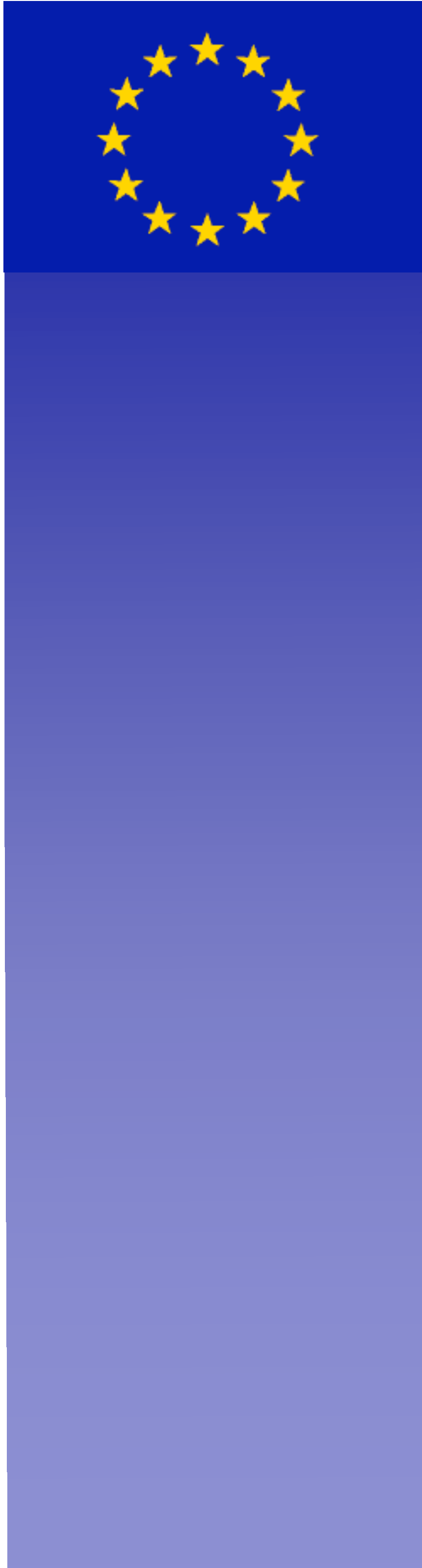

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United They Rose, Divided They Fall: The EU and the Economic Crisis

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United They Rose, Divided They Fall: The EU and the Economic Crisis

Vanessa Marzo[♦]

In an increasingly globalized world, threats become ever harder to contain because of their easiness to spread. Terrorism, drug trafficking, epidemics, nuclear proliferation, etc. are only a few of the countless threats that frighten civilians and nations' leaders around the globe. However, from late 2008, all eyes are focused on a new pressing issue that has led world economies into a terrible storm. 2009 began with the unwinding of a major world economic crisis, which was placed under a sole spotlight and has attracted the undivided attention of nations everywhere. Worldwide, newspaper headlines read: Le Monde: "Sur un nuage"; "La crise frappe encore plus violemment les pays pauvres: Le Sud aussi a besoin de plans de relance"; El País: "El FMI pone cifras a la Gran Recesión"; The Financial Times: "Into the Storm"; China Daily: "China injects $38b into Asian crisis fund". However, the crisis does not only hurt countries economically, but also politically and socially. As countries struggle to get their economies back on track, they neglect the bonds forged by an increasingly interdependent world and childish disputes on "who started it?" and "You fix it" arise. Childish disputes, since 'what?' or 'who?' caused the crisis are, for the moment, inconsequential subjects compared to 'What should be done to curtail its devastating effects?'

Economics is convulsing European politics. Strikes or protests have erupted in the streets of Greece, Ireland, France, Germany, Britain, Lithuania, Ukraine and Bulgaria. This spasm of unrest was unexpected, since Europeans believed they would be spared the worst effects of a disaster carrying a "Made in USA" tag. However, the crisis has spread with a dramatic speed giving way to ever more gloomy predictions for the foreseeable future. As president of the European Commission, Jose Manuel Barroso, states, "There is no doubt we are living through the greatest financial and economic crisis in living memory" (Thornhill, 7). The European Union is being stress tested as never before, as its proudest achievements (peace and stability, a single market, a common currency and the convergence between west and east) are threatened by the economic storm.

