously propose amendments. It will then be up to the Commission to work with these two sets of amendments, devise a workable outcome and then return them to the two bodies. Given the delay in meeting times for the Council of Ministers responsible for the final proposals, it is doubtful that any new draft will appear within the next twelve months. Insurance industry lobbyists are hopeful of having a significant input into any amendments that may go back for re-consideration. Recent proposals, that could have permitted the re-monopolisation of a section of the car parts industry, were deleted after heavy lobbying (from the ABI, amongst others). Plans are also afoot to examine the different levels of payout for car insurance claims in EU countries. Directives 1–3 cannot expect to escape a broad sweep from the broom of review.

Other EU changes being foreshadowed relate to the inevitable increase in competition that will accompany the introduction of the euro in January. One initiative would see buyers of motor insurance over the telephone given a compulsory 'cooling-off' period. The problems attendant on this could be significant, especially if the consumer expects immediate cover. A range of issues – such as the short-term premium to be charged if the customer decides against continuing after the cooling-off period – all need to be canvassed. Whilst having to deal with the euro itself will prove initially disconcerting, additional regulation designed by the European Parliament to be pro-consumer will have the ironic effect of delaying any benefits, rather than enhancing them.

The initial announcement made just over a year ago was drawn up because a proposal formulated by the EU-wide Council of Bureaux working with the European Insurance Committee failed to obtain sufficient agreement to proceed. Having taken so long to progress this far, final resolution is still not near. What is certain is that motor insurers will need to keep their third eye on Brussels before they leap into any pan-European gambit.

Jason Groves is Deputy Editor of Global Insurance Monitor, *published by Datamonitor plc, where this article first appeared. He was formerly on the staff of a minister in the Australian government. He is also the Convenor of the UK branch of Australians for Constitutional Monarchy.*

Why the Tories lost the 1997 British General Election

by Robert M. Worcester

Elections are 'fought' during 'campaigns', with 'strategy' and 'tactics', 'battlebuses' and 'footsoldiers'. Every war has its elements of strategy and tactics; no less this last election. The Conservatives lost the 1997 General Election at four strategic points in the long campaign which began soon after John Major's stunning and unexpected victory in 1992, long before the tactics of the short campaign came into play. Three were avoidable, the fourth chance:

by taking sterling into the ERM at an unsustainable exchange rate, the government set in train a chain of events that destroyed the Tories' chance to benefit politically from economic recovery;

by failing to call a referendum on the Maastricht treaty, they lost the chance to transfer responsibility for Europe from their party to the people of Britain and thereby side-step the divisions over Europe that tore the party apart;

by keeping John Major as leader they lost any opportunity to wipe the slate clean and recast their image as they had done in 1990;

and by the sudden death of John Smith, opening the way for Tony Blair's election, completing Labour's renaissance as an electable party, ensuring that voters could run the risk of making the Tories pay for their failings.

In fact, the 1997 British General Election campaign itself, the 'tactics' if you will, as opposed to the 'strategy', was 'lost' by Labour: they shed votes throughout it, mostly to the LibDems (the real 'winners') while the Tories were making modest net gains from returning waverers. But by then it was far too late: an irrelevant battle won when the war was already lost. Labour didn't need to hold all the support they had in mid-March, they only needed to hold enough to win, and they did so – to an extent that far surpassed most expectations, though a less inept Conservative campaign might still have made the margin somewhat closer.

The loss of the economic talisman

The first strategic error, even before the 1992 election, was entering the ERM at an impossible exchange rate, led inevitably to 'Black Wednesday', 16 September 1992. This humiliation, just five months into the parliament, damaged any chance the government might have had of claiming credit for economic recovery.

The Conservatives persisted in assuming that achieving a strong economy – economic determinism – was the trump card that would swing the votes to them and prove the polls wrong. Led by Michael Heseltine, many expected, or so they said, that a grateful British public would reward them for their cautious, and successful, management of the economy. "When, did the British voting not follow economic optimism?" they asked; 1 May 1997 was the answer.

MORI measures the EOI or Economic Optimism Index ('consumer confidence' or 'feel-good factor') monthly. EOI had risen sharply in the last few months before each election since the Tories came to power, and this encouraged them to think that the economy had the potential to help them again, if they could harness their fortunes to it. In most past elections a rise in the EOI tended to go with a rise in the Government's popularity in the opinion polls, and vice-versa; in statistical terms, there was a high correlation between the two variables.

In the six months preceding the 1997 election, by contrast, there was a *nil* correlation. In the event, as in past elections the EOI *did* rise: from -9 in December 1996 to +13 the weekend before the election, peaking at +28 (a record) a fortnight after Labour's victory. But it didn't help the Tories at the polls; other factors pertained.

Divisions over Europe

Next came the refusal of a referendum over Maastricht. If the Prime Minister, Chancellor and Foreign Secretary had transferred responsibility for the decision to sign Maastricht from themselves to the people, they could have avoided the awful divisions that tore the Tory Party apart. Time after time I argued they should. John Major said he couldn't get it through the Cabinet. Canny Ken asked "How do you know we'd win?" Douglas Hurd wrote to me to say that to consult the public in a referendum was 'not done'.

We regularly measure the public's perception of party image, asking them which of a list of descriptions (some positive, some negative) fit their impressions of each party. Survey by survey from the late eighties the Conservatives lost their positive attributes and hardened the perception the public had of the negatives, until only the negatives were left. Perhaps most damagingly, by 1997 two-thirds of the public identified the Conservatives as 'divided'. Divided parties don't win British elections. In addition, of course, they became tagged as the Party of sleaze, and managed to strengthen both impressions further during the election campaign itself.

