



# The Union of disparity

Opinions are divided when it comes to the question of how Europe should progress in the future. On the one side are the Eurosceptics, who wish for stronger nation states. But on the other there are also many advocates of stronger European integration. At the **Max Planck Institute for the Study of Societies** in Cologne, research on Europe by **Martin Höpner** and his group and **Fritz Scharpf** explores to what extent there is any chance for the member states to move closer together, given their significant structural differences.

TEXT **CASPAR DOHMEN**

Photo: shutterstock



Europe will be whatever the Europeans can agree on, or there will be no Europe,” wrote the politicians Hans Eichel (SPD), Roland Koch (CDU), the philosopher Jürgen Habermas, and the economist Bert Rürup in their appeal for more solidarity in Europe in the fall of 2018. They called for more Europe, from an integrated European army to minimum standards of social protection for the unemployed from Portugal to Romania. Other pro-Europeans are demanding a greener Europe, or a more social Europe. There are many good reasons for them to do so. But how likely is it that the 27 EU members remaining after Britain has left can agree on such ambitious steps towards integration?

The researchers at the Max Planck Institute for the Study of Societies (MPIfG) in Cologne have found that the political and economic heterogeneity of the member states has a significant impact on European integration. “Their heterogeneity has a decisive influence on the scope of what is politically possible,” says the political scientist Martin Höpner, leader of the “Political Economy of European Integration” research group at the MPIfG. “It determines what is realistically possible, and what is not.” Given the serious structural differences, the researchers are skeptical. Their perspective is likely to make them seem unduly negative to European visionaries, yet their objective is to identify realistic courses of action.

Worlds apart: in Bulgaria, the poorest member state of the EU, 20 percent of people are so poor that they cannot cover their basic needs. Roma people (left) are the hardest hit. In Luxembourg, the richest EU country, seven percent of citizens are millionaires, and some like to display their wealth.

That might also help to prevent disappointment among citizens when the high-flying plans of the visionaries cannot be realized.

For a long time, there was much to be said for aligning living standards in the EU, in theory. In practice, however, the story of European integration took another course: the differences between the member states increased with each enlargement and, except in the case of Ireland, diminished little over time. >



Record export levels: Germany exported more goods than ever before in 2018. The German economy benefits from the fact that the euro – because of the economically weaker countries of the eurozone – is valued too low by international comparison.

The six founding members of the European Community (Germany, France, Italy, Belgium, the Netherlands, and Luxembourg) were initially a relatively homogeneous group, measured by their economic performance. This first began to change when the southern countries (Spain, Portugal, and Greece) joined in the early 1980s, and then did so very significantly with the wave of accessions of Eastern and Central European countries after the fall of the Berlin Wall. The wealth gap continues to this day: gross domestic product per citizen is more than ten times higher in Luxembourg, the richest member state, than in Bulgaria, the poorest country in the EU. This inequality is also reflected in minimum wages, which are EUR 11.55 per hour in Luxembourg and only EUR 1.57 in Bulgaria.

The MPIfG research group on Europe works in particular with comparative political economy, an approach commonly used by political scientists, sociologists, and economists. With it, researchers examine the structural dif-

ferences between states and find out whether heterogeneity has consequences, for example for the integration of regional economic areas such as in the European Union. Essentially it is concerned with different manifestations of capitalism. This is how the American political scientist Peter A. Hall and the British economist David Soskice differentiate in their classic book *Varieties of Capitalism* between coordinated economies in “core Europe” and liberal market economies such as the U.S. or Great Britain. The Danish sociologist Gøsta Esping-Andersen classifies states according to their social-democratic, conservative, and liberal welfare models. As early as the late 1970s, Fritz Scharpf, an Emeritus Director of the Cologne-based MPIfG and still actively researching today, identified other important variables for determining national differences in economic development: how they control inflation and how they set wages. The impact of these factors became clear with the oil crisis, caus-

