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EU Institutional Framework and Euro zone Crisis

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Abstract
This paper explores the impact of Europe’s existing institutional framework on the degree of macroeconomic disparity in the Eurozone. It draws on analysis of the costs of this framework as well as of the benefits of European economic and monetary unification. It also highlights how these costs and benefits are distributed geographically.

There is a fundamental difference between the economic advantages of European economic and monetary unification, and the costs and risks associated with the system set up to promote unification. Many of the benefits of economic and monetary unification will only really be felt in the medium or even long term. In contrast the impact of the costs incurred by EMU operation is increasingly apparent – and more so as time passes – mainly penalizing the least developed European countries.

The thrust of this study is that in its current form the EMU’s institutional framework is not viable. It encourages the accumulation of lasting imbalances at the expense of Europe’s least developed nations. While giving rise to substantial costs and risks for these countries, it jeopardizes the institutions and mechanisms which would enable them to cope. Imbalances associated with the operation of the EU give rise to negative externalities for the Union as a whole. The emergence of global finance – to which the Single European Act contributed – reveals and accentuates the Community’s structural imbalance. To maintain consistent operation of the EMU, the burden of these costs and risks must be shouldered collectively, through the coordination and centralization of economic policies and the development of budgetary federalism. But such conditions are extremely difficult to achieve and involve significant costs – some monetary, others not – that should be borne by the most prosperous European countries. These costs give rise to an uncooperative attitude, compromising the EMU as a viable system. One solution which merits consideration would be a reappraisal – on a negotiated and collectively approved basis - of certain aspects of Europe’s existing institutional framework.
Introduction

The recent Euro zone crisis has led to increasing awareness of the disparities in economic conditions and competitive positions among member countries of the zone. These disparities, which underscore the diversity and rivalry among member countries and even among European institutions, give rise to questions about the viability of the European economic and monetary unification process.

The European economic and monetary unification is an extremely ambitious historical experience given not only the number of countries involved in the process but also the structural imbalances and development gaps between these countries. In fact, fully established monetary unions in market economies have always been made up of territorial entities within the same nation. This is in particular the case with the Italian and German monetary unification in the second half of the nineteenth century. In addition, the monetary unification of these territorial entities was accompanied by their economic and political unification that helped to reduce disparities and increase homogenization.

The European economic and monetary unification is based on an institutional framework including not only the founding treaties of the European Union - the Maastricht Treaty (1992) and Amsterdam Treaty (1997) - as it is often suggested - but also the Treaty on the Single European Act (1986) which established the single market, the European financial zone and the full liberalization of capital flow. Although the Single Act reforms were not initially linked explicitly to the prospect of establishing a common currency, European monetary unification is inconceivable without first establishing a single market for goods and financial services. To understand the causes of the Euro zone crisis, it is essential to consider also the consequences of the Single European Act on the economies of member countries.

Total liberalization of capital flow constitutes a loophole in the logic and dynamics that characterize European integration process since its inception. Indeed, this reform opens the way to financial globalization and to finance capital expansion which weakens the role of the States and economic policies. Meanwhile, the European unification project was a project borne by European States with the implicit purpose of reproducing at a higher level the policy mix hitherto conducted at the national level. The project's success depended on the willingness of States to gradually give up whole sectors of their prerogatives in the area of macroeconomic policies with a view to reconstituting at the supranational level - European level - the coherence of national policy- mix. It was mainly the "creative imbalance" model ("Monnet" method) that conceptualized, or even "guided" the European project from Rome Treaty (1957) to Maastricht Treaty (1992). "Securitization" of public debt that comes with the complete liberalization of capital flow of the Single European Act is the main lever of the growing ascendancy of finance capital over public authorities.

The European project is also based on "differentiation" of the European area in relation to the rest of the world economy. This "differentiation" is materialized particularly in the abolition of customs barriers between European countries and the establishment of common external tariffs. It is also reflected in the establishment of common institutions consistent with the Community structure - European Court of Justice, Court of Auditors, European Investment Bank ... - and more especially in the implementation of common policies. One of the key objectives of the project was to promote the strengthening of European capital. Trade liberalization under the auspices of the WTO - which accompanies globalization of
production of European businesses and the expansion of financial globalization in Europe - questions the idea of "differentiation" of the European community area with regards to the rest of the world economy.

