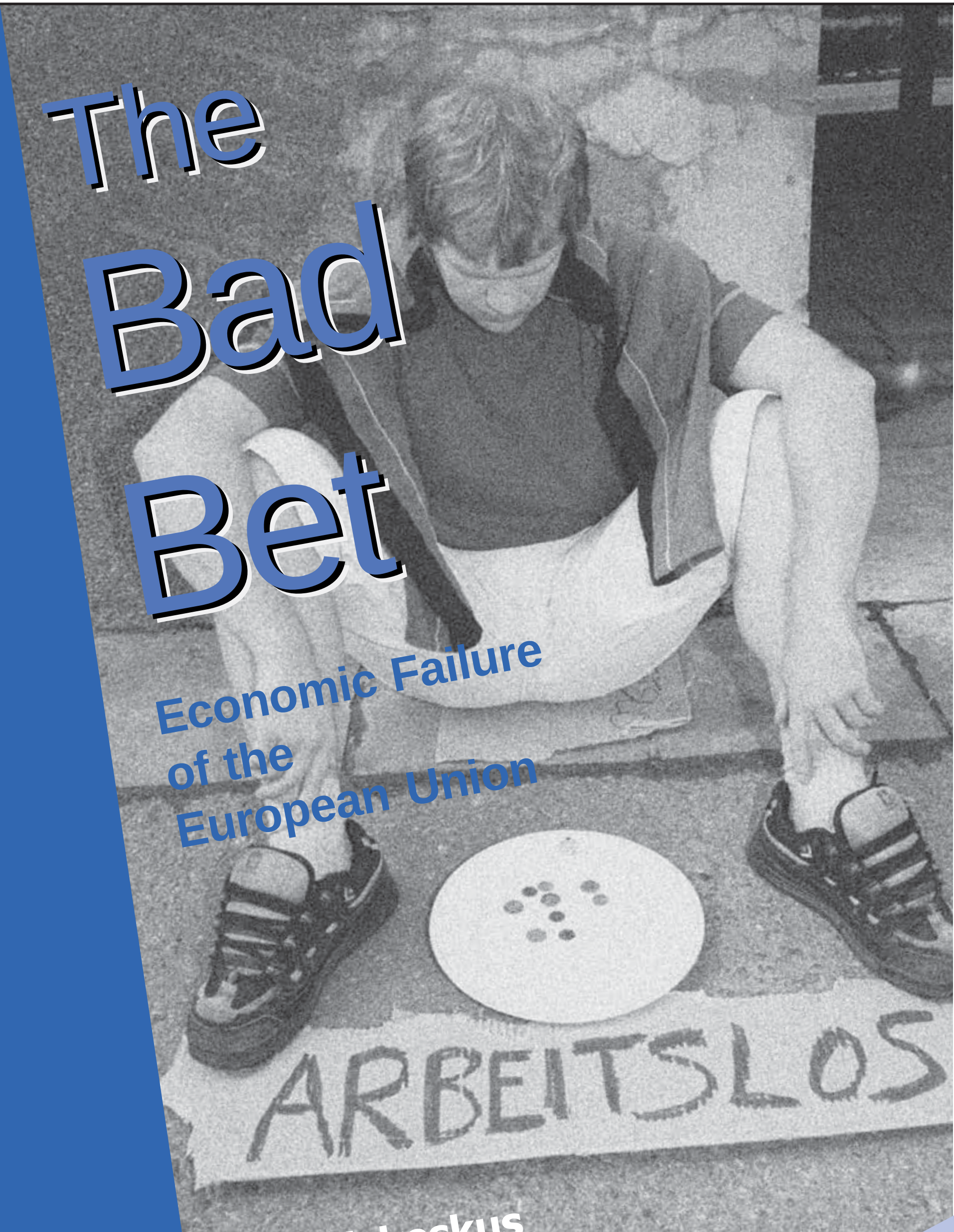
The Bad Bet

Economic Failure of the European Union



by
John Redwood

with a foreword by
Professor Ivar Raig

Uurimiskeskus
Vaba Euroopa

Research Centre
Free Europe

UKVE is a Foundation registered in Estonia. UKVE is governed by a board.

info@ukve.ee

www.ukve.ee

UKVE PK 4231, Tallinnas Peaspostkontor, Tallinn, Estonia 10510

Research Centre Free Europe
Uurimiskeskus Vaba Euroopa

PK 4231, Tallinna Peaspostkontor, Tallinn 10510, Estonia

Associate Membership

It is possible to become an associate member of Research Centre Free Europe and receive our occasional papers and journal as well as invitations to our events.

I apply for associate status with Research Centre Free Europe

Your name ....

Your address ....

....

Your email ....

Your telephone ....

Signature ....

I enclose a donation of

☐ £25 EEK500 €40 ☐ £50 EEK1000 €80 ☐ other £ ......

How to pay

By cheque made payable to "Research Centre Free Europe" sent to
UKVE PK 4231, Tallinnas Peaspostkontor, Tallinn, Estonia 10510.
By transfer into account
Uurimiskeskus Vaba Euroopa 10220025631017
at SEB Eesti Ühispank S.W.I.F.T. EEUHEE2X

Credit Card type ☐ expires ☐☐☐☐

☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐

The Economic Failure of the European Union

Rt Hon John Redwood MP

Series editor David WIlkinson

Introduction

David Wilkinson

This is the fourth in our series of booklets published since the referendums on the EU Constitution. Those referendums have presented us all with an opportunity to discuss what shape the future might take. They have also placed on Europeans of all countries an obligation to look hard at even the most fundamental projects of the EU construction. There are alternatives that are now possible.

The rejection of the EU Constitution by popular vote has liberated Europe to consider a new freer and more prosperous future.

This is one of a series of books published with different partners from different areas of political life. Each addresses a different aspect of the problem the Union presents to Europe - and a view to solutions.

David Wilkinson
Director, UKVE
Series editor

Tallinn, February 2006

Foreword

Professor Ivar Raig

How to overcome the economic failure of the European Union?

This booklet gives to you an excellent overview about current difficulties of the economy and economic policy of the European Union.

The author of the booklet, Rt. Hon MP John Redwood MP, gives an accessible description of the general trends in the world economy and asks "where does the EU fit into the American led, globalised world?"

This pamphlet has set the general steps the EU should take and its member states should take if they are serious about living successfully and prosperously in an increasingly global world.

Meanwhile our author gives a true overview of the reasons of the EU's current and prospective economic failure. He begins his description from demographic analyses, then touches taxation and overall over-regulation of the EU economic environment. He shows clearly how some EU policies and laws are harmful for economic growth and competitiveness of the European economies. The author explains that EU agricultural policy is too expensive and harmful not only for U.K. but for most of EU countries as all member countries must adopt extensive financial transfers to farmers from the taxpayers.

To date, the EU response to the situation has not been serious. Comfort is offered in that the EU today is better than World War Two or, for us, the Soviet occupation that followed. But we cannot be satisfied by comparisons with the unhappiest episodes in all human history. There is a world wide economic boom going on and Europe is missing out. The author's tough analysis demands of us a greater confidence and a greater optimism so that we should make comparison with, and aspire to, the best.

The big continental European economies are still in the phase of stagnation. I hope that Great Britain together with some new member countries should take a leading position to swing the centre of gravity towards genuine reforms.

After the referendums in France and The Netherlands questions of the future of the European Union are once again on the agenda and this booklet might show the direction we could take so European countries should once again become competitive and more serious players in the world economy and politics.

Ivar Raig
Professor of Economic Policy
International University Concordia Audentes, Estonia

The Economic Failure of the European Union

1 Globalisation

We live in a global world. In recent years there has been a rapid expansion of overseas trade. Many new and well-established multinational corporations have spread their investments ever more widely across the five continents. More and more consumers in the developing worlds of Asia, Latin America and Africa aspire to the lifestyles and the products of the advanced West. We've been living through the decades of American enterprise capitalism.

In the last 20 years a digital communications revolution has been trailblazed by the large, new, American corporations like Microsoft, IBM, Digital, Google and the cable networks. The success of American digitalized computer and communications technology has been everywhere obvious. It has given America new strength as a superpower, seeing off her old adversary the Soviet Union. It has given the media industries a new breath of life, enabling instantaneous communications from any point on the surface of the globe to anywhere else. It is now revolutionising business and home life as more and more people have access to their own computers and communications systems.

All those who believed in the theory of free trade have taken great heart from the success of expanding free trade in lifting many more people out of poverty. It's as if the whole world is conducting an experiment in the theory of international specialisation. As more and more goods and services are traded across frontiers, as more large multinational corporations rise up acknowledging no national boundary, so different countries, regions, towns and cities come to specialise in things they are best at. London, New York and Tokyo have discovered their metier in financial services, creating three dominant financial marketplaces if the world. China has awoken as a great manufacturing centre, in the first instance concentrating on domination in world textile supply but now moving on to engineering based disciplines. California is triumphant as the world's number one centre for microchip technology and computing. Hong Kong has grown rich as one of Asia's leading financial and manufacturing centres, whilst Singapore has flexed her muscles as a trading centre backed by a most successful airport and seaport. Germany has kept some of her traditional strength in capital goods and automotive assembly.

If distance is no longer a problem and if national frontiers no longer represent impenetrable barriers to the movement of goods, people and services, international specialisation can flourish. These great centres reinforce their success by being the places that attract the skilled individuals, backed up by transport systems and supporting services necessary to sustain and develop their forte.

In *'The global marketplace, capitalism and its future'* which I published in 1992 I highlighted the importance of the communications revolution, and what it would do for the creation of global business and customer ambitions. *"American television has done more than any other single industry to create similar aspirations. It is the sight of American living standards on television screens in India and Africa, and in the Far East and South America, that has led to so many demands for political and economic systems similar to, or capable of competing with the American dream."* I looked forward to the coming digital revolution, the bringing together of computing and telephony to supply the necessary data, video and information at the press of a button any time of the day and night. *"The development of open network systems in computing means that on the desk of the successful business executive in the middle 1990s will be a piece of equipment capable of transmitting and receiving video tape, voice messages and data, or any mixture of them, around the offices of his group worldwide. Information is crucial to the control of businesses and to the spread of the service driven culture of the 1990s. The information revolution is now providing more computing power more cheaply than ever before and in a more accessible form, so that even those with limited computer skills are able to use the machinery.'"*

It has been the explosive power of American technology above all that has set off this revolution. The pace of American led change was so great that Japan was left struggling in her wake despite enormous success as a manufacturer of engineered, electrical and electronic products in the 1970s and 1980s. The US so outpaced the Soviet Union in the arms race, applying the new digital technologies to weaponry, that the Soviet Union split up, deciding it could no longer compete. Now the world is settling down to a richer, more common experience, using the American advances to communicate with each other, conducting most of its business on Microsoft software and learning of world events through CNN.

2 Where does the EU fit into the American led, globalised world?

The European Union has sought to define itself by reference to the United States of America, the world's current only superpower. Those who share Jean Monet's dream of a United States of Europe see the USE as a potential rival to the United States of American, capable of standing up to American power with a view to taming or humanising it. The cultural background of the Franco-German integrationalists in the European Union is anti-American for a variety of different reasons. They resent the relatively recent arrival of the USA as the central superpower of the world. They often do not agree with American aims and ambitions to spread democracy, American enterprise and American influence worldwide. They see the United States of America as brash, American capitalism as having too many hard edges, and the exercise of American military force as too rough. The Europeans want to believe there is a kinder, gentler, subtler way of running the world, fashioning it to European values of solidarity, social justice and regulated order from strong government.

Franco-German integrationalists in the European Union are anti-American

To the Americans the Europeans are offering a sandwich without the beef. How can the European Union, they ask, be serious about wishing to influence the world when it lacks the military capacity to intervene outside the European area without the help of its American allies? How can the EU be serious about projecting its foreign policy at all when it spends so little on planes and ships capable of moving men and projecting its power abroad, and is so far behind the United States of America in the crucial command, control and communications technologies that dictate the pace and style of modern military engagements? The US is more inclined to see the EU as cynical manipulators, seeking to use straightforward or duplicitous diplomacy to follow its own ends, without the force to tackle problems as they arise or to stabilise countries that diplomacy and other political actions may have destabilised.

