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EUROPE 2020 – A NEW STRATEGIC FANTASY?

Evropa 2020 – nova strateška fantazija?

Abstract

Modern societies are preoccupied with efficiency and economic growth; the EU concentrated this preoccupation in Lisbon strategy of 2000. It should turn Europe into the most efficient knowledge based economy. Growth was to be achieved by increased competitiveness assisted by globalization. In 2005, the "old" strategy was replaced by a "renewed" one. The "scientific" pillar of both strategies was production function while their Achilles' heel was total negligence of aggregate demand.

In 2010, the two failed strategies were replaced by Europe 2020. According to it, the EU should become a smart, sustainable and inclusive economy. Europe 2020 is a slightly more realistic plan than the predecessors but nevertheless a kind of pre election program with a lot of promises, newly invented expressions, and empty slogans; the demand side is again ignored. Therefore, Europe 2020 will most likely soon turn to a worthless political document providing speech-making and jobs for the EU bureaucracy responsible for its "implementation".

The negligence of the demand side is however much more fatal in actual economic policies which insist on the assumption that excessive public expenditures is to be blamed for the crisis and try to heal it by hysteric savings. In reality, the crisis was created by long lasting redistribution of GDP, hyper production, creation of demand by credits, and financial speculations. Public sector became "excessive" because governments had to prevent financial collapse created by private sector. Steadiness on current economic policies and savings hysterics therefore do not threaten only the Europe 2020, they threaten the sole existence of the EU. Euro, for many years the most prestigious element of European unification turned to its threat, as well.

Key words: *economic growth, production function, technological change, globalization, EU, euro, monetary union, fiscal union, aggregate demand*

Sažetak

Moderna društva preokupirana su efikasnošću i privrednom rastom; EU je ovu preokupaciju koncentrisala u Lisabonskoj strategiji 2000. Ona bi trebalo da pretvori Evropu u najefikasnije na znanju bazirano društvo. Rast bi trebalo postići povećanjem konkurentnosti kojoj bi pomogla globalizacija. U 2005, „stara“ strategija zamenjena je „obnovljenom“. „Naučna“ osnova obe strategije je proizvodna funkcija, a njihova Ahilova peta je potpuno zanemarivanje agregatne tražnje.

U 2010, propale strategije zamenjene su strategijom Evropa 2020. U skladu s njom trebalo bi da Evropa postane pametna, održiva i inkluzivna privreda. Evropa 2020 je realističnija od svojih prethodnica ali ipak ostaje dominantno „predizborni“ program sa mnogim obećanjima, na novo izumljenim frazama i izrazima te puna praznih slogana; agregatna tražnja je ponovo zanemarena. Zbog toga će i Evropa 2020 verovatno brzo postati bezvredni dokument za pravljenje političkih govora i stvaranje radnih mesta za EU birokratiju, odgovornu za „implementaciju“ strategije.

Zanemarivanje tražnje je pak mnogo sudbonosnije u aktuelnim ekonomskim politikama koje se oslanjaju na pretpostavku, da su krizu stvorili suviše veliki javni izdaci i da je zbog toga iz nje moguće izaći histeričnom štednjom. U stvarnosti, kriza je stvorena u decenijama preraspodele društvenog proizvoda, hiperprodukcije, stvaranja tražnje kreditima i finansijskim spekulacijama. Javni sektor je postao suviše velik jer su države morale sprečiti finansijski kolaps koji je stvorio privatni finansijski sektor. Istrajavanje na sadašnjim politikama histerične štednje neće ugroziti samo Evropu 2020, ono ugrožava i samu Evropsku uniju. I euro, koji je mnogo godina služio kao najprestižniji element evropskog udruživanja, pretvara se u njegovu pretnju.

Ključne reči: *privredni rast, proizvodna funkcija, tehnološke promene, globalizacija, EU, euro, monetarna unija, fiskalna unija, agregatna tražnja*

Empty talks of Lisbon strategies

Modern societies and governments are preoccupied with efficiency and economic growth¹ which is taken as limitless due to enhanced total factor productivity and prevalence of services over production of goods. The EU condensed this obsession in the Lisbon strategy signed in March 2000. The strategy should have ensured Europe to become by 2010 the most efficient knowledge based society of full employment, and an economy which could compete in the globalization contest. After some years of mantras on strategy, actual development and the report of the Wim Kok committee at the end of 2004 brought soberness and admittance that the EU was not only far from the Lisbon goals, but also heading in the opposite direction. European Commission reluctantly admitted that Lisbon strategy failed. The “old” strategy was therefore replaced in February 2005 by the “renewed” one: “Partnership for Growth and Jobs – New Beginning of the Lisbon Strategy”. In it, the ending year 2010 was abandoned, number of goals was reduced, and responsibilities were turned to the governments of member states. The “renewed” strategy was said to be simple, pragmatic, and tangible². It was supposed to be based on the partnership between the Commission and member states, which were supposed to create their own “lisbons” and become responsible for efficiency, increase of productivity, and employment. The sum of local “Lisbons” was aimed to result in common EU “Lisbon”. Economic growth and job creation were at the core of it; they were planned to be attained by assistance of healthy macroeconomic policy supporting structural reforms. The “Lisbon Action Plan” was supposed to improve the management of the strategy, for example,

by founding national ministries for the implementation of the strategy (Mr. or Mrs. Lisbon).