Yet Europe in itself was not an election winning or losing issue: it simply wasn't important enough to enough voters. When we asked which issues from a list electors thought would be very important in deciding which party to vote for, more than two-thirds picked 'health care' and three in five 'education'; fewer than a quarter said Europe would be very important, and of them only two in five thought the Tories had the best policies on Europe.

In fact, the Tory image on Europe was so ambivalent that it could hardly have helped them even if it had been higher on the agenda. A recent article by Geoffrey Evans in the *British Journal of Political Science*, analysing data from the British Election Panel Study on perceptions of the parties in 1996, showed that people who perceived the Conservatives as anti-European tended to themselves be pro-European, while those who perceived the party to be pro-European were more likely to be anti-European. (Neither of the other parties had the same handicap.) The divisions on Europe had not simply made it harder to exploit the issue but had actually turned it into a more dangerous one.

The leadership

The third strategic error was in not replacing John Major as leader when he gave them the chance, by voluntarily initiating a leadership contest.

In the Spring of 1990 the Conservative Party lagged the Labour Party by 23% in the polls. What did they do? They changed their leader, Margaret Thatcher for John Major, they changed their policies, especially by dropping the hated poll tax, they changed a third of their Cabinet, and they changed the Party Chairman. In 1992 they won the General Election, albeit by such a narrow margin that if one person in two hundred

who voted Tory had voted for the second party in their constituency, it would have been a hung Parliament.

In the Spring of 1994, the Conservatives lagged the Labour Party in the polls by 22%. What did they do? They kept their Leader, they kept their policies, they kept their Cabinet. They changed the Party Chairman, twice, and got it wrong both times. Throughout this period the Prime Minister complacently stressed the improving economic situation and his confidence that once the British public were aware that inflation was down, unemployment was falling and the economic management by his Government was sound, that the public would return them, gratefully, to office for an unprecedented fifth term. The senior members of the Government repeatedly ignored the worsening political poll findings, repeating how they'd proved the polls wrong in 1992, and they'd do it again. Heseltine's cry: "We'll win by 60."

We also regularly measure leader image. John Major came into Downing Street in November 1990, and the country was involved immediately in the Gulf War. By the following February, Major was seen as 'capable', 'good in a crisis' and 'has sound judgement'. But over time he became much like Mrs Thatcher in trousers, except that he was thought neither 'capable' nor 'good in a crisis'. His image became fixed in the minds of the electorate: John Major was perceived as a 'nice guy', but electorally he had become a liability.

Furthermore, the campaigns run by Central Office and the men he appointed Chairman, Jeremy Hanley and Brian Mawhinney, were disastrously unsuccessful. Their advertising was counter-productive, they focused attention on the wrong policy issues, and their final attempt to seize the initiative at a key moment of opportunity consisted of sending out a man dressed in a chicken suit to peck at the heels of Tony Blair.

I have a theory about the most notorious of the ads. At one of the Prime Minister's regular Sunday evening meetings with his advertising and PR gurus, Lords Saatchi and Chadlington, and (Sir) Tim Bell. The PM was saying that "If we don't get Europe off the agenda, we're dead!" Maurice Saatchi replied: "Well Prime Minister, we've been thinking…", and pulled out a mock up of the ad that was to become 'Satanic Eyes'.

Was it worth it? The evidence suggests not. The campaign ran for just one day, in three papers, and on the hoardings, but received enormous media coverage. Shortly afterwards, we asked the public "Has the Conservative Party's poster campaign showing Tony Blair with 'satanic eyes' made you **less** likely to vote Labour (sic) at the next general election, **more** likely to vote Labour (sic) at the next general election, or has it made no difference?", 11% said it made them more likely, 3% less likely, and 75% said it made no difference (11:3). Among ex-Conservative voters the ratio was 18:4; among new Labour switchers, 11:2. When 'New Labour, New Danger' was resurrected in January 1997, we asked the public's view again, with results even less favourable to the Conservatives.

Central Office might have found this out for themselves, of course, before running the ads, but M&C Saatchi refused to pre-test their material in the normal way with focus groups.

Floundering in the swamp of sleaze

By the time the Prime Minister called the election it was already too late to win, but a competent campaign might have limited the damage; but the tactical phase proved as unrewarding as the strategic phase had been. Mr Major hoped to launch the election surfing the good economic news and the announcement of reduced unemployment rates. Little did he know that his first two weeks were to be swamped in sleaze.

Nothing that the Tories could do, would get the media's attention back onto the policy issues of the election. It well suited Labour to continue the focus on sleaze, for they were characterised by only a third of the electorate as 'sleazy', while two-thirds so described the Conservatives. The Mandelson machine was of course helped by the early declaration of the *Sun* for Labour, as vitriolic against the Tories in 1997 as it had been vicious in their favour in 1992. The *Sun* is read by nearly one in five voters.

The focus of the Tories' election campaign, too, was badly misconceived. We had been tracking the relative salience to the public of 16 possible issues, asking which would be 'very important' in influencing their votes. It was soon apparent that the 'four horsemen' of the election would be health care, education, unemployment and law & order. That's what Labour spokesmen concentrated on, right from the beginning when they were the chosen themes of the 'Road to the Manifesto', at their press conferences, in their leader's speeches, and even the 'pledge cards' which they handed out to the nation.

Meanwhile the Prime Minister spent the third week talking about constitutional threats of Labour's policies and especially devolution. Out of 16 issues, 'constitutional issues/devolution' ranked 16th in importance with the voters, and the issue that the Deputy Prime Minister spent most of the same week talking about, trade unions, ranked 15th out of 16.

