Address given by Nigel Lawson on the Delors Report (London, 25 January 1989)

Caption: On 25 January 1989, addressing the Royal Institute for International Affairs in London, the British Chancellor of the Exchequer, Nigel Lawson, severely criticises the European Commission's proposals regarding economic and monetary union (EMU).

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What sort of European Financial Area?

I am most grateful to the Royal Institute for International Affairs for arranging this meeting. It is the lot of finance ministers that their speeches on international topics tend to be made overseas at the various international meetings which are a regular part of the calendar. So it is a particular pleasure to be giving this speech here tonight, on home territory.

My subject tonight is “What sort of European Financial Area?” — a new bit of jargon dreamt up by the European Commission in 1987 when it put forward its proposal for the complete freedom of capital movements within the Community, and which has come to encompass the financial and monetary dimension of European integration.

That is the core of what I want to discuss this evening. But it cannot be divorced from the wider issues of the Single Market and 1992.

The Single Market offers an historic opportunity for Europe and thus for Britain. It was implicit in the original Treaty of Rome that we should move towards unimpeded freedom of movement for goods, for services, for people, and for capital. But after some important early steps, primarily on the free movement of goods, progress stalled, or at best advanced only at a snail’s pace. As President Delors noted last week, it took 18 years for the Community to adopt a directive on the mutual recognition of architects’ qualifications, and 16 years for a similar one on pharmacists.

The fresh impetus given by the Single European Act, with its objective of removing all barriers by 1992, was long overdue. It was a development which Britain played a major part in creating. And it is one which has now caught the attention of business and of the public more generally, we are at long last on the march towards achieving the prime objective of the original treaty.

The Single Market is a radical step. And it is a decisive step towards a more liberal Europe, one based on freeing up markets. It is about freedom of movement for goods, for services and for capital. It is about the ending of protective barriers, whether direct or indirect. It is about exposing Europe to competition, in the belief that greater competition is the spur to greater efficiency, and the key to economic success.

As the Prime Minister put it in her Bruges speech in September:

“The aim of a Europe open to enterprise is the moving force behind the creation of the Single European Market by 1992 … It means action to free markets, to widen choice and to produce greater economic convergence through reduced government intervention.”

But there are others in Europe who have only now begun to realise — rather late in the day, after they have signed up to it — that this liberal, free-market vision of 1992 is not altogether to their taste. So they are trying to claw back lost ground, substituting a concept of 1992 based on supranational regulation, not so much one where barriers are broken down, but one where restrictions and controls are levelled up.

And there are yet others who, even if they feel obliged to accept that a liberal regime within the Community is now inescapable, are seeking to make it an exclusive club; one where members enjoy the benefits but the rest of the world is allowed across the doorstep only under strict supervision; one where the Single Market is defined not by its commitment to liberalisation, but by the barriers erected around it.

The contrast between the two rival visions of Europe has become very clear. On the one hand, an over-regulated, bureaucratic, protectionist Europe, where uniform standards are enforced by new directives and new regulations from Brussels, where outsiders are excluded, and where competition is seen as a threat,

rather than a challenge to greater efficiency, a Europe in which “regulate and protect” might be the motto. On the other hand, there is the vision of a deregulated, free-market, open Europe, one where competition is seen as the key to improved economic performance; one driven by consumer choice, by transferring sovereignty not to Brussels but to the people.

In this critical struggle over the future of Europe, there is no doubt where Britain stands.

We have consistently fought to break down barriers, to reduce protection, and to free up trade. Not just within Europe: it would be the height of folly for Europe to dismantle internal trade barriers only to erect new ones against the rest of the world. Fortress Europe would increasingly be isolated from the opportunities which the globalisation of the world economy is bringing. Just as it makes no sense for Britain to isolate herself from what is happening in Europe, so it makes no sense for Europe to seek to isolate herself from the rest of the world.

I was encouraged to read that President Delors, in his speech to the European Parliament last week, said:

“Economically speaking, it would be absurd for the largest exporter in the world to close its frontiers to foreign products … Europe would be the first victim of mounting protectionism, particularly since the Community is more dependent than its partners on international trade.”

