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# *Stability and Competitiveness in the European Monetary Union*

Structural non-competitiveness and unruly policies have provoked severe financial instability and put certain euro zone countries in a shocking situation. Indeed, the entire European Union is at economic and political systemic risk. In this paper we shall analyze the coinciding conditions which helped generate this perfect and fatal storm: a) the structures of the European economy and of some Member States; b) the non-optimal currency zone that is the euro area; c) the profligate policies of certain governments and institutions; and d) the deficit in European economic governance. Newer and tougher mechanisms for European financial stability and detailed government measures for budget sustainability and structural reforms need to be most effective to be able to address the risks and challenges many States, and the Union itself, are facing.

Un déficit estructural de competitividad y unas políticas díscolas han causado una grave inestabilidad financiera en ciertos países de la zona euro, llevándolos a situaciones límite. Más aún, la propia Unión Europea padece ahora un elevado riesgo sistémico, económico y político. En este artículo se analizan las condiciones que generaron esta grave situación: a) las estructuras económicas y de ciertos Estados miembros; b) el carácter no óptimo de la zona euro; c) las políticas despilfarradoras de ciertos gobiernos e instituciones; y d) el déficit de gobernanza económica europea. Para afrontar los riesgos y retos de algunos Estados y a la propia Unión se necesitan nuevos y sólidos mecanismos para la estabilización financiera, así como protocolos detallados para la sostenibilidad fiscal y las reformas estructurales.

*Lehiaren defizit estrukturalak, eta horrekin batera, politika bihurri batzuek, ezegonkortasun finantzario larria eragin dute eta euro-guneko herri batzuk kinka larrian daude orain. Are gehiago, Europar Batasuna bera arrisku sistemiko, ekonomiko eta politikoa pairatzen ari da. Artikulu honetan, egoera honetara ekarri gaituztek faktoreak aztertzen dira: a) Europaren eta estatu-kide batzuen egitura ekonomikoak; b) euro-gunea eremu desegokia izatea; c) erakunde eta gobernu batzuetako politika diru-xahutzaileak; eta d) Europako gobernantza ekonomikoaren defizita. Egonkortze finantzarioa lortzeko tresna berri eta sendoagoak behar dira, baita iraunkortasun fiskala bermatzeko eta egiturak berritzeko neurri zehatzak ere. Hala, estatu batzuek eta Europak berak dauzkan erronkei eta arriskuei aurre egiteko gai izango gara.*

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Palabras clave: Estabilidad; Competitividad; Unión Monetaria Europea; Política Económica; Europa.  
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## **1. INTRODUCTION**

The European Union (EU) is in a most delicate situation: The European economy is weathering a turbulent recession because of the financial instability and limited competitiveness of some EU Member States (MS) of the euro area (EA). The EU's prospects don't look healthy. The EU has neither the power (because it doesn't have the necessary instruments) nor the willpower (because it doesn't have a political consensus) to rebalance the European economy. As usual, when politics doesn't take economics into account, politics distorts economics.

The twin presence of severe financial instability and structural non-competitiveness has generated a perfect and fatal storm in some EA MS. Palliative measures taken by the MS, EU and the European Central Bank (ECB) such as the implementation of mechanisms for the financial stabilization of the EA and the rescue programs of the sovereign debt of some MS with the participation of the International Monetary Fund (IMF), despite being well-executed, were not enough

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<sup>1</sup> This acronym suggests variations on order (PIIGS), extensions (GIP, GIPS, GIPSI, GIPSIF...) and allusions (Club MED...).

to avoid the contagion of the financial and banking system of many other MS. The MS debt crisis is having a cascade impact on banking and finance: both governments and banks can fail and attend together the bankruptcy.

In blunt terms, there has been a collapse of the sovereign debt markets of Greece, Ireland, Portugal, Spain and Italy (GIPSI)<sup>2</sup> hindering the financing of the growing public deficit due to the growing gap between falling revenues and rising expenditures. All of these elements have conspired to provoke a serious recession (European Commission, 2012).

This is not the fall of the euro but of the GIPSI. The fall of the GIPSI and its tumultuous effects to be felt throughout the whole the EU is due to the general economic crisis, the structural limitations these countries have regarding competitiveness, the bursting of the financing, housing and general bubbles, the unruly MS policies that were only possible because of the cushy ECB monetary conditions for the quantity of money and its negative real price, and the poor design of the European economic governance accompanying the euro and EU protocol (Edmund S. Phelps and Hans-Werner Sinn, eds., 2011). The structural limitations the European economy has regarding employment, productivity and competitiveness are most acute in the GIPSI. But other states such as France, Belgium, the United Kingdom and many of the newer MS are facing growing difficulties.

The last decade has seen great developments in the European economy: the launch, rise and fall of the euro, the huge growth and depression of the GIPSI, their subsequent sovereign debt crisis, recession in many EA MS, the success of the German and other virtuous economies, the growing divergence in the performances of the Nordic and central MS and the Southern and Eastern MS. But the structural limitations of the European economy –most of which manifest themselves through a limited capacity for competitiveness– and the current difficulties faced by the European economy related to the sustainability of public finance and the financial sector have been highlighted by the EU forms and the European economic governance deficit. Thus far, there does not seem to be any clear path towards the ending of financial instability and the addressing of competitiveness challenges (Brunet, 2013).

To paraphrase Jacques Delors, Europe does not have the instruments to realize its ambitions - and what is worse, Europe does not have the instruments to fulfil its needs; indeed, the attainment of such is proving quite problematic. The EU's economic and political challenges, the urgent need for stability, competitiveness and governance and the incapability of overcoming these obstacles are generating grave systemic risks.

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<sup>2</sup> This acronym suggests variations on order (PIIGS), extensions (GIP, GIPS, GIPSI, GIPSIF...) and allusions (Club MED...).

Because of the euro and the public deficit in Europe, all debate on economic policy –which is still a competence of the M– has been centred on the EU, its objectives, competences, policies, and, even more concretely, on its summits, meetings and dispositions. In reality, not all of the problems stem from to the euro, the instability in the EA and the public deficit (Sinn and Timo Wollmershäuser, 2011). Nevertheless, these problems are serious precisely because they are rooted in the limited competitiveness of the EU, in particular in the GIPSI's competitiveness (or lack thereof). Thus the solutions for the EA's problems are to be found not only in stabilization (monetary policy and the management of the public deficit, as austerity or as stimulus, in the current situation) but in structural reforms allowing the EU, and by extension the GIPSI, to be more competitive (Daniel S. Hamilton, 2011).

The debate in the EU on the European economy and economic policy is varied and rich. This debate is especially welcome for the Europeanists: finally, European subjects are under serious discussion. The debate has a multitude of participants, with representatives of each culture being involved (Martin Feldstein, 2012; and Charles Wyploz, 2012). The best and the worst arguments happen to be those addressing the European economy and economic policy (Brunet, 2012e). Finally, the main immediate problem (the sustainability of public budgets and their balance, the zero deficit) was discovered, but sometimes it is spoken of in simplistic terms, such as the opposition between austerity measures and the desire for growth and employment.

