



The gap between Europe's rich and poor economies presents a huge challenge
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Reform is the key for Britain and Europe, not voting 'in' or 'out'

Gerard Lyons

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Europe has been the hot economic issue of the summer. The focus has been on its dismal economic performance and on Britain's future relationship with it.

When we talk about Europe in economic terms, we focus on the 18 countries that use the euro. This is not a surprise, as Germany and France made clear that the survival of the euro was central to the survival of the European project. That project, lest we forget, is ever closer union, although most people would judge it

more in terms of better economic conditions and improving living standards.

Unfortunately, Europe's present economic situation is poor. Much-needed economic change in Ireland, Greece and elsewhere has come at a heavy cost, so much so that European Monetary Union – EMU – should really be renamed Even More Unemployment, with record high rates of youth unemployment.

Europe's poor performance is in stark contrast to what is unfolding elsewhere. As I highlight in my book *The Consolations of Economics*, there are positive signs across the world economy. Indeed, one positive for Europe is its ability to export more to other growing regions, led by China.

The United States and Britain are also in the early stages of recovery and their attention is on when to exit from record low interest rates. In stark contrast, the European Central Bank is on the verge of having to do more, printing money through quantitative easing. It needs to act decisively and soon.

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Europe is suffering from a lack of demand. It also faces the risk of deflation, where prices fall. If this happened, it would have the double whammy of further exposing the competitive gap between Germany and Greece and also denting confidence among people and firms across the Continent.

Although the idea of prices falling sounds good, that is for individual items. When it happens across a whole economy, it tends to discourage people from spending as they wait until prices fall further, and it deters companies from investing as margins are squeezed. Usually, unemployment rises further.

Naturally, Europe's problems weigh on Britain. A recurring question from business and investors has been: "What does the Europe debate mean for London?" Despite a positive view of London's prospects, there is often concern about both the weakness of the eurozone economy and about what the future may hold if the UK were to have a referendum on the European Union. As a result, in early August, *The Europe Report: A win-win situation*, which I had written for the mayor, was released. It looked at the key issues in the UK-EU debate, with a particular emphasis on London.

It was called win-win as longer-term forecasts prepared for the report by Volterra, the economic consultancy, showed that the UK has the ability to do well in or out of the EU. The best outcome would be to stay in a reformed EU.

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The trouble with much of the debate is that it gives the impression that Britain will succeed only either if it is in the EU — that is the "yes" campaign — or if it leaves — that is the "no" campaign. The reality is more complex.

Although staying or leaving is a vital decision, it is not the only thing that matters. The analysis in *The Europe Report* showed that the outlook also depends upon the policies adopted. If we stay in the EU, the key question is whether it will reform? For

that to happen, the UK needs to play an engaged role. Meanwhile, if the UK leaves, the outlook will depend upon the policies adopted outside and also on the relationship that Britain has with both Europe and the rest of the world.

The report outlined some key reforms. One of the most important is the future relationship between the eurozone and non-eurozone members of the EU and safeguarding the future rights of the non-eurozone not to be outvoted by the eurozone.

The more that measures are taken to help the eurozone, the more this could drive a wedge between the eurozone and non-eurozone. This is a vital area for the City and for the London economy. A worry is that, in addition to UK-imposed regulations on banks, an unsympathetic regulatory burden from the EU would hamper the City compared with other global financial centres.

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Another is ensuring that the single market works and in doing so addresses issues relating to services, people and to preventing regulatory intrusion. The single market in services needs to work fully. If so, the UK would gain. The idea of free movement of people also needs to change to reflect that expansion of the EU has resulted in huge variations in income levels, pay and benefits between economies such as the UK and others in eastern Europe.

Another vital reform is the need to change the mindset to make Europe more productive, outward-looking and competitive.

The main challenge facing Europe today is about the demand side of the economy and the need to encourage more spending. The main challenge tomorrow is about the supply side and the need to reform and innovate. The UK has a vital role to play, both as recovery here shows the rest of Europe the route to take and as we push the case for future economic reform.

The key is a successful economic model fit for the 21st century, positioning London, the UK and continental Europe to succeed in a changing, growing global economy.

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