Gergő Literáti

Stumbling Blocks to EU and Member State Development?

In the Light of the Collection of Studies "The Aftermath of the Global Crisis in the European Union"

(Edited by Beáta Farkas, Cambridge Scholars Publishing, 2012)

The collection of studies entitled "The Aftermath of the Global Crisis in the European Union[1]" presents the various dimensions of the effects of the 2008 global crisis on the European Union. The analysis of the subject matter is made more difficult, for both the analyst and the reader, by the complexity and dynamics of the structure of the European Union. One source of the complexity is the large number and heterogeneity of the Member States, the other is the multitude of macroeconomic aspects. As for the dynamics, the region is in a state of transition: the current 28 Member States are moving at different speeds from sovereign nation-statehood to a future vision of a European federation, which is not yet fully developed. Probably the two most important chapters in the 60 years of this "convergence process" were concluded with the introduction of the single currency in 1999 and the accession of 13 new Member States since 2004, when the European Union was hit by several waves of the crisis sparked by the collapse of Lehman Brothers.

In summary: the object of the investigation is a complex macro-region with its components getting combined at many levels, when the system suffers an external shock that affects its elements differently. The book's structure logically follows from the scope of the comprehensive subject matter as stated in its title: *Beáta Farkas* brings together papers by 11 distinctive authors, enabling the various viewpoints to be expounded by the most expert researchers in each field.

In view of the wide-ranging scope of the problem the editor divides the volume into three major chapters, which encompass the European Union's outlook for growth, fiscal and monetary policy challenges and the steps taken in response to the crisis by the so-called cohesion countries. The 11 papers selected demonstrate a varied approach with regard to the type of research: in addition to papers presenting or synthesising the results of other

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studies, we can find descriptive reasoning and novel argumentations supported by deeper econometric investigations. There is a degree of overlap in certain papers, which is understandable given the 11 different authors, but this is not disturbing for the reader as it serves to clarify earlier content rather than repeat it.

A Lost Decade or Stronger Future? Fittingly chosen as the first paper is *A Lost Decade or Stronger Future?*, by *Fabian Zuleeg*, chief economist at the European Policy Center, in which he presents, as food for thought, an overall view of the problems to be expanded upon in subsequent papers. The author, first and foremost, calls our attention to the peculiarities of European social and economic structures. It is a fact that in 2012 GDP-proportionate public expenditures were 6 per cent higher in EU Member States than in OECD countries. It is also a fact that this difference is due to the universal provision of services such as healthcare and education and the maintenance of a relatively generous social safety net. It is the author's opinion that this feature reflects the values of Europeans: while they have a strong belief in the basic principles of the capitalist market economy they are also convinced that US-style free-market capitalism is in need of fine-tuning. That is to say that before we evaluate the challenges facing us we have to appreciate the commitment to the so-called "social market economy" or "welfare state". This commitment has recently been supplemented with an emphasis on issues of sustainability.

The paper outlines five challenges which threaten long-term growth and which Europe must tackle. The first is that arising from factors related to globalisation. Without a doubt Europe has been one of the major beneficiaries of globalisation and though it has, through its dominant role in world trade, been able to raise living standards, problems have arisen in the field of competitiveness. The USA outdoes Europe in the fields of innovation and entrepreneurship, while in the developing countries the lower labour costs represent a competitive advantage. The heterogeneity of the European community can also be seen in this respect: in the 2012 World Economic Forum's global competitiveness index six of the top ten countries are from north and west Europe while France is in 18th and Greece in 91st place. The author points out that, if we wish to retain our European values, global competition requires the higher level of taxation to be utilised in a quality manner. That is to say that public spending cannot be "simply an additional cost" but must generate social benefit. Taxes must be invested in human capital and infrastructure if they are to contribute to the region's long-term economic performance. Failure to heed the above is accompanied by a reduction in competitiveness, that is a loss of the ability to attract capital, which poses the risk of easily mobilised manufacturing operations being moved elsewhere and the loss of jobs for low-skilled workers.