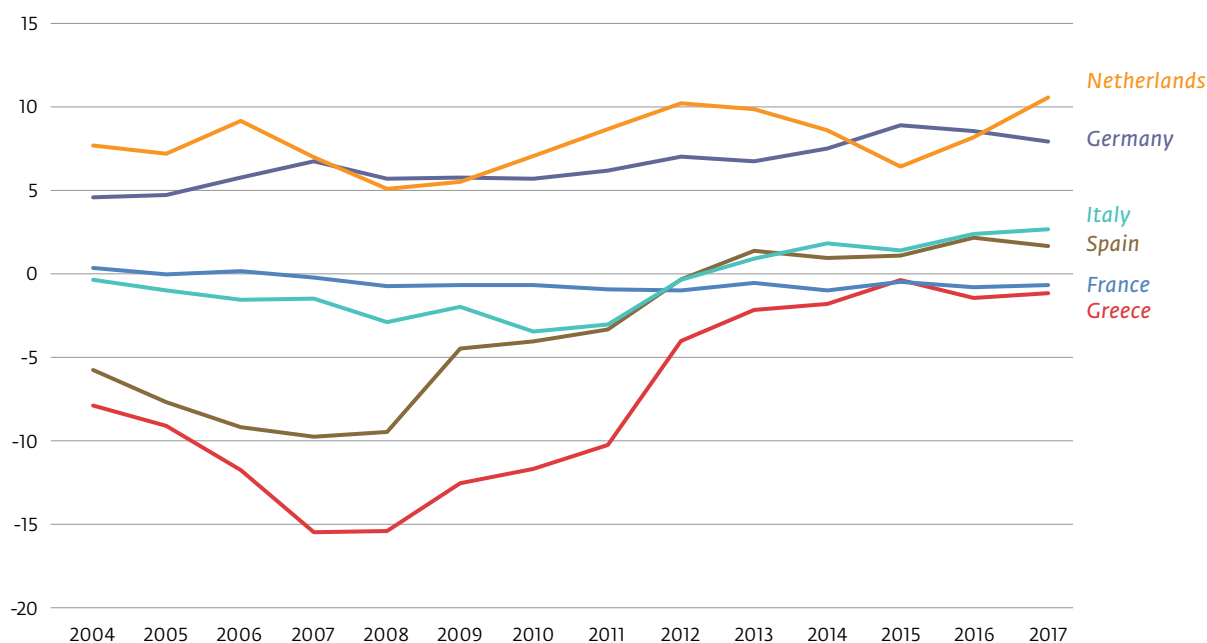
ing countries that were once comparable to drift apart economically during the 1970s.

## EUROPEAN CONSENSUS HINDERED BY DIFFERENCES

According to Höpner, there is no definite threshold from which heterogeneity prevents integration. However, in political economy research there is a consensus that “the heterogeneity of the EU member states is enormous.” This is clearly illustrated by factors including minimum wage levels, worker participation arrangements, or methods of taxation. Nevertheless, a large amount of integration has taken place in the EU – in a variety of ways.

In the early 1990s, Fritz Scharpf already distinguished between positive and negative integration which is essential to understanding the approach taken by the Cologne researchers. The terms are used neutrally, merely intended to describe two different ways of achieving “more Europe.” Negative

Current account balance as a percentage of GDP



integration takes place when national trade barriers are removed in the individual countries. The best example of this is the creation of a single European market. The Community banned protectionist measures in all member states, such as customs duties and individual product specifications, so-called non-tariff barriers to trade. This resulted in the liberalization of the EU Single Market.

Negative integration, however, is not only brought about by European legislation. It is also extended by interpretation in the judgments of the European Court of Justice (CJEU). This happens on a regular basis. An example of a landmark judgment of the CJEU is the Cassis de Dijon ruling of 1979. The judges ruled that if a product was lawfully marketed in one member state, it was generally permitted for this product to also be sold in all other member states.

Meanwhile, the researchers talk about positive integration if the EU creates policies that are binding for all member states. To this day, such decisions in the EU require a large degree of political consensus among the members. "Owing to the structural econom-

ic differences, however, it is extremely difficult to reach this kind of consensus," Höpner says.

