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The EU at a Crossroads: Responding to Challenges for the Euro-zone and the EU

Edited by Takamoto Sugisaki

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Introduction

Takamoto Sugisaki

This volume of *REAPS* combines previous Numbers 2 and 3 in a collection of papers revised following presentations at the 2015 EUSI Tokyo International Conference and the 2016 EUSI Tokyo Economics Unit & Tsuda College FD Support Seminar Series.[1]

The International Conference occurred amidst the Greek Crisis, and the EU's austerity policy was among the main issues discussed. Since then, successively important matters have arisen in and around the EU. The EU's humanitarian open-door policy triggered an influx of Syrian refugees and a migrant crisis that sired sweeping economic and political nationalism. The June 2016 referendum in the United Kingdom delivered the historic and erroneous decision favouring Brexit. It was followed by a blatantly nationalistic presidential campaign in the United States.

The impact on Europe of the US-instigated 2007–2008 global financial crisis has been debated extensively, and we had some trials to consider the meaning of the European integration after the international monetary crisis in globalisation.[2] As the situation evolved from a U.S. monetary crisis into the European Sovereign Debt Crisis in 2011–2012, it became necessary to consider the Eurozone's predicament within the context of globalisation. Challenged by US-centric globalisation, Europe has reached a crossroads: one path leads towards dissolution of the EU and Balkanization into small states again; the other, towards greater integration and a European super-state.[3]

REAPS Vol.1 (2013) introduced Mundell's tri-lemma praxis to consider unrestricted movement of capital among EU states (Mundell, 1963). Mundell's tri-lemma shows that perfect international capital mobility and independent monetary domestic policy are incompatible in stabilizing pegged foreign exchange rates. This tri-lemma praxis was applied to introduction of a single currency in the Eurozone, where every state abdicates power over monetary policy to the European Central Bank. The United Kingdom could not countenance doing so. Notwithstanding convergence of monetary policies, finance and budgetary problems remain far from convergence because countries' social problems differ. Accordingly, Mundell's tri-lemma model should be expanded to encompass to monetary policy alongside public finance policies inter-dependent on domestic social dimensions (Sugisaki, 2007).

The GCES (Global Capital Exchanges States) structure model is introduced in this context. In this model, mobility of global capital (GC) confronts a restrictive territorial sovereign (S), and the conflict between

[1] The former conference—Responding to Challenges for the Euro-zone: Resilience of Europe and New Perspectives on EU Studies—was held 8–9 March 2015 at the Sendagaya Campus of Tsuda College. The latter—Thinking about Economics: On EU Studies—occurred in February 2016 at the Kodaira Campus of Tsuda College.

[2] EUSI Tokyo (Economics & Economic History), *Review of EU Asia Pacific Studies (REAPS)*, No1 (March, 2013), as a result of the EUSI Tokyo International Conference The EU at a Crossroads: The Euro-zone Crisis under Globalization held 12–13 October 2012 at Tsuda College, Japan.

[3] Ibid. p.4.

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them should be adjusted via exchange rates (E) (Sugisaki, 2016). Under the single-currency mechanism of the euro, however, conflict between member states' territorial sovereignty and capital mobility have intensified in several respects. First, states affected by movements of global capital relinquish fiscal autonomy, especially when foreigners own much of their sovereign debt. The Greek Crisis exemplifies this conflict. It also reveals weaknesses in the EU's fiscal power through its inability to defend Greece from capital flight. Second, sovereign states cannot set internal labour policy when capital and labour flow within one borderless market. Free flows of capital, labour and other productive inputs are inseparable for monetary and market integration. Yet the 2015 influx of refugees revealed dire consequences when countries relinquish control over their borders. In addition, a consolidated monetary area must be able to curtail entry of labour from without, further eroding states' control over internal labour markets.

Trans-border mobility of labour under the Schengen Treaty is the basis of European monetary integration. That is why the conflict between GC and S caused by capital mobility now appears as a conflict involving mobility of labour. Absent adjustments via exchange rates within the GCES structure, freedom of GC in the EU contradicts sovereignty of individual states (S) over their public finances and labour markets. In 2017, elections in several EU countries will decide the future of the EU. Will member states opt for stronger integration, abrogating independent fiscal sovereignty, including labour-market policy, or will they revert to fragmented sovereign states?

Although these questions deserve extensive discussion, contributors and discussants at the Conference agreed almost unanimously that the central problems are monetary integration without fiscal power based on democratically made decisions and absence of cohesion among countries. Therefore, this volume focuses on several countries disrupted by the increasing mobility of factors of production in a multispeed integration in the EU.

Part I—The EU at a Crossroads in Economic Perspectives—features fiver papers. Yousef Cassis ('Europe's Crisis in the Early Twenty-First Century: A Historical Perspective') and highlights lessons from the 1930's relevant to the three-fold current crisis. Zsolt Darvas ('Economic Outlook and Policies in Europe') illuminates the crisis comprehensively and focuses on six short-term economic difficulties that impair the EU's long-term economic growth. Kentaro Kawasaki's 'Comments' on Darvas's Paper' accentuates the importance of the latter and the problem presented by the Eurozone's political and social incohesion. Bernadette Andreosso-O'Callaghan ('Post Global Financial Crisis Ireland: A "Model" of Economic Recovery?') discusses Ireland's post-crisis recovery as an export-oriented economy benefitting from the multinational pharmaceutical industry. Abridged from his edited book, Yoji Koyama's 'Prospect of New Member States for Euro Adoption Based on Small Countries' Experiences' shows the importance of new states adopting the euro and emphasises the necessity of replacing austerity measures.

Part II—Special Lectures: the Background of European Integration—contains two papers.
Toru Iwami ('The International Monetary System revisited 20 Years Later') discusses changes in the global economic power structure over two decades to set the monetary problem of the euro in historical context. Hidenori Tozawa ('Richard Coudenhove-Kalergi and Japan: A Brief History') supplies basic

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knowledge to understand the historical background of European integration.

Part III—Presentations at the Conference—assembles materials presented at the conference. Panos Tsakloglou ('The Greek Debt Crisis and its Aftermath') provides valuable information about the Greek economy and Greece's financial and sovereign crisis. Werner Bührer ('Crisis! What Crisis? The "German Model": Facing Economic and Financial Challenges since the 1990s') makes points we hope to develop further.

The Round Table—Social Cohesion and its Resilience in Europe—supplies materials from Henk Overbeek's presentation ('Europe at a Crossroads: Is Austerity Destroying the EU or Can It Revitalise It?').

Part IV—Werner Bührer supplies supplementary paper which we found important to consider the title of this volume.

Rallying to cries of 'Britain First!' and 'America First!', two countries that have led globalisation since the 1980s turned toward economic nationalism during 2016. The consequences spread beyond Europe to the Pacific as the Trump Administration disavowed the Trans-Pacific Partnership. The two nations' emergent subordination of globalisation to domestic industrial and labour supremacy portends protectionism and beggar-thy-neighbour international policies.

As editor, my closing question is *who* now stands at that crossroads—the Eurozone and the EU, the Asia-Pacific, or the entire world? The next few years promise massive historic transformation. This combined-numbers edition will prompt deeper scholarly understanding of these issues and cooperative research.

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Part I

The EU at a Crossroads: In the Economic Perspectives

Europe's Crisis in the Early Twenty-First Century: A Historical Perspective

Youssef Cassis

In the last decade or so, Europe has faced a triple crisis. The first is a financial crisis: it was the financial debacle that followed the collapse of Lehman Brothers in September 2008. The second is an economic crisis –the recession which followed the financial crisis and has lasted longer than in the United States, with significant differences between countries. And the third is a sovereign-debt crisis, the so-called 'Euro-Crisis', which could have turned turn into a currency crisis if one or several member-states had left the common currency. To these three crises could be added a fourth one, of a different order, which some have called an 'identity crisis'. Under this generic label, a number of issues related to the state of the European Union are usually gathered –issues of governance, democracy, further integration but also dissent, internal solidarity, position in a global world, and long-term decline. This 'identity crisis' has been exacerbated by more recent events: first the refugee crisis, which intensified in 2015 and 2016, strengthening the position of populist parties across the continent; and second 'Brexit' –Britain's decision to leave the European Union as a result of the referendum that took place on 23 June 2016.

The purpose of this paper is not to present an overview of these crises, which are obviously all related. Most aspects of the 'identity crisis', including Brexit and the migrants drama, are at least in part due Europe's economic travails. In the same way, Europe's hesitant management of the Euro-Crisis can be seen as another aspect if its 'identity crisis'. And Brexit is of course as much a political as an economic issue. While taking into account these interactions, this paper will concentrate on Europe's economic problems. Being a historian's contribution to the debate, the paper will do so by putting these events in historical perspective, by identifying some meaningful historical parallels and also, perhaps more importantly, differences. The object is not to draw ready-made lessons –historical lessons do not exist. It is to better understand the context within which these events have been happening, to distinguish what is new from what is less new, what is likely from what is unlikely to happen, always remembering that history never repeats itself and that there is always much room for the unexpected. And historians are notoriously bad at making forecasts. So prudence is of the essence, but I do believe that history can provide some landmarks, some tools for reflection, in order to ask oneself the right questions.

When considering Europe's economic crises in the early twentieth century, two moments require particular attention. One is the financial crisis of 2008, and the other is the advent of the single currency, which took place less than a decade earlier. The financial crisis was an extremely violent and unexpected shock, which tested to the limit the strengths and weaknesses of Europe's monetary Union.

I

Let us start with the financial debacle of 2008. It is true that it was not a specifically European crisis. It was a global financial crisis, originating in the United States. But Europe was certainly not spared. In many respects, there was nothing particularly new in the financial crisis. It was clearly fuelled by a massive

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credit expansion, inordinate levels of indebtedness, and speculative excesses with the belief, to use Reinhart's and Rogoff's formula, that this time was different. However, while all crises share common features, each one displays its own characteristics.[1]

I would emphasise three specific features of the financial crisis of 2008. First, it was a global financial crisis taking place in advanced economies. This might not seem particular new or unusual, but major financial crises had been a very rare occurrence in advanced economies since the Great Depression. They had either been limited to single financial institutions (for example BCCI in Britain in 1991, Crédit lyonnais in France in 1993, or LTCM in the United States in 1998) or single countries (including Japan in 1998). The only global shock since the Great Depression came in August 1982, when Mexico unilaterally declared a three-month moratorium on payment of its debt principal. Several of the world's leading banks were seriously exposed and risked failure if there were defaults, with a real risk of implosion of the international financial system. However, a major crisis was averted when agreement was reached between the banks and the Latin-American countries under the auspices of the IMF.[2]

A second specificity of the 2008 financial crisis is the socio-economic context within which it took place. The transition to a post-industrial society from the 1980s onwards had gone hand in hand with tremendous growth of the tertiary sector in general and the financial sector in particular. The globalisation of the world economy had also reached unprecedented levels, even compared with the pre-First World War period, leading to a hitherto unequalled degree of interdependence between financial institutions. The very business of banking had also radically changed during the twenty years preceding the crisis, through the inexorable march towards securitisation, the continuous flow of innovations and the devising of new financial products. These products were extremely complex and opaque, few bankers really understood them, and therefore few were able to assess the risks involved. Warren Buffett famously referred to derivatives as 'weapons of mass destruction'.

And the third specificity of the recent financial crisis was its extreme severity. It was not the most severe since the Great Depression; it was the most severe financial crisis in modern history.[3] Never before did so many leading banks –in terms of both size and reputation– in so many advanced economies, find themselves at almost exactly the same moment requiring state intervention to save them from failing. The risk of collapse of the international financial system was never so acute during the Great Depression – which is of course the crisis with which all comparisons are made.

Despite the global nature of the Great Depression, the banking crises then did not affect all countries simultaneously. Some, like Britain, escaped them altogether. In others such as France, the crisis was protracted but never very severe. The most serious banking crises occurred in the two countries most affected by the depression, the United States and Germany. In Germany, all the country's major banks stood on the edge of the abyss in July 1931 and government intervention just managed to save the day –a situation not dissimilar, at national rather than global level, to what happened in September 2008.[4] In the United States, four banking crises broke out and more than 10 000 banks disappeared between autumn

[1] See C.P. Kindleberger, *Manias, Panics and Crashes. A History of Financial Crises* (London, 1978); R. Reinhart and K. Rogoff, *This Time is Different. Eight Centuries of Financial Folly* (Princeton and Oxford, 2009).
[2] See G. Bird, *Commercial Bank Lending and third World Debt* (London, 1989); R. Devlin, *Debt and Crisis in Latin America: the Supply Side Story* (Princeton and Oxford, 1989); H. James, *International Monetary Cooperation since Bretton Woods* (New York and Oxford, 1996).
[3] See Y. Cassis, *Crises and Opportunities. The Shaping of Modern Finance* (Oxford, 2011).
[4] See in particular H. James, 'The Causes of the German Banking Crisis of 1931', *Economic History Review*, 38 (1984); T. Balderston, 'The Banks and the Gold Standard in the German Financial Crisis of 1931', *Financial History Review*, 1, 1 (1994); I. Schnabel, 'The German Twin Crisis of 1931', *Journal of Economic History*, 64, 3 (2004), and the ensuing discussion with T. Ferguson and P. Temin in the same volume.

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1930 and spring 1933. But it was only in February 1933 that the American banking system came to a near complete standstill. All the country's banks had to be closed for a week, during which the new President, Franklin Roosevelt, announced a series of measures designed to restore confidence.[5]

If we now turn to the relationship between financial crisis and economic crisis, it clearly appears that the Wall Street crash of October 1929 was not the cause of, but a contributory factor to the Great Depression, whereas the financial crisis of September 2008 was clearly the cause of what has come to be known as the Great Recession. The causes of the Great Depression lay elsewhere, above all in the international monetary system of the time, the gold standard, which was a fixed exchange rate system, and the deflationary monetary policies that this system generated.[6] The banking crises of the 1930s happened once the economic crisis was well under way, between 1930 and 1934, and they obviously further aggravated the situation.[7]

The effects of the financial debacle of 2008 on the real economy were soon felt. GDP in the OECD countries fell by 2% in the fourth quarter of 2008 and by 2.1% in the first quarter of 2009, then bottomed out (-0.02%) over the second quarter. The unemployment rate went up from 5.6% in April 2008 to 8.2% in June 2009, before stabilising over the next few months.[8] These trends were initially, comparable with those observed in 1929-1930. On the other hand, the expansionist policies pursued by the political and monetary authorities, in contrast to the deflationist policies of those in charge in the early 1930s, had a positive effect and prevented the "Great Recession" from becoming a 'Great Depression'.[9]

There are thus both parallels and differences between 1929 and 2008. As a strictly financial crisis, the financial crisis of 2008 can be considered the most severe in history. Nevertheless, taken together over a period of five years and with thousands of bank failures, the financial crises of the Great Depression were more traumatic and caused greater damage to the real economy than the credit crunch and the crisis of 2007-2008. These parallels and differences are reflected in the responses to the crisis, whether in terms or regulatory or recovery measures.

The Great Depression was the 'crisis to end all crises' and in most countries, regulatory measures were taken to that effect –first and foremost in the United States.[10] A series of radical reforms reshaped the American financial system, including the Banking Act of 1933, better known as the Glass-Steagall Act, which decreed the complete separation of commercial banking activities (taking deposits and making loans) from investment banking activities (issuing, distributing and trading securities). A number of European countries, including Italy, Belgium, and later France, took a similar path. Nearly everywhere, including Germany and Switzerland, banking laws were passed, restricting entry to the profession and establishing supervisory bodies. Admittedly, the real change in Europe, especially in Britain and France, came after the Second World War, but this was part of the same phenomenon, the 'Thirty Years War of the Twentieth Century' –the period 1914-1945, marked by two world wars and the most severe depression of the twentieth century.

The regulatory measures taken in the aftermath of the financial crisis of 2008 have proved rather disappointing. Of course, measures such as Basel III, the Dodd-Frank Act in the United States, the Vickers

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[5] See E. Wicker, *The Banking Panics of the Great Depression* (Cambridge, 1996).
[6] See B. Eichengreen, *Golden Fetters. The Gold Standard and the Great Depression 1919-1939* (Oxford, 1992).
[7] On the impact of the banking crises on the depression in the United States, see in particular B. Bernanke, *Essays on the Great Depression* (Princeton, 2000).
[8] OECD Quarterly National Accounts, 25 March 2009; OECD Harmonised Unemployment Rates, 8 June 2008.
[9] B. Eichengreen and K. O'Rourke, 'A Tale of Two Recessions: what the new data tell us?" *VoxEU.org*, 8 March 2010.
[10] See Y. Cassis, 'Regulatory Responses to the Financial Crises of the Great Depression: Britain, France and the United States', in E. Balleisen et al., *Policy Shock: Recalibrating Risk and Regulation after Oil Spills, Nuclear Accidents and Financial Crises* (Cambridge, forthcoming, 2017).

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Report in Britain, or the European System of Financial Supervision cannot be readily dismissed. They have raised capital requirements and more generally tighten regulation, but they do not amount to a reshaping of the financial system. Where is the 'New Glass-Steagall Act' or the 'New Bretton Woods' called for in the wake of the panic of 2008? So, one wonders if the recent financial crisis has been severe enough to be followed by a fundamental overhaul of the financial system. There are reasons to be sceptical, and worried.

II

The Great Recession might not have been as severe as the Great Depression, but it was a very steep downturn, the steepest since the 1930s, far more than in the mid-1970s, the early 1980s or the early 1990s. The recession was particularly severe in Europe. GDP in the Eurozone decreased by 2.4 per cent between 2008 and 2012, and GDP per head by 3.7 per cent, while unemployment rose by 4.2 per cent –and by nearly 20 per cent in countries such as Greece and Spain. Growth rates have been anaemic since 2013 and by 2014 GDP had not yet regained its pre-crisis level. By contrast, the recession was shorter in the United States, where growth resumed, though at a comparatively slow pace, in the third quarter of 2009.

How to explain this prolonged recession? The jury is still out, but there is no doubt about the restrictive fiscal policies adopted by all European governments from 2010. The measures taken in 2008 and 2009 to save the financial system and avoid a depression had led to a deterioration of public finances. From being virtually in balance in 2008, government budgets in the Eurozone spiralled to a 6.4 per cent deficit in 2010, before being reduced to 4.1 per cent in 2012 and 2.9 per cent in 2014. Reducing budget deficit required austerity measures, with tax increases and spending cuts amounting to 1.5 per cent of GDP in 2011 and 2 per cent in 2012 –which did very little to boost economic growth. On the contrary, with most European economies shrinking, public debt as a proportion of GDP continued to rise –from 60 per cent in 2008 to 84 per cent in 2012 and 89 per cent in 2014 for the Eurozone.

The recession was compounded by a sovereign-debt crisis affecting the weaker economies of Europe's periphery, the so-called PIGS, who imported massive amount of capital in the early years of the twenty-first century –Greece, Ireland, Portugal, and Spain. Doubts were even expressed about Italy. Greece was of course the worst case of unsustainable debt, with budget deficit reaching 13 per cent of GDP in 2009 and public debt 110 per cent. Ireland was crushed by the burst of the housing bubble and the failure of its banks whose depositors and creditors had been given a government guarantee. Portugal suffered from its low productivity and the lack of competitiveness of its economy. In Spain, despite a stronger economy and comparatively low level of public debt, the crash of the property boom threatened the already weak savings banks, the *cajas*, which benefited from a state guarantee. With their government bond yields rising to alarming levels, these countries were no longer in a position to borrow from the market. Greece, Ireland and Portugal were bailed out by the so-called troika (IMF, European Commission and European Central Bank), on the condition of reducing public deficit and implementing various reforms. Spain's bailout was less humiliating and its banks benefited from the support of the European Stability Mechanism.[11]

The sovereign-debt crisis led to the so-called Euro-crisis. The Euro itself was not in crisis and its internal and external value remained fairly stable. Nevertheless, doubts started to mount about its irreversible character. Would Greece have to leave the Euro and if so would Ireland, Portugal and Spain be forced to follow suit? And what would be the consequences of such exit, or exits, for those leaving the single currency and for the Eurozone itself? It has usually been assumed that both would pay a hefty price, though it hasn't been quite clear how high the price would be. Perhaps even more worryingly, it has been

[11] See F. Allen, E. Carletti and G. Corsetti (eds.), *Life in the Eurozone with or without Sovereign Debt Crisis* (Florence, 2011); F. Allen, E. Carletti and S. Simonelli (eds.), *Governance for the Eurozone: Integration of Disintegration ?* (Florence, 2012).

feared throughout the crisis that a break-up of the Euro would mean the end of the European Union. The end of the crisis does not mean that the future of the Euro is entirely secure –for both economic and political reasons.

III

The effects of the financial crisis of 2008 on the European economy have been compounded by the experience of monetary union. This was a new experience, not so much because the European Central Bank was still a young and inexperienced institution, but because such a monetary union was a first in history, with no prior landmarks to rely on.

Europe's monetary unification is a curious phenomenon, where both economic and political factors have been at work. Starting with the Werner Plan in 1970 and ending with the introduction of the Euro in 1999/2002, it took about thirty years to come to fruition. Interestingly, this is about the same time as the German monetary unification, which was completed over a 33 years period, from the Dresden Convention in 1838 to the striking of the first Marks in 1871. The impetus for German monetary unification was given by the formation of the Zollverein in 1834. Pressure from business interests mounted in the 1860s, but it was Germany's political unification which eventually paved the way for monetary unification. Other monetary unifications took place at about the same time, as part of the formation of nation states – Switzerland in 1848, Italy in 1862.[12]

In Europe, monetary union took place not only before but *without*, at any rate for the foreseeable future, political union. There was a kind of precedent for this type of regional monetary union, where participating countries remained politically independent. It was the Latin Monetary Union –a monetary convention signed in 1865 between France, Italy, Belgium and Switzerland. Its purpose was to reach agreement on the proportion of silver contained in the low-denomination coins of the four countries as, in accordance with the Gresham Law, the coins with the highest fineness had been disappearing from circulation. The convention was renewed in 1878 and officially lasted until 1921 –de facto until 1914. It survived a massive fall in the price of silver, suspension of convertibility in France and Italy, and the deterioration of Franco-Italian diplomatic relationships following Italy's joining of the Triple Alliance alongside Germany and Austria-Hungary.[13] So it proved resilient. But it managed to survive in the absence of political unification because its objective was fairly narrow –it was limited to coins, which were losing ground in the late nineteenth century, banknotes were excluded from the convention; and because the Latin Monetary Union was integrated into a broader monetary system, the gold standard, a system of fixed rates, which is not strictly speaking a monetary union even though it displays some of its characteristics.

Many doubts have been expressed about the possibility of achieving monetary union without political union –in the run-up to the introduction of the Euro in the 1990s and again since the beginning of the Euro-crisis in 2010. There has also been much discussion about why Europe decided to follow this route. One point is clear: there was a very strong economic imperative to establish a single currency, in addition to the political will –an imperative going back to the early days of the Common Market and becoming stronger ever since. This is why European countries were not only prepared to take the risks entailed by monetary union without political union, but were convinced that they would reap ample benefits. This is also why the Euro-crisis has been managed in such an awkward way in the last five years.

[12] See M. Bordo and H. James, 'A long term perspective on the euro' and B. Eichengreen, 'Sui generis EMU', both in M. Buti et al., *The Euro. The First Decade* (Cambridge, 2010).
[13] See L. Einaudi, *Money and Politics. European Monetary Unification and the International Gold standard (1865-1873)*, (Oxford, 2001).

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The Treaty of Rome, signed in March 1957, which created the Common Market, did not envisage the creation of a monetary area. However, the Bretton Woods system did not entirely satisfy the needs for exchange rate stability of the nascent European community. A first problem to arise was the maximum possible fluctuation between two European currencies, which could be as high as 4%. The European Monetary Agreement, signed in December 1958, reduced this spread to 3%, by narrowing the fluctuation margin of European currencies against the dollar from ±1 to ±0.75%.[14]

Maintaining exchange rate stability required further cooperation in the late 1960s because of growing divergence between member states. The need for such stability came, in particular, from the requirements of the Common Agricultural Policy, which guaranteed the price and free movements of agricultural products. In February 1969, the Barre Plan recommended, among other proposals, setting up a mechanism of cooperation in order to provide support in case of balance of payments difficulties. And in December 1969, at The Hague summit of the Heads of State and Government, a further step was taken with the decision that economic and monetary union should be a long-term objective of the European Community.

The result was the Werner Plan, submitted in October 1970, which defined a three stages process leading, from 1971 to 1980, to economic and monetary union –starting with the removal of controls on capital flows; followed by a complete integration of banking and financial markets; and ending with the elimination of fluctuation margins between currencies and the establishment of irrevocably fixed parities. The final objective was the creation of a common currency. The Werner Plan was adopted by the Council of Ministers in March 1971, despite French reservations (they were opposed to supra-nationality in economic and financial affairs) and German caution (they insisted that economic convergence should precede monetary integration, unlike their French counterparts, who considered that fixed exchange rates would accelerate the process of economic convergence).[15]

The Werner Plan had to be abandoned in 1977 in the face of the monetary upheavals of the early 1970s. Yet the imperatives of monetary integration had not disappeared. The end of Bretton Woods and the advent of floating exchange rates made it even more necessary for Europe to create, at regional level, an area of fixed exchange rates or of some form of monetary stability. The European Monetary System came into force for that purpose in March 1979.[16] It established fixed, but adjustable, exchange rates between European currencies, within margins of fluctuation of ±2.25%. A central feature of the system was the European Currency Unit (ECU) –a composite currency, made up of a basket of currencies, weighted according to each country's macroeconomic significance, with each member state's currency having a central rate against the ECU.

The Single European Act of 1987 pushed towards further monetary integration. The goal that it set itself was to complete the internal market by 1st January 1993, by making a space without internal borders within which the free circulation of goods, people, services and capital was assured. The Delors Report, made public in April 1989, kept with this logic, re-launching the Werner Plan with improved chances of success. It was more precise about the three stages, and made provision for the creation of a central bank. Inflation, which had been devastating in the previous two decades, seemed under control. And the Delors Plan enjoyed strong political support. The French president François Mitterrand pushed very hard for economic

[14] See E. Apel, *European Monetary Integration: 1958-2002* (London, 1998).
[15] See Apel, *European Monetary Integration*; D. Ikemoto, *European Monetary Integration, 1970-79. British and French Experiences* (Basingstoke, 2011); H. James, *Making the European Monetary Union. The Role of the Committee of Central Bank Governors and the Origins of the European Central Bank* (Cambridge, Mass., 2012).
[16] See E. Mourlon-Druol, *A Europe Made of Money. The Emergence of the European Monetary System* (Ithaca and London, 2012).

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and monetary union in exchange for German re-unification. The Treaty of Maastricht, signed in February 1992, paved the way for the introduction of the single currency in 1999.

It would be foolish to underestimate the role of political factors in this process. There was nothing automatic or spontaneous in the advent of the Euro. It was clearly a political decision, arising both from the wish to give a boost to European construction and from the international climate following the fall of the Berlin Wall. And yet economic imperatives soon reasserted themselves with the currency crisis of September 1992, when vast speculative movements drove the British pound and the Italian lira –the latter temporarily– to leave the exchange-rate mechanism and the peseta to devalue by 5 per cent, while striking fear into the French franc. Such risks of instability would be irrevocably removed if, instead of a system of fixed exchange-rates, currencies were irreversibly locked in a single currency. If anything, the currency crisis of 1992 reinforced the wish to succeed, despite persisting doubts in Britain and the United States.[17] For there were other advantages to be gained from a single currency –not least those brought by a currency capable of holding its own against the dollar or even to replace it; or those deriving from the creation of a genuine European financial market.

Europe's crisis in the early twentieth century has to a large extent been the consequence of a monetary union without sufficient political integration, in other words a proper political union. Political union is particularly important to bind together countries, or regions, with significant differences in levels of income and productivity, in order to make possible the necessary transfers from surplus to deficit areas, to achieve, as has been repeatedly mooted during the crisis, a fiscal union and a banking union.

