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ECONOMICS OF THE NEW MEMBER STATES: A POST-CRISIS PERSPECTIVE

This essay addresses four major issues confronting the Central and Eastern European new members of the European Union in the decade to come. First: what to think of the financial meltdown of 2008-2009. Second, what have they learned from the tremors, having shaken the previous star performers of the EU? Third we ask if we can expect a return to 'normalcy' as forecast by most models of financial rating agencies and international financial institutions? Fourth the question is raised what did the new members benefit from their EU membership? Some conclusions on the future of EU reforms and policies close the overview.

INTRODUCTION

2008–2009 witnessed a largely unexpected derailment in the catching-up process of the new member-states (NMS) of the European Union. Convergence to EU-15 levels has come to a halt already by 2008 with the slowdown of economic activity, and has been positively reverted in 2009. The contraction of GDP in most NMS exceeded that of the Euro Zone by 2.1 per cent, with Hungary registering a drop of 6.3 per cent and the previous envy of the rest, the Baltic States registering double digit drops, unprecedented in peace time development [more on that in: WIIW 2010]. Since recovery in 2010 is modest and also in 2011 likely to be mediocre, at least an election cycle– but perhaps more – is wasted in terms of real convergence, conventionally postulated in theories of economic integration. Also this development stands in stark contrast with the generally upbeat mood, strongly represented in the literature [Kolodko 2009] seeing a fast and continuous catching up as a baseline scenario, provided rather innocent, commonsensical maxims of economic policy making – such as avoidance of excessive deficits and disregard for externalities – are being observed.

These developments took by surprise most observers of the regions as well as central banks, fiscal authorities and international institutions. The vulnerability of the NMS to external disturbances was though a subject of some theorizing, however the intensity and imminent occurrence of the spillover of global financial crisis has called for some reflection, both among policy-makers and academics. In short, while some envision a return to normalcy, and that relatively soon, others [Myant and Drahokoupil, eds 2010] interpret the financial crisis as the final verdict on transition, one that has finally uncovered the long lasting unilateral dependence and unilateral, asymmetric integration of Central and Eastern Europe in the global hegemonic system of capitalism.

ON THE GLOBAL FINANCIAL CRISIS

A., With the passage of time we learn more data about the size and scope of the meltdown. First, while the crisis indeed wiped out entire industries, such as most investment banking, it has not wiped out the entire financial sector. Moreover the more we learn about the balance sheets of banks around the globe, the more we might be surprised to see, that many of the big financial institutions are in pretty good shape. Profits are slightly below the levels of the previous year, but all in all business seems to have been as usual. And while the press was preoccupied with cases of major public bailouts, several other institutions were in no need of public money, and far not only Barclays with its conspicuous overseas takeovers. Major banks in a number of EU states, including those in Spain, Poland and Hungary did not require public action, contrary to their Irish or German counterparts. In short, while some financial institutions collapsed, others flourished. We can by no means talk about the crisis of the entire financial sector of the globe, not even of that in all advanced economies. Interestingly, major collapses occurred not in the relatively unregulated areas like hedge funds, but in the fields where the visible hand and yes, the so frequently required regulator was more than marginally present, such as in mortgage lending. The subprime crisis was therefore clearly one of state failure, rather than market failure [Dimsky 2010]. The role of over the counter deals, structured products and financial innovation with its related lack of transparency was clearly overrated in the popular reaction.

Likewise more detailed analyses of the causes and the mechanisms of the crisis [Reinhart and Rogoff 2009] were able to demonstrate the fundamental differences to those of the Great Depression, not least owing to differences in the workings of global capital markets and owing to the presence of major automatic stabilizers, primarily public transfers and coordinated action by the public authorities in the global scale, avoiding thus the beggar thy neighbor policies of the interwar period. The much criticized disciplines of the WTO as well as the mechanisms of the EU single market, most importantly competition policies and the joint fiscal framework, helped avoid a relapse into old fashioned protectionism. Likewise the survival of the institutional and policy framework allowed to start working on what is euphemistically called as an *exit strategy*, implying the discontinuation of pumping indiscriminate amounts of money into the economy, and reverting the mostly improvised proliferation of interventions into the workings of the market.

