Maastricht and All That

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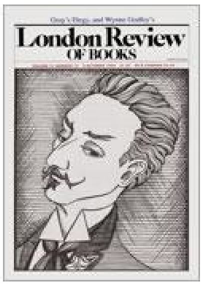

A lot of people throughout Europe have suddenly realised that they know hardly anything about the Maastricht Treaty while rightly sensing that it could make a huge difference to their lives. Their legitimate anxiety has provoked Jacques Delors to make a statement to the effect that the views of ordinary people should in future be more sensitively consulted. He might have thought of that before. Although I support the move towards political integration in Europe, I think that the Maastricht proposals as they stand are seriously defective, and also that public discussion of them has been curiously impoverished. With a Danish rejection, a near-miss in France, and the very existence of the ERM in question after the depredations by currency markets, it is a good moment to take stock.

The central idea of the Maastricht Treaty is that the EC countries should move towards an economic and monetary union, with a single currency managed by an independent central bank. But how is the rest of economic policy to be run? As the treaty proposes no new institutions other than a European bank, its sponsors must suppose that nothing more is needed. But this could only be correct if modern economies were self-adjusting systems that didn't need any management at all.

I am driven to the conclusion that such a view – that economies are self-righting organisms which never under any circumstances need management at all – did indeed determine the way in which the Maastricht Treaty was framed. It is a crude and extreme version of the view which for some time now has constituted Europe's conventional wisdom (though not that of the US or Japan) that governments are unable, and therefore should not try, to achieve any of the traditional goals of economic policy, such as growth and full employment. All that can legitimately be done, according to this view, is to control the money supply and balance the budget. It took a group largely composed of bankers (the Delors Committee) to reach the conclusion that an independent central bank was the only supra-national institution necessary to run an integrated, supra-national Europe.

But there is much more to it all. It needs to be emphasised at the start that the establishment of a single currency in the EC would indeed bring to an end the sovereignty of its component nations and their power to take independent action on major issues. As Mr Tim Congdon has argued very cogently, the power to issue its own money, to make drafts on its own central bank, is the main thing which defines national independence. If a country gives up or loses this power, it acquires the status of a local authority or colony. Local authorities and regions obviously cannot devalue. But they also lose the power to finance deficits through money creation while other methods of raising finance are subject to central regulation. Nor can they change interest rates. As local authorities possess none of the instruments of macro-economic policy, their political choice is confined to relatively minor matters of emphasis – a bit more education here, a bit less infrastructure there. I think that when Jacques Delors lays new emphasis on the principle of 'subsidiarity', he is really only telling us we will be allowed to make decisions about a larger number of relatively unimportant matters than we might previously have supposed. Perhaps he will let us have curly cucumbers after all. Big deal!

Let me express a different view. I think that the central government of any sovereign state ought to be striving all the time to determine the optimum overall level of public provision, the correct overall burden of taxation, the correct allocation of total expenditures between competing requirements and the just distribution of the tax burden. It must also determine the extent to which any gap between expenditure and taxation is financed by making a draft on the central bank and how much it is financed by borrowing and on what terms. The way in which governments decide all these (and some other) issues, and the quality of leadership which they can deploy, will, in interaction with the decisions of individuals, corporations and foreigners, determine such things as interest rates, the exchange rate, the inflation rate, the growth rate and the unemployment rate. It will also profoundly influence the distribution of income and wealth not only between individuals but between whole regions, assisting, one hopes, those adversely affected by structural change.

Almost nothing simple can be said about the use of these instruments, with all their inter-dependencies, to promote the well-being of a nation and protect it as well as may be from the shocks of various kinds to which it will inevitably be subjected. It only has limited meaning, for instance, to say that budgets should always be balanced when a balanced budget with expenditure and taxation both running at 40 per cent of GDP would have an entirely different (and much more expansionary) impact than a balanced budget at 10 per cent. To imagine the complexity and importance of a government's macro-economic decisions, one has only to ask what would be the appropriate response, in terms of fiscal, monetary and exchange rate policy, for a country about to produce large quantities of oil, of a fourfold increase in the price of oil. Would it have been right to do nothing at all? And it should never be forgotten that in periods of very great crisis, it may even be appropriate for a central government to sin against the Holy Ghost of all central banks and invoke the 'inflation tax' – deliberately appropriating resources by reducing, through inflation, the real value of a nation's paper wealth. It was, after all, by means of the inflation tax that Keynes proposed that we should pay for the war.

