

# CLASSICAL LIBERAL VIEW ON EUROPEAN ECONOMIC INTEGRATION\*

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1. European economic integration is contradictory to the principles which guarantee individual liberty. It contributes to the lagging behind of economic performance and living standards in Europe in comparison with the more dynamically developing regions (e.g. in Southeast Asia or North America).<sup>1</sup>
2. The continuation of the launched and pursued trend in the economic integration of Europe may only deepen these negative features.
3. The alternative, consistent with classical liberalism and conservatism, which might reverse the negative trend and bring the people more freedom and prosperity, is a return to the values which constituted the source of wealth of individuals and, thereby, nations in Europe in the past (for instance, in England during the second half of the 19th century).

## 1. European economic integration against individual liberty and heighten prosperity of people

European economic integration is increasingly aimed against the natural principles in human life and individual liberty (mainly against the principles of free competition and diversity).<sup>2</sup> This is confirmed, although originally, it was based on four basic freedoms: free movement of goods, services, persons (especially as labour force) and capital. However, these freedoms are natural to humans in their voluntary relations, neither enforced nor given by governments nor supranational institutions. On the contrary, these were, and are, restricted also in the European Union (EU) up to certain degree (the temporary obstacles to the free employment of persons from new Member States in many old EU Member States confirm this). Therefore, the question appears, whether these freedoms were, and are the relevant argument for the foundation of the former European Economic Community (EEC) and the existence of today's EU.

From the very beginning of the European integration process, the main driving force of its “founding fathers“ was the creation of a common European State.<sup>3</sup> From the start, economic integration became, and it still is, more and more subordinated to political integration. The idea of the four freedoms and customs-free area of free trade is being more and more overcome by many regulations and other distortions, as well as by the centralization and unification of conditions within the Union.

Thus two interlinked negative trends prevail today in the economic integration of Europe:

- a) transfer of system distortions (regulations etc.) from national onto supranational level;
- b) the „from-above“ (centralized) harmonization of conditions in the Union.

The already mentioned trends (together with the policies of big governments, generous and costly social systems, high taxes and social contributions etc.) are the main reasons of the lagging behind of the EU as far as economic performance, degree of personal freedom and standards of living are concerned, when compared to some countries of Southeastern Asia (e.g. Hong Kong and Singapore)

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<sup>1</sup> The terms „Europe“, „Asia“ and “America“ in the context of economic performance and living standard are presented only for illustration. They, of course, mean economic performance and living standard of people living in these regions.

<sup>2</sup> See the lecture “Economic Liberalism: Natural and Beneficial“ for more details on principles of economics and economic liberalism (Gonda, 2006).

<sup>3</sup> This confirms even the proposal of Winston Churchill for the foundation of United States of Europe, made before the creation of European Coal and Steel Community during his speech in Zurich (Switzerland) in 1946 (see for example on the <http://www.nrsr.sk/sub/sk/eu/info/zaklady.html>).

and for example, to the U.S. Only to illustrate and confirm it, I would like to mention the significant fall in ratio of economic performance in Sweden to USA, calculated by Gross Domestic Product (GDP) per capita, from 90.5 % in 1975 to only 76.5 % in 2004.<sup>4</sup> Up to a certain degree, there are two visible exceptions in the EU: Ireland (which carried out crucial economic reforms) and Luxemburg.<sup>5</sup>

*Ad a): Systemic Distortions Transferred from National Levels onto Supranational Level*

However, most European countries are similar with a wide range of government regulations and an excessive level of redistribution through government spending. EU countries have been shifting many of such distortions from national level to EU level. The examples worth mentioning from among the distortions, which cause serious economic problems, are the following:

- regulation of trade and markets within the Union, such as quotas and minimum prices in agriculture (e.g. for sugar), regulation and restrictions on labour markets (restrictions related to working time, and other restrictions on the labour market), trade regulations within the Union (e.g. the restriction of the sale of bananas, tomatoes, cucumbers etc.), mandatory guarantee periods etc.;
- restrictions on trade with economic subjects from countries outside the EU (import and export quotas, licences etc.);
- subsidies to agriculture (nearly 50% of the EU budget) with an impact on the lower efficiency of farmers and creating product surpluses and higher prices;
- subsidies to entities in „underdeveloped regions” with the purpose of (in reality not achieved), reducing the differences;
- universally guaranteed social rights, the introduction of pseudo-principles such as “social cohesion“, “social inclusion“ or “anti-discrimination“ (for example, in employment affairs) to European and, subsequently, to national legislative norms.

