

The Future of Europe

Julian Hodge Institute
of Applied Macroeconomics

Annual Lecture
Given by Roger Bootle,
Chairman of Capital Economics





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About Roger Bootle

One of the City of London's best-known economists, Roger Bootle is the founder and chairman of Capital Economics, one of the world's largest economics consultancies. He is also an Honorary Fellow of the Institute of Actuaries and a Specialist Adviser to the House of Commons Treasury Committee. Roger is a regular columnist for The Daily Telegraph. In the Comment Awards 2012 he was named Economics Commentator of the year. He was formerly Group Chief Economist of HSBC, Visiting Professor at Manchester Business School and Economic Adviser to Deloitte. Under Kenneth Clarke, he was appointed a member of the Chancellor's panel of economic advisers ("the Wise Men"). Roger has written several books, including his widely acclaimed latest, *The Trouble with Europe*, which examines how the EU needs to be reformed and what could take its place if it fails to change. It follows *The Trouble with Markets*, *Money for Nothing* and the prophetic *The Death of Inflation*, published in 1996. In July 2012 Roger and a team from Capital Economics won the Wolfson Prize.

About the Julian Hodge Institute of Applied Macroeconomics

The Julian Hodge Institute of Applied Macroeconomics was launched in autumn 1999 in a new collaboration between the Cardiff Business School of Cardiff University and Hodge. The aim of the Institute is to carry out research into the behaviour of the UK economy, and to study in particular its relationship with the other economies of Europe. The research has been particularly germane in recent years and has proved to be of significant social and political relevance as Europe has navigated the difficulties of the global financial crash, the Eurozone crisis and most recently the UK referendum on EU membership.

About Hodge

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The future of Europe

It is a great pleasure to be here, even though, when I looked at the roster of past speakers, I felt somewhat overwhelmed. It really is a very great honour to be asked to deliver this lecture, and let me please give my thanks to the Julian Hodge Bank for sponsoring it and for inviting me.

The title of my address is “The Future of Europe”, and that is indeed what I am going to speak about. But most of what I have got to say is about the EU. That is going to lead onto Europe more generally including, of course, the UK. I am going to start off, though, by talking a bit about a historical perspective on the EU, without which I think you cannot understand it, or come to a reasoned view on its future. And then I will move on to talk about what I think the future holds in store. I will finish by saying something about what I think the UK’s role will be in relation to the future of Europe.

Seeing the light

The place I am going to start my historical foray, though, is not in Europe, actually but in Russia. Well, there’s a question, you might say. Is Russia part of Europe or not? In the last year, the dying year, of the Soviet Union, I made a trip to Russia as a member of an economists’ group tour, a mixture of field trip and holiday. (Only economists could think a trip like this was a holiday!) We toured around seeing all the usual suspects and trying to come to a view as to what was going to happen.

I recall one particular meeting that I was dreading, at one of the Soviet Union’s huge study institutes. Not a university; I think institute is the right word. In fact, these institutes were on the scale of a small town. Huge numbers of people beyond those studying: the gardeners, the cooks, the bottle-washers, the drivers, everything. We were going to see the Director-General. I was dreading this meeting because, knowing a bit about the Soviet Union, and having been there before, I knew that the price mechanism was not allowed to work. One of the consequences was that people had no idea of the value of time – their time and your time. They would speak endlessly, and if you asked them a direct question, they would follow their initial two-hour diatribe with another two-hour diatribe which didn’t answer the question.

So I went to see this Director-General with a very heavy heart. I walked in, sat down and immediately, I knew something was different. He said very little, and then threw over the session to us for questions. I thought, gosh, I had better get in my killer question pretty quickly - although still dreading the two-hour reply. My question to him was “When do you think things started to go wrong in the Soviet Union?” I got an answer back from him which pulled me up short. He said, “1917”. At that point, I knew that we were in a different world.

He then went on to something equally interesting. He said that you must not underestimate the importance of time lags.

The essence of what subsequently went wrong began in 1917, but things take a long time to go seriously bad. For a start, you begin with people - tradesmen, skilled workers - who know what they are doing. They have habits of work, they know how to make bread or beer or whatever. They do not stop doing that immediately after the whole system goes crazy; they continue to work normally; they don't lose their skills. Eventually, of course, they die. And then things go into a downward spiral for that reason alone.

But then there are the children. They may not know exactly what the parents knew; their habits of work may not be exactly the same, but they did see their parents working and they saw them making the bread and the beer and all the rest of it, so some of the knowledge of their parents lives on.

Eventually, though, they die. And in the end, you land up with a complete loss of skills, knowledge, habits. You end up with a degradation of society, culminating, I guess, in the well-known reproach of Soviet workmen to their bosses: "We pretend to work and you pretend to pay us." By the end, in the Soviet Union they really couldn't make bread. I mean the bread was absolutely inedible. For some strange reason, they could make ice cream, though. Some of the best ice cream I have ever tasted, actually, was in Moscow in that ghastly GUM store on Red Square.

Another thing they couldn't make was sugar. Their sugar cubes would not dissolve. You put them into a cup of tea and you had to bash them with a spoon. I still have some of these at home, these undissolvable sugar cubes.