The greatest advance of the European integrationists in recent years was the launch of the euro as the new single currency of the main EU countries on the Continent. They described the euro as a currency designed to rival the dollar and they confidently predicted the central banks and investors around the world would have to buy billions of euros to balance their portfolios, creating a strong currency of which the Europeans could be proud. Unfortunately in the early days it turned out rather differently with the euro falling against the dollar, as the world decided that the American economy was the more vibrant and that claims on the US economy through holding dollar assets made much more sense than claims on Europe. The Europeans thought they were creating a currency as strong as the old deutschmark but in practice have created a currency which is much more middle of the road, experiencing periods of weakness and periods of strength. As yet there is no defined trend in the long-term value of the euro but a sinking feeling amongst many holders and potential buyers, that the euro is not backed by a strong economic zone which is bound to win in the highly competitive global marketplace.

The Europeans thought they were creating a currency as strong as the old deutschmark

The EU dilemma is now very acute. Many on the Continent, including architects and creators of a more integrated Europe accept privately that the EU has to be an economic success if it is to succeed politically. They accept that many people voted for their countries to join or to stay in the Union because they see it as the way of latching on to the living standards of the rich West. If the EU falls further and further behind the United States of America discovering it no longer has what it takes to compete successfully in an intensifyingly competitive world, popular support will dwindle or vanish.

The strength of the old European economy of the 1970s and 1980s was very real. Before American capitalism stepped up a gear with its digital revolution the leading countries on the Continent, especially France and Germany, were within sight of American living standards and growth rates. The German economy was based on engineering excellence, capable of producing world-class motor cars, trucks, buses, cameras and capital goods to run factories. The French economy did well out of exports of sophisticated weapon systems to third world countries in the Francophone zone, out of aerospace and the lower tech industries like food, drink and fashion and high quality consumer goods.

France and Germany had their international specialisations which they were good at. The French fashion houses and French wines and the German cars and cameras were worldwide recognised brands in considerable demand. Indeed, Germany had been a stellar economic performer in the post-war years. The spur of rebuilding a shattered country after intense bombing and military desecration, coupled with the advent of a large number of willing guest workers from Eastern Europe, created a model of economic performance based on the so-called social market policies of the early post-war German governments. These policies were more market than social, keeping the regulations and tax demands on business to relatively lower levels, enabling enterprise to flourish and business to deliver the goods.

The EU dilemma is now very acute

The French model was based on more government intervention and higher taxes. Fortunately the leading French brands were relatively priced inelastic being pre-eminent in their chosen fields, whilst a great deal of French exporting was done to the Francophone zone of influence through a system that worked well for France.


Distribué par Carrefour Belgium
Verdeeld door Carrefour Belgium
Avenue Des Olympiades 20
Olympiadenlaan
1140 Evere
FABRIQUÉ EN BANGLADESH
FABRICADO EN BANGLADESH
PRODOTTO IN BANGLADESH
GEFABRICEERD IN BANGLADESH
MADE IN
CHINA
L
30158 390
RED
100%COTTON
40
WASH DARK COLOURS
SEPARATELY
800210
MADE IN INDIA

3 The growing competitive threat to the EU

Today that comfortable world of the 1970s and 80s is rapidly vanishing. We can see the competitive pressures that have already emerged in some of the areas vital to Franco-German economic success. The French thought that they had the market in fine wines sewn up. For many years smart dining groups and fashionable restaurants from Sydney and Singapore to London and Los Angeles would only consider listing Burgundy and Bordeaux on their red wine list. Today the emergence of fine wines from the valleys of California and the attractive countryside of Australia and New Zealand has challenged those assumptions. The wine market in Britain, one of the more important around the world, has been transformed by the attractive bottles of wines from Chile, South African, Eastern Europe the USA and the Antipodes. These new arrivals are jostling French product to a less prominent position on the shelves, or off the shelves altogether.

The German car industry in the 80s and 90s has had to confront the serious challenge from Japan. The guaranteed supremacy of Volkswagen at the popular end and Mercedes and BMW at the top end of the market has been tested by Toyota, Honda and Lexus emerging from the East. So far the German industry has coped reasonably well with the challenge, aided by government intervention to control the market and reduce the ability of the Japanese to sell onto the Continent. It is by no means clear that the next 10 years will be so comfortable as the Chinese and Indians enter the fray. The first Chinese cars have already landed in Europe. China is establishing a formidable reputation as a manufacturing centre. Her economy is unrestricted by burdens and regulations, planning controls, poor labour practices and dear labour, in the way the West is. The Germany motor industry today, still the centre of considerable technical excellence backed by formidable engineering resources, is busily contemplating how quickly it can, and must, base its manufacturing facilities outside its Western European heartlands in order to remain competitive. Today the German motor industry is considering extending its assembly and production in Eastern Europe. Tomorrow, if it wishes to survive, the German industry will have to contemplate manufacturing many of its components and even undertaking substantial assembly work, in China itself.

At the beginning of 2005 the textile market was finally opened for free trade worldwide. The EU had demanded and had been granted a long transitional period from managed trade to free trade in this important sector, on the grounds that its industries needed time to adapt and change. When the final Asian onslaught arrived at the beginning of 2005 we discovered that the European textile industry was still not ready. Textile producers in Italy, Spain and other European Union countries complained bitterly about the good quality and low price of the incoming Chinese product, and sought refuge in political action. A temporary ban was imposed on Chinese imports and a desperate effort made to impose and police a quota restriction yet again. It looks as if the free trade genie is out of the bottle and the temporary expedient of a new agreement with China cobbled together just before the year end of 2005 is not going to represent a lasting solution. The Chinese have proved far more imaginative and competitive than many Europeans expected, and the result will be a much smaller European textile industry.

4 The coming decline of the European Union

In 2002 the European Union's review set out its prospect for the first half of the 21st century. On the EU's own forecast its share of global output will almost halve, falling from 18% at the turn of the 21st century to an estimated 10% by 2050. In comparison, the EU forecasts the United States of America will experience a rise in its share of world output from 23% in 2000 to 26% 50 years later.

These are dramatic figures coming from the EU's own forecasting and statistical section. They imply that the United States of America will move from a position where it is 30% bigger economically than the European Union, to a position where it is 160% bigger than the European Union in the space of a mere half century. America will change from being 1.3 times the size of the European Union to 2.6 times.

These figures for the European Union's demise may prove optimistic. The British Treasury, forecasting more recently, reckons that the Chinese share of world output will move up from 3% in 1980 to 19% by 2015. China could easily go on to be the largest world economy, overhauling the United States of America by 2050. In such a world it is most likely that the European Union will be severely squeezed. If the European Union remained competitive then it would be possible for European Union output to be a smaller proportion of the much bigger world total by 2050 but for European countries still to be successful and rich. The danger is that the European Union will not remain sufficiently competitive and so people living in the EU zone will experience not just the erosion of their relative economic power but also the erosion of their relative living standards, as their economies struggle to keep up. We need to ask ourselves which of the different models of economic and social development are likely to be the most successful in this dynamically changing world?

Projected Shares of Global GDP

% World GDP	2000	2050	Change
EU "15"	18	10	(44%)
USA	23	26	13%
Ratio US/EU	1.3 times	2.6 times	

Source: European Commission: The EU Economy 2002 Review

GDP Growth Rates Comparison

EU/US

EU 15 and US real GDP growth 1997 to 2003

China: 9% per annum

	Index (1995 = 100)		Annual percentage change	
	US	**EU 15**	**US**	**EU 15**
1996	103.7	101.7		
1997	108.4	104.3	4.5%	2.6%
1998	112.9	107.4	4.2%	3.0%
1999	117.9	110.5	4.4%	2.9%
2000	122.2	114.5	3.6%	3.6%
2001	122.8	116.5	0.5%	1.7%
2002	125.5	117.8	2.2%	1.1%
2003	129.5	118.8	3.2%	0.8%

1995 to 2003 US +24.8% EU +16.8%
Last 5 years US +14.6% EU +10.5%

Forecast World trade in 21st Century

Share of World Trade

Country/Bloc	2002	2050 estimated
EU	22%	12%
North America	25%	23%
China (including Hong Kong, Macau, Taiwan	18%	24%

5 The three different political and economic models

The US system of free enterprise, capitalism and democracy is the current, most successful model and the dominant model worldwide. Communism has been on the retreat for many years triggered by the collapse of the Soviet Union, the change of the Eastern European countries into fledging enterprise democracies, and the development of the twin system in China, including the annexation of Hong Kong.

The American political system rests upon the separation of the three branches of government activity. The Senate and Congress represent the legislature creating and passing new laws. The President and White House staff, backed by the main departments of state, are the executive, drawing up budgets, spending money, and directing the armed forces. The Supreme Court and judiciary sit in judgement over the executive as well as the rest of the population, to make sure that no laws are being broken. Whilst the President has considerable power and

Growth Rates
2001 - 2004 % Change

USA	UK	Eurozone	Germany
10.34	9.7	5.4	2.4

Forecasts 2005-06 (OECD)

USA	UK	Eurozone
7.0	5.06	4.44

Growth rates 2001-06

USA	UK	Eurozone
18.1	15.8	10.0

influence to change the law through Senate and Congress, he too is beneath the law and answerable for his actions.

The political system in the United States of America is settled. The United States was born of bloodshed. It fought a war against the former colonial power, the United Kingdom, to establish its independence only to have to fight a much more bloody and unpleasant conflict a half century later to unite the country under Washington control, and to enforce the might of the north against the different lifestyles of the freedom loving south. The US settlers from Europe also hounded and killed most of the indigenous inhabitants of the mighty continent, making the unification of the United States of America with one currency, one president and one set of law codes that much easier.

Today the United States of America is as settled politically as any country can be. The broad shape and size of the union are well defined. The constitution is laid out in beautiful prose that is now 200 years young, and the United States has a political mechanism for resolving conflicts and sorting out difficulties.

The political disagreements between the two main parties in the United States of America are not huge. For choice the Democrats would regulate more and spend more in central government, and the Republicans would legislate less and spend less. In practice the differences are more in the rhetoric than in the actions. Comparing the Republican Bush presidency with the Democrat Clinton presidency, it would be difficult to sustain the argument that the Republicans spend less and regulate less.

The United States did not blight itself with a large number of nationalised monopolies in the way Western Europe decided to do after the end of the Second World War. As a result, the United States powered ahead in energy, telecommunications and transport, areas that fell under the spell for the evil genius of nationalisation in many European countries. The United States trusts free enterprise to make the connections, power the factories and deliver the goods, just as it trusts free enterprise to do most other things. It is relatively easy to set up a new business in America and relatively easy to kill one off. America is far from being unregulated: it has plenty of lawyers to keep the corporate sector and individuals on their toes. However, the US system is based on less interference in business by government than centrally planned systems, or than the European system being developed by the EU.

As businesses like certainty, the United States is a good place to set up in business. Entrepreneurs can be relatively assured that there will be no major political upheavals, no huge changes in the legislative or fiscal background, and no big additional demands on business once you've established your factory or office.

The EU model is very different. Instability is at the heart of the current EU. No-one can be sure how many countries will ultimately join, how much the power the central government will ultimately have, and how long lasting the whole edifice will prove. The attempt in 2004/5 to establish a new constitution for the European Union met with stiff resistance, with both the Dutch and the French voting it down in a referendum. The Union began as a group of six countries - France, Germany, Italy, Belgium, Holland and Luxembourg. It has now expanded to 25 and is considering admitting further countries in Eastern Europe, and has begun entry negotiations with Turkey.

Debate over whether Turkey should be admitted or not is fundamental to the future of the Union. Turkey is a young, dynamic country with a large population. If Turkey is admitted to the Union she will be the largest single current country in it, with more votes than Germany or France or Britain in the Council of Ministers, and more members of the European Parliament. Turkey is a relatively low income country where many people are very willing to work for much lower wages than people accept in the richer west of Europe. Turkey is also an Islamic country with a different cultural and religious outlook from the more Christian and sceptical outlook of the founder members of the Union.

> The European Union is still in a state of flux

Whilst in some ways the Union structure is modelled on the United States of America in other ways it is materially different. The European Union has a President of the Commission, the executive government of the Union, and wishes to beef up the indirectly elected President, the Prime Minister, Head of State or Head of Government of the member state chairing the Union at any given time. The Union has its own parliament but members of the parliament are not able to draft and propose their own laws. Nor does the parliament have any real control over the amount the Union spends and the amount of tax that therefore has to be raised. The Supreme Court, the European Court of Justice, is an important federal institution, driving forward the process of integration through a series of decisions that incline to the view that there should be a European answer to many problems.