In short, a return from exceptional, 'war-time' management practices of the panic phase of 2008-2009 a certain 'return to normalcy' is already in the making. Governments declared their schedules to return to the numerical limits of the Stability and Growth Pact, and ECB calls to revive solid operations, typical of 'peace times' are being heeded. The wrestling over Greece in early 2010 is a clear indication that in most of Europe the inclination to take wartime as normalcy, and peacetime as exceptional is no longer given.

B., What should we think about the real economy in terms of usual activity indicators that characterize macroeconomic performance of EU nations? First and foremost, it is important to recall, that global output in 2009 contracted by a mere 1.2

per cent, Euro Zone output by 2.1 per cent, EU output by 4.3 per cent, while several economies managed to grow, like China, India but also Poland. This is exactly the opposite pattern to the ones observed during the Great Depression, when core economies contracted much more than those in the periphery.[1] According to the consensus view of analysts, from the OECD to the IMF and the EU Commission, the global and the European economies are to grow in 2010 and 2011, even if recovery is fragile and thus its robustness may well be less than mechanistic modeling would have it. Thus, at the bottom line, we registered *a single year of contraction*, which is though unpleasant, but not without parallels.

In terms of inflation the good news is that it has not been extinct. While many analysts feared of a *deflation*, the overall contraction of price levels has not materialized in the sense of ECB, implying four- rather than just two- quarters of consecutive decreases in the overall price levels. On the contrary, in some cases - as Hungary and the Baltics - inflation already flared up, and in other cases, as in Britain and Ireland, Spain and Greece, the question whether governmental spending translates into inflation is a matter of 'when', rather than of 'if'.

In terms of unemployment the situation is equally sobering, but by no means extreme or catastrophic. The unemployment rate of the EU has climbed close to the double digit levels by early 2010, which is certainly bad news.[2] But this overall number is hardly above the customary rate of the 1990s. True, this had been, already then a major social and economic challenge for the Union. Still, 9.9 per cent for the Euro Zone and 9.5 for the entire EU at the end of 2009 is not a severe overshooting over 9.8 per cent of the 1996-2000 average, or 8.6 per cent for the 2001-2005 average, even if in certain countries and regions, especially in Spain, reaching 20 per cent by spring 2010 and Latvia, exceeding the 25 per cent level, which is devastating. By contrast, and defying the bad track record of the 1995-2005 period, unemployment has not soared in traditionally weak Slovak and Polish labor markets. Their respective 12.9 and 11.9 per cent,[3] but remain way below the 18 to 18.5 per cent that featured the preceding period. This observation should not be read in terms of complacency, as governments must surely act, but the macroeconomic impact must be put in proper numerical perspective. Even in the Czech Republic, the 2009 figure of 9.2 per cent is surprising by traditional standards, rather than extremely high in EU standards.

C., What has been summarized above translates in economic theory as a clear case of a *cyclical slump as contrasted to a structural crisis*, a difference the world has known to appreciate in the 1973 and 1979 global downturn. If the recession is cyclical, it usually does not call for structural measures, let alone rethinking the economic theories and the fundamentals of the market system, as several commentators,

1 While the US economy contracted by about 50 per cent in the seven years between 1929-36, the Hungarian economy contracted by only 10 per cent in 1930-31 and grew from 1932,

2 Throughout the paper, the source of data, unless otherwise indicated is the ECB's Statistics Pocket Book, February, 2010.

3 Central Statistical Office of Poland webpage, accessed on 15 March, 2010.

and not just in the press, have called for. Rather what we observe is a *return to normalcy*, a point to be elaborated below.

First and foremost, what we observe is a corrective phase, when previous overvaluation of assets, especially on the stock markets, were cut back to size, i.e. brought in line with the realistic ability of those assets to generate revenues in the medium run. Certainly, following two decades of what Alan Greenspan termed already in 1996 as 'irrational exuberance' it takes a longer period of trial and error until the new terms of exchange emerge, thus there is nothing surprising in the relatively slow and tumbling recovery of financial markets.

