The failures of European crisis management  
and its micro and meso level reasons

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Abstract

The current European crisis started as the infiltration of the global financial crisis. The real economy was hit badly by the sudden contraction of the financial sector. The European Commission’s recovery plan of 2008, followed by most member states at that time, built on the quick restoration of demand and trust, mostly based on increased public expenditure. However, instead of reaching these objectives, the chapter of public finances crisis opened up for many parts of Europe in 2010-2011. The growth objectives could not be reached either. Instead, political and social crises unfolded, mostly in the periphery of the Eurozone. Lately, growth and employment have again come to the forefront of European policies, and austerity measures are highly denied by more and more political forces and societies. But, despite such policy shifts, the problems are still not solved.

The question arises why practically all European crisis management measures of the past years have failed. We believe that the overall failure is to be explained by micro and meso level reasons: the problems usually come when the originally ‘nice’ ideas come to implementation. In order to understand these problems, we have to examine the efficiency outlooks of top-down policies in general, and the fate of economic and social policies which do not build strongly on the values determining the behaviour of the targeted actors. From this viewpoint, therefore, it is extremely important that these values are identified in their broad variety across Europe, and that any economic policy leadership, be it national or European, relies on these deeply-rooted values. Also, any policy aiming at inducing changes, should target the influencing of these values, convictions, and broadly shared views in the first place. If following this logic, we eventually arrive to the European social market model, highly desirable by European societies but definitely not sustainable in its current form.

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Introduction

At the time of drafting this paper, a bit more than five years have passed since the Lehman Brothers’ default, considered as the moment of the outburst of the global financial and economic crisis, in certain ways the greatest in history so far. Its infiltration into the EU, quickly following the US’ subprime mortgage market collapse, occurred mainly due to the intensive interconnectedness of the world economy and that of the economies of the US and the EU in particular. In 2008, the US was the far largest trading partner of the EU in terms of exports (Figure 1), and second largest in terms of imports² (Figure 2).

*Figure 1: Extra EU-27 exports, by main partners, 2008, %*


² China was at that time the biggest importer to the EU and Russia was third with a just slightly smaller volume (178,294 million EUR) than that of the US (182,351 million EUR). The ratios in the EU’s export and import structures by trading partners have not changed considerably, notwithstanding the crisis, affecting the main trading partners in different ways and to different extents.
The EU and its member states were not well prepared to face the events. Also, in the years preceding 2008, in a relatively favourable international economic climate, member states were following highly divergent macroeconomic policies, both in terms of performance and commitment to commonly defined European objectives, laid down most explicitly in the Lisbon Strategy (EC 2000) and at the time of its restart (EC 2005). The member states, partly but not exclusively for reasons lying in their institutional settings developed on a historical scale (Jackson – Deeg 2012), were at that time already performing rather large diversities in their public finance situations (Figures 3 and 4). Nevertheless, it is worth re-reading pre-crisis economic analyses in order to understand to what extent this was not sensed as a problem back then. The ECB, in its 2007 annual report, wrote, for example: “Fiscal developments in 2007 continued to be relatively favourable, mainly owing to strong economic activity, further revenue windfalls, some consolidation efforts and the unwinding of temporary factors that had pushed up the 2006 deficit in Italy. According to the euro area countries’ updated stability programmes, the average general government deficit in the euro area declined from 1.5% of GDP in 2006 to 0.8% in 2007. (...) [T]he average government debt ratio in the euro area declined by close to 2 percentage points to a level of 66.7% of

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3 It is out of the scope of this paper to show the public finance history of the member states since the introduction of the euro.
GDP, the lowest debt level as a percentage of GDP since the start of Stage Three of EMU in 1999” (ECB 2008, pp. 70-71).

**Figure 3: General government deficit/surplus of EU member states, 2008, % of GDP**

![Chart showing general government deficit/surplus of EU member states, 2008, % of GDP](http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/data/main_tables)

**Figure 4: General government gross debt of EU member states, 2008, % of GDP**

![Chart showing general government gross debt of EU member states, 2008, % of GDP](http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/data/main_tables)

Average good performance gave way to modest optimism and the divergences between the member states were not paid much attention to. Anyhow, retrospectively, we now
know very well that the (EU-27) average performance has also suffered severe deterioration during the crisis (Figures 5 and 6)\(^4\), not mentioning the extent of deterioration in some extreme cases of member states (e.g. Greece).

