Only the Paranoid Survive

As the Intel and CEO founder of Hungarian origin, Andrew S. Grove (Gróf András István) put it in a very appropriate manner, the crucial thing is how to *exploit the crisis points*. His analysis focuses on how companies should survive, and even more, how they should turn into their advantages crises or, if you want, a change of paradigm, a paradigm shift *à la* Thomas Kuhn. In a nutshell, there is always a turning point in every business that needs to be recognised and handled in order to avoid collapse and go on with your business in a different way. Nevertheless, his thesis does not concern only companies, it can also be transposed to every segment of life: your personal life, your career evolvement, cinema industry or even politics. Paradigm shifts can therefore be of huge significance, such as the Second World War or of much less magnitude, such as the release of an album by Elvis Presley which changed the face of music industry. What matters is that you realise the occurring of the radical change and the direction the world is taking. But for Grove a radical change is even more complex, he calls it Strategic Inflection Point (SIP). He spotted for the future the appearance of Internet as a point inducing extremely fast changes that cannot be undone. Who can contradict when one looks back at the past? Data protection, retail distribution, media, music or cinema industry experts, among many others, will certainly not. When these segments have still not entirely recovered from the radical change, Intel successfully outrode competition with Japanese better-quality lower-cost chipmakers in the 90's. His advice is thus worth being seriously taken into account.

European Union does not make exception to this rule. Milestone events were numerous during the last twenty years: the digital revolution at the end of the 90's; in 2001 the collapse of the North and South Towers of the WTC; between 2004 and 2012 EU15 has become EU28; in 2005 the French and Dutch voters said no to the European Constitution; in September 2008 the world discovered how markets left alone cannot resolve anything; in 2015 migration shook the EU at it its very foundations; the UK voted Brexit in 2016 and the same year Donald Trump was elected president in the US. Many events with multiple consequences, but which one is SIP and which one is the consequence of SIP? At the risk of disappointing the readers of the first English edition of the European Mirror, we have to admit that we do not have the answer. However, by reading our contributors very often turning to the different crises (and even to the questions related to their management – Szegedi), the 2008 economic crisis seems to be the event with the biggest underlying multiple way consequences (Elekes and Halmai, Kovács, Orosz and Nyikos). Professor de Mestral has a critical approach to the Achmea judgement of the ECJ in March 2018, which is one of the logical consequences of the 2004–2012 enlargement process while, on the same path of accession of the EU, Professor

Hettyey underlines the shift of the German bilateral approach to the Central Eastern European Member States to a multilateral one often manifesting in a "hiding behind the EU institutions" attitude. Commissioner Vestager underlines that the political role of the European Commission is to be limited to the prioritisation of the tasks of the institution and advocates a Commission "one Member State one Commissioner" approach notwithstanding Emmanuel Macron's proposal to reduce the number of Commissioners to 15. Many opinions, many views, many angles; this is the strength of the European Mirror.

Nevertheless, while the European Mirror has not found the philosopher's stone, it does however permit to understand the very complex processes the European Union is going through. So, don't shoot the messenger, just keep in mind: *Only the Paranoid Survive*.

Krisztián Kecsmár

Andrea Elekes – Péter Halmai

Erosion and Crisis of the European Growth Potential. What Can the EU and the National Governments Do?[1]

We suppose that the dramatic decline in the European output is more than a cyclical diversion from the potential output. We performed a medium term quantitative analysis combining data based on the production function and growth accounting approach. Our results show that the erosion of the European growth potential has been a longer latent process. It began well before the outbreak of the latest economic crisis. Simulations suggest that the recovery in the rate of potential growth can only be partial in the medium term and further erosion of the European growth potential can be expected in the longer term.

Keywords: potential growth, growth accounting, European Union, crisis, total factor productivity

JEL classification: O11, O41, O52, E17

Andrea Elekes, Associate Professor, National University of Public Service, Institute of International Economics and Economics. E-mail: elekes.andrea@uni-nke.hu

Péter Halmai, Corr. Member of the Hungarian Academy of Sciences; Director, National University of Public Service, Institute of International Economics and Economics. E-mail: halmai.peter@uni-nke.hu

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Introduction

In Europe, the pain caused by the current crisis has been particularly acute. We suppose that the dramatic loss of the European output is more than a cyclical diversion from the potential output. There were clear signs of the European moderating growth potential for a long time. The previously latent elements began "to come to the surface" from the mid-1990s. At the same time, the financial and economic crisis that began in 2008 has had significant impacts on the European growth potential, too. The impacts of the latest crisis and the slow recovery on the potential output are also reviewed in our paper. These tendencies are examined in detail through the quantitative analysis. In order to test our hypothesis, we perform a medium term quantitative analysis combining data based on the production function and growth accounting approach.

Methodology of the Potential Growth Analysis

Potential growth is a cumulative measure showing the sustainable and non-inflationary growth generating capacity of the economy. Growth rate of the potential output reflects the steady-state economic dynamics (growth potential). Unlike the actual growth rate it does not contain cyclical factors. (For details see e.g. Denis et al., 2002; Denis et al., 2006; Hobza–Mc Morrow–Mourre, 2009; Basu–Fernald, 2009; Steindel, 2009; D'Auria et al., 2010; Havik et al., 2014)

The difference of the actual and the potential growth is the so called output gap, a fundamental measure of business cycles. Instruments of the economic policy strongly depend on the development of the output gap. However, it is very difficult to estimate the value of the output gap. Potential growth cannot be directly observed, while data on actual output could be updated from time to time.

The literature about growth is mainly dominated by articles discussing actual growth trends. These trends reflect the business (and other kind of) cycles and they provide important information. However, actual growth cannot permanently differ from potential growth.

The European growth model and the performance of its sub-models can be analysed also on the basis of potential growth. Potential growth can be analysed on the one hand based on the past development path. There is an advantage in the ex post analysis, namely that the degree of the actual output is known. At the same time, potential growth can be measured through future projections, too. Methodological difficulties may occur in both cases.

Calculation (or estimation) of potential growth creates an opportunity to separate structural development from cyclical development. There are different approaches. Potential output can be estimated by trend outputs resulting from moving averages of GDP time series and different filtering approaches. The most commonly used application is the Hodrick–Prescott (HP) filter. It is a simple and transparent method. Data with the highest frequency are utilized through the application of the filter.[1] However, there are significant problems,

[1] We get the filtered series (τ_i) from the original GDP series (y_t) with the help of the following algorithm:

$$\min_{\tau_t} \sum_{t=1}^{T} (y_t - \tau_t)^2 + \lambda \sum_{t=2}^{T-1} \left[(\tau_{t+1} - \tau_t) - (\tau_t - \tau_{t-1}) \right]^2$$

too. The method of HP filters does not have its roots in economic theories. Its features depend on the specific value of the smoothing parameters.[2]

On the other hand, as all centred filters, they are loaded with endpoint distortions, i.e. real time trend output estimates should be based on extrapolations of GDP, possibly with subsequent revisions. Finally, similarly to other methods applied for filtering GDP series, it cannot utilize information adequately to separate cyclical and structural changes.

An alternative to simple data filtering is based on the supply side model of the economy. Potential output is calculated in this case on the basis of a production function, which is the result of the combination of contributions of production factors and technological level. Compared with simple growth accounting, the production function based approach of potential output is consistent with the balanced utilization of the available resources (i.e. oversupply or excess demand can be excluded).

However, although there are clear benefits relative to the HP filter, this approach has its limits, too. Its credibility depends on both the accessibility and the quality of data on the contribution of production factors. This is a great challenge, especially as regards the new member states of the EU.

We follow the growth accounting and production function approach in order to calculate potential growth. This approach focuses mainly on the supply-side of the economy, on the quantity and quality of labour, accumulation of capital and on the total factor productivity as a driver of the output. The objective of this paper is to identify the impacts of these drivers and to decompose the growth rate of the output based on their impacts. In the production function approach potential growth can be calculated on the basis of the development of labour and capital inputs and of the total factor productivity. In order to apply the method, equilibrium rates of unemployment are required, too. These are provided by the NAIRU or NAWRU approaches.[3]

Under the framework of the production function approach, the determining factors of the neoclassical growth model are taken into account. Recent growth (and development) theories emphasize also the importance of further, mainly quality factors (innovation, geographical location, institutional system, macroeconomic policy etc.). (See e.g. the overall analysis of Jones–Romer, 2011)

The latter factors are important also in the ex post analyses. The uncertainty involved in the ex ante analyses is, however, extremely high. In the production function approach these factors have an impact through the development of the total factor productivity. (The important qualitative factors of the economic system are taken into account in an implicit way.) At the same time, it is difficult to quantify some of the factors mentioned. That is why the ex ante analyses need to be carried out very cautiously. After all these considerations, the production function approach can be applied in researches on growth and development.

The production function and growth accounting approach has recently received increasing attention in the literature. As regards to their long term application, studies, e.g. on ageing in the European Union, are considered significant contributions to the

2 The smoothing parameter generally equals 100 in case of yearly GDP data. This is the standard value applied by the European Commission in trend output estimates.

3 NAWRU: Non-Accelerating Wage Rate of Unemployment.

literature. (e.g. EC, 2014, 2015; Carone et al., 2006) As an example of the short term approach and the mid-term extension of the growth accounting analysis we can mention the database of the EU EPC Output Gaps Working Group (OGWG). (For their methodology see Denis et al., 2006; D'Auria et al., 2010; Havik et al., 2014) The methodology of the production function approach is described in the Appendix.

Impact of the Crisis on the Potential Growth

The financial and economic crisis might have a significant impact on potential growth. In the short run the significant decrease in the level of potential output is the result of the decrease in the productive capital stock (increasing capital depreciation), and the negative impact on the labour supply and structural unemployment. The decisive question is: what is the impact of the crisis on the long-term potential output growth. If potential growth intensifies due to the increasing productive capital stock and more favourable employment environment after the crisis, then the loss caused by the decrease in the output level might be compensated for after a while. As the crisis may force out structural change, which in turn increases the efficiency of the economy, the economy might get on a higher, sustainable growth path.

In order to understand profoundly the impacts of the crisis on the potential output and its growth, the individual growth factors need to be analysed in detail. As mentioned above, under the framework of the production function approach the recession might have an impact on growth through three different channels: capital accumulation, labour input and total factor productivity. Labour supply can further be divided into the participation rate; the average hours worked and the working age population; and the structural unemployment rate. (The latter is NAWRU – *Non-Accelerating Wage Rate of Unemployment*.) Total factor productivity (TFP) shows the effectiveness of the use of production factors.[4]

For the time being, economic recession may have different impacts on these factors of potential growth. Depending on the mechanism of the growth process, the relation between downturn and potential growth may be both negative and positive.

Financial crises in general have deep impacts on the long-term output growth. (See Furceri–Mourougane, 2009; Haltmaier, 2012; Ball, 2014) According to Cerra and Saxena's analysis (2008) recession was not followed by a rapid recovery in these cases, moreover, neither was the loss of trend output fully recovered. The loss of the GDP level was generally not offset by higher growth after the crisis.

Recessions following a financial market crisis are deeper than "ordinary" recessions. Those are generally associated with a significant decrease in housing prices and construction output. (For more details see Reinhard–Rogoff, 2009; Claessens et al., 2008; Crafts, 2012) Consumption decreases significantly during recessions. It reflects also the loss of assets (e.g. decrease in housing prices).

Economic recessions (not only the financial crises) have had diverse effects on the long-term potential growth in the European countries in the last few decades. Potential

4 As the latter is actually unobservable, it is often calculated as the residue.

growth – based on our calculations – has increased in about half of the countries during the decade following the crisis.

The dynamics of capital accumulation has decelerated in most European economies in the short- and medium term. (For details see e.g. Haugh et al., 2009; Hobza et al., 2009; Noord et al., 2009) In the long run the contribution of capital accumulation to the potential growth has basically not changed in most EU Member States. Dynamism of capital intensity slowed down in a smaller group of the examined countries (Finland, Sweden and Ireland). Although the recession affected their capital accumulation in the short run, the structural factors played a decisive role in the long run. The growth model of these economies changed significantly in the 1990s: due to the change in the economic structure, capital accumulation declined and the contribution of the TFP to the potential growth increased.

Haugh et al. (2009) argue that the output loss resulting from a bank crisis is 2–3 times higher than the loss originating from other kinds of downturns, and also the output needs more time to reach its potential level. The latest crisis is a very robust one as regards the level of both the output and the investment. It can only be compared to the great world economic crisis of 1930s.

In terms of the demand components, the main factor in the downturn was the collapse of the fixed capital formation. The development of household consumption, the fixed capital formation and the net exports contributed to the recession, as well. It is not clear, however, what mechanism can result in the increase in investment or private consumption. The deleveraging has continued in the household and the corporate sectors (financial and non-financial sectors) also during the deepening of the recession.

The likelihood of lasting effects on potential growth is much higher in case of the latest crisis than in any previous recession. The length of the crisis, its global nature and the change in the risk related behaviour might explain that. It has had an adverse effect on investments – on intangible investments in particular (namely R&D) – which has a severe impact on the TFP growth and the potential output. On the one hand the NAIRU might increase due to the hysteresis effect (as shown by Blanchard et al., 1989; 2000; Gali, 2015), resulting in a further drop in the potential output level and a slowing down in potential growth in the short and medium term. Many discouraged workers left the labour market and this way decreased the labour supply.

Structural adjustment and the reallocation of resources are of decisive importance. The latent erosion of potential growth (hidden by relatively favourable actual growth rates) in the years preceding the crisis and transitionally very low capital costs in the period of the great moderation resulted in the exceptionally high level of the investment rate in the EU member states. However, this accumulation was not based on a high level of a marginal product of capital resulting from improving total factor productivity. Investment boom was mainly restricted to non-traded goods and services (mainly real estate). Overheating of the economy was accompanied by an asset bubble and, with the outbreak of the crisis, recession and adjustment became unavoidable. External imbalances, significant current account deficits and increasing vulnerability characterized the member states with the most at stake. The unavoidable adjustment requires reallocation of resources from the non-tradable to the tradable sector. As the competition is more intense and the cost pressure is higher, productivity in the export-oriented sectors is higher, so increasing their share will improve efficiency, too. A fast reallocation of resources may reduce the loss in the growth potential. Integration into global value chains may enhance the structural change. Reallocation disturbances, however, may worsen the utilization of resources and increase the rate of unemployment.[5]

The changing attitude to risk prevents R&D and innovation financing. It holds back reallocation of resources to potentially more dynamic activities, weakening the growth of total factor productivity in the longer term.

Although the double-dip recession has been a great challenge for the European economy, the output shows a slightly increasing trend since spring 2013 in most of the member states (the exceptions are the countries with the highest level of sovereign debt).[6] Nevertheless, the long lasting recession has had significant and permanent impact on the main factors of the production function. Negative structural developments can be expected on the potential growth path. Among the risks, we can mention the echo phenomenon. Recession generally results in investment scarcity and strong depreciation of capital stock. There is a positive echo in the phase of the boom. Renewal of capital is fast due to the investment boom, there are technological breakthroughs and the dynamism of the total factor productivity can possibly increase. This kind of process characterized Sweden and Finland after the recession of the 1990s.

The latest crisis results in a loss of potential output for the European Union. At the same time, parallel reductions in the medium and longer term dynamics of the potential output (supposing unchanged policies) seem to be unavoidable mainly due to the significantly weakening dynamics of total factor productivity.

Development of Potential Growth and Its Factors (Quantitative Analysis[7])

As credible, longer term time series are not available as for the EU27, we examined the development of potential growth in the EU15 (member states of the EU before 2004) and in the United States in our growth accounting analysis. Countries of the EU15 were grouped into three groups. The six founding countries (DE, FR, IT, B, NL, L) of the European Economic Community (EEC) belong to the group of Founding 6 (F6). Economies of these countries have developed under the European integration framework for more than 50 years. These countries represent the continental European model. (See Halmai–Vásáry, 2012) The “New” member states (N6) are the (relatively) more developed

[5] As possibilities and conditions of the different member states are very different as regards their structural change, their recovery should follow a different pattern, as well.

[6] The strengthening interaction between the bank and sovereign debt crises resulted in more pronounced real economic effects. There was an unfavourable switchover in the examined period. (See Furceri–Zdienicka, 2012)
Since 2011, not only problems of the bank sector, but also the problems related to sovereign debt have been increasingly accentuated in the processes of the European crisis. This is an important feature of the deep financial crisis. (See Reinhart–Rogoff, 2011; Claessens et al., 2011; Mody–Sandri, 2012)

[7] Analyses are based on the OGWG database as of 2017 winter.

countries that joined the European Communities or the European Union in 1973 or in 1995: UK and IE representing the Anglo–Saxon model and DK, FI and SE following the Scandinavian model and finally AT.[8] The group of the Mediterranean countries (M3) comprises Greece (EL), which joined the Community in 1981 and the countries that have been member states since 1986 (ES and PT). Members of this latter group follow the so called Mediterranean (economic development) model.

Based on the above analysis we can summarize the main characteristics of the growth models of the examined country groups.

The potential growth rate of the EU15 has kept on decreasing since 1989 (see Figure 1). This decrease can be explained by the development of the labour productivity.[9] The labour contribution was positive between 1995–2008, however the growth rate of labour productivity has continuously decreased since 1993. As the capital contribution to the potential growth did not decrease significantly until 2009 (its rate was between 0.7–0.9% per year), the unfavourable development of the total factor productivity became a structural factor as regards the decreasing trend of labour productivity. (The growth rate of total factor productivity dropped by a third between 1981 and 2017.)

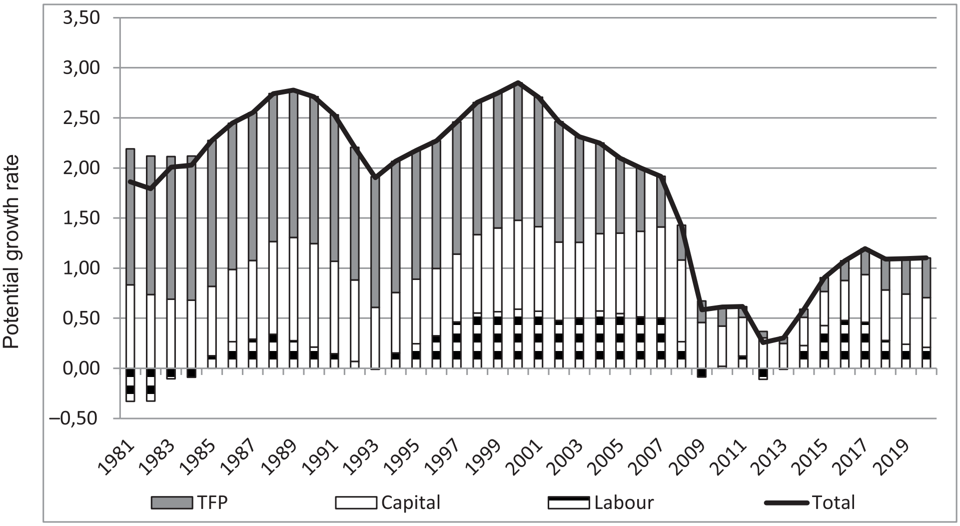

Figure 1.
Development of potential growth and its factors in the EU15
Source: Authors' own calculation

The growth model of the F6 countries shares the same characteristics. As regards the F6, the labour contribution to the potential growth was moderate but positive over almost all

[8] In the meantime, the EU was enlarged by 10 new member states in 2004, by 2 in 2007 and by another one in 2013. These countries are considered to be the new member states nowadays. However, new member states refer to the above mentioned countries in this chapter.

[9] In this analysis the impact of framework labour productivity on the potential growth is the sum of the contribution of capital and TFP.

the examined period. The capital contribution was between 0.6–0.9% per year until 2009. The most important explaining factor of this dynamism (or more precisely of this decrease) was the permanent and strong decline of the TFP (see Figure 2). Therefore, we can conclude that the rate of potential growth dropped to 1.4% per year (from the rate of 2.8% in 1990) even before the crisis, and it will be around 1% in the examined period in the F6 countries.