While the goals of the “Partnership” (growth, jobs, and social security) were not questionable, the “renewed” strategy was not more trustworthy than the “old” one, which was already equally utopian in 2000, when it had been accepted, as it was in 2005. The “renewed” strategy did not assure that low economic growth accompanied by budget deficits, high unemployment, and moderate inflation will end. There were no provisions for the turning point of such development. Instead, the new strategy surprised with the abundance of words, empty talks, newly invented phraseology and concepts, action plans and programs, priorities, mobilizations, new institutions and similar claptraps³.

The supply side and technological change

The “scientific” pillar of the two strategies was production function. Let us consider, for simplicity, that it has a form of Cobb-Douglas production function $Y = A \cdot K^a \cdot L^b$. It simply says that one must work (L) and have machinery (K) to produce (Y) while a and b indicate how changes in K and L affect Y . Growth which cannot be explained by the increases of K and L is attributed to technological change or total factor productivity (embodied in A), which provides room for slogans on competitiveness, human capital, entrepreneurship, efficient and inexpensive state administration etc.

Though production function can have many different forms, the essence and the causality is clear; output is a dependent variable while labor, capital, and technological change are independent variables. A (total factor productivity) is the crucial element of Lisbon strategy; less attention is given to capital and labor, though shallowness of the capital market and inflexibility of the labor market were often blamed for low growth and higher unemployment in Europe compared to the USA. The inflexibility of labor implies that workers in the EU countries are not willing to work for 200 € a month while Chinese workers are

1 Contemporary economics is based on the relation : Selfishness → Profit → Growth; most textbooks start with the assertion that economic activity attempts to fulfill limitless needs. However, if needs are limitless, so must be economic growth. Can we therefore talk about limitless growth? The logical answer is no. If the needs are limitless, they cannot be fulfilled, if we produce in a finite environment, growth cannot be limitless. Nevertheless, the idea that economic growth is not limitless has only a few supporters. Most economists believe in the old assertion that productivity of natural resources is growing exponentially [19] and that economic growth is based on services and limitless growth of knowledge. Thus, production of material goods is not very relevant. This should assure that growth can be limitless [1].

2 Communication to the Spring European Council, *Working together for Growth and Jobs*, A new start for the Lisbon Strategy, COM (2005) 24, Brussels, February, 2.2005;

3 See for example: *Delivering on Growth and Jobs: A New and Integrated Economic and Employment Co-ordination Cycle in the EU*, Companion document to the Communication to the Spring European Council (COM (2005) 24) Brussels, February 3., 2005;

willing to work for much lower wages. The shallowness of the capital market implies that financial sector lacks new financial products and that the credit/output ratio is too low.

Crucial for the lagging⁴ of Europe was nevertheless supposed to be slow growth of total factor productivity caused by modest investment expenditures for research and development, inappropriate education, and feeble spread of knowledge. Thus, research and development, innovations, and knowledge should, according to the strategy, assure competitiveness of the EU in the world market in which other countries compete with cheap labor and abundance of raw materials. The importance of scientific inventions and organization of European research area, which had been stressed already in the “old” Lisbon strategy, remained the pillar of growth and jobs in the “renewed” strategy, as well. Thus, to end the lagging of the EU behind the USA, the EU member countries should increase their R&D expenditures to 3 percents of GDP from the existing 1.93 percent (2002)⁵. The European Commission (EC) itself proposed doubling the amount of money for R&D from 5 to 10 billion € in the EU budget for the 2006-2013 fiscal period which would create research friendly environment. This financial effort would be enhanced by creating numerous more or less necessary bureaucratic institutions such as Joint European Technology Initiative, 22 European Technology Platforms, European Research Council, European Strategy Forum for Research Infrastructures, and National Contact Points. The EC apparently believed that production of scientific discoveries can be assured by creation of institutions dealing with orderly arranged procedures for research proposals and their financing. However, there are no inevitable causal links between expenditures for R&D, growth, and jobs⁶.

4 Whether the EU actually lags behind USA, depends on how one defines performance, which is a matter of value judgments.

5 Expenditures for R&D in USA reached 2.76 percent (2003) of GDP and they were 3.14 percent in Japan.

6 For example, in the period 1995-2002, Ireland attained far the fastest average growth in EU, 8 percent per year, while its expenditures for R&D in the same period were among the lowest, slightly more than 1 percent of GDP, and decreasing. Two countries with the highest expenditures for R&D, Sweden and Finland, attained rather modest growth. While expenditures for R&D in Sweden were constant in the observed period, Finland was the only country in which the share of R&D expenditures was growing; it was accompanied by the declining growth of GDP.

