

# THE EU'S CREDIBILITY CRUNCH

Creator of  
economic downturn,  
Impediment to recovery

Damon Lambert



# **The EU's Credibility Crunch**

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## **About the Author**

Damon Lambert is the UK Corporate Tax Director of a major European Bank. Previously, he worked for 11 years in KPMG's financial sector practice where he specialised in advising on mergers and acquisitions, primarily for financial sector multinationals. The advice he provided to clients included amongst other issues the impact of the EU and the ECJ on UK tax law. Damon is a qualified Chartered Accountant. He regularly writes on European tax matters and was a member of the working party on the Tax Reform Commission instigated by George Osborne, co-authoring the chapters on business taxation and tax reforms in other jurisdictions.

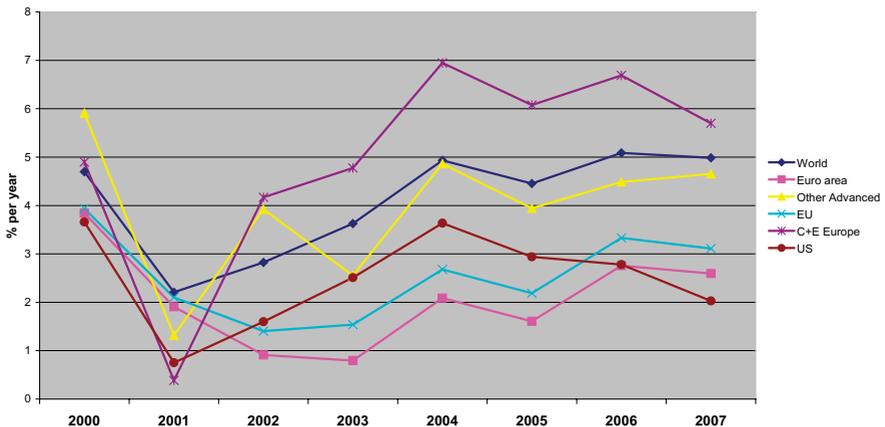
## Executive Summary

The EU has been a major contributor to the economic malaise of Western Europe. Its policies have helped cause and accentuate the downturn; and its plans for recovery are either counterproductive or irrelevant to the present situation.

### In short:

- **The economic crisis is as deep within the European Union as elsewhere in the world. The labelling of the economic crisis as a “US problem” is inaccurate and misleading.** More government monies are pledged to support EU banks than US banks, both in actual terms, and even more so as a percentage of GDP. Many of the banks now requiring government support have primarily been the victim of poor board level management.
- **Since 2000 the eurozone has been the slowest growing region of the major developed economies.**

GDP Growth 2000 to 2007 by Region

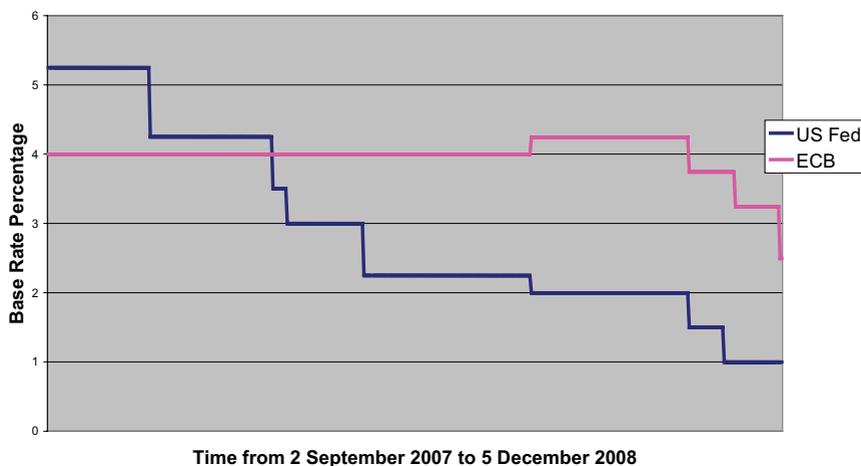


- **Despite the economic success stories of New Europe, the EU has grown considerably slower than other advanced economies outside of the European Union.** This contradicts the well-propagated myth that the UK could not survive outside the EU; the evidence indicates that similar economies to the UK outside the EU grow by 1.4% more each year than similar member states inside the EU. European economies would be better placed to deal with the downturn if EU membership did not weaken them,

e.g. in the form of the costly Common Agricultural Policy, or by blocking the extension of free trade agreements to non-EU economies.

- **The euro has been proven to be a one-size-fits-no-one policy that impinges, and even reverses, economic growth.** It is especially unsuitable for high growth economies; e.g. Ireland is now in recession, mainly due to the uncompetitive exchange rates, and high interest rates, the euro bloc imposes. However, euro members have no short-term prospect of a White Wednesday to kick-off recovery; having made their currencies extinct, a White Half-Decade is probably the best they can hope for.
- **The European Central Bank is undemocratic and unresponsive.** As recently as July 2008 it increased interest rates when the experience of previous downturns shows that interest rates should be cut to avoid, or mitigate, any recession. If you compare the actions of the ECB to the US Federal Reserve Bank then the ECB was slow to diagnose the depth of the economic crisis and even slower to act appropriately.

US Fed vs ECB interest rates during the Credit Crunch



- **The inability of EU members to negotiate their own trade agreements has, in the last decade, prevented pro-trade states, e.g. the UK, Ireland and the Netherlands, from expanding their markets.** The examples of Australia and the USA show that it was possible to eliminate tariffs with countries based on every continent other than Europe; creating free trade



zones that covered hundreds of millions of people. The benefits of these agreements will aid the economic recovery, reduce prices for consumers, and additionally help the US and Australia build political ties with their trade counterparties. One of the curses of EU membership is the inability to obtain the access to wider markets beyond the continent.

- **EU policies helped lead to the property boom.** Certain European Union policies, notably on migration and the effective enforced ending of Dividend Tax Credits, have been among the contributors to the property bubbles arising in several EU states, including the UK and Ireland.
- **The EU claim that the economic crisis is due to a lack of regulation is misleading.** As the author of most financial sector regulation, any fault in that legislation primarily belongs to the EU; indeed in certain cases, notably the mark to market regime, regulation deepened rather than aided the banks financial position. Evidence shows that member states have substantial regulatory rulebooks and small armies of regulators; plus there already exist many multinational bodies that regulate or co-operate in the regulation of financial institutions. Yet, European Union leaders are calling for increased regulation especially by the EU. Proposals exist to deepen the regulation of sectors such as private equity, despite the fact that private equity is not responsible for the economic downturn. The EU should consider better quality, and more localised, regulation; rather than seeking to increase an already high regulatory burden, that ultimately makes the EU globally less competitive and has a substantial cost that inevitably gets passed onto consumers.
- **The European Economic Recovery Plan is in the main an incoherent wish list of funding requirements for the European Commission's pet projects.** Most of these, e.g. environmentally-friendly cars and factories and expanding internet access to very rural areas, are irrelevant to a crisis in the EU's financial sector. Yet the cost of the plan is 1.5% of GDP, which would be approximately **£25 billion** to the UK; equivalent to 6 pence off the basic rate of income tax for a year.

The European Union's approach to the crisis is one of top-down instruction by the elites to businesses and individuals; there is an overriding belief that more European government will solve a crisis. Yet, European government, via its regulatory rules, the CAP and the inaction of the ECB, has aided and abetted the economic crisis. The single currency, the EU's inability to extend free trade, and further EU spending demands and regulations will all impede the recovery.



There is no better time to analyse the performance of the European Union, note that it is economically the worst in the developed world and wake-up to the benefits of being a free-trading advanced economy, free of the EU's costs and shackles.

## **Examining the Economic Downturn in a European Context**

The Credit Crunch refers to the increasing lack of liquidity in the financial markets, and the unwillingness of banks to lend to their consumers and other banks. The first reported examples of this were from the USA where “subprime”, i.e. debt lent at a high risk. Subsequently, borrowers were not able to repay and started to default on repayments. The lack of lending and illiquidity then led to a reduction in economic growth.

However, many of the financial institutions in trouble are victims of their own management. Many simply lent too much money to too many people with inadequate considerations of the risks. A number of banks had based their own long-term lending on short-term borrowings. Those banks took a risk that when the short-term borrowings came up for repayment, replacement funds would be available; it was a gamble that failed. Contrary to certain politicians, financial institutions across Europe have been guilty of this level of mismanagement, frequently with little or no direct cause from the USA.