New Labour, No Danger

Going hand in hand with Tory decline was Labour recovery, driven by the election of Tony Blair. This had two principal consequences. When the electorate looked at Neil Kinnock they saw over one shoulder the spectre of the loony left, CND, and tax and spend; over the other, the spectre of the trade union barons. There was a trace of those ghosts over John Smith's shoulders as well. And while Kinnock had had Peter Mandelson by his side, Smith had him banished from the court. When you looked at Tony Blair, there were no ghosts, and Mandelson was back, to chair the most effective campaign in Labour's history.

By the time the strategic phase was played out, the election called and the short-term tactics of the campaign itself begun, the election was already effectively lost. Had the referendum on Maastricht been held, it would not have saved the Tories from defeat. But it could have saved the humiliation of a 179 Labour majority.

Robert M. Worcester is Chairman of MORI and Visiting Professor of Government at LSE. This article is extracted from a book by Worcester and Mortimore (forthcoming).

With reference to the section 'Divisions over Europe': The predictions of the Maastricht rebels have been proved beyond doubt. In the last 18 months, readers will recall a) the Sheffield Nottingham Study, which showed that 60% of Tory MPs who voted for Maastricht were privately against it; and b) the recent Nottingham Trent Survey which showed that 67% of current Tory MPs privately say 'Never' to a single currency. See the Conference edition of the European Journal, *Sept./Oct. 1998.*

Editor

The Retreat of the State in International Affairs

Extracts from a speech by ***The Rt Hon. the Lord Owen, CH,*** *delivered on 21 October 1998, in Norwich Cathedral, as part of the Launcelot Fleming Lecture Series '98*

The most significant attempt to dilute national sovereignty in the area of collective defence started after the end of the First World War in the negotiations over the Covenant to establish the League of Nations. In 1919 most people in Europe were ready to accept the leadership of President Woodrow Wilson at the Peace Conference in Paris. It was agreed early on in Paris that America's Monroe Doctrine, guaranteeing US supremacy in Latin America, was to remain exempt from the Covenant. The controversy back in the United States came from Article X, the commitment to "preserve against external aggression the territorial integrity and existing political independence of all members of the League". This left Wilson wide open to the jibe from Theodore Roosevelt, the former President, who was himself not shy about using America's weight overseas, that "every time a Yugoslav wishes to slap a Czechoslovak in the face" it would mean that President Wilson would go to war. Wilson thought that the Senate would never dare to reject the whole elaborate structure of the Treaties of Paris. But on the 19th November 1919 the Senate voted against. A second vote on the 19th March 1920 also failed to pass. Few events illustrate better the separation of powers in the US constitution and the limitations of Presidential power as the United States' refusal to join the League of Nations.

American reluctance to be involved once more on the continent of Europe was shown again on the 3rd of September 1939 when Britain's ultimatum to German to suspend their attack on Poland expired. While Britain and France declared war, President Franklin Roosevelt coincidentally made a proclamation of neutrality similar to that made by President Wilson in 1914. The evacuation from the beaches of Dunkirk in June 1940 and the RAF's Battle of Britain in August 1940 began to tilt the balance of public opinion about the war in Europe in the United States. But there was still no majority sentiment to become involved. Roosevelt was re-elected on the 5th of November 1940. In January 1941 he introduced the Lend-Lease Bill, for financial loans to Britain, to Congress. After an acrimonious debate, the Bill was eventually pushed through on the 11th March 1941. Churchill later described the Lend-Lease Bill in his war memoirs as "the most unsordid act in the history of any nation". Its generosity was surpassed only by the post-war Marshall Plan.

On 7th December 1941, after 366 Japanese war planes had launched a surprise attack on the US Pacific fleet in Pearl Harbor, Hawaii, America declared war on Japan. It was, however, Germany on 11th December which declared war on the United States which was still neutral in Europe. Churchill's biographer, Martin Gilbert, described Hitler's decision as "perhaps the greatest error, and certainly the single most decisive act, of the Second World War". For it brought the United States back to Europe as a belligerent.

With war over in 1945 the US started to move their forces back home. They also initially took a rather favourable view of Stalin though disillusionment soon set in. The American people were, however, ready to allow President Harry Truman, with bipartisan support in Congress, to play the key role in the San Francisco Conference in 1945 which established the United Nations. Truman, who had fought in Europe in 1918, carried in his wallet all his life Tennyson's dream, the last two lines being:

> *Till the war-drum throbb'd no longer*
> *and the battle flags were furled*
> *In the Parliament of Man,*
> *the Federation of the World.*

Winston Churchill called those words the most wonderful of prophecies and his famous 'Iron Curtain' speech in 1946 was devoted to extolling the merits of the United Nations.

In December 1946 the Greek Government was losing its civil war in the north against the Greek communists who were operating from mountain strongholds in communist Albania, Bulgaria and Yugoslavia. British aid was drying up and on 21 February 1947 Britain, in deep financial trouble, told the US it would have to stop financial aid to Greece and Turkey by the end of March.

On 12 March the Truman Doctrine was set out in a speech to a joint session of Congress, establishing one of the primary objectives of American policy as, "the creation of conditions in which we and other nations will be able to work out a way of life free of coercion". Truman went on to say, "should we fail to add Greece and Turkey in this fateful hour, the effect will be far reaching to the West as well as to the East."

American public opinion now accepted, after losing their own men in two wars fought outside their own territory, that they were no able to insulate their country from world problems. Isolationism gave no protection and furthermore even they needed allies to assure victory. Congressional opinion in 1948 was ready to support the establishment of the North Atlantic Treaty Organisation which carried a permanent commitment to the defence of Europe, something they could not accept in 1920.