The latter, coupled with the reduction in labour-intensive industries, leads to an explosive growth in unemployment. The painful, additional phenomena of unemployment, the failure of immigrant communities to integrate, ethnicity-based social exclusion and increasing social inequalities impose an unbearable burden on the welfare system, impacting on competitiveness and sustainability. These thoughts are far-reaching if the reader compares them with the ILO's[2] most recent data, according to which six million jobs have been lost in Europe since the 2008 crisis. Meanwhile GDP now is close to the output level at that time and the majority of stock markets are at record high levels. If we, therefore, take into account that the adjustment of the economy, through technological development, is capable of shedding this much labour in five years, while providing the profitability of 2007, then this raises additional questions

about the effectiveness of traditional crisis-management methods.

As far as demographic processes are concerned, the combination of a slow increase in population and higher life expectancy will have a profound impact on European societies. At the same time the increased demand generated by the growing middle classes of the world's most populous countries exacerbates the import-reliant European economies' fight for natural resources and results in significant inflationary pressure and limits on growth potential.

The author notes that the question of climate change is somewhat different from the previously listed factors. While Europe has made serious commitments to limit the effects of climate change, it is unable to influence the overall problem of greenhouse gas emissions without support from other major powers. In essence we are faced with two choices. The first is that Europe should, at the risk of its own welfare, continue with its commitments and demonstrate that environmental sustainability can be combined with or even be made a driver for growth. The second is that it should give up on this goal and ignore its global responsibilities. This question reminds the reader of the dilemmas found in game theory, which may be an avenue for further investigation of this problem.

How to Accelerate Growth in Europe? In his paper, *How to Accelerate Growth in Europe?*, Finnish professor of economics, *Matti Viren*, looks for an answer to the question of what can be the driver for recovery given the quantitative limitations identified in the first chapter. On the basis of historical data he establishes that there has been a declining trend in economic growth rates in Europe since the end of World War II and that these have lagged behind growth in the US and the newly industrialised countries. The various growth theories do not provide a uniform answer to this problem, but with a short review of these the author attempts to select the common characteristic within the different approaches. That common characteristic is qualitative development. The classical Solow model states that the key is technological progress, while the more optimistic new growth theory says that it is the ability to save a large proportion of GDP, as a portion of this will find its way into financing a higher rate of technological progress and thereby stimulate growth. The Schumpeterian view holds that this requires a more innovation-friendly legal and financial environment.

On the basis of this the analysis sets out to explore the impact on growth of key institutional and structural factors, instead of using aggregates in national accounts. In his opinion these factors influence growth through productive inputs and the total factor productivity. The author applies his empirical model with its logarithmic estimation of output growth for the data from the 15 old EU Member States between 1971 and 2011. Variables in the regression analysis: wage share as a proportion of GDP, government expenditure share of GDP, annual number of working hours, dependency ratio, real interest rate, exchange rate, the share of high industries of the value added of the total manufacturing industry and the terms of trade. Since GDP growth focuses on cross-sectional variation instead of cyclical variations in output, the author uses a fixed effects model in the course of his estimations. Out of the 10 regression estimates presented, the closest match shows a 78.8 per cent explanatory power.

The results are presented in a variety of ways which assist in the reader's understanding. First the growth effects of one standard deviation increase are presented. This is illustrated in more detail by the cross-section fixed effects, representing a level-difference by countries from predictions of the respective model.

Finally the most graphic demonstration of the results is that given in the interpretation in the case of which a decision maker wishing to increase the growth rate from 2.4% to 3.4% who must, for example, manipulate the following variables accordingly:

- wage share 66% => 61%
- government expenditure share 48% => 43%
- annual working hours 1,600 hours => 1,700 hours
- dependency ration 24% => 23%
- real interest rate 3% => 2%

Although the author calls our attention several times to the simplified nature of the model, he has definitely achieved his goal as far as the results are concerned, showing in an attractive format that kick-starting growth in Europe is not completely impossible.