Managing a monetary union without a political union has been an entirely new historical experience, and a perilous one after the shock of the financial crisis of 2008. For Europe's weaker economies, there was no longer the possibility to devalue their currency or even, as in the days of the gold standard, to leave a system of fixed exchange rate. Before 1914, defaulting countries would as a rule leave the gold standard and return at a later stage, usually with a depreciated currency. This was for example the case with Argentina between 1876 and 1883, and again between 1885 and 1889.[18] But the Euro being irreversible, austerity and deflation are the only options in the absence of transfers. Public borrowings also pose entirely new constraints. Member states of the Eurozone, while borrowing in their own currency, are in fact in the position of countries borrowing in a foreign currency, with no possibility for their central bank to print money. The markets could once again speculate against the ability of a country to sustain its debt.

There have been many accounts of the way the sovereign debt crisis has been handled, or rather mishandled, especially in the case of Greece. From a historical perspective, it is interesting to notice that Europe hardly had any experience in handling sovereign debt crises. Of course, Europe had been the world's banker before 1914 and had dealt with many a sovereign-debt crisis, whether in the Ottoman Empire, Egypt, or Argentina –as well as Greece. They sometimes interfered directly in the debtor country's internal affairs –there were a British and a French minister in the Egyptian government in 1879. Sovereign debt crises happened in the periphery, not in the core industrial countries. More recently, the International Debt Crisis of 1982, to which I referred at the beginning of this paper, provided a template, but it involved Mexico, Argentina, Brazil, as well as Poland, Zaire and other smaller debtors –not the Europe Union. Moreover, the very functioning of the European Union made it difficult to deal with an

[17] O. Issing, *The Birth of the Euro* (Cambridge, 2008); D. Marsh, *The Euro. The Politics of the New Global Currency* (New haven and London, 2009); James, *Making the European Monetary Union*.
[18] C. Marichal, *A Century of Debt Crisis in Latin America. From Independence to the Great Depression, 1820-1930* (Princeton, 1989); B. Eichengreen and P. Lindert (eds.), *The International Debt Crisis in Historical Perspective* (Cambridge, Mass., 1991); J. Flores, 'Sovereign Debt Defaults', in Y. Cassis, R. Grossman, and C. Schenk (eds.), *The Oxford Handbook of Banking and Financial History* (Oxford, 2016).

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internal sovereign debt crisis. So when the Greek crisis broke out in early 2010, the IMF was called to take charge the negotiations with the Greek government, together with the European Commission and the European Central Bank.[19] This was not only interference in European affairs. It also created a dividing line, between core and periphery, within the Eurozone.

IV

What can history tell us about the challenges facing Europe in the early twenty-first century? There might be few meaningful historical parallels, given the novelty of some of these challenges. But some long-term trends can nonetheless be perceived –though the direction to which they point is not entirely clear.

One trend is the economic imperatives of the single currency –they have not disappeared and the political will is still there, which would suggest that the Euro is here to stay. Another is that economic downturns are always followed by recovery. By 2015, the situation has started to improve and the European Central Bank's quantitative easing programme provided a much needed boost. And a third is that Europe, to paraphrase Jean Monnet, has been built through crises and by finding solutions to these crises –so here was another opportunity to move one step forward.

There are, however, a number of pitfalls suggesting that a less optimistic scenario cannot entirely be ruled out, at any rate for southern Europe. Adherence to a system of fixed-exchange rates can lead to the adoption of savage deflationary policies, with devastating economic effects, not least in terms of unemployment, and dramatic political consequences –as was the case in the 1930s in several European countries. Europe would not easily withstand such a course of events.

Avoiding such pitfalls is a political rather than an economic challenge. Monetary union requires a fiscal union, in other words moving closer to a political union. Some advances have undoubtedly been made in the last five years. The Banking Union, for example, whatever its limitations, is a move in the right direction. Several proposals have been made in order to secure the future of Europe's monetary union.[20] The debate is still going on –about their political feasibility, and how resilient Europe would prove when confronted with a new crisis.

Writing in late 2016, one cannot end a paper on Europe's crisis in the early twenty-first century without a word on Brexit –the most recent shock, of a very different nature from the Euro crisis. How serious the economic consequences of this shock will be remains, at this stage, impossible to assess, whether for the European Union or Great Britain, though they are likely to prove deeper for the latter. In any case, Brexit is both an economic and political shock. From a historical perspective, it is worth remembering the reasons for Britain joining the Common Market in 1973. It was in no small part in order to be part of a dynamic, fast growing economic area: Britain disappointing growth rate in the 'golden age' was widely seen as a consequence of its having missed the boat by not joining the EEC from the very start in 1958. Now Britain is leaving the European Union in the hope of freeing itself from a continent beleaguered by a sclerotic economy. Whether Britain got it right or was wrong again sixty years later will tell us a lot about Europe's crisis in the early twenty-first century.

[19] See B. Eichengreen, *Hall of Mirrors. The Great Depression, the Great Recession and the Uses – and Misuses – of History* (Oxford, 2015).
[20] See for example R. Baldwin and F. Giavezzi, *How to Fix Europe's monetary union: Views from leading economists*, Vox.EU, 2016.

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Economic outlook and policies in Europe[1]

Zsolt Darvas

1. Introduction

Even though the acute phase of the euro-crisis is over, the European economy faces major challenges. In addition to long-standing problems, there are problems related to the aftermath of global and European economic and financial crisis:

- The European Union's older member states (members before 2004) face a long-standing growth problem: following the period of the reconstruction after World War II, from the early 1970s most countries were unable to converge closer to the US (Figure 1)[2].
- There is a pressing current growth problem: the EU's economic performance since 2009 has been much worse than in other advanced countries and the outlook is weak (Figure 2). Investment activity and inflation are extremely low, which mirror economic weaknesses. The unemployment rate continues to be high.

There is also a huge dispersion within the EU. For example, Germany managed to achieve a solid economic recovery while the unemployment rate remained historically low, but Greek output collapsed by a more than a quarter and unemployment is historically high. Figures 2 and 3 also report GDP, GDP per capita and unemployment developments for three country groups within the euro-area: "core" (Austria, Belgium, Finland, Germany and the Netherlands), "mid" (France and Italy) and "periphery" (Greece, Ireland, Portugal and Spain). Developments in the three country groups underline the diversity and the social cost in countries facing economic difficulties.

These problems are coupled with lack of cohesion within the EU, which makes it difficult to find proper solutions to Europe's pressing growth and social problems. Despite vast crisis lending and institutional building during the crisis, there is mistrust and discord in various issues within the EU. The support for further solidarity and integration is limited. More nationalistic approaches dominate, while the support for democracy is weakening in the hardest hit countries. This development is especially worrying, since democracy is the core principle on which the EU is built.

[1] Paper based on the presentation that the author gave at the EUSI Tokyo International Conference "Responding to Challenges for the Euro-zone: Resilience of Europe and New Perspectives of the EU Studies", 8-9 March 2015, Tokyo, Tsuda College, Sendagaya Campus.
[2] The newer member states of the EU, which joined between 2004-2013 and labelled as "Central" and "East" on Figure 1, are different and are able to reduce their gap with the USA, though they still have a long way to narrow the gap further.
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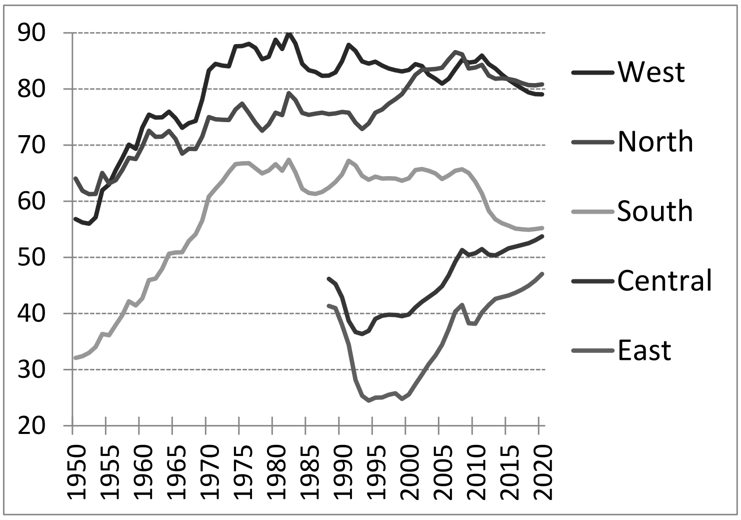
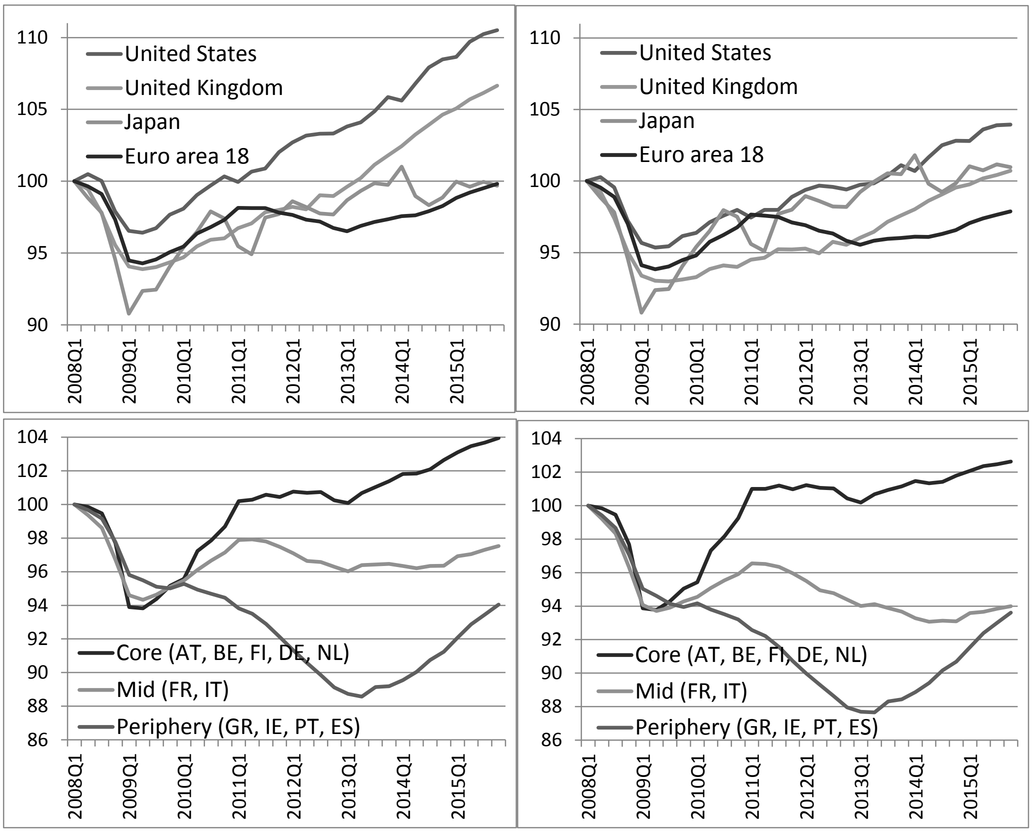
Figure 1: GDP per capita at Purchasing Power Parity in the European Union (US = 100), 1950-2020



Source: author's calculation using data from the October 2015 IMF World Economic Outlook, PENN World Tables and EBRD. Note: unweighted group average values are shown. West: Austria, Belgium, France, Germany, Netherlands. North: Denmark, Finland, Sweden, Ireland, UK. South: Greece, Italy, Portugal, Spain. Central: Czech Rep., Hungary, Poland, Slovakia, Slovenia. East: Estonia, Latvia, Lithuania, Bulgaria, Romania

Figure 2: GDP and GDP per capita (2008Q1=100), 2008Q1-2015Q4

GDP **GDP/capita**



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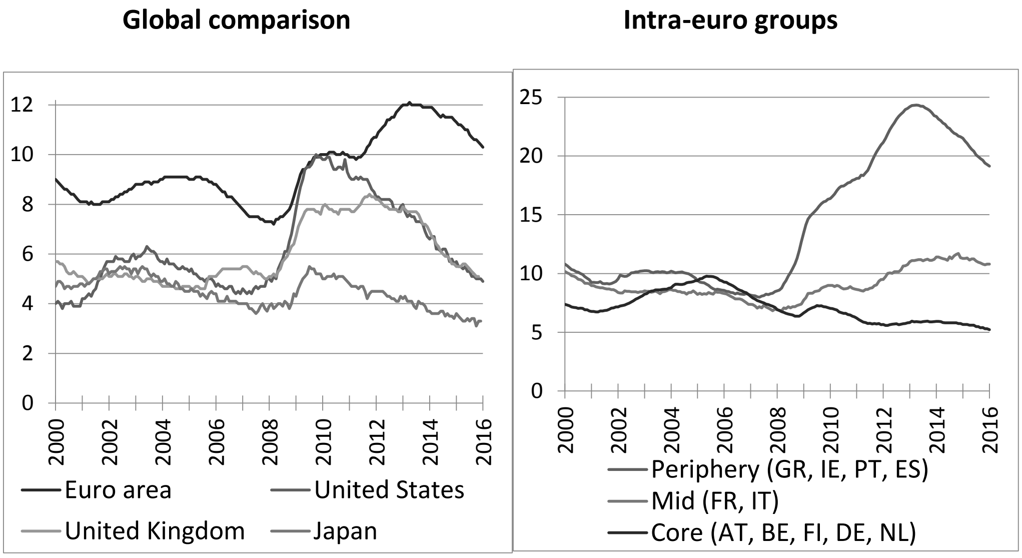
Source: Author's calculation using data from Eurostat, OECD and IMF. Note: The three euro-area country groups represent the weighted averages of countries: euro-area core: Austria (AT: 7%), Belgium (BE: 9%), Finland (FI: 5%), Germany (DE: 64%) and Netherlands (NL: 15%); euro-area mid: France (FR: 54%) and Italy (IT: 46%); euro-area periphery: Greece (GR: 13%), Ireland (IE: 11%), Portugal (PT: 11%) and Spain (ES: 66%).

Figure 3: Unemployment rate (%), January 2000 – January 2016



Source: Author's calculation using data from Eurostat. Note: see the definition of the three euro-area groups in the note to Figure 2.

2. Why was the euro-area crisis so deep and why is the recovery so anaemic?

I highlight four key areas: macroeconomic issues, microeconomic factors, euro exit fears and insufficient decision making process in the euro area.

First, macroeconomic and financial policies in the US and Europe were almost the opposite. In the US a severe stress test of the financial sector took place very rapidly and effective actions were taken to restore confidence in the financial sector. A major fiscal expansion and a major monetary stimulus (in the form of large-scale purchases of government bonds and asset-backed securities) supported the economy at the time when households aimed to decrease their indebtedness and thereby private demand was weak.

In contrast, in Europe delayed and weak stress tests prolonged banking woes. Since 2010 the strong focus on fiscal consolidation made private sector deleveraging more difficult, while the ECB reacted with a serious delay in easing monetary conditions[3].

At the same time, southern euro-area members face a major macroeconomic adjustment problem, which is in the heart of the economic troubles of the euro area. Before crisis, there was a close zero aggregate euro-area current account balance in the euro area, which masked major divergences within the area, such as

[3] Yet ECB was effective in supporting banks with ample liquidity under much relaxed collateral requirements, as I describe later.

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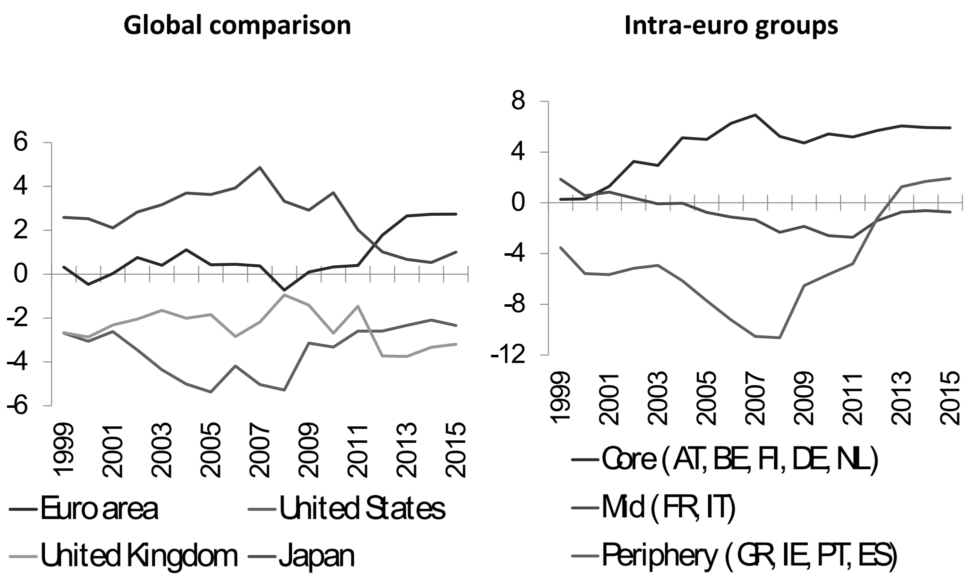
divergences in credit growth, property prices, consumer prices, labour costs, productivity, current account balances and international investment positions.

During this pre-crisis period, southern euro-area members lost their price and wage competitiveness relative to core euro-area countries. Starting in late 2009, euro-members with large external deficits faced a 'standard' balance of payments crisis: reversal of private capital flows, which were replaced by European Central Bank financing of banks. ECB financing of banks was only a temporary relief. A lasting improvement in current account was needed, which necessitate reversing the pre-crisis divergences of prices and wages. This is very difficult in a monetary union, because the countries with too-high wages and prices cannot rely on a currency devaluation, because they are 'locked-in' the euro. The only available tool to address this issue was the so-called internal devaluation, that is, the reduction of prices and wages relative to main trading partners. This process has started and there were some achievement in the southern periphery, yet unfortunately the adjustment was largely one-sided: while the deficit countries underwent a major adjustment which was especially painful in terms of increases in unemployment, surplus countries hardly adjusted. As Figure 4 demonstrates, current account surpluses in core euro-area countries remained practically unchanged. Thereby, the euro area as a whole moved from the close-to-balance position to a current account surplus of about 3% of GDP. As a side effect, the euro area became a major contributor to global current account imbalances.

Figure 4: Current account balance (%GDP), 1999 – 2015



Source: author's calculation using data from AMECO. Note: see the definition of the three euro-area groups in the note to Figure 2.

Second, as regards microeconomic factors, Europe has less flexible economies and less cross-country adjustment capacity, which made the adjustments both within and across countries more difficult.

Third, fears from the exit of Greece from the euro area in 2010-12 also deterred investments both in Greece and in the rest of the euro area, because a break-up would have had major negative consequences for the whole euro area in my view.

And fourth, decision making at the European level is fragmented and inefficient, while federal level decision making and implementation are strong and effective in the US.

3. EU policy responses

EU institutions and national policymakers adopted various measures to address the triple crises that the continent faced: the balance of payments crisis, the banking crisis and the sovereign debt crisis.

3.1 Revamped economic policy coordination in the EU

In order to tackle the balance of payments crisis the European Commission argued for structural reforms supported by intensified policy coordination and advice. A new instrument, the so-called Macroeconomic Imbalances Procedure (MIP) was introduced, which aims to detect and correct various kinds of imbalances, including in the private sector. Moreover, a new annual cycle of policy coordination and enforcement of EU rules have been introduced under the name of "European Semester". Unfortunately, the European Semester has been rather ineffective so far as demonstrated by Darvas and Leandro (2015).

3.2 Banking policies

For the banking crisis the ECB provided unlimited liquidity to banks under relaxed collateral requirements. New institutions were launched, like the European Systemic Risk Board (ESRB) to advice on EU-wide financial stability issues and the European Banking Authority (EBA) to ensure effective and consistent prudential regulation and supervision across the European banking sector. The European Banking Union was proposed and already partially implemented, which is the biggest institutional development in the EU since the creation of the euro in 1999 (Véron, 2015). New plans for a European Capital Markets Union were developed by the new European Commission since late 2014.

3.3 Sovereign debt crisis management

In order to address the sovereign debt crisis which impacted several southern euro-area members (and also some central and eastern European EU members outside the euro area) various rescue funds were launched to provide loans to stressed government, under strict conditionality related to fiscal adjustment, structural reforms and banking sector repair. Fiscal rules were strengthened by several agreements (6-pack, Euro-plus-pack, Fiscal compact, 2-pack), whereby more emphasis was placed on automaticity and sanctions. Yet fiscal consolidation at the aggregate euro-area level and in most member states became pro-cyclical, which widened the negative output gap further and increased unemployment (Darvas and Tschekassin, 2015). A major handicap of the euro-area framework was the lack of a lender of last resort for sovereigns: by launching Outright Monetary Transactions (OMT) in the summer of 2012 was a major step in crisis resolution in the euro area (Darvas, 2012a). Under the OMT the ECB is ready to purchase unlimited government bonds of stressed countries provided they are subject to a financial assistance programme.

3.4 The Juncker investment plan: a step in the right direction, but unlikely to have a sizable impact

Actions against insufficient investments in the EU were for long more a slogan than a real action plan. Specific programs have been announced, but implementation was not always a success. In June 2012 there was an agreement, the so-called Compact for Growth and Jobs, which reiterated several earlier plans such

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as the completion of the single market, structural reforms and growth-friendly fiscal consolidation, while it also included a commitment by EU Member States to provide €10 billion new capital to European Investment Bank. This was useful, but too small. More recently, the Juncker EU Commission made investment a top priority and launched an investment plan, which has a higher potential to support investment than earlier European attempts, yet I am sceptical whether it can have a sizeable impact.

The plan addresses the European investment problem by attracting private investors unwilling to take risks by absorbing first losses. The main constraint that the European Commission faced is that the European Commission does not have unused resources, EU member states did not want to provide public money for investments and they did not agree to a plan which would involve borrowing at the EU level to fund EU-wide investments. Therefore, the Juncker plan reallocates €21 billion from the EU budget and EIB resources to be used as guarantees for private investors participating in the plan and presents a nice example of financial engineering to arrive from €21 billion in guarantees to €315 billion in investment.

Given that no EU and national public money was available for a new investment plan and there was no willingness to borrow at the EU-level to invest, this plan is probably constitutes the most that the European Commission could propose. The Commission therefore deserves appreciation for its attempt to foster investments.

However, there are two crucial questions about the contribution of this plan to aggregate investments in the EU. Both are related to additionally.

First, by definition, all projects supported by this plan will be new. However, since private sector projects will be supported, we will never know if the participating private companies will provide new resources to invest in this plan, or redirect some of their earlier investment plans to this plan, in order to benefit from the EU guarantee. If the latter will dominate, aggregate investment will not be much higher with this plan, only its composition will change.

Second, most of the EU budget contribution is taken away from Horizon 2020 and Connecting Europe Facility budget lines, which support projects with potentially high long term returns. Therefore, these facilities will be able to support less investment on their own.

The Juncker investment plan is not only about mobilising investment finance and supporting projects and investments, but it has a third pillar to improve the investment environment by removing sector-specific and other financial and non-financial barriers to investment. This third pillar is highly welcome and I look forward to seeing the action plan and its results.

3.5 Monetary policy measures

The primary objective of the European Central bank is to maintain price stability. The governing Council of the ECB published the definition: "*Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%*". The Governing Council has also clarified that it aims to maintain inflation below, but close to, two percent over the medium term, though it has not quantified what 'closeness' means, nor has it given a precise definition of the 'medium term'. The clarification has been widely interpreted to mean that the actual target of the ECB is close to, but below, two percent inflation in the medium term.

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Inflation in the euro area has been below 2% in most years since 2008. While there are major benefits to price stability, too-low inflation should be avoided too. Competitiveness adjustment in struggling southern euro area members requires persistently lower inflation than in major trading partners, but if the average euro inflation is low, inflation has to be even lower in southern Europe. And there are good reasons for avoiding too low inflation both at the euro-area level and in each country, because:

- it worsens the public debt sustainability;
- it leads to higher real interest rates;
- it leads to postponement of consumption and investment decisions;
- it makes reallocation across sectors more difficult;
- nominal wage rigidity requires some inflation otherwise adjustment goes via increased unemployment.

Therefore, at least the 2% threshold of the ECB should be reached. To support inflation, economic activity and also financial stability (which has indirect implications for price stability), the ECB adopted several key monetary and financial stability measures:

- Extensive liquidity support to banks since 2007 including eased collateral policy;
- Targeted credit easing through asset purchases: small-scale covered bonds purchasing programs in 2009, 2010 and 2014, also small-scale asset backed security purchases in 2014;
- Supporting distresses sovereign bond markets: securities markets program (SMP) in May 2010 and Outright Monetary Transactions (OMT) in summer 2012;
- Cut in central bank interest rates from 2008, though temporary increase in 2011;
- Negative central bank deposit rate for banks in late 2014;
- Quantitative easing from March 2015 on.

Up to 2014, these measures were less effective in easing monetary conditions than the measures adopted by the Federal Reserve. A useful indicator of monetary stance is the so-called 'shadow interest rate', which is an estimate of the interest rate that would occur in the absence of a zero lower bound for interest rates. Using this indicator Figure 5 suggests that from early 2008 up to 2014 the ECB's monetary stance was relatively tight. However, since 2015 when the large-scale quantitative easing programme was launched, the estimated shadow interest rate fell substantially, to a level well below the US estimates for 2010-14 period.

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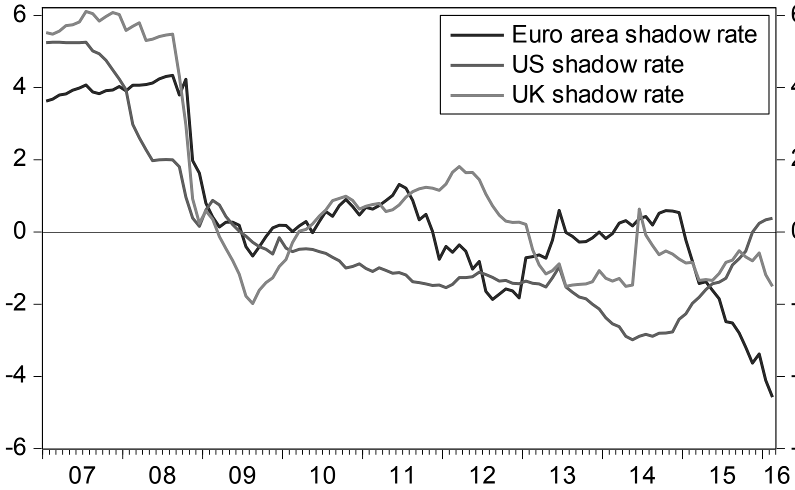
Figure 5: Estimated shadow central bank rates (%), January 2007 – February 2016



Source: updated dataset of Jing Cynthia Wu and Fan Dora Xia (2016).

Still, euro-area headline inflation has remained close to zero since the ECB stepped up its quantitative easing programmes in early 2015. But as Darvas (2016) demonstrates, this does not mean that QE has been ineffective: core inflation and its adjusted version for the indirect effects of low oil prices have steadily increased throughout 2015.

Low energy prices impact inflation, and not just because energy products accounts for more than 10 percent of the total consumer basket used to calculate inflation. Energy has indirect and second round effects on inflation too, and so falling energy prices exert a downward pressure on core inflation. For example, the cost of transportation might fall, but more generally, lower energy prices reduce the costs of all producers, which may then reduce their sales prices in various sectors.

Since energy price developments are exogenous to ECB actions, it is worthwhile to calculate an adjusted measure of core inflation which excludes the impact of energy prices. The results of Darvas (2016) are reported in Figure 6, which shows that euro-area core inflation and its energy adjusted version have increased steadily since early 2015, at least using quarterly figures. Current and energy-adjusted euro-area core inflation rates are still well below the ECB's 2% threshold and are also below US core inflation, but my analysis shows that the very low euro-area headline inflation rates cannot be used to argue for the ineffectiveness of ECB QE.