The European Union is still in a state of flux as the different institutions involved in its governance jostle with each other for power and authority. The European Parliament wishes to limit the ability of ministers from elected governments of the member states to set the agenda and make the decisions. The Commission is seeking more power in its own name, to give it authority above and beyond the inherited authority from the elected ministers of the member states assembled. Different member states are seeking to impose their own agenda upon the European Union but finding it increasingly difficult to do so. The European Union is a babble of voices as they struggle for power. It is constantly self-obsessed, examining and re-examining its law codes and rules, and trying all the time to push the boundaries of how much power and influence it can exercise both at home and abroad.

There is considerable ambiguity in the deeds and words of the Union because most of its decisions take the form of political comprises between different elected governments, with different viewpoints, interests and political opinions. The ambiguity is increased by the unwillingness of successive United Kingdom governments to accept that the ultimate end-game of many on the Continent is full union. The governments of both John Major and Tony Blair, from 1990 through to the present day in the United Kingdom, have asserted that the European Union is very different from an integrated state and will not become a United States of Europe. They claim it is largely inter-governmental, thriving on the cut and thrust of debate between the member states to see what common agreements can be reached. This interpretation is not shared by many other commentators, observers and participants in the European debate. Most recognise that the European Union has moved on from being an intergovernmental organisation capable of reaching common positions when need and interest arise and coincide. The European Union today has its own law codes, its own Supreme Court, its own single currency, its own parliament, its own anthem, and its own draft constitution. It wishes to have its own single foreign policy backed up by its own military resources, its own criminal and civil law codes, its own criminal justice system, and a fully integrated single economy.

Any commentator would have to accept that there is a great deal of doubt and uncertainty surrounding the current and future shape of the European Union. We are ignorant of how wide its bounds will be set, of how many people will be living in its area, of how much central power will be asserted, and how far the European Union would have got in its ambition to become a fully fledged United States of Europe with its own foreign affairs minister, its own army, as well as its own economy. What we can be sure about is that the current model is not delivering. European Union growth falls behind the United States of America's growth every year. The gap in America's favour is growing every year. The EU economy remains bedevilled by slow growth and no growth. It also faces a problem not shared with the rising giants of Asia or the established giant of the

United States: falling population. The European Union is going to find its task of self-discovery and projection made even more difficult by the very low birth rates in most of the member states.

The European model is not very democratic. Instead of starting with the creation of a strong, independent parliament from which the European Union could choose its commissioners or executive government, the Union's gone about it in the opposite way. The unelected executive government has been more successful in wrestling power from the elected governments of the member states than has the elected parliament. Those of us who do not want a United States of Europe are very keen not to give powers to the elected parliament but wish the power to reside with the elected governments of the member states. Those who favour a strong United States of Europe are worried that the parliament will not prove manageable and amenable to their views, and so they have favoured passing the power to senior, unelected officials instead. This has brought about the debate over the so-called democratic deficit.

We are ignorant of how wide the bounds of the EU will be set

There are three ways to resolve the problem. The route favoured by Euro-sceptics is to transfer power back to the member states as these are all democratically accountable, parliamentary style countries. The second solution is to put the Commission more firmly under the control of the parliament, and to choose the Commission from amongst the membership of the elected parliament. The third model favoured more broadly by the integrationists is to create an elected President of the United States of Europe, as a direct comparison and challenge to the elected President of the United States of America. Such a president would mould and shape the direction of the Commission and the executive government, and would have even more authority in seeing off the pretensions and challenges of the parliament.

The European Union believes it has found a third way between the extremes of free enterprise capitalism embodied in the American system, and the heavily government controlled, fully planned systems of the remaining communist countries of the word, and of some dictatorships which still disfigure parts of Latin America and Africa. The European Union believes it is developing a warmer, gentler kind of capitalism. In its idealised self-delusion it believes that by regulating business more it can pursue broader social objectives than enterprise capitalism would permit unfettered. Instead what it is doing is developing a model which has many of the drawbacks of the old Soviet Union without the terror and tyranny that went with it.

The third main model that is proving economically successful in today's world is the Chinese. China is still a totalitarian communist country in many respects. There are no elections, no choice between competing parties, a strong central leadership which evolves and finds its own successors in a mysterious way. China is not about to transform itself overnight into a liberal democracy following free enterprise capitalism on American lines. It is, however, embarking on a fascinating experiment in dramatic economic liberalisation sector by sector, as the Chinese leadership have decided they are serious about raising the living standards of their people and the economic power of their country as quickly as possible.

The Chinese leadership brought China in from the cold in many respects. They have joined the World Trade Organisation and have benefited from the massive liberalisation of sectors like textiles where they are now dominant. They have won the next Olympic Games for Beijing and intend to make that a showcase to the world. China now sports one of the most modern and impressive Grand Prix circuits, and has shown that it has a capability to take on the best ideas and technology of the West and implement large projects quickly and purposefully. China already has a Maglev train up and running on concrete track at speeds well in excess of anything more conventional steel rail technology permits in the West. China is regularly growing her economy at 9% or 10% per annum and has recently taken number four slot in the world, overhauling the United Kingdom. She will soon overtake Germany and be the third largest economy in the world. China is expanding, incorporating Hong Kong and Macau into her territory in recent years. She's also casting an eye across the narrow straits to Taiwan whose independence is, for the time being, staunchly guaranteed by American might.

* China is currently the world's fourth largest economy at market exchange rates and the second largest at purchasing power parity rates.

* Treasury Forecast: 3% of world output 1980
  19% of world output 2015

* G7 countries (USA, Canada, Germany, France, Italy, Japan, UK):
· 50% of world output 1980
· Estimated 33% of world output 2015.

6 What lies at lies behind the EU's current and prospective economic failure?

THE DEMOGRAPHIC TIMEBOMB

The biggest unique problem the European Union faces in the next 50 years is the projected collapse of its working age population. On UN figures, Italy will experience 32% decline in its working age population, Spain a 26% decline, Germany a 19% decline, and even France an 9% decline. By 2050 the UN believes the EU population overall will be a little lower than it was in 2000, excluding the consequences of inviting any new countries into the Union. Within that figure there will be a big increase in the number of elderly dependent people, and a big reduction in the number of working age people. In contrast, the UN believes that the US population will surge from 285 million to 395 million, whilst China is way out ahead with 1.3 billion people already.

In China the demographics remain very favourable to economic growth, even allowing for modest growth in the population overall as a result of their population control policies and a decline in working age population. China is going to live a long period when there will be a massive redeployment of people from unproductive agricultural activities into far more productive industrial and service sector enterprises.

The last time anything happened on this scale in Europe was in the middle 14th century when the bubonic plague attacked. The population levels fell precipitately. Historians believe that in England alone after the arrival of the Black Death in 1348 there was a decline of between a third and one half in the total population. The continent of Europe was similarly ravaged.

This was faster than the population decline anticipated in Western Europe in the first half of the 21st century but the overall magnitude of the decline in the working age population was surprisingly similar to what the UN predicts will happen in the worst affected countries on the Continent this time round. In the 14th century the results socially and economically were equally dramatic. The serfs were able to gain their freedom legally or illegally because the market to hire labour was

Total population (millions)

Country	2005	2050	% change
Austria	8.19	8.07	-1.5%
Belgium	10.42	10.30	-1.1%
Cyprus	0.84	1.17	+39.3%
Czech Republic	10.22	8.45	-17.3%
Denmark	5.43	5.85	+7.7%
Estonia	1.33	1.12	-15.8%
Finland	5.25	5.33	+1.5%
France	60.50	63.12	+4.3%
Germany	82.69	78.77	-4.7%
Greece	11.12	10.74	-3.4%
Hungary	10.10	8.26	-18.2%
Ireland	4.15	5.76	+38.8%
Italy	58.09	50.91	-12.4%
Latvia	2.31	1.68	-4.7%
Lithuania	3.43	2.57	-25.1%
Luxembourg	0.47	0.72	+53.2%
Malta	0.40	0.43	+7.5%
Netherlands	16.30	17.14	+5.2%
Poland	38.53	31.92	-17.1%
Portugal	10.50	10.72	+2.1%
Slovakia	5.40	4.61	-14.6%
Slovenia	1.97	1.63	-17.3%
Spain	43.06	42.54	-1.2%
Sweden	9.04	10.05	+11.2%
United Kingdom	59.67	67.14	+12.5%
EU-25	**459.39**	**449.01**	**-2.3%**
Brazil	186.41	253.11	+35.8%
China	1,315.84	1,392.31	+5.8%
India	1,103.37	1,592.70	+44.3%
Japan	128.09	112.20	-12.4%
Russia	143.20	111.75	-22%
United States	298.21	394.98	+32.5%

Source: United Nations, Population Division, *World Population Prospects: The 2004 Revision*

Total population aged 15-64 (millions)

	2005	% total pop.	2050	% total pop.	% change population age 15-64
Austria	5.55	67.8%	4.50	55.8%	-19%
Belgium	6.84	65.6%	5.92	57.5%	-13.5%
Cyprus	0.57	68.1%	0.72	61.2%	+26.3%
Czech Republic	7.27	71.2%	4.64	54.8%	-36.2%
Denmark	3.59	66.2%	3.55	60.6%	-1.1%
Estonia	0.91	68.3%	0.66	59.0%	-27.5%
Finland	3.51	66.8%	3.09	58.1%	-12%
France	39.46	65.2%	36.07	57.1%	-8.6%
Germany	55.34	66.9%	44.66	56.7%	-19.3%
Greece	7.51	67.5%	6.03	56.1%	-19.7%
Hungary	6.97	69.1%	4.73	57.2%	-32.1%
Ireland	2.86	68.9%	3.38	58.6%	+18.2%
Italy	38.35	66.0%	26.14	51.3%	-31.8%
Latvia	1.58	68.4%	0.96	57.1%	-39.2%
Lithuania	2.33	67.8%	1.49	58.1%	-36.1%
Luxembourg	0.31	67.3%	0.45	61.8%	+45.1%
Malta	0.28	68.9%	0.25	57.1%	-10.7%
Netherlands	11.04	67.7%	10.11	59.0%	-8.6%
Poland	27.25	70.7%	18.18	57.0%	-33.3%
Portugal	7.04	67.0%	5.94	55.4%	-15.6%
Slovakia	3.86	71.5%	2.62	56.9%	-32.1%
Slovenia	1.39	70.5%	0.89	54.5%	-36%
Spain	29.80	69.2%	21.97	51.6%	-26.3%
Sweden	5.90	65.3%	5.95	59.1%	+1.0%
United Kingdom	39.44	66.1%	40.56	60.4%	+2.8%
EU-25	**308.93**	**67.2%**	**253.44**	**56.4%**	**-18%**
Brazil	123.06	66.0%	159.55	63.0%	+29.7%
China	934.06	71.0%	844.78	60.7%	-9.5%
India	691.45	62.7%	1,064.38	66.8%	+53.9%
Japan	84.89	66.6%	56.86	50.7%	-33%
Russia	10.60	70.9%	67.47	60.4%	-33.6%
United States	199.56	66.9%	245.24	62.1%	+22.9%

Source: United Nations, Population Division, *World Population Prospects: The 2004 Revision* so buoyant, and transformed in favour of the hired hand. In England a new generation of yeomen farmers emerged capable of working the land for themselves, and enjoying the freedom from labour service to the lord of the manor. Wages rose despite government attempts to regulate. It was a very good time to have labour to sell. Depopulation lowered land prices and affected the pattern of settlements. Some villages and towns contracted. Some villages were abandoned altogether as there simply weren't the people to sustain the settlements.

In the first half of the 21st century there will be some notable differences. If the UN is right, the total number of people in the Western European countries is not going to decline very much. There will not be the same visible depopulation that there was in the later part of the 14th century. However, this means a far bigger social problem than they experienced as a result of the Black Death. That killed the elderly as well as the young so it did not disrupt the balance between the generations. In modern Western Europe the balance between the generations is going to shift markedly. More and more elderly are going to rely on fewer and fewer people of working age. The promises made between the generations in the sophisticated welfare societies of Western Europe are going to be sorely challenged by this big arithmetical shift.

