

Cato's Letter

*A Quarterly
Message
on Liberty*

*Spring 2013
Volume 11
Number 2*

The Illusions of European Integration

VÁCLAV KLAUS

Today is a special moment for me. In March, my second term as president of the Czech Republic expired, and it is with a high degree of probability that this will mark the end of my more than 23-year-long career in politics—a career lasting without interruption from the fall of communism following the Velvet Revolution until this spring.

I was extremely honored to be invited to become a distinguished senior fellow at the Cato Institute and am eager to fulfill this role. I greatly appreciate the role Cato has played over the decades in defending liberty, free markets, and limited government. Today is just the beginning of my new life here with you.

I was asked to say a few words about Europe—which has always been one of my favorite topics—and I'd like to begin by putting the Continent's problems into a broader perspective.



Václav Klaus is a distinguished senior fellow at the Cato Institute. From 2003 until March 2013, Klaus was the president of the Czech Republic. He is the author, most recently, of Europe: The Shattering of Illusions.

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My new book, which the British publisher decided to call *Europe: The Shattering of Illusions*, reflects my frustration with the developments in Europe. That title, by the way, was not exactly my idea. I never had any illusions about European integration, so for me it was never necessary to shatter them.

Nevertheless, the book goes on to explore the current institutional arrangements in Europe—which developed over time from the Second World War to the outbreak of the Eurozone debt crisis—as well as the costly reactions to those developments. In short, the excessive optimism surrounding the economic

(EU), and a *nonmember* of the Eurozone. A country cannot be a member of Europe, and it is important to emphasize that fact. Almost 85 percent of Czech exports go to Europe—a region experiencing both protracted economic stagnation and an acute sovereign debt crisis. Even with a freely floating currency, the Czech Republic cannot disconnect itself from the economic trends in the rest of the Continent.

My country is a textbook example of a small, open economy. But to grow, the Czech Republic needs a strong relationship with trading partners that are economically healthy.

This is, regretfully, not the case at the moment. In March, the Czech Statistical Office announced that the country's gross domestic product contracted 0.2 percent. All of the available evidence suggests that the economic future will not be easy for those of us living in Europe with our families, children, and grandchildren. We cannot escape the fate of the Continent as a whole. We therefore have a genuine interest, and not simply an academic one, in the future of Europe.

The present economic situation is not accidental. It is a consequence of at least two things. On the one hand, it is due to the gradually impaired, yet deliberately chosen, economic and social system throughout Europe. On the other hand, it's a

“The excessive optimism surrounding the economic benefits of Europe’s integration is, and has always been, naive. The consequences of denationalization and centralization are undemocratic.”

benefits of territorial integration is, and has always been, naive. The consequences of denationalization and centralization are, in a word, undemocratic.

It is important to note that the Czech Republic is a *part* of Europe, a *member* of the European Union

consequence of the increasingly centralized and bureaucratically intrusive institutional arrangements within the EU. They both form a fundamental obstacle to any further positive development, an obstacle which cannot be removed by marginal corrections to short-term economic policies. The problems are much deeper.

It is more than evident that an overregulated economy in Europe is additionally constrained by a heavy load of social and environmental requirements, which operate within a paternalistic welfare-state atmosphere. This burden is too heavy, and the incentives for productive work are too weak, to achieve growth. If Europe wants to jump-start its economic development, it has to undertake a fundamental transformation, a systemic change. This is something we in central and Eastern Europe had to do 20 years ago.

The second part of the problem is the European integration model. The excessive and unnatural unification, standardization, and harmonization of the European continent based on the concept of “an ever-closer Union” is truly an obstacle to any positive development.

The moment when the marginal costs of the European integration project started to visibly exceed the benefits came as a result of the attempt to monetarily unify the entire continent. This failure was expected—inevitable, in fact—and its consequences were well understood by

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many of us in advance. This path was entirely predictable for the economically weaker countries in Europe as well, which had repeatedly undergone unpleasant, yet unavoidable, adjustments through devaluations of their currencies in the past.

All economists who deserve the title were aware of the fact that Greece was doomed to failure, having been imprisoned in the system I’ve just described. History gives us many similar examples.

The benefits promised as a result of accepting a common currency never arrived. The presumed increase in international trade and financial transactions was relatively small and was more than offset by the costs of this arrangement.

In good economic weather, even the nonoptimal currency areas can function, as all kinds of fixed exchange rate regimes did for some time. But when bad weather comes, including the financial crisis at the end of the last decade, all of the inconsistencies, weaknesses, inefficiencies, discrepancies, imbalances, and disequilibria become evident and the

monetary union ceases to properly function. This shouldn't be a surprise. In the past, all fixed exchange rate regimes, including the Bretton Woods system, required exchange rate realignments sooner or later—an insight found in every elementary economic textbook.