I wholly endorse that view. But actions as well as words are needed.

Another area where the rival visions of the Community are seen is the so-called “social dimension” of 1992. Having spent getting on for ten years gradually removing the dead hand of corporatism in Britain, I have to say that we have no intention of accepting its reintroduction at the European level. The attempt to level up all sorts of so-called “worker protection” provisions is a sure way not of protecting jobs but of destroying them, as employers become burdened with unnecessary regulations and increased costs. And grandiose attempts to reduce regional disparities by ever-greater resource transfers is likely to be no more successful at the Community level than it has been within individual countries. Subsidising industries and subsidising regions destroys their will to compete, and thus their ability to compete.

Nor are we prepared to see protectionism introduced under the guise of “reciprocity”. Europe certainly needs to drive a hard bargain with the rest of the world: and it is an important objective to persuade other countries to open their markets. But, all too often, proposals for “reciprocity” go far beyond this legitimate aim, and seek either to impose constraints on bilateral trade — this is protectionism at its worst — or to make such unreasonable and doctrinaire demands for the terms of Community access to other markets that the predictable result is no access at all. Looked at from another angle, the effect of creating major obstacles to foreign firms who want to set up in the Community is all too likely to be that business is simply diverted elsewhere.

In short, the United Kingdom is committed to breaking down barriers, so that the Single Market really is a free trade area. And as the barriers come down, it is up to business and industry to meet the challenge this presents. If they are not capable of seizing the opportunities within a deregulated Europe, they will have little hope of competing successfully in world markets.

All the signs are that most of British industry is now well equipped to take on these challenges, with the record growth in profitability, productivity and investment over recent years all serving to strengthen industry’s position very considerably. Forward-looking firms are now increasingly planning their operations, and their investments. With 1992 in mind.

But there is much still to do before we complete the Single Market. Far too many barriers are still standing. The Cecchini Report found that eliminating multiple national standards was much the most significant step which was needed to secure the full benefits of the Single Market. And a glance through the 16 volumes and

nearly 6,000 pages of research material on “The Cost of Non-Europe” reveals in graphic detail how innocent-sounding national requirements for testing or certification can impose very substantial costs on a firm in one Community country seeking to export to another.

To take just one small example — and there are many others — the French regulations for wood-working machines require the testing, in France, of every variant of every type of machine a manufacturer produces, even if the machine is fully approved in another Member State. This inevitably adds greatly to the costs, and to the time required — it takes six months to a year to get approval in France compared to two to three months in other countries.

There is a vital principle here, one that lies at the heart of the Single Market, past attempts to agree common standards, common regulations, common rules for authorising businesses have almost always got bogged down in a morass of technical detail. Different countries have different approaches and do not see why they should change their ways. The breakthrough of the Single Market was the acceptance of the principle that there is no reason why these national differences cannot continue, applied to a country’s own products and businesses, provided each country accepts that firms and products approved in one country should be free to compete throughout the Community and that people should be free to purchase goods and services from anywhere within the Community.

This is a completely logical extension of consumer sovereignty, and a vital ingredient of the Single Market. It is the true market approach, exposing regulation itself to competition, with the result that, over time, countries will be obliged to concentrate on what really matters, not on preserving inefficient industries or protecting vested interests.

In so far as there are areas — and I believe there are very few — where a convincing case can be made for a common Community regulation, the important and related principle is that this must never be, as so many instinctively assume, harmonisation on the average of existing national regulations, but harmonisation on the best — which means on the minimum the situation requires. Individual countries can go further than this if they wish to, on the wholly non-discriminatory basis I have already described; but they have to accept the economic consequences.

Needless to say, in common with all other Community countries, the UK is not without its own regulations and barriers which appear to impose substantial costs, and the Government has for some time been subjecting them to scrutiny. But I think it is fair to say that, in general, the protectionist impact of technical standards is considerably more extensive in other countries than it is here.