Background

With the end of World War II came the dawn of the European Union. The Wars had left an instable, shattered and deeply divided Europe, and at the time the idea of its integration seemed completely ludicrous. However, by 1947 it had become clear to the United States that if it did not act to ignite the European economy, the communists would gain a political grip in Western Europe. On June 5, 1947 the Marshall plan was born as an effort to revive the European continent and foster its reconstruction. The Marshall Plan recipients formed the OEEC in 1948 to engage in coordination of aid and related projects (Ginsberg, 44). The Marshall Plan paved the way for the Schuman Plan and the European Coal and Steel Community, the driving engine of regional integration in Europe.

After World War II, the Europeans had not only lost influence in the world but were also faced with instability at home and countless threats abroad. Jean Monnet, known as 'The Father of Europe' (Fontaine, 5), thought a collective response was needed. Monnet believed that the

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Franco-German problem represented “the greatest obstacle to a united Europe” (Ginsberg, 42), and he proposed a solution to the dilemma. Since neither side in the past had felt secure unless it controlled all the resources along the French-German border Monnet’s solution was for France and Germany to exercise joint sovereignty over their coal and steel resources (42). Although the ECSC was an idea originally conceived by Jean Monnet, French Foreign Minister Robert Schuman proposed the establishment of a European Coal and Steel Community (Fontaine, 5). On April 18, 1951 Benelux, France, Italy, and West Germany signed the Treaty of Paris -based on the Schuman Declaration- and so the economic community was born. The treaty spelled out a deliberately vague political program to achieve peace and prosperity through economic interdependence (Ginsberg, 46). The ECSC provided for majority voting, a characteristic that allowed it to stimulate further regional integration in the 1950’s (42,Ginsberg). Without a doubt the ECSC’s greatest accomplishment was to serve as stepping stone for a much larger project in European integration, which was the creation of the European Union in the 1990’s (49, Ginsberg).

In 1954, the ECSC’s limitations to serve as the engine for further European integration, lead an inspired Monnet to establish the Action Committee for a United States of Europe. During these years, political unity was no longer in vogue, as countries’ attention shifted towards the development of atomic energy (Gillingham, 361). Benelux proposed a plan based on the establishment of a customs union for the whole of the ECSC countries. What Monnet saw as a new initiative to foster further European integration, countries saw as a welcomed step to develop their national economies. On May 1956, the Foreign Ministers approved the Spaak report and the six nations agreed to accept it as the basis for the Treaties of Rome creating the European Economic Community and Euratom. The EEC Treaty aimed to establish over time a common market. Unlike the vague 1951 Treaty of Paris, whose preamble spelled out the vision of a united Europe, the Rome treaties were far less visionary in that they did not explicitly link economic integration with the goal of political unity. Twelve years after World War II, governments were more eager to integrate economically than to encourage institutionalized political cooperation. Moreover, Roy Ginsberg explains in his book –Demystifying the European Union- that,

> The EEC Treaty’s preamble reveals the primacy placed on economic cooperation over political union, with one exception: in the first clause the Treaty refers implicitly to a political union. However, the rest of the preamble and the Treaty focus on functional issues within a new common market: economic and social progress, improvement in working and living conditions, and economic development of backward regions (55).

The EEC and Euratom Treaties entered into force on January 1, 1958. Which shaped the contours of today’s European Union and the economies of the six charter members enjoyed sustained growth and development in the 1960’s and early 1970’s.

The 1980s were a difficult period for European integration. The late 1970’s and early 1980’s was known as the era of Eurosclerosis, which was characterized by massive crises of ‘old industries’, such as steel production, the chemical industry and the textiles particularly due to the astronomic rise of Japanese and East Asian economic competitiveness (Ginsberg, 78). “Politics at the national and EC levels responded with massive state subsidies and a temporary encouragement of collusive agreements” (Resch, 416). This period also witnessed, the enlargement of the EC from nine members (Belgium, France, Italy, Luxembourg, Germany, the Netherlands, the United Kingdom, Ireland, and Denmark) to twelve with the additions of Greece in 1981, followed by Spain and Portugal in 1986 (Gungor, 6). Also, the Single European Act was ratified in 1987, it established a new set of policy tasks to create a Single European Market through the elimination of existing trade barriers and through liberalization of trade in services and capital. Then of course, came the end of the Cold War between 1989 and 1991 and with it the dawn of new phase of EC development, a phase of widening and deepening of the Union. The

collapse of the Soviet Union meant that the EC was now responsible to help Central and Eastern European countries to solidify their democratic and market transitions and to stabilize a post-Cold War Europe rendering war "materially impossible" (Ginsberg, 80).