The expectations—or perhaps delusions—that a very heterogeneous European economy could be homogenized through monetary unification were quickly proven wrong. Since the introduction of the euro, the European economies have diverged rather than converged. The elimination of one of the most important economic variables

—the exchange rate—from the existing economic system led to a certain blindness among politicians, economists, and bankers.

Some may remember that 20 years ago, the dissolution of another monetary, political, and fiscal union known as Czechoslovakia took place. I was in charge of organizing that split. In fact, February marked the 20th anniversary of the Czech Republic's monetary disintegration with Slovakia, and our experience is quite clear.

The former Czechoslovak federation was together for 70 years but had to accept that the nominal integration was not sufficient for the

elimination of economic differences between the two countries. There were, of course, other reasons for the split, but the economic ones were chief among them.

Let's not be misled, however. When discussing the current problems playing out in Europe, it is

wrong to concentrate on the achievements or failures of individual countries. Greece did not bring about the current European problem. To the contrary, Greece is the victim of the Eurozone system of one currency. They made just one tragic error by entering the Eurozone. Everything else amounted to the country's usual behavior, which none of us



has a right to criticize.

Greece's degree of economic efficiency or inefficiency, as well as its propensity to live with a sovereign debt, should have been well known to anyone. I believe that letting Greece leave the Eurozone would be the beginning of a long journey of this country to a healthy economic future. But I have no ambitions to change Greece. I want to change the institutional arrangements of the EU. The Greeks hopefully understand at this point that one size does not fit all. I only wish that the leading politicians in the EU would grasp the same insight.

I don't see it, however. Their way

of thinking is based on a certain type of reasoning, as if economic laws do not exist and politics can therefore dictate economics. People like myself were raised in an era when this mode of thinking was dominant in the communist countries of central and Eastern Europe. Some of us dared to express our disagreement with it at the time. We were considered enemies then, and we are considered enemies now.

Europe is ripe for a fundamental decision: Should we continue believing in the dogma that politics can dictate economics and defend the current institutional arrangements at any cost? Or should we finally accept that we must return to economic rationality?

The answer given by the overwhelming majority of European politicians until now has been to continue down the current path. It is our task to tell them that the consequences of such a conclusion will be higher, and will produce higher costs for all of us. Eventually, these costs will become unbearable. I am convinced that we should turn around.

What we need in Europe are not more frequent summits in Brussels, but a fundamental transformation of our thinking and our behavior. Europe has to undertake a systemic change—a paradigm shift—and this requires the results of a genuine political process, not the approval of a sophisticated document prepared

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behind closed doors. The solution must arise as an outcome of political debates within individual EU member countries. It must be generated by the people, by the demos of these countries.

It is fashionable in both the United States and Europe now to speak about a crisis. But a crisis entails, in the economist Joseph Schumpeter's definition, a process of “creative destruction.” Following a crisis, not everything can be saved and maintained. Something must be left behind in the process, especially the wrong ideas. At this moment, we should make a point of discarding utopian dreams, of rejecting irrational economic activities, of denying their promotion by European governments. Part of this implies that even some states must be left to fall.

The opponents of this position keep saying that such a solution would be costly. I see it differently. To me, prolonging the current course is more costly. The costs the Europeans are afraid of are already here. They should be called sunk costs. ■



Cato Scholar Profile: ALEX NOWRASTEH

ALEX NOWRASTEH is the immigration policy analyst at the Cato Institute's Center for Global Liberty and Prosperity. Previously he was the immigration policy analyst at the Competitive Enterprise Institute. His work has appeared in the *Wall Street Journal*, *Boston Globe*, *Journal of Economic Behavior and Organization*, and elsewhere. He has appeared on *Fox News*, as well as numerous television and radio stations across the country. He received his BA in economics from George Mason University and MSc in economic history from the London School of Economics.

What impact has immigration had on the U.S. economy over these last few decades?

Immigration's impact on the U.S. economy has been extremely positive and—at worst—lowered the wages of adult American workers without a high school degree by about 4.7 percent since 1990. For those with a high school degree—about 90 percent of the population—immigration has actually made them more productive, increasing their wages.

Immigrants are more likely to be higher skilled or lower skilled than most Americans. Labor-market heterogeneity means Americans and immigrants are more likely to be complements in the labor market rather than substitutes or competitors.

On the supply side, immigrants increase production and are more likely to start firms than Americans, while on the demand side, they consume the goods and services produced by Americans. Supply, demand, and productivity gains from immigration vastly outweigh the economic costs to lower-skilled Americans.

What are the key components of an effective guest worker visa program?

A guest worker visa program must be large and cheap enough to channel the vast majority of would-be unauthorized immigrant workers into the legal market. Furthermore, the program must be dynamic and allow the widest possible variety of businesses from all sectors of the economy to hire guest workers in the numbers they deem fit.

To prevent the possibility of employer abuse of guest workers, guest workers must

be mobile. They should be able to legally quit and change jobs with a minimum of government oversight without relying on prior permission or the threat of deportation if they are temporarily unemployed. This can be accomplished by registering guest workers and employers, and allowing both parties to seek each other out without government matching workers to businesses.