A nation, whether democratic or not, has as one of its most distinctive features a readiness to fight to defend its territory when under attack. The most profound decision in a democracy is that which politicians take to send their nation's children, often including their own, off to war. That is one reason why democracies are said to be slow to fight. After the wanton sacrifice of the First World War, Wilfred Owen and other poets have made us establish a new language for war. Today very few would claim *"dulce et decorum est pro patria mori"*. Nonetheless, when the threat is real a duty of collective self responsibility asserts itself. A mutual identity, a sense of collective self regard and self responsibility is the hallmark of a nation. A multinational state can best build those characteristics within a democratic framework, but it is harder to achieve and sometimes founders where there are internal ethnic divisions. The character and unity of a nation depends a great deal on how it retains an identity.

No wise political leader will dare take the collective will to fight for granted or lightly invoke it. The best protection against the irresponsible sacrifice of the nation's young is that in a democracy the wrath of the family will be visited through the ballot box on politicians who do act irresponsibly.

In any analysis of what can be sound and sensible retreats in the power of the state in international affairs, one needs to be sure that nothing is done which damages the

basic instinct for self preservation, nor erodes the collective will to fight in one's own national self defence. Also one needs to consider whether a retreat in the power of the state deepens, or weakens, the democratic way of life of the nation, democracy of itself makes a massive contribution to the collective will to defend what one respects and identifies with. Democracy is the system whereby individuals can best relate to the national interest, for it is far easier to act unselfishly and accept constraints if there is a system of governance premised on strict accountability to freely arrived at majority opinion.

The European Union in its development so far represents a unique attempt to marry the strengths of individual nationhood with the strengths of nations combining together. The founding fathers and some of the politicians at the time of the Messina Conference, which established the Treaty of Rome, did envisage that the commitment to an ever greater unity would inexorably lead to a nation called Europe developing in the fullness of time. But they avoided spelling that out in treaty form. A pragmatic step by step approach to the evolution of the future has governed all subsequent treaties. As a direct consequence of this there is a calculated ambivalence as to whether we are creating a Union of European nation states or a United States of Europe. It is as legitimate to argue that the EU's destiny is to remain a union with limits to the retreat from nationhood as it is to argue that the EU's destiny is to continue the retreat until it is a United States of Europe. It is a travesty to say, however, that those who argue for limits are Eurosceptics. I am not a Eurosceptic but an enthusiastic supporter of building a consensus on as many issues as possible with our nearest neighbours in Europe. I defy anyone to challenge my political record as a convinced champion of the EU. But I am just as proud to fight within the EU to retain the sinews of British nationhood and to set limits on the retreat of our state. I look to the politicians in the House of Commons today to have the self-confidence to use the veto powers contained within the treaties to block retreats that erode the essentials of our national identity. That is one of the main reasons that I supported the Maastricht Treaty because it does set limits on the retreat of the state.

In 1956 the United Kingdom chose, with few dissenters, not to participate in the creation of what was initially the Common Market. Geography dictated we stayed outside the Coal and Steel Community which did so much to bring the great industries of France and Germany together across their national boundaries. History stopped us from being active at the Messina Conference. In 1962 the UK did, however, embark on a genuine debate about whether we should join the Common Market and

I look to the politicians in the House of Commons today to have the self-confidence to use the veto powers contained within the treaties

the two politicians of their time who, by nature, dissembled least faced up to the unresolved issue of federalism with honesty. Hugh Gaitskell, then leader of the Labour Party, replying to Prime Minister Harold Macmillan's television broadcast, asked if Macmillan wanted to enter a European Federation. If so it "means the end of Britain as an independent nation; we become no more than 'Texas' or 'California' to the United State of Europe". Jo Grimond, then leader of the Liberal Party, put the contrary view, saying that if we were going to "control the running of Europe democratically, you've got to move towards some form of federalism and if anyone says different to that they are misleading the public". Would that many of the politicians who came after had had the same honesty. In what I once called the politics of 'fudge and mudge', it has become an art form in the UK to obfuscate. Too many politicians deny the pressures within the Brussels bureaucracy to undermine the nation state. Before the Maastricht Treaty signatures were dry, many continental politicians were trying to erode the three intergovernmental pillars which they had only reluctantly accepted. To say this is not to be paranoid or to believe in conspiracy theories. To their credit on the continent most politicians are quite open about their federalist intentions.

On the single currency the British and Danish opt-out in the Maastricht Treaty reflected in the main a number of differences of view. Firstly, whether it was possible to run a single currency successfully across eleven national boundaries without inevitably moving towards single economic and fiscal policies. Also there was a concern that these economic and fiscal decisions would not be made democratically without a federalist structure. A single currency across national boundaries involves a fundamental political change of direction for the UK and it is right that this should be made outside the confines of party politics and requires a referendum. The onus of proof has been placed on those who want to give up the pound to show real benefits if such a referendum is ever called. The implication of a single currency for the security and foreign policy intergovernmental pillars is something which I will concentrate on in this lecture leaving the economic and fiscal questions to one side.

I am certain that majority voting designed to produce a single, as distinct from a common, foreign and security policy is an absolute Rubicon for a nation state. Cross it and you have given up your nationhood even though some politicians will not admit this. As to a single currency my deep suspicion is that, though in my judgement it is not a Rubicon, for those countries who take it it will prove to be a threshold decision. A decision on a slippery slope where, unless the foreign and security intergovernmental pillar is reinforced, the slide will be towards a United States of Europe. The nature of the economic and fiscal decisions necessary for convergence will drive those who choose to live in Euroland to develop most of the characteristics of a nation called Europe and in that process they will be even more relaxed than they are at present about introduced qualified majority voting in the framework of a CFSP.