The Maastricht Treaty was signed in 1992 and ratified in 1993 (80, Ginsberg); this treaty established the European Union (Fontaine, 9) and gave a detailed outline for the establishment of EMU by the end of the decade. On June 1993, the European Council set forth the Copenhagen Criteria, which defines the conditions that must be met by any country seeking membership of the EU. Then came the 1995 enlargement, where Austria, Finland and Sweden joined the now European Union. From 1987 to 1996 thirteen countries submitted applications to join the European Union. While in 1997, the Luxembourg European Council launched the EU enlargement process (Gungor, 6). The Copenhagen European Council of December 2002 found that 10 of the 13 candidate countries fulfilled the necessary requirements to become EU member states. After 15 years of reform Cyprus, Estonia, Hungary, Poland, the Czech Republic, Slovenia, Latvia, Lithuania, Malta and Slovakia officially joined the EU on 1 May 2004, followed by Bulgaria and Romania in 2007 (Past, 1). "For the former communist countries of Central and Eastern Europe, the EU membership means a symbolic break with a difficult past, and more importantly, political and economic stability in the short run, and prosperity in the long run" (Gungor, 7).

The December 2001 European Council declared the need for a new treaty that could "provide adequately for the reforms in EU governmental decision-making needed for a union of twenty-five or more states to act efficiently and effectively" (Ginsberg, 84). Therefore, the European Council called for a constitutional convention to convene in 2002, where a draft Constitutional treaty was created, which was presented to the EU Council in June-July 2003 (Union Europea, 2). The Constitutional Treaty would replace the primary European Treaties for a single legal text (3). However, the results of the Dutch and French referenda in 2005 forced the European Council to postpone the ratification process for a so-called period of reflection. The Lisbon treaty is a new version of the Constitutional Treaty that was rejected in 2005 (del Rio, 508), only this time its rejection came from the Irish referendum in June 2008 (Deals, 1).

The Economic Crisis

For the first time since the Second World War, the world's rich economies have sunk simultaneously into a deep recession. Summer came to an abrupt end in early September when Fannie Mae and Freddie Mac, the two largest US mortgage lenders, became crushed by severe liquidity problems and were subsequently nationalized. The problems did not stop there, as Wall Street saw its leading investment banks collapse, bought out or turned into retail banks.

Then, on Monday September 15 2008, the demise of Lehman Brothers fuelled the by then global financial crisis. In a matter of days, the world's financial system came to the point of collapse. Barely a day passed without a large institution requiring a bailout or a country struggling to retain the confidence of its creditors. Consumer confidence was destroyed; in rich countries citizens were too scared to spend for fear of losing their jobs or for their failure to secure credit. Retailers around the globe were declaring bankruptcy and car sales fell through the floor. While companies, for their part, would not risk investment in such a gloomy climate leading to drop in innovation and GDP growth.

Critics would argue that the US' economy would take the most devastating blows from the economic storm; however, as the US is now recuperating from its recession thanks to President Obama's active and rapid policies the international arena is worried of the permanent damages that the crisis will unveil.

As the Bush administration advocated for a 700 billion dollars rescue plan to bailout American banks, in the UK banks were saved only by the government's promise of taxpayer support and guarantees on wholesale funding. Many European banks were also bailed out, while

Ireland "guaranteed all its banks' liabilities to stop a mass run" (Giles, 8). At a ravaging speed, the turmoil spread beyond the rich world to crush emerging markets.

The Euro zone

The adoption of the Euro is considered one of the most important steps in European integration, second only to the Schuman Declaration announcing the establishment of the European Community of Coal and Steel (Roy, 17). The common currency is definitely an important symbol of the region's shared sovereignty "over a range of crucially important economic and political processes" (Mulhearm, 1). However, what started out as a strategy to pull Europe together economically and politically now harms its least fortunate members.

The Treaty on European Union (TEU) entered into force in 1993 and provided for the establishment of the Economic and Monetary Union (Ginsberg, 247). The Euro was first introduced in 1999 as a virtual currency used for cash-less payments and accounting purposes. It then appeared in physical form on 1 January 2002 (The Euro). It is worth noting that the EMU does not include all 27 EU member states, at the moment it is comprised of 16 member states. Furthermore, the EMU is a monetary union but it is not a full economic union, as the EU does not have sovereignty over fiscal policy (Ginsberg, 247).

With the establishment of the EMU, member states gave up their freedom to print and regulate currency, set interest rates and use Monetary Policy to address both periods of growth and periods of recession (247). On the other hand, members of the Euro zone also stood to gain economically. Without a doubt, some EU members could see the currency's potential to at some point compete against the US dollar in the international arena (Landon, 1), which made the establishment of the EMU that more appealing for EU member states. However, politics played a greater role in the adoption of the Euro than economics.