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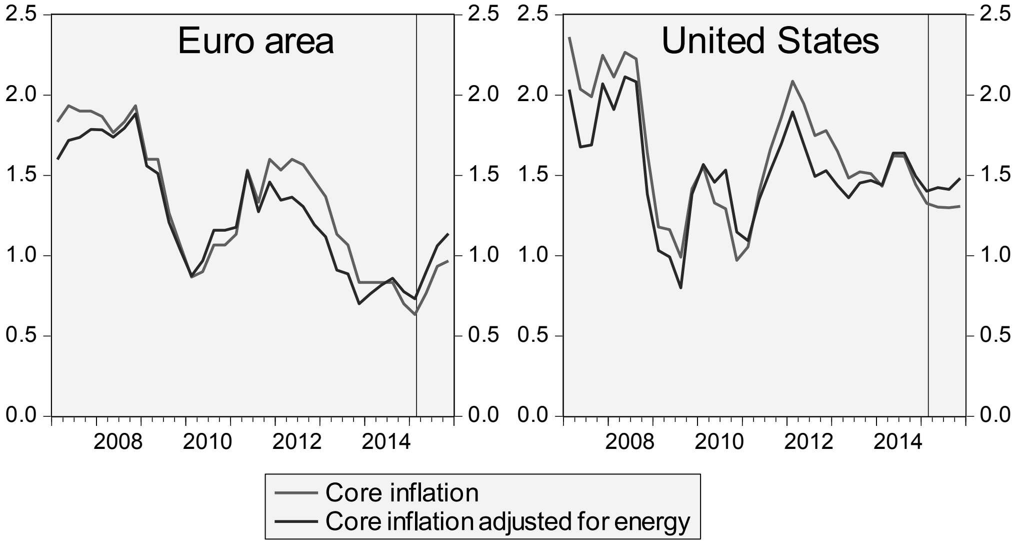
Figure 6: Core inflation and its adjusted version, quarterly data, 2007 – 2015 (% change compared to the same quarter of the previous year)



Source: calculations of Darvas (2016), based on data from Eurostat and the European Central Bank.

There are various channels through which the ECB's quantitative easing influences inflation. The asset purchases alter yields and spreads, rebalance portfolios, depreciate the euro exchange rate (Figure 7), have wealth effects and serve as a devise to make forward guidance more credible. All these measures will increase both demand for and supply of money, which will likely impact both growth and inflation (Darvas, 2015)[4].

[4] While the above mentioned channels are likely at play in Europe, I would like to highlighth that the situation in the euro area is different than it was in the US when quantitative easting has been launched. In the US, yields were higher that time and also mortgage market plays a crucial role in the US than in the euro area.

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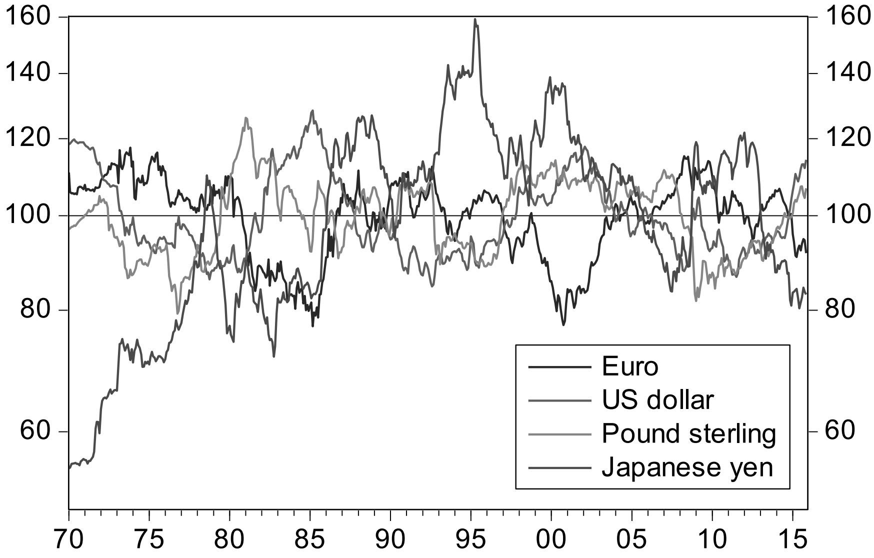
Figure 7: Real effective exchange rates (average 1970-2015 = 100), January 1970 – November 2015



Source: updated dataset of Darvas (2012b). Note: based on consumer prices, calculated with respect to 41 trading partners.

The fall of the real exchange rate of the euro (Figure 7) will not only help the aggregate export performance of the euro area, but also help intra-euro real exchange rate corrections. Further intra-euro adjustment is necessary but not sufficient (Darvas, 2012c). Intra-euro adjustment requires lower inflation and wage increases in the periphery than in core countries. But if the periphery has too-low inflation, debt sustainability is in danger and unemployment could increase if deflation is not going away. The euro depreciation can boost exports, particularly in Germany, which should lead to wage increases due to tight labour markets. Due to the still high unemployment in the periphery, the impact of euro depreciation on wages should be minimal. It is also expected that euro depreciation increase the imported inflation.

Overall, while many new initiatives have been made in the EU and the most acute phase of the crisis is over now, the EU institutional framework was rather ineffective in dealing the crisis. While unemployment is falling since early 2014, it is still very high. Investment activity and inflation are low, while the outlook is weak. The recovery and job creation in the USA started much earlier and much more forcefully than in the EU.

4. The harmful impact of short-term troubles on long-term growth[5]

Europe has a long-standing growth problem, but there is a major risk that short-term economic troubles will damage further the long-term growth potential, for six main reasons.

First, persistently high unemployment is eroding skills, discouraging labour market participation, thereby undermining the long-term growth potential. Youth unemployment, which is at record high in a number of countries, is especially alarming as a long period of unemployment after graduation, when a worker should

[5] This section is based on Darvas (2013).

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acquire the first working skills, can undermine the whole career of a worker. EU leaders promised to act decisively against unemployment, yet no result is seen so far.

Second, business research and development (R&D) activities are rather pro-cyclical, i.e. firms spend much less on these activities in an economic downturn, especially when the timing of recovery is seen remote. But a long period of withheld R&D reduces the efficiency of companies. Since 2007, total factor productivity is sinking in most of Europe. At a lower efficiency, the growth of supply can be slower when demand returns.

Third, weak economic growth and weak bank balance sheet are mutually reinforcing each other, with negative implications for long-term growth. A weak economy leads to bank losses, thereby deteriorating bank balance sheets. Banks with weak balance sheet tend to roll-over the dubious loans of their existing clients, instead of realising further losses (a process frequently called “zombificaion”), and do not grant credit to young and innovative firms. Thereby, struggling firms that do not generate much growth are kept alive, but new and more productive firms are unable to grow. Similar developments characterised Japan in the 1990ies that has led to a lost decade. Europe committed to shore-up banks, but policies so far was clearly inferior to the US, where bank restructuring was largely completed by 2009. It needs to be seen if the European Banking Union will be able instrumental in avoiding the zombificaion of weaker banks in the euro area.

Fourth, before the crisis, household and corporate debt increased substantially and reached too-high levels in a number of EU countries. But private debt deleveraging has been much slower in Europe than in the US since the crisis. History shows that deleveraging episodes can be protracted and can act as a drag on growth. Economic stagnation in the short run makes it more difficult for the private sector to deleverage and thereby can protract the period of deleveraging and undermine growth in the medium term.

Fifth, stagnation in Europe undermines the attractiveness of Europe for investment. When investment moves to other locations instead of Europe, the long-run growth potential of Europe is weakened.

And sixth, a protracted period of weak growth and high unemployment are undermining the EU citizens’ trust in the ability of EU institutions to provide useful policy advice. It can also undermine the trust in democracy, which is the fundamental principle on which the EU is built (Figure 8). Thereby, it weakens domestic commitments to vitally important but painful structural reforms, which are also fostered by EU institutions. Backtracking on structural reforms would weaken the long-term growth potential.

(10 March 2016)

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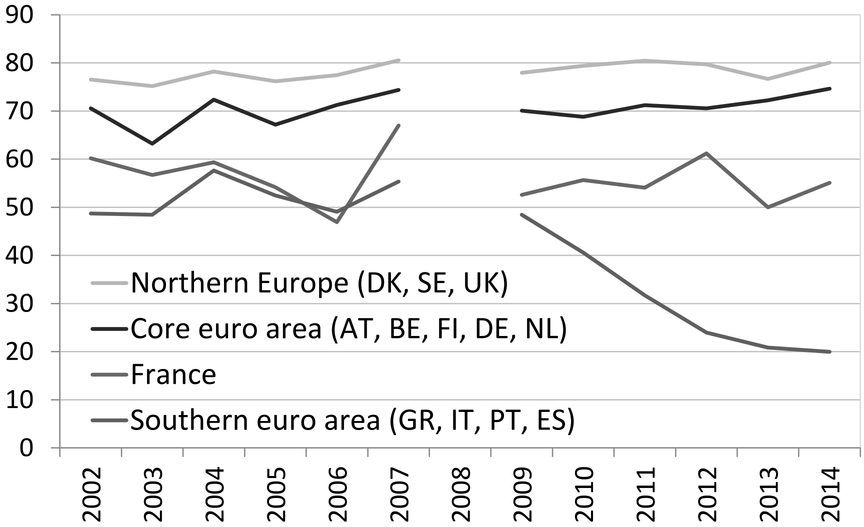
Figure 8: Evolution of satisfaction with democracy



Source: update, using Eurobarometer data, of Alonso (2013). Note: average % of respondents who replied 'very' and 'fairly' (among those who responded) to the question if he/she is satisfied with democracy in his/her own country. This question was not asked in 2008.

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Comments

Kentaro Kawasaki[1]

The paper proposed by Dr. Zsolt Darvas gives detailed and skillful explanations on recent European economy, institutional frameworks and policy response to deal with the "triple crisis" in Eurozone. When the newly-elected Greek prime minister, Alexis Tsipras calls a confidence vote about the EU bailout deal in 2015, a public sentiment might show that many among other Euro member states harbor a negative stereotype toward the Greek people and the future of the Eurozone economy. The skepticism on sustainability of the common currency union became more widespread because, obviously, the European policy makers did not have a magical wand to address the Greek issues. The pessimistic views revealed on the titles of articles on tabloids or elites papers might easily spark a populistic or nationalistic sentiment against the regional integration in Europe. This might make difficult to foster further economic growth in the EU, while the other developed economies such as the US could have recovered and moved to the next phases of economic growth.

However, the source of triple crisis, the balance of payments crisis, the banking crisis and the sovereign debt crisis, which the EU has faced, are not Euro-specific issues at all. Speaking of the banking crisis and the sovereign debt crisis, most of the developed countries had faced similar problems in the years after the global financial crisis. Also, the balance of payment crisis would possibly happen in any economies, when the huge capital inflows follow the asset bubble in the financial market and sudden capital outflows leads the fall in asset prices and exchange rates. Therefore, this paper does not address primitive discussions about the possibility of collapsing the Economic and Monetary Union, which is the Euro-specific regime. Obviously, the author regards that the lack of political and social cohesion among the Eurozone countries, rather than the single currency, makes it difficult to foster further growth,

What are the lessons of the Eurozone crisis? The banking crisis could be included into the sovereign debt crisis, because the banking problem should be calmed by the public funds injections. The public injections could solve short-term problems for financial environments, by mitigating liquidity constraints, credit constraints, and market pessimism and current losses on the balance sheets of the damaged banks. However, the injected money could not expand future gains, or increase competitiveness of the banking sector, and it would only accumulate the government debt. Moreover, to support the economic recovery and assure sustainable economic growth in the long run, the governments had to expand their fiscal expenditures as investments for their future. The huge amount of money financed by the government bonds turns the banking problems into the sovereign debt problems soon or later. The acceleration of government debt accumulation might become severe as the sovereign debt crisis.

Therefore, one of the lessons from the Eurozone crisis is the sovereign debt. As the author pointed out, it was a major step in crisis resolution that the ECB has become now ready to purchase government bonds of stressed countries as a lender of last resort for sovereigns. This was crucially helpful to the Periphery countries which had accumulated huge government deficits. After launching Outright Monetary Transactions, market pressures on the CDS for government bonds seem to have become eased to the levels before 2012.

Apparently, the other lesson of crisis is the balance of payment crisis.

This paper is spared for the justification and evaluations for "Monetary policy measure." This topic is related to the questions such as how the EU member states can solve the low growth problem. When the central banks in the developed countries adopt the inflation targeting monetary policy, they assume that the monetary policy might affect the future expectations through the effect of forward guidance. The announcements of the longer-term political commitment to the inflation rates

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by the central bank contribute to increasing current demand. The forward guidance is regarded as a more powerful tool to stimulate economic demand than the traditional monetary policy tools.

As the author pointed out, the ECB's political commitments have been very weak so far. To successfully adjust productivity competitiveness in the Southern European countries, the inflation there has to be even lower than in the core countries. Although the ECB's commitment to 2% inflation rate might be enough for the core countries' economies to stimulate their demand, the level might be too high for the periphery to prompt a decrease in the relatively high wage level. If the average euro inflation rates were too low, the forward guidance effect would be weak. Although the ECB's monetary policy supports economic growth as an engine, the dilemma originated from this "one-size fit all" policy measure might be a crucial obstacle for further economic growth.

As the Fed introduced the unemployment rates as another political measure to continue the monetary easing effectively, the ECB should not focus their monetary policy target on inflation only. Especially, the historically very high unemployment rate in the mid and periphery Euro countries should be addressed by other political options.

However, the policy response by the EU institutions, such as the Junker investment plan, was ineffective in addressing the high unemployment problem in the periphery. As the author pointed out; "the actions against insufficient investments in the EU were for long more a slogan than a real action plan." The effective investments should be implemented. Expanding investments would be one of growth engines to foster further economic growth in Europe.

After mid-2015, the European countries have faced the European refugee crisis and a fear of terrorism. Hence the readers would ask that whether the Eurozone crisis is over, or it is the calm before another storm. How can the EU member states handle these new challenges? The author mentioned in the introduction; "*The support for further solidarity and integration is limited. More nationalistic approaches dominate, while the support for democracy is weakening in the hardest hit countries. This development is especially worrying, since democracy is the core principle on which the EU is built.*"

Under these difficult situations, each of the member states has to control or manage reactionary sentiments against the immigration issue. The immigrants from outside Europe might make it difficult for the intra-euro adjustment to foster economic growth. Once the regional collective actions on refugee issues fail, "anti-EU sentiments" among the EU member states would arise and never disappear. It would become a fateful crisis. Therefore, the EU member states have to strengthen their political and social cohesion to handle these new challenges, subjecting to further economic stability in Europe, as Dr. Darvas has argued.

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Post global financial crisis Ireland:

A 'model' of economic recovery?

Bernadette Andreosso-O'Callaghan

Introduction

During the first phase of the so-called 'celtic tiger' expansionary period (1994-2000), Ireland enjoyed the fastest growth rate of all OECD countries. The catching-up of the country towards the highest per capita GDP levels in the European Union was made possible by a successful growth model of rapid industrialisation-by-invitation with large inflows of inward foreign direct investment (FDI) being invested in the country, mostly from the USA, in line with the long phase of economic prosperity enjoyed by the USA at the time, the longest indeed in its economic history (Field, 2007). This was followed by a second economic boom period (2000-2007/08), period during which economic growth and employment growth were fuelled by credit expansion and by an unprecedented property boom (Nolan *et al.*, 2014), a phenomenon that can in short be referred to as the period of 'financialization' of the Irish and other western economies (Krippner, 2005; Orhangazi, 2008; Zwan, 2014). The economic success was such that according to The Economist (2005) magazine, Ireland ranked first in 2005 in terms of the magazine's Quality of Life Index based on variables such as material wellbeing, job security, political stability and security.

The 'financialisation' of the Irish economy during the second 'celtic tiger' period, with its oversized property and banking sectors, was gradually becoming apparent with the analysis of several key macroeconomic indicators. First, the construction industry accounted for 9 per cent of GDP in 2007 (CSO, 2008). In the second quarter of 2007, the average price of a new house in Ireland increased to its highest level at a staggering €331,000 (CSO, 2015), compared with an annual pre-tax average industrial wage of €32,616 at the time (CSO, 2007). Second, the level of household's indebtedness increased dramatically during the 'celtic tiger' period. For example, credit card debt soared from €102 per capita to €707 in 2008 (Russell *et al*., 2012). In 2008, the extent of the private debt problem was exceptionally high in EU terms, and it was still the fifth highest in the euro-area in 2013 (Whelan *et al*., 2015). Third, an over-sized banking sector was visible through the building-up of non-performing loans (NPLs) which eventually became the main issue to tackle in the aftermath of the property collapse. NPLs were valued at €64bn in the Autumn 2009, representing more than 40 percent of yearly GDP at the time, although their pre-crisis cost was close to €90bn. The setting up of the National Asset Management Agency (NAMA) at the end of 2009 was aimed at recuperating as much value as possible from these distressed assets. Although many of the NAMA-managed properties were gradually being sold, the domestic banks were nevertheless left with the issue of problematic mortgages. The stock of mortgages in arrears peaked in Q3-2013, but during the first quarter of

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2014, more than a quarter of all loans (27 per cent) were still 'non-performing', with the Irish banking sector continuing to report losses (BNP Paribas, 2014) despite the massive injections of public money. As investigated by McCarthy (2014), in 85 per cent of reported mortgage arrear cases, the head of the household was actually in full employment. This situation inherited from past beggar-thy-neighbour (or totally irresponsible) behaviour implies that non-performing housing loans are a lasting problem of contemporary Ireland and that they are placing enormous constraints on bank loans for domestic investment.

Ireland officially entered the recession in 2008 as the country experienced negative growth in GDP over the first two quarters of that year (CSO, 2012). As argued elsewhere, what started as a subprime crisis in the USA became eventually a euro crisis thanks to propagation effects materialising through the Irish door (Andreosso-O'Callaghan, 2013). A negative growth trend ensued as real GDP growth fell in 2009 to between a low -6.4 per cent, according to Department of Finance figures, and -7.1 per cent (ESRI, 2010). Consequently, residential construction declined in cumulative terms by approximately 80 per cent between 2006 and 2012 (BNP Paribas, 2014).[1] According to CSO figures, unemployment rose from less than 5 per cent in 2005 to nearly 15 per cent in 2012, investment rates fell to an all-times low and domestic consumption shrank severely.

The objective of this contribution is to present briefly the main policies introduced aimed at dealing with the crisis and their impact (part II). Part III will discuss the current puzzle characterising the current Irish economy, which can be summarised as: jobs without growth and growth without jobs. The analysis is aimed at uncovering what is behind the relatively high growth rates of 2013 and 2014 and what trends can be foreseen for the near future. Do these trends allow the observer to see the Irish economy as a 'model' of post-2008 crisis economic recovery?

II. Policies introduced to deal with the crisis and their impact

Quick-fix policies first looked at the hot issue of potentially *zombie* banks crippled with their NPLs. The NPLs of these banks, including those of the most vulnerable of them - Anglo-Irish Bank which was eventually let to 'wind down' - were transferred to the NAMA structure, the newly-created bad bank. When coupled with the Irish government bank guarantee of September 2008,[2] this implies that, in spite of the unprecedented severity of the crisis, most of the Irish (domestic) banking structure remained unchanged. Through a massive injection of taxpayers' funds, the Irish banking sector was recapitalised (and nationalized partially in some instances) so as to keep instilling confidence in the euro-area market. Other measures such as the reform of bankruptcy, authorisation of home repossessions (although very marginal when compared with Spain and other countries), loan restructuring (such as a moratorium on debt servicing) have also been introduced to deal with the problem of mortgage arrears. Not allowing any Irish banking institutions to

[1] Note that real estate prices started rising again between the summer 2013 and December 2014.
[2] The Irish government announced on 30 September 2008 a guarantee of all banks' loans and deposits to the height of €440bn, or nearly three times the country's annual GDP at the time.

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collapse *à la* Lehman Brothers implied the acceptance in November 2010 of the IMF, European Central Bank and EU Commission's *forced* €67bn bail-out package with stringent macroeconomic conditions attached to it, institutionalising thereby a prolonged period of economic austerity. These austerity policies encompassed the downsizing of the public sector, the increase in personal income tax, of indirect tax, and the introduction of other taxes such as a property tax and a so-called 'Universal Social Charge', as well as the controversial water charges. Meanwhile, the 12.5 per cent corporation tax rate remained unchanged, as this has been repeatedly presented in EU circles as the 'fig-leaf' of Irish industrial policy (Andreosso-O'Callaghan *et al*., 2014). Finally, other important measures have centred around the idea of allowing Ireland to become once again price competitive on a world-wide basis. This has implied a downward pressure on labour costs (or internal devaluation) in the hope that growth would be rejuvenated through exports. Interestingly, the export-led growth model, which at the very same time was very much criticised in Chinese political and economic circles as being rather *passé*, was becoming fashionable again in an EU economy that once boasted among the highest GDP per capita performance.

Seven years after the burst of the Irish property bubble, the impact of the sharp 'adjustment' on the economy as a whole leads to a series of rather mixed results. As shown in table 1, growth seems to have resumed since 2011 – although it dipped again into negative figures in the following year - , and the various equilibria in public finance (a primary objective in EU circles), have been restored with for example a shrinking exchequer deficit. Note that the exchequer deficit at 5.7 per cent of GDP in 2013 is seen in the eyes of the EU Commission as being, for a large part, of a structural nature. The explosion of the general government debt (at 123.3 per cent of GDP in 2013) has eventually become less of a concern with the change in the presidency of the European Central Bank in November 2011 and its eventual and gradual initiation of a quantitative easing policy; the concomitantly unprecedented low interest rates have meant that, for example, 10 year interest rate yields on Irish government bonds fell to a low 1.18 per cent in May 2015.

Table 1: Macroeconomic Indicators - Ireland (*annual % change unless otherwise specified, 2006-14)*

	2006	2007	2008	2009	2010	2011	2012	2013	2014	Source
(1) Real GDP	5.5	4.9	-2.6	-6.4	-0.3	2.8	-0.3	0.2	4.8 (e)	DoF, Dublin
(2a) HCPI	2.7	2.9	3.1	-1.7	-1.6	1.2	1.9	0.5	0.3	Eurostat, Luxembourg
(2b) CPI	4.0	4.9	4.1	-4.5	-1.0	2.6	1.7	0.5	0.2	CSO, Dublin
(3) General government debt (% of GDP)	24.6	24.9	44.2	64.4	87.4	111.1	121.7	123.3	110.5(e)	DoF, Dublin
(4) Unemployment rate	4.5	4.7	6.4	12.0	13.8	14.6	14.7	13.1	11.3	CSO, Cork

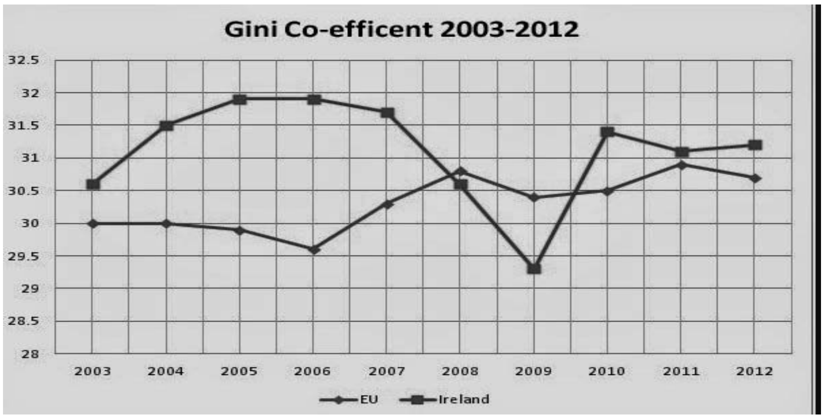
(5) Investment (GFCF)	9.4	1.4	-16.7	-26.9	-21.2	-4.5	8.6	-1.8	14.5	Own Eurostat based calculations. CSO for 2014
(6) Household final consumption expenditure	6.6	6.7	-0.2	-5.9	0.4	-1.1	-1.4	-0.4	1.1	Eurostat, Luxembourg
(7) Exports	0.0	2.8	-3.2	-0.7	4.5	1.7	0.5	-5.1	2.4	CSO, Own Calculation
(8) Current account (% of GDP)	-3.6	-5.4	-5.7	-3.1	0.6	0.8	1.6	4.4	4.9 (e)	CSO for 2014 DoF, Dublin
(9) Exchequer Surplus/Deficit (% of GNP)	1.4	-1.0	-8.0	-17.8	-13.6	-18.1	-10.5	-7.8	NA	DoF, Dublin
(10) Government budget balance (% of GDP)	2.9	0.2	-7.4	-13.7	-30.1	-12.6	-8.1	-5.7	-3.7 (e)	DoF, Dublin

Key: DoF: Department of Finance, Dublin. CSO: Central Statistics Office, Cork and Dublin. HCPI: Household Consumer Price Index. GFCF: Gross Fixed Capital Formation.

These macroeconomic indicators show overall an improvement in the fundamentals of the Irish economy, although they do not allow the analyst to discern a definite linear trend. The ability of Ireland to exit the bail-out package on 15th December 2013, a sign that the country had 'delivered' in terms of economic reforms, must nevertheless be appraised in parallel with a number of other performance indicators; we will focus here on socio-economic as well as manufacturing investment and innovation indicators. These indicators are of primary concern to any government interested in the issue of sustainable (or long-term) economic development.

With regard to the socio-economic impact of the adjustment measures, how detrimental to social cohesion have these austerity measures been? What is striking about the Irish adjustment package is that the different measures have fallen disproportionately on the labour factor of production, with declining earnings due to wage cuts particularly in the public sector, and therefore with declining net incomes explained also by a high fiscal burden (Callan *et al.,* 2013). Not surprisingly, the Gini coefficient, as a first measure of social cohesion, shows how inequality has risen more in Ireland as a result of the different policy measures, when compared with the EU as a whole (Figure 1). What is also astonishing about such figures is that income inequality did not recede during the 'celtic tiger' period, but that it has in fact even been increasing during some of the 'celtic tiger' years, as shown in figure 1.

Figure 1. Gini Coefficient – Ireland and the EU (2003 – 2012)



Source: EUROSTAT, Luxembourg.

Whether the resulting phenomenon is that of a 'middle class squeeze' remains an open question. The differentiated impact of the austerity measures on the different income groups, age groups or social classes is studied by Whelan *et al.* (2015). This study uses a common measure of poverty, which is 60 per cent of median equivalised household income, combined with economic stress and material depravation variables to assess the full extent of the crisis on poverty.[3] Whelan *et al.* (2015) identify five income categories[4], and by using different econometric tests, the authors arrive at the following main conclusions, highlighting the life-cycle characteristics of households. Income stress levels have increased across all income groups for the 35 to 64 years old group. For the younger cohort, *i.e.* those aged less than 35 years, only the income poor have seen a decreased in their level of income stress. For the older cohort (65 years plus), income stress levels have decreased for the less well off (the income poor), and also quite paradoxically for the affluent class. As a result, the 'middle class squeeze' is rather, in the Irish case, a 'precarious class squeeze' and a 'lower middle-class squeeze'.

Another long-term performance indicator relates to investment and innovation policy. According to CSO data, the rate of Gross Fixed Capital Formation (GFCF) averaged 22 per cent of GDP over the period

[3] Equivalised implies taking into account the composition of the household with the first adult being given a weight of 1, each additional adult 0.66 and each child 0.33. Economic stress variables include the ability of households to pay their mortgage and other debts and to their ability to save. Material deprivation variables encompass for example the ability to possess or buy certain basic goods and services such as heating for the house. The data are drawn from the Survey on Income and Living Conditions (SILC) for Ireland, which is a voluntary survey, covering between 4,300 and 6,000 households between 2004 and 2011.