This is not an economic downturn driven by a sole factor. This paper seeks to set out that the economic downturn is prevalent in Europe, and has been caused to a large degree by the policies of the EU, including; euro membership, the EU's institutions such as the European Central Bank, and that the EU's policies have over a long-period of time weakened the economy so that they are poorly placed to respond to the challenges of the current financial environment.

We need to consider the European picture, so the reader, if living in the UK is asked to consider the wider context. Whilst there are areas of EU law that do heavily impact the UK, the UK has particular problems, e.g. massive private and government pension deficits, a substantial housing bubble, out of control government spending, and an uncompetitive tax regime, all of which have accentuated the impact of the Economic crisis.

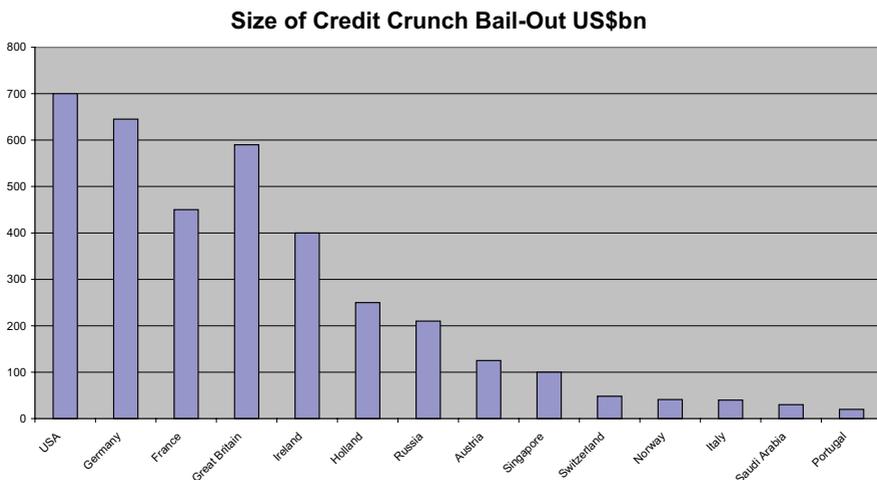
As a percentage of GDP the UK has comfortably provided the greatest amount of financial support of any major economy to its banks. Certain factors remain peculiar to the UK, even in growth years the UK government borrowed heavily both on and off the balance sheet, building up large tax demands for future years. Many European economies, e.g. Ireland, Sweden, Estonia did “fix the room whilst

the sun shone” and have had consistent structural budget surpluses giving their governments some flexibility. Conversely Sterling remains a floating currency, and hence does not suffer the detriments of euro membership which would have impacted its export markets and which is explained within this paper.

### **The Economic Crisis in the Financial Sector: The Myth of the American Crisis That Became a Global Crisis**

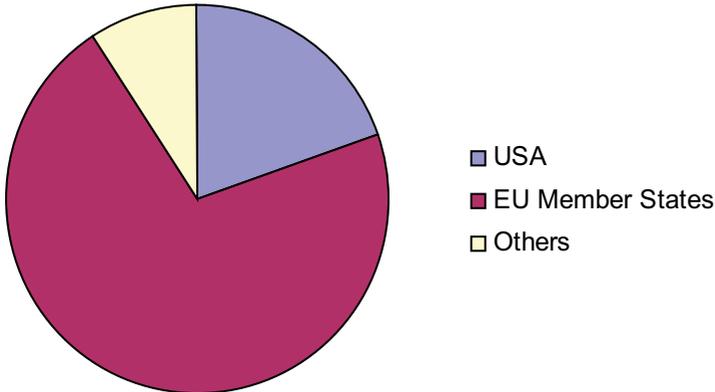
The EU has an attitude that it is somehow superior to the rest of the world, believing that it has merely been polluted by American capitalism. It should be noted that both Angela Merkel and Gordon Brown, leaders of Germany and Great Britain were a few months ago talking of an “American” crisis, as their own economies enter into recession they now refer to it as a “Global” crisis. However, a review of the government support or bail-out funds for central banks shows that the crisis is at its deepest within the European Union.

**Chart 1: The bail-out funds of major economies as at 22 November 2008.**



If we then compare the EU to the USA and the Rest of the World we are shown the extent of the EU problem. Expressed as a percentage of GDP the US and EU bail out funds represent 5% and 11% of their respective GDP.

## Size of Credit Crunch Bail-Out - USA v EU v RoW



An analysis of the financial institutions in difficulty also indicates that this is an EU problem.

For example the following organisations have all needed government help in order to survive the Credit Crunch. This ignores the banks which have separately sought capital from new sources; this is in addition to any guarantee provided for customers' deposits.

Country	Banks
Germany	Commerzbank, HypoRealEstate
Belgium	Fortis, Dexia, KBC Bank
UK	HBOS, Northern Rock, Bradford and Bingley, Lloyds TSB, Royal Bank of Scotland
France	6 largest banks
Netherlands	ING, Fortis
Italy	Unicredit, others
Ireland	Bank of Ireland

If we take the UK as an example the reason for the bail-out is not US driven but the results of localised failure.

The biggest single problem was poor management at some of the banks; not least the matching of short term borrowing to fund long-term mortgage products in direct contrast to basic principles of financial management and the relaxation of mortgage approval standards from 3.5 times salary and a 5% deposit required to 5 times salary and no deposit. In some cases the loan was greater than the



value of the property, contrary to the basic principles of common sense and arithmetic. At no point did the UK government, or the UK opposition, or indeed any governmental body seek to address this expansion in debt.

All of these banks met their core EU regulatory capital requirements in their 2007 financial statements and therefore remained open to new business. Many also were Sarbannes-Oxley compliant. None of these Banks have “failed” directly due to the US markets. It should be noted that the UK Bank with the highest US and Far Eastern exposure, HSBC is regarded as the safest bank in the UK. Indeed, there is no case of an EU centred bank failing or having to seek government support directly due to the economic downturn in the US; most of the problems are of a domestic making.

*Even if the EU is right to blame America, is that not a failure of its own strategy?*

It proves that the EU has failed in its goal to be an economic superpower independent of the USA if the European crisis is a US problem. In a globalized world with the Russian, Chinese, Indian and Eastern European economies having grown strongly over the last decade, the US represents a smaller proportion of global GDP and therefore is globally less significant. Therefore, the EU should be less dependent upon the US, not more dependent. What this of course shows is that the EU economies are actually suffering largely due to problems that originated in the European Union.

## What Caused the Economic Crisis in Europe

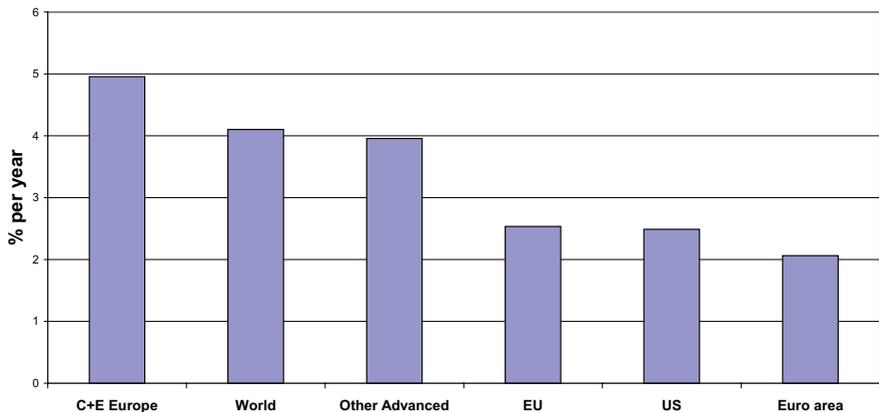
### Year in, year-out the EU fails the ordinary man

We need to remember that if the EU economies were stronger they would be better placed to withstand the occasional shocks that occur to any economic system. The EU's policies hit the ordinary man on a day-in, day-out, year-in, year-out and decade-in, decade-out basis. Without these policies the EU economy would be substantially stronger and hence better able to withstand shocks.

### Overview of the performance of the EU economy 2000 to 2007

If we examine the rate of growth of the World's regions in the period from 2000 to 2007 it is clear that the eurozone has the lowest rate of growth of all the advanced economic regions.