Many studies carried out especially in the preparatory stages of euro implementation highlighted significant economic benefits of the European economic and monetary unification (Rapport Emerson, 1990). These benefits are firstly microeconomic in nature, resulting from the elimination of currency conversion costs and reduction on exchange loss coverage. These cost economies would facilitate improvement in the competitive positions of European firms and accelerate growth by stimulating investment. The expected benefits of the common currency are also macroeconomic in nature. It helps member countries to considerably alleviate the constraint of the balance of trade. It also enables consolidation of the single market and promotes better coordination of other branches of economic policy. Finally, the benefits of monetary unification are also geo-economic and geopolitical. The European monetary unification would improve the balance of power for Europe to negotiate with the US an exchange policy more in line with European interest. More generally, it promotes - given the effect of its size and synergy - the emergence of a “Europe-power”.

Significant literature has also been written about the costs and risks of the common currency especially for the less developed European countries. These costs and risks include the economic slowdown resulting from the effort to meet the Maastricht criteria; the consequences of asymmetric shocks, the effects related to the loss of key instruments of economic policy for member countries; insufficient co-ordination of economic policies and lack of well-developed budgetary federalism (BARTHE M.-A., 2003).

Some of the expected benefits of the common currency were found to be exaggerated and even illusory. This is mainly the case with microeconomic benefits. Growing profitability and competitiveness of European businesses has not been a factor for boosting investment and growth in Europe. On the contrary, the production and financial globalization context consolidated since the mid-80s with reforms of the Single Act tends to promote relocation of investment by large European companies, a factor of anemia in growth. The common currency has considerably eased the constraint of the balance of trade and removed the risk of speculative attacks against national currencies. But at the same time “securitization” of public debt resulting from the Single Act reforms has gendered more serious risks than the previous ones, the risk of speculative attacks against sovereign debts.

There are also fundamental differences between the benefits and costs as well as the risks of the common currency. Many of the benefits of economic and monetary unification can be felt only if the EMU succeeds in the long run. It is essentially the case for being able to negotiate with the Americans over exchange policy in the interest of Europe and the emergence of “Europe-power”. Moreover, the benefits of the common currency are unequally distributed among member countries: the consolidation of the single market and the emergence of a “Europe-power” are more in the interest of the most developed European countries. In contrast the impact of the costs incurred by EMU operation is increasingly apparent – and more so as time passes – mainly penalizing the least developed European countries. This is mainly the case with the consequences of the operation of a single market and with those of asymmetric shocks.
Our study is concerned with the impact of the current European institutional framework in relation to the macroeconomic imbalances within the Euro zone. It is based on the analysis of costs and benefits of this framework and their distribution among member countries.

The thrust of this study is that in its current form the EMU’s institutional framework is not viable. It encourages the accumulation of lasting imbalances at the expense of Europe’s least developed nations. While giving rise to substantial costs and risks for these countries, it jeopardizes the institutions and mechanisms which would enable them to cope. Imbalances associated with the operation of the EU give rise to negative externalities for the Union as a whole. The emergence of global finance – to which the Single European Act contributed – reveals and accentuates the Community’s structural imbalance. To maintain consistent operation of the EMU, the burden of these costs and risks must be shouldered collectively, through the coordination and centralization of economic policies and the development of budgetary federalism. But such conditions are extremely difficult to achieve and involve significant costs – some monetary, others not – that should be borne by the most prosperous European countries. These costs give rise to an uncooperative attitude, compromising the EMU as a viable system. One solution which merits consideration would be a reappraisal – on a negotiated and collectively approved basis - of certain aspects of Europe’s existing institutional framework.

The first part of this study (I) analyzes the reasons why the European institutional framework is inconsistent. The second part (II) specifies the conditions for consistent running of the European Union as well as the difficulties and obstacles hindering its success.

I/ The operation of the EU lacks coherence: accumulation of lasting imbalances due to costs at the expense of less developed European countries that have negative externalities for the whole Union.

The operation costs of the EU result from the economic and monetary unification process of an area characterized by significant structural and cyclical differentiation and gaps in development levels.

The structural differentiation of the European Area – which is getting worse with the successive enlargements of the euro zone – entails disparities in structural inflation rates, varied specializations of the production system, different sensitivities of exports to price competitiveness and differences in financial and real structures.