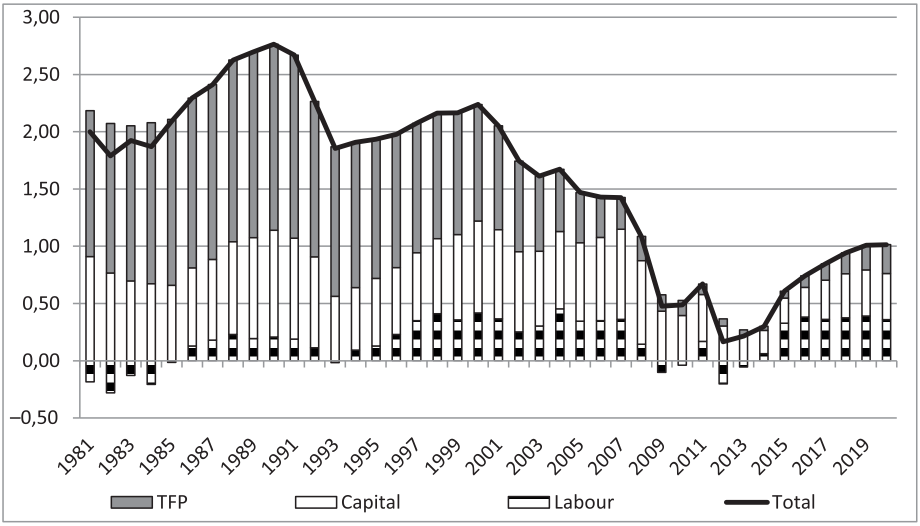

Figure 2.
Development of potential growth and its factors in the F6 countries
Source: Authors' own calculation

The main trends in the N6 differ from the previously reviewed situation of the F6 in several aspects. Countries of the N6 experienced the highest rate of potential growth in 1999–2000 (3.4% per year!). The decrease in this rate began only after that period (see Figure 3), arriving at 2.1% in 2007 and 0.8% at the bottom of the crisis (in 2009). However, from 2010 we can see the signs of recovery and the rate of potential growth could reach 1.8% by 2017–2018. (Exceeding the average rate of the EU15 by almost 50%.) Labour contributed to the rate of potential growth with 0.3–0.6% per year between 1984–1989 and 1996–2007. At the same time, the increasing labour productivity (2–3% per year) was the decisive factor in the development of the potential growth, just as in the case of the F6. As the effect of the capital was 0.7–1.0% in the periods of 1985–1991 and 1997–2008, development of the TFP was the dominant factor in their case, too. The contribution of TFP exceeded significantly even that of the United States until 2006. However, the growth rate of the TFP has showed an accelerating decreasing trend since 2000. This was partly compensated for by the effect of the transitionally increasing capital accumulation and by the increasing contribution of labour (as a result of the labour market reforms). The contribution of labour became negative again at the time of the crisis. The contributions of capital and TFP moderated significantly, too. The dynamism of the labour productivity improved again at the time of the recovery:

simulations suggest that the contribution of both capital deepening and TFP will reach 0.6% by 2019–2020.

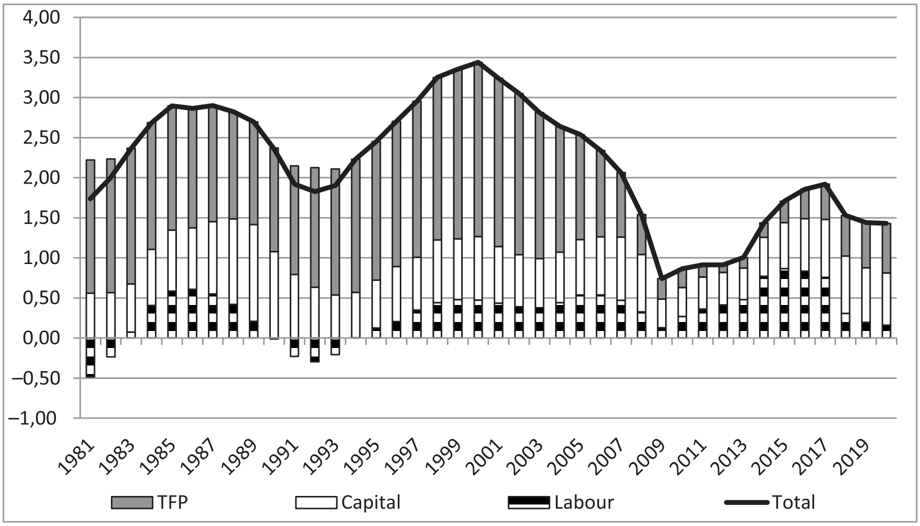

Figure 3.
Development of potential growth and its factors in the N6 countries
Source: Authors' own calculation

Following the accession, the rate of potential growth steadily increased for more than two decades in the countries of the M3 (see Figure 4). The contribution of labour became positive and significant (with structural unemployment decreasing simultaneously): its rate was 0.9–1.7% in the periods of 1988–1990 and 1997–2007. The contribution of capital was 1.1–1.6% between 1987–1992 and 1997–2008. Although TFP was above 1% until 1989, it began to decline after that period. The current crisis has resulted in a structural cut-off point in the development of potential growth of the M3. Our calculations show, that after a significant decrease, the rate of potential growth is expected to become and remain negative between 2011 and 2015 and staying below the average of the EU15 until the end of the examined period. The contribution of labour has been negative since 2009. The crisis, and particularly the sovereign debt crisis that hit the examined countries especially hard, has resulted in significantly increasing capital costs and narrower capital accumulation possibilities. Therefore, capital – in fact – will not contribute to the growth of the potential output after 2011. The contribution of TFP in the period 1995–2007 was around 0.4–0.5% per year, significantly less, than in the previous period. This contribution was very low after the outbreak of the crisis, and it was negative in certain years. Therefore, we can argue, it will be this group of the M3 that will experience the most unfavourable labour productivity trend.

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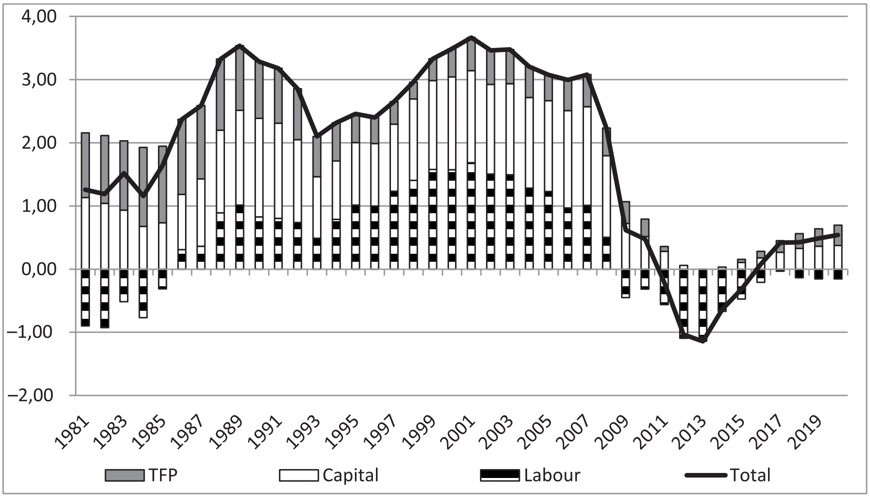

Figure 4.
Development of potential growth and its factors in the M3 countries
Source: Authors' own calculation

Structural unemployment (NAWRU) in the EU15 slightly increased until the mid-1990s and then decreased until the current crisis. Structural unemployment has been the highest in the M3 countries throughout the examined period. (Its ratio exceeded 10%.) NAWRU has decreased significantly since the mid '90s in the M3. It began to rise along with the emergence of the current crisis, reached a record level in 2010 and continues to rise. Projections suggest that structural unemployment will continue to rise between 2013–2020 due to the recovery and mainly to the sovereign debt crisis, however the average of the M3 may increase above 17% (!) from 2012.

The potential growth rate of the United States exceeded the EU15's average in almost all single years throughout the examined period (see Figure 5). The potential growth showed a relatively strong dynamism until the beginning of 2000: its rate fell below 3% only in certain years. As regards growth, permanent and significant positive contributions of labour were amongst the most important factors. At the same time, there was a significant (about 50%) increase between 1980 and the end of the 1990s regarding the contribution of TFP. The contribution of capital has increased from the middle of the 1990s. The rate of potential growth has moderated since 2000, and it stood at 50% of the former level before the crisis. Any positive effect of labour has more or less faded away and the dynamism of the TFP has also started to decline. The potential growth rate declined dramatically between 2008 and 2011. (The effect of labour became negative and in parallel to the moderating TFP, the contribution of capital accumulation significantly decreased.) Recovery characterizes the 2012–2018 period. Labour becomes positive again and contribution of all of the three factors (labour, TFP and capital) increases. Potential growth reached its pre-crisis level by 2014 in the United States.

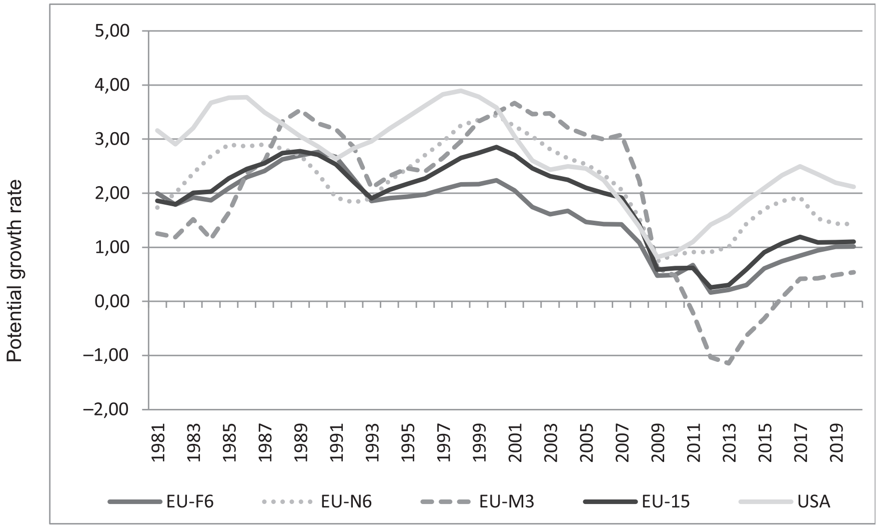

Figure 5.
Development of potential growth in the examined country groups
Source: Authors' own calculation

We can argue that the growth model of the USA involved a higher level of growth dynamics in the examined three and a half decades. Average growth potential of the EU15 lags behind that of the USA. We could not identify a catch up potential for the EU15 in the examined period. The same comment applies for the F6 countries. As regards their potential growth rate, the M3 countries managed to cut back somewhat on the large differences in certain periods (from 1988 to 1992 and between 2000 and 2009), but their fall-back relative to the better performing country groups seems to be unstoppable since the outbreak of the crisis. Development of potential growth in the N6 countries however, is similar to that of the USA. (The growth of potential output between 2001 and 2008 was even faster in the N6 countries than in the USA.) Labour productivity, and particularly the dynamics of the total factor productivity, is the decisive factors in accounting for the growth performance of the N6. The growth rate of these factors exceeded the US levels up to 2006.

However, the USA had more robust structural characteristics (more favourable total factor productivity above all)[10] even before the outbreak of the crisis. Forecasted demographic and TFP trends and investment and productivity dynamics are more favourable than the forecasted trends for the EU15 and for the member states of the Eurozone (see Figure 6). Therefore, it is not surprising that the dynamics of the pre-crisis growth potential can recover more or less in the United States, while it can reach only half of the pre-crisis level in the examined European countries.

10 The TFP gap, that has developed between the USA and the EU15 since the mid-1990s can mainly be attributed to the differences in the intensity of the competitive environment, differences in innovation mechanisms and industrial structure, and to the different ratio of ICT and ICT dependent sectors. Revealing impact mechanisms of these factors requires further research.

Table 1.

Development of potential growth and its factors in the examined country groups (% of potential GDP, annual average in the examined period)

	EU15					F6					N6					M3				
	1988–1993	1994–2000	2001–2008	2009–2013	2014–2018	1988–1993	1994–2000	2001–2008	2009–2013	2014–2018	1988–1993	1994–2000	2001–2008	2009–2013	2014–2018	1988–1993	1994–2000	2001–2008	2009–2013	2014–2018
PF potential growth	2.48	2.46	2.25	0.47	1.01	2.48	2.07	1.63	0.40	0.78	2.26	2.91	2.67	0.89	1.62	3.05	2.80	3.28	0.46	0.14
Labour productivity	2.31	2.05	1.72	0.49	0.68	2.33	1.78	1.28	0.45	0.46	2.28	2.62	2.21	0.58	1.06	2.25	1.57	1.97	0.44	0.40
Total labour (hours) contribution	0.17	0.41	0.53	-0.01	0.33	0.15	0.28	0.35	-0.05	0.32	-0.02	0.30	0.46	0.33	0.56	0.79	1.23	1.31	-0.70	-0.26
Capital accu-mulation contribution	0.89	0.73	0.82	0.36	0.43	0.81	0.65	0.71	0.35	0.32	0.89	0.69	0.69	0.38	0.64	1.36	1.16	1.47	0.32	0.24
TFP contribution	1.42	1.32	0.91	0.13	0.25	1.52	1.14	0.57	0.10	0.14	1.39	1.92	1.53	0.17	0.42	0.89	0.41	0.50	0.12	0.16
NAIRU (% of labour force)	8.59	8.63	7.73	8.90	9.30	8.13	8.78	7.91	8.52	9.61	7.41	6.82	5.83	6.23	5.89	14.23	12.81	11.73	16.12	17.80
Investment ratio (% of potential output)	21.60	20.45	22.00	19.29	19.92	21.37	20.39	22.13	20.31	20.21	21.84	19.83	19.83	17.59	19.58	22.49	22.38	26.83	19.53	20.16

Source: Authors' own calculation

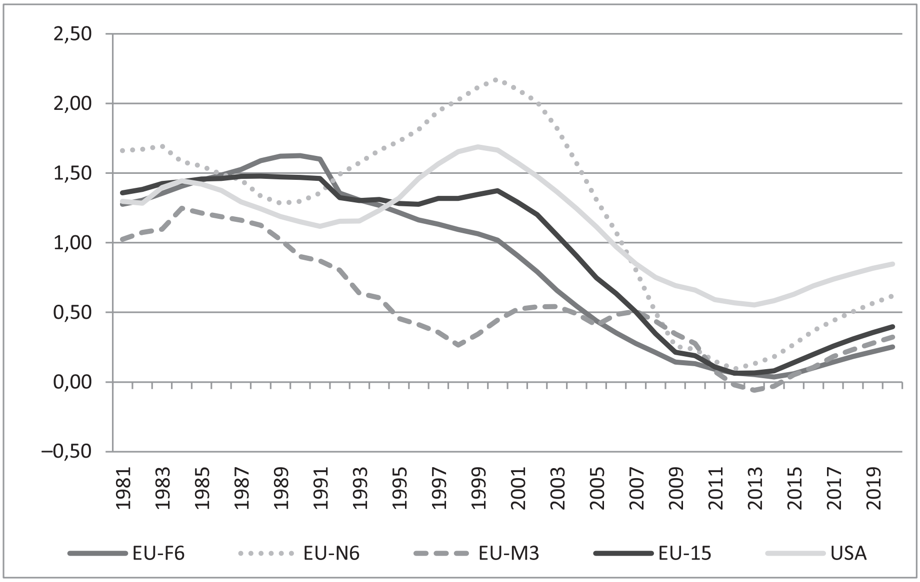

Figure 6.
Contribution of TFP to potential output growth
Source: Authors' own calculation

Conclusions

The main conclusions are summarized as follows:

1. The rate of potential growth in the EU15 has continuously and gradually decreased since 1990. At the same time, the latest financial and economic crisis has resulted in a significant decline in the dynamism of the potential output and the simulations suggest that it can reach only half of the pre-crisis level in the medium term. It is the development of labour productivity that can explain the decreasing dynamism of potential output. Declining TFP growth rate is a decisive and structural factor of this development.
2. Significant differences are revealed among the different country groups of the EU15. Potential growth rate of the founding (F6) countries has declined continuously (mainly due to the development of the TFP). The dynamism of potential output increased until 2000 in the new member states (N6 countries), and then it began to gradually decline. The chance of a possible recovery is the greatest in this country group in the medium term. TFP is the dominant factor in their performance. The Mediterranean (M3) countries followed a catch-up path until the outbreak of the latest crisis. High structural unemployment was successfully reduced and it became the decisive factor of potential growth. From 2009 onwards very serious growth crises have developed in these countries

resulting in an extraordinary high level of the NAWRU and a low level of investment and TFP.

3. It is important to compare the European and the US growth model. In the long run the potential growth rate shows a declining trend both in the USA and the EU15 countries. The TFP growth rate is much higher in the USA from the middle of the 1990s onwards than in the EU15. This higher dynamic is expected to last also in the medium term.
4. Due to the globalization and competitiveness problems of the European Union's economy – the current average annual rate of potential growth in the European Union of 1.2% could significantly fall in the coming decades. The decisive structural element here is the decreasing dynamics of total factor productivity. At the same time, potential growth prospects of the EU12 are more unfavourable than that of the EU15, convergence may stop and even divergence may become apparent. (Elekes–Halmai, 2013)
5. The risk of shock repetition is high. The expected changes project a further erosion of the European growth potential. That is: due to the crisis and its potential longer term impacts, development of the potential growth on the longer term might even be more unfavourable than indicated in the previous points. The trajectory of a permanent shock poses the threat of the complete collapse of the European growth and catch-up model.

What Can the EU and the National Governments Do?

It is interesting to examine *what is in the background of the more dynamic US TFP growth.* Several studies have argued that the crisis hit more seriously the EU. Although most of the EU member states managed to recover, they paid a high price: growing unemployment rates which can also contribute to the slower productivity growth. Hysteresis effects may have emerged following the financial crisis. As outlined by economist Nouriel Roubini (2016), protracted recessions can slow productivity growth for two reasons: because people who remain unemployed for a long time lose their skills and because slowing investment prevents the latest technologies embedded in capital goods from being used. And this will have a roll over effect increasing the productivity gap between the US and the EU.

The Nobel laureate economist Robert Solow (1956) noted that rising incomes should not largely be attributed to capital accumulation, but to technological progress. Joseph Schumpeter (1934) argued that the central virtue of a market economy was its capacity to innovate. And these arguments seem to be confirmed by the latest Global Competitiveness Report (GCR, 2017). The authors argue that productivity remains a key driver of prosperity, although measuring productivity has become more complex during the rise of the Fourth Industrial Revolution. Prosperity can increase only if inputs of production are used in smarter and more efficient ways to fulfil constantly evolving human demands. And *this is a question of innovative capacity.* Even the meaning of innovation had to be updated. “The capacity of a country to be innovative has to be thought of as an ecosystem that not only produces scientific knowledge but also enables all industries – including in the service sector – and society at large to be more flexible, interconnected, and open to new ideas and business models. This way of understanding innovation focuses on a country's ability to bring new products and services to market, and it attributes equal importance to non-technical and technical inventions."(Schumpeter, 1934)

So how the EU performs in this changing environment? Looking at the rankings of the GCR, we can find that the EU still performs above the global average in terms of competitiveness. This is driven by the performance of a group of regional champions: the Netherlands (4th), Germany (5th), Sweden (6th), the United Kingdom (7th), Finland (10th), and Denmark (12th). As for the EU as a whole, there is a wide dispersion in regional performance on several pillars. The largest gap is in the macroeconomic environment pillar, a reflection of the fact that the region has been recovering unevenly from the global financial crisis. *Europe's median performance is weakest across the innovation indicators*. And this is an important fact, especially relative to the US performance.

It is enough to look at the list of the world's top 10 technology companies (based on their market value): Apple, Alphabet (Google and its side-projects), Microsoft, Facebook, Samsung, Oracle, Tencent, Intel, Cisco Systems and IBM. It is also interesting to see in which areas we can find the most valuable start-ups (or unicorns): Uber (US, ride-hailing service and mobile application), Didi Kuaidi (the biggest ride-hailing company in China), Xiaomi (China, smartphones, mobile apps, and related electronics), Airbnb (US, social website – accommodation), Palantir (US, software and services company, specializing in data analysis). The top 3 sectors covered are: E-commerce, Internet Software & Services and FinTech. More than half (54%) of the world's unicorns are based in the United States. Other countries with the most unicorns include China (23%), India (4%), the UK (4%), Germany (2%) and South Korea (2%). No other country has three or more private companies with a valuation of at least $1 billion. There are no European companies on the top 10 lists at all. We can also see that market size does really matter. It could not be an accidental event that the most valuable tech companies can be found in the largest and most populated countries. Economies of scale is an important factor both as regards innovations and production. In order to push the costs down we need markets. That is why the single market and market liberalization is so important.