[4] These categories are as follows 1. Income poor or less than 60 % of median equivalized income, 2. Precarious income class or 60–75 % of median equivalized income, 3. Lower middle income class or 75–125 % of median equivalized income, 4. Upper middle income class or 125–166 % of median equivalized income, and 5. Affluent class or with an income greater than 167 % of median equivalized income.

1971-2008 and fell to a low 10 per cent in 2011 and 2012. This is less than half the OECD average, half the euro-area average and substantially lower than that of other crises-stricken countries, such as Italy and Spain. As shown in Table 1, the contraction of GFCF was particularly severe in 2009 and 2010, whereas this variable continued to decrease by between 2.4 and 1.8 per cent in 2013, according to either BNP Paribas (2014) or EUROSTAT data respectively. What is somewhat reassuring is that the severe drop of 2008-2010 has been followed by a surge of investment in 2014. Here again, the sinusoidal path of the GFCF variable since 2006 does not unfortunately allow us to bring a solid conclusive avenue. These unprecedented low investment rates tend to introduce and accentuate the phenomenon of de-industrialization, which has become an uncontested and visible phenomenon in the EU as a whole since the crisis, even allowing for the small statistical discrepancy arising from its measurement.[5] A changing international division of labour which, - through shifting comparative advantages due to labour cost differentials leads the different EU countries to specialize increasingly in services areas such as the UK in financial services -, is the main reason for de-industrialization in the EU as a whole. In the case of Ireland, the case for policies aimed at sustaining and fostering a strong (domestic) manufacturing base has been reiterated at the outset of the global financial crisis (see Andreosso-O'Callaghan and Lenihan 2011). The rationale for these policies is well-known and it lies in the fact that, despite industrial change, the manufacturing sector still remains the core element of the value added chain:

- In terms of nurturing skills, as well as a certain industrial tradition (Marshall, 1899).
- In terms of its driving effect, through derived demand, on the services sector and on the economy as a whole.
- In terms of its contribution to R&D which typically represents more than 60 per cent of a country's total (private-sector) R&D spending (Kroker and Lichtblau, 2013).

Consequently, a strong manufacturing base is paralleled with a reservoir of highly skilled workers and it supports the demand that it generates for business-related activities and for other services. Conversely, a shrinking manufacturing sector weakens the whole future industrial potential of a country and increases the vulnerability of a country.

Uncertainty in terms of the viability of an industrial model in the future can be gauged also from some basic innovation indicators. Table 2 (in the Appendix), shows a number of input and output indicators of innovation for the years 2006-2013. Input indicators, such as the growth in the number of researchers in relative terms, show a decrease in 2009-2010, whereas the expenditure on education as a share of gross national income (GNI) has been either contracting in 2010 or flat since 2012. Output indicators such as patents and gross value added (VA) of both education and scientific research and development show a

[5] For more on this issue, the interested reader can refer for example to Heymann and Vetter (2013). Note that the boundaries between manufacturing and services have tended to become somewhat blurred, with the increased incidence of outsourcing in the past few decades and with services companies driving some of the current change (Google for example entering the biotechnology sector, in the area of age-related diseases; see Berger, 2014).

negative performance during most of the 2006-2013 period.[6] In particular, although the gross VA of scientific R&D has kept increasing between 2008 and 2010, it has declined since. Some of the increase visible during these years can be explained by already committed funding for research as opposed to a new wave of capital injection for R&D purposes.[7] The decline of the gross VA in Irish education for most of the period under review is probably the most striking observation emanating from Table 2. Moreover, gross domestic expenditure on R&D has declined during the period 2009-2012 (Table 3), with most of the decline explained by a drop in the higher education sector.

Table 3 - Gross domestic expenditure on R&D by source of funds in Ireland (based on current euro figures)

	2007	2008	2009	2010	2011	2012	2013
Total (funding sector), of which:	9,91	13,61	-2,77	-2,81	-11,00	-0,14	1,00
Business enterprise	36,36	52,00	-12,28	-18,50	-15,34	-15,22	-15,21
Higher education	654,72	-7,00	-19,35	-20,00	-19,58	-19,69	-19,69

Source: OECD (2014) Science Technology and Industry Outlook, Paris

Whereas, thanks to its 'celtic tiger' period, Ireland had once managed to start pulling itself in the league of other innovating countries such as the UK (although still considered as an 'innovation follower'), the adjustment policies in response to the 2008 crisis seem to have seriously jeopardized this trend. As a result of policies that focused primarily and exclusively on the financial and banking sector, Ireland now stands out as a country left profoundly hurt when it comes to its innovative performance and potential. As Table 4 shows, the relatively low GERD to GDP ratio at the beginning of the period declined from a small peak at 1.69 per cent in 2009-2010; this needs to be appreciated in the background of a decreasing, or at best constant, GDP. The situation is such that in 2012, Ireland's ratio was lower than that of the EU-28 average and substantially lower than that of a new and poorer EU-member country such as Slovenia.

Table 4: Gross Expenditure on R&D (GERD) as a percentage of GDP (2007-2012), Ireland compared to other small EU economies

	2007	2008	2009	2010	2011	2012
Denmark	2.58	2.85	3.16	3	2.98	2.98
Finland	3.47	3.7	3.94	3.9	3.8	3.55
Greece	0.6	..	..	..	0.67	0.69
Ireland	1.28	1.45	1.69	1.69	1.61	1.66
Slovenia	1.45	1.66	1.85	2.1	2.47	2.63
Sweden	3.43	3.7	3.62	3.39	3.39	3.41
European Union (28 countries)	1.76	1.83	1.91	1.91	1.95	1.98

Source: OECD (2014) Science Technology and Industry Outlook, Paris.

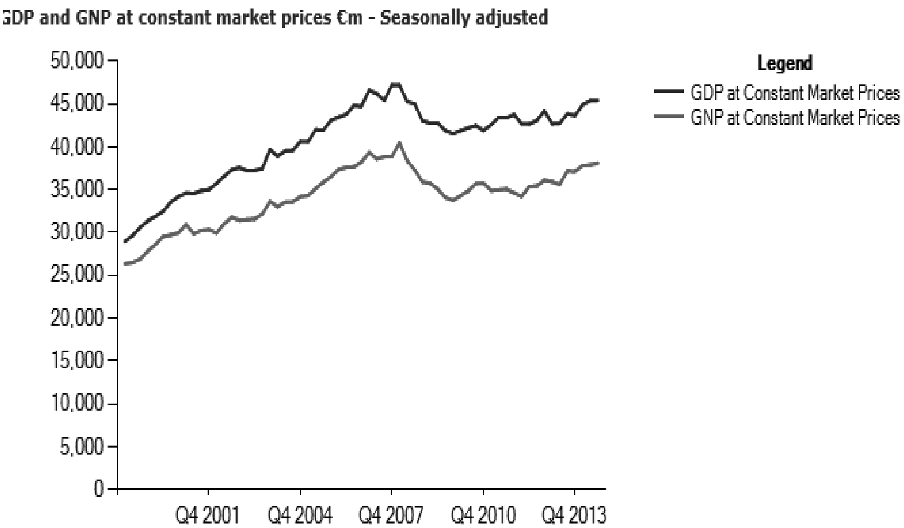
[6] Data on patents must however be analysed with some caution as they are subject to the cyclical feature embodied in 'patent cliff' (see BNP Paribas, 2014).
[7] As has been the case since with, for example, the Irish Government's announcement in March 2011 of euros 24 million being injected in view of developing five different areas of scientific research. These corresponded to already committed funds.

The implementation of the so-called 'smart economy' initiative (Department of an Taoiseach, 2008) that was still predicated on sustained investment in research and development seems to have been called into question. With a much reduced margin of manoeuvre in terms of public spending as evidenced by the conditional bail-out package and its aftermath, the Irish Government stopped its injection of funds in the area of research and third level education (Table 3). Timid industrial policy measures such as the *enterprise stabilisation fund* aimed at stimulating GFCF, the *back to work allowance* as well as the *jobs initiative* announced in May 2011 that comprises a reduced VAT rate for jobs in the tourism sector, and the *internship scheme* have been insufficient measures that have not satisfactorily addressed the pressing double issue of domestic investment revitalisation and human capital development.

3. Explaining post crisis economic growth in Ireland

After prolonged negative growth during the years following the crisis (Figure 2), the growth rate of GDP stagnated in real terms at 0.2 per cent in 2013 and is estimated by the Central Statistical Office to have reached 3.5 per cent in 2014 (4.8 per cent according to EUROSTAT figures).

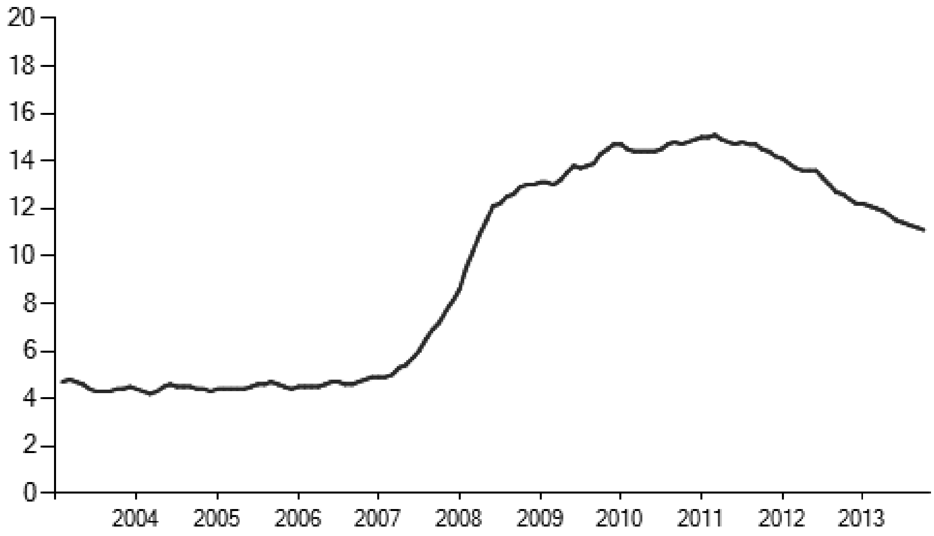
Figure 2. Growth rates 2001-2013



Source: CSO, 2015, Cork.

During the post-crisis period, the evolution of GNP growth rates has been rather puzzling. Given the large multinational enterprise sector of foreign-owned firms transferring their profits generated in Ireland, there has traditionally been a substantial difference between GDP and GNP measures in Ireland, with the former outstripping the second measure by 16 per cent over the past 10 years or so (BNP Paribas, 2014). In 2012, a change in this trend appeared with GNP growth rates outpacing stagnant GDP growth rates. GNP grew by 1.9 per cent in 2012 (when GDP was still contracting) and by 3.2 per cent in 2013 (when GDP was stagnating). According to FitzGerald (2013), a large part of the explanation in these differences resides in the domiciliation (in Ireland) of US public limited companies (plcs). By establishing a legal presence in Ireland, the profits of these companies, mostly generated in the rest of the world, are paid to them in Ireland and taxed in Ireland, with the help of double taxation agreements and although their tax liability for the profit repatriated in Ireland would theoretically arise in other jurisdictions. *In fine*, the domiciliation exercise allows these companies to enhance their value and consequently the recorded inflows of these domiciled plcs' retained earnings (or profits) into the economy are solely attributed to their foreign owners. From a macroeconomic viewpoint, the effect is that domiciliation raises the current account surplus in the Irish balance of payments and increases the level of nominal GNP with no benefits at all in terms of investment or jobs to the Irish economy.

Figure 3. Unemployment rate 2003-2013



Source: Central Statistical Office, Cork, 2014.

These recent trends in GDP and GNP growth rates tend to create a disconnection between economic growth and employment growth. As can be gathered from figure 3, employment rose in 2013 although real GDP stagnated. During that year, the agri-food sector was the biggest provider of new job opportunities which explains a small part of the growth in GNP in 2013 (growth-less jobs). During 2014, employment growth was only slightly more vigorous than during the previous year but GDP growth reached an estimated 3.5 to 4.8 per cent (jobless growth).[8] As of December 2014, the official unemployment rate is down to 11.1

[8] The year 2014 has been a relatively good year on the jobs front in Ireland. Some 14,000 full-time jobs were created during that year, but this has to be examined in the background of about 7,000 jobs destroyed in the economy for the same year. Some

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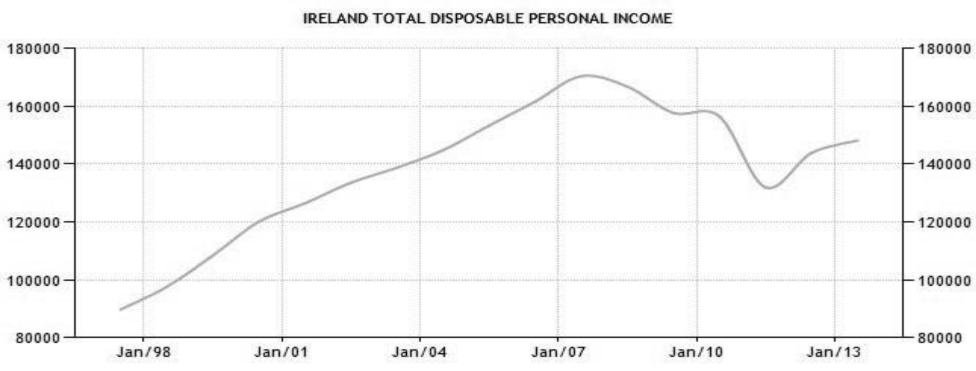
per cent with 239,500 unemployed people. However, if one adds the 75,600 unpaid or low-paid people in public internship schemes and other schemes, the unemployment rate reaches 14.6 per cent (Finfacts Business News Center, January 2015). In addition, the CSO Quarterly National Household survey shows that some 124,000 part-time workers (or 6 per cent of the labour force) wish to be in full-time employment. When these full-time positions are taken into account, the rate of effective unemployment would reach 20.6 per cent (without taking into account the figures denoting the large outflow of labour since 2008).

At this juncture, it is worth examining what factors are behind what is commonly referred to as the 'economic recovery' in Ireland, judging by positive GDP and GNP (depending on the case) growth rates. We have seen that, overall, supply-side explanatory factors such as investment (GFCF) and technological innovation have been lethargic, a factor explained further by credit rationing for domestic firms combined with limited direct investment inflows. It is clear that most of the explanation for the recovery must be found on the demand-side, namely consumption, either domestic or foreign.

Figure 4. Consumer spending and total disposable income in Ireland (1998-2013)



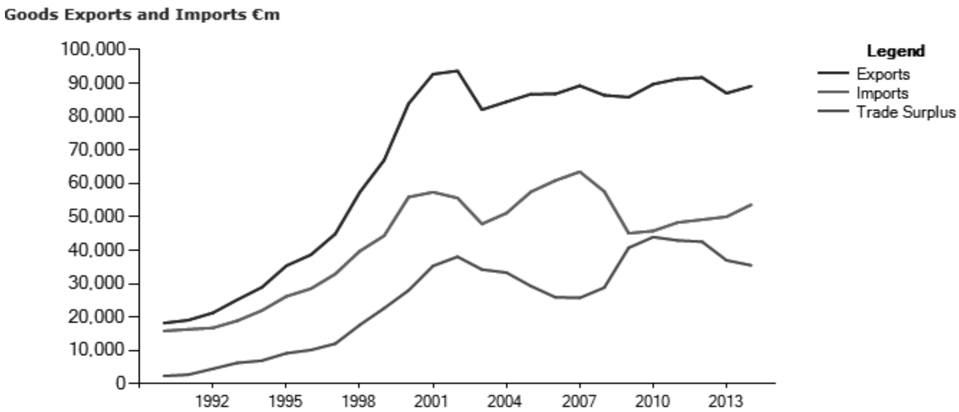
Source: Trading Economics.Com, based on Central Statistics Office Figures, Cork.

estimates show that the Irish economy would need to create 40,000 full-time jobs every year to reach the objective of full-time employment defined as being 2.1 million fully employed people (this corresponds to the pre-crisis figure). In 2014, the labour-force actually declined, a phenomenon which is attributable to the fact that more individuals in the 16-24 age cohort decided either to stay in education or to go back to education.

As shown in figure 4, personal consumption declined by 2.5 per cent between 2008 and 2013 (at current prices). Household consumption continued to fall by 0.8 per cent in 2013 and stagnated during the first quarter of 2014 (BNP Paribas, 2014). During 2014, average earnings continued to fall, in spite of some industries experiencing pay growth such as in the case of the hospitality sector (+5.3 per cent). The November 2014 budget was the first post-crisis budget that has given some consideration to domestic demand as a potential engine of future economic growth. This might explain the small increase of 1.1 per cent of household consumption expenditure during that year as shown in table 1.

Needless to say, a final important explanatory factor that accounts for a great deal of the recovery is foreign demand. In particular, the role of exports by multinational enterprises in the pharmaceutical sector needs to be acknowledged. One characteristic of the 'celtic tiger' has been, owing to its size, its over-reliance on international markets. This trend has tended to be amplified by the reactive policy measures after 2008. This reliance is such that the country's ratio of total exports of goods and services to GDP stood at more than 114 per cent in the first quarter of 2014 (this compares with 40.1 per cent for Portugal, 31.3 per cent for Spain, 28.8 per cent for Italy and only 28.4 per cent for Greece, according to Eurostat external trade figures). Figure 5 shows an improvement in the trade surplus from 2008, although here again, a definite linear trend cannot be inferred.

Figure 5. Trade performance (1991-2014. Goods exports, imports and balance)



Source: CSO, 2015, Cork.

The positive trade balance has been consolidated since the advent of the global financial crisis and the recent Irish export performance is remarkable particularly in 2014 with an increase of more than 5 per cent over the previous year when world trade was almost flat. The main products accounting for the surge of exports have been dairy products and baby food (to China) which is consistent with the employment growth figures and some of the GNP figures discussed above. According to the Irish Exporters Association, the largest single exporters are nevertheless drawn from IT-related and pharmaceutical fields. These are Google (€17bn exports in 2014), Microsoft (€15bn), Johnson and Johnson (€10.5bn) and Pfizer (€5bn). The main export oriented industry is pharmaceuticals representing 28 percent of total Irish export. Unfortunately, a vigorous export-oriented sector has not been a sufficient vehicle for invigorating renewed growth trends in the Irish economy, at least to the extent that was envisaged by the IMF, ECB and EU Commission in 2010.

Conclusions

Severe adjustment policies inflicted upon the Irish economy after the burst of its property sector in 2008 have led to rather mixed results. The various equilibria in the public finances have been successfully restored with for example a debt to GDP ratio declining substantially since 2014. Real GDP growth has been positive since 2013 and unemployment shrank (although more on paper than in reality) by nearly a third since its peak in 2011. What is of utmost importance in the Irish case is that, in the case of most of its macroeconomic indicators and with the exception of exports, definite (linear) trends have not as yet been discernible. For example, real GDP and GNP performance has tended to follow a sinusoidal path, which on the one hand mirrors the fragility of recovery in the euro-area, and which on the other hand masks some specific features of the Irish economy such as the disconnection between economic growth and employment growth, without commensurate productivity growth. An indisputable commendable performance is in terms of trade performance, partly a result of the rediscovery by the Irish government of the key role that a sector such as the agri-food sector can play in an economy and partly as a result of the 'internal devaluation' policy.

Whether these mixed results were worth the severe adjustment policies is highly debatable. All they suggest is a disproportion existing between the meagre results achieved (if one focuses solely on the Irish economy) and the severity of the adjustment costs which, as we have shown here, are twofold. First, by falling disproportionately on the labour factor (and on households), adjustment policies have tended to increase the disparities in terms of income distribution and they may have further jeopardised social cohesion in Ireland. Second, adjustment policies seem to have tolled the bell of the EU Lisbon Strategy; indeed, innovation, human capital formation and the availability of credit for innovative indigenous firms has not been very much a priority on the agenda of Irish policy making since the crisis. In particular, low investment rates in scientific research and development for a few years are of particular concern, as they damage seriously the ability of a country to embark upon a sustainable economic development path.

Acknowledgements

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Appendix

Table 2 – Selected innovation indicators for Ireland

Annual % change (unless otherwise specified)	2006	2007	2008	2009	2010	2011	2012	2013	Source
Researchers in R&D (per million people)	3.4%	2.7%	12.6%	-3.5%	-1.4%	5.7%	4.7%	NA	Derived from Worldbank data
Education expenditure (% of GNI)	0.0%	4.0%	13.5%	20.3%	-1.4%	1.4%	0.0%	0.0%	Derived from Worldbank data
Patent applications (residents and non-residents)	8.2%	-1.1%	8.9%	-4.6%	-17.6%	-29.2%	-1.1%	-29.7%	Derived from Worldbank data
Gross Value Added of Scientific research and development and of education (Constant Basic Prices)	-2.3%	0.7%	-2.7%	-1.8%	-2.1%	-1.7%	-2.2%	-1.1%	Derived from CSO
Gross Value Added of Scientific research and development (Constant Basic Prices)	2.6%	-3.4%	4.0%	3.8%	1.2%	-4.9%	-2.1%	-2.2%	Derived from CSO
Gross Value Added of Education (Constant Basic Prices)	-2.4%	0.8%	-2.8%	-2.0%	-2.2%	-1.6%	-2.2%	-1.0%	Derived from CSO

http://databank.worldbank.org/data/ accessed on the 7th May 2015 and CSO available at http://www.cso.ie/

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Prospect of New EU Member States for the Euro Adoption: Based on Small Countries' Experiences

Yoji Koyama

1. Introduction

In May 2004, 8 countries from CEE, i.e. Poland, the Czech Republic, Slovakia, Hungary, Slovenia, Estonia, Latvia and Lithuania were admitted to the EU. In January 2007 Romania and Bulgaria, and in July 2013 Croatia were admitted to the EU. Among 11 New EU Member States (NMS) from CEE, 5 countries adopted the euro one after another, first Slovenia (2007) followed by Slovakia (2009), Estonia (2011), Latvia (2014) and Lithuania (2015). One of the important challenges facing NMS after EU accession is to join the Economic and Monetary Union (EMU), i.e. adopt the euro, after having satisfied the Maastricht convergence criteria. At present 6 out of 11 NMS from CEE have not adopted the euro yet. They are not allowed the right to opt out as the UK and Denmark have had, and they are requested to eventually adopt the euro. These countries have their own problems.

This paper considers the prospect for euro adoption by reviewing the experiences of NMS which have adopted the euro and by presenting main issues which have been discussed in the book that I have edited (Koyama, 2016).

2. Experiences of NMS which have already adopted the Euro.

1) Positive Experiences

In the case of Slovakia, for a while, prior to the EU accession (1997-1999), the country was classified as the second wave due to a delay in reforms in the country. Finally the distinction between the first and the second waves was removed and Slovakia became able to join the EU in 2004 together with other countries from CEE. Due to its bitter experience in 1997-1999, Slovakia actively chose its early entry into the EMU in order to get rid of its uneasiness of non-EMU membership and joined the EMU in 2009. The automobile industry, in which foreign automobile producers invested during the period of the Dzurinda government, has been leading exports from this country, and therefore, the Slovak economy has been doing well, although its economic growth was interrupted for a while by the 2008 global financial crisis.

2) Bitter Experiences of Two Small Countries

Critical situations in periphery countries in Southern Europe including Greece (Ireland is included in this case) have attracted attention, but situations in NMS in CEE were also serious. Here cases of 2

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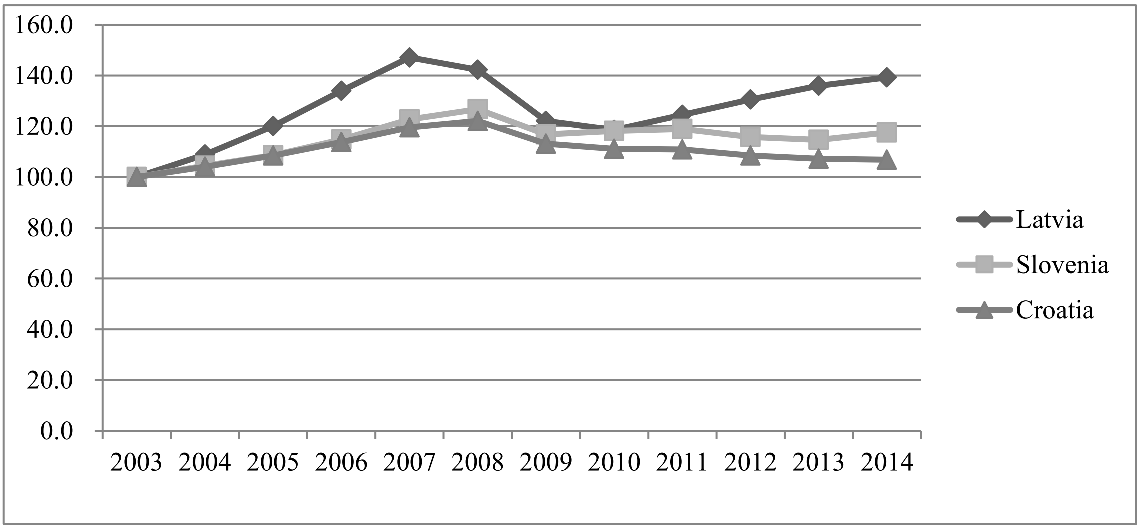
countries, Latvia (population as of 2014 is a little less than 2 million) and Slovenia (a little more than 2 million) are discussed. Inflows of foreign capitals in these countries took the following routes: 1) inward foreign direct investment (FDI); 2) portfolio investment; and 3) other investments (funds transfer from parent banks to local branches and between banks), among which 1) and 3) are important. An analysis of the movement in inflows and outflows of capitals is represented by Latvia's case.

Latvia

Latvia, one of the Baltic States, has had common characteristics with Estonia and Lithuania. After the independence from the Soviet Union in September 1991 Latvia aimed actively at participation in the Western economy, joined the EU in 2004 and adopted the euro in January 2013. The Baltic States have actively attracted foreign capitals. Foreign capitals, which had flowed into these countries since the mid-1990s, greatly contributed to their economic development bringing about 2-digit economic growth rates in the mid-2000s.

The share for manufacturing has been very small. FDI inflow concentrated mainly in non-tradable sectors such as retail trade, real estate and financial services. At the same time, Nordic banks advanced to the Baltic States. Swedish banks in particular were very active. Nordic banks' strategies toward the Baltic States were viewed by Estonian economists as follows: "The Nordic banks opted for aggressive business strategies to gain market share and set nominal interest rates and other loan conditions at levels quite similar to those in their home markets (Hansson and Randveer, 2013, p. 6). All of the Baltic States were hit hard by the 2008 global financial crisis and recorded a 2-digit negative economic growth in 2009. Among them Latvia's case was the most serious.

Figure 1 GDP Growth Rates in 3 Countries



Source: Prepared by the author based on data from the Eurostat.

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In Latvia the economic growth rate was as high as 12.2% in 2006. The inflation rate soared reflecting a consumption boom and a housing bubble. As the inflation rate was so high, from the end of February through early March 2007 the Lat, the Latvian currency, came under pressure of depreciation on the foreign market and the central bank was forced to intervene in the market for the first time in several years. The government of Latvia finally switched its policy to manage aggregate demand more actively and launched a package of measures geared to delivering a durable reduction. The restrained policies began to be effective in autumn. Property prices started to decline and by October were around 12% lower than at the start of 2007. Thus the housing bubble bust. The Lehman shock in September 2008 dealt the Latvian economy a final blow.

Looking at Table 1, we can find that FDI inflow turned negative in the 4th quarter of 2008 and in the section of other investment assets-banks recorded negative values for three consecutive quarters from the 4th quarter of 2008, meaning net outflow of capital during these periods. Without resorting to devaluation of the Lat, the country responded to this crisis by its people's desperate efforts to improve its export competitiveness by internal depreciation (through the reduction of wages, pension and public services). Latvia has often been mentioned as a successful example of the country which has accomplished a V-shape recovery after the crisis (see Figure 1), but we should not forget the tremendous sacrifice such as the exodus of about 10% of population to foreign countries since the outburst of the global financial crisis. The public debt as a percentage of GDP in 2014 is 40.7%, which is not serious, but the external debt exceeding 140% GDP is a cause for concern.