## 2. ELEMENTS OF THE EUROPEAN ECONOMIC GOVERNANCE

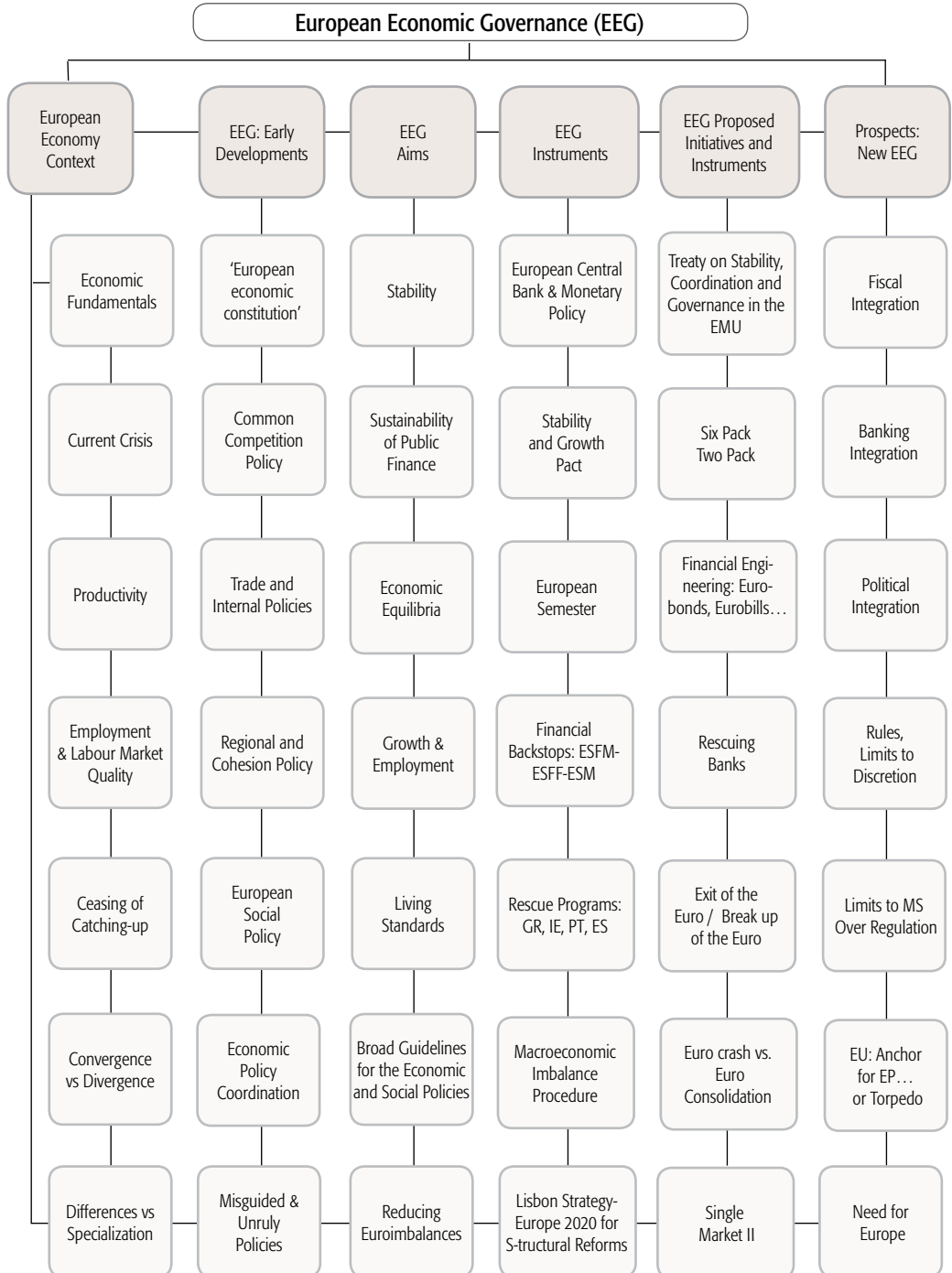
### 2.1. Economic Policy by Government vs. Economic Governance in a Multilevel System

Governance is a more streamlined means of regulation developed not directly by government but by non-State entities. Governance is a growing phenomenon, especially in economic regulation in which competences and instruments are assigned to non-State organizations.

In the EU, the growth of governance comes from two sources: the competences transferred from MS to national regulatory institutions and the competences transferred from MS to the EU (Brunet, 2008a, 2010a, and 2012a). The EU is a model place for governance because:

- a) It is a set of institutions which is not (yet) a State. In the EU, power does not emanate from the people and their parliament but from MS, with whom sovereignty remains (Nicolas Jabko, 2011).
- b) Economics is both the principle matter for the EU and the principle means through which governance is developed (Jean-François Jamet, Wernes Mussler and Stefaan De Corte, 2011).

Figure nº 1. **THE EUROPEAN ECONOMIC GOVERNANCE FRAMEWORK**



Source: Author elaboration.

In such a fashion EU economic governance gradually grew, and continues to grow as part of the process of integration. The hegemony of MS in economic policy is being substituted by the hegemony of economic governance in the EU and by the EU. Thus a multilevel economic governance system is being developed in the EU, though dissonance is felt between MS economic policy determinations and those of the new EU economic governance. Usually the immediate winners are the MS, but this doesn't last and the overall winner is the EU economic governance, which is strengthened to an even greater degree.

A framework for European economic governance can be considered in Figure 1: in contexts ranging from economic fundamentals to the impact of the crisis; the early developments, from the implicit European economic constitution to the pre-crisis initiatives; the aims of the EEG, from stability to competitiveness; the EEG's instruments, such as ECB to Europe 2020 policy; the initiatives and instruments proposed for EEG, from a Treaty to the euro break-up; and some prospects for EEG (EU, 2010; and Council of the EU, 2012).

Scrutinization of European economic governance will bring to the fore certain deficits, limitations and gaps, foremost being the gap between the current possibilities of European economic governance and the EU's economic governance needs. There is also a considerable gap between the economic policy and economic governance capabilities of the EEG and that of the the United States (US) (Raymond J. Ahearn, coord., 2011), not to mention that between the EEG and the MS economic policy. These gaps, limitations and deficits to be found in European economic governance are acute and broadly-felt in the current great recession.

## 2.2. **The European Way: The Forms of the EU System and the Formal and Policy Conditions for European Economic Governance**

The EU is not just a State. Its specific forms have great sway on the specific developments of European economic governance; thus it follows that EU needs and prefers to work through consensus and unanimity, through gradual processes working for the economy, which always comes first (Brunet, 2011b).