Second, as previously privately hold toxic assets have been transferred to public hands, authorities will have a tough time in figuring out what to do with those. In other words, the crisis of private banking has been transformed into a severe disequilibrium in public finances, with no clear cut strategy to overcome the new challenge. What is clear however is that private markets are unwilling to finance any levels of debt, and a relapse into inflationary finance in the open manners of the 1970s is no longer an option. Under this angle it is a welcome development that the EU institutions in general and the ECB in particular continues to act in defense of solid finances and do not make allowances coming from the political sphere to 'bridge' fiscal disequilibria at any cost and through any means, irrespective of costs and consequences.[4]

Third, as it can be elaborated at greater length, the improvised set of state interventions created a situation where unintended side effects dominate the intended ones, therefore the exit strategy can by no means be found in the direction of further state intervention and the revival of Keynesian recipes, that were elaborated under different conditions, especially different conditions pertaining to the transmission mechanisms of money markets [Leijonhufvoud 2009; Csaba 2009]. From this it follows that the way out will be in the discontinuation of conditions of an economic martial law and a return to established peace time practices, with significant improvement in terms of regulation.

NEW MEMBER STATES IN THE MELTDOWN

A., The new member states could gather a series of experiences during the 2008 - 2010 period. First, as can be shown prior to the out brake of the crisis, simplistic policy options aiming at shortcut solutions - and aiming at saving the pains of slow ad complex institution building - enhanced the external vulnerability of the star performers, primarily the Baltics and Bulgaria, to an unprecedented degree [Csaba 2008]. This vulnerability translated into immediate external shocks when quick adoption of the single currency proved impossible, and when the currency mismatch, between earnings in local currency and debts accumulated in foreign currency, primarily of households and the corporate sector, exploded as a side effect of

4 Top Notenbanker droht merkel mit Verfassungsklage. Handelsblatt, 24 March, 2010, online edition, downloaded on the same day.

the global financial panic that ensued from the collapse of Lehman Brothers in September 2008.

But the fragility of economic development has become manifest in all other states. Czech GDP declined by 4.2 per cent and unemployment rose to 9.2 per cent. The previous growth champion of central Europe, Slovakia also experienced a steep decline in her GDP, reaching a drop of over 5 per cent against the impressive growth of 6.2 per cent in 2008 and 10.2 per cent in 2007.[5] While Poland managed to grow by nearly 2 per cent in 2009 (after the upward revisions of the last quarter), Hungary experienced a drop of 6.3 per cent, and the currency crisis could only be averted by resorting to a jumbo IMF-EU-World Bank loan, a unique arrangement of its kind orchestrated in October 2008. The experience of the Visegrad countries less Poland reflect that doing nothing over years is not an innocent lapse that would run without costs in the short and medium runs.

The deepest decline hit the previous star performers, the Baltic States, where the decline of GDP was double digit, and unemployment rates soared accordingly. The crux of the problem here was lack of institutions and lack of will, on the side of the authorities, to cool down the economy when unsustainable current account deficits surfaced already in the middle of the decade. While the currency board regime does exclude devaluation and limits severely the possibilities of setting interest rates at will, however it does not mean a lack of any policy instrument. For instance banking supervision is at the hand of authorities and borrowing, especially in foreign currency, can be limited e.g. by imposing a compulsory deposit requirement or taxing the profits accruing from this form of lending. Likewise tax policy has been around and so are many other policies, provided higher tax revenues are spent on a variety of items with public goods character, such as improving the physical and institutional infrastructure, protecting the environment or building up stabilization funds along the Norwegian or Russian lines. But authorities have refrained from acting, as the naive belief in growth as a panacea for any social ills, along the 'bigger the better' lines, was universal. Also the steep fall of output and living standards, that followed Soviet disintegration propelled expectations.