I recite all this to suggest, not that sovereignty should not be given up in the noble cause of European integration, but that if all these functions are renounced by individual governments they simply have to be taken on by some other authority. The incredible lacuna in the Maastricht programme is that, while it contains a blueprint for the establishment and modus operandi of an independent central bank, there is no blueprint whatever of the analogue, in Community terms, of a central government. Yet there would simply have to be a system of institutions which fulfils all those functions at a Community level which are at present exercised by the central governments of individual member countries.

The counterpart of giving up sovereignty should be that the component nations are constituted into a federation to whom their sovereignty is entrusted. And the federal system, or government, as it had better be called, would have to exercise all those functions in relation to its members and to the outside world which I have briefly outlined above.

Consider two important examples of what a federal government, in charge of a federal budget, should be doing.

European countries are at present locked into a severe recession. As things stand, particularly as the economies of the USA and Japan are also faltering, it is very unclear when any significant recovery will take place. The political implications of this are becoming frightening. Yet the interdependence of the European economies is already so great that no individual country, with the theoretical exception of Germany, feels able to pursue expansionary policies on its own, because any country that did try to expand on its own would soon encounter a balance-of-payments constraint. The present situation is screaming aloud for co-ordinated reflation, but there exist neither the institutions nor an agreed framework of thought which will bring about this obviously desirable result. It should be frankly recognised that if the depression really were to take a serious turn for the worse – for instance, if the unemployment rate went back permanently to the 20-25 per cent characteristic of the Thirties – individual countries would sooner or later exercise their sovereign right to declare the entire movement towards integration a disaster and resort to exchange controls and protection – a siege economy if you will. This would amount to a re-run of the inter-war period.

If there were an economic and monetary union, in which the power to act independently had actually been abolished, 'co-ordinated' reflation of the kind which is so urgently needed now could only be undertaken by a federal European government. Without such an institution, EMU would prevent effective action by individual countries and put nothing in its place.

Another important role which any central government must perform is to put a safety net under the livelihood of component regions which are in distress for structural reasons – because of the decline of some industry, say, or because of some economically-adverse demographic change. At present this happens in the natural course of events, without anyone really noticing, because common standards of public provision (for instance, health, education, pensions and rates of unemployment benefit) and a common (it is to be hoped, progressive) burden of taxation are both generally instituted throughout individual realms. As a consequence, if one region suffers an unusual degree of structural decline, the fiscal system automatically generates net transfers in favour of it. *In extremis*, a region which could produce nothing at all would not starve because it would be in receipt of pensions, unemployment benefit and the incomes of public servants.

What happens if a whole country – a potential 'region' in a fully integrated community – suffers a structural setback? So long as it is a sovereign state, it can devalue its currency. It can then trade successfully at full employment provided its people accept the necessary cut in their real incomes. With an economic and monetary union, this recourse is obviously barred, and its prospect is grave indeed unless federal budgeting arrangements are made which fulfil a redistributive role. As was clearly recognised in the MacDougall Report which was published in 1977, there has to be a quid pro quo for giving up the devaluation option in the form of fiscal redistribution. Some writers (such as Samuel Brittan and Sir Douglas Hague) have seriously suggested that EMU, by abolishing the balance of payments problem in its present form, would indeed abolish the problem, where it exists, of persistent failure to compete successfully in world markets. But as Professor Martin Feldstein pointed out in a major article in the *Economist* (13 June), this argument is very dangerously mistaken. If a country or region has no power to devalue, and if it is not the beneficiary of a system of fiscal equalisation, then there is nothing to stop it suffering a process of cumulative and terminal decline leading, in the end, to emigration as the only alternative to poverty or starvation. I sympathise with the position of those (like Margaret Thatcher) who, faced with the loss of sovereignty, wish to get off the EMU train altogether. I also sympathise with those who seek integration under the jurisdiction of some kind of federal constitution with a federal budget very much larger than that of the Community budget. What I find totally baffling is the position of those who are aiming for economic and monetary union without the creation of new political institutions (apart from a new central bank), and who raise their hands in horror at the words 'federal' or 'federalism'. This is the position currently adopted by the Government and by most of those who take part in the public discussion.