L-R: Keith James (Chairman, Hodge), Patrick Minford, Roger Bootle, David Austin (Managing Director, Hodge)

The beginnings of the EU

Now we turn to the EU. You may well have guessed what I am about to say to you. When did things start to go wrong with the EU? The answer is simple: 1957, with the Treaty of Rome. And the same point about time lags applies. There, in the Treaty of Rome, is the statement that this is a movement pursuing ever-closer union between the peoples of Europe. Of course, in this country, we were not made aware of that by most of our leaders; we were told in 1973 that we were joining a Common Market, but it is there, right at the beginning in the Treaty of Rome. And what was there in the minds of the founding fathers was undoubtedly the creation of what effectively amounted to a country.

Bearing in mind the disparate nature of the members of the EU, if you want to shoehorn these different countries into some sort of commonality, you have to regulate and harmonise, and all those things with which we have subsequently become so familiar. The roots of it are there, right at the beginning.

It is very important to understand the EU in its historical context, 1957 was only 12 years after the end of the war. The world was dominated by two giants, the Soviet Union and the United States. And the founding fathers thought that the only way forward both politically and economically was to be the same sort of size. That was the way you could stand up to them, look them in the eye. Interestingly, Mrs. Thatcher at one point felt exactly the same thing, she being

an early supporter, believe it or not, of the organisation that we have come to call the European Union.

Right from the beginning, you can see in the writings of the founding fathers, a number of characteristics that have driven this project forward and in many ways are still there. There is a sense of zeal and determination behind this movement, let me call it 'Europeanism'.

My own view is that the nuclear bomb and the presence of the Americans and NATO is what has kept the peace in Europe rather than the EU.

I know, by the way, that not all of you are going to agree with my line on this, but this creed, Europeanism, has its sacred text, namely the Treaty of Rome, its patron saints, the founders, John Monnet and Robert Schuman, its ultimate goal, that is to say the formation of the United States of Europe and, to go with it, a sense that all this is somehow or other inevitable, just like the triumph of good over evil or the achievement of communist society in Marxism. In other words, Europeanism has had many of the traits of a religion. And indeed, I think it has actually become a religion.

This belief system, and the union that emerged from it, was founded from the



Invited guests gather in anticipation to hear Roger Bootle speak

highest of motives. It was forged in the shadow of the Second World War; and, as I like to say, in the foreshadow of a new and more terrible war that might yet begin. Those who forged it were driven by a determination to prevent another European war. They saw the diminution of national sovereignty, the pooling of sovereignty, and the emergence of this union as a factor that would prevent such a war from happening.

I think it is wrong to disparage that sentiment. The aims were absolutely honourable and noble. I just do not agree with the notion that this is what the EU has done for Europe. My own view is that the nuclear bomb and the presence of the Americans and NATO is what has kept the peace in Europe rather than the EU. Indeed, more recently, the EU's contribution has rather been in the

opposite direction. The EU played a role, I think, in provoking what President Putin did in Crimea and Eastern Ukraine. In typical fashion, the EU just didn't think through the consequences of meddling in Ukrainian affairs. It has this remarkable combination of very big ideas, overblown ideas, about what Europe could be, with zero military capacity or will to use it. And that is a losing combination.

All along, the important thing to realise about the EU is that its objectives were political, not economic. The ends were to be achieved through economic means and it was widely believed by the founding fathers and others that economic benefits would come from this. But essentially the project was political.

It is interesting, I think, that although John

Monnet was himself a political economist, as the union developed, it was driven forward largely by lawyers rather than economists. I happen to think that's not a good thing. (Apologies to those of you in the audience who follow that noble calling!)

Now, coming back to my initial theme about time lags, first of all, of course, things went pretty well in the European Union. The first few decades were economically successful. One has to remember quite why that was. First of all, there was post-war reconstruction which unleashed a boom across much of Europe. Moreover, there was a shift of people from low productivity agriculture to higher productivity industry across much of Europe. Italy is one of my favourite examples. At times in the 1950s and 1960s it was growing fantastically fast precisely for this reason. Furthermore, there was the Marshall Plan, which provided financial aid from America to many European countries.

Here I am on dodgy territory, but I rather suspect that in those early years, even the Customs Union may actually have been a good thing. That is to say, I suspect that during that early period, trade creation, the creation of trade between European countries, outweighed trade diversion. I suspect that it is not true any more, but I think it may well have been true in those early years.

This is the period, of course, before so many of the things that caused the union to go wrong, had appeared - before the Single Market, before Schengen, before the Euro. In those early years, only the CAP, the Common

Agricultural Policy, I think, stands out as being an egregious nonsense, and it was an expensive nonsense as well. But most of the things that have caused the European Union to develop in the way it has occurred a good deal later.

It was about roughly self-cancelling movements, which was good for business, good for people, good for everything. That is what we thought free movement was.

What went wrong?