*Ad b): Centralised Harmonisation of Conditions within the Union*

Moreover many of these regulations and standards and other forms of policies have been introduced from the bureaucratic centre as mandatory, at least at minimum requirement level. It is harmonisation according to the EU. Mainly the following points belong here:

- mandatory observance of technical, environmental, safety and labour-related and other administrative and technical standards;
- artificial European single currency and Economic and Monetary Union (EMU) binds the economies, not only via one fixed exchange rate, but also by means of a centralised monetary policy, Stability and Growth Pact and by other conditions and commitments under EMU;
- minimal standards of social and tax level (e.g. minimally permitted rates for value added tax - VAT and consumption taxes).

It is a paradox that the harmonisation of conditions in EU is aimed to create a competitive environment for the Single internal market. However, I consider it as a logical mistake. From above managed harmonisation (unification) does not boost the competitive environment and the competitiveness of the entities within the EU. On the contrary it has an inverse effect. Such harmonization causes an undesirable leveling and reduces the motivation to become better and more successful, restricts competition and the search for better conditions, thus reducing economic performance and the standard of living in the EU. So, centralized harmonisation and its aim of a more competitive environment not only impair the competitiveness, but it even goes against (the otherwise absurd) aim of the EU; an increase in competitiveness.

It has been forgotten that it is not harmonisation, but diversity (also of conditions) that is the prerequisite for competition. For example, the Professor of Economics at Université Paris-Dauphine

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<sup>4</sup> Gross Domestic Product per capita, measured in power purchasing parity (source: [www.oecd.org](http://www.oecd.org)).

<sup>5</sup> Relevant data are available for example on the web pages: [www.oecd.org](http://www.oecd.org) and [www.heritage.org](http://www.heritage.org).

Pascal Salin says, that „...competition is possible and desirable whenever people are (trying to be) different and live in different conditions...“ (Salin, 2003). On the contrary, it is forgotten also that competition generates such diversity and differences among the people (for example, in their incomes), as are natural and necessary.

Centrally managed harmonisation is not necessary, and it is harmful for the functioning of the (Single) market and economic integration. Therefore I am convinced that centralized harmonisation is the main false premise, on which the European economic integration is based.

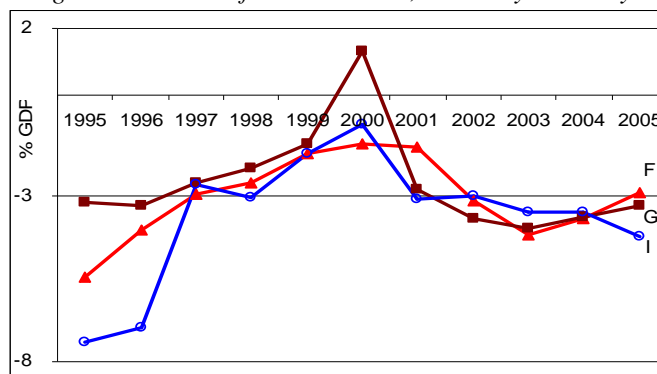
## 2. Continuation of the Already Started Trend – Risks of Further Integration

The core problem of European integration lies in the social-engineering efforts of the centre aimed at generating conditions to minimise differences in the Union and for a real direction towards political centralisation. Before considering the future alternatives, it makes sense to evaluate, what would be the impact of keeping the currently achieved level of economic integration.

### *Alternative 1: Status Quo*

This means the possibility of keeping current situation, thus combining national fiscal policies with supranational Economic and Monetary Policy. However, this motivates governments to shift the financial burdens of part of their programmes onto the European Central Bank (ECB). Because of this contradiction between them, the governments are not pushed to reduce fiscal deficits and what would be most desirable, to obtain a balanced budget. Contrary wise, this enables, and leads the governments to increase fiscal indiscipline and to heighten fiscal deficits achieving 3% of GDP or more. Worsening fiscal discipline after the start of EMU (1999) is evident in some of its core economies: France, Germany and Italy (*Figure 1*).

*Figure 1: Fiscal deficits in France, Germany and Italy*



Legend: F – France, G – Germany, I – Italy, GDP – Gross Domestic Product

Source: OECD (2006)

Such “fiscal free riding” or “moral hazard in fiscal policies” can be seen in an increasing number of governments. This results in decreasing economic performance, increase in distrust and conflicts among the countries and, subsequently, in higher costs for keeping the Monetary Union in Europe functional.