The monetary unification of an area that is characterized by cyclical and structural disparities can lead to a differentiation in the effects of a common monetary policy on member countries. Every EU country regardless of its level of development can suffer from the consequences of this incoherence (GRUBER T., OHR R., 1997).

However, most of the running costs and risks of the EU are generally borne by the less developed countries. Firstly, it is about costs associated with the single market and the European economic policy rules (a). Secondly, it concerns the risk of asymmetric shocks and costs associated with the European policy mix. These costs and risks significantly reduce the possibility of establishing stabilizing policies (b). Operating costs of the EU are the root cause of growing disequilbria which give rise to negative externalities for the entire Union (c).
a/ The process of European Economic and Monetary Unification (EMU) engenders costs in terms of growth and competitiveness in less developed countries.

…Costs associated with the single market

The costs of the European institutional device are to be linked primarily with the operation of the single market.

The establishment of the single market led to the removal of all non-tariff barriers to free movements of goods within the EU – technical and sanitary controls - as well as access to public procurements hitherto reserved for national companies. The latter represent about 10% of the EU GDP. The single market reforms are accompanied by the strengthening of competition policy role which is progressively playing a dominant role within the European “common” policies. The main purpose of competition policy is to prevent the State from “distorting” the free play of market forces by granting aids especially to public companies.

The single market and competition policy work together to the detriment of countries in the “periphery” of the euro zone with less efficient production systems. They freeze competitive positions and reproduce, or even compound development inequalities. The single market promotes increasing trade balance deficits of less developed countries. The single market thus worsens the consequences of globalization on competitiveness of the Euro zone “peripheral” countries. These countries’ higher structural inflation rates are an additional factor of degrading competitiveness due to the fact that they cannot be compensated by depreciating the euro exchange rate.

Both the FDI - that capital flow liberalization was supposed to promote - and the substantial increase in structural and regional funds could enable EU “peripheral” countries to face the single market shock. As a matter of fact, the FDI is not directed to these countries which have high wage costs, overvalued currency and sluggish growth rates. It is rather directed to Western and Central European countries which are not yet Euro zone members and even – increasingly - to the rapidly growing South-Eastern Asian countries with very low wage levels. The increase in structural and regional funds failed on its own to reduce the gaps in development levels. The receiving countries are also to blame for the failure. Besides, the economic weight of these funds decreases considerably for the ancient member countries following successive EU enlargements and the consequent increase in the number of beneficiaries. Thus, neither the FDI nor the structural and regional funds which were likely to mitigate the negative consequences of the single market, produce the expected effects.

Lack of market outlets associated not only with the single market but also with competition from newly industrialized countries (NIC) affects investment rate (Portugal) as well as the quality of investment projects (Spain, Greece): real estate and tourism investments are multiplied while they do not contribute to improve competitiveness.

- Costs linked with the European economic policy rules

Monetary unification of a multi-state area raises the problem of choosing economic policy rules for the Union. These rules can only be those of the dominant countries. They give priority to price stability and a “strong” euro. The monetary unification of the European area based on the Maastricht Treaty clauses, enhanced by the Stability Pact, generates increasing costs linked to structural heterogeneity and inequality in levels of development of member countries.
These costs are related to pro-cyclical effects of aligning fiscal and budgetary policy of less developed countries with economic policy standards of countries with strong currencies in a context of weak growth and rising unemployment. These policies increase the risk of social shocks. They also slow down the pace of less developed countries’ growth while the EMU bet success was conditioned to the maintenance of growth differentials in favour of their development catching-up process. The problem is more with the EU’s exchange rate policy. The euro appreciation policy promotes the loss of export market shares for “peripheral” countries as well as for Italy and France due to higher price sensitivity of their exports. The policy of a “strong” euro thus contributes to the anemic growth in Europe (RICHES-FLORES, 2004).

The costs of these policies materialize the effects of domination of leading countries “structure” and they can also exist in the absence of a monetary union. Thus, the alignment of the European countries monetary policy with the German monetary policy is an essential fact in the operation of the European monetary system (EMS). However, if corrective mechanisms are not installed, the establishment of the EMU will tend to perpetuate and stiffen this structural influence by making it impossible for less developed countries to adapt – even marginally- their economic policy to their own needs.

