Centre for Economic and Regional Studies
of the Hungarian Academy of Sciences,
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Euro Zone Crisis, Member States' Interests, Economic Dilemmas

Proceedings of the 9th Hungarian-Romanian bilateral workshop

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FOREWORD

The cooperation between the Institute for World Economy, Romanian Academy and the Institute of World Economics of the Centre for Economic and Regional Studies of the Hungarian Academy of Sciences (IWE CERS-HAS) dates back to several years. The cooperation between these institutes has broadened during the past years by an extensive exchange of researchers, joint research projects and the regular organisation of bilateral workshops on economic issues attracting wide public interest. It is our aim to share and disseminate the information and the experiences of academic and policy-oriented research to the wider public.

The key field of cooperation is Romania's and Hungary's EU integration process. The emphasis has been laid on the main factors of long term economic and social development. Recently the main areas of the common research have been the short and long term effects of the current economic crisis on the European integration, focusing especially on the potential structural reforms. Additionally development in the Central and Eastern European region has been investigated with special attention to the fragility of the economic structure. The similar development route of both countries, based on external resources and export-oriented growth strategy facilitate joint research projects, pointing out similarities and differences of development trajectories.

The 9th Hungarian – Romanian bilateral workshop "*Eurozone crisis, member states interests, economic dilemmas*" took place on 30 November 2012. The workshop was organised by IWE CERS-HAS in Budapest after a very successful meeting in Bucharest the previous year. This volume contains the revised version of contributions that were originally presented at the workshop.

This edition includes studies dealing with the most important and current issues of the European integration, among others the current financial and economic crisis within the European Union, the reform of the economic governance or the interests of different players in the next multiannual financial framework debate. Some essays concentrate on more specific issues of agriculture or energy policy.

Budapest, July 2013

THE EUROZONE CRISIS AND THE FUTURE DEVELOPMENT FACTORS FOR EU

Simona Moagăr Poladian[*]
Eugen Andreescu[**]

This paper focuses on the EU financial and economic crisis. The European Union has been fighting the second step of the crisis since 2012 and this step seems to be more profound that the first. The economic convergence stipulated in the Maastricht criteria for the last phase of the Economic and Monetary Union has not brought the planned advantages. On the contrary, the fast developing countries have been dragged down by the contagious effects from the Southern part of Europe. From the very beginning, the EMU was designated to bring prosperity and welfare on a European level, but the present crisis has hit almost all European Union countries and proved what an important role long-term economic growth and economic convergence have. That is why we consider a re-evaluation of the future steps guaranteeing a good future in the EU necessary, as these measures could stimulate economic growth and lower the unemployment rate.

Key words: eurozone, criteria, admission

JEL classification: F15, G01, O52

This paper consists of four parts, namely:

1. New rules, new strategies
2. Rescue measures for the eurozone and the fulfilment of convergence criteria
3. Romania and the eurozone
4. Concluding remarks

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1) New rules, new strategies

For the first time in IMF history it was affirmed openly that one developed region, namely the eurozone, is considered “the ill part of the world economy.” The public debt of the eurozone is considered the “main risk” for the world financial stability (IMF Report from October 2012).

Eurozone tensions have been amplified also on the base of private capital running from the marginal countries toward the core countries. For example, only in the period of June 2011 to June 2012, over 296 billion euros left Spain and 235 billion euros from Italy, respectively. This process has caused additional credit costs for the population and also for the firms in these two countries.

The main banks operating in the eurozone would assist a substantial diminishing of capital by 2,177 billion euros that could provoke a credit shrinkage by 9% until the end of 2013 and a blockage of the real world economy if this phenomenon were to continue.

To avoid such a pessimistic scenario, Jose Vinals, Director for IMF Capital Market Department suggested the following crucial measures to be implemented:

* Banking recapitalisation;
* The closure of “ill banks”;
* Public finance balance;
* The application of the European Stability Mechanism and the ECB bonds transfer programme; and
* A European Banking Union through common observation rules.

The IMF report drew attention to the lessons that could be learnt from the eurozone experience (USA and Japan should learn from it also) because “Easy money and lower interest rates of the two eurozone countries that benefited a long period of time has convened a misleading security feeling. Delaying the necessary adopting rescue measures could lead to future financial and economic confusion that is hard to estimate.”

For Japan, the IMF report stresses the fact that in the following five years the public bonds will have an enormous share of 33 per cent from the banking assets, that represent a major risk in the circumstance of interest growing on the world level.

The total debt (public and private) of the USA is worsening as it reaches 375 per cent of the GDP that means over 16,000 billion euros.

2) Rescue measures for eurozone and the fulfilment of convergence criteria

Under the unprecedented financial crisis pressures, the eurozone countries have been forced to gradually build all the previously lacking elements for the conversion of the EMU into the Optimal Currency Union during the current year. This means that all the three missing elements, namely budgetary harmonisation, financial solidarity and a banking union are necessary to be implemented for avoiding the asymmetric shocks caused by the crisis.

But achieving these three elements in a short time would require higher social and political costs in eurozone and this would be rather intolerable even for countries with a higher standard of living.

1. *The budgetary pact is the common name for the "European Treaty for Stability, Coordination and Governance"* that required all eurozone countries to be more balanced in terms of public finance.
2. *The European Stability Mechanism (ESM)* could manage funds of up to 700 billion euros that would help the indebted countries with further loans to lower costs but at the same time it would recapitalise the banking system directly through the ESM.
3. *The Banking Union* foresees the surveillance of the all 6,000-plus banks from the eurozone. This was established by Brussels in 18 October 2012. The banking union was an indispensable element for the Monetary Union due to the fact that banking surveillance is a basis for banking recapitalisation through the ESM. Spain could be the first beneficiary country by signing an agreement for a credit line amounting to 100 billion euros for the banks' recapitalisation.

   Having all these extremely necessary 3 financial tools (the budgetary union, the banking union and financial solidarity) the eurozone would be more prepared in case of further financial turmoil that could happen in the near future. This prevention process lets the EU to focus more on solving the more difficult problems such as the European Economic growth stimulus and diminishing the rate of unemployment that is approaching an 11 per cent average.
4. *Unlimited ECB intervention*. At the beginning of October 2012, the ECB had prepared a declaration that surprised everyone: it would buy limitless bonds from the states with financial difficulties if and only if these countries adopted firm structural reforms.

This message has directly led to a lowering of the interest of five-year bonds by 250-350 pp on the bond market in comparison to the figure a few days previously. By taking this decision, the ECB matches the FED or the Bank of England by considerably reducing the possibility of overindebted countries becoming vulnerable to bond speculations.

This announcement also intended to disappoint any investors who had wished to take a short-term risk based on the fears that would be created, knowing that the ECB would take these bonds unconstrained.

The ECB suggestion that bond acquisitions would be “conditional, temporary and unlimited” also created confusion because it is difficult to achieve all three at the same time since the intervention is possible only for 1-3 years bonds.

It is worth mentioning that already the majority of the bonds of the marginal eurozone countries is inside the ECB balance.

What does conditionality mean in this context? It is referring to the signing of an agreement with the Troika (of the ECB, the IMF and the European Commission) for structural reform implementation.

The monetary union adjustment into a budgetary and banking union could in time lead to a federative European state. This way the ECB is creating a solid economic base in preparation for the case of Greece withdrawing from the eurozone. It is eliminating the option of a massive selling of the bonds of indebted countries like Spain, Italy, Portugal and Ireland, thus impeding spreading the negative effects. The effects of all these four measures could be registered from 2013 onwards.

In the years that have passed since 2008 when the international financial crisis spread throughout the EU, the new member states from Central and Eastern Europe have tried to fulfil the Maastricht criteria enforced for the last stage of the EMU.

The examination of the convergence criteria referring to the inflation, budgetary deficit, public debt, the rate of exchange and the long-term interest among the candidate countries highlights the asymmetries among them. For example, in the case of Romania, Hungary, Poland, Lithuania and Latvia the rate of inflation is well above the reference value for the eurozone (3.1 per cent). Bulgaria, the Czech Republic and Sweden, on the contrary, have stayed well within the suggested inflation rate. The public debt is a criterion that is almost fulfilled by the candidate countries with one exception: Hungary registered a 78.5 per cent of PIB in 2012.

Table 1
The fulfilment of the convergence criteria in the candidate countries, between 2010 and 2012

Candidate Countries	Inflation (%)			Budgetary Deficit (% of PIB)			Public Debt (% of PIB)			Rate of Exchange (variation %)			Long-term interest (%)		
	2010	2011	2012*	2010	2011	2012*	2010	2011	2012*	2010	2011	2012	2010	2011	2012
Bulgaria	3.0	3.4	2.7	3.1	2.1	1.9	16.3	16.3	17.6	0.0	0.0	0.0	6.0	5.4	5.3
Czech Rep.	1.2	2.1	2.7	4.8	3.1	2.9	38.1	41.2	43.9	4.4	2.7	-1.8	3.9	3.7	3.5
Latvia	-1.2	4.2	4.1	8.2	3.5	2.1	44.7	42.6	43.5	-0.4	0.3	1.1	10.3	5.9	5.8
Lituania	1.2	4.1	4.2	7.2	5.5	3.2	38.0	38.5	40.4	0.0	0.0	0.0	5.6	5.2	5.2
Poland	2.7	3.9	4.0	7.8	5.1	3.0	54.8	56.3	55.0	7.7	-3.2	-2.4	5.8	6.0	5.8
Romania	6.1	5.8	4.6	6.8	5.2	2.8	30.5	33.3	34.6	0.7	-0.6	-2.8	7.3	7.3	7.3
Hungary	4.7	3.9	4.3	4.2	4.3	2.5	81.4	80.6	78.5	1.7	-1.4	-6.1	7.3	7.6	8.0
Sweden	1.9	1.4	1.3	+0.3	+0.3	0.3	39.4	38.4	35.6	10.2	5.3	1.9	2.9	2.6	2.2
Reference value	-	-	3.1	-	-	3.0	-	-	60.0	-	-	±15%	-	-	5.8

Source: own calculation based on Eurostat database, 2012

From 2001 until the beginning of 2010, the emerging Europe experienced:

* Large capital inflows from the EU (*see table 3*);
* A credit eruption;
* A rapid extension in consumption and investment;
* Debt denominated in foreign currency with great threat of exposure to a drop of the nominal exchange rate;
* Since foreign banks contributed to credit booms and external debt accumulation in the emerging Europe, the overall effect of financial integration on the crisis in this group of countries appears to have been mixed.
* While foreign banks had a stabilizing effect in the crisis, this mainly took the form of neutralising imbalances that theythemselves had helped create in previous years.

If GDP per capita expressed in Purchasing Power Standards (PPS) varied from 45 per cent to 274 per cent of the EU average PIB in 2011, in the case of the NMS it was around 45 to 66 below the EU average. The Czech Republic is the only candidate country that was around 80 per cent below the average.

Table 2
GDP/capita classification of the European candidate countries
(at pps)

Countries	GDP/capita expressed in PPS in comparison to the EU average
Czech Rep.	80
Poland	65
Lithuania	62
Hungary	66
Latvia	58
Romania	47
Bulgaria	45

Source: Eurostat/20 June 2012

Moreover, the trade integration between the older EU member states and the new member countries ranged from 50 to 80 per cent from the total trade. Also for the NMS the investment flows of the eurozone countries is over 77 per cent of the total ISD (*see table 3*).

Table 3
ISD inward flows in the candidate countries
from EU and the eurozone, in 2011

Candidate Countries	UE-27	Eurozone
Bulgaria	88.8	87.4
Czech Rep.	89.0	84.3
Latvia	77.7	51.0
Lithuania	80.2	41.0
Poland	86.5	78.2
Romania	90.7	86.2
Hungary	77.4	74.5

Source: Moody's investors service, August, 2012

But the economic and financial problems from the eurozone countries has spread concerns over the candidate countries and the figures below show the current official position throughout this group of countries (*see table 4*).

Table 4
The official position concerning the eurozone admission

	October 2010 –official position	Current official position
Bulgaria	2014	No official date
Czech Rep.	2015	No intention to join at the moment
Latvia	2014	2015-2016
Lithuania	2014	2015-2016
Poland	2015	No official date
Romania	2015	No official date
Hungary	2014	Beyond 2020

Source: official declarations

3) Romania and the eurozone

What is happening in Romania? In November 2012, the Governor of Romania, Mugur Isarescu, declared that the eurozone admission date of 2015 is no longer a realistic one.

Explanations could be found in the following causes:

1. Romania does not fulfil all the Maastricht criteria (*see table 5*);
2. Romania is waiting to see when the financial problems of the eurozone would be solved;
3. Restructuring measures for macroeconomic stability are necessary prior to the admittance into the eurozone;
4. Regarding its GDP, Romania is occupying the 17th place among the EU-27, with 136.4 billion euros (cf. Hungary's 100.7 billion euros);
5. GDP/capita at ppp is 12,300 euros (Hungary's is 16,500 euros at ppp);
6. The Romanian GDP represents 1 per cent of the total EU GDP.

Romania is fulfilling only three from the five criteria. As previously shown, Romania does not fulfil the inflation criterion as that is the highest in the whole EU (5.8 per cent in the 2011-2012 period. The long-term interest criterion is not fulfilled either, it being too high in comparison to the EU average (*see table 5*)

Table 5
The Romanian criteria fulfilment in the 2010-2012 periods in comparison to the reference value for eurozone

	Inflation (%)			Budgetary Deficit (% din PIB)			Public Debt (% din PIB)			Rate of Exchange (variation %)			Long-term interest (%)		
	2010	2011	2012*	2010	2011	2012*	2010	2011	2012*	2010	2011	2012	2010	2011	2012
Romania	6.1	5.8	4.6	6.8	5.2	2.8	30.5	33.3	34.6	0.7	-0.6	-2.8	7.3	7.3	7.3
Reference value for eurozone admittance	-	-	3.1	-	-	3.0	-	-	60.0	-	-	±15%	-	-	5.8

Source: NBR database, 2012

Concluding remarks

Presently, it seems that even the Europeans would be willing decide to abandon the euro; it does not appear to be possible any more. Christine Lagarde affirmed that "the total debt of developed countries has reached 110 per cent of the GDP and it is already at the same level as it had been during the Second World War."

The euro is already a universal currency and the most important countries and regions are based on the euro, the dollar and the renmimbi (Chinese authorities already would prefer the gold convertibility for the renmimbi). The Chinese, the Russians, the emerging countries and the Americans do not agree to this scenario because the US. dollar would appreciate too much and this would affect exports. Russia has 60 per cent of the total commercial trade in euros.

In our opinion we should learn from the actual crisis that the state as public administrator must to regain its position because of the dynamic of the social problems that has become more and more uncontrolled and dangerous due to the sustained crisis. The real existing problem in the EU states is the high rate of unemployment, especially in the southern EU countries. A solution to this crisis could be a long-term equilibrium between the private and the public responsibility; to achieve this the role of the state needs to be intensified since many analysts are predicting a decade of austerity from now on. The ending of the cold war and the opening up of the world have created the opportunity for some countries like China, India and Brazil to become world powers and the ideological importance has been reduced substantially. That is why not only the NMS but the entire EU should make significant steps toward improving competitiveness. The sectors that are not competitive in the market continue to be important indicators that partially explain the gap between the EU countries and delay the construction of an Optimal Monetary Zone. The "asymmetric shocks" should be analysed in all profound aspects when a candidate country is in support of the euro adoption. We should learn from the existing difficulties of the eurozone with a determination to avoid comparable difficulties in the coming years.

* * * * *

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THE EUROZONE CRISIS FROM THE FRENCH POINT OF VIEW*

Mikós Somai **

Abstract

There is a growing concern among politicians, decision-makers and experts about France's poor economic performance of the last couple of years, and its possible effects on the Franco-German relationship, so far the main driving and accelerating force of the European integration. Being off track for too long, France runs the risk of losing more and more ground against Germany, which may cause important shifts in balance of forces within the EU. The main aim of my paper is to compare France's economy to that of Germany, to display and analyse the state of French public finances, as well as the country's role in the eurozone crisis management, and to make a short assessment of the first achievements of the new leftwing government.

JEL: E00, G01, H50. H60, O11

The biggest problem of the French economy is its slowing growth trend. But it is only at the surface. At the root of the problem, there is something much deeper, something lasting and significant: the country's worsening international competitiveness. Unfortunately, this is not a new phenomenon at all. But while the trend has been around for decades now, the global crisis made the weaknesses of the French economy and a steady loss of competitiveness relative to that of its main integration partner, the German one more evident. Also, the scoreboard – this early-warning system created as part of the Six-Pack and intended to trigger in-depth studies searching for the nature of macroeconomic imbalances – clearly displays that the German economy is built on a much stronger basis than the French one (see table 1).

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Table 1
Scoreboard-indicators for France and Germany covering the major sources of macro-economic imbalances
(the dark background indicates which one of the two countries' performance is weaker)

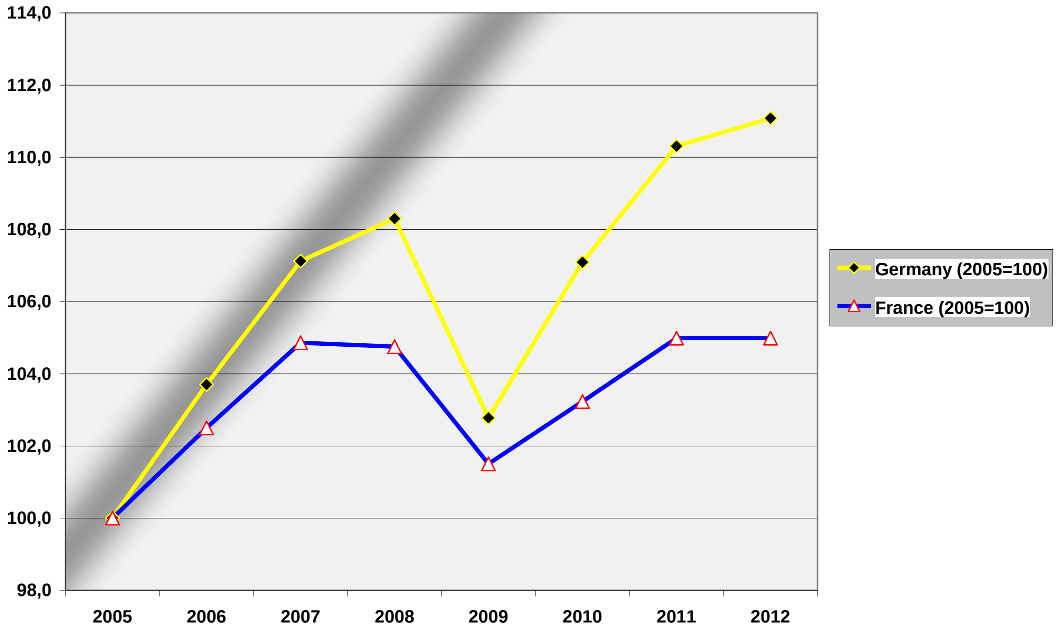
	France					Thresh-old value	Germany				
	2007	2008	2009	2010	2011		2007	2008	2009	2010	2011
Current account balance	-0.7	-1.1	-1.4	-1.5	-1.6	-4/6%	6.3	6.6	6.5	6.1	5.9
NIIP	-1.5	-12.9	-9.4	-7.8	-15.9	-35%	26.5	25.4	33.8	34.9	32.6
Δ real effective ex-change rate	0.2	2.7	2.9	-1.2	-3.2	± 5%	0.6	2.4	3.2	-2.9	-3.9
Δ shares of world exports	-18	-21.5	-10	-13.4	-11.2	-6%	2	-5.3	-4.6	-7.2	-8.4
ΔULC	5.4	6.8	8.8	7.7	6	+ 9%	-3.7	-0.6	7.2	6.8	5.9
Private debt	142.5	149.9	156.8	158.6	160.4	160%	122.3	123.6	130.5	127.2	127.8
Δ private credit flow	12.6	9.1	-1.8	1.8	4	+15%	3.6	3	1.8	3.1	4.8
Δ house price index	4.4	-2	-6.6	3.9	n.a.	+6%	-3.6	-0.3	0.8	-1	n.a.
General gov. debt	64.2	68.2	79.2	82.3	86	60%	65.2	66.8	74.5	82.5	80.5
Unemploy. rate	9	8.5	8.6	9	9.7	10%	10.1	8.8	8	7.5	6.9

Source: Eurostat (web) Current account balance in % of GDP – 3 year average; NIPP = net international investment position in % of GDP (annual data); Real effective exchange rate – 3 year % change (annual data); Shares of World exports – 5 year % change; ΔULC = nominal unit labour cost index (2005 = 100) – 3 year % change; Private debt in % of GDP (annual data); Private credit flow in % of GDP (annual data); House price index (deflated) – 1 year % change; General government gross debt (Maastricht debt) in % of GDP (annual data); Unemployment rate – 3 year average.

With the exception of 2009, economy in Germany grew at a higher rate than in France for each of the years since 2005 (see figure 1). For the entire period of 2005-2012, this resulted in a difference in GDP-growth rate of more than 1:2, since the German economy achieved a cumulative growth of 11,1%, while the French one a mere 5%.

It is true that such diverging growth patterns may have already been observed in the two countries' long-term development (see figure 2). Therefore, it seems quite normal for their GDP growth lines to swirl around and cross each other approximately every 10-plus years, as they did for the last two and a half decades. However, the current divergence period, in place since 2007, is unique in that it coincides with the global financial and economic crisis, which in turn found the two countries in very different economic and social situations: on the eve of the crisis, enormous structural changes had already been made in Germany, while in France these changes were still to come.

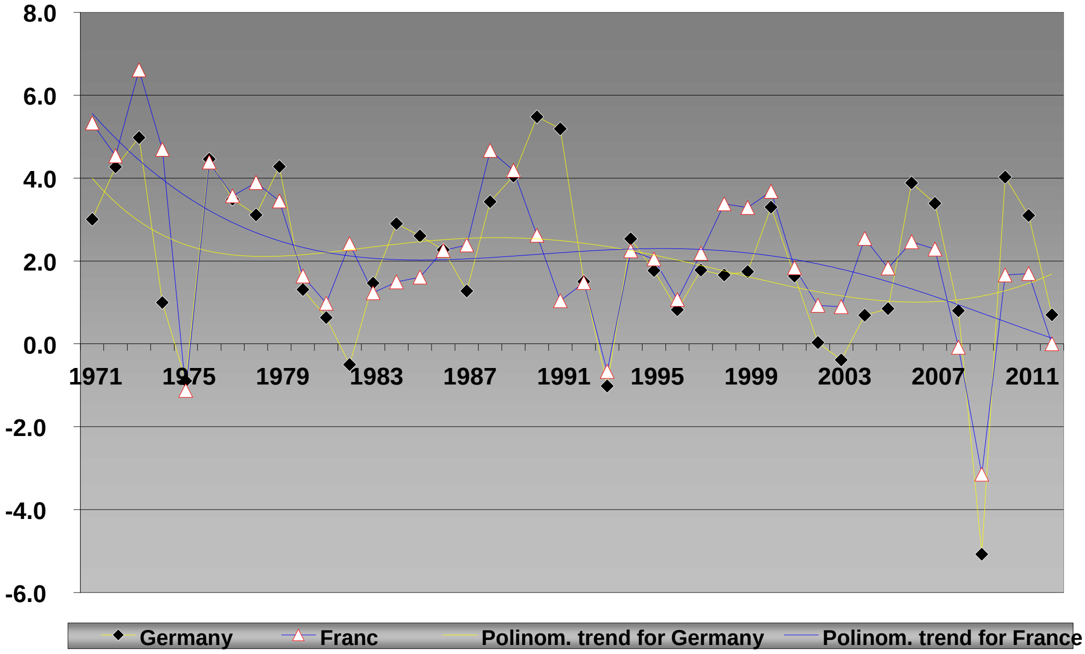
Figure 1
Cumulative real GDP growth of France and Germany since 2005



Source: Eurostat (web); for data concerning the year of 2012: Destatis (web) and Insee (web)

The gap between the two countries' long-term perspectives was widening further by the diverging economic policy measures implemented in the two capitals during the first years of the crisis. In Berlin, they restricted the salaries, boosted the exports and brought the public finances under control by 2011. In Paris, they hoped to overcome the crisis by the strength of the internal consumption and let the deficit rise high above the level allowed by the Stability and Growth Pact. The French government started to put forward mild austerity packages only in late August 2011 – practically three years after the outburst of the crisis – and the new left-wing coalition, in power since mid-May 2012, has both very little propensity and political space to introduce comprehensive structural reforms.

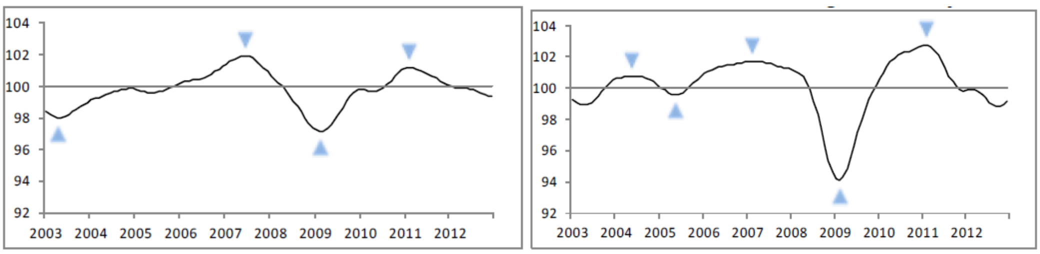
Figure 2
Real GDP growth patterns in Germany and France since 1971
(annual % growth)



Source: Eurostat (web); for data concerning the year of 2012: Destatis (web) and Insee (web)

This diverging growth path of France and Germany has recently been revealed and pointed out in an OECD publication, too.[1] While in Germany the so-called "composite leading indicators" (CLIs), which are designed to provide early signals of turning-points in business cycles, fluctuations in economic activity around its long-term potential level, point to a stabilisation in growth prospects, in France growth is expected to remain weak (see figure 3).

Figure 3
OECD Composite Leading Indicators for France (on the left)
and Germany (on the right)



Source: OECD (2013) page 2 – Triangles mark confirmed turning points of the CLI, which in turn tend to precede turning points in economic activity relative to long-term trend – represented here by the horizontal line at 100 – by approximately six months. (For detailed method: see OECD (2012)

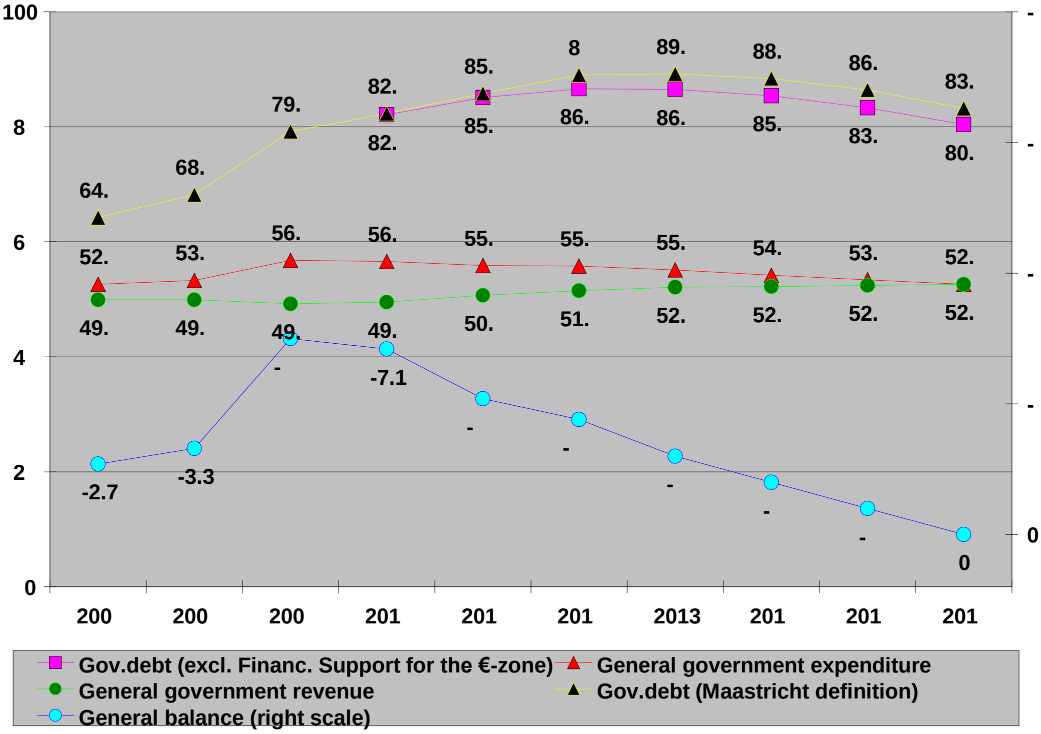
[1] OECD (2013)

Apparently, France is at a crossroads: with its slowing economy, persistent public and widening current account deficit, enormous public debt and unemployment, low and stagnating investments, either the country brings about deeper structural reforms – especially in the field of basic social services like the untenable pension system – or it runs a risk of the European balance of power being irrevocably changed, and Germany becoming not only the economic but also the political centre of Europe.

