# Rules for European Integration and Economic Policy
# Comment to A. Knoester, A. Kolodziejak and G. Muijzers

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# Discussion

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This paper is a revised and improved version of that presented at the Conference. The new version takes much of the discussant's criticism into account; basically, it is a plea for policy coordination and a more speedy development of the European monetary system.

I would like to make two comments at this stage of the discussion.

The first concerns the reason for policy coordination. Knoester, Kolodziejak and Muijzers point to the fact that significant fractions of Keynesian multiplier effects spill over to other countries when the country carrying out the policy is small – as, for example, the Netherlands. Citing the example of the Mitterrand experiment and the results of a number of macro-economic models, they make the case for a coordination of fiscal policies to avoid the spillovers and to internalise the presumably beneficial effects of multiplier policies.

While I do not deny the validity of this argument, I find allocative reasons for policy coordination between the members of the EC much more important. Unlike short-run Keynesian policies, allocative policies can have a much more profound and lasting effect on people's well-being, and indeed unbridled competition of economic policies may be very harmful. There are many examples for this.

- *Environmental regulation* In the presence of international spill-overs of waste and pollution via commonly-owned media such as air and water, it is in a single country's interest to impose less rigid pollution controls than is efficient from the viewpoint of all countries together.
- *Quality Standards* When there is asymmetric information on product quality (as in the Akerlof model), countries have an incentive overly to relax their quality and safety regulations, for this reduces their industries' production costs without deterring ignorant foreign consumers.
- *Income redistribution* When factors of production (or simply legal tax bases) can easily be moved across national boundaries, competitive governments cannot carry out redistributive tax policies. Each government has an incentive to undercut its rivals' taxes

on the rich and benefits granted to the poor until a situation of mere benefit taxation is reached.

- *Public goods* Public goods, which are defined by decreasing or even zero marginal costs with regard to the number of users, cannot be supplied by competitive governments since the tax prices charged on the users cannot exceed the marginal costs and are thus insufficient to finance intra-marginal costs.

In all of these examples, policy coordination would be useful to avoid the devastating effects of fiscal competition. Common European environmental standards, equal quality standards or at least a common system of well-defined and popularised quality categories, an extended social charter, and harmonised tax systems seem necessary; but all of this has little to do with Keynesian multiplier effects.

My second comment refers to the requirements the authors believe to be necessary for a workable European currency union. Among the requirements and aims of official policy listed are external stability and balanced government budgets. If these postulates are to be understood as proscriptions of borrowing and lending activities by countries and governments, I find them highly objectionable.

I do not see any particular reason why countries should not be allowed to exploit the welfare gains from intertemporal trade in economic resources which come along with extended periods of current-account imbalances. Why should a rapidly-growing country not borrow to smooth its international consumption pattern or to finance its investment projects? There are certainly moral hazard problems involved, but they should not be put forward completely to forbid current account deficits.

My reservation against the proscription of public borrowing has a similar motivation. Borrowing can help shift the burden of long-lasting public investment projects to those who benefit from them; it is a way of overcoming the markets' liquidity constraints against private borrowing; and, as the Domar formula tells us, it can, in a growing economy, continue indefinitely without ever creating bankruptcy problems.

Apart from this criticism I fully share the other postulates the authors establish for a European Currency Union. The independence of the Central Bank from national governments, including the full independence of the national governors delegated to the European Reserve Board, is a necessary requirement for a credible commitment to a policy of price level stability, a point of view I am pleased to see shared and further developed in the paper.