

ASPECTS OF THE CURRENT FOCUS OF TENSION IN THE EUROPEAN UNION

Michaela Ševčková, PhD

University of Economics, Faculty of Economics, Prague, Czech Republic

Abstract

The main purpose of this paper is to explore the current status of the European Union and Eurozone, focusing on economic and political aspects and in the context of decisions made quite recently. The contemporary crises have shown that especially the common monetary policy of the ECB and single interest rate are inadequate for all euro area members and caused deterioration in the economic situation of some peripheral countries. The paper elaborates on the main flaws of the EU and Eurozone, highlights and draws attention to a vacuum of European law in the case of the option to leave the Eurozone. The paper critically analyses decision-making carried out at European level by the political class where the reality of European specifics and the continent's historic development was ignored.

Keywords: European Union, euro, monetary policy, convergence, crisis

Introduction

The European Union is experiencing one of the biggest challenges in its history following the summer of this year. The refugee crisis hit some member states to an unprecedented extent and revealed other faults in common European political decisions. The opportunity was missed to concentrate on the necessary structural reforms and enhance the functioning of the internal market; elites in Brussels will have to make a huge effort to deal with this overarching issue affecting the future composition of the European continent in the coming decades. This problem relegated other areas of tension within the European Union to the background. In particular, further development in some Eurozone countries, which are contending - for their economy - with a strong euro, lower competitiveness and economic growth. Attention directed towards important issues such as high public debt and unemployment rate in some countries; consolidating positions of protest parties and movements; the matter of Brexit; Greece; escalating use of unconventional policy by ECB; absence of fiscal transfers within the monetary union, and the ageing European population could well be

downgraded. This paper analyses some of the basic inadequacies of the European integration process which undermine the theory of its operation. It discusses fundamental issues that especially make the Eurozone situation so complicated and outlines why the European Union will struggle with both its organisational and institutional architecture as well as future development.

Ignorance of theoretical prerequisites in the economic field and unconventional policy

European integration has been evolving through various developmental stages since its inception. The first of these stages included notions of federalism and functionalism; the sixties and seventies argued on behalf of the concept of an intergovernmental approach. The next two decades were influenced and characterized by many aspects such as multi-level governance, social constructivism, new institutionalism and a liberal intergovernmental approach (Rosamond 2000; Schneider&Aspinwall 2001).

The new form of the European Union arising in the nineties was based on two important pillars: Monetary Union and the Schengen system. Both possess an unflattering status these days. The idea of monetary union among European countries has existed for decades. Some theoretical and practical benefits of single currency and free movement are indisputable. However, the EU's founding fathers and European officials completely omitted certain vital aspects; they made unrealistic and wrong assumptions, respectively. They didn't take into consideration different functioning and specific processes occurring between northern countries and the less competitive southern periphery bound by common monetary policy with the single interest rate set for all by the European Central Bank. It's a matter of fact that the single interest rate does not suit all euro area members.

The Taylor rule (despite some of its limitations) applied to core and periphery countries between 1999 and 2013 confirmed the inappropriateness of the "one size fits all" concept. Moreover, calculations for the pre-crisis period have demonstrated that some of the peripheral countries should have had their interest rates around twice as high as the core countries (Ševčíková, 2015, p. 133).

The Creators of European Economic and Monetary Union also proceeded from the wrong assumption of the theory of endogeneity (described in Frankel & Rose, 1998) that common currency will be the main engine for the mutual convergence of the union's economies. It basically means that the convergence among its members will occur ex-post.

The statistical testing of real economic convergence based on the method of β -convergence between the core and peripheral countries over the whole period 2003-2012 confirmed much less than convergence but on the contrary their divergence (Ševčíková, 2015). In practice, this entails that

economies with higher incomes (core countries) grew faster than most of those who are characterized by lower gross domestic product per capita (peripheral countries). On the other hand, the theory of convergence is applicable to old and new member states and to periphery countries and new member states in 2003 - 2012 and the pre-crisis period (Ševčíková, 2015). Since 2008, the catching-up effect has almost stopped. Some euro area countries, especially Greece, Ireland, Spain, Cyprus and others experienced a significant fall in their standard of living measured in GDP per capita in PPS. Currently, with the exception of three countries, all EU states have become more indebted since 2004.

Being verified from many aspects and by various authors (Kadarmo 2008; Eichengreen 1991; Artis 2003), it remains true that the current members of the euro zone cannot be considered an optimum currency area (OCA). The neglect of essential theoretical prerequisites of OCA by EU authorities (notably heterogeneity of economies, weak mobility of production factors, low flexibility of prices and wages, absence of extensive fiscal transfers towards the weaker members) emphasise the less than successful operating of euro in some countries. Moreover, as M. Feldstein (1997, p. 41) states: “Uniform monetary policy and inflexible exchange rates will create conflicts whenever cyclical conditions differ among the member countries”. This does not mean that common currency would not work well in select current euro area countries.

Recent development in European and global economy has shown that theoretical postulates valid for decades do not apply to the current global setting. However, the conditions of the theory of OCA are still relevant as can be seen in the example of euro area. It would not be correct to argue that common currency is the only cause of the poor state of some Eurozone members. First of all, the main culprits are the member states themselves along with the erroneous politico-economic activities of their governing classes. That being said, legitimate criticism must be directed to all who essentially concentrated on nominal Maastricht criteria and probably neglected the more important criteria of real convergence.