B., What has been described above is a set of policy mistakes, that revolve around the notion of populism. This implies a propensity of decision-makers to follow the immediate preferences of their electorate, irrespective of their longer term ramifications. Procrastinating with long overdue reforms in the central Europeans (save Slovakia), or staying idle when faced for longish years of overheating is certainly not attributable to broader systemic factors, to institutional structure or long term historical path dependence. On the contrary: these are prime examples of *policy omissions/mistakes*, which recall in elder observers the Latin American experience with recurring currency crises, i.e. the inability to learn the lessons of the past. While these may, and indeed do, have deeper social, historic and other roots, the mistakes themselves should not be identified with the former. For this reason it seems premature to consider the crisis as 'the final verdict on transition', as the insightful collec-

5 Data from the website of the National Bank of Slovakia, accessed on 15 March 2010.

tion by Myant and Drahokoupil [eds, 2010] does. For the structural and institutional weaknesses they list, including the insufficient upgrading of export patterns and the one-sided integration of the transition economies to the global financial markets, together do not explain the specifics of the crisis. Neither its timing, nor its mechanism, let alone the differences in scope by the country.

Should we accept the view that asset bubbles are by and large inevitable byproducts of the workings of free markets, as we have observed over the past two centuries or so, it were difficult to see the Spanish or Irish burst of the real estate bubble as systemic rather than cyclical crises. Likewise it would be hard to draw such broad, theory-shaping conclusions as the above cited authors do, joining the choir of many voices deploring the allegedly incurable ills of market capitalism. Be what those ills might be, it is certainly a *non sequitur* to infer them from a cyclical downturn whose length is neither unprecedented nor its depth is unparalleled in postwar economic history.

C., What NMS experienced in the 2008-2010 years was, in terms of European policies, the *limits to solidarity*. If one compares the unprecedented – and of course more than justified – efforts of the EU to forestall the collapse of the Greek domino/not least in fear of its spillover to Spain, Italy and Ireland/ in the spring of 2010, to the hesitant and regularly belated reaction to the deep crises in the Baltics, Hungary, Romania and their neighbors, Ukraine and Serbia, all turning to the IMF for rescue, the picture becomes sobering. Moreover, while public authorities, including the Commission, did finally act to assist the countries listed, private agents, especially headquarters of financial institutions were not slow in using their affiliations in NMS as milking cows for covering the losses suffered by themselves from adventuresome investments, primarily in overseas markets.

It is important to put the events in perspective. For one, it is beyond doubt that registered capital flows have not followed calls from President Sarkozy and other leaders for patriotic economic policies and relocate their activities in the home countries. On the other hand, the credit crunch in the region was exacerbated by the freeze on lending decisions, not justified by local market conditions. This was certainly not an outcome of 'concerted action' orchestrated by some dark forces. But the consequence of having outsourced the centers of decision making abroad, following the microeconomic considerations and neglecting macro repercussions has also become manifest for the policymakers in and outside the NMS.

AFTER THE CRISIS – BACK TO NORMALCY?

A., Seeing the end of the crisis phenomena, the recovery of output and financial market indicators, it is indeed tempting to offer the convenient assumption: after rainy days sunny ones must be coming. However, reality might be more complex. Recovery in the global economy might turn more fragile and less evenly distributed as most models customarily would have it. If there is any lesson commonly distilled from the experience of previous crises [Eichengreen 2001; Stiglitz 2009] is that after a crisis 'normalcy' does not mean a return of the *status quo ante*. On the contrary, the only item we know for sure that new players, new rules of the game, new modalities of conducting business and new forms of regulation are bound to emerge. One of the obviously foreseeable outcomes is that surviving actors will be even bigger to fail, than the traditional ones. Efforts of the US administration, to tackle those by way of the Volcker rules, go in the right direction, however the problem will be hard to tackle. It is not only the size, it might be other, and often hard to delineate broader considerations, such as regional relevance, or professional significance that may prompt governments to intervene, in a chain, quite in line with the bleak forecast of Ludwig von Mises before World War One [v. Mises 1929(1996)].