And as well as trying to remove unnecessary barriers of our own, the United Kingdom has been in the forefront in promoting practical steps to free up trade within the Community. In the financial area, for example, it was we who took the lead in pressing for freedom of capital movements. We have long been urging the need for the liberalisation of trade in insurance, where significant progress has been made over the past year. And we have been active in negotiating for a true internal market in banking and investment services, where important draft directives are now before the Council.

The liberalisation of trade in financial services is of particular importance, not just to Britain, the home of Europe’s leading financial centre, but to Europe as a whole. For, like it or not, financial services are likely to remain for the foreseeable future one of the fastest growing industries in the world. And of all businesses, it is the most mobile. Europe cannot afford not to provide it with an environment in which it can flourish as well — if not better — than anywhere else in the world.

Public procurement, too, is another key area where opening up the market to competition within Europe can bring enormous benefits. For public purchases amount to some 15 per cent of the Community’s GDP, and the Single Market would fail if they were to be excluded from the breaking down of barriers to competition.

We also need to ensure fair competition between companies in the field of takeovers and mergers. The UK has a tradition of an open and liberal regime. But many other countries maintain barriers, usually of an

indirect or covert nature, which have the effect of preventing capital markets from operating efficiently, we must look for a level playing field. But we must equally avoid the trap, here as elsewhere, of building up new barriers under the guise of harmonisation, or of creating new centralised powers. A so-called Community "industrial policy" would be just as misconceived as past national "industrial policies" have been.

There is much hard and detailed work to be done in getting agreement on progress in these and in other crucial areas. There are few more politically difficult endeavours than the removal of discriminatory national barriers. And the temptation is always present to concentrate, not on this difficult, vital but often humdrum task, but on some headline-catching grand design instead.

Tax approximation

One proposal which has certainly grabbed the headlines has been that on indirect tax approximation — and in particular the harmonisation of VAT and excise duty rates within narrow bands. As is well known, on the basis of the current proposals, this would mean the enforced abandonment of the United Kingdom's zero rates on such items as food and children's clothing. We have already made our objections to these proposals perfectly clear. But what is equally clear from the Commission's own studies is that enforced tax approximation is in no way a necessary feature of the Single Market. The Cecchini Report itself estimates that multiple technical standards and regulations are something like seven times as costly as all border controls put together; and the UK experience is that the costs of dealing with differing indirect tax rates in turn account for only a small proportion of the total costs of border controls.

Moreover, indirect tax approximation is not an end in itself, but is seen by its proponents as an intermediate objective towards the declared goal of removing fiscal frontiers. It follows that if we can secure the final objective without going through the intermediate step of tax approximation, there is clearly little point in wasting any more time on that, not least since it is now widely recognised as being politically impossible at least so far as excise duties on alcohol and tobacco are concerned. Within the spirit of the Single Market, I have therefore put forward, on behalf of the United Kingdom, a market-based approach to dealing with fiscal frontiers. This approach does not attempt to impose harmonised tax rates, but instead allows market forces to produce the incentive for such closer convergence as is desirable.

At the same time, the UK proposals envisage an early and substantial reduction in border formalities for commercial traffic within the EC, with controls increasingly taking place inland at traders' premises as part of the normal system of VAT and excise control, rather than at the frontier. Moreover, making greater use of the domestic VAT control systems would be far simpler than the bureaucratic proposals by the Commission for a "clearing house" to account for VAT owing on goods exported from one Member State to another.

The new Commission is discussing with Member States how these issues might best be taken forward. But in the meantime the British customs and excise will in any case be taking steps later this year to speed up the processing of Community freight traffic through our ports by their new "fast lane" proposals.

For individual travellers, I proposed that we should make large and progressive increases in the "tax paid" allowances on goods brought back from other Member States, with the eventual aim of having no limit at all, except probably for alcohol and tobacco.

The present limit is some 250 pounds sterling. I believe that a realistic first step — which should be taken as soon as possible — would be to quadruple that limit, so that 1000 pounds sterling of tax paid goods could be imported from another Community country without any need to make a customs declaration at all. That would be a major step towards reducing customs formalities for individuals, thus breaking down fiscal frontiers and enlarging individual freedom.