It is true, that the large domestic market in the United States represents a major source of competitiveness advantage over other advanced economies. But the United States ranks 3rd for the third consecutive year, which cannot exclusively be explained by the market size. From the point of view of cost competitiveness, it is also an important development that although both the US and the EU used to be a net importer of oil, due to the technological developments (fracking) the US nowadays can rely on its shale stocks pushing down the prices and therefore costs of production. The EU has extensive shale stocks as well, but here (as in so many cases – e.g. agricultural and food production, animal welfare, environmental protection etc.) European producers have to meet stricter standards. Most of the EU member states prohibit fracking due to environmental concerns.[11] The higher standards mean usually extra costs for the European producers

[11] It is worth noting here that environmental factors or more specifically the climate agreement may rearrange the markets in the future. Stock valuations of a lot of oil companies are based on assets (oil stocks) that cannot be mined due to the carbon limits. This is the so called carbon bubble. Burst of this bubble may even result in a financial crisis.

which costs are not always honoured by the market. Based on their performance however, "it is tempting to assume that the competitiveness *factors that matter the most for* firms and *countries looking to benefit from the Fourth Industrial Revolution are linked primarily to measures of technological sophistication and innovation*". (WEF, 2017: 53)

Porter and Heppelmann (2014) argue that information technology is revolutionizing products. The changing nature of products is disrupting the value chains and the *smart, connected products have brought about a new era of competition.* "It is the expanded capabilities of smart, connected products and the data they generate that are ushering in a new era of competition. [...] These new types of products alter industry structure and the nature of competition, exposing companies to new competitive opportunities and threats. They are reshaping industry boundaries and creating entirely new industries." (Porter–Heppelmann, 2014) And the leading position of the USA on this area is unquestionable.

So what the EU and the governments that do not want to lag behind can do in order to improve the performance? The answer interestingly comes from Mohammed bin Rashid Al Maktoum (2015), the Vice President and Prime Minister of the United Arab Emirates and Ruler of Dubai. He argues that countries whose governments grow old face the same fate as outdated companies. Their choice is simple: innovate or become irrelevant. "*The lifecycle of companies should teach governments that the secret of eternal youth is constant innovation.*" (Maktoum, 2015) The first key to business-like innovation in government is a focus on skills. Top-tier companies continuously invest in their employees to provide them with the right skills for the marketplace. Governments must do the same, by constantly upgrading skills and nurturing innovation among their own employees, across key sectors of the economy, and at the foundations of the education system. The second key to transforming governments into engines of innovation is to shift the balance of investment toward intangibles, as in the private sector: in the knowledge and skills of their employees and the intellectual property embedded in their products. "Governments, too, should think strategically about shifting their spending away from tangible infrastructure like roads and buildings, and toward intangibles like education and research and development in order to build and sustain a knowledge economy." (Maktoum, 2015)

In sum: "to be truly innovative, a country should not only file patents and support research and development in science and technology, but *should also provide a networked, connected environment that promotes creativity and entrepreneurship, fosters collaboration, and rewards individuals who are open-minded and embrace new ways to perform tasks.*" (WEF, 2017)

Governments have a lot to do in order to enhance the innovative capacity of their countries. The possibilities of the Fourth Industrial Revolution to produce productivity gains depend on a number of factors. "Ultimately the goal is for individuals, firms, and sectors to be able to access emerging technologies, incorporate them into their innovation and operational processes, and participate meaningfully in both new and transforming value networks." (WEF, 2017: 53) The Global Information Technology Report (WEF, 2016) reveals that *countries looking to capitalize on economic gains of ICTs should promote not just access, but also adoption and use of digital networks.*

While the Fourth Industrial Revolution will feature technologies such as the blockchain that can support both private and public governance, these technologies alone will not replace the importance of an enabling environment. Technology has yet to show its full impact on productivity. *We need time to re-invent our organizations, laws, and rules to fully leverage new technologies.* In some cases, a governance vacuum prevents some of the more advanced technologies, such as self-driving cars and drones, from being translated into reality. In other cases, we recognize the potential of new technologies but do not yet know how best to deploy them. (WEF, 2017: 53) Reil Kurzweil (2005) wrote in his book that the power of human-created technology is expanding at an exponential pace and development becomes more visible around 2020.[12]

Sometimes it takes years that an innovation becomes productive and begins to generate income. It cannot be done without support. But it is the government's liability where the resources are channelled. Private incentives are not always well aligned with social returns. "Firms can gain from innovations that increase their market power, enable them to circumvent regulations, or channel rents that would otherwise accrue to others. Successful industrial policies identify sources of positive externalities – sectors where learning might generate benefits elsewhere in the economy." (Stiglitz, 2014) Governments must follow industrial policies – in which governments intervene in the allocation of resources among sectors or favour some technologies over others – this can help infant economies learn. And it is not easy to find the prospective successful areas. The theory of strategic trade policy may help but in general we can say that governments should be able to identify the areas with the highest possible spill-over benefits to other economic activities. Such policies, when adopted, have been frequent targets of criticism. "Studies show that average returns to the economy from government research projects are actually higher than those from private-sector projects. Especially because the government invests more heavily in important basic research." (Stiglitz, 2014) Benefits of the development of the Internet, the discovery of DNA, robotics, IT and nanotechnologies are unquestionable. And Stiglitz argues that evidence that knowledge generated by clean tech can be similar. Jung (2014) writes that "policymakers need to understand how to establish, manage, and thus measure the conditions that encourage innovators to flock to a region and forge a prosperous future there. Innovation metrics must capture the value of new ideas years before those ideas become profitable in traditionally measured ways." He also identifies some important features that characterize a thriving innovation ecosystem in its birth stages: they include top-level talent, serial entrepreneurs with good track records, start-ups backed by reputable capital, and breakthrough products protected by intellectual-property rights. He (and his colleagues) found that five of today's most successful start-ups in the information-technology sector had two attributes in common by the end of their third year in business: they had filed more than one patent and been funded by more than one top venture-capital firm. And this highlights another

[12] "The Singularity will represent the culmination of the merger of our biological thinking and existence with our technology, resulting in a world that is still human but that transcends our biological roots. There will be no distinction, post-Singularity, between human and machine or between physical and virtual reality. If you wonder what will remain unequivocally human in such a world, it's simply this quality: ours is the species that inherently seeks to extend its physical and mental reach beyond current limitations." (Kurzweil, 2005: 25)

important difference between the US and EU innovation environment: financing. Risk-taking level of the US society is much higher. It is a part of the "business as usual" to fail. However, European societies do not really tolerate business fails. That is why it is so difficult to get resources to finance new ideas. And this is not only true for official and bank sector funding. Venture capital is more limited, as well.

Even the measurement can be a source of concern. "Productivity measurements capture only monetary transactions, so non-monetary transactions (e.g. those initiated in the sharing economy) may not be captured. We may not be able to measure spreading free digital services correctly – how do we account for the output of companies such as Google or Wikipedia or for the matchmaking efficiency achieved by Etsy or Airbnb? And how do we measure cross-border trade in data?" (WEF, 2017: 54) In the same way, qualitative improvements to products and services (mainly due to the positive impacts of the Internet of Things) are equally inherently difficult to capture in national accounts. "There is a growing awareness among policymakers and planners that virtual assets like creative talent and entrepreneurial skill make up an increasing portion of a country's wealth." (Jung, 2014) The US Bureau of Economic Analysis acknowledged this when it changed the definition of GDP in 2013 to represent better the contributions of intellectual property and research and development to productivity and economic vitality. As former US Federal Reserve Chairman Ben Bernanke noted in a 2011 speech, "We will be more likely to promote innovative activity if we are able to measure it more effectively and document its role in economic growth." (Jung, 2014)

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Appendix

The production function approach focuses on the supply potential of the economy. In the framework of the production function approach potential GDP is the result of the combination of factor inputs and technological level (total factor productivity, TFP). While measuring potential output the cyclical factor is removed in case of labour and capital, as well. (For details see Havik et al., 2014)

The Cobb–Douglas production function simplifies the analysis. Potential GDP can be calculated as follows:

$$1.\ Y = (U_L L E_L)^{\alpha}(U_K K E_K)^{1-\alpha} = L^{\alpha}K^{1-\alpha} * TFP$$

Where U_L, U_K is degree of excess capacity; E_L, E_K is efficiency level of the production factors

$$2.\ TFP = (E_L^{\alpha} E_K^{1-\alpha})(U_L^{\alpha} U_K^{1-\alpha})$$

TFP summarizes the degree of utilization of production factors and their technological level. Factor inputs are measured in physical units. (Through hours worked for labour input and a comprehensive measure including spending on infrastructure and equipment for capital.)

The most important assumptions entering the specification of the production function are: constant returns to scale and factor price elasticity, which equals 1. The main advantage of these assumptions is simplicity. These assumptions are largely consistent with empirical evidence at the macro level. The assumption of unit elasticity is consistent with the relative constancy of nominal factor shares. The labour and capital elasticity are represented by α and (1- α). Under the assumption of constant returns to scale and perfect competition, these elasticities can be estimated from the wage share.[13]

While moving from actual to potential output the potential factor use (labour and capital input) and the trend level (normal level) of efficiency of factor inputs need to be defined.

The contribution of capital to the potential output is given by the full utilization of available capital in the economy. As capital stock is the indicator of full capacity, it is unnecessary to smooth time series when applying the production function approach. Series without smoothing tend to be more stable both for the EU and the USA. (For details see Havik et al., 2014) Investment shows significant fluctuation over the years. The contributions of capital, however, are relatively stable. (Net investment is only a small portion of capital stock in all of the years.)

It is more difficult to calculate the contribution of labour. Estimation of labour input has several steps. The starting point is the maximum possible level, the development of the working age population. The level of trend labour can be determined from participation rates by applying HP filters. The next step is the calculation of the trend unemployment in consistency with the NAWRU. Finally, we can calculate the potential labour supply (number of trend work hours) multiplying trend employment with average work hours. This approach generates relatively stable potential employment series. At the same time, yearly development of the series may strongly relate to long term demographic and labour market developments, to the actual population of working age, to trend participation rate and to the development of the structural unemployment.

As regards the production function approach potential output refers to the level of output which can be produced with a "normal" level of efficiency of factor input. This trend level efficiency level is measured by using a bivariate Kalman filter model which

13 Based on the mean wage share for the EU15 over the period 1960–2003 α = 0.63 and (1- α) = 0.37. The OGWG calculated with 0.65 and 0.35 as factor elasticity.

is based on the link between the TFP cycle and the degree of capacity utilization in the economy. (For details see Planas–Roeger–Rossi, 2010) Normalizing the full utilization of factor inputs, the potential output can be described as follows:

$$3.\ Y^P = (L^P E_L^T)^{\alpha} (K E_K^T)^{1-\alpha}$$

In the model described briefly the exogenous variables are as follows: population of working age (POPW), smoothed participation rate (PARTS), investment ratio (expressed as percentage of potential GDP, IYPOT) structural unemployment (Non-Accelerating Wage Rate of Unemployment – NAWRU), Kalman filtered Solow Residual and trend average hours worked (HOURST). The endogenous variables are the potential employment (LP), investment (I), capital stock (K) and the potential output. (YPOT).

Potential employment for a given time period is determined as follows:

LPt=(POPWt*PARTSt*(1-NAWRUt)*HOURSTt

Development of investment and capital stock are determined by the following equation: $I_t=IYPOT_t*YPOT_t$ *and* $K_t=I_t+(1\text{-}dep_t)K_{t-1}$, where dep_t is depreciation rate of year *t*.

Based on all these the equation of the potential output can be described as follows:

$$4.\ YPOT=LP\ 0.65\ K\ 0.35\ SRK$$

We can determine the output gap with the following equation:

$$YGAP = (Y/YPOT - 1)$$

The output estimates derived from production functions show the present output capacity of the economy. Those enable a mid-term extension: they indicate the likely development, if past trends were to persist.[14] Projections for 2017–2020 in the OGWG database can be considered technical extrapolations instead of forecasts.

[14] In the mid-term extension the trend TFP, the NAWRU (Non-Accelerating Wage Rate of Unemployment), the population of working age, participation rate changes, average hours worked, and the investment to potential GDP ratio are determined.

Olivér Kovács

The Complexity of the European Integration – The General Vectors of Disorientegration[1]

The paper transcends prevailing literature on the crisis of European integration by demonstrating that disorientegration (losing orientation and weakening integration) is not a recent fortuitous event but a systemic pattern. It shows how the centrifugal force towards weakening European integration has developed by asking what are the general non-EU specific vectors of such a gradient. We argue that disorientegration is an echo effect of a complex amalgam of intertwined mechanisms secularly shaping the European integration process. Our paper also outlines the critical mass of conceptual prerequisites of reversing the European disorientegration.

Keywords: EU integration, complexity, orientation, innovation, governance

JEL classification: E10, E60, F15, H10, H70, O10

Olivér Kovács, Research Fellow, ICEG European Center; Senior Research Fellow, National University of Public Service; Member of the Economics and Law Section of the Hungarian Academy of Sciences, Committee on World Economics and Development Studies. E-mail: Kovacs.Oliver.Istvan@uni-nke.hu
Web: http://oliverkovacs.com

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Introduction

As the largest economy of the world, the European Union (EU) has served as a salient wealth generator for one of the most talented populations on Earth.[1] Still, for the first time in its 60-year history, the European integration is increasingly seen as a process that can be stopped or reversed in some aspects. Although a recovery appears on the horizon in terms of growth prospects, remaining challenges are still warning us that this is *no time for complacency*. (See EIB 2017; OECD 2017a) In 2016, the United Kingdom voted to leave the EU which left us in daze and we do not really know the direct and indirect consequences of such historic decision for the entire integration (e.g. domino effect for leaving the EU in other countries). With the gargantuan task of challenges, the European integration shows the sign of secular deterioration by becoming disoriented from its purposes. The assumption that the motor of the integration is the spirit of a faith community, by now has become a myth by nourishing disintegration. As the current president of the European Commission, Jean-Claude Juncker expressed it with commendable honesty: "There is not enough Europe in this Union. And there is not enough Union in this Union." (Juncker, 2015)

Importantly, the state-of-the-art literature on the shortcomings of the European integration mostly concentrates on EU-specific factors rather than embracing more systemic processes shaping the integration process. Moreover, to date, the available literature interprets the permanent crises in the EU as anomalies along the course of integration, while we are to show that the configuration has been encoded and developed endogenously. That literature tends to merely emphasise the absurd nature of the architecture of the Economic and Monetary Union (EMU) from the viewpoint of the theory on Optimal Currency Area and the recent Eurozone crisis and its lacklustre crisis management. Nonetheless, the conventional wisdom of this literature mostly lacks of a broader perspective and leaves the development of the *configuration of processes* at loose ends. Available literature has a predilection either to reduce the shortcomings of the European integration to only some factors (e.g. the lack of fiscal union) or to pay attention to certain topics without addressing dynamic relationships (e.g. Eurozone crisis [Baldwin–Giavazzi, 2016], impact on agriculture [Csáki–Jámbor, 2012], dealing with debt [Corsetti et al., 2015] or with core-periphery relations [Magone et al., 2016], or just with the contradiction between inter-governmentalism and supranationalism [Csaba, 2015; Spolaore, 2015]). The literature has just sporadically emphasised the danger of integrational crisis (Palánkai–Miklós, 2014; Vollaard, 2014), however, more and more signs indicated that (e.g. the new stream of Comparative Regional Integration Studies also emerged, see [Fioramonti, 2012]). Furthermore, studies have a strong tendency to express just a sheer claim for structural reforms to spark competitiveness via innovation throughout the EU. (Palánkai, 1999; Halmai, 2014) Even the new handbook on Economics of European Integration (Badinger–Nitsch, 2016) misses to outline the general vectors that have been influencing the configuration of processes resulting in a reasonable feeling

1 73% of the TOP 15 countries ranked in the IMD World Talent Ranking 2017 are Europeans. 70% of the TOP 10 countries ranked in the Global Talent Competitiveness Index 2017 are Europeans. (INSEAD, 2017)

of disorientegration. Moreover, addressing the nature of secular disorientegration is of essence because the psychological behaviour of people can spectacularly make things even worse. And since the process of European integration has always been influenced by public opinions (Bølstad, 2014), clarifying whether disorientegration is systematically encoded or not is crucial to get a better picture (opinions) over what exactly Europe is dealing with. This, however, requires a more *complexity-based system view*.

Complexity science conveys that the European integration is a *dissipative system*. Such systems, described originally by Ilya Prigogine, a Nobel Laureate in Chemistry, are far from equilibrium by being open, adaptive, showing irreversibilities in time, and can change course by creating new qualities and new structures. Accordingly, the integration is a dissipative system the existence of which relies heavily and primarily on the flow of energy (i.e. the willingness to integrate by overcoming a series of crises while realising social-economic and environmental progress). It is like a vortex in water, the pattern of which is dynamic and its shape is sustainable up until the flow of water is guaranteed. The European disorientegration did not therefore appear from some kind of historical vacuum, but rather logically and organically along the dynamics of integration. True, more and more studies are addressing the European integration through the lens of complexity. (See Geyer, 2003; 2018) Complexity means dependent entanglement among the large number of parts continuously interacting with each other. In a complex system, macro patterns are emerging from the interactions of constituent agents (e.g. universe, climate, living-organisms, ecosystems, society and culture, organisations, cities, traffic, and thus the European Union and the process of integration etc.). Still, the studies fall short either in uncovering the configuration of processes or contouring a modern governance capable of reversing disorientegration.

Our paper transcends prevailing studies on the shortcomings of the European integration by deciphering *what are the main non-EU specific mechanisms behind the secular "disorientegration" of the European Union*. To this end, it unravels the strongly intertwined general vectors of disorientegration that are creating ambiguous situations by implying an *encoded disorientegrative centrifugal trend*. Finally, the paper draws potential recommendations relevant for avoiding the collapse of the European vortex, that is to say, for reversing disorientegration.

General Vectors of Disorientegration

In the spirit of a complexity approach, we broaden the research canvas by considering the dynamics of the following contextual vectors of disorientegration: 1. the changing nature of external pressure; 2. the changing nature of policy horizon; and 3. the increasing importance of time.

The changing nature of external pressure

Studies on the shortcomings of the European integration either have a predilection to focus on the institutional architecture related problem[2] or they mostly have an ingrained practise to analyse merely the integration related narrow, and more importantly, quantifiable aspects to deliver well-exposed inferences.[3] Albeit these undertakings are of particular relevance, incorporating the qualitative impacts as well must be a *de rigueur* aspect of any kind of evaluation-oriented research if for no other reason than one of the most important and deeply rooted aims of the integration: to institutionalise peace. And, as Brennan and Hamlin (2004) stated, if the probability of war is significantly reduced, the integration brings unquestionable value (an emblematic recognition of this was the Nobel Peace Prize awarded to the EU in 2012).

Undoubtedly, the most powerful driving force of the European integration was the apparent common external pressure, especially after the Second World War and during the decades of the Cold War up until the implosion of the Soviet Union *(Union of Soviet Socialist Republics, USSR)* and the German reunification. It required to avoid unilateral and destructive policies in Europe. Rekindling the flame of the European economy was of high priority not only in an economic and social but also in a political dimension on both sides of the Atlantic. It was considered as a defense mechanism against communism insofar as the enlargement of the integration continues by strengthening the Western alliance. The consistency of interests of European countries (including the United Kingdom) more or less dominated the process of European integration (European Coal and Steal Community, Common Market, European Monetary System [ESM], Single Market, Euro) from the 1950s up until the German reunification as a bifurcation point giving rise to conflicting interests. The German reunification entailed enormous fiscal burdens on West Germany and the Bundesbank was then forced to raise interest rates by triggering negative impetus on other ESM countries by leading to instability in the long political deal between France and Germany which eventually struck due to the repercussions of reunification. This was the time by when the coercive power of external pressure substantially dissolved into air in the perceptions of European policymakers and the internal dynamics of European country-level interests started to dominate.

