ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

ГОДИНА XX, 2011, 2

András Inotai[1]

THE MANAGEMENT OF THE COSTS OF CRISIS MANAGEMENT EUROZONE, EU 2020 AND THE FUTURE OF EUROPEAN INTEGRATION[2]

Although the European Union (EU) was not the main source of the global financial and economic crisis, as one of the leading economic players, it was fundamentally affected by the immediate and longer-term consequences of the crisis. Similarly, it is expected that it would play an important role in how to get out of the crisis (not yet clear, whether a passive or an active one).

Almost all areas of community-level and member-state-based economic policy were affected by the crisis. Three of them have been chosen to be addressed in this paper. First, the challenge to the Eurozone and the common currency, as an immediate impact of the crisis will be dealt with. Second, as a coordinated answer to crisis management and post-crisis coordinating (and decision-making) mechanism, the idea of European Economic Governance will be analyzed. Third, in a longer-term perspective of post-crisis sustainable growth, the EU 2020 project will be shortly described and assessed.

JEL: O57; F43; F36

1. Crisis in the Eurozone

Together with the enlargement to Central and Eastern Europe, the creation of the EMU and the introduction of the common currency was – justly – considered as the two success stories of the European integration in the last decade, particularly as compared to a large number of areas where real progress could not be identified and the deepening of the integration was practically blocked.

The crisis has drastically changed this situation. It has, however, to be added that the pre-crisis view was always distorted in favour of self-complacency, for every expert (and maybe also politician) dealing with this issue had to know how, with what kind of „dirty compromises" the EMU had been helped to life. Of course, the crisis made immediately clear the internal fault lines of the whole structure and raised a number of crucial questions about the viability of the project. In addition, some of the

[1] *András Inotai is Prof. Dr., General Director of Institute for World Economy, Hungarian Academy of Sciences.*

[2] The manuscript was closed at the end of October 2010 and reflects the actions of the EU and the respective European institutions until this date.

problems would have come to the fore without the „benign or malign support" by the crisis. Namely, the appearance of some fundamental construction failures on the surface and in everyday politics, as well as the financial and monetary management of the EMU could not have been avoided. There was a fortunate or unfortunate overlapping in time, because the long maturing internal conflicts became manifest shortly before the crisis and were heavily exacerbated by the spreading crisis phenomena.

The construction failures start with the difference between theory and practice (I would not like to say that theory is always right, see for instance the early stage of the treatment of the systemic transformation in Central and Eastern Europe by international institutions as part of „development economics".) In fact, there was a lot of discussion among EU member countries about the right sequencing between political and monetary union. Since the former was far from reality and the EU wanted to create a deeper layer of integration before the transforming countries would join the first layer of integration, political will was in favour of a monetary union without deeper political coordination (let alone supranational decision-making). Another discussion developed along the interrelation between monetary and fiscal integration. However, most member-states insisted on their independence in fiscal issues (practically to the harsh reality to keep the national parliaments, the constituent parties in the parliament and the decision-making on annual budget as a fully sovereign national issue). Thus, fiscal and monetary integration had to be separated. Some fiscal discipline was expected to be imposed on the member countries by the Maastricht criteria and the Germany-forced Stability and Growth Pact (SGP). Last but not least, and still on the level of comparing theory and practice, the deficiencies of the EMU as compared to an optimum currency area have to be mentioned. Although the EU did achieve a high level of integration, but the internal market did not become fully operational, because several barriers to the free circulation of different production factors (mainly services and labour) remained in force. Let alone that an optimum currency area can only be implemented among countries on similar level of economic development and sustained/sustainable competitiveness. This, however, would have required a very strong economic policy coordination/harmonization well beyond the frequently quoted „fiscal cooperation" (not to speak of „harmonization").

Conflicts between theoretical approach and practical implementation have been burdened by several decisions. The first was the taking of some member countries into the original (starting) group of EMU that were „astronomically away" from fulfilling the basic entry conditions (both criteria and convergence process).[3] This option has weakened the efficiency of the EMU from the first moment on and has sown the cells of future conflicts. Second, the „Bible" of the EMU was built on the Maastricht criteria and on the SGP. However, the first contained a number of important but nominal adjustment criteria without considering the more important conditions of real convergence (e.g. structural reforms, current account balance,

[3] In this way Italy and Belgium had to be part of the first group despite their huge public debt over 100 per cent of GDP, while Spain and Portugal raised several questions of competitiveness (with special regard to real convergence).

flexibility of the economy and the society, burden-sharing capability, etc.). It has been demonstrated that the fulfilment of the nominal criteria does not tell a lot about the status, quality and speed of real convergence (being the Baltic countries with their „transformation bubble" the best examples). The second, namely the SGP could have served as an important policy instrument but, in critical situations, its rules of the game have been either not observed or even obstructed (violated), sometimes just by the large member countries, such as France and Germany. Several times, excessive deficit procedures, as foreseen in the SGP, have not been initiated or were announced without any consequence on the country breaching the rules. (At the same time, all potential applicants outside the Eurozone were examined with utmost precision. Concerning several Maastricht criteria applicants were fulfilling them much more than members of the Eurozone, an issue difficult to be explained to the society of the applicant country and even less to avoid rapidly spreading populism and demagogy about „second-class membership".)