Table 1

Inflows and Outflows of Capitals in Latvia： From the Fourth Quarter of 2007 through the Second Quarter of 2009

	2007	2008				2009	
	Q4 07	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
Current account	-771,444	-627,842	-627,651	-533,233	-324,662	42,254	478,811
Trade balance	-739,399	-584,950	-562,515	-583,441	-487,146	-138,120	1,853
FDI inflow	190,939	270,322	269,921	209,708	-143,453	15,812	-128,980
Portfolio investment	19,530	302,142	-163,085	19,723	19,398	43,532	48,170
Other investment							
Assets-banks	-853,090	638,142	-356,208	342,011	-86,743	492,653	-215,311
Liabilities-banks	1,148,314	-304,627	899,064	240,324	-575,445	-1,293,496	-501,244

Source: Bank of Latvia, *Quarterly Bulletin Latvia's Balance of Payments*, issues of 4Q 2008 and 3Q 2009.

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Slovenia

Having inherited the tradition of self-management socialism from former Yugoslavia, this country is characterized by neo-corporatism (cooperative relationship among government, managers' association and trade unions' associations), quite different from other post-socialist countries. Its transition to a market economy was carried out in a gradualist way and privatization was implemented with priority being given to insiders. This country has had a relatively high level of technology and strong international competitiveness. Most of Slovenians have been rather cautious about the sale of their productive assets to foreigners. Other countries in CEE have been willing to invite FDI in order to supplement insufficient domestic capitals and absorb advanced technology and managerial know-how. In contrast, Slovenia has not been so enthusiastic in attracting FDI. Rather this country has been more enthusiastic in outward FDI since early time. With exception of 2002 and 2004, the amount of outward FDI exceeded that of inward FDI until 2007. When it was admitted to the EU in May 2004 it had already satisfied the Maastricht convergence criteria and after having joined the ERM II in June in the same year the country was admitted to the EMU, i.e., adoption of the euro in January 2007 earlier than any other NMS. In that sense it was the best performer among NMS. I would like to add that until the mid-2000s its current account had been almost balanced, the budgetary deficit had been small and both public debt and external debt had been relatively small (Table 2).

The euro adoption combined with a neoliberal courses taken by the center-right coalition government caused a sudden increase in inflows of foreign capital, and a bubble economy. In the case of this country, rather banks' borrowing on international financial wholesale markets played a more important role. Slovenian banks borrowed short-term capitals at low interest rates and then provided domestic companies with loans in large quantities. This small country with an open economy was hit hard by the reversal of international capital flow after the 2008 global financial crisis. Although the economy picked up somewhat in 2010-2011, it fell into a serious depression in 2012 under a "double-dip" recession in the eurozone. Since then the Slovenian economy recorded negative economic growth for two consecutive years. A larger proportion of loans provided to the construction sector and financial holding companies became non-performing. It was three major banks under state control that actively gave loans to these companies. These banks suffered from a huge amount of non-performing loans.

Table 2

Changes in Public debt and External debt in 3 Countries

Year		2004	2008	2009	2010	2011	2012	2013	2014
Latvia	Public debt	14.9	19.8	36.7	44.5	42.8	41.3	39.8	40.7
	External debt	92.7	130.0	157.1	166.2	147.0	137.6	133.7	141.6
Slovenia	Public debt	27.2	22.0	35.0	38.6	46.9	53.7	70.8	80.8

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	External debt	56.7	105.3	113.3	114.4	111.2	119.1	116.0	124.2
Croatia	Public debt	37.8	29.3	35.8	42.2	63.7	69.2	80.8	85.1
	External debt	71.6	83.6	97.7	103.6	103.7	103.0	105.6	108.4

Notes: Public debt by definition of the EU; External debt is in gross value.

Source: *Current Analyses and Forecasts*, wiiw, various issues.

The government embarked on the rescue of the banking sector. Transferring most of the non-performing loans to a newly-established "bad bank", the government injected fresh capitals into these banks. Due to this, the country's budgetary deficit finally amounted to a staggering 14.4% of GDP in 2013. Thus the public debt increased rapidly from 22% of GDP in 2008 to 80.8% in 2014. At the same time the gross external debt also increased rapidly from 56.7 % of GDP in 2004 to 105.3% in 2008 and to 124.2% in 2014 (Table 2). In order to decrease the public debt the country has been obliged to take austerity measures. In addition, the Troika (European Commission, ECB and IMF) is pressing the government to promote privatization in the area of infrastructure and make the labor market more flexible

Lessons from the Two Small Countries' Experiences

The small countries in CEE were at the mercy of massive cross-border capital inflow, which caused bubbles in the mid-2000s, suddenly stopped when the Lehman shock occurred in 2008 and then reversed. Due to a decrease in the budget revenue, an increase in social expenditures and the governments' support of domestic banks, the budget deficit expanded. The above-mentioned facts tell us the following two points: firstly, there should be some regulation on cross-border capital flow, at least on short-term cross-border capital flow. Secondly, instead of the principle of home country supervision, Eurozone-wide financial supervisory institutions should be created. Thirdly, austerity can no longer be maintained in the EU member states, and consequently their policy changes are inevitable.

3. Important Issues which have been discussed in the Book

Attitude toward the entry in the EMU

As Gabriela Dragan points out, Sweden fulfils all Maastricht criteria except for the exchange rate criterion. It seems that Sweden has deliberately not fulfilled the convergence criteria by not joining the ERM II, thereby postponing its entry into the Eurozone. The economic support for Greece through the EFSF was a considerable burden for the Eurozone member states. Many people expressed dissatisfaction over contributions to the EFSF. In Slovakia, for example, there was a complaint, "In spite of lower income, Slovakia would have to allocate a lot of money in support of a larger country's support". Finally the proposal by the government was accepted by the parliament in exchange for the

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Prime Minister's resignation[1]. The "threat of solidarity contributions for Greece"[2] is affecting the issue of the EMU entry by non-euro NMS. Probably, these countries are hesitating to enter into the Eurozone and for the time being are adopting a 'wait and see strategy" following Sweden's example (Chapter 9). Most of the non-euro NMS have not set their target dates for euro adoption. It is noteworthy that in such a situation Romania remains the only non-euro member state which has formally set a target date for euro-adoption, which is January 1, 2019. As Dragan says, it might be used in public discourse toward reforms for its likely catalytic effect.

Problems concerning Convergence

As Ryszard Rapacki, Gabriela Dragan and Hiroshi Tanaka point out, a nominal convergence is not enough for entry into the EMU. The Maastricht convergence criteria are called explicit criteria, and a convergence viewed from the angle of these criteria is called a nominal convergence. Economic literature has made an important distinction between *nominal convergence*, assimilated with the fulfilment of the Maastricht criteria, and *real convergence*. Real convergence is usually understood as the convergence of real variables, such as GDP per capita, and in a broader sense, as the fulfilment of *optimum currency area criteria*, such as trade openness or labor productivity (Chapter 9). In addition, there is institutional convergence. Both real and institutional convergences are called implicit convergences. Rapacki, Dragan and Tanaka stress the necessity for real convergence and institutional convergence (Chapters 5, 7 and 9).

Dragan argues that the Maastricht convergence criteria are necessary conditions but not sufficient conditions for entry into the EMU, which requires real convergence. According to her, there were expectations that if a country entered, then a convergence and catching-up would emerge, but they are not automatic results of the EU accession. She argues that the long-term sustainability of the Eurozone will strongly depend not only on the respect of new fiscal rules or stronger coordination of economic policies, but particularly on the EU's capacity to reduce its internal economic divergence (Chapter 9).

Macroeconomic Stability

Dragan argues that macroeconomic stability should be considered a prerequisite rather than a final goal in the convergence process (Chapter 9). Generally speaking, the European Commission, the ECB and central banks in EU member states were not alert to the bubbles at that time. The banking supervision system was not well-developed.

Industrial Policy

[1] *Asahi Shimbun*, October 12 and 13, 2011.

[2] Professor Mejstrik's power point presented at the 9th World Congress of ICCEES, held in Makuhari on August 6, 2015.

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The Croatian economy recorded negative growth for 6 consecutive years from 2009 through 2014 (see Figure 1), the longest depression among post-socialist countries in CEE. As Croatia has had an industrial structure quite similar to that of Greece, the active use of industrial policy is desirable in order to upgrade its industrial structure (Chapter 8). In addition to the EU's own funds (Structural Funds and Cohesion Fund), it is necessary for the EU to take the necessary measures to induce private funds to be invested into this country. This point also applies to NMS in less developed South Eastern Europe, i.e. Romania and Bulgaria.

Loss of Monetary Autonomy

By joining the EMU, i.e. the Eurozone, NMS lose adequate space for their own monetary policies. More exactly speaking, EU member states lose monetary autonomy when they join the ERM II. Mentioning this point, Mencinger argues: "By entering the EU in May 2004 and the ERM II in June 2004, Slovenia also formally lost its monetary autonomy. … In a decade and a half, a newly born national economy turned again to a regional economy". However, "the loss of monetary autonomy" is taken in various ways depending on the people and countries. According to Vanya Ivanova, for example, Bulgaria has already lost its monetary autonomy since 1997 when the country adopted the currency board regime, and the only instrument of state influence on the economy since that time has been the state budget. Even if the country joined the EMU, such a situation would remain unchanged. Rather, by joining the EMU the Bulgarian central bank will be able to carry out open market operations and to extend loans to the commercial banks (without the formal restrictions imposed by the currency board) and will get full access to the EU financial assistance mechanisms, such as the ESB and emergency liquidity assistance for financial institutions. In addition, she claims that once the BNB participates in the determining of the monetary policy within the Eurozone, it will actually have a greater influence on the Bulgarian monetary environment than that at present. Bulgaria's position is similar to that of the Baltic States which had been incorporated into the Soviet Union for about a half century, and regained their independence only in September 1991. In addition, Lithuania also had the currency board regime until its entry into the EMU. It seems that these countries willingly entered the economic area of the EU by placing more emphasis on a complete withdrawal from the economic area of Russia rather than the loss of monetary autonomy by their entry into the EMU.

4. Conclusion

As Mejestrik's expression the "threat of solidarity contributions for Greece" explains the current situation well, the Eurozone crisis starting from the Greek crisis has been seriously affecting the Eurozone enlargement. Dragan says, "The Greek crisis has demonstrated that the admittance of an unprepared country would not be the correct solution either for the acceding country or for the admitting club", and she emphasizes the importance of necessity for accomplishment of substantial convergence criteria. Also many other authors emphasize the importance of necessity for accomplishment not only of Maastricht criteria of nominal convergence but also of criteria of substantial and institutional convergence.

The Czech Republic is in a position very close to the EMU membership in terms of nominal and substantial convergence. However, Vaclav Klaus, the former President of the Republic, was a famous for Euroscepticism, and the Czech government continued to take a negative attitude toward the euro. It is noteworthy that with the appearance of a pro-Euro new President of the Republic in 2013 the government and monetary authorities are taking a positive attitude toward the euro. However, if this country adopts the euro it is most likely that the euro will be adopted after around 2020. Rapacki says that the decision on the Euro adoption in Poland remains strictly political. This point also applies to other non-Euro NMS.

I think that in order for non-Euro NMS to adopt the euro it is dispensable for the European Commission to formulate a new strategy for the economic development in the EU periphery including NMS. In this regard, wisdom which should replace austerity measures is urgently required. Without this, the Euro adoption by non-euro NMS will not make substantial progress.

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Part II

Special Lectures: Background of the European Integration

International Monetary System revisited 20 Years later

Toru Iwami

1. Introduction

Let me begin with briefly comparing the current international monetary and financial situations with those of twenty years ago. Why twenty years? The initial reason is simply personal. In a book[1] published in 1995, I discussed the tripartite monetary regime composed of the US dollar, D-Mark and yen, which was widely discussed around 1990. In the meantime, however, the structure of the world economy has undergone great changes, and what I mentioned in the book requires now not small-scale revisions. One clear example is the fact that now twenty years later, discussions of the similar regime is focused on the US dollar, euro and Renminbi (人民元). [2]

The question of what caused such a remarkable change in the international monetary relations is seemingly not difficult to answer. Firstly, D-Mark was replaced by the newly born common currency, euro. Secondly, Japanese yen has declined to a rather minor position along with the lost two decades of its national economy, whereas China has risen to the second largest economy in the world and still increasing its weight.

The sole currency preserving the key role in international transactions is the US dollar. What factors have enabled such a position, despite its unstable exchange rate and a large scale of US international debt position? Another issue is the future of the euro and the Renminbi. Naturally there remain other questions, one of the most important of which is how the international monetary and financial system would work, and what would be its impact on the world economy at large in the near future. I will discuss the first part of questions in the section 2, and the second question in the following section 3, respectively.

2. The Rise of a Currency on the International Stage

What happened to the international status of the major currencies during the last two decades is shown in the Table 1: the share of the US dollar is almost unchanged in terms of foreign exchange turn-over and bank deposits, but it rather increased in terms of international reserves. The euro, on the other hand, maintains the second position, although surpassing the dollar in trade invoicing. While the share of yen has declined, what attracts our attention is the fact that Renminbi still stands as a negligible currency. Below is explained the characteristics of each currency, which leads to a more general

[1] Iwami (1995).
[2] For example, compare Tavlas (1998) and Eichengreen (2010).

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discussion on the conditions for a currency to acquire a dominant international status, in my definition, as a key currency.

Why the US Dollar has maintained its major positions?

The textbook taxonomy of functions of money, namely unit of account, means of payment, and store of value, holds good also for international transactions. A currency preserving an advantage in each function is bound to rise on the international stage, through the selection by economic agents.

The first factor for a currency to enjoy a leading international position is the economic scale of the issuing country. A larger national economy leads to a larger volume of transactions in that currency, either through trade or investments. During the past decades, the relative scale of the US economy has indeed declined clearly in terms of the merchandise trade, but rather stabilized in terms of the nominal GDP. The Eurozone, on the other hand, has declined in both terms, despite its trade share still occupying almost a quarter of the world total (Table 2). China is growing remarkably faster than developed countries, and predicted to overtake the United States in the near future. From this trend seen, the share of Renminbi is far smaller than its national economy would warrant, whereas the decline of the yen seems to be a natural course of the trend.

The next factor for a currency to be used as a unit of account and store of value is a stable relative prices, in other words, stable exchange rates. Its advantage is supposed to be increased by a transparent and reliable monetary policy. Yet, the exchange rate of the US dollar has been fluctuating widely, and the US economy has recently shown large scale deficits in the current account of the balance of payments and experienced a financial crisis, characterized as the largest one since the Great Depression. Despite these facts, the sustained position of the US dollar is sometimes explained from the so called "inertia"[3]. But it is not clear yet, what the "inertia" actually means, and how it is created. Is it simply an outcome of the conservative sentiments of the economic agents?

For being a trade currency, in other words, means of international payments, those facilities such as spot- and forward foreign exchange markets, hedging and liquidity supply are all indispensable. Global transactions, or network externalities, strengthen international status of the dollar as well. The falling oil prices, and thereby export value of the oil producing countries, on the other hand, will reduce, at least for the time being, the share of the US dollar in the world trade.

In the case of financial transactions in particular, wide and deep financial markets, open and free from governmental controls, providing sophisticated financial goods; those factors actually favor the dollar. Even during the financial turmoil after the Lehman bankruptcy, liquidity needs for the financial settlements increased demand for the dollar. Since financial transactions are accompanied by the scale economy, those denominated in the dollar extends to a far wider range than the US national economy itself actually requires.

[3] Goldberg (2010).

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Euro

The use of euro has increased to an extent that corresponds to the growing economic transactions within the Eurozone and with neighboring countries. The latter tend to select euro, as an anchoring currency, unilaterally without being promoted by any commitments of the European Central Bank (ECB). In this sense, the foreign trade relations of the EU countries are worth noting. More than a half, almost 60% is exported intra-regionally, a major part of which is supposed to be settled in euro. As for the global interregional trade (export and import) in 2010, those between EU and the NAFTA (North-American Free Trade Area) stand as the largest at 638.8 billion dollars, followed by the second one between EU and China of 500.7 billion dollars, and the third between NAFTA and China of 480.1 billion dollars.[4] For the trade with the NAFTA, a de facto US dollar zone, Eurozone countries cannot insist on payments in the euro. Moreover, as the subprime-loan crisis revealed clearly, European investors were so deeply involved in the American financial bubble that required naturally payment in the US dollar.

It is true that financial markets in Europe are no less wide, deep and transparent than US counterparts. Yet, payment in euro is not easy for the trade with China and East Asia, where trade and financial transactions are historically based on the US dollar, in particular in the case of economic triangle relations across the Pacific as discussed below. In this sense, the international use of the euro as a trade currency is almost confined to Eurozone and neighboring countries.

The future of euro, now enjoying the position of the second major international currency, depends critically on its credibility of the financial and political stability in the region.[5]The instability was recently heightened by the difficulties in debt service of the Greek public bonds in the early summer of 2015. The government supported by popular sentiments cannot easily introduce restructuring schemes required by the EU and other creditors. Not only rescheduling but also the hair cut of the Greek public debt seem to be inevitable at the moment, but the latter might cause in the future a chain effect on Portuguese, Spanish, and probably Italian debts.

As is widely discussed, the lack of consistent fiscal policies or a united fiscal policy of the member countries is bound to cause the instability of the euro. The difference in fiscal and monetary stance most clearly appears between northern creditors, Germany, the Netherlands, and Finland, on the one hand, and southern debtors, on the other. However, this difference already appeared during the initial stage of the monetary integration in the 1980s and 90s.

For the European countries, except for Germany, one of the motives to introduce a common currency was to put a brake on the obstinate, anti-inflation policy imposed by the German Bundesbank. The de facto D-Mark zone in Europe had a tendency of not solely low inflation, but also a high unemployment rate in the periphery. Helmut Kohl, the German Chancellor then, opted for an appeasement through accepting the united currency, despite the strong resistance from the Bundesbank and public opinions.

[4] METI (2011), p.90.
[5] See Tavlas (1998), for example.

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The national security of the united Germany would be promoted within the framework of the coming EU. The current difficulties seem to be a recurrence of the history before the monetary unification, even with some differences that the German economic power has so far grown remarkably and the crisis today is triggered by the large scale deficits on the part of Greece.

It is worth recalling that the West-Germany was allowed debt-reduction in the postwar year of the early 1950s. This episode can be a starting point for negotiations of another debt bail-out within Europe. Once the compromise is attained, the next step is naturally narrowing the gap of fiscal stance that requires debtor countries to restructure their public expenditure, in particular of social welfare such as pension payments.

Renminbi and Yen

In order to understand the international monetary relations in East Asia, we have to note the growing triangular transactions, trade and financial, across the Pacific. One important factor is the horizontal division of labor in electronics and automobile industries. The South-east Asian countries, China and Korea import parts and semi-manufactured goods from Japan, and then export manufactured goods to United States as well as within the region, while Japan for itself export manufactured goods to neighboring countries and across the Pacific.[6] The trade surplus thereby created flows back to the United States as international reserves and investments in the US market. This triangular link is the actual basis for the US dollar to sustain its dominant position in the region, despite the decline of the US economy relative to growing Asians.

Chinese authorities recently took a further step to increase the international use of Renminbi, in particular for trade invoicing. Since July 2009, they have liberalized transaction in the off-shore markets mainly in Hong Kong, while the on-shore markets are still tightly regulated.[7] The main hurdle for Renminbi to rise to a higher international position corresponding to the size of its national economy is the strict regulations on financial transactions, undermined also by less transparent and credible policy of the monetary authorities.

Interesting to note in this respect is the reason why the Japanese yen did not enjoy an international status reflecting its economic scale (the second largest national economy then) until the turn of the millennium. Japanese monetary authorities took steps to introduce wide-range liberalization schemes as proposed by the US-Japan Dollar-Yen Committee established in 1984.[8] Yet, the preference for the yen was almost limited to the Japanese firms. The largest trade and financial partner then, United States, naturally preferred transactions in its currency and the Asian countries, on their part, largely depend on the dollar instead of the yen, because their largest economic counterpart was also the United States. The basis for selecting an international currency was, and still is the economic relationship across the Pacific as discussed above. Moreover, the largest import item of Japan is fossil fuel (oil and

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[6] METI (2011), p.95 ff.
[7] See for example, ECB (2011), pp.41-3.
[8] Kawai and Takagi (2011).

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natural gas) that is traded globally in the US dollar. Thus, the limit for international use of yen is attributed to trade (and partly financial) linkage.

The second element to note is political. The Japanese government was not strong enough to strive for the internationalization of its currency, despite its announced official view admitting it. Japan rarely dared to launch into an initiative in economic diplomacy, rather sitting in the shadow of the United States. A rare occasion was the idea of the Asian Monetary Fund (AMF) during the Asian currency crisis. It finally collapsed, however, because of the American disapproval. Its main function was later realized in the form of the currency-swap arrangements, named the Chiang Mai Initiative (CMI).

In contrast to the case of yen, the political element will strengthen the position of Renminbi. Chinese government does not hesitate to show their strong will if necessary. Its regional use among the neighboring countries will grow, in particular when supported by the governmental initiative, to such an extent that constitutes a big challenge for Japanese yen. Globally seen, however, the international use of Renminbi will not progress easily, because of the strict regulations.

3. How to manage a sound international monetary system and the world economy

Discussions on each currency so far do not provide us yet enough insights into the prospects for the world economy at large. Indeed, a sound international monetary and financial system is an important precondition for a sustained economic development, whereas vice versa, instability in the world economy puts a heavy stress on the working of the global financial markets. In this regard, we have to look carefully at asset markets, such as stocks and real estates in both China and the United States. Moreover, the recurrence of euro crisis would be another large risk factor for the international monetary and financial system. To avoid these potentially unstable factors from growing to actual perils, we have to search out a new basis for international cooperation that reflects the changing global power structure, economic as well as political.

Economic transformations during the past three decades

From a longer perspective seen, the future of the system is to be reinterpreted in the context of the new trend in the world economy that took shape from the 1980s onwards; namely globalization and "financialization."[9] Although the latter concept is not widely used among economists, it actually implies a tendency that the financial sector has occupied an ever growing share in the economy on both national and international level. Since the economic "globalization" has appeared most dramatically in international financial markets, these two concepts are closely interconnected. The United States and United Kingdom took initiative for the "financialization" with successive deregulation measures. The result is growing domestic financial claims of these two countries relative

9 For more details, see Iwami (2014).

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to their GDP from the mid-1980s (Figure 1). The increased international use of the US dollar is naturally a byproduct of this tendency, which resulted in the financial instability, however.

Another aspect of this "financialization" has appeared as the "de-industrialization" of the developed economies, in particular in the United States and United Kingdom, in the sense that manufacturing sector has shifted to the emerging countries, East Asia for example. The emerging countries, together with some of the Europeans and Japan, flow their surplus generated by increased manufacturing exports back to the United States, thereby stimulating financial expansion. Although financial instability is potentially another side of the coin of this changing economic structure, the world economy as a whole enjoyed the benefits from these transactions as far as the financial expansion kept its pace.

Comparing the current situation with thirty years ago, the core of the problem in the mid-1980s was how to stabilize the international monetary order with guiding the overvalued US dollar to a soft-landing. Although American banks had not fully recovered from the overhung debts of Latin America, financial markets of the developed countries were far more stabilized than thirty years later. Today in contrast, exchange rates of major currencies is not a matter of serious concerns. More important is the question how to avoid a recurrence of financial crisis of the 2008 scale, on the one hand, and to sustain a continuous economic recovery, on the other hand. While the actual effects of financial re-regulation initiated by Volker Plan is not yet clear, the euro credit crisis is another factor of careful attention.

Unconventional monetary policies, so-called QQE (quantitative and qualitative easing), of major central banks, Federal Reserve Board, Bank of Japan, and later ECB, have so far contributed to financial stability in the short-run, but it is yet unforeseen what repercussions of the exit process from these policies would bring forth in the medium- and longer-run. A reversal of international capital flows might cause a large-scale blow to the vulnerable group of emerging economies, which might in turn cause not small repercussions on the developed countries. In the process, unpredictable movements of asset prices would appear.

More generally speaking, to be carefully considered is conditions for a multi-polar system to work smoothly, without a burst of bubbles or other financial disorders. In the long-run, creation of a unified international key currency might be indeed desirable, but it is not necessarily a condition for the world economy to be stabilized. A side-evidence is the history of the pre-1914 world, when the gold standard was based not solely on the pound-sterling, but also the French Franc and the Mark sharing the reserve currency function, as Eichengreen stressed (2010). The reason why this multipolar currency system worked rather well is attributed to the credibility of the system, in other words working of the self-adjusting capital flows, and international cooperation among major currency countries in emergency. Today, are such stability factors actually attainable?

One example is the aftermath of the financial crisis of 2008. Compared with the Great Depression in the 1930s, the extent and speed of the downturn after 2008 in terms of the world industrial production, foreign trade and share prices showed quite a similar or even larger scale. However, the recovery from the trough was in recent times remarkable and rapid.[10] This difference can be explained by the lessons for the policy makers learned from the 1930s; the flexible, discretional stabilization policies, on the one hand and international cooperation such as realized by the G-20 summit of 2009 in Pittsburgh, on the other hand. Yet it is not always warranted that emerging countries, in particular China, would behave in a desirable manner.

Political-economy aspect

Lately Chinese government seems to have decided to enlarge its influence on the global scene. One peculiar example is a challenge to the postwar international financial regime of the Bretton Woods.

China is supposed to have no clear image of the new international monetary system. Former president, Hu Jin-tao (胡錦濤) once spoke that the SDR should be assigned a larger role. The US congress, in the meantime, has not approved and would not like to approve amendment of the IMF charter that would strengthen the voices of the BRICs, in particular China. China then opted for a bypath outside of the Bretton Woods, one example of which is the idea of BRICS Bank and the AIIB (Asian Infrastructure Investment Bank) proposed by Xi Jing-ping (習近平). They could be rivals to the World Bank and its regional organization, the Asian Development Bank (ADB).

It is true that the Asian countries need a wide range of infrastructure building (electricity, roads, railways and ports) in order to sustain their high-speed economic growth. The AIIB is expected to facilitate inflows of the large scale regional savings into their economic growth channel, which is as a matter of fact reasonable.

This scheme would lead to a new international monetary order. As stated above, a large part of over-saving in East Asian countries has hitherto flowed to the United States, because of building monetary reserves and preparing for liquidity needs in times of emergency like a currency crisis, with a result of financing the US current account deficits. In order to channel this flow back to the region, the financial facilities of Asian currencies should be improved.

Yet, we have to note also remaining concerns about the new regional development bank. Its lending policy might not pay enough attention to human rights, and other important issues such as poverty reduction and preservation of the environment, as the public construction and urban development projects in China hitherto revealed. There is also a possibility that it might contribute mainly to the Chinese national interests. Because of its location in the east end of the Eurasian continent, infrastructure building in the region would be, directly or indirectly, bound to pave transport routes toward Beijing.

4. Concluding remarks

The international monetary system is a reflection of the global economic power structure, in the sense that the economic strength of a country forms a basis for the international use of its currency.

[10] See Eichengreen and O'Rourke (2010).

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Yet, the economic strength in this sense does not imply solely such factors as economic scale or competitiveness in a narrower sense. The scale economies, network externalities, and “inertia” all play a significant role. Political factors also influence the international status of a currency. The last factor is, in my view, in recent times gaining weight.

The changing global power structure requires a new form of international cooperation, on the one hand, but the emerging economic powers strongly want to change the framework, rules of the game so far imposed, on the other hand. The latter aspect makes an international cooperation rather difficult to be materialized. Compared to the global level, the regional cooperation within the Eurozone is theoretically easier, because the membership of the monetary integration presupposes initial common interests. With the time elapsed, however, difference in the economic performance blocks cooperation that existed before. If the regional cooperation becomes harder in Europe, it would be far more difficult in Asia, where efforts for regional integration are historically short and have not yet attained the similar level as in Europe.