By now, the external pressure, which created the consistency of interests for a long time, as a contextual vector of integration, seems to have been losing ground. Its nature has radically changed in terms of direction and complexity due to at least two intertwined reasons.

First, hegemonic powers have been weakening. With the implosion of the USSR and with the transition of post-communist Central and Eastern European countries, the emerging context made it able for the US with its faded hegemonic glory to have more inward orientation. (See Temin–Vines, 2013) As a consequence, the influential

[2] Literature on federalism pinpoints the lack of political union, the lack of strong fiscal union with transfer mechanism. The European Union has developed mostly in the spirit of Ordnungspolitik with its limited governmental intervention logic (i.e. Lisbon Treaty suggests more intergovernmentalism).

[3] Eichengreen and Boltho (2010) tried to quantify the economic impact of the European integration by admitting the difficulty of the task. They offered only a rough “guesstimation” that EU GDP is some 5 percent higher today than it would otherwise have been.

power of the US on the progress of the European integration has been gradually slowing down since the 1960s.[4] While other conflicts were mostly frozen by the East-West confrontation during the Cold War, these old Ghosts (with new features) were released from the bottle after the collapse of the USSR (e.g. growing disparities within Europe; recurrently crisis-ridden Russia; Ukrainian military conflict and upheaval with Russia; slowing Chinese economy; armed conflicts in the Asian part of the Middle East etc.). Today, external threatening dangers are not manifesting primarily in the form of expansive and invader-like behaviour of countries or certain group of countries, but in the array of complex grand challenges spanning across the traditional borders of countries (e.g. climate change, refugee and migrant influx etc.). Due to the more complex and elusive nature of external pressures coming from various directions (i.e. set of challenges), peoples' attention is more likely to become more fragmented (disoriented) by not powering enough to keep their eyes on the pulse of integration.

Second, external pressure started to increasingly falling short in terms of economic dimension. In the era of Great Moderation (1992–2007) there has been a widely held belief that policymakers have the ultimate tools and instruments to fend off any turmoil and spectacular deterioration, and the experienced moderation of macroeconomic volatility in various dimensions gave merit to such understanding. In this period, structural reforms seemed to have reached a plateau in the European Union, and this *status quo* was favoured by the increasing belief on decreasing uncertainties due to lowering macroeconomic fluctuations by leading to some sort of halo-effect as well as positive attitudes towards public policies in the advanced world, including the European continent. This contributed to a latent *disorientation* from not pursuing welfare through deliberate actions and the European integration has not been proved to be a developmental mechanism. As a result of the 2008 financial and economic crisis, Europe also entered into the era of Great Recession when uncertainty started to rise giving impetus to adapt, change, modify, even to reform current functions and processes. By the same token, increasing uncertainty and the lacklustre crisis management refuelled secessionism across Europe, particularly in the wealthiest regions of countries with large income disparities.[5] This can be interpreted as a symptom of *disintegrative* forces.[6]

Let us add that full sovereignty was never considered a top priority of the European integration because an *Alle Menschen werden Brüder* mentality would lead to moral hazard in a more dedicated way. This is why the godfathers of the European integration did not emphasise sovereignty so much, rather welfare and peace, because they were aware that future integration of rather different countries will make sovereignty unrealistic to be pursued at the harmful expenses of others driving the union more rigorously.

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4 On the crucial role of the United States in initiating the European integration. (See Berend, 2016)

5 Autonomy orientation is typically arising in regions being substantial net contributors to the regional redistribution system. (See Zipfel et al., 2015)

6 In 2014, the Scots held a referendum about their independence, while similar tendencies were observable in Catalonia and in case of the Flanders. In June 2016, the United Kingdom voted to leave the European Union. Additionally, there were also voices from France, Denmark, Sweden, Austria, and the Netherlands about deteriorating faith in the EU.

The changing nature of policy horizon

Despite policy actions towards creating ever-closer Europe at the beginning of the integration, its dynamism was highly volatile and even slowing down over time. This was mainly due to phenomena triggering 1. *ever more complex world,* as well as 2. *the broken harmony between the financial sector and the real economy* whereby the policy horizon has become more and more limited.

Ever more complex world

The irreversible and complex process of globalisation resulted in increasing interconnectedness with asymmetrical interdependency being coupled with growing Knightian uncertainties. (Knight, 1921)[7] One of the most pivotal driving forces of globalisation has been the quite dynamic development and diffusion of information and telecommunication technologies (ICT) since the early 1970s, whereby accessing relevant as well as irrelevant information widely and rapidly has become an ubiquitous feature of these days. Affluent information about phenomena perpetually creates impressions, perceptions and decisions in the mind-set of economic agents about how to act. Since extensive information does not necessarily lead to the useful and relevant thesaurus of knowledge because of our limited rationality, considering uncertainty as a reducible component of ignorance (Hart, 1942) *via* learning-by-doing does not inevitably hold true. What is more, proactive perceptions are generating rising expectations over the timing of proper governmental interventions.

The age of immediacy is therefore here to stay instilling uncertainties because there is no governance – neither national nor international – with the necessary *lapis philosophorum* to scientifically properly overlook *ex ante* the whole system and all the effects of the actions imposed because of the complexity it faces. Thus the performance assessment of public policies has become ever more limited.[8] Consequently, today we live

7 For example, Federal Reserve interest rate policy in the US affects the European economy, as well.

8 *Daniel Kahneman* stressed that the predictive power of our knowledge reaches its diminishing marginal returns relatively fast. This psychological finding holds especially in case of predicting non-linear processes evolving in the complex global system interspersed with growing interconnectedness and interdependency and the current dominance of uncertainties. This can be demonstrated on many policy grounds. For example, estimating ex ante the value of fiscal multiplier precisely is particularly cumbersome as it was admittedly the case documented by *Olivier Blanchard and Daniel Leigh* (2013). Unsurprisingly, the predictive power of the fiscal policy related forecasts has been rather poor. (Barroso–de Mendonça, 2015) Another apparent example is the case of public service provision. In case of health care performance of a country, the set of mostly influential factors (social, economic, political) are far beyond the control of authorities and public bodies. (Di Meglio et al., 2015)
For example, willingness to integrate requires inclusive growth and development to be triggered. In this respect, fast-growing SMEs *(gazelles),* creating more jobs than any other companies, seem to have been in the policy limelight, however, there is no quantifiable evidence whether those policies are really for achieving goals like increasing employment and innovation activity. (See OECD, 2013)
The picture has also become blurred on another quite relevant front: whether the transfer system in a federal system can lead to convergence (minimised inequalities). A recent study showed the inefficient and ineffective functioning of the so-called Finanzausgleich transfer mechanism across the German Länder, where the transfers did not foster growth. (See Baskaran et al., 2017)

in a heavily interconnected world economy where "no one is fully in charge", and where micro or national fluctuations are often amplified to a macroscopic level. Global economy is therefore pervaded by ever-increasing complexity that is mainly given by intertwined phenomena. Our belief in a repairable world, which dates back to the Enlightenment era, has become obsolete. The European continent is not an exception to this new norm (e.g. climate change marked by intensifying extreme weather anomalies; ageing society, increasing income and wealth inequality; broken harmony between the financial sector and the real economy; increasing inequalities etc.).[9] In case of such "wicked" challenges, goals are not necessarily known or are very ambiguous; and the relationships between means and ends are pervaded by a good deal of uncertainty and they are mostly poorly understood (unknown unintended consequences, unknown trade-offs and even unknown unknowns are existing).

These wicked problems, being highly resistant to resolution, are spanning across the borders of countries. Tackling them requires a more systematic understanding of their nature at national, regional and continent-wide levels to refine meaningfully the dominating economic policy toolkit. Harmonising economic, social and environmental dimensions by affecting the complicated and non-linear processes within, what is more, preventing the escalation of anthropogenic climate change require *collective action*.

Importantly, collective action must acknowledge the increasing complexity of the socio-economic system, which requires policy to avoid really bad outcomes rather than to perpetually trying to optimise the good ones. Otherwise, policymaking potentially brings hectic movements into the life of the society through Hayekian *scientism*-based interventions, which might have a depressing effect on the trust infrastructure (being inevitable also for strengthening the European integration). There is another side of *scientism*-based policy, which is *quantophrenia* (i.e. the dominant application of quantitative methods and tools). The ingrained practice of using mostly statistical quantification can become a camouflage in an ever-more complex world. By analysing and collecting statistical data and information, the observer does nothing, but synthetically manufactures reality, which does not necessarily equal to the "real" reality. Experts and economic practitioners are therefore inclined to put more weight on numerical, statistically recorded data than subjective opinions in their analyses. Actually, this bias represents our natural claim to get closer to certainty.[10] People think that certainty is everything, certainty equals with truth and the ultimate goal of science is to find truth. In this mind-set, statistical data are the fingerprints of what is really going on. This can easily lead to a policy cult which considers scoreboard, mechanistically derived targets as optimal ones having the potential to trigger continuous adjustment in the behaviour of agents. Experts' narratives are mostly based on those recorded data and their analyses influence the perceptions of other agents, too (e.g. policymakers) over what is really going on in the economy. Distortions and misguided impressions are therefore on the cards more vigorously regarding reality due to the omission of complex relationships. This points to another intriguing implication related to the limited policy horizon, namely to the *deterioration potential of democratic deficit* when it comes to referendums

9 Inequality has been increasing even among firms. (Andrews et al., 2016)
10 Big Data databases can also be misleading or delusional. (See Kovács, 2017a: 980)

because complex issues cannot be simply reduced to binary voting choices. In an era of growing complexity, achieving far-reaching and complex goals has become more and more cumbersome as for instance the case of the Lisbon Agenda exemplifies. In 2018, the EU has still not achieved the aim of the Lisbon Agenda to make the EU the most dynamic and competitive knowledge-based economy in the world even though this was planned to be fulfilled by 2010. It is hardly by chance that the European Commission (2018) emphasises that the EU should invest much more in the creation of the most innovative knowledge-based economy by being more ambitious in supporting breakthrough innovation.

All in all, increasing globalisation, growing complexity resulting wicked challenges have been directing toward a more limited policy horizon to govern (e.g. the integration process).

The non-amicable relationship between the financial sector and the real economy

There is another equally important feature of modern capitalism heavily affecting the policy horizon in general. It is *the broken harmony between the financial sector and the real economy* with all its symptoms (such as *credit consumerism* as well as the *bias towards larger companies*) and consequences (reinforcing *secular stagnation*).

Credit consumerism has evolved along the disproportional growth of the financial sector derailing from its original purpose to be a stewardship of society's assets.[11] With the benefit of hindsight, ICT-based new techno-economic paradigm together with lax financial regulations were the key driving force of globalisation and led to global financial market having ever-increasing liquidity (credit supply) eagerly seeking opportunity to be absorbed with better returns, i.e. because of the regulatory shortcomings in the financial markets, more people passed to financial markets and devoted attention to financial investments in fields like real estate.[12] In addition, there was another systemic aspect that provoked banks and investors to strongly prefer financial investments over investments in the real economy, that is to say in riskier technological or non-technological innovations and R&D activities. Namely, the ICT-based services oriented knowledge economy has some specific features that have been directing towards lower productivity through labour-saving technologies (i.e. automation, standardisation by means of ICT etc.) which entailed

[11] The European Systemic Risk Board (2016) showed that there are extensive intra-financial exposures in derivatives markets. Additionally, non-banking financial companies started to soar in the shadow by leading to bubbles, overvaluation of assets. (See Abad et al., 2017: 35) The parasitic character of the financial sphere is also mirrored in the growing trend in share buy-backs thereby the players intend to boost stock markets. It implies that they are not looking for riskier and productivity-enhancing investments in the real economy (40% of S&P 500 firms bought back shares in 1990, their proportion was 60% in 1997–2003, while it was 85% in 2017).

[12] In the US, the debt of households started to accumulate rapidly, especially in case of low-income households being in low-inequality regions where the financial market, banking sector could spread the risk seemingly in a more efficient way. (See Coibion et al., 2014)

secular downward trends in manufacturing labour shares as Neiman (2013) shows.[13] Beyond the fact that this *per se* reinforces secular stagnation,[14] it also affected negatively the gap between rich and poor, and the features of services dominated economies in the advanced world (i.e. requiring higher skills and competences to pursue service innovation that have more qualitative outcomes) might also be counterincentive to diminishing income inequality. This is why casino finance has become a magnet[15] and *excessive credit consumerism* has appeared ubiquitous in the advanced world (e.g. in 1970, the share of domestic credit provided by the financial sector in percentage of the GDP was 87% in OECD countries, 54% in the European Union, and 112% in case of the United States; by 2012, the data were as follows: 210%, 168% and 235%).[16]

This is problematic because the intermediation role of the financial sector has to some extent ceased to exist, a phenomena being undeservingly neglected even in the most recent literature.[17] The symbiotic relationship between the financial sector and the real economy got impaired by creating a parasitic-like financial sector. (Hossein-zadeh, 2014: 67) If excessive *credit consumerism* is here to stay without lasting positive impetus on productivity, as historical statistical records show,[18] consumption and production patterns are unsustainable.[19]

Of course, excessive credit consumerism is also observable in case of states in the form of public debt overhangs. The ever-more limiting nature of policy horizon raises here again since empirical evidence suggest that assessing a given country's sovereign

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13 The declining productivity growth was shown even in the ICT-using industries over time. (Kovács, 2017b, Chart 3) True, there is some problem with measuring productivity growth in an era of ICT-triggered services innovations and the increasing investments in intangibles (such as software, R&D, design, branding, training, and business process engineering) as Haskel and Westlake (2017) pointed out.

14 For a great account on secular stagnation see Teulings and Baldwin (2014).

15 Since 1950, securities, commodities, venture capital, private equity, hedge funds, trusts, and other investment activities like investment banking have been gaining dominance rapidly, plus more and more graduates from Yale, Harvard and Princeton were absorbed by the more speculative fields within the financial sector. In addition, bank lending has also been on rise. The boom of the financial sector was mostly responsible for the extensively increasing income and wealth inequality in the US. Unsurprisingly, the labour share of income has been secularly declining since the midst of the 1970s. (See OECD, 2015) By analysing where the wealth of billionaires has come from, a study found that over 40 percent of the growth in the billionaire population in the US is attributable to growth in the financial sector. The growing financialisation of the American economy contributed to the extreme wealth creation in the US: 27 percent of US billionaires worked in finance in 2014, compared with 10 percent in Europe and 20 percent in non-European developed countries. (Freund–Oliver, 2016)

16 See the World Development Indicators of the World Bank. According to recent estimates, credits above 90–95% of the GDP are more likely to be a serious drag on growth. (See Chong et al., 2017)

17 Studies addressing the factors behind structural change and the associated decline in labour share of income also neglects the role of the financial sector. (See Alvarez-Cuadrado et al., 2018) Still, the issue has been gaining more and more attention, as one of the most recent analyses by Alexiou et al. (2018) admitted and showed that there has been a severance of the link between the financial sector and the real economy.

18 Credit consumerism can be captured by the over-indebtedness of households. (See Mian et al., 2017) Importantly, albeit an increase in short term household debt can boost economic growth, the positive effect will be reversed after 3 to 5 years and growth will be deteriorating. (See IMF, 2017, Chapter 2)

19 Excessive credit consumerism is also propelled by manipulation and deception. (Akerlof–Shiller, 2015) For overproduction and overconsumption, just take a mere glimpse on the historical account of increasing waste generation. (See IPCC, 2007)

credit risk has its roots predominantly in financial sectors rather than in macroeconomic fundamentals, (see Ang–Longstaff, 2013) hence the hardly measurable dynamic patterns of psychological factors bring more uncertainty into policymaking.

Another symptom of the broken harmony is *the bias towards larger companies* that are dominating more easily than ever before. In the era of ICT-based network-oriented knowledge economy, monopolies can be maintained easier for a longer time due to ICT-related laws. In other words, the Baumolian contestable market principle has been weakened. It has become ever more difficult to beat those giants that are in the global frontier, while the share of medium size companies has been shrinking, larger companies have become the largest employers in the EU (according to Eurostat, 33% of total employment is given by larger companies, 29.2% by micro-enterprises). More and more quantitative evidence suggests that the declining dynamism of productivity in the real economy is mainly due to the disproportionately increasing financial sector (Cecchetti–Kharroubi, 2012; 2015), which started to prefer investments in the real economy that are less risky but can easily result in low productivity improvements, merely. In this way, the link between the financial sector and the real economy has become weakened and distorted by resulting a rise in market concentration in various industries. What is more, the uncertain economic climate drives risk-aversion strengthening the bias from the side of the financial/banking sector towards companies having higher net worth but not being necessarily more productive/innovative. (Gopinath et al., 2017; OECD, 2017b) This systemic bias towards larger companies is able to stifle down the positive effects of any kind of productivity-stimulating policies and programmes not only because larger companies can roll barriers in front of innovative start-ups via strategic use of patents, but also because zombie companies (i.e. longer-living unproductive companies in the market without being selected out) are living among us more vehemently;[20] hence wage stagnation,[21] intensifying joblessness with dispiriting growth performance,[22] moderated innovation activity and increasing inequalities have become the new norm.

Excessive credit consumerism and the broken harmony between the financial sector and the real economy are, of course, intertwined by creating unsustainable patterns. And once the unsustainable patterns of overconsumption and overproduction hold, non-differentiated monetary and fiscal stimulus become ineffective in reinvigorating growth rates of today because a more qualitative growth is needed.

20 The European crisis management has increased the amount of non-financial zombie firms, whose interest bill exceeds earnings before interest and taxes. (See BIS, 2017: 13)

21 For instance, Berlingieri et al. (2017) demonstrated that globalisation and digitalisation are associated with higher wage divergence between firms within any given sector by engendering growing labour income inequality within a country in a more conspicuous way.

22 The throttle of the European growth has become rustier because of the savings-oriented attitude of large older cohorts by putting low real interest rates into longer perspective. And once the population is aging, as Acemoglu and Restrepo (2018) documented, companies have become more and more willing to substitute (middle-aged) workers to robots or to reduce their numbers via intensified automation.

The increasing importance of time

Time has become more and more important when it comes to interpreting the disorientegration process in the European integration. In this respect, time has at least two layers: 1. *the realm of the "long time ago"*; 2. *from being to becoming*.

As far as the realm of the "long time ago" is concerned, the major message of studies on how war affects social and political behaviour in post-war periods is that propensity to cooperate and pursue civic engagement as a form of pro-social behaviour weakens with time. (See Bauer et al., 2016) The horrors of the first half of the 20th century are too far from today's generation. The dramatic impacts of the wars are living vividly only in the living memory of a soupçon of people. As former French President Valéry Giscard d'Estaing noted, the post-war consumer generation did not care about the war. (See Spiegel, 2012) People who lived through those bestial times appreciate and cherish peace the most and they were to hand over that feeling to their next generation; however, the life-changing trauma of wars has eased and even dissolved to a great extent into air over time with newer generations. And what behavioural economics and psychology science suggest is that people tend to be more sensitive to losses and pains than to forgone gains. (See Kahneman–Tversky, 1979) One might even argue that newer generations in Western European core-countries did not reach out peace by their own but have been increasingly treating it as a natural constituent of their lives. With new generations, the bases of people's expectations have been reoriented from evaluating the power of integration as a bulwark of peace at the first place to aspiring for more welfare in quantitative and qualitative means (e.g. increasing earnings and employment, fast growth rates, thriving productivity and competitiveness, access to modern public services etc.). And these *expectations* have not yet been entirely fulfilled.[23] This is why trust in European integration seems to have been weakening and the crisis-tolerance level of newer generations along the course of the integration has eroded and become even more erratic. Thus, the ethos of putting peace preservation as a common goal in front of individual (Member State) objectives has faded. Thus, *the gap between what should be done and what voters tolerate has been increasing*. Additionally, there is also a lack of momentum at higher levels in core countries to absolutely work together on the future of Europe. To overcome this driverless state, much more needs to be done.[24]

From *being to becoming* refers to the flow of time in our socio-economic innovation ecosystem in which structures, processes, and the psychic capital of people are in constant change over time due to bifurcations, irreversibility and non-equilibrium. On the front of structures and processes, let us underscore that ecosystems – such as our socio-economic innovation ecosystem being an open, dynamic and adaptive system embracing a large number of diverse interacting parts – are perfused with irreversible events even at the macro level. (Prigogine, 1980; 1997) This influences the context of

[23] According to the Nobel Laureate Kenneth J. Arrow, expectations are governing our decisions and actions, especially our expectations about others' expected behaviour. Regarding the expectations of new generations over the integration, the picture has not been as blight as previously expected in terms of employment, productivity, innovation and competitiveness. (See Sapir et al., 2004)

[24] Since the fall of 2017, the so-called Leaders' Agenda meetings take place to guide EU action over the next two years.

the European integration. For example, during the European integration an entirely new techno-economic system emerged in the advanced world. The theory of techno-economic paradigm suggests that the socio-economic development has recurrently arrive at a bifurcation point in time when irreversible changes occur. This cyclically evolving pattern is driven by technological revolutions by forming a new techno-economic paradigm. (Perez, 2009) As we indicated earlier, the new ICT-based techno-economic paradigm that emerged since the midst of the 1970s not only provoked profound changes in the production process, but also tailored them to a more service-oriented economy. In a system with such dynamics, it is hardly by chance that the European integration has been often considered as a process of *chain reaction* where the full range of steps forward cannot be precisely known *ex ante*. And the detectable fact that the integration is only partial was expected to help moving forward *via* constantly emerging irreversible steps towards political integration.[25] One may conclude that the European integration process has been a chaos as a type of unstable order.

