***Critically assess the main challenges facing the EU in 2013 and its capacity to meet them, with particular reference either to enlargement or to further integration.***

## Introduction

This brief essay aims to assess the challenges facing the European Union (EU) in 2013 together with its capacity to meet them. The focus will be on further integration, which relates to those who are currently members of the EU. The essay begins with an introduction to political economy and the EU, to provide a context for the discussion that follows. The essay continues by identifying the main challenges of 2013 and justifying their selection, before assessing whether the EU can meet them and if not, what options might be available. The essay concludes with a summary of the key findings of the analysis.

## Introduction: Political Economy and The European Union

Political economy was “the original name of what is now known as economics” (Black *et al.*, 2012, p.313). The term now refers to “the ‘new political economy’ that draws attention to the political motivation of economic policies: policy-makers and lobbyists are often more concerned with the income distribution of their electorate than with the efficiency effects of policies” (Black *et al.*, 2012, p.313). This definition highlights one of the issues facing the EU, namely, tax avoidance and evasion by businesses and individuals, as they relate to income distribution within different EU countries.

The EU was initially formed with twelve countries: Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain and the United Kingdom (Black *et al.*, 2012, p.138). In 1995, Austria, Finland and Sweden joined, with Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia joining in 2004 (Black *et al.*, 2012, p.138). In 2007 Bulgaria and Romania joined the EU and potential candidates for EU membership are Croatia, the Republic of Macedonia, Turkey, Albania, Bosnia and Herzegovina, Montenegro and Serbia (Black *et al.*, 2012, p.138). Seventeen countries comprise the eurozone: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain (Black *et al.*, 2012, p.138). Other countries use the euro both with and without legal agreements with the EU (Black *et al.*, 2012, p.138).

## Main Challenges of 2013 and Capacity to Meet Them

There are several issues facing the EU at present. However, the most important appear to be the result of the banking bailout in 2007-2009, the ability of organisations and individuals to avoid paying income tax in their home countries and/or countries within which trading takes place, and the survival of the euro. Each of these will now be assessed.

### Fallout Following the 2007-2009 Bailout

Jackson (2010) provides an overview of the financial crisis, together with the reactions of both the USA and the EU and the likely actions to be taken by each. The short-term problem for the EU has been to "resolve the financial crisis while stimulating domestic demand to stem the economic downturn" (Jackson, 2010, p.27). Over time, the objective for the EU is stated to be searching for a regulatory scheme that "provides for greater stability while not inadvertently offering advantages to any one country or group" (Jackson, 2010, p.27). EU governments have attempted to use fiscal measures to stimulate their economies while dealing with banks that are technically failing (Jackson, 2010, p.28). However, a major issue for the EU is that the member states can enact regulation and legislation as they deem appropriate, unlike the USA where all states will be bound by federal law (Jackson, 2010, p.28). This gives each member state the ability to make their own rules to govern financial services and banking. Interestingly, Jackson's (2010, p.28) report suggests that the EU would be focusing on those governments who are deemed to be not expending economic resources relative to the size of the underlying economy to stimulate economic growth. In the event, since 2010, the focus of much of the EU has been on austerity measures, with a special focus on certain countries that have required bail-outs: Ireland, Greece, Spain, Portugal, Italy and most recently, Cyprus (Csermely, 2013, p.8). The terms of the bail-outs include strict budgetary control and deep cuts in public spending, leading to higher unemployment, lower state benefit payments and a widening gap between rich and poor (Csermely, 2013, pp.11-12). It has also dramatically reduced economic growth, with EU countries returning to recession after bank bail-outs and what appeared to be growing economies (Csermely, 2013, p.11-12).