Not only in the region, but also on the global scene, the important point is how China will behave. Without a sound international economy, its economic performance will not attain a level satisfactory enough for the Communist party. For that reason and to that extent, the new superpower is expected to behave in a cooperative manner. However, if it sticks to the potential desire of expanding national interests, it might result in another unstable factor.

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Table 1. Shares of Currencies in International Use (%)

	US $	£	CHF	DM	Euro	Yen	RMB
Foreign reserves							
1990	55.6	3.5	1.4	19.2	–	9.1	–
2010	61.5	4	0.1	–	26.2	3.8	n.a.
Foreign exchange turnover							
Apr–89	45	7.5	1	13.5	–	13.5	–
2011	42.5	6.5	3.2	–	19.6	9.5	0.5
Trade invoicing							
1992	47.6	5.7	n.a.	15.3	–	4.8	–
2010	ca.35	ca.8	ca.2	–	ca.39	ca.3	0.2
Bonds issued (1989) and outstanding (2010)							
1989	49.7	7.5	7.3	6.5	–	9.4	–
2010	38.2	n.a.	n.a.	–	26.7	15.3	n.a.
Loans outstanding							
1989	77.2	6.5	0.4	3.2	–	5.4	–
2010	54.1	n.a.	n.a.	–	19.1	2.3	n.a.
Deposits							
1989	69.7	2.3	3.6	11	–	3.9	–
2010	60.5	n.a.	n.a.	–	21.6	1.4	n.a.

Source: IMF, *Annual Report*, Iwami and Kawai (1990), Ilzkovitz (1994), Tavlas (1998), ECB (2011), Auboin (2012)

Table 2. Shares of Nominal GDP and Merchandise Exports (%) 1980 and 2013

Nominal GDP			Merchandise Exports	
year	1980	2013	1980	2013
USA	23.9	22.7	11	8.4
Eurozone*	23.7	17.1	30.6	24.7
China**	2.8	12.9	1.9	14.5
Japan	9	6.6	6.4	3.8

Source: UNCTAD, *Handbook of Statistics 2014.*

Note: *For 1980, countries joining Euro as of 2013. ** including Hong Kong.

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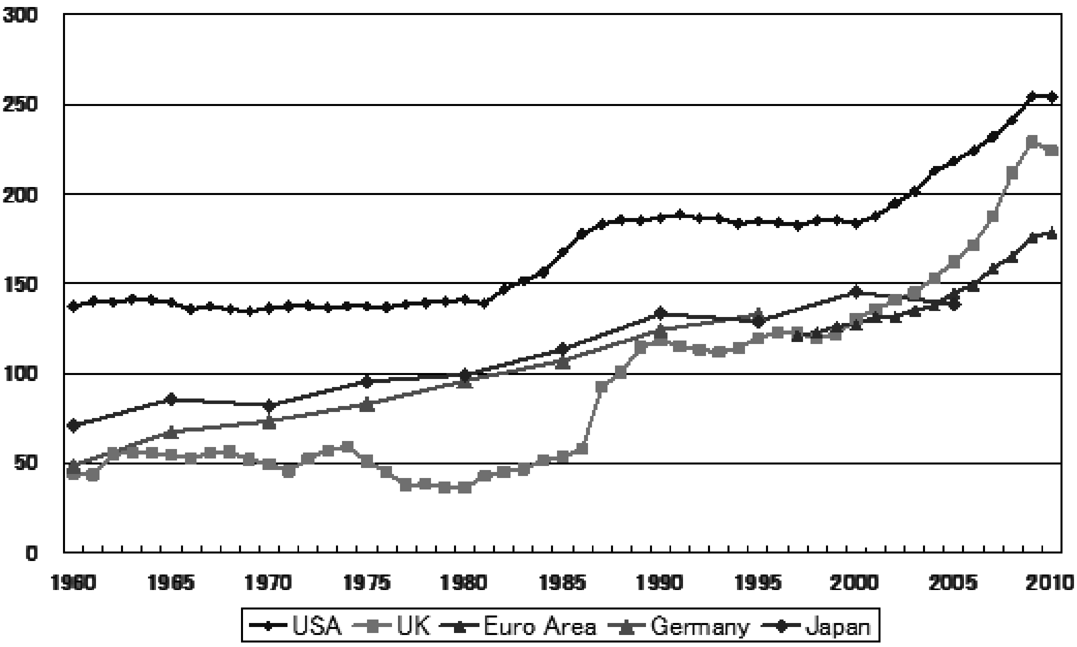
Figure1. Domestic claims of financial institutions relative to nominal GDP (%)



Source: IMF, *International Financial Statistics* CD-ROM, *Economic Report of the U.S. President*.

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Richard Coudenhove-Kalergi and Japan: A Brief History[1]

Hidenori Tozawa

Introduction

Richard Coudenhove-Kalergi (hereafter RCK) has been celebrated as one of the "Founding Fathers" of European integration more in Japan than in contemporary Europe. This unique situation in Japan is understandable; his mother Mitsuko was a celebrated Meiji-era born women, who has become a legend for Japanese xenophiles. There are many books, plays, TV series on Mitsuko. A recent example is the musical written by Shuichiro Koike, Takarazuka theatrical group, 2012. There was the solo-play by Kazuko Yoshiyuki as well, which was performed also on the 100th anniversary of RCK's birthday in Gstaad in 1994. Another recent example is the girly comic (*manga*) by Waki Yamato published in 1973 and 1996, entitled "Lady Mitsuko". This "Mitsuko" legend has not only affected Japanese women, but also Japanese historiography on European integration; almost every textbook on the EU begins with RCK's Paneuropa, which might be rather exceptional in contemporary Europe.

However, RCK himself is not paid as much attention in Japan as his mother is. Nowadays, some interesting aspects of the relations between RCK and Japan are almost forgotten; that is, for example, RCK's influence on Japanese policy toward Asia in prewar Japan, and his relations with Dr. Kajima, the former prime ministers Hatoyama, and Sôka-gakkai in postwar Japan.

1. RCK's reception in prewar Japan

1) Morinosuke Kajima

Morinosuke Nagatomi (later Kajima) was born in 1898 as the fourth son of a rich landowner's family in Ibogawa, Hyogo (which is famous for its *sômen*.) He graduated from the University of Tokyo and entered the diplomatic service in 1921. He was posted to Berlin as a young diplomat between 1922-25. On the ship going to Europe, he met Seiichi Kajima, who would be his father-in-law some years later.

In Berlin, his main tasks were to gather and analyze information on German politics. He happened to read the article of RCK (*Pan-europa: Ein Vorschlag*) in the Vössische Zeitung, and reported its content, with excitement, to the ambassador, Kumataro Honda. Ambassador Honda seemed uninterested in the article, but he surprised Morinosuke with the words, "I know Richard. I knew the Coudenhove-Kalergis when I

[1] The original version of this lecture was published in: *Human Security* (Tokai University Strategic Peace and International Affairs Research Institute), No.9 (2004/2005), pp.163-169. Some parts of the paper are modified and updated.

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was posted to Vienna. I will let you meet him, if you want to." When RCK visited Berlin some time later, Ambassador Honda arranged the meeting between Morinosuke and RCK at his residence. Morinosuke was quite excited not just by talking with RCK, but also with his wife Ida. Morinosuke was not just moved, but almost felt admiration for RCK.

Just before coming back to Japan in 1925, Morinosuke visited RCK in Zell am See, central Austria. According to Morinosuke, RCK told him, "I will organize Pan-Europe; you shall organize Pan-Asia. One day when our tasks are accomplished, then we, Pan-Europe, will present Indonesia to you for our friendship."

When Morinosuke arrived in Japan, he had almost finished translating *Paneuropa* into Japanese. Though he had some difficulty in finding a publisher for the translation, he finally managed to publish it in 1926 from the Japanese Association for the League of Nations.

About the same time, he got married to Ume Kajima. He was posted at the Embassy in Rome between 1926-8, and after coming back to Japan, he quit the diplomatic service and ran for the House of Representatives. He advocated "Pan-Asia" during the election campaign, but nobody in the Hyogo 4th constituency understood him. He was defeated twice. After the bad defeat, he became active in his family enterprise, Kajima-Gumi, which he managed to make into one of the biggest construction companies in Japan. He also got a doctorate from the University of Tokyo for his thesis on diplomatic history and worked as a commentator for international affairs from time to time on the national radio or in journals.

Ironically, RCK and Morinosuke went the opposite way from that time. In 1938, the headquarters of Pan-European Union was assaulted and occupied by Nazis, and RCK was forced to go into exile in the USA in 1940. On the other hand, Japan became an ally of Nazis Germany in 1938. Morinosuke tried to influence Japanese politics toward East Asia, first as a commentator, and he entered the Konoe government in 1940. Until then, his pan-asian concept had been more influenced by German "Lebensraum" ideology than RCK's Pan-europa. I can't tell if Kajima knew about RCK's activity in exile, or if RCK knew about Kajima's activity. However, the letter from RCK to Kajima in 1961 strongly suggests that both sides lost contact completely.

2) Others

The publishing of the translation of *Paneuropa* was made possible partly because two prominent scholars on international law had helped Morinosuke: Hikomatsu Kamikawa at the Imperial University of Tokyo, and Kazuo Matsubara at Tohoku University. (After World War II, Kamikawa, together with Kajima, founded the Japan Institute for International Affairs.) Curiously though, both scholars were rather cautious toward RCK's *Paneuropa*. Kamikawa wrote in 1926, "Paneuropa will do harm to the League of Nations".

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This negative judgment was due to the fact that positive attitudes toward the League of Nations were dominant among Japanese intellectuals in the 1920s. At the latest in 1933 when Japan left the League of Nations, the tide had changed and scholars like Kamikawa had become more and more nationalistic.

However, Morinosuke's translation attracted some readers even in prewar era, which would influence the reception of RCK after the war.

2. RCK's reception in postwar Japan

1) Ichiro Hatoyama and YUAI (Young Men's Association for Fraternity)

After World War II, another important interlocutor between RCK and Japan appeared; Ichiro Hatoyama, who became the 5th prime minister in postwar Japan. He had been "purged" (banned from holding a public office) by the GHQ (American occupational force) in 1947, just before he seemed about to be nominated as the prime minister. The reasoning for this purge was not really solid, which was often the case at that time.

The purge lasted more than 5 years. Those were the days of simple life and of deliberation for Hatoyama, as the Japanese saying "Seikô-Udoku" (working as a farmer on sunny days, reading books on rainy days) could best describe. Hatoyama worked as a farmer in Karuizawa, a summer resort which is located about 200 km north of Tokyo. One day, Hatoyama got a book of RCK. This copy of the book, "*Totalitarian State against Men*" reached Hatoyama after a long journey. RCK gave the book to Minister Kikuji Yonezawa in Lisbon, Portugal, in 1940, thanking him for his help in getting a visa out of Europe. Yonezawa gave the book to Shigeharu Matsumoto, who was a famous journalist and later founded the International House of Japan (Kokusai Bunka Kaikan)[2]. During his stay in Karuizawa in the summer of 1950, Matsumoto gave the book to Kesazo Ichimura, professor of Waseda University. (Photo: Ichimura Memorial House, former residence of Fumimaro Konoe.) Ichimura, as a nephew of Keijiro Amemiya, a railroad tycoon, inherited vast estates in Karuizawa and opened the Cultural Village in Minamihara, where prominent scholars, intellectuals, and artists share the summer villas. (Nobuyuki Idei, the former CEO of Sony, was brought up here as a son of a Waseda University professor.) As soon as Ichimura had a quick look at the book, he decided to recommend the book to Ichiro Hatoyama and cycled to Hatoyama's residence at once. Ichimura wanted Hatoyama to translate the book and publish it, which would be a rare case for a Japanese prime minister.

Hatoyama's translation of the book "*Totalitarian State against Men*" appeared in 1953, under the title of *Jiyû-to-Jinsei* (literally, "Liberty and Life"). Hatoyama was moved especially by its last chapter, "Revolution for Fraternity". He decided to organize a movement for the revolution for fraternity, and he founded YUAI (Young Men's Association for fraternity) in December 1953. These Association attracted

[2] http://www.i-house.or.jp/

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young people who were interested in political activities and skeptical of left-wing movements. The membership amounted to officially nearly 100,000 at its height. In 1954, they had RCK as the honorary president. YUAI members were eager to study RCK's works and soon wanted to invite RCK to Japan. However, their eagerness could not be materialized easily, as the communication between Europe and Japan was tenuous and expensive at that time.

2) Kajima's 'rediscovery'

Kajima had been purged between 1946 and 1951 by GHQ as well. He, with his wife Ume, concentrated on activities for their construction company. He tried hard to modernize the Japanese construction business, and also to get grand state projects, with the help of their connections with prominent politicians. He was really an entrepreneur and made Kajima Corporation, one of the biggest companies in Japan. One proof of his entrepreneurship is the Kasumigaseki Building (venue of the conference). At the time of construction of this building, few people believed that a skyscraper would be possible on a land of earthquakes as in Japan.

Thus, Kajima was quite busy in managing his company, and after his purge was lifted, he became a member of the House of Councilors (Upper House) in 1953. Though his wife Ume took over running of Kajima Corporation, Morinosuke became busier as a politician. As I mentioned before, most probably, Kajima didn't know RCK's postwar activity until the late 1950s. As YUAI's relation with RCK strengthened, YUAI and Kajima came to know each other, through RCK's suggestion.

Kajima seemed quite surprised to know that RCK was (alive and) so active after World War II. RCK must have been surprised to know that a young diplomat had become a politician and owned the biggest construction company in Japan. In their correspondence in March 1961 (which were the first exchanges after W.W. II), both sides expressed surprise and wanted to see recent photographs. From that time, the old relationship was revitalized and Kajima became eager to publish the translation of RCK's works.

Kajima was also helpful for YUAI's relation with RCK. As he knew that YUAI found difficulty in inviting RCK to Japan, Kajima involved his old friend Yukinori Maeda, the president of NHK (the public broadcasting company in Japan). Maeda was a foreign correspondent of Asahi Shimbun in the prewar era and acquainted himself with Kajima in Rome. Maeda himself was inspired by reading *Paneuropa* and established the Asian Broadcasting Union (a cooperation scheme) in the 1950s. He agreed to Kajima for co-sponsoring RCK's visit to Japan.

3) RCK's visit to Japan

One may ask the reasons why RCK decided to visit Japan in 1967, after some 60 years since he left Japan at the age of 2. Three reasons could be pointed out. Firstly, the situation in Europe: French president de Gaulle's "chaise vide" policy against the EEC in 1966-7. Although RCK was supportive of de Gaulle's

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European policy, RCK found it more and more difficult to make his activities consistent with de Gaulle's, since European federalists came to regard him as "anti-European". The second factor was the increasing number of Japanese visitors to Europe; as the Japanese economy recovered and grew, more people could have a chance to visit RCK personally and reminded him of the invitation. The third and most direct reason might be for the Nobel Peace Prize. During his stay in Japan, Otto von Habsburg tried to work on the Nobel Prize committee in Europe. Some parts of RCK's visit to Japan were designed to play up his candidacy.

RCK's two weeks' visit to Japan in 1967 was quite sensational. He appeared twice on NHK's TV programs, and gave a series of lectures in Tokyo, Onomichi, Hiroshima etc. His activities were covered by the media in detail. He became a symbol of European integration (and world peace) and Mitsuko was labeled "Mother of the EEC". (Following Maeda's instruction, a famous NHK producer, Naoya Yoshida, made a documentary on Mitsuko and her seven children in 1972, with the most popular actress Sayuri Yoshinaga as "Mitsuko".)

4) Sôka-gakkai

During his stay in 1967, RCK met the president of Sôka-gakkai, Daisaku Ikeda. This meeting was arranged because RCK wished strongly, though Kajima or YUAI were reluctant. RCK was interested in Sôka-gakkai's rapid development, admiring that some religious faith in Japan was growing rather strongly, which would mark a sharp contrast with the European situation. According to RCK, he was struck by Ikeda's strong personality, and probably, Ikeda was moved by RCK as well.

Sôka-gakkai invited RCK to Japan in 1970. This time NHK, the public broadcasting company, had to keep a distance from the religious organization. Nor were Kajima or YUAI involved. As a result, this second visit to Japan was virtually non-existent in media. As I couldn't get enough documents so far, I can't tell what happened between RCK and Sôka-gakkai. Nor can I tell how their relations went afterward in detail: reviewing with RCK's archives, however, the relation between RCK and Japan seemed almost monopolized by Sôka-gakkai between 1970-72. In 1971, the comic (*manga*) *Kalergi Haku (Count Kalergi)* was published by Ushio publishing, which is affiliated to Sôka-gakkai. This comic influenced the younger generation and therefore had a prolonged effect among Japanese people.

5) Discourse toward European integration in Japan thereafter

Even after RCK passed away, RCK's contribution to European integration has been commemorated from time to time, with "Mitsuko" being one of the favorite heroines of Japanese popular culture. Following President Maeda's instruction, a famous NHK producer, Naoya Yoshida, made a documentary on Mitsuko and her seven children in 1972, with the most popular actress Sayuri Yoshinaga as "Mitsuko".

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As "Mitsuko" is often labeled "Mother of the EU" and adored, RCK's achievements tend to be appreciated only idealistically.

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6) The temporal revival of YUAI

As RCK passed away in 1972, the relation between Pan-Europe and Japan faded away. The president of Pan-Europe Union was taken over by Otto von Habsburg (and later succeeded by a right wing of CSU), whose activity would be very different from RCK. Otto's pan-europe got a spectacular success of the Pan-European picnic in August 1989 at Sopron which triggered the fall of Berlin wall, though RCK himself got into oblivion.

In the meantime, RCK was not forgotten in Japan, thanks to his legendary mother Mitsuko. And then, all of a sudden, RCK was mentioned frequently in the real politics in Japan. Yukio Hatoyama, a grandson of Ichiro Hatoyama, became the Prime Minister in September 2009. His philosophy and policy has been strongly influenced by YUAI. The core of Hatoyama's foreign policy was an "East Asian Community", which was directly influenced by RCK.

Now we all agree that the Democratic Party of Japan as a ruling party was a failure, although there are discussions about the reasons. I agree that Prime Minister Naoto Kan was a catastrophe, Prime Minister Noda was a puppet of Ministry of Finance or other bureaucrats, but I don't agree with those who criticizes Hatoyama as a "traitor" or else. Still, I know the general sentiments in Japan, especially the feelings of rightward-inclined younger people including many of my students.

Closing Remarks

The motives of European integrations depend on a philosopher or actor; so is the case with RCK. His Pan -Europe movement included imperialistic, expansionistic, anti-communistic (and nostalgic after the World War II) motives, but also cosmopolitan and peace-oriented for sure.

Those various motives influenced many actors in Japan differently; Kajima was moved by RCK's *noblesse oblige* attitude in order to save declining Europe and then advocated his imperialistic version of Pan-Asia. Though Ichiro Hatoyama did not choose RCK himself, some parts of RCK's anti-communistic and aristocratic philosophy struck him and he organized the YUAI movement. When his grandson advocated YUAI some 55 years later, Yukio Hatoyama used YUAI (fraternity) not as a anti-communistic (nor

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anti-egalitarian) slogan, but rather anti-libertarian motto. RCK was interested in Sôka-gakkai; its expansionistic dynamism might have been RCK's dream.

Nowadays, RCK's aspiration toward a united Europe is in crisis; so is the important legacy by him in Japan, that is, an East Asian Community. Though the crises in Europe and Asia look like having different backgrounds, it might have the common roots, like deepening of competitive society in the age of globalization. I hope we can find a better way-out, and learn each other to overcome conflictive situations.

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Part III

Presentations in the Conference

THE GREEK DEBT CRISIS AND ITS AFTERMATH

PAPER PRESENTED AT THE EUSI TOKYO INTERNATIONAL CONFERENCE
TOKYO, 8TH AND 9TH MARCH 2015

March 2015

Panos Tsakloglou (Athens University of Economics and Business)
Marianthi Anastasatou (Council of Economic Advisors)

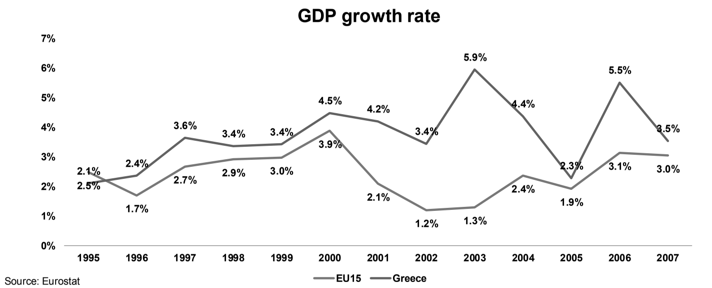
*

- Getting into the debt crisis
- Fiscal consolidation
- External rebalancing
- Developments in 2013 and 2014
- Structural reforms
- Socioeconomic costs of adjustment
- Recent developments
- Growth prospects and challenges

High growth rates before the crisis

*

- Greece joined the, then, EEC in 1981 and adopted the euro in 2001
- 1980s and early 1990s: slow growth
- From the mid-90's to the beginning of the crisis, the Greek economy was growing at a faster rate than the EU average (3.9% vs 2.4%)
- Growth model based on consumption and external borrowing

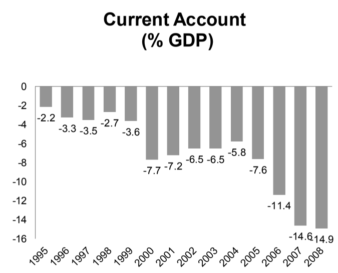


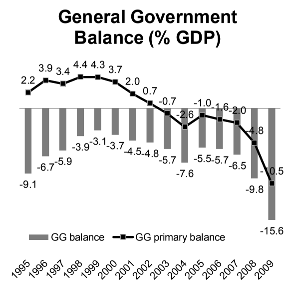
Source: Eurostat

Twin deficits

*

- Until 2000, low current account deficits
- External deficit trended upwards in the period 1995-2008
- General Government Deficit, although contained before Euro accession, increased afterwards





Source: Eurostat, Ameco

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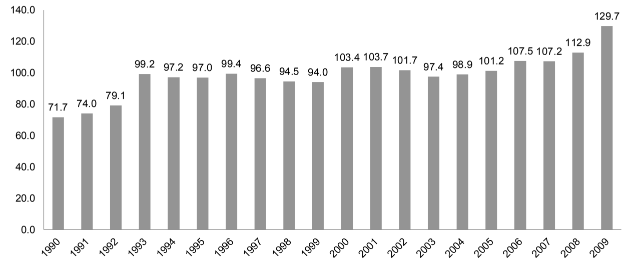
Public debt

*

In 1990-2009, public debt rose by 60 p.p. of GDP



Source: Eurostat, Ameco

Getting into the debt crisis

*

- Greece hit by banking crisis only indirectly
- 2008 first year with negative growth rate
- In 2009, early elections due to implicit government inability to pass the budget
- New government; revelation of large deficits (*Greek statistics*); ambivalent reaction
- In 2010 Greece could not tap the international markets anymore
- Forced to seek borrowing from our European partners and the IMF
- Two Programs: 2010 & 2012
  - Loans in exchange of Fiscal Consolidation and Structural Reforms
- Different Approaches
  - First Program (GLF) : Liquidity
  - Second Program (EFSF) : Solvency

Getting into the debt crisis

*

- Largest loan in history
  - 245* bn Euro (221 bn Euro already disbursed)
    - 198 from Euro Area countries
    - 47 from the IMF*
    - Private Sector Involvement (PSI) to reduce the public debt by 107 billion EUR via bond swapping
      - 53.5% haircut; Net write-down 54 bn;
        Real effects of PSI: Duration; Interest Rates; Public
      - December 2012: Debt buy-back (net benefit: 21 bn)
- The global financial crisis revealed the chronic problems of the Greek economy
  - Structural rigidities; loss of competitiveness
  - Growth model based on consumption and borrowing

*Approx. 18 bn refer to IMF's rollover and thus don't add up to the public debt

*

- Getting into the debt crisis
- **Fiscal consolidation**
- External rebalancing
- Developments in 2013 and 2014
- Structural reforms
- Socioeconomic costs of adjustment
- Recent developments
- Growth prospects and challenges