Complexity science conveys that *non-equilibrium* (or disruption, or instability) arises endogenously in a complex system (Prigogine, 1977) such as the European arena interspersed with a large number of interacting members with their own dynamics. This system is *inter alia* pervaded by spillovers, non-linear processes, turbulences, far-from equilibrium situations, small changes with big cascading or escalating effects, and the legion of causes of events that are emerging in time. Non-equilibrium can be interpreted as some sort of asymmetry, as well. According to the well-known Noether's theorem, symmetry in nature always means that some sort of conservation of corresponding things is working behind the curtain (momentum, energy etc.). (See Noether–Tavel, 1971)

Consequently, when we see or perceive any kind of asymmetry, the conservation process falls short or is missing. This might be the case when it comes to the European integration in which heterogeneous countries do not show the ethos of faith community (as the energy of integration) as one would have previously expected. Noether's theorem also suggests that a complex system is by no means equal with the sum of its parts, but *the sum of its parts taken with the interactions among them*. This consideration is in order, for example, when it comes to understanding the dynamics of the European integration process meaning the progress from being to becoming. With the continuous enlargement of the EU and the growing linkages among Member States, the integration process has been becoming a mostly irreversible process continuously influencing our development opportunities. From the early 1950s onwards, the new stream of economic literature was evolving, it is called dependency theory. Interdependency is "[…] a situation in which the economy of a certain group of countries is conditioned by the development and expansion of another economy, to which their own is subjected". (Santos, 1970: 231) Under the auspices of dependency theory, economics incorporated more and more the Noetherian view about interactions, for instance, by analysing the core-periphery relations as manifestations of asymmetrical interdependency in the European integration. There is a good reason to think that real socio-economic development throughout the becoming EU – i.e. creating conditions for the realisation of human personality rests upon our

25 As Nietzsche noted, you must have chaos within you to give birth to a dancing star. It was reflected in certain cases (e.g. Beyen plan for a common market; the Hague summit etc.).

ability to stimulate synergies by influencing the dynamic relationship between core countries and peripheral ones.

Psychic capital also bears the stamp of increasing importance of time. The aggregated memory of actors (e.g. in the European integration) forms the so-called psychic capital (Boulding, 1950: 140) then brings path-dependency into any development path. The welcome and the support of economic policy actions depend a lot on the current status of (positive or negative) psychic capital which embraces memories of pleasure, success, achievement, recognition as well as memories of failures, disasters, atrocities, or perceived injustices and indignities. Introduced and implemented policy actions, initiatives, statements (e.g. regarding European integration) either from the government or the independent central bank can by no means be completely removed from the system or even neutralised. They become part of the memory of the given socio-economic-political system by impinging on psychological factors and behaviour. In the context of the European integration, the dynamics of psychic capital can be portrayed both at national and supranational levels having the potential to contribute to the disorientegration forces. At national level, for example, the Empty Chair Crisis of 1965 was a harbinger of long-standing and hard to dampen objection of a core country to build up a more supranational architecture.[26] At supranational level, for example, when the President of the European Central Bank was to free the ECB from its shackles by stressing that "do whatever it takes" to safeguard financial stability and the survival of the Eurozone by launching unlimited purchase of debt instruments from debt-crisis ridden states from July 2013; uncertainty, on the one hand, was reduced because of the powerful institutional signalling that boosted trust and confidence of markets. On the other hand, this action also had uncertainty-generating feature since this declaration was crystal-clearly unlawful (i.e. breaching Article 123 of the Treaty on the Functioning of the European Union) and it may have therefore catalysed further non-compliance in case of other actors by intensifying uncertainty.[27] Furthermore, psychic capital dynamics can also be captured by Public Opinion surveys since 1973 that are furnishing the message that attitudes towards enlargement and integration have been conspicuously decreasing since the 1990s.[28]

In sum, the changing nature of external pressure in case of the European integration, intermixed with the diminution of policy horizon, as well as with the increasing importance of time seem to be autochthonously forming a centrifugal force powerful enough to encode weakening into the integration process by making it less and less resilient over time. Disorientegration is therefore not a recent fortuitous event but a systemic pattern.

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26 France held a referendum on the Maastricht Treaty, and even rejected the adoption of the Constitutional Treaty in 2005.

27 The commitment to no-bailout principle in the US applied in the 1840s is still remembered and this memory has strengthened the credibility of the federal system even today.

28 For instance, emerging scandals were harmful for the trust base of citizens in Europe (e.g. the Santer Commission's scandal in 1999; the 2006 Galvin Report highlighted the lack of control over MEPs' spending on assistants' wages and social security; the Cash for Influence Scandal in 2011 in case of a former Austrian MEP. And, of course, EU cohesion has also been challenged by the Euro crisis, the influx of refugees and migrants, increasing nationalism and populism in Central and Eastern Europe showing some sort of derailment from EU-values.

STUDIES

Conclusions

This contribution addressed the dynamic configuration of non-EU specific processes lurking behind the European disorientegration phenomena. Despite the consensual rhetoric recording disintegration as a relatively new-fangled phenomenon being the result of the 2008 financial and economic crisis and its ensuing sovereign debt crisis, with a veneer of complexity-awareness, we have identified the general vectors of which secularly evolved collage has been directing towards disorientegration.

Bearing in mind the nature of the European integration, our paper can by no means offer the full panoply of policy prescriptions for national and supranational governance. Still, and beyond the usual suggestion of "complete the internal market", at least three *conceptual prerequisites of reversing the European disorientegration* can be outlined.

First, *European and national governance should have a more nuanced, complexity-aware approach* in addressing grand challenges rather than intending to solve them once and for all. Encoded disorientegration directs toward the need for some sort of *contingency-aware governance* which is not in denial *vis-à-vis* our complex innovation ecosystem characterised by uncertainty, non-linearity, unpredictability and emergence (from being to becoming). The basic requirements of such governance shall be as follows: 1. *System thinking with more interdisciplinarity* to address the dynamic configuration of processes related to disorientegration in the EU as an endogenous phenomena, e.g. core-periphery nexus, or by taking into account the features of our current ICT-based, services dominated techno-economic paradigm which is far-from equilibrium). 2. *Acknowledging our limited knowledge and policy horizon:* the system (European integration) cannot be understood as a whole and what is more it cannot be governed since it has emergence, non-linearities etc. No one is in full charge of challenges. In the era of immediacy, policy is expected to follow arousing tensions and crises in due time; however, this is impossible. Therefore, social learning shall be cultivated by accepting that blossoming quantification can misguide and distort our evaluations over the effectiveness of various policies in tackling complex challenges and interpretations over socio-economic phenomena. Unless such shift is made, a bias toward more quantified and well established ideas of older vintage will exist further on without paving a way to riskier and more collaborative innovations having more qualitative impacts on our life.[29]

Second, *limited discretionalism is in order,* which is less likely to dismantle the trust infrastructure, by building more on collaborative participatory mind-set, especially in turbulent times pervaded by uncertainties. Some argue that Europe needs more democracy, it might nevertheless intensify disorientegration (e.g. BREXIT voting). For this reason, democratic deficit shall be mitigated *via* feeling the pulse of the citizen opinion without triggering negative impetus on governance and integration. For instance, the introduction of participatory budgeting can be a good way forward, i.e.

[29] However, economic history exemplified that new and riskier ideas spur subsequent inventions more frequently. See Packalen and Bhattacharya (2015) in case of the US patent history. The European R&D statistics also lend support to the higher risk-aversion on the one hand, and the fiscal incapacity of national public finances to support R&D&I via fiscal incentives (as Eurostat [2016b] shows, the progress toward the R&D target of the Europe2020 strategy has been infinitesimally slow in the period of 2008–2015).

discussing budget-related issues with citizens on public service delivery when it comes to prioritising. Participatory budgeting provides a higher quality of feedback circle. (Kovács, 2012)

Third, the *EU governance shall re-establish and strengthen the trust and confidence* of EU citizens. Growing uncertainty, recessionary periods with grand challenges might lower the political costs of overarching reforms because the voters are more likely to accept that the outcome starts to depend on the weaving relations of various external processes and not mainly on governmental actions. Reforms may contain fostering positive green finance to address unsustainable credit consumerism and consumption patterns to transform the economic model via breaking secular stagnation, reducing the ever-widening gulf of inequality without ignoring employment–Industry 4.0 development nexus, and taking into account environmental constraints. Beyond game-changing reforms, the public sector also plays and important role in reinvigorating trust and confidence. Challenges associated with fundamental uncertainty call for good governance and more innovative public sectors signalling their ability to cope with the challenges by creating and maintaining necessary trust. Public sector innovation is "[…] the process of generating new ideas and implementing them to create value for society, covering new or improved processes and services". (European Commission, 2013: 7) The public sector should be a hotbed of innovation which can not only be a demonstrator for the private sector but can also become a mechanism of increasing the *quality of governance* across the board (by maintaining the quality of service provision, reducing excessive expenditures while not imposing additional burdens on labour and the economy as a whole by fostering trust building in time when painful measures are inevitable).

All in all, disorientegration is an echo effect of a complex amalgam of mutually intertwined and interrelated mechanisms secularly shaping the European integration process. Further research shall analyse the interplay between non-EU-specific and EU-specific vectors to better ground the contours of some sort of contingency governance in a more detailed manner.

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Ágnes Orosz

The Development of Social Spending in East Central Europe[1]

The overall aim of the paper is to provide a comprehensive analysis of welfare state policies and expenditures of the East Central European (ECE)[2] *countries. The article collects the historical-institutional features of East Central European welfare states after transition and analyses the composition of welfare state spending. Since the outbreak of the financial crisis enforced welfare state retrenchment in the ECE region as well, recent developments play a key role in understanding the major features. The development of welfare services shows that the East Central European countries are at the very beginning of building a modern and efficient market-driven welfare state with several challenges ahead of them.*

Keywords: East Central Europe, welfare state, welfare regime

JEL classification: H53, I39

Ágnes Orosz, Assistant Professor, National University of Public Service; Research Fellow, Institute of World Economics, Centre for Economic and Regional Studies of the Hungarian Academy of Sciences (MTA KRTK VGI). E-mail: oroszagnes@uni-nke.hu

1 The work was created in commission of the National University of Public Service under the priority project PACSDOP-2.1.2-CCHOP-15 entitled "Public Service Development Establishing Good Governance" in the Egyed István Postdoctoral Program.

2 East Central Europe is referred to as the examined six new EU member states which are members of the OECD as well, namely: the Czech Republic, Estonia, Hungary, Poland, the Slovak Republic and Slovenia. CEECs are referred to as the whole Central and Eastern European region (broader term).

Introduction

The formation and development of the welfare state in East Central European (ECE) countries has brought much attention. The collapse of the communist regime was followed by rapid and radical changes, institutions of parliamentary democracy have emerged and produced laws to harmonize with the new system, installing a market-conform legal infrastructure. While the private sector developed rapidly, the reform of the pension system, medical care and social assistance systems have been laid aside for several years. (Kornai, 1997)

However, there are studies claiming that the post-communist welfare state does not follow a single pattern (Cerami, 2005), Deacon (1992), for instance, predicted that the East Central European countries will develop their social policies in the future into distinct regimes that may even lie outside the three worlds of welfare capitalism described by Esping-Andersen (1990). The theoretical argument whether there is a specific ECE (CEEC[3] or post-communist) welfare state model is still inconclusive. The transition of the post-communist welfare states involves communist legacies and strong elements of path-dependency, as well as innovations and path-departing changes. (Cook, 2010)

Inglot (2008) pointed out that the welfare states of East Central Europe are dynamic historical entities, "works in progress", rather than static, finished models. (Inglot, 2008: 8) It is a common feature of the countries of the model that due to delayed and obstructed political and socioeconomic development, no consolidated "regime types" may appear among the late-developers. These countries are more likely to remain "permanent construction sites or layered structuring of social policy institutions, which often incorporate highly inventive combinations of old and new benefit programs". (Inglot, 2008: 307) This paper argues that due to historical legacies and institutional similarities East Central European countries can be treated as a distinct welfare state regime. It is essential to understand the different social policy changes, reforms within the European Union, especially in East Central Europe. The study seeks to answer what are the distinct features of the East Central European welfare states.

The structure of the article is as follows. The next section presents the historical-institutional features of East Central European welfare states after transition. There follows the analysis of the composition of welfare state spending. The third part collects recent features of welfare state development of the region. The main findings are summarized in the conclusion part.

[3] "Central and Eastern Europe seems easier to define by what is not, than by what it is. It is an area without clear geographical borders. (Batt, 1998: 1; Pásztor, 2012; Pénzes et al., 2014) Based on the definition of the OECD, Central and Eastern European Countries (CEECs) is an OECD term for the group of countries comprising Albania, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, Slovenia, and the three Baltic States: Estonia, Latvia and Lithuania. Therefore, the dissertation does not use the term CEECs, it limits itself to the concept of East Central Europe (ECE), including the four Visegrád countries, plus Slovenia and Estonia. In welfare state literature these countries are often referred to as CEECs or post-communist welfare regimes; however, in general, the scope of analysis is varying.

Historical-institutional Features of East Central European Welfare States

East Central European countries share a common communist legacy with markedly different political and welfare cultures compared to Western capitalist democracies. Since the concept of welfare state is typically applied for parliamentary democracies and market economies, this paper focuses only on the development of the region after 1990. Earlier stages of welfare state development of the region are well described by Szikra and Tomka (2009) who defined the major features of communist welfare regimes in East Central Europe. Their systematic analysis collects "peculiarities of pre- and post-war development" (Szikra–Tomka, 2009: 17) and describes the operation of welfare policies under communism.

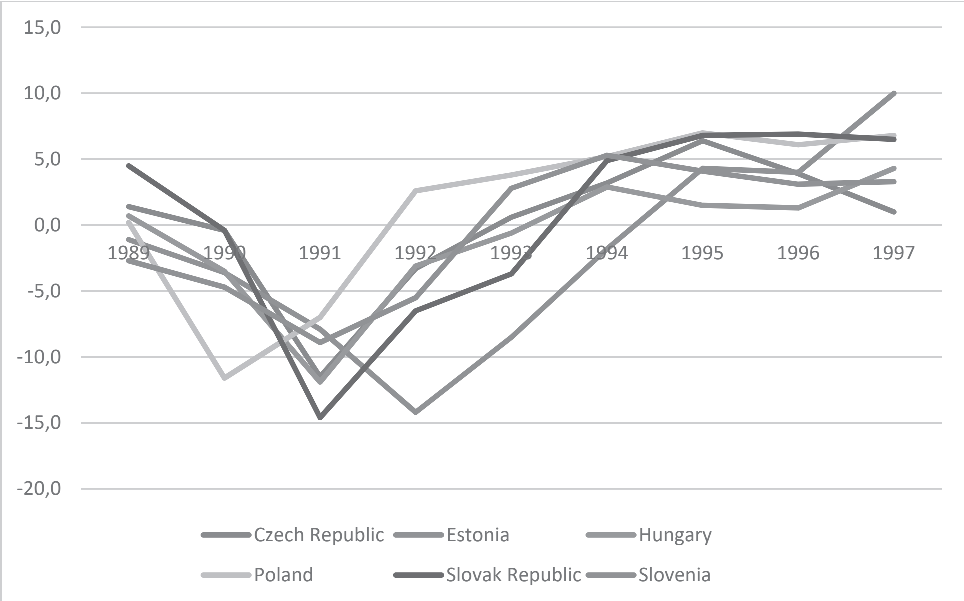

Figure 1.
Real GDP growth rate in countries of the ECE model (1989–1997)
Source of data: Pittlik, 2000: 41

Social, political and economic transition in East Central Europe shaped the operation of welfare systems. Transition to market economy negatively affected welfare systems in several different ways, former practices diminished, and demand for welfare services increased, while the number of contributors to social insurance budgets significantly decreased. (Szikra–Tomka, 2009) Transition brought three major challenges for the post-communist welfare states: the elimination of most price subsidies, the end of full employment, and the transformation of state-owned enterprises into profit-making companies. These shocks, accompanied with growing social need and economic reforms caused a massive recession. (Orenstein, 2008)

A common pattern of ECE countries is that all of them experienced a severe output decline (Figure 1). Countries of the model returned to pre-1989 levels of economic output within four to five years and then began a period of solid economic growth; however, the transformation process took massive tolls in the long term negatively affecting the socio-economic environment.

The dramatic effect of the end of full employment can be demonstrated by Figure 2. With respect to labour market developments, economies of the ECE region experienced a salient rise in official unemployment rate exceeding 10%, with the exception of the Czech Republic where it stayed below 5% until 1997 and in Estonia where unemployment rate fluctuated around 5.5% between 1992 and 1996.

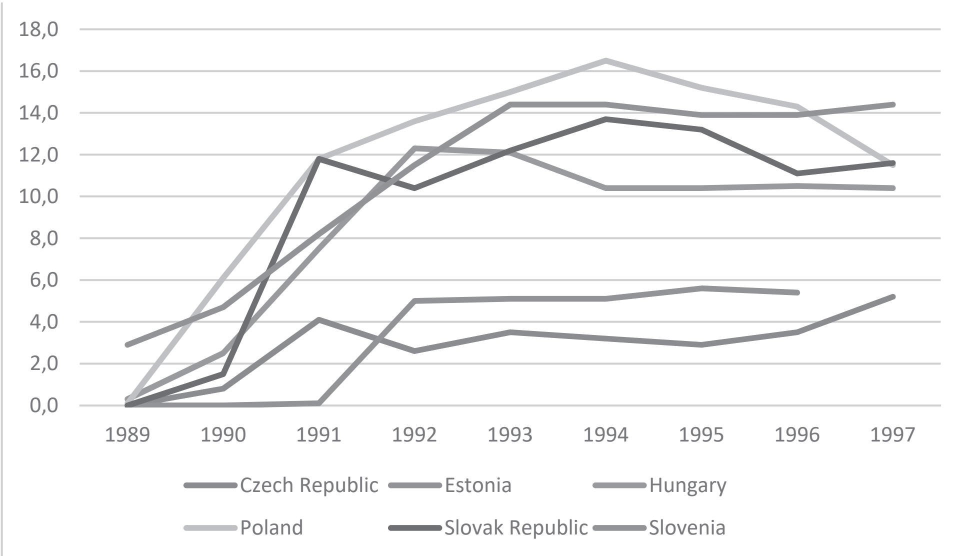

Figure 2.
Unemployment rate in countries of the ECE model (1989–1997)
Source of data: Pittlik, 2000: 41

At the beginning of transition, inflation in Poland and Slovenia exploded to rates of more than 600 and 270%, respectively, in 1989. Estonia experienced hyperinflation of 300% in 1991 and almost 1000% in 1992. Table 1 illustrates that inflation varied considerably. Hungary, for example, never had an inflation rate above 35% and the Czech level only exceeded 50% in 1991, later stabilizing around 10%. Inflation in Slovakia was the lowest during almost the whole period, and after its peak in 1989 and 1991 Slovenia could keep inflation level below 10 %.