Moreover, the opting-out (exit) possibility did not become part of the basic treaty of the European Central Bank (ECB). Although, due to strong German insistence, the statute of the ECB clarifies that there is no rescue or bailing-out obligation by any member country to any other that may fail. This statement should have been complemented by a clear and unequivocal procedure of insolvence (Schweickert, 2010, p. 13.).

The crisis hit the Eurozone at the moment when a decade-long economic development of different member countries accumulated a critical mass of internal discrepancies. Before the crisis, all EMU member countries did have access to easy money, at the same conditions, because they have borrowed in euro and this currency was accepted at equal terms, whether the money was raised by Greece, Portugal or Germany. Since, however, some less developed member countries followed a (re)lax(ed) wage policy without linking wage development to productivity gain, experienced higher inflation. The spread between borrowing cheap money and registering relatively high(er) inflation disappeared, or sometimes credits in euro could be taken at zero or even negative interest rate. This situation seduced particularly the Mediterranean members to keep on borrowing, enhance the living standard and forgetting about (unpleasant) structural changes. For a decade, the international capital market did not make any difference between euro credits taken by different member countries of the EMU. The ECB was considered as a reliable ultimate player or „last resort". However, different wage developments and productivity gains increasingly expressed in diverging competitiveness and accumulating huge surpluses and deficit in trade among the EMU member countries started to signalize the conflict potential well before the outbreak of the crisis.[4]

[4] In most cases, differences in wage development in one year do not introduce dramatic changes in relative competitiveness. However, if the wage difference is maintained and accumulated for a longer period, the "performance gap" will become visible. In fact, while in the first decade of the EMU German unit labour costs grew by about 3 per cent, this indicator experienced in some EMU member countries a 20 to 30 per cent growth.

Finally, another birth failure of the EMU remains that may be exacerbated in the next years when the future of the European integration will be at stake. It is about „fiscal solidarity" or the challenge of the „transfer union". Monetary integrations involving countries on different levels of development, competitiveness, GDP per capita and (cap)ability and willingness to reforms can hardly survive without some kind of internal transfers. This system can be found in several monetary (and, of course, political) unions, such as the USA, Germany, Spain and others. One of the key challenges of and threats to the future of the European integration is this issue – evidently with widely diverging interests and emotions among the member countries.

The Greek crisis represented a qualitative turning point in the history of the EMU and, most likely, also in that of the EU as well. The open crisis was the combined result of long-term economic (and social) mismanagement in Greece and the manifestation of the construction failures of the EMU at the same time. The „attack" by the international capital markets targeted Greece as the weakest chain in the system, but the main effort was directed against the EMU in general, and its leading (anchor) country, Germany. In fact, the solidity and cohesion of the entire monetary system was tested – maybe, not for the last time. The answer suffered several months of delay and increased the initially estimated bailing-out costs of Euro 25 bn to Euro 110 bn by early May 2010 just for Greece. In addition, another umbrella has also been created to avoid similar „pitfalls" or, in the worst case, disposing of the necessary instruments to intervene into adverse processes at due time.

In cooperation between the ECB/EU and the IMF the rescue plan for Greece has become operational in May and is scheduled for a three-year period. Greece has to implement a number of deep and painful reforms in this period, and the process of implementation will be closely controlled (otherwise the next part of the credit will not be transferred). EMU member countries put together Euro 80 bn and lend money to Greece on a bilateral basis (at 5 % interest rate that brings net profit, since it is higher than the interest rate of the money at which the lending countries can borrow on the international market). Although the price Greece has to pay is rather high, but going alone, the country would not have been able to find money at these conditions (or no money at all). This is the current price of „bailing-out". The project is, however, not free from some obstacles.