Compared with the usual aims and means available to most states, EU law and its policies and actions are limited by their international origin. Despite this, they are propelled forward by the immediate and direct effect of the EU law and its supremacy over of those of the MS. Similarly, the *acquis communautaire* is referred to in order to guarantee the attained level of integration and to impede backsliding. The EU is a construction of law and is maintained through law. The international origins through interstate treaty of EU law is complemented by EU derived law, of which both primary and secondary law have immediate and direct effect, and prevail over MS law.

Nevertheless, the enormous power of EU determinations is making itself felt through the principle of subsidiarity, in that these need to be developed by the MS themselves. EU actions can be implemented through the community method, that is, directly through EU forms and instruments, or through interstate cooperation carried out in an international style which calls on forms of intergovernmentalism, reinforced collaboration, variable geometry, among others, such as the open method of coordination.

The EU is sometimes considered a soft power (Martin Heipertz and Amy Verdun, 2010; Brunet, 2012b; and World Bank, 2012b). This is because the contrast of the EU forms with those of the real States (as the MS are) and with those of the US (EEAG, 2011; and Robert L. Hetzel, 2012). But it must also be taken into account that the EU is a soft power precisely because of its purposes, though these are frequently limited due to their shared development with the MS. Thus the integration process under the EU can be considered as following a liberal drift (Richard Münch, 2010).

### 2.3. **The EU Competences in Economics**

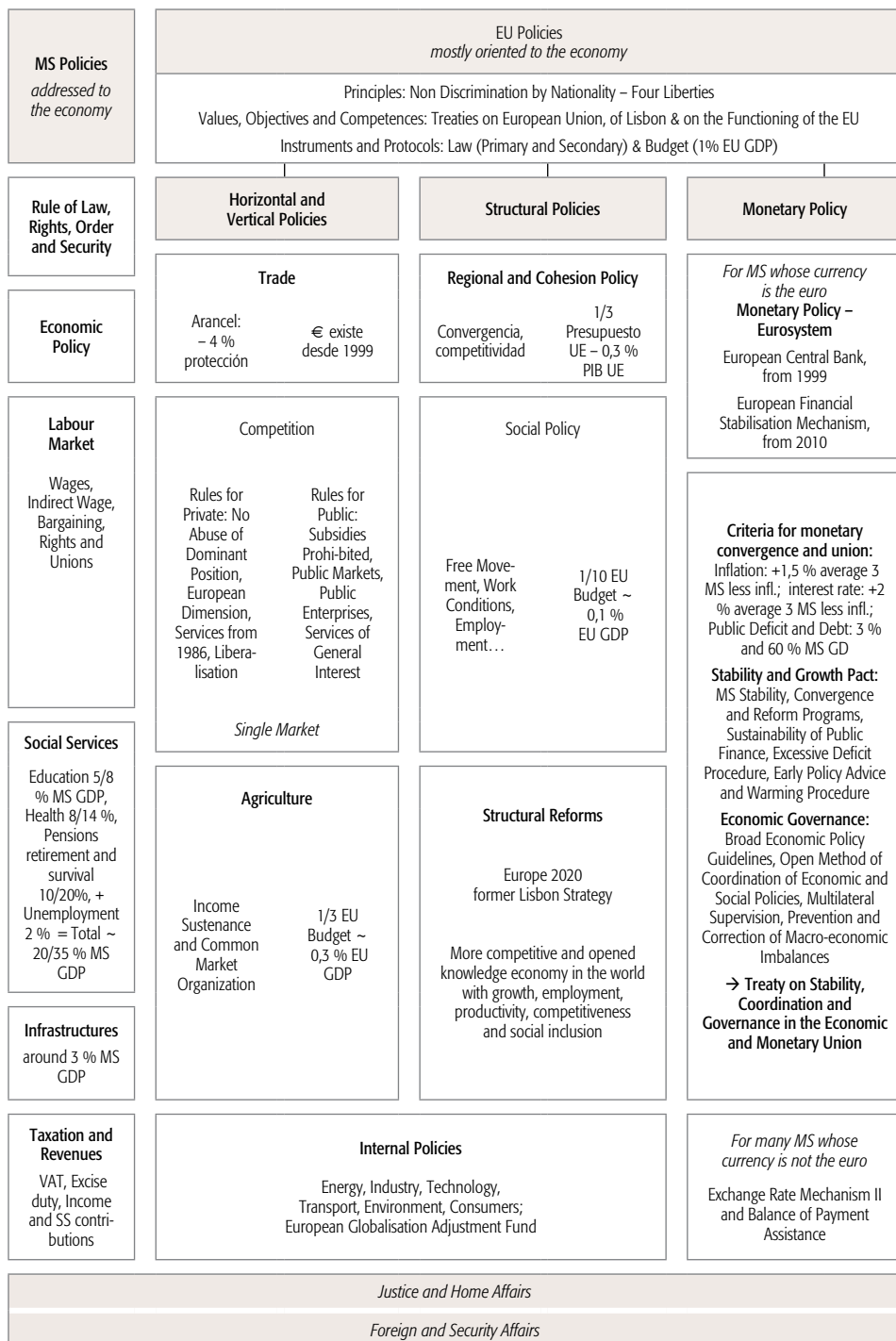
The EU competences in economics can be based on those received from the MS as established in the treaties and derived law. More concretely, there is a list of the objectives and a list of matters (Brunet, 2010) for which the Council of the Union chooses the decisive method, through unanimity or simple majority. The principle of non-discrimination because of nationality or of equal treatment acts as the centre of the economic constitution of the EU. Applied to market, labour, capital and services matters, the principle is transformed into the four economic liberties, of which the mainstay is the internal market; the application to enterprises of the non-discrimination principle is the foundation of the common competition policy, itself the mainstay of the EU (House of Lords. EU Committee, 2012).

Thus, being broader than an explicit economic constitution (Brunet, 2008a), the principle of non-discrimination and the competition policy also serve to act as an implicit European economic constitution. Implicitly, the main EU economic constitution is that related to the free circulation of goods in the internal market and the common competition policy. The EU also displays

originality regarding the institutions which manage competences in EP. There are different European institutions (the European Council, the Council of the Union, the European Commission, the European Parliament, the European Central Bank...) and they act in most original ways: under the leadership of the Council, under that of the MS ministers, and for debated matters, under the guidance of some MS presidents or prime ministers (European Commission, 2008).

Figure nº 2.

**THE SOURCES OF THE EUROPEAN ECONOMIC GOVERNANCE**



Source: Author elaboration.



The most part of Union policies are economic.<sup>3</sup> The competence in economic policy is considered to belong to the MS, except when affecting the common market, as is the tradition. The coordination of MS economic policies as an imperative appeared early in the history of the European Communities but is really circumspect - at least practically. Thus the (economic) policies of MS (see Figure 2, left column) are always key for the EU, and they include matters related to the forms of society, representation, rule of law, foreign policies, labour and social, taxation, as well as general economic policy, such as fiscal and finance.