Low real interest rates resulting from higher inflation rates in Southern European countries and the financialization phenomenon have both masked for a long time, the consequences of the single market and the European economic policy rules. They have promoted particularly, the maintenance of high investment and growth rates through resorting to leverage by public and private agents. The debt burden, worsened considerably by the “subprime” crisis is the fulcrum of recent attacks against sovereign debt.

b/ The operation of the EU engenders costs linked with the inability of establishing stabilizing polices and the European policy mix

Based on the conditions set by the Maastricht Treaty, the European Monetary Unification creates costs connected with the question of member countries being able to establish stabilization policies.

The monetary unification of this area leads to the permanent loss of the ability for member countries to influence internal and external value of the currency and short term interest rates. This loss entails costs especially in the case of divergent macro-economic conditions of member countries which would require a differentiation of the internal and external monetary policy with regards to the situation of different countries.

The Literature on Optimum Currency Zones (OCZ) can throw light on consequences for member countries of losing instruments of economic policy, and especially of exchange rate in case of asymmetric shock (BOURGUINAT H., 1995; BROCINER A., 1994). Low manpower mobility in Europe and almost inexistent budgetary federalism increase costs of asymmetric shocks. Meanwhile, heterogeneous specializations and structural inequalities of European countries increase asymmetric shocks risk and more so as monetary unification leads to reinforcing heterogeneity and structural inequalities. This is the lesson we can derive from the experience of Federal states. Krugman (KRUGMAN P., 1993) shows that comparative advantages as well as agglomeration externalities have led American states to specialize in some products they exchange with their neighbors. That increases vulnerability to asymmetric shocks of States having inadapted specializations. The effects of these shocks last so long as specializations are maintained for a long time. So, the gap of growth rates of
the American States is wide. Certain States do not really have any increase in employment rate for the last four decades. Others have recorded average annual growth rates of 5%. If unemployment rate gap between States is not high, it is due to a strong labour mobility (ATKINSON A. B, BLANCHARD O. E., 1992).

The negative consequences of abandoning essential instruments of economic stabilization are clear, even within the framework of the EMS whose operation was yet based on voluntary but revocable abandon of the implementation by member states of the monetary policy. Thus during the summer of 1993, the refusal to envisage a modification of the FF/DM parity within the framework of a rigorous monetary policy led by Bundesbank - while the economic situation in France and Germany diverged (need to sustain growth in Germany in order to take care of the re-unification, need to boost growth in France in order to absorb unemployment) - led to the EMS crisis and the devaluation of the FF. The current crisis of sovereign debts in Europe shows even more strikingly, the consequences of the loss of the exchange rate instrument for the affected countries.

The current European policy mix engenders on its own, costs related to the incapacity of establishing a satisfactory coordination among different sectors of economic policy. Centralizing only monetary policy transfers - given the low manpower mobility and the resistance to downward pressure on wages - the adjustment pressure to the budgetary policy by increasing the temptation of excessive deficits. In fact, a centralized monetary policy removes the possibility for member countries to secure revenues through ‘seignior age’. It also removes the national currency depreciation sanction which would discredit any reckless budgetary policy in the eyes of public opinion. The temptation of raising public deficit grows within the framework of a full monetary union especially for less developed countries. That can be explained by two main reasons: on the one hand, the interest rates of common currency denominated debt are lower than those of a debt denominated in the countries’ currencies; and on the other hand, the member countries can no longer benefit from a “captive” market to place their debt following the European financial systems reform (MASSON P. R, TAYLOR M.P, 1994).

The temptation of excessive deficit due to the co-existence of a centralized monetary policy and national budgetary policies inevitably leads to the setting of rules for public deficits which when the “bar is put too high,” as it is the case with the EMU framework, remove any flexibility in the policy mix of the Union.

The establishment of rules for public finances is an expedient that results from the lack of willingness especially on the part of countries with strong currencies to move towards the path of coordinating or even centralizing economic policies and strengthening budgetary federalism.

It is generally accepted that the rule of 3% on budget deficit constitutes an obstacle to establishing not only “active” but also stabilizing budgetary policies. Several economic studies have been devoted to the negative impact the loss of the Union’s policy mix stabilizing capacity on the collective well-being. Here are some illustrative examples of these negative results:

Since the exchange rate instrument is not available within a monetary union, only the use of budgetary policy can help to cope with an asymmetric shock of demand (VAN DER PLOEG, F. 1993). Similarly, it could sometimes be necessary to lower the interest rates within the Euro zone. Such a strategy can only be implemented on the condition that some countries
practice restrictive budgetary policies. This will require taking into account the economic situation of different countries on a cooperative basis. Finally, it is possible that monetary policy alone is not enough to deal with a given situation. For instance, if a country’s balance of trade is on deficit while its currency is undervalued, it’s the budgetary instrument that should be used between countries either at a federal level or on a coordinated basis (MUET P-A., 1995).