In technical terms, one can easily be overcome, namely the Slovak opposition to participate in the lending operation. Although Slovakia became the most recent member of the EMU (in 2009), the newly formed Slovak Government raised two objections (they were already part of the election campaign, a clear sign of how European issues can easily be „internalized" and form arguments „against Europe", a fundamental danger in several member countries and a real challenge for the future of integration). First, it emphasized that Slovakia has a substantially lower GDP per capita figure than Greece, so it is difficult to convince the Slovak society why a poorer country has to participate in a bail-out project for a richer one. Second, not without some exaggerated complacency, Slovak politicians pointed out that while Slovakia did implement the necessary reforms before joining the EU and the EMU, Greece failed to do so for decades (the second part of the argument is correct, the first only with partly serious reservation). In consequence, Slovakia's part of the project (about Euro 800 mn) will have to be taken over by other members willing to support Greece. At first glance, the Slovak arguments can be justified. However the „second glance" looks at and asks for „solidarity" that should not be a one-way street among EU members (first of all, in the future if we want to build a competitive and cohesive Europe).

The other issue is more difficult and open-ended. What happens, if at the moment the current support scheme expires (in three years), the Greek economy will not be in a better shape than today, maybe despite all the structural changes that were required to be implemented as a precondition of continuous financing within the given period. To be sure, the fundamental problem is structural and mental, not financial, budgetary or even economic. Sustainable growth in Greece can only be based on a more competitive economic structure based on more high-tech production, a substantial increase of exports (out of agriculture), more efficient skilled-labour, cooperation with transnational companies to be located in Greece and cooperating with (competitive) local small and medium-sized firms. Can such a structure be created in a three-year period, with special attention to the serious fiscal restrictions on the one hand, and the rather unfavourable global and European economic environment of the „post-crisis" (?) period? And even if all these conditions were available, can a society with centuries long history-rooted traditions and decades of „subsidy mentality" change itself in a few years? And if this objective is to be achieved, which are the potential or very real costs of „adjustment" in economic, social but also Europe-wide security terms?

The stability fund was established together with the signing of the Greek bailing-out package (on May 09, 2010). The Euro 750 bn project consists of three elements: 440 bn is provided by the member countries of the EMU, 60 bn comes from the EU budget (guarantee offer) and 250 bn originates in the IMF. Similar to the Greek package, it is based on cooperation between the ECB/EU and the IMF (with the USA behind it). However, it differs from the Greek pattern, because the credits, if necessary, will not be provided on a bilateral basis but by the „European Financial Stability Facility" (EFSF).[5]

According to some experts, the key „mission" of the ESFS does not consist in providing credits to EMU member countries with serious financial difficulties but to create a preventive and early-warning system that, on the one hand, keeps international speculation away from potential „candidates" for bankruptcy (Spain, Portugal, Ireland but also Italy), while, on the other hand, develops and implements a system that makes countries with potential risk aware of the looming problems and can mobilize domestic policy-makers to take the necessary measures, including fundamental reforms. Some experts unequivocally state that the Fund can only fulfil

[5] The EFSF has been created according to Luxembourg law, and is headed by Klaus Regling, a German expert. Another compromise in favour of reluctant Germany was that Euro 60 bn out of the Euro 440 bn will not be paid out but will be used to achieve an AAA rating for the EFSF, an important aim in order to raise credits at the best term on the international financial market. For details see: *Frankfurter Allgemeine Zeitung,* July 14 and July 23, 2010.

its function if, in fact, it will not be claimed to be used. The underlying fear is that any intervention of the Fund could either contribute to higher inflation (if the financial support will be provided by fresh money, including that borrowed from the IMF) or buy bad (non-performing) state bonds, the costs of which have to be taken up by financially stable countries and their citizens (or, as an alternative, the loss has to be „socialized" by new printed money leading again to higher inflation).[6]

In order to avoid the unavoidable (last resort) utilization of the ESFS, first of all the rules of the game of the SGP have to be tightened. In this context, a French-German joint initiative deserves attention that was elaborated in July 2010.[7] Although differences in terminology (or probably also conceptual ones) have remained, because the Germans talk about „economic policy steering" (wirtschaftspolitische Steuerung), while the French about economic governance (gouvernement économique), there is agreement on the necessity of a „genuine European economic strategy" („wahre europaeische Wirtschaftsstrategie"). The proposals include the acceleration of the excessive deficit procedure, with clear consequences for all those who are not ready to fulfil the Maastricht criteria of budget deficit (and public debt) according to a prefixed timetable. The punishment spreads from special deposits (with interest rate) over the non-payment of EU contributions from the structural fund to the withdrawing of voting rights in the Council of Ministers of the EU (practically non-participation in the decision-making process of the integration). France accepted the strict German demand that all member countries have to incorporate into their national legislation a „debt brake" that constitutionally limits the indebtedness of the State. The new rules have been analyzed in detail in a recent publication by Deutsche Bank Research (2010). In turn, Germany supports the French initiative to extend the economic policy supervision of the member states by the EU and set up a supranational authority to safeguard the debtor's financial affairs. Importantly, this supervision would not be limited to the fiscal and budgetary policies of the respective countries but would cover also areas such as competition policy and structural reforms. In addition, the indebtedness of private households, an important element of overall indebtedness in several countries (not least in some new members that created an „early-born consumer society") will also be included into the supervision.