So what have the big mistakes been? Ironically, first of all, the Single Market. Not that I think the Single Market was a bad thing. Initiated by the British, approved of by Mrs. Thatcher, in essence it was a very good idea! The trouble is, it happened to coincide with the onset of great zeal for more regulation in Europe, so the Single Market became the mechanism through which Europe became over-regulated. Essentially, the Single Market is a single regulatory system. This, of course, then did away with the possibility for regulatory competition between countries, which might have brought the hope of suppressing this urge towards excessive regulation. So in the end, this good thing, the Single Market, came to be a mistake.

Then there was the extension of the Union to the east to take in the members of the former Soviet bloc. Again, although I am calling this a mistake, I must clarify my remarks because I don't think in a broader sense it was a bad thing at all. In many ways, it is the best thing that the EU has done. My own view is that when historians look back on all this, they will see it, as it were, as the EU's finest hour.

What the EU did was to provide a home for those countries that were escaping communism's icy embrace, and to give an incentive to get their affairs straight, in order to be able to join the EU and to stay on the straight and narrow afterwards (although one or two of them have recently been veering off). I have called it a mistake, but it was not actually a mistake in itself. The mistake came in pushing this through without simultaneously re-thinking the nature of the union. So we have ended up with the same principles, the same objectives, the same methods of operation for a union of 28 countries as existed for a union of six!

And this is not just about numbers, it is about types. If you look at the GDP and level of development for the original six members; or even when the union expanded to the EU 10 and the EU 12, they were all broadly similar. This is extremely important. There was free movement of people written into the Treaty of Rome. I do not recall anyone really worrying about free movement when we joined in 1973 or when we voted in the first referendum in 1975. And I can tell you why no one worried about it. What free movement meant then was that if someone in Britain wanted to work in Italy, that was fine,

someone in Italy wanted to work in Paris, that was fine, someone in Paris wanted to work in Frankfurt, that was also fine. It was about roughly self-cancelling movements, which was good for business, good for people, good for everything. That is what we thought free movement was.



Roger Bootle

When you extend the union to the former communist countries of the East with much, much lower levels of GDP per capita and development, that is when you get huge mass movements of people in one direction. This was not envisaged in 1973 or 1975. It arose precisely out of the failure to rethink the Union. This Union of 28 countries, much, much bigger, with disparate membership, cannot function in the same way as a union of six, ten, or twelve countries, all roughly at the same level of development.

Then there was the Schengen passport-free travel zone which, of course, we remained outside. Nice in theory, certainly very convenient. I have benefitted from it myself on many occasions. But not exactly the sort of path it is recommended to go down in an age of terrorism. Those people who developed

it did not exactly display great powers of foresight. But the most egregious error of the lot was, of course, the formation of the Euro. I say “of course”, because I am hoping that we can reach some measure of agreement on this issue if not on others. Actually, I now find lots of people who take a different view from me about the EU and the Brexit vote, who now say, “Well, of course, the Euro was a massive mistake. Mind you, that’s not the same thing as wanting it to break up”.

The Euro should not have been formed in the first place. They cannot say that they weren’t told, by the way. They were told by umpteen people, especially from this island, but not only from this island. One of my mentors, Sir Donald McDougall, former Chief Economic Adviser to the government, was very strong

on this issue. It simply would not work. The EU forged ahead with the Euro for political reasons; again, the central theme of the EU is using economic things to progress the Union, but essentially, it was political at its heart.

The Franco-German Motor

The driving force behind the EU has always been the relationship between France and Germany. The breakdown of the Soviet Union and the communist bloc permitted reunification of Germany which, of course, Germany wanted. The French were a bit wary of this, wary of increasing German domination in Europe. So a deal was done between the German Chancellor, Helmut



Kohl, and the French President, Francois Mitterand. France would agree to German reunification, but Germany must adopt (what subsequently became) the Euro. That was supposed to end the monetary domination of Europe by Germany, end the power of the Bundesbank, and end the power of the Deutschmark.

The French evidently thought that German power and German success came as a result of the fact that Germany had a powerful currency. They got it completely and

absolutely wrong! Indeed, what has gone awry with the European economy since the formation of the Euro is primarily the Euro. If Germany had kept the Deutschmark, then Europe as a whole, including France, would be much more prosperous.

Why? Because the Deutschmark tended to rise. The Deutschmark was our weapon, not the German weapon. It kept the Germans' tendency to export very successfully and to save too much, in check, because whenever this happened, the Deutschmark went up.



And this kept the weaker members of the system, including Britain, in the game. So, right at the very beginning of the Euro, there was a fundamental misunderstanding. Again, note, the dominance of politics over economics and the inability to understand the fundamental economics. This is funny really, because in economics, as I realise many of you know, there is a substantial body of theory called the Theory of Optimum Currency Areas. Some of the great economic brains of the West have concentrated on the question of which countries or areas are best advised to share monetary sovereignty.

Yet in this particular case, the formation of the new European currency, the Euro, had nothing whatever to do with any of that. It was all about the politics. The leaders of the EU did it for the wrong reasons; they let the wrong countries in, especially Greece, but I think arguably Italy as well; and they did not put in place the other elements which are necessary to make the union work, that is to say, fiscal union, political union and banking union.