But it is not only in the field of indirect taxes where there is pressure for harmful and unnecessary harmonisation. Next month, the Commission is due to bring forward proposals aimed at reducing tax avoidance following the abolition of exchange controls, and these seem likely to include some form of

enforced withholding tax on the income from savings.

The harmonisation of taxes on savings is clearly not a requirement of the Single Market — indeed not even its most ardent proponents pretend that it is. Instead, it is advocated by those who argue that the abolition of exchange controls could increase the scope for tax avoidance and even evasion, as savings are transferred from one Community country to another. In other words, having accepted the principle of freedom of capital movements, they are seeking to escape from its consequences.

In fact, fears about tax avoidance are greatly exaggerated. There was similar concern expressed about the risks in the UK when we abolished exchange controls in 1979. But our experience since then gives absolutely no reason to suppose that those concerns had any foundation. And only this month socialist Sweden committed itself to ending exchange controls, without seeing any need to try to negotiate special new arrangements with other countries to counter avoidance.

Freedom of capital movements was something which the UK had taken the lead in urging. It was finally achieved in June last year. It was a remarkable and historic step. All European Community Member States are now committed to the complete elimination of exchange controls, most of them by the middle of next year. This is something which would have been unthinkable ten years ago. It has, quite rightly, been recognised that freedom of capital movements is an essential element of the Single Market, and that, in any case, exchange controls were becoming increasingly irrelevant, if not counterproductive, in today’s global markets.

Nor can I accept the case for the enforced harmonisation of business taxes. Here again, market forces can be allowed to do the job. The House of Lords Select Committee put the point well in its report a couple of months ago:

“There seems little need for the Community to force the harmonisation of company taxation. … provided tax rates remain broadly in line, (we) do not believe that there will be significant misallocation of resources within the Community.”

Moreover, both in the taxation of savings and in company taxation, we must be aware of the wider world context. There is no gain at all to the Community if the effect of introducing harmonised restrictions within the Community is simply to divert business or savings outside the Community altogether. And in today’s global markets that is all too likely to be the result.

Where enforced harmonisation is absolutely necessary, the objective must, to repeat, be to harmonise on the best, which invariably means the minimum. Where it is not necessary, which is normally the case, the answer must be to leave it to market forces to produce a distribution of business and of tax rates that satisfies the different objectives of different countries, who will inevitably have different priorities, not least as to the level of public expenditure — which at the end of the day must match the level of taxation. Harmonising on the mean — let alone harmonising on the most restrictive — will satisfy no-one except the bureaucrats and will serve only to turn Europe into a financial backwater, at great cost to its people.

EMU

A potentially much more significant diversion from the important but difficult work still needed if we are to complete the Single Market by 1992, is the pressure from some quarters for a dramatic leap forward beyond the Single Market towards so-called Economic and Monetary Union or EMU.

After the turmoils of the early and mid-1970s, the Community made an important step towards greater monetary cooperation with the setting up of the European Monetary System in 1979. Since then, the UK has consistently promoted practical steps to increase monetary co-operation further — both within the Community and more widely in the G7.

We have, for example, been a strong advocate of greater use of the ecu. Our issue of ecu treasury bills, begun last autumn, has provided the short-term, high quality instrument which the market needed to underpin its liquidity. And we have been urging others to join us in making greater use of the ecu in foreign exchange reserves, and in intervention.

We also see a wider role for cross-holdings of individual Community currencies. A diversification of reserve holdings provides greater flexibility than holding only dollars.

And, most important of all for developing greater monetary co-operation and paving the way for the Single Market, the UK took the lead, as I have said, in pressing for the adoption of the Directive on the Freedom of Capital Movements.

The UK has not yet, of course, joined the Exchange Rate Mechanism of the EMS. As the Prime Minister has pointed out on a number of occasions we will join the Exchange Rate Mechanism when we believe that the time is appropriate. Subject to the overriding need to bear down on inflation, we fully accept the advantages of reducing currency fluctuations, though sterling's status as an internationally held currency inevitably makes that more difficult than is the case with the other currencies that are linked to the Deutschmark in the EMS.

