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Article

Economic Integration and the Welfare State

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Let me start by saying that the best social policy is to have as many well-paid jobs as possible and that economic growth is the best way to get more and better jobs. This is a quote from the Lisbon Strategy. It is a very nice and ambitious goal, but the problem is reality. Regarding economic growth and competitiveness, from 2000 on the gap between the United States and the EU has not shrunk but has rather widened. And this has not been only due to different developments in employment. GDP per employed person is also decreasing in the EU as compared to the U.S.. Another fact is the composition of growth in past years: EU potential growth is declining as compared to the U.S., and even more alarming is the decline in competitiveness as measured by the quality of technology and the quality of institutions, i.e. institutional conditions for high-growth.

Comparing the old and the new member countries, i.e. EU15 and EU25, we see a big difference in economic growth between the two groups of countries. There are two major reasons for this difference. First of all, in the new member countries there is converging growth from a much lower level. More important, however, are the structural reforms. The lack of structural reforms is the biggest problem of the EU 15. This is, of course, closely related with the sustainability of the welfare system.

Let me tell you what I think are the greatest obstacles to achieving higher and sustainable economic growth in the old Member States and to an increase in competitiveness. Firstly, it is the lack of economic freedom in general. It is very difficult to understand how a country, whose public expenditures are 55 percent of GDP, like for example France, should be able to be competitive in the present conditions of globalisation and an increasingly competitive environment. Secondly, it is insufficient market flexibility, especially labour market flexibility, but also financial market flexi-

bility, the lack of venture capital financing, etc. Thirdly, it is long-term fiscal sustainability. High fiscal deficits have very negative direct and indirect effects on the competitiveness of business. This is closely connected with important structural reforms, of course, like pension reforms, health care reforms and others. Fourthly, competitiveness is also very closely connected with the business environment. It is necessary to have structural reforms for a more business and investment friendly environment in the EU.

One good example is the tax system.

Let me just briefly outline the basic features of the Slovakian tax reform. In Slovakia, from January of this year, we have a new tax system that is much more business friendly and has reduced the tax burden from direct taxes significantly. We have cancelled the dividend tax, the gift tax, the inheritance tax and the real estate transfer tax. We have changed the progressive taxation of personal income, which ranged from 10 percent to 38 percent, to a uniform rate of 19 percent. The corporate tax, which was 25 percent, is now also 19 percent, and we have also unified VAT to 19 percent from previously 14 percent and 19 percent. We have cut direct taxes and raised indirect taxes. These changes have created a more business friendly system, they have provided a very neutral, very simple, very transparent system, which has improved the business environment and is attracting more and more investment to Slovakia. Of course, there have been other reforms as well, which I have no time to discuss here, however.

From the point of view of enlargement, it is my opinion that enlargement is a win-win strategy. I am deeply convinced of that. Of course, enlargement is also showing up weaknesses and deformations of the present system. But one should not blame the messenger. The problems are internal. The weight of the new member countries is only 16 percent in terms of population, but only 8 percent in terms of GDP in purchasing power parities. In nominal terms it is much less. Globalisation is here, competitive



pressure is here, and enlargement is only making the weaknesses more visible. If enlargement exerts the pressure for undertaking the necessary structural reforms it will benefit the old member countries, too. Therefore I am convinced that enlargement is a win-win strategy; it is not only good for the new member countries but also for the EU15, because without structural reforms we can forget about becoming the most competitive economic region of the world.