Harsher winds started to blow already. In the summer of 2010 all EU members had to face the starting of (or the prolongation of earlier started) excessive deficit procedures. Even those countries that previously could escape this „straitjacket" (such as Finland or Luxembourg) have been involved in the „debt brake" structure.

Still, despite the determined action of the ECB and the two key Eurozone member states, some questions remain unanswered. First, some German priorities have not been mentioned in the joint position paper, such as the limitation of the „bailing-out umbrella" to not more than three years or the creation of clear rules of insolvency procedure for over-indebted Eurozone countries. In addition, Dennis Snower, president of the Kiel Institute of World Economy raises several concerns (Snower,

[6] Willgerodt (2010), p. 24.
[7] For a detailed description see: *Frankfurter Allgemeine Zeitung,* July 22, 2010.

2010). He has serious doubts whether the recently adopted bailing-out package (ESFS) would be sufficient if Greece were followed by other member countries, particularly by Spain. Also, he argues that financial straitjacket rules could certainly force countries to nominal convergence but, at the same time, they would be deprived of fiscal instruments required for higher growth and more manoeuvring room in reforming and overcoming structural rigidities. Moreover, the availability of Eurobonds to indebted countries would be a strong incentive to get further indebted at very favourable interest rate, instead of restraining them from further indebtedness. Also the exclusion (or expulsion) of the '"sinners" is considered a double-edge approach, since the citizens of the given country could withdraw their savings from the banks (of course, in euro), before the Damocles sward started to hit. This could destroy the entire banking system with unpredictable consequences of the expected domino effect on other members. Moreover, the punishment in financial terms of irresponsible members does not seem the right approach, because it deprives countries of resources that it is anyhow already missing or would desperately need them to get out of the crisis. Finally, an international supervision over how to manage national budget, fiscal policy and public debt reduction could seriously violate the democratic system and the national sovereignty of the given country, with anti-EU and „anti-international" emotions and actions and with reminiscences of remote colonial times. This would hardly support the cohesion of European integration. Therefore, he recommends a two-stage strategy. In the first stage national fiscal rules have to be established that identify the speed (timetable) and the ways of bringing back the public debt level to the 60 per cent target. In the second stage, each government has to set up an independent „debt commission" responsible for the implementation of the procedure as established in the first stage.

2. European Economic Governance

The financial and macroeconomic crisis did not raise the idea of a common EU strategy. Just the opposite, both the banking crisis and the unfolding economic downturn were predominantly managed by national policies. It was surprising how little European-level thinking (let alone acting) characterized most member states, particularly the large ones with more manoeuvring room.[8] The Euro 200 bn package communicated by the Commission consisted of the sum of national rescue plans in the amount of Euro 170 bn, with a tiny contribution by the EU budget and – potentially – by the European Investment Bank (EIB), each of Euro 15 bn. The alarm bell started to sound when the common currerncy had to face the challenge of the global financial market. From this very moment on we can seriously talk and think about the necessity of a European Economic Governance (EEG). In the first months of 2010 the EEG idea was strictly linked to how to save the euro and what kind of procedures should be elaborated and implemented in order to save member countries that, for different reasons, became the target of international financial attacks („speculations"). As a result, the EEG appeared as a suitable (unavoidable?)

[8] The situation was very similar to that during the first oil crisis at the end of 1973, when *The Economist* published an editorial starting with the sentence: „Everybody for himself and God save the strongest". However, the level, quality and depth of the European integration in 2008-2010 cannot be compared to those at the early seventies.

institution to enforce the Maastricht criteria and tighten the SGP rules. Only in recent weeks a broader approach started to emerge concerning the potential function of the EEG by incorporating structural policies (such as competition, labour market, innovation, the idea of introducing an EU tax,[9] etc.) into the agenda of the EU-level coordination framework elaborated by the task force headed by Herman van Rompuy by the end of October and to be approved by the European Council Summet in December 2010.

Although the need for more economic coordination in the EU is widely accepted, the challenge has had an ambiguous impact on the French-German tandem. On the one hand, it demanded a renewed common effort that manifested itself in more intensive cooperation, including the elaboration of the above mentioned joint position paper. On the other hand, however, it made once again evident the different „philosophical" approach of both leading countries. While France claims for an economic governance with supranational competences (although the word „supranational" can hardly be found in the official arguments), Germany emphasizes the importance of economic coordination but without a common economic governance.[10] Germans fear the return of French „state dirigism" that could impair Europe's global competitiveness (mainly that of Germany, of course), could jeopardize the independence of the ECB (and its basic principle, the price stability) and, at the end of the day, establish a „transfer union". In addition, the birth deficiencies of the monetary union could not be eliminated by a supranational EEG. In turn, France sees another (historical) opportunity to strengthen its (co-)leadership in Europe the gravity centre of which did shift from the Atlantic to the geographic core of the continent with Germany in the centre as the consequence of „Eastern" enlargement(s) and the additional dynamism created by the new member countries (not only in economic, but, with delayed impact, also in mental terms).