### THE EU OFTEN ANNULS STANDARDS BUT DOES NOT CREATE NEW ONES

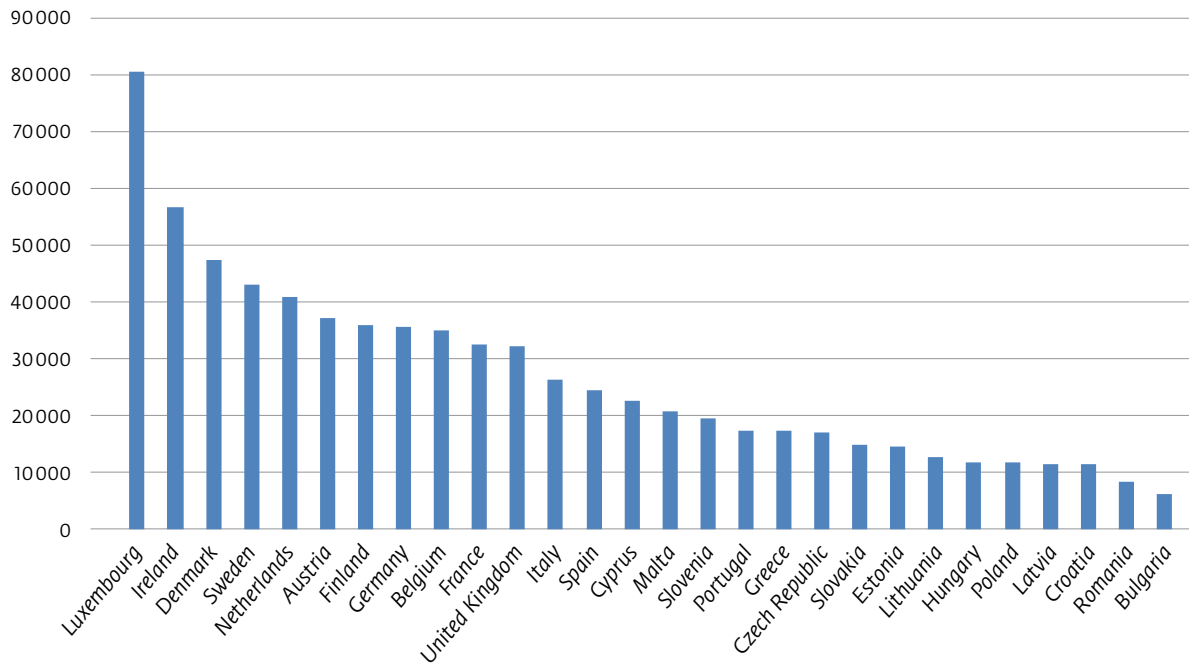
The best example of this is the discussion about tax harmonization. Large EU states have much to lose through tax competition and tend to push for harmonization of tax rates, for example for corporate taxes. Smaller and poorer EU countries are more interested in attracting companies with lower tax rates. "This is a legitimate interest," Höpner points out. Interests also clash when it comes to regulating the employment market, as the Posting of Workers Directive shows. Poorer countries are interested in their domestic companies being able to export lower standards and wages to richer countries, at least in part. Meanwhile, the wealthier countries try as far as possible to prevent this. These divergent interests make it very difficult to agree on consistent overriding principles in the Community, whether for social welfare, capital taxes, or worker participation.

Forced harmonization: the current account balance – the difference between the value of exported and the value of imported goods and services – has developed positively in Greece and Spain. However, in order to achieve this, people in these countries have had to suffer significant wage reductions and severe cutbacks in their health and pension systems.

The institutional regulations make it much easier to achieve political progress in the EU by means of negative integration than by positive integration. "This asymmetry is embedded in the European institutional system, and thus in the deep grammar of the EU, so to speak," says Höpner: "Negative integration generates a momentum that positive integration never could."

