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Welcoming Address by

EDMUND STOIBER

Minister-President of the Free State of Bavaria,

presented by Otto Wiesheu,
Bavarian State Minister of Economic Affairs,
Infrastructure, Transport and Technology

EU enlargement, integration and policy options

Professor Sinn, Mr Schellhorn, Minister Miklos,
excellencies, ladies and gentlemen,

Dr. Stoiber, the minister-president of the State of Bavaria, regrets very much that urgent business has detained him in Berlin. He has therefore asked me to represent him today at the opening of this year's Munich Economic Summit and present to you the address that he had prepared for you. I would first like to extend a very warm welcome to you here in Munich, the capital of Bavaria. I am happy to note that this summit is already tradition. In Bavaria we say that anything that happens for the first time is an innovation and everything that happens more than twice is tradition. This tradition augurs well for the conference and its high-ranking participants. I am very glad that so many outstanding personalities from every part of the world have gathered once again at this year's Munich Economic Summit. I hope that you will feel at home here in Munich and that you will take away a lasting impression of Bavarian hospitality; I further hope that you will find an opportunity to enjoy one or another of the cultural events that are being offered in our great city.

On May 1st, 2004, the European Union underwent a sea change. Ten new member countries with approximately 75 million citizens joined the European Union, which is not only a community of states, but also of values. That is beyond doubt an historical milestone in the process of European unification. It is an historical event whose importance goes beyond the borders of Europe, for it not only changes the map of Europe, but also changes the direction of Europe's development, turning the continent in a

direction that is quite different from the direction pursued in past centuries. It opens up a chance that one should acknowledge and respect and also examine critically. I personally believe that if this development is handled well, then this project will redound to the benefit of all. But this requires that possibly undesirable developments should be identified and discussed and timely action taken in order to forestall them. The extent of the change we are facing – its breadth and its depth – is still not recognised by everyone. The accession of the new member countries brings about an entirely new situation. It is not just a matter of extending the area covered by the EU, or the size of its population, it is not just a matter of an organisational change. It is much more than that: Eastern and Western Europe are growing together; the historical situation that prevailed in post-war Europe is ended, enormous differences in the economic performance of the member countries will be overcome, and this extends to the differences in wages and living standards, as well as to differences in mentality and ways of life. The tasks that we are confronted with are not only singular in the forty-five year history of the European Union, they are unique in all of economic history. On May 1st, 2004, old Europe, if the expression is permitted, took an enormous step in the direction of a new and much larger Europe, and if this new Europe is to be a success for the old and the new member countries, then great changes are necessary, particularly in the old member countries. To continue being capable of taking necessary action, the European Union must concentrate its resources and must – more than in the past – focus more sharply on basic problems. The core tasks of the European Union lie in

- a common policy in the area of foreign affairs, defence and internal security;
- a closer co-operation between the member countries particularly with respect to internal security and especially the fight against terrorism;
- the cross-border dimensions of environmental and infrastructure policy;
- completing and ensuring the continued efficient functioning of Europe's internal market;

- and last but not least, the reform of regional and structural policy.

Regional and structural policy can serve as an instrument that can make a great contribution to evening out excessive welfare differentials within the European Union, not along the lines of communicating tubes where the improvement in one part is at the cost of another part, but with the objective of raising, in the medium term, the economic level of poorer regions or sectors disproportionately. In this way, the incentives for migration from poorer regions to the rich centres should be weakened. However, one must not lose sight of the fact that this is a medium-term process, possibly even a long-term process, and hence this policy area must have a longer time frame. We can learn quite a bit from the experience gained from the reunification of Germany. Despite the considerable volume of transfer income and investment that has flowed to east Germany, the convergence has not gone forward nearly as rapidly as was forecast ten or twelve years ago.

The enlargement of the European Union will put Germany at the centre of the largest internal market in the world. And since in an East – West perspective Bavaria is at the centre of Germany, it will draw in particular measure advantages from this development. It makes Bavaria an extremely interesting location for innovative and growth oriented enterprises from all over the world. Bavaria's geographical position is without a doubt an important reason why the enlargement of the European Union offers Bavaria great opportunities. But it also brings with it a series of problems which at a conference such as today's Munich Economic Summit can and should be addressed.

EU enlargement will offer new markets and new market chances for enterprises located in Germany. In almost all of the new member countries, annual economic growth rates of higher than three percent are forecast. That is a figure that is, to be sure, not overwhelming, but compared with current growth in Germany it is nevertheless surprisingly high. This trend is good for us. It has made itself felt in a pronounced increase in Bavarian and German exports in recent years. For the Free State of Bavaria, the new member countries of the EU will, taken as a group, form the largest export market after the United States and such long-standing trading partners as Italy, Austria and France.

