SEEKING REAL CAUSES OF THE EUROPEAN CRISIS

This is an edited version of the keynote speech **President Václav Klaus** gave at the 13th Gulf Industrialists' Conference in Riyadh on 17 January 2012

Europe has become—for many people rather rapidly and unexpectedly—a problematic region.[1] The majority of foreign observers and commentators were not prepared for that. They started to pay closer attention to Europe as late as in the last two years in the moment of the explicit Eurozone debt crisis because they—quite incorrectly—considered even the 2008–09 crisis a global crisis, which means a non-European crisis. This was, however, not the case. It was a European and North American crisis, not a global one. The previous, very problematic developments in Europe were evidently underestimated.[2]

The current sovereign debt crisis, which makes headlines in the media every day, is only the most visible tip of the iceberg of a much deeper and much longer existing European crisis coming from:

- the form and the method of the undergoing European integration process, and
- the European economic and social model characterised by government overregulation and an unproductive welfare state.

The European integration started with a basically rational and positive ambition of its founders to liberalise Europe,[3] to open it up, to eliminate various kinds of barriers existing at the borders of the countries, to establish a free-trade zone and a customs union, and to build a common market and a large, interconnected economic space. These tendencies more or less dominated the first era of the European integration and they were a real improvement. However, I am repeatedly frustrated to see how people both in Europe and abroad still assume this is the right description of the current era as well.

The European integration— gradually but quite deliberately—moved to a different stage and form, and its impact has become much less positive. The overall liberalisation and removal of inter-country barriers were replaced by an ambition that was poles apart—by centralisation, regulation, standardisation and harmonisation; by a radical shift of competencies from individual member countries to the European Union's 'commanding heights' in Brussels; by the transformation of the whole concept of integration from inter-governmentalism to supranationalism; by the weakening of the cohesion of European member states; and by a wide-ranging shift towards European governance. A heterogeneous European continent flourished due to its diversity, non-uniformity, and internal competition.[4] This continent has been in the last decades step by step unified and artificially homogenised by a centrally organised governance and legislation. It brought us the negative economic outcomes we face now and led to what is called a democratic deficit (or a lack of democratic accountability). I call it post-democracy.

This very problematic tendency has been accelerating in time—with radical turning points both in the Maastricht and Lisbon treaties. At a lower level of integration, the consequences

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had not been that dramatic. Now, in the era of a deeper integration, the existing European heterogeneity is more and more in contradiction with the institutional uniformity, which turned into a form of straitjacket and keeps blocking economic activity.

The most important (and dangerous) moment in this process was the establishment of the European Monetary Union and the introduction of one currency into a group of originally 12, and now 17, countries that do not form an optimal currency area. The undergoing Eurozone sovereign debt crisis is an inevitable consequence of one currency, one exchange rate, and one interest rate for countries with very diverse economic parameters.[5] The political decision about this arrangement was taken without sufficient attention being paid to the existing economic fundamentals. It is fair to say that some of us have been criticising this project since the early 1990s.

The economists know that non-optimal monetary unions may be—hypothetically—'saved' by a very high degree of solidarity among their members and by huge fiscal transfers, but it asks for the fulfilment of two not so simple conditions:

- a truly authentic feeling of solidarity (which existed, for example, in Germany after its unification, but does not exist in Europe), and[6]

- a sufficient size of funds in the hands of the political authorities to compensate for exchange and interest rates which are not appropriate for many countries.

Neither of these preconditions exists and that is why I don't see any easy solution to the Eurozone sovereign debt problem. John O'Sullivan correctly says: 'The Mediterranean countries in the EU will be locked into economic austerity without end—and northern Europe will be locked into paying an endless flow of subsidies to them.'[7] A longer-term solution, if we exclude the non-realistic 'revolutionary' increase in the authentic (or unforced) solidarity, depends on the acceleration of economic growth in Europe. It is, however, difficult to find any reason for such a magic acceleration of growth to occur. The necessary fiscal adjustments do not make a fiscal stimulation possible. Most of the EU countries must make fiscal cuts, not fiscal expansions, and not only in the short term but at least in the medium term as well.

The European 'soziale Markwirtschaft,' as it is aptly called in German, prefers social policy based on income redistribution to productive activities.

In addition to the many pitfalls of the concept of integration itself, a further problem lies in the European economic and social system that—by its very nature—doesn't allow for a rapid economic growth. The European 'soziale Marktwirtschaft,' as it is aptly called in German, prefers social policy based on income redistribution to productive activities. It prefers leisure, free time, and long holidays to hard work. It prefers consumption to investments, debt to savings, and security to risk-taking. All of this is, however, part of a broader civilisational and cultural framework, deeply rooted in the European continent or in most of its countries. It can't be abandoned overnight, it can't be replaced as a result of one or another EU summit, and it can't be corrected by painless or cosmetic changes. To make it better requires a deep systemic change, something structurally similar to the task we had to accomplish more than two decades ago in the Czech Republic when we wanted to get rid of communism.