The ideological origins of the EU's errors

So the euro has been the biggest of the EU's mistakes so far. I am going to say a bit more in a moment about what mistakes might be coming in the future. But first I want to discuss the ideological underpinnings of what went wrong. There are, I think, four ideas that have led European elites up the garden path. The first is what I call "sizeism", in relation to both political bodies and economies. Funny this, because there is so much evidence around the world that

actually lots of small countries do extremely well! You don't need to be huge. Indeed, many big countries have done very badly in terms of growth of per capita GDP.

The second key ideological mistake is what I call "proximity fetishism", i.e. the idea that the group that you should belong to, economically and politically, should have contiguous borders with its members. This echoes the experience of Mitteleuropean empires, back for hundreds of years. But, of course, it is completely against the history of the seaborne empires of Europe, which cast their political net, as it were, across the whole world.

We are used to the idea that the European Union, until recently, has been doing extremely well economically. Well, it hasn't!

It seems particularly odd for Britain to embrace the idea that in order to have a political union and an economic union, you have to do this with countries that are geographically close to you, when the whole of British history, in an age when distance really mattered, is a story about a union far flung across the world. It is the political and economic equivalent of feeling that you have little choice but to marry your next-door neighbour. If ever there was an age when association, political and other, can take place over large distances, surely it is this one.

And then, there is what I call “top-table syndrome”. This is the belief of the elites that to function effectively in negotiations and in meetings it is really important to have a seat at the top table. And for Britain in particular, this has been a very important point because we have a Rolls Royce civil service, especially the Diplomatic Service. They are jolly good, and they are very proud of it. They are used to running the world, and before the EU they were in danger of ending up running only their own rather small island. For this group of people, the EU has represented the chance of still sitting at the top table.

Frankly, although we are all going to be sitting at a table quite shortly, I do not care whether my table is top, bottom, left, sideways or whatever. But for a key group of people, they were absolutely obsessed with this idea of the top table.

And not just from considerations of their own self-interest. They genuinely thought that national advantage derives from sitting at the top table. If you are not there, and without the EU, Britain would not be, they think, then all sorts of nasty things will happen to you. They have believed this, despite the evidence of Switzerland, Singapore and heaven knows how many other countries that could not be bothered about sitting at the top table, and have just got on with their knitting and producing wonderful results.

Lastly there is the idea of “uniformity”, the idea that in order to be really effective, things had to be uniform in Europe. Again, I find this very odd. As you may have gathered, I tend to think about all things historically. What

strikes me is that Europe’s golden age was a time of anything but uniformity. Actually it was a period of competition between states, and not only nation states but also city states.

Britain has done spectacularly well in hanging on to its very high ranking. We have so many universities in the top 50 or the top 100 compared to the continent.

If you think that some of this political stuff about ever-closer union and so on is a bit over the top, I recommend the words of Romano Prodi, who was at one time President of the European Commission, and also Prime Minister of Italy. In October 1999, (1999, of course, being the year of the formation of the Euro), he said: ‘We must now face the difficult task of moving towards a single economy, a single political entity; for the first time since the fall of the Roman Empire, we have the opportunity to unite Europe.’ There, in a nutshell, is the EU’s essential ideology and its motives.

Wider still and wider

Mind you, what is the Europe that needs to be united? Now we come up against a fundamental problem. Europe suffers from a profound identity crisis. What is Europe? When the EEC was formed, you had the border between east and west, running across



Kevin Beevers, Commercial Lending Director, Hodge

Europe. That sealed this question of identity because the Europe that people talked about was, of course, the Europe to the west of that border. Now that this border no longer exists there is a critical question: how big should the EU be? And indeed what is it? Is it an attempt to re-create Christendom? Is it a group of countries that just happen to live close to each other? What is it?

This question is not easy to answer. So we have seen the European Union dabbling with the idea of Ukraine joining, and hence the difficulty over Russia. At one point the EU even flirted with the idea of Russia itself eventually joining. What about North Africa, Israel, and of course, the most difficult country of all, namely Turkey?

Poor economic performance

These essential ideas running through the history of the EU, I think misguided ideas, have led it up the garden path. They were there from the very beginning. Admittedly, they have taken a long time to come to fruition, and they are still playing out. But one can see the results in the economic performance of the European Union.

In this country, we are used to the idea that the European Union, until recently, has been doing extremely well economically. Well, it hasn't! Ironically, it did very well in the first few decades for reasons I mentioned before - in the run up to the period when we joined it. Pretty much ever since then actually, and especially since Patrick Minford helped to unleash the Thatcher revolution in the 1980s,

the UK's relative performance compared to the rest of the EU has improved. Forget the emerging markets; they are in a different category. Look at the performance of the EU compared to other developed countries: the United States, Canada, Australia, Switzerland, almost any country in the world. The EU's growth figures are really very disappointing. And I think it is clear why.

First of all, before the Euro, there was a gathering mass of regulation and interference. Over and above this there was something else that I will come to in a moment. But then you get the Euro, which has been a disaster for economic performance.