B., Coming to the NMS we may revive the insight, summarizing the first decade of systemic change: institutions matter but so do policies [Havylyshyn–van Roden 2003]. Comparing the experiences of Hungary to Poland in the 2002–2010 period speaks for itself already at the elementary level. Instituting measures of solid public finance, avoiding adventuresome external funding for consumptive purposes, sustaining price stability and conducting policies generally converging to EMU criteria allows saving the country from vulnerability and externally imposed discipline.

On the other hand, Bulgarian, Romanian and the Baltic experience seem to suggest that shortcut solutions, often advocated by policymakers and businessmen as well as the media, do not work in the longer run. Sound macro policies though do create growth, which is good. But without creating the institutional memory in the form of setting up institutions capable of sustaining the results of social learning previously experienced problems may revive, and avoidable mistakes might be repeated. The relevance of regulation, especially in the financial sector, counts by today among the platitudes, thus is in no need of elaboration. Implementing rules of prudent banking is certainly a must, especially if the already observable return of malpractices is to be avoided and social explosion - or alternatively even more costly future bailouts - to be avoided.

C., One of the truly strategic debates in and on the NMS is if they should/can return to the previous path of export-led growth, or a more ‘balanced’ path, i.e. more reliance on the domestic markets is the way to sustainable growth. On the base of what we know from economic theory and history, we do not know of a single case in the postwar period, where growth based on domestic markets could have been sustainable, especially in small open economies. While outward orientation – a concept much broader than export-led growth – does carry a cost, the experience of the past three decades is overwhelming in terms of the efficiency of outward orientation. True, more recent literature [e.g. Pitlik 2008; Baitagi et al 2009] calls attention to the relevance of institutional and policy complementarities. In short, it is not a sectoral approach, but a broad set of coordinated policy and institution building measures that deliver results in the long run.

D., Finally mention should be made of the erosion of the European growth potential, which is particularly observable in the NMS [Halmai 2009]. By dodging most of the structural reforms by most member states, the EU has maneuvered itself into a dead alley. Structural changes that should have revived the labor markets remained fragmentary. The crisis also called attention to the procrastination in terms of capital market reforms and their regulation at the EU level. What was called the Lisbon Agenda, i.e. to try to balance flexibility and competitiveness [Palánkai 2006] was to a large degree watered down and implementation remained partial.

The erosion of European growth potential has also been exacerbated by the insufficient attention to long term challenges, such as ageing and the research and development potential. It is not just the amount of spending which is inadequate, but its composition and relation to business practices, where 'embodied technological progress' is being generated remained lukewarm. The explosion of public debt in a number of core EU economies is itself a factor of slowdown owing to the inevitable crowding out effects.

The foreseeable slowdown in the core EU implies that the external environment of the NMS will not be particularly strongly conducive to growth. Mistaken hopes on the EU as a major factor fostering growth, which used to figure high in the pro-EU political discourse in the NMS is likely to produce disenchantment only. The farther is the perspective of joining the Euro Zone, the graver is the risk of aggravating myopia in the policy conduct of the NMS, further delaying painful but necessary changes if the growth potential is to be revived. The drift between formal qualifications, which exploded, and actual marketable skills, social and professional alike, is likely to develop into a major factor of social discontent, reflected in the lastingly low levels of labor market participation in all NMS. In turn, their ability to cope with expanding health and pension costs will remain structurally constrained - an issue demonstrated also for a historically vibrant and much less aging US economy [Rogoff and Bertelsman 2010].

While the global discourse, influenced to a large degree by environmental considerations, often calls for a zero growth scenario in order to avoid the climate catastrophe, from the point of view of NMS zero growth is a non starter. The level of their per capita GDP is between 40.5 per cent of the EU average (Bulgaria) and 88.2 per cent (Cyprus), that is for the majority the catching up process will take generations, even under the best of circumstances. Furthermore, as we argued above, catching up is by no means an automatic process triggered by EU membership. Rather the question marks behind any scenario of relatively fast and steady real convergence continue to multiply, not least due to the structural and institutional weaknesses uncovered by the impacts of the global financial meltdown.

WHAT TO THINK OF EU MEMBERSHIP?

