FINANCIAL TIMES – 5 APRILE 2009

How to save the market economy in Europe

di Mario Monti

If the world economy is in crisis, the market economy is even more in crisis. It is seen as unfair, having generated unacceptable inequalities; and inefficient, having attracted massive resources into financial activities whose contribution to the economy is questioned. Yet the world needs an integrated market economy, a necessary, though not sufficient, condition for growth and welfare.

The Group of 20 countries has focused on recovery plans and financial regulation. But this is only a first step towards restoring the credibility of the market economy and taming economic nationalism, the seed of disintegration.

The key test for market economies, perhaps even for democracies, will be whether they master the growing in-equalities, including within countries, caused by ungoverned globalisation and aggravated by the crisis. This requires two developments: getting the best out of competing economic models; and firming up market integration by moderating tax competition. While the former has started, the latter is not even on the agenda.

The crisis is leading countries embracing the Anglo-Saxon model, such as the US, the UK and Ireland, to reconsider some of its features. Perhaps they relied too much on market mechanisms and too little on regulation; overextended their financial industry while neglecting manufacturing; and did not care enough about inequalities and welfare systems.

They now look with greater respect, as does China, at countries in Europe, such as Germany and France, that have long followed social market economy models. The Anglo-Saxons should not feel embarrassed by their partial conversion. Nor should the social market countries be too emboldened by this vindication. After all, during the previous decade, they had to move in the Anglo-Saxon direction, introducing economic reforms to gain competitiveness. They should continue to do so.

This convergence on the middle in domestic models gives the international community an unexpected political opportunity. Although it seems to have escaped the attention of policymakers, this opportunity would allow the European Union and the G20 to meet the increasing social challenges while safeguarding integration.

In the EU, each group of countries has a major concern. The Anglo-Saxons and new member states are rightly angry with the social market countries – France in particular but also Germany and others – because they are increasingly intolerant of existing rules of the single market (including competition and state aid rules), let alone of further developing it.

The social market countries complain, also rightly, that the long-standing opposition by the Anglo-Saxon countries and new member states to any form of tax co-ordination makes it hard for them to meet social objectives through their budgets. Tax receipts, curtailed by tax competition, often do not allow the funding of social programmes. In addition, mobile tax bases – capital, corporations, skilled professionals – tend to move to countries with favourable tax regimes, thus driving a race to the bottom as regards tax rates. Labour, being less mobile, carries an increasing burden.

To avoid frustration in both groups of countries, resulting in resentment against “Europe” generally and the single market specifically, the EU should grab this chance for a compromise. The Commission should first confront the Council, the European parliament and public opinion with a realistic – that is, rather worrying – assessment of the outlook for European integration as economic nationalism gains ground. It should then propose a strategic pact, comprising two elements.

The first would be a renewed, binding commitment to the single market, including strengthened enforcement mechanisms and initiatives, with deadlines, to implement the single market in areas where it is still lacking.

The second would be limited measures of tax co-ordination, aiming not at full tax harmonisation (neither feasible nor necessary) but at enabling member states to retain tax sovereignty by acting together on parts of it. If they prefer to defend individually the principle of tax sovereignty, they will see the continuing de facto evaporation of their nominal sovereignty through unrestrained tax competition.

The Anglo-Saxons and new member states would make an opening on tax co-ordination (which they may need anyhow, as they intend to care more about welfare) but also secure the future of the single market. The social market countries would feel the heat of an effective single market, but would gain more margins to pursue social objectives without having to tear apart the market’s rules. Both groups would come closer to the Nordic countries, which combine the market and social dimensions more effectively. Last, but not least, the pact would give new vigour to the faltering European project.

The EU should promote work on tax co-ordination also within the G8 and the G20. A crackdown on a few tax havens, just decided by the G20, is important. But it only addresses tax evasion, not legal tax avoidance, which goes on massively as most states engage in unlimited tax competition with each other. Governed, market-based globalisation cannot be achieved if the tax sovereignty of governments is more and more eroded by the market. To achieve their social objectives, governments must be able to use their budgets effectively or they will abuse the market.

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