EUROPEAN ECONOMIC MODEL: *QUE VADIS* UE?

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Abstract: Recent evolutions in Europe raise questions on the viability of the actual economic and social model that defines the European construction project. In this paper, I will try to explain the viability of institutional European model that stick between free market mechanisms and protectionism. The main challenge for the EU is about the possibility to bring together the institutional convergence and the wellbeing for all Europeans. If „development through integration" seems to be harmonization through „institutional transplant", how could then be the European model one sufficiently wide open to market which creates the prosperity so long waited for by new member countries?

Key words: economic model, institutions, economic integration, competition

Latest news presented great union demonstrations that almost paralyzed symbol towns of EU. Worried and astonished, we assisted to the terrifying show offered to the entire world. "Bolkenstein Directive", against which were hundreds of thousands of European people, seemed to become a horror movie title that threatened to dethrone social privileges of the welfare state. In France, politics proposed in order to liberalize the labor market turned Paris in a siege capital, through which unions almost colonized the state. This is the image of an unprecedented institutional crisis that characterizes the present social arrangements of UE. There is no doubt that we speak about an amazing state of affairs, contrary to "social cohesion and solidarity" challenges that begin and end almost all EU programmatic documents.

Harmonized Europe or European Harmony?

European integration is built on a system of common policies negotiated and adopted by European governments. This integration process is not the result of the political constraints abolition, it does not mean free market and competition mechanisms, despite all efforts towards these. We can speak about a political-bureaucratic option towards *what should be the economic and society European model*. And this political normative derived into an institutional arrangement exported, with the highest fidelity possible, to member countries and to those that applied for membership.

We are all aware of the confusion that the philosophy of EU political elite makes between "harmonization" and "harmony". In fact, harmonization is another way of speaking about "unification", meaning accepting a unique rule, in fact "standardization" that European institutional arrangement propose to almost all social life sectors.

Harmonization architects seem to ignore what is most important precondition for the economic prosperity, meaning diversity, competition between different institutional arrangements and, in globalization terms, even between different fiscal systems. Competition is the only one that can improve the situation, meaning reducing tax burdens and improving public services.

Within economic sectors, same as in music, harmony does not derive from unanimity agreement, but from diversity agreement. This could be the future of fiscal Europe: European contributors capitalize the inter–jurisdictional differences, and those will facilitate tax competition. For the very moment, hundreds of young French go abroad trying to escape from the French tax system rapaciousness. Which could be the harmonization scope? To stop the free movement of production factors by constraining the other European countries to "harmonize" (it could be also read "increase") their tax system to rough requirements of welfare state.

Free Market vs. Protectionism

The entire EU institutional arrangement - with American pedigree at its origins - is fundamentally the result of the European political system. Despite many economic arguments being quoted in favor of European integration, the defining source of the European project is, par excellence, primary a political one. Initially, the energies of the European integration were animated by the necessity to build a (political) power to counterbalance the American "imperialism" and the un-precedent taking aim of East Asia. In time, the economic dimension gained (an) increasing importance.

But who are the creators of this political project and what were they aiming at? The founding fathers of the "United States of Europe", starting with Jean Monnet, were convinced that the "high" European authorities would have the capacity to plan the economic development overriding the economic principles of the market. We talk here about the model of an economy built via and surrounding the state policies and budgets?. As shown in Institutions and Prosperity. From Ethics to Efficiency (Marinescu, 2004), the allocation of public resources does not impede the exigencies of economic calculus and of markets, but rather political rationales. In fact, the political allocation of resources bears the stamp of any governmental budget. European budgets are built on an immense scheme of subsidies, aids, structural funds and financial external assistance. All this explains the redistribution of resources in the European space via governmental budgets, the European budget and the common policies.

The candidate countries, being in the position of net-receivers, consider this a very positive process, at least at this stage. Since the Marshall Plan, it became clear that the dramatic expansion of „foreign aid" programmes is the result of a political option and not necessary of an efficiency criterion. Hence, the impossibility to assess whether the politically „exported" resources will serve a real economic need or will only contribute to feeding corruption and the "ossification" of the state elites. Billions of dollars external aids offered generously to the African countries by international financial institutions had a modest efficiency or proved to be painfully failure in reducing poverty (India, some countries from Latin America or Africa). Numerous studies have shown that external financial assistance neither creates, nor is it correlated with the essential sources of prosperity. If liberty is the determining source of prosperity, one could notice that a reduction of economic freedom is often – paradoxically - the result of foreign aid increasing[1]. Setting external fund at the foundation of a country's economic success is a dismal illusion. This approach neglects the role of liberal policies (some of them even anti-European) in creating prosperity.

[1] See the works of Lal (2002), Bauer (1993), Johnson (2003), Bandow and Vasquez (2001).