JAPAN'S TWO LOST DECADES: LESSONS FOR TODAY'S EURO CRISIS? The first chapter closes with Kobe University professor *Masahiko Yoshii*'s paper, *Japan's Two Lost Decades: Lessons for Today's Euro Crisis?* Japan's nominal GDP in 2011 was roughly the same as that in 1991. Over the past twenty years economists have studied extensively the causes of and potential solutions to Japan's two lost decades. It is the Japanese researcher's firm intention to use the combined experiences of these studies to draw conclusions that can also be used from the point of view of the European crisis.

Until the end of the 1980's Japanese banks placed credit with no regard to the quality of the mortgage or the borrower's ability to generate income, thereby maintaining an uninterrupted rise in the price of property and stocks. Asset boom and increased capital leverage fuelled consumption, poor and extreme investments – that is to say the irrational expansion of capacity – and ultimately growth. In order to cool the economy, in the 1990's the central bank began to aggressively raise interest rates, which triggered the bursting of the stock and housing market bubble. The author shows in detail how the mishandling of default corporate loans and failure to take the monetary and fiscal measures at the right time and to the right extent led to the protraction of the crisis.

The deterioration in Japan's relative position is well demonstrated by its fall from the world's most competitive country in 1990 to 26th place in the ranking. Though the paper begins with the bursting of the bubble, it could perhaps have better helped our understanding had the list of events immediately preceding this included the signing of the so-called Plaza Accord – by the United States, the United Kingdom, France, West-Germany and Japan in order to depreciate the U.S. dollar in relation to the Japanese Yen and German Deutsche Mark – which proved to be a key moment in Japan's economic ordeals. The yen's exchange rate strengthened, from its 1985 figure of around 200 to the dollar, to 135 in 1990 and 80 by 2011.

The author warns that while 2012 ESM and the Europe 2020 strategy are welcome measures, the key economic policy institutions must take decisive and coordinated steps if Europe is to avoid two lost decades. If the reader considers how complicated and lumbering the European decision-making mechanism is, compared to just one state, then the author's cautionary words appear well-founded.

THE EU BUDGET: A "TROJAN HORSE" FOR BETTER NATIONAL SPENDING? *Gabriele Cipriani* joined the European Court of Auditors in 1978 and is currently Director of the Audit Chamber "Structural policies, Transports & Energy". The second chapter begins with his paper, *The EU Budget: A "Trojan Horse" for Better National Spending?*, which examines the qualitative aspects of EU budget allocation. The value of the paper is enhanced by the author's use of carefully selected excerpts from reports by the European Court of Auditors in support of his arguments.

The community's annual budgetary expenditure, equivalent to 1% of the total EU GDP, is marginal when compared to that of a state. In light of this the European Parliament confirmed that it must play a different role: the goal of EU budgetary expenditure is to create European added value.

This not fully developed approach is embodied by the theoretical requirement that interventions by the community must create greater added value than would result from measures introduced, with identical resources, by a Member State. The realisation of this calls for the provision of three concurrent practical expectations.

Firstly the expectation that decision-makers put policy efficiency ahead of political efficiency[3] and that the measure of success should be the achievement of planned social results rather than the allocation of resources.

Secondly EU expenditures must be:

- catalytic,
- targeted (directed to achieving the greatest added value on the basis of impact analysis)
- and realistic (the objectives set must be achievable).

The expectation of a catalytic effect calls for the provision of "sufficient critical resources" which enable the achievement of visible results which otherwise could not, or only very slowly, be realised. This means that resources must be better concentrated and that the current practice – whereby resources are scattered across 70 different projects – be reviewed. The EU budget "should provide the cake rather than the icing", as the author aptly puts it.

Thirdly, when it comes to measures and projects, we need to pay particular attention to four factors in order to make the best use of resources:

- adequate institutional capacity for the identification of "sensible" projects,
- identification of needs,
- establishment of objectives consistent with resources available,
- presentation of achieved results with the aid of substantial, meaningful indicators.

The list contains all the elements indispensable for the organisation of a successful community project. In line with this the EU's Lisbon Treaty lays down the necessity of an evaluation report. The elements of the programme evaluation methodology, endorsed by INTOSAI, are basically repeated in the professional expectations for this report.