Average GDP Growth per region 2000 to 2007



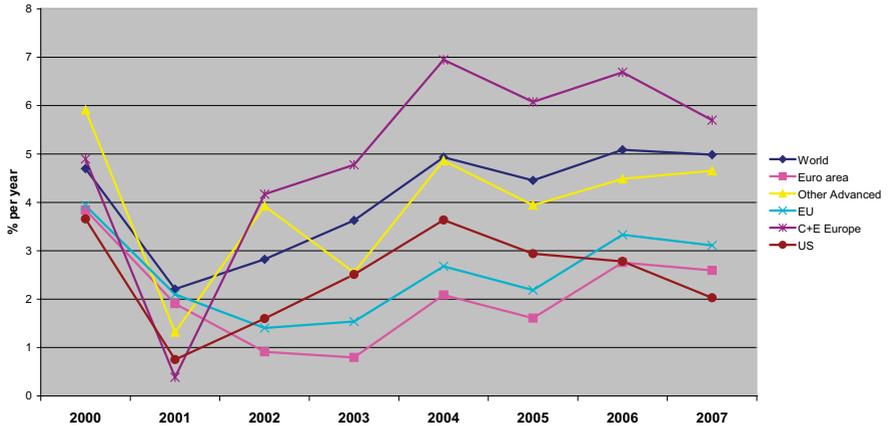
Source: International Monetary Fund Statistics website

### Clear indication that EU Membership is not necessary for economic growth

The reader should also note the record of the Non-EU and G7 Advanced Economies. This category includes Australia, New Zealand, South Africa and Switzerland, and best represents the category the UK would have been in had it not been a member of the European Union. These economies grew at a rate of 1.42% more per annum faster than the EU economies, and 1.9% faster than the Euro Area economies. In respect of the UK, had it been able to grow at the speed

of the non-EU economies, it would have added £18 billion<sup>1</sup> each year to its own economy, including £7 billion of tax receipts.

**GDP Growth 2000 to 2007 by Region**



Source: International Monetary Fund Statistics, graphs by author based on those statistics

It is of course necessary to consider factors other than pure EU membership when examining economic growth. If you were to take the Tax:GDP ratios of the same areas, then there is a strong correlation between low taxation and economic growth.

EU policies have meant that the economies of the EU are weaker than they should have been. Whilst the Credit Crunch focuses our minds on the short-term problem of intra-bank lending, when considering the economic scenario we need to also consider the day-in, day-out economic policies, which because they are everyday, it can be all too easy to forget the damage that they inflict.

#### *Common Agricultural Policy*

The Common Agricultural Policy continues to inflate the price of everyday foodstuffs; in times of financial hardship the impact is harder, especially for the poor and newly unemployed for whom foodstuffs form a far higher proportion of their weekly budget. Whilst the CAP is not the focus of this paper, the long-term damage it does to EU household budgets cannot be omitted.

#### *The EU's Protectionist Attitude – failure to build free trade*

Free Trade is good because it produces the following benefits:

<sup>1</sup> Based on UK GDP per the Pre-Budget Report 2008 of £1,266 billion. The same report has UK Money GDP as being £1,461 billion, so the estimate above is potentially understated

- 
- Greater competition for goods, ultimately resulting in a reduction of prices for consumers and therefore it counters inflation; benefiting both businesses and consumers
  - Access to newer and more diverse products
  - Greater export markets for domestic businesses to expand into and enhance profitability
  - Ability to further outsource and reduce costs
  - Helps build long-term strategic relationships with the counterparty states
  - Free trade tends to strengthen the middle classes in states that are not full democracies, ultimately resulting in a stronger drive towards democracy

Despite the long-term merits of free trade the EU has not pursued such agreements.

#### *The Approach the UK could have adopted outside of the EU*

The EU has failed to agree a reduction in tariffs with other key trading partners through the various World Trade Organisation talks. This is often due to EU intransigence. This can be shown by how the French offered to fly the then EU Commissioner for Trade (Peter Mandelson) to Paris to effectively inform him what terms to agree. Whilst the US were often reluctant at WTO events to come to an agreement, it should be noted that the Bush Administration, agreed a number of bilateral trade agreements with non-EU nations, plus Bush as shown in his conduct with Congress was typically prepared to negotiate to get the deal done. The Howard administration in Australia was also successful in completing Free Trade Agreements.

The success of recent US and Australian administrations in building Free Trade Agreements will benefit those economies for many years to come. The US and Australia were able to enter into bilateral Free Trade Agreements as set out above, and since 2000, only one of which, Israel, existed prior to the Bush Presidency. The US was already within NAFTA with Canada and Mexico. The ASEAN Free Trade Agreement that Australia signed in October 2008 consists of over 570 million people. The geographical spread of the counterparties shows a globalised and open-minded approach to trade; nations in Central America, South America, Northern and Southern Africa, South-East Asia, Australasia, Korea, and the Middle East are intended to have access to the US consumer. Many of the Euro-elites who dismiss the George W. Bush administration as parochial would do well to consider the extent to which Bush sought to develop long-lasting economic ties with other

nations, regardless of ethnicity or current wealth and to compare that with the protectionist approach of the EU.

*Free Trade Agreements entered into or negotiated by the USA and Australia*

USA	Australia
Signed Treaties	
Australia, Bahrain, Chile, Israel, Jordan, Oman, Peru, Panama, Morocco Singapore	USA, Chile, New Zealand ASEAN- Laos, Cambodia, Brunei, Myanmar, Philippines Singapore, Thailand, Vietnam Malaysia, Indonesia
Subject to Congressional approval	
Panama, South Korea, Columbia	
In negotiation	
United Arab Emirates Malaysia , Thailand, Southern Africa (South Africa, Botswana, Lesotho, Swaziland and Namibia)	China Japan Gulf Co-Operation

Sources: Australian Government, Department of Foreign Affairs and Trade website and Office of the United States Trade Representative

What's more these Free Trade Agreements, unlike the European Single Market do not prevent the members entering into further Free Trade Agreements. Yet the UK, where all three major political parties proclaim to be advocates of free trade has not been able to enter into a single such agreement.

*And what the Member States of the EU achieved by way of comparison*

Under EU Trade Policy, member states are disabled from making their own bilateral trade agreements, hence they are restricted from accessing the benefits of globalisation; e.g. the UK, Ireland, Netherlands and Eastern Europe are typically pro-free trade and would have been able, had they not been members of the EU to conclude bilateral treaties.

Had the EU accepted greater free trade, then inflation would have been lower and the ECB would not have necessarily had to pursue the high interest rate policy that it did.

To give the European Union its fair due, its Economic Recovery Plan, does on page 18 out of 20 recommend the completion of the Doha Plan, and the extension of free trade around the globe; this approach of the Commission, however belated, is welcome. Yet previous experience indicates that the EU moves to trade liberalisation at the pace of its slowest member; and that such an intention by the Commission is unlikely to come to short-term fruition. It is also somewhat in



contrast to the same Economic Recovery Plan's recommendation that member states should seek to make full use of state aid (i.e. subsidies) that EU rules permit, and that the EU's own website has a policy which it clearly states is not that of pursuing classical free trade.

### **Bilateral Level**

“The Development dimension is reflected in bilateral trade relations of the EU with developing countries. The most significant example is the Economic Partnership Agreements (EPA) which are being negotiated between the EU and African, Caribbean and Pacific (ACP) countries. EPAs are an instrument for development by strengthening regional integration and improving the business environment in a credible and sustainable way. **These agreements have been in negotiation since 2002. These are not classical free trade negotiations. The objective of EPAs is not to open markets but rather build markets.**”

The emphasis is the author's.

### **EU Labour Relations**

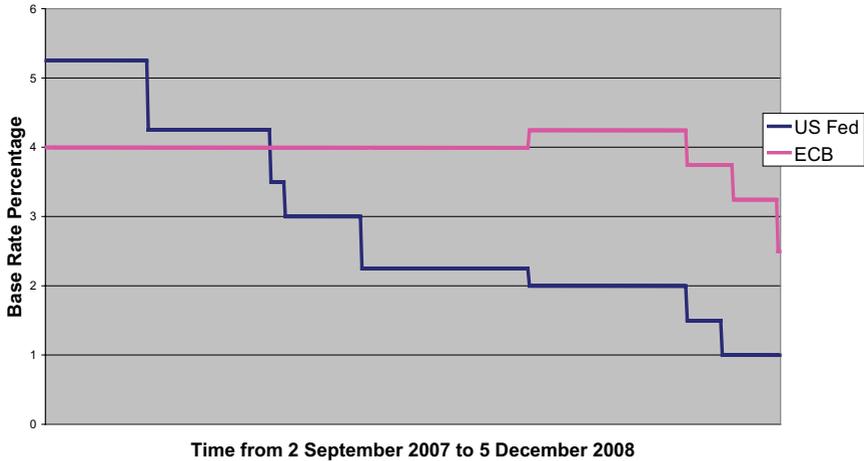
EU Labour laws impose restrictions on how a business can treat its workforce, even in certain member states when the workforce wishes to break those restrictions itself, e.g. where the employees choose to work longer hours due to the higher rates of pay offered by overtime, which is far more likely in a period of inflation on basic household goods and lower salaries. Such restrictive practices make the EU less attractive to investors from the US and the Far East where Labour laws are more flexible. And in a downturn potentially puts EU businesses at a greater risk of closure.