The current period is characterized by the very active or, to put it better, activist role of the European Central Bank. ECB is flexing its muscles and has launched a new program of European quantitative easing in the form of the public sector purchase programme (ECB, 2015) as a part of the expanded asset purchase programme in spring this year. The era of pumping money into economies continues, the spill over effect into real economy is very uncertain. According to the latest estimates of Eurostat from September 2015, the euro area struggled with deflation of -0.1%, well below the ECB's inflation target, which is set at close to 2%. Likewise, real economic growth in the European Union lags behind its largest trading partners, the USA and

China, over an extended period. Additional money from the world's central banks can alleviate tension in the short term but would provoke and give rise to other speculative bubbles in the medium or long term period. In 2014, for the first time in history, such a bank of the size and magnitude of the ECB determined a negative interest rate for the deposit facility, currently amounting to -0.2%. If this approach further expands, it could be viewed as an attack on conventional and traditional banking. Finally, we witness the era of employing unconventional and non-standard instruments as the European Central Bank performs its activities and operations on the brink of the framework of European law or in some controversial cases (e.g. Securities Market Programme, proposed Outright Monetary Transaction, Emergency liquidity assistance for Greece), probably even beyond its mandate outlined in the Protocol on the Statute of the European system of central banks and of the European Central Bank.

The last European financial and economic crisis also unveiled strong connectedness and interdependence between central banks, commercial banks and governments. Talk of a vicious circle was even heard in Brussels, where central banks were supplying liquidity to commercial bank and in return these banks were purchasing government bonds.

Legal vacuum and other fundamental inadequacies in the process of European integration

In the late nineties, the euro area was considered an elite club by many leaders, representatives and authorities. A club which nobody would ever want to leave. The European Union obtained legal personality with the adoption of The Treaty of Lisbon (until then it had only European Community). According to that same Treaty, Article 50 allows for voluntary withdrawal from the EU. This eventuality comes more than a half-century after the establishment of the European Economic Community. This issue is more complicated with "membership" in the euro area, because it is still legally impossible to leave the euro zone. The reason is simple, no such thing as a euro zone in terms of an international institution with legal personality exists in European law. Eurozone is only some kind of politic and economic entity.

What does this mean for euro area countries in practice? If a country would like to abandon the single currency without breaking the *acquis communautaire*, the only option is to withdraw from the European Union. Even if it would be more advantageous for a country to reintroduce domestic currency, no mechanism can currently provide for it. One of the consequences of this basic legal drawback could be discerned as the current cheerless status in Greece.

Greece is a prime example of a country that has ridden the wave of the initial success of euro and is now paying high relative costs for the mistakes of its political elites, who have alternated in power since the mid-seventies. Greece as the Cradle of Western Civilization faced the ignominy of being the first modern liberal EU democracy to go bankrupt after World War II. It de facto happened in 2012 when private creditors were forced to write off more than 70% of their real bond's value within PSI (Private Sector involvement). Solely in the case of Greece, the European Union violated one of its rules: the no-bailout clause, which is a condition dictating that countries do not take responsibility for each other's debt. This clause is laid down in the Maastricht Treaty (1993, Art. 104 Sec 1). The Establishment of European Stability Mechanism (wherein Greece is currently one of the recipients of financial assistance, alongside Cyprus) required changing a primary law.

Representatives in the EU - alternatively it applies to some national politics - take the path of ad hoc solutions (e.g. the network of rescue and bailout funds) rather than concentrating on and addressing the causes. The sticking point of the decision-making process in European integration is a clash of national and European (central) view. The European Union has huge potential in mutual economic cooperation, though most likely it was a wrong decision to introduce single currency among heterogeneous members before the appointed time, as recent developments somewhat confirm. Some European authorities and elites are trying to push the current status of the EU more towards political union. The latest Five Presidents' (European Commission, Euro Summit, Euro group, European Central Bank, European Parliament) Report from June 2015 has presented an ambitious concept to further deepen Economic and monetary Union by 2015. An effort is made to strengthen the common fiscal system. One of the barriers hindering the progress of transforming into a political union is just a weakness of European fiscal transfers. Only around 1% of EU GDP is still redistributed throughout the European budget.

Generally, as can be seen from the history of European integration, a large number of measures proposed at European level can be difficult to implement for many various reasons. To name a few: European interest (if there is such a thing) can be in conflict with national interests of individual countries; absence of a combined European nation and patriotism for the European Union culminating in a shared European identity; transferring part of national sovereignty as a symbol of national state to supranational level weakens European countries. The current status of the Union is somewhat unusual and could be described as a community of "sovereign" states with some federal fundamentals. The European Union and its institutional representatives try to achieve a form which it hasn't grown into yet.

Considering European history, questions remain if this transformation will ever happen.

Conclusion

The adopting of the Maastricht Treaty in the early nineties has changed the European integration process. Important economic factors and assumptions took a back seat at the expense of prevailing political reasons. Subsequent ignoring of fundamental theoretical and other aspects (Optimum Currency Area, theory of convergence, etc.) had negative implications for some Eurozone members. In particular, the common monetary policy of ECB and its monopoly on setting the interest rate were unsuitable for the group of periphery countries. The diverse economic features, performance and competitiveness of the EU's members will create further tensions considering the absence of appropriate fiscal transfer correcting e.g. the unequal development of asymmetric shocks. Greece is an example of a state, which became a victim of the poor governance of its domestic elites and of the premature introduction of the euro. The country and the currency proved a disservice to each other.

The violations and manoeuvring on the edge of rules and law from the side of European Union leaders and institutions send wrong signals to its citizens. It's rather incredible that European law, encompassing such a great amount of details in our everyday life, does not remember the possible condition of cancelling membership of the euro area, a state giving up single currency and reintroducing its own currency.

The European Union is unfortunately very often lacking comprehensive and real strategies, particularly exit ones. Increasingly, it seems clearer that the efforts to unite Europe in the near and distant future from the central supranational level will be nigh on impossible and unsuccessful for the reasons mentioned and analysed in this paper.

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