Public finance scenario

The trajectory of how to create order in French public finances has been set in the country's Stability Programme, in which Paris took the engagement to reduce the government deficit to 3 per cent of the GDP by 2013 and to restore the structural balance of public finances by 2016.[2] The stability programme is renewed yearly, the main data having to be adjusted in relation to changes in the macroeconomic path of the country. Only one thing is set in stone: the objective of a 3 per cent budget deficit for 2013 (see figure 4). The outgoing right-wing government was most anxious about this objective and over-fulfilled it in both 2010 and 2011. However, the slowing down of economic growth as of the end of 2011, the higher-than-previously-

Figure 4
France's multiyear public finance trajectory
(% of GDP)



Source: Eurostat + European Commission (2012) – France Stability Programme 2012-2016

[2] European Commission: France Stability Programme 2012-2016: 9

prevailing debt refinancing interest rates, and the special responsibility of France (together with Germany) in tackling the eurozone crisis put further pressure on public debt, so the planned decrease of this latter might be postponed by years.

France's participation in the eurozone crisis management

When Europe's future is at stake the Franco-German cooperation always returns to the centre of attention. During hard times, this duo has special responsibility to reach a consensus of their own regarding the main policy directions to be followed by the European integration.

As already mentioned, differences in economic policy philosophy – and especially in the field of fiscal discipline – between the German and the French, and more generally between the stricter Northern and the more permissive Southern European approach, reappeared at the beginning of the crisis. The convergence of approaches only took place at early 2010 when the situation in Greece started to worsen dramatically and the French counter-cyclical economic policy yielded almost no results. Paris began to realise that the programme of small steps in the field of modernising/rationalising the public administration – e.g. to replace only every second retiring civil servant – could be insufficient and more comprehensive structural reforms would be needed to restore competitiveness. A consensus was about to emerge between France and Germany on the prospect that there would be no sustainable growth without getting their public finances in order and that there should be no financial transfers to support member states in case they did not commit themselves to take the necessary steps into this policy direction.

Therefore, Paris and Berlin were becoming more and more engaged as active partners in their efforts to strengthen the EU economic governance. The main objectives of this are to ensure fiscal discipline and stabilisation in the European economy and to prevent a new crisis from happening. Other priorities are to promote sustainable growth and employment, which in turn could help further social and economic policy targets to be met.[3] This growth, however, should not push the inflation rate too high. But – and there is still some conflict between the interpretations of Berlin and Paris – the internal market and investments, as sources of competitiveness, have as much of a role in growth promotion as exports. This growth should also be supported by the domestic demand of countries with large external surplus; otherwise the efforts of some EU member states to reduce the deficit in their current account become totally meaningless.[4]

[3] *„To combat poverty and support vulnerable groups"* appears as an important target in the Conclusions paper of the European Council of 28/29 June 2012. See: European Council (2012): 8.

[4] See: Fillon (2010): 8 – A clear allusion to Germany's responsibility for the build-up of huge imbalances in the balance of payment terms, as the country consistently runs 60 per cent of its trade surplus vis-à-vis the eurozone. (Ibid. 3)

Despite the remaining differences in their views, France and Germany have come a long way in the field of European crisis management. They came to an understanding about rescue plans for Greece, which turned the principle of no-bailout, seen by Berlin as taboo, obsolete.[5] In return, Paris agreed to make the financial rescue packages conditional upon the implementation of stringent austerity programmes in the member states concerned; programmes having always been seen in France as inefficient at times of crisis. The tight cooperation of the two leading European partners was crucial in the creation of the European Financial Stability Facility (EFSF) in May 2010, its strengthening and enlargement in July and October 2011, and finally its perpetuation in the form of the European Stability Mechanism (ESM) in October 2012.

Considerable progress has also been achieved in the area of economic governance. In October 2010, the two countries reached an agreement on the reinforcement of the Stability and Growth Pact (SGP), incorporated into the so-called Six Pack which has been in force since 13 December 2011. Further milestones in Franco-German cooperation were marked by the European Semester, the Euro-Plus Pact and the European Fiscal Compact. The latter – formally called the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union – introduced an even stricter mechanism than that of the Six Pack, by requiring contracting parties to converge towards their medium-term objective, as defined in the SGP, with a lower limit of a structural deficit of 0.5 per cent.[6]

The Fiscal Compact – as a live issue at the time with a very restrictive character – emerged as one of the main themes of the French presidential election campaign in 2012. This intergovernmental agreement was signed by 25 EU Member States (all but the UK and the Czech Republic) just a couple weeks before the first round of the election. Francois Holland, the then Socialist Party candidate, had pledged to re-negotiate the Fiscal Compact in order to include growth measures, in case he won. At the end, this election promise has gone the same way as so many others; it was in no way realised as it had been promised. The French Parliament ratified the Fiscal Compact as it had been signed by the outgoing President Nicolas Sarkozy – not a word had been changed in it.[7] At the European Council of June 2012, however, after convincing his European partners of the need for flanking measures to stimulate economic growth, President Holland obtained a modest package of €120 billion (equivalent to around 1.0 per cent of EU GNI), the Growth Compact in EU slang, designed to boost the financing of the European economy.[8]

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[5] See: Article 125 of the Lisbon Treaty whereby neither the EU nor any of its Member States *“shall be liable for or assume the commitments of central governments, regional, local or other public authorities”* etc. of any (other) Member State. http://www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-the-functioning-of-the-european-union-andcomments/part-3-union-policies-and-internal-actions/title-viii-economic-and-monetary-policy/chapter-1-economic-policy/393-article-125.html.

[6] 1.0 per cent of the GDP if the Member State has a debt ratio significantly below 60 per cent of the GDP. See: European Commission (web).

[7] The Fiscal Compact entered into force on 1 January 2013 for the 16 EU Member States which completed the ratification prior to this date. See: Council (2012).

[8] For further details, see: European Council (2012): 10-12.

At the above-mentioned EU-summit of June 2012, however, the Growth Compact was far from being the most interesting topic. The possibility had been raised that institutions (most notably the ESM) established to finance rescue packages for the euro area Member States could – naturally, only under strictly defined conditions – recapitalise banks directly.[9] The vicious circle between banks and sovereigns could, in this way, be broken. In other words: this would prevent the euro area governments' bank-saving programmes from turning automatically into sovereignty crises. Naturally, in order to realise this plan, member states first need to agree on the establishment of a single supervisory (SSM). The starting point for such an agreement – but also as a first step towards an integrated "banking union" – may be the proposals on the SSM put forward by the Commission on 12 September 2012. They also include components such as a single rulebook, common deposit protection and a single bank resolution mechanism.[10]

Table 2
Euro area Member States' shares in guarantees that back up the EFSF's effective lending capacity of €440 billion

Eurozone Members	Original EFSF(ECB) contribution key (%)	EFSF amended[1] contribution key (%)	ESFS amended[1] guarantee commitments	
			(€ bn)	of € 440 bn
Germany	27.06	29.07	211.0	**47.96%**
France	20.31	21.82	158.4	**36.00%**
The Netherlands	5.70	6.12	44.4	10.10%
Belgium	3.47	3.73	27.1	6.15%
Austria	2.78	2.99	21.7	4.93%
Finland	1.79	1.92	14.0	3.17%
Luxembourg	0.25	0.27	1.9	0.44%
Estonia	0.26	0.28	2.0	0.46%
		First class[2] guarantors:	**480.5**	**109.21%**
Italy	17.86	19.18	139.3	31.65%
Spain	11.87	12.75	92.6	21.04%
Slovakia	0.99	1.06	7.7	1.75%
Slovenia	0.47	0.50	3.7	0.83%
Cyprus	0.20	0.21	1.6	0.35%
Malta	0.09	0.10	0.7	0.16%
		Other guarantors:	**245.5**	**55.79%**
Ireland	1.59	-	-	-
Greece	2.81	-	-	-
Portugal	2.50	-	-	-
	100.00	**99.72**	**726.0**	**165.00%**

Source: EFSF (web); 1 = The amended contribution key takes into account the stepping out of Greece, Ireland and Portugal. 2 = countries rated AAA or AA by S&P, i.e. having extremely or very strong capacity to meet their financial commitments.

[9] Council (2012)

[10] Commission (web)

Even if the Franco-German relations had cooled a bit since Holland's election as French president, the harmonisation of EU policy proposals between the two countries did not come to a halt. As a matter of fact, the Paris-Berlin axis has been making good use of its capacity to exert greater influence on the definition of the European "rules of game" than other Member States do. It is, however, not to be forgotten that these two countries together provide more than 80 per cent of the first class guarantees (i.e. having real value for investors) covering EFSF rescue packages (see table 2). Stemming from their fundamental role in financing the euro crisis, France and Germany will no doubt continue to play a major role in shaping the future of the European integration.

What has changed with the arrival of the left-wing government?

The growing costs of debt refinancing and the possible lowering of the country's credit rating greatly decreased the room for manoeuvre of French economic policy as of the last quarter of 2011; a fact which could not be ignored or overlooked even by the new left-wing government. The latter, clever enough to keep election rhetoric but break election promises, decided to implement austerity packages worth €37 billion in two steps: the first one (circa €7 billion) included measures, as part of an amended 2012 budget, targeting the wealthiest households and the biggest companies;[11] the second one (€30 billion) was supposed to come true thanks to the government's 2013 budget proposals. As a contrast to what had been decided and taken by the former government as commitments in their Stability Programme of 2012 – namely to make a fiscal consolidation effort of €115 billion between 2011 and 2016 with two thirds coming from spending cuts and the rest from additional revenues – the 2013 budget intends to reverse this ratio by dropping the deficit to 3 per cent of the GDP with €20 billion in increased taxes on individuals and businesses, and with savings of €10 billion through a freeze in public expenditure.[12]

In spite of all rhetoric of putting the burden of extra taxes on the well-off rather than the poor, life soon returned to normal. In November 2012 – based on the recommendations of a report prepared by a panel led by Louis Gallois, one of the country's most prominent industrialists – the government introduced a payroll tax cut, aimed at easing high employment costs for companies by €20 billion a year from 2014 onwards.[13] The tax credit will work out to a 6 per cent reduction in social security charges on workers on one up to 2.5 times the minimum wage and will be

[11] L'Expansion – L'Express (web)

[12] See: Commission (2012): 9 and Ministry of Economy, Finances and Industry (France) (web) 50/58 (ppt).

[13] Ministry of Economy, Finances and Industry (France) (web-a)

financed by €10 billion in spending cuts and another 10 billion of increase in value added tax (VAT) and green taxes.[14]

Two months later, French employers' groups and some of the main trade unions agreed on a deal to overhaul rigid labour rules, paving the way for new legislation in 2013 – an event so much anticipated by S&P that they threatened to cut France's credit rating if reforms failed.[15] The reform should help firms in their efforts to adjust to downturns in demand and reduce costs in the event of layoffs, while offering more job security to workers on short-term contracts. Two hard-line unions, however, the CGT and the FO, denounced the deal to be a backward step for workers' rights as it contained the decrease of salaries in certain cases, primacy of individual collective agreements over cross-sector framework agreements, and the facilitation of forced mobility and of the firing of workers.[16]

Similarly to internal economic policy matters, the latitude of the French government in European policy-making is also circumscribed. Leaders of the left argue that uniform crisis management – i.e. fiscal austerity across Europe – implemented without paying attention to support economic growth leads to recession; the latter caused a strengthening of populist political parties in Southern Europe and a decline of solidarity in the North. This situation has to be changed and that is why people voted the left into power in France.[17]

But it is only rhetoric. When it comes to policy proposals there is no change in the French approach. France calls for more solidarity towards the Mediterranean countries which is easily understandable given the enormous sovereign debt exposure of its banking system to the region, exceeding by far that of Germany's.[18] Hence the inclination of the French government to consider a partial debt mutualisation at European level to be a solution to the euro crisis, which would involve two things: Eurobonds and the European Central Bank (ECB) as lender of last resort. This idea is fiercely opposed by Germany, fearing it would endanger the ECB's independence and in the end lead to higher inflation. For Berlin, solidarity of the rich regions of Europe toward the poor regions will only make sense once fiscal consolidation is achieved and fiscal discipline is strengthened.[19]

Instead of conclusions

France is a rich country with a lot of talents: increasing population, high-level public services in the widest term of the word (healthcare, education, all sorts of infra-

[14] The standard rate of VAT will rise from 19.6 to 20 per cent as of 2014. The intermediate rate will rise from 7 to 10 per cent. The minimum rate, however, will be cut from 5.5 to 5.0 per cent. See: The Local (web).

[15] The Wall Street Journal (2012)

[16] For more details, see: Le Figaro (web).

[17] French Prime Minister (2012)

[18] The New York Times (2011)

[19] French Prime Minister (2012) and Stark (2011): 14-15.

structure), creative enterprises, dynamic intellectual life, etc. It is one of the world's most popular destinations for tourism, and also one of the biggest exporters of agricultural and food products, as well as of services. It ranks amongst the leaders in such future oriented sectors as energy, aeronautics, space, luxury and the pharmaceutical industry, as well as in network services.

The space of the country's development has, however, been steadily slowing down for several years now. Restructuring in the public sector is underway, but whether it will be deep enough to bring about the desired results in terms of budget balance without undermining solidarity and social cohesion, is to be seen. Nevertheless, experiences of the first couple of months of the left-wing power have shown how narrow the path the new government ought to follow… Market forces seem to prevail over any other considerations…

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GERMAN CRISIS MANAGEMENT – AN EXEMPLARY APPROACH AND ITS BACKGROUND*

*Ágnes Orosz***

Abstract

In this paper we illustrate why Germany seems to be more resistent to recent global financial and economic turmoil. In doing so we shed light on economic policy measures that were geared towards more resilience right before the crisis, and we also pinpoint how German consolidation resulted in a uniquely favourable position compared to other eurozone member states

Keywords: eurozone crisis, crisis management, German labour market

JEL Classification: H7, H75

The global financial crisis that started in 2008 manhandled the economy of most EU member states and resulted in strong crisis management and economic stimulating measures. From the spring of 2010 onwards, the probability of disintegration has been growing and the idea of the EU splitting up comed to the forefront from time to time. When examining the crisis, we have to underline the fact that the consequences of crisis management and responses to the crisis are completely different within Europe and worldwide. However, the leading role of Germany is obvious; the recovery in Germany took place in a relatively short time, coupled with amending labour market performance. The reaction of the labour market to the 2008/2009 crisis in Germany is so peculiar that it is worth revealing its causes in detail.

Germany plays a key role in the future of the integration: a current example for that is the 12 September 2012 decision of the German Federal Constitutional Court

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(Bundesverfassungsgericht) that also defined the further fate of ESM.[1] According to this decision, ESM and the fiscal pact can be inserted into the German legal system, the ratification process can move on (Bundesverfassungsgericht, 2012), but the judges require certain minimal supplements before the treaty is ratified (Antpöhler, 2012). A refusal could have had catastrophic effect on the eurozone and the future of the whole European Union. Another milestone and line of fracture at the same time: legal acts related to the banking union. In October 2012 an agreement was signed on direct banking supervision but Germany wants to avoid direct capital injection to struggling banks (The Economist, 2012). This example well represents how German domestic politics and the elections in 2013 influence the whole future of European integration.

1) What is the key to German success?

To understand the current situation of Germany, and its key role in the euro area crisis management we have to look through reforms and fiscal processes in the 2000s. The first years of the new millenium brought the reform of state allocation systems in Germany, coupled with the effect of world economic changes. Compared to 2000, in the following two years there was a drop in GDP growth, and the pace of broadening of domestic demand was slower than that of growth, so growth remained export-led (Rácz, 2001). Persistent growth problems resulted in a growing number of unemployed and a worsening fiscal performance. So in this period the government was facing the problem of ameliorating the budgetary situation, producing an over 2 per cent growth, and reducing the number of more than five million unemployed (Rácz, 2005).

ILO (2011) lists the current German employment situation as exemplary which proves the success of reforms although the relatively stable employment was realised through decreasing working hours. One of the major drawbacks of this exemplary status is that the ratio of low income activities increased, which resulted in huge income inequalities. As a consequence of the lack of a generally defined minimum wage, hourly wages in several Eastern Länder (in the area of German Democratic Republic, DDR) are under 1 euro. The number of "working poor" increased more dynamically in Germany than in the euro area altogether, although their average stayed below the eurozone average (Marsh – Hansen, 2012). What were the reform measures that led to this ambiguous labour market situation?

From 2002 onwards, Germany was unable to respect the Stability and Growth Pact,[2] budget deficit was over 3 per cent year after year, and the public debt rose

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[1] European Stability Mechanism – Created to achieve financial stability, substituting EFSF (European Financial Stability Facility) and EFSM (European Financial Stability Mechanism), it expires in 2013 (European Council, 2012a).

[2] There are three reasons for not punishing those big EU countries (among others France and Germany) that did not respect the rules: (i) we are talking about the grandfathers of EU integration; (ii) these countries are motors of EU-wide growth, and the EDP might have decreased demand and caused recession; and (iii) it was an implicit way of acknowledging that trespassing the threshold

from 59.1 per cent in 2001 to 66.3 per cent in 2004. After the 2001 informal warning, in 2003 Germany was included in the Excessive Deficit Procedure. The 2004 stability programme was reshaped several times since originally the government used a more favourable GDP growth number. On 14 March, 2003, the Schröder government launched the reform initiative entitled "Agenda 2010" that consisted of labour market, budgetary and sickness insurance reform, but further pensionary reforms were needed to complement this programme (Bundesregierung, 2003). In 2007, more significant changes took place in the pension system: mandatory retirement age was raised to 67 years. Further reforms were not accomplished but the prolonged crisis might put further political pressure on the pension system (Bonin, 2009).

"Agenda 2010" is the most comprehensive reform programme of Germany; the government set the basis of returning to growth and employment with comprehensive structural reforms. Its fundamental aims were sustainability and stability in light of demographic processes, consolidation of the state budget, cutback on subventions, and reduction of bureaucracy. The long-term goal of these measures was to reach full employment. The "Agenda 2010" package comprised of employment measures initiated by the committee of Peter Hartz. Laws Hartz I. and II. entered into force on 1 January 2003, offering new employment possibilities, ameliorating recruitment agencies' quality and pace, setting new orientation for professional trainings and strengthen the provider quality of the Federal Employment Agency. The third and fourth law aimed at converting the Federal Employment Agency into a performance- and client-oriented recruitment service, a more effective labour market policy, the simplification of labour market tools, setting new standards for employment safety of the elderly and new employment possibilities for the young, and the merger of social and unemployment benefits. The third and fourth Hartz law entered into force on 1 January 2004 and 2005, respectively. The above-mentioned four laws transformed connections between people looking for employment, employment agencies and employment providers, rewrote the rules of personal responsibility and social welfare. Labour market reforms were complemented by important labour law reforms, comprising of changing the Termination of Employment under German Law. Laws on partial employment and limited duration employment were signed to enhance recruitment, especially for smaller companies (Frey, 2006).

Reforms brought mixed results: widening capacities for employment agencies, training programmes and wage subventions were successful, contrary to temporary public jobs and voucher systems for placement services and training measures which were relatively less auspicious (Miniszterelnöki Hivatal, 2010). For the unemployment benefit, one had to prove having looked actively for a job, and a mandatory „activity" period was set when the applicant had to participate in programmes helping to find employment. From this mandatory participation originates the obligation of accepting a so-called one-euro job that contributed to a growing ratio of the "working poor" (Mózer – Simonyi, 2011).

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does not necessarily imply problems – the structure of debt and factors of deficit growth are more relevant data.

Table 1
Major macroeconomic indices

	2007	2008	2009	2010	2011	2012*	2013*
GDP growth, percentage	3.3	1.1	-5.1	4.2	3.0	0.8	0.8
Unemployment, percentage	8.7	7.5	7.8	7.1	5.9	5.5	5.6
Investments, percentage of GDP	18.4	18.6	17.2	17.4	18.1	18.3	18.7
General government deficit, percentage of GDP	0.2	-0.1	-3.2	-4.3	-1.0	0.0	-0.4
Public debt, percentage of GDP	65.2	66.7	74.4	83.0	81.2	83.0	n.a.
Current account surplus, percentage of GDP	7.4	6.2	5.9	6.1	5.7	6.1	5.3
Unit labour cost (2005=100)	97.2	99.4	105	103.8	105.3	108.3	109.9

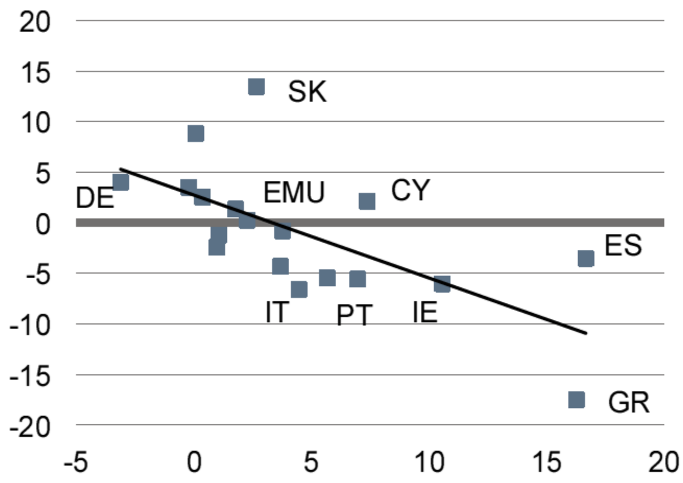
* Forecast. Note: source of governmental data: Deutsche Bank (2012); source of unemployment data; European Commission (2012a)

Source: Eurostat

Based on Germany's 2007-11 updated stability programme (European Council, 2008) we can establish that compared to the first part of decade, in 2006 and 2007 German economic growth was a lot more robust, over 3 per cent. The stabilising measures and the unexpected real economic effects of the escalating crisis in 2008 resulted in a downward movement of real GDP growth from 3.3 per cent in 2007 to around 1 per cent in 2008, followed by a 5.2 per cent decrease in GDP in 2009 (see table 1). In 2010, the economy was revived, but 2012 only produced minimal GDP growth, and Eurostat forecasts 0.8 per cent GDP growth for 2013. The exit from the recession brought a reduced unemployment rate, which is an unprecedented phenomenon in the EU for that period (see figure 1).

Competitiveness has been restored by wage restraint and structural reforms. While employment has been increased, real wages have been continuously reduced as a consequence of the cuts at the unemployment benefits and the increasing share of part-time employment. Economic prosperity helped the completion of the reforms to offset the negative effects. The positive developments of the labour market supports the forecast on the improving domestic demand, however, external demand is expected to weaken. Additional positive effects have been created by the improving innovation performance and the efficiency gains arising from the simplification of taxation.

Figure 1
German labour market outlook in European perspective



Source: Deutsche Bank (2012)
x axis: : change in unemployment rate Aug 07–Aug 12
y axis: real GDP growth Q2 07–Q2 12

A steady decline in unemployment can be observed since 2007, reaching 5.9 per cent in 2011 resulting in the rising number of people paying into the social security system. As an outstanding feature of the German labour market, the unemployment rate decreased in 2012, and would remain stable in 2013 as well.

Table 1 shows us that before the crisis Unit Labour Cost (ULC) for Germany slightly increased (base year is 2005) and afterwards the growth rate of ULC has been one of the lowest for Germany. According to Felipe and Kumar (2011) unit labour costs have increased in all countries without exception within the eurozone, in some cases by a factor of 15 (*e.g.*, Greece). The lowest increases were registered by Germany and the Netherlands for the period of 1980 to 2007, it can be interpreted as a competitiveness gain for Germany compared to the other eurozone member states. Real wage growth in Germany has lagged behind labour productivity growth through the analysed period. For the periphery of the eurozone the introduction of the euro resulted in an increasing current account deficit and worsening price and wage competitiveness, while the core countries – especially Germany – could improve their current account position and competitiveness (Watt, 2012).

Growth in 2011 was driven mainly by domestic demand; in 2012 the key driving force of growth was both consumption and exports when the German GDP rebounded, and the contribution of gross fixed capital formation was negative (see table 2). Germany has a significant trade surplus; however uncertain external environment is increasingly expected to take a toll on exports (European Commission, 2012a). Current account surplus is outstanding, since 2007 it was about 6 per cent of the GDP each year. One dimension of the growing imbalances among the EU member states is manifested in their significant and persistent divergence of the current accounts and net external positions. Besides Germany, other surplus countries in the eurozone[3] are the Netherlands, Belgium, Finland, Austria and Luxembourg (European Commission, 2012b).

Table 2
Contribution to GDP growth
(annual percentage change)

	2008	2009	2010	2011	2012*	2013*
Domestic demand	1.2	-1.5	1.9	2.2	0.6	1.1
Inventories	0.0	-0.8	0.6	0.2	-0.5	-0.1
Net exports	-0.1	-2.8	1.7	0.6	0.7	-0.2
GDP	1.1	-5.1	4.2	3.0	0.8	0.8

* Forecast

Source: European Commission (2012a): 60

Germany is a prime example for successful budgetary consolidation, in which the main fiscal consolidation efforts focused on the expenditure side. In order to ensure long-term sustainability, promoting growth and improving employment circumstances have been on the agenda as well as the cuts of public expenditures.

The consolidation scenario for 2007-2011 was rewritten by the outbreak of the crisis. Gross public debt amounted to 65 per cent of GDP in 2007, and after a dramatic increase it reached 83 per cent in 2010.[4] The excessive deficit procedure (EDP) for Germany was opened in December 2009, general government deficit and general government gross debt were above the threshold (3.7 per cent and 74.2 per cent of GDP respectively). To bring its deficit back below the 3 per cent of the GDP threshold, Germany made the fiscal effort of at least 0.5 per cent of GDP on average annually over the 2011-13 period (Council of the European Union, 2012). By 2011, the country could manage to stabilise its public finances, and in 2012 the Council adopted a decision of closing the EDP for Germany.

German labour market developments contributed to the unique crisis responses; this period is often cited as the "new German economic miracle,"[5] which was accompanied by successful fiscal consolidation. Several reasons are able to explain this unusual response of Germany. First, the economic crisis mostly hit financially strong companies that were able to impelement working-time flexibility instruments. Second, in the years prior to the recession, Germany had introduced comprehensive labour market reforms to improve efficiency. Third, demographic challenges were maintained as well, policy-makers payed special attention to the labour market (Caliendo – Hogenacker, 2012). Recent reforms of the pensions system, especially the reform in 2007 contributed to the further increase of the labour market participation of older workers. There are two channels through which the pension

[3] Outside the monetary union, Denmark and Sweden ran important surpluses as well.