Some people argue that there is no danger of the foreign and security intergovernmental pillar eroding in Euroland, But it is not hard to see how this erosion would happen. In the Maastricht Treaty there is a potentially far reaching provision for declaring an area of foreign policy to be the subject of joint action. This decision has, however, to be taken unanimously but thereafter the implementing decisions are to be taken by qualified majority voting. The mechanism was wished on the UK at Maastricht by those who saw this mechanism as the thin end of a potentially very long wedge. The temptation to invoke joint action will come at a time when the

UK has a very strong foreign policy objective and wants the EU to support it. It is not hard to imagine others in the EU suggesting that this policy should only be adopted if it is to be subject to joint action. It only then requires a Foreign Secretary who either believes in Euroland or is too ready to accept the advice of a Foreign Office often eager to go along with the European consensus and have difficulty with ever exercising a veto and the UK will have crossed the all important threshold, qualified majority voting in foreign policy. I have no doubt that the UK should never under any circumstances, however tempting, cross that threshold.

Any EU nation needs to have an inner self confidence to step out of an otherwise EU consensus position on foreign and defence policy. There can be no doubt that a country whose currency is part of the euro will be under additional pressures to avoid the tough choices of following an independent foreign policy line that carries risks of trade embargoes or economic discrimination. For one simple reason, retaliation on a participating member in the single currency will no longer affect only that country but all participants. It can be argued, therefore, and sometimes is, that countries operating within a monetary union have more economic protection to take a robust foreign policy line. Yet EU experience shows that what is more likely to develop is a soft CFSP designed to keep policy within the middle of the euro pack. Something which we have seen all too recently over Kosovo. One does not need to invoke British foreign policy over the last one thousand years. One only has to recall, with the exception of France, the continental European equivocation over nuclear weapons while we were still confronting the Soviet Union in the 1970s and 1980s to know why we should refuse to lose our independence in foreign and defence policy. While French also know this to be true and are sympathetic to British fears, in the last analysis they believe that Germany will always support France out of solidarity if French vital interests are at stake. Britain has no such bilateral buttress.

Some in Britain dream of joining the Franco–German Alliance. It is now said that because of the SPD victory in Germany we will be able to develop a trilateral relationship with France and Germany to match the bilateral Franco–German relationship. Yet Oscar Lafontaine comes from the Saarland and is very close to France in all respects. Gerhard Schroeder is more sympathetic but will find the German bureaucracy totally set on the primacy of the Franco–German Alliance. Whitehall is now beginning to adjust the language and talk of a quadrilateral relationship including Italy, but this will cause even more resentment across the EU.

The wise decision of Tony Blair as Prime Minister to put the onus in a referendum on demonstrating concrete benefits means that the proponents, instead of talking about 'missing the train', or failing to 'catch the bus' or building up a vague belief that joining the euro is inevitable, will have to answer hard questions of national interest. Also the new proposals from the Neill Committee on Standards in Public Life mean that there will be rules in place on the fair conduct of any referendum. Personally I eschew fixing any timetables. I hope we never have to be part of a single currency and only if the economic disadvantages that I foresee prove to be unjustified and the political ramifications are less than I fear would I be prepared to contemplate it.

Prudence would dictate first seeing how countries whose economies are not converging with the majority within the euro weather an economic downturn without the capacity to devalue their currency, or to alter their interest rates. Also how such countries ease rising unemployment without the migration possibilities to other EU countries that, for example, a worker in the US east coast rust belt has to enable them to move down south or out west. Also to just the effect on unemployment of not having the fiscal transfers between the countries of Europe that exists between the prosperous and rich states in the US. Waiting and seeing means judging that it will not be sufficient for those politicians who want to join to mouth bland generalities about political will and the need not to be left behind in Europe.

Summary of the Maastricht Treaty Provisions on CFSP

The objectives of the common and foreign security policy shall be:

- to safeguard the common values, fundamental interests and independence of the union;
- to strengthen the security of the union and its member states in all ways;
- to preserve peace and strengthen international security, in accordance with the principles of the UN Charter and the Helsinki Final Act, and the objectives of the Paris Charter;
- to develop and consolidate democracy and the rule of law, and respect for human rights

The procedure for adopting joint action in matters covered by the foreign and security policy is that:

- the council shall decide, on the basis of general guidelines from the European Council, that a matter should be the subject of joint action. Whenever the council decides on the principle of joint action it shall lay down specific scope, the union's general and specific objectives in carrying out such actions, if necessary its duration, and the means, procedures and conditions for its implementation.
- the council shall, when adopting the joint action and at any stage during its developments , define those matters on which decisions are to be taken by a qualified majority. Where the council is required to act by a qualified majority pursuant to the preceding subparagraph, the votes of its members shall be weighted in accordance with Article 148(2) of the treaty establishing the European Community, and for their adoption, acts of the council shall require at least 54 votes in favour, cast by at least eight members.

Not joining the euro is in no way comparable to staying away from the Messina Conference which set up the Common Market in 1956. We are today full members of the EU, we have helped shape the European Monetary Union for those countries who want to join. We are entitled to join the single currency if we wish at any time after fulfilling the criteria within the Maastricht Treaty. There cannot be any veto from another EU country on our joining. Like over the ERM we participated in the EMS and kept our options open to join as and when we wished. We do not need to use a veto, all we need is self-confidence and the will to exploit the euro to our commercial benefit as we have done for the dollar and the yen.

We do need to watch carefully how other countries behave on all aspects of the EU's political development. In that sense we will be better able to assess the political impact of monetary union and the certainty of our being able to continue to pursue an independent foreign policy after the passage of the years. Our political leaders need the confidence to wait and see and not be carried away by an illusion that leadership is always about action. Some of the best leaders are those who understand the power of patience. Claims to leadership in Europe usually turn out to be transient or illusory. We best lead on the many issues where the US policy is a major factor, not because we have an exclusive relationship with the US but because of a national affinity on most, but not all, issues.