### **Specific Factors in EU policy contributing to the Economic Downturn**

#### *The Role of the EU in interest rate management*

Alan Greenspan has attracted criticism for holding US Federal Reserve bank interest rates too low post the World Trade Center tragedy. The same could be said of the European Central Bank, This has led to property booms, notably in the economies that have been successful in generating economic growth, notably Ireland and Spain, by having interest rates too low; especially for their growing economies.

US Fed vs ECB interest rates during the Credit Crunch



Now the EU holds interest rates too high. As the following chart shows the EU has held interest rates too high for too long and as recently as July 2008 actually increased ECB rates. Note the timing of the US Federal Reserve Bank's interest rate cuts compared to those of the European Central Bank.

Countries furthest in recession are those for whom the ECB's interest rates are most inappropriate, e.g. Ireland.

Alarming, until autumn 2008 there had been no meeting of European ministers since 1999 to discuss euro interest rates, indicating the sheer lack of control elected officials have over this cornerstone of economic policy; contrast this to the numerous meetings over a Constitution / Lisbon Treaty. The autumn 2008 meeting was over a year after the Credit Crunch started, and a year after the US Federal Reserve Board had started cutting interest rates. Indeed, despite the Credit Crunch being over 9 months old and well-known about, with banks struggling to obtain funds to lend onto customers, the European Central Bank actually raised interest rates in July 2008.



## **The role of the euro in the financial crisis**

*The problems of an undemocratic and unresponsive currency – the myth of stability against the reality of recession*

“The euro, in particular, has proved to be an invaluable asset for the EU economies and an essential element of stability. Supported by the strong role played by the independent European Central Bank, the euro protects against destabilising exchange rate movements, which would have greatly complicated the national responses to the crisis.”<sup>2</sup>

Yet as we have seen earlier, the Euro Area has since 2000 had the lowest economic growth of any region of the developed world. By having a higher interest rate than its major competitors the ECB is artificially making the euro expensive and hence making goods and services of the export economies of the eurozone overpriced on the global market; resulting in exporters being unable to compete, subsequently companies make losses and have to get rid of jobs.

This is already having a substantial impact in both Ireland and Germany, two of the euro economies that are in recession. Estonia is also entering into recession. Whilst Estonia is not a member of the euro the Estonian currency is however fixed to the price of the euro. Amazingly, up until 2008, both Estonia and Ireland were high growth economies; the Irish economy growing at over 5% and government debt at a comparatively low 28%.

“Ireland has traditionally been a strong performer under the Stability and Growth Pact. It has had General Government Surpluses for ten of the last eleven years. In addition, General Government debt has decreased from 54% of GDP in 1998 to 25% in 2007 before account is taken of the assets in the National Pensions Reserve Fund.”

The Estonian economy grew at over 10%, with governments who year after year generated revenue surpluses and has a well educated workforce; Estonia did not even have government debt, the International Monetary Fund referred to its “sound macroeconomic and prudential policies”. This is very similar to the economic consequences that the UK faced in 1992 from its membership of the Exchange Rate Mechanism; despite then having relatively low government debt, undertaken successful supply-side reforms and then having a highly competitive tax regime by international standards. Its currency was overpriced, its interest rates were too high and therefore its economy overall, and especially its exporters

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2 Communication from the Commission to the European Council, A European Economic Recovery Plan, COM (2008) 800, 26th November 2008, page 5



suffered. This was only cured by the UK exiting the Exchange Rate Mechanism, at which time economic growth commenced almost immediately. The trouble with an economy such as Ireland which is a euro economy is that its exit from that currency is difficult given it has made the Punt extinct. In 1992 the UK was able to have a White Wednesday, Ireland may need to have a White Half-Decade; a lesson potential new members of the euro should strongly heed.

Compare the situation of Ireland and Sweden, both have been broadly tax-cutting governments with good economic growth in recent years and both governments have regularly run a fiscal surplus. However, the Irish now have to raise taxes in a recession in order to meet the ECB limits on the size of a deficit a member state can run each year. Even though the Aherne administration did “fix the roof whilst the sun shone” and had surpluses in 10 of the last 11 years.

#### *The ECB currency rules*

EU rules limit the deficit a Member State can run each year as a percentage of GDP. These rules have been manipulated by some in what should have been good years (albeit by EU growth standards). Now some of the countries who did make some effort “to fix the roof whilst the sun shone” and who particularly suffer from the interest rate policy of the European Central Bank wish to run at a deficit, because that interest rate policy is killing their tax revenues but they are not allowed to. This then compels them to raise taxes at the precise time they should be cutting them to stimulate demand.<sup>3</sup> This situation would be made even worse if Member States acquiesce to the 1.2% of GDP the EU is now demanding from them as additional funding!

### **The impact of Regulation**

This is covered in more detail in the subsequent chapter, as it is best to consider the impact of existing regulation and the new regulation the EU wishes simultaneously.

### **The Role of the EU in the Housing Bubble**

#### *The Role of Immigration in the Housing Bubble*

One of the key worries about the downturn is the sudden fall in house values, already being witnessed in Ireland, Spain and the UK; although logically we should examine and be concerned about the sudden increases in property to unaffordable levels as well as the later market correction. Whilst the main causes of the property

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<sup>3</sup> One potential solution to this would for those countries to adopt a dynamic modelling of the impact of tax cuts, which would of course show that cutting tax rates, especially on corporation tax and income tax invariably boosts, rather than ameliorates, tax revenues.

bubble were loose credit from both Central Banks and mortgage lenders, the EU's immigration policy did have a supporting role.

Put simply, if you have a relatively fixed housing stock but ever increasing numbers of people wanting a house, whether to buy or rent, then ultimately the basic rules of supply and demand will mean there will be an increase in the price of housing. If we examine the immigration statistics for Ireland, Spain and the UK, then you can note the impact on housing prices. An immigration policy that opens up borders makes immigration into the old EU from New Europe more feasible. Having such a flexible immigration policy, especially one not gradually introduced, can result in a housing price bubble due to the resultant population growth. It must be stated however, that the UK, Sweden and Ireland, by being the only EU15 member states to allow persons from New Europe to migrate in, did contribute themselves to this problem.<sup>4</sup>

*Net immigration to the UK – 2001-02 to 2006-07*

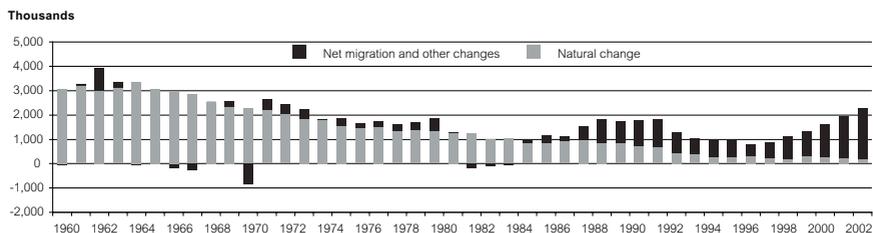
Thousands						
	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
<b>Population at the start of the period</b>	59,113	59,323	59,557	59,846	60,238	60,587
Births	663	682	707	718	734	758
Deaths	601	605	603	591	575	571
Natural Change	62	77	104	127	159	187
InMigration	483	512	537	599	574	605
OutMigration	334	358	352	337	385	406
Net Migration	148	154	185	262	189	198
Other Changes	0	3	0	3	1	3
Net migration and other changes	148	157	185	266	190	201
<b>Total Changes</b>	210	234	289	393	349	388
<b>Population at the end of period</b>	59,323	59,557	59,846	60,238	60,587	60,975
NB Figures may not add exactly due to rounding						

Source: Office of National Statistics website

4 For clarity, the author is a proponent of the UK welcoming immigration, an explanation of its advantages is not however the subject of this paper. However, sudden inflows of people will have an inevitable impact on housing demand and the author did not previously give due credit to certain of the prescient warnings of organisations such as MigrationWatch.