Over the last 50 years there has been an implicit contract between the generations in most Western European states. People of working age have said to their parents we will pay tax to meet your pensions. In return we will expect our children to pay tax to meet ours. The main continental countries have offered ever more generous pensions over the second half of the 20th century, on the basis that each succeeding generation of younger people will be bright enough and energetic enough to pay the taxes necessary to meet the bills. Only the United Kingdom took a different view. In the United Kingdom many of us felt that people's main income in retirement should rest on the secure foundation of money they themselves had saved, rather than on the promise of their children. It is an irony that the United Kingdom has done the most to save privately for retirement when it has the least bad of all the retirement problems because it still has a growing population, without so great an adverse shift in the balance between elderly and younger people that we are witnessing in the continental countries. There will be some deterioration in the balance in Britain as we are all tending to live longer than previous generations. The advent of many young people through rapid migration is preventing the balance getting out of control.

Continental governments have been faced with a cruel dilemma. Now they are coming to see just how bad the demographic trends may be they recognise there are only two options. The first is to increase taxes substantially on the falling number and proportion of working people to meet the promises made to the older generations. There are limits to how far they can take this as the younger generations have considerable voting strength, and can also vote with their feet by leaving high tax jurisdictions to work elsewhere, making the problem even worse. The second option which many of the member states of the Union are now following is to reduce the cost of their welfare policies by reneging on some of the promises. Most of the European countries are now saying they will only index pensions to prices rather than to wages, cutting the rate of growth in the pension payments, and enacting higher retirement ages to cut the number of years they have to make the pension payments to the retired population. These measures may not be enough. France is looking at policies again to stimulate a higher birth rate. So far none of the continental countries seem attracted to the Anglo Saxon model pursued in Ireland, the United Kingdom and the United States of America of allowing or encouraging large scale immigration, bringing younger people with a higher birth rate into the country to compensate for the low birth rate and gentle aging of the indigenous population. It is a matter for national political debate what if anything should be done about population decline, as there are many sensitivities in both family and migration policy.

In modern Western Europe the balance between the generations is going to shift markedly.

This demographic time bomb will mean, just as its predecessor did in the 14th century, that the price of labour will tend to rise. As elderly people with some spending power from their pensions will want an ever wider array of labour intensive services - health, leisure, travel, education - so the price of labour will be bid up. This too causes a catch-22 situation for the European Union. The more the labour rates rise as a combined result of the wish of the elderly to have labour intensive services provided to them, and the falling proportion of the young, energetic workers, so the price of labour is bid up for all uses. This will make the European Union even less competitive in world markets where goods and services are traded across frontiers. It will mean further difficulty for the European Union in tackling the problem of Chinese and Indian competition.

The consequences for public spending are also extremely worrying. European Union countries already have a relatively high proportion of national income collected in taxes and spent by the state, compared with successful economies elsewhere. It is not only the rising pension costs which will afflict them in the next half century. Elderly people require more state or social spending on them than younger people, given attitudes and balance of services provided in most western states. Many Western European countries have free healthcare systems at the point of use or heavily subsidised ones. The United Kingdom is one of the costliest positions in this respect, having an entirely free at the point of use service. People may require as much healthcare in the last two or three years of their life as they've required in all the rest of their life put together. The longer people live the more healthcare they require in their declining years. Pensioners also enjoy in most western societies access to subsidised or free public transport; and subsidised or free nursing and residential care when they can no longer fend for themselves. They make good use of further education and free leisure services; enjoy borrowing books from free libraries; and often need domestic help from Social Services. The balance of public spending is going to shift in favour of more and more being spent on the elderly, and the total sums involved are going to escalate as more and more elderly people live longer to enjoy such services.

As the demands on the state increase so the tax revenue generated from the working age population reduces as a result of its decline. The Italian and Spanish states in particular will be caught in the vice-like grip of rising demand for public spending from the growing elderly population, at exactly the same time as the alarm bells are ringing over the falling revenue from the income earning population. Just as with the pensions crisis, so with the more general public expenditure crisis the government will be faced with two unpleasant choices. Governments will probably do a bit of both - both increasing the tax rates on those who are in work and cutting back some of the free service offerings to the elderly population.

There is going to be a problem over who will do some of the least desirable jobs. If we are right in our assumption that the number of people available to work is reducing and the price of labour is rising, it also follows that it will be more and more difficult to recruit the people to do the dirty, difficult and menial jobs that require attention even in an advanced and sophisticated, automated western economy. The answer for business, if it wishes to maintain factories at all in Italy or Germany, may well be further capital investment to replace labour. It is possible in a factory setting for robots to take the strain, live in the heat, do the dirty jobs. They don't go on strike, they don't need bank holidays and Christmas off, and they don't put in demands for pay rises. They do require some service and maintenance attention and occasional oiling but they can represent a very good substitute for manual labour. It is not so easy to automate in the service and residential sectors. No-one has developed a convincing machine for cleaning the cooker hob or the loo of an elderly person, and, despite the complexity of modern computers, there is no substitute for a care worker sitting down and talking to someone to tackle their loneliness and to make sure their daily needs are met.

The Anglo-Saxon economies will solve this problem by importing the labour. If the continental countries still refuse to allow a substantial number of migrants to solve their problem, then they are going to have to face the fact that the cost of providing a decent standard of social care to the elderly is going to rise more than proportionately. The only way to get people to cook, clean and care would be a big relative increase in the rates of pay for such activities.

Whilst on the current population forecasts we're not anticipating massive depopulation overall on the scale of the later 14th century, there will be consequences for the property market. In a country like Italy there will be places where the population fall would be very visible. It is likely that the best seaside locations, mountain resort and great cities will continue to attract buying demand, both from home and abroad. This means that property elsewhere will not meet with the same interest and there could be notable weak spots in parts of the Italian property market. If a large number of people from the rich north of Europe decide that Italian or Spanish property is very attractive, made more so by the lack of strong domestic demand through the falling population, then the property market will gain some support from such buying. This in some ways will exacerbate the labour shortage problems, as many of the newcomers will not be planning to work in the country where they are buying their second or third home, and will expect full services when they come to stay. They will be able to bid up the price of labour still further. The static overall population and the declining working age population is the principle reason why the European Union economy is expected to underperform the American one so badly over the next 45 years.

TAXATION

The second main reason the European Union economies are regularly falling behind the United States and the faster growing parts of Asia lies in the high tax rates they choose to impose. In 2003 the average tax rate in Sweden was 55.8%, in France 44.2%, and in Italy 43.4%. In contrast fast growing Ireland within the European Union imposed an average tax rate of 30% and the United States of America 25.4%. The Asian tigers, Hong Kong and Singapore, have relatively low tax rates on income and enterprise and very favourable regimes on capital gains. The newer, emerging economies of Eastern Europe and the rest of Asia are also learning the lesson and offering attractive tax packages and low tax rates to enterprises setting up there. Ireland only levies a 12.5% tax on business profits. Hong Kong charges 17.5%, Singapore 20% and Chile 15% in special economic zones.

There is a very good correlation between low taxes and fast growth and high taxes and slow growth. If a state needs to raise substantial sums of money it does less economic damage to raise it by means of a sales tax than through an income tax. Modern businesses are footloose and fancy-free. They do not have to be based in any particular country. They can exploit the global marketplace from a variety of advantage points around the world in the lowest tax jurisdictions that are convenient. Multinationals scour the world trying to find the right places in which to invest. They judge the investment case on the numbers. They look at access to market, access to raw materials, cost of labour, cost of government, and the tax rate that will be imposed.

Their figure work is very sensitive to tax rates. The corporate tax rate on profits affects the figures every year. A 25 to 50 year investment looks very different against the backdrop of a 25% average tax rate compared with one where a 40% average tax rate is anticipated. The European Union has often seemed to think that it needs to offer inducements to new investors to come in the form of one-off subsidies or capital grants. These are never going to win against the relentless advantage of lower tax rates year in, year out, over the whole lifetime of the investment. Offering any form of subsidy to business is a one-off proposition which can be two-edged. While some businesses may be grateful, businesses already established in the country are extremely angry that subsidies are offered to new rivals to come in and compete. Those contemplating the move will not be swayed by it if part of the price of the subsidy is a higher average tax rate than they could be offered elsewhere.

The Irish tiger economy has performed extremely strongly in the last couple of decades. There are those within the European Union who attribute this in general terms to Ireland's membership of the European Union, and specifically to the amount of grant that has been sent to Ireland through the Common Agricultural Policy and other measures. Whilst it is obviously helpful to be a net recipient rather than a net contributor to the EU budget in the way the UK is, the story of the Irish economy is rather different from the romantic portrait of the EU integrationist. Ireland has made a great leap forward economically for two principal reasons. The first was breaking the link with the British pound a quarter of a century ago. Ireland decided she needed her own freely floating currency to reflect Irish costs, and to make Irish prices more competitive in the world market. In the early days of floating the Irish pound against sterling the Irish pound did drift down, giving Ireland a competitive edge.

Secondly, the Irish government in recent years has pursued a very low tax policy, offering particularly low rates of corporation tax as an induce-

Global Tax Levels

Tax burden in OECD countries
Total tax revenue as % of GDP

Country	2003	2004
Belgium	45.4%	45.6%
Denmark	48.3%	49.6%
France	43.4%	43.7%
Germany	35.5%	34.6%
Italy	43.1%	42.2%
Ireland	29.7%	30.2%
Netherlands	38.8%	39.3%
Spain	34.9%	35.1%
Sweden	50.6%	50.7%
United Kingdom	35.6%	36.1%
EU 15	**40.5%**	**N/A**
Australia	31.6%	N/A
New Zealand	34.9%	35.4%
United States	25.6%	25.4%
Switzerland	29.5%	29.4%
Japan	25.3%	N/A
Korea	25.3%	24.6%
OECD Total	**36.3%**	**N/A**
OECD America	**26.1%**	**25.6%**
OECD Pacific	**29.3%**	**N/A**

Source: OECD, *Revenue Statistics 1965-2004*, 2005, Table A ment to new investors to come in to Ireland. It has been remarkably successful. There are a number of investors from the United States of America in particular looking for an English speaking base within Europe, with low taxes and a flexible labour market. So successful has the Irish experiment with low taxes been that many talented Irish people have returned to Ireland, fuelling the growth and adding to the flexibility of the labour market and the pool of skills on which new companies can draw. Ireland has managed to detach herself from the typical EU low growth or no growth experience by following a rogue policy within the Union. Fortunately for Ireland she was too small, and in the early days too poor, to excite jealousy or attention. Now she is in the euro she will lose one of the advantages she enjoyed in the 80s and 90s, the ability to set a competitive exchange rate through her own currency.

To be competitive in the modern world, a country needs to set corporation tax rates on profits of around 20% or below, and income tax rates at similar levels. A country determined to attract inward investment should forego capital gains tax, perhaps taxing short-term gains as income, and would guaranteed the free convertibility of its currency and freedom of movement and money in and out of the country, to reassure investors. The European Union countries have fallen a long way behind the best in the world on corporation tax and capital gains tax rates and treatment, although they do guarantee convertibility. EU countries are in the bind of having high and rising public expenditures because of the welfare costs of the demographic time bomb, and at the same time becoming aware that they need lower tax rates in order to attract in the wealth makers and wealth creators of the future to broaden the tax base. In the recent German elections in 2005 the Christian Democrats campaigned for lower taxes. Unfortunately when they won only an important minority of the seats they decided to go into coalition with their rivals, the Social Democratic Party, on a platform of raising taxes rather than lowering them. Meanwhile the United States of America continues with a tax cutting strategy despite a large budget deficit, based on the belief that taxable capacity will expand more quickly if tax rates are low and can be reduced further.

President Reagan tried such a strategy in the United States of America in the 1980s. His critics constantly warned that America would run out of money, the budget deficit was too large, and the experiment would end in failure. The reverse happened with the American economy going from strength to strength. By the end of the following decade the American economy was repaying large sums of public debt despite having public spending considerably higher than during the Reagan years. Such was the strength of the American economic machine.

REGULATION

The third big reason why the European Union economies are lagging behind lies in over-regulation. The European Union is primarily a legislating and regulating institution. It delights in poking into the minutiae of every day life. For every production process, for every product, for every animal on the farm, there is a regulation and a piece of paper. EU officials delight in forcing EU companies and farmers to fill in an ever increasing number of forms, to apply for an ever increasing number of licences, to work to a mind blowingly complicated system of quotas, recipes and menus, and expect EU businesses to be compliant with the 2,500 new regulations and directives that pour from the printing presses every year.