It is perhaps not possible to emphasise the author's words enough that we should beware of the myth that results can only be achieved with financial resources, since it is often in the regulatory sector that the greatest added value is released.

The author deals separately with the three major problems of the financial correction mechanisms:

- the Commission can only demand restoration from the Member State which, in all probability, does not affect the final recipients,
- since these corrections are decided upon at the end of the programmes, they are not capable of fixing the programme's fundamental faults,
- because of the input nature of the EU spending, the repayment of funds is not triggered by failure to meet results or desired effects, but by irregularities in allocation.

Since the aim of the EU budget is the realisation of joint European objectives it is fair to expect the Commission to be held fully accountable with regard to resources utilised. For this to happen we need to end the current situation whereby the EU has no influence over the micro-level management of projects and is not competent in implementation. Logically following from this is the author's proposal that the Commission should be prepared to verify the professional competency of national agencies in charge of resource al-

location, thereby taking responsibility for the decision-making process.

With consideration of these points it should be possible for the EU budget to be embedded in the system of national budgets and in spite of its small size produce significant positive results in the manner of a benevolent Trojan Horse.

The Euro Crisis: Ten Roots but Fewer Solutions *Zsolt Darvas*, researcher at the Hungarian Academy of Sciences and Bruegel Institute, examines the key causes of the single currency's problems in his paper, *The Euro Crisis: Ten Roots but Fewer Solutions.* In the first part of the study the author reviews the euro's structural flaws and other factors hindering recovery:

- the failure of the Stability and Growth Pact, the indiscipline of Member States,
- neglect of private sector vulnerabilities: non-productive investment and consumption "booms", manifested in high current-account deficits,
- lack of structural adjustment,
- lack of a crisis-resolution mechanism,
- interdependence of the banking system and the sovereign debt: a "lethal correlation" due to the large home-country bias in banks' government-bond holdings,
- increased interdependence of Member States (potential contagion),
- lack of a lender of last resort (for the states),
- downward spiral and negative feedback between the crisis and growth,
- lack of a euro area fiscal policy,
- executive and democratic deficit.

It is clear that the first four factors were obvious problems even before the crisis while the others only came to the forefront with the effects of the crisis. Reading between the lines, it appears that the solutions, developed to handle the problems, are only suitable for allowing decision-makers more time. As for long-term solutions to the problems, only a further deepening of integration seems to offer a possible way forward, insofar as the goal is the preservation of the European way of life as described in the introductory paper. Banking union, the "Eurobond" and fiscal union could be the next steps on the road to development. The paper clearly suggests that this is a one-way street and the only way to escape the problems is to keep moving forward.

In the second part of the paper the author emphasises that, from the euro's point of view, the debt path and growth outlooks of the southern European states present the most serious problems. He argues that from a starting point of downwardly rigid wages, only export growth driven inflation as a consequence of a weaker euro can help to eliminate disproportionality in wages and prices. The increase in output growth caused by this export surplus would lead to higher unit wage costs in developed European countries, because of their low unemployment, but not in the "mis-priced" economies because of their high unemployment and labour supply. It should be stressed that, in this case, the depreciation could not only be used to kick-start growth, but also – recognising that imbalances in national economies' relative prices can only be eliminated in the case of rising prices – to restore the competitiveness of the southern states. As far as the debt is concerned the author urges a significant European investment programme for the southern members instead of aid and lending.

The Sovereign Debt Crisis and the Weakening of the Pillars of the Economic and Monetary Union The final piece in this chapter is the paper by *Miklós Losoncz,* Doctor of the Hungarian Academy of Sciences, entitled *Sovereign Debt Crisis and the Weakening of the Pillars of the Economic and Monetary Union.* This paper complements well the previous study, these two being the most closely related in the volume.