This increasingly closer economic integration helps to preserve and to create employment opportunities and prosperity. The new Europe thus gains in economic potential and in stability. But at the same time competition arises with countries where labour costs are scarcely a fifth of German labour costs, or even less. It is true that this competition has existed during the past ten years, and that the labour cost differential has been a factor contributing to the transfer of jobs. Viewed in this light, the entry of the new members in the European Union has not brought about fundamental change. But we shall observe that particularly in border regions, entrepreneurs will face competitors from the new member countries when they submit tenders for contracts. Since the 1st of May, freedom to provide cross-border services is guaranteed, with the exception of construction, housing repair and house cleaning. This represents a change in the conditions of competition. And this means that we shall have to face up to lower tax rates, lower social standards, less strict environmental norms, and a much more flexible labour market in these countries. This situation is made more critical by the difference in the level of subsidies, which aggravates the competitive situation, particularly with respect to the competition for investors. We shall learn that structural change can also involve problems. Now structural change is nothing new: we have experienced the challenge of structural change in the past decades and have met it by new domestic investment. But in coming years the competition for new investment will be keener, largely because it will be more international. This is a theme that is often subsumed under "globalisation", and among the aspects of globalisation that play a role here are the possibilities of assistance and subsidisation that are available to the new countries. This is in addition to the other differences – tax rates, social standards, wage levels – which work in their favour and which will lead to loss of jobs and shifts in location of production activity. This will be felt especially in border regions, although it will extend to other regions further from the border as well.

When people's employment is threatened, then the welfare state is automatically threatened. In the past year, around 620,000 jobs covered by social security were lost in Germany. Total employment fell from just under 27 million persons to 26.3 million.

Now the responsibility for this development cannot be assigned to the eastern enlargement of the EU.

But it should be taken as a warning signal, not only because of the personal misfortune of those directly involved, but also because 100,000 jobs covered by, and paying into social security, represent yearly receipts of the social security system of approximately €1 billion and tax revenue of €300 million. And to the labour office they represent once again €1 billion of unemployment benefits and other costs related to unemployment. Taken together, 100,000 jobs lost represent a burden to the state of €2.3 billion; 620 000 lost jobs sum up to nearly €14 billion in costs and foregone revenue. This affects the welfare state in a massive way, as Professor Sinn has pointed out, and makes radical reforms in the areas of economic and social policy unavoidable and not only in Germany. And in this context I would add that this is Germany's homework, and we've got to do it ourselves, the EU cannot – and should not – take it on for us. And let me add the personal remark: in the last ten years, out of around thirteen million jobs in the industrial sector, we have lost three million. This is a process that cannot only be explained by rationalisation and outsourcing. It is a process that has assumed the form of progressive deindustrialisation. And for these reasons, the figures concerning exports which I mentioned deserve to be studied very carefully; as professor Sinn pointed out in one of his studies: the increase in the volume of German exports can no longer be taken as giving a clear indication of economic performance and international competitiveness, because a substantial part of the value embodied in the products exported was created in foreign countries and because subcontracted parts make up a considerable part of our exports.

The eastward enlargement puts pressure on the adaptive capacity of our welfare systems in other ways. We were successful in advocating a seven year interim arrangement with respect to the freedom of workers' movement across borders. This has been criticised by the new member countries. As has already been mentioned, there are also interim arrangements in areas of services such as construction, house repair and house cleaning. For the rest, all citizens of EU countries, including those that are not economically active, enjoy freedom of movement. Despite the legal hurdles that have been set up, this carries with it the threat of abuse of these systems, especially since the very considerable differences in income levels provide sufficient incentives for migration to those countries with well developed systems of social securi-

ty. Professor Sinn has dealt with this problem in detail.

The new EU guidelines on freedom of movement provide that the immigrant must have sufficient health insurance coverage and sufficient income to ensure that he or she will not become a burden on the social security system of the host country. But if these conditions are no longer fulfilled and the immigrant does claim – and is granted – social assistance, then according to European law the fact of claiming and receiving assistance does not, by itself, constitute grounds for expulsion.