Ireland is a very good illustration of the case when the reduction of public expenditure exceeded the inflow of European funds.

In its essence, the transition to market economy resides in the generalization of the private property as a fundamental institution and its logic corollaries: economic freedom, markets and economic calculus. For all candidate countries, excepting probably Estonia, embracing the European model was the equivalent of reducing the degree of state intervention in the economy and accompanied by an expansion of the market mechanisms. From this point of view, for the governments of Central and East European countries, accession represented an external constraint favoring the completion of reforms towards the market. For example, the liberalization of external trade (the adoption of a common trade policy), reducing the barriers to foreign investment and the free movement, the competition policy in general which can clarify the national business environments and even the almost obsessively invoked safeguard of legal stability and certainty.

However, the very European model itself is insufficiently open to the market mechanism in order to rapidly induce in the candidate countries the long waited for prosperity. Moreover, embracing this model requires costs which are far from negligible and which can reflect in the slow down the economic performance. The so much wanted economic growth is the product of economic liberalization and market mechanisms. Prosperity is not a spontaneous result of gaining the EU membership, but of sound economic policies which stimulate capital accumulation, investment and entrepreneurship.

CEE economies are emerging economies for which economic progress and spread of prosperity via the market could be more important than the protection by the state of consumers' interests, job security or other aspects related to environmental protection. Moreover, it has been admitted that the implementation of European rules in labour, agriculture and environmental sectors is associated with huge costs, which would vitiate the potential for economic growth.

For instance, if the European environmental regulations were immediately applied, they would sentence the Romanian economy to stagnation, by the imposition of the required high standards and prohibitive costs. It is understandable why, at present, the most stringent standards and legislations regarding environmental issues are to be found in the developed countries: improving the environmental quality is the consequence and the reflection of an improvement in the standard of living. Empirical studies have shown that environmental standards tend to rise with the GDP/capita. This means that the European exigencies should give priority to the fast economic growth in the CEEC which should be followed, rather than preceded, by an improvement in the environmental standards. Besides, the possibilities of reforming the present approach (state ownership, high standards and huge governmental spending) through the systematic expansion of the private property in the environmental sector are an illusion.

Institutional Transplant of European Centralism

There are two ways in which the national governments could react to the generalization and the intensification of competition: giving up to the market forces or forming a cartel. The first means the consolidation of freedom and a greater prosperity, the second one erodes freedom, determines the preservation of the *status quo* and only redistributes wealth.

The first way reflects the generalization of the institutional competition, which represents the spontaneous adjustment of the national institutional arrangements with the aim of improving competitiveness and economic performance. IN the context of globalization – intensification of cross-border trade and the increased mobility of factors of production – economic systems are prone to certain adjustments and even to institutional changes of high magnitude. Under the new circumstances, the institutional competition – the competition between rules – is the natural consequence of technological and organizational innovations. These have induced the increase in the mobility of goods and people at international level, the unprecedented development of communications through the reduction of transaction costs. Thus, the opportunities offered by the external market are greater and their fructification becomes more advantageous.

The European model of institutional building and political governance corresponds to the second path. This derives from the European political elite belief that the politically and economically uniformed, harmonized United Europe will better resist the "disruptive" forces of globalization. In this view, the *acquis* would represent an instrument of harmonization through institutional transplant and the taking over the legislation *corpus* (*acquis communitaire*).

The Brussels bureaucracy, also called Eurocracy, has developed specific forms of hierarchical coordination and administrative harmonization (read *standardization*) in almost every domain of public policy. The transposition of the 97.000 pages of European legislation means importing institutions, administrative structures, legal practices and economic policies. The *acquis* illustrates probably the best way the legislation can be turned into a governing (political) instrument, thus creating a radical discrepancy between Legislation (governing regulation) and Law (applying the rule of law through the distinction between good and evil). Moreover, the project of the European Constitution, the longest and most politicized constitution of all times - 270 pages and 70.000 words, in comparison with the only 17 pages and 4.500 words that the USA Constitution counts) is a clear example of European centralism at economic, institutional and political level.

With regard to the constitutional arrangements, one needs to mention that the most important difference between the American Constitution and the Constitutional project of the European Union resides in their view on "rights". The „Bill of Rights" of the US Constitution consists in a list of individual rights against the state and its constraining powers, the „Charter of Fundamental Rights" of the European project consists in a long list of rights to the state monopolized services, like the right to education and health, the right to security, social assistance, right to work etc. The US Constitution is largely build on the philosophy of "the right to …" (ownership) because, lastly, the philosophy of the natural right of John Locke demonstrates the human rights cannot be conceived other than as ownership rights. In turn, the European constitutional project talks about "the right of…", a concept that implies the very undermining of the true human rights, by the expansion of political power and the authority of the state over the life of the individual. By the sacrifice of these fundamental principles of law, the authors of the constitutional treaty project have overloaded the vessel of social rights with nothing else but privileges that dilute the concepts of contract and individual responsibility, favoring set up of a union like, collectivist regime.

