

The Future of the European Union

Interview with Laurent Fabius

Throughout most of 2000, the European Union's new currency, the euro, fell in value against the dollar. To many people, this decline suggested a basic weakness in Europe's ambitious new plans to adopt a single currency and to unify politically. The meeting of the EU's leaders in Nice last December was also seen as unsuccessful.

Yet, despite skepticism, the value of the euro began to rise. In fact, the forces holding Europe together are stronger than Americans generally realize, and the euro itself is widely regarded on the Continent as a significant success. Challenge's editor spoke to one of Europe's leading figures—Laurent Fabius, former prime minister of France and now its finance minister—about the future of this bold political experiment.

Q There was a widespread belief that the Nice conference of the European Union leaders in December was not as successful as had been hoped. Compromise is getting harder

to reach. I assume you believe that over time the European nations can overcome many of their differences. What will the future European Union look like?

A. We have two or three theoretical possibilities. The EU might be enlarged to twenty-seven or thirty countries, but with rather weak institutions. This route might result in a loosening of the links between us, and, at the end of it all, we shall have a sort of free-trade zone. Clearly, this is not a good scheme. A second possibility is that we will eventually agree on many matters and have a large entity with strong institutions. Perhaps, we will arrive at a third possibility, in which we will have a large entity to which some rules apply, but have a smaller group of countries, probably countries that today have already chosen the euro [twelve countries now have adopted the euro], and these countries will move ahead faster toward stronger institutional agreements. I do not know yet the legal aspect of it, or what the framework will be, but I can see the possibility of a system in which most nations abide by some looser arrangement, but a core of nations will become more closely knit in terms of economic and social policies.

Q Let me step back and ask a broader philosophical question. When I look at the history of the Common Market, it started as a political union. The principal goal in the 1950s was to sustain peace and even to have an army. But this aim turned out to be too lofty and impossible to achieve. The leaders turned to economic union as a fallback. It was almost an afterthought: We cannot unify politically, so let us form an economic union. That, at least, is a first step, although it inevitably brought the nations closer together politically. Do you think of the EU as both a political union and an economic union? Which comes first?

A. My understanding of the history of recent Europe is both economic and political. The original idea, as you say, was how to avoid war, which is why the alliance of Germany and France was so decisive. The founding fathers had decided to build unity on steel and coal. They were thinking that if Germany and France were brought together over their common interests in steel and coal, they would not have to go to war.

Q. The reason I ask is that economic union seemed to pave the way for political union and may continue to do so.

A. Yes. The fact that we already have a unique currency will be much more decisive and influential in the future. When people have the same currency in their pocket in 2002, they will somehow think and act differently. And the twelve countries that have adopted the euro are in fact the more pro-European Union countries. We shall probably build something that will be more ambitious than what we have today—at least those twelve nations and maybe a few more.

Q What might be an example of that? I hear you saying that a single currency, once it is in everyone's pocket in 2002, might help overcome some of the political friction over time.

A. Yes. Take one example. The finance ministers have a meeting every month called the Euro Group. There are only twelve of us, not an assembly of a hundred. At the beginning it was a bit theoretical, but now every month we discuss substantive issues concerning fiscal and social policies. We talk about retirement schemes and redundancy, for example. But what is important is that, step by step, we are building a common culture. At the beginning it is economic, but then it becomes social. And because of the importance of economy in our societies, it leads to the discussion of other problems—political problems, cultural problems. Apart from that, we also become friends. For me, this is exciting.

Q What are the advantages of an economically unified Europe?

A. There are many driving advantages. First is the question of size. If you take one nation of 30 million people, or 60 million people, as in the case of France, you can build an economy that reaches only niche markets. But if you have thirty small nations, each reaching the same niches, that is not a strategy for success. The size of the market is very important. We are coming to an era that will be dominated by continents: the United States of America, Mexico, Canada; then Japan and Asia; and then Europe. Therefore, size will be an advantage. I do not know if big is beautiful, but it is useful. We have to build what we call European champions. We have a champion in the aircraft industry; we have a champion in pharmaceutical products. We need more of them, and you can only do this with a large market.

Second is that before we had the euro, we had problems with our currencies every two years—problems between the values of the French franc and German mark, Italian lira, and the Spanish peseta. Now, with the euro, we do not have these problems. The euro enables us to have currency stability. One nation is not raising interest rates to maintain the value of its currency against that of another nation. Therefore, we have low interest rates, which is decisive for our rate of unemployment. The fact that now we are thinking in terms not only of Europe but also of the euro itself is very positive for our economic health.

Third, my understanding of the twenty-first century is that the decisive factors will be innovation, creation, knowledge, and research. We have excellent computer experts and researchers, as you know, but many of them go to the United States, and do not return. We can build something, a very strong country, if we offer opportunity to researchers, to innovators, to the brightest people, that a market of 300 million people can provide.

Q. Is this kind of vision widely felt among your colleagues in different countries?

A. It is probably shared to some extent by my German colleague. But a part of it is shared and a part of it is different because we each have our own history. I was speaking to my Spanish colleague. He, for example, has a strong interest in Latin America. The smaller countries are strong believers in a united Europe partly because it allows them to be much larger than they are. It is true for us in France, too, but to a different extent.

Q Let me continue with a question about the euro. Why, in your view, did the euro fall well below parity with the dollar in 2000?