I shall leave it as an open question whether this legal arrangement with respect to freedom of movement in Europe will induce a race to the bottom in social policy, a dumping competition with respect to social standards. In any case, to the extent that it gives rise to migration that is motivated by hopes of taking advantage of higher social standards, to that extent it will make it harder to maintain the old standards of the welfare systems. We have accumulated considerable experience in this respect during the last decades; the abuse of the right of asylum is a theme that we have been discussing for the last twenty years. That is why my personal opinion is that we should change to the country-of-origin principle, as Professor Sinn mentioned. This seems to me to be a sensible regulatory alternative, which moreover would permit constructive competition between national welfare systems at the European level. However, I have my doubts whether such a paradigm change would be politically feasible at the European level.

Another of today's topics will deal with immigration from outside the European Union, which usefully supplements the questions I have just referred to. In our view, this theme does not belong to the core tasks of the European Union. Different from policies on asylum and refugees, immigration policy does not represent an international legal obligation, which has been voluntarily and constitutionally assumed by the member countries of the EU, but rather the willingness to admit immigrants is voluntary and the decision with respect to immigration must be based on the interests of the individual member state. In this respect, the member countries may have quite different interests.

With these considerations in mind, it must be left up to each individual member state to decide how many

immigrants it is prepared to admit, which persons are eligible for admission and what requirements for entry it will impose. The proposal that was discussed at today's governmental conference in Brussels for an EU constitution takes considerations concerning immigration from outside the European Union only partly into account.

The flexibility and the absorptive capacity of Europe's labour markets are the decisive factors that will determine how we must deal with migration within Europe and with immigration from countries outside Europe. And in this context, Germany and many other parts of Europe are having labour market problems. In 2003, the EU of 25 had an average unemployment rate of 9.1 percent. The extremes were 3.8 percent in the Netherlands vs. 17.1 percent in Slovakia.

Another worrying indicator is the growth gap of almost 11 percent between the EU of 15 and the United States during the period 1995–2003. If this development of the recent past continues, as it seems likely to do, then the so-called vision of Lisbon will turn out to be the illusion of Lisbon.

We are in the process of becoming a knowledge-based industrial and service society. Periods of social transition are always difficult, and one of the greatest difficulties is the changes that citizens experience at their place of work. Industrial jobs are disappearing or have already disappeared. Our economic and social policy objective must be to promote the creation of more complex jobs which produce higher value. This requires more mobility, more flexibility, more innovation, more research and development, more transfer of knowledge, and more aggressiveness in all of these areas. But in all of these areas there is too little movement in our country.

To attain any of these objectives we need to intensify our efforts in the area of industrial policy at EU and national levels. It is not a matter of the state determining the direction in which the economy should develop, but rather of creating the framework that will ensure that we preserve and expand the industrial base we need; that we can develop and produce new products and new methods of production; that we accept the challenges and not give up in the face of the difficulties.

Europeanization, globalisation and other demographic and social manifestations of change affect all

of Western Europe's industrial nations to the same degree. This means that in Europe the welfare state will only survive if it resolutely faces up to the challenge. The role of the European Union must be strictly based on the principle of subsidiarity: as much centralism as necessary, and as much decentralized, on-site decision-making as possible. For in an era of globalisation and flexibility, efficient decision-making processes are vital. This also applies to decision-making in the political area.

With respect to social and labour market policy, the consequence to be drawn from this analysis is that, with the exception of problems with a cross-border component, e.g. cross-border commuters within the EU, these areas of government responsibility should not be assigned to the EU. There is another reason for coming to this conclusion: social policy is above all redistribution policy. Within a solidarity community like a national state this is acceptable and can be designed and implemented.

The draft constitution does not provide for additional legislative powers for the European Union in the field of social or labour market policy. However, it must be pointed out that the open method of coordinating social policies provided for in the draft opens the way for the Commission to establish guidelines and indicators in areas such as employment, labour law, as well as social security, the right to form coalitions, and collective negotiations between employers and employees, i.e. in nearly all areas of social and labour law. Furthermore, the Commission is authorised to set up and develop the instruments necessary for a continual monitoring and evaluation of the policies of the member countries. The instrument of the open method of coordination is already being used to assign goals concerning labour market, social and other policy areas to member countries as part of coordination processes, although the treaty provides no authorisation for this. All the measures taken by the EU – from the Lisbon strategy to the general coordination of the economic policy of member countries, on through to the open method of coordination – do not absolve the member states from their obligation to carry out the necessary reforms on their own. Passing on the responsibility to Brussels may seem to be the line of least resistance, but in fact it does nothing to solve the problems, but rather tends to slow down the reform processes that are needed. No member country can avoid doing its economic and social policy homework, and since it has to be done, it should be done promptly and thoroughly. The compe-

tion between the individual member countries that will arise out of this process of finding the best labour market, tax and social policies will redound to the benefit of all.