In 1999 came the European monetary union (EMU) for certain MS, 17 in 2012. The EMU was the turning point in the European economic policy (Jean Pisani-Ferry and Adam S. Posen, eds., 2009; Pisani-Ferry, André Sapir, and Guntram B. Wolff, 2011; and Marsh, 2011): the MS whose currency was the euro had now left the monetary policy in the hands of the European Central Bank (ECB), despite the general competences in economic policy (including the fiscal policy) still belonged to the MS.

A contradiction appears between Euro MS economic policy and EU monetary policy (see Figure 2, right column). In the middle of these two policies the EU performs the traditional roles: from competition policy (horizontal policy) to internal policies (vertical policies), passing through the regional and territorial cohesion policy. Sometimes called microeconomic, these EU core policies are strategic, affecting the allocation of resources and having medium and long-term consequences, e. g. the benefits to be had in terms of competitiveness.

### 3. THE EUROPEAN ECONOMIC CHALLENGES

#### 3.1. Miracles, Bubbles and the Great Recession

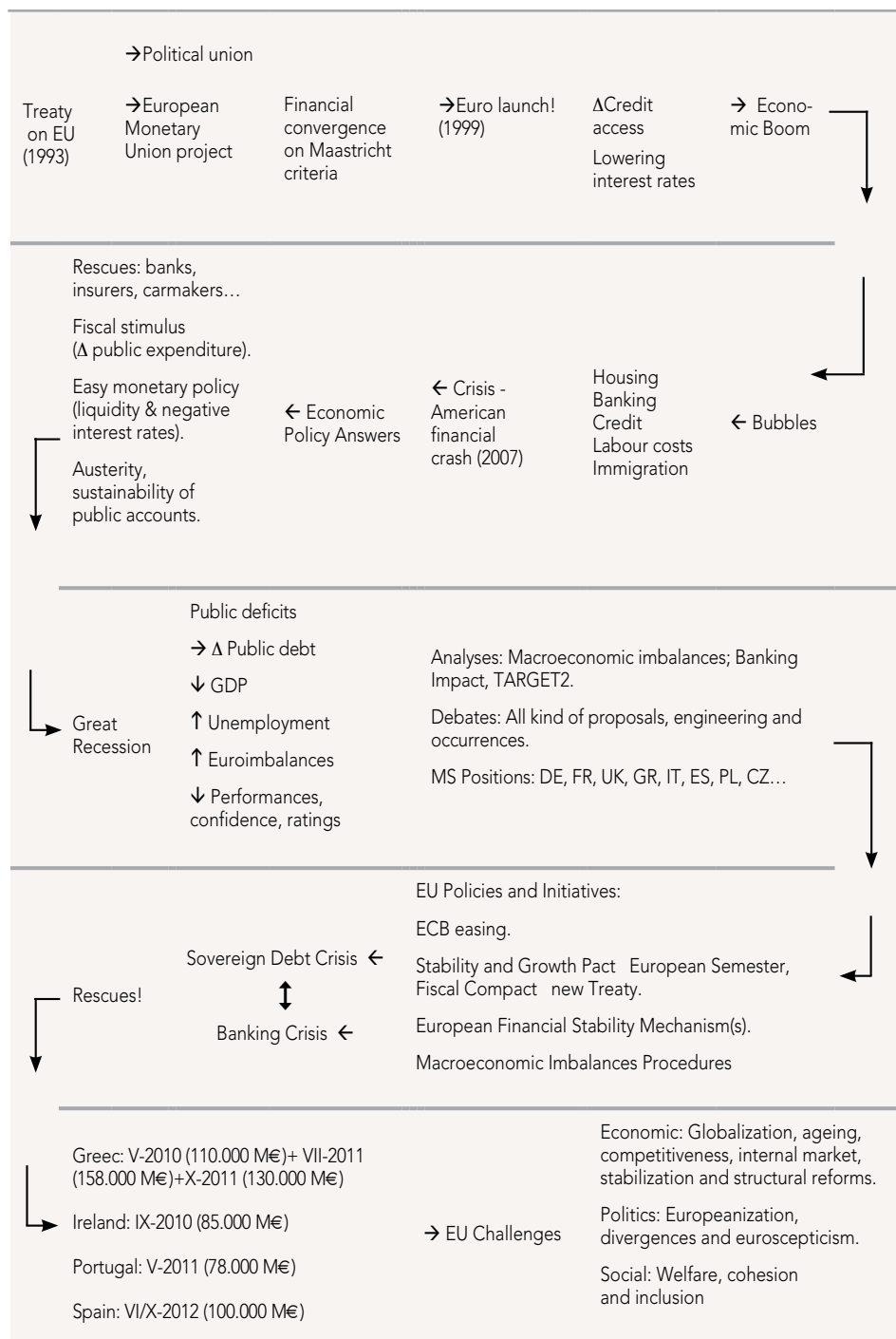
The European economic situation has passed from a one in which:

– In the period 2008-2012, recession prevails: growth is higher in Northern countries and Southern (and some Eastern; Ewald Nowotny, Peter Mooslechner, and Doris Ritzberger-Grünwald, 2011; and Brunet, 2012b) MS have huge negative records in growth and in all public, foreign, labour market balances (Gerson Lehrman Group, 2010).<sup>4</sup>

<sup>3</sup> As it directly affects people, social policy is essential for the EU. But the European social policy is logically centred on the free movement of people. The welfare policies (education, health, pensions, and their financing) are the competence of each MS.

<sup>4</sup> For a powerful crisis timeline see ECB (2012a).

Figure nº 3. SEQUENCES OF THE EURO CRISIS



Source: Author elaboration.

The first phase provokes housing and banking bubbles. The second phase is the fruit of the bursting of the Southern (and Irish) bubbles, because of the credit from the rest of the euro zone. It follows that the success and fall of the South is due to the introduction of the euro and to its institutional limitations (a non-optimal currency area, no labour market or banking integration), to the uncompetitive structural conditions of the Southern countries, to the policy deficit of the EU and the policy choices (public deficit), all of which were thrown into shocking relief by the financial and economic crisis (EC. DG Economic and Financial Affairs, 2010a and 2010b).

Both the introduction of the euro and the crisis underlined the need for competitiveness and the limitations of the EU and MS policies which hindered the performances of all of the Southern MS. The miracle of the euro, of the EU and especially of the MED has been transformed into the martyrdom of the euro, the torture of public finance, and the rescue of the Southern MS. In Figure 3, we can see the sequential development of the economic and financial crisis in Europe.

### 3.2. The European Economic Deficits and Imbalances

Europe is generating a) considerable and ever-growing gaps between its economy and that of the US (Martin Neil Baily and Jacob Funk Kirkegaard, 2004; Brunet, 2008a; Alberto Alesina and Francesco Giavazzi, 2006); and b) equally considerable and ever-growing gaps between many MS and some of the more advanced MS. As we can see in Table 1, the deficits in regulatory quality, employment, productivity, competition, creativity, competitiveness, living-standard, and human development index are serious. All considered, these indicators show the different economic models existent in Europe: liberal; Nordic, continental, Mediterranean; Central and Eastern, large and medium in-transition MS; newly-independent, small and in-transition MS; candidates to the EU; and neighbouring countries.