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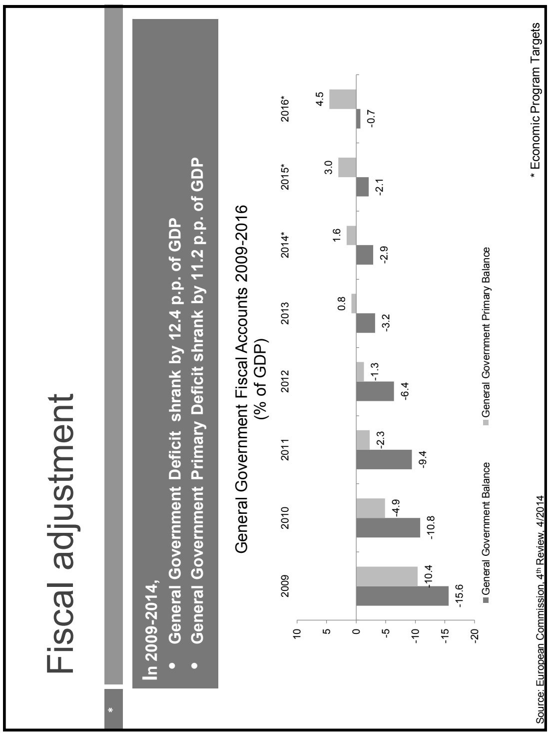
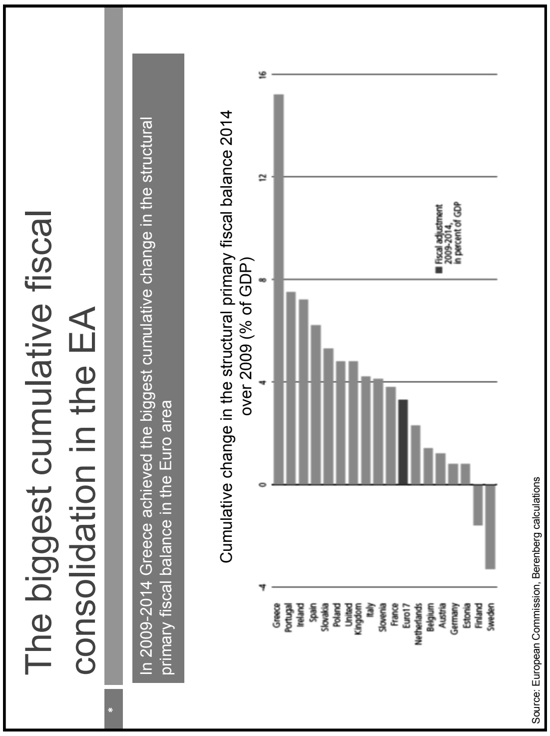
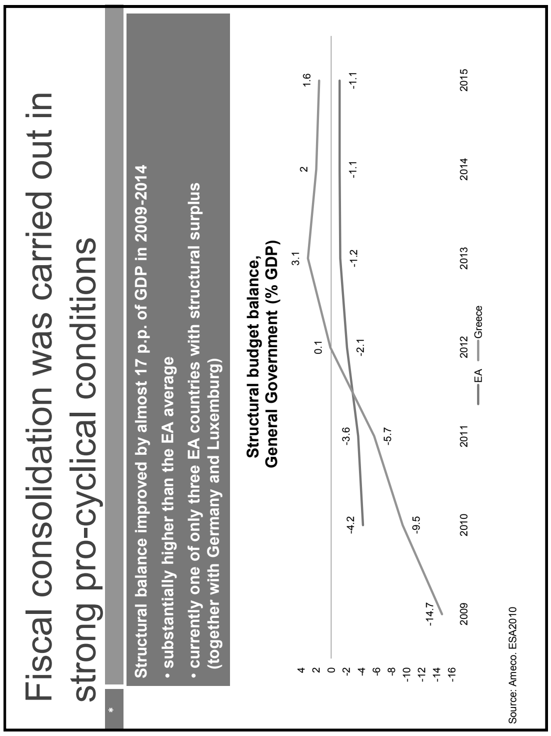
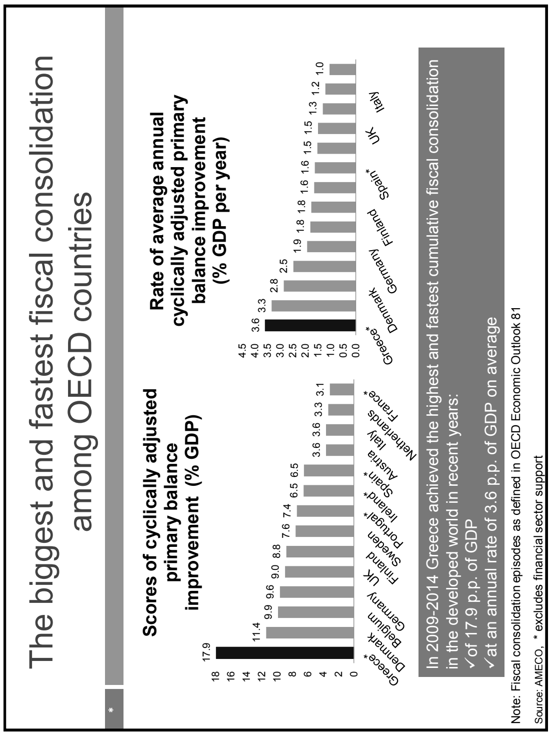
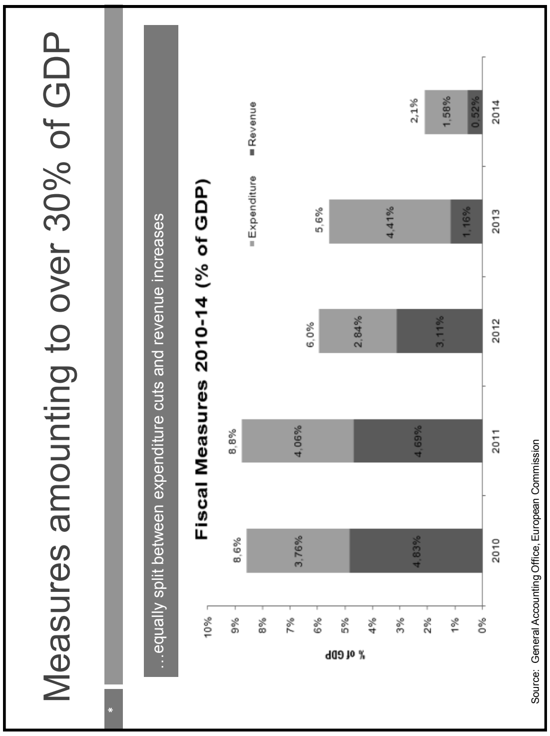
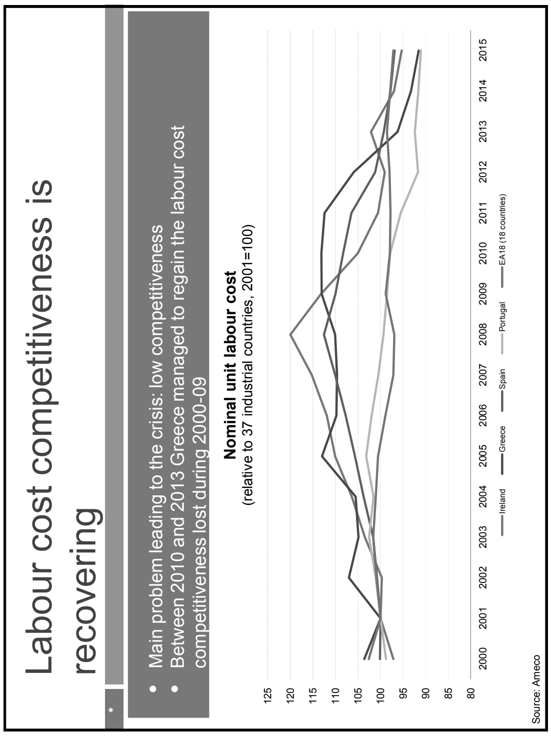

Fiscal adjustment
In 2009-2014,
• General Government Deficit shrank by 12.4 p.p. of GDP
• General Government Primary Deficit shrank by 11.2 p.p. of GDP
General Government Fiscal Accounts 2009-2016 (% of GDP)
2009 2010 2011 2012 2013 2014* 2015* 2016*
-15.6 -10.4 -10.8 -4.9 -9.4 -2.3 -6.4 -1.3 -3.2 0.8 -2.9 1.6 -2.1 3.0 -0.7 4.5
General Government Balance
General Government Primary Balance
Source: European Commission, 4th Review, 4/2014
* Economic Program Targets

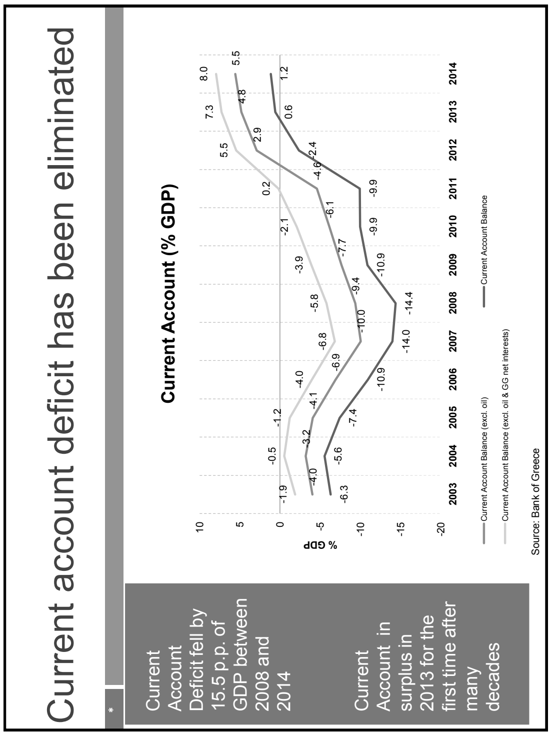

The biggest cumulative fiscal consolidation in the EA
In 2009-2014 Greece achieved the biggest cumulative change in the structural primary fiscal balance in the Euro area
Cumulative change in the structural primary fiscal balance 2014 over 2009 (% of GDP)
Greece
Portugal
Ireland
Spain
Slovakia
Poland
United Kingdom
Italy
Slovenia
France
Euro17
Netherlands
Belgium
Austria
Germany
Estonia
Finland
Sweden
Fiscal adjustment 2009-2014, in percent of GDP
Source: European Commission, Berenberg calculations


Fiscal consolidation was carried out in strong pro-cyclical conditions
Structural balance improved by almost 17 p.p. of GDP in 2009-2014
• substantially higher than the EA average
• currently one of only three EA countries with structural surplus (together with Germany and Luxemburg)
Structural budget balance, General Government (% GDP)
2009 2010 2011 2012 2013 2014 2015
EA: -4.2 -3.6 -2.1 -1.2 -1.1 -1.1
Greece: -14.7 -9.5 -5.7 0.1 3.1 2 1.6
EA
Greece
Source: Ameco. ESA2010


The biggest and fastest fiscal consolidation among OECD countries
Scores of cyclically adjusted primary balance improvement (% GDP)
Greece* 17.9, Denmark 11.4, Belgium 9.9, Germany 9.6, UK 9.0, Finland 8.8, Sweden 7.6, Portugal* 7.4, Ireland* 6.5, Spain* 6.5, Austria 3.6, Italy 3.6, Netherlands 3.3, France* 3.1
Rate of average annual cyclically adjusted primary balance improvement (% GDP per year)
Greece* 3.6, 3.3, Denmark 2.8, 2.5, Germany 1.9, 1.8, Finland 1.8, 1.6, Spain* 1.6, 1.5, UK 1.5, 1.3, Italy 1.2, 1.0
In 2009-2014 Greece achieved the highest and fastest cumulative fiscal consolidation in the developed world in recent years:
✓of 17.9 p.p. of GDP
✓at an annual rate of 3.6 p.p. of GDP on average
Note: Fiscal consolidation episodes as defined in OECD Economic Outlook 81
Source: AMECO, * excludes financial sector support







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•Getting into the debt crisis

•Fiscal consolidation

•External rebalancing

•Developments in 2013 and 2014

•Structural reforms

•Socioeconomic costs of adjustment

•Recent developments

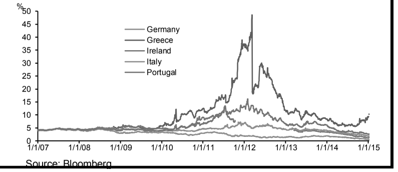
•Growth prospects and challenges

Developments in 2013 and first three quarters in 2014

Performance in 2013 better than expected:

- -3.9% GDP growth compared to expected -4.2%
- Unemployment rate started to decline in the last quarter of the year after more than three years of constant increases
- General Government balance -3.2% of GDP compared to a target of -4.1%
- General Government primary surplus 0.8% of GDP compared to a target of 0%
- 0.7% GDP surplus in the Current Account compared to expected -0.8%
- €5.8 billion of public sector expenditure and tax refund arrears to private enterprises and households cleared.

•10-year bond yields declined by 298 bps



Source: Bloomberg

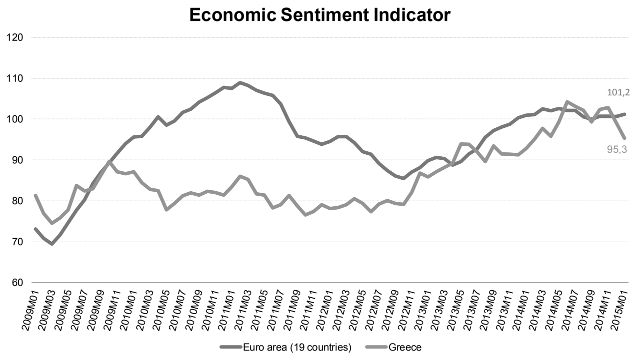
Developments in 2013 and first three quarters in 2014

Performance in the first three quarters of 2014 also promising:

- 0.7% GDP growth in Q3 2014 compared to -0.3% in Q3 2013.
  (nine month data suggest that annual growth rate of 0.6% is conservative)
- 3.8 bn Current Account surplus in Jan-Sep 2014 compared to 2.4 bn in Jan-Sep 2013
- Unemployment rate remained on a decreasing path (2.3 p.p. cumulative decline since peak)
- Improvement in public finances continued
- 10-year bond yields declined further by 250 bps
- In April and after four years with no access to the international capital markets, the Greek sovereign raised €3 billion at a coupon rate of 4.75% through the sale of 5-year bonds that was almost seven times oversubscribed.

  Further issuance of €1.5 bn in 3-yr paper in July (3.38% coupon), plus another €1.7 bn (5-yr and 3-yr) in exchange of T-bills in September
- In Q1 2014, the four systemic banks raised additional capital of 8.5 bn €, comfortably in excess of the needs identified by the supervisor (6.4 bn €), and placed medium-term bonds for the first time since 2009 to boost their liquidity (2.25 bn €), .

Resulting in improvements in "soft" economic indicators



Source: Eurostat

•Getting into the debt crisis

•Fiscal consolidation

•External rebalancing

•Recent developments

•Structural reforms

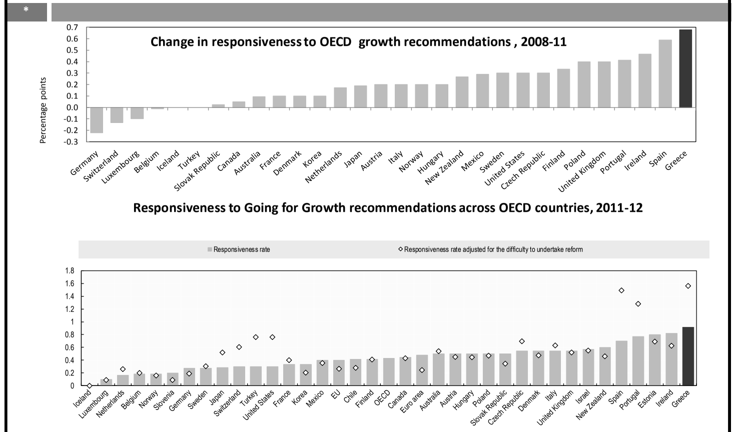
•Socioeconomic costs of adjustment

•Growth prospects and challenges

Structural Reforms

- Main contributing factor for competitiveness deterioration:
  Lack of structural reforms (since 2001)
- Greece in very low positions in international competitiveness rankings
- Usual accusation: *"Greece is not adopting structural reforms"*
  Any thing but true
- Since 2010 reforms in every sector of economic activity:
  tax administration, labour market, product market, pensions,
  social protection, health care, business environment, local government,
  education, public administration, privatizations, etc
- Some of the reforms truly drastic; others less so
- Improvement in all "league tables": World Bank, Lisbon Group and, especially, OECD (esp. *"Going for Growth")*
- But, still, a long way to go

Structural Reforms

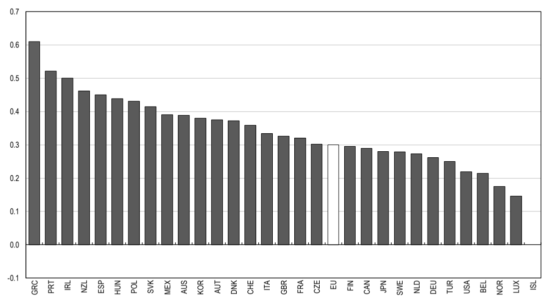


Source: OECD, Economic Policy Reforms: *Going for Growth*

Structural Reforms

Despite the fact that in the first three years of this period there were, virtually, no reforms

Overall reform responsiveness over the period 2007-14



Source: OECD, Economic Policy Reforms: *Going for Growth*

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- •Getting into the debt crisis
- •Fiscal consolidation
- •External rebalancing
- •Developments in 2013 and 2014
- •Structural reforms
- •Socioeconomic costs of adjustment
- •Recent developments
- •Growth prospects and challenges

Adjustment has come at a very high socio-economic cost

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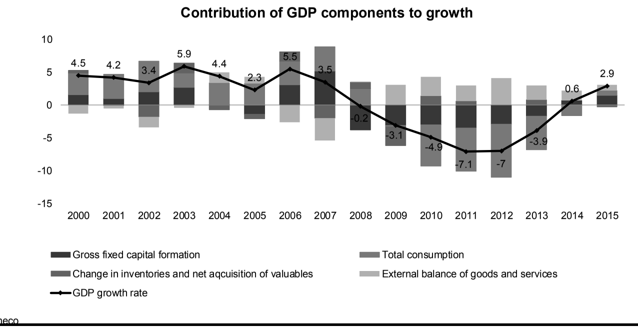
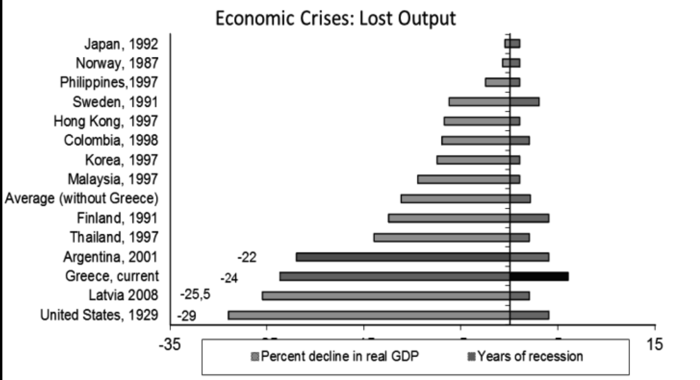
Between 2008 and 2013 the Greek GDP declined by almost a quarter, but started growing again in 2014



Source: Ameco

One of the largest declines in GDP ever recorded



Source: IMF, Reinhart and Rogoff (2009) and own calculations

Was the (severity of the) recession inevitable

- To close the, very large, fiscal gap revenue increases and spending cuts
- Deep recession probably inevitable; but not so deep
- Why this outcome?
- Faults in the design of the program (esp. the first)
- No haircut; short adjustment period; no private sector wage cuts
- Fiscal multipliers
- But; also, political factors
- Dauville and, especially, Grexit
- Of secondary importance: composition of austerity measures and timing of structural reforms

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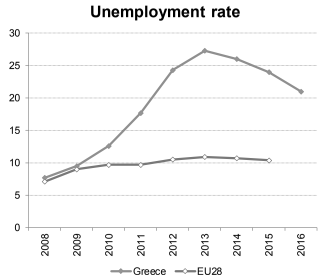
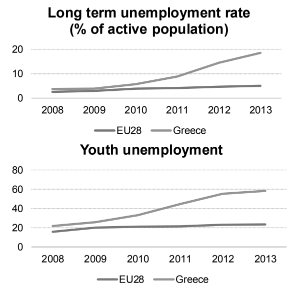
As a result, unemployment skyrocketed

- Unemployment in 2013 above 27% of the labour force
- Youth unemployment the highest in the Euro-area (58%)
- Long-term unemployed 18% of the active population or 65% of all unemployed





Source: European Commission, Winter Forecast 2014

Sharp worsening of social indicators

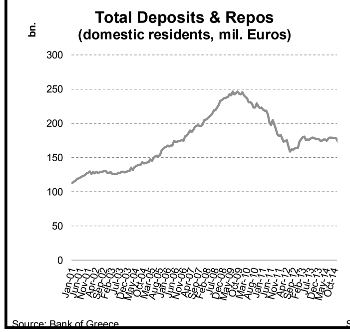
Between 2009 - 2013:

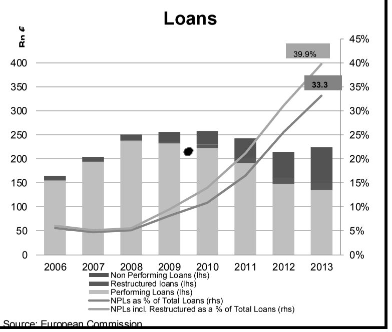
- Average disposable income declined by over 35% (due to sharp decline in economic activity and part reliance on tax increase for fiscal consolidation)
- Share of population at risk of poverty or social exclusion rose from 27.0% to 34.8%
- Gini index of inequality rose by 4% (despite relatively well-targeted measures)

Source: Eurostat, EU-SILC

Deposits were depleted and non-performing loans increased

✓The deposit base has been eroded with a peak-to-trough decline of almost EUR 84 billion (one third of the base)
✓One out of three loans is non-performing





Source: Bank of Greece

Source: European Commission

- Getting into the debt crisis
- Fiscal consolidation
- External rebalancing
- Developments in 2013 and 2014
- Structural reforms
- Socioeconomic costs of adjustment
- Recent developments
- Growth prospects and challenges

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Developments since Q4 2014

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Performance since the last quarter of 2014:
- Break down in negotiations with Troika
- Failure to elect President of the Republic
- Early elections / SYRIZA victory; promises to end austerity, reverse reforms and and cut debt
- Left/right gvt replaced centre-right/centre-left coalition
- Heightened political uncertainty / reversal of earlier trends
  - Collapse in public finances
  - Deposit outflows (20 bn; over 10% of GDP) / severe lack of liquidity
  - Bond spreads rose sharply
  - Greece cut off (again) from international capital markets
  - Stalemate in negotiations with the “Institutions” (Troika)
  - Talk of Grexit returned
  - *Growth reversal / increase in unemployment*

*

- Getting into the debt crisis
- Fiscal consolidation
- External rebalancing
- Recent developments
- Structural reforms
- Socioeconomic costs of adjustment
- Growth prospects and challenges

Growth prospects 1/2

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Need to shift resources from consumption to investment and increase substantially the share of exports in GDP

Independent studies suggest excellent growth prospects

• Tourism • Primary sector and agro-food industry • Logistics and interoperability • Energy • Shipping-related activities	• Pharmaceuticals • Research, technology and innovation • Metal and construction materials industries • Tradable services

Not all sub-sectors exhibit the same comparative advantage
Sub-sectors outside the below periphery might exhibit comparative advantage

Well educated human capital is the real comparative advantage

* Source: KEPE, IOVE, McKinsey

Growth prospects 2/2

*

✓To shift the resources of the Greek economy to higher value added production, the studies suggest further reforms

Horizontal reforms
- Creation of favourable investment climate and facilitation of business activities
- Elimination of barriers to entry- reinforcement of competition and competitiveness
- Valorization of public property-privatizations
- Facilitation of international trade-extroversion
- Improvement of tax policy
- Increase labour market flexibility and security
- Emphasis on innovation
- Reorganization of public administration and improvement of the services to the citizens
- Investment in human capital
- Fight against corruption and enhancement of reliability and transparency
- Acceleration and improvement in the justice system
- Reinforcement of social cohesion

* Source: KEPE, IOVE, McKinsey

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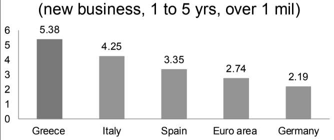
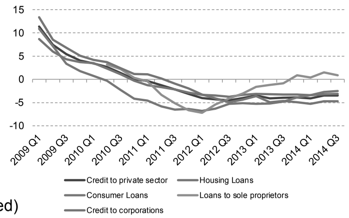
Challenges
Short term: Liquidity constraints

Interest rates on loans to Non-Financial corporations- May 2014
(new business, 1 to 5 yrs, over 1 mil)



Source: ECB

Credit growth



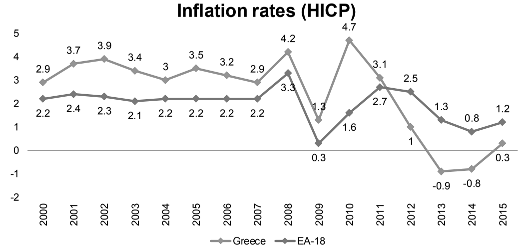
Source: Bank of Greece

- ✓Sharp decline in sovereign risk (recently reversed)
- ✓Decline in savings reversed (recently reversed)
- ✓Large Greek firms started tapping international markets (recently reversed)
- ✓Increased EIB lending, particularly for SMEs
- ✓Banks were fully recapitalized, restructured or resolved; have already re-accessed capital markets
- ✓Creation of specialized Development Fund (IfG) in cooperation with EIB, KfW and private sector institutions, targeting SMEs and infrastructure projects

Challenges
Medium term: Deflation

- ✓Improvement in competitiveness
- ✓Increases purchasing power of consumers
- ✓But, ceteris paribus, deteriorates Debt/GDP ratio

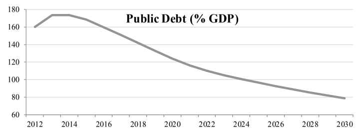
Inflation rates (HICP)



Source: Eurostat

Challenges
Long term: Debt sustainability & brain drain

Debt sustainability



Source: European Commission

- ✓ Manageable in the medium term
- ✓ Long average maturity (17 yrs)
- ✓ Low average interest rate (2%)
- ✓ Only 29 bn held by the private sector
- ✓ Approx. 80% of the public debt with the official sector
- ✓ Low debt servicing costs for the next 8 years (approx. €6 billion per annum or 3% of GDP vs 4.6% on average for Euro Area periphery peers)
- ✓ EU commitment to help Greece reduce debt to substantially below 110% of GDP in 2022 if needed

Brain drain

- ✓Several structural fund supported programs targeted to young scientists with high qualifications
- ✓Establishment of R&D centres by a number of multinational firms in Greece

Concluding

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- Greece made an enormous adjustment in restoring internal and external balances in a short period of time
- The economy is in a far healthier state than it has been for a long time
- The whole effort aims to shift resources from consumption to investment and increase substantially the share of exports in GDP
- Bold structural reforms have already been implemented but the reform effort needs to continue
- But, will the process continue?
- Political uncertainty, discontinuity and growth prospects

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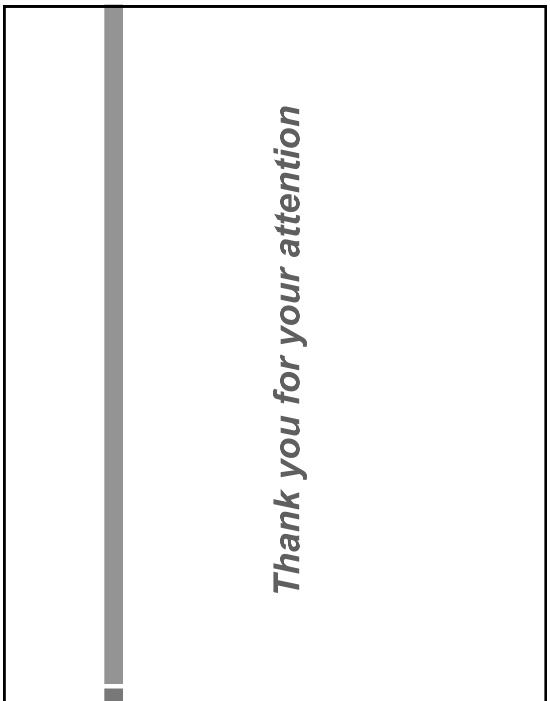

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EUROPE AT A CROSSROADS:
IS AUSTERITY DESTROYING THE EU OR CAN IT REVITALISE IT?

HENK OVERBEEK
TSUDA COLLEGE, TOKIO 9 MARCH 2015

BACK IN 2012

The Great Depression of 1929-1945 led to street war between Communists and Fascists, to victory of Nazism, and to World War II. The solution came only after 1949, among other things thanks to European integration.

The contemporary crisis is of a comparable structural nature, is already leading to large scale social and political unrest in Southern Europe, may well lead to the collapse of the Euro-zone and even the European Union, and eventually to a return of the “ solutions” of the 1930s.

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TECHNOCRATIC EUROPEANISATION

- ✓ Macro-economic co-ordination, budget control
- ✓ Fiscal and economic union: Minister of Finance
- ✓ Expand mandates of ECB and European Commission
  (Draghi’s announcement in September 2012)
- ✓ Asymmetrical adjustments
- ✓ Negates political nature of problem

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TOWARDS A TRUE SOCIAL EUROPE: POLITICIZATION OF DEBT

- ○ Write-off of unsustainable debt, *debt audit*
- ✓ Regulation of financial markets
- ○ Nationalization of banks
- ○ Euro-bonds (common financing of public debt)
- ○ Necessity of economic growth and complementarity:
  expand role of EIB, public investment program
- ○ Democratization of (decision-making in) Europe

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Review of EU Asia Pacific Studies No.2&3 (March, 2017):86-88

SOCIAL AND DEMOCRATIC RESILIENCE ?

Social resilience: emerging new forms of communal spirit

Political resilience? Mixed picture

- Rise of nationalist right-wing movements in North-West and Eastern Europe
- Rise of populist left-wing movements in Mediterranean Europe
- Rising confrontation

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EUROPEAN PARLIAMENT ELECTION RESULTS 2004-2014

Party group	Share of vote 2004 in %	Share of vote 2009 in %	Share of vote 2014 in %
EPP Christian-Democratic	38.1	36.0	29.4
S&D Social-Democratic	27.2	25.0	25,4
ECR Conservative	--	7.3	9.3
ALDE Liberal	9.2	11.4	8.9
GUE/NGL / Greens Left-Green	10.8	12.3	13.6
EFDD / NI Populist Right	11.1	8.0	13.3

source: http://www.europarl.europa.eu

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RIGHT WING IN RECENT ELECTIONS OR POLLS:

France:	NF		30 %
Germany:	AfD		6-7 %
		Linke	9 %
Greece:		Syriza	36.3 % (+ 9.4)
	Golden Dawn		6.3 % (- 0.6)
Hungary:	Fidesz		24 % (- 10)
	Jobbik		8 % (- 12)
Netherlands:	PVV		17 %
Spain:		Podemos	28 %
Sweden:	SD		12.9 %
UK:	UKIP		14 %

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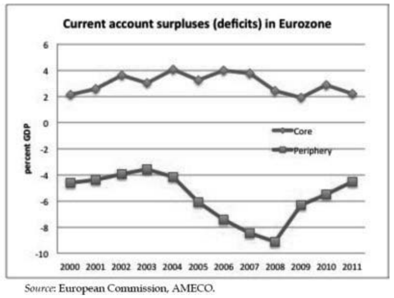
CULTURE CLASH OR NORTH-SOUTH DIVIDE?