A., Accession to the EU tended to be over politicized from the very outset. As a consequence, there were both inflated expectations in terms of immediate welfare improvements, and conversely, skeptical voices aired before any of the joint European policies could take effect. The latter is the case in terms of cohesion, in terms of the single currency as well as in terms of environmental protection.

In a way the process of Europeanization has progressed considerably, insofar as the paradoxes typical of old member states could be seen replicated. The median voter does not seem to be very well informed about the complexities of the Union.

Therefore if his concern is joblessness, he/she can blame the EU, although the Community has next to no competences in terms of labor markets. If democratic controls, or the judiciary for that matter, do not work perfectly in a member state, the tendency to blame the EU is there even if it is not justified on material grounds. For this reason the Hungarian public tends to be fairly Eurosceptic according to recent surveys.[6]

However, if we take the proper historical perspective, EU accession is surely a major success story in any area we care to mention. First and foremost, NMS ceased to be on the borderline of competing empires, threatened by constant insecurity and being treated as sources/triggers of insoluble interethnic conflicts. While nobody would doubt the presence of ethnic strains, this is by no means constrained to NMS, as the recent attacks on French police by Basque terrorists indicate. In short, being a member of the European architecture constructed in the spirit and practice of postwar reconciliation has ruled out many options, which were indeed on the cards, should the EU not have played its anchor role for the NMS. Therefore it seems simplistic to 'try to put numbers on EU membership' and try to assess costs and benefits exclusively or even mainly in terms of transfer balances, or in terms of additional trade or FDI flows. Important as these might be, they surely remain subordinate to the fundamental historic rearrangement discussed above.

But if we take the narrower, financial perspective, the beneficial impact of the EU is still beyond doubt, despite the well known methodological problems of assessing the macroeconomic impacts of EU cohesion funds properly [Sirehej 2008]. First and foremost, the 'convergence game' has been at play ever since 2002, i.e. when the political decision on eastward enlargement was taken. This implied more stable exchange rates and lower external costs of funding, for public and private investments alike. Second, from the point of view of capital investors, direct and portfolio managers, the NMS ceased to be a part of some murky emerging market economies and were requalified as secure European investment spots protected by a supranationally imposed Community legislation. Third, the revision of the post-2007 financial guidelines decreased the co-financing requirements to EU sponsored projects to as low as 15 per cent, which of course allowed for more projects to be implemented than under the traditional arrangements, when 50 per cent co-financing was the rule. It is a different cup of tea if we were to ask, whether the priorities set by the NMS, or more precisely the outcome of what many observers consider as an outcome of ad-hoc political bargains on the spot, indeed produce those growth accelerating and multiplier effects, or more broadly speaking any externalities that figure high in the official justification of cohesion spending.[7]

Finally in terms of institution building we might be upbeat. Whatever may the weaknesses of EU practices be, introducing a degree of Community-wide trans-

6 Eurobarometer survey, published on 18 September, 2009, available on the website of the Commission.

7 As a fan of classical music I can only welcome the long overdue renovation of the Liszt Music Academy in Budapest, wherever the funding is coming from. Likewise constructing funeral houses where the number of deaths exceeds that of births, or building fountains in the center of small towns are all welcome, without however being anywhere close to the theories justifying why these expenditures should be Community funded, rather than locally financed.

parency, accountability and even-handedness, including regular external checks on the way money had been spent, are welcome additions in countries which are in the middle of setting up new and in theory, internationally competitive institutions of their own. Under this heading the administrative and material expenses on setting up specialized agencies and introducing the practice of competitive bidding in a number of areas might well be seen as a benefit rather than a sacrifice in the NMS concerned.

B., One of the more important insights in assessing the overall impact of the Union on the NMS is that the EU, with its policies and institutions, surely constitutes *a framework for, rather than a guarantee of, economic success*. Joining the Euro Zone, for one, does entail a number of straightforward advantages widely appreciated in all strands of the literature. Meanwhile experiences of countries like Portugal and Greece clearly indicate that being within the fences is though clearly a plus over being left out in the cold, but is a long way from being the panacea for all economic ills, be that low productivity or profligate public finances.