**Figure 5: Average general government deficit of EU-27, 2001-2012, % of GDP**

![Graph showing average general government deficit of EU-27, 2001-2012, % of GDP](http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/data/main_tables)

The trend of EU average gross debt is more frightening than that of EU average deficit. This may give floor to concerns but, at the same time, also calls for a rethinking of EU and member state level policies and, even more so, highlights the need to harmonise them. Such an ‘intellectual reform’ is necessary even if the severeness of public finances deterioration can obviously be explained by the crisis. Why do we have to re-form our thinking? Because, in our view, part of our problems in Europe today can be deductible from misguidance in early crisis management and should not be explained solely by the crisis. We now take a closer look at what measures were taken by the EU and its member states in the different periods of crisis management. We follow a chronological order.

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\(^4\) And so has Eurozone average that we are not showing by figures.
The European Economic Recovery Plan of 2008

Following the appearance of the crisis in the EU, the European Commission was rather quick in presenting, as early as 26 November 2008, its own crisis management strategy, the European Economic Recovery Plan (EC 2008), with the dauntless slogan: “the time to act is now” (EC 2008, p. 3). The Commission did indeed put a quick, practical and operative plan on the member states’ table.

The Commission’s starting-point was that, in times of crisis, governments compete with one another. At the same time, the Commission believed, crisis was an opportunity for action. Accordingly, the two pillars of the Economic Recovery Plan were:

1. Purchasing power has to be increased.
2. Short-term actions have to serve the long-term strengthening of European competitiveness.

The document claimed that, in the fight against the crisis, the EU should to build on its own existing strengths. Among these, according to the Commission, the most important ones are:

- effective coordination;
- the credible economic policy coordination framework and the Lisbon Strategy;
• the euro providing stability;
• so-called ‘smart measures’ in favour of innovation and the protection of the environment.

Tremendous debates have been pursued concerning practically all the above aspects: whether they actually are the strengths of the EU and, if so, to what extent has the EU in fact built on these strengths. The most questionable part of the Economic Recovery Plan is that it gave way to a high wave of fiscal stimuli, starting already at the end of 2008. The spring forecast of May 2009 signalled softly that the budgetary stimulus proposed by the Economic Recovery Plan adds to the worsening of the fiscal positions caused by the sharp economic slowdown (EC 2009a). On the other hand, the forecast also communicated that, in 2010, stabilisation would follow as “support measures take effect” (EC 2009b).

In order to reach the objectives of the Economic Recovery Plan, all political tools (fiscal, structural, financial) and external action were to be implemented – a decisive statement of great consequence on behalf of the Commission. Nevertheless, this intention of the Commission was, at the time of publishing the Economic Recovery Plan, widely supported by experts and interested parties, according to a global survey (Forte – Pesce 2009). The Economic Recovery Plan also warned that fiscal expansion must not undermine the so far integration of the single market and EU-level competition as the major achievements of the whole economic integration process. The recovery plan also pointed out that budgetary incentives at the member states’ level should only be applied temporarily and, in the medium term, balance should be the objective. Nevertheless, in the course of 2009, as many as 18 member states have gotten under excessive deficit procedure and ‘the club’ was enlarged by 5 more member states in 2010. This was more than the number of procedures carried out all together since the 1999 introduction of the Pact.

The Economic Recovery Plan recited some basic economic theses and recommended member states to consider them. Of these, we find the following the most relevant in light of our topic:

• Government expenditure has a short-term effect on demand so, on the expenditure side, only short-term, temporary measures are justified.
• State guarantee is useful in cases where access to credits and loans is limited and where this serves as a balance to the lack of turnover capital.

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6 Ongoing and closed excessive deficit procedures are overviewed at: http://ec.europa.eu/economy_finance/economic_governance/sgp/corrective_arm/index_en.htm
• Well designed financial incentives may at the same time serve long-term objectives (e.g. energy efficiency).
• Incentives to promote demand may only bring long-lasting results if accompanied by structural reforms. The economy’s adjustment capacity is the key success factor of a rapid recovery.
• The purchasing power of consumers can only be increased in a sustainable manner if there is an improvement in the functioning of markets.
• Competitiveness problems have to be addressed immediately.