We must also not feel too threatened by loose talk that our place in the G7 will be put in jeopardy if we are not part of the single currency. Canada will not exactly give up G7 participation. Nor would I be that confident that Germany, France and Italy, when the single currency is operating, will agree to be represented by the President of the European Bank or one Prime Minister. Unless, of course, they appoint or elect, as many wish, a Euroland Cabinet with a President and Finance Minister. Russia has only just secured their G8 position and their power will slowly recover.

If an informal G3 of the dollar, yen and euro develops, so be it. We have lived in the UK with the reality for some years where the Deutschmark has given the German Bundesbank and German Government a stronger role on international monetary matters than the UK. Nevertheless an independent Governor of the Bank of England operating a successful economy with a strong pound will find a welcome in most monetary forums and a British Prime Minister's political influence in G8 will continue to have real value.

Britain does not have to stay in a bunker while exercising its euro opt-out. Instead it should champion and develop further the common, not single, foreign and security intergovernmental pillar. We can demonstrate that in this area we are not negative but positive reformers, ready to become a key player within the EU. We should talk intensively with the French and I suspect we can both learn from the dialogue over what was called the Fouchet Plan even though it was held in 1962. The Plan failed because of a dispute over limiting the supranationality of a 'Union of States'. Now such a debate will in some matters be easier for the parameters of the EU are much better defined. France wants Britain to be more forthcoming over European defence. Britain's defence partnership on the ground with France from 1992 onwards in Bosnia, as I witnessed at close quarters, has left both armed forces with considerable mutual respect. The far closer working relationship between the FCO and the Quai d'Orsay established in 1991 with the break up of Yugoslavia has meant that the old scars from the failed collaboration over Suez in 1956 have largely healed. Paris has noted with both surprise and appreciation the readiness of London to seriously differ at times with the Washington line over Yugoslavia. It is essential for Britain that we build on this relationship with France, which should not be in any way based on downplaying the US or diminishing Germany, let alone being antagonistic to NATO. It is in our interest to ensure that the intergovernmental pillar supporting CFSP is bedded into the practice and future development of the EU. A wise British government would quietly let our European friends know that this needs to be done before the UK will every seriously contemplate participating in the single currency.

It will be the generation of people untouched by the Cold War who will decide the limits to the UK's future role within the European Union and the extent of any further retreats. We who lived through the most testing period of deterrence and detente confronting the Soviet Union have a duty as far as possible to ensure that the younger generation make their decision in the full possession of all the facts, against the background of a UK that has rebuilt a strong economic base and has redeveloped a broad, confident, global outlook.

Mr Blair's European Army

by Keith Simpson, MP

In October we witnessed a classic example of Blairite style over substance. A Blairite proposal spun outside Parliament and in advance of a European summit, a hint of a new policy initiative, which, under scrutiny became a will-o'-the-wisp that left his own ministers confused and our allies disappointed. I refer to the strange case of Mr Blair's apparent conversion to a defence role for the European Union, trailed before the EU summit in Austria. Mr Blair appeared to suggest that Britain was prepared to concede a defence role to the European Union, to see the eventual scrapping of the Western European Union, and the creation of some kind of new structures whereby troops from different European countries could act together in either peacekeeping or combat roles.

In the same breath Mr Blair denied that he was seeking to undermine NATO or create a European Army or have the European Commission undertake a security role. Mr Blair's briefings to the press took place on the second day of Parliament's debate on the Strategic Defence Review when his ministers were claiming solid support for NATO and a limited role for the WEU. When the Conservatives sought clarification of the government's position through an adjournment debate on the European Union (Defence Policy) on 11th November we were left none the wiser. To say the very least it has left many defence experts puzzled and many politicians with a sneaking suspicion that Mr Blair is trying to move Britain closer to some of its European partners on the question of a truly European defence identity. But given his own government's officially stated position at Amsterdam, the deep suspicion within the Foreign Office and Ministry of Defence,

and the sharp reaction by the Conservatives this is a change of policy that "dares not speak its name."

Of course New Labour deals in counterfeit briefings, double entendre and kite flying as a substitute for policy. A recent report by the think-tank Demos has proposed the idea of a single 'European Army', something which has been floated amongst a number of European think tanks over the years, but to date has found very little support in Britain. But perhaps now is the time, amongst the contradictory rhetoric of New Labour defence thinking, to look at the viability of a 'European Army'.

Let me say at the outset that a 'European Army' is not an impossibility – given political will, political and structural fusion and a real identity of interests and values it could be created – but the 'given' is quite an assumption. The concept of a 'European Army' is not new. It was first (out of fairness I have excluded Hitler's concept of creating a European Army to fight Bolshevism after 1943) seriously considered fifty years ago as part of the movement to create a European Defence Community. Every now and again since then it has been taken out and dusted down either as a vague concept for the Europeans to pull their weight in NATO or as a stalking horse by the French who resent what they see as the US domination of NATO and hence of Europe.

A truly 'European Army' cannot be created without creating a real European Union with integrated sovereignty and co-ordination of policy and one political voice. There are Euro-federalists who seriously want to achieve that political union, but such a concept is not achievable in anything like a short time scale. And for those British critics who firmly place France in that unionist role there are some fascinating contradictions of Gallic behaviour. I believe that France wants the US to be more of an associate in Europe than a serious political player, and sees any European Union dominated by French interests and political structures. It is interesting that in the current debate within the UN over the restructuring of the Security Council, the French are in favour of expanding the permanent membership by including Germany and Japan but appear uninterested in a single EU representative which would inevitably lead to the exclusion of Britain and France.