The UK above shows recorded immigration into the UK over the period 2001-02 to 2006-07 of 3.31 million people, and net migration of 1.147 million. Similarly, “Ireland’s population increased by 313,000, or 8.1%, between 2002 and 2006. Of this increase 213,000 was from migration.”<sup>5</sup> That is a 5.5% increase in population in only 4 years due to immigration alone. Spain’s population had the highest level of net migration of anywhere in the EU between 2000 and 2004.<sup>6</sup> Its population grew by 2.5 million between 2000 and 2004; compare this to the UK which with a nearly 50% larger starting basis had net population growth of 1.0 million in the same period.

**Population change, EU25, 1960 to 2003**



Source: Eurostat

Witness above a very impressive graphic from “The UK Population in the European Context”. The darker purple element shows the net migration change from Net Migration and other changes, i.e. population change other than from births and deaths. Since the late 1980’s, there has been a strong pattern of immigration into the EU, accelerating from the late 90s to 2003 when the graphic ceases. This population increase, which unlike natural births cannot be contained in a family home, must have driven up property demand and hence house prices. There are many benefits to immigration but its impact must be considered.

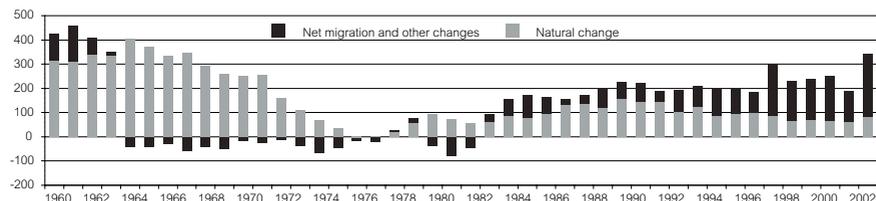
5 Fear, Unemployment and Migration, speech by Professor David Blanchflower, member of the Monetary Policy Committee, Bank of England Quarterly Bulletin, Q4 2007

6 “The UK Population in the European Context” by Roma Chappell, David Pearce, Francois Carlos-Bovagnet and Dennis Till, page 178

Now, compare the pattern to that of UK migration and note the strong correlation between the two.

#### Population change, UK, 1960 to 2003

Thousands



Source: Eurostat

*The role of Member State governments and the ECJ in making debt more attractive on a post-tax basis than equity*

The ability of the European Court of Justice to effectively dictate member state tax policy has not only contributed to the economic crisis, it potentially entrenches such problems by blocking the reforms necessary to amend market distortions that arise due to member states tax policies.

The European Court of Justice (ECJ) has held that Dividend Tax Credits, (the same Credits abolished in the UK by the Labour Government in 1997), where they exist or existed, should not apply just to dividends received by the Pension Fund from companies resident in the member state it operates in, but should also be payable by the tax authority of the pension fund, even when the dividends received came from another member state (i.e. the refund is of tax actually collected in another member state). This ultimately makes Dividend Tax Credits unworkable for EU Member States; for example, the Tax Reform Commission established by George Osborne, Shadow Chancellor of the Exchequer, to look at UK tax policy had to dismiss the reintroduction of a Dividend Tax Credit due to a conflict with EU legislation.

When Dividend Tax Credits existed, then the post-tax position for debt and equity would be broadly comparable, e.g. for debt the payer would obtain tax relief for the interest payment, but the pension fund would not be taxed on the interest income, so interest income was tax-free to a pension fund; the Dividend Tax Credit would effectively refund to the pension scheme some of the corporation tax levied on the dividend, so that Equity income was near-enough tax free. The abolition of Dividend Tax Credits though means that although the effective tax rate between investor and investee on debt remains 0%, for equity it reverts to being



the corporate tax rate for the company paying the dividend; e.g. in the UK it would typically be 28%. Therefore, this causes a market distortion as debt generates more post-tax return than equity making debt more attractive. When you have this situation, especially when as in much of Old Europe the corporation tax rate is high, you inevitably end up with a disproportionate level of debt compared to equity. That has knock-on impacts, e.g equity capital provides the most security so in turn you weaken the security corporates offer; the reduction in post-tax income in pension funds discourages individuals from using pensions as a form of saving, often diverting that money towards property.

Whether due to poor decision making by member states as in the EU, or through the impact of the ECJ effectively striking out member states tax laws, the inadvertent impact is to deter investment in core equity capital and pension saving and encourage debt finance.



## The Response of the EU to the Economic Crisis

The response of the EU, and the various meetings of its First Ministers is multi-faceted. The many different elements are considered below, and then the European Commission's Economic Recover Plan is analysed.

### **The Red Herring of Global Co-Operation: Multinational talking shops.**

The EU has called for Global Co-Operation to arrest the economic downturn.

Yet the record of such organisations remains poor, for example:

- EU Ministers took over a year from the commencement of the Credit Crunch to meet to address the problems of the economic crisis
- The inability of the EU to reform its own damaging Common Agricultural Policy
- The failure of EU Ministers to meet for at least 9 years to discuss European Central Bank policy
- The failure over many years of the Doha talks to achieve a reduction in trade tariffs
- The tendency of other multinational bodies to fail to deliver, e.g. NATO projects to only be supported by the US and 1 or 2 other signatories of that Treaty
- No concrete result from the G20 summit, no new summit until April 2009; indeed it is already difficult to remember that the G20 summit took place; the G20 leaders' even failed to meet their individual key objective of getting a photograph with President-Elect Obama

### *EU Myth: The economic downturn is the result of a lack of regulation*

The EU has called for more regulation to try and prevent such an equivalent crisis occurring again. Yet banks are already subject to considerable EU regulation, which is then enforced by a member state regulator.<sup>7</sup> This regulation has clearly not worked. Even now most of the banks have capital resources greater than the EU requirement of 8% Tier 1 capital. It also shows that certain other regulatory measures, e.g. Sarbannes-Oxley and its European copies do not ultimately protect against the biggest risk to shareholders and customers which is not business fraud but bad management decisions by key executives.

We should also reject the cause of the Credit Crunch being due to the absence of State Intervention in the Banking industry. As will be shown later, state regulation,

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<sup>7</sup> Or several regulations in case of the tripartite UK system



much of it EU driven has either caused or further accentuated the Credit Crunch. To blame the Credit Crunch on “Big Bang” reforms is:

1. To not understand the nature of most of those reforms
2. To fail to appreciate that poor management at many leading banks has little to do with Deregulation; bad M&A transactions and loose mortgage lending were not permitted by the Big Bang; the failures in the banks are more fundamental than that.
3. To completely ignore the year on year growth of the UK economy achieved in consequence of the Big Bang reforms of the mid to late 1980s

Warren Buffet’s quip that derivatives are “Weapons of Financial Mass Destruction” is an appropriate phrase because just like the military “Weapons of Mass Destruction” a thorough search will find no evidence of such smoking financial guns. Derivatives are used predominantly to hedge and reduce risk, not to increase it. By being able to control certain risks using derivatives, Banks can then expand their range of lending, e.g. a bank that mainly has Sterling depositors can lend in euros and use a derivative to hedge the forex exposure that arises on the euro lendings. If derivatives are banned, or their use restricted, then banks will be more limited in the lending they can do as the precise time when member states are encouraging Banks to expand lines of credit. None of the banking failures can be attributed specifically to the use of derivatives; indeed the most common cause is the use of short-term borrowing to fund long-term lending to customers, causing liquidity problems when the short-term borrowing was up for renewal. This gap could potentially have been breached in some cases by derivatives.

We should also ignore that argument that there are not enough regulators or regulations. The size of the staffing pool at the UK Financial Services Authority has effectively doubled to 2,600 over a 10 year period, and they are paid on average £55,000 a year (approximately double the average UK wage) not including a number of secondees from the Big 4 accountancy firms.<sup>8</sup> BafFin, the German Regulator employs 1,693 people.<sup>9</sup> The FSA Guidance and Handbook extends to 8,000 pages, meaning that the regulation for one business sector is only slighter shorter than the entirety of the UK’s notoriously complex tax system.

What this indicates, if anything, is the inability of the EU to act as an effective regulator, and its failure to see the wood for the trees, 8,000 pages is hardly insufficient regulation.