The period of internationally safeguarded national adjustment programmes in the EU periphery

The year 2010 opened up a new era in European crisis management. The 2010 spring forecast, published on 5 May 2010, was still rather optimistic, stating that “[t]he economic recession came to an end in the EU in the third quarter of last year, in large part thanks to the exceptional crisis measures put in place under the European Economic Recovery Plan” (EC 2010a, p. ix). The report only mentioned “subdued recovery amidst lower imbalances” in Spain, that “the recovery slowly gains strength” in Italy, and Ireland “adjusting for recovery”. It only spoke about “deep but inevitable adjustment” in relation to Greece. The 2010 autumn forecast was the first Commission document to admit that uncertainties across the EU and especially the Eurozone have remained high (EC 2010b). The 2011 spring forecast finally turned attention to “pronounced differences across countries”, and Europe-wide uncertainties elevating further (EC 2011a). Opinion-forming publications of this time period (e.g. Allen – Carletti – Simonelli (2011) and Allen – Carletti – Simonelli (2012)) boldly calculated with the split-up of the Eurozone with a real probability. However, others (e.g. IMF (2012)) urged further integration instead. The EU has so far escaped that scenario. How? By taking a stake in coordinating external assistance in the crisis management of the most problematic member states.

As regards assistance to certain member states of the EU, the first economic adjustment programme was launched for Greece (EC 2010c) in spring 2010, the second one (EC 2012) two years later. Under these programmes, the European Commission was not acting as a borrower but was entitled by the Eurozone member states with the coordination and administration of pooled bilateral loans, including their disbursement. In July 2011, a special task force was set up by the Commission, upon the request of the Greek government.
Disbursements under the two programmes for Greece have been numerous and large-scale (Tables 1 and 2).

Table 1: Overview of disbursements under the First Economic Adjustment Programme for Greece (EUR billion)

<table>
<thead>
<tr>
<th>Disbursement</th>
<th>Date</th>
<th>Euro area</th>
<th>IMF</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>May 2010</td>
<td>14.5</td>
<td>5.5</td>
<td>20.0</td>
</tr>
<tr>
<td>2</td>
<td>Sept 2010</td>
<td>6.5</td>
<td>2.6</td>
<td>9.1</td>
</tr>
<tr>
<td>3</td>
<td>Dec 10 / Jan 11</td>
<td>6.5</td>
<td>2.5</td>
<td>9.0</td>
</tr>
<tr>
<td>4</td>
<td>March 2011</td>
<td>10.9</td>
<td>4.1</td>
<td>15.0</td>
</tr>
<tr>
<td>5</td>
<td>July 2011</td>
<td>8.7</td>
<td>3.2</td>
<td>11.9</td>
</tr>
<tr>
<td>6</td>
<td>December 2011</td>
<td>5.8</td>
<td>2.2</td>
<td>8.0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>52.9</td>
<td>20.1</td>
<td>73.0</td>
</tr>
</tbody>
</table>

Source: http://ec.europa.eu/economy_finance/assistance_eu_ms/greek_loan_facility/index_en.htm

Table 2: Overview of disbursements under the First Economic Adjustment Programme for Greece (EUR billion)

<table>
<thead>
<tr>
<th>Disbursement</th>
<th>Date</th>
<th>EFSF</th>
<th>IMF</th>
<th>Total</th>
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</thead>
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<tr>
<td>1.1</td>
<td>March – June 2012 / 1</td>
<td>74</td>
<td>1.6</td>
<td>75.6</td>
</tr>
<tr>
<td>2.1</td>
<td>December 2012 / 2</td>
<td>34.3</td>
<td>-</td>
<td>34.3</td>
</tr>
<tr>
<td>2.2</td>
<td>January 2013 / 3</td>
<td>7.2</td>
<td>-</td>
<td>7.2</td>
</tr>
<tr>
<td>2.3</td>
<td>January 2013</td>
<td>2.0</td>
<td>3.24</td>
<td>5.24</td>
</tr>
<tr>
<td>2.4</td>
<td>February 2013</td>
<td>2.8</td>
<td>-</td>
<td>2.8</td>
</tr>
<tr>
<td>2.5</td>
<td>May 2013</td>
<td>2.8</td>
<td>-</td>
<td>2.8</td>
</tr>
<tr>
<td>3.1</td>
<td>May 2013 / 4</td>
<td>4.2</td>
<td>1.74</td>
<td>5.94</td>
</tr>
<tr>
<td>3.2</td>
<td>June 2013</td>
<td>3.3</td>
<td>-</td>
<td>3.3</td>
</tr>
<tr>
<td>4.1</td>
<td>July 2013 / 5</td>
<td>2.5</td>
<td>1.8</td>
<td>4.3</td>
</tr>
</tbody>
</table>