The Economic Monetary Union strengthened the internal market. It "eliminated the costs of converting currencies in the exchange of goods and services for its member firms and consumers, and ended the uncertainty of fluctuating exchange rates among its members who trade within the internal market" (Ginsberg, 247). Under the Maastricht Convergence Criteria, in order for a member of the EU to become part of the Euro zone, their national budget deficits must not exceed 3 percent of GDP; total national debt must not surpass 60 percent of GDP; exchange rates must stay within the ERM range of fluctuations for at least two years; inflation cannot be more than 1.5 percentage points higher than the three lowest inflation member states of the EU; and long-term interest rates must not be more than 2 percent above the average of the lowest three performers (Ginsberg, 249).

Consequently, in the 1990s many member states made arduous efforts, through fiscal tightening, wage restraint and product and labor market reforms, to qualify under the Maastricht Convergence Criteria for euro membership (High, 37). However, once accepted into the Euro zone they relaxed, fooled by the notion that membership would be a panacea to their problems. Instead, countries should have pursued more vigorous national reforms to make their economies better able to compete with Germany's; and they should have tightened fiscal policy to offset the euro's easier monetary policy (High, 37).

Today, Europe (and the world) is in a deep recession. In Spain and Ireland property bubbles that were inflated in part by the switch to low euro interest rates have burst. In Greece, Italy and Portugal a steady loss of wage competitiveness is eroding growth. In all five countries, as budget deficits grow, worries that public finances may arrive to an unsustainable path are rising exponentially.

The rules of the single currency forbid any bailout of one country by the center or by other member states. The Germans fear that they will be asked to pay for the recklessness of others and on March 1, Germany rejected a rescue plan of several thousand million Euros for Eastern Europe (Verhaegen, 10). Nevertheless, Germany, as euro area's biggest economy and

biggest exporter, would suffer most from any member's default. That need not imply a straightforward bailout; however, it would imply both a bigger role for the center and more intrusive monitoring of euro members' budgets (High, 37).

In Frankfurt, the ECB, the EU's independent Central Bank, sets interest rates and monitors the money supply in the Euro zone. One grave concern with the ECB's supranational power is the uniformly set interest rates for the whole of the EU, mainly, because of the economic differences among its 27 member states. The uniformly set interest rates do not comply with the needs of all countries alike, since these needs widely vary across borders. In the present economic crisis many Euro zone member states –such as Spain, Slovakia, and Greece- need liquidity in order to stimulate their economies. However, the ECB will not increase the money supply in the Euro zone because countries –like Germany- that do not need the extra liquidity will be affected by a devastating rise in inflation.

Nevertheless, for a decade, the EMU has brought major benefits in terms of price stability, new investment opportunities and more efficient markets. The young currency has also proven to be a powerful shield against external economic shocks. However, today, the euro faces the first recession in its history and, in the words of Joaquin Almunia, "there is no question this year will be a stress test for the European single currency" (Almunia, 1). Thus, while Euro zones' poorest members gained from sharing a currency with some of the mightiest economies in the world, with the present economic crisis membership seems more like a burden to these countries since the rules of membership are keeping them from implementing policies to "ride out the economic storm" (Landon, 1).

The current economic crisis hit central and eastern Europeans so disproportionately hard for two major policy errors by their respective governments. The first was to encourage households to obtain mortgages in foreign currencies. While the second policy mistake was that the new EU members treated euro zone membership as a voluntary policy choice, which is clearly a misinterpretation of their own accession treaties. Of course, the new members were not under an obligation to join the euro zone immediately, but they were obliged to conduct policies consistent with eventual membership. The decision to procrastinate their integration into the euro zone has "turned out to be a financial stability disaster" (Munchau, 1). These are problems that the euro zone cannot choose to overlook, mainly, because most eastern European banks are branches of western European banks. According to *l'agence de notations Moody's,* banks from Austria, Germany, Italy, France, Sweden, and Belgium account for 84% of banks in Eastern Europe. (Le Monde, 1). Economists from the Dresdner bank said that eastern European currencies are trapped in a depreciation spiral, which for the euro "is like a bomb with delayed-action" (Le monde, 1).

Certainly, membership to the Euro zone is not a panacea for a country's social and economic problems but in times of crisis the ESCB must act to protect the Euro zone from a catastrophe, and in order to do that it must help eastern European countries to adopt the Euro. Hungary, Poland, along with the rest of the Baltic countries are pleading for the EU to accelerate their accession process so they could join the Euro zone as soon as possible (Verhaegen, 10). Also, the EU could provide financial aid through the IMF to prevent an economic meltdown in the midst of the present crisis. The ESCB should also reconsider some of its membership requirements and think about bending the rules to make it easier for non-member states to join the Euro zone.