When the British presidency of the European Union in the 1980s pushed the partners to make a reality out of the dream of a Common Market, the bureaucrats responded by coming up with some 300 legislative proposals which they said in those days were absolutely crucial to the establishment of a Common Market. It was an absurd proposition. All you need for a Common Market between any group of countries is a single rule. The rule states that if a product is deemed to be of merchandisable quality in state A and can be offered for sale there, then similarly it should automatically be deemed to be of merchandisable quality in state B and could be offered for sale there as well. This does not mean that French people have to buy Yorkshire puddings or that English people have to buy French wine. It just means that because the French authorities are happy that claret is of saleable quality in Bordeaux, so the English authorities should automatically except such products for sale in Britain suitably labelled. Conversely, if a Yorkshire pudding product is on offer in an English supermarket there should be nothing standing in the way of its maker trying to offer it for sale in France. Whether French people wanted to buy the Yorkshire pudding or not is a matter of taste and marketing skill for the British company. It should not be banned by law from market entry nor should it need a special directive to gain it market entry.

The whole form of the European Union is of a legislating club.

The whole form of the European Union is of a legislating club. The rotating presidency which gives the chair of the Union to a different member every six months encourages more and more unnecessary legislation to pour from the legislators' pens. The Commission is very astute at playing presidencies off one against another. It visits the country concerned, gets the measure of the administration in charge, and decides which proposals in its large stockroom of unlegislated proposals are likely to appeal or could be foisted upon the incoming presidency government. There is something for everyone in the legislative cupboard. For the French there are social regulations that raise the cost of labour and give people the false impression of better protection in the workforce. For the British there are so-called market opening proposals which offer the hint of more free trade and more competition, particularly in the service sector. For the poorer countries of the east and south there are measures to beef up and stimulate the structural funds, and to encourage more EU financed projects. Each presidency is persuaded that it needs to achieve something during its brief six-month period, and achievement usually means more legislation to burden the businesses and people of the European Union.

In the year 2000 in Lisbon the heads of government met together and agreed the so-called Lisbon Agenda. As early as the year 2000 they were becoming aware of the way in which the European Union was falling further and further behind the United States of America, and was failing to match the super growth rates in parts of Asia. They were also persuaded that part of the problem lay with over-regulation, the very thing that the EU excels at. They laid down that in future there would be better regulation throughout the Union and less regulation. Unfortunately the Commission never had any intention of implementing these wishes, and decided to interpret the less regulation as meaning on a good day fewer new regulations being added today than were being added yesterday. It still meant adding more regulations. Worse still, since the agreement in 2000, the weight and importance of an individual regulation has gone up as the EU has attempted to regulate ever more complicated and important areas of life, with ever more detailed directives and regulations.

Sometimes these regulations are designed to damage or reduce a whole area of economic activity.

Sometimes these regulations are designed to damage or reduce a whole area of economic activity. For example, following successful lobbying by some in the pharmaceutical industry, the European Union decided to regulate herbal remedies and food supplements. They decided that these popular and harmless products needed to go through the same elaborate safety testing procedures that chemical pharmaceuticals need to go through. Images were conjured up of the dangers that could be done to people who ingested too much Vitamin C or bought too many exotic plants from their local organic store. Many of the businesses that produced herbal remedies around the European Union are small businesses. Many of the distributors and shops that sell them are also small. The European Union now expects them to meet exacting and expensive targets for analysis and testing of their products before allowing them on to the shelves for sale. Many of the businesses will close down because they simply cannot meet the requirements.

This caused an outcry in the United Kingdom where many people enjoy and benefit from herbal remedies and food supplements. Despite a rally in Trafalgar Square, a mass write-in, a lobby of MPs and active opposition in the House of Commons, the Labour government decided to push through the measures required by the European legislation instead of standing up to the euro regulators in Brussels against the proposition in the first place. Another industry had come to rue the day that a British government minister had failed to defend their interests in important committees on the Continent.

My main memory of negotiating endless directives as part of the single market programme in the early 1990s was of trying to fend off economic and industrial disasters from the foolish flourish of the legislator's pen. Rarely did people come to my office saying they really did want a directive in a certain area in order to make their businesses easier or to give them more chance of selling successfully on the Continent. Usually I told people what the European Union had in mind and received substantial delegations telling me how dangerous and difficult it could prove, and asking me to do my best to remove the worst excesses of regulation from the draft. On one occasion the European Union wished to define a stock market in a way which seemed to exclude the way the London stock market traded, the biggest and most successful stock market within the European Union. On another occasion a food directive seemed to make illegal a number of specially flavoured crisp and snack products for no particular reason. On that occasion German tastes were affected as well as British and it proved easier to force the Commission to rewrite the proposal. In the case of the stock market proposal, it took substantial lobbying and meetings to get the Commission to back off and to understand that, just because London traded in a different way from Frankfurt and Paris, did not mean it was wrong and it needed to be banned.

Most of the problems arose because of the very nature of the legislative endeavour on the Continent. Not only could the legislators leave nothing alone unregulated but also they felt they needed, in their directive or regulation, to set out how something should be done, regardless of how it is done or might be done in the future. It was based entirely upon their own partial view of what was current best practice or how their friends currently operated. There is no need to have a regulation saying that the wheels and tyres of cars should be round. People have established by long use and testing that round wheels and tyres are best. If at some point in the future people discover this is no longer true, it would be foolish to have a directive preventing them doing this. If it is innate, in the nature of the product and the physics that they will always be round, again there is absolutely no need to have a directive saying they must be.

So many directives are hostile to the whole idea of innovation. If the EU insists on laying down a recipe, menu or recommended way of producing and designing a given product, it will make it very difficult or impossible for people to come up with new ways of doing things that may be superior. The European Union is currently turning its attention to financial services, an extremely successful area of activity especially in London in the last 30 years. There is the danger that this attitude, hostile to innovation, will begin to have an adverse effect even on the very successful London market. In a recent conversation with an investment manager he explained to me that his more interesting, innovative products were no longer offered in Britain because he found the regulatory system was already quite suffocating, and there was no point in going to all the trouble and cost of trying to persuade the regulators about the product. It was simpler to service them offshore and sell them to people who did not have to come within the UK regulatory net. It is exactly that sort of response that we should expect as the EU regulatory claws get stuck in ever more deeply to the UK domestic economy.

The French and the other advocates of ever more regulation in the EU claim that it is the better regulation which distinguishes the EU from the raw edges of American capitalism, and provides it with a friendly, social face. They believe that social solidarity is encouraged by endless labour market regulation. They draw up a wish list. Wouldn't it be nice if everybody could work shorter hours? Wouldn't it be good if part timers could have all the same terms and conditions proportionately to full timers? Wouldn't it be great if every woman could have a year off to have a baby when she wished? And why should fathers be left out, shouldn't they too have the benefit of paternity leave? Why should drivers have to drive through the night or drive for long hours? Why should doctors have to work longer than a standard week?

Of course, it would be great to live in a world where everybody was so productive and so rich that no-one needed to work more than 40 hours, everyone could have all the time off they wanted for their family commitments, and part timers were treated exactly the same as full timers. Unfortunately, this is not the view taken by our leading competitors elsewhere in the world. So instead of creating greater social solidarity and happiness, the EU's labour regulation has done the opposite. 1 in 10 of all people of working age wishing to work on the Continent in the leading centres are now out of work. The more that people working for the large corporations in Europe are cosseted by regulation, the more the incumbents are looked after, the worse the position is for those on the outside looking in who do not yet have a job. The advent of high cost Europe has led to many factory closures, to the relocation of service businesses to India and elsewhere, and to the transfer of employment out of the European Union altogether. Far from being a social model this is a very antisocial model. Instead of looking after everybody it looks after the minority who have good, comfortable jobs with large and successful corporations who are not about to move. It penalises those in the less successful corporations who may lose their jobs through restructuring, and hits those who do not yet have jobs who find it more and more difficult to get one on the terms they would like.

> Many regulations achieve the very opposite of what they set out to achieve.

Asking the European Union to stop regulating is like asking a publican to stop selling beer. It is inherent in the nature of the beast that they will go on regulating until there are no businesses left of any importance in the European Union to regulate. The Commission is there to draft new laws and it believes the member states are there to rubber stamp them through the system. The latest genuflection to better regulation at the insistence of the British presidency in the second half of 2005 means little or nothing. The few draft laws they have scrapped are proposals that the Commission either thought weren't going to go through anyway, or have been superseded by far grander dreams of more comprehensive regulation for the sectors they would have affected. Ministers claim to be reassured that in future more attention will be given to the impact and costs of a regulation before it goes through. We've heard all this before. All European regulations that meant to have been accompanied by an assessment of the cost they would impose on others for the last 20 years. Some have been, some have not been but rarely have the compliance cost assessments been used in meaningful debate, to either modify the regulation or throw it out on the grounds that it is too expensive.

Many regulations achieve the very opposite of what they set out to achieve. We've seen this in the case of social solidarity regulations. We also see it in the case of the fishing regulations. When the United Kingdom joined the European Economic Community in 1972 she agreed to make the North Sea fishery within her territorial waters a common European resource. This meant that fishing vessels from other member states could come and enjoy the bounty of the seas by virtue of being fellow members of the EEC. They came in great numbers. The Danish industrial trawlers hoovered up much of the seabed. The Spanish trawler fleets waxed prosperously on the fruits of the North Sea. The combination of damage to the marine environment from the crude attacks of industrial trawling, and the over-fishing from the presence of far more vessels than had been fishing the grounds when they were under British control, has created an environmental disaster.

The European Union has responded in the way it knows best by imposing ever stiffer regulations, especially upon the British trawler fleet. Countries are given quotas for how much fish they can land. The quotas are broken down into the different species of fish as if a trawler, dragging a large steel mesh net behind it in the water, has any ability to decide

Index of Economic Freedom

	Rank	Score
Hong Kong	1	1.34
Singapore	2	1.61
UK	7	1.79
USA	10	1.85
Germany	18	2.03
France	44	2.63
Greece	54	2.80
Algeria	100	3.31
N Korea	155	5.00

Source: Heritage Foundation & Wall Street Journal 2004 edition

Note: A lower score means the country is freer which fish it will catch and which fish it will leave. As a result of the absurd regulations from the European Union, the fishing vessels that catch the wrong kind of fish have to throw them back dead into the sea from whence they've come, rather than land them. This is done in the name of conservation but, of course, achieves the opposite. It means that the fishermen have to fish for longer in order to try and find the fish they are allowed to land, whilst at the same time slinging a lot of dead fish back into the sea which pollutes the sea and does nothing to feed the mouths back home. Such folly should be abolished and a sensible fishing policy adopted like that being used to restore the fishing grounds off the north east coast of Canada and the United States of America. The policies successfully pursued by the Norwegians and the Icelanders who kept out of the European Union, primarily as they wish to retain control of their prolific fishing grounds themselves, shows there is a better way through local control.

More and more businesses complain about the burden of this foolish regulation upon themselves. Boards of Directors meeting in Western European countries spend more and more of their time discussing corporate regulatory and compliance with regulation. This means they have less and less time to spend discussing what their customers want, what the future of their business should be, how they design the goods and services of tomorrow, and how they should best spend their shareholders' money on improving and updating the business. This diversion of a high level of time is mirrored throughout the organisation. Companies have to employ compliance officers, regulatory specialists, lobbyists, and specialists in government to warn them of things coming up on the agenda, to try and steer the Brussels government away from the more damaging proposals, and to make sure that the business is compliant with those that get through the rather large holed, legislative sieve. This is one of the reasons why many businesses are now saying to themselves 'Is it worth the hassle?'. Why not set up outside the EU where the regulations are lighter and less foolishly enforced? If a suitable tax haven can be found which, at the same time, takes a more realistic view of how much regulation is really necessary the business wins twice over by relocating.

NATIONALISATION

The fourth reason the European Union is falling behind is the legacy of state involvement and nationalisation in some of the key sectors of the economy. The UK was particularly badly afflicted by the European disease of nationalisation in the period after 1945. There was a common view in many European countries that the state should control the sinews of war, the coal, iron and steel industries, transport, energy, communications and much else besides. The experience with these nationalised industries was desultory. They were usually loss-making; they ended up sacking a very large number of their employees; they lacked the will to innovate; they often failed to meet the demands of their customers for quality and price in an acceptable way; and became the plaything of politicians and bureaucrats. The European Economic Community itself began as a result of the discussions on the merger of the French and German iron and steel industries in the post-war period. The British Labour government of 1945-50 pushed through the nationalisation of the coal mines, the railways and the steel industry to go alongside the strong municipal and central government involvement in energy, post and water.