[4] In 2007 the fulfilment of the Maastricht criterion on debt was targeted by 2010. The dramatic effect of the crisis can be demonstrated by the counter-movements of debt trends.

[5] The phrase "economic miracle" relates to Germany's economic performance at time of the 2008/2009 crisis (Bonin, 2012; Caliendo–Hogenacker, 2012; Rinne–Zimmermann, 2012).

system has been able to build up reserves to be resilient to the weakened economic conditions: growing revenues as a consequence of improving labour market performance, and decreasing expenses because of strict regulations and the increase of the statutory retirement age to 67 years (Bonin, 2009).

2) Crisis management in Germany

In the case of Germany, the crisis was transmitted through both trade and finance channels. External demand for German goods and services shrank considerably, abd they resulted in a significant, (on an annual basis) nearly 7 per cent GDP loss, higher than in most other advanced economies. Despite the dramatic effects on the GDP, the German labour market has performed exceptionally well. The finance channel has contributed to the crisis, when the sub-prime market in the United States crashed in the summer of 2007, and various German banks, including state-owned banks that had heavily invested in collateralised debt obligations (CDOs), suffered significant financial losses.

The dramatic decline of the GDP changed in Q1 2010 when the growth rate turned positive, and the stable employment supported domestic demand did not to decline. It is remarkable that within the European Union the only country in which the employment rate grew from 2008 to 2009 was Germany.[6]

In 2008 Germany defined its main fields of responses to the financial crisis as follows: (1) short-term stabilisation, long-term reforms; (2) good framework for stimulating trust within the economy; (3) maintaining public finances to support economic growth; (4) restructuring the labour market; (5) increasing the efficiency of the social insurance system; (6) rationalisation of the energy policy; (7) supporting innovation in order to improve competitiveness; and finally, (8) improving Germany's position on the global market through international and European economic policy actions (Kőrösi, 2011).

In accordance with the global trend in 2008, the Federal Parliament of Germany passed a law to stabilise the financial markets, namely Finanzmarktstabilisierungsgesetz (2008). A €400 billion financial market stabilisation fund was set up based on this legislation and another €80 billion was added to recapitalise the banking sector. The aims of these credit guarantee and credit expansion measures were to maintain interbank lending, avoid bankruptcy of banks and ensure the availability of credit for businesses. In 2009 the German government established €80 billion fund (Wirtschaftsfonds Deutschland) for credit guarantees and support for German enterprises (ILO, 2011).

Beside maintaining financial stability and boosting credit supply, Germany announced three stimulus packages in order to ease the negative consequences of the crisis between November 2008 and December 2009. The first announced stimulus package (FSP I, 2008) of €50 billion was entitled "Pact for employment security through enhanced growth" (Beschäftigungssicherung durch Wachstumsstärkung)

[6] Based on Eurostat data.

with the aim of saving or creating 500,000 jobs. The second stimulus package (FSP II, 2009) with the same amount as the first was entitled "Pact for employment and stability in Germany" (Pakt für Beschäftigung und Stabilität in Deutschland) and it contained a mix of tax cuts, different support for companies and investments into infrastructure and education. The third stimulus package (FSP III, 2009) "Law on the Acceleration of Economic Growth" (Wachstumsbeschleunigungsgesetz) amounted for €22 billion and was related to tax reliefs for enterprises and individuals.

On the one hand, the fiscal stimulus packages had a significant impact; they have been estimated to represent around 4 per cent of 2008 GDP, Germany being ranked in the middle among the G20 economies (ILO, 2011). On the other hand, in the case of Germany the effects ofautomatic stabilisers were rather salient, and they amounted to around 2.5 per cent of the 2009 and 2010 GDP (ILO, 2010).

Germany has been the most devoted advocator of rules-based fiscal policy for long. In 2009, Germany incorporated a debt brake into its constitution and introduced a sizeable package in order to cut back the structural deficit constantly until reaching the target of 0.35 per cent of GDP from 2016 onwards. The federal budget for 2011 was already prepared to comply with the new regulations. The inclusion of the debt brake as an effectively strict limit on the sovereign debt in Germany's Constitution can be understood as a tool to enhance the country's credibility on the financial markets, leading to lower risk premiums (Truger – Will, 2012). A special feature of the German regulation is that it is even stricter than the provision of the Stability and Growth Pact for balanced budget rule with a lower limit of a structural deficit of 0.5 per cent of the GDP (Benczes – Váradi, 2011). Germany's debt brake is an intelligent and promising concept for achieving a long-term reduction in public debt. The main advantage of the debt brake is that it has both the structural and the cyclical deficit components, the fiscal targets are dynamic; therefore, the debt brake could easily be extended to other countries. The introduced debt brake can be understood as Germany's first step towards growth-oriented consolidation. Germany's benchmark role on the capital markets is unambiguous; other eurozone countries could soon decide to take similar steps (Heinen, 2010).

Besides strict fiscal consolidation measures and a rules-based fiscal policy, the specific feature of the German crisis management is that the country has been able to maintain high living standards for its citizens. Germany has sustained the pre-crisis level of domestic demand while using automatic stabilisers to lessen the negative social impacts of the crisis. Since 2009 almost all categories of social insurance[7] spending have witnessed significant year-on-year increases in spending, ranging from 2.2 per cent in pensions (€5.4 billion) to more than 37 per cent on unemployment benefits (€10 billion) (ILO, 2011). This mechanism ensures that with a higher economic growth social expenditures can be reduced, despite the fragile economic circumstances, especially at a time of crisis when targeted social policies are required to counterbalance the negative consequences.

[7] With the exception of accident insurance.

Conclusion

Despite major parts of the eurozone living through a period of severe fiscal austerity, as a consequence of the successful fiscal consolidation and the crisis management measures, Germany has manoeuvred itself into a favourable position within the EU.

The “new German economic miracle” is the consequence of the labour market developments accompanied by a successful fiscal consolidation. Admittedly, the German situation is extremely unique, yet the following factors lie behind its success: (1) the economic crisis mostly hit financially strong companies that were able to implement working-time flexibility instruments; (2) Germany had introduced comprehensive labour market reforms to improve efficiency already years before the recession; and (3) demographic challenges were maintained as well, with policy-makers paying special attention to the labour market. The examplary features are obvious; however, these special institutional factors cannot be copied to be implemented anywhere else.

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CURRENT CRISIS AND CONVERGENCE PROCESS IN EU*

*Lucian-Liviu Albu***

Abstract

Intuitively, some authors could consider that the current crisis seems to affect convergence in the EU. On the contrary, our analysis shall demonstrate that on the long run the convergence process is not essentially altered. Depending on the evaluation methodology, the indicators used and the periods considered, the results of studies on convergence are often ambiguous. By using the Lorenz curve model and its attached Gini coefficients or variation coefficient, our study shows that during the last decade there was a significant convergence in the EU despite the negative impact of the actual crisis on growth rate. However, differences in the matter of convergence still exist within the groups of countries. Thus, generally while in the EU-10 (last adhered countries to the EU) is manifesting a strong convergence, in the EU-15 (old members of the EU) a significant trend of divergence was demonstrated.

Keywords: convergence, Gini coefficient, Lorenz curve, variation coefficient, divergence

JEL Classification: C8, E20, F02, O11, O47

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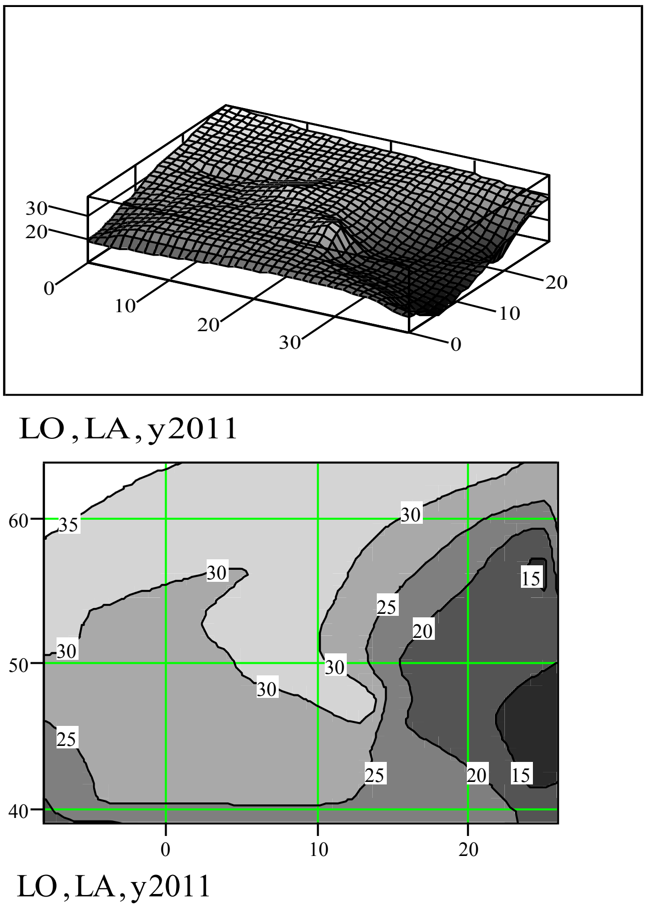
1) Introduction

Convergence theory and empirical evidences show a general convergence trend as a long-term process during the economic development. Also in the history of the EU there is significant progress in the matter of convergence. However, convergence is not linear; there are periods of acceleration and periods of braking, due to a number of specific conditions.

Following the Sollow model (Solow, 1956), real convergence in the EU refers explicitely to the income per inhabitant or to the level of productivity per employed person. Also, taking into account the contemporary globalisation phenomenon we analyse convergence in the EU regarding export and import per capita. Moreover, on the structural convergence side we estimate some indicators reflecting changes in the share of main sectors in total employment.

2) Empirical evidences

Figure 1
Spatial distribution of GDP per capita in the EU, in 2011

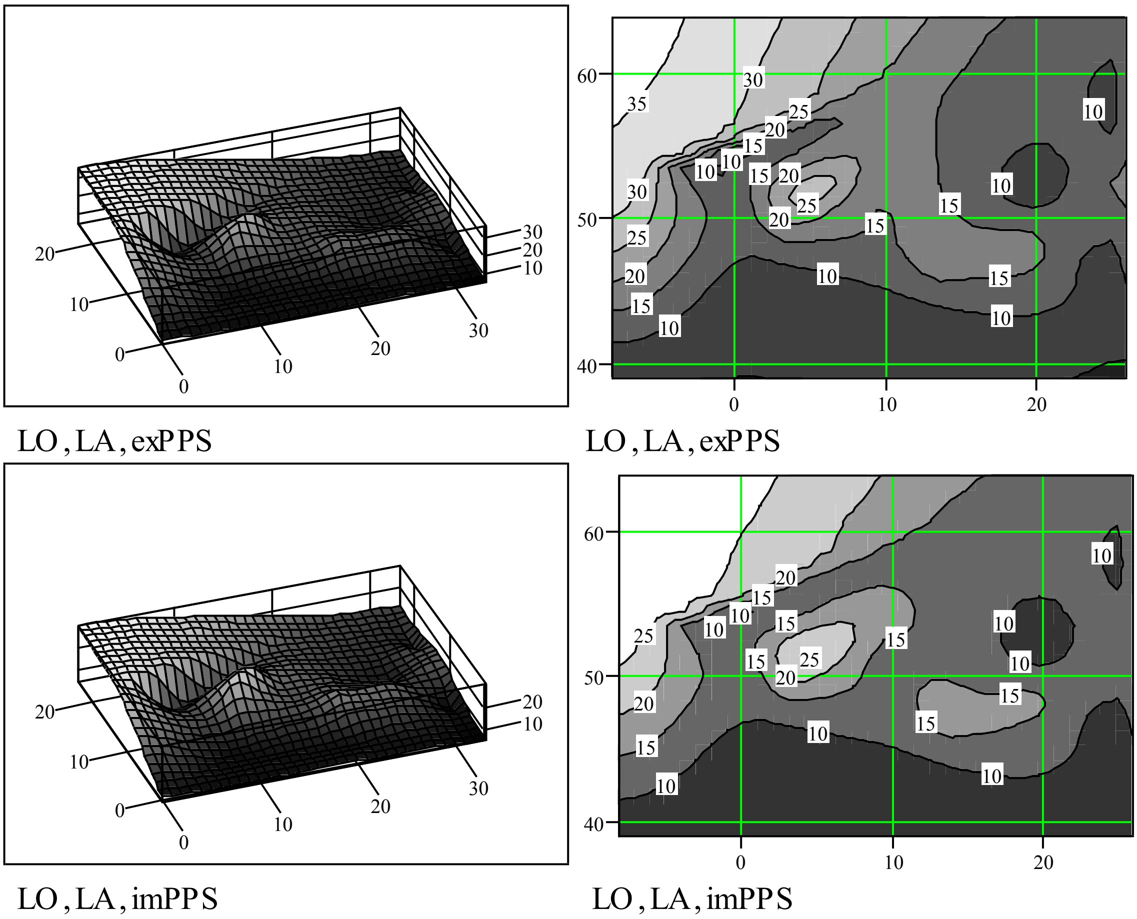


Source: Own calculations based on Eurostat data

Despite efforts to achieve convergence in the EU, there are still significant discrepancies today among countries regarding GDP per capita. As empirical evidence, we are presenting in figure 1 the 2011 spatial distribution of GDP per inhabitant in EU, where LO means longitude (on the left side relating to the origin, 0 meridian, the Western longitude, as it is marked usually on geographical maps, is changed into negative values), LA – latitude, and y – GDP per inhabitant in purchasing power standard. The purchasing power standard, denoted as PPS, is an artificial currency unit (PPS is the technical term used by Eurostat for the common currency in which national accounts aggregates are expressed when adjusted for price level differences using PPPs; PPP being Purchasing power parity). Beside the three-dimensional picture is its attached "geodesic" map (or the so-called contour plot). We excluded from the graphical representation of figure 1 two island states (Malta and Cyprus) and Luxembourg due to its high level of GDP per inhabitant (273 per cent comparing to the EU average level).

On such a stylised map of the EU, the proportions of an actual geographical map were kept in the longitude and latitude dimensions. As in the case of a geographical map, light colours correspond to high lands and dark colours to abyssal zones. We consider that the advantage of such maps is that the transition from one country to another or from one region to another is smooth and not abrupt, unlike in the case of using a map with a limited number of colours (as the conventional borders could block the transition of economic factors, economic phenomena and processes common between neighbouring geographic areas, which is unlike reality, especially in the actual situation of the disappearance of borders, as is the case in the European Union. Also, in the case of the spatial representation of distributions (3D images usually shown on the left side of the figures) we selected the best perspective by allowing for some rotation (both horizontally and vertically) of the image, thus changing the resolution.

Figure 2
Spatial distribution of export and import per capita in the EU, in 2011



Source: Own calculations based on Eurostat data

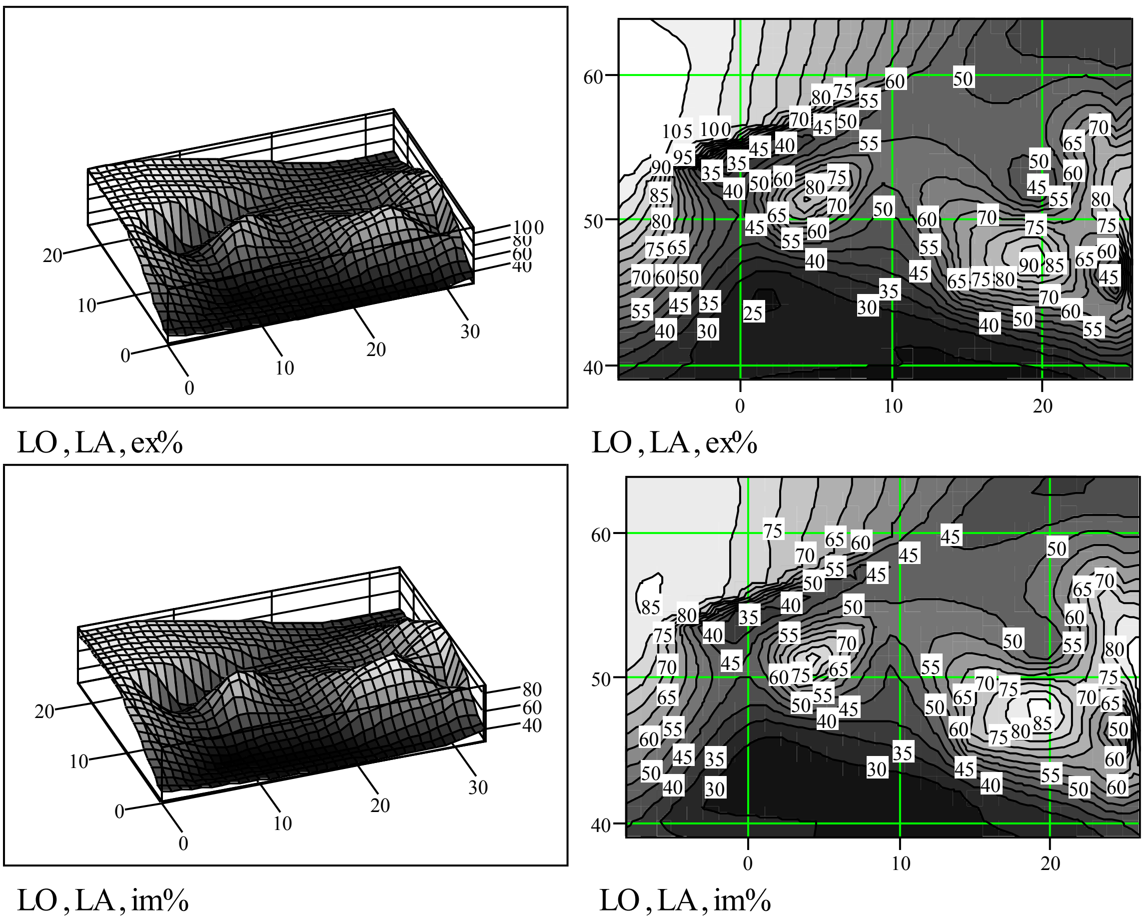
Usually, synthetic indicators of foreign trade development are considered exports and imports per capita (expressed in thousand PPS). Their distributions in the EU in 2011 are shown in figure 2 (where, for reasons of image enhancement, again two island countries, Cyprus and Malta, and respectively Luxembourg, due to its too large level, were excluded).

Differences among countries in the EU area are really impressive on the two indicators of trade intensity per capita (expressed in PPS), values ranging from 4,700 to 5,100 in Romania and Greece, up to 33,700 and 117,700 in Ireland and Luxembourg for export, and for import from 5,300 to 6,700 in Romania and Greece, up to 26,800 in Ireland and 96,600 in Luxembourg.

Unlike the distribution of per capita indicators in the EU, in the case of the share of export and the share of import in GDP, the distributions are very different. According to graphs in figure 3, we can see high levels (areas marked with light colours) also in the eastern part of the EU. For example, in some developed countries such as England, France and Italy, in 2011 there were lower values of respective weights than in countries such as Bulgaria, the Czech Republic and Hungary. This is because, on the one hand, the levels of GDP per capita of those Eastern countries are lower than those of the Western countries, and, on the other hand, the fact that a high foreign trade enables faster economic growth which may reduce future gaps still existing today in terms of overall development.

Figure 3

Spatial distribution of the share of export and import in GDP in the EU, in 2011



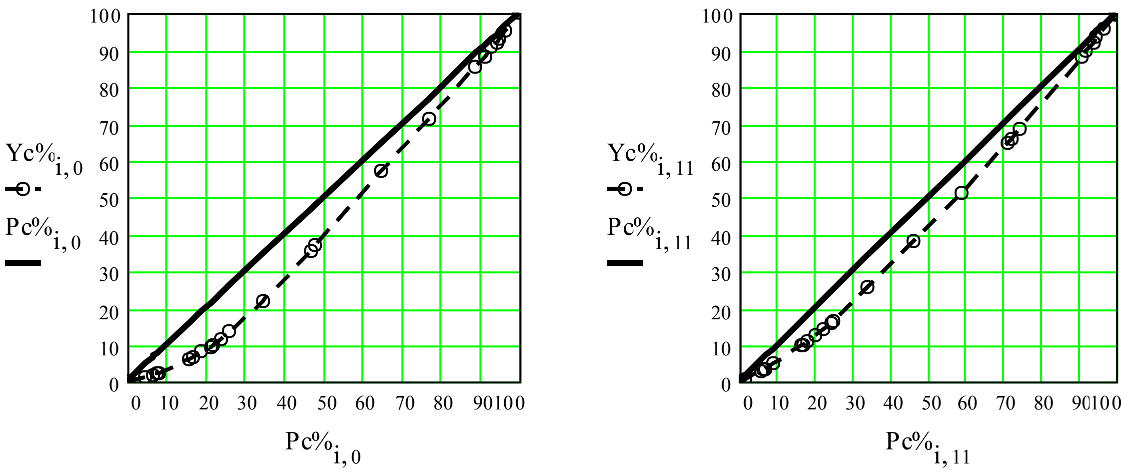
Source: Own calculations based on Eurostat data

3) Trends in convergence in the EU between 2000 and 2011

In order to evaluate the convergence process in the EU during the last decade we used some concentration indicators, such as the Lorenz curve (developed by Max O. Lorenz in 1905), its attached Gini coefficients and variation coefficient. Changes in the degree of concentration during a period could be the measure of convergence. For instance, in figure 3 the Lorenz curve for the EU in 2000 and in 2011 is presented (where the cumulated weight of countries, i=1,...27, in GDP, Yc%, on the ordinate and those of population, Pc%, on abscissa are expressed as percentages). We can see a smaller area marked by the Lorenz curve and the diagonal line in 2011 (noted as year 11) compared to 2000 (noted as year 0) that represents a trend of convergence in this period.

Figure 4

The Lorenz curve in the case of GDP distribution on the EU, in 2000 and 2011



Source: Own calculations based on Eurostat data

For instance, in 2011, the Lorenz curve shows that 25 per cent of the EU population (the poorest 14 countries with a GDP per capita less than 23,000 PPS) covered only 16.5 per cent of the total EU GDP, whereas 20 per cent of the EU population (the poorest 9 countries with a GDP per capita of less than 19,400 PPS) covered only 12.4 per cent of the total EU GDP.

In table 1 our estimates for the two indicators of convergence (the Gini coefficient estimated by the trapezoid method and variation coefficient), in the period of 2000-2011, and the average level of GDP per capita in PPS are presented.

Table 1
Convergence in GDP per inhabitant in the EU, 2000-2011

Year	Gini Coefficient	Variation Coefficient	GDP per capita (in PPS)
	- in % -		
2000	15.794	26.208	19356
2001	15.314	25.458	20072
2002	14.954	24.208	20736
2003	14.584	22.970	21032
2004	14.482	22.179	22001
2005	14.175	21.622	22855
2006	13.605	20.831	24053
2007	12.891	19.774	25393
2008	12.223	18.506	25426
2009	11.718	17.680	23878
2010	12.322	18.135	24875
2011	12.161	17.998	25544

Source: Own calculations based on Eurostat data

During the considered period, we can see, as a general rule, a significant diminution in value of the convergence indicators, which means a trend of higher concentration inside the EU. Thus, between 2000 and 2011, the Gini coefficient was reduced by 23.0 per cent and the variation coefficient by 31.3 per cent. At the same time, GDP per capita increased by 32.0 per cent. However, during the last part of the investigated period the impact of the actual crisis was materialised in the cessation of the convergence process, which is reflected by the higher values of the two indicators in 2010 and 2011 than those in 2009.

At the level of the EU similar results were obtained when analysing the convergence regarding the export per capita and import per capita for the period of 2000-2011. However, significant differences occur when we analyse the convergence process inside certain groups of countries in the EU. This is the case when EU countries (excluding two island states, Cyprus and Malta) are split into two groups: (1) the old EU countries, those who were members already before the last wave of enlargement between 2004 and 2007, the so-called EU-15 group (Austria, Belgium, Denmark, Germany, Greece, Finland, France, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and UK); and (2) the former communist countries of Central and Eastern Europe, the so-called EU-10 group (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia).

4) Discrepancies between **the** EU-**10 and the EU-15**

Before comparing indicators of convergence between the two groups of countries, one needs to evaluate the degree of concentration within those groups. Thus, applying the same methodology as to the level of EU (EU-27), we estimated the values of convergence indicators for the two groups of countries in the period of 2000-2011. The results of our estimating procedure for the GDP per capita expressed in PPS, in the period of 2000-2011, are summarized in table 2 for the EU-10 and in table 3 for the EU-15, respectively.

Table 2
Convergence in GDP per inhabitant in the EU-10, 2000-2011

Year	Gini Coefficient	Variation Coefficient	GDP per capita (in PPS)
	- in % -		
2000	17.098	25.582	8606
2001	16.969	23.963	9122
2002	16.333	23.202	9696
2003	15.787	21.106	10243
2004	14.675	19.809	11102
2005	14.437	19.478	11784
2006	13.240	18.528	12764
2007	12.446	16.915	14114
2008	10.571	14.766	14787
2009	10.539	15.091	14238
2010	10.007	15.451	14895
2011	9.268	14.443	15772

Source: Own calculations based on Eurostat data

Table 3
Divergence in GDP per inhabitant in the EU-15, 2000-2011

Year	Gini coefficient	Variation coefficient	GDP per capita (in PPS)
	- in % -		
2000	4.876	6.655	22351
2001	4.615	6.377	23103
2002	4.651	6.855	23774
2003	4.827	6.441	23951
2004	5.363	7.071	24931
2005	5.324	7.353	25807
2006	5.096	6.842	27042
2007	4.919	6.611	28355
2008	4.862	6.350	28198
2009	4.613	6.255	26379
2010	5.662	8.032	27457
2011	6.179	8.727	28062

Source: Own calculations based on Eurostat data

Generally, we can see a strong convergence process inside the EU-10 group, contrary to a divergence process inside the EU-15. In the case of the EU-10 the actual crisis does not affect the convergence trend, but in that of the EU-15 it provoked a divergence tendency after 2009.

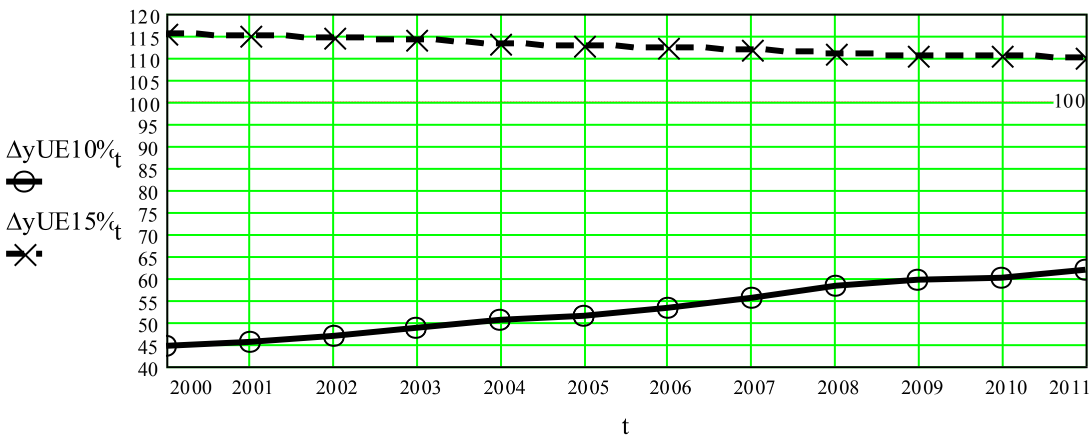
While in the group of less developed countries (EU-10) a significant decrease was registered in the value of the selected indicators (-45.8 per cent for the Gini coefficient and -43.5 per cent for the variation coefficient, respectively), which means increasing concentration and hence the existence of an intense process of convergence, in the case of the developed countries (EU-15) an accentuated decrease was registered in the degree of concentration, thus a process of divergence, reflected by the increase in the value of the selected indicators (+26.7 per cent for the Gini coefficient and +31.1 per cent for the variation coefficient, respectively).

