Europe Begins to *Rise Early*

By Samuel Brittan

With the Germans leading the way.

Pessimism about Europe is fashionable among foreign policy circles in the United States. The West as a whole is certain to decline in relative economic strength—and quite likely in relative military power as well—as the twenty-first century wears on. This follows from the vast population preponderance of China and India. What requires explanation is why the trend has taken so long to develop. Napoleon partially foresaw this turn of events when he speculated about what would happen when that "sleeping giant, China," woke up.

Yet there is more to say. The vibrancy of a civilization does not depend just on aggregate economic or military strength. There can be flourishing city states which do not aspire to empire or worldwide influence. But it is this kind of vibrancy that some observers assert is missing—more so in Europe than in North America. For instance, a noted American historian of German extraction, Walter Laqueur, has recently produced a widely noted book, *The Last Days of Europe: Epitaph for an Old Continent* (Thomas Dunne Books), where he canvasses the possibility that "Europe, or at any rate considerable parts of it, will turn into a cultural theme park, a kind of Disneyland of a certain sophistication

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Samuel Brittan is a columnist with the Financial Times.

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888 16th Street, N.W.
Suite 740
Washington, D.C. 20006
Phone: 202-861-0791
Fax: 202-861-0790
www.international-economy.com

Life Ain't Fair

The cost of French President Nicolas Sarkozy's budgetary "reforms" such as the tax subsidies for housing loans and overtime has been estimated by Morgan Stanley as costing €11 billion or adding 0.6 percent of GDP onto the French budget deficit. Such is the unfairness of life that Sarkozy might well retain business and financial confidence in the face of fiscal excesses which might have sunk a more "left wing" president. Moreover, the costs of business protection are long-term and partly intangible and need not prevent a medium-term recovery in indicators such as GDP on which most analysts concentrate. For as Colbert's great antagonist Adam Smith observed in the following century, "There is an awful lot of ruin in a nation."

—S. Brittan

Nicolas Sarkozy

for well-to-do visitors from China or India, something like Brugge, Venice, Versailles, Stratford-upon-Avon or Rothenburg ob der Tauber on a larger scale."

He parades all the usual suspects: a low birth rate, insufficient to maintain the indigenous population; difficulties in assimilating migrants; and the troubles of an overblown welfare state, increasingly difficult to afford with an aging population. In the end, he bases his pessimism on the difficulties of absorbing an ever-growing Muslim element into the population. He is careful to avoid crude anti-Islamic polemics. Indeed, he goes to great trouble to analyze the many different trends among European Muslims. He focuses particularly on the alienation of second- and third-generation young citizens who are not deeply attached either to their own religion or to their host countries, but who tend to form gangs combining the worst elements of their own traditions with the worst of European pop ("hip-hop") culture.

He is unclear whether European political integration is a sad failure or a misplaced utopian project. But it is difficult to disagree that the venture is faltering. At the time of writing, new French president Nicolas Sarkozy has just succeeded in deleting the competition element in the preamble to a new (or rather revived old) European treaty. The end result has been a dog's breakfast in which all sides from the open market British to the mercantilist French claim to have introduced tasty morsels. If the treaty is ever ratified, its meaning will have to be decided by the European Court which has a record of supporting federalist interpretations. In any case, the episode is bound to leave a legacy of rancor and bitterness.

The unseemly fracas should also have shattered any illusions about Monsieur Sarkozy as a neoliberal reformer—not that anyone who studied his record should have had any illusions. If he is a reformer, it is in the spirit of Jean-Baptiste Colbert, Louis XIV's highly mercantilist principal minister who devoted himself to protecting French business and trying to "pick winners" among industries and trades. The new French president's distance from any any kind of liberalism was revealed in his election pitch as the

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spokesman for "the France that wants to get up early in the morning." This is every bit as authoritarian as his left-wing and center predecessors who tried to slash working hours under the mistaken belief—the lump of labor fallacy—that this was the way to create jobs. The really revolutionary European leader will be the one who first asserts that working hours are for workers and employers to decide for themselves on a case-by-case basis.