The later 20th century economic revolution was powered by the development of the digital highway and the coming together of media, data communications, computing and telephony. The United States was best placed to bring off this great coup because it had free market media, film, computing and telephony industries. The United States was early into the idea of competition and choice in telephones, pushing through the successful challenge to the Bell Telephone monopoly through the development of microwave link competitors. This was followed by the break up of the Bell monopoly to encourage a proper competitive market. The dynamism which break up and competitive challenge unleashed in the American telephony market helped to find the breakthrough, in conjunction with the flourishing, competitive and successful US computer industry in Silicon Valley and elsewhere.

The UK was also relatively well-placed after the sale of BT and the liberalisation of the telephone market in the middle to late 1980s. The UK transformed its position from being a backwater in telecommunications to being one of the world leaders, in a short 10-year burst following privatisation and liberalisation. So successful were the twin policies that the successor Labour government has never once wavered in its support for a liberalised, free enterprise solution to telecoms. It never so much hinted that it would like to renationalise.

Elsewhere in the European Union countries have been much slower to break up their state monoliths and to introduce competitive challenge to the big industrial groupings. The state monopoly energy companies have not been in the forefront of opening up new sources of supply and lowering costs, or improving the thermal efficiency of what they do. State transport companies have not been successful in offering good quality, low price service to domestic businesses, whilst monopoly telephone services have usually been slow to adopt the latest technology and to understand the full scale of the technical revolution unleashed by the American digital experience.

As a result, the European Union's progress in developing the infrastructure necessary for a modern economy has proved to be very patchy. There is nothing to match the dynamic low fare marketplace of jet travel around the United States of America between the principal cities in the European Union. There have been all sorts of regulatory blocks in the way of trying to establish city to city links for low cost airline operators. A combination of national and local government, out to protect what they have, airports that are often not operated in the interests of expansion, and some airlines in a quasi monopoly position who've not welcomed the idea of challenge, has ensured that there has not been the same development of point-to-point air travel in Western Europe that we have witnessed in the United States of America. Nor there has there been the same consistent investment in the highway network across the European Union countries that the United States of America has experienced in the last 25 years. Britain in particular has lagged behind, failing to complete its motorway network during the years when it was still acceptable to build large roads, only to confront far more political difficulties in the 21st century.

As a result, European Union economies are held back compared with the United States by the patchy and sometimes poor performance of their energy and transportation systems. It is more difficult getting goods and people around the whole of the European Union than it is to undertake comparable journeys in the United States of America. Recent disputes between Russia and the Ukraine have shown how vulnerable the European energy position is. In the United Kingdom energy policy is currently up for review again following a decade of missed opportunity. The United Kingdom did not take advantage of the breathing space given to it by the large natural oil and gas reserves found offshore which started to decline from the beginning of the current century. There's been no bold move to decide whether and how to replace the ageing nuclear stations that currently supply one-fifth of all our electric power. Similarly, there has been no bold move in Germany to overcome its dependence on imported gas and oil through any alternative strategy.

The European Union's progress in developing the infrastructure necessary for a modern economy has proved to be very patchy.

AGRICULTURE

The European Union is also held back by the wish of its government to rig certain markets against the interests of the customers and the rest of the world. It is true this is not a feature unique to the European Union. The agricultural support systems of Japan and the United States of America are far form perfect either. The European Union has relatively the most expensive, the most wasteful, and the most damaging of all the agricultural support systems in advanced countries around the world. It is the future of the Common Agricultural Policy that has bedevilled the budget discussions within the European Union in recent months, and has threatened the success of the international trade talks. The Common Agricultural Policy manages to provide a bad deal to European customers who end up paying far more for their food than if they were free to import it on the open market, as well as upsetting European taxpayers who have to pay large subsidies to the farmers. This system also does considerable damage to Third World farmers who have better and cheaper produce which is either excluded outright from the European market, or faces substantial quota and tariff barriers to overcome before it can be sold anywhere within the European Union. Worst still can follow for Third World producers. Some times the European Union actually dumps its own very expensive agricultural produce at very low prices on world markets, when it has managed to produce too much food for its own consumption in a given product area.

> The European Union which claims to believe in relatively free trade shies away from the idea of free trade in agricultural products

Successive British governments have tried to persuade the European Union to reform its ways. The United Kingdom can afford to do so. It has a relatively small farming sector within its economy as a whole and a relatively efficient one. Because the process of farm amalgamation has gone further in Britain than in a country like France, British farmers are fewer in number, have much bigger agricultural estates, and as a result can get the benefits of economies of scale. They can make the investments in the very large and expensive new tractors, combines and other machinery, and operate it at full stretch over their many thousand acres. Small, poor farmers on the continent of Europe, sometimes hobby farmers with other jobs to make a living, cannot hope to compete with expensive, highly mechanised farming in the more successful consolidated farms in Britain or, more importantly, with the highly productive and cost efficient farms in the prairie lands of the United States of America or on the great plains of Argentina and the other principal food producers of the world.

The European Union which claims to believe in relatively free trade in industrial products, where it thinks that a country like Germany has an advantage, shies away from the idea of free trade in agricultural products where it knows that other countries have great advantages. There is nothing in Europe to match the great granary of the American prairies or the great ranches of Argentina. If European Union farms and farmers were made to confront commercial reality, there would probably be wholesale conversion out of wheat and beef cattle into higher value products for the local market, including fruit, vegetables and specialist animal rearing. Shielded from world competition, the European Union continues to perform poorly in agriculture. A typical European Union farmer is more interested in devoting his attention to filling in the subsidy form correctly and checking that every cow has the right EU cow passport, than he is at improving his livestock husbandry. In some cases farmers' heavily subsidised farms within the European Union get more than half their income from the state rather than from the customer buying the end product.

The new countries coming into the European Union from the east also have a long way to catch up with the best performing farms of the world. They are short of capital, often staffed by a substantial workforce on low wages, insufficiently backed by modern machinery. These new countries coming in can often take the view that it will be unfair to end the subsidy bonanza just as they join. They look forward to getting their fair share of the money out of the Common Agricultural Policy, a share which would be swelled by the relative inefficiency and backwardness of their own farms. The budget debates prove quite lethal, breaking the normal good relations between the United Kingdom on the one hand and the new entrants to the east on the other hand. On the issue of agricultural their interests are fundamentally opposed. The United Kingdom, with its relatively small and efficient farming sector, would be happy to do the decent thing and to open agriculture up to proper worldwide competition. The eastern countries, like France, think that Europe should continue to protect what agriculture it has from the cold winds of global competition.

The Common Agricultural Policy in a way sums up the comfort which some Europeans take from the European Union, and the frustration which it causes all the rest of us. For those who believe that European agriculture should stay in aspic, organised along the lines it has been for the last 50 years through smallholdings without access to big capital and protected from the competition of the American prairies or the Asian valleys, the Common Agricultural Policy is just fine. It is an example of European Union solidarity at its best. The rich and successful pay more in to subsidise the poor and less successful. The foreign product is kept out, the European Union muddles along, priding itself that it is still self-sufficient in many agricultural products, and ignores the fact that it is poorer as a result, as well as ignoring the moral slight to the rest of the world.

To the critics of the Common Agricultural Policy it sums up what happens when you put the politicians and bureaucrats in control of an industry. It keeps out the competitive and lively from elsewhere in the world. It means you pay more for your product, it stifles innovation, it delays the structural changes that are really needed, and often conspires to prevent the agricultural sector modernising with access to the capital and machinery it needs. Who is going to invest long-term in such an artificial structure when so much of the money is recycled through government?

The result of the European Union activity is to reduce the wealth of the European people and to make it more difficult for them to compete successfully in a rapidly changing, globalising world. The Europeans have assumed an effortless superiority which was scarcely justified by the facts and is looking more ridiculous by the day. Many of them felt that by divine right the great German car corporations, the great French vineyards and fashion houses, and the Italian textile companies would continue to wow and impress and earn a relatively easy living around the world. The EU regulators and legislators thought the problem was to tame business and to turn it to more social purposes, not to help it compete against those in India, China, the United States of America and elsewhere. The extent of this change is now very visible in the figures.

7 Relative growth rates of the US and the EU

In the period between 1995 and 2003 the United States managed to grow by almost one quarter, 24.8%, whilst the EU struggled to grow at 16.8%, 8 percentage points lower or one-third less than that achieved by America. The pattern is the same over the last five years. The United States of America has grown by 14.6% compared with the European Union's growth of only 10.5%. In every year bar one over the last decade the United States of America has grown more quickly than the European Union. This has occurred despite the fact that the United States of America is a richer country to start with, and by definition cannot catch up with the Europeans by adopting their technology in the way that Europe can catch up with America by adopting hers. This has also occurred despite the fact that the United States of America went through a particularly painful puncturing of its hi-tech bubble in 2000. The only year in which the EU managed to outgrow the United States of America was the year of the hi-tech collapse. Share prices in the hi-tech companies fell by three-quarters or more in a relatively few months. Large paper fortunes were wiped out, and there was an immediate impact upon the ability of those in the hi-tech sector to borrow and consume in the way they had been doing. Wall Street itself overall fell sharply.

Despite this, the US economy managed to avoid contracting in that difficult year. Many Europeans seemed to take a secret delight in the collapse of the American dream as they saw it. They drew attention to the way in which the United States' economy was prone to boom and bust, unlike the European Union which managed to avoid the busts by also avoiding the booms. Much ink was spilled in the fashionable European press and time spent in the European media, discussing how superior the European model was avoiding the excesses of capitalist euphoria and the sharp change to expectations which had brought about the stock market crash. Despite the temporary joy the facts remain obstinately in America's favour. Even in her worst year the economy did not contract. European Union economies had many years of slow growth and in some cases went into recession. Year after year the American economy outperformed, raising productivity higher, generating more income, and paying its people better salaries.

The European media again alighted upon poverty in New Orleans when the floods occurred in 2005, and seemed to take great delight in proving that some people in New Orleans were on relatively low incomes. It is a sobering thought that if New Orleans were a city in Western Europe it would be one of the richest not one of the poorest. Indeed in many countries in the European Union New Orleans would be by far and away the richest city, if it were located there.

The fashionable western media may wish to believe that the problem of poverty is an American capitalist one but the reality around the world is that the problem of poverty is at its most acute in fully planned, government controlled societies, whether run by right wing tyrants or left wing ideologues. Because the European Union cannot let go of a great deal of political power that was commonplace in Eastern Europe under the communists, and typical of many sectors of the economy in Western Europe throughout the post-war period, Western Europe remains a poor performer. No economists think this is about to change soon. It is not that the European Union has just had a difficult 10 years owing to its wish to integrate, to set up the euro, and to bring a widely diverse group of countries closer together in their economic and social performance. If only it was that. Most commentators believe that America will continue to widen the gap in her favour, and consensus forecasts for 2006 and 2007 show more of the same compared to the last 10 years.

8 How could the EU compete more successfully?

Some of the thinkers involved in the great project to integrate the governments of Western Europe have now come to see the dangers of continuing with an economic and social model which does not deliver world-class, competitive businesses, and leading world-class prosperity. They realise that their ambition to challenge the United States of America and become the second superpower of the world is going to come to nought if they cannot solve the conundrum of the poor performance of the European economy. Some of them are prepared to go further and to acknowledge that some of the weaknesses lie in European government itself. They usually descend into bickering and rows between the government of the Union, the Commission and the member states. The Commission claims that Europe is too bureaucratic because of the way the member states gold plate and add to the regulation coming from the European Union. The member states sometimes say that it is the European love of regulation coming from the Commission that is providing too much on top of established national law codes.

There are similar problems with the budget. European Union government believes that spending only 1% of the gross national products of the member states leaves it too little money to fashion the policies it requires, to implement its vision of government led success in the various sectors. Some of the member states believe their own budgets are difficult enough without having further demands for tax and spend on top at the European level. There is a delicious irony in the European Union government lecturing the member states on the need to cut their budget deficits, to reduce public spending effectively in their countries, at exactly the same time that the European Union believes that it should have access to more of their taxpayers' money to spend on projects of its choosing. It is difficult to have moral authority for an austerity package when the package is not going to apply to the people offering the lecture.