The Economic Crisis hits home

"British jobs for British workers", "Buy Spanish", "Invest in France", "No new iron curtain", these are some of the slogans that resonate throughout the EU. The strain of the economic crisis is certainly opening up divisions within the union, or in the words of the Prime Minister of Hungary, "the iron curtain" that will divide the European continent between the rich and the poor

(Verhaengen, 10). Protectionism is surfacing in Western Europe and state aid rules that avert "the promotion of national industrial champions are being cheerfully trashed" (Rachman, 11). As Nicolas Sarkozy urged car companies to invest at home rather than elsewhere in the EU, and Spain launched its "Buy Spanish-"campaign.

President Sarkozy sees the EU as part of the problem rather than the solution naming the 27-member organization the "Trojan horse of globalization" (Thornhill, 7). The French president, along with other national leaders, have been directing their own response to the financial crisis that infringes state aid and competition rubric while also "trashing the eurozone's fiscal rules" (Thornhill, 7).

In Spain, unemployment has reached 15 per cent. Spanish unemployment is the highest in the euro zone, and it is expected to reach 20 per cent as the recession deepens (New Spanish Steps). The rapid rise of Spanish unemployment, mainly from the building sector, along with the increase of bad loans on the banking system show the dangers of Spain's dependency on home construction during the last decade. Spain debates between more stimulus for its national economy and the protection of its financial markets. Facing a similar situation was Ireland, which opted for raising taxes. However, Spanish personal and corporate taxes are already high (New Spanish Steps).

The Council of the European Union informed the public through a press release in Luxembourg on 27 April that the national budget deficits of Spain, Ireland, Greece, and France exceeded 3% of GDP and prompted for immediate action to reduce their deficits by the deadlines established by the Council (15).

Poland and its currency initially avoided the worst of the financial meltdown in the United States and Western Europe. In late February the zloty stood at 4.73 to the euro, which was good news for the Polish. Though, then the Central Statistical Office announced that Poland's industrial production dropped close to 15 per cent in January compared to the same month in 2008. Which meant that for three consecutive months Poland witnessed a decline in its industrial production, definitely signals of an unhealthy economy. The financial crisis threatens Poland's goal of adopting the euro in 2012, but Poland's finance minister –Jacek Rostowski- told parliament that, "Secure public finances and a quick adoption of the euro are the best way out of the crisis for Poland" (Lucas,2). While Poland is eager to join the euro zone, Slovakia finds membership to be a "double-edge sword" (Cienski, 2).

Conclusion

Since October 2008, the European Union has failed to recognize the economic crisis as a European problem rather than national problems. Since then, a stream of unilateral actions to save national banks and prop-up structurally flawed industries dominate the economic arena. However, for the EU to combat the financial crisis it must implement both short-run and long run measures. "It needs to add short term actions to its structural reform agenda", while at the same time continue to invest in the future (Communication, 5). The policy instruments for dealing with employment and stimulating demand are mainly in the hands of the Member States, but if Member States and the Commission work in unison the results would be much more efficient.

Some of the policies the EU should implement are:

- Increasing investment in R&D innovation and Education. Which will lead to a boost of GDP growth along with real GDP that will allow countries to avoid a rise in inflation.
- Enhance European competitiveness by developing an ever greener economy that would create jobs in the short-run and would definitely benefit the economies in the long run through the creation of new technologies and the achievement of EU environmental goals.

But above all, the 27-member states must put their selfish interest aside and work as a united front to tackle the economic storm and ensure the survival of the Union and its greatest achievements. "Protectionism and Nationalism are close cousins" (Rachman, 11). The EU's enlargement to include the countries from the former Soviet bloc was an incredible step towards spreading political and economic freedom across the Continent.

A lack of economic development in vulnerable economies will not be the only consequence of a division in Europe during this financial crisis. The Eastern members' political stability could very well unleash the demons of the past, as mounting anger over recession, unemployment and debt could fuel populism with unpredictable consequences. Some central and eastern European countries feel betrayed and excluded by the union as western countries –like France- support national solutions rather than the much needed international solutions, and Germany turns its back on the Eastern bloc.

The achievements of the European integration process have been remarkable over the past 50 years, and indeed strength comes in numbers. If Europe faces this crisis as a sole united front it will stand a better chance to survive and to ensure peace and stability throughout the continent. However, divided the Union will undoubtedly fall and the consequences would be catastrophic.

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