To create a real 'European Army' would ultimately mean a complete loss of national sovereignty and an inability to use national defence assets for national interests. At present the European members of NATO – let alone of the WEU or OSCE – have considerable differences in foreign and security policy objectives, in the organisation and effectiveness of their armed forces, and in their national ability to project power beyond their own frontiers. Amongst the European members of NATO only Britain and France have the traditions, will power and capability for real force projection and sustainability. Other European countries in varying degrees – the Netherlands, Belgium, Germany – can participate on a limited liability, whilst others are useful at the political flag waving end of the support spectrum.

If the objectives of political integration are objectionable and almost unattainable then they are mirrored by the military constraints on a 'European Army'. At present the US provides almost all NATO's significant strategic assets – nuclear, conventional firepower, communications, lift, logistics and intelligence, and, more significantly, co-ordination. That's not to downplay the British and European contributions, without which, ironically the US is constrained, but the strategic initiative lies with the US. Quite rightly, the last Conservative government was keen to support greater European co-operation and integration in NATO, and see the WEU fulfil a real role which complemented rather than supported NATO. Ironically, the British and French at the military level have many common interests, experiences, and professional characteristics, and close co-operation makes sense. But it is a another matter to talk of creating a 'European Army'. This would necessitate the functional fusion of defence policy, defence industrial recruitment policy, training and the ethos of a rich variety of European armed forces. To gain an advantage at a European level we would lose all those national military attributes, which make our individual armies effective at so many other levels.

The responsibility of any British government is to exercise a foreign and security policy which promotes and protects British interests. Above all else it should not weaken the ultimate ability of a British government to use military force on its own to defend British interests, citizens or national territory. Total military independence is not a realistic policy and most assumptions made by the last Conservative government were based upon close co-operation with allies. But the ultimate responsibility to deploy British armed forces and to exercise national power must remain with a British government. The creation of a 'European Army' would be the ultimate erosion of national sovereignty. Mr Blair's trail on a 'European Army' bares comparison with his policy initiatives on devolution and constitutional change before the general election – not clearly thought through, incomplete, and ultimately a threat to the sovereignty of the United Kingdom.

Keith Simpson is Conservative MP for Mid-Norfolk and a Front Bench Defence Spokesman. He was Senior Lecturer in War Studies at the Royal Military Academy, Sandhurst from 1973 to 1986.

… news in brief

German banks disappointed by new government

The head of Commerzbank has expressed his disappointment with the start of the new Social Democratic government. Speaking in his capacity as President of the Federal Union of German Banks, Martin Kohlhausen regretted the public argument between it and the Bundesbank and said that its new economic policy lacked coherence. "If you push forwards on the port side and backwards on starboard you go around in a circle", said Martin Kohlhausen. He also attacked the idea of setting up exchange rate corridors between the euro, the yen and the dollar as "counterproductive". Only a stable euro, he said, could solve unemployment in Europe. [*Handelsblatt,* 17th November 1998]

Lafontaine back-pedals

The new German Finance Minister has said that he agrees with the Bundesbank on interest rate and monetary policy and that the primary goal should be price stability. There had been no argument between him and Frankfurt, he insisted, speaking at a meeting of the French and German finance ministers and central bank chiefs. Lafontaine also retracted his earlier suggestion that there should be a sort of planetary ERM for all the world's currencies. [*Handelsblatt,* 17th November 1998] It is unlikely, however, that this is anything other than a matter of image making. Lafontaine remains committed to the principle of stimulating growth in the European economies, as does his opposite partner in France, Dominique Strauss-Kahn.

The UK, the Euro and the Treasury Tests

by Brian Burkitt

In October 1997 the Treasury constructed five economic tests to be met before Britain entered EMU. Therefore it is timely to analyse how far these tests have been reached and, if not, whether they can be attained in the early years of the next century, when it is widely assumed that the present government will be planning a referendum and preparing the UK for EMU membership.

Test One: *Are business cycles and economic structures compatible, so that the UK could live comfortably with an EU-wide monetary policy on a permanent basis?*

There is no sign of such convergence. Indeed UK exports to the EU actually fell in 1997, whilst exports to the rest of the world rose on an accelerating trend. Neither the Bank of England nor the Treasury has developed any programme to produce cyclical of structural convergence between the British and continental economies. Specifically, the Monetary Policy Committee of the Bank of England is not attempting to co-ordinate with other EU interest rates, but focuses upon running monetary policy to secure the government's prescribed inflation target.

Moreover, the Government's Spending Review ensured that UK interest rates will remain higher for longer than if the Chancellor had not boosted public expenditure. Therefore the rate of interest differential between the UK and Euroland will widen. By making it harder to join EMU, the government is demonstrating that domestic policy is its primary concern. Additionally the relationship between the pound and the deutschmark remains unsustainable. If sterling was merged with the euro at approximately the current £-DM rate, businesses would go bankrupt, jobs be lost and the public finances move into deficit.

As for structural divergences, such as the acute sensitivity of the UK economy to changes in interest rates or the British balance of payments' unique dependence on earnings from overseas investments, no trends have emerged to indicate that they will disappear. Nor has the government introduced any policy measures designed to remove them. Therefore the pursuit of structural convergence remains a chimera.

Test Two: *If economic crises occur does sufficient flexibility in product and labour markets exist for them to adjust rapidly and efficiently?*

The current government is attempting to improve skills flexibility, but, by signing up to the Social Chapter, it will create additional rigidities. More importantly, no strategy has been devised to reduce the cultural and linguistic barriers to labour mobility across the euro zone, which is a crucial determinant of EMU's success or failure. Consequently this test (largely outside UK control) cannot be met in the foreseeable future.