Let me say, though, that I do not think that everything that is wrong with Europe, by any manner or means, is because of the EU or the Euro. If you look at the different members of the EU, it is quite striking how differently they have performed, particularly in the labour market. There are some countries which are very successful; Germany has a very low rate of unemployment; so has the Netherlands. Then you have other countries where the unemployment rate is deeply shocking; Greece, Spain, a number of other countries. Even France has a rate of about 10%. The reason cannot be EU regulations as such, because there is such a disparate performance across the whole of Europe. These appalling levels of unemployment are the result of national interventions in the labour market for which the EU cannot be held directly responsible.

There is also something beyond the national and beyond the EU. There is a more general European malaise, which you can see in relation to very low rates of innovation in the European Union. What has been happening in Europe with regard to driving things forward, developing new technologies, doing things differently? Technological leadership in the world is not coming from Europe.

Most particularly, and I say this especially to this audience, with the presence of the university as it were, looming very close to us, look at European universities. If you go back to the late 19th and early 20th centuries, European universities, by which I mean, sorry, non-British, European universities, were leading the field in science, technology, mathematics, philosophy, history, just about everything. More recently, the performance of continental universities has been a disgrace. Britain has done spectacularly well in hanging on to its very high ranking. We have so many universities in the top 50 or the top 100 compared to the continent.

Over the last 25 years, the share of Europe in world GDP has fallen quite dramatically.

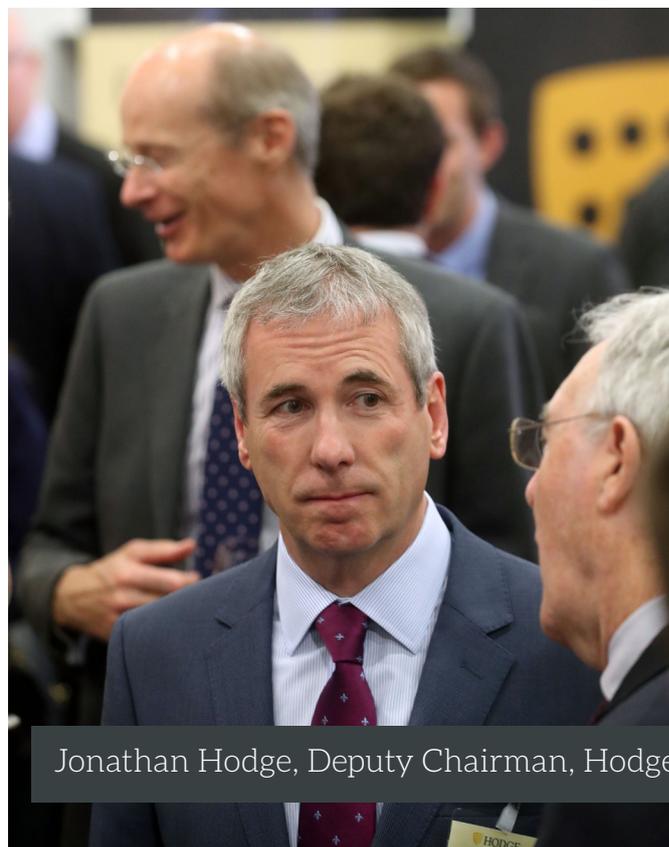
Can the problem of European universities be laid at the feet of the EU? I do not think so. There is something more fundamental that has gone wrong in Europe. A diminution of

aspiration? And with regard to the labour market, it is not all about regulations. I think it is also about the growth of welfareism. So it is not all to do with the EU. There is a deeper malaise there which I think needs explanation in another way. Having said that, I do not think that the EU has helped deal with this malaise. In fact, I think it has definitely hindered our ability to escape from it. Again, it is this point about competition. I am not talking here about competition between firms, but rather about competition between governments and competition between systems.

The EU has constructed a system under which we are all supposedly heading in the same direction - most of the time, I think, the wrong direction. So, even though governments might do something on their own initiative, the likelihood is that other EU governments are doing the same sort of thing - or will soon do so. So within the EU, it would not have been possible easily for a country to have struck out down a completely different path. The result is the suppression of competition within the EU. So many of those things which have gone wrong which may not have the EU as their origin, I think might well have been sorted out in a different atmosphere of competition between governments and between systems.

New challenges

Because of the nature of the EU and its institutions, bad decision-making is in its DNA. I suspect that whatever the issues are that are thrown up on which to make a choice, it will make bad decisions. There



are two other issues coming up in the lift which I should briefly refer to. The first is the growing pensions crisis, the mismatch between pension entitlements that were set in a different age, and increasing longevity. Can you imagine the European Union forging a harmonised policy with regard to pensions? I can imagine it. I can imagine the consequences too, given the huge differences in pension systems across Europe. That has the makings of an almighty disaster.

And then there is the development of robotics and the artificial intelligence revolution, which could be utterly profound in what they imply for productivity, growth and incomes. What do you think will be the instinct of the EU with regard to this revolutionary change? I think I know - regulate it, tax it, inhibit it, at just the time that so many of our competitors around the world, notably in Asia, will be doing exactly the opposite.

The future of the Euro

So, what does the future hold? If this whole lot hangs together, I think what the future holds is continued sharp falls in the relevance and importance of Europe in the world. Already, over the last 25 years, the share of Europe in world GDP has fallen quite dramatically.