Unlimited renewals of visas, if the migrant is law-abiding, will encourage good behavior and disincentivize absconding into the black market.

You recently wrote that “poor immigrants are a welfare bargain compared to poor natives.” How so?

Poor immigrants are in means-tested welfare programs at a lower rate than poor natives and the average dollar value of their benefits is also less. Using Medicaid as an example, noncitizens are 25 percent less likely to sign up for it than their poor native-born equivalents. When they do sign up, poor immigrant adults consumed \$941 less on average than poor native adults in 2010. Poor immigrant children consume \$565 fewer dollars of children's Medicaid than poor native-born American children do. Lower use rates and benefit levels mean that poor adult immigrants per capita cost Medicaid 42 percent less than a similar group of natives. For children, poor immigrants cost 66 percent less on average than poor native-born American children.

More should be done to limit immigrant access to welfare, but welfare is largely a home-grown problem and not an imported one. ■

A PROFILE IN GIVING: Richard Aster



Richard Aster was a loyal and long-term supporter of Cato during his life. In fact, he was more than a supporter—he became part of the fabric of Cato. Over the years, Rick kept pace with the work of Cato’s scholars and became a personal friend to many at Cato. As someone who fervently believed in individual liberty, free markets, and the rule of law, Rick did not want his ability to fund Cato’s mission to end at his death. Therefore he left a significant bequest to Cato, one that will help Cato for years to come.

Rick Aster was a pretty amazing man, really a Renaissance man. His vocation, his career, was that of a successful money manager, so successful that he was named the Morningstar runner-up manager of the year in 2010. His avocations were many. A natural athlete who played golf, tennis, and basketball, Rick coached Catholic Youth Organization basketball for many years, often bringing his team to the championship level. A world traveler, Rick dug deep into the history and economics of each country he visited. Not surprisingly this world traveler was a voracious reader of history and biography.

Fit, well traveled, and well read, Rick was passionate when it came to politics and economics. His experience taught him the positive power of free markets and individual liberty. And in the Cato Institute he found a powerful and effective advocate for the

ideas that he believed must necessarily form the basis of a free and prosperous society.

If you are inclined to follow Rick Aster’s example of leaving a bequest to Cato, you’ll find that it’s a pretty straightforward thing to do. Just have your lawyer insert into your will (or will substitute) language to the effect of, “I leave the sum of \$xxx to the Cato Institute.” Rather than a specific sum of

money, you might decide to leave a percentage of your assets or, alternatively, all assets after the payment of expenses and specific gifts. This latter option is called a residuary bequest.

Of course, you may be one of those people whose assets are weighted toward retirement accounts such as rollover IRAs. These assets do not pass under your will but rather by a “beneficiary designation form” dedicated to that account. Still, it’s simple enough to name Cato as a beneficiary of one or more retirement accounts by simply filling out the form for that account. You should also bear in mind that, since retirement accounts are subject to a heavy combination of income, estate, and generation-skipping taxes, using such assets to fund a charitable gift can be practical and tax effective.

Rick Aster left a wonderful living legacy. We thank him for that. And, if you too might be interested in leaving a legacy for Cato, please contact **Gayllis Ward**, Cato’s director of planned giving, at gward@cato.org or at (202) 218-4631. ■



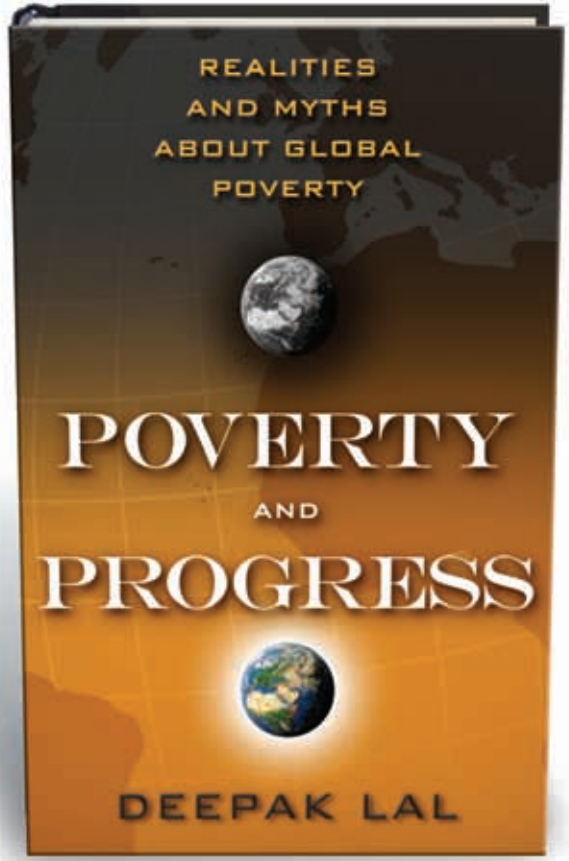
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