This has significant consequences, as the two integration mechanisms address different policy areas. Positive integration is usually used to create new regulations and establish standards, for example in the fields of environmental or social policy. Negative integration, on the other hand, often affects the economic policy field. Here national standards are almost always eliminated, which is why negative integration almost always has a liberal-

GDP per capita in euros in 2017



An indicator of inequality: the gross domestic product per capita reflects the disparities in the levels of prosperity. The gap between the EU members is apparent, despite the fact that the figures are slightly distorted by the high number of cross-border commuters in Luxembourg and Ireland's favorable taxation conditions for non-European companies.

izing effect. This theory can be used to explain why so many steps towards liberalization have been taken in the EU but there is little harmonization in the social sphere.

Structural differences have explosive effects in the eurozone of 19 EU countries. According Fritz Scharpf, Emeritus Director of the Institute, they are to a large extent caused by a single factor: differences in the relative size of the export sector and of the non-traded sector where goods and services are produced for domestic demand.

Wage and price increases have a different effect in export-oriented countries such as Germany or the Netherlands than they have in countries depending primarily on domestic demand, such as Italy or Spain. In the export sector rising wages that increase the costs of production may force export-oriented companies to increase the prices of their products or services,

which will put them at a competitive disadvantage compared to their competitors in the international market.

**INFLATION PUSHES UP EXPORT PRICES**

Of course, there are also exporting companies in countries that focus on their domestic market. For these companies, wage increases are a competitive disadvantage, too. However, increasing wages increases household incomes, causing demand to rise, and this can be far more significant for the development of the national economy. Companies are then able to achieve higher prices at home and can expand production and employment as a result. This may well cause inflation to rise, but inflation in a country with a large domestic sector can have a different significance for its economy than in a country with a large export sector. It may therefore

make sense for central banks in national economies that focus on domestic sales to allow higher inflation.

The common currency is also problematic when it comes to evaluation of the current accounts of domestic-market and export-oriented countries. Economists talk about a negative trade balance if the value of goods and services purchased from abroad by a national economy is higher than that of the goods and services sold abroad. If the opposite is the case, they talk about a positive trade balance. The trade balance is the largest component of the current account. Before the common currency was launched, imbalances between the current accounts of EU member states could be compensated through appreciation or depreciation of the respective national currencies.

Since the introduction of the single currency, adjustments have only been possible through internal devaluation.

» It would take enormous sums to reduce the economic disparity that exists in the eurozone. It makes no sense for everyone to keep the euro.

Economists use this term to refer to a lowering of prices and wages to improve the competitiveness of a national economy. Internal devaluation on a particularly large scale took place in heavily indebted euro member states during the financial crisis – in part under significant pressure from the so-called Troika, the EU Commission, the European Central Bank, and the International Monetary Fund.

#### **WAGES IN GREECE FELL BY A QUARTER**

In practice, such measures apply mostly to wage and non-wage labor costs. In Greece, for example, gross wages fell by around one quarter, the tariff system was eroded, and many workers today receive only the minimum wage. These so-called austerity measures are intended to make companies from one national economy more competitive compared to their competitors from other national economies. However, the right economic policy for an export-oriented country may prove counterproductive for those with a focus on domestic sales, as can be seen from the countries hit by the crisis. The strategy has proven successful in the sense that current account deficits and the wage share have decreased, and exports are growing faster than gross domestic product. However, employment has fallen in the crisis countries, and national debt is significantly higher than it was before the crisis. What is more, the already high German export surpluses have increased further, as the euro is undervalued compared to the rest of the world.

“The gap in international competitiveness between northern and southern EU countries still exists. It could

only be closed by further extending and intensifying present austerity policies,” Scharpf explains. Prices and wages in crisis-ridden countries would need to decrease even further, an option he considers to be “politically impossible.”

Trade unions in many EU countries have already been weakened by the austerity policies, for example because wage settlements have been decentralized to plant level. Local works councils are in a weaker negotiating position than trade unions that bargain collective wage agreements for entire industries. Education, health, and pension systems have also been weakened. All of this is not without consequences. “Certain types of social order are hard to create and easy to destroy,” says Höpner: “Liberalization often produces irreversible results.”