The North – South divide must be bridged, and Syriza and Podemos offer us a chance to turn around before it is too late.

Golden Dawn and their likes are waiting in the wings.

The problem is not financial but political.

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Review of EU Asia Pacific Studies No.2&3 (March, 2017):86-88

EUROPE AS A POLITICAL PROJECT

'Europe' has always been a transnational political project, aimed at safeguarding peace, democracy and rule of law in Europe through market integration and shared prosperity.

1) International Ruhr Authority - ECSC - EEC (1945 – 1958)
2) SEA – TEU – Lisbon Treaty (1986 – 2009)
3) Eastern Enlargement (1990 – 2015)
4) Monetary Union (1990 – 1997 – 2015)
5) Limits of Project: Turkey – Caucasus – Ukraine

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EUROPE AT A CROSSROADS

Europe is at a crossroads: its survival as a project is at stake:

- Europe will need to come to terms with the limits to its expansion to the East and to the South
- Monetary union on current terms is destroying Europe by exhausting society's resilience, deligitimating any idea of European solidarity, and playing into the hands of right-wing nationalism
- We need a New Deal, and we need it by June when new terms will have to be agreed for Greece's continued membership of the Eurozone, leaving short-sighted austerity and market fundamentalism behind.

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TOWARDS A NEW DEAL FOR EUROPE?

Leave short-sighted austerity and market fundamentalism behind and take substantial steps towards a social Europe:

1) An agenda for growth and equity
2) Regulation of financial markets, creation of public banks
3) A common asylum and migration policy

Can this be done within the EMU?

Reconceptualise the relationship between national and European democracy so that we will take decisive steps in the direction of a truly democratic multi-level polity in the EU.

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Part Ⅳ
Supplement

Crisis! What Crisis? The "German Model" facing economic and financial challenges since the 1990s

Werner Bührer

Looking at the latest figures concerning Gross Domestic Product (GDP), unemployment, national budget, or public and private investments in Germany (see *Frankfurter Allgemeine Zeitung*, 16 January 2015, p. 19), in the spring of 2015 the German government and the German public seemed to have no reason to be unsatisfied:

GDP in 2014 increased by 1.5 percent compared to 2013. The expected average in the Euro zone was 0.8 percent respectively 1.3 percent in the EU altogether.

The rate of unemployment amounted to 4.7 percent, which was the lowest rate since the German unification in 1990.

Public and private investments increased by 3.7 percent in 2014 compared to 2013.

Germany was besides Luxembourg the only EU member state with a balanced national budget.

As historian Adam Tooze already put it some years ago: "With the euro in crisis, Germany has come to seem like a lone island of fiscal stability in Europe. Its debt levels are modest, its government bonds are safe havens for investors around the world, and it has avoided the kinds of private credit booms and housing bubbles that have destabilized the rest of the continent" (Tooze, 2012: 23). My following remarks will concentrate on some of the characteristics and features of the German economy and economic policy that may help to understand why Germany performed quite well, at least compared to most other EU member states. I am trying to explain (1) what is meant by the term "German model" and to what extent it was adapted to and modified by the challenges of globalization and German unification. Then I will mention (2) some of the reasons why most Germans are so interested in or, as some foreign observers would say: obsessed, with monetary and financial stability and how these views influenced the German attitude towards European economic and monetary cooperation since the early 1970s. Following is an attempt to focus on those (3) political measures and reforms that were at the moment held responsible for the current record of success. In conclusion I will touch upon (4) some of the problems that are expected to endanger the remarkable performance of the last years – because, so the warning by the above quoted commentator, "for all the talk of its financial strength, Germany has so far squandered the opportunity to secure long-term economic growth...Berlin may have secured a dominant place in Europe, but it has not made adequate provisions for the future." (Tooze, 2012: 23-24).

1) Strengths and weaknesses of the "German model"

It is surely known that Germany, together with the majority of the OECD-countries including Japan, according to the "variety of capitalism"-approach figures among the "coordinated market economies". In such economies, "firms depend more heavily on non-market relationships to coordinate their endeavours with other actors". These "non-market modes of coordination generally entail more extensive relational...contracting, ...based on the exchange of private information inside networks, and more reliance on collaborative, as opposed to competitive, relationships to build the competencies" of the individual company (see Hall/Soskice, 2001: 8). During the second half of the 1970s the German version of capitalism was referred to as the "German model" (*Modell Deutschland*). This model consisted of five important

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elements: "a strategic focus on individualized high-quality production; strong trade unions" – and employer associations on the branch and the national level, one may add – "with an institutionalized presence in the polity at large and in the enterprise; stable employment in an efficient, jointly administered internal labour market; a flexible socio-technical system of work; and a market-independent system of industrial skill generation" (Streeck, 2009:109; see also Dyson, 2001; Rödder, 2013). In order to identify the characteristics of the "German model", another scholar stressed the peculiarities of the German "production regime", especially highly qualified regular workforce, institutionalized bargaining between "capital" and "labor" respectively employer associations and trade unions, co-determination on the company level, a system of "principal banks" (*Hausbanken*) as providers of cheap credit to German companies, long-term finance methods, "stakeholder value", corporatist structures based on powerful business associations and trade unions, long-term capital investment, and modest cartel regulations (see Abelshauser, 2003: 99). Especially the system of industrial relations, in principle based on the willingness of trade unions and employers to cooperate and compromise, was often regarded as explanation of Germany's economic success – although it is of course impossible to quantify exactly the impact of the "social partnership"-regime on economic growth and political stability. This way of discussing and regulating matters of economic and social policy was established in the early 1950s, and it survived several "difficult" situations until today.

The good reputation of the "German model" in the late 1970s and the first half of the 1980s was, of course, the result of the superior performance of the German economy, at least as compared to the more liberal, free-market capitalism of the United States and the United Kingdom. But even in those years critics pointed to some potential weaknesses, for example the rigid system of collective wage bargaining, the inflexible regime of employment protection, and an economic structure still dominated by a "somewhat oversized manufacturing sector, so that even industries in which West Germany had lost previous comparative advantage did not have to shrink all that drastically" (Giersch/Paqué/Schmieding, 1992: 222). These problems became more crucial since the mid-1980s when unemployment and public debts rose to new highest levels. As in the United States and in Great Britain the German government, since 1982 led by a conservative-liberal coalition under Chancellor Helmut Kohl, tried to solve these problems by new economic and social policy measures inspired by the so-called neoliberal paradigm, for example by cutting down social expenditures and welfare state regulations, by making working conditions such as working time and rules of dismissal, and by de-regulation and privatization in general (see Rödder, 2013). But in contrast to the United States during the presidency of Ronald Reagan and Margret Thatcher's United Kingdom the change of policy was, due among other reasons to the Christian-Social orientation of the Christian Democrats and their employee dominated electorate, quite moderate.

In 1990, when the unification of West and East Germany was put on the agenda, economic prospects were favourable. The years 1988 –1990 brought an average real GDP growth of 3.9 per cent p.a., "a rate not known since the late 1970s, with price inflation far less of a threat than at that time". Investment in plant and equipment "picked up again and reached a growth rate of 6.8 per cent p.a. in 1988-1990, more than in any three consecutive years since the early 1970s". In these three years, employment increased by a "respectable" total of 1.4 million jobs, which led to a reduction of the unemployment rate by almost two percentage points. "Although the core of long-term unemployment largely remained untouched, a new dynamics of the labour market became visible" (Giersch et al., 1992: 276). So one may perhaps understand why Chancellor Kohl was quoted with the grandiose announcement that the unification would be paid out of the petty cash (*Portokasse*). But this turned out to be a terrible miscalculation.

After the unification of the Federal Republic of Germany and the German Democratic Republic (GDR) in October 1990 the "normal" problems caused by the process of globalization – increasing the competitiveness of the unified economy – were superseded and intensified by the economic and financial effects of the integration of the East German economy. "Unification hit German politics and the German economy unexpectedly and required them to address, from one day to the next, problems of a kind and

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magnitude that were entirely unprecedented”. As a result, “unification was carried out as a transfer to the former GDR of exactly the same West German institutions that by the late 1980s had already begun to show critical signs of exhaustion and dysfunction” (Streeck, 2009: 207, 209). The introduction of the *D-Mark* in the former GDR “at a politically expedient but economically catastrophic rate” (ibid: 211) was one of the major wrong decisions causing “extraordinarily high unemployment rates” and “declining rates of economic activity that were to become emblematic of East Germany in subsequent years” (ibid: 212).

2) The obsession with monetary and financial stability

During the 20th century Germany went through three dramatic monetary reforms combined with more or less drastic devaluations: 1923, 1948, and 1990. Whereas the first two were experienced by all Germans, the last one affected only the citizens of the former GDR. These experiences may explain to certain degree why monetary stability became one of the key elements of German identity (see Taylor, 2013): The *D-Mark* was seen as symbol of the economic *and* political rebirth after the Second World War and was used to replace other, more or less discredited pillars of national pride. So when, in 2001, the Euro replaced the D-Mark, scepticism in Germany was strong and widespread.

It is not possible here to discuss the reasons of the inflationary process in Germany after the defeat of 1918. Surely, the heavy burden imposed on Germany by the Treaty of Versailles – 269 billion gold marks, nearly 200 percent of GDP – was one of its major causes. Important in the context of my paper is, that “the hyperinflation, that reached its chaotic climax in Germany in 1923came to be seared, seemingly forever, in the country’s collective consciousness”. This fear of inflation was nowhere deeper than in Germany, and this German fear, as political scientist Barry Eichengreen recently observed, “translated into European policy, given the Bundesbank-like structure of the European Central Bank (ECB) and the desire of its French president, Jean-Claude Trichet, to demonstrate that he was as dedicated an inflation fighter as any German” (Eichengreen, 2015: 36, 8).

The second experience of inflation occurred after the Second World War. When, in 1933, the National Socialists had seized power, their ruthlessly expansionary monetary policy had created an inflationary pressure that could only be held in check to a certain degree by the price freeze of 1936. In addition, “the financing of the war through the printing press pushed up the money supply roughly tenfold”. At the end of the war, industrial production had dropped to about a quarter of its pre-war level. So, “with more money chasing fewer goods at fixed prices, Germany found itself in a state of ‘repressed inflation’. The official money lost it’s value not via rising prices (open inflation) but via a spreading reluctance to accept this money as a medium of exchange” (Giersch et al., 1992: 20-21). This gave rise to “black markets”, where cigarettes replaced the *Reichsmark* as the standard means of payment. In order to stop this development and to create a stable and trustworthy currency, the three Western occupying powers enacted a currency reform in the Western zones of occupation in 1948. It consisted of a “drastic contraction of the money supply by the introduction of the Deutsche Mark”, a “restructuring and consolidation of existing private and public debt”, and the “establishment of strong institutional safeguards against future inflationary policies”. This currency reform scaled down private cash balances and bank deposits by a factor of ten. Official Prices, wages, rents and social security payments remained unchanged (1 *Reichsmark* = 1 *D-Mark*). Since the Soviets implemented a currency reform with similar effects to private savings accounts in their zone of occupation, again all Germans lost most of their savings. What reinforced the German’s “stability obsession” in addition were the institutional safeguards established by the Western Allies against future financing of public debt by money creation: “First, the *Bank deutscher Länder* (i.e. the new central bank, later renamed in *Deutsche Bundesbank*) became the sole provider of legal tender; contrary to the wishes of many German experts, the new central bank was to be independent from government and all other political bodies. And second, the Military Governments explicitly forbade excessive budget deficits” (ibid: 36-37). So the American, British and French authorities, too, contributed to the German “obsession” with monetary stability.

The third monetary reform happened in course of the German unification. Whereas wages, pensions and rents remained unchanged (1 East German Mark = 1 *D-Mark*), the savings of most former GDR citizens, to be exact those between 14 and 58 years of age, exceeding 4.000 East German Mark were divided in half (ibid.: 263; see also Waigel/Schell, 1994). Although the devaluations of 1948 and 1990 did not have traumatic effects similar to those of the hyperinflation of 1923 – in part, because in both cases conditions soon turned better for the majority of Germans – these experiences kept alive German worrying about stable money. These anxieties were revitalized when, in the late 1980s and the early 1990s, the discussions and negotiations about a common European currency intensified.

German concerns about safeguards for a stable single currency taken into account, Chancellor Kohl supported the idea of a European Monetary Union (EMU) as "a means to anchor Germany firmly and durably in the European integration framework and to make the European integration process and with it the European peace project 'irreversible'". German unification, of course, reinforced this readiness to intensify European integration. To be sure, "growing economic interdependence and the economic interests of export-oriented companies and German banks help to explain the German willingness to head for EMU", too. The decision to move ahead towards EMU came against the background of the fall of the Berlin Wall on 9 November 1989: "This coincidence gave rise to the interpretation that Germany had to sacrifice the *D-Mark* for French support for German unification. This interpretation, however, does not stand up to the empirical evidence", since the process leading towards EMU had been well underway since early 1988, "with Germany in the highly prominent role of a promoter, not a reluctant follower" (Krotz/Schild, 2013: 192-193). Even more, German considerations concerning monetary cooperation can be traced back till late 1960s and the early 1970s.

At the European summit at The Hague in December 1969, German Chancellor Willy Brandt presented proposals for a two-stage evolution towards EMU with economic convergence first, and moves towards EMU in a second stage. A committee was set up to outline the details. The resulting report, called after its chairman, the Luxembourg prime minister, Pierre Werner, "foresaw achieving EMU in three stages by 1980 and advocated parallel progress on monetary cooperation and economic convergence" (ibid: 186). Although the monetary disorder during the final years of the Bretton Woods system prevented further progress along the lines of the "Werner plan" at that time, discussions in the German Foreign Office give evidence to the interpretation that Germany was from the beginning supporting plans to foster monetary cooperation and to create some sort of European union with a single currency. Although German officials preferred to harmonize economic policy and to overcome imbalances among the members of the European Economic Community before starting towards monetary cooperation (AAPD 1970, 2001: 380), nobody raised fundamental objections. Another Foreign Ministry edict declared as a German goal to create a "community of stability and growth", but stressed the necessity of harmonizing and coordinating economic aims and economic policy within the Community. Such a harmonization and coordination was seen as "prerequisite of further measures of monetary policy". To guaranty a common, stability-orientated policy, "monetary measures should not be given priority" (ibid: 1435). Again, although it is obvious that Germany preferred to harmonize and coordinate economic, budget and finance policies *before* starting towards EMU, German government officials agreed to the basic economic and political goals as formulated in the "Werner report" (ibid:1878). So to maintain that Germany sacrificed the D-Mark for French and other EU members' support for German unification is indeed not in accord with empirical evidence. Germany's main motivation for a single currency was in the early 1970s as in the 1990s, as political scientist Andrew Moravcsik put it, "to promote its own economic welfare through open markets, a competitive exchange rate, and anti-inflationary monetary policy". And most German business and government leaders believed then and believe now "that the European economy would best be supported by independent central banks that are like their own *Bundesbank*, which almost always prioritizes low inflation over growth or employment" (Moravcsik, 2012: 55).

3) Did Germany win the Euro Crisis?

As mentioned in the beginning: Not only has the German economy "bounced back from the 2008-9 financial crisis – with revitalized export industries and record-low unemployment – it has done so while most other European economies are still reeling" (see for this and the following, including quotations, Reisenbichler/Morgan, 2013). The common wisdom is that Germany's success is the "hard won reward for strict economic management". Yet "fiscal conservatism" and "structural reforms" alone do not account for Germany's export-led growth, "which in fact is largely the product of adjustments in business and labour relations that reinvigorated German industries". The country also owes much of its economic rebound "to the specific structure of the EMU and even to the labour and financial fallout of the euro zone crisis". But Chancellor Merkel's drive for austerity is rather risky: "Although it seems to be working to Germany's advantage, it has failed to lift up a recession-hit Europe". Germany, however, benefits from an economically healthy Europe, because it exports roughly 40 per cent of its products to this area. Therefore, replacing the traditional austerity-oriented policies by more growth-oriented policies for the rest of Europe might be advantageous to the German industry, especially car industry and mechanical engineering.

When looking for the sources of Germany's remarkable performance, most commentators point to the quite radical labour market reforms and fiscal conservatism. The labour market reforms of the early 2000s, also known as the "*Agenda 2010*", were implemented by a coalition government of Social Democrats and Greens led by Gerhard Schröder (see Nawrat, 2012). It consisted of a set of welfare and labour-market measures that cut benefits and made it easier for firms to create "less-well protected and often temporary low-wage jobs". These measures obviously contributed to the reduction of labour costs and encouraged more people to work since unemployment benefits and welfare aid declined considerably. To quote once more political scientist Barry Eichengreen: "Only Schröder as Social Democrat could have convinced Germany's still powerful trade unions "that wage moderation, decentralized bargaining, and a reformed welfare state were in their interest". Following the 2003 reforms, unit labour costs in German manufacturing stopped rising, "reflecting strong productivity growth and the unions' newfound acceptance of wage moderation" (Eichengreen, 2015: 96). To a certain degree the *Agenda 2010* symbolized a turning away from the "German model" because of the deregulation of the labour market and the reduction of public spending. Nevertheless, this was not a completely new policy. Especially the conventional orientation to consent and co-operation concerning industrial relations was not abandoned. So you could say that the "German model" was adapted to the requirements of globalization, but not replaced by a completely new arrangement.

Meanwhile, fiscal responsibility, mandated by the German constitution and stipulated by the so-called stability law of 1967, supposedly underwrote Germany's strong economic performance. German policymakers, especially Christian Democrats, therefore have preached "austerity and structural labour-market changes as the model for other European countries looking to foster competitiveness, boost growth and increase employment" (see for this and the following, including quotations, Reisenbichler/Morgan, 2013). In addition, decade-long adjustments in business and labour relations coupled with Germany's place in the Monetary Union contributed to Germany's economic revival, too: Long before the 'Agenda 2010' reforms, "German manufacturing firms, faced with growing global competition, started to impose wage restraints and adjust working time and pay while granting job security for skilled workers". With the "grudging consent" of trade unions, companies developed a series of flexible instruments that allowed them "to tweak working hours and pay to their economic needs, instead of touching workers' employment protection". In other words, job security was granted in return for labour concessions. To be sure: such deals would have been impossible without strong trade unions, but nevertheless *willing* to compromise – and being *able* to compromise.

In addition, Germany has been able to use its place within the EMU to boost its exports: Given its "highly coordinated collective-bargaining institutions", Germany has already had a "clear advantage over other

European states in restraining industry-wide wages". This "form of internal devaluation – an equivalent to currency devaluation based on depressing wages – has fuelled an export boom and made the German economy more competitive than other euro zone countries". In short, for now, "Germany enjoys the best of all worlds – a competitive manufacturing sector and low unemployment, minimal borrowing costs in financial markets, a balanced budget in 2014, and a growing skilled workforce".

To sum up, some of those institutions and regulations that had been under harsh criticism during the second half of the 1980s and during the 1990s because of their inflexibility and their restraints to competition now proved to be – at least for a couple of years in the past and maybe for some years to come – the sources and guarantors of Germany's economic revival and success. This is especially true for the industrial relations regime including powerful trade unions. Even the imbalance of the economic structure in favour of the industrial sector and to the disadvantage of the services sector, often fiercely criticized by economists, seemed to have lessened the impact of the financial crisis of 2008-9 on the German economy.

4) Future Threats to the German Performance

Today Germany is dominating the European Union more than ever. In 2014, Germany's share in Euro zone GDP was about 29 per cent, in EU GDP 21 per cent (see *Frankfurter Allgemeine Zeitung*, 16 January 2015, p. 19). In 2015 and 2016 these shares remained nearly unchanged. And apart from the bare figures, as a German commentator recently emphasized, "Europe acts according to patterns and rules coined by Germany" (Bonse, 2015: 5). This hegemony has been put into effect less by certain German officials holding top positions inside the EU apparatus (see "Die EU spricht deutsch", in *Frankfurter Allgemeine Zeitung*, 26 June 2014), but more by rules and regulations. The result is "a system tilted toward German priorities: low inflation, austerity, and the repayment of creditors" (Moravscik, 2012: 66). This system, however, did not bring growth and stability to all the other EU members. And in the meantime, the so-called refugee crisis and the Brexit shock caused violent turmoil in Germany and in the EU. Seriously alarmed, historian and political writer Timothy Garton Ash therefore asked recently: "Is Europe Disintegrating?" (The New York Review of Books, 19 January 2017). So the Germans indeed should be worried about the future. Not only are they challenged by EU partners like Greece or Poland and, already determined to leave, Britain. In addition, the new American administration under President Donald Trump is attacking the Merkel government's economic and trade policy. On top of these troubles Germany faces some enormous domestic long-term problems: "Its workforce is shrinking, its energy sector needs to be remade, and its public infrastructure has gone too long without improvement" (Tooze, 2012: 23). But there are other fault lines underlying Germany's economic model (see ibid: 24-6):

Germany is enjoying a huge trade surplus, but in contrast to the 1950s and 1960s the country is investing abroad rather than at home.

Even though the German population is rapidly aging, the government has underinvested in human capital.

Germany's spending on primary and secondary education remains below the average for OECD countries; Germany loaned far more to foreigners to buy German goods than it spent on the education of its own children.

Germany's birth rate is low – in 2009, only three other countries in the OECD had fewer babies per woman.

Following Japan's Fukushima nuclear disaster in 2011, Germany resolved to close all its nuclear plants by 2022. The government aims to cover 35 percent of the country's energy needs with renewable energy by 2020. This energy transformation will likely end up costing over 200 billion euro.

According to OECD surveys income inequality in Germany has risen twice as rapidly as the OECD average.

Political scientist Henrik Enderlein added to this list deficiencies of "reforming eagerness" (*Reformfreudigkeit*) concerning especially digitalization or services ("Dampf machen", in: *Süddeutsche Zeitung*, 23 April 2016).

As Moravcsik believes, the best way for Germany to surmount these problems would be a bold strategy for growth – for Germany and the rest of Europe as well. This would imply to "treat austerity not as a permanent economic policy but as a form of shock therapy". In order to come up to its responsibility as Europe's present-day "hegemonic" power Germany should aim to leave future generations "not only with fewer liabilities but also with the makings of a better world" (ibid: 30). But there are other proposals and ideas. Martin Schulz for example, social democratic candidate for the position of chancellor in the parliamentary elections in September 2017, has announced to correct "errors" of Chancellor Schröder's *Agenda 2010* ("Die Agenda 2010 im Check", in: *Süddeutsche Zeitung*, 1 March 2017). Trump and his advisers, on the other hand, ask of the German government to stop its alleged "reduction in wage levels" and its "monetary dumping" (Uwe Jean Heuser, "Falsche Feinde", in: *Die Zeit*, 16 February 2017). Of course, both proposals met with harsh criticism. So at the moment there are many ideas – but a really convincing plan how to deal with all the pressing problems is still missing.

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"Responding to Challenges for the Euro-zone: Resilience of Europe and New Perspectives of the EU Studies"

Venue: Sendagaya Campus, Tsuda College

Day One 8th March, 2015

Preconference Seminars :Special Lectures and Academic Meeting

Day Two 9th March, 2015

Plenary Session

"Responding to Challenges for the Euro-zone:

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Lecture Series "Thinking about Economics: On EU Studies"

EUSI Tokyo Economics Unit & Tsuda College FD Support Seminar

23rd February, 2016

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EUSI Tokyo International Conference (EU Economics Project) Programme

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8th March, 2015 Day One

Preconference Seminars :Special Lectures and Academic Meeting

Moderator: Takamoto Sugisaki

Registration

Opening Remarks

Takamoto Sugisaki, Professor Tsuda College, EUSI Tokyo,

Welcome Speech

Kyoji Kawasaki, Former Director, EUSI Tokyo, Professor, Hitotsubashi University

Special Lecture

"Richard Nikolaus Eijiro Graf Coudenhove-Kalergi and the Pan-Europa Movement" (Tentative)

Hidenori Tozawa

Professor, Tohoku University, School of Law

Special Lecture

"Asia-Pacific View Point on the Euro and Global Monetary System"

Toru Iwami

Emeritus Professor, Tokyo University, School of Economics

"EUSI Tokyo Activities" by Satoshi Fujikawa, Secretary General of EUSI Tokyo

Meeting for the Conference and Publication by Takamoto Sugisaki

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9th March, 2015

Day Two: Plenary Session "Responding to Challenges for the Euro-zone: Resilience of Europe and New Perspectives of the EU Studies"

Venue: Sendagaya Campus, Tsuda College

Moderator: Rene Duignan (Delegation of the European Union to Japan)

Takamoto Sugisaki, Professor Tsuda College/ EUSI Tokyo

Welcome Speech

Mari Kunieda, President, Professor,Tsuda College

Opening Address

Viorel ISTICIOAIA-BUDURA

Ambassador, European Union Delegation of the European Commission to Japan

Keynote Speech

Takamoto Sugisaki, Professor Tsuda College, EUSI Tokyo,

<Opening Lecture>

"Financial Dimensions in History: Europe's Crisis in Historical Perspective"

Youssef Cassis

Professor of Economic History, Joint Chair Department of History and Civilisation

Robert Schuman Centre for Advanced Studies, EUI

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"Update on European Economic Situation"

Zsolt Darvas

Senior Fellow, Bruegel - Brussels European and Global Economic Laboratory

Discussant

Kentaro Kawasaki, Associate Professor, Toyo University

"Reviewing the Situation in Greece: The Greek Debt Crisis and its Aftermath"

Panos Tsakloglou

Professor, Department of International and European Economic Studies (DIEES)

Athens University of Economics and Business

Discussant

Sara Konoe, Associate Professor, Kansai University

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"Financial Crisis and Recovery in Ireland"

Marie-Bernadette Andreosso-O'Callaghan

Professor Jean Monnet Chair of Economics at the University of Limerick, Ireland

Discussant: Rene Duignan (Delegation of the European Union to Japan)

"The German Case after 2007-08 International Financial Crisis"

Werner Bührer

Professor,Technische Universität München, TUM School of Education

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Ryosuke Amiya-Nakada, Professor, Tsuda College

Session 3 Round Table "Social Cohesion and its Resilience in Europe: Economic, Political and Social Dimensions "

(Chair: Takamoto Sugisaki)

Proposal

Henk Overbeek

Emeritus Professor of International Relations

Department of Political Science and Public Administration

Academic Director, VU-Renmin Minor in Contemporary China Studies,

VU University Amsterdam

Comment Zsolt Darvas

Q&A Discussion

Discussants: Ryosuke Amiya-Nakada
Marie-Bernadette Andreosso-O'Callaghan
Werner Bührer
Youssef Cassis
Zsolt Darvas
Rene Duignan
Sara Konoe
Henk Overbeek
Panos Tsakloglou
Hidenori Tozawa, Professor, Tohoku University

Closing Remarks

Rene Duignan

Ryosuke Amiya-Nakada

Takamoto Sugisaki,

Lecture Series "Thinking about Economics: On EU Studies"

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15th January, 2016,

'E.F. Schumacher's Critique of Modern Economics and His Idea of Meta-Economics'

Nagamitsu Miura (Emeritus Professor, Tsuda College)

23rd February, 2016

'The Euro-Crisis and the Struggle in Greece'

Soko Tanaka (Emeritus Prof. Tohoku University)

25th February, 2016

'Money in the Modern Capitalism'

Katsuhito Iwai (Visiting Prof. ICU, Emeritus Prof. Tohoku University

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