The accession process, as it was conceived, was based on the creation and consolidation of an executive specialized branch at national level, which favors the executive component of government. This derives from the fact that the negotiating process and the adoption of European norms is, in reality, an administrative exercise which has the nature of consolidating even more the “statist model” in Europe through the perpetuation of the welfare (redistributive) state and the social market economy model - a model whose economic performances are more and more modest. The fact that the whole process of EU enlargement has developed in a purely elitist, technocratic way has eroded the public support and the trust in the integration process. This could explain why, in what regards the enlargement issue, the public opinion in many European countries is less enthusiastic than in the Brussels officials’ declarations.

From an economic perspective, it is not clear why should EU be an centralized institutional and political arrangement. The free market and competition are capable of boosting Europeans prosperity without necessarily regulating the size and shape of fruits and vegetables, as it happens with the European legislation. Almost all economic and social policies and subject to “harmonization” at a pan-European level while enlargement based on a strictly conditionality system becomes a powerful instrument of reducing diversity.

At fiscal level, harmonization could lead to the alignment of taxes “higher” at the level of most burdensome fiscal regimes. It is alarming that European officials tackle the competition issue only half the way: competition is good, but not between governments (at fiscal level). It seems ironic that many European officials have shown concerns for the fact that some countries use fiscal dumping as more and more business turn towards more friendly fiscal jurisdictions. Moreover, both at EU and OECD level, there are concrete proposals for fiscal harmonization in order to prevent the damages of fiscal competition!! These measures are meant to prevent the national governments to resort to the fiscal competition “gun” as the main means of rending their business environment more appealing; this is similar with prohibiting the entrepreneurs to use all the tools and instruments they know for obtaining the best quality product in the least costly way. In that case, the constitutional rights of American and Swiss citizens to legislative proposals of fiscal reductions should be forbidden, since this would lead to the reduction of revenues from taxation to the German of the French government?! And, to finally conclude on the issue of fiscal competition, we should quote Pascal Salin who said that prosperity needs not to abolish the “fiscal paradises”, but to abolish the „fiscal hell”...

Theoretically, *fiscal competition* if the natural consequence of the mobility of taxation base between the states. As a non-cooperative game between governments, the fiscal competition generates the incentive to reduce the fiscal pressure for the taxation bases with a higher mobility and the increase of the burden for the factor of production and activities less mobile. As globalization diminishes the possibilities for monopolies to resist in different markets, so it acts towards the limitation of the monopoly of governmental power. Consequently, governments that cannot resist fiscal competition could exhibit the tendency to operate at a higher level of constraint of the political monopoly, in a fiscal cartel very likely to be built at European level.

At present, the ample technological and institutional changes facilitate the international migration and the intensification of fiscal policy in the labour markets, a factor whose mobility has increased significantly: the high tech sector specific skills, artists, sportsmen, all place their activities taking into account the friendliest fiscal jurisdiction. For instance, the fiscal authority in France reports that each year, thousands of tax-payers leave the country for fiscal reasons; a large number of French entrepreneurs place their operations in UK; the strong relief of fiscal pressure in Ireland has reversed the traditional trend of migration.

At sector policy level, guided by its aim to "organize" (read make uniform) whole sectors of economic activity, the European Commission has adopted the strategy of „common policies", based on the proliferation of regulations, administrative controls and political subsidies. What are the results? The ACP - an expression of the view that private agriculture is impossible – has deprived consumers, contributors and even farmers. The Brussels fixed prices did not prevent the rural exodus; they have put pressure on households' income, while the protectionist policy diminishes the benefits from agricultural cheaper imports. Moreover, as a result of accession, the farmers in the new Member States will have to reduce their output in conformity with the already negotiated and arbitrary established quotas together with the European decision making bodies, based on un-loyal competition grounds, despite the fact that old Member States export more to Easter Europe than they import. But how do the production quotas – a concept reminiscent from the old soviet system - shake hands with the idea of a true, compete internal market?

The Welfare State or the Redistribution that deprives

When the economic history of Europe from the last third of 20th century will be written, we will understand the whole series of battles that national governments have launched against the economic reality, with the mere illusion that victory can be granted by the embodiment of a simple majority. In this period, Europe was dominated by the institutional arrangement of the welfare state, whose practices were promising education, healthcare, security, prosperity, jobs, in a word happiness for everyone. For the achievement of this goal, national governments understood to increase governmental spending to over 50% of their GDP.