If the member states and the European Commission were serious about creating a competitive Europe, they would need to study the American example more carefully with less prejudiced eyes. Whilst I'm sure it is possible to improve upon the American model, no-one has yet succeeded in doing so worldwide by creating a globally competitive economy of any size that is richer, more successful and growing faster than the United States does. Maybe the US would grow even faster if it did not have quite as many laws and lawyers as it currently has. Maybe the US would make a bigger contribution to world prosperity if it reformed its agricultural system more quickly and more fundamentally. Maybe the US would do itself, as well as the rest of the world, more favours if it was less protective on some of its crucial technologies and industries. All these are possible beliefs for a free trader. However, the challenge for the European Union is how to try and catch up with the United States of America, how to reproduce the things that the United States has got right rather than complaining about the things that she's got wrong.

If the European Union is serious about wanting more internationally competitive companies to set up business within its territories, then it must be committed to lower taxes. The single most important change European member states could make to attract more of the large multinationals and their corporate investment to European shores, would be a substantial and permanent reduction in the rate of profits or corporation tax, matched by a similar reduction in the rate of income tax on employee salaries and a favourable regime on capital gains tax for those wishing to build up substantial assets through shareholdings. To help bring this about the European Union should not be contemplating any increase in its budget for the next decade but should be making a more dramatic contribution to bringing about lower corporate taxes and income taxes, by cutting the amount it wishes to spend.

The European Union should not be contemplating any increase in its budget

It is tentatively moving towards farm reform. Agricultural spending still amounts to some half of the total budget. If and when agricultural spending can be brought down, the proceeds of this should be returned to the taxpayers of the member states, permitting their governments to cut income taxes in the way described. The last thing the member states can afford is a rising set of financial demands from the European Union, at the same time that they are in the welfare vice of their own creating and at the same time as the European Union is insisting that they kerb their budget deficits.

Agriculture is not the only area where the European Union budget could be reduced profitability for Europe and the rest of the world. Many of the projects financed from the social and regional funds of the European Union are at best marginal. Indeed, under the terms of reference of these funds the money can only be spent on projects which a member state would otherwise not undertake. This implies that these projects are marginal projects. It should be possible to cut these funds, again with the sole intention of returning more of the money to the member states to spend as they see fit, preferably on tax reductions to make their countries more economically competitive, and to leave their citizens more money to spend on goods and services.

The second contribution the European Union could and should make to a more competitive EU would be to put a stop to its passion for regulation. It is not good enough to say that in future it will regulate a bit less. This doesn't mean that it will regulate less, it means that the rate of increase in regulation will reduce little, if we're lucky. What we need is a period of a year when the European Union does not legislate at all but spends the time profitably re-examining the whole corpus of its current law, with a view to the member states deciding what can be best done by them, by the EU and what need not be done at all. At the end of the year the European Union should bring forward a large, deregulatory repeal statement and make a positive contribution to easier business conditions by removing large chunks of regulation currently on the statue book.

My critics will immediately object. This means I favour poor working conditions, damage to the environment, and the other things which business are alleged to do if left alone and unregulated. On the contrary, I believe that modern business is at its best when a company looks after its workforce, recognises its duties to its employees, and is a good neighbour. Business success in the 21st century will go to those who are green and clean. Indeed, green business is good business. It means burning less energy which is going to become scarcer and dearer, and it means having fewer rows with the neighbours over noise and pollution. There is nothing wrong with setting general and improving standards of air quality, water purity and the like. There is everything wrong with the extremely detailed regulation of business, company by company and product by product which can stifle activity and drive it offshore to countries where environmental and social standards are much lower. As we've seen, the demographic imperative in Western Europe is going to prevent any company that did dally with the idea of being unfair or unkind to its workforce from doing that. The power of organised labour is going to increase as the workforce shrinks. There is no need to go into detailed prescription about working hours and conditions when these can be freely negotiated in a way which will be benign to the employee.

The Working Time Directive perversely has hindered rather than helped many workers. It is in effect the abolition of overtime directive which prevents, for example, young family men working longer hours and earning extra to buy Christmas presents or the special summer holiday when they wish to do so.

The third thing the European Union could do is to create a genuinely free and open market across the European Union area. It's still not done so. It persists in the belief that it has to go into detail sector by sector and case by case, coming up with prescriptive regulation before the market can be truly opened with common standards and common definitions. Instead all we need to see is the effective enforcement of the logic of the Cassis de Dijon judgement. It should be commonplace that if something is merchandisable or saleable in one country, people should be free to offer it for sale in another. It is then up to the customer and the competitive marketplace to sort out the rival claims and decide which are the best products and services. It is a disgrace that there are still substantial state monopoly areas in European Union member economies that cannot be challenged by more competitive and more liberally based enterprise activities from the more advanced countries. It would be good for the receiving country if the markets were more contestable as it would serve to raise quality, improve innovation and lower prices.

The fourth thing that needs to happen in the individual member states is greater attention should be placed on sorting out public infrastructure. In particular, transport networks for many Western European countries are not up to the task of meeting the huge demands now being placed on them by people and goods. Countries like the Netherlands that have been most farsighted in building the very large airport of Schiphol and the very large container port of Amsterdam are relatively the most successful. There needs to be recognition in other member states, especially a country like the United Kingdom, that transport capacity needs to grow in order to cope with the increasing demands of the globalised world, where more and more components and services cross frontiers daily as part of an intricate pattern building up to the final product for the ultimate customer.

The fifth thing that the European Union member states need to do is to develop energy policies that are going to ensure the lights stay on and the factories stay turning over the years ahead. We are likely to live through a world of increasing shortages of oil and gas. The phenomenal demand unleashed by China and India as they industrialise rapidly on a huge scale is going to have a continuous, upwards impact upon the price of fuel. The western European countries have plenty of coal. Maybe they should be encouraging more development for clean coal and alternative fuel technology. Maybe part of the answer to the agricultural problem in western Europe is conversion to the production of crops that can fuel the boilers. Maybe there is considerable scope for alternative sources of energy from renewables and nuclear. One way or another European Union member states need to make a better fist in creating the right framework for energy policy, so that the private sector can get on with the huge investments that are going to be needed to ensure stable and sensibly priced supplies over the next 50 years.

The sixth thing that the EU and its member states need to understand is the importance of fostering and developing the entrepreneur. In the United Kingdom even a once very socialist Chancellor of the Exchequer, the UK's Finance Minister Gordon Brown, has come to understand the importance of the entrepreneur to a successful enterprise economy. A government which has a primary role in education is now more concerned to see some favourable understanding of entrepreneurship and small business activity develop at school and university. We do need to live in a world where the brightest and best people are told at school and college, as well as others, that setting up on your own and running your own business is a first class career option. The introduction of business exercises and games, of business education, more business schools, of basic computing and accounting as course options are all helpful steps in the right direction. Unfortunately member states' governments and the European Union itself often seem to take a rather different view of entrepreneurs, regarding them as people likely to cheat the taxman, to fiddle expenses or to cut corners over regulation. The message has to be whole and united. We should praise all entrepreneurs and distinguish them from criminals.

The seventh thing which EU member states have to get better at is the pursuit of knowledge. If I had been given £10 for every occasion when a European politician or senior official talked about the growth of the knowledge based economy, I would now be an exceedingly rich man. Unfortunately the more they have talked the more they have fallen behind in the race with the United States of America in just this vital area.

Most commentators and many politicians and bureaucrats share the view that people in European Union countries are going to want to continue to be paid high wages, and that that rules them out from producing commodity products and relatively low value items. The way to ensure the thick wage packets continue in the years ahead is, in their view, to ally substantial knowledge, technology and brain power to the work of the factory and the mill. No-one believes that many entrepreneurs will get rich trying to make basic white cotton t-shirts in a first world country against the phenomenal competition from many Asian factories. All believe it is possible for the great fashion houses of Western Europe to extend, develop and promote their brands and to improve their designs, in a way which enables them to make high quality goods within the European Union and sell them at premium prices. To do so the European Union needs to train first class designers with flair and skill. The same is true of all other industries ranging from the increasingly technical computer based specification of the modern executive motor car, through to the highly elaborate technology that goes into a present day missile, tank, ship, telephone or business computer.

If America has excelled in any one field it is arguably in this crucial area of developing blue sky thinking, widening man's horizons of knowledge and at the same time finding practical applications for the new ideas that people in the academies have developed. Up to the 1960s there were still other parts of the world capable of doing just that. It was Britain after all that got a long way with developing the deathly technology of the atom bomb which it shared with America at a crucial stage in the Second World War, and it was Britain that first developed both the jet engine and the Hovercraft which had more friendly applications. The Soviet Union was technically competent and competitive up to and including the 60s, putting the first man into space and developing robust and straightforward rockets, missiles and space capsules. The Japanese were world beaters in hi-fi and photographic technology later still in the 70s, 80s and 90s. In the last 10 years no other country has kept up with the searing pace of American development with the digital highway, the communications revolution and the expansion of the media.

If we look behind the crude statistics of the growth of the great American corporations and the increasing global span of IBM, Hewlett Packard, Microsoft, the American telephone and media companies, to the academic background, we see there America's lead has also been gathering.

In the generally accepted world rankings of universities, there are only three non American universities in the top 10. Two of those are British, Oxford and Cambridge, and the other just in the top 10 is Tokyo. The top 10 is led by the huge success of Harvard. Harvard is now in a league of its own. It is backed by a massive $26 billion endowment. Its access to large amounts of capital enable it to give generous bursaries and scholarships to the brightest students from poor backgrounds, and enable it to pay faculty members world beating salaries to attract and retain the best professorial talent. It means Harvard is not short of a book or two, of the right laboratories or the other equipment necessary to sustain the highest level of research.

The world league is based upon a mixture of assessments of the resources the great institutions enjoy and the achievements they have managed on the back of them. A great deal of the assessment is based upon peer review of the quality of research work produced - the books, papers and other materials that come from the presses. The assessors look at the number of times the work is cited to provide an indication of how influential it is, and seek review from other leading scholars to provide some information on its quality as well as its quantity. There is general agreement that the quality and quantity of academic and research work coming out of the American universities is greatly superior to the quantity and quality of academic research work coming out of the universities of the rest of the world.

What could be done to deal with this imbalance? The European Union and many of its member states' governments lecture us incessantly that they wish to create this knowledge driven, world beating economy. What actions then are they taking or should they take to give the European Union great universities that can rival Harvard?

The first thing that the European Union member states would have to understand is that regarding universities as creatures of the state, wholly owned subsidiaries of the central government, is not conducive either to them having substantial resources or to them attracting and retaining the best kind of free-thinking talent. The university world which is one of the best outside the United States of America is becoming clogged up with bureaucratic exercises, as it plays its role of petitioner at the court of the central government in quest of funds. It makes it difficult for all the universities all of the time to keep up the very high standards they would wish when the government marks them down for having high dropout rates, or for not achieving certain targets for first and upper second class degrees, or getting a certain number of people through the necessary rigours of a doctoral thesis. It means that faculty members have to spend a lot of their time form filling and box ticking, rather than doing what they would prefer to do and do best, researching their chosen subject. Many young people arrive at British universities sadly ill-equipped to deal with the excitement and challenge of independent study. They have been used to a cramming, box ticking, multiple choice answer style of education. They have been used to a system where a substantial proportion of their mark goes to achieving the necessary uniform standard of coursework which often militates against independence of thought or the maverick intuition. Some of them arrive at university without a sufficient grasp of the basic languages of English and mathematics to be able to carry out their maths or English based studies in science or the arts to a high enough level. If you cannot read and write well by the time you reach university, it is difficult to take full advantage of the great university libraries and to do justice to an English literature, history or modern languages course. If your maths is inadequate it makes achieving the best results in physics or cosmology or economics very difficult.

The British government is aware of its problem standards and is trying to combat poor achievement in English and maths by a number of interventionist routes in state schools. The problem is not so acute in some parts of the Continent but they have a more acute problem in trying to have high quality universities. Many continental students have to spend time earning a living at the same time as attending lectures and trying to meet the requirements of their university courses. The continental European universities are notably absent from the tables of top flying institutions, and increasingly the most talented students gravitate towards the great universities of the English speaking world. There they can improve their English which is the now the *lingua franca* of international business and gain qualifications that are of greater global value.