From 1999 and the birth of the EMU, there has been serious growth in current account imbalances between different MS. As the global imbalances grew (Olivier Blanchard et alii, 2011), in Europe the euroimbalances between different MS were on the rise: Current Account (CA) surpluses in Continental and Nordic MS of around 6 per cent of the GDP corresponded to CA deficits in MED of between 6 and 12 % of the GDP (Sinn, 2012; Silvia Merler and Pisani-Ferry, 2012). The growing euroimbalances are the expression of the growing competition in a non-optimal monetary area. The economic agents of the less competitive countries were able to finance their deficits, at least in the first stage of the euro, in which the risk prime against the German assets was no sensible (Marsh, 2011).

– In the period 1999-2007, growth at an average of about two per cent a year, with the Southern and Eastern MS growing considerably more, and a sustained gap with the US (McKinsey Global Institute, 2010).

It is all too clear that the growing euroimbalances are the fruit of the asymmetrical impact of the EMU. In place of convergence there is a marked divergence between the Northern and Southern European countries (Robert Solow and Hamilton, eds. 2011). Here follows a compendium of the European deficits shown in the light of the differences between EU standards and those of the US, which are nothing if not acute - and are growing in certain MS (see Table 1):

- *Employment deficit*: The gap in employment is huge, as is unemployment; both are crippling productive capabilities and raising social costs (Eurostat, 2012).

Table n° 1. **THE EUROPEAN DEFICITS**

MS Order: Grouped by origin and scored by smaller Competition Deficit. Sign for cells with:	Regulatory Quality Deficit	Employment Deficit	Productivity Deficit	Competition Deficit	Creativity Deficit	Competitiveness Deficit	Living Standard Deficit	Human Development Index Deficit
Bad score < 15 for col. 1; < 30 for the other cols	1	2	3	4	5	6	7	8
<b>«Liberal»</b>								
Ireland	-2.4	-3.0	-2	-17.6	-36	-16.8	-7.7	+0.8
UK	-2.0	+1.0	-18	-20.5	-21	-16.3	-23.1	-0.5
Denmark	-1.0	+5.0	-15	-20.8	-15	-9.1	-18.2	-0.2
<b>«Nordic»</b>								
Netherlands	-4.4	+1.6	-2	-23.2	-6	-12.1	-14.6	+0.2
Finland	-2.9	-0.4	-18	-25.2	-1	-14.1	-24.8	+0.1
Sweden	-7.3	+5.3	-11	-29.6	-8	-9.9	-22.3	+0.3
<b>«Continental»</b>								
Luxembourg	-1.5	-9.7	+43	-24.8	..	-14.8	+80.2	-0.7
Belgium	-12.2	-8.6	-4	-28.5	-20	-20.7	-20.4	-0.5
Germany	-8.8	+0.3	-7	-28.8	-16	-14.0	-26.4	-1.6
Austria	-5.4	-0.6	-16	-30.0	-31	-16.4	-16.8	-0.3
France	-17.1	-5.2	-1	-34.6	-27	-21.3	-27.0	+0.1
<b>«Mediterranean»</b>								
Spain	-18.0	-14.7	-22	-30.3	-35	-30.2	-33.9	-0.2
Portugal	-19.0	-1.2	-52	-35.7	-54	-33.2	-51.8	-5.4
Italy	-25.9	-12.8	-24	-37.5	-39	-38.2	-33.1	-1.0
Greece	-28.9	-8.3	..	-39.9	-42	-39.6	-37.5	-2.5

.../...

Central and Eastern Large and Medium in Transition EU MS								
Hungary	-14.1	-13.4	-53	-32.8	..	-35.2	-57.9	-7.7
Bulgaria	-33.7	..	..	-37.1	..	-39.7	-76.0	-12.7
Romania	-38.0	..	..	-38.5	..	-41.2	-75.8	-13.8
Poland	-30.7	-12.1	-62	-40.5	..	-38.3	-65.8	-8.1
Newly Independent, Small and in Transition EU MS								
Estonia	-7.8	..	..	-22.2	..	-23.4	-56.2	-9.1
Cyprus	-13.2	..	..	-28.7	..	-25.4	-39.7	-4.8
Lithuania	-18.5	..	..	-29.2	..	-32.3	-62.8	-8.9
Slovakia	-16.6	-7.1	-50	-31.3	..	-31.1	-59.0	-8.8
Czech R.	-20.5	-5.5	-56	-31.5	..	-28.5	-48.8	-6.0
Latvia	-17.6	..	..	-31.7	..	-22.2	-63.9	-9.6
Malta	-13.7	..	..	-34.0	..	-25.8	-51.2	-7.3
Slovenia	-27.3	..	..	-39.4	..	-31.5	-42.7	-3.4
Candidates to the EU								
Croatia	-38.5	..	..	-45.4	..	-40.3	..	-10.1
FYR Macedonia	-47.3	..	..	-38.9	..	-34.2	-67.8	-15.0
Iceland	..	..	..	..	..	..	..	..
Turkey	-42.4	-24.3	-71	-39.2	..	-39.8	-81.0	-17.6
Some EU Neighbours								
Albania	-51.2	..	..	-36.7	..	-38.6	..	-15.0
Bosnia & H.	-65.4	..	..	-46.3	..	-37.4	..	-14.8
Montenegro	-62.4	..	..	-44.1	..	-31.0	..	..
Serbia	-59.5	..	..	-46.0	..	-33.3	..	..
Norway	-9.3	+3.6	-41	-31.0	..	-14.4	+21.2	+1.7
Switzerland	-6.8	+6.3	-20	-20.3	..	-5.6	-12.1	+0.4
For Reference								
United States	-6.3	0.0 [75.3]	0 [\$50,400]	-19.4	0 [0.73]	0.0 [5.67]	0.0 [\$36,300]	0.0 [95.1]
Canada	-5.9	+3.1	-18	-19.8	..	-11.5	-18.5	-1.0
Japan	-12.7	-1.7	-29	-27.5	..	-17.1	-26.4	+0.2
China	-53.7	..	..	-47.2	..	-19.4	..	-17.4

For columns 1 and 4 the reference value is 100. For the other columns the reference values are that of the US [in brackets].

Source: Author calculations on data for 2011 and from AMECO (2012), Bertelsman Stiftung (2012), DICE (2012), Eurostat (2012), IMF (2012a), INSEAD (2012), fedStats (2012), OECD (2012a and 2012b), UN (2012), WB (2012a and 2012b), and WEF (2011 and 2012).