Let us assume that reorganization of science, its regulation, and institutionalization within the EU would indeed bring new technological inventions and economic growth. They should, according to the strategy and in combination with more flexible labor market, bring more and better jobs, transfer of workers from jobs with low value added to jobs with high value added, and reduce unemployment. However, technological change is most often labor saving; it undoubtedly increases productivity and creates better jobs, it, however, at least directly, does not create more jobs. New jobs created by it in a specific industry, in which change takes place, are most likely fewer than jobs which are in the same industry eliminated by change. Only some of the workers who lose jobs because of technological change can find new jobs in the same or other industries producing material goods with higher value added. Some of them move to the service sectors with the same, higher, or lower value added jobs, while some of them move to the activity with zero value added jobs, thus, among unemployed. Technological change, which directly reduces jobs, however, enable creating new jobs in services, public or private, with higher (public servants, lawyers. etc.) value added jobs or lower (waitresses, garbage workers etc.) value added jobs. In the last decade, practically all new jobs in the EU countries have been created in services, share of services in GDP therefore increased to more than 70 percent. Indeed, the aggregate effects of technological change on employment and unemployment are a combination of different effects; some reducing, others enhancing employment.

The EC, while admitting that the central role in job creation belonged to the public sector, however, at the same time, assumed that liberalization of the labor market in public services would create more jobs. This was a rather strange assumption, as liberalization of the labor market is to increase efficiency, which implies that the same amount of public services could be provided by fewer public servants. Furthermore, value added in services, particularly public, is determined by monopolistic power of their suppliers and inclination of the state to make these services obligatory. If, for example, notaries - their number and their required services are regulated

by the state - earn more than anybody else, their value added is by a definition the highest.

The Achilles' heel of Lisbon strategies, the "old" one and the "renewed" one, was total negligence of aggregate demand and full reliance on the premises of neo-classical economics, according to which demand equals supply because of perfect adaptation of economic subjects. This is also evident by the central role of the production function in the strategy. Production function is, by no doubt, a useful device for establishing potential growth but it is much less useful for establishing actual growth. Causality implied by the production function is, namely, not very relevant in an economy in which companies are much more concerned with how to sell products than with how to produce them, and in which capital and labour are abundant. Therefore, for a contemporary market economy, aggregate consumption function, aggregate investment function, and aggregate employment function are far more relevant in determining output and jobs than production function.

Globalization – opportunity or threat?

Economic globalization, as defined by Bhagwati, "constitutes integration of national economies into the international economy through trade, direct foreign investment (by corporations and multinationals), short term capital flows, international flows of workers and humanity generally, and flows of technology" [2, p. 440]. It is supposed to diminish transaction costs, enable efficiency in allocation, and enhance trade based on comparative advantages. The pressures of the world market are also considered more than proper alternatives to government interventions.

Admirers of globalization believe that it is a positive-sum game which enables equalization of incomes in more and less developed countries, increases employment and wages, and also abolishes provincialism, racism and ignorance. Thus, it should at least in the long run, enhance welfare of everybody. Theoretical pillars for these beliefs are to be found in neoclassical economics stressing perfect adaptability of economic units, and benefits of competition; therefore denouncing barriers to it. Critics and skeptics are warning of the "globalization trap", they

are cautious regarding the increases in efficiency, and stress negative social features. For them, only a few individuals and countries enjoy fruits of globalization as it increases income disparities among and within countries, creates unemployment in developed countries while keeping wages in developing countries meager. Merciless battles for the market shares enhanced by mergers and acquisitions lead into a kind of economic cannibalism.

Globalization occurred when American model of capitalism prevailed not only over socialism but also over other models of capitalism. The collapse of socialism was simply attributed to the advantages of the "western" world, which was most often reduced to the American institutional arrangements considered to be the only viable and eternal. This belief was best expressed by the Francis Fukujama's "end of history" which implies globalization of market fundamentalism⁷. One should also not overlook that the linkages between national state on one side and globalization and internationalization on the other, have changed. While fast internationalizations in the past were linking national economies and preserving their national sovereignty, globalization is weakening it. It creates borderless world for corporations and multinationals in which nation states become redundant economic subjects.

By creation of the EU some of the globalization challenges of the member states were shifted from the national to the EU level. However, it soon became obvious that also the EU as an entity has been unable to preserve European social model, existing standard of living, and economic growth while competing in global economy. Huge enough decrease of labor costs (by further liberalization of labor market or by administrative reduction of wages and social benefits) which would suffice for the competition with much more ruthless societies, China, in particular, would imply the abandoning of the social market economy model which is politically impossible and socially unacceptable. Due to the vanishing of the traditional employer-employee relationship, predominance of "shareholder value" maxim, and unbounded mobility

⁷ Fundamentalism is not meant to be insulting. I simply want to express doubts in ideological constructions of reality which are often expressed by American economists who consider themselves being liberals and who overlook that American institutional arrangements are not the only ones that work.

of capital, production was moving to the countries with exceptionally low labor costs. This happened not only in many traditional industries with low value added jobs (textile) but also in industries of goods and services with high value added jobs. By their relocation to the countries with miserable wages and nil social security (and despite high initial profits), these industries also swiftly turned to endangered industries with low value added jobs. The relocation of production, thus, also diminished the ability of the EU countries for indirectly creating more jobs in services. It is for this reason why the EU might be forced, while repeating slogans of adherence to free trade, to gradually close its markets. How to do that is unclear; one of the possibilities is offered by imposing “ISO standards” requesting that imported goods and services are produced in accordance with the rules which exist in the EU. It is certain that by higher economic growth and by increase in the standard of living in the rest of the world, new markets will emerge, but their emergence will however lag behind loss of jobs due to production being shifted from the EU.