Last but not least, the hybrid nature of the European policy mix leads to a differentiation factor increasing heterogeneity in the macro-economic policy of European countries with respect to their social and fiscal policies. Centralizing monetary policy only – given the low mobility of labour factor and the 3% limit set by the Stability Pact – restricts any form of leverage to social and especially to fiscal policy. This trend encourages “beggar thy neighbour” behavior, with European states attempting to make their national space more competitive and more attractive by compressing salaries and by lowering fiscal pressure, which in turn benefits the most mobile production factors, in particular the capital factor. The upward tendency of the euro against dollar since 2002 encourages this trend as well. Fiscal competition poses the problem of the sustainability of taxes on the least mobile factors and involves the risk of reducing the fiscal attractiveness of all European countries (“snowball effect”). Lastly, it contracts the size of the public sector and damages the political unity of the EU. As for “social” competition, it fosters disaffection of public opinion for the single currency.

The uncooperative policies of “competitive” devaluations of the 1970s are thus replaced by the uncooperative policies of fiscal and social competition which are encouraged by the current European policy mix. But unlike the former, policies of fiscal and social competition can also be practiced – and it is being increasingly done - by the more developed European countries.

c/ Costs associated with the European institutional framework and growing inequalities within the euro zone.

The costs and risks associated with the operation of the EU lead to the accumulation of imbalances at the expense of less developed European countries. These costs are related to:

- The amplification of current accounts balance and balance of trade deficits;
- The growing indebtedness of public and private agents.

Current account deficits of peripheral countries in the euro zone lead in return to surpluses for the countries in the “Center”. There is considerable deterioration in the current accounts balances in Southern Europe countries: 20.163 million euro deficit for Portugal in 2008, against a surplus of 224 million in 1993; 104.413 million deficit for Spain in 2008, against a deficit of 4,861 in 1993. The data for Italy is a deficit of 53,593 in 2008 against a surplus of 8,152 in 1993. Within the Euro zone, two countries – Germany and the Netherlands – are net exporters, up to 110 and 150 billion euros respectively (2008) (ROUBEN H., 2010). Two great relay countries have relatively balanced accounts. Italy which imports from these two countries and exports to France, Spain and Greece; France which imports mainly from Germany, Belgium and the Netherlands and compensates its deficit within the euro zone with the surplus of its extra-zone trade. Finally three countries record a trade deficit: Spain, Portugal and Greece. The new element in the balance of trade situation of the euro zone
countries is that the so called “relay” countries, France - one of the two driving forces of the European integration – and Italy are now gradually becoming chronic importers.

The current account deficits of less developed countries correspond with the financial deficits of private agents - firms and households - and of the public sector. They are funded, given the weakness of the FDI flow, by leverage mostly from banks of the more developed European countries.

So far, discussions have focused on the problem of public debt. However, the increase of private debt involves risks just as serious for the banks and therefore for their countries of origin – last resort lenders “constraints”. In fact, the increasing public debts into which private debts are transformed (the case of Ireland and to a lesser extent, Spain) provokes attacks against sovereign debts. These attacks reinforce heterogeneity of the euro zone. Debt of the less developed countries, particularly Southern European countries, is mainly private. Private debt represents 87% of debt for Spain, 85 % for Portugal and 58% for Greece. Besides, Spain’s and Portugal’s rates of indebtedness (private and public debt/PIB) are higher than that of Greece which is currently in the focus of financial markets: 506%, 479% and 296% of the GDP respectively (LAPAVITSAS C. et alii, 2010).

Monetary unification of a multi-state area creates a *de facto* solidarity within this area. The result is that current imbalances which affect less developed countries generate negative externalities for the entire Union and especially for the more prosperous countries:

- They can affect the credibility of the monetary policy and therefore the internal and external value of the single currency, key variables of the economic policy (VAN DER PLOEG, 1993).

- They put pressure in favour of questioning the economic policy rules on which the European monetary unification process was committed. These rules are those of more developed countries and conform to their “structure” preferences.