Beyond the increase in public spending, the welfare state machinery was fortified by numerous protectionist laws, ranging from an extremely elaborated system of "working rights" to a huge administrative mechanism in the social insurance and social care. The almost full subordination of the economic to the political was justified, on a large scale, by two reasons. The first one, packaged in cheap electoral pills like „The man counts more than the market" or „In democracy, it is the votes that decide, not the dollars", is based on the fallacy that man, on one side and dollars, on the other side, have conflicting interests. The second reason, one that amplified the invasion of economy by a multitude of "welfare" policies consists in the unhappy belief that the redistribution of income by the government through taxation and policies is an act of "social justice" and a moral duty.

The institutional arrangement initially named "welfare state" was later on recalled in numerous programmatic declarations of EU as the "European model. This very skilful linguistic manoeuvre is meant to underline the clear antagonism of the „European model" in contrast with the „Anglo-Saxon" or, even further, with its political rival, the „American model". In this sense, the supporters of the institutional construction of the EU try to accredit the idea that the performance of this „European model" will be the more obvious, the more the good Europeans will disagree with the cultural model of Anglo-Saxon origin.

Obviously, the claim that, at present, this „European model" would be representative for all Europeans is biased. Essentially, the nature of the „model" is French-German. Its essence is derived from the French socialism of military Gaullist inspiration, from the German social-democracy and the doctrine of the unions[1]. Thus, the European model gets attached, as it is the case for any „rational planned" society, to its own system of cultural values, meant to clearly illustrate the dislike of the Anglo – Saxon civilization, still liberal, but more and more to a lesser extent.

The fundamental trait of the "European model", taken over *ad-literram* from the arrangement of the „welfare state", consists in the redistribution of welfare in the society. Nowadays, the political redistribution of property is considered, even amongst economists, a "natural" prerogative of the state. But the institutionalization of the redistributive practices of the *welfare state* produces, during time, as it has been proved, two types of consequences that inhibit economic prosperity (Marinescu, 2004):

a) *At economic level*, the incentives for work, initiative and entrepreneurial activity are negatively affected; a decrease in the rate of capital formation, the disincentive of the investments with depressive effects on the economic activity.

b) *At socio-cultural level*, changes occur in the social structure regarding the types of personality and character of humans. Social assistance is the one that creates a "mentality of assisted" and favors the collectivist and equalizing cultural values.

Beyond the precarious realism of the policies of the European welfare state, the main goal of the "model" consists in developing a vast scheme of social security, starting with the full monopoly of state in the education sector, goes further with the legal protection of labour places, the best paid holidays, the lowest duration of labour-time that ever existed and ends up with the social insurances for the unemployed and the state pensions.

But which are the economic costs of this social „generosity"? First, we need to understand this public "generosity" is built on higher taxes that have always defined the welfare state institutional arrangement. The redistribution mechanisms and the burdensome taxation are the very sources of the economic problems that Europe faces at this moment. First, we talk about a very pale economic growth experienced by some of the *hard-core* members of the Union. Economic growth rates of 1-2% have become almost a rule, thus being official figures of the economic counter-performance in the EU. Happily, the economic growth deficit in the EU raises serious constraints for the European elite in continuing to rolling systematically the social (read "political") leverages of "welfare". Secondly, it is the serious frictions in the way of the realization of "social harmony" whose source resides, ultimately, in the administrative defection of the labour market mechanism. During the thirty years since the "social model" became a political must, unemployment exploded from an average of 4% to over 10% in France and to approx. 12% in Germany. And from the side-slip of the labour market (if we allow ourselves to call it labour market) to the undermining of the fundamentals of civilizations, of "social cohesion" (a concept so dear to the planners of the EU) are only a few very small steps.

The morale is that social policies meant at ensuring social cohesion end up by off-setting economic growth and implicitly, the creation of jobs, which also explains the dramatic tensions in the labour market in countries like France and Germany.

[1] The European Union tradition is well known. The Americans had spoiled theirs by the capitalist „spirit" that animated the initial development of their economy. If *socialism* was aiming at collective state property on capital, the *union-ship* (as a doctrine and a tactic) had as a fundamental goal the abolition of the separation of workers from the means of production and consequently the annihilation of the entrepreneurial spirit (see Ludwig von Mises, 1966, chapter XXXIII).

Moreover, the partisans of the "European social model" proved the misunderstanding of a simple economic logic when they claim that unemployment is high in Europe because the model is not "social" enough…or "European", which holds the danger of giving birth to an even more stringent need of European "harmonization. In reality, unemployment is the consequence of a labour market stiffens by its own over-regulations by the job protectionism. This is contrary even to the principle of "freedom of contracts" by a fiscal burden that ruins the incentives of entrepreneurship, hence the scarcity of the newly created jobs. In an economy dominated by the public sector, the thirty years time of economic socialist policies have spoiled the incentives of the entrepreneurship and turned the "working class" to an amorphous mass continuously nourished with preferential legislation.

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