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Why Europe then?

An English version of "Mais pourquoi l'Europe?", by popular demand...

“Europe” here refers to the political superstructure that the nation-states of the continent have been building over the past half century. The purpose of the venture is not completely clear to say the least. Doubts about it abound, and the more so after repeated rebuffs by several national electorates during the past few years, especially regarding the proposed “constitutional law” that would represent a further step towards a federal continental integration. On June 8th, only 43% of European voters did participate (a steady downward trend in election after election), and only a little more than 40% of French voters went to the booths. Hence the “why”.

Obviously the building of a political Europe is not intended to foster any more a large internal market where corporations could take advantage of economies of scale, because the common market has been completed a long time ago, because national markets have been opened everywhere to globalization and free trade, and because the current corporate management trend favors downsizing over large scale.

Political Europe is not intended as a means for social policy either, since it remains the exclusive preserve of national authorities, and since there are apparently no economies of scale to be gained there, while a common social policy would lose much of its selectivity and capacity to target specific clienteles.

The aim could not be defense or security since the implosion of the Soviet union removed the threat of an international nuclear conflict, although nuclear terrorism cannot be dismissed so easily.

It is not (any more) to build a super-state or world power in an era of fragmentation of large states, and considering the very limited military budgets and efforts of all the continent’s states.

Why then are practically all political leaders (and business elites) tirelessly advocating further integration in defiance of the growing disinterest in Europe that voters express (the "no" of French and Irish referendums, the majority of French people who do not trust the euro according to the polls, the 59.4% of abstentions in France in the recent vote), in the absence of immediate external danger and given the constant protection of U.S. military power since 1945 while no European nation consent indeed a major defense effort?

Why this obstinate research of political scale, while all over the world large nations are fragmenting and independence is the key word? Why did European leaders chose to expand from 12 to 15 and then to 27, a move which can only increase the difficulties of common governance?

Why a political union at all when the key element of this centralization, the single currency, has an economic cost which clearly exceeds its benefits (see Martin Feldstein, "Reflections on Americans' Views of the Euro Ex Ante" *NBER Working Paper* No. 14696, January 2009)?

There are, ultimately, only two answers, which are also complementary: one which concerns the States interests, and the other concerning the big business interests, while the voters, on the contrary, express disinterest in or opposition to the venture.

For the States: the goal is of course to maximize revenues. Their agents pursue a resource maximization strategy, just like private agents in the economy. But in an era of globalization, and thus of increased mobility of men and capital resulting from trade liberalization, and the abrupt fall of transaction costs, increased tax competition undermines the states' collection of resources.

How to deal with that? An answer is to be found in a profound analysis of David Friedman: "A Theory of the Size and Shape of Nations", (*Journal of Political Economy*, February 1977). It starts from the simple fact that while the burden of a tax falls, in fine, on individuals, capitalists or wage earners (employees), it can be levied on different factors of production or on products. The comparative costs of using these different tax bases determine the specific tax structure and the "optimal tax dimension” of a nation (a “t-nation” as defined by Friedman).

A tax on trade, for example, collected by several tax authorities along a trade route, encourages each of them either to tax too much the product transported by the addition of several local taxes, if the route is unique, or to lower too much their tax rates if the trade can take other routes, for fear of diverting the trade flows away from each local jurisdiction. In both cases the chosen tax rates diverge from the “optimal” rate of a monopoly authority covering the whole trade route, optimal rate that would maximize tax revenues. Political integration then maximizes fiscal resources when the tax is levied on trade.

On the contrary there is no incentive for increasing the size of the nation in the case of a land tax.

A tax on labor is rather similar to a tax on trade to the extent that labor is mobile. A way for the tax authority to overcome this difficulty is to reduce the mobility of its workforce through the development of a national culture (e.g. a national language) that makes adaptation abroad more difficult, or through sheer regulations hindering emigration. Another approach is to broaden the territory under a same tax authority, or to organize a tax cartel of several neighboring countries in order to suppress tax competition, which obviously reduces the value of emigration to these countries, and allows an increase of the tax on labor.
The question then is: why would business people support a project that aims at raising taxes?

For corporations, the political unification presents two advantages.
The first is that taxes are levied essentially on the less mobile bases, those that cannot escape taxation. Today, capital is more mobile than labor, so that it is mainly the latter which is imposed. In the case of integration the owners of capital are thus relatively certain to be better treated than wage earners.

But secondly, and more importantly, corporations derive a direct benefit from integration. European countries emerged from World War II with basically unchanged prewar industrial structures, corporatist, cartel-ridden regimes, in which collusion was organized between big business, the governments and large, officially recognized, unions. The postwar institutional construction of the common market

started with the cartels of coal and steel, a Franco-German enterprise at first, progressively extended to other countries and other sectors.
Trade was managed as a matter of fact by intra-industry agreements that allowed large companies to fix prices in order to generate rents and limit competition (see the analysis of the initial step by Françoise Berger: “France,Germany and steel (1932-1952). From the strategynof cartels to the creation of CECA”, *Université de Paris 1*, a doctoral thesis in history, defended in 2000).

But the globalization of trade that occurred later, in the 70s and 80s, threatened this system by opening the door to a much more active competition. At the same time, the fluctuation of exchange rates that became the rule after the collapse of the Bretton Woods system in 1971, made international price agreements much more difficult to manage. The return to fixed exchange rates, which could only be secured by a single currency, is thus a way to restore a cartel management of industries across the whole continent. And here again, the larger the union, the more efficient the cartel rule.

This is why the business establishment – and especially that of the financial sector - has pushed so hard for the creation and defense of the euro, even though its political “raison d’être” is fast disappearing and its adverse economic effects are becoming more evident every day.

These two kinds of collusion, the cartel of States and the European wide cartels of corporations, define together the nature of the European centralization venture and process.

The conclusion is unavoidable: smaller size, independent States, are subject to both a more intense competition between companies for the benefit of the consumer, on the one hand, and to a weakening of their tax extraction power, on the other hand, because they are smaller and thus more open to foreign trade. And a lower tax burden, in a globalized world, mainly benefits employees because they are less mobile and therefore more taxed than capital.

The employees would thus be the first beneficiaries of the competitive independence of smaller nations, while state bureaucracies and large business firms prefer the collusion of a politically unified continent. Apparently abstention in the recent poll came mainly from the less affluent parts of the electorate.