It is up to the van Rompuy task force, but, more importantly, to the political and business leaders of the member countries to find the right balance between opposite priorities. First, to what extent should the EEG serve just the consolidation of the rules of the game in the Eurozone or be extended to other community-level policy areas as well. Second, how can a sustainable compromise shared by all member countries be found between more supranational decision-making urged by fundamental global challenges and the preservation of „national sovereignty" in key issues of economic policy. Third, a viable solution should be found for the (apparent) contradiction between enhancing global competitiveness of Europe and the sustainability of the critical minimum of cohesion and solidarity, in order to keep the integration alive and make it fit for facing the opportunities and threats/risks of the 21st century (where Europe stopped to be the centre of economic growth).

---

[9] For the unfolding discussion see: Alfred Boss: Brauchen wir eine EU-Steuer? *Frankfurter Allgemeine Zeitung,* August 11, 2010.

[10] See the fascinating debate on this issue in *ifo Schnelldienst* (2010).

3. EU 2020: Chances for a New Strategy for Europe

In the Chinese script, crisis is described by two signs: threat and opportunity (risk and chance). In fact, the unprecedented global crisis would need a twofold approach. China opted for seizing the chances, while the United States, as the only real global player at present, seems to apply both policies (extensive crisis management and preparing for keeping its leading role in the rapidly changing global environment of the 21st century). In turn, the EU seems to be submerged in short-term crisis management, how to avoid or minimize risks, even if the costs of management would undermine the economic, financial and social manoeuvring room to grasp some of the opportunities offered by the crisis. This approach can be verified by national crisis management, short-term bailing-out projects, the stabilization of the past (and that of vested interests linked to the past and present) and the general lack (or insufficiency) of forward-looking, let alone comprehensive, strategy. (If such strategic approach exists, one can identify it on the national thank-tank level in some countries, but not on the level of the integration.)

At first glance, the recently launched EU 2020 strategy seems to be either the exception or an attempt to break out of the „short-termism" of the socio- economic and political decision-making routine. By no surprise, in strategic thinking the business community is far ahead of the political „class" and the public administration.[11]

The European Roundtable of Industrialists, the top gremium of European business published its vision for a competitve Europe in 2025, based on a study prepared by the European Commission (The World in 2025: Rising Asia and socio-ecological transition, 2009) and the global forecast of the US National Intelligence Council (Scanning the future: American and European perspectives, ISS Policy Brief, 2008).[12] The framework of the global setting in which Europe has to find its place has been substantially influenced (and co-shaped) by the shift of economic growth and weight to the developing countries in general, and to Asia, in particular. Trade and capital flows will remain the basic driving force of growth. The USA and Europe will be facing R+D challenge from a number of emerging economies. Demographic changes will negatively influence Europe's position (due to its shrinking population in global terms and the ageing of population), while the international aid role of Europe will not be reduced at all. In addition, smooth accession to raw materials (minerals, energy and food) will be more difficult, and climate change would require a universal response and adaptation. Based on current experience and future challenges, the US (and potentially China as well) do consider Europe as a weakening power in global competition. This is mainly due to internal differences, lack of economic liberalization, insufficient reform of welfare systems and the protracted decision-making process. Although further enlargement and

[11] The same happened during the process of "Eastern" enlargement. The international, and particularly the European business involved the new member countries into their strategic plans and development projects years before the political decision on enlargement/accession was taken.

[12] European Round table of Industrialists (2010).

special relations to Eastern neighbours may generate some additional dynamism, the EU can easily be locked into an inward-looking policy with growing conflicts both with other regions of the world and in its intra-regional framework.