Although the euro area does not satisfy the optimal currency zone's basic criteria and is in many ways structurally flawed, in the author's

view we can dismiss the claim that it was the single currency's introduction which led to the grave crisis, but that this was much rather a result of economic policy and budgetary recklessness. The euro has not failed as a means of payment or reserve currency, has not suffered any serious depreciation as a result of the crisis and has safeguarded the Member States from any serious exchange rate shock. The euro fulfilled its basic objective: the reduction of transaction costs in the area gave a considerable boost to output.

The paper demonstrates the effect of the debt crisis on the EMU's three pillars: "no exit", "no default" and "no bail out". Following the author's train of thought, it becomes clear to the reader that the three pillars reflect the initial "love-hate relationship" with the euro zone. The fact that there is no common fiscal policy which could resolve the zone's equilibrium problems with a shared shouldering of burdens, means that there is no trust between Member States and that the only solution to the moral hazard, originating from irresponsible management, is to close the loopholes, the direct consequence of which is the previously mentioned three principles. The non-viability of these was not apparent during times of prosperity, the need to relax them only made necessary by the rising debt crisis. Since these are the basic pillars of the EMU they can be watered down but not completely erased. The author explains in detail how these principles were softened and what steps were taken towards a greater degree of cooperation as well as the kind of new structures which still need to be established.

One of the most interesting parts of the author's message is his attempt to illustrate the build up of disequilibrium in the balance of payments. He notes that while the "no rescue package rule" directly prevents the existence of an optimal currency area, it does not even meet the *Mundell* theory conditions of free movement of human capital and internal homogeneity. These weak points were further reinforced by the imperfections in the EMU's institutional and political frameworks. From the point of view of southern European states, the primacy of the interest channel over the exchange rate channel proved a decisive factor. The ECB's "one size fits all"[4] monetary policy resulted in a negative real interest rate in these countries. This creates a situation where positive yields cannot be made without taking on greater risk, which brings about a fall in the savings rate and can furthermore result in consumption and forced investment "booms". It is a fact that prices and wages rose sharply in South European countries, reducing their international competitiveness. It is also a fact that, at the same time, west and north European countries were amassing huge current account balance surpluses, while their southern partners amassed similarly sized deficits. The author's words appear to be supported by the fact that, on the basis of statistical time series, publicly available to the reader, the Spanish real effective exchange rate has risen by 18 per cent and the German by 6 per cent since the introduction of the euro.

Reading the paper it appears certain that the current transitional state is not eternal and that either integration must deepen or the process must be reversed. The calculations quoted in the paper – that for example Greece would suffer a 50 per cent and Germany a 20 per cent drop in GDP respectively were Greece to exit the euro zone – clearly demonstrate the potential costs of deferring such decisions.

European integration is only justified as long as the parties have a mutual stake in the process. In the case of the developed countries, their stake arises from the recognition that they can only effectively represent their interests and maintain their social structures as part of a unified global power. For the less developed countries it is the promise of economic convergence.

The Crisis as a Turning Point in the European Convergence Model Beáta Farkas, professor at the University of Szeged, starts off the third chapter with her paper, *The Crisis as a Turning Point in the European Convergence Model*, in which she seeks to answer how we can breathe new life into the stalled convergence process by learning from past mistakes and positive examples.

Her starting point is that European politics must recognise that when it comes to fragility caused by the crisis, the fault line is not between the old and the new Member States, but between the developed and cohesion countries. The driver of convergence in all these countries was the influx of foreign capital alongside a low savings rate. Consequently the consolidation of the negative investment positions, created against the developed countries, may take a long time which reduces the probability of foreign capital playing a similar a role in the near future. From the point of view of sustainability there is a further risk that – as individual countries make use of foreign resources with differing effectiveness – in the absence of certain interventions, the reduced levels of external debt could rise again.

The other fundamental problem, as the trend in per capita GDP growth appears to verify: the largest strides towards convergence were made by those cohesion countries with a low level of development; the convergence model was not the answer for the more developed ones. The author illustrates this well with the parallel presentation of per capita final consumption. Since individual countries occupy rather different places in the two rankings we can learn more about living standard convergence and the role of consumption in growth.