- *Productivity deficit*: Because of the lower use of labour in Europe, the average working total is around 1500 hours a year in most EU MS, compared with around 1800 in the US (Eurostat, 2012; and FedStats, 2012).
- *Competition deficit*: Owing to MS over-regulation, despite efforts at Europeanization (Brunet, 2008b).
- *Regulatory quality deficit*: An intelligent means of regulation is a long way off for many European countries (Brunet, 2012c).
- *Creativity deficit*: In the main field of the knowledge economy, Europe is far behind the US (INSEAD, 2012).
- *Competitiveness deficit*: Enormous current accounts deficits highlight the muted performance of many MS (Brunet, 2010b).
- *Living-standard and Human Development Index deficits*: European social protection balances the deficits in other areas but many MS and third European countries have considerable room for improvement (UN, 2012).
- *Convergence deficit*: *As a result of these asymmetrical conditions and their consequences, there has been a cease in the catching-up process - the divergences between MS, and between the EU and the US, are growing.*

### 3.3. European Monetary Union and the Crisis: The Design of the EMU vs. MS Competitiveness and Policies

The EMU underwent three phases: a) from the European Monetary System, in which currencies were floated together, and to the EMU through to the Maastricht criteria (from 1993 to 1999); b) from the launch of the euro to the financial and economic crisis (1999-2007-2009); and c) from the sovereign debt crisis to the present (2009-2012).

The first two stages of the EMU were very successful (and widely celebrated as being a glorious ten years; Pisani-Ferry and Posen, eds., 2009; and Marsh, 2011), but the third stage is certainly a problematic one. The first stage brought about a convergence in financial indicators, and the second stage enormous growth, especially in the less advanced euro MS, because of the quantity and price of credit. Inversely, at that time, owing to its reunification, Germany was the millstone around Europe's neck! The third stage provoked an immense crisis, especially among the less competitive euro area MS, as a consequence of the drying up of cheap credit and financing of the structural imbalances in public budget and in current accounts. Thus we can see that the MED are adding to the already high price of the crisis the price of their limited competitiveness and of being part of a non-optimal monetary area.

## 4. THE EUROPEAN ECONOMIC GOVERNANCE DEFICIT

### 4.1. The Failure of the European Economic Policy

European economic governance was never developed to a serious degree, as the main economic policy competences remained with the MS (as seen above in Figure 2) and the design of the EMU had serious shortcomings (Franklin Allen, Elena Carletti and Giancarlo Corsetti, eds., 2011). In fact, there is a deficit of European economic governance, gaps between various needs and the means of fulfilling them, only being further highlighted by the current crisis. Despite all this, it is possible to reduce this deficit by means of initiatives in development since October 2009 (see Table 2 below).

Usually, EU policies are well-empowered. This is the case for policies based on subsidies, as are the agricultural and regional policies; it is even also the case that certain European policies which have regulation as an instrument are backed up by decisive implementation, e.g. competition, but this is due to the force of the Community method (Brunet, 2010). Inversely, most of the hindrances to the empowerment of EU policies were because their implementation was the competence of the MS, and sometimes powerful incentives to avoid the empowerment of EU policies can make themselves known, as happened with two key policies which wield heavy influence over the current EU economic governance problems:

- a) The fiscal policy known as the Stability and Growth Pact (with the supplement of the Broad Economic Policy Guidelines), its progress was hindered not by the absence of rules but by the little respect with which it was regarded (Robert J. Samuelson, 2008; and John B. Taylor, 2012).<sup>5</sup>
- b) The EU structural reform policy known as the European Initiative for Growth, renamed the Lisbon Strategy for 2010, then Europa 2020 and now Compact for Growth and Jobs, it was placed under the cover of the open method of national coordination designed for the mutual understanding of and the education about the good practices of the MS.

So we see that the more general and key EU economic policies failed, both the more discretionary ones and those completely implemented by the MS, as well as the structural reforms and numerous EU rules and sanctions based on the SGP. European economic governance is a cemetery of wishful-thinking slogans: Open Method of Coordination of Economic and Social Policies, Sustainability of Public Finance, Excessive Deficit Procedure, Early Policy Advice and Warning Procedure, Macroeconomic Dialogue (Köln Process), Multilateral Supervision, Employment Pact, European Employment Strategy (good practices, excellence, flexisecurity),

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<sup>5</sup> Between 1999 to 2011 the SGP was violated 97 times: of these only 29 were permitted (because of recession). Despite the sanctions previewed in the SGP in case of violation, not a single one has been imposed (EEAG, 2011: 79).

Convergence and Reform Programs and Structural Policies Coordination (Cardiff Process)... (House of Lords. EU Committee, 2012).

**Table nº 2. THE DYNAMICS OF THE EUROPEAN GOVERNANCE IN TIMES OF CRISIS**

	Pre-existing 2007 and substantially maintained	New, modified or additional
Initiatives	European economic constitution (EU treaties and derived law). Competition Policy and the other EU Policies.	European Recovery Plan..
	EMU, Stability and Growth Pact (preventive and dissuasive arms; for each MS: stability program and convergence and structural reform program), Excessive Deficit Procedure, Early Warning Mechanism and Policy Advice.	Economic Governance Package: broader and enhanced surveillance, effective enforcement of budgetary surveillance in the EA; European Semester on the MS budgetary framework; preventing and correcting macroeconomic imbalances (by the EC), enforcement mechanisms → 'fiscal compact' → Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCGEMU).
	Broad Economic Policy Guidelines, Macroeconomic Dialogue and Multilateral Supervision.	Competitiveness Pact for the Euro → Euro Plus Pact. Surveillance of intra-euro area imbalances, alert mechanism through a scoreboard, excessive imbalance procedure (EIP, by peer pressure, and fine of 0,1 % GDP).
		Reinforced Multilateral Surveillance.
	Single Market Strategy.	
	Employment Pact, European Employment Strategy, Flexisecurity, Social Agenda.	
	Open Method of Coordination of Economic and Social Policies.	
	Lisbon Strategy for the Structural Reforms of the economy → Structural Policies Coordination.	→ Europe 2020.
Balance of Payments assistance (BoP, following the Community method, administered by the European Commission).	BoP assistances for Hungary, Latvia and Romania.	
Macro-financial Assistance to non-EU countries.		