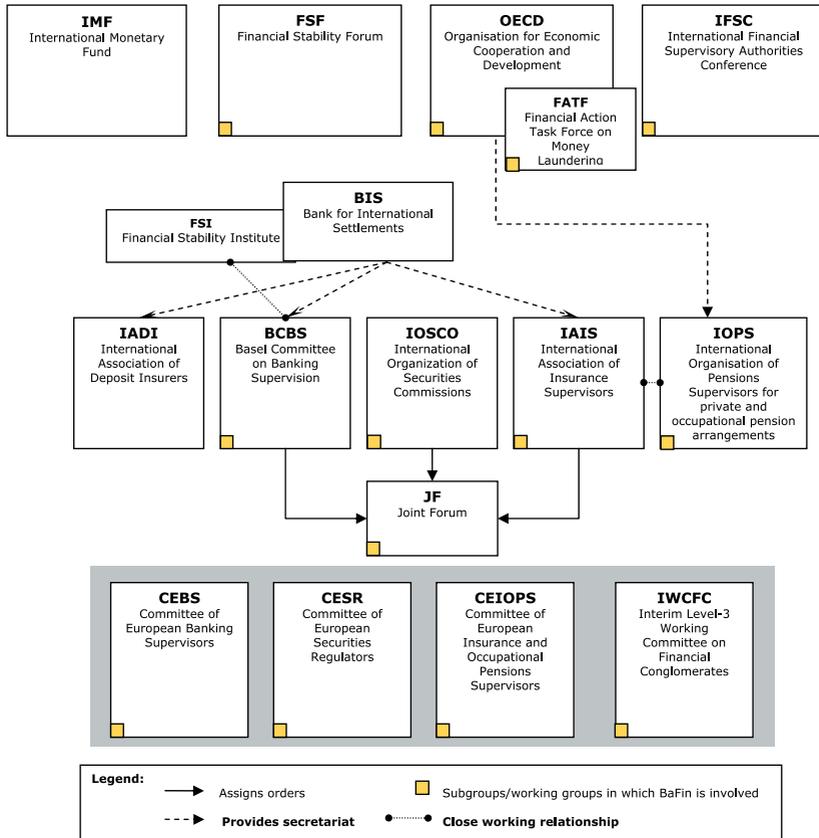
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8 2005-06 National Audit Office report on the FSA

9 Bundesanstalt für Finanzdienstleistungsaufsicht website

### The myth of a lack of international co-operation

The following chart<sup>10</sup> shows the extent of multinational co-operation on financial regulation. Given the size and number of bodies involved it begs the question, how would increasing the boxes and lines in this chart improve the quality of regulation.



10 Annual Report, Federal Financial Supervisory Authority, (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin), April 2008



*It is not our fault say EU Politicians...*

“The time is coming, we can no longer trust self-regulation on financial markets”, Walter Bos, Dutch finance minister

Comments like that ignore the crucial fact that the financial markets are actually regulated under EU rules as applied by member states, e.g. in the UK by the Financial Services Authority. Its somewhat amiss of the EU to blame the regulatory rulebook that it wrote.

### **The role of regulation in actually deepening the economic crisis**

#### *The “mark to market” regulation*

EU Regulations which required assets to be valued at quoted market prices were suspended on 30<sup>th</sup> September 2008, but that was too late. This policy imposed a strict rule on bank capital even at times of severe market value movements and accentuated the banking crisis.

The problem of marking to market in a bear market is that:

1. You have to use the prices available. These are often understated, so that the quoter is not compelled to buy assets it may then struggle to sell on at a profit.
2. The price itself will often not reflect the fact that the borrower is likely to fully payback any capital and meet all the interest payments on time; hence to the bank the asset is still a good asset.
3. Falling assets mean reducing capital. If the assets fall in value too much you then have to sell those assets to protect your capital from going below the minimum levels required. So in a market where you have more sellers than buyers, regulation causes even more sellers to exist, hence even bigger falls in value arise. Yet the underlying assets may have no actual impairment so in the case of a bond, all interest and capital repayments due on that bond are still expected to be made in full. Had these rules been suspended earlier then certain of the problems facing banks would have been avoided and the general levels of bank lending, would still have fallen, but not to the extent they have.
4. Yet this should have already been known about; a similar problem occurred for insurance companies when in 2002-2003 they were forced to sell equities as equity markets collapsed following the World Trade Centre attack and the internet bubble, and in the UK a number of institutions were forced to close themselves to new business and make massive redundancies.



## *The Shortselling Ban*

Where the state intervened they even got it wrong. Governments enacted a Shortselling Ban, effectively blocking “short positions”, where persons sell at a future date more of a certain stock than they currently hold. This ban on shortselling actually “fuelled the fire” and broke hedging strategies presently in place and consequently resulted in a further fall in prices. The “shortselling” ban was also regulation based on rumour;<sup>11</sup> analysis of the markets at the time shortselling was meant to be problematic actually showed no increase in the amount of stock lent. This is actually an example of market efficiency, as the stock markets accurately predicted the downturn some months before the official economic forecasters of member states.

### **A higher regulatory burden – both in quantum of regulations and organisations to be regulated:**

From the conclusions of the informal meeting of the Council of the European Union Heads of State or Government on 7th November a further increase in regulation is planned.

“All financial players of systemic importance, such as rating agencies or geared funds, will accordingly have to be subject to rules or at least to oversight wherever they operate... Transparency of financial transactions must be ensured by means of a more comprehensive information system, which no longer omits vast swathes of financial activity from auditable, certifiable accounts.”

Yet as shown in the mark to market rules and the short-selling ban, regulation has actually contributed to the financial malaise; as has the inability to let certain currencies values be determined by the market. The above assessment of the resources of the Financial Services Authority in London hardly shows there to be a “self-regulated” market.

The call to regulate private equity and hedge fund monies is unwarranted. The investors in these are almost all highly informed investors who know what they are investing in and do not need regulatory protection; they can always invest their funds elsewhere. Additionally, in almost all cases, the private equity and hedge fund managers are also investors so that their interests and those of the investors are aligned. Private equity works best when it takes over an ailing business and turns it around through incentivisation of staff and management, cost-cutting,

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11 Allegedly, one financial group was spreading the rumour to try and counter the stories, true as it turned out, that it was short of money



product innovation and financial engineering. Regulating this business is only likely to place restrictions that impede or prevent such measures being undertaken; and may require private equity to become more public in disclosure of investors. These measures are only likely to deter investors, especially those from outside the EU. Given the importance of private equity as a source of funding, especially for medium-sized businesses, measures that may cause that capital to seek a home outside the EU must be avoided.

What is curious about the drive to regulate Private Equity especially, is that there is no broad suggestion or evidence that private equity is responsible for the current financial crisis.

The request for information comes at a time when institutions spend more and more time in accounting, tax and regulatory terms providing information for authorities. There is no evidence that this information will be particularly useful, but it will impose a further administrative burden on businesses. A rewrite of what information is actually required may be more effective.

### **“A penalty for prudent behaviour and subsidy for risk-taking” - No Bank will be allowed to Fail**

What's wrong with bank failure? Allowing institutions, and their shareholders and creditors to survive through a failure they may have been complicit in teaching the lesson that security is nothing and risk is everything. It is part of the deal when you invest in shares, that if the company goes under you are the last in line to get your money back. It also involves the investment of taxpayer money to effectively subsidise losses the shareholder should bare; taking from those who have acted prudently and giving to those who have been reckless. That is both inequitable and disincentivises good behaviour.

The total failure argument is also a myth, Banks do fail, e.g. Lehman Brothers in the US. What happens in practice, except in the worst cases is the following:

- In certain cases, a more solvent financial institution, better able to run the business and hence safer to investors acquires the business at a low price; Lloyds TSB are rumoured to have been prevented from doing this with Northern Rock. Alternatively, temporary support with often high interest rates and a strong overseer is made by other financial institutions who see the failing bank's weakness as a chance to increase their own profits
- If there is no buyer, or prior to one emerging, The failing bank cuts unnecessary costs; generally leading to job losses and closes business units or sells them to other banks or financial institutions; e.g. Lehman's business



units have been bought by Nomura, Barclays and now others; BNP Paribas bought part of Fortis' operations, bids were received for London Scottish less than a week after it ceased trading.

- There are some funds left, initially to pay the main creditors, the biggest losses are borne by shareholders and by those who invested in subordinated debt; who are in the majority case informed investors who knew the risks they were taking as long as the upside of potential higher returns than safer investments
- Specialists are used; or develop, who manage the workout of the bank to the advantage of the creditors and customers as far as possible
- Banks and insurance companies who deposit with the failing bank will have losses on balances with that bank; that is the whole reason why they have solvency capital to absorb and protect their customers in such situations;
- Deposit interest rates increase due to the perceived greater danger in the market
- The market, once the apologies of the politicians and executives responsible for the mistakes are seen-through, learns from the errors of a failing bank and both banks and customers adapt their behaviour accordingly; e.g. both banks and customers now test more severely the security of a bank when depositing or lending and also seek greater diversity through holding more deposit accounts to dilute concentration risk.