The necessary information for the recalibration of the European convergence model can be easily read, with the author's guidance, from the interconnections of balance of payment statistics. In the cohesion countries, acceding from 2004, foreign capital characteristically arrived in the form of FDI, unlike the Mediterranean countries which attracted mainly portfolio or securities investments. FDI in the CEE region was mainly found in the processing industry sector, characterised by export capacity, while in the other new Member States in the banking, property and other non-export sectors causing, among other things, housing bubbles. Consequently the benefits of rapid technology transfer were mostly enjoyed by the CEE countries. This is well illustrated by the figure shown, according to which, in terms of the proportion of medium and high tech exports, the top five places are occupied by CEE countries. Only Slovakia, Poland and the Czech Republic were able to take advantage of this favourable situation and avoid accumulating severe balance of payments deficits with the production of positive trade balances.

Beáta Farkas concludes that there is a need for technological change and innovation in sectors with foreign trade potential, since convergence cannot be realised if the cohesion countries are unable to move away from being at the lowest level in the international production chain. The competitiveness of the export basket must be increased through investments in human capital and technology. She adds that it is doubtful whether all cohesion countries can claim distinguished governmental achievements in this field.

Crisis Management Similarities and Differences in the Newly Accessed Central and Eastern European Countries In his paper *Crisis Management Similarities and Differences in the Newly Accessed Central and Eastern European Countries* former chairman of INTOSAI and president of the State Audit Office of Hungary and current chairman of the Fiscal Council, *Árpád Kovács* evaluates the governmental responses to the crisis of the ex-socialist planned economies, with special focus on their budgetary and public finance peculiarities.

In terms of the relative size of budgetary expenditure, distribution (operating expenditure, investment, wages, social allowances), and the debt paths he finds no significant difference between the old and the new Member States which would determine the sustainability of the budget. This reinforces the assumption that the fault line is not drawn between the old and new groups of Member States.

The countries that were defenceless in the face of the crisis were mainly those that were unable to align their budgetary expenditure with their level of growth or sources of revenue before the outbreak of the crisis. Overconsumption and inefficient but over-generous welfare services combined with a lack of domestic savings were manifested in twin deficits. The increased foreign debt repayment burden, resulting from the latter, undermines the chances of recovery by squeezing investments and presenting a new crisis management challenge. By way of demonstrating these effects he shows to what extent the increase in government debt was a result of deterioration in the primary balance and changes in the financing environment in each country between 2007 and 2011.

Regarding the countries under review, progress is halted, among others, by the fact that – partly due to the entitlement systems from the "socialist" legacy – the structure of public finance systems is rather rigid and changing it would require an emergency situation or broader support from society.

Following the assessment of the initial conditions, the author presents the crisis management measures of the individual countries, broken down into two phases. This is due to the following difference: while in the first phase measures were mostly lagging behind the events, in the second phase the countries under review – apart from Hungary and Romania – form a unified group which shifted from wide-range activities towards more restricted indirect interventions. Regarding bank taxes, the author notes that in terms of the performance and size of the banking system, as well as the volume of budgetary revenues, the solution employed in Hungary was incomparably more radical than the measures introduced in other countries and of a magnitude that might endanger the financing activity of the banking system and also economic growth.

According to the author›s final conclusion, these days it seems that decision-making based on socio-economic research is absent at the level of governmental, global and regional institutions, and the conceptual strategic handling of the problems is missing. Another important statement of the paper is that the success of crisis management does not only depend on the appropriate mix or dosage of economic rationalisations, but also on external and internal social adaptabilities, so-called quality adaptabilities that cannot be quantified. Great self-discipline, restraint, patience and consensus seeking are required to ensure that endeavours to adjust to the changes are not distracted by the reflex to intervene immediately, resulting in improvised solutions.