So, what political conclusions do the researchers in Cologne draw from their findings? In theory, the economic disparity in the eurozone could be reduced by transfers between richer and poorer countries, much like the fiscal equalization that takes place among the German federal states. This would require enormous sums, likely to overstrain the donor states. Taking the major structural differences into account, however, the MPIfG researchers consider this solution to be highly unlikely anyway. More inflation in the north would ease the burden of adjustment in southern economies, as this would reduce price distortions within the eurozone. But this is easier said than done. Higher inflation cannot be prescribed against the will of those it affects. The only other way to keep the eurozone together would therefore be more austerity, which would cause considerable unrest among the affected citizens. >



Research-active Emeritus: Fritz Scharpf was a Director of the Max Planck Institute for the Study of Societies between 1986 and 2003 and continues to work on issues relating to Europe.



A political scientist with an economic focus: Martin Höpner leads the MPIfG research group on the “Political Economy of European Integration”.


“It makes no sense for everyone to keep the euro,” says Höpner. He believes it would be wise to implement a mechanism in the eurozone that enables states to opt out of the single currency, as well as back in. For this type of reform he also sees major obstacles, however. There is an intense fear of the consequences that dissolving the euro might have, as well as the tendency to associate the euro with a pro-European attitude. As the German Chancellor Angela Merkel succinctly put it before the Bundestag, “If the euro fails, Europe fails.” Höpner considers the “emotional or ideological identification of the euro with Europe [to be] part of the problem, as it prevents a necessary correction of the currency union.” The essence of the researchers’ findings is this: ambitions for the EU should be lowered. This may not produce a United States of Europe, but it could lead to a more functional union of states.

The researchers consider the likelihood of establishing a European welfare state to be “non-existent.” A European welfare state that works in Bulgaria and Denmark at the same time? “It is impossible to imagine, even in theory,” says

Höpner. Scharpf and Höpner nevertheless see realistic chances of social progress, for example in the form of EU assistance to enable poorer member

states to strengthen basic social protection. Höpner considers a voluntary basis for such assistance to be appropriate, which the countries will be hard pressed to refuse given the great benefit to their citizens.

Sober assessments like this may not be as exciting as the dream of a United States of Europe, but they may provide better opportunities for making actual political progress in the EU despite all the structural differences between the member states. ◀

 [www.mpg.de/podcasts/europa](http://www.mpg.de/podcasts/europa) (in German)

### SUMMARY

- There are significant differences between the economic structure and performance of the member states of the European Union.
- The resulting conflicts of interests make it almost impossible to reach agreement in certain areas, for example in the case of a common tax policy or EU-wide social standards.
- There are also significant disparities within the eurozone: depending on whether a country’s economy focuses on its domestic market or on exports, policy measures – for example to lower inflation or cut wage costs – can have a positive or negative effect.
- In setting its targets, the EU should pay more attention to the heterogeneity of its members. Euro countries should also be able to temporarily opt out of the common currency.

### GLOSSARY

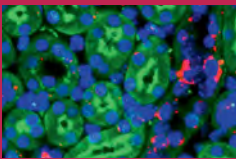
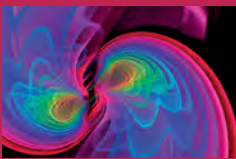
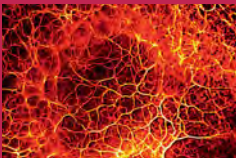
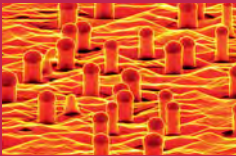
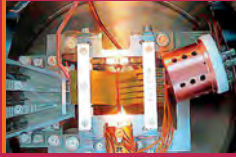
**Austerity** refers to policies provided pursued by governments in an economic downturn in order to cut spending and make the country more attractive for investors through lower wage and incidental non-wage labor costs.

**The trade balance** of a country’s economy is a calculation of all exports and imports of goods and services over a certain period. A positive trade balance is where the sum of a country’s exports is higher than that of its imports.

**The current account** is made up of the trade balance, transfers to and from abroad, and residents’ net income.



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