One of the causes of the problems within the eurozone relates to the different currencies that were in force when the euro was launched, and the relative price of the old currency compared to the euro. Some claim that the rates at which some currencies were converted were too high or too low, allowing some member states to avoid budgetary discipline (Csermely, 2013, p.11). Since the launch of the euro, member states have lost the use of their own currency as a way of devaluing that currency and reducing the debt burden. At present, the main provider of funds is Germany, and it is their Chancellor who insists on austerity policies for countries subject to bail-out, although other member states are now claiming that such policies have failed and should no longer be imposed where a bail-out is required (Coman and Willsher, 2013). Worse, however, is the undermining of the economic model used to justify austerity policies: Reinhart and Rogoff's model was revealed to contain an error in the spread sheet upon which the theory was based (Moore, 2013). A closer integration between those member states who are members of the eurozone in both economic and political terms might have helped avoid some of the excesses of some governments, providing some budgetary discipline and avoiding excess borrowing to cover a lack of real growth and poor tax revenues.

Tax Avoidance and Evasion

Within the budgetary issues facing the EU is the problem that large global organisations and extremely rich individuals are not paying as much tax as they should. Syal *et al.*, (2013) report that the big four major accounting firms in the UK use knowledge gained through assisting in the drafting of tax legislation to help their clients avoid tax, which the Commons Public Accounts Committee has called a conflict of interests. Public campaigns have appeared with groups occupying different outlets where it is believed insufficient tax has been paid and online campaigns have targeted underpaying companies (see for example, Macalister, 2013; Boffey, 2012; and Inman, 2013). Arguments against tax avoidance and evasion include that it would reduce the impact of austerity on the poor by reducing the requirement to cut the welfare budget as deeply as it has been. However, whether all countries involved in offshore tax havens will actually take effective action to identify those using their facilities remains to be seen. The UK has made various pledges, but nothing appears to have actually been done (see, for example, Elliott and Stewart, 2013; and Wintour, 2013). The lack of economic policy integration within the EU means that member states can make whatever claims they like and the EU is powerless to compel them to take action.

The Survival of the Euro

One of the consequences of the bail-outs provided to some EU member states is that they consider leaving the Euro. This allows them to recreate their original currency and print as much money as they need to recapitalise their country. Many countries are becoming angry with the impact of the bail-out terms imposed, primarily by Germany, and general elections are favouring Eurosceptic parties (Sinn, 2013). Interestingly, one of the world's best known financiers and philanthropists, George Soros, believes that the euro can be saved by Germany leaving it (Soros, 2013). He states that the causes of the crisis in the EU are many and complicated, with a major problem being the lack of control that member states have over the euro (Soros, 2013). He believes that the minimum possible was done to preserve the euro but no correction was made to the structural deficits of the euro (Soros, 2013). Soros (2013) also believes that austerity is the wrong policy precisely because members of the euro cannot control the currency, so cannot increase exports and reduce imports as, say, the UK can because the UK controls its own currency. Germany is too strong for the euro and if it does not support the creation of eurobonds as a way of helping resolve the euro crisis, then it should leave (Soros, 2013).

This is an unusual idea, which is unlikely to happen in practice, but it does highlight the problems caused by a lack of economic and political integration within, as a minimum, those countries who are members of the eurozone. Had there been full political and economic integration at the launch of the euro, no one country could have enacted a budget that did not support the euro at the same time as promoting growth for the country. It is unlikely that any further political and/or economic union will take place, as several member states are now under rescue terms and such a move would penalise them even further. Whether the euro survives the continuing economic crisis remains to be seen.

## Conclusion

This essay considered three problems currently facing the European Union: the aftermath of the global financial crisis of 2007-2009, the avoidance and evasion of tax and the survival of the euro. It is unclear as to whether closer economic and political integration would have produced a different result to the financial crisis than what was actually done, but the continuing problems of high levels of debt may require an integration solution to be of any benefit. Closer economic and political integration might increase the regulation of taxes for both individuals and organisations, leading to less avoidance and evasion, although it could force global organisations to reconsider the location of their head office and select a location with lower tax rates than those charged in the EU. The survival of the euro may also require greater integration in both political and economic terms, although much depends on the financial health, or otherwise, of those EU states that have not required a bail-out. Equally, the actions of Germany will have a significant impact on how the euro zone is run, as they are the biggest supplier of cash within the EU. Overall, integration would appear to have been a better option from the start, rather than attempting to integrate totally different systems existing in member states.

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