THE ADEQUACY OF INFLATION-TARGETING MONETARY POLICY AND EURO ZONE PARTICIPATION FOR THE CENTRAL-EAST EUROPEAN COUNTRIES Of all the works in the volume the paper by *Gábor Dávid Kiss*, assistant lecturer at the University of Szeged and *Andreász Kosztopulosz*, professor at the University of Szeged navigates, without doubt, the greatest depths of econometrics. Their paper, entitled *The Adequacy of Inflation-targeting Monetary Policy and Euro Zone Participation for the Central-East European Countries* evaluates the monetary policies and their outlook of the three CEE countries, Poland, Czech Republic and Hungary, stuck on the brink of joining the euro area.

The fundamental question is whether there is any interest or exchange rate convergence, in the Maastricht sense, between these coun-

tries, characterised by underdeveloped capital markets, low levels of savings, overcentralised banking systems and significant capital imports, and the capital markets of the euro area countries and whether the inflation-targeting monetary policy in these countries is capable of independently tackling the financial market crises.

The study belongs to the branch of economic research which, recognising the imperfect nature of capital markets and presence of dominant market players, attempts to create a more fitting model in place of market efficiency. Regarding the first issue, it means that if a complex capital market model with collective behaviours such as contagion, divergence or interdependence explains the behaviour of the markets examined, it leads us to assume that the convergence is temporary or distorted. Although there may be several reasons for such collective behaviour, in light of the authors' research findings, these phenomena result from the dynamic characteristics of extreme events that are nested functions of scale-free networks. Scale-free networks are characterised by a small number of hubs and a large number of other players within their network elements. Besides the expansion of the world wide web, the number of proteins in our bodies and sexually transmitted diseases, the behaviour of networks among economic players and financial markets can also be described with the oligopolistic model of scale-free networks. Although these networks are fault tolerant, in this case they are extremely sensitive to the defects of the financial hubs. This also means that the vulnerability of small economies under review is not only influenced by their macrofoundations and the state of their banking system, but also by the behaviour of the hubs and the quality of their connections to these hubs – for example the maturity structure of external assets.

The authors' second question is a direct consequence of the above. The autonomy of monetary policy – according to which the central bank can set the base rate based on the state of the macro-economy, in other words, irrespective of the monetary policies of key currency areas – may run into walls on such a level of dependency.

In order to answer the questions raised, the study sets up a diagnostic model that uses the above reasoning which has been elaborated over many decades. They use 3-month and 10-year government bond, foreign exchange and stock market daily yields as indicators for their conclusions. Their aim is to explore the indirect impacts on euro-candidate countries, generated by the FED and the ECB. First they discard the hypothesis about the efficiency of the markets under review, then they use the changes in inter-market correlations on extreme days to define the different forms of collective behaviour.

THE ROLE OF FISCAL POLICY In her paper *Addressing the Crisis in Greece: The Role of Fiscal Policy, Anna Visvizi,* associate professor at the American College of Greece seeks an answer to the question of how Greece managed the opportunity provided, through a framework of international cooperation, by the two loan and bond exchange programmes. She presents in detail the quantitative and qualitative criteria tied to each loan package and the contents of the package of measures created.

The paper's approach is novel in that it concentrates on an examination of the quality of fiscal interventions rather than a correlation analysis of macroeconomic variables and the Greek economic ordeal. She argues that the decline in economic activity and the dramatic increase in unemployment and social expenditures were mainly caused by growth-inhibiting, "front-loaded" fiscal policies.

Although the aims laid down in the Memorandum of Understanding of May 2010 fol-

lowed the usual prescription for fiscal consolidation advised by the IMF, as lender of last resort, the programme was significantly hindered by three factors from the beginning. Firstly, – the author maintains,– the Greek crisis was mistakenly treated as a liquidity problem and so structural problems were pushed into the background from the very beginning. Secondly, the objective and the time span, within which the fiscal consolidation was to be implemented, were overly ambitious and thus infeasible. Thirdly, prior to the arrival of the IMF negotiating team the government, keen to prove its resoluteness, called for an extremely strict tax package which decisively influenced the initial agreement between the "Troika" and PASOK. With their programme, which is "front-loaded" from short-term revenues, the governing party created ample leeway to implement the programme's measures with a fair bit of freedom. This mechanism allowed the governing party to shift the burden of fiscal adjustment away from the public sector and thus away from expenditure reducing measures towards the private sector and revenue enhancing measures: the latter were implemented at the designated time and with added burden, while the former were introduced with a reduced content, with a delay or not at all. The pace of consolidation of the initial, huge tax package was not sustainable in subsequent years: the tables show in detail how the government fell short of its revenue appropriation year after year.