Indeed, the assertions that globalization increases welfare and economic growth, have recently become conditional and the claims that globalization reduces poverty less affirmative. The proper answer is most likely that “globalization may bring enhanced growth, but need not, and it may lead to increased poverty, but need not” [20, p. 466].

Europe 2020

Flood of strategies, some stretching to 2060, others dealing with how to exit the crisis, was in 2010 enriched by *Europe 2020*: the EU’s growth strategy for the decade. The collapses of two previous strategies made European planners a little bit more cautious and the third strategy a little bit more realistic. For example, the former pillar of economic progress – globalization is now put among long run problems together with scarcity of natural resources and aging of the population. At least here, Europe 2020 is right. The idea that European “knowledge based economy” can compete with socially much more ruthless societies on the world market has been condemned to fail in advance; knowledge is even more flexible than capital. The ability to

request “fair” trade and competition which would request that other countries comply with minimal social norms and rights of workers has been missed by greed of the EU multinationals and its own thoughtlessness.

In the introduction to the document and in an accompanying document [5] the EC assessed the causes of current economic crisis. According to the commission, structural deficiencies, low investments, non-dynamic management environment, aging of the population, lower employment rates, and minor working efforts than in the USA and Japan should be blamed for it. This is totally wrong. The commission sees the problems on the supply side and considers the crisis being unpredictable like recent earthquakes in Chile and Haiti; according to the views of the EC Lisbon strategies actually helped that the damage of the crisis is similar to the damage in Chile and not to the damage in Haiti. Indeed, the EC overlooked its own role, though the Commission can be easily considered one of the accomplices for the crisis. Instead of preventing spread of ideology which led to the crisis, the EC supported it. The EC consented to the ideas of full adaptability of markets and believed in comparative advantages of the EU as a seller of knowledge, it supported privatization of public services and “sound” economic policies. The pillar of the latter should be reduction of wages and social security benefits which would make the EU competitive to much more ruthless societies. It overlooked that all jobs which were lost in production of goods cannot be replaced by jobs in services, and that high value added activities turn to low value added activities when they are transferred to a country with low wage and no social security. Indeed, reduction of labour costs by lower wages and less social security sufficient for competition implies abandoning of European social market economy.

According to Europe 2020, the EU should become a *smart, sustainable and inclusive economy*. Europe 2020 is to deliver growth which is: *smart* (based on more effective investments in education, research and innovation); *sustainable*, (thanks to a move towards a low-carbon economy); and *inclusive* (with a strong emphasis on job creation and poverty reduction). The strategy is focused on five goals in the areas of *employment* (75% of the 20-64 year-olds to be employed), *innovation* (3% of the EU’s GDP

to be invested in R&D), *education* (reducing school drop-out rates below 10% and at least 40% of 30-34-year-olds completing third level education), *poverty reduction* (at least 20 million fewer people in or at risk of poverty and social exclusion), and *climate change* (lowering energy greenhouse gas emissions by 20%, increasing energy production from renewable sources by 20% and increasing energy efficiency by 20%). Member states are committed to achieving Europe 2020 targets and also had to translate them into national targets and growth-enhancing policies; each member state should adopt its own national targets and actions at national level to underpin the strategy.

The first goal of Europe 2020 (75 per cent employment rate) which does not include economic growth indicate an important shift in philosophy or awareness that the basic problem of contemporary world is lack of jobs and that economic and political development in the near future will be determined by employment and unemployment and their social consequences. The problem of the world is not the shortage of goods and wealth, but their distribution, large enough consumption, and creation of jobs. Unemployment is far the biggest problem of the EU and the EU apparently has to create jobs. When a new production unit is opened, nobody cares for what will be produced in it, everybody is preoccupied with a number of jobs which will be created. Business companies are not concerned with the question how to produce a product or a service but with the question how to sell it. Ups and downs in economic activity are explained by movements of final demand categories rather than by supply side restrictions. Creation of new services and institutions is needed to nullify the effects of technological change on employment and to prevent formation of “one third society”. Out of three kinds of economic growth: “smart, sustainable and inclusive”, the EU will therefore have to care for the inclusive growth: creation of new jobs. Also sustainability of growth appears to be a kind of an excuse for job creation. Actual concern with competitiveness will be how to diminish the competitiveness of “Chinese” products rather than increasing the competitiveness of the EU products. Most jobs in the decade before the crisis were lost in manufacturing, partly because of “smart” growth or technological change, and partly because of

moving production to “China”; part of manufacturing and employment in it can only be brought back by actually holding back imports to the EU while repeating free trade rhetoric.