Accumulation of imbalances and the growing indebtedness which weaken bank’s position make the ECB to review the modalities and certain principles of the single monetary policy. The no-bail-out rule is implicitly questioned. This situation provokes criticism in dominant European countries. “Last but not least”, the latter are made to take up a major part of the responsibility in the aid plans for the countries in need.

Thus, while the costs associated with running the EU are borne mainly by less developed countries – and more recently and to a lesser extent by France and Italy - the imbalances they generate are beginning to create significant and increasing expenses for the dominant countries.

**II/ Conditions for a coherent functioning of the EU, difficulties and obstacles**

The negative spillovers created by the growing imbalances related to the functioning of the EU make it necessary to go towards a more integrated European policy mix (a). However an increased integration of the European policy mix faces many economic obstacles, as well as social and political ones, which makes its realization very difficult (b).
a/ Conditions for a coherent functioning of the EU: coordination/centralization of the budgetary and fiscal policies, and reinforcement of budgetary federalism

Negative spillover effects of the EU functioning make collective cost sharing necessary by reinforcing budgetary federalism and coordination/centralization of economic policy (MUET P.-A, 1995) (VAN DER PLOEG F., 1993) (WALSH C., 1993) (WALSH C., REICHENBACH H. et alii). This is the lesson drawn from several experiences of monetary unification, especially the Japanese monetary unification and more recently the German one. Coordination and centralization of economic policy allow taking in charge costs related to lack of coordination previously analyzed: public sector’s decreasing size and loss of capacity to stabilize economy in the event of symmetric or asymmetric shock. Federalist theory posits that among three recognized functions of economic policy – allocation of goods and services, redistribution of income, and stabilization policies – the last two should be controlled by the central power. In the case of the European Union this would mean centralizing redistribution and stabilization functions. Concerning stabilization policies, especially budgetary stabilization policy, at least three major arguments are put forward by federalist theory justifying their centralization (GOODHEART C., SMITH S., 1993).

1/ The policies of budgetary stabilization conducted by each individual state result in important negative spillover effects at the level of the other states of a federation or of a union depending on the degree of opening of these economies. Centralized stabilization strategies are therefore likely to have much more important effects on the economic cycle.

2/ Owing to the greater degree of integration of the national (federal) capital market, a local (national) decision to resort to debt-funded financing is likely to result in a bigger increase in the external debt of the region (state) than if it had been made at the centralized level. It should therefore result in a maximization of the real income allocated to reimbursements.

3/ The centralization of the monetary and budgetary policies makes it possible to have a more efficient policy mix, enabling the monetary and budgetary authorities to negotiate the simultaneous use of their instruments.

For lack of centralization, - taking into account the spillover effects linked to the national economic policies, particularly the budgetary ones, and to the necessity to stabilize the demand in case of a shock - the coordination of fiscal policies together with that of the other instruments of economic policy appears absolutely necessary. No significant measure aiming at a real centralization of budgetary policies has been planned in the European treaties.

Regarding fiscal policy many studies have concluded that the optimal level – between federalism and devolution – is achieved when certain taxes are centralized. Given the externalities related to national economic policy, in the absence of actual centralization, at least some coordination seems necessary.

In the least centralized OECD countries expenditure by central government represents at least 30% of GNP. In the United States the federal budget exceeds the total budget of states and local authorities. Expenditure on goods and services by federal government accounts for about 40% of such expenditure by public bodies. Looking more specifically at expenditure linked to the stabilization function, Sachs and Sala-i-Martin observe that in the United States when a fiscal region suffers a real drop in its GNP following a downturn, federal transfers compensate 40% of the loss, mainly thanks to the progressive nature of income tax (PISANY FERRY, J. 1993). In contrast the EU’s budget is minute. It does not exceed 2% of the GNP of member states (WYPLOSZ C., 1990).
b/ The obstacles in the way of better coordinated organization of the European policy mix

Obviously greater coordination of economic policy in Europe would involve major difficulties. The first relates to the large number of jurisdictions concerned by the coordination process, namely the ECB and the many national budgetary authorities. The second is due to the risk of asymmetry in the perception of the nature of economic shocks by the various authorities involved in the process. The risk may be considerable given the diversity of the shocks with which European countries can cope. Another obstacle to greater coordination as well as to centralization of the European policy mix is heterogeneity in preferences of different European peoples.