Source: http://ec.europa.eu/economy_finance/assistance_eu_ms/greek_loan_facility/index_en.htm

Financial support to Ireland was coordinated under the European Financial Stability Mechanism (EFSM). The Economic Adjustment Programme for Ireland was agreed on in December 2010 and was launched in January 2011 (EC 2011b). It aimed at strengthening the banking sector, contributing to the correction of fiscal deficit by 2015, and supporting growth-enhancing reforms. The programme amounted for 85 billion EUR loan disbursements all together. Complimentary disbursements have been realised by the European Financial Stability Facility (EFSF) and the International Monetary Fund (IMF).

Eurozone member states’ assistance to Spain through the EFSF has so far amounted to 100 billion EUR. Assistance has gradually been shifted to the European Stability Mechanism (ESM). Assistance is conditional on specific policy measures (MoU 2012). Outside Greece, Ireland and Spain, the following member states have received external financial assistance in
crisis management: Latvia, Hungary, Portugal, Romania and Cyprus.\footnote{http://ec.europa.eu/economy_finance/assistance_eu_ms/index_en.htm} Most of the programmes applied in these countries, all found on the (geographical but also economic) periphery of the EU, called for austerity measures to be applied by the national governments.

**The threats of internal imbalances**

The austerity measures implemented by many of the member states in order to redirect their public finances on a sustainable track were, obviously, politically undesired but, and this seems to be a greater problem in the medium term, most of them have not brought about full economic recovery and a return to previous growth-paths and sound public finance trends, even if inferring exceptionally high social costs. What are the major deficiencies of the so-called ‘adjustment programmes’ leading to such failures in effectiveness? In our view, the problems are manifold; we hereby highlight two types of discrepancies. Firstly, the ignorance of pre-crisis imbalances and inequalities (see for example Bertola (2007) or Papantoniou (2012)) in early crisis management generated problems that could have been avoided if handled with greater care in pre-crisis years. We could possibly live in a more equal EU in case policy had been wiser and more pro-active in this respect. Even so, imbalances and inequalities cannot be ignored forever. Secondly, the top-down pressure across policy levels (from European to member state) in implementing the austerity measures serving higher-level priorities (e.g. keeping the Eurozone together), and the lack of their harmonisation with bottom-up interests have also been reasons for the failures of austerity policies. If that is the case, future policies should aim at dissolving these conflicts between priorities and interests, and should create the harmony between the different governance levels.

Internal imbalances are shown rather apparently by the global competitiveness rank of countries set up by the World Economic Forum (WEF) each year. According to the 2013 Global Competitiveness Report (WEF 2013a), five EU member states have made it to be included in the top-ten most competitive economies in the world: Finland (rank 3) performs best of them, thanks to its well-functioning and highly transparent public institutions and its corporations most ethical in the world. Germany (rank 4) could qualify in this elite club with its strongly competitive small- and medium-sized sector, Sweden (rank 6) with its innovation-driven growth, the Netherlands (rank 8) with its sophisticated and innovative corporate sector, and the United Kingdom (rank 10) with its exceptionally flexible labour market. On the other end of the competitiveness scale of EU member states, we find Greece (rank 91), Slovakia (rank 78), Romania (rank 76), Croatia (rank 75) and Hungary (63), all of them struggling with
evident weaknesses in their competitiveness. Last year the WEF identified ‘four Europes’ (WEF 2012): an innovation-driven North pulling up the whole of the EU (Denmark, Finland, Sweden), a relatively well performing West (including Estonia as a new-comer), a Southern and Eastern Europe in the middle third of the world rank, and a Southeast Europe lagging behind (Greece, Romania, Bulgaria). This year’s report formed only three groups of European states in respect of their competitiveness: Northern, Southern, and Central Eastern Europe perform evident differences along the dimensions of institutions, higher education and training, and innovation.