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Those who concentrate on medium-term macroeconomic trends should realize that they have the easier task. The heart of the twenty-seven-nation European Union is the thirteen-nation Eurozone containing the core of "Old Europe," namely Germany and France, but from which the United Kingdom has an opt out, as the British government thinks it has from so many other EU obligations. Despite all the contradictions within the Single Currency venture, this zone has started to confound its critics. It is a recurrent feature of economic analysis that no sooner has a trend become conventional wisdom than it begins to change. In every year after 2000, up to and including 2005, the growth rate of the Eurozone was less than that of the United Kingdom and usually less than that of the United States, while unemployment was much higher. Recently, however, while attention has been concentrated elsewhere, the Eurozone growth rate has at last started to pick up and overtake that of both the United Kingdom and the United States in the last few months of 2006. There was a faltering at the beginning of 2007, but business has interpreted it as a slight flutter, perhaps associated with Germany's increased VAT rate. German business surveys still show near-record optimism. Nor is it only output. German unemployment is now lower than at any time since 1990 and labor force participation has risen.

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It is becoming too simple to dismiss everything as merely a cyclical recovery. If you are looking for signs of strain they are to be found in the diverse national responses to the strong euro. German business has had to contend with both the rise in the euro exchange rate and the "one size fits all" policies of the European Central Bank. Yet the Bundesbank, which is not noted for being a cheerleader, published in its February bulletin an analysis of German con-

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ditions headed "Upturn with a bright outlook." Export success seems to have bred more confidence at home. The Bundesbank remarks that for the first time since 2000 there has been no further rise in the household savings ratio. At the same time "investment is clearly on the up." So far from there being a fiscal stimulus, the German budget deficit has fallen from around 4 percent of GDP earlier this decade to 1.3 percent, the lowest in the G7 apart from Canada. While half of all unemployment is long-term and the productivity gap with the United States continues to grow, the country is hardly an international model, but it is at least time to recognize the turnaround.

The labor market reforms undertaken near the end of the Schröder government had more effect than generally realized. But most of the turnaround seems to reflect spontaneous behavior by both business and labor. Germany has has been one of the very few countries, apart from Japan, to experience an actual fall in unit labor costs in manufacturing. While the nominal trade-weighted exchange rate for the euro has risen by over 20 percent since the beginning of 2000, the real effective German exchange rate has fallen by nearly 10 percent—admittedly on an index based on manufacturing, a sector in which Germany has been traditionally strong.

Although Germany has been in the vanguard, unemployment has also fallen in France, Spain, and Italy, which are generally regarded as not having adjusted so well to the rising euro and where therefore the persistence of this improvement must be in doubt. Italy has, at least in terms of the statistics, suffered a 35 percent real appreciation over the same period. France is, on this indicator, in between Germany and Italy, as its real exchange rate has been level-pegging over the period.

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Some wishful thinkers suppose that tensions such as those affecting Italy will break apart the EMU. Maybe they would have done if Prime Minister Sylvio Berlusconi had remained in office. But the doom-mongers underrate the Italian habit of coming through at the last moment, the commitment of the country's political and financial establishments to the idea of "Europe," and the never-mentioned probability that in some way or other the eurozone governments and the ECB will do what is necessary to prevent their single currency experiment from disintegrating.

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Economist Milton Friedman once made the case for a floating exchange rate by comparing it with daylight saving time, which spares us the need to get up an hour earlier to take advantage of the extra sunlight. Nevertheless, if the government refuses to fix a date for changing the clocks, we can as a last resort make our own efforts to rise a little earlier, which is probably what will happen inside the EMU. This reluctant early rising is hardly an optimal policy and does not vindicate the "one size fits all" policy of monetary union; nor does it suggest that the United Kingdom should throw away the inestimable advantage of a floating exchange rate to join the euro any time soon. ◆