For us here in Germany this means that fundamental reforms in our social security systems must be carried out, otherwise we shall no longer be able to afford these systems. And this means that the welfare state must not only be insulated against demographic developments, but also against influences coming from Europe or from the process of globalisation: here I say that the key is economic growth and job creation. We shall not succeed in getting the problem under control if the loss of jobs causes the number of persons paying into the social systems to decline more rapidly than the pace at which the reforms are being carried out; it is clear that a decline in the number of people in employment, and hence a decline in the number of those paying into the social security system, goes hand in hand with an increase in the number of people claiming benefits from the system, and that such a process imposes a huge burden on the social security system and the state. If this vicious circle cannot be stopped, then, ladies and gentlemen, we shall be confronted by a situation in which the reforms are constantly trailing behind actual developments. And that means that it is not five minutes before noon, it is already high noon. This and the flexibilisation of the labour market are the central themes which demand a prompt solution. This in turn means that we need a simple tax system that is internationally competitive. To attain that, we must quickly reduce supplementary wage costs; at present, social security contributions amount to a 42 percent supplement to basic wage costs in Germany.

Higher supplementary wage costs make labour more expensive here, and this aggravates the danger that jobs will be transferred abroad or that more work will take place in the informal sector of the economy. This has become the experience in Germany recently: the underground economy is booming and the transfer of jobs to other countries is flourishing. If the supplementary wage costs are not brought under control, then with the present system, demographic developments will bring about an explosion in supplementary wage costs in order to support the social security system; under a status quo assumption they will increase to 50 percent by 2030!

Our objective must be to bring about a short-term reduction in supplementary labour costs that gets

them below the 40 percent level; we must give market mechanisms more scope in our welfare system. This implies, of course, that people must accept more responsibility for their fate, that they themselves must make provision for their welfare. Stated bluntly, we must say farewell to a mentality that demands comprehensive protection against all of life's risks if we are to preserve the indispensable core of the welfare state. And there is another consequence that follows from demographic developments: in future we shall not be able to do without the abilities and the experience of our older fellow citizens. Today, people retire at age 59 or 60. It is necessary – and hopefully it will be possible – to put an end to this. Working time over one's entire life span must and will be lengthened. In the first instance, we must make 65 years the normal age of retirement in practice. It is up to the private sector of the economy to offer suitable jobs to older people. Once 65 has been established as the normal age of retirement, we can begin to discuss the possibilities of raising the standard retirement age further, thus extending people's period of employment over a greater part of their lives. But it is no use to discuss the extension of life-time working time, if at the same time working time on a weekly or yearly basis is being reduced.

Beyond these reforms, we need reforms in the labour market which promote formal work at competitive prices. We can only charge more to the extent that we are better. Our objective must be to get those now working in the informal sector into regular employment and this requires that union wage scales be reduced, and that in some areas of the economy agreement be reached on paying low wages. At the same time, we must stop considering unemployment as a form of leisure that deserves public support.

The objective of a subsidiary, active social policy must be to promote and encourage the instatement or reinstatement of unemployed people into gainful employment, if necessary by means of complementary benefits. And the theme of activating social policy is a central theme, if it is our serious intention to reduce the burden of income-substitution payments. Here again, Professor Sinn has formulated a series of proposals which hopefully will be turned into legislation in the near future. We need, as soon as possible, a tax reform which rewards performance and strengthens the international competitiveness of Germany.

If we can accomplish all this, then we shall have succeeded in making Germany a more attractive location for enterprises and jobs. This is the way to prepare our labour market and our welfare state for the future. Here, all levels of government, the EU and the nation states in the context of their competencies, must pull together and implement the reforms that are needed. This is the central task that confronts us here in Germany. It will require considerable spending cuts, and the government's Agenda 2010 will not be sufficient. This seems to be the view of the Chancellor, of the private sector of the economy, of the Council of Economic Experts, and of all the other advisory councils; and in the face of this unanimity, one can only say today: enough of analysis, it's time to get on with the job and implement the decisions.

If all of the measures that I advocate are implemented, then the risk of massive migration within Europe from the poorer regions, and particularly the new member countries in Central and Eastern Europe, to the prosperous social states will be mitigated.