Instituciones y organismos	<p>Council: ECOFIN.</p> <p>Commission: DG EcFin and other DG related to the Economic Policies (Competition, Market, Enterprise, Trade, Employment).</p> <p>European Investment Bank (EIB).</p> <p>Economic and Social Committee (ESC).</p>	<p>European financial stabilization:</p> <p>A. Institutions (agencies or bodies): European Stability Mechanism (ESM), established 8 October 2012 by the corresponding Treaty, is a permanent body to safeguard the financial stability in the euro area as a whole. It provides financial assistance to euro area MS experiencing or being threatened by severe financing problems. The ESM prolongs the European Financial Stabilization Mechanism (ESFM, established 9 May 2010 under the community method). As part of the overall rescue package of 700 billion €, the ESM is able to issue bonds for up 440 billion € guaranteed by the EA MS, the other provided by the EU through the European Financial Stability Facility (EFSF, created by the Euro area Member States as Luxembourg-registered company owned by the EA MS, and under the intergovernmental method, who gives 60 billion €) and the IMF (200 billion €). The ESM has been assigned the best possible credit ratings (there are AAA, by S&amp;P and Fitch Ratings, and Aaa by Moody's).</p> <p>B. Packages of Financial and Economic Support: For Greece, Portugal, Ireland and Spain.</p>
	<p>Banco Europeo de Reconstrucción y Desarrollo (BERD).</p> <p>Comité Económico y Financiero (CEF).</p> <p>Comité de políticas económicas (CPE).</p> <p>Comité de Asuntos monetarios y económicos del Parlamento Europeo.</p>	<p>Following the launch of the European Systemic Risk Board (ESRB) on 16 December 2010, three European supervisory authorities start their work for the supervision of financial activities with regard to banks, markets and insurances and pensions, respectively: <i>European Banking Authority (EBA)</i>, <i>European Securities and Markets Authority (ESMA)</i> and <i>European Insurance and Occupational Pensions Authority (EIOPA)</i>. A <i>Joint Committee of these three European supervisory authorities exists from 2011</i>.</p>
	<p>Eurogroup (MS' ministries of Economy and Finance, chaired by Jean-Claude Juncker).</p>	<p>Task Force on Economic Governance chaired by the President of the European Council, Herman Van Rompuy working on financial assistance banking integration.</p>
	<p>European Central Bank</p>	<p>Securities Markets Programme.</p> <p>Outright Monetary Transactions.</p> <p>Unconventional measures.</p>

Source: Author elaboration.

Underlying the deficit and failure of European economic governance, there is one even bigger failure: that of the Constitution for Europe, published in the *Official Journal* in 2004, abandoned in 2007 after the negative results in the Dutch and French referenda (Jabko, 2011).

#### 4.2. **The Failure of the MS Economic Policies**

The EU has failed in its economic governance. This is because of the forms of the EU and the complexity of the intergovernmentality not to mention the tatonnement practice, the absence of course (Taylor, 2012) and the submission of the MS policies to the electoral game. This is the case for the dialectics of stimulus vs. austerity, in particular the management of the fiscal balance (Raghuram G. Rajan, 2010; and Jean-Claude Trichet, 2011). What should be the main deficit, and hence the policy priority: the demand deficit (related to general economic crisis and recession) or the public accounts deficits?

Will the current economic difficulties be checked by reducing the demand deficit and enlarging it with public debt? (National Commission on the Causes of the Financial and Economic Crisis, 2011) Or on the other hand, is the way to recovery the shortening of the public deficit via reducing expenditures in a context of fall in revenue (fiscal scissors)?

Faced by such dilemmas, the moment comes when markets cut out (Carmen M. Reinhart and Kenneth Rogoff, 2009): when there is no more confidence in the capabilities of countries to return credit, the financing of public deficit is stopped. Ongoing and deeply structural, the deficit in public accounts is a great hindrance for growth and a considerable economic and social cost (IMF, 2012a). As in budgeting in economic policy, MS have little room to manoeuvre. 'Compete or borrow' is an expression for times gone by: now it is impossible to borrow, the only course left is to compete. But there is a significant gap in competition and in the other MS policies on the labour market and social policies. Most of the other regulations don't help competition at all. Such as it is, two advancements in EU direction are proving to be of some help: a) the passing from discretion to rules; and b) greater capability of empowering the rules (République française. Sénat, 2010).

European policy seems to be nothing but cheap talk, a bazaar the European Union provides for all kinds of purposes given the name of 'policies' (European Commission, 2008), but not exactly implemented as such. Thus, questions regarding the effectiveness and the efficiency of European economic policy are most pertinent.

#### 4.3. **The Crisis of the PIGS: Convergence and Divergence in the European Socio-economic Model(s)**

PIGS are in serious turmoil because of: a) the general crisis and their previous boom dynamics; b) their own economic structures and policies; c) their inability to manage their liquidity deficits; and d) European economic governance deficit. The crisis of the MED is the engine of the euro crisis, a sovereign debt crisis founded in MED competitiveness deficit. Here we have the rise and fall of MED, the miracle turned into an inferno (Brunet, 2012d; Sinn, 2012).

The collapse of the PIGS raises serious questions about the European socio-economic model(s):

- Do the current growing material divergences between the failing Southern MS and the successful Northern MS make up the prelude to a formal convergence into one European economic model?
- Is the European welfare state sustainable? Probably, but only with reforms: the non-competitiveness of the Southern MS is the first stage of a major medium and long-term European non-competitiveness.
- What is the place of the EU? The bailouts decided upon need to be sustained with state-building tasks, avoiding unruly policies and introducing hard reforms of the non-performing structures.

## 5. THE EUROPEAN UNION ECONOMIC AND POLITICAL CHALLENGES

### 5.1. European Economic Policy Challenges

The current financial crisis and economic recession is accentuating the challenges to the EU economy, because of the deficits (see Table 1), and to its economic policy, because of the MS and EU forms and the dilemmas they address (see Table 2). These economic and economic policy challenges can be synthesized into one pressing need: to be competitive in the global economy. In this context, Europe has certain advantages, such as high productivity, and certain disadvantages, such as considerable welfare protection. But the main immediate problem for the EU is that it lacks the instruments to address this ordeal –both the short-term tools related to fiscal and banking stabilization and the medium and long-term tools related to structural reforms– are in the hands of the MS, and usually they are not encouraged to use them because of their suspected political costs.

Another perspective of the situation is to be seen in the MS who addressed the economic and economic policy challenges with virtuous fiscal and structural policies and are now among the performing countries for which the recession is passing away without serious financial turbulence. This is the success of the first to reform. From this we can see the asymmetrical impact of the crisis because of the different structural abilities of various MS to compete, not to mention their economic policy choices. For the EU, the challenges of stabilization and competitiveness manifest themselves in the guise of the unruly PIGS crying for help to the virtuous Nordics. The longer this fiscal crisis continues, the higher the possibility of a welfare state bankruptcy.