Although during the period under review within the group EU-10 the degree of concentration increased in contrast with a decrease of concentration inside the EU-15, the gap between the two groups of countries, although down from 2000, was still significant at the 2011 level: 3.1 percentage points (12.2 percentage points in 2000) in the case of the Gini coefficient and 5.7 percentage points (12.3 percentage points in 2000) in the case of the variation coefficient, respectively.

At the EU level, convergence tendency is better reflected in the graph of figure 5 (where ΔyUE10% and □yUE15% are percentage deviations from the EU average in both groups of countries). Between the two groups of countries we can see large differences regarding GDP per capita. Thus, in 2000 this indicator for the EU-10 represented only 44.5 per cent of the EU average, compared with 115.5 per cent for the EU-15. However, in the last decade, there was a significant process of convergence between the two groups of countries, so that in 2011 the GDP per capita in the EU-10 has grown to represent 61.7 per cent of the EU average, compared to 109.9 per cent for the EU-15.

Figure 5

Trends in GDP per inhabitant in the EU-10 and the EU-15, 2000-2011



Source: Own calculations based on Eurostat data

Moreover, regarding the correlation between convergence indicators and the level of GDP per capita there is a significant difference between the two groups of countries. Thus, while inside the EU-10 the convergence process was positively influenced by the growth of average GDP per capita, inside the EU-15 the growth of average GDP per capita was accompanied by a process of divergence.

Thus, for the EU-10 there was a strong negative correlation between the average GDP per capita and the value of convergence indicators (the correlation coefficient was -0.986 in the case of the Gini coefficient and -0.983 in the case of the variation coefficient, respectively). By contrast, for the EU-15 during the considered period, there was a positive correlation between the average GDP per capita and the value of convergence indicators (the correlation coefficient was +0.480 in the case of the Gini coefficient and +0.376 in the case of the variation coefficient, respectively).

Regarding the analysis of convergence in the matter of export per capita, by applying the same methodology we estimated the values of convergence indicators for the two groups of countries in the period of 2000-2011. The results are summarised in table 4 (where as a convergence indicator we included only the variation coefficient).

As in the case of GDP per capita, we can see a strong convergence process inside the EU-10 group, contrary to a divergence process inside the EU-15. Generally, the actual crisis does not seem to significantly influence the previous tendencies.

While in the group of less developed countries (EU-10) a significant decrease was registered in the value of the variation coefficient (-30.8 per cent), which means increasing concentration and hence the existence of an intense process of convergence, in the case of the developed countries (EU-15) an accentuated decrease was registered in the degree of concentration, thus a process of divergence, reflected by the increase in the value of the variation coefficient (+37.7 per cent). Moreover, since 2009 the absolute value of the variation coefficient in the case of the EU-10 is less than its value for the EU-15, meaning a higher degree of concentration inside the group of Eastern countries than that of Western countries. This reversal of trends is probably a result of the global crisis, which seems to have seriously affected the foreign trade in the case of the EU-15, compared to the EU-10 countries.

Table 4

Convergence and divergence in export per inhabitant in EU, 2000-2011

Year	Variation coefficient (in %)		Export per capita (in PPS)	
	EU-10	EU-15	EU-10	EU-15
2000	57.306	31.289	3865	7874
2001	58.467	29.896	4143	8117
2002	52.794	31.785	4301	8179
2003	48.344	33.028	4747	8006
2004	44.510	35.826	5446	8630
2005	48.690	37.452	5785	9290
2006	47.366	38.530	6822	10334
2007	47.655	40.948	7515	10995
2008	45.276	41.601	7722	11207
2009	39.796	41.240	6945	9301
2010	40.121	42.896	8165	10707
2011	39.679	43.077	9358	11699

Source: Own calculations based on Eurostat data

By groups of countries, there is a tendency to approximate the value of exports per capita. Thus, in the period under review, exports per capita relative to the EU average for the EU-10 increased from 55.1 per cent in 2000 to 80.1 per cent in 2011, while for the EU-15 this figure fell from 112.3 per cent in 2000 to 104.2 per cent in 2011.

Based on the analysis of the period of 2000-2011, it is noteworthy that there are opposite signs of the correlation between the variation coefficient and the value of exports per capita in the case of the two groups of countries. Thus, while in the case of the EU-10 there is a significant negative correlation between the per capita export and the coefficient of variation (-0.836), for the EU-15 it is strongly positive (+0.910). Therefore, we can say that for the EU-10 an increasing export value per capita is an important stimulus for convergence, while for the EU-15 it almost automatically leads to divergence.

5) **Convergence in structural changes** in the EU**-10 and in the EU-15**

As indicator to evaluate structural convergence in the EU we used the variation coefficient estimated for the share of services in employment, during the period of 2000-2011. From data in table 5, we can see a higher degree of concentration inside the EU-15 than inside the EU-10, expressed by smaller values of the variation coefficient (more than double in the EU-10 than in the EU-15 group). During the investigated period, there was a tendency of rapprochement between the two groups of countries, as the gap in terms of the average share of services in employment compared to the EU average level decreased significantly.

Table 5

Convergence in the matter of share of services in employment in EU, 2000-2011

(%)

Year	Variation coefficient		Share of services in employment	
	EU-10	EU-15	EU-10	EU-15
2000	18.057	6.896	45.582	70.644
2001	18.916	6.791	47.331	71.088
2002	14.577	6.736	49.694	71.680
2003	15.186	6.698	50.259	72.198
2004	13.078	6.561	51.126	72.722
2005	12.712	6.438	51.642	73.080
2006	11.926	6.275	52.564	73.433
2007	11.923	6.217	52.893	73.634
2008	11.482	5.966	53.175	74.060
2009	11.857	5.500	54.504	74.914
2010	12.471	5.263	55.275	75.539
2011	12.580	5.203	55.122	75.932

Source: Own calculations based on Eurostat data

Thus, while the share of services in employment inside the EU-10 increased by almost ten percentage points (from 45.6 per cent in 2000 to 55.1 per cent in 2011), inside the EU-15 it increased only by slightly over five percentage points (from 70.6 per cent in 2000 to 75.9 per cent in 2011). We can conclude that in the period of 2000-2011 a clear convergence process was registered in both groups of contries.

Conclusions

During the last decade a convergence trend was manifested inside the EU. However, despite various efforts significant discrepancies still exist among the countries regarding GDP per capita. Moreover, differences among countries in the EU are impressive regarding trade intensity per capita (expressed in PPS), values ranging in 2011 from 4700 to 5100 in Romania and Greece, up to 33700 and 117700 in Ireland and Luxembourg for export, and from 5300 to 6700 in Romania and Greece, up to 26800 in Ireland and 96600 in Luxembourg for import.

Between the two groups of countries, the EU-10 and the EU-15, we can see large differences in the matter of GDP per capita. Thus, in 2000 this indicator for the EU-10 represented only 44.5 per cent of the EU average, compared with 115.5 per cent for the EU-15. However, in the last decade, there was a significant process of convergence between the two groups of countries, so that in 2011 the GDP per capita in the EU-10 has grown to represent 61.7 per cent of the EU average, compared to 109.9 per cent for the EU-15.

The impact of the actual crisis was stopping the convergence process, which is reflected by the higher values of the selected indicators (meaning a decrease in concentration inside the EU) in 2010 and 2011 than those in 2009.

Generally, in the matter of GDP per capita there was a strong convergence process inside the EU-10, contrary to a divergence process inside the EU-15. In the case of the EU-10 the actual crisis did not affect the convergence trend, but in that of the EU-15 it provoked a divergence tendency after 2009.

As in the case of GDP per capita, there was a strong convergence process inside the EU-10 for export per capita, contrary to a divergence process inside the EU-15.

After 2008, the absolute value of the variation coefficient in the case of the EU-10 is less than its value for the EU-15, meaning a higher degree of concentration inside the group of Eastern countries than the group of Western countries. This reversal of trends is probably a result of the global crisis, which seems to affect the foreign trade of the EU-15 more than the EU-10 countries.

There are significant differences in the EU regarding structural convergence. For instance, the share of services in employment inside the EU-10 increased in the period of 2000-2011 by almost ten percentage points, while inside the EU-15 it increased only slightly over five percentage points. However, we can conclude that in the period of 2000-2011 a clear convergence process can be registered in both groups of countries.

* * * * *

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IMPACTS OF EU ACCESSION ON THE HUNGARIAN AND ROMANIAN AGRICULTURES*

*Judit Kiss***

Introduction

Though, in historical terms, only some years have passed since Hungary's accession to the EU in 2004, let alone Romania's joining in 2007, it might be instructive to draw the preliminary balance of accession. Especially in the case of agriculture, which was one of the most hotly debated and negotiated parts of Eastern enlargement. This debate is going to be continued in the course of the adaptation of the new Common Agricultural Policy of the EU.

Furthermore, agriculture is still an important sector of the economy both for Hungary and Romania. Though agriculture gave only 3.53 per cent of the GDP in Hungary in 2010 and 7.14 per cent of the GDP in Romania (Csáki-Jámbor, 2012), this sector employed 5.5 per cent of the workforce in Hungary and 19.1 per cent (!) in Romania.[1] In Hungary 27.4 per cent of household expenditure is spent on food consumption, while in Romania 32.7 per cent. Both countries are significant agricultural exporters and basically rural societies[2] due to their outstanding agro-potential, high share of agricultural land[3] and abundance of labour force. However,

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[1] It is interesting to note that in Romania 1.7 million people were engaged in the agricultural sector, 0.4 million more than in the USA agriculture.

[2] In Romania 46 per cent of active population lives in rural areas and 60 per cent of rural population is employed in agriculture (Kerekes, 2010).

[3] In Romania 61.8 per cent of the total territory is agricultural land (Kerekes, 2010).

their agricultures suffer from the scarcity of capital, ageing agricultural labour force[4] and should cope with low productivity and competitiveness.

An in-depth assessment of accession is all the more indispensable as the new member states (NMS) had high expectations concerning accession, especially in the case of agriculture. They hoped to:

- get free and unlimited access to the enlarged single market of 500 million customers;
- enjoy the relatively stable and high agricultural prices;
- benefit from the intervention and the export refund systems of the Common Agricultural Policy; and
- get access to direct payments and various rural development measures.

The main aim of the paper is to analyse and compare the impact of agricultural accession on the two neighbouring new member countries (Hungary and Romania) with special regard to agricultural production, employment, income and foreign trade in agricultural goods.

1) Agricultural production performance

The first issue to be analysed is whether agricultural production has increased after the accession. As Hungary's and Romania's agricultural production is dominated by crop production to a degree of 65 per cent and 75 per cent (2011), respectively,[5] due to the high share of arable land, we start our analysis with crop production.

As it can be seen from table 1 the value of crop production increased in the first years of the accession (2004, 2005 and 2007, 2008, respectively), then it dropped in 2009 and recovered in 2010 and 2011. As a consequence the share of the NMS in the EU-27 crop production increased from around 10 per cent in 2000 to 19.2 per cent in 2011. The main factors behind the increasing tendency for crop production are:

- increasing producer prices: in the case of Hungary by 2010 the crop producer price indices increased to 163.3 compared to 2005 in nominal terms and to 125.9 in real terms (the same figures for Romania were 161.1, and 119.2, respectively) (Agriculture in the European Union.... 2011);
- volume increase due to higher yields[6] as the land area was stagnating;
- increasing land and labour productivity as the labour input decreased; and
- economic incentives provided to crop producers by the EU support system in the framework of the SAPS.

[4] In Hungary 55 per cent of the farmers are above the age of 55, while in Romania 67.5 per cent.

[5] The new member states' average was 58.5 per cent in 2010 (Farming structure and accounts...).

[6] In the case of cereals the Hungarian yields increased 35 per cent from 2000-2003 to 2004-2007 (Csáki-Jámbor, 2009).

Table 1

Crop output

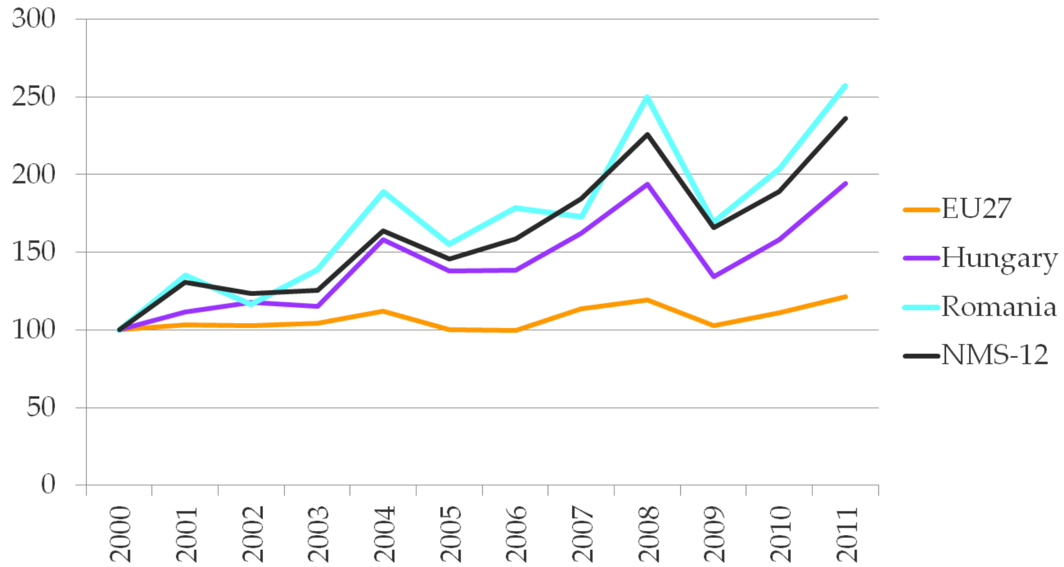
(Production value at basic price - million EUR)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU27	168855.0	174359.7	173798.7	176310.7	189092.6	169479.3	168625.3	192177.7	201163.8	173473.5	187428.5	204944.6
Bulgaria	1304.7	1515.4	1667.6	1628.8	1762.7	1627.5	1757.8	1565.8	2489.5	2012.6	2039.8	2542.0
Czech Rep.	1397.9	1623.9	1653.1	1379.4	1975.8	1677.6	1746.0	2391.5	2505.8	1931.1	2162.4	2856.4
Estonia	150.0	156.7	182.8	165.5	167.3	204.5	211.0	336.2	249.7	226.5	255.0	336.3
Cyprus	0.0	0.0	0.0	288.0	312.7	326.0	320.6	327.4	304.5	312.0	331.1	342.4
Latvia	198.7	226.6	257.5	264.7	308.2	346.0	384.8	525.3	529.7	434.9	470.4	549.6
Lithuania	634.4	572.0	625.3	676.9	681.8	792.1	703.3	1147.0	1238.4	1004.7	1017.2	1452.9
Hungary	2404.1	2679.4	2827.7	2772.5	3804.5	3315.9	3333.0	3896.1	4655.5	3232.7	3799.5	4676.3
Malta	48.8	52.0	50.5	43.2	44.5	43.6	45.3	48.0	52.7	51.3	50.1	51.4
Poland	6059.3	7163.7	6394.7	5758.0	7399.7	6973.7	7810.7	10399.2	11539.0	8643.8	9800.7	11964.3
Romania	4974.7	6722.7	5783.2	6902.4	9404.4	7721.6	8885.1	8612.0	12421.2	8428.4	10154.6	12781.0
Slovenia	464.0	431.1	534.4	431.4	572.2	530.8	517.1	598.9	600.1	547.2	576.2	678.8
Slovakia	462.2	665.3	660.0	629.7	954.3	752.7	792.9	951.3	1108.5	850.6	929.7	1202.7
NMS-12	16700.9	21808.8	20636.8	20940.4	27388.1	24311.9	26507.9	30798.5	37694.6	27675.9	31586.6	39434.1
Per cent	9.9	12.5	11.9	11.9	14.5	14.3	15.7	16.0	18.7	16.0	16.9	19.2

Source: own composition and calculations based on Eurostat data

As it is shown by figure 1 the Romanian crop output growth outpaced the Hungarian one and the NMS-12 average: between 2000 and 2011 the value of the Romanian crop output increased by 2.57 times, while the Hungarian one 1.9 times only.

Figure 1
Crop output
(2000 = 100)



Source: Eurostat

As far as animal production is concerned (see table 2), its value varied significantly: there was a slight increase with wide fluctuations. As a consequence, the NMS's share in the EU-27 total animal output grew only a little, from 12.0 to 14.2 per cent between 2000 and 2011. In the case of Hungary the level of animal output in 2011 was around the pre-accession level of 2001-2002, and though the Romanian animal output grew twice as fast as the Hungarian one (see fig. 2), its 2011 level was also below its pre-accession level. These poor results are due to the decreasing livestock[7] and low productivity, though producer prices increased a little bit in nominal terms, while they decreased in real terms.[8]

[7] In Hungary pig numbers decreased from 3.87 million to 3.16 million, and in Romania from 6.56 million to 5.3 million between 2008 and 2011. Cattle numbers decreased from 705,000 to 681,000 in Hungary from 2007 to 2010 and from 2.8 million to 2.0 million in Romania in the same time.

[8] In Hungary in2010 the livestock producer price indices grew to 118.3 compared to 2005 in nominal terms, but decreased to 91.2 in real terms. The same figures for Romania were 133.7, and 98.9, respectively (Agriculture in the European Union…, 2011).

Table 2

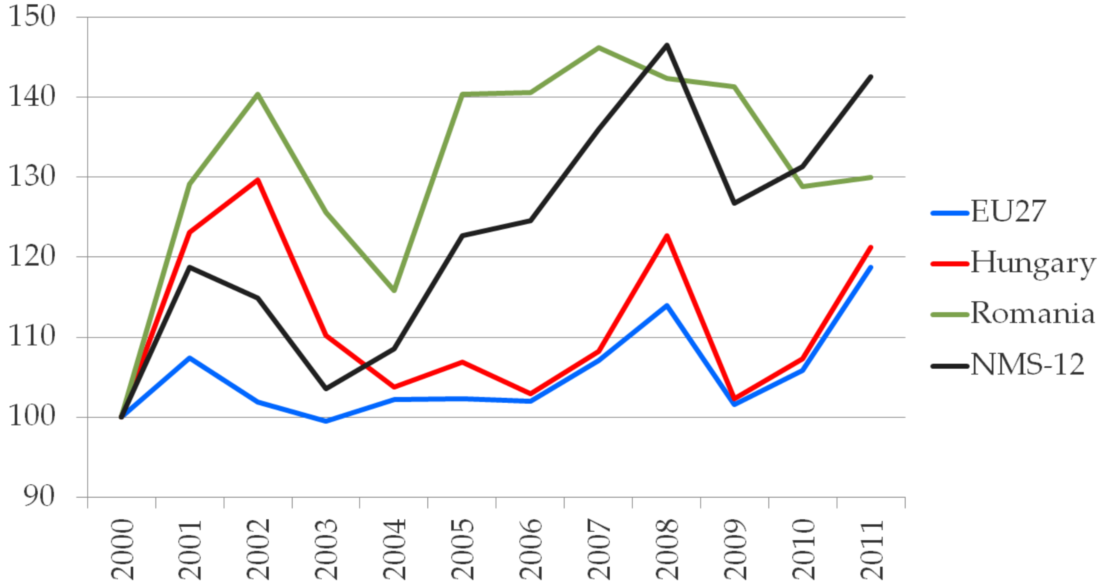
Animal output

(Production value at basic price - millions ECU/EUR)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU27	132809.1	142587.1	135364.5	132138.8	135733.3	135797.7	135515.7	142277.0	151453.5	134996.9	140677.9	157728.5
Bulgaria	1448.2	1530.5	1186.9	1018.7	1087.9	1129.5	1109.4	1246.5	1375.2	1131.6	1184.1	1230.3
Czech Rep.	1420.0	1579.6	1568.6	1456.3	1532.4	1601.6	1686.4	1770.2	2101.2	1598.2	1643.1	1765.6
Estonia	189.1	242.7	216.7	211.0	268.7	278.0	295.8	300.9	342.4	280.7	318.1	387.8
Cyprus	0.0	0.0	0.0	292.5	306.1	301.2	284.0	279.4	297.8	321.5	331.7	330.5
Latvia	227.9	286.6	260.9	228.0	275.2	301.7	350.0	396.2	404.0	346.1	369.2	419.6
Lithuania	486.5	563.8	532.8	515.0	641.3	750.1	803.6	820.0	901.5	687.7	806.2	920.3
Hungary	2089.7	2571.8	2711.2	2302.1	2169.0	2233.0	2151.1	2260.3	2563.8	2136.8	2241.5	2532.8
Malta	76.6	79.9	80.7	76.3	72.7	71.6	70.5	71.5	77.7	72.0	71.0	69.7
Poland	5885.9	7136.8	6399.2	5499.6	6383.2	7586.1	7773.3	8965.9	9639.0	8297.6	9029.1	9989.7
Romania	2992.7	3863.0	4201.8	3759.6	3465.4	4202.4	4207.5	4374.6	4262.0	4229.6	3855.6	3889.2
Slovenia	501.6	535.3	522.9	512.8	504.7	515.8	529.6	509.2	563.8	484.0	495.3	535.3
Slovakia	772.9	732.9	808.7	798.7	763.9	765.5	780.9	889.5	1038.1	813.4	780.0	876.9
NMS-12	16091.2	19123.0	18490.3	16670.4	17470.5	19736.5	20042.1	21884.0	23566.5	20399.0	21124.9	22947.7
Per cent	12.1	13.4	13.7	12.6	12.9	14.5	14.8	15.4	15.6	15.1	15.0	14.5

Source: own compilation and calculation based on Eurostat data

Figure 2
Animal output
(2000 = 100)



Source: Eurostat

2) Agricultural employment and income

Prior to the accession, one of the main concerns was related to the social consequences of joining the EU: whether the accession would lead to decreasing rural (agricultural) employment and/or farmers being better off. Both expectations came true. Agricultural employment measured in annual work unit (AWU) decreased by more than one third to 5.8 million in the NMS-12 between 2000 and 2009 (Agricultural labour input..., 2011). In the case of Hungary the decline was almost the same (34.8 per cent), while in Romania the decline was steeper (41.1 per cent). While in 2005 190,000 persons were employed in Hungarian agriculture, in 2010 only 169,000. The same figures for Romania are 2.943 million and 2.78 million, respectively. (Agriculture in the European Union..., 2011)

One of the reasons behind decreasing agricultural employment is diminishing labour input as labour is replaced by capital and technology.[9] The other is the changing farm structure: the decreasing number of agricultural holdings (see table 3), the concentration

[9] In Romania labour input decreased even prior to accession (by 40 per cent between 2000 and 2007).

of holdings and increasing farm size,[10] which result in fewer, larger and more capital-intensive farms. In spite of all these changes, in the NMS the share of small farms is still high[11] and many countries are characterised by a dual farm structure, namely the dichotomy of few big commercial farms and many small-sized, semi-subsistence plots.

Table 3
Number of agricultural holdings
(1,000)

	2000	2003	2005	2007	2010
EU27	:	15021.0	14482.0	13700.4	
Hungary	966.9	773.4	714.8	626.3	576.8
Poland	:	2172.2	2476.5	2391.0	1506.6
Romania	:	4484.9	4256.2	3931.4	3859.0
NMS-12		25806.6	25122.9	23745.4	6789.3

Source: Eurostat 4)

The good news is that the NMS's agricultural income increased after the accession (by 60 per cent between 2000 and 2009). In the case of Hungary and Romania the income increase was more than 2.4 times between 2000 and 2011 (see table 4 and fig. 3) due to decreasing agricultural labour input, increasing production values and considerable EU subsidies (direct payments) and national supports (top-ups). In Hungary between 2005 and 2010 EU support (direct payment + rural development measures) increased from €820 million to 1.515 billion, while in Romania from €1.62 billion to 2.071 billion between 2008 and 2010. However, after the accession national support to agriculture decreased: in Hungary from €317 million to 288 million between 2004 and 2010, and in Romania from €1,100 million to 94 million between 2007 and 2010 (Agriculture in the European agriculture..., 2011).

However, despite the noteworthy agricultural income increase, there is still a significant income gap between the old and the new member states (it was 9.5 times between 2000 and 2002, and decreased to 6.4 times in the period of 2007-2009) (Agricultural labour input..., 2011).

[10] Between 2003 and 2007 the NMS-12 average farm size increased from 5.3 to 6 hectares, however, the EU-average was 12 hectares. In Hungary the average farm size increased from 6.0 hectares in 2005 to 6.8 hectares in 2007, while in Romania it increased only slightly, from 3.3 to 3.5 hectares (Agriculture in the European Union…, 2011).

[11] In 2007 58 per cent of NMS' holdings cultivated less than 2 hectares and 34 per cent between 2-10 hectares, that is 92 per cent of the holdings are relatively small. Both in Hungary and Romania almost 90 per cent of the farms cultivate less than 5 hectares (Agriculture in the European Union…, 2011).