Coordination and à fortiori centralisation of economic policy also involve considerable – monetary and non-monetary costs for the more developed European countries, which explain their lack of willingness to move forward to a more integrated economic policy (KABABJIAN G., 1994; STERDYNIAK H. and VILLA P. 1993; VAN DER PLOEG, 1993; AGLIETTA M., 1996)).

The increased budgetary federalism would require a transfer of resources from member states to the European budget. This would enable, in particular, stabilization policies to be deployed at a European level or indeed transfers to be made in the event of asymmetric shocks. A large part of the cost of transferring resources from member states to the Community budget would be borne by the most highly developed EU countries, given the current structure of resources and budget expenditure. A large share (about 70%) of the EU’s budget resources come from contributions by member states proportionate to GDP. In turn most of the expenditure by the EU budget consists of expenditure related to the Common Agricultural Policy and Regional Policy – respectively 46% and 40% of the total. This expenditure mainly benefits countries with the least well developed economies. The share of developed countries in budget resources being larger than their share of expenditure, they are net contributors to the EU budget. The structure of resources and budget expenditure is the result of compromises reached among European states during the negotiations leading up to the start of the Common market and subsequently the Single market. The position of the richest EU countries, which are net contributors, explains their negative attitude regarding increased coordination of budgetary policy.

Intermediate levels of budgetary federalism are possible – halfway between the current EU system and federal states. In particular it has been proposed to set up – in the absence of a significant federal budget – automatic stabilization mechanisms paid for by member states to compensate asymmetric shocks. Such mechanisms would not be costly – less than 1% of contributing countries’ GDP – and though wielding less stabilizing power than in federal states, they would nevertheless be significant (MUET P.-A., 1995). Other proposals advocate better organization of Euro zone economic policy, with for instance the setting up of an Economic Policy Council bringing together Euro zone finance ministers. This council would enjoy decision-making powers over budgetary policy orientations and the overall thrust of economic policy in the Euro zone. Council decisions would not be legally binding, given the treaties currently in force. But non-compliance would nevertheless carry “on account of the transparent, official nature of decisions, high political costs in terms of reputation and credibility” (JACQUET P., PISANI-FERRY, 2000).
Contrary to the costs of greater coordination of budgetary policy, the cost of harmonizing fiscal policy would be borne mainly by the least developed EU countries. In their struggle to catch up, the smallest nations resort to fiscal competition, often followed by their more powerful neighbours. The smaller countries are therefore hostile to any significant attempt to harmonize fiscal rules, particularly with respect to capital taxation.

Another major obstacle holding back the development of budgetary federalism is the fact that such development impinges on key attributes of the nation state. It would require EU States, especially in the most highly developed countries, to abandon a substantial amount of sovereignty. The nature of political power itself and the main issues at stake hinge on raising and allocating taxation. “Taxation expresses and nurtures political sovereignty; it has gradually imposed parliamentary representation, making parliament the place where budgetary and fiscal policies are framed” (DELESSY H., LERAIS F., STERDYNIAK H., 1994). Nations states constitute a space in which various forms of solidarity are deployed. Such solidarity, which has taken time to develop, is the result of social struggle and is rooted in a community of language, culture and history. The first obstacle in the way of any transfer of sovereignty, as part of greater budgetary federalism, is the resistance of competent national bodies – national parliaments and governments in the more developed European countries - determined to protect their powers. The second hurdle is the as yet limited legitimacy of European institutions in the eyes of European public opinion. This shortfall in legitimacy is due to inadequate control exerted by the European Parliament over the the Commission on the one hand and on the other, over the EU budget. The Parliament only has an advisory role in a large number of fields. Furthermore, mandatory expenditure, on which Parliament is not consulted, represents the lion’s share of expenditure.

Lastly globalization and the growing control over European states exerted by multinational capital are contributing to the current blockage in the process of integrating the European policy mix. Freedom of capital movements enhances the mobility of capital and its ability to arbitrate at any given point in time between markets and stocks. This profoundly changes the balance of power between the owners of the means of production and employees, and between shareholders and managers, to the advantage of shareholders. It greatly increases the power shareholders may wield to sanction business strategies or state policies deemed contrary to their interests, thus consolidating the control of capital over European States. Capital’s growing control over states has accentuated the neo-liberal bias of public policy: continued tax relief for business, privatization of banks and public corporations, rethinking of pay-as-you-go retirement systems, reforms to “flexibilize” labour markets. The discourse of European governments seeks, aided and abetted by the opaque workings of EU institutions, to give credence to the idea that Brussels is behind these policies. Admittedly the influence of corporate lobbies on the Commission is not only a well-established fact; it has become a part of the institution itself. Responsibility for the neo-liberal bias of European policy should however be mainly borne by member States, given their weight in the decision-making process. The discourse of European governments fuels public disaffection towards the European project, whereas the reforms needed to “rationalize” the policy mix can only be implemented with the largest possible support among European peoples.