Table 1.
Inflation rate in countries of the ECE model (1989–1997)

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Czech Republic	1.5	18.4	52.0	12.7	18.2	9.7	7.9	8.6	10.0
Estonia	n.a.	n.a.	303.8	935.5	35.6	42.0	29.0	15.0	12.0
Hungary	18.9	33.4	32.2	21.6	21.1	21.2	28.3	19.8	18.4
Poland	639.5	249.0	60.4	44.3	37.6	29.4	21.6	18.5	13.2
Slovak Republic	1.5	18.4	58.3	9.3	25.1	11.7	7.2	5.4	6.4
Slovenia	272.0	105.0	247.1	92.9	22.9	18.3	8.6	8.8	9.4

Note: CPI end of year. N.a.: not available.

Source of data: Pittlik, 2000: 41

Transition resulted in worsening macroeconomic conditions during the first four or five-year long period, policy reforms were accompanied with a serious transition recession (deterioration of economic performance, rising unemployment).

How did the transition affect welfare systems of the model? Before transition, communist economies did not perform particularly well; they only ensured a basic standard of living for all. As this guarantee began to diminish, governments introduced emergency responses to address the growing social crisis, which shaped welfare-state policy through the mid-1990s. Coordinated policy responses began to emerge only later. (Orenstein, 2008) In some cases the social costs of transition were compensated through the welfare system. (Szanyi, 2013)

A distinct period of transition among East Central European countries lasted roughly from 1989 to 1993 which can be defined as the first phase of welfare state development. Due to deep economic recession, policymakers expanded welfare provision to mitigate the immediate social distress of mass unemployment resulting from the dismissal of workers from state-owned enterprises and poverty. (Hemerijck, 2013) Cerami (2010: 242) called this period "compensating for the transition" in which the temporary growth of welfare service provisions were aimed at solving the problem of mass unemployment by introducing extensive early retirement policies and by establishing relatively far-reaching unemployment and social assistance programs. Vanhuysse (2006) defined these actions as a "divide and pacify strategy" meaning that "the work-welfare status of individuals can be manipulated by governments in order to reduce the capacity of reform losers for mobilizing". (Vanhuysse, 2006: 49) This strategy led to relatively generous welfare benefits, especially if we take into account the real performance of these transition economies. (Cerami, 2010)

After 1994, when the cumulative burden of social protection expansion of the previous period (1989–1993) proved to be financially unsustainable, the second phase of post-transition welfare state development has started, in which retrenchment and privatization gained prevailing importance. (Hemerijck, 2013) The early generosity of welfare systems soon became unsustainable, especially due to the escalating number of unemployed. (Cerami, 2010) The new direction of this period resulted in advice from the

IMF and the World Bank and in the introduction and expansion of multi-pillar pension systems in most ECE countries. This period is characterized by three important features: 1. welfare retrenchment and cost containment including shifting away from tax financing to increased payroll financing, linking duration and benefit levels to contribution, plus indexation; 2. pension reform, in particular the privatization and individualization of savings; and finally 3. the creeping re-familiarization of social policies, meaning that by the late 1990s family allowances started to expand. (Hemerijck, 2013)

During the first few years of transition the priority of welfare state reform was subordinated to political and economic aspects, "the transformation of social security system [...] could be treated as a second order phenomenon". (Wagener, 2002: 156) The early 1990s were shaped by the dynamism of transition, while the late 1990s and early 2000s were in flux as a part of the EU accession. An economic boom in ECE countries during the early and mid-2000s can be observed (which offered hope for a more rapid convergence with the old EU member states), but the global economic crisis and the European debt crises after 2008 resulted in a serious decline of economic performance in countries of the region (Figure 3). (Nenovsky–Tochkov, 2013)

The second phase of welfare state development, the accession process has contributed to significantly improved living standards in the new Member States, fostering economic and social cohesion within the European Union. Economic catch-up has occurred, income per capita rose from 40% of the old Member States' average in 1999 to 52% in 2008. It is estimated that the accession process boosted economic growth in the new Member States, by about 1.75 percentage points per year over 2000 and 2008, when growth increased from 3.5%, on average, between 1999 and 2003 to 5.5% for the period between 2004 and 2008. (European Commission, 2009) Fostering social cohesion is presented in the Report of the European Commission, welfare states in the ECE countries has operated with declining welfare efforts.

Sachs (1996) argued that high government expenditure – and high welfare expenditure in particular – is considered a threat to economic growth for the countries in the region. This statement is exemplified by the fact that during the early 2000s the highest growth rates were recorded in Estonia and Slovakia where aggregated public social expenditures were the lowest during that period.

The third phase of welfare state development from 2001 to the outbreak of the global financial and economic crisis can be characterized by recalibration of social policies and by policy learning mechanisms. The growing number of unprotected citizens attempting to benefit from the already indebted social insurance funds caused severe problems, while the excessively optimistic expectations for market-driven change did not survive long. (Cerami, 2010) In this period, activation and active labour market and social inclusion policies gained more prominence, partly due to the EU Lisbon Agenda, moreover family benefits further increased in the 2000s. (Hemerijck, 2010)

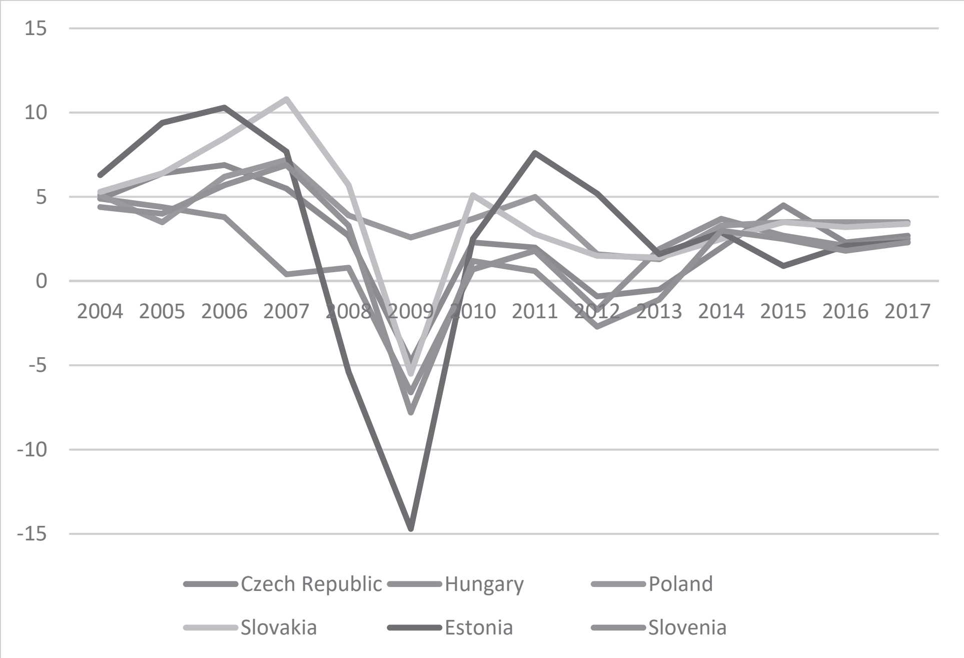

Figure 3.
Real GDP growth rate in countries of the ECE model (1998–2017)
Source: Eurostat statistics, online code: [tec00115]

As a consequence of the above mentioned waves of welfare state formation in East Central Europe, a mixed or "hybridized" welfare model has evolved combining Continental Bismarckian elements, Anglo–Saxon market-based pensions and social services supported by basic egalitarian universalist safety-net provisions. (Zeitlin, 2003)

Composition of Welfare State Spending

The analysis of composition of public social expenditures can be a good indicator to sum up commonalities and differences among the countries of the model for the period from 2000 to 2013.[4] In 2000, the most important item for the ECE countries within public social expenditures was the cumulative level of old age and survivors' pensions, fluctuating around 6–7% of the GDP in the Czech and the Slovak Republic and Estonia, 8% in Hungary and around 10% in Poland and Slovenia. Pension expenditures accounted for 40% of all public social expenditures and even for one half in case of Slovenia (Figure 4–9) in 2000.

4 2000 is the earliest year when data for each country are accessible, 2013 is the most recent year for data of social expenditure branches in the OECD SOCX data base.

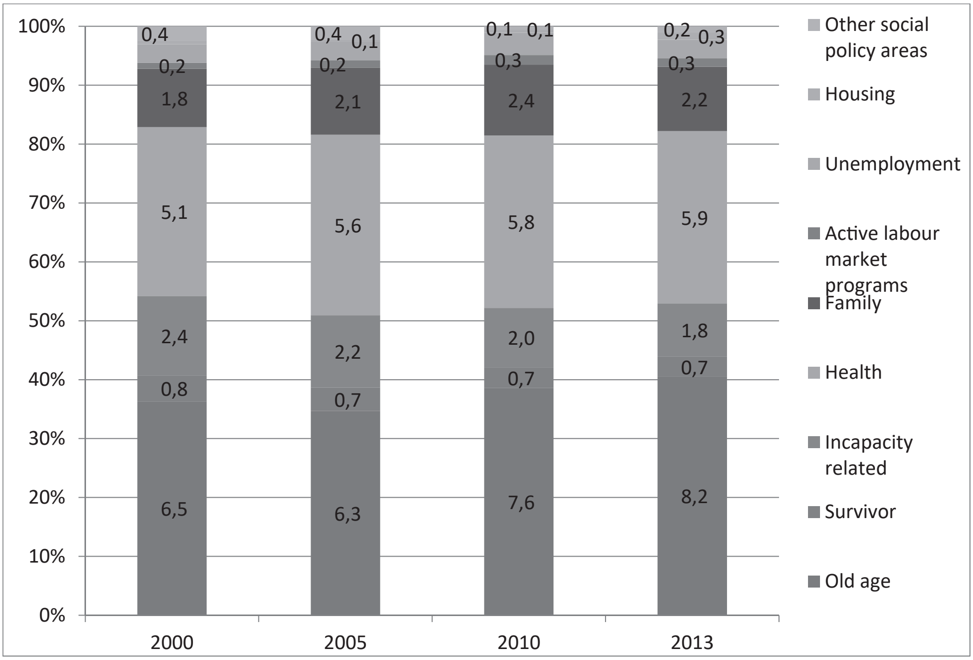

Figure 4.
Composition of aggregated public social expenditures in the Czech Republic
Note: Numbers represent the different types of gross public social expenditure as a percentage of the GDP.

Source of data: OECD SOCX database

The high share of pensioners is due to the economic restructuring of the early 1990s, when early retirement pension was to absorb the large number of unemployed workers. With the exception of Slovenia, all countries of the model experienced salient increase of pension expenditures by 2013, the highest, around 2% points in the Czech Republic and Hungary. In Slovenia the growth of pension spending was minor until 2000, then it started to decrease during the 2000s which was followed by a slight upturn. The distribution of these two categories varies within the model. Survivors' pension was not pronounced during the whole examined period in Estonia, such as in Slovenia which increased survivors' pension spending considerably reaching 1.6% of the GDP, which was the highest value within the model in 2013.

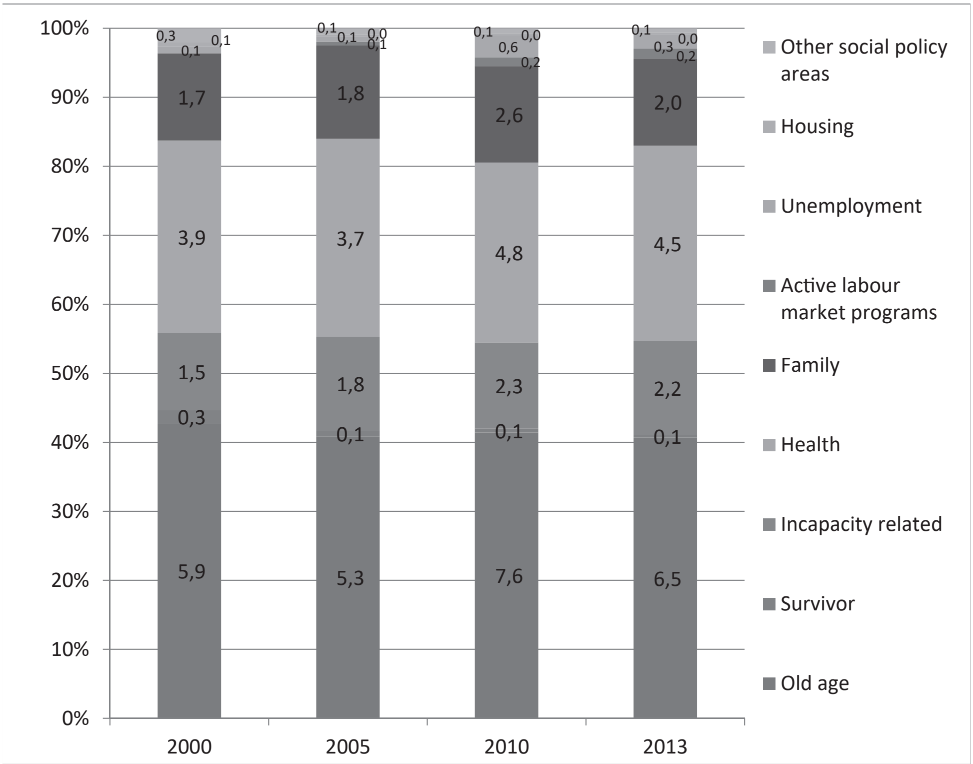

Figure 5.

Composition of aggregated public social expenditures in Estonia

Note: Numbers represent the different types of gross public social expenditure as a percentage of the GDP.

Source of data: OECD SOCX database

Since the mid-1990s, CEE countries have carried out structural reforms on their pension systems. Notably, several countries have introduced a Chilean-type mandatory, privately managed pension system (the so-called second-pillar pension system). The ECE countries that implemented this type of pension system includes Hungary (1998), Poland (1999), Estonia (2002) and the Slovak Republic (2005) (with numbers in brackets indicating the year of implementation). Hungary, Poland, Estonia and the Slovak Republic had pre-existing state pension systems, the reforms resulted in scaling down the state pension systems and partially replacing them with privately managed individual savings accounts. At the same time, state pension systems (now called the first-pillar pension systems) were also reformed by changing some key scheme parameters (extension of qualifying period for pensions, increase in retirement age and transition from wage indexation to price indexation). (Hirose, 2011)

Figure 6.

Composition of aggregated public social expenditures in Hungary

Note: Numbers represent the different types of gross public social expenditure as a percentage of the GDP.

Source of data: OECD SOCX database

Surprisingly the effects of these reforms cannot be observed in the figures. Pension spending significantly increased in the Czech Republic (from 6.5% to 8.2% of the GDP) and in Hungary (from 6.9% to 9.6% of the GDP). In Poland, old age and survivors' pension expenditures soared dramatically and continuously during the analysed period, reaching their peak of 11.8% as a share of the GDP in 2009, exceeding half of all pubic social expenditures. Estonia, Slovakia and Slovenia maintained a slight growth rate of pension spending. It is worth noting that none of the ECE countries that implemented pension reforms witnessed reduction of pension spending.

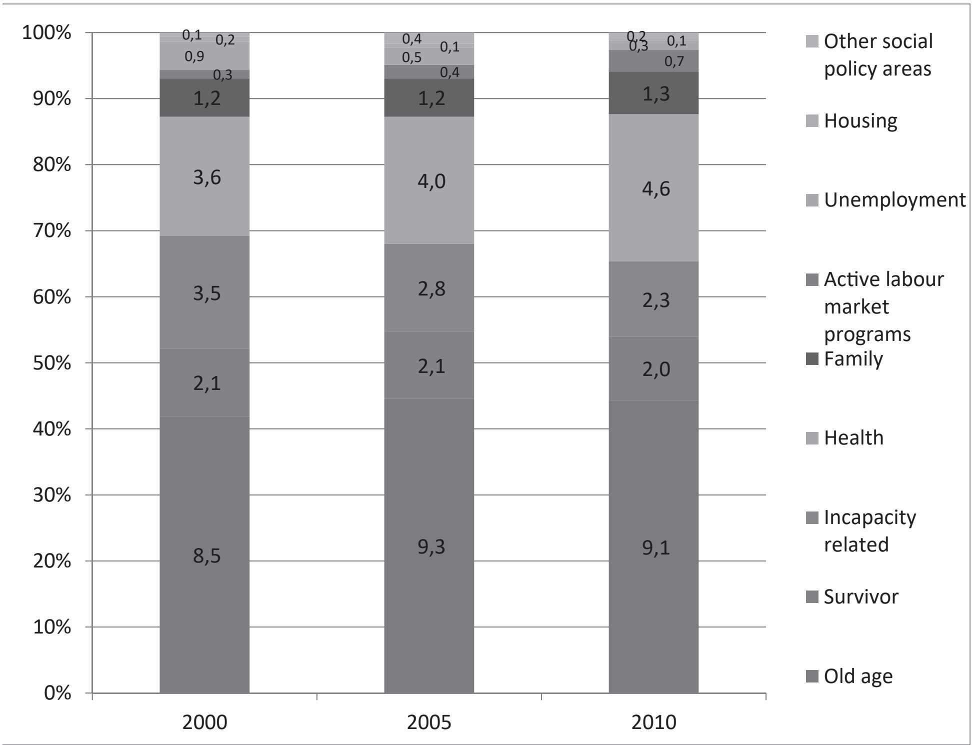

Figure 7.

Composition of aggregated public social expenditures in Poland

Note: Numbers represent the different types of gross public social expenditure as a percentage of the GDP.

Source of data: OECD SOCX database

In 2000, the share of pension expenditures compared to the total amount of public social spending was the highest in Slovenia, reaching almost 50% (10.3% of the GDP in 2013). Until 2009, Slovenia managed the same levels in both terms; however, the structure was changed, shifting towards more support for survivor. After 2009 pension expenditures have started to increase.

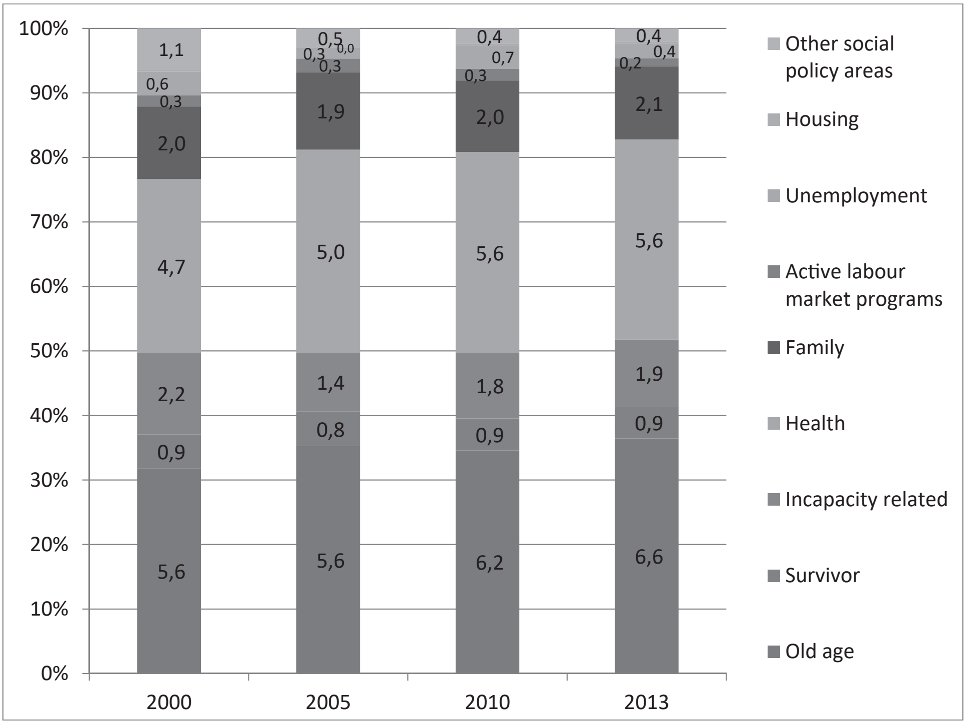

Figure 8.