Clearly, some of the problems over sterling's joining the ERM have diminished over time: for example, it is no longer seen as a so-called petro-currency. And, as 1992 approaches and the proportion of our trade with other EC countries continues its long-term increase, it is clear that exchange rates against other European countries will become increasingly important.

But the difference between full membership of the EMS and Economic and Monetary Union could not be more fundamental.

The EMS is an agreement between independent sovereign states whose economic policies remain distinct and different. By close co-operation, they can achieve greater stability of exchange rates, and — as we have seen — reinforce their efforts to bring down inflation.

Economic and Monetary Union, by contrast, is incompatible with independent sovereign states with control over their own fiscal and monetary policies.

It would be impossible, for example, to have irrevocably fixed exchange rates while individual countries retained independent monetary policies. Quite apart from the theoretical problems, it is clear that such a system could never have the credibility necessary to persuade the market that there was no risk of realignment. Thus EMU inevitably implies a single European currency, with monetary decisions — the setting of monetary targets and of short-term interest rates — taken not by national governments and/or central banks, but by a European Central Bank.

Nor would individual countries be able to retain responsibility for fiscal policy. With a single European monetary policy there would need to be central control over the size of budget deficits and, particularly, over their financing. New European institutions would be required, to determine overall Community fiscal policy and agree the distribution of deficits between individual Member States.

These are not technical issues. The setting up of a European Central Bank or a new European institution to determine Community fiscal policies go to the very heart of nationhood. What organisation would really be the government? It is clear that Economic and Monetary Union implies nothing less than European government — albeit a federal one — and political union: the United States of Europe. That is simply not on the agenda now, nor will it be for the foreseeable future.

Although some have argued that the gold standard provides an example of monetary union operated by independent states, it was in fact very far from monetary union. Under the gold standard, the co-operation

was informal and not institutionalised; and although countries could see advantages to them in maintaining their parity against gold, they were free to change if it seemed in their national interest to do so. The gold standard acted as an important and beneficial discipline, but allowed countries to pursue separate and independent economic policies within that framework.

It is also instructive to consider the evolution of Germany in the 19th century. The Customs Union or Zollverein which was formed in 1834 neither required, nor in itself led to, monetary union. It was only 40 years later, after Bismarck had imposed political union under Prussian hegemony, that monetary union and a common currency followed.

As the Prime Minister said in Bruges:

"My first guiding principle is this: active co-operation between independent sovereign states is the best way to build a successful European Community. To try to suppress nationhood and concentrate power at the centre of a European conglomerate would be highly damaging and would jeopardise the objectives we seek to achieve."

This is by no means a narrow view held only by the British Government. Within the UK, for example, the House of Lords Select Committee said:

"The Committee do not believe it is helpful to say that monetary union will or will not come by a certain date. Whether or not the individual political leaders of Europe consider a common currency and a European Central Bank to be one of the Community's ultimate goals, they are not ready to take such a step at this time. If political rhetoric focuses on distant objectives and emotive ideology, needless divisions tend to arise."

Again, from a different perspective, the recent annual report of the German Council of Experts on Overall Economic Development — the so-called "Five Wise Men" — conceded the essential point:

"Hasty institutional agreements on monetary union would greatly damage the process of unification by creating the illusion that the absence of the wish for political unification can be overcome by fast progress on monetary policy. Inevitable disappointments would ensue, causing delay if not regression in the integration process: only the knowledge that monetary union is not possible without political union can prevent such a development."

There are some who might argue that the goal of monetary union is of such importance that we should impose whatever political union is necessary to achieve it. This is not only unacceptable to the British people: it is wholly counter to the realities of national identity. You have only to look at the current problems of the Soviet Union to see a reminder of how strong these forces are.

The European Council, in Hanover last year, nonetheless decided to set up a committee to examine possible steps towards Economic and Monetary Union. The committee is chaired by Jacques Delors, and made up largely of central bank governors, in a personal capacity. It is due to complete its work in time for the Council of Finance Ministers — Ecofin — to consider the results before the next European Council in Madrid in June.