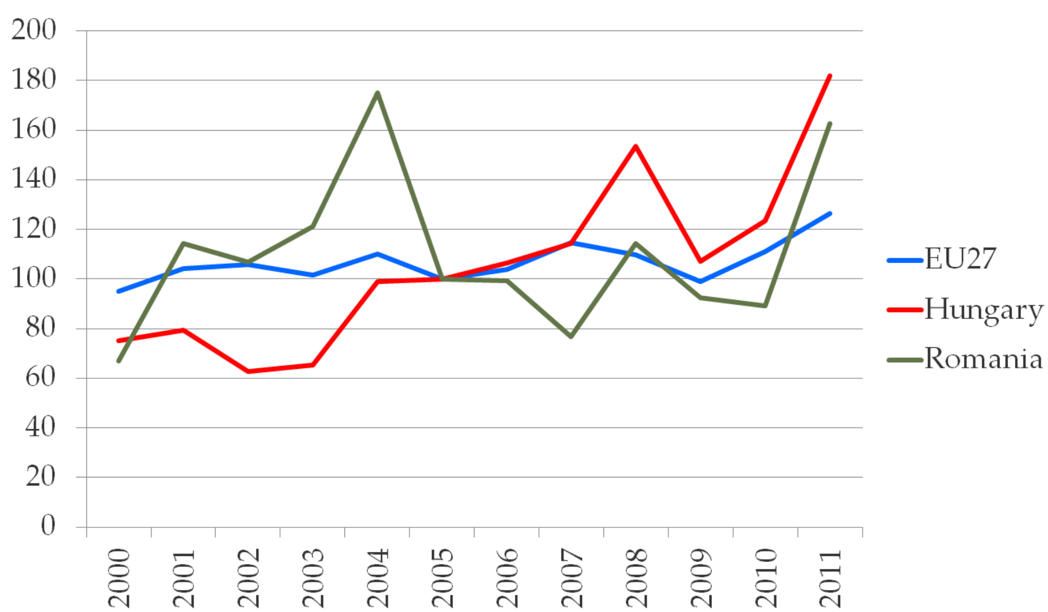
Table 4
Indices of Indicator A of agricultural income in the NMS-12
(2005 = 100)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU27	94.9	104.3	105.8	101.6	110.2	100.0	104.0	114.8	109.9	98.9	111.1	*126.5
Bulgaria	105.1	118.0	94.7	88.6	87.4	100.0	97.5	98.8	161.2	125.3	158.7	*134.5
Czech Rep.	66.4	85.0	68.8	59.2	93.2	100.0	102.7	118.6	125.1	98.5	113.9	165.8
Estonia	40.5	53.2	51.6	57.6	94.8	100.0	100.4	142.1	112.1	94.5	138.2	196.7
Cyprus	95.0	105.9	107.3	98.7	96.6	100.0	90.4	90.2	85.7	92.3	92.0	*92.7
Latvia	41.1	53.4	52.5	57.6	96.0	100.0	131.8	137.8	117.2	102.4	127.8	140.0
Lithuania	60.8	56.4	52.3	58.7	92.5	100.0	89.0	133.4	123.4	106.6	121.8	157.0
Hungary	75.1	79.3	62.7	65.4	99.1	100.0	106.6	114.3	153.4	107.2	123.3	182.0
Malta	78.7	91.2	90.7	85.9	82.6	100.0	97.5	94.5	90.3	101.0	114.4	81.7
Poland	61.0	70.2	63.4	58.5	110.3	100.0	110.5	134.9	108.9	134.7	145.2	179.0
Romania	66.9	114.2	106.8	121.2	175.2	100.0	99.3	76.8	114.4	92.4	89.1	*162.8
Slovenia	71.5	62.1	81.9	64.6	99.5	100.0	97.4	109.6	99.1	86.7	92.8	116.8
Slovakia	82.4	93.7	88.6	82.9	107.3	100.0	122.1	128.9	143.5	110.5	115.2	197.2

Indicator A = combines the development in net value added at factor costs (factor income) and the development in agricultural labour input. * estimates

Source: own composition based on Eurostat

Figure 3
Agricultural incomes
(2005 = 100)

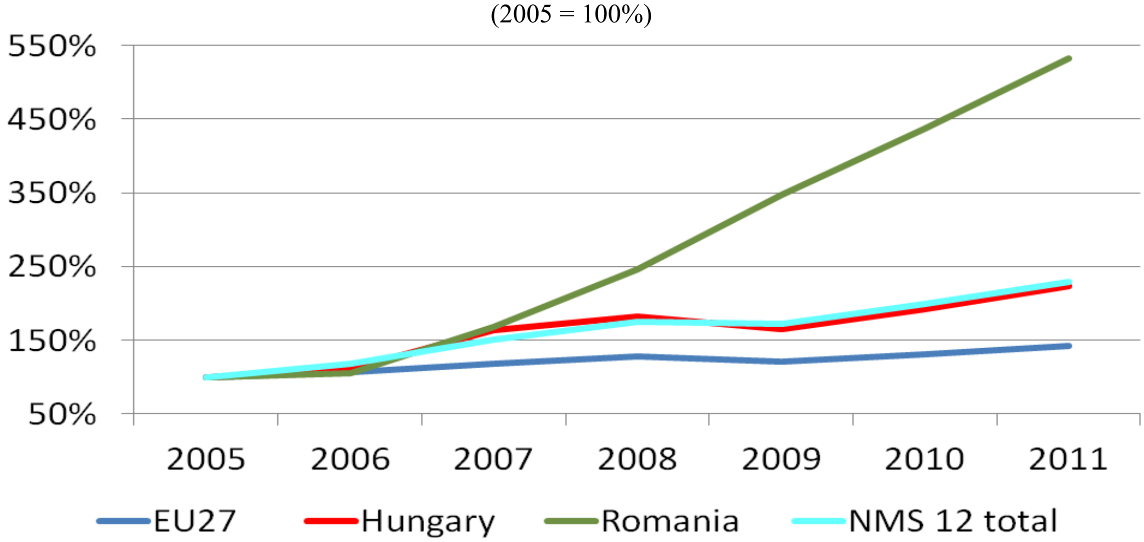


Source: Eurostat

3) Foreign trade in agricultural goods

As it was expected, the NMS' agricultural exports (SITC 0+ 1) to the EU increased: by 2.3 times between 2005 and 2011 (see table 5 and fig. 4) and their share in the EU27 intra-trade increased by 4.3 per cent points, from 6.8 per cent to 11.1 per cent. Hungary's intra-EU agricultural exports increased according to the trend (by 2.2 times) mainly due to Romania's accession in 2007. Though Romania's exports grew faster (by 5.3 times), it was mainly due to the low base. Their shares in the intra-EU agricultural exports increased from 1.1 per cent to 1.8 per cent, and from 0.2 per cent to 0.8 per cent, respectively. As far as the export structure is concerned, it has changed in an unfavourable direction: the share of raw materials increased *vis-à-vis* processed goods (Csáki-Jámbor, 2009, Jámbor 2010). In 2011, 61 per cent of the Romanian exports to the other EU-countries consisted of raw materials, while in the case of Hungary it was 35 per cent (Csáki-Jámbor, 2012).

Figure 4
Intra-EU Exports
(2005 = 100%)



Source: Eurostat

Table 5
NMS intra-EU agricultural trade
(Dispatches/Export)

	Value (Mio ECU/Euro)							Share of EU total by SITC (%)						
	2005	2006	2007	2008	2009	2010	2011	2005	2006	2007	2008	2009	2010	2011
EU27	187995	201229	223178	240825	227101	246541	268003	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Bulgaria	436	492	629	912	1130	1403	1654	0.2	0.2	0.3	0.4	0.5	0.6	0.6
Czech Rep.	2081	2308	2835	3487	3134	3366	4058	1.1	1.1	1.3	1.4	1.4	1.4	1.5
Estonia	296	328	394	461	405	473	613	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Cyprus	117	121	137	133	127	130	148	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Latvia	314	383	525	602	539	672	769	0.2	0.2	0.2	0.3	0.2	0.2	0.3
Lithuania	828	966	1307	1337	1327	1531	1762	0.4	0.5	0.6	0.6	0.6	0.6	0.7
Hungary	2109	2353	3462	3850	3476	4058	4721	1.1	1.2	1.6	1.6	1.5	1.5	1.8
Malta	21	18	20	26	17	18	25	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Poland	5139	6347	7608	8847	8716	10057	11046	2.7	3.2	3.4	3.7	3.8	3.8	4.1
Romania	383	403	646	944	1332	1672	2039	0.2	0.2	0.3	0.4	0.6	0.6	0.8
Slovenia	273	448	591	640	705	786	787	0.1	0.2	0.3	0.3	0.3	0.3	0.3
Slovakia	983	1249	1480	1540	1520	1739	2189	0.5	0.6	0.7	0.6	0.7	0.7	0.8
NMS 12 total	12980	15416	19634	22779	22428	25905	29811	6.8	7.7	9.0	9.6	9.9	10.5	11.1

Source: own composition and calculations based on Eurostat data

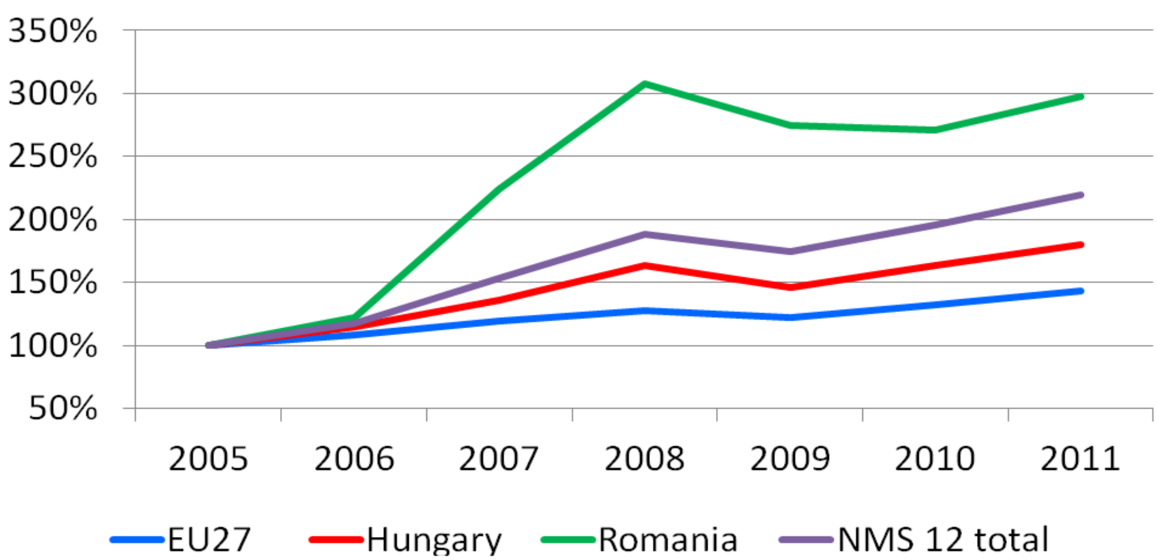
Table 6
NMS intra-EU agricultural trade
(Arrivals/Imports)

	Value (Mio ECU/Euro)							Share of EU total by SITC (%)						
	2005	2006	2007	2008	2009	2010	2011	2005	2006	2007	2008	2009	2010	2011
EU27	184 335	198 797	219 424	235 516	225 296	242777	263902	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Bulgaria	330	413	889	1221	1190	1360	1653	0.2	0.2	0.4	0.5	0.5	0.6	0.6
Czech Rep.	2796	3317	3970	4393	4273	4695	5250	1.5	1.7	1.8	1.9	1.9	1.9	2.0
Estonia	585	667	910	948	794	889	1084	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Cyprus	447	504	587	646	634	700	734	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Latvia	646	812	1003	1188	1059	1207	1398	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Lithuania	734	1006	1311	1762	1462	1818	2131	0.4	0.5	0.6	0.7	0.6	0.7	0.8
Hungary	1891	2172	2562	3081	2767	3083	3398	1.0	1.1	1.2	1.3	1.2	1.3	1.3
Malta	307	326	389	404	388	400	426	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Poland	3695	4276	5544	7222	6665	7890	8692	2.0	2.2	2.5	3.1	3.0	3.2	3.3
Romania	991	1212	2216	3052	2722	2681	2945	0.5	0.6	1.0	1.3	1.2	1.1	1.1
Slovenia	772	874	1040	1211	1175	1226	1333	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Slovakia	1492	1624	2143	2451	2482	2768	3123	0.8	0.8	1.0	1.0	1.1	1.1	1.2
NMS12 total	14686	17203	22564	27579	25611	28717	32167	7.9	8.7	10.4	11.7	11.4	11.8	12.2

Source: own calculations based on Eurostat

In the case of agricultural imports from the EU, the NMS increased their imports by 2.2 times between 2005 and 2011 (see table 6 and fig. 5) and their share increased from 7.9 per cent to 12.2 per cent, consequently the NMS are more important markets for the other EU countries than sources of import. Hungary's agricultural imports from the other EU countries increased by 1.8 times only, while Romania's imports by 3.0 times (less than their exports). Their shares in the intra-EU agricultural imports increased from 1.0 per cent to 1.3 per cent (Hungary), and from 0.5 per cent to 1.1 per cent (Romania) between 2005 and 2011.

Figure 5
Intra-EU Imports
(2005 = 100)



If we compare the NMS' agricultural export and import performance in the case of intra-EU trade, the foreign trade balance deterioration is obvious: between 2005 and 2011 the agricultural trade deficit of the NMS increased from €1.7 billion to 2.35 billion (see fig. 6 and table 7) with the highest deficit occurring in 2008 (€-4.8 billion). However, the NMS have a positive balance in their extra-EU agricultural trade (see table 7): €1.4 billion surplus in 2005 and 3.5 billion in 2011.

While Hungary managed to keep and even increase its intra-EU agricultural trade surplus from €0.2 billion in 2005 to 1.3 billion in 2011, Romania's agricultural trade was in deficit (€0.6 billion in 2005 and 0.9 billion in 2011, with a peak of 2.1 billion in 2008) (see fig. 6). While Hungary has a permanent trade balance in her extra-EU agricultural trade, Romania is just around the balance (see fig. 7).

Figure 6
Intra-EU balance

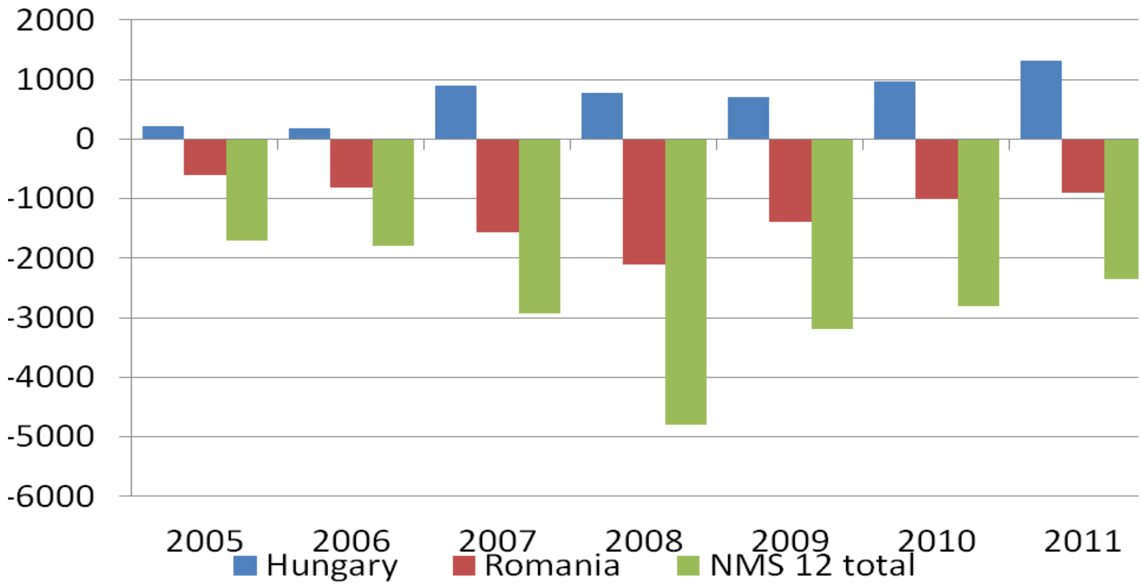


Figure 7
Extra-EU balance

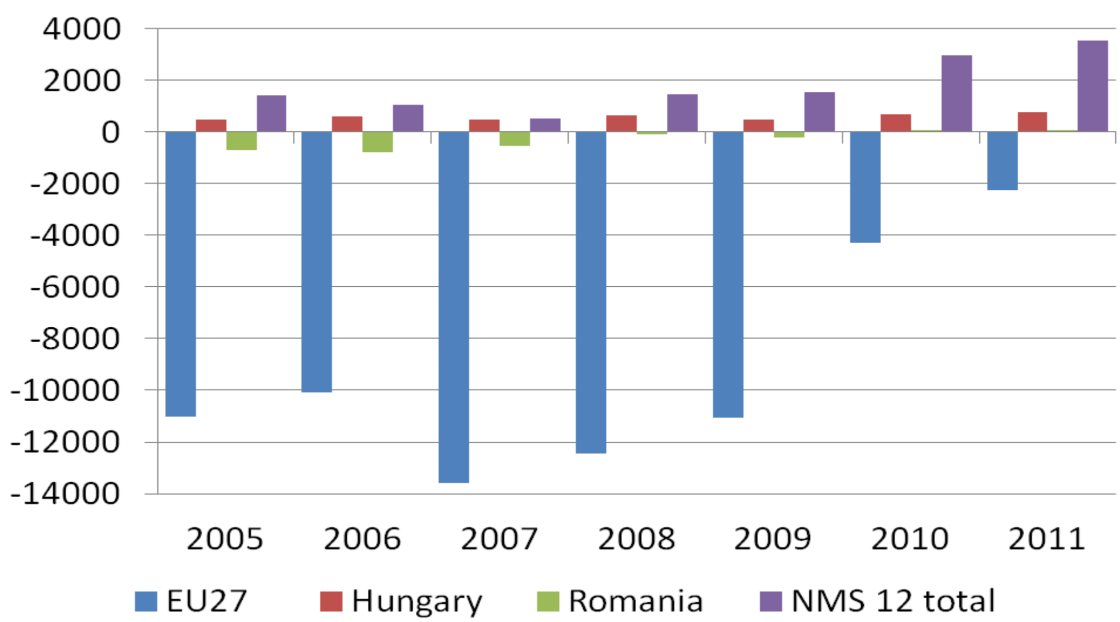


Table 7
NMS extra – and intra-EU agricultural trade balances
(Mio ECDU/Euro)

	Extra-EU27							Intra-EU27						
	2005	2006	2007	2008	2009	2010	2011	2005	2006	2007	2008	2009	2010	2011
EU27	-11012	-10067	-13581	-12446	-11061	-4283	-2233							
Bulgaria	92	0	85	252	43	249	282	105	76	-260	-309	-60	44	2
Czech Rep.	-12	10	-30	-36	-8	-13	-41	-718	-1009	-1136	-907	-1139	-1329	-1192
Estonia	40	109	191	161	128	209	229	-289	-339	-516	-487	-390	-416	-471
Cyprus	-58	-72	-100	-167	-107	-111	-98	-330	-383	-450	-513	-507	-571	-586
Latvia	52	89	129	276	271	376	459	-332	-429	-479	-585	-519	-535	-629
Lithuania	982	724	147	17	534	779	932	94	-40	-4	-425	-135	-288	-368
Hungary	469	593	501	634	483	694	767	217	182	900	769	709	975	1323
Malta	47	71	78	56	12	70	56	-286	-308	-370	-378	-372	-383	-401
Poland	550	431	295	499	671	942	1179	1443	2071	2064	1624	2051	2168	2354
Romania	-709	-778	-551	-74	-211	68	71	-607	-809	-1570	-2108	-1390	-1009	-906
Slovenia	-21	-122	-222	-164	-278	-285	-302	-498	-427	-449	-571	-470	-441	-546
Slovakia	-23	-16	-13	3	-10	-12	14	-509	-375	-664	-910	-962	-1029	-934
NMS 12 total	1409	1039	510	1457	1528	2966	3548	-1710	-1790	-2934	-4800	-3184	-2814	-2354

Source: own composition and calculations based on Eurostat

4) Conclusion

The preliminary results of agricultural accession in the case of Hungary and Romania are rather mixed and unambiguous. The following are the encouraging signs:

* growing production values as the accession provided incentives to agricultural production and to utilise natural endowments (mainly agricultural land);
* increasing farm incomes due to higher producer prices and support given to agricultural producers;
* land/farm concentration, though at the expense of the destruction of smaller farms;
* increasing land and labour productivity; and
* good agricultural trade performance outside the EU.

However, one should not forget the negative consequences of agricultural accession, such as:

* decreasing agricultural and rural employment due to increasing productivity, technological change and land concentration;
* deteriorating intra-EU trade performance especially in the case of Romania due to increasing imports and exports lagging behind;
* increasing competition on the domestic market due to massive import penetration;
* further extensification of agricultural production structure due to support given to crop production and the low productivity of animal husbandry;
* still significant income, productivity and competitiveness difference between the old and the new members states; and
* increasing share of raw materials in the exports, and increasing share of processed goods in imports.

As far as future prospects are concerned, it highly depends on the reformulation of the Common Agricultural Policy, the new budget of the EU and the national economic policies and the domestic agricultural situation of the countries concerned (New member states..., 2011).

* * * * *

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THE REFORM OF ECONOMIC GOVERNANCE IN THE EU

Petre Prisecaru[*]

Abstract

The main objectives of the reform of economic governance in the EU from the last three years were the following: the prevention and correction of macroeconomic imbalances; ensuring the financial stability within the eurozone; and supporting the economic and social development strategy (Europe 2020). These were achieved through different instruments (legislative, financial, institutional) and mechanisms. The reform has advanced quickly to an upper level: banking union, fiscal union and even political union but the eurozone is still going through a period of economic stagnation without great prospects of resuming the growth, which reflects the failure of austerity prescriptions.

Key words: reform, governance, mechanism, fiscal, budget, imbalance, union

JEL Classification: D 04, E 44, E 61, E 62, F 15, F 32, F 34, G 28

1) Some features of the EU economic governance

Economic governance of the EMU, defined as the supervision and coordination of macroeconomic policies at the supranational level, began with the Maastricht Treaty. The Treaty introduced constraints on fiscal/budgetary policy, which were being reinforced by the Stability and Growth Pact (SGP), and it was signed in Amsterdam in 1997, setting limits for budget deficit and public debt. However, the SGP rules had been violated repeatedly in the early part of the last decade, and as a result the pact was reformed in 2005 with a focus on structural policies and by relaxing

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the mechanisms for imposing sanctions in order to block the European Commission's recommendations for sanctions within the Council of the EU.

The Maastricht Treaty introduced the Large Economic Policy Guidelines as an instrument for economic policy coordination of the Member States (MS), which established a monitoring and reporting procedure by which the Commission makes annual recommendations to the MS on the basis of the guidelines and the MS make annual progress reports. Sanctions that could be applied were not formally materialised but appeared as only warnings without special effects. The Amsterdam Treaty also introduced the Guidelines of Employment, a tool of the European Employment Strategy (launched in Luxembourg in December 1997). The Open Method of Coordination, with its outlines created at Maastricht and Amsterdam by the Large Economic Guidelines and Employment Guidelines, was enshrined in the Lisbon Agenda (2000) and extended to other areas of life. However, although successful, the monetary union did not cover all the MS and left fiscal and economic policy responsibility largely to the national level.

The Lisbon Treaty entered into force in 2009 and laid down certain principles of macroeconomic policy coordination, without changing the essential basic concepts of the EMU (Köhler-Töglhofer – Part, 2011). Achieving the EMU is one of the objectives stipulated in Article 3 of the TEU and in Title VIII of the TFEU which reveal the close relationship between monetary and economic policy. Economic union as defined in Articles 119 and 120 of the TFEU is founded mainly on the single market and secondary on the coordination of national policies and setting common objectives for the economic and social development focused on competitiveness and employment. The principles contained in the two articles are requirements or constraints for economic and fiscal policies of the MS, to ensure financial and price stability. Macroeconomic coordination principles arising from the TFEU, but also from the SGP and EU regulations are the following: (1) *imposing market discipline on national fiscal policies;* (2) *increased engagement of national fiscal policy to fiscal rules;* (3) *strong commitment of MS to reduce excessive macroeconomic imbalances;* (4) *a new and permanent mechanism to address the financial crisis;* (5) *strengthening the surveillance of economic policies of MS.*

The EU economic governance reform has been achieved on several levels (Kohler-Töglhofer – Part, 2011) through the provisions of the Lisbon Treaty and the introduction of the European Semester by providing a better surveillance of national economic and fiscal policies, and a better policy coordination at the Community level, introducing a procedure for monitoring macroeconomic imbalances, setting up a permanent surveillance of structural reforms in the MS and bringing in a new crisis management mechanism for ensuring financial stability in the euro area.

In 2010 three major financial decisions were adopted with notable impact on fiscal policy in the euro area and also on the single monetary policy. The first, adopted by the European Council, ECOFIN and Eurogroup, refers to the financial stabilisation programme including the European Financial Stabilisation Mechanism and the European Financial Stability Facility. The second concerns their replacement by the European Stability Mechanism (ESM) from 2013 onwards. The third refers to the Securities Markets Programme adopted and implemented by the European Central Bank (ECB) for indebted eurozone states.

The European Stability Mechanism designed to insure financial solidarity between the euro area MS is a new financial institution based on Article 136 (3) of the TFEU and was established by a treaty negotiated by all MS. The European Stability Mechanism will have an initial capital of 700 billion euros and a lending capacity of 500 billion euros, and by its statute as financial lender the ESB may repay the financial assistance even if a debtor state is in an insolvency situation and may involve the private financial sector in line with the established practice of the IMF. Besides financial assistance provided through established mechanisms, the European Council has considered the possibility of debt restructuring for the states in insolvency, which is feasible under a debt sustainability analysis that may conclude the inability to restore financial balance and the need to initiate talks with creditors for debt restructuring (Verhelst S., 2011). The Securities Markets Programme, established under the provisions of Article 127 (2) of the TFEU, allows the ECB to finance the purchase of debt instruments issued by euro area governments to ensure sufficient liquidity in dysfunctional bond market segments. According to Article 123 of the TFEU the central banks and the ECB are not allowed to lend funds to national governments, but the ECB may buy government bonds in secondary markets.

2) Main governance reforms since 2010

2.1. European Semester

The European Semester was proposed in 2010 and adopted in 2011 and under this new instrument the coordination process has three specific time points:

(1) In March of each year, at its Spring Summit, the European Council is setting the priorities for economic policy based on the report presented by the European Commission on annual economic growth, followed by recommendations for budgetary policy, i.e. for two sets of programmes: a) the National Stability and Convergence Programmes; and b) the National Reform Programmes.

(2) In April of each year, Member States shall send their budgetary and economic strategies to the European Commission, in accordance with the recommendations received one month previously; and then the European Commission analyses and submits them to the ECOFIN Council.

(3) In June and July of each year, the European Council and ECOFIN develop specific recommendations for the MS on two types of policies: economic policies and budgetary policies. During the following year the reports of the European Commission assess how these recommendations have been implemented.

2.2. Package of six laws

In September 2010, the European Commission presented a package of six measures: five regulations (1173-1177/2011) and a directive to reinforce the economic pillar of the EMU and at the ECOFIN Council meeting of 15 March 2011 a preliminary agreement was reached on this package, with the European Parliament being involved in the co-decision procedure. On 28 September 2011 the European Parliament approved the legislative package for improving the functioning of the SGP, and on 13 December 2011 it came into effect.

2.3. Europlus Pact

The Europlus Pact was signed by euro area countries and six non-euro states with the goal to strengthen the economic pillar of the EMU and enhance the quality of economic policy coordination in order to increase the economic competitiveness and ensure a high degree of convergence for reinforcing the social market economy. Based on indicators and principles contained in the Pact, signatory states were going to announce concrete actions and clear commitments in the next 12 months, to be included in the Stability and Convergence Programmes and the National Reform Programmes.

2.4. Treaty on Stability, Coordination and Governance in the EMU

The Treaty on Stability, Coordination and Governance in the EMU was signed in March 2012 by the 26 MS, except the United Kingdom. Its aim is to deepen the economic pillar of the EMU integration and to create a fiscal stability union. This treaty deals with three main issues: (1) fiscal stability, i.e. rules on fiscal deficits and public debt levels (fiscal rules in the Treaty are sometimes described as “Fiscal Compact”); (2) EU economic coordination; and (3) governance of the eurozone.

Although detailed rules were introduced on fiscal stability issues, the treaty repeats some of these rules, and also strengthens and introduces some new ones. It states that the European Court of Justice will play an important role in the enforcement of fiscal stability. The treaty provides that the countries, which have ratified it, should have a general government deficit (structural) of no more than 0.5 per cent of the GDP or the orientation towards this goal within the time limits set by the EU (this is sometimes called “deficit brake”) and the general government debt should not exceed 60 per cent of the GDP. If, nevertheless, it is above 60 per cent, it should be reduced at a rate of 1/20 each year (this is sometimes called “debt brake”).

The Treaty provides that the rules on public deficits and debts should be introduced into national law and there will be a national body responsible for monitoring their implementation. Failure to introduce these rules into national legislation could bring the country to the European Court of Justice that would have the power to impose sanctions – up to a maximum of 0.1 per cent of GDP.