A. Parity with the dollar is an important element, but it is only one aspect of the euro. The euro has been very positive for all of our countries for several reasons. First, it has enabled us to avoid financial crises. There were financial crises in Asia, in Russia, and in South American countries, and our economy remained stable. The euro has been very positive in terms of our inflation and interest rates. During the three years we have had the euro, inflation has been low, and interest rates have been lower than in the United States. The result is that Europe is growing steadily.

As for parity with the dollar, when we decided to adopt the euro, the main criticism within Europe was coming from politicians who thought the euro would be too strong. What has taken place as I see it, is not a weakness of the euro but a strengthening of the dollar and of the American economy. This makes sense. If you compare different currencies, you try to compare economic fundamentals, and during the last few years the American economy has been strong. This has an influence on the markets. But it is changing. The euro has begun to increase in value. It is

now very likely that our general growth will be a bit higher than the American one.

There is also another point to bear in mind. We Europeans shall have the euro bills and coins in our pockets as of January 1, 2002. So I could put it the other way around. It is very impressive that, despite the newness of the euro, it has held up so well. Also, it held up even though we had many acquisitions of American firms by European firms. These outcomes are, in the long term, very positive for the economy. But from a purely technical point of view, what does it mean? It means that European firms that want to acquire American firms have to buy dollars and sell euros, which obviously has an effect on the falling euro.

All that having been said, my own guess is that the euro will appreciate in value. It is already taking place. I can see a situation not too far in the future in which the problem will be the opposite of what it was some months ago.

Q. Which is to say that the dollar will be low and the euro will be high?

A. We have known the dollar to be worth four francs in the past. Now it is worth about seven. One other important factor is the way your stock market goes. If it falls, investors could sell the dollar.

Q. Do you think the EU rules limiting the size of a budget deficit as a percentage of gross domestic product are too restrictive and therefore restrain economic growth? Will they be widened at some point?

A. No, they are wide enough. It is fair. Obviously, you can always discuss it, but I think it is fair. What does it mean, really? It means that in an international, open economy, when the economy is strong, you have a solid budgetary situation. If the economy is weak, you can use, reasonably, the fiscal weapon.

Q. However, if you have a recession in Europe, will the percentage restriction be widened?

A. We can use our budgetary means when necessary. But because we are closer to each other, we have to consult.

Q Have you been concerned that the monetary policy of the European Central Bank has been too restrictive, too tight? That interest rates have been too high? Real interest rates are quite high.

A. Not ours. No, they have been reasonable. The proper policy mix is to have judicious budgetary policy and, at the same time, a serious but accommodating monetary policy.

Q. To what do you attribute France's recent growth? The economy is doing quite well now.

A. There are two or three main points. The international environment is positive. National decisions have been accurate, reinforcing both demand and supply, reducing budget deficits and taxes modernizing our economy—the infusion of new technologies—has come more quickly and has been much larger than we had imagined. We also have had a mix of strong champions and dynamic small firms, which is rather impressive. I should add another point. You know, probably 90 percent of economics is psychological. The French are now more optimistic. Five years ago, in my constituency, people believed it would be more difficult for their children than for them. Now, in just five years, that outlook has changed completely.

Q. So you think the new optimism breeds a kind of energy?

A. It is decisive. But obviously it has something to do with the economic elements, the drop in unemployment, the way of solving social problems.

Q Many people in America, as you know, attributed the slow growth of Europe to rigid employment policies. Do you

think that was overstated? Have employment policies become less rigid? Is that a contribution?

A. There have been changes, some tax changes. But, in fact, many factors contributed to growth. But it is clearly a new state of mind.

Q. What do you expect France and Europe's growth to be in the next year or two? If the U.S. economy slows, is Europe sufficiently isolated from it?

A. I do not imagine a very hard landing in the United States. I imagine something softer that will not have a strong influence on Europe. Ninety percent of our trade is internal.

Q. One French policy that attracted lot of attention, as you know, is the shorter-workweek policy. How has that worked out in France?

A. It is too soon to say. One positive influence that we were not expecting as much was that employers and workers began talking together more to solve problems. This was not true in the past. One problem is that the new workweek can be absorbed more easily by large companies than by small companies. We will work on that. On balance, I would say it has improved productivity.

Q. So you think people working fewer hours actually improved productivity?

A. Sure. But my main concern is that we have to adapt to different situations. It is increasingly difficult in a modern economy to make sensible decisions that apply to everybody in the same way. Therefore, you can have general decisions, but afterward you have to adjust.

Q. Getting back to the philosophical underpinnings of the EU, why is it so important in the European mind, if I may use

**that expression, to expand to twenty-seven or thirty nations?
What is the driving force behind that?**

A. The driving force is that future history must coincide with geography. Europe is a continent, but because of historical events it has been divided. The history of Europe has been the history of division—the history of war. Now, old communism is finished, and the formerly communist countries have recovered their freedom—they have a right to join Europe. We are in a position to achieve European political unity. It will be a different model from the one that exists elsewhere. We need an equilibrium between economic efficiency and social fairness and attention to individual cultures, creativity, initiative. This equilibrium, which has something to do with the European tradition, must be embedded on the scale of a continent. What surprises me is that, even if we have a lot of political weaknesses in the present Europe, new countries want to join the European Union so much. It is very impressive. They tell us they have the right to join Europe because it is our common geography and they deserve it.

Q. Is war the issue?

A. It is over. War was the issue of that generation in Germany and France. Internal conflict, however, may be the issue now. Yugoslavia, for example. The idea is that there is no peace without democracy. There is no democracy without economic prosperity. There is no economic prosperity without the euro.