The paper further reveals that Greece's administrative system, which is relatively the second largest of the cohesion countries after Hungary, is characterised by serious imbalances both in terms of size and remuneration. The author finally, on the basis of OECD tax collection efficiency indicators, repudiates the popular but inaccurate view that the main reason for the decline in government tax revenues was tax avoidance.

The Causes of Slow Growth in Hungary *It takes all the running you can do to keep in the same place*[5] quotes *Péter Mihályi*, associate member of the Hungarian Academy of Sciences, from the words of the Red Queen to Alice, alluding to the fact that the Hungarian economy must change in order for its relative position in the global or European environment not to change. While Hungary's goal is to catch up, it needs to come to terms with the thought that development is needed even in order to avoid lagging behind. In his paper, *The Causes of Slow Growth in Hungary*, the author presents Hungary's performance, relative to its European and global environment, since the Compromise of 1867. On the basis of the time series it can be said that there has not previously been any cycle in which we have over-performed without a notable deterioration – in external debt. Looking at all the potential causes, he considers low labour productivity a much more serious problem than the lack of natural resources, indebtedness, the low employment rate – greatly compensated by the high number of working hours – or the rising dependency ratio. Within this he excludes the under-financed education system as a potential cause because of its average performance in international comparisons and, while he sees great potential in migration he considers the lack of economies of scale the final answer. The Hungarian economy's human and material capital is extremely fragmented as is well exemplified by its leading position in the European ranking of the number of micro-enterprises per 10,000 population. Translated into the language of productivity this means that, so long as there is no reduction in the significant difference in annual added value per employee in micro-enterprises and large ones of 4.5 and 8.2 M HUF respectively, the current capital structure will involve huge sacrifices in growth. Unfortunately this difference continues to grow. At this point we ar-

rive at the dilemma whereby, because of the low level of productivity accompanied by high standard scales of unit cost and consequent low demand, there are insufficient funds available for qualitative (innovation) or quantitative (investment) growth. If, however, there is no possibility for growth then there is also no possibility to increase productivity through the advantages of economies of scale. Péter Mihályi presents in detail the changes in attitude required for Hungary's economy to break out of this vicious circle.

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The distinctive feature of Beáta Farkas' volume is that each element encourages the reader to, with its help, try over and over again to reconstruct the European zone's past and present in search of a potential vision of the future. For western Europeans, integration was the answer to the question of how to maintain or raise their living standards and significance in world politics, beside a background of weakening foundations. And to the question of how such integration should occur, the answer was through enlargement rather than intensification. The current standard of living is founded, therefore, on integrational synergies and growth in the debt volume, as shown by the current crisis. Since both indebtedness and enlargement have reached their limits, the only available remaining means is intensification. This is inconceivable without agreement among the regional powers on currently diverging federational and confederational concepts and also maturity and discipline in the cohesion countries. In summary the message of the volume is that we are not speaking of a cyclical crisis but of a deep-rooted structural crisis which will fundamentally influence the European socio-economic model. As far as managing the problem is concerned, it can be discerned from the authors' words that there is a need for responsible, well-founded economic politics coupled, in the most part, with sceptical expectations.

It is concentrated reading given that each of the 11 aspects would be deserving of a separate volume. In spite of this the authors have succeeded, for the most part, in condensing their message without loss of information. An excellent publication for those who like to see the whole picture.

Notes

[1] "The Aftermath of the Global Crisis in the European Union"

[2] The UN Labour Agency

[3] The original text uses the expressions "political efficiency" and "policy efficiency"

[4] The implication being that the equivalent rates of interest adapt to the conditions in each Member State

[5] "It takes all the running you can do to keep in the same place."