The EU 2020 program (called also Post-Lisbon Agenda) (see Deutsche Bank Research, 2009) calls for facing global and regional challenges (partly identified above) with an offensive EU strategy. The EU 2020 program substantially differs from its predecessors, the Lisbon Strategy of 2000 and its updated version from 2005. First, the global environment has dramatically changed in the last decade, a fact that has to be taken account of. Therefore, the competitiveness framework of the EU has been extended. It is not any more a bilateral competition between the USA and the EU but a multi-player competition including the emerging countries, first of members of the BRIC (Brazil, Russia, India, and particularly China) and of other rapidly catching-up countries (South Africa, Indonesia, Argentina, Mexico, Turkey, let alone the already competitive East Asian first- and second-generation tigers). Second, the EU 2020 program is embedded in the period and short-term priorities of crisis management. The recently announced financial stabilization plan seriously narrows the chances and sources of implementing the EU 2020 plan. At least for the first years of the decade (until 2013-2014) there will be practically no additional resources available for implementing far-reaching goals (excepting some earthquake-like change happens in the system of social redistribution of the welfare state that, of course, could generate another earthquake-like change in the political and social texture of several member countries). Realistically, in the best case, the implementation of the EU 2020 plan could find the necessary favourable conditions about the mid of the decade. It does not mean that a lot could not be done before but a comprehensive breakthrough seems to be blocked by the primacy of financial consolidation (either accepted or enforced by common rules or by external pressure/reality) in all member countries.

Of course, one can only agree with the basic goals of the EU 2020 program, essentially with the need for a new growth strategy. However, it is not clear how this goal could be achieved. First, the triangle of priorities (growth, employment and sustainable development) contains several conflictive goals. Up to 2-2.5 per cent of growth there is no positive impact on the labour market in a developed and competitiveness-driven economy, because this growth can „automatically" be produced by technological progress, improved management practice, productivity gains and international spill-over effects of competition. There is no medium-term growth forecast predicting figures even near to this level. In fact, the available labour volume can be redistributed among more people (part-time work, working at home, etc.) but it would not increase either the volume of the labour market or the aggregate purchsing power of the employees/consumers. Similarly, the effort to simultaneously achieve the growth figures and the environmental cleaning purposes (including climate change-related programs) can be agreed upon but it would inevitably reduce the growth rate (and, at least temporarily, competitiveness as well – in a rapidly changing world).[13] Third, the EU 2020 still insists on quantitative

[13] If the implementation of the dual priority occured in a static world characterized by slow and protracted changes, the benefits would be evident. However, in the current stuation the

indicators (member-country tasks or obligations). This is very similar to the Maastricht criteria of nominal convergence. In effect, the discussion remains in the framework of which amount of the GDP should be spent on R+D and which should be the share of high-school absolvents in the given age group of the population. Particularly in he new member countries, we have plenty of experience how little R+D/GDP does tell about the reality. What would really be important is the efficiency of R+D (2 per cent can bring more to the economy than 4 %). Not less importantly, the quality and the demand-orientation towards the labour-market of education are the substantial indicators not the number of (mis-educated and many times low-quality) students. Fourth, the coordination mechanism of how to achieve (or to force member countries to achieve) the EU 2020 goals remains unclear. The original Lisbon Strategy emphasized the importance of the open mechanism of coordination (OMC), expecting that the best-performing countries (and best-practice policies) could exert a positive impact on other, lagging-behind countries. For several reasons, this approach did not work, partly because none of the lagging-behind (or non-performing) member countries was punished. Some punishment may have come from the international market, but, mainly for Eurozone countries, this threat was overcompensated by having access to unlimited credits in euro at cheap interest rate, a substantial barrier to any reform effort. The new method opted for improved communication „to engage national populations, interest groups and decision-making bodies with the reform targets" (Deutsche Bank Research, 2009). It remains more than unclear to what extent such a communication will materialize and if yes, how could it address the different target groups. Without identifying and communicating a clear „mission" of the EU, such efforts do no promise any progress (sometimes just the opposite).

4. Looking at the Future: Domestic and Global Challenges Ahead

Despite some mildly encouraging signs, global and European growth did not consolidate at the moment. In the last months, positive and negative messages have been communicated by politicians, business, capital markets and experts alike. Once the USA was considered to be out of recession and pulling the global train, another time China and the emerging markets were considered to be the likely locomotives, and, most recently, German economic upswing is expected to mean the end of recession, not least in Europe. As a good example of lasting uncertainties, rapid shifts (fluctuations) can be observed in the exchange rate developments between the US dollar and the Euro. The fundaments of a sustainable growth that, at the same time would be able to successfully manage the costs of crisis management, remain weak and unpredictable, both in Europe and in the USA. In a positive case, a double-dip can be avoided that it would not automatically lead to sustainable and higher growth but, particularly and most probably in Europe, to a sluggish growth

outcome will only become manifest int he medium-term, while in the short-term loss of competitiveness (with all of its consequences) seems to be likely. It is an open question how this (temporary) gap can be managed and bridged over by the EU, including the member country politicians and societies.

with continuing signs of stagnation (or even deterioration) in selected areas of the economy and the labour market.