Composition of aggregated public social expenditures in Slovakia

Note: Numbers represent the different types of gross public social expenditure as a percentage of the GDP.

Source of data: OECD SOCX database

In post-communist welfare states disability pension was often considered to be an alternative to retirement for persons failing to meet the requirements of an early retirement pension. The substantial share of disability pensioners, particularly at older age suggests that those who were not eligible for old-age pension applied for disability pension and managed to receive them. This was only possible by using a broad definition of disability (incapacity to perform work) and the tendency of medical doctors to make generous assessments of disability. (Hirose, 2011)

Incapacity-related benefits fluctuated around 2–3% of the GDP with minor variations within the model and over time. The only outlier is Poland, where almost 6% of the GDP was spent on disability pension. Until 2010 Poland radically cut back incapacity-related benefits, reaching the mean value of the ECE model.

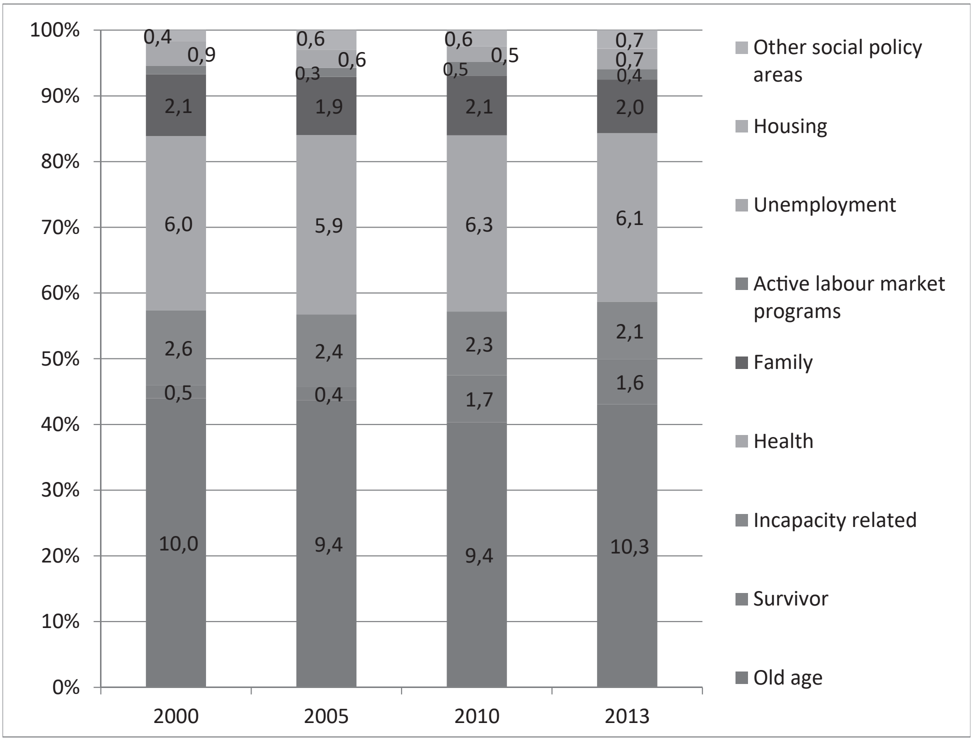

Figure 9.

Composition of aggregated public social expenditures in Slovenia

Note: Numbers represent the different types of gross public social expenditure as a percentage of the GDP.

Source of data: OECD SOCX database

Goldstein et al. (1996) summarized the main characteristic of health financing in the region as follows: these countries "follow the general trend in which the share of GDP spent on health is positively correlated with per capita income. However, the share of GDP spent on health tends to be higher in CEE countries than in developing countries at similar income levels". (Goldstein et al., 1996: 24) This statement can be proven by the fact that in 1995 health expenditures fluctuated around 6% of the GDP in the Czech and Slovak Republics and in Slovenia, higher than in the countries of the Mediterranean model, while in Hungary health expenditures fluctuated around 5% of the GDP. In Poland and Estonia health care spending was considerably lower at 4% of the GDP. Until 2009 health care spending increased in all countries of the model, only in Hungary was health care spending below the initial level in 2009. After the 2009 crisis Estonia, Hungary and Slovenia slightly cut back on their health care spending, while the Czech and Slovak Republics and Slovenia have been able to manage an increasing trend.

A specific feature of the ECE model is the extensive system of family benefits. For example it exceeds 3% of the GDP in Hungary, the level of family support which is similar to the Continental countries. In the Czech and Slovak Republic, Estonia and Slovenia it fluctuated around 2% during the examined period. The support for families was somewhat lower in Poland and, similarly to the Mediterranean level, it was fluctuating around 1% of the GDP. Within the model, historically, family benefits are the highest in Hungary amounting to around 3% of the GDP.

Active labour market policies (ALMPs) accounted for less than 1% of the GDP in all countries of the model during the whole period examined. The initial level of ALMPs was the highest in Slovakia and Hungary in 1995 (0.8 and 0.7% of the GDP respectively), but the use of these tools was reduced significantly in both countries, however Hungary and Poland as well started to noticeably expand the use of ALMPs after 2009.

Estonia significantly expanded support for the unemployed due to the salient hike in unemployment rate. The first available data shows 0.1% of the GDP being spent on unemployment benefits, peaking at 1.1% as a share of the GDP in 2009. During the 2000s, Poland was able to remarkably cut back on spending on unemployment benefits, from 1.6% in 1995 to 0.3% in 2009. Spending on unemployment benefits does not vary significantly within the model. The patterns did not change considerably during the 2000s, but the 2008/2009 crisis indicated an increase of unemployment benefits until 2010. Apart from Slovenia, all the countries of the model were able to cut back on unemployment spending by 2013.

Hungary is the only country within the model where housing is part of the social policy. Housing spending fluctuated around 0.5% of the GDP between 2000 and 2010, which was followed by a slight reduction in 2013. In the other countries (except Slovenia), housing accounted for about 0.1% of the GDP. Spending on other social policies amounted to approximately 0.5% of the GDP in the countries of the model, although in Slovakia the initial level of such expenditure was slightly higher.

There are differences between the countries of the model, the level and composition of social spending in some cases show different patterns, but within-model variation is subtle, not higher than in other welfare state models. The main trends are relatively similar, especially in case of pension and health care spending. Ferge (2001) argued that the similarities of the ECE model are due to the influence of globalizing forces on the welfare systems. This so called residualization policy has become the dominant welfare strategy of the East Central European countries. (Sengoku, 2004) Despite the similarities, each country has developed its own approach towards social welfare restructuring. (Potůček, 2008)

The expansion of welfare services among the ECE countries is in accordance with the thesis of Wilensky (1975): much of the expansion of the welfare state can be accounted for as a function of "economic growth and its bureaucratic outcomes". (Wilensky, 1975: xiii) "Once societies attain certain thresholds of economic development, all begin to pass social security, health and other forms of welfare legislation, and over time they devote an increasing share of the public purse to these programs". (Cox, 1993: 9) Castles (2004) identified the problem as how modern welfare states cope with the self-contradiction that while providing welfare services they are also generating increased demand for them.

Recent Developments of Welfare Policies and Spending

The outbreak of the financial crisis enforced welfare state retrenchment in the ECE countries, as well, meaning the end of the expansion of the welfare state. Exceptionally, reduction of welfare spending in Hungary started much earlier in 2003 as a part of a broader consolidation package that has been intensified later due to the negative effects of crisis retrenchment. Within the ECE model, Hungary is the only country in which real public social spending in 2011/12 was considerably (13%) lower than in 2007/08. For the same period growth of real public expenditures amounted to around 20% in Poland and Estonia and exceeded 10% in Slovenia and Slovakia, while the Czech Republic experienced a modest increase.

Aggregated public social expenditures increased after the crisis (Table 2) resulting in less generous welfare services due to the proportionally higher increase of the share of population being dependent on the welfare state (increase of unemployment rate).

Table 2.
Aggregated public social expenditures in ECE countries (% of the GDP)

	1995	**2000**	**2005**	**2010**	**2013**	**2014**	**2015**	**2016**
Czech Republic	16.1	18.0	18.1	19.8	20.3	19.9	19.5	19.4
Estonia	n.a.	13.8	13.0	18.3	15.9	16.0	17.0	17.4
Hungary	n.a.	20.1	21.9	23.0	22.1	21.4	20.7	20.6
Poland	21.8	20.2	20.9	20.6	19.6	19.5	19.4	20.2
Slovak Republic	18.4	17.6	15.8	18.1	18.1	19.3	19.4	18.6
Slovenia	5.7	22.4	21.4	23.4	24.0	23.1	22.4	22.8

Source: OECD SOCX database

During the 2000s, preceding the financial and economic crisis, ECE countries experienced a considerable increase in employment. The only exception was Hungary where employment was stagnant. As a consequence of economic recession, employment in 2009 fell in all countries, though by less than what would have been proportionate to the decrease in GDP. In Estonia the drop of employment was two-digit large. After 2010 employment has started to improve in all countries with the exception of Slovenia. The decline in employment in 2009 and 2010 led to an increase in unemployment rate, although not at a similar magnitude. The rise of unemployment was dramatic in Estonia, but the country experienced fast recovery of the labour market, as well. The increase of unemployment in 2009 was rather moderate and after 2013 a downward trend has started. The only exception is Slovenia, where the unemployment rate has been on the rise since 2012.

The financial and economic crisis have caused a marked decline in economic activity, a sharp increase in unemployment, fiscal constraints to public budgets and an increasing indebtedness. Analysing the overall impacts of the crisis is a complex task, because it varied from country to country depending on a number of factors, such as the country's reliance on global markets, the strength of domestic currency, levels of domestic revenues and the available room for fiscal manoeuvre with which governments may stimulate the economy, etc. (Romano, 2014; Pásztor–Szíjártó, 2016) Despite the serious effects of the global recession in countries of the ECE model, recovery has been faster and more pronounced for them than in case of the Mediterranean countries. In 2012 and 2013 the highest unemployment rates were recorded in Spain, Greece and Ireland and they were followed by Slovakia, while unemployment rate also reached a double-digit level in Hungary, Poland and Slovenia due to the crisis.

The crisis was accompanied by an expansion of the level of unemployment, by an increase of the budget deficit and by a corresponding increase of the public debt. However, increases of budget deficits are similar to the augmentation of deficits in the rest of the EU, while public debts in ECE countries are lower than in most of the EU member countries, which is due to the short capitalist history of these countries. The only exception is Hungary where gross public debt has been close to the EU27 average during the post-crisis period; however, a slight decline is forecasted.

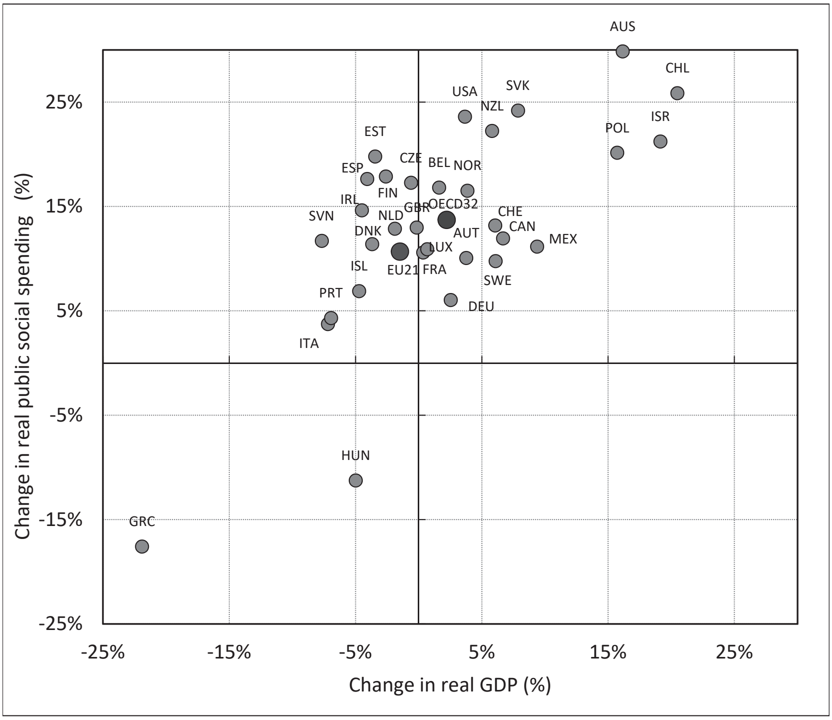

Figure 10.

Percentage changes in real public social spending and real GDP, 2007/08 to 2012/13

Note: Estimates for 2007–08 and 2012–13 are averaged over two-year periods to allow for the different years in which the crisis began across countries and to limit the effect of year-on-year fluctuations.

Source: OECD (2013), OECD Social Expenditure Database (SOCX)

Any crisis has a significant influence on the operation of the welfare states, welfare regimes. Well-functioning systems of social protection increase spending in times of recession, and scale it back as the economy recovers, therefore the welfare state can operate as an effective "automatic stabiliser".

Figure 10 shows us that social spending increased least in countries most affected by the crisis. Countries of the Nordic, Continental and even the Anglo–Saxon model have been equipped with an automatic stabilising function, expenditure on social protection went up in order to mitigate the negative consequences of the financial and economic crisis. Social spending in the countries of the Mediterranean model increased only in the early years of the crisis, however, in 2012 the level of real public social expenditures was significantly lower than in Greece, gently lower in Portugal, the increase was modest in Italy and average in Spain compared to the reference year of 2007. There is a need for cutting back social expenditures in the Mediterranean countries, even as unemployment still remains a dramatic problem in these countries.

The Mediterranean countries have been subject to an austerity regime, at varying degree and harshness. In Greece and Portugal fiscal adjustment is being supervised by the EU, ECB and the IMF. The governments have lost much control over national budgetary decisions. Spain's request for financial assistance was approved by the EU in July 2012, whose "conditionality" is less strict, while in Italy fiscal adjustment has been enforced by the market (large spreads on Italian bonds). The welfare states cannot perform as automatic stabilisers if budgetary decisions are subordinated to the harsh need for fiscal consolidation.

Within the ECE model, welfare states have been able to function as an automatic stabiliser with the exception of Hungary. In Hungary, as in case of the Mediterranean model, economic recession was accompanied by chronic and increasing current account deficit. Indebtedness and current deficits became unsustainable in 2008, when the country signed stand-by agreements with the IMF, being the first joint EU/IMF programme. The automatic stabilising function of the welfare state has been tied by the implemented harsh austerity measures. In times of a crisis the welfare state is able to work primarily via the so-called automatic stabilisers if budgetary decisions are not subordinated to fiscal austerity.

There are several problems in the ECE economies, however, they have been overshadowed to a great extent by the problems of EU periphery countries (Greece, Spain, Portugal) that represent a much more dangerous threat for the future of the EU than the difficulties of the ECE region. Furthermore, the ECE countries performed relatively well lately; Poland is the only EU country which has not faced depression, GDP in Slovakia recovered quickly and the economic circumstances have been improving in Hungary, the Czech Republic and Estonia. (Mencinger, 2013) East Central European countries in spite of drastic increase of their debts managed to avoid the sovereign debt crisis, which heavily hit the Southern regions. In fact, in many ECE countries the debts more than doubled, but remained still below the critical 60% of the GDP.

Even if the crisis caused the deterioration of welfare services, after 2010, the countries of the ECE model have been able to maintain their welfare states, which outperformed the level of the Mediterranean countries in every year since 2010.

Concluding Remarks

The paper analysed welfare state policies and expenditures of the East Central European (ECE) countries. Based on the historical-institutional features of East Central European welfare states after transition and the composition of social spending a mixed or "hybridized" welfare model has evolved combining Continental Bismarckian elements, Anglo–Saxon market-based pensions and social services supported by basic egalitarian universalist safety-net provisions. Since the outbreak of the financial crisis enforced welfare state retrenchment in the ECE region as well, recent developments show that the countries of the ECE model have been able to maintain their welfare states, which outperformed the level of the Mediterranean countries in every year since 2010.

Drahokoupil (2007) argued that among the East Central European countries, the Visegrád countries are competition states. It means that they became structurally dependent on foreign capital, which controls access to technology, know-how and distribution networks. However, this feature is relevant for the whole region, as well. Being locked in the competitive direction has significant impact on social policy developments. Aiming to promote workforce flexibility and employability according to the needs of capital has been the driving force of shaping social policy after transition and this trend will continue. The need for external financing and foreign direct capital might lead to a situation in which social policy is further subordinated to attracting capital and economic competitiveness.

Building a modern and efficient market-driven welfare state in post-communist economies requires decades to reach political consensus in different approaches (health, housing, education, research, etc.) and to develop institutional and legal frameworks. Even the most advanced ECE economies (or other CEE countries) are at the very beginning of this process, the major obstacles of which are the low quality of political debates and the political elite. (Koźmiński, 2011) In general, the correct configuration of the time-frame is a key factor in any socio-economic transition in order to avoid unrealistic expectations and growing resistance in the long run.

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András Hettyey

A Multilateralized Civilian Power Approach: The German Foreign Policy and Central Eastern Europe[1]

Applying the insights of role theory, this paper investigates Germany's foreign policy since 1990 towards the Central and Eastern European region in general, and Hungary in particular. Applying Germany's "civilian power" role concept as a yardstick, we explore whether Germany lived up to the expectations in the area of economic assistance, minority rights and the Eastern enlargement of the EU. In the next step, we review how Germany's civilian power approach has changed since the CEE countries became members of the EU in 2004/2007. Overall, we find that Bonn very much lived up to its role concept before 2004/2007. What changed since then is that Germany's role concept was multilateralized: in effect, the EU and Germany share a similar foreign policy playbook, as many have characterized the EU itself as a civilian power. At its optimum, this gives Berlin a significant leverage over the CEE countries: the common weight of the EU apparatus and Germany is considerable.

Keywords: Germany, Hungary, foreign policy, Central and Eastern Europe, European Union, minority rights, economic assistance, Angela Merkel, civilian power

Introduction

Role theory has been an important tool in Foreign Policy Analysis (FPA) since Kalevi Holsti's seminal article was published in 1970. (Holsti, 1970) Building on the insights

András Hettyey, Assistant Professor, National University of Public Service. E-mail: hettyey.andras@uni-nke.hu.

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role theory has brought to sociology and psychology, and using the works of James N. Rosenau, Richard C. Snyder, H. W. Bruck and Burton Sapin as a stepping stone, Holsti and other role theorists asserted that states evince regular behavioural patterns in the bipolar Cold War structure, e.g. "non-aligned", "ally" or "satellites". (Walker, 1979; Wish, 1980) Role concepts are defined by Holsti as "the policymaker's own definitions of the general kind of decisions, commitments, rules and actions suitable to their state, and of the functions, if any, their state should perform on a continuing basis in the international system or in subordinate regional systems. It is their "image" of the appropriate orientations or functions of their state toward, or in, the external environment". (Holsti, 1970: 245–246) In short, role concepts are templates for states to guide their foreign policy actions. What makes role concepts particularly useful for FPA is that they constitute an ideal situation, a yardstick, against which to measure the actual foreign policy actions (role performance). Since the early 1970s, a growing number of role theorists have asserted the existence of an expanding number of social roles – such as that of "leader", "mediator", "initiator", "defender of the faith", "aggressor" – as the social structure of international relations evolved. (Harnisch, 2011: 7)

There is a significant consensus in the literature that Germany's role concept can be best described as a "civilian power" ("Zivilmacht" in German). The term was coined by Hanns W. Maull in 1990. (Maull, 1990; Maull, 2007) Rooted in (West) Germany's post-1949 history, Maull and Henning Tewes argued that the ideal type civilian power exhibits the following five characteristics:

- the acceptance of the necessity of cooperation with others in the pursuit of international objectives;
- the concentration on non-military, primarily economic means to secure national goals, with military power left as a residual instrument serving essentially to safeguard other means of international interaction;
- a willingness to develop supranational structures to address critical issues of international management;
- the upholding of values such as democracy, the rule of law and human rights including minority rights;
- a view of economic interdependence that not only accepts interdependence as a given, but that gears domestic actors to reap the maximum benefits from it; and
- a vision of an international system that exhibits the legalisation of social relations, the development of participatory forms of decision making, the institutional channelling of conflict resolution and the taming of the use of force. (Maull, 1990; Tewes, 1997)

Applying the civilian power role concept more specifically to Eastern Europe after 1990 but prior to the EU and NATO accession of the countries of the region, we can postulate from the above five characteristics that we will witness:

1. A multilateral German approach to the region instead of a bilateral regional German strategy.
2. Significant German support for the EU and NATO integration of the region terminating in full membership.