This inefficiency and costs are, and will remain one of the main arguments for Euro-planners to defend an alternative of extending EMU through the European Fiscal Union (EFU) and European Social Union (ESU) to a Euro-State.

### *Alternative 2: Direction towards Euro-State*

Therefore the most probable, and at the same time, most risky alternative in European integration is the development towards tougher political centralisation and the creation of the Euro-State with a Euro-federal government. It has been created gradually from the EEC (1957) through to the EC/EU (1993), regulations and standards, EMU (1999), EFU and ESU, and the proposed European Constitution to the European Political Union (EPU).

The cornerstone has already been laid: the Euro as a common currency, and EMU as tools for political centralisation in Europe. Although it has been confirmed in practice that the monetary policies cannot be efficient at national levels, and their impact on the economy is not significant. However the decisions taken within the more centralised monetary policy (administered by ECB) will be even less efficient with regard to conditions in Slovakia than those taken by National Bank of Slovakia (NBS). Even today, the single monetary policy of the ECB accentuates the problems of some countries (e.g. of Germany, where the labour market is too restricted and the welfare system is too generous). The negative impact on (not only) the Slovak economy due to lower efficiency and more difficult control over a centralised and uniform monetary policy of the ECB constitute a real risk.

But the Eurocrats are unable to imagine a Union with several currencies. On the contrary, a single currency therein is neither necessary nor economically justifiable prerequisite for the Union's existence. For example, the Professor of Economics at the University of California, Berkeley; Barry Eichengreen expresses that *“the principle of the benefits of the single market can in fact be reaped with floating exchange rates between distinct national currencies”* (Eichengreen, 1993).

So, the next step towards the Euro-State is the harmonisation of other economic conditions, including conditions for the tax and social policies (leading to EFU and ESU). Euro-planners argue, seemingly rationally, in economic terms when the urge for further unification of other conditions, including public finance, is put as a prerequisite for sustainable and relatively efficient existence of Monetary union.

Also, no tax harmonization as a prerequisite for the common market is defensible. For instance, Pascal Salin says on the tax harmonization, that *“...as far as the economic theory and real world is concerned, there is no reason for Value Added Tax and income tax harmonisation. The citizens should decide, either by moving themselves or their savings, in which tax and fiscal environment they want to live”* (Salin, 2003). For instance, the individual U.S. states have different tax and welfare systems.<sup>6</sup> I agree with Daniel Mitchell from Heritage Foundation who says that *“The USA is a common market and in spite of that indirect taxes are not harmonised. For instance Texas and California still have very different tax systems. And this is the problem of tax harmonisation in Europe. Nobody has explained why there should be a common free trade zone with different tax systems”* (Americans..., 2004).

The uniform tax and welfare systems in Union would mean the end of quasi competition in tax reduction among the governments. For Slovakia, this would mean a pressure leading to higher taxes, a more complicated tax system and more costly welfare standards; in the worst case scenario, those based on German, French or Swedish models. Significant costs (higher than in old-EU member states) would be the result for the businesses in Slovakia.

The last step towards EPU and the Euro-State is the European Constitution in whatever form it shall take. However, the approval of its recent draft would mean not only the strengthening of political centralisation and harmonisation, but also the strengthening of the regulations and positive social rights, thus higher costs for economic subjects.

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<sup>6</sup> For more details see for instance on the following web pages: [http://en.wikipedia.org/wiki/Income\\_tax](http://en.wikipedia.org/wiki/Income_tax) and <http://www.heritage.org/Research/features/issues/issuearea/WelfareReform.cfm>

The Union, for instance, uses the constitution to usurp exclusive rights in certain areas where only the Union may develop legislative activities and accept legal norms while member states may do so only after being authorized by the Union. It applies to Customs Union, Common Trade and Monetary Policy as well as on economic competition rules that are necessary for domestic market functioning. This might, along with the “flexibility clause” (defined in current version of Treaty Establishing a Constitution for Europe)<sup>7</sup>, become an excuse for the harmonisation of anything. Moreover, the draft of the Treaty universally guarantees too many positive (social) rights without responsibilities for their recipients and without sources for their funding. “*Such rights represent the most important potential tension in the European Union*” (Niskanen, 2005).<sup>8</sup>

In case of its approval, the conflict between Monetary Union and the generous social standards and systems in Europe might escalate in future. I agree with the ECB chief economist Mr. Otmar Issing, that “*the European social model is in discrepancy with the requirements for EMU existence. The Social Union requirements according to the European pattern, lead to labour market regulation, however, Monetary Union requires the contrary: considerably higher flexibility of the labour market*” (Issing, 1997).