And there is something else that is going to make that trend even more marked, that is to say the appalling demographic outlook in much of Europe. I have asked myself whether this also can be laid at the foot of the EU. I have tried, but I don't really think it can. But whatever the reason is – and I suspect something connected with that other, deeper, European malaise that I referred to earlier – the consequences are massive. The result of very low birth rates in Italy, Spain, Germany, and much of central Europe is that there are going to be far fewer Europeans.

Bringing these things together, the bad economic performance and the appalling demographics, you end up with a picture in which Europe just fades in relation to the world as a whole.

But things do not have to end up that way, and in particular, I believe there is a very good chance that the Euro will break up. All along, I have thought that the weakest link is not Greece, but Italy. Because Greece is sufficiently small, although its debts are very high proportionately, and it is obviously in an appalling state, it is so small that essentially, it is fudgeable. Someone can find enough money, and what's more, the Greeks feel that,

in their difficult political and geographical position, they do not have many alternatives.

Italy is a different kettle of fish, a much bigger economy, with serious industries and, I think, a viable option outside the Euro.

I am often asked by groups of investors from all over the world for my view on the outlook for Europe. I say that I find it difficult to give a view, but I will tell them what I think the outlook is under the current setup, and it is pretty bad! But then you have to take account of the fact that there could be a Euro bust-up. They then say well, gosh, that's pretty pessimistic, isn't it? And I say; no, no, no! That's optimistic! That's the most optimistic I can be! If you get a Euro bust-up, what then happens is that the peripheral countries become an awful lot more competitive. Suddenly you get serious growth again in Italy and Spain and possibly France, depending on what she decides to do.

But then here comes the real killer point, which most people find very surprising. At the moment, without the Deutschmark, Germany is running a policy which is certainly antithetical to European interests, but in the end, I think is also against its own interest. It is running a current account surplus, an excess of income from abroad over what it spends abroad, if you like, exports minus imports, broadly conceived, of, pushing 9% of GDP! So what would happen if the Euro were to break up? I think what would happen is that the new Deutschmark, or whatever it might be, the Northern Euro perhaps, would go up on the exchanges.



Invited guests gather in anticipation to hear Roger Bootle speak

In that case we would get back to the position that we were in before the formation of the Euro. The German exchange rate is our solution and our protection. And in Germany, the higher exchange rate transfers income from companies that do not spend their money, to consumers who do spend their money. And it also puts pressure on the German government to start expanding fiscally, to spend some money on infrastructure, spend some money on anything, just spending, rather than living off aggregate demand created elsewhere, which is what Germany has been doing for the last several years. So I think that the end of the Euro would be a jolly good thing indeed, good for growth in both the peripheral countries and Germany itself.

Would the EU be able to withstand the breakup of the Euro? Lots of people think that it would. I personally do not think it

could. And this is ironic, because it was not necessary to form the Euro; they could have had the Single Market without the Euro; they could have had everything else without the Euro. This was an integration too far; it was done, as I say, for political reasons, it was a massive mistake, even from the point of view of those people who wanted an integrated Europe.

But given that it has happened, how could the EU hold together after its undoing? The degree of mistrust and bad feeling between countries would be quite extraordinary; the peripherals against the core, Germany against France, France against Germany. It would be very difficult, I think, to hold the whole thing together.

So supposing the EU does break up, what does that mean for the world? It partly depends, I suppose, on what takes its place. You see, I do

not think that necessarily, if the EU broke up, we are all going to go back to trade barriers and atomistic economies, in a way that would destroy prosperity. I do not see that we have to do that at all.

The central idea for the way that the countries of Europe should develop is there staring us in the face. It was there a long time ago in the shape of the European Free Trade Association, EFTA, which didn't have any of this political mumbo-jumbo. It just wanted free trade. That is what Europe should be aiming at – free trade, friendship, cooperation. And I would want Turkey inside such a grouping. After all, if this grouping is not aiming at fiscal, monetary and political union, and does not espouse free movement, why wouldn't you want Turkey inside? That would potentially yield major strategic gains. By contrast, you cannot have Turkey inside, or should not want it inside, if you are aiming for fiscal and political union, with the free movement of people. That would be suicidal, ridiculous. So I think there is the possibility of a much better form of European association, once the EU has gone.

“The Industrial Revolution happened to the British first by accident and they've been trying to escape their fate ever since”.

Indeed, I could even see the evolution of a common European defence policy. It makes

perfect sense for Europe to be defending itself. You cannot rely on the American umbrella forever. And linked to all this also, I suspect that once we have seen the back of the EU, we may actually, ironically, paradoxically, begin to rediscover our very Europeanness, that is to say the European identity, the cultural identity which we have all built together, which has been rather undermined by the liberal multiculturalism that has been foisted upon us by European elites.

What about timing? Let us think about the Soviet Union – which takes us back, of course, to where I began my remarks. The Russian Revolution occurred in 1917 but the Soviet Union did not formally come into existence until 1922. It broke up in 1991. If the EU followed that same time pattern, then we are talking about break up in 2031 or, if you take the later date, 1922, as the start, then 2026. I suspect that it will not last that long. I will not try to be any more precise than that.