Certainly, an encouraging sign is the revival of international trade. Following a deep decline in 2009, international trade measured on figures submitted by the G-20 group recovered by 10 per cent that does not fully compensate the size of decline in 2009, but can be considered as a strong support to overall rebound. Beyond this favourable but short-term impact, this trend has two and more important longer-term messages. First, it seems to prove that the export-oriented development pattern of many countries, although highly vulnerable in crisis, should and **must not be** replaced by a high-cost and „adventurous" attempt to turn fundamentally to domestic markets. Second, and connected with the previous statement, the rise of protectionism on the global scale could be prevented, despite the fact that multilateral negotiations in the Doha Round were paralyzed and the pressure to protect selected domestic industries (and jobs) is unlikely to be weakened for unemployment is expected to keep on rising despite the bottoming-out of GDP decline.

A further factor of EU recovery is linked to the exchange rate of the euro against the US dollar in general, but to some other currencies (mainly that of China) in particular. In the past period, ups and downs could be observed with sizeable impact on investment decisions and trade flows of most companies. Some experts predict a weak decline of the euro aginst the dollar (from today's 1.32-1.33 to the range between 1.15 and 1.20), while others starting from the weakining and increasingly difficult financing of the US economy have much higher exchange rate forecasts (up to 1.50 USD per Euro). Evidently, this move cannot be decided either by the FED or by the ECB (or any close cooperation between both institutions that, in fact, exists). The ECB is confronted with another challenge within the Eurozone. How to shape the appropriate monetary (and interest rate) policy in a monetary union that includes countries characterized by widening gap of growth potential. Member countries with large deficits would need the lowest possible interest rate of the euro, while recovering economies would require a bit higher interest rate in order to prevent potential overheating. Of course, the current low interest rate (and still favourable exchange rate) is helping the export-based recovery.

It is an open question how the EU (and the member countries) will be able to solve the dilemma between continued stimulus and financial consolidation. In this framework, an addditional issue can be raised: whatever the decision will be (most probably it will be financial consolidation and exit strategies from the stimulus project), will the consolidation take place in a pre-agreed framework of common actions/policies or each country will individually opt for the solution it considers the best as regards its „national interest".

An encouraging sign, rarely observed in the past, may be the growing public support across Europe for a financial consolidation strategy in Europe based on cutting spending.[14] According to the latest opinion poll conducted by the Financial Times

[14] *The Financial Times,* July 12, 2010 and *Frankfurter Allgemeine Zeitung,* August 07, 2010.

and Harris, the majority of citizens in the five largest countries of the EU oppose any rise in the national budget deficit. Fiscal consolidation (even conservatism) seems to be on the agenda not only in political and economic decision-making circles but in a growing section of the societies as well. This may create more elbow-room for the spending cuts (and partly also structural reforms) of governments, if they are able to come up with convincing arguments why cuts, including in the social welfare net, are unavoidable. In addition, suggestions where deficits could be cut do not undermine longer-term factors of competitiveness. Sectors with the lowest level of cuts include healthcare and education, while much higher cuts have been proposed in defence and in aid to developing countries. In sum, most European citizens start to understand that stable or increasing social benefits cannot be enjoyed without additional economic growth. Not less importantly, particularly new member countries should learn that the EU (and its net-contributing countries) will not be ready to keep on financing higher social standards and economic welfare than those in conformity with their respective economic performance.

In this context, two key issues are presented for further discussion. First: if the redistributing role of the State is likely to decline would it automatically mean the general withdrawal of the State from the management of socio-economic processes or should also States be reshaped and strengthened in order to face the new challenges of the changing global environment? Second: how should less developed new member countries be treated in order to suport their gradual cathing-up process and maintain European stability, cohesion and solidarity at an acceptable level? Here, the negotiations on the next EU budget (from 2014 to 2020) to be started in 2011 may provide relevant information.

Unfortunately, the crisis made the EU more inward-looking, just at a crucial period when, at least in principle, its global role could have been enhanced. At least two relevant reasons can be found to explain the increasingly inward-orienting attitude. On the one hand, the global crisis pointed to several deficiencies of the „European construction" (mainly regarding the Eurozone, institutions and the slowness and ambiguity of the Community-level decision-making process). As a consequence, the EU had to give more attention to intra-EU issues and work on the better functioning of internal mechanisms (particularly that of the EMU). On the other hand, the crisis –both with its risks and chances – found the European integration unprepared to develop and submit for international discussion its own global strategy for the 21st century. Although EU member states are still overrepresented in most international institutions, including the G-20, their impact remained from very low to ignorable. At the same time, the Commission was not able and entitled to speak on behalf of the member countries, because each of them (at least the largest ones) wanted to keep their „national independence" and act according to their „sovereign status" in a world globalizing at a dramatic speed and creating a new quality of international relations.