If this alternative towards one common European State would prevail, then it together with increased market regulations, “bureaucratisation“, centrally managed harmonisation and aiming towards the Union's federalisation, will mean increasing restrictions on competition and individual liberty. Also, it will lead to levelling, lower efficiency and reduction of productivity and flexibility of economic entities within the Union. This would also increase the dependence of Slovakia on the Euro-zone and slow down (or even stop) the increase of economic performance and the standard of living of the Union's inhabitants.

However, such developments may cause significant negative responses and turmoil based, for instance, on aggressive forms of nationalism. Therefore, the Euro-State trend may become the source of uncontrolled disintegration of the EU.

### **3. Desirable Development Alternatives for Europe in the Future**

Which alternatives are consistent with the values of classical liberalism, conservatism, and at the same time contributing to the economic and ethical revival of Europe?

I am convinced that these should be the alternatives aimed at getting as close as possible to the existence of such a European market which is based on:

- competition principles (for entities, currencies and also the quasi competition of the tax systems of the individual national governments),
- voluntary and diversity principles and
- economic conditions without restrictions, regulations, standards etc.

Generally, it is possible to summarise several possibilities for a desirable strategy within European integration as the accessibility of free trade area within the community of autonomous European states.

#### ***Alternative 3: Free Trade Area within the Union's Community of National States***

The Free Trade Area free of customs and other restrictions not only inwards, but also with other countries worldwide, without any regulations and directives and with currency competition and unrestricted competition of goods and services might be not only a sufficient, but above all, successful

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<sup>7</sup> It is true that this clause does not go above the line drawn by the Nice Treaty.

<sup>8</sup> See more for example in Niskanen, 2005 and Gonda, 2004.

form of economic integration. This should apply even more if their representatives would be able to agree with the North American Free Trade Area and jointly they would create a form of “North Atlantic Free Trade Area”<sup>9</sup>.

Politically, the area could be covered by the alliance of states, which would agree upon it voluntarily. For instance, Mr. Václav Klaus, the President of the Czech Republic, called this an “Organisation of European States” (Klaus, 2005). Such an inter-governmental Europe would have neither common citizenship nor direct voting related to its government. The basic concept for representation would be the number of inhabitants. However, such a community should not have taxing authority, and the contributions of the member states should be proportional to the weight of their representation (Niskanen, 2005).

The creation of such zone within Organization of European States requires at least the following:

- refusal of any potential proposals for further steps of European integration, including non acceptance of the European Constitution (especially when it is “spiced up” with market regulations and positive social rights);
- cancellation of today's harmonization elements (in taxes, welfare etc.);
- creation of conditions making currency competition in the Union possible;
- gradual cancellation of the Common Agricultural Policy and Regional Policy of the EU
- cancellation of all agreements within the Union, starting with the Single European Act, cancellation of the European Parliament and other useless EU institutions;
- pushing for the cancellation of trade and market regulations, customs for non-member countries etc.
- change of procedure for potential exit of any community member so that no consent of the remaining members would be necessary etc.

#### ***Alternative 4: Economic Integration outside the EU***

Similar agreements and developments of such European integration are hardly conceivable and executable today in practice. Therefore also other alternatives are coming into consideration: the alternatives outside today's EU. This would be possible only by means of the exit of Slovakia or more countries from the current EU. Should only Slovakia exit the EU, then it should be reasonable to apply for membership of EFTA (European Free Trade Area, today consisting of Switzerland, Norway, Iceland and Liechtenstein). Should there be more countries exiting the EU, they might either constitute a new free trade area in Europe, free of regulations and under the criteria defined in the alternative 3 or join EFTA together.

#### **Instead of a Conclusion**

I am convinced that successful and useful alternatives for the people to European (economic) integration should be aimed at getting as close as possible to the roots of Europe’s wealth from the past: individual liberty to go hand in hand with personal responsibility, free competition and property rights. Therefore, in the long term, I find it as useful for the people (not only) in Slovakia only those economic and other integrations in Europe, within or outside the EU, which is based on principles of competition and free market instead of centrally managed harmonization and market and trade regulations created by the bureaucrats.

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<sup>9</sup> The U.S. submitted such proposal e.g. by Marian L. Tupy from Cato Institute (Tupy, 2004).

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