“Smart” growth is linked to the second goal “3 per cent of the EU’s GDP to be invested in R&D. The goal implies that expenditures for R&D bring technological change, economic growth and employment, though this is not confirmed empirically regardless of data used: cross section, time series or panel. As stated above, technological change creates better jobs, it, however, at least directly, does not create more jobs. Its aggregate effects on employment and unemployment are a combination of different effects; some reducing, others enhancing employment. In the last decade, practically all new jobs in the EU countries have been created in services, share of services in GDP therefore increased to more than 70 per cent which was indirectly enabled by technological change in production of goods.

When we come to the third goal “reducing school drop-out rates below 10% and at least 40% of 30-34-year-olds completing third level education” we cannot overlook the damage produced by Bologna reform which should increase efficiency of higher education but ended in lowering the quality of higher education which was predictable and predicted. Whether poverty will endanger 20 million less people than now depends on the fulfilment of the first goal, 75 per cent employment rate. High employment rate does not prevent poverty but it is the best way to reduce it.

As a document, Europe 2020 remains a kind of pre-election program with a lot of promises and newly invented expressions well manifested for example in “smart, sustainable and inclusive growth”, and empty slogans such as “Europe must succeed”. If rhetoric would suffice, the goals would most likely be attained but as this is not the case, Europe 2020 will most likely turn to a worthless political document sharing the fate of two previous strategies. Though, it is less dogmatically than the two predecessors linked to supply side economics, flexibility of the labour market, and financial deepening, Europe 2020 ignores aggregate demand. The document will therefore provide only jobs for the EU bureaucracy responsible for its “implementation” in the centre and in the member states.

The EC has, namely, set up a whole bunch of administrative rules in yearly cycle of economic policy coordination called the *European Semester*. According to it, the EC is to undertake a detailed analysis of economic and structural reforms and to provide the member states with recommendations for the next 12-18 months. The semester starts when the commission adopts its annual growth survey, usually towards the end of the year, and sets out EU priorities for the coming year. In March, the EU heads of state and government issue guidance for national policies, the Spring meeting of the EC is to survey overall macroeconomic situation, progress towards the five EU-level targets, progress under the flagship initiatives and to provide policy orientations covering fiscal, macroeconomic structural reform and growth enhancing areas, and to advise on linkages between them. In April, member states must submit their plans for sound public finances (Stability or Convergence Programs), and reforms and measures to make progress towards smart, sustainable and inclusive growth (National Reform Programs). In May and June, the Commission assesses these programs and provides country-specific recommendations as appropriate which are then endorsed by the European Council. Finally, end of June or in early July, the Council formally adopts the country-specific recommendations. If the recommendations are not acted on within the given time-frame, policy warnings can be issued. There is also an option for enforcement through incentives and sanctions in the case of excessive macroeconomic and budgetary imbalances.

Reality 2012

Europe 2020 has been much less used for political speeches than two predecessors were in the period preceding the crisis. Indeed, at the very beginning of the crisis, the EC representatives continued to adhere to the rhetoric of Lisbon strategy and Stability Pact though it was evident that supply side economics is inappropriate and that “sound” economic policy cannot prevent spread and deepening of the crisis. Lisbon rhetoric was afterwards abandoned while the EU adhered to “sound” economic policies in seeking to placate credit rating agencies and “financial markets”. Excessive public expenditure has

been proclaimed the culprit of the crisis. This implied that the crisis should be heeled by savings in the public sector and its cutback. In reality, the crisis was created by long lasting redistribution of GDP in favour of capital, shifting of production to “China” and resulting hyper production, creation of demand by credits, and financial speculations. Public sector became “excessive” because governments had to prevent financial collapses of the countries.

The size of “normal” budget deficit of a country in the long run is determined by its fiscal system, historical development, and the size of public debt, while in the short run it depends on economic growth. High economic growth decreases budget deficit because it increases tax revenues due to increased tax bases (amount of transactions, income, profits), while stagnation necessarily increases budget deficit for the same reason, i.e. the squeeze of tax bases. This is enhanced by the increased needs for social transfers. However, admitting that large budget deficits and growing public debt are inevitable consequences of the squeezed economic activity would request giving up ideology of Stability Pact by which “eternal” economic growth is ascertained by small share of public sector in the economy and balanced budget. Preventing growth of budget deficits and introducing “structural” reforms during the recession to squeeze “natural” European level of public sector is but not only harmful for a country, it is destructive for the existence of the EU (see Figure 1 and Table 1).

Figure 1: Growth and budget deficit in EU27

Source: Eurostat

Although the whole of the euro area is in recession, it is much more severe in “southern” (Greece, Spain, Italy, Portugal, Slovenia) than in “northern” part of it (Germany, Austria, Netherlands, Finland). Greece has been faring far the worst, with GDP drop by over 17% in four years of the crisis. It is followed by small new member states, in which most of the drop was created by enormous decrease of exports in 2009. These are Slovenia, Estonia (euro zone members) Latvia and Lithuania; the speed of their recovery has differed; the slowest being in Slovenia. Among “old” member states the drop of GDP was the largest in Ireland, Portugal, Spain and Italy. Poland is the only country which has passed the crisis unharmed (see Figure 2). GDP between 2008 and 2012 increased by 13 percent while real GDP in 2012 is to be higher than in 2008 also in Sweden, Slovakia, Malta, Germany, Belgium, Austria and France.