2.5. Pact for Growth and Jobs

The Pact for Growth and Jobs was adopted at the European Council summit from June 2012 at the initiative of France and provides that MS shall take immediate and necessary measures at national level to meet the targets of Europe 2020 and that the new tools of the EU economic governance must be implemented fully and effectively. Besides a differentiated fiscal consolidation and favorable economic growth, special attention should be paid to investments in future-oriented areas and directly related to the economy's growth potential and ensuring the sustainability of pension systems. Solutions must be found in terms of unemployment and addressing effectively the social consequences of the crisis; also one should accelerate reforms aimed at improving the employability of labour, and intensified efforts should be made to increase employment among young people, in particular to improve the possibility of young people obtaining their first professional experience and to increase their participation in the labour market, with the objective that within months of leaving school young people must receive offers of employment, training, apprenticeships and traineeships of good quality that may be supported by the European Social Fund. Additionally, effective policies for combating poverty and supporting vulnerable groups are needed to be developed and implemented quickly. Member States were supposed to promptly implement national plans for jobs and to develop more ambitious and precise national plans for jobs for the next European Semester and to use the funding possibilities for recruitment through temporary subsidies granted by the European Social Fund.

2.6. Package of two laws

A package of two laws was proposed in 2012 by the European Commission; it consists of two regulations, applicable only to the euro area MS (based on Art 136 of the TFEU), aiming at further strengthening the surveillance mechanisms in the euro area. One regulation is concerning the monitoring and assessing of draft budgetary plans and ensuring the correction of excessive deficits in the euro area MS. The other regulation refers to the enhanced surveillance of the euro area MS experiencing or threatened with financial difficulties.

2.7. Banking Union

The Banking Union was proposed on 12 September 2012 by the European Commission with a Single Supervisory Mechanism (SSM) for banks led by the European Central Bank (ECB) in order to strengthen the Economic and Monetary Union. The set of proposals was a first step towards an integrated "banking union," which includes further components such as a single rulebook, common deposit protection and a single bank resolution mechanism. Later, during the European Council meetings the components and mechanisms of such a banking union were debated and approved.

While France was supporting a banking union more during last autumn, Germany, backed by Van Rompuy and Barroso, pleaded for a *fiscal union* for the eurozone, with a large separate budget, binding budget contracts and some form of joint borrowing for financing a common fund or a treasury, providing aid to eurozone countries engaged in reform programmes.

3) Macroeconomic imbalances and the EU approach

Thomas Wieser (2011) thinks that a macroeconomic imbalance refers to a positive or a negative position of domestic or foreign financial variables which, if not corrected in time, makes the savings/investments balance unsustainable and determines its self-correction, causing a significant shock adjustment. Various authors like Wieser (2011), Blanchard (2009), Essl and Stiglbauer (2011) see a close connection between the savings/investments balance and current account balance, the main component of the balance of payments.

Usually it renders evident a direct relationship between rising fiscal deficit and the current account and interest rate increase, but also there is a certain correlation between deficits and growth rate (GDP). Accumulation of fiscal deficits leads to the increase of government (public) debt, which is financed by issuing bonds. Accumulation of current account deficits leads to external indebtedness of a country and may be partially compensated by large capital inflows from abroad, but usually involving currency devaluation and imposing a significant increase of exports. To highlight the relationship between the two deficits, there are business cycle models SIGMA of the Fed and GEM of the IMF which indicate that fiscal deficit has no effect in the short term and has very little effect in the medium term upon current account deficit. But Michael Kumhof and Douglas Laxton (2009), from the Research Department of the IMF, have developed a model that shows a correlation between the amount of fiscal deficit and the amount of current account deficit, which would confirm the assertions of conventional Keynesian theory of the twin deficits on the effects of fiscal deficit on current account balance by increasing aggregate demand for goods and services, including imports. Kumhof and Laxton's model as well as the other empirical analyses indicate that while the fiscal deficit has an immediate impact on the current account balance, the full effect of external deficits occurs later and it is difficult to distinguish it from the effects of other factors. Models of exchange rate regimes of Mundell and Fleming from 1962 (Obstfeld, 2001) also showed that fiscal deficits had an impact on the current account deficit resulting in an increase of interest rates, exchange rates and capital inflows, but these findings were countered by arguments of a Ricardian order (hypothesis of equivalence and neutrality), which in turn were challenged by analysts such as Blanchard (2009).

On the other hand, persistent current account deficit puts pressure on the exchange rate and its depreciation affects the inflation, aggregate output, budget revenues and expenditures and hence the amount of fiscal deficit. Considerable increase of private debt from large current account deficits may adversely affect not only economic development but also the contribution of private companies to the formation of budget revenues, which may alter the level of fiscal deficit.

However, these two imbalances may create serious problems in a monetary union where there is no national monetary policy, and the different macro developments in the MS and the different evolutions at macroeconomic level among the members of the monetary union, highlighted by high imbalances in Southern Europe, made the impact of the crisis quite different, obviously affecting the southern part of the EU more. Nevertheless, new challenges have emerged for a common monetary policy and for the single currency, but also for the coordination process of the fiscal and economic policy at the EU level.

After the formation of the monetary union, deficits and imbalances persisted for a long time, favoured by the competitive deficits and lack of structural reforms, populist policies and weaknesses of fiscal policy, and cheap money/credit policy of the ECB, but they came out only once the financial and economic crisis stroke heavily. The Stability and Growth Pact, supported by Regulation 1466/97, focused excessively on the fiscal deficit neglecting other deficits/imbalances with impact on public finances and macroeconomic stability. Andrew Watt (2011) believed that the importance of public (fiscal) deficit was overrated at the expense of the private sector deficits. Iain Begg gives the example of Spain, with a good situation of public finances in the 1999-2007 period when the share of government debt to GDP fell from 62 per cent to 36 per cent due to budget surpluses, but it reached a share of about 70 per cent in 2011, due to the disastrous situation of the building sector (with a high share in revenues) and probably also due to the difficulties of the banking sector and large current account deficits. But it is not only governmental factors that may be blamed for populist policies, for allowing corruption and evasion, for the inconsistency of fiscal policies, for the unsustainable accumulation of public debt, but also the private sector which supported the housing bubble and the speculative bubble on capital markets, and borrowed excessively and accumulated huge debts, while neglecting the issue of competitiveness and economic restructuring.

Without a monetary policy, the only instruments at the government's disposal remain the fiscal policy and wage policy, but their influence on wage flexibility and free movement of labour is quite limited. Labour costs increased slowly in Northern European countries led by Germany but very quickly and substantially in Southern Europe (Greece, Spain, Italy, Portugal) and Ireland. Germany has another important advantage: maintaining industry (the major exporter) at a significant share (24 per cent) in the GDP in 2010. Trade deficits and surpluses between Southern and Northern Europe, due to competitiveness gaps, created a lot of troubles in the eurozone, mirrored by huge public and private debts in the first group of countries.

Macroeconomic indicator imbalances may lead to financial crises that are difficult to solve only by a monetary policy due to the liquidity trap. Fiscal and current account deficits should be reduced or even eliminated by drastically cutting the public spending and by diminishing the tax evasion (estimated at 20 per cent of the GDP across the EU). Excessive budget austerity cannot be the only solution to address the deficits and imbalances, because the reduction of private consumption and the under-financing of social sectors cannot restore the growth of economy and reinforce its competitiveness (see the good example of the Scandinavian countries).

Improvement of EU governance within the framework of the European Semester meant the introduction of a new procedure for the prevention and correction of macroeconomic imbalances, having two major components: a preventing one, involving the regular evaluation of imbalance risks and a corrective one, involving remedial measures for excessive macroeconomic imbalances. On the prevention part there is an alert mechanism consisting of a set of 10 indicators and a qualitative analysis. Five indicators refer to external imbalances and competitiveness: current account balance, net international investment position, real effective exchange rate, export market share, nominal unit labor costs; and five indicators refer to internal imbalances: real housing prices, private sector credit flow, private sector debt, public debt, unemployment. Also there were established threshold limit values for the indicators that helo with the quantitative assessment of their progress and the final interpretation based on qualitative analysis.

Predicting and preventing the excessive imbalances by means of this procedure based on ten indicators do not represent a perfect tool, as one may see from their evolution during the first seven years of the last decade. The conclusion drawn by some analysts (Essl –Stiglbauer, 2011) on the basis that Southern European countries had not accomplished the threshold values for the more relevant indicators is that they have proved very vulnerable to the eurozone crisis, so that the indicators would have been useful in predicting the crisis and revealing which states would be vulnerable to it. However, it should be noted that the financial crisis started in the U.S. and propagated worldwide, and American investment banks led by Goldman Sachs played a very negative role in the crisis and in the catastrophic economic governance of Greece but also of other EU Southern countries. Italy that passed through a very difficult period in 2011 and 2012 had no particular problems with nine indicators in the last decade, except for the public debt level, which exceeded 100 per cent of the GDP, and represents the best example that disproves the possibility of correct predictions using the scoreboard indicators. Other issues are the importance/relevance of competitiveness indicators, such as nominal unit labour costs, also the relevance of current account surpluses, the interdependence in the evolution of some indicators, the need to introduce a financial market indicator, the possibility of coordinating and correcting their development at the EU level and improving the threshold values, the rethinking of new indicators and how their development may be influenced by national government policies in the MS and their support for the corrective recommended actions, the role and jurisdiction of various European institutions and institutional structure for preventing and correcting imbalances and the possibility of imposing financial penalties by reverse qualified majority in the Council of the EU, the acceptance by MS to cede their sovereignty in the field of macroeconomic policy.

All pacts, documents, legislative acts, procedures, mechanisms established in the last three years at the EU level aimed at a better coordination of the member states' economic policies, improving economic performance and preventing imbalances. But at national level there is not enough political will and expertise or small possibilities to influence the level and evolution of some indicators, linked more to the private sector activity. Hence the natural question regarding the legitimacy of sanctions applied to national governments for the failure of some indicators on which they are unable to intervene effectively. However, there are some levers or measures by which the governments may influence the activity and performance of the private sector. At the community level one may see divergent interests and positions regarding the use or the importance of risk assessment indicators for macroeconomic imbalances.

4) Romania's adjustments due to the crisis

The evolution of major macroeconomic indicators in Romania in the period of 2005-2011 is presented in table 1. In this period Romania's major macroeconomic indicators – current account deficit and fiscal deficit – recorded a negative evolution. Current account deficit exceeded the -4 per cent threshold value in all years, attaining -11.8 per cent in 2008, where the deficit of consolidated budget was more than -3 per cent in 2008-2011(-9 per cent in 2009), public debt more than doubled, to 33.3 per cent of the GDP, private sector debt increased three-fold from 2005 to 2009 (122.9 per cent of the GDP) and the unemployment rate was around 7 per cent. The situation improved in 2011 and 2012 to a certain extent, as one may see in figures 1 and 2.

The speculative bubble in the real estate sector, where prices had soared in the last decade, showed a strong increase of incomes and consumer demand, and the expansion of consumer credit and mortgage credit made a significant contribution to the large current account deficit. Fiscal deficit was caused by the huge tax evasion (26 per cent of the GDP in 2011), black market economy and the rapid increase of wages and pensions. A large part of public investments and expenditures was wasted, poorly done or even stolen. It is obvious that fiscal expansion led to a deterioration of the current account, and there was a close link between the increase of public debt and the decrease of private sector debt in the last three years (2010-2012).

Austerity measures taken in 2009 and 2010 at the suggestion and with the financial support of the IMF and the European Commission were based on a reduction of wages by 25 per cent, the freezing of pension level, an increase of VAT from 19 per cent to 24 per cent; they led to a large fiscal adjustment and to a significant reduction of current account deficit. But the crisis seriously hit Romania and this was mirrored by a strong decrease of FDI from 9 billion euros in 2008 to 1.9 billion euros in 2011, a decrease of export markets demand, the decline of domestic consumer demand, weak absorption of European funds, a large GDP contraction (-7.1 per cent in 2009) and a weak and slow recovery (in fact, a prolonged economic stagnation) in the last three years (2010-2012).

The economic prospects for the following years (see the scenarios from figure 3) largely depend on the economic situation in the eurozone, the main export area for Romania, developments within global economy, low capital inflows, the reduction of credit and deleveraging, low absorption of structural funds, the privatisation of state companies, attraction of FDI outside the EU, the support for SME's, infrastructure, education and innovation, the revival of the capital market, the counter-acting of tax evasion, the good prioritisation of public investments and the flexibilisation of the labour market.

Table 1

The breakdown of main macroeconomic indicators in Romania in the period of 2005-2011 (%)

Indicator (% of GDP)	Threshold	2005	2006	2007	2008	2009	2010	2011
1)Current account deficit	*6%/-4%*	-7,6	-9,1	-10,8	-11,8	-9,7	-6,7	-4,3
2) Fiscal deficit	*-3%*	-1,2	-2,2	-2,5	-5,7	-9	-6,8	-5,5
3) Public debt	*60%*	15,8	12,4	12,8	13,4	23,6	30,5	33,3
4) N.I.I.P.	*-35%*	-29,5	36,2	-47,1	-53,4	-62,2	-63,8	-62,5
5) Private debt	*150%*	42,2	67,7	107	115	123	76,4	71,8
6) Unemployment rate (% of workforce)	*10%*	7,3	7,5	6,9	6,5	6,4	6,6	7,2

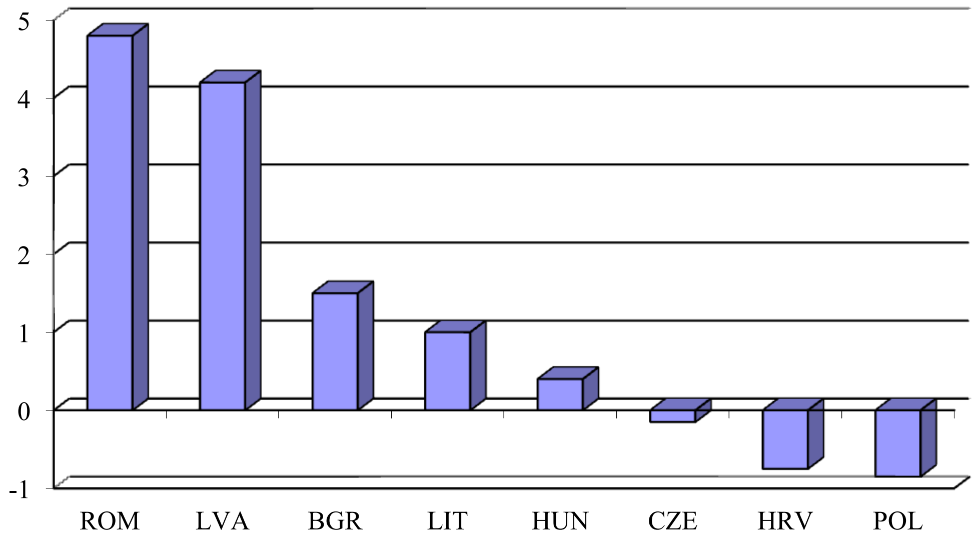
Source: Eurostat, 2012, National Institute for Statistics, 2012

Figure 1

Change in fiscal structural balance

(in percent of GDP, 2008-2011)

Romania has implemented a relatively large fiscal adjustment

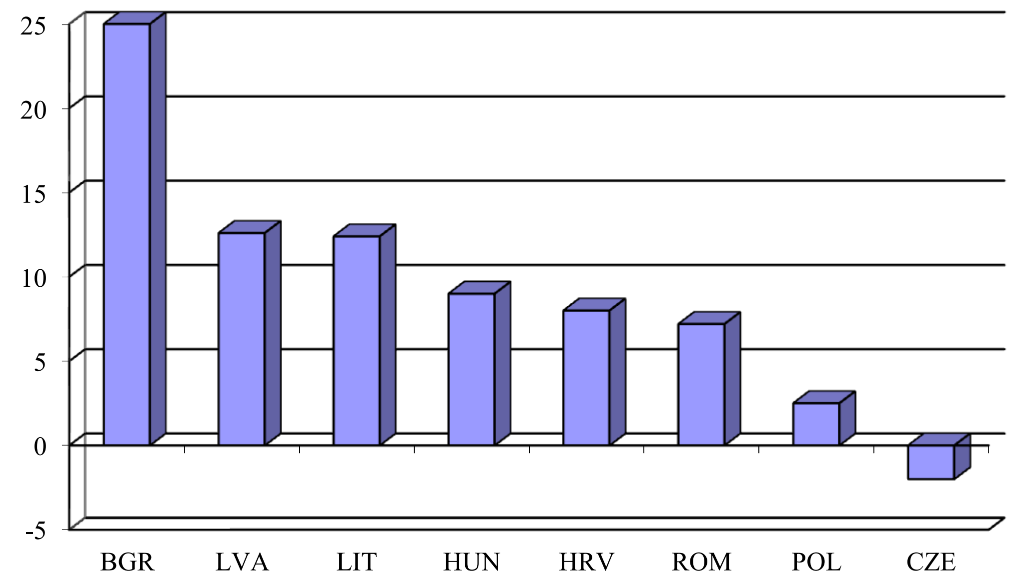


Source: WEO IMF, 2012

Note: Cyclically adjusted balances are used for HRV and LVA

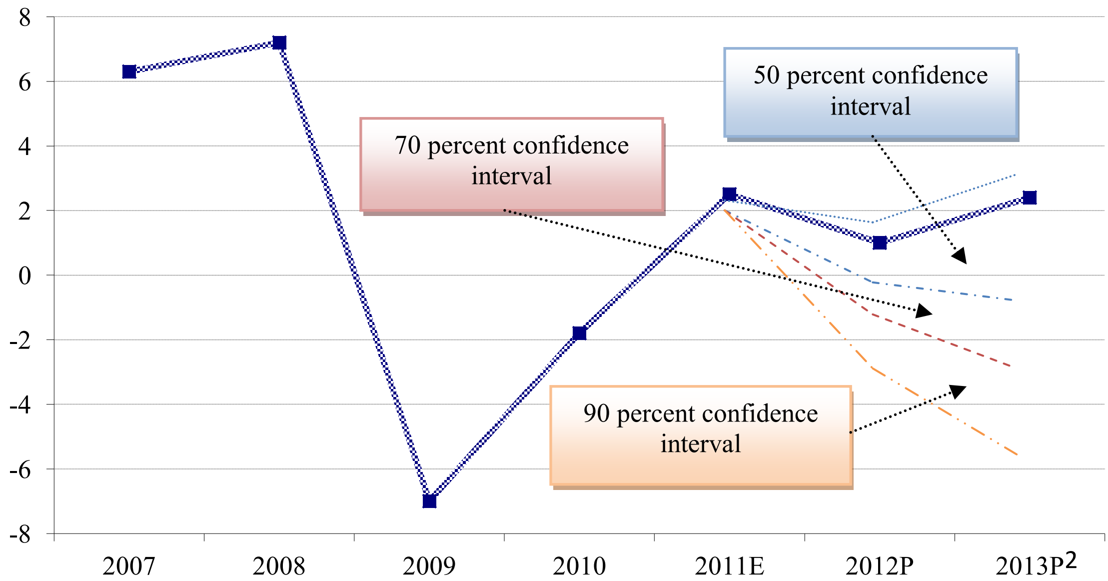
Figure 2
Change in current account balance
(in percent of GDP, 2008-2012)

While the current account deficit has also reversed significantly



Source: WEO IMF, 2012

Figure 3
Real GDP growth: risks to the forecast
(% change)



Source: WEO IMF, 2012 and IMF staff calculations, 2012

5) Conclusions

(1) The systemic character of the crisis created a vicious circle of shocks between governments and the banking sector in Southern Europe and the markets have lost their confidence in European and national decision makers. Establishing a banking union without achieving a fiscal union cannot solve the underlying problems of EU economic governance.

(2) The reform of EU economic governance must be accompanied by reform of the corporate governance and global governance, also by deploying substantial reforms of governance at the national level in order to overcome moral hazard problems related to fiscal policy and the financial sector.

(3) Strict supervision of the private sector and public deficits is needed by means of scoreboard indicators (the ten indicators), which may be completed in the near future.

(4) The credibility of European institutions and how they represent the interests of citizens is a major theme of debate nowadays. The president of the European Commission, Jose Manuel Barroso spoke repeatedly on the crisis of confidence of the markets and citizens, the need for less bureaucracy and technocracy and more democracy, the requirement of a political union (a federation), but in fact we may see a crisis of political elites and a lack of viable visions for the future of a prosperous Europe.

(5) In the last years all that European leaders offered to their citizens was an austerity recipe, which affected demand and investment and has been criticised by Paul Krugman and Joseph Stiglitz, and led to a chronic stagnation with no prospects for economic recovery in the medium term. Still one may choose between stimulating the demand (Krugman) by increasing public spending and investments, credit recovery, the revival of aggregate demand and stimulating the supply (Robert Mundell – David Harper) by applying fiscal incentives, improving competition policy, promoting sectoral policies and supporting the re-industrialisation process. Bearing in mind that capital investment plays an engine role for total factor productivity, emphasis should be placed on SMEs, education, innovation, clusters and but also on measures for increasing the labour market flexibility, upgrading infrastructure and good governance at all levels.

(6) In a recent report on the European growth model, the World Bank (2012) analysed the main components of it: *strong*–trade and finance, *medium*–enterprise and innovation, *weak*–labour and government. To remain a global economic leader, Europe has to sustain regional integration (completion of single market), reduce public debt (big fiscal adjustments), stimulate/support innovation and foster competition, reform social security (around 10 per cent of the GDP), revamp employment protection laws and institute a business climate rewarding skills and entrepreneurship.

(7) Romania did not face a financial crisis but only a sudden contraction of the GDP in 2009 after four years of strong economic growth when the current account deficit was very high, but austerity measures like the heavy adjustment of

salaries from the public sector and the drastic cut of social protection expenses led to a significant reduction in fiscal deficit but also to a strong contraction of consumer demand. A large part of economic difficulties may be explained by the poor quality of governance at a national and local level, characterised by corruption, clientelism, bureaucracy, managerial incompetence and the lack of a strategic vision.

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INTERESTS OF THE DIFFERENT PLAYERS IN THE MFF DEBATE*

Miklós Somai

Abstract

As already well known, the European Council, at its meeting of 8 February 2013, reached an agreement on the next multiannual financial framework (MFF) which lays down the European Union's (EU) budgetary priorities and ceilings for the period of 2014-2020. The next MFF will retain more or less its current structure, with somewhat more money earmarked for research and development, physical infrastructure and education, but substantially less money saved for agricultural and cohesion policy. Although it would be tempting to give a detailed description of the agreement, this paper rather intends to examine both the way to and the member states' interests behind the agreement.
JEL: E60, F02, F36, F55, H77

The way to the Commission's proposals

Before the Commission came out with their proposals entitled *A Budget for Europe 2020* there were almost no or very few clues as to what the upcoming proposals would contain.[1] The first such clue was *Europe 2020,* a 10-year strategy proposed by the Commission in early March 2010, in which all important targets and initiatives concerning the fight against poverty, unemployment, early school-leaving or climate change as well as fostering a knowledge-based economy were set out for

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[1] Commission (web)

the current decade. In this document the expression of *"cohesion policy"* is mentioned twice and that of *"common agricultural policy"* not at all.[2]

The second clue came a few weeks later when, at the end of the summit of 25/25 March 2010, the European Council published its *Conclusions*.[3] This document could be read as a direct riposte to the Commission's *Europe 2020* paper: here both cohesion and agriculture were viewed as integral parts and necessary for the support of the 2020 strategy.

The Commission's *Budget Review,* a necessary and, under normal circumstances, important step in the process of implementing the current MFF, was brought out in October 2010, several years later than originally planned.[4] The Commission did not want to put the unity of the integration at risk by coming up with new ideas in such a sensitive and contentious topic as the EU budget, in the hard times of the crisis. The review came too late to effect any changes in the remaining years of the MFF 2007-2013.

As a very important clue, as to what could be the outcome of the whole negotiation process, arrived in December 2010: the common letter of the leaders of the five net beneficiary member states (D, F, NL, SF, UK) to the budget, in which they warned Commission President Barroso not to overshoot with the proposals on the next MFF (2014-2020) the level of the current one (2007-2013). They meant that appropriations for payments should not increase faster than the annual inflation and those for commitments should not exceed their level foreseen for 2013, adjusted with less than the annual inflation for the whole MFF to come.[5] It is important to remember that something very similar had happened at the end of 2003, not long before the Commission was going to present its proposals on the current MFF.[6]

Finally on 8 June 2011, just a couple of weeks before the Commission proposals were published, the European Parliament (EP), disobeying those member states who wanted to freeze the MFF, voted a resolution which called for an increase of at least 5 per cent of the expenditure side of the next MFF.[7] With this resolution the EP insisted on the need for maintaining the chances that the objectives and policies agreed for in the EU 2020 Strategy would be completed.

Commission's proposals

Officially, the negotiation on the next multiannual financial framework (MFF 2014-2020) started at the end of the Hungarian presidency, on 29 June 2011 when the

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[2] Commission (2010a)

[3] European Council (2010)

[4] Commission (2010b)

[5] British Embassy, Paris (2010)

[6] Then six net contributors had made a strong statement in support of limiting the expenditure side of the common budget to a mere one per cent of the total EU GNI[6] (BBC News, 2003).

[7] European Parliament (2011)

European Commission presented its proposals.[8] When the paper entitled *Budget for Europe 2020* came to light, it seemed that the Commission had taken most of the views of the EP into account, as in its proposal for total EU spending it earmarked €972 billion as payments, and €1,025 billion as commitments, both representing, in real term, an increase of circa 3 per cent vis-à-vis the relevant figures of the current MFF. In terms of EU GNI,[9] these spending figures were set at a level of 1.05 for commitments and 1.00 per cent for payments, showing a slight increase rather than a stabilisation or decrease if compared to the originally decided levels for the current MFF (1.045 and 0.99 per cent)[10]. As a matter of fact, the Commission's bid rose further – to levels of 1.08 and 1.03 per cent of EU GNI – when on 6 July 2012, in order to take into account the forthcoming Croatian membership, it amended its proposals.[11]

It is quite an interesting question to elucidate how these two institutions – the EP and mainly the Commission, it being the official initiator of common positions in the EU – can fix the MFF ceilings at such a high a level as if they had been totally ignoring the wish of the net contributor member states and as if it had been realistic for them not to embrace this wish. Considering the several billion euros spent yearly on the financing of the Commission's huge staff (but also those millions spent on that of the EP), it is shocking to see these institutions working on plans and knowing in advance that they would never succeed. For one did not need to be a prophet to foresee that in the context of the crisis and the already traditional cleavage between net beneficiaries and net contributors (better known recently as "friends of cohesion" and "friends of better spending"), it would by no means be possible to expand the size of the budget, or to significantly alter its structure. The crisis itself, and the fact that those most affected by it were the same member countries that had for long been receiving massive financial support through different policy frameworks from the EU budget, did not leave too much room for doubt on whether the net contributors would be willing to raise more funds for whatsoever plans.

However, the Commission, disregarding all the above, tabled its proposals with several innovative elements and changes to the "rules of the game" for the would-be multiannual financial framework. The main novelties worth mentioning can be summarised as follows:

* the concentration on key policy priorities, in order to reach the *Europe 2020* strategic objectives, as well as to promote growth and employment to counter the EU's economic crisis:
    - €80 billion to be dedicated to research and development within a newly created common strategic framework closely linked to key sectoral policy priori-

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[8] Commission (2011a)

[9] Gross National Income

[10] The original levels of appropriations for commitments and payments decided upon at the 19th December 2005 European Council (see: European Council, 2005) have in fact increased to 1.12 and 1.06 per cent of the EU GNI respectively, due to weaker-than-expected growth rates of the European economy during the current MFF period (2007-2013) (http://europa.eu/newsroom/highlights/multiannual-financial-framework-2014-2020/index_en.htm).