The Czech Republic is a member of the European Union but not of the Eurozone. As a Central European country located in the heart of Europe, we had no other choice but to participate in the European integration process—almost eight years ago, we became a member of the European Union. However, we still have our own currency, the Czech crown. We were—sufficiently and in advance—aware of the problems connected with the common

European currency. We didn't want to impede our economic growth. We also wanted to continue our much needed overall adjustment process with sufficient adjustment capability, which requires our own flexible exchange rates, our own interest rates, and our own monetary policies. We didn't find any advantage in using the German or Greek exchange and interest rates. For the time being, we don't have any plans to enter the Eurozone.

> My guess is that the net positive effect of the membership of a country such as the Czech Republic is very small, if not negative.

At the same time, we try not to close our eyes to the overall costs and benefits of our EU membership, even though it is considered fashionable and politically correct in Europe now to talk only about benefits. They are considered by politicians and their fellow-travelers in the media and in academia—a priori—as enormous and undisputable.

The economic benefits of the EU membership can be structured in the following way:

- Becoming a part of what was—until recently—a prestigious club of economically developed and stable countries is supposed to improve the image of the country and to attract foreign investors. Switzerland does not need it, the post-communist countries needed it.

- A territorially bigger market—without protectionist barriers among countries—is an advantage (on condition it is not undermined by financial instability).

- Certain fiscal transfers in the European Union do exist (on condition the country's GDP per capita is below the EU average, which is the case of the Czech Republic), but net fiscal gains are not large. Macroeconomically, they are practically irrelevant (fiscal transfers were relevant when just two countries—Spain and Portugal—needed them and were getting them two decades ago).

- The obligatory implementation of the European legislation and of the European way of governing is a benefit on condition the country itself has less liberal legislation and is generally less organised. (It is, however, impossible to legislate the positive cultural and civilisational habits and patterns of behaviour that exist in some 'old' European countries).

There is, as always, the other side of the coin. The economic costs connected with the EU membership are:

- Every country has to participate in co-financing this large, expensive and highly bureaucratic organisation, which is a more relevant problem for smaller and economically less developed countries.

- There are non-negligible domestic costs connected with the membership (bureaucratic paper work and all kinds of other similar requirements; the need to organise endless conferences, meetings and trips abroad; and financing the artificially created EU jobs).

- The implementation of a very heavy and, therefore, economic activity undermining legislation based on centralisation, excessive regulation, controlling, harmonisation, standardisation, and subsidisation.

- The more or less inevitable acceptance of an overgenerous and therefore demotivating European welfare system.

It is very difficult, if not impossible, to give quantitative estimates for all these factors. My guess is that the net positive effect of the membership of a country such as the Czech Republic is very small, if not negative.

The very sluggish economic growth connected with half a century of the deepening of the integration process and of 'more and more Europe' does not indicate that the opposite could be the case. The currently suggested solution—the move to a fiscal union—is another example of 'more Europe.' The new 'fiscal pact' would imply Brussels monitors the budgets of all governments (and of all levels of government!). That would require an enormous bureaucracy with knowledge of all individual member countries. The individual countries can also lose the motivation to control budgets themselves.

As a result, Europe will not be a 'locomotive' of the world economic recovery and growth. I expect the BRIC countries—together with rationally functioning oil-exporting countries—to be the most dynamic part of the world economy in the visible future. The plans to introduce fiscal union among the EU institutions will not make any difference.

Endnotes

1 See Václav Klaus, *European Integration Without Illusions* (only in Czech) (Prague: Knižní klub, 2011) for a longer discussion.

2 Everyone is aware of the ratio of Greek public debt to GDP reaching 160%, but the ratio was already 107% before the financial and economic crisis. And we also know Greece is not alone in having public debt problems. It is also interesting that this ratio was 39% in the new EU member countries (former communist countries in Central and Eastern Europe) but 85% in the whole European Union in 2010.

3 It should be stressed—at least now, with a very long delay—that they wanted to liberalise 'Europe,' which means the inter-country relations. They had absolutely no intention to introduce a liberal economic system inside individual countries. They wanted to keep the previous illiberal and corporatist economic European 'traditions' untouched. These traditions are still considered an economic (and especially non-economic) 'advantage.'

4 To competition at the markets of goods and services but to competition in a systemic sense as well.

5 Oliver M. Hartwich made a very persuasive point when he demonstrated that the Italian lira depreciated by 84.2 % against the German mark between 1963 and 1998 (before the euro), the Spanish peseta by 82%, and the French franc by 63% (Oliver M. Hartwich, 'Europe's Three Crises' in *Trans-Atlantic Fiscal Follies: The Sequel* (Sydney: The Centre for Independent Studies, 2011). During the night of 31 December 1998, all these developments should have been ceased.

6 The feeling of solidarity exists probably among EU politicians but not among citizens of individual European countries—and they should not be blamed for it. They are not ready to finance Greece, Portugal, Italy and Spain as one large mezzogiorno or East Germany endlessly.

7 John O'Sullivan, 'Random Thoughts on Recent Events,' *Hungarian Review* 3:1 (19 December 2011).