UK exports to the EU actually fell in 1997, whilst exports to the rest of the world rose on an accelerating trend

Test Three: *Would joining EMU create better conditions for firms making long term investment decisions in the UK?*

Economic convergence, both cyclical and structural, is central to attaining the investment criteria. As already argued, there is no indication that the UK is converging, or will converge, with the continental economies. Especially, in the improbable event that convergence took place, changes in demand, productivity and technical progress, inevitable in a dynamic economy, would soon re-establish divergence. So too will the impact of a uniform EU-wide monetary policy. Moreover, UK inward investment is threatened by the loss of the UK's competitive tax regime due to EU attempts at fiscal harmonisation.

Test Four: *What impact would EMU entry exert upon the competitive position of the UK's financial services industry?*

The City of London's dominance has not been threatened by the government's decision to opt out from the launch of the single currency on 1st January 1999. Nor is it likely to be given the substantial competitive advantages the City enjoys over all its EU rivals. Conversely, EMU participation will undermine the City's supremacy if the European Commission's plans to promote tax harmonisation proceed. A contemporary example is the Commission's proposal to impose a 20% tax on interest paid on international bonds, the chief method whereby governments, larger corporations and banks raise funds. The results for Britain would be catastrophic. 75% of all this business currently increasing by a trillion dollars a year is conducted through London, helping the City to be easily the biggest overseas earner in the UK economy. The immediate impact of the Commission's tax, scheduled to be levied from 1st January 2001, would be a loss of an annual gross revenue of £1 billion and 11,000 jobs, although the long term effects will run much wider as investors switch their transactions outside the EU. The episode illustrates how much the City of London has to lose if its is incorporated within EU financial regulations.

Test Five: *Will joining EMU provide greater stability, higher growth and a permanent increase in jobs?*

The achievement of cyclical and structural convergence is essential for meeting the growth and jobs test, yet neither is likely to occur over the foreseeable future. In these circumstances EMU membership will reduce growth and destroy jobs in Britain. It is clearly not supported by the weight of economic evidence.

Summary: British participation in EMU could only be an economic success if permanent cyclical and structural convergence existed between the UK and the euro zone economies. Such a situation is far from being established, whilst on the experience of the last year there is no evidence of trends or policies leading to convergence. The conclusion is that EMU membership will make Britain poorer.

Dr Brian Burkitt is Senior Lecturer in Economics at the University of Bradford.

EURODATA

The New European Way

A group of European Socialists, Social Democratic Finance Ministers, and Finance spokespersons from the Party of European Socialists, adopted an illuminating policy agenda last month. Gordon Brown signed the document for the UK.

The document, ' The New European Way To A People's Europe', is the group's response to the effect of globalisation. The group argues that the benefits of globalisation are unevenly distributed and lead to social exclusion. The 'new European way' will combine " a new economic dynamism with a well-established commitment to solidarity, equal opportunities, and social justice."

Economic Reform Policies

The Socialists and Social Democrats desire to adopt an outward looking strategy characterised by helping markets to work and eliminating the barriers to free trade. To achieve a successful outward-looking strategy, the agenda calls for strong governance within Europe. The agenda states that the ECB "has to" conduct macroeconomic policies in order to attain 'full employment' and sustained fiscal discipline, while at the same time ensure economic flexibility in the case of an economic downturn.

Significantly, the 'New European Way' policies involve all the EU members, in or out of EMU. This is particularly important in the case of tax, where harmonisation to prevent 'harmful competition' is planned for all countries, although EMU makes it logical for just the eleven.

The Social Agenda

Juggling strong economic policy with a commitment to social justice is central to the New European Way. The authors strive to ensure a framework in which " Europe's workforce can continually adapt to a rapidly changing world." The agenda calls for active labour market policies that involve investment in early education, improving skills of the workforce, and unemployment spending that is focused on preparing people to return to work.

The new way includes 'an active state' and large public sector that takes up the "core competences of creating a stable macro-economic framework and common rules for competition." With some foreboding, the agenda promises a "new culture of regulation."

Comment on the 'New European Way' has questioned whether it is an agenda, or just a rhetorical policy statement.

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The European Foundation

The *Great College Street Group* was formed in October 1992 in order to oppose the Maastricht Treaty. The group, consisting of academics, businessmen, lawyers and economists, provided comprehensive briefs in the campaign to win the arguments in Parliament and in the country. The European Foundation was created after the Maastricht debates. Its task has been to mount a vigorous and constructive campaign in the United Kingdom and throughout Europe for the reform of the EC as a community of independent sovereign states. The Foundation continues to establish links with other like-minded institutes across Europe.

Objectives

The objectives of the Foundation, set out in its constitution, are as follows:

- to provide a forum for the development of ideas and policies for the furtherance of commerce and democracy in Europe;
- to increase co-operation between independent sovereign states in the European Community and the promotion of the widening and enlargement of that Community to include all applicant European nations;
- to resist by all lawful democratic means all and any moves tending towards the coming into being of a European federal or unitary state and for the furtherance and/or maintenance of such end;

Activities

The Foundation pursues its objectives by:

- organising meetings and conferences in the UK and in mainland Europe;
- publishing newsletters, periodicals and other material and participating in radio and television broadcasts;
- producing policy papers and briefs;
- monitoring EC developments and the evolution of public opinion and its impact on the political process in the main EC countries;
- liaison with like-minded organisations in other EC and EC applicant countries and elsewhere;
- liaison with trade associations and other professional bodies .affected by EC action and policy.

The Foundation

The Foundation addresses itself to the general public and to politicians, journalists, academics, students, economists, lawyers, businessmen, trade associations and the City.

It concerns itself with the following main topics:

- industrial and commercial policy;
- economic and monetary matters;
- foreign policy;
- security and defence;
- environmental issues;
- the Common Agricultural Policy;
- the reform of Community institutions;
- the developing world.

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