Unemployment shows a similar divide. The overall jobless rate in the first quarter of 2012 was 10.7 per cent in EU27 and 11.5 per cent in euro zone. It was nearly 25 per cent in Spain and 23 per cent in Greece; but only 4.4 per cent in Austria. In twelve countries unemployment exceeded 10 per cent; Germany is the only country with jobless rate lower in 2012/I than in 2008. Unemployment is definitely the most important economic, social, and political challenge which the EU is to face in the near future.

Government debt at the end of 2011 reached 82.5 per cent of GDP in EU27 and 87.4 per cent in euro zone. It was above 100 per cent of GDP in Greece, Ireland, Italy and Portugal. By contrast, it was only 6 per cent in Estonia and 16 per cent in Bulgaria. Budget deficits in 2011 were lower than in 2009 which is a result of savings hysteresis, prolonging and deepening the recession (see Table 2).

Table 1: Fiscal state in the crisis EU-27

	2007	2008	2009	2010	2011
GDP (bill. €)	12397	12465	11750	12246	12629
Budget balance	-110	-302	-810	-805	-564
(% GDP)	-0.9	-2.4	-6.9	-6.6	-4.5
Expenditures (% GDP)	45.6	47.1	51.0	50.6	49.1
Revenues (% GDP)	44.7	44.7	44.1	44.1	44.4
Public debt (bill. €)	7315	7791	8779	9816	10422
(% GDP)	59.0	62.5	74.7	80.2	82.5

Source: Eurostat

Figure 2: GDP growth, budget deficits and unemployment in the crisis

Source: Eurostat, own calculations

Is Euro irreversible?

One should admit that the EU has proved to be a stable association, though, the pillars of the EU stability are rather strange: inertia, ability to disregard its own rules, democratic deficit, constant creation of new institutions, and empty talks. There are many cases to prove the claim. Inertia, for example, can be observed in slow adaptation of CAP. That the EU disregards or adapts the rules according to political needs is manifested by admittance of Italy or Belgium to the euro area though their public debt was twice higher than required by the rules. The benefits of democratic deficit were well demonstrated when negative voting on the EU constitution in France and Netherlands was replaced by Lisbon treaty. By creating new and new institutions not only in Brussels but also in the member states one get more and more people with vested interests in

the EU. Finally, the documents produced by the commission are full of empty talks and resemble similar documents produced in Yugoslavia thirty years ago. However, this does not imply that rather strange pillars of the EU stability are useless. On the contrary; they enabled enlargements and have been keeping the EU together.

Enlargement of monetary union to the whole EU was in the past considered natural and desired future of the EU; all new EU members entering the EU should become members of monetary union. This was based on wrong assumption that euro area will become an optimal currency area. However, euro was from the very beginning a political project without sound economic foundations. It was therefore obvious that euro area will run into difficulties due to the loss of exchange rate and monetary policies in an area which is not optimal currency area, and that euro might increase rather than decrease economic and social