Ladies and gentlemen, the celebration of D-Day on June 6th has made unmistakably clear that there is no alternative to the European Union. This community of nations is beyond a shadow of doubt the most successful project in the service of freedom, peace and prosperity that Europe in its long history has ever known. And the European Union is also the most successful project ever put in the service of reconciling former enemies, and of gathering them together in a community of values, having as its common objective the growth of all the countries within the Union. For all these reasons we welcome this development. The new challenges, and most of all the enlargement to the East, give rise to massive economic pressure to carry out comprehensive reforms. These reforms are needed at the EU level, and in the member countries as well. This challenge is also an opportunity – a chance to carry out wide-reaching reforms in Europe and we must not frivolously let it slip through our fingers.

And above all, we must carry the citizens of Europe with us on the way to the further development of the EU. The poor participation in the European elections showed that this will not be easy. But one should not just push aside the theme. Many say that "Europe" is an intellectual construct, having its existence mainly in a few peoples' minds, and there is without a doubt a measure of truth in that observa-

tion. But many political decisions were initially not supported by the majority of the population. In Germany we must not forget that the introduction of the social market economy found little or no approval at the beginning and that Ludwig Erhardt, in the years immediately following 1949, was one of the best-hated politicians in Germany, but is now one of our most admired historical figures. This merely shows that it is up to the politicians to show responsibility and take the unpopular course when it is necessary. Nor should it be forgotten that Germany's decision to join NATO was extremely controversial at home; at the time the decision was made, opinion was much divided. Today, Germany's membership in NATO is regarded at home as something that is a matter of course. The establishment of the European Union, or the European Economic Community, as it was at first called, was a similar situation. The fact that the enlargement of the European Union demands a decision from those with political responsibility that does not enjoy the same degree of support everywhere is nothing unusual in a democracy. Nevertheless, it is important to engage in an intensive dialogue with our citizens in connection with the processes of extending the EU, to explain to them the implications of the decision, in order to avoid a situation in which decisions affecting Europe would have to be taken in a political atmosphere in which anti-European attitudes predominate. After all, it must be possible to discuss the pros and cons of the necessity and the consequences of decisions affecting the EU.

Europe and the European Union must not be allowed to become a project that in the eyes of the citizens is seen as a project that principally concerns the political elites. Thus it is important to draw the necessary conclusions for the political decisions; and it is equally important, ladies and gentlemen, that the problems that are related to Europe and the European Union should be openly addressed and discussed. And for these reasons I am very happy that the BMW Foundation Herbert Quandt together with CESifo have arranged and carried out a conference such as the Munich Economic Summit, in which controversial topics, including those that often have a label attached to them, can be discussed in an open and friendly atmosphere. I earnestly request of you not to put labels on the themes related to migration, but rather to discuss them seriously and thoroughly. For the most serious danger facing Europe is that problems are not recognised and that discussion is not opened up early enough to ensure that solutions

are identified in time for them to be of use. If this process of recognition, discussion and solution finding is not started in good time, then an attitude of aversion may develop in the new member countries, which could have been avoided if a process of clearing up the problem would have started early enough. We must also take care that the process of European unification should be designed in such a way that despite all the problems of adaptation that we have, we keep frictional losses to a minimum, and the utility to those immediately concerned as large as possible; this applies to the area of economic policy as much as to any other area. We must try as best we can to recognise problems with foresight, to analyse them, and to take the right decisions early on, in order to eschew, to the extent possible, the unwelcome effects of avoidable or remediable problems. That is my understanding of the theme and the concept of today's conference and thus – despite all the controversies that might arise – we should focus our efforts on identifying the problems and attempting to formulate solutions in time to move forward in a constructive way in the process of European unification. We should not just seek formal unification in governmental areas, but unification in a more profound sense: agreement with respect to what we see as a reasonable path of future common development. And let me say as I draw to a conclusion, that it is deeply gratifying that since the Second World War Germany has experienced the longest period of peace in its history. Today the younger generation, and the older generation of Germans as well, regard the countries on our borders as neighbours, and not as “traditional enemies” or “arch enemies” as the old expression was. Thank God for this development. Only fools could believe that we should, or would, or must, return to the old attitudes vis-à-vis the countries that surround us or that one or another unavoidable development would inevitably lead to the former hostility. Together with our East and South-East European neighbours, we have the chance to set in motion a process of peaceful development, in which all the countries of the European Union and all their neighbours can participate.

It is my hope and wish that conferences such as this may influence political decisions. So you have my best wishes for fruitful discussions, for an interesting day in Munich and for a pleasant stay in Bavaria. Thank you.