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- MARCH 21, 2011

## Prepare for a European Union Divided in Two

- By IRWIN STELZER



Twenty-seven divided by two equals 17, with 10 left over. That's the new Euromath.

Sooner or later, the euro-zone financial crisis will be over. Greek, Irish, Portuguese and probably Spanish creditors will have neatly trimmed hair, the banks will have had to shore up their inadequate capital, German exporters will continue to cash the profits from the euro their southern partners have obligingly weakened, and the eurocracy will have found other reasons to meet. But Europe will not be the same.

It will be changed in two very important ways. First, the 27-nation European Union will have fractured into separate groups of 17 and 10. Second, the economies of the Gang of 17 will be centrally managed by a Franco-German coalition, while the nations among the 10 "leftovers" will fight a losing battle to effect the policies of the EU of which they are paid-up members. Peaceful coexistence between the 17 and the 10 is no sure thing.

The 17 euro-zone countries have made the direction in which they are heading very clear. The felt need to prevent defaults by its overly indebted members is leading to a more pervasive system of central economic management. The 17 are to have access to Germany's balance sheet, in return for which Germany is quite properly demanding a say in how they manage their economic affairs. Not only their budgets, but all the factors that affect their international competitiveness: methods of wage bargaining; the generosity of their welfare states, including the timing and terms of retirement;

regulations concerning access to various occupations; and, most of all, tax rates.



Bloomberg News

The European Union is effectively being split into separate groups of 17 and 10.

It's not on for Greece to borrow money from the stronger euro-zone countries while operating loss-making, nationalized transport systems; or for euro-countries to index retirement benefits to wage rates rather than retail prices, with Germany the payer of last resort; or for one member to maintain corporate tax rates at half the level of the group average. It has become clear that a one-size-fits-all interest rate must be accompanied by more uniform fiscal and related economic policies. Joy unbounded in Paris as the long-sought French goal of a 17-nation euro-zone "economic government" comes closer to realization, marginalizing EU institutions.

The nations outside of the euro zone, the left-over 10, maintain their own national currencies, and retain control over their own interest rates. The value of their currencies can fluctuate, allowing depreciation if they are over-valued, and appreciation if inflation threatens. Their central banks can raise or lower interest rates in response to changing economic conditions. And to some extent they are free to follow the more liberal economic policies they prefer, rather than hew to the line set by the more anti-free-market euro-zone 17.

Those differences between the 17 and the 10 are creating a threat to the cohesion of the 27-member European Union. The euro-zone countries are developing rules for coordinated economic management without consulting the excluded group of 10. Next step: apply some of those rules to the 27-nation EU to prevent non-euro

countries from gaining a competitive advantage over euro-zone members, as France and others complain Britain has done by allowing the pound to float, countenancing a less regulated labor market, and keeping regulation of financial services to an essential minimum.

The excluded 10 are well aware of their exclusion from meetings that set policies that will affect them. "It really rankles that they [Denmark and Sweden] can't get into important policy meetings," reports the Economist. Add Britain to the increasingly rankled as Brussels makes it more costly to employ part-time workers and weaves a new web of regulations around the U.K. financial services sector, and you have a core group that just might decide that exclusion from euro-zone summits makes membership in the EU less attractive. After all, majority voting allows the bloc of 17 to dominate rule-making in the EU.

France has a solution for the under-represented, non-euro countries: get rid of your national currencies adopt the euro, and get to have a say—a tiny one compared to Germany and ours, but a say nevertheless—in the rules being drafted to implement the new European-wide system of economic management. That has little appeal for many members of the excluded 10. Britain's economic reasons for refusing to buy a seat at the table by surrendering its own currency are rooted in basic differences from euro-zone countries—a more interest-rate sensitive economy, greater reliance on financial services, the need for a currency that adjusts to changing economic conditions. These remain as powerful a deterrent to membership as when they were first developed by then-Chancellor of the Exchequer Gordon Brown and the current shadow chancellor, Ed Balls.

Meanwhile, Sweden points out that its economy is the fastest growing in the EU, Danish voters believe they are not Ireland because the krone is not the euro, and euro members Greece and Ireland are wondering whether friends-in-need should have to pay usurious interest rates to their friends-in-deed.

The American colonies went to war to break away from Britain, and fought under the banner, "Taxation without representation is tyranny." The excluded 10 will have to decide just how long they want to

tolerate marginalization before deciding that regulation without representation is equally tyrannical.

—Irwin Stelzer is the director of economic-policy studies at the Hudson Institute in Washington.

Write to Irwin Stelzer at [irwin.stelzer@wsj.com](mailto:irwin.stelzer@wsj.com)