[11] Commission (2012a)

ties such as health, food security and bio-economy, energy and climate change;
  - o more than €15 billion to be spent to strengthen Community programmes for education and vocational training;
  - o €50 billion, of which €10 billion would come from the Cohesion Fund, to be earmarked to create a new subheading "Connecting Europe Facility" to fill persistent gaps, remove bottlenecks and ensure cross-border connections in the field of transport, energy and information technology;
  - o about 20 per cent of MFF funds to be used for climate-related expenditure, but without creating specific instruments dedicated to climate and environment;
- ∗ the simplification and reduction of instruments and administrative burden, especially concerning structural funds and R&D funding; the growing flexibility within and across budget headings; and the introduction of ex ante and ex post as well as macro-economic conditionality in cohesion policy and agriculture with the aim of sharpening the focus on results rather than on inputs, and ensuring coherence between the overall economic policy and the EU budget[12];
- ∗ the introduction of two new resources of their own; the aim of making such innovations is to give the EU budget greater autonomy and new sources of income whereby the part of the GNI-based resource could fall from three fourth to two fifth in total EU financing (see table 1):
  - o a financial transaction tax (FTT) to be set at very low rates (e.g. 0.1 per cent for bonds and shares, and 0.01 per cent on derivative products); and
  - o a simplified and modernised VAT resource to be applied (e.g. at a rate of 1 per cent) on those goods and services only which are subject to the standard rate in each and every member state; it is intended to replace the current utterly complex and opaque VAT-based resource;
- ∗ the reform of the correction mechanisms consisting of:
  - o replacing all country-specific corrections (including the most famous one, that of the UK) with a new system of lump sum gross reductions on yearly GNI payments for only four member states (D, S, NL and UK);
  - o and the bringing back of the rate of retention, by way of collection costs, of 25 per cent of the amounts of traditional own resources (almost exclusively customs duties) collected by the member states and considered to be a hidden correction mechanism, to 10 per cent, the level in place until 2000.

However, the Commission presented such forward-looking proposals in vain if in the issue of the MFF the interests of all member states have to be taken into account: in accordance with the special legislative procedure, the Council, after obtaining the consent of the European Parliament, acts unanimously, so each EU member has veto power. There are, however, three big member states which, by their political and economic influence, may have major impact on the future of the European budget.

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[12] Thus avoiding situations where the effectiveness of EU funding is put at risk by unreasonable macro-fiscal policies (Commission, 2011a: 9).

Table 1
Estimated evolution of the structure of EU financing
(2012-2020)

	Draft budget 2012		2020	
	EUR billion	% of own resources	EUR billion	% of own resources
Traditional own resources	**19.3**	**14.7**	**30.7**	**18.9**
Existing national contributions of which	**111.8**	**85.3**	**65.6**	**40.3**
VAT-based own resource	14.5	11.1	-	-
GNI-based own resource	97.3	74.2	65.6	40.3
New own resources of which	-	-	**66.3**	**40.8**
New VAT resource	-	-	29.4	18.1
EU financial transaction tax	-	-	37.0	22.7
Total own resources	**131.1**	**100.0**	**162.7**	**100.0**

Source: Proposal on a Council decision on the system of own resources of the European Union, Commission COM(2011) 510 final, Brussels 29.06.2011

Big member states' interests

The first such member country is Germany which has, since the end of the 1970s, undoubtedly been the biggest net contributor to the common European budget. As for the last five year period from 2007 to 2011, for which there were available data at the moment of finalising this paper, Germany alone was responsible for 30.68 per cent of the total net contributions in terms of operating budgetary balance.[13] For decades, the Germans have not done too much to prevent the regular reproduction of their deficit; for political reasons or because in other areas of the European integration, such as the internal trade, they could easily earn back what they lost in the common budget, they have been content to pay a proportionally high share of the EU's running cost. Since the reunification, however, their motivation for making compromises has weakened. Moreover, under the circumstances of the crisis, Berlin faces domestic budget cuts and needs to raise euro billions in capital for stocking up of the eurozone's bailout funds, which fuels the determination to ensure better value for money during the process of MFF negotiations.[14] Germany's situation remained nevertheless delicate, for the country could not afford to overlook the interests of member states in Central and Eastern Europe, its traditional region of influence. So, it could not openly advocate a quick cutting back on the funding of old policies, as

[13] Commission, EU expenditure and revenue – http://ec.europa.eu/budget/figures/interactive/index_en.cfm

[14] Openeurope, 2012: 10

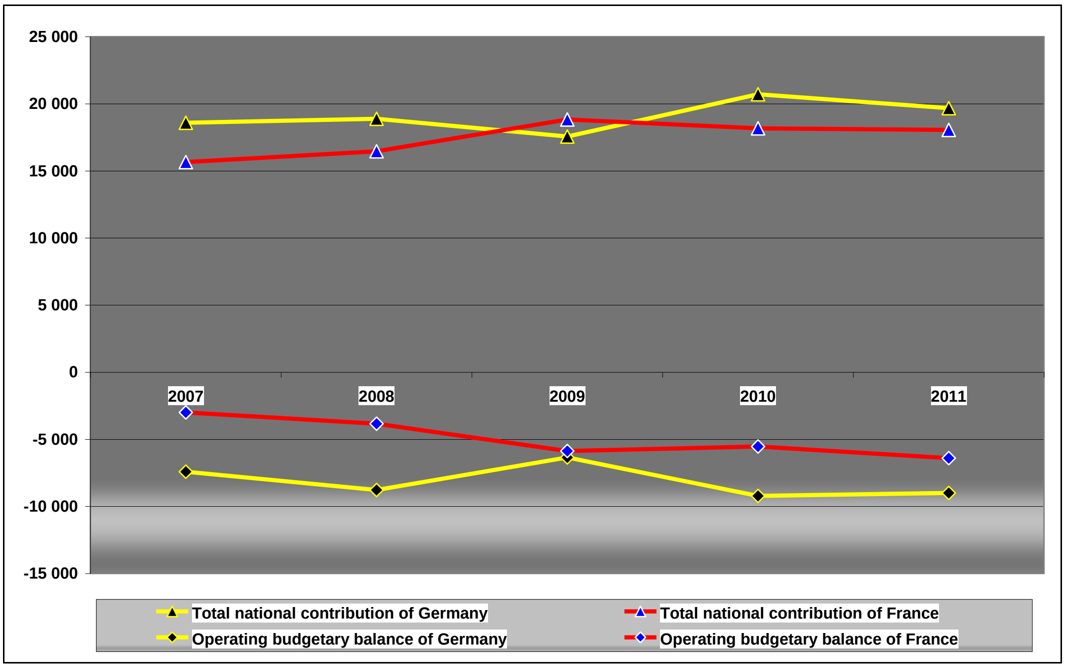
it wished to avoid a situation where too many of the member states would feel themselves lose position.

As for the second country, France, due the significant subsidies coming from the CAP, had for decades enjoyed the privileged position of being a moderate net contributor to the European common budget. But this state of grace came to an end when the budget related dispositions of the Agenda 2000 entered into force, as since 2002 onwards France has recorded a sharp increase in both its contribution to and net operating balance vis-à-vis the budget. By the end of the current financial framework (2007-2013), France's position may be quite comparable with that of Germany (see fig. 1). As for the per capita contribution to the budget, France even surpassed Germany, and for the per capita operating balance the two countries are almost at the same level (see fig. 2). Hence, it is quite obvious why France joined the club of "Friends of Better Spending." Paris' main ambition during the negotiations has been to preserve the CAP subsidies, at least in absolute terms. As the British rebate has for long been put on stake against a radical cut in CAP spending, by defending the CAP Paris involuntarily defended the status quo for the rebate as well.

The third influential country is the United Kingdom. Its main interests lay in continuing with the rebate, which was obtained by Margaret Thatcher at the Fontainebleau Summit in 1984 and which resulted in gaining back approximately two thirds of its net contribution to the European budget annually. Thanks to the rebate, which for the period of 2003-2009 averaged at more than € 5.4 billion a year, the UK has, for its operating net balance, been in a pretty good situation compared with other similarly developed member states (see fig. 3). This situation changed only in recent years as a result of the British "gesture" made at the end of the negotiation process for the current MFF, by giving up a part of the rebate in order to save an agreement, but also to prolong the rebate for another seven year period. As of 2009, the UK has gradually joined the group of other net contributors for the level of its net budgetary deficit measured in its GNI. (See Figure 3) Under these circumstances the UK's priorities in the negotiations for the next MFF could only be to protect the rebate from further reduction and freeze the overall size of the budget.[15] Key data about the position of the three above member in the EU budget are displayed in table 2.

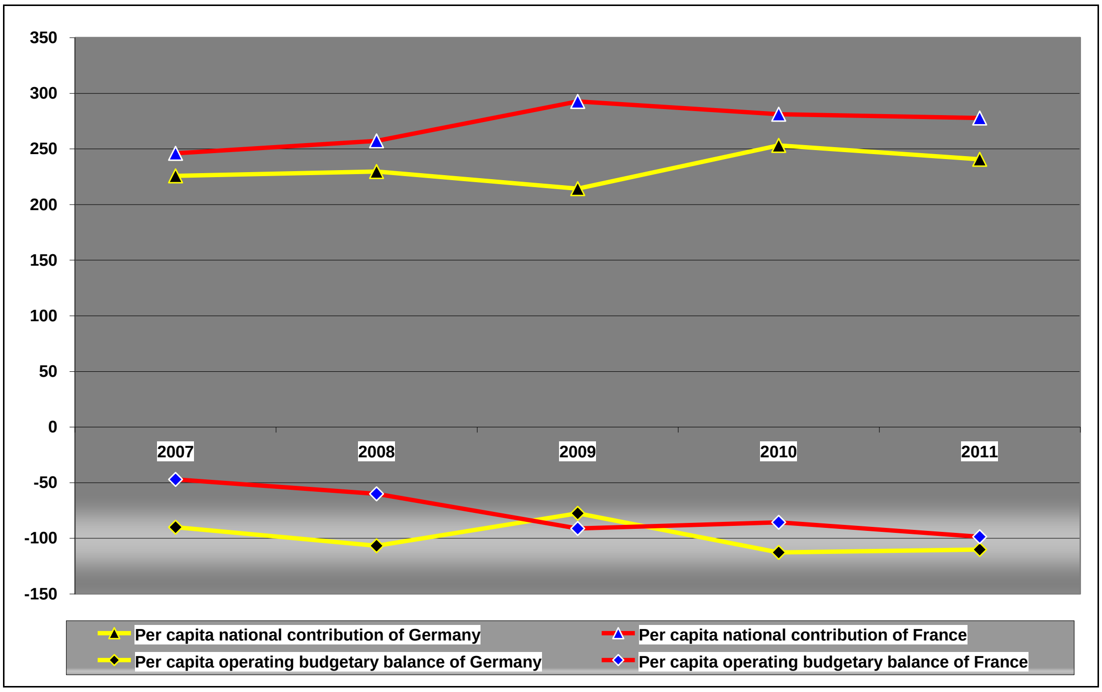
[15] Ibid. 9

Figure 1
Contribution to EU budget and operating budget balance of France & Germany
(€ mn)



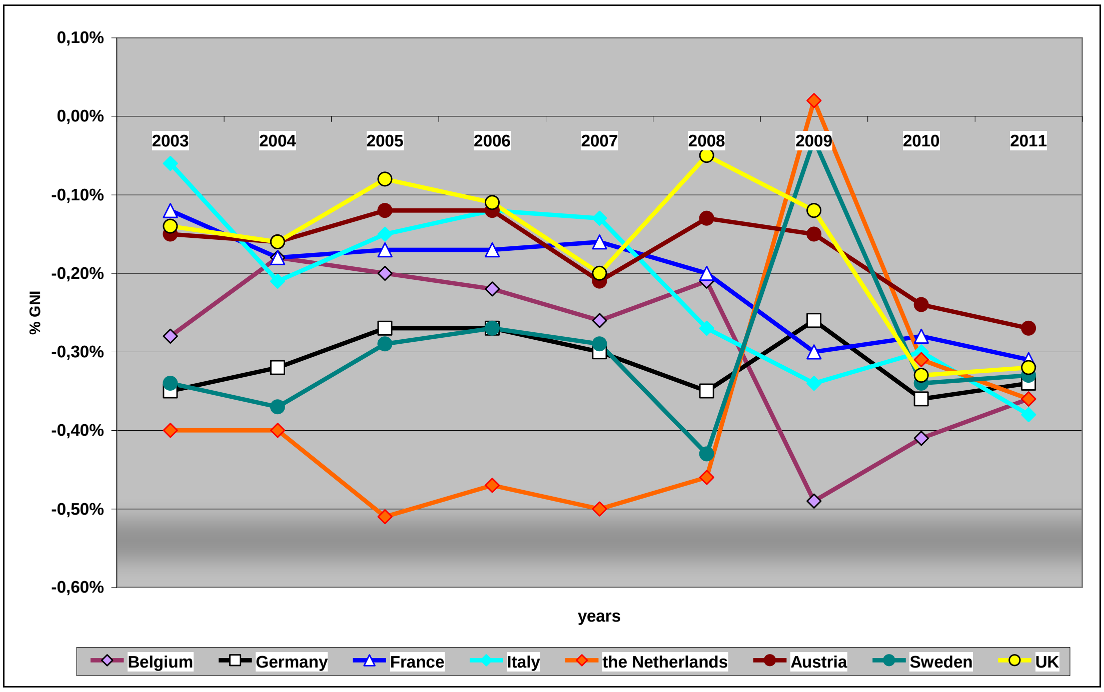
Source: Commission, EU expenditure and revenue –
http://ec.europa.eu/budget/figures/interactive/index_en.cfm

Figure 2
Per capita contribution and operating budgetary balance of France and Germany
(€)



Source: Commission, EU expenditure and revenue –
http://ec.europa.eu/budget/figures/interactive/index_en.cfm

Figure 3
Operating budgetary balances
(*i.e.* excluding administrative expenditure and TOR, and including UK correction)



Source: Commission (2012b) – EU budget 2011, p. 102
TOR = Traditional own resources (customs duties and sugar levies)

Table 2
Key data on EU budget positions for Germany, France and the United Kingdom

Average data for the period 2007-2011	DE	FR	UK
Total expenditure, EUR million	11 870	13 504	6 859
Total national contribution, EUR million	19 081	17 433	9 937
Gross National Income (GNI) EUR billion	2 507	1 962	1 796
Operating budgetary balance (OBB) EUR million	- 8 155	- 4 931	- 3 619
OBB/GNI	- 0.32%	- 0.25%	- 0.20%
Population (average 2007-2011), million	82.0	64.3	61.6
Total expenditure, EUR per capita	144.7	209.9	111.3
Total national contribution, EUR per capita	232.6	271.0	161.3
Gross National Income (GNI), EUR per capita	30,569	30,492	29,150
Operating budgetary balance, EUR per capita	- 99.4	- 76.6	- 58.7

Source: DESTATIS (2012), Foreign trade; and Eurostat (for demographic data) – http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=demo_gind&lang=en

Endgame

There is an interesting game surrounding the MFF negotiation process, a certain ritual in which net contributors aim for freezing the expenditures, the Commission and the European Parliament propose a net increase in spending, and member states band together advocating entirely opposite conceptions of how to spend and how much to spend. Then, the process develops into a stage when some authority brings the expenditure figures closer to reality by presenting a very economic budget (see HvR-I and HvR-II).[16] Finally, one or several of the most developed countries seem to practice generosity by renouncing a certain share of those headings and subheadings in which they have substantial interests.

As the deadline for reaching an agreement approached, Herman van Rompuy tried to make tremendous cuts to both cohesion and agricultural policy, by saving more than €100 billion compared to MFF 2007-13, part of which he transferred to subheading 1a "Competitiveness for Growth and Jobs." Even if only some days later, Van Rompuy came out with a somewhat softer version (HvR-II.), the European Council of 22/23 November 2012 failed. And finally, at their summit of 7/8 February 2013 – the politicians reached a political agreement on the maximum figures of EU-28 expenditure for 2014-2020.[17] The heads of state and government portrayed the agreement as a victory not only for their home country but for all member states.

However, are the European Council's Conclusions on the next MFF a triumph really for all member states? The data displayed in Table 3 below testify to the fact that the changes in the repartition of financial means among the various common policies have been a clear victory for the wealthiest net contributor member states, "Friends of better spending" and the UK.

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[16] Packages of proposals named after Herman van Rompuy, President of the European Council who drafted them in preparation for the summit of 22/23 November 2012, a special meeting dedicated to the budget, but the parties were unable to arrive at a compromise on the terms of the next multiannual financial framework.

[17] European Council, Conclusions, Brussels, 8 February 2013

Table 3

MFF (2014-2020), as agreed by the European Council of 7/8 February 2013, the current MFF (2007-2013) and Commission Proposals for the EU28 in July 2012

Commitment appropriations	MFF 2014-2020		MFF 2007-2013		COM (28)
	bn €	%	bn €	%	bn €
1. Smart and inclusive growth	450	*46.9*	446	*44.9*	495
1/a Competitiveness for growth and jobs	126	*13.1*	91	*9.2*	116
1/b Economic, social and territorial cohesion	325	*33.9*	355	*35.7*	379
2. Sustainable growth: natural resources	373	*38.9*	421	*42.3*	386
of which: market related expend. & DP	*278*	*28.9*	*337*	*33.9*	*283*
3. Security & citizenship	16	*1.6*	12	*1.2*	19
4. Global Europe	59	*6.1*	57	*5.7*	70
5. Administration	62	*6.4*	57	*5.7*	63
Total commitment appropriations	960	*100*	994	*100*	1033
as a percentage of GNI	*1.00*		*1.12*		*1.08*
Total payment appropriations	908		943		988
as a percentage of GNI	*0.95*		*1.06*		*1.03*

Source: European Council (2013) and http://europa.eu/newsroom/highlights/multiannual-financial-framework-2014-2020/index_en.htm

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European Council (2013): *Conclusions*, Brussels, 8 February 2013. Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/135344.pdf

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Central and Eastern Europe's Dependence on Russian Gas Imports: Playing the Source and Transit Diversification Game*

*Csaba Weiner***

Central and East European countries express a strong fear of Russian gas, yet they have done little to reduce dependence. However, recently, some progress has been made in the diversification of supply and increasing the security of supply. It was not only the Russo–Ukrainian gas crisis in early 2009, but the period since 2008 and 2009 has shown how different the conditions of each state are, i.e. to what extent they could have taken advantage of the benefits of changed conditions and globalising gas markets. For a Central and East European consumer, the focus is mainly on pricing, and the anti-trust probe that has been launched by the European Commission against Gazprom stresses the crucial importance of this issue. Despite many criticisms, the EU has made a few steps that can help reduce the fear and influence of Russia.[1]

JEL Classification: D42; F14; L12; L71; L78; L95; L98; Q41; Q48

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[1] Based on information up to 30 November 2012 (*i.e.* up to the date of the roundtable).

1) Introduction

It has been conventional wisdom to talk about Central and East European (CEE) dependence on Russian gas imports and the western Commonwealth of Independent States (CIS)[2] as transit routes. But despite the common past, the CEE region is not totally homogeneous. The 13 gas importing countries[3] of Central and Eastern Europe have different conditions. They are to a different extent dependent on gas, gas imports and Russian gas. A central question is the extent to which a country's domestic gas production can meet its demand. Besides, other major elements need to be looked at: on how many pipelines and from how many directions a country can receive gas; which transit pipelines pass through it (if any); whether the country has a seashore to make use of terminals to regasify liquefied natural gas (LNG); and what the capacity of the particular country's underground gas storage(s) is.[4]

The Russo–Ukrainian gas crisis in January 2009 showed exactly the conditions of the Central and East European states and the achievements in improving the security of supply at that time. South-East Europe suffered very seriously, but in Central Europe, Slovakia was also strongly affected by the gas crisis.

Since 2005, several gas supply contracts have been signed or extended with Gazprom[5] in the CEE region, but some contracts will expire already at the beginning and in the middle of the 2010's. Before the extension of these contracts, it is important to see how much Russian gas will be needed, and in order to enjoy a better bargaining position, it would be necessary to show progress in diversification projects.

2) Market changes, with special attention to the pricing

In the last four to five years, the global gas market picture has changed significantly, although these events have affected different regions differently, even within

[2] Belarus, Ukraine and Moldova.

[3] These are Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Slovenia, Serbia, Bosnia-Herzegovina and Macedonia. Croatia did not extend its long-term gas supply contract with Russia when it expired at the end of 2010. Among the Central and East European countries, Albania and Montenegro (and Kosovo) do not import gas at all. They have no import capacity.

[4] The issue of underground gas storage facilities is not analysed here, while emphasising their importance. Among Gazprom's customers in the region, there are no gas storage facilities in Estonia, Lithuania, Slovenia, Bosnia-Herzegovina and Macedonia, while in Serbia one has recently been opened.

[5] Gazprom or its 100 per cent owned subsidiaries have the exclusive right to export gas or LNG produced in Russia. In principle, this monopoly does not apply to production-sharing agreements (PSA), but Gazprom has successfully prevented the Sakhalin-1 PSA project to export gas directly to China.

Europe. Several factors have been shaping the process. Among the most important are: the onset and the effects of the economic crisis, the sharp rise in unconventional gas production (most importantly the shale gas revolution in the US), the surge in LNG production and globalising gas markets.

The main challenge for gas is the way it is priced.[6] Since the end of 2008, the so-called "two-price" or "hybrid price" market has been seen in Europe.[7] The role of the gas trading hubs and their prices started to grow. As a consequence of the over-supply, the spot market gas prices have fallen well below oil product-indexed prices in long-term gas supply contracts. Moreover, after having recovered from a downward spiral, oil prices have remained (relatively) high.

Gas consumption fell in Europe not only in 2009, the year of the economic crisis, but in 2011 as well, and it is projected to fall again in 2012,[8] despite the gas demand shock in early 2012. In 2011, three additional factors deserved serious attention: the temporary suspension of Libya's gas exports, the Fukushima nuclear disaster and the subsequent decisions on nuclear power plants. At present, apart from the weather conditions, European gas demand is driven by the problems of economic growth, the (relatively) high gas prices, the strong growth of renewables and the extremely low CO_2 prices.[9] "Because of coal's replacement by gas in the US, more coal is being exported to the EU, because of weak [carbon reduction] targets and because the gas prices are very high here."[10] At its lowest level in 2012, gas in the US traded at around one-fifth of import prices in Europe and one-eighth of those in Japan.[11]

Gas exports outside the former Soviet Union[12] by Gazprom Export, a 100 per cent owned subsidiary of Gazprom, fell sharply in 2009 (from 158.8 bcm[13] in 2008 to 140.6 bcm in 2009), in which the lower gas demand, high contract prices and gas interruption during the Russo–Ukrainian gas crisis in January 2009 also played a role. 2010 brought a slight further decline before soaring in 2011 (from 138.6 bcm in 2010 to 150.0 bcm in 2011), still far below the 2008 level. High oil product-linked contract prices of Gazprom have clearly been curbing gas demand.

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[6] Answer given by Jonathan Stern to the Fondazione Eni Enrico Mattei about the main challenge facing the gas industry over the next years (http://www.youtube.com/watch?v=VJMWBr-R9Cg).

[7] Stern–Rogers (2011).

[8] *Dow Jones Newswires,* 1 October 2012.

[9] IEA (2012a, 2012d).

[10] Stephan Singer of WWF for *Natural Gas Europe* (28 November 2012 http://www.naturalgaseurope.com/shale-gas-environmentalist-perspective).

[11] IEA (2012e): 2.

[12] This gas belongs to Gazprom's gas balance (or produced/owned by Gazprom) and is sold under long-term gas supply contracts. In this paper, we do not analyse the causes of differences between data taken from the Russian customs statistics and various Gazprom sources.

[13] The abbreviations used for units of measurement in this study are: bcm – billion cubic metres; bcma – billion cubic metres per annum; mcm – thousand cubic metres.

Table 1
Prices for Russian gas in Europe
($/mcm)*

	2011[a, 1)]	2010[a, 1)]	2010[b]	2009[b]
Macedonia	462	381		
Bosnia and Herzegovina	429	339		
Poland	420	331	336	333
Czech Republic	419	326	~320[2)]	n.d.
Greece	414	359	357	n.d.
Italy	410	331	331	321
Switzerland	400	296		
France	399	306	306	297
Baltic States[3)]	397	333		
Bulgaria	391	311	310	n.d.
Austria	387	305	304	259
Hungary	383	350	348	306
Turkey	381	326	328	290
Romania	380	325	304	294
Germany	379	270	271	294
Slovenia	377	312		
Netherlands	366	308	302	312
Finland	358	273	271	250
Slovakia	333	371	~370[2)]	n.d.
Great Britain	331[4)]	240[4)]	191	260

* No data was given for Serbia. [1)] Average prices, including European operations, i.e. there is no available price data for gas that comes exclusively from the territory of Russia. [2)] Preliminary data. [3)] An average for the three states (Estonia, Latvia and Lithuania). [4)] There is no accurate price data for Great Britain, thus average spot prices at the British National Balancing Point (NBP) are given.

Source: [a] *Vedomosti*, 18 June 2012. [b] INEI RAN (2011): 15–16.

In 2009, almost all customers of Gazprom Export outside the former Soviet Union bought less gas than in 2008. In 2009, Poland was the only one, which, after the removal of the controversial Russo–Ukrainian intermediary company Rosukrenergo, increased its imports, and significantly so, while Switzerland took roughly the same amount as in 2008. In 2010, Poland became the fourth largest customer of Gazprom Export outside the former Soviet Union, ahead of France, and it still retains that position.[14]

In 2011, 25.3 per cent of gas exports by Gazprom Export outside the former Soviet Union went to ten Central and East European states. This volume (accounting for 38 bcm of gas) is more than 10 per cent below the 2008 level, but if Croatia is not counted in this, then it is almost 8 per cent below the 2008 volume. Besides Poland, the Czech Republic, Hungary and Slovakia are among the large customers in the region. In 2011, apart from Poland and Macedonia, all countries bought less gas from Gazprom than in 2008.

Gazprom wants prices that are independent of market conditions. But if it continues, Gazprom will have more and more problems with gas exports.[15] Since 2010, Gazprom has granted various concessions regarding the long-term gas supply contracts, but the best is yet to come. In 2011, 58 per cent of the gas sold in Europe was under an oil-linked formula, but due to renegotiations and arbitration cases, this ra-

[14] As to Gazprom Group's total sales in Europe, Poland and France had already changed places in 2009, but in 2009 and 2011, gas sales to the UK exceeded those achieved in Poland.

[15] *Bloomberg,* 14 March 2012. http://www.bloomberg.com/news/2012-03-14/gazprom-trips-in-india-as-shale-upends-asia-gas-markets-energy.html.

tio has been falling.[16] According to late 2011 and early 2012 information, Gazprom supplies only 7 per cent of its total gas exports to Europe at spot rates.[17] Gazprom responded too late to the market processes, and has lost its market share in Europe. In 2011, the EU's main external source of supply was Russia, representing 24 per cent of the EU's gas consumption. Other major sources were Norway (19 per cent), Algeria (9 per cent) and Qatar (7 per cent).[18]

In the CEE region, price disputes of RWE Transgas, the Czech subsidiary of Germany's RWE and the Lithuanian Energy Ministry with the Gazprom Group are to be resolved via arbitration. PGNiG of Poland has recently secured a deal with Gazprom, closing the arbitration proceedings. In October 2012, RWE Transgas won an arbitration procedure for the fulfilment of the take or pay clauses, but Gazprom Export will certainly appeal.