While focusing on the financial sector's sustainability, drawing up the EU 2020 project and, as a result of the finally ratified Lisbon Agenda, working on future responsibilities within the EU bureaucracy, little attention and energy were paid to the necessity of elaborating a global strategy for the EU (Solbes-Youngs, 2010), with particular regard to the unfolding G-20 cooperation in general, and the very special G-2 contacts between the USA and China, in particular. As a result, and despite the continuous emphasis on „multilateralism", the EU is threatened to be (self-)excluded from the emerging basic fora that are expected to shape the future of the international system (Inotai, 2010). The underlying reason is by far not only the lack of intra-EU coordination and a common position in various areas of the international arena but, more importantly, the still surviving „supremacy" and self-complacency feeling and attitude of selected (mainly ex-colonial) EU member states. As a consequence, we do not know about any EU-level project or proposal concerning the long-term role of the IMF or the EU's **active** role in and **genuine contribution** to the post-crisis new world order. Although the traditional „teachers' role" to some emerging countries (mainly China) started to change as a result of recognizing rapidly changing geopolitical and economic realities, old reflexes are hard to die (such as „hidden protectionism" widely practised during the crisis not in form of trade barriers but in the context of state subsidies, stronger rules to control immigration, increasing nationalism, etc.).

If the EU wanted to become a real global player, both by keeping its current economic influence and enhance its political weight in the new world order, it has to give clear answers to four key questions, both for intra-EU communication as well as for global purposes.

First: it has to define what is '"European identity" (exempted from colonial and semi-colonial reminiscences and prejudices that still dominate the behaviour of politicians and the attitude of large part of the public opinion).

Second: a widespread and in-depth opinion poll should be started about the (so-called) „European values". Do they exist, and if yes, which are these values (in a positive, progressive sense, and not by telling that „we are different").

Third, and most importantly: the EU that, from the beginning of its foundation was understood not only as an economic but also as a political community (finalité politique), has to identify and communicate its expectations, priorities and potential role in the international system of the 21st century. For this purpose, reference made to historical documents does not suffice (even more, it does not matter at all any more). What the EU urgently needs is a strategy paper on its **„mission"** for the longer period ahead of us. There is no doubt that such a **„mission paper"** could be filled with highly interesting and challenging contents (from soft power over environment and migration up to international aid, regional development and global solidarity).

Fourth: this strategy should be implemented by a strong leadership that could represent the EU as a really global player and not a „soft and uncertain amalgam" (mixture) of mutually rivalring national interests.

The global financial, macroeconomic and social crisis had a serious impact on the European integration. Probably the most serious one following the breakup of the post-war „order" in Europe 20 years ago. It is broadly recognized that the European integration always needs internal and (mostly) external shocks for its further development (deepening). In this context, one could not have imagined a stronger external shock than the impact of the current crisis on the future development of the EU. In effect, short-term and immediate challenges seem to have been managed appropriately, although by far not always on the level of integration. However, some challenges that may substantially influence the future of the „European construction" remain unanswered. But let be optimistic… However, the biggest challenge is global: how can the EU remain a global economic and become an more influential political power in the network of rapidly changing international power relations. It is probably the most urgent and, for its survival a not less important, literally „vital" task of the EU to tackle this issue. All other EU policies, from internal market through EMU to enlargement have to be „subordinated" to this challenge.

References

Deutsche Bank Research (2010), Debt brales for Euroland. Strengthening the stability pact with national debt rules. (EU Monitor 74), July 12, 16 pp.

Deutsche Bank Research (2009), Post-Lisbon Agenda. Looking to make Europefit for the future. (EU monitor 70), November 11. 13 pp.

European Round Table of Industrialists (2010), ERT's Vision for a competitive Europe in 2025. Brussels, February, 15 pp.

ifo Schnelldienst (2010), Ist eine europaeische Wirtschaftsregierung eien sinnvolle Option? (panel discussants: Rainer Brüderle, Georg Fahrenschon, Carsten Hefeket, Rainer Schweickert, Konrad Lammers), vol. 63. no. 14. pp. 3-19.

Inotai, András (2010), Impact of the global crisis on trade relations between the European Union and China. Budapest, August. (manuscript submitted for publication). 30 pp.

Schweickert, Rainer (2010), Ist eine europaeische Wirtschaftsregierung eine sinnvolle Option? *ifo Schnelldienst,* vol. 63, no. 14. pp. 11-14.

Snower, Dennis J. (2010), Wie die Euro-Zone zu retten ist und wie nicht. *Frankfurter Allgemeine Zeitung,* July 14.

Solbes, Pedro – Youngs, Richard (2010), Europe is failing to shape the global governance debate. *Europe's World,* Summer, pp. 8-13.

Willgerodt, Hans (2010), Ist der Euro in Gefahr? Droht eine Inflation oder eine Abwertung? *ifo Schnelldienst,* vol. 63. no. 14. pp. 20.24.