The first thing that EU member state governments should do is to grant their universities greater freedom. In order to make this a reality they not only need to give more of their state's attention to the university in relation to a simple figure like student numbers, rather than to bigger bureaucratic intervention in the workings of the institution. They also need to free the institutions to raise more of their own money from independent sources.

The universities themselves need to respond, pressing for tax breaks and favourable terms on which people could make money available to them. Harvard is so much richer than other universities in the world for two main reasons. The first is that it has been tapping its ex-alumni more regularly and more successfully than other universities. It has discovered that many of its former students are now very successful and rich. Many of them are very happy to return to their alma mater for dinners, lectures and functions in return for granting substantial sums of money to help Harvard build up its endowment. Even larger donations are possible when people die. Many people have more money than they wish to give to their immediate relatives, and some die either without children or at a time of life when their children are rich and well-

The first thing that EU member state governments should do is to grant their universities greater freedom

established themselves and do not need large sums from their ailing parents. Wealthy bequests can make a large difference to a university's endowment.

The second reason Harvard is so much richer is that it has been so much more successful at investing the monies people have given it. Harvard was early into the Japanese market in the last century, recognising the phenomenal growth that Japan was about to achieve and enjoying the ride in the stock market that resulted from it. Subsequently Harvard was correct about the technology boom and the move into private equity. It has been an early exploiter of the benefits of alternative investments, including hedge funds and property.

The European universities have to appoint themselves better investment advisers and to study the success of the leading American institutions, in husbanding their resources and choosing good investments for their endowment.

As the universities start to raise more endowment money, so they will have more cash to spend on bursaries and scholarships for the really bright students from poor backgrounds, freeing them of the necessity to take on part time jobs as well. They will have more money to spend on attracting and retaining faculty members they really want involved with there institution. If a Russian billionaire can create a world beating football team at Chelsea simply by spending more money and recruiting the right talent, it should not be beyond the wit of the leading European universities to build world beating academies, based on extra spending power from raising more money and investing it well. That after all accounts for Harvard's success.

As the universities start to raise more endowment money, so they will have more cash to spend on bursaries and scholarships for the really bright students from poor backgrounds, freeing them of the necessity to take on part time jobs as well.

Governments need not do very much to bring this about other than the most difficult and most important thing - getting out of the way. Tax breaks for endowment gifts where they are not already available would help, as would the more vigorous promotion with the tax breaks already on offer. Simplifying the paperwork and bureaucratic demands on the universities would help, and getting out of the university's way when they decide on how much they wish to pay their faculty members and what terms of contract they wish to draw up with them is also vital. Universities may discover some of the brightest and best talents do not wish to work full time or permanently for the university. They may wish to offer mid career breaks for very successful engineers, accountants, lawyers and others from the commercial world, so that the university can have the benefit of their skills and immediate hands on experience for a limited period of time. Universities may wish to persuade very talented people to split their time between the real world of work and the world of the academy. Universities should certainly encourage scientists and engineers to be entrepreneurs in their spare time. Both Cambridge and Oxford universities have got better at this in recent years, allowing faculty members to spin off ideas that they've developed in the university laboratory, and help create companies to exploit them on the adjacent business parks. Other universities have followed with incubator units. The campus is becoming a place of business as well as a place of study.

Conclusions

The European Union, on its own admission, is going to fall further and further behind the United States of America. It is going to watch as the Chinese and Indian economies continue to surge forward. Whilst in the 50 year period of our predictions we may not reach the position where the average Indian and the average Chinese earns more and enjoys a higher living standard than the average western European, we're certainly going to reach quite early in that period a position where the Chinese and the Indian economies are considerably bigger and, therefore, have more economic clout than even the largest member state economies within the EU. Before the end of that period the Chinese and Indian economies will exceed the size of the European economies in aggregate.

This big change in relative economic power matters a lot. Whilst one of the primary reasons for the European Union falling behind is demographic, it should not be used as a fatalistic excuse for doing nothing about it or refusing to worry about it. The demographic problem itself could be solved if policies on immigration were changed, and European economies became successful attracters of talent and labour in the way that Ireland has done in recent years. For the European Union as a whole, if it did ever bite the bullet and admit Turkey, the demographic profile would look very different but it would only solve the problem of the individual member states' economies if at the same time as admitting Turkey, countries like Italy and Germany welcomed itinerant Turkish workers in to fill the gaps created in their own economies by the declining workforce.

The relative decline of the European Union matters for two main reasons. The first is that it makes ridiculous the European Union aspirations to be a global power. There is no way that a weak economic performance, coupled with a declining population, can sustain the heavy investment and spending on armaments that it would require to provide a rival superpower to the United States of America. Although the European Union is currently embarked on such a course, investing heavily in satellite spying technology and asking its member states to make progress in developing a heavy lift capability and the communications capability it would take to send European Union forces outside the Continent, it is difficult to foresee on current projections the European Union having enough money or technical resource to get anywhere near catching up the United States of America in the next 50 years. Indeed, the budget figures look so terrible that we are more likely to experience defence reductions and cuts in Western Europe than the opposite.

The decline in economic power matters for a more important reason. For many of us we do not wish to see the European Union become a military power in its own right. We think that might destabilise rather than stabilise the world more. We do, however, wish to see the European peoples live comfortable with a high standard of living. Part of the reason the EU is going to fall so dramatically behind the United States and underperform India and China, is the very poor technology and productivity performance now being achieved by the European Union economies. Most forecasters expect this to continue. As a result, we can expect the European Union to become relatively worse off with citizens of the member states watching as Americans get progressively richer relative to them. On current trends, Americans will be more likely to have a job, will be more likely to be well paid, and will be more likely to buy many more goods and services with their pay than Europeans. If Europe continues on its present course of over-regulation and high taxation, it could get considerably worse with major industries in Western Europe going the way of the textile industry. We can see the wave of factory closures in engineering, automotive and capital goods if Europe does not take the Chinese, Indian and American challenge more seriously.

This pamphlet has set out the steps the European Union should take and its member states should take if they are serious about living successfully and prosperously in an increasingly global world. My one single piece of heartfelt advice to the European Union is the one it will find most difficult to accept. It should spend less, do less and legislate less. If it could keep to those three central tenets it would start to make a contribution to solving the problem of European competitiveness and laggardly economic performance just as surely, as it has been one of the main causes of that poor performance in recent years. The European Union model does not represent a clever and successful third way that combines social justice with economic prosperity. It is a cruel model which offers no social justice to the poor in the *bonlieus* of Paris or in the inner cities of Britain. It is a system which can ensure failure and poverty reinforce each other, as people become prisoners of a benefit and job protection system that conspire to keep the privileged in work and the underprivileged on the dole. The EU is not friendly enough to enterprise, sensitive enough to freedom, or understanding enough of the power of the globalising marketplace.

On current form the American model is going to continue to win economically and politically. China will become the most likely political challenger to the United States of America, as the sheer size and scale of her economy make a growing impact on the world, and as she decides to re-arm to a higher standard. India too will emerge as an economic giant but she does not have the same global political ambitions that her near neighbour in the East currently harbours. Europeans are going to have to get used to a new bipolar world where our future depends on the US-China relationship. Europeans will be well-advised to go back to basics and to understand that they need to do a great deal to reform themselves, their politics and their economies just to preserve and improve their prosperity.

About UKVE

In order to thrive, Europe must be free.

Uurimiskeskus Vaba Euroopa (UKVE), or Research Centre Free Europe in English, is an international think tank based in Tallinn, capital of Estonia.

UKVE has grown out from a loose academic group that did not accept the official position of only one truth without choices for any given nation or state. Seeking alternatives, offering more rational solutions and informing the public of our different options is what UKVE is all about.

We offer a fresh view on European affairs without defining life in Europe in terms of the EU. We try to look one step ahead of the conventional narrow minded daily quarrels of the political elites of Europe. Based on a belief in free trade, freedom for individuals and states - and fair competition between them.

We offer possible solutions to those for whom overregulated, incompetent, centralised, undemocratic EU is not a solution but a problem. We fish for the floating new ideas and visions, turning them into policies we can then offer to parties and opinion makers.

UKVE is an association registered in Estonia. It is administered by a board and operated by a staff based in our Tallinn offices. Our thinking originates with an expanding group of Fellows and partners who see UKVE as an appropriate publisher of their ideas on specific issues.

UKVE pursues its aims by tried and tested means on the classic model of a think tank - with just a little innovation. We publish a quarterly journal, occaisional papers and books. UKVE organises conferences and seminars and specialist briefings. We provide experts to participate in conferences worldwide. On behalf of selected partners, we conduct research into specific areas of policy.

Books by the same author

Death of Britain Palgrave Macmillan £9.99

Just Say No! Methuen Publishing £8.99

Singing the Blues Methuen Publishing £18.99

Stars & Strife Palgrave Macmillan £16.99

Superpower Struggles: Mighty America, Faltering Europe, Rising Asia
Palgrave Macmillan £18.99

Third Way Which Way Middlesex University Press£10.99

To contact John Redwood

Email: redwoodj@parliament.uk
Website: http://www.johnredwood.com
Phone: 0118 962 9501

Other publications in the V series from UKVE

The Perils of Pegging
by Meelis Angerma. In association with The Bruges Group. An in depth and expert account of the problems presented to the new members of the EU by pegging to the Euro.

New Atlantic
by Ivar Raig is a vision of a renewed relationship between European nations and the USA

The Regulation Race
with Liberty Ideas, this best selling of our papers is a plea for competition between regulatory regimes - damning of the doctrine of "harmonisation"

All £2 or 40- EEK

Also from UKVE

These Tides

These Tides has become the journal of UKVE having existed as an independent magazine serving the broader international eurosceptic movement.

It is published roughly quarterly and is available by subscription. Subscription is free for associate members of UKVE. For a sample copy please send a stamped addressed envelope to the address below.

UKVE PK 4231, Tallinnas Peaspostkontor, Tallinn, Estonia 10510

Partners in this series

Partnership in a title in this series of publication does not indicate a formal alliance but rather an engagement in a conversation between people of similar but various opinions.

Liberty Ideas

liberty ideas is an international platform dedicated to the idea of individual liberty. It features the most comprehensive database of pro-liberty arguments and thinkers worldwide and is the hub of a network of activists spreading the idea of liberty.

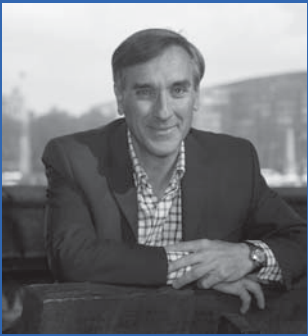
Website: http://liberty.li
Email: info@liberty.li

Bruges Group

Democracy Movement

Democracy Movement, Kershaw House, 449 Great West Road,
Hounslow TW5 0BU
020 8570 5681
020 8570 5213
E-mail: mail@democracymovement.org.uk

The Author



John Redwood has been in Parliament since being elected as MP for Wokingham in 1987. He is a business man by background, has been a schoolteacher and a Director of a merchant bank, a temporary postman and the Chairman of a major Stock Exchange quoted industrial company, a County Councillor and a University Professor, a shop assistant and the pioneer of privatisation worldwide, a bank clerk and the Head of the Prime Minister's Policy Unit.

He was a fellow of All Souls College Oxford 1972-86 and 2003-5.

John has written several books and many articles. His most recent publications include Singing the Blues, Third Way - Which Way? (on how to pay for public services), Just Say No! (100 arguments against the Euro), Stars and Strife (on US-EU relations), *Get a Move on* (Selsden 2002 on transport policy), and *Healthy Choices* (NTB 2002 with co-authors on the NHS). and more recently "Superpower Struggles.

John was soon made a Minister, joining the front bench in 1989 as Parliamentary Under-Secretary in the DTI. Promoted to Minister of State in 1990, he supervised the liberalisation of the telecoms industry and served in other ministerial positions during the last Conservative government.

In 1997 he joined the Shadow Cabinet handling the DTI brief. In 1999 he became Shadow Secretary of State for the Environment. In 2000, he was appointed Head of the Parliamentary Campaigns Unit. In September 2004, he became Shadow Secretary of State for Deregulation.

Since December 2005, he has been the Chairman of the Party's Economic Competitiveness Policy Group.

Published by UKVE in association with Democracy Movement as part of "Vision Europe"
www.visioneurope.ee

£2 40.- EEK €3