The broader is the perspective of assessment, the more important is to underscore this point, which might sound as a truism for the economist. For if we recall the political atmosphere that lead to the rejection of the Constitutional Treaty in France and the Netherlands, or the one that surrounded the ratification of the Lisbon Treaty in Ireland, Poland, Britain and the Czech Republic, the relevance of the argument increases. Those opposing any deepening tend to underscore - often very real - shortcomings of the existing arrangements. They express often very profound doubts that improvised policy options could be indeed beneficial. And it is common experience in old and new members, that the public opinion tends to blame the EU for a number of issues the Community has no competences over, such as taxation or public education.

The discourse in the NMS has switched from bad to worse in the past few years. Initially the tendency to overrate the benefits from Union membership reached ironic points. By now the shuttle moved to the other extreme, and the Union tends to be blamed for most of the local illnesses, from corruption to lack of fiscal discipline, from the insufficient support for small businesses to the lack of willingness of commercial banks to lend.

Let us be clear: an organization in charge of redistributing a mere 1 per cent of GNI is by definition in no position to work miracles. On the other hand, if such framework arrangements as the Stability and Growth Pact, or the European Social Charter are made use of, these may allow for a more professional and more pragmatic streamlining of local arrangements, than a free experimentation along any initiative in a perfect democracy would.

C., Finally one should rethink the position of the new member-states on issues of the fundamental reform of the EU. Both the decision-making/organizational structure and the major common policies [Kengyel, ed. 2010] are known to have evolved as an outcome of ad-hoc policy bargains rather than following any theoretical maxim, let alone constructivist design. The numbers in the Stability and Growth Pact, the relative share of farm related spending or the entitlements in cohesion spending count among the best known and most widely analyzed items in the literature on Europe.

Thus there are two basic ways one might approach these complex issues, intensively discussed at the official level in the preparation for the Financial Guidelines for the post-2014 period. In one, traditional way we may adopt a static approach. If we take things as given, it is in the interest of the NMS to stick to present arrangements, since these contain references to and potentials for solidarity, in terms of sustaining substantial spending on rural areas and on physical infrastructure development, two fields where the Communist heritage of negligence is certainly strongly felt. By contrast, if priorizing R&D and competitiveness related spending, the edge of the UK and the Scandinavians, which is quite significant anyway, is only to be further increased. Under this angle the status quo is the best of all conceivable worlds.

The alternative approach calls attention to the fact that net contributors have already found ways of attaining a de facto equalization of net contributions and benefits in most areas [Richter 2008]. Furthermore by sustaining expenditure priorities which clearly do not reflect the changed perceptions of European electorates, favoring such items as environmental protection, energy security and inward migration, will be next to impossible to legislate and sell domestically. From the economic perspective, narrow as it may be, it is hard to justify the public finance sense of the expenditure items I listed in the preceding section, from funeral houses to city fountains. The more serious we get about the agenda of competitiveness – or Europe 2020 – the less grandfatherish our position on sustaining spending items unrelated to either demonstrable common gain or competitiveness we may be. Furthermore it is already foreseeable that global trade talks and domestic pressures will translate into a major trimming of agriculture related expenditure [Elekes–Halmai 2009].

Under this angle a fundamental rethinking of the way priorities are set is in order. For one, if the EU is not, in the future, about big and often wasteful investment projects, the 'maximization of drawable funds' should no longer be seen as the interest of any NMS. The more we appreciate that expenditure priorities often follow a logic alien to them, such as the priority to the development of sparsely populated and arctic areas, or the focus on animal welfare, the less we shall see it as a sensible and axiomatic requirement that those funds should be drawn, just because of their availability.

Such a reassessment of priority setting would be in line with more recent insights of broader development economics [Szakolczai 2006] stressing the relevance of institutional and generally broader social considerations at the expense of mere quantitative expansion. Under this angle the quality of growth, just as much the quality of life, is the real success indicator. In order to improve that, it is a Community spending focusing on externalities and common value added, creating a framework for sustainable development, a category much broader than growth, is becoming the focus. And this is in line with the long term interests of the population of the NMS as well.

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