Table 2: Performance of the EU during the crisis

	public sector share	drop of GDP	budget deficit % GDP			Debt % of GDP		unemployment rate		
	2001-2011 average	2012/2008	2009	2010	2011	2008	2011	2008	2012/1Q	Youth 2011
European Union	47,6	-0,9	-6,9	-6,5	-4,5	62,5	82,5	7,1	10,7	21,4
Euro area	48,1	-0,7	-6,4	-6,2	-4,1	70,2	87,4	7,6	11,5	20,8
Belgium	50,7	1,3	-5,6	-3,8	-3,7	89,3	98,0	7,0	7,2	18,7
Bulgaria	38,3	-3,0	-4,3	-3,1	-2,1	13,7	16,3	5,6	13,0	25,0
Czech Republic	43,8	-0,5	-5,8	-4,8	-3,1	28,7	41,2	4,4	7,2	18,1
Denmark	54,4	-2,8	-2,7	-2,5	-1,8	33,4	46,5	3,4	8,2	14,2
Germany	46,6	2,5	-3,2	-4,3	-1,0	66,7	81,2	7,5	6,0	8,6
Estonia	36,7	-4,1	-2,0	0,2	1,0	4,5	6,0	5,5	11,8	22,3
Ireland	40,3	-6,2	-14,0	-31,	-13,	44,2	108,2	6,3	15,0	29,4
Greece	47,5	-17,2	-15,6	-10,	-9,1	113,0	165,3	7,7	22,8	44,4
Spain	40,7	-4,8	-11,2	-9,3	-8,5	40,2	68,5	11,3	24,6	46,4
France	53,9	0,6	-7,5	-7,1	-5,2	68,2	85,8	7,8	10,0	22,9
Italy	48,6	-4,7	-5,4	-4,6	-3,9	105,7	120,1	6,7	11,1	29,1
Cyprus	43,1	-1,1	-6,1	-5,3	-6,3	48,9	71,6	3,8	11,4	22,4
Latvia	38,0	-11,6	-9,8	-8,2	-3,5	19,8	42,6	8,0	16,6	31,0
Lithuania	36,2	-6,3	-9,4	-7,2	-5,5	15,5	38,5	5,8	14,7	32,9
Luxembourg	40,4	-0,2	-0,8	-0,9	-0,6	13,7	18,2	4,9	5,9	16,4
Hungary	49,9	-4,3	-4,6	-4,2	-4,3	73,0	80,6	7,8	11,8	26,1
Malta	43,8	3,1	-3,8	-3,7	-2,7	62,3	72,0	6,0	6,1	13,8
Netherlands	47,2	-2,0	-5,6	-5,1	-4,7	58,5	65,2	3,1	5,2	7,6
Austria	50,9	1,6	-4,1	-4,5	-2,6	63,8	72,2	3,8	4,4	8,3
Poland	43,8	13,1	-7,4	-7,8	-5,1	47,1	56,3	7,1	10,7	25,8
Portugal	46,1	-6,3	-10,2	-9,8	-4,2	71,6	107,8	8,5	15,6	30,1
Romania	36,7	-4,6	-9,0	-6,8	-5,2	13,4	33,3	5,8	7,9	23,7
Slovenia	46,6	-8,2	-6,1	-6,0	-6,4	21,9	47,6	4,4	8,7	15,7
Slovakia	39,1	4,2	-8,0	-7,7	-4,8	27,9	43,3	9,6	14,1	33,5
Finland	50,8	-2,2	-2,5	-2,5	-0,5	33,9	48,6	6,4	8,1	20,1
Sweden	53,4	5,1	-0,7	0,3	0,3	38,8	38,4	6,2	8,0	22,9
United Kingdom	45,2	-1,0	-11,5	-10	-8,3	54,8	85,7	5,6	8,3	21,1

Source: Eurostat, own calculations

differences among member states, creating tensions and well known accusations of “exploitation” [14]. After fourteen years during which it was indecent to doubt into euro and its eternity, economic arguments are relevant again and the discussions, whether euro can be preserved, and if so, what are the costs of its upholding are getting relevant again.

The debates on euro concentrate on the question whether centralized monetary system and policy can coexist with decentralized fiscal system and policy. Three options appear: fiscal disintegration, fiscal pact, and fiscal union.

In the first case, monetary union could coexist with decentralized fiscal system and policy, if a member of the union is solely responsible for its economic situation and will not be bailed out by other members⁸. The question in this case is why do we need monetary union at all?

⁸ In this case, Greece would be allowed to bankrupt; this would most likely happen if bankruptcy would not endanger French and German banks.

According to the second option, centralized monetary policy and decentralized fiscal policy can coexist if the latter is coordinated by for example the so called “golden rule” on budget deficit. In reality it implies that fiscal policy of the mighty (Germany) is the right fiscal policy regardless of enormous differences in the size of public debt in member states, the ways in which public debt was created, different economic situations in the countries and therefore the differences in the real burden of the debt. Furthermore, coordinated fiscal policies synchronize and enhance economic cycles. In short, asymmetric shock of fiscal pact will join asymmetric shocks of monetary union.

In the third option, monetary union is accompanied by fiscal union, thus, by the shift of fiscal policies from “republics” to the “federation”. This option however implies fiscal federalism i.e. agreements on what are the tasks of different levels of government and corresponding

Table 3: Balance of payments 2001–2010 average, % BDP

	Current account					Financial account Investments		
	Total	goods	services	incomes	transfers	direct	Portfolio	other
Belgium	1,81	0,74	1,18	1,63	-1,75	1,87	-0,63	-2,53
Bulgaria	-10,74	-15,77	3,52	-1,65	3,17	12,38	-1,39	4,78
Czech Republic	-3,64	-0,16	1,45	-5,17	0,25	4,57	0,34	0,67
Denmark	3,24	2,74	2,08	0,14	-1,72	-1,37	-2,24	2,21
Germany	4,50	6,53	-1,61	0,91	-1,33	-1,00	0,56	-4,16
Estonia	-8,20	-12,59	8,34	-4,87	1,04	5,69	-2,73	4,83
Ireland	-2,26	19,54	-6,03	-15,63	-0,15	-2,46	1,28	5,23
Greece	-9,59	-15,05	6,95	-2,99	1,50	0,09	5,39	2,19
Spain	-6,17	-6,32	2,64	-2,13	-0,36	-1,57	4,23	2,87
France	-0,28	-1,26	0,82	1,30	-1,20	-1,82	0,50	1,30
Italy	-1,80	0,20	-0,26	-0,51	-0,75	-0,88	1,90	0,77
Cyprus	-7,51	-27,07	23,16	-3,84	0,33	3,14	-18,54	24,33
Latvia	-9,45	-17,11	4,83	-0,28	3,11	3,34	-0,33	8,46
Lithuania	-6,32	-9,86	3,04	-2,15	2,65	2,77	0,95	2,73
Luxembourg	9,05	-10,31	44,00	-21,84	-2,81	n.a.	114,64	-96,29
Hungary	-5,77	-1,59	1,51	-5,82	0,13	2,54	1,70	3,60
Malta	-5,16	-16,01	13,78	-3,10	0,18	9,23	-24,46	20,23
Netherlands	5,70	6,48	0,76	0,18	-1,71	-3,73	1,26	-1,22
Austria	2,47	-0,40	3,96	-0,45	-0,63	-1,30	1,50	-2,17
Poland	-4,13	-3,04	0,52	-2,41	0,79	2,59	1,69	1,35
Portugal	-9,80	-11,23	3,06	-3,37	1,73	0,65	2,32	4,89
Romania	-7,58	-9,10	0,00	-2,24	3,81	4,94	0,45	5,59
Slovenia	-2,02	-3,45	2,97	-1,37	-0,18	0,64	0,13	2,78
Slovakia	-6,39	-3,47	0,47	-3,31	-0,08	5,59	-0,30	3,12
Finland	4,60	5,48	0,05	-0,16	-0,77	-0,12	-2,99	0,19
Sweden	7,00	4,89	2,05	1,26	-1,20	-2,00	-0,95	-0,91
Un. Kingdom	-2,22	-5,48	2,50	1,70	-0,94	-0,20	3,32	-0,96