The UK's position

How will the UK do if outside the EU - if it survives? This is not an extended Brexit talk, so I can just give you a thumbnail sketch. I think we are going to do extremely well. I should say, by the way, that our economic interest, our self-interest, is not in them doing badly. On the contrary, it is in our self-interest that our continental neighbours do well. This is a sense in which, bearing in mind what I said earlier on, there is a sting in the tail here, if the EU and the Euro survive. We are going to face a problem for, in my view, these markets which are so important to us,

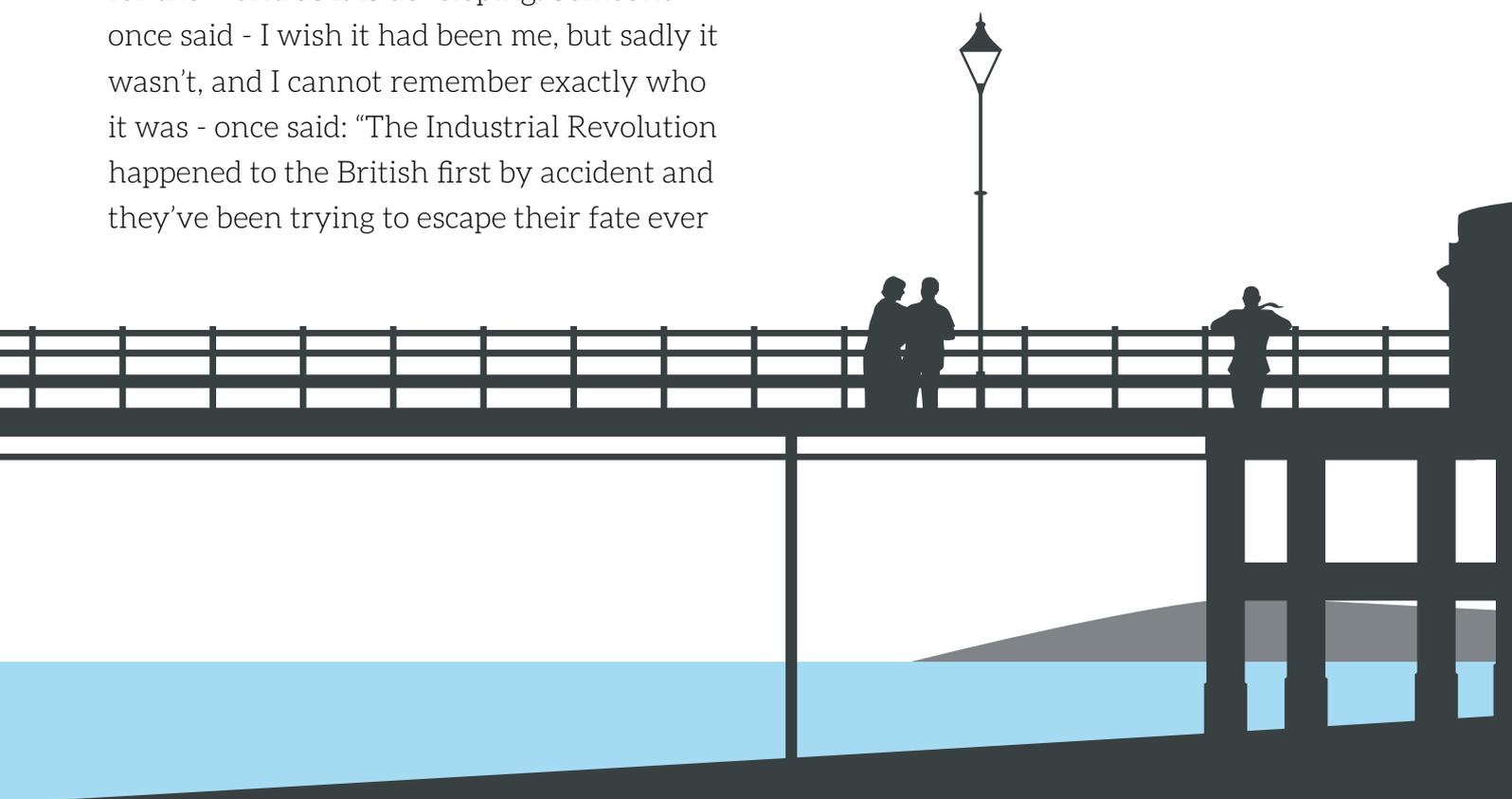
will not be growing strongly. By contrast, in the scenario that I painted in which the Euro and the EU break up, I think there is every prospect of those markets growing much more rapidly.

Having said that, with every passing year, the economic relevance to us of the countries across the channel diminishes. It is still big, but it is diminishing. It is diminishing because of their slow growth compared to rapid growth elsewhere. And there is no doubt whatever in my mind that what really matters for Britain's future, is not so much its relationship with the countries of the continent, but rather its relationship with the rest of the world, which proportionately is getting bigger and bigger.

