All smiles as a federal Europe creeps closer

Plans for an 'economic government' in the eurozone will exacerbate not ease the effects of the financial crisis

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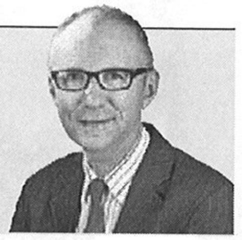

As far as is known, David Cameron showed no discomfort at last Friday's EU summit when he was presented with the Franco-German plan to create a federal Europe. Officially known as the "pact for competitiveness", these proposals were proudly described by President Sarkozy and Chancellor Merkel as the long overdue blueprint for a "European economic government". It aims to harmonise six hugely controversial areas of national economic and social policy for the eurozone countries: corporate taxes, pension systems, wage bargaining, educational qualifications, public debt limits and the management regimes for troubled banks.

Considering Mr Cameron's Eurosceptic background, the absence of any opposition might have come as a surprise. Why is the British Government apparently so relaxed about this enormous step in the EU's journey towards full federal statehood, a proposal that would have caused paroxysms for Margaret Thatcher or even John Major?

There seem to be five reasons for the British Government's lack of interest in European issues at present. First, there is the influence of eurofederalist Liberal Democrats within the coalition. Second, the stability of the euro and the EU banking system are important for Britain's recovery.

Third, the Government takes comfort from the fact that recent plans for joint economic management have mostly been presented as intergovernmental deals between national leaders rather than transfers of authority to the European Commission. Fourth, the diehard eurosceptics remaining within the Government believe that Britain can insulate itself from such unwelcome EU developments by staying outside the eurozone. Finally, the European Union Bill now before Parliament will

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attach a referendum "lock" to any further transfers of sovereignty from Westminster to Brussels.

The first point speaks for itself, but the others all rest on a misconception of historic proportions: that the forward march of economic federalism at present is merely an unavoidable ad hoc response to the financial crises in Greece, Ireland and Spain triggered by the 2008 credit crunch. The hope in Whitehall is that this centralisation programme will be quietly abandoned, or even reversed, once the crisis is over; but the likelihood is the opposite. The new institutions and agreements inspired by the euro crisis will be permanent features of the European political landscape, continually evolving into the full-scale federal government that Jacques Delors, Helmut Kohl and Mrs Thatcher all saw as the inevitable consequence of Europe's decision to create a single currency and monetary union.

Last week's summit plan perfectly illustrates this process. The proposed harmonisation of tax, labour and pension policies has no direct relevance to the euro crisis and will do nothing to make Greece or Ireland more credit-worthy. On the contrary, Ireland would suffer outflows of capital and employment if forced to harmonise its tax rates up to German and French levels. Centralising wage bargaining across Europe, far from allowing poor countries to become more competitive by taking advantage of their cheap labour, would create a mechanism to protect high German and French wages and social charges.

Meanwhile, the one feature of the Franco-German proposal that could do most to stabilise the European financial system — the creation of a pan-European mechanism for guaranteeing and recapitalising troubled banks — hardly received a mention at the summit and is likely to be dropped, at least for the time being.

In short, last week's proposals were not so much an attempt to solve the euro crisis as an effort to exploit it to advance the eurofederalist agenda that had been stalled for years.

Germany, in particular, has seen the crisis as an ideal opportunity to promote its vision of a federal Europe, in which all member countries are forced to comply with strict budgetary rules and centralised wage bargaining, as well as providing a generous social safety net and levying the relatively high taxes required to pay for it. This is in many ways an attractive model but it is unlikely to work in the poorer and

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less orderly countries of Southern and Central Europe.

While Germany has the whip hand at present, power relationships will quickly alter if and when the euro crisis is contained. Once Germany signs up to irrevocable financial guarantees for the debts of other euro countries, the political conditions it has imposed as a quid pro quo will surely be watered down. It is almost certain, for example, that the supposedly "automatic" penalties for breaching budget rules that Germany is likely to win in exchange for its financial guarantees will quickly be ignored, just like the "no-bailout clause" that stated that members of the eurozone would never guarantee each other's debts.

The same is likely to be true of Germany's insistence that the EU harmonisation should be policed increasingly by national leaders at summits, rather than by EU commissioners in Brussels. The Commission provides the only mechanism for implementing intergovernmental decisions and everything in EU history suggests that it will soon gain complete control. Moreover, the other members of the eurozone are all determined not to be governed by Germany, or even by a Franco-German directorate. They will ensure that the main responsibilities for "economic government" move rapidly to the Commission, once Germany signs up to irrevocable guarantees for the euro's financial stability and thereby loses its veto power.

Speaking of vetoes brings us back to the position of Britain. The British Government finds the German preference for intergovernmental mechanisms very reassuring and is unperturbed by EU developments that are confined to the eurozone. But it is illusory that Britain can prevent further EU integration. As the 17 member countries in the eurozone move inexorably in the direction of economic and political union, the interests of this cohesive bloc will become ever more dominant in all EU institutions.

The non-euro countries, especially Britain, will then have to face up to the reality of a multi-speed Europe, with a fully integrated federal core, and a much looser coalition of trading partners on the outside. This vision of a looser Europe has much to commend it, but is one that successive British governments have struggled for decades to avoid. It is now a fact of life.