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Structural Competition: Impediment to an EU Foreign Policy

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A joke of our times has Mike Pompeo calling Europe's famous number, once called for by his great predecessor, Henry Kissinger. The number – in existence since the Lisbon Treaty of 2009 established the High Commissioner for Foreign Affairs – rings. Eventually, Pompeo gets the answering machine. The voice comes on: "for German foreign policy, please press 1; for French foreign policy, please press 2.."

For all the thinking, for all the bold action that has gone into making Europe strong and united on the world stage, we're nowhere near joy. 'Europe' hardly exists in global politics. Europe's allies know that all too well. And Europe's enemies know it, too. They use Europe's fragmentation to increase their own relative might, driving further wedges into Europe's unity in the process.

On the surface, the causes of that are many and diverse, from the cultural to the political. There is one that stands out, however. One that is at least an important root of Europe's inability to move forward with asserting its place in the world through a common foreign policy. It's a kind of problem risk consultants call a massive fat tail risk threatening investors and sovereign states alike. A problem that fuels current and future strategic conflicts between member states. This is the incompleteness of the single market.

That a more complete single market would make Europeans richer is nothing new to anyone. The existing structure has already brought great benefits to Europeans. According to the European Commission's estimates[2], between 1992 and 2006 the deepening of the market increased the EU's gross domestic product by 2.2% and employment by 1.3% (translating to €306 billion at current prices and 2.8 million jobs). Should Europe move to deepen the market further, benefits would skyrocket; estimates range from €615 billion (4.4%, the estimate of the European Added Value Unit of DG EPRS for the European Parliament's Committee on the Internal Market and Consumer Protection[3]) to €1 trillion per year (according to EAVA).

But the damages caused by a half-baked single market go beyond a simple failure to reach integration's full economic potential. It is functioning as a perverse incentive for member states to

[1] Delivered at What EU Foreign Policy Do We Want? Differentiated Cooperation in Action Part #2: Foreign Policy, organised by GLOBSEC.

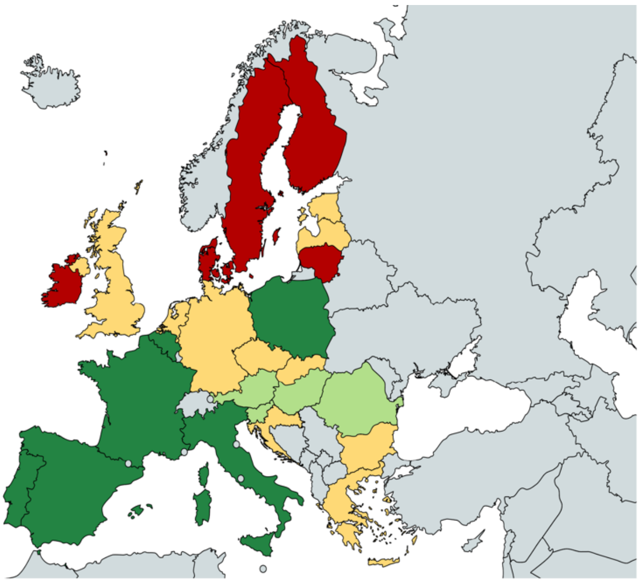
[2] http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_STU(2017)603239

[3] http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_STU(2017)603239

compete with each other for foreign investments. Corporate tax, tax breaks, labour regulations from worker protection and strike law to benefits systems: these are all instruments with which member states can hope to lure investment away from other member states.

Some believe that the decision of the Hungarian government, last December, to increase the legal overtime limit from 260 to 400 hours per year was made pursuant to requests by German auto manufacturers. In fact, Peter Szijjarto, the country's foreign minister, has said so. But let us put the tinfoil hat back into the closet. What we do know is that German carmakers, as other manufacturers, benefit from laxer labour regulations.

Or take the example of the Digital Services Tax negotiations. With the exception of Ireland, which with its 13% corporate tax rate is the number one beneficiary of the status quo, member state governments agree in principle that digital services providers doing business in Europe should be taxed in Europe. But of course every state assessed the likely effects of the planned tax on its own economy. And since the thresholds for user and contract numbers were high, some small member states were not convinced. They simply did not see what was in the proposal for them. In steps the digital services lobby, and the tax will not materialise anytime soon. What corporations – including digital services providers – do not realise is the risk they are running by taking advantage of the fragmentation of the market. (Depending on the life-cycle of their investments, of course. Investments with life-cycles shorter than 10 years are not affected.)

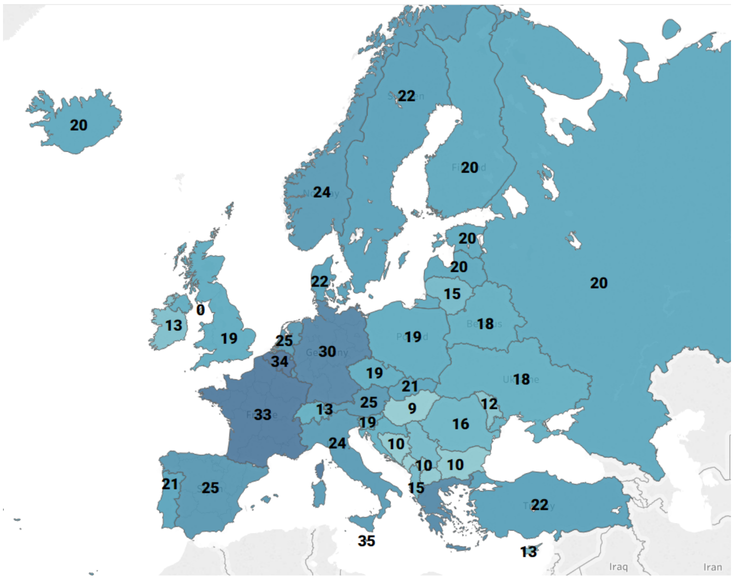


Member states' positions on the DST (green: for, red: against, amber: unclear)

What is that risk, then? Why, it is the instability of the European Union through disunity among its members, through strategic conflict.