I think Britain is actually pretty well-placed for the world as it is developing. Someone once said - I wish it had been me, but sadly it wasn't, and I cannot remember exactly who it was - once said: "The Industrial Revolution happened to the British first by accident and they've been trying to escape their fate ever

since". In the digital, inter-connected world that we are in, which is going to develop still further with AI and robotics, Britain's skills, inclinations and global connections are going to be extremely valuable.

I was intrigued to read that Phillip Hammond, the Chancellor of the Exchequer, as part of the pre-negotiations with the EU, has been warning our continental friends that if they do not play ball and give us a decent trade agreement, then we are going to turn ourselves into Singapore on steroids. What I find particularly odd about this is that if you should want to be Singapore on steroids, and actually, I would quite like it, why on earth would you not do it because they sign a trade agreement with you? The logic of the UK's position in having left the EU is that we should indeed try to turn ourselves



into Singapore on steroids. That is to say, we should aim for a low tax and low regulation environment.

What about the UK's role if the EU does break up? What should we be doing, and what should we be thinking about? I am afraid that I am now going to self-plagiarise. I cannot put this any better than I have put it before so I am going to quote from my recent book, "The Trouble with Europe", which has just undergone extensive revision for a new, fourth, edition.

As we all know, the UK did not play a role in how the EU began, but I reckon it is set to play a major role in how it ends. This would be fitting. The people of the UK have made a marvellous contribution to the world, but one that is not evenly spread. Our contribution to popular music is outstanding, yet our contribution to unpopular, i.e. classical music, is not in the same league, although you here in Wales have produced Carl Davies, of whom I'm a great admirer. Wonderful though our classical composers are, you could not say that their music bears comparison with



the greatest from Germany (and Austria). In painting, we cannot match the Italians, the Spanish or the French, or perhaps even the Dutch. Our literature is wonderful, but so it is for many European countries. Of course, our native cuisine is unique - but not quite in the way we might hope.

Our contribution to the world has been enormous in science and the advance of knowledge, yet I suspect the area in which the UK has made the greatest overall contribution is not in this exalted sphere but rather at the other end of the spectrum, in the messy business of democratic government. Parliament and the common law are the foundations of freedom - and prosperity.

It is striking that the British genius - or is it rather the abiding nature of perfidious

Albion - somehow enabled us to avoid the two greatest errors of the EU's ascendancy: namely the Euro and the Schengen passport-free travel zone. Still, these victories are only minor. The EU hurtles towards a truly ghastly end - economically, politically and socially. British voters, having elected to leave the union, although they'll be able to avoid the worst of this coming crisis, they will be unable to avoid the fallout from the gathering disaster across the channel.

Having chosen to take the UK out of the EU, although there will be many painful wrenchings, the British may trigger a series of consequences that will save not just the UK but Europe as a whole. And in keeping with what the British are best at, they will soon be in pole position to help construct a new Europe from the wreckage of the old.



A history of past lectures

The first Julian Hodge Institute of Applied Macroeconomics Lecture was delivered in 2000. Since this time the lecture series held in Cardiff has included some of the world's leading economists.

- 2000 Sir Alan Walters - Former Chief Economic Adviser to Margaret Thatcher.
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- 2004 Professor Danny Quah - Professor of Economics at the London School of Economics and Political Science (LSE).
- 2005 Professor Nicholas Crafts - Professor of Economic History at the London School of Economics (LSE).
- 2006 Ludovit Odor - Member of the Bank Board of the National Bank of Slovakia.
- 2007 Paul De Grauwe - Professor of International Economics at the University of Leuven, Belgium.
- 2008 Colin Robinson - Emeritus Professor at the University of Surrey.
- 2009 Professor Dale Henderson - Visiting Professor of Economics at Georgetown University.
- 2010 Professor Michael Beenstock - Professor of Economics, Hebrew University of Jerusalem.
- 2011 Professor Akos Valentinyi - Professor of Economics, Cardiff Business School.
- 2012 Professor Nicholas Crafts - Director of ESRC Research Centre on Competitive Advantage in the Global Economy.
- 2013 Prof. Hans - Werner Sinn - Professor of Economics and Public Finance at the University of Munich (LMU).
- 2014 Forrest Capie - Professor Emeritus of Economic History at the CASS Business School, City University, London.
- 2015 David Smith - Economic Editor of the Sunday Times.
- 2016 Professor Nick Barr - Professor of Public Economics at the London school of Economics.

Before this a series of lectures associated with Sir Julian Hodge commenced in 1970 entitled the Jane Hodge Memorial Lectures.

- 1970 The Rt. Hon. Sir Leslie O'Brien GBE - Governor of the Bank of England.
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- 1973 David Rockefeller LLD, PhD - Chairman, Chase Manhattan Bank.
- 1973 H.R.H. The Prince Philip Duke of Edinburgh.
- 1976 His Excellency Sheikh Ahmed Zaki Yamani.
- 1984 Robin Leigh Pemberton - Governor of the Bank of England.
- 1990 Sir George Blunden - Deputy Governor of the Bank of England.

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Hodge Bank

One Central Square, Cardiff, CF10 1FS

(029) 2022 0800 | deposits@hodgebank.co.uk | hodgebank.co.uk

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