Financial globalization thus contributes to establishing market forces and capital, particularly its most international segments, in the place of states at the heart of the European integration process (SIFAKIS – KAPETANAKIS C., 2007). These segments are supposed to henceforth
become the driving force of the process. However, the perimeter of the interests of capital is set by the constraint of its valorisation. The aim of the capital, being the maximization of profit, limits its horizon to the direct determinants of its valorisation. Capital cannot not be the driving force of projects bearing a strong political, almost visionary dimension, such as the deepening of European integration. Financial globalization even leads to a divergence of interests between the globalized segments of European capital and greater European integration. Deregulation of capital transfers in Europe encourages a process of delocalization and globalization of European firms. During the 1986-99 period acquisitions by European firms mainly targeted international rather than European companies (Sachwald, 2004). Furthermore the vast majority – about 70% – of strategic alliances involving European firms in the 1990s concerned partners outside Europe (OCDE, 2001). This suggests that the dominant trend for firms is towards greater globalization, rather than European. As a result the whole planet, not Europe, becomes the relevant space for the reproduction of European capital. Europe’s multinational firms also derive considerable benefit from a situation in which the tax systems of individual nations are forced to compete, due to the lack of fiscal harmonization in the EU. European capital also benefits from the decline in labour’s bargaining power and the advance of neo-liberal policies in Europe, made possible by financial globalization. Lastly globalization of finance and production encourage fiscal competition, by consolidating the position of European countries that oppose any attempt to question this trend. Harmonization of taxes on capital would only have a limited effect as long as capital can still move freely all over the world.

Conclusion

The aim of this study is to analyze the reasons why the functioning of the EU lacks economic coherence.

We have shown that the functioning of the EU generates growing costs and risks for the member countries. These costs and risks are essentially supported by the less developed countries and first by the countries of southern Europe: costs in terms of growth and competitiveness as well as in their ability to stabilise the economy in case of asymmetrical shocks. These costs make for the accumulation of real and financial disequilibria i.e. growing deficits in the balance of trade and the current accounts balance, increased indebtedness of public and private agents. The problem of the sovereign debts is made much worse by the attacks on the financial markets and has serious economic and social consequences for these countries i.e. economic recession, rising unemployment, de tricotage of the Welfare State, pauperization of the middle classes, emigration.

But the functioning of the EU begins to generate growing costs for some of the founder countries of the EU as well, such as Italy but also and particularly, France. The increase in financial imbalances inside the EU also generates negative spillovers in the whole Union. These spillovers involve growing costs for the dominant countries which until recently were the major beneficiaries of the single currency. Therefore the balance sheet of the present functioning of the EU is beginning to turn globally negative.

We have also shown that the Eurozone is deadlocked today. The costs and imbalances generated by the functioning of the EU make the experiment in European monetary unification unsustainable. On the other hand the costs of a « rationalization » of the experiment which would guarantee its viability make this « rationalization » very difficult to
achieve. Indeed the « rationalization » of the functioning of the EU depends on an increased integration of the policy mix. This integration has important – monetary and non-monetary – costs which would be supported by the dominant countries. These costs themselves induce a non-cooperative attitude which accounts for the stagnation of the integration process.

Finally the present deadlock of the Eurozone shows the limits of the theories of «engrenage » or « creative imbalance » (Monnet's method) which have conceptualized but also provided the guidelines for the European construction: the problem is to set member states goals which appear desirable and easily attainable such as the single market or the single currency. Achieving these goals requires that the States abandon part of their sovereignty and therefore be deprived progressively of their power i.e. « entrapping the states » (COHEN E., 1994; COHEN B., 1977 ).

It is evident that these « theories » can be valid only as long as the increased integration of the European construction operates in the direction of the interests of the two leading countries. Once the « traps » are prejudicial to their interests – even if only one country is concerned - the consensus is broken and the process of European unification is at a standstill.

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