As a consequence of these differences, the feasibility or even the justifiability of the EU’s growth strategy (currently the Europe 2020 strategy) for the 2010-2020 decade can be questioned. At this point the WEF also deals with the European competitive divide in a separate project (WEF 2013b). Political consistency is among the five key enablers identified by the WEF – we can only agree with that. Another intriguing aspect has been highlighted by European Commissioner Olli Rehn at an international forum this summer: in his view, member states of the EU tend to follow two models of competitiveness (Rehn 2013). Core member states had been characterised by structural competitiveness already before the crisis: they are able to produce high value added thanks to their high-quality education and strong innovation, thus being able to sustainably finance good quality public administration and public services. Not marginally, these countries were the first to overcome the crisis within the EU. According to Rehn, the other group of EU member states are countries of the periphery who, prior to the crisis, had excessive spendings. This is especially true for the Eurozone periphery. In these countries, there is now a strong incentive to realise (wage-)cost-competitiveness succeeding the often painful adjustments. This approach may help them in creating workplaces, which is a crucial economic policy objective in these countries at the moment, in light of employment statistics (Figure 7) and general conditions of their societies. Moreover, the core region may also benefit from the cost-competitiveness ambitions of the periphery as those products produced at competitive prices would be freely available across the internal market and capital could also flow freely to the serve the periphery’s capacity-building efforts. Eventually, this may also appear as a feasible way to go but this would be a declaration of the two-speed Europe.
As the WEF report points out, the EU accounts for 7 per cent of the world’s population who produce 19 per cent of the world’s GDP. If we add the data that 50 per cent of welfare expenditure is realised in the EU, it is obvious that the European social and economic model is facing huge challenges (Pelle 2013).

Rehn was surprisingly honest in another aspect when stating that the accumulated European regulation appears as a barrier to competitiveness for the whole of the EU (Rehn 2013). Therefore, better – and not more – regulation is crucial. However, improvement of regulation should be based on interested harmonised at the EU level. Are the member states ready to find the common denominator? This is the crucial question of further integration. Let us examine the chances for such advancements.

The chances for a truly harmonised European policy setting

According to Richardson (2005) analysing the European policy-making process thoroughly, it is not only the quantity of European regulation that should be challenged but also its quality and the processes in which they are drafted and adopted. It has by now become a common place that an institutional setting designed for 6 members cannot be suitable for 28. Among the stakeholders of European policy-making, member states are those who tend to
regard the EU level governance as excessive. This may appear interesting in light of the fact that, among the stakeholders, member states have the most influence in the decision-making process. Nevertheless, the political construct has obviously reached its limits.

A lot has been discussed about the institutional anomalies of the EU. Börzel (2003) proposes that top-down and bottom-up processes should be linked in the decision-making process. The bottom-up (‘ascending’) method should prevail in policy formulation and decision-making while top-down (descending) techniques should be applied when it comes to implementation. This is the only way to guarantee the democratic support needed to succeed in implementing European decisions. In evolutionary economic theory, an intermediate level is inserted between the micro and macro levels: in this theoretical setting, rules construct the meso level and establish the relation between the micro and the macro (Dopfer – Foster – Potts 2004). An adequate application of this evolutionary economics approach may well contribute to better understand European economic governance and to construct an adequately function future EU.8

Nevertheless, when constructing a possible framework for an efficient bottom-up aggregation of interests and objectives (the ‘meso’ of the European economy), we inevitably arrive to the issue of values. Do we have common European values that we all share? The World Values Survey9 may provide guidance. In fact, European countries perform large dispersions along the dimensions that may be relevant to building a strong Europe (see Appendix).

Conclusion

We must understand that Europe is at the crossroads of integration or disintegration (Schwab 2012). We, as European citizens, must ask ourselves the right questions all across our countries regarding what kind of a Europe we would like to have. If we come to the conclusion that we choose further integration instead of disintegration, we must continue by defining its basic medium-term course. We will do our job best if we strive for jointly defining the common denominator of European democracy. There must be a common denominator. Future plans have to be drafted based on that common denominator. There is no other feasible way to go – muddling through (Aizenman 2013) cannot be the way. Obviously, in our discourses on the future of Europe, we must not avoid a re-interpretation of the European social and economic model, tailored to the needs and conditions of our 21st century realities.

8 This may be regarded as a research idea to elaborate further.
9 http://www.worldvaluessurvey.org/
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Appendix: Values in some EU member states based on the World Values Survey data
Incomes should be made more equal - We need larger income differences as incentives for individual effort.