Take the example of the UK life assurance market. In the period from 2002 to 2004 a number of UK life assurers were forced to enter into "run-off"; effectively meaning that they could not underwrite new policies. Whilst some of this was symptomatic of long-term poor operation of such businesses and losses in the industry the trigger at the time was the fall in equity markets; and the regulation causing those life assurers to sell equities low; hence converting those investments into bonds when bond prices were high and preventing the life assurer holding onto the equities and awaiting a recovery in prices (another example of regulation acting against the interests of both the institution and the customers by forcing sales in a bear market).

The UK government, other than via negative regulatory impacts outlined above did not intervene. Correspondingly, the market developed its own solutions for the 'failed' life assurers, notably via the entry of Run-off specialists. These used outsourcing, economies of scale and new investment techniques. And



thus improved the life insurers financial strength and policyholder security and returns.

### **Guaranteeing Bank Deposits**

Markets have already learnt many of their mistakes and are seeking to ensure banks they deposit money with offer, not just good interest rates but, sufficient financial strength to ensure the deposit is safe. However, when member states and the EU guarantee all banking deposits then the market mechanism which would compel a Bank to adopt a prudent policy in order to attract deposits, effectively drops away as customers have no need to consider the bank's security when comparing the pros and cons of depositing money with a particular bank.

At least the member states are now adopting broad deposit guarantees. In the UK, the government guaranteed deposits in Northern Rock. The result of which was that depositors, rightly concerned about the security of their savings, ploughed their money into the only bank with a AAA guarantee even though that bank was effectively bankrupt. At a critical time, this took deposits away from other solvent banks accentuating the liquidity problems arising from the credit crunch.

However, if member states do want banks to lend more then they should stop borrowing themselves. In a nervy market, investors place greater value on security and hence government backed instruments. Therefore, when member states issue billions of new bonds and gilts this absorbs funds that would otherwise be deposited at banks; eating up funds that could have been lent to customers. The EU could help this situation by reducing its budget rather than seeking to increase it.

### **Restricting Executive Pay: Talent flow from Banking Institutions when they most need it**

The EU strategy to resolve the economic crisis proposes to seek to cap the salaries of the highest paid banking employees. Whilst these caps are very high for the ordinary man, they are relatively low for the most effective bankers who can generate returns well in excess of their remuneration. Imposing such a salary cap is likely to have the following consequences:

*Bankers will stop working:* Why work harder if your remuneration will not increase?

*Flow of talent:* The already high levels of personal income taxation in the EU are an incentive for such bankers to locate to other financial centres, e.g. Hong Kong, Sydney, New York. A salary cap will worsen this.



*Going Indie:* Another alternative is for such bankers to set up boutique practices, which are privately owned and not banks, and hence not subject to the salary cap.

*Loss of Taxation:* Capping salaries for some bankers will effectively mean they have 100% taxation on their marginal levels of income. Therefore, they may choose to limit their efforts. Additionally, large bonuses are often subject to 41%+ taxation across the EU, and generate additional tax through VAT when spent. Member states would be foregoing this tax.

### **Restricting Dividend Payments**

Potentially this policy may be dropped. It is a key issue though; given that banks have insufficient equity capital, it seems ridiculous to impose a condition that prevents one of the key rewards of investing in equity in the first place and hence is likely to cause capital to flow into industries other than Banking.

### **The EU's Specific Response to the Economic Situation**

Broadly, the European Commission and EU leaders consider that there is no problem that cannot be resolved by a combination of the imposition of top-down laws and multinational talking shops. Yet the engine-room of economic recovery will be the entrepreneurs, businessmen and employees of businesses at the microeconomic level, especially if suitable supply-side reforms are made.

However when the European Union actually published its own recovery plan, the case was more confusing than the collection of ad-hoc measures referred to above.

### **The European Economic Recovery Plan**

The European Economic Recovery Plan<sup>12</sup> agreed on Friday, 12th December 2008 only specifically addresses the economic crisis and the low-growth rates of the eurozone sporadically within its 20 pages. In the main, it's a shopping list for the EU's own pet projects whose relevance to economic recovery is questionable.

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12 Communication from the Commission to the European Council, A European Economic Recovery Plan, COM (2008) 800, 26th November 2008



For example:

- There was an immediate call from member states for **€200 billion**, 1.5% of GDP – to boost demand. This equates to a demand for approximately **£25 billion** more money from the UK<sup>13</sup>
- The EU will make a **€4.5 billion** acceleration in the **€347 billion** Financial Envelope; the Financial Envelope is not itself explained
- **€5 billion** for “trans-European energy interconnections and broadband infrastructure projects”<sup>14</sup>
- **€5 billion** will be spent on a European Green Cars initiative
- **€1.2 billion** on “a factories of the future” initiative
- **€1 billion** for European Energy Buildings initiative
- **€1 billion** for Broadband Internet connections where commercial suppliers are refusing to connect<sup>15</sup>
- **€3 billion** CAP health-check for climate friendly investments in rural development<sup>16</sup>
- The EIB will significantly increase its financing of “climate change, energy security and infrastructure investments” by up to **€6 billion** per year
- The EU proposes a total **€32 billion**<sup>17</sup> increase in lending by the European Investment Bank over the next 2 years; there’s no precise details as to how the EIB will get that money to on lend
- The European Social Fund will be enlarged so members can get **€1.8 billion**<sup>18</sup> earlier
- The Western Balkans “Crisis Response Package” will see **€120 million**<sup>19</sup> given to countries that are not even within the European Union

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13 Ibid, Page 2

14 Ibid, Page 13

15 Ibid, Page 16 for the 4 items above

16 Ibid, Page 13

17 Ibid, Page 12

18 Ibid, Page 11

19 Ibid, Page 17

- Confirmation that EU's Overseas Development Assistance will increase to 0.7% of GDP by 2015<sup>20</sup>

The Plan does not refer to what the knock-on consequences of member states borrowing 1.5% of their GDP to fund these projects is, or indeed how they can borrow to onlend and remain within the EU's own Stability and Growth Pact.

The Economic Recovery Plan is not even consistent within its 20 pages. On page 4:

*"The fundamental principle of this programme is solidarity and social justice."*

Just a page earlier, the EU sees the prime generator of economic salvation as state directed investment in green technologies; as backed up by its financial demands:

*"The Plan sets out a comprehensive programme to direct action to "smart" investment. Smart investment means investing in the right skills for tomorrow's needs; investing in energy efficiency to create jobs and save energy; investing in clean technologies to boost sectors like construction and automobiles in the low-carbon markets of the future; and investing in infrastructure and inter-connection to promote efficiency and innovation."*

When reading the recovery plan you half expect to see Al Gore's name as signatory rather than Barroso's.

With amazing hypocrisy, the EIB is actually seeking to develop "two innovative financial instruments" with the Commission; which are "the Risk Sharing Finance Facility to support R&D and the Loan Guarantee Instrument for TEN-T projects to stimulate greater participation of the private sector", whose name indicates they are the complex financial instruments the EU wishes to ban the financial sector from operating.

There is one redeeming feature to the recovery plan, on page 17 it seeks an early agreement to the Doha Development round of trade talks. Whilst, cynics may suggest that 2002 would have been an early agreement to the Doha round, this intention should be welcomed and it must be hoped member states push forward with this particular recommendation.

### **Summary of the EU response**

Overall the EU seems unable to envisage anything other than a top-down response to the economic slowdown. EU elites seem to believe they can spend or regulate their way to economic recovery. They fail to appreciate that economic

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20 Ibid, Page 18



growth will arise not when governmental restrictions are increased, but instead when individuals and businesses benefit from supply-side reforms that enable and encourage them to develop.

## **The Right Response to the Economic Crisis: There's never been a better time for a good dose of Thatcherism**

The economic crisis gives EU member states an opportunity to make brave, Thatcher-style, decisions that will lift them out of recession.

### **1. Withdrawing from the euro; unfixing their exchange rates**

Whether it is by way of euro membership, pegging the exchange rate of a local currency to the euro or as in the last economic downturn, by membership of the Exchange Rate Mechanism, fixed exchange rates are damaging to economies in a downturn. The ECB is an undemocratic body and its raising of interest rates in July 2008, despite the Credit Crunch then being in full swing shows its desire to follow its own objectives beyond those actually required; itself very similar to the Bank of England's policy of fixing the price of sterling to the Gold Standard in the late 1920s which also caused an economic downturn and unemployment.