Table nº 3. **DILEMMAS AND DEBATES ON THE EUROPEAN ECONOMIC GOVERNANCE**

Some dilemmas on the European economic policy. Elements from different sides are mixed often	
Intergovernmentality, International Cooperation	<i>Méthode communautaire</i>
Centralization	Federalism
Consensus, Unanimity	Majority
<i>Many speeds, Europe à la carte, permits degrees in deepening</i>	One speed, no degrees in deepening
Discretion	Rules
Unruly	Virtuous
Primacy of politics	Smart regulation
Interventionist	Liberal
Macroeconomic, financial, (neo)keynesian, left	Microeconomic, real, (neo)classical, right
Demand	Supply
Living standard	Competitiveness
Market failure	Policy failure
Fiscal stimulus financed by issuing debt	Austerity, rigor, efficiency
Austerity trap	Crowding out
Financial engineering	Sustainability of public finances
Eurobonds	No eurobonds
Wishful thinking, Anaesthesia, Politically correct thinking	Realism
Too big to fail	Failure
<i>Bail out, rescue</i>	<i>Bail in, no rescue</i>
EU alone	IMF together with the EU
Welfare state defence	Structural Reforms of the economy
MS wrong policies producing public deficit and public debt	EU good structural reforms proposals
MS Over regulation	EU Deficit of governance
Keynesian-heterodoxy = new orthodoxy-conservatism-money-distribution	Hayekian-orthodoxy = new heterodoxy-politically incorrect- real economy-production
Regulationism	Ordoliberalism
Euro Break-up or split	Euro exit
	Euro continuity
<i>Different orientations, sensibilities, structures, policies, needs and interests</i>	
East	GIPSCI
France	United Kingdom
	Germany
	Nordic

Source: Author elaboration.

## 5.2. European Political and Institutional Challenges: The EU Systemic Risks

As usual in the European integration process, politics follow economics. The EU is undergoing the double critical process of developing institutional forms to satisfy the economic and economic policy challenges which arose from European monetary union developments, e.g. the sovereign debt crisis in the MED. The Union's political and institutional challenges are as daunting as its economic challenges. There is a *mixtura compositum* between one and the other. This overlap helps to nurture two systemic risks:

- *Economic systemic risk*: The financing of public deficit by credit generates a) a crowding effect of enterprises from financing, reducing investment, employment and GDP; that is, a general recession of the economic system; and b) a systemic banking risk borne of the government's danger of defaulting. Upon this, the financing of sovereign states and their failure will be accompanied by the failure of banks and thus economic turmoil. The complexity and insufficiencies of the EU are accentuating the economic risks of the MS (Wolff, 2012).
- *Political systemic risk*: A malaise is growing among the MS and the EU because of the inability to turn around these economic difficulties, some of them due to government fiscal deficit financing and the special EU forms and policy. The inability of MS and EU to settle contradictions is due to the euro-immobilism (old Europe, protectionism...; Alesina and Giavazzi, 2006; Baily and Natalie McGarry, 2011; and Waltraud Schelkle, 2012) and generates euro-scepticism (from both extremes, xenophobia...). MS governments are deeply afraid to adopt stabilization and reform measures, despite their urgent need (OECD, 2011a; and C. Fred Bergsten and Funk Kirkegaard, 2012).

With these two correlated systemic risks, the EU (and many MS) faces a high risk of collapse.<sup>6</sup> Some principal MS remain out of the debate and even out of the new agreements; some are holding referenda regarding their ties with the EU (the break-up of the EU appears to be an even more realistic proposition than the dissolution of the euro).

## 5.3. The Long Road to a New European Economic Governance

Just as the EMU aspires to be an optimal currency area and MS to be competitive, the EU aspires to meet its challenges and beat its systemic risks. The dilemmas to be resolved, the debates to be expounded upon and the decisions to be made by MS

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<sup>6</sup> Integration promotes disintegration? The secession of regions a) is a MS phenomena but one fostered by the EU crisis; and b) could have tremendous consequences, not only for many MS but also for the entire European integration process, a precious outcome of recent history and the last utopia... therein lies a new and stiff challenge for the EU.

and EU are great. But there is also a consensus on the European Economic Governance. A European Consensus<sup>7</sup> can be expressed in this Decalogue for the New European Economic Governance:

1. Social Market Economy: Competitive (Efficiency-Competition) and Welfare State (Justice-Solidarity) (as in Brunet 2008a).
2. Public Finance: Equilibrium and Sustainability (OECD, 2011b and 2012c).
3. Labour Market: Flexisecurity.
4. Competitiveness: Productivity for Mass Consumption and Welfare.
5. Environment: Sustainable and Responsible.
6. Sound Credit and Deleverage (Charles Roxburgh et al. 2010; and Greta Krippner, 2011).
7. Policy Mix Objectives: Austerity & Growth & Inclusion (IMF, 2011b and 2012b).
8. Policy Mix Instruments: Stabilization & Structural Reforms & Economic Governance.
9. European Regulation / European Economic Governance: Smart, pro-competitive and market oriented.
10. European Union: multilevel Governance system avoiding over-regulation and following a liberal drift (Münch, 2010).

Perhaps there is a broad consensus about the above concepts, but what appears more immediately is confrontation: government vs. opposition, MS vs. EU, stimulus vs. sustainability, the austerity trap vs. competitiveness deficit... The instruments needed to face these dilemmas suffer from a) an excess of indetermination and visibility, despite political correctness and technocratic language, and b) the EU limited abilities in making and implementing the decisions.

The European way is the only common course possible, but it comes at a cost. With the sovereign crisis, the road to European economic governance is a long one (see Figure 3 and Table 2), and the people, the economy, MS and the EU need to reap its rewards now.

## 6. CONCLUSION

The European monetary union, the financial flows and the euro itself are facing huge risks because of the instability and lack of competitiveness of some MS. The competitiveness deficit is due to their economic structural limitations and unruly

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<sup>7</sup> Variations, extensions and allusions are allowed: Brussels-Frankfurt-Berlin-Paris Consensus.

policies, the non-optimal monetary area that is the euro zone and the absence of complexity of the institutions of the financial union, and to the deficit in European economic governance. After a considerable credit bubble, the economic and financial crisis has pushed competition inside the euro zone. The MS are showing serious imbalances between themselves, in the form of huge surpluses in virtuous Nordic economies and huge deficits in non-performing Southern economies.

The conjunction of instability and lack of competitiveness produced a perfect storm to weather the structures of the euro and the management of the public deficit and debt of the MED MS. The future of the euro depends on the ability of the South to be more competitive and advance toward an optimal currency area.

The EU has worked as an anchor for virtuous policies, impelling them, but it can also turn into a torpedo when MS behave in an unruly fashion. Europe is gradually bypassing MS over-regulation and turning from a EU governance deficit to a liberal multilevel economic governance system. The EU is taking on an immense state-building task, favouring regulatory quality, competitiveness and socio-economic performance.

The EU acts as an anchor favouring virtuous policies... or as a torpedo for unruly policies. The building of states is not a primary EU objective but a happy consequence. A MS can only be virtuous and competitive... and they will be helped to achieve this. Clearly there is a need for Europe, the benefits of membership greatly outweigh the costs of cooperation. Certainly, there are degrees in the need for Europe as seen in the variances between Portugal and the UK, Sweden and Estonia, Poland or the Czech Republic... a collapse and disintegration of the EU will push a lot of countries into hell, the most benign form of which is over-regulation and misery. Finally, the achievement of the Union is the success of the fostering of freedom, civilization and progress.

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