# The Blight of Isolation

12 Dec 2011

Britain's decision not to sign on to the European Union fiscal agreement is triumph of short-termism and nationalist emotion over sound economics, writes Ian McAuley.

Britain has never been comfortable with its geographic and economic location. Many British refer to "Europe" as some other place, ignoring their own ethnic, linguistic and religious heritage.

The Euro zone crisis has reinforced this isolation. The British are smug in the belief that they are not bearing the public debt of the Mediterranean countries or the pressure on the northern European countries to bail out their profligate southern neighbours and save the Euro. (The reality is that at 80 per cent of GDP Britain's public debt is higher than Spain's, and its rate of economic growth slower than that of most other European countries.)

The Euro's problems go back to the 1992 Maastricht Treaty which established the ground rules for membership of the single currency zone. That treaty imposed tough entry rules — countries had to keep annual government deficits to less than 3 per cent of GDP and to keep accumulated public debt below 60 per cent of GDP. These were sensible rules of fiscal coordination to underpin a common currency.

The trouble with the Maastricht Treaty is that once countries were admitted to the club, no-one thought to go on enforcing the rules. In fact there was no mechanism to do so. After all these were all prosperous "developed" countries with responsible governments.

In the Mediterranean countries responsibility was short-lived. Governments on the left spent without raising taxes to match, while governments on the right let tax revenue slip — in the case of Greece and Italy by turning a blind eye to widespread tax evasion.

Last week's agreement, signed by 26 out of the 27 European Union countries is essentially an imposition of the Maastricht rules on an ongoing basis, made effective through agreed sanctions, with support from the non-Euro countries in the European Union such as Sweden and Denmark which also have a strong stake in European fiscal integration.

The burden of saving the Euro will fall mainly on German and French taxpayers, and their governments have reasonably insisted that conditions apply to the debtor nations before they are bailed out. Those taxpayers need assurance that fiscal discipline will accompany their generosity. Both Germany and France face elections within two years, and, for the Germans at least, the easy option of "printing money" to let inflation erode the debt is strictly verboten — they still remember how inflation wiped out the Weimar Republic, making way for Hitler's rise to power.

Whatever the cost of a rescue, the cost of abandoning the Euro would be far greater. In itself the ease of a single currency covering 17 countries is a huge benefit for businesses and consumers, as any Australian who travelled in Europe before 1999 would know.

Much more important is the accumulated investment which has gone into the European project. The last 66 years, two thirds of a century, have been an extraordinary period in modern European history, for, with the exception of the Balkans, they have marked a period of peace and shared prosperity among countries with a bloody history of wars and unrest. It has drawn on people's reserves of goodwill, forgiveness and a willingness to place the collective interest above short-term opportunism — a willingness the UK was unable to demonstrate last week.

The stakes last week were high. A collapse of the Euro would most likely be followed by emergence of beggar-thy-neighbour policies in European states — competitive devaluations, competitive austerity, and trade barriers. These are the very conditions which contributed so strongly to the economic misery and thus to the armed conflicts of last century.

Populist politicians in Britain are exploiting anti-European sentiment, and thwarting European cooperation has become a mark of national loyalty with talk of a "bulldog spirit", to use Cameron's words. It's easy to appeal to the emotions by talking about handing over power to bureaucrats in Brussels. It's easy to appeal to the short-term interests of London's financial sector who would find a transaction tax rather stifling — never mind the fact that speculators in London's finance sector bear a large proportion of the blame for the European financial crisis. And, no doubt those same bankers were hoping for a return to the good old days when they could take their commissions exchanging Deutschmarks to Francs, Liras to Guilders and so on.

The more fearsome appeal, lying just below the surface, is to longheld British hostility to France and Germany. So long as there was tension between these two countries, the British were relaxed, but the displays of strong unity between Sarkozy and Merkel would have sent shivers up the spines of those British who look back with nostalgia to days when King Henry's archers thrashed the French at Agincourt and when Spitfire pilots repelled the might of the Luftwaffe. It's not hard to give legitimacy to those sentiments, particularly in a country which so strongly glorifies its naval and military traditions.

Australia would do well to support those seeking to keep Europe together, and not to assume some sentimental alignment with British interests. Perhaps, in order to communicate that message, our government should assert our independence and resume Paul Keating's progress towards severing constitutional links with the UK.