Furthermore, the examples of Spain and Ireland shows that the loss of control over your own interest rate compels you to follow a policy which whilst potentially suitable for some EU economies, but may accentuate a boom and bust approach to your own.

By having a local currency with a floating exchange rate, EU economies can:

- Set a fiscal policy that fits their economy; that if suitably applied can reduce the risk of boom and bust
- Ensure that their exports are competitively priced around the world; hence ensuring their businesses can compete cross-border
- Avoid the EU deficit rules, which can prevent economies who save in good years using that surplus when downturns arise, causing them to increase taxes

### **2. Actively pursue free trade**

To avoid a deep recession similar to that experienced in the 1930s, which followed the world entering a highly protectionist phase, member states should seek to push for a free trade agenda. Whilst the EU is now seeking a completion of the Doha round of talks, the EU has prevented such agreement for some time and individual member states would be far better placed to extend such policies if they



could negotiate their own trade agreements rather than being tied to EU policies that are often protectionist. Witness the recent success of the Bush and Howard administrations in extending free trade elsewhere in the globe. What's more the benefit of lower prices would help counter inflation, giving more purchasing power to the individual and enabling a reduction in interest rates.

### **3. Ending EU wide regulation**

The EU's slowness to act, even when existing regulations are actually deepening banking woes, shows its ineffectiveness as a regulator in a global world. The decision as to what is the appropriate level of regulation should be taken back by member states allowing prompt reaction in times of trouble.

The one example within the EU of a system allowed to regulate itself is Lloyd's of London. This self-regulation of London insurance markets is not perfect, but the businesses that are members of Lloyd's have never failed to pay a valid claim in 300 years of existence. They are licensed to underwrite in many jurisdictions outside the EU and the additional flexibility that Lloyd's regulations have enable more versatile, but still secure, ways of providing capital to protect policyholders.<sup>21</sup>

### **4. Allow banks to "fail" – market solutions do exist**

The continual pattern of using the ordinary taxpayers funds to support "failing banks" needs to stop. This effectively subsidises poor management and penalises good management and certain of the government guarantees actually remove much of the incentive financial institutions have to act in a prudent manner.

Notice should be taken of how in the UK insurance sector specialists emerged able to take-over and improve the performance of UK insurance companies that had effectively failed. Bizarrely, the UK banking sector is now encouraging two banks short of funds to merge and form an effective monopolistic position that will, post-recovery, penalise consumers.

### **5. Cut tax rates and cut public expenditure**

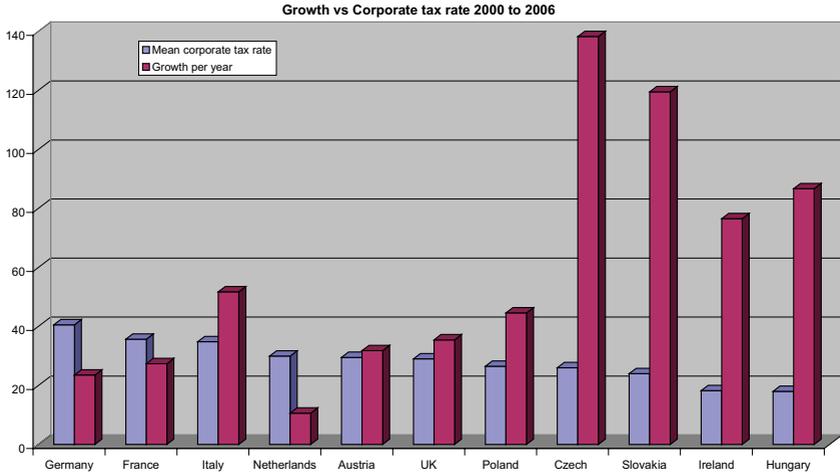
Study after study has shown that cutting taxes, especially income and corporate taxes, boosts economic growth and tax revenues. Therefore, EU member states should be decelerating if not abandoning its public expenditure programmes not seeking to increases and expand them.

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21 Lloyd's does however operate in a relatively mobile market, and the UK tax rate as applied to general insurance is high and hence causing much business to seek an alternative low-tax location

The graph below shows the clear economic and tax revenue benefits of cutting corporation tax.

An analysis of Corporation Tax Revenues across the EU shows the following:<sup>22</sup>



As the reader can see as you move from left to right, corporate tax rates decrease and growth rates accelerate, clearly indicating a strong correlation between low growth and high corporate tax rates. Yet still most of Old Europe persists in having most of the world’s highest rates. This is one easily solved matter, which governments should themselves implement.

The EU’s plans for a Common Consolidated Corporate Tax Base project should also end. As shown in *Complex, Costly and Counterproductive: The Case Against the CCCTB*<sup>23</sup> the CCCTB if ever enacted will cause severe market distortions and are a one-size-fits-no-one solution, when global evidence shows the emphasis should be on lower, flatter taxes.

*The need to end VAT fraud*

Urgent reform is also needed in the field of VAT to prevent excess waste, from the mouth of the EU Commissioner for Taxation

“Tax administrations in the EU have been particularly preoccupied by VAT fraud for the last few years. Considering the size of the phenomenon,

22 Information for GDP sourced from the OECD Data Index; information for Corporate Tax revenues sourced from Eurostat, Corporate Tax rates sourced from KPMG

23 Published by the Bruges Group, October 2008 by Damon Lambert



approximately €250 billion yearly according to some estimates this is not surprising.”<sup>24</sup>

€250 billion is probably an overstatement but the UK is estimated to have lost £7 billion of tax revenues in 2005-06<sup>25</sup> and £14.5 billion in the last 3 years. It should be noted that VAT is very much an EU tax. However, it is also unduly complicated and outdated. Recently the Head of Office for the EU Commissioner for taxation is rumoured to have admitted that VAT was an outdated and unduly inefficient system that at best could only be reformed to be fit for the late twentieth-century. Therefore, would it not be best to return control of legislating, collecting and reforming indirect taxes to member states

## **6. Withdrawing from the European Union**

Withdrawal from the European Union would free the more dynamic economies of Europe to:

- Follow the example of the Bush and Howard administrations in the USA and Australia and pursue bilateral Free Trade Agreements to help boost their economies
- End association with the Common Agricultural Policy which continues to reward inefficient agricultural practices and keeps the price of foodstuffs artificially high; hurting those who food is the highest proportion of their budget, the poor, the hardest
- Free them from burdensome and ultimately ineffective EU regulation that deters investors but ultimately does not guarantee stability in the financial system. Local regulators should also be more responsive to jolts to the system
- Avoid the EU's proposed new measures that require either funding (e.g. European Investment Bank) or will result in new, unwarranted regulation, e.g on the Private Equity industry
- Avoid the colossal waste and inefficient public expenditure of the EU's programmes, e.g. the **€350 billion** due to be spent on the EU “Financial Envelope”, the **€250 billion** of VAT fraud
- Obtain the higher economic growth rates that advanced economies which sit outside the EU benefit from

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24 Keynote speech of Commissioner Laszlo Kovacs at the Congress of the International Fiscal Association, 31 August 2008

25 Measuring Indirect Tax Gaps, HMRC Report, November 2008, page 6,



Contrary to the EU's claims, the economic crisis does not show the ever greater need for the EU. Instead, the EU is shown either to be at best an expensive irrelevance to economic recovery and at worst, responsible for many of the factors that both cause the downturn and impede the recovery. Its time the role and responsibilities of this undemocratic body were re-examined and redrawn.

## THE BRUGES GROUP

The Bruges Group is an independent all-party think tank. Set up in February 1989, its aim was to promote the idea of a less centralised European structure than that emerging in Brussels. Its inspiration was Margaret Thatcher's Bruges speech in September 1988, in which she remarked that "We have not successfully rolled back the frontiers of the state in Britain, only to see them re-imposed at a European level...". The Bruges Group has had a major effect on public opinion and forged links with Members of Parliament as well as with similarly minded groups in other countries. The Bruges Group spearheads the intellectual battle against the notion of "ever-closer Union" in Europe. Through its ground-breaking publications and wide-ranging discussions it will continue its fight against further integration and, above all, against British involvement in a single European state.

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## BRUGES GROUP MEETINGS

The Bruges Group holds regular high-profile public meetings, seminars, debates and conferences. These enable influential speakers to contribute to the European debate. Speakers are selected purely by the contribution they can make to enhance the debate.

For further information about the Bruges Group, to attend our meetings, or join and receive our publications, please see the membership form at the end of this paper. Alternatively, you can visit our website [www.brugesgroup.com](http://www.brugesgroup.com) or contact us at [info@brugesgroup.com](mailto:info@brugesgroup.com).

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