M. Delors referred to the work of this group in his statement to the European Parliament last week. He said

that Economic and Monetary Union could be achieved only by a further institutional change, to set up a European central banking system and a framework for enhancing the consistency and effectiveness of national economic policies. The European Council would be presented with a plan for the establishment of Economic and Monetary Union, and progress towards that

"would be considerably facilitated by an appropriate institutional framework. If this is the case, it will be necessary, as in 1985, to open the way for another inter-governmental conference to prepare institutional provisions designed, like those of the Single Act, to amend the Treaty of Rome".

As an expression of personal opinion, fair enough. But any attempt to persuade the nations of the European Community to accept this as a prescription would be deeply divisive and damaging. Certainly, neither the British Government nor the British Parliament is prepared to accept the further treaty amendment which the President of the Commission evidently envisages.

Indeed, the overwhelming question one is left with is this: how can it be, little more than three years after the treaty amendment achieved by the Single European Act, with so much still to do to achieve the goal of the Single Market by 1992, how can it be that this great boulder should so carelessly be thrown into the pool?

Even if complete Economic and Monetary Union were desirable, would it not be more rational to say: let us devote all our energies and resources to the completion of the Single Market, if humanly possible by 1992, and only then, after it has been in place for a sufficient time to demonstrate the benefits it confers, let us consider whether we wish to take the steps necessary to proceed towards EMU.

But that is not what is happening.

It is difficult to escape the conclusion that this divisive and intensely difficult new issue has been propelled into the forefront of European debate at this time either out of culpable carelessness, or as a smokescreen to obscure a lack of sufficient progress towards the Single Market — or, worse, as a means of running away from taking the practical but difficult steps the Single Market requires, running away from the challenge of freedom.

For it is an observable fact that those nations that are most vocal about their support for EMU now, tend to be those that are most assiduous in preserving barriers to free trade within the Community.

The experience of the United Kingdom in the '80s has demonstrated decisively that it is supply side reforms that are the key to better economic performance. But reforming the supply side is often neither easy nor very newsworthy, and there are always those who seek short cuts and instant answers. This Government has succeeded to the extent that it has because it has consistently ignored those calls, and been prepared to submit every aspect of the British economy to rigorous and radical scrutiny to see whether the rules and restrictions built up over generations still serve any useful purpose or, as is so often the case, merely stifle enterprise.

The same lessons apply to the European Community too. The Single Market is a great prize, and one whose significance is being increasingly recognised right around the world. But to cross the final hurdles to 1992 still requires a great deal of hard, detailed work, to hack away at the remaining barriers and clear the ground for wider competition, more efficient industry and greater consumer choice. And uncomfortable vested interests in each and every Member State will be challenged and disturbed.

It is inevitable that there are those who tire quickly of this, and flutter towards the flame of Economic and Monetary Union, or other great ideas. And others who have never much liked hacking away at regulations and bureaucracy anyway, and are only too keen to escape into dreams of EMU instead.

We must have none of that. We must set our sights clearly on the important and practical steps that are

needed to implement the Single Market by 1992. In that context, EMU is essentially a damaging diversion. We must recognise it as such, and press ahead resolutely with removing barriers to the free movement of people, goods, services and capital — the true goal of the Single Market — for the benefit of the peoples of a freer Europe.

From time to time we hear talk of the dangers of euro-sclerosis. It reminds one of the British disease. Of course the Europe of 1989 is in much better shape than the Britain of 1979. But the sense of falling behind, the dangers of taking an "easy" interventionist, protectionist, state-subsidy route out of the problems posed by heightened international competition, are not so very different. And many of the cures we took in Britain ten years ago are relevant to the Europe of today. Governments must try to do less. By deregulating and allowing markets to work, Europe can compete successfully in the 21st century. And the lessons of a decade ago are equally relevant: individuals and businesses, not bureaucrats, create jobs and prosperity.

Thus it is that the Single Market offers an historic opportunity. But if Europe takes the other road, of red tape, bureaucracy, supranational intervention and protectionism, euro-sclerosis would be more than mere talk; it would be a reality. And the dream of 1992 would have become a nightmare. We must not allow that to happen.