In early September 2012, one year after the end-September 2011 inspections at the premises of companies active in the supply, transmission and storage of gas in several EU Member States (mainly in Central and Eastern Europe), the European Commission launched an anti-trust probe against Gazprom. The Commission is investigating three suspected anti-competitive practices in Central and Eastern Europe, involving Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, Hungary and Bulgaria.[19] First, Gazprom may have divided gas markets by hindering the free flow of gas across Member States. Second, Gazprom may have prevented the diversification of gas supply. Finally and third, Gazprom may have imposed unfair prices on its customers by linking the price of gas to oil [product] prices.

3) Gas demand and production in Central and Eastern Europe

The Central and East European countries[20] can be divided into three distinct groups based on the role of gas in primary energy consumption. In 2011, Hungary and Lithuania were the countries where gas had the biggest part in primary energy con-

[16] *Natural Gas Europe,* 13 September 2012. http://www.naturalgaseurope.com/shale-gas-needed-for-fully-functioning-eu-gas-market.

[17] This data is derived from Gazprom's 2011 November Base Prospectus and reiterated by Alexander Medvedev (of Gazprom) in Gazprom's Investor Day in London on 14 February 2012. However, we understand that this figure has increased since that time (Gazprom Investor Day, Questions and answers, London, 14 February 2012 http://www.gazprom.com/f/posts/67/590264/2012-02-14-investor-day-london-en.pdf).

[18] *Eurogas – Press Release,* 29 March 2012. http://www.eurogas.org/uploaded/Eurogas%20press%20release%20on%20More%20customers,%20consuming%20less%20gas,%20in%202011.pdf.

[19] *European Commission – Press Release* (IP/12/937, 4 September 2012); *Bloomberg* (4 September 2012, http://www.bloomberg.com/news/2012-09-04/gazprom-faces-eu-antitrust-probe-on-eastern-european-gas-sales.html).

[20] Without Montenegro and Albania, but with Croatia.

sumption, but the ratio was also high in Latvia, Romania, Croatia and Slovakia. In all six cases, representing the first group of countries, ratios were higher than the OECD average, and even the OECD Europe average. However, it was below the average in countries of the second group, comprising the Czech Republic, Bulgaria, Poland, Slovenia, Serbia and Estonia. Finally, in countries such as Macedonia and Bosnia-Herzegovina gas played an extremely low role in the energy balance.

Table 2
Gas balances of the Central and East European countries in 2011*
(bcm)

	Estonia	Latvia	Lithua-nia	Poland	Czech R.	Slovakia	Hungary	Romania
Production	-	-	-	6.2[(a)]	0.2	0.1	2.8	11.0
Gas demand	0.6	1.6	3.4	17.2	8.9	5.6	11.6	14.4
Total imports	0.6	1.7	3.5	11.8	9.3	5.9	8.0	3.1
of which LNG	-	-	-	-	-	-	-	-
Total exports	-	-	-	0.0	0.2	0.0	0.6	-
Total storage capacity	-	2.3	-	1.7	2.5	2.7	4.2	3.1
Share of gas in TPES[(a)] (%)	10.1	33.1	36.0	12.6	17.2	28.1	38.2	30.8
Self-sufficiency (%)	-	-	-	36.0	2.2	1.8	24.1	76.4

	Bulgaria	Slovenia	Croatia	Bosnia-H.	Serbia	Macedonia
Production	0.5	0.0	2.3	-	0.4	-
Gas demand	3.3	0.9	3.2	0.2	2.4	0.1
Total imports	2.8	0.9	0.9	0.2	2.0	0.1
of which LNG	-	-	-	-	-	-
Total exports	-	-	0.2	-	-	-
Total storage capacity	0.3	-	0.6	-	0.5	-
Share of gas in TPES[(b)] (%)	12.9	12.0	30.8	3.1	11.9	3.3
Self-sufficiency (%)	15.2	0.0	71.9	-	16.7	-

* Estimates. [(a)] Compare it with other data sources! For example, according to national sources, domestic gas production was 4.3 bcm in 2011, similar to that of BP. [(b)] Total Primary Energy Supply.

- Nil. 0.0 Negligible.

Source: The table is based on the numbers of the IEA's 'Gas Trade Flow in Europe'. We assume that the IEA uses '0' where the amount is negligible or nil. We corrected these numbers with data from IEA (2012a, 2012b, 2012c) and Gazprom. However, in some cases, data for correction were only available for 2010.

In the CEE region, Poland, Romania and Hungary are the largest gas consumers, with a combined share of nearly 60 per cent in 2011.[21] In 2009, in all countries under review except for Albania (where it did not change), gas consumption decreased, quite dramatically in certain cases (in the order of 30 to 40 per cent). How-

[21] The data was taken from the IEA.

ever, in most countries, gas demand reached its peak years before 2008.[22] A key question is to evaluate the extent of additional gas demand in the CEE region, but the forecasts are contradictory. The current fickle economic conditions and uncertainties around energy policies are no help in planning, making predictions or decisions.

Table 3
Gas demand scenarios for the Central and East European region
(per cent)

	OIES by Honoré (2010)	IHS CERA[1)] cited by Roberts (2012)	TYNDP (2011)[2)]	Kantor – Booz & Co. (2012)[3)]		
	2020/2008	2020/2008	2020/2008	2020/2010		
				Min	Base	Max
Estonia	0.0		+8.4			
Latvia	-2.5		-20.3			
Lithuania	-26.3		-15.0			
Poland	+26.7		+15.3	+22.7	+45.3	+51.8
Czech R.	+2.9		+54.3	+23.0	+38.2	+60.0
Slovakia	+6.7		+15.5	+16.5	+24.4	+33.5
Hungary	-1.4	-8.3	+23.4	+5.3	+26.0	+55.6
Romania	+12.9	+16.2	-20.0	+17.2	+25.2	+37.9
Bulgaria	-7.4	+21.9	-13.0	+41.5	+77.5	+110.9
Croatia	-14.3	+58.6	+33.5	+34.5	+86.9	+105.2
Slovenia	-34.0	+30.0	+68.2	+14.3	+35.2	+42.4
Serbia & M.	+2.0	+39.1	+75.5[(b)]			
Bosnia-H.	-32.5	+100.0				
Macedonia	+10.0	+8x	+7x			
Albania	0.0	-[(a)]				

[1)] The information came from a private study conducted by IHS CERA. John Roberts of Platts told this author that he thought the information dated back to 2010. [2)] Final customers. [3)] The data for 2010 is also an estimate. [(a)] 2008: 0.0 bcm; 2020: 0.2 bcm. [(b)] Without Montenegro and UNMIK.

In Central and Eastern Europe, only Romania has substantial gas production, but gas production in Poland, Croatia and Hungary also needs to be mentioned. Romania and Croatia have been largely self-sufficient in their natural gas supplies, with 76.4 per cent and 71.9 per cent of gas consumed in 2011, respectively.[23]

It is hoped that unconventional gas would bring competition to the Russian-dominated markets and lower gas prices. But one cannot predict the future of unconventional gas in Central and Eastern Europe. However, Black Sea gas is that Romania and, as a follower, Bulgaria are focusing on in 2012. And it looks like the Polish shale gas euphoria is disappearing, thus opening up to the realties. In order to avoid letting shale gas be the victim of PR failures, there are very strict rules that should be adhered to from the very beginning. Without following these principles, in some countries they will not even reach the point of determining whether or not they contain economically recoverable resources. In January 2012, after seeing lots of protests throughout the country, the technology of hydraulic fracturing for shale

[22] IEA (2008, 2011a, 2012a).

[23] According to IEA definitions.

gas exploration and extraction was banned and Chevron's exploration permit was revoked in Bulgaria. In Romania, the coming of the new government meant the end of Romania's pro-shale gas position. A moratorium is effectively in place, in spite of the fact that so far, no relevant legislation has been adopted to implement such measures.[24] In the Czech Republic, a moratorium on shale gas exploration is expected to be put in place until (at least) mid-2014 as well.

4) Transit through the western CIS states and Central and Eastern Europe

The bulk of Russian gas exports to consumers outside the former Soviet Union transits through three western CIS states, namely through Ukraine, Belarus and Moldova. Finland is interconnected with Russia. A large part of Turkish exports is delivered via the Blue Stream pipeline in the Black Sea, and gas deliveries via the Nord Stream pipeline in the Baltic Sea started in 2011. The gas pipelines going through Ukraine heading towards Europe follow the route of Poland, Slovakia, Hungary, Romania and Moldova. Gas travelling through Moldova flows to Romania and onwards. Belarus provides transit services in the direction of Lithuania, Poland and Ukraine. In 2011, 101 bcm of gas was transited to Europe through Ukraine, while 44 bcm through Belarus and nearly 20 bcm through Moldova. There is no free transit through Russia. Among the three western CIS transit states, Gazprom owns the Belarusian section of the Yamal-Europe pipeline, carrying Russian gas to Poland and Germany (and onwards), and the trunk gas pipeline network of Belarus' Beltransgaz. In Moldova, Gazprom holds half of shares in Moldovagaz, including transmission pipelines. In Ukraine, Gazprom has no such position.

In the CEE region, the three main transit routes lead through Slovakia, Poland and Romania. Gas transit through Slovakia reached a peak of nearly 85 bcm in 1999.[25] The Yamal-Europe gas pipeline, commissioned in 1999, reduced the significance of Slovakia, while Poland became an important transit country to Germany.

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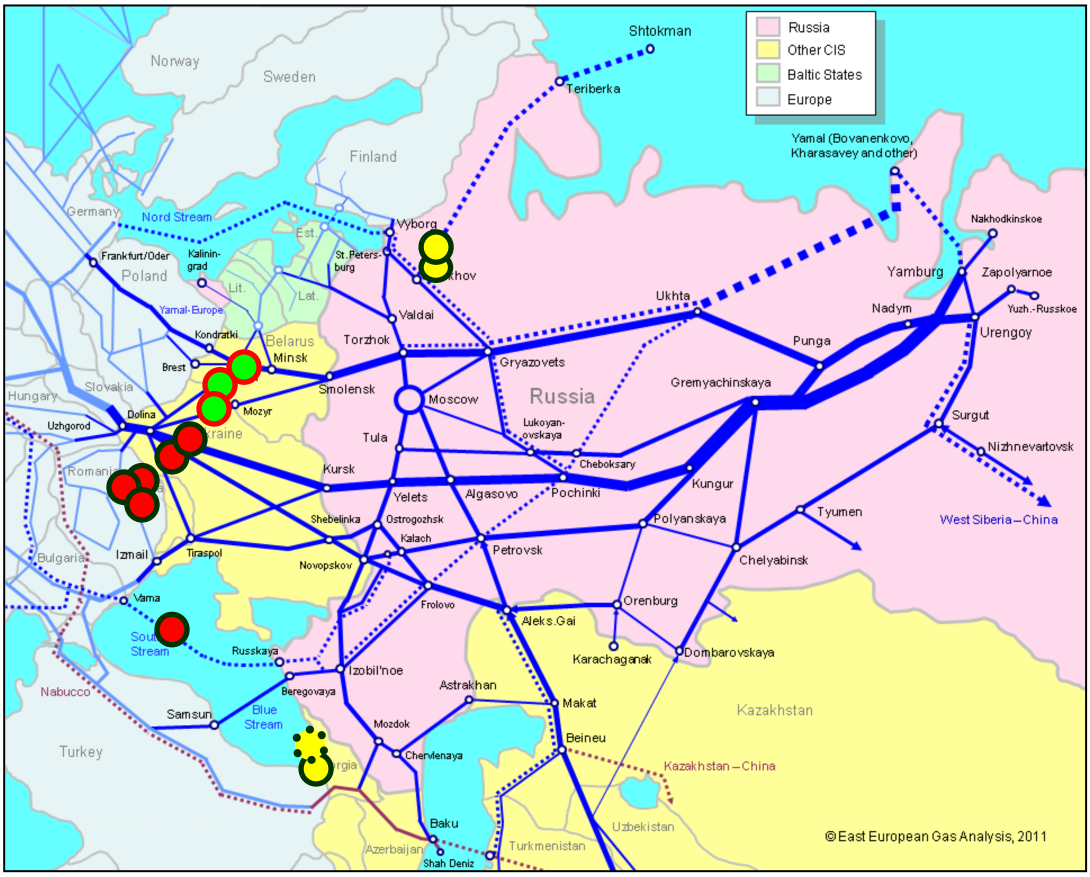
[24] *Transindex* (21 June 2012, http://itthon.transindex.ro/?hir=29748); *Natural Gas Europe* (16 August 2012, http://www.naturalgaseurope.com/shale-gas-exploitation-in-romania-postponed); Dąborowski–Groszkowski (2012).

[25] IEA (2005): 140.

Figure 1
Cross-border entry/exit points of Russian gas to Europe
at the borders of the former Soviet Union



Source: Based on a 2011 map of East European Gas Analysis.

Ukraine's neighbours will or can find themselves in a new role of providing transmission services to Ukraine. In November 2012, for the first time, gas deliveries to Ukraine were managed from the west by reverse flow. RWE started to supply physical gas flows to Ukraine from/through Poland, while Ukraine reduced its purchases from Russia below the take or pay minimum. The Ukrainians also approached Hungary to find out whether physical gas supply to Ukraine is possible. By now, there are both technical and legal possibilities to pump gas to Ukraine from Hungary.[26] Naturally, the Ukrainian partner should buy gas somewhere. At the same time, Slovakia's transmission system operator (TSO) Eustream was considering the construction of a new bi-directional interconnection between the gas transmission systems of Slovakia and Ukraine, but, as it was announced in October 2012, the Open Season had not identified sufficient binding market interest in new transmission capacity.[27]

[26] According to information provided this author by János Zsuga, CEO of Hungary's TSO.

[27] *Eustream – News,* 19 June 2012, 15 October 2012.

4.1. Bypass pipelines and their effects on transit

The first line of the Nord Stream gas pipeline, with a capacity of 27.5 bcma, had become operational in November 2011, followed by the opening of the second line in October 2012. If it is up to Russia to decide, this will not be the last line in the Baltic Sea. The Nord Stream shareholders considered a preliminary feasibility study for the third and fourth lines, and their construction was recognised as economically expedient and technically possible. One of the lines may go to Great Britain.[28] The capacity utilisation rate of the Nord Stream pipeline is expected to attain high levels, but since November 2011, the first line has only moderately been loaded.

The South Stream pipeline through the Black Sea will provide a transport capacity of 63 bcma consisting of four strings; each of them is to have a capacity of 15.75 bcma. The earlier plans envisaged two branches, a northern one and a southern one, starting from Bulgaria, however, the southern branch (Greece and southern Italy) has been removed from the agenda. Gas will go through Bulgaria, Serbia, Hungary and Slovenia to north-east Italy, and legs are planned to be built to the Bosnian Serb Republic and Croatia from Serbia. In the end, Austria will not be connected to the South Stream pipeline (at least in the next five years),[29] but Macedonia and (perhaps) Montenegro could join the project. In compliance with Putin's end-December 2011 "recommendation," the construction of South Stream would be officially (!) launched at the end of 2012. South Stream has a very high price tag, and both Nord Stream and South Stream spur a huge wave of pipeline construction in Russia as well.

Nord Stream and South Stream create large additional capacity. Gas transit through Belarus and Poland are not at stake. In fact, Gazprom would increase the transit through Belarus at the expense of Ukraine. However, the Slovakian transit route has already been negatively affected. Transit through the Czech Republic will be doubly affected by the Nord Stream pipeline. This is because when completed, the Gazelle pipeline will increase transit through the Czech Republic. Gazelle is the continuation of Germany's OPAL gas pipeline through the Czech Republic. OPAL is connected to the Nord Stream pipeline.

A range of criticisms have been made of the intergovernmental agreements on South Stream signed by various countries in early 2008, partly because the agreements state that the Russian party has the right to use all the capacity in the pipeline. But such mistakes can and must be avoided by at least using the information exchange mechanism on intergovernmental agreements between Member States and third countries (see the Decision No 994/2012/EU of the European Parliament and of the Council of 25 October 2012).[30]

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[28] *RIA Novosti,* 8 October 2012.

[29] *Népszabadság,* 11 November 2012. http://nol.hu/archivum/20121110-gaz_van__penz_lesz.

[30] For antecedents, see the EU Regulation No 994/2010 of 20 October 2010, concerning measures to safeguard the security of gas supply and the Conclusions of the European Council of 4 February 2011.

Gazprom is strongly opposed to the EU's Third Energy Package, not just because of the capacity utilisation, but also because of the so-called unbundling. Unbundling is a serious source of conflict with Russia on existing assets with Russian ownership as well. In Poland, the owner of the Polish section of the Yamal-Europe gas pipeline (EuRoPol GAZ) handed over operation and the Polish state-owned company Gaz-System became the independent system operator (ISO) in 2010. Gazprom has stakes in all three "national" gas companies (in Estonia's Eesti Gaas, Latvia's Latvijas Gāze and Lithuania's Lietuvos Dujos) of the three Baltic Sates, respectively, so, unbundling concerns these assets. In Lithuania, the Government set an October 2014 deadline for the unbundling. The dispute between Lithuania and Russia is very intense. In Estonia, the national company must sell its natural gas transportation network before the end of 2014, and the Government is required to approve the sale. Latvia also announced its intention to unbundle gas monopoly. The deadline is no later than 2017.

5) CEE countries on the way to diversification

The gas crisis in early 2009 and also the year 2010 showed how different conditions of each CEE state have. The two extremes were represented by Croatia and Poland. The most significant results were achieved by Croatia in reducing dependence on Russian gas. The CEE region has not yet seen anything like it. However, it is obvious that Croatia's participation in the South Stream project (*i.e.* the decision to construct a leg from South Stream to Croatia) means that Croatia will buy gas from Russia in the future again. Despite various projects, Gazprom Export has an increased part in gas supplies in Poland thanks to the elimination of Rosukrenergo. Such intermediary companies offered a certain degree of diversification in Hungary and elsewhere for some time. Excluding Croatia, Slovenia is the least dependent on Russian gas supplies and it has the most diversified portfolio of gas importing contracts. The position of the Czech Republic and Hungary is worse than that of Slovenia, but long-term contracts with western countries and spot markets for cheaper natural gas bring a certain degree of diversification to their portfolio. The January 2009 gas crisis was needed to force Slovakia to start diversification and consider the security of supply measures, to have at least contracts with western suppliers and import capacity other than from Russia. With the exception of very small amounts of gas imports, Serbia purchases most of its natural gas from Russia. The rest comes from Hungary. Romania is also able to buy gas from and through Hungary using the Hungarian–Romanian interconnector completed in 2009. Bosnia-Herzegovina, Bulgaria, Macedonia and the Baltic States are solely dependent on Russia for their gas supplies. However, physical reverse flow is possible for Bulgaria, as in the case of Slovakia.

5.1. Diversification through interconnections and LNG regasification projects

The European Council of 4 February 2011 concluded that no EU Member State should remain isolated from the European gas networks after 2015 or see its energy security jeopardised by the lack of the appropriate connections. The European Commission's November 2010 communication on energy infrastructure priorities identified the following as priority projects in the CEE region: the North-South Corridor in "Central Eastern and South-East Europe", the Southern Corridor and the Baltic Energy Market Interconnection Plan in gas (BEMIP Gas). According to the EU Regulation No 994/2010 of 20 October 2010, concerning measures to safeguard the security of gas supply, the transmission system operators shall enable permanent bi-directional capacity on all cross-border interconnections between Member States at the latest by December 2013, with some exceptions. This regulation also includes the binding infrastructure standard 'N-1'.

In contrast to the large projects, the importance of interconnections is (also) emphasised. Building gas interconnections has been a long-standing unresolved issue in Central and Eastern Europe, but recently some progress has been made. Hungary has taken significant steps in this area. However, the European Commission argues in its most recent Staff Working Document on investment projects in energy infrastructure (dated 15 November 2012) that Hungary "needs to increase its cross-border capacity" because "its current capacity is insufficient to ensure the integration of national markets on a regional level".[31] The case of the Slovak–Hungarian interconnector showed clearly what options are available when considering a project that cannot be made on market terms. Looking at the region south of Hungary, very little has been done apart from the interconnections with Hungary. The European Commission, among others, points out that Bulgaria "needs to play a more proactive part in opening up the Southern Gas Corridor."[32]

Among the LNG regasification projects in the region, the Polish and Lithuanian projects are to be realised by 2014. The others are only in planning stages. In Croatia, the Adria LNG project of an international consortium has stalled. Thus, the Croatian state-owned pipeline operator Plinacro is examining an alternative project, the so-called 'migration concept.' In Romania, the project of the Azerbaijan–Georgia–Romania–Hungary interconnector would develop an LNG regasification plant. Bulgaria is focused on compressed natural gas (CNG), and not LNG. The increasingly protracted issue of a regional LNG terminal in the Baltic States has also shown how difficult it is to get any regional cooperation.[33] In Lithuania, the LNG project is helped by the gas quota through the LNG terminal. However, in Poland, the maximum share of gas imported from one country has already been set since 2000.

[31] European Commission (2012b).

[32] Ibid.

[33] We do not believe in these Black Sea plans.

5.2. Diversification through the Southern Corridor

The Southern Corridor[34] initiative includes routes going through and from Turkey and other routes that could pass the Black Sea (both pipelines as well as CNG and LNG options) and the Eastern Mediterranean to the EU. The Trans-Caspian Pipeline would also be a major project in the Southern Corridor to bring new sources of gas to Europe. South Stream is not part of the Southern Corridor initiative.

Apart from the delays, the common characteristic of the projects is that all Southern Corridor projects, except for the Trans-Caspian Pipeline and projects through the Eastern Mediterranean, bid for Azeri gas, namely gas from the second stage of the Shah Deniz field development (Shah Deniz 2).

Since the autumn of 2011, important changes have occurred in the Southern Corridor, but the outcome is still far away. The first crucial change was when in September 2011 BP came up with the concept of the so-called South East Europe Pipeline (SEEP), which would have started in western Turkey and would have run across Bulgaria and Romania to Hungary's eastern frontier, representing about a third of Nabucco's length. The second crucial change was when, in November 2011, Azerbaijan and Turkey started work on the Trans-Anatolian Gas Pipeline (TANAP) project from Turkey's eastern border to its western border.[35]

The Shah Deniz consortium conducts a three-round selection process among pipelines from the western border of Turkey. In the first round of the race, in February 2012, it chose the Trans Adriatic Pipeline (TAP) over ITGI[36] as a possible route, should it decide on the south of Italy as the destination. In the second round of the race, in June 2012, the Nabucco West project, an already scaled-down version of Nabucco 'classic,' was selected, rejecting the South East Europe Pipeline as pipeline option to Central and South East Europe. The Shah Deniz consortium is expected to make a final decision between Nabucco West and the Trans Adriatic Pipeline by mid-2013. Before the submission of the proposal for Nabucco West to the Shah Deniz consortium, the Hungarian Prime Minister indicated on 23 April 2012 that Hungary's Mol, or precisely FGSZ, owned by Mol, was leaving the project. By this time, several negative messages had been received from not only Mol, but from the Hungarian government, RWE, Bulgaria, the EU or the US. RWE is also considering leaving the project.

The South East Europe Pipeline and Nabucco West mean an adaptation to the reality. Main problems with the ten-year old Nabucco 'classic' have not been solved, and even though progress has been made on some issues, new problems have arisen. The State Oil Company of the Azerbaijani Republic, or SOCAR, holding a controlling stake in the Trans-Anatolian Gas Pipeline, can be a guarantee for the

[34] The Southern Corridor would be – after the Northern Corridor from Norway, the Eastern Corridor from Russia, the Mediterranean Corridor from Africa and besides LNG – the fourth big axis. It aims at the transmission of gas from the Caspian Basin, Central Asia, the Middle East and the Eastern Mediterranean Basin to the EU (European Commission, 2010, 2012a).

[35] The South Caucasus (Baku–Tbilisi–Erzurum) Pipeline needs to be expanded.

[36] ITGI (Interconnector Turkey–Greece–Italy) comprises the already operating ITG (Interconnector Turkey–Greece) and the IGI (Interconnector Greece–Italy) project, the latter including IGI Onshore and IGI Poseidon.

Turkish project. Certain other members of the Shah Deniz consortium (BP, Statoil and Total) will also be shareholders of the pipeline. Certain Shah Deniz shareholders will get shares in the pipeline that is to be selected to deliver gas from the western border of Turkey as well.

According to Jonathan Stern, the decision to court Caspian gas was first and foremost a political one.[37] But buying gas is rather a market-driven decision. European utilities expect supplies from the Caspian to be priced to reflect conditions across the continent's freely traded gas hub markets. It must be noted that diversification alone does not inevitably lead to supply security. And Azerbaijan has not yet demonstrated that it is a reliable supplier.[38] Moreover, the Trans-Caspian Gas Pipeline, if ever built, would make Azerbaijan an important gas transit state as well.[39]

6) Conclusions

Since 2008, Gazprom's market position has changed totally, while Gazprom is locked into the European market. In such a difficult situation, it has launched gas production in the Yamal Peninsula and is about to start building the South Stream gas pipeline. Additionally, in this situation, Gazprom faces an EU anti-trust probe, of which the most important issue is how gas is priced. In order to avoid more arbitration, Gazprom recognised the need to narrow the gap between oil product-linked contract prices and hub-based market prices. The series of concessions means that Gazprom is aware that the status quo cannot be maintained, but has not yet accepted the need to shift to hub-based pricing.[40]

Central and East European countries can take very limited advantage of the benefits of changed conditions and globalising gas markets. This is partly due to the lack of necessary import capacity, and partly due to the long-term contracts. However, some countries have really benefited from the ongoing developments.

Forecasts for gas demand in the Central and East European region are vague and different. Internal gas production has been steadily declining, so in countries where domestic gas plays a significant role in gas consumption, the degree of self-sufficiency has also been eroding. The future role of unconventional and Black Sea gas in gas balances of particular countries remains a conundrum, but we do not see any revolution in the making. In such circumstances, Central and East European countries should put a much greater emphasis on energy efficiency.

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[37] Rausch (2012).

[38] Ibid.

[39] On 12 September 2011, the European Commission was given a mandate to negotiate a legally binding treaty between the EU, Azerbaijan and Turkmenistan to build a Trans-Caspian Pipeline System.

[40] These are Jonathan Stern's findings about pricing principles of Gazprom. *Bloomberg* (17 January 2012, http://www.bloomberg.com/news/2012-01-17/gazprom-price-retreat-offers-eon-hope-as-euro-crisis-cuts-demand.html); *Financial Times* (16 February 2012, http://www.ft.com/intl/cms/s/0/2e57f4c4-58ad-11e1-9f28-00144feabdc0.html#axzz1oivhTm7f).

Nord Stream and South Stream can increase the security of supply. In the CEE region, South Stream dramatically rearranges the existing transportation and transit directions, thus some former investments may turn out to be unnecessary. It is important to emphasise that the Third Energy Package cannot be avoided by tactics when it comes to implementing pipeline projects with either Russian or non-Russian participation. For example, it refers to both South Stream and the Hungarian–Slovakian interconnector.

Demonstration of the possibility of diversification plays an important role in diversification steps, if only showing Russia that there are other options. Different countries have taken different steps to ensure the security of supply and diversification since the early nineties and, in particular, the January 2009 crisis, but the best is yet to come. LNG and pipeline projects are moving forward very slowly and being delayed for long. Acting on a commercial basis, these can be accepted but greatly erode the credibility of those governments' and companies' commitments.

To obtain the Azeri gas is a key. By the end of the decade, Shah Deniz 2 gas could reach Europe. Nevertheless, in the future one must remember that Turkey is not an easy case to negotiate.

We are convinced that Russia remains the single largest gas supplier to Europe. The vision or the goal of energy independence, which has been communicated in certain CEE countries, is far off the reality, regardless of what is to be understood by such statements.

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