Source: Eurostat, own calculations

distribution of revenues and expenditures [13]. A decision on taxes belonging to “federation” or on which “federation” and “republics” participate is needed. Custom duties and eventual Tobin’s tax on financial transactions would not suffice for the creation of fiscal union, larger “federal” participation on VAT or excise tax would be needed. It is not very likely, that member states could reach an agreement on the revenue side of fiscal union. It is but much more unlikely that they could reach an agreement on the expenditure side of the budget. Whether creation of a fiscal union is a feasible solution depends on the amount of redistribution of GDP among member states⁹.

Though, euro was recently proclaimed irreversible by ECB governor Draghi, the question whether it can be preserved should be replaced by a question whether the costs of preservation are not higher than the benefits. European countries outside the single-currency zone like Sweden, Poland and Britain may now be happy for not joining the euro. Though they are being hurt by the crisis by tight trading and financial links they are better off because they can fight the crisis with exchange rate and monetary policy, while member states are forced to “beggary”. The exclusion of Greece would not help much as other “poor” members would follow until monetary union is reduced to the optimal currency area or to “DEM union” composed of the countries which used to be the members of de facto monetary union (Germany, Austria, Belgium, Netherlands, Luxembourg) before euro. Which

countries belong and which do not belong to proper optimal currency area can be easily found out by their balance of payments characteristics in the last decade presented in Table 3. The countries with current account surpluses are Germany, Belgium, Luxembourg, Netherlands, Austria and Finland (euro zone members) Denmark and Sweden.

Unfortunately, the debates on Euro bear resemblances to similar debates in the eighties in Yugoslavia, when the country gradually disintegrated as an economic entity, and on the taboo themes of that time, when it was inappropriate to doubt into eternity of “brotherhood and unity”. Euro has also been considered irreversible; no legal provisions were created for a country to leave euro area which also reminds someone on Yugoslavia; there were no legal provisions for a republic to leave. Indeed, some resemblances are striking: heterogeneity in the level of development, a political question on what is more democratic “one man, one vote” or “one state, one vote” and the most worrisome is what I label the “Yugoslav syndrome”. Namely, during the stagnation in the eighties, people began looking for who is to be blamed and who exploits them. At the end, each republic was “exploited” by all other republics. This is what is more and more appearing in the EU. Yugoslavia survived a decade long stagnation before falling apart. Can euro zone survive a crisis which would last a decade? This does not mean that it will happen. Entry and exit are not symmetrical; euro might persist simply because nobody knows how, dares to, or is able to leave.

9 For hypothetical calculations, a »Yugoslav« model of tax revenue participation was used for monetary union. According to it, revenues of the customs belonged to federal authorities, revenues of direct taxes (social contributions) to republics, while revenues of indirect taxes (sales tax) were split between federation and republics. In the experiment, VAT and excise tax rates in the member states were first equalized. After their equalization, “federal” government in Brussels would be entitled to 50 percent of the fiscal revenues generated by indirect taxes which would amount to 6.5 percent of GDP of member states. The “federal” revenues would then be used for all citizens of the federation equally or distributed among member states in accordance with their shares in population of the fiscal union. In such a case, GDP of eight member states would decrease and of nine member states would increase. Luxemburg would lose most: 4.37 percent of GDP, while Germany would lose 0.44 percent, France 0.47 percent, Ireland 2.46 percent, Netherlands 1.40 percent, Austria 1.08 percent and Finland 1.29 percent. On the other side, GDP in small “new member states” (entering the EU in 2004) would increase substantially; in Slovakia for 11.45 percent, in Estonia 8.97 percent, in Slovenia 4.10 percent. GDP would increase also in some “old member states”; in Greece and Cyprus for 2.41 percent, in Portugal 4.91 percent, in Spain 1.16 percent, and in Italy 0.40 percent. [15]

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