Think of investments coming from countries such as Russia, China and the Gulf states, all three of which are on the rise, particularly in Central-Eastern Europe's 'new' member states. Investment from Europe's geopolitical competitors.

The Cooperation between China and Central and Eastern European Countries, also known as 16+1, is a format within which 11 EU member states and 5 Balkan countries 'cooperate' with China. It's a cooperation in name only. In reality, it is an arena within which Central and Eastern European countries compete for Chinese investment, particularly in infrastructure, within China's Belt and Road Initiative. Chinese investment into the region has grown considerably in recent years, and one big winner is Hungary. Hungary is also a country with a recent history of consistently vetoing EU statements with a reference to China's human rights record. Vetoes were levied in 2016, 2017. Greece, which has also seen a substantial increase in Chinese FDI inflows, including the historic sale of the Piraeus port, has been Hungary's partner in vetoing those statements.



Corporate tax rates in Europe

Or take Russia. Russia sees a strong Europe as a threat to its security, and there is ample evidence to suggest that it actively sows discord within the EU by, for example, extending financing to Eurosceptic political forces such as the Front National. Another strategy for breaking unity consists precisely in taking advantage of the fragmentation of the single market and cutting deals with member states one on one. The Russian-built, Russian-financed nuclear power plant in Hungary, Paks 2, will guarantee the country a degree of influence over Hungary for decades to come. The EU proved unable or unwilling to stop the deal, despite apparent challenges related to the tender.

CEEC countries

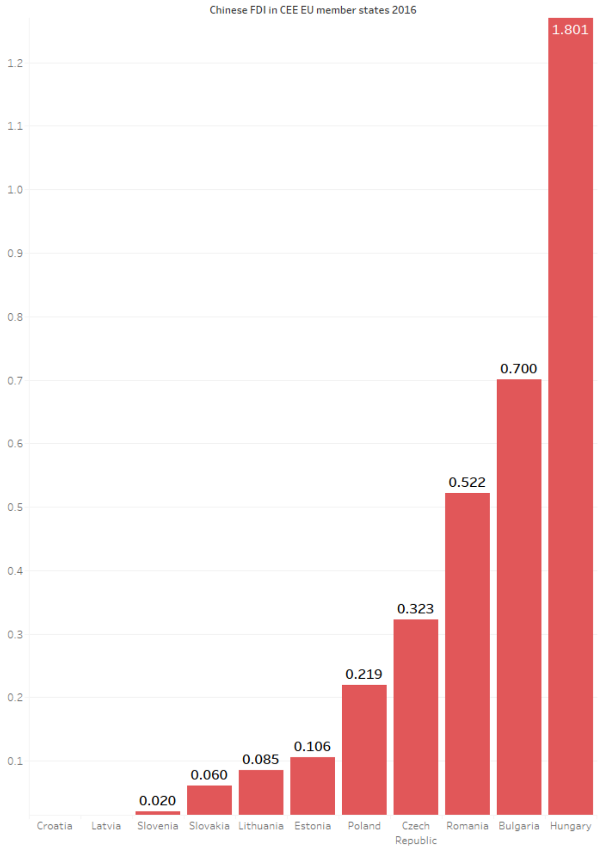
The fragmented nature of the single market – the lack of far-reaching harmonisation of corporate tax rates and labour regulations in particular – creates a situation where member states with similar structural constraints and opportunities, such as CEE states, are forced to compete for the same investments. These investments often – and when they come from geopolitical competitors, almost uniformly – come with a political pricetag attached. To cater for growth at home, therefore, member states must lean in different directions strategically.

Strategic conflict between member states is coded in the single market's shortcomings. That undermines the unity needed for an EU foreign policy, and it undermines the EU's very cohesion and stability.

Europe will have no 'single voice' while its fragmented single market drives diverging member state interests. It follows that the EU needs to move ahead with the completion of the single market.

The problem is, as so often in the EU, the member states. You can't do integration without the member states.

But as it stands, member state governments' short-term interests dictate attracting investment by sabotaging the completion of the single market. They are interested in attracting US digital services providers by styling themselves as minor tax havens. They are interested in selling out strategic industries to geopolitical competitors and promising minor political favours in return for those deals. They are interested in filling up state coffers by granting Schengen residency to Russian and Chinese investors, often state investors; the Hungarian and Cypriot residency programmes are cases in point. And thus the issue gets circular.



Chinese FDI into CEE
(Source: Mercator Institute)

Member states' long-term interest is, of course, increasing the cohesion of the EU and facilitating the emergence of a common European foreign policy. But democratic governments rarely sacrifice short-term benefits for long-term ones.

To move past this deadlock, bold political leadership will be needed. Leadership that incentivises member states, including smaller member states, including CEE member states, to support the move towards a more complete single market.

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