3. A propensity to use economic means (economic assistance, aid, trade etc.) to achieve German goals (stability and prosperity) in the region.
4. Support for the economic opening up of the region to increase economic interdependence with the EU.

We will now turn to the question whether Germany lived up to its civilian power vocation in the actual implementation of its foreign policy after 1990. In other words, we try to establish if Germany's role concept and role performance aligned or diverged in this period. Throughout, we will mostly focus on German–Hungarian relations, but to give a wider picture, where possible, we will take a glimpse of Germany's foreign policy towards Central Eastern Europe (CEE) in general, as well. To do all this, we firstly review German foreign policy in three crucial areas which are touched upon in our four aforementioned expectations: economic assistance, minority policy and EU accession. In this, we will focus on the years prior to the EU accession of Hungary (and the region), i.e. 2004/2007. Secondly, we try to sketch if and how Germany's civilian power vocation vis-à-vis the CEE region has changed since these countries became part of the European Union. Our sources include not only the relevant secondary literature, but reports and policy papers from the Hungarian Foreign Ministry from the period 1990–2003, as well.

German Economic Assistance after 1990

Did Germany's commitment to being a civilian power live up to the expectations in the field of economic assistance? Tewes argues that this is an issue area where the congruence of role concept and role performance of a civilian power can be ascertained or refuted, because the awareness of the high costs of military force should let a civilian power engage in active development policies in order to prevent conflicts. (Tewes, 1997) Therefore, ambitious aid programs ought to be examples of a particularly active development policy suited to a civilian power. More concretely, Davis and Dombrowski postulate that in keeping with the cheque book diplomacy practiced in Western Europe, Germany should have sought to establish a regional economic environment and commercial ties compatible with the needs of its domestic economy. It should also have encouraged the transitional economies to pursue policies of openness toward global markets. (Davis–Dombrowski, 1997)

It is notoriously hard to establish just how much assistance Germany has given to the region, especially 25 years later. Even when data is to be found, differences in book-keeping, different time-frames, currencies and categories confuse the picture. Moreover, pledged sums do not equal actual aid disbursements as some of the sums did not find addressees. (This was the case with a credit Germany gave to Hungary in 1996. It turned out that the interest rate was higher than that which could be obtained in the market, making the assistance unattractive.)[2] Nevertheless, even rough numbers give a good impression on Germany's commitment to the countries of the region.

Turning first to absolute numbers, Germany bilaterally assisted the three Visegrád countries and Romania and Bulgaria to the tune of 20 billion DM in the period 1989–93 – this without its share in EU and EBRD transfers (Table 1). If we add Germany's share in EU assistance (for example, the PHARE program), the sum is 22.5 billion DM over five years or 4.5 billion DM a year. This does not include one-off, ad-hoc forms of assistance as the cancellation of Hungary's transfer Rubel debt it owed to former Eastern German companies for deliveries received but not paid in 1990. In comparison, the German financial contribution to the Gulf war in classic cheque book fashion amounted to 18 billion DM. The biggest single contribution of all was Poland's debt cancellation. Overall, bilateral assistance to all Central and Eastern European countries amounted to 0.2 per cent of German GNP in 1992. (Davis–Dombrowski, 1997: 8) The numbers clearly show a bias toward the three Visegrád countries. The Visegrád countries as a group received ten times as much as Bulgaria and Romania put together (18.3 to 1.7 billion DM). Although not included in this table, the Baltics and the Balkan region were similarly disadvantaged compared to the Visegrád countries. (Davis–Dombrowski, 1997: 12)

Table 1.

German assistance to selected Eastern European countries 1989–1993 (in million DM)

	Bulgaria	**Czecho-slovakia**	**Poland**	**Hungary**	**Romania**
Bilateral...					
Federal credits	198	5677	2727	2684	1129
State credits	0	0	0	500	0
Humanitarian assistance	27	0	20	50	179
Debt cancellation	0	0	6118	0	0
Other	27	80	191	275	127
Total bilateral	**252**	**5757**	**9056**	**3509**	**1435**
Per capita	**28 DM**	**558 DM**	**237 DM**	**340 DM**	**63 DM**
Multilateral...					
Share in EU assistance	353	381	554	852	428

Source: Antwort der Bundesregierung auf die Große Anfrage der Fraktionen der CDU/CSU und F.D.P., Drucksache 12/6162, November 12, 1993. 61.

Comparing German assistance to other countries is trickier still due to different national book-keeping standards and different currencies. Yet a compilation of statistics provided

2 *A német szövetségi kormány, vm. a bajor, a baden-württembergi és az északrajna-vesztfáliai tartomány által felajánlott 1,3 Mrd. DEM értékű hitelkeret felhasználásáról.* [About the utilization of the credit offered by Bavaria, Baden-Württemberg and North Rhine-Westphalia to the tune of 1.3 bln. DM.] KKM Irattár, Külügyminisztérium Tük, 109. csomó, 00813, February 28, 1997.

by the Bundestag in 1996 sheds some light on how much the EU-15 countries were assisting Central and Eastern Europe in the period of 1990–95.[3] In total, EU member states bilaterally provided 32.6 billion ECU worth of assistance to the region (Table 2). Of this, Germany held the lion share with 45 per cent of the total sum. In view of its relative geographic distance from the region, France's contribution of 19 per cent can also be viewed as significant. The third biggest donor was Austria, due to its obvious interest in stabilizing the region. However, Italy's and, especially, the UK's relatively low share stand out while Holland's contribution can be characterized as paltry in light of the fact that it was very much profiting from the region: in Hungary, Dutch firms were the second biggest investors as late as 2002. As percentage of GNP, only Austria contributed more to the region than Germany at 0.22 per cent in 1992. The US contribution was 0.01 per cent that same year. (Davis–Dombrowski, 1997: 21) All this in a period, when the German budgetary situation was extremely tight: due to the rebuilding of former Eastern Germany, ever-increasing German contributions to EU budgets and ad-hoc outlays (such as approx. 15 billion DM to the Soviet Union for removing its troops under the 2 + 4 agreement), Germany's public debt tripled in 1990–1998. (Hinrichs, 2002: 7) After 1990, Germany's debt grew 17.3 per cent every year. Overall, the financial side of civilianization was no doubt costly to Germany at a time when domestically it had to face a vicious circle of high taxation, high unemployment and slack economic growth. (Tewes, 1997: 107)

Table 2.
Assistance to CEE countries by the EU-15 (1990–1995)

Total EU-15 countries	32613	100%
Germany	14645	45%
France	6162	19%
Austria	3421	10.5%
Italy	1542	4.7%
Sweden	1487	4.5%
The Netherlands	1267	3.9%
Denmark	1092	3.3%
Spain	1039	3.2%
UK	836	2.6%
Finland	720	2.2%

Source: Antwort der Bundesregierung auf die Große Anfrage der Abgeordneten Klaus Francke (Hamburg), Karl Lamers und der Fraktion der CDU/CSU sowie der Abgeordneten Ulrich Irmer, Dr. Olaf Feldmann, Dr. Helmut Haussmann, Dr.-Ing. Karl-Hans Laermann und der Fraktion der F.D.P. Drucksache 13/5601, September 25 1996. 59.

3 Antwort der Bundesregierung auf die Große Anfrage der Abgeordneten Klaus Francke (Hamburg), Karl Lamers und der Fraktion der CDU/CSU sowie der Abgeordneten Ulrich Irmer, Dr. Olaf Feldmann, Dr. Helmut Haussmann, Dr.-Ing. Karl-Hans Laermann und der Fraktion der F.D.P. Drucksache 13/5601, September 25, 1996. 59.

Having established that Germany provided significant help to the region both bilaterally and multilaterally, we might ask to what extent was German assistance geared towards goals that might be expected from a civilian power, e.g. conflict prevention, economic stabilization and encouragement of openness toward global markets? In the first years after 1990, the countries of the region were economically at the edge of a precipice because of recession, high inflation, huge deficits and ballooning public debts. The situation was perhaps the gravest in Poland, where the government could not service its debt which exceeded 100 per cent of the GDP. To avert bankruptcy, the creditors, among them the German state and German banks, cancelled a significant part of Warsaw's debt, a move which cost German taxpayers 6.1 billion DM. In a similar, life-saving fashion Hungary received in its first "democratic" winter of 1990/91 a last-minute, non-refundable German assistance to the tune of 50 million DM to buy coal supplies which Budapest could not secure due to cash-flow problems.[4]

German assistance did not always come in such dramatic fashion, though. The Transform program, initiated in 1994, bundled the long-term technical assistance Germany was giving to the region. Areas of training were demand-driven and included microeconomic consultancy, environmental co-operation, economic policy making, advice on privatization, the restructuring of agricultural sectors and the training of civil servants in legal matters and EU norms and standards. In 1993–2005, the program spent approximately 1.1 billion DM in the countries of Central and Eastern Europe. (Sell–Schauf, 2003: 45) Another successful, long-term assistance was the so-called KMU-Förderprogramm of the Kreditanstalt für Wiederaufbau (KfW). The aim was to give cheap loans to small and medium enterprises (SME) in the region. In case of Hungary, the initial sum of 100 million DM provided by the German side in 1991 was soon exhausted so the program was extended in 1994. In the first four years, almost 5000 Hungarian SMEs profited from the cheap loans.[5] In effect, Germany expended significant resources on building a strong SME sector in Central and Eastern Europe, thus developing enterprises which might later become competitors to its own SMEs.

In addition to these measures, Germany was also interested in the strengthening of trade links with the region. For this, the Hermes export-insurance program was the preferred instrument, whereby in contracts, where incalculable political risks prevent private insurances from giving guarantees, the German state steps in to insure German exporters. Overall, the purpose of Hermes guarantees was to encourage German companies to explore export opportunities from which they would otherwise refrain, i.e. in Central and Eastern Europe. In 1992, 32.4 per cent of all German exports to the region were insured by the Hermes program. (Tewes, 1997: 108–109) The German state also provided insurances for German companies investing in the region through the C&L Treuarbeit Deutsche Revision AG. All in all, 3.5 billion DM of German investments were insured this way. (Tewes, 1997: 110)

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4 Állami Számvevőszék: *Jelentés 100 millió márka kedvezményes hitel (START-hitel) és az 50 millió márka német szénsegély felhasználásának az ellenőrzéséről.* [Report on the control of the utilization of the 100 mln. DM START Credit and the 50 mln. German coal help.] October 6, 1995. 2.

5 Cím nélkül. [Without title.] MNL OL, Antall József személyes iratai, 117. doboz, 432/1992, Feburary 5, 1992.

Hand in hand with these various assistance measures went schemes to make it easy for workers from the CEE region to get work in Germany. Through various federal programs, guest workers, seasonal labourers, project-tied workers and border commuters from the region were able to access the German work market through the preferential treatment afforded to them by the German state. (Sieveking–Reim–Sandbrink, 1998; Pásztor, 2013) For Hungary, this meant that, in 1996, for instance, 14,000 persons found work in Germany, easing the unemployment in the country and generating a profit of 500,000 Dollars, according to Foreign Ministry estimates.[6] At the turn of the century, Germany was issuing around 350,000 work permits per year for workers from the CEE region.[7] True to its civilian power vocation, Bonn maintained this preferential treatment even in the years when the unemployment in Germany increased, reaching 9.8 per cent in 1993. Although Germany lowered the various quotas through which it was regulating the flow of incoming Eastern European workers, it did not abandon its commitment to help the CEE countries through these workforce schemes.

All these cases should not be viewed as altruistic initiatives on the side of Germany. A civilian power very much pursues its own set of interests, yet in an enlightened way, eschewing military force, coercion or domination. The stabilization of Eastern and Central Europe was very much in Germany's political and economic interest as was the kick-starting of investments and the expansion of trade. Yet other actors, similarly interested in this outcome, expended much less resources on this goal. There were no similar French or Italian aid programs for the countries of the region. Moreover, the German civilian power approach saw to it that the demands of the CEE countries were taken into consideration: the Transform program was tailored to the needs of each country. Through the aid programs, credits, humanitarian assistance, debt relief and Hermes insurances, the ability of the governments of the region to put in motion the necessary economic transformation was significantly enhanced. To talk about German unilateral domination, something which is incompatible with the civilian power approach, can be further refuted by pointing to the fact that Germany was ready to share the CEE market with its competitors. In the first years after 1990, American firms invested much more than Germans in Hungary. Even today, Germany is only the third biggest investor in Slovakia.

German Minority Policy after 1990

Human rights policy is a constitutive element of Germany's civilian power role concept. (Heinz, 2007) Probably the most important dimension of human rights in Central and Eastern Europe are ethnic minority rights. After 1990, approximately 3 million Hungarians continued to live in the neighboring countries as ethnic minorities, more than 10 million Russians in the Baltic countries, Belarus, Ukraine and Moldova, and around a quarter of a million Germans in Poland, the Czech Republic and Hungary. Germany thus had a double

6 *Tárgyalási témajavaslat – Antall József és Helmut Kohl megbeszéléséhez.* [Topics for discussion for the meeting between Antall József and Helmut Kohl.] Antall József személyes iratai, 242. doboz, June 23, 1993.

7 Unterrichtung durch die Beauftragte der Bundesregierung für Migration, Flüchtlinge und Integration – Migrationsbericht 2003, Drucksache 15/2262, December 18, 2003. 64.

interest in the institutionalization and observance of minority rights in Eastern Europe: by it, a traditional cause of discord in the region could be neutralized while the situation of the German minority abroad could be improved.

Germany had an interest in making minority rights as stable as possible and having them to comply with the political requirements laid down in international documents like that of the OSCE. (Kiss J., 2002) Judging by the reports of the Hungarian Foreign Ministry, Germany did expend significant political capital to do just that after 1990. Germany was supportive of the codification of individual minority rights through the Council of Europe (CoE), such as the European Charter for Regional and Minority Languages of 1992, the recommendation 1201 of 1993 and the Framework Convention on the Protection of National Minorities of 1994. Bonn also supported the Copenhagen Document of the Organization for Security and Co-operation in Europe (OSCE) in 1990. All these documents provided wide ranging individual rights for the minorities. According to a Hungarian report, Germany was ready to put pressure on France to equip the recommendation 1201 of the CoE with a much tougher wording. Chancellor Helmut Kohl even hinted that otherwise he would not attend the forthcoming CoE summit, but to no avail: the French position prevailed.[8] Yet those minority rights standards that are in force currently in Europe were codified with Bonn's support.

More importantly, Germany was ready to expend some bilateral political capital on the issue. For example, Germany put pressure on Romania and Slovakia, where the situation of the Hungarian minority was less than satisfactory.[9] In 1995 the German Foreign Minister Klaus Kinkel urged his Romanian colleague to reach out to its Hungarian minority and sign the long-awaited Basic Treaty. (Smith, 1999: 142) Earlier, Kohl also expressed his worries about Romania's internal developments to President Ion Iliescu.[10] Because of the problematic human rights situation, Germany cancelled all financial and economic assistance to Yugoslavia by 1991, Kohl assured Hungarian Prime Minister Antall József. (Jeszenszky, 2016: 192) Yet Germany's activism in this respect clearly had its limits: to Hungarian requests to put pressure on Bratislava or Bucharest it usually suggested that Budapest should strive to hold its neighbours responsible to the international norms embodied in the OSCE and CoE documents. In other words, instead of counting on German help in solving the problem, Hungary should multilateralize its grievances.[11] Bonn also politely but continuously opposed the goal of the Hungarian governments, namely the idea of giving collective minority rights (in essence, autonomy) to the various ethnic communities. Here, two civilian power-goals clashed: on the one side there was the commitment to human rights, including minority rights. On the other hand, there was the overarching goal of political stability in Central and Eastern Europe. According to the

8 *Német követ véleménye a magyar–magyar csúcs közös nyilatkozatáról ás az ET 1201 ajánlásáról.* [Opinion of the German Ambassador on the joint communique of the Hungarian–Hungarian Summit and the Recommendation 1201 of the Council of Europe.] KKM Irattár, Külügyminisztérium Admin, 109. csomó, 7173, August 7, 1996.

9 *W. Schäuble látogatása a nagykövetségen.* [The visit of W. Schäuble at the Embassy.] MNL OL, Külügyminisztérium Tük, 28. doboz, 00179, January 15, 1993.

10 *Jelentés a bonni konzultációról (1995. május 11.).* [Report on the consultations in Bonn, May 11, 1995.] KKM Irattár, Külügyminisztérium Tük, 3465-7, May 16, 1995.

11 *1993. évi nagyköveti beszámoló jelentés.* [The Ambassador's yearly report of 1993.] MNL OL, Külügyminisztérium Tük, 28. doboz, 002122, June 28, 1993.

prevailing German perspective, calls for autonomy might open a Pandora's box and could destabilize Europe. This is why even the "token" stability of the region is more important to the German Government than the effective solving of minority problems, sighed an exasperated Hungarian diplomat in 2002.[12] Ultimately, Germany saw the region's EU membership as the ultimate solution to the issue of ethnic minorities.[13] No doubt, this fell far short of what successive Hungarian governments were expecting from Germany. Still, in essence, Germany's role performance in the area of minority rights matched those of a civilian power.

Germany and the EU and NATO Enlargement

The ultimate proof of Germany's civilian power vocation was the Eastern enlargement of the European Union which was set in motion and strongly supported by Germany. This story has been recounted many times. (Baun, 2000; Jerabek, 2011; Becker, 2011) Even if the German position was occasionally characterized by stalling and ambivalence as to the conditions and date of the accession, there can be no doubt that Bonn was one of the motors of this epochal development. (Becker, 2011: 147–155) One must not forget that the Kohl and Schröder governments had to expend significant political capital on this issue, because the enlargement was by no means particularly popular with the German society at large or with various sectoral economic stakeholders. (Becker, 2011: 140–141) Through it all, Germany evinced a civilian power approach to the question. In effect, Germany had no dedicated, CEE-strategy after 1990: it substituted this with the enlargement policy of the EU, which became Germany's regional foreign policy strategy. (Lang, 2012) Also, Bonn was committed to shape the process true to its belief in multilateralism: Bonn continuously and sincerely tried to reassure Paris (as well as Moscow) that it is not out to dominate Europe in the process. (Lang, 2012) Hungarian diplomats were repeatedly reminded by their German colleagues to focus their efforts on convincing France (and other sceptical countries) of the benefits of enlargement.[14] German diplomats also suggested the establishment of a common German–French–Hungarian working group on the level of ambassadors to allay French fears, an idea picked up by the Hungarian side.[15]

Less noted at the time, but a similar strategy was used by Germany when it came to the Eastern Enlargement of NATO. Here, Germany's high regard for a multilateral approach manifested itself in the way that it tried to allay the fears of the Russians while keeping the pro-enlargement Americans on board and, at the same time, persuade the

12 *Konzultáció Berlinben.* [Consultation in Berlin.] KKM Irattár, KKM Irattár, Külügyminisztérium Admin, 2773, February 4, 2002.

13 *Jelentés a Kormány részére Joschka Fischer német külügyminiszter magyarországi látogatásáról (1999. január 7.).* [Report for the Government on the visit of Foreign Minister Joschka Fischer in Hungary, January 7, 1999.] KKM Irattár, Külügyminisztérium Admin, 499-3, January 12, 1999.

14 *Jelentés a Kormány számára Horn Gyula miniszterelnök látogatásáról az NSZK-ban.* [Report for the Government on Prime Minister Horn Gyula's visit to Germany.] KKM Irattár, Külügyminisztérium Admin, 109. csomó, 6510-27. October 10, 1995.

15 *Heinichen nagykövet Németország támogató szerepéről, a német–francia különleges kapcsolatokról.* [Ambassador Heinichen on Germany's supportive role and the special relationship between Germany and France.] KKM Irattár, Külügyminisztérium Admin, 64. doboz, 483-7. June 2, 1994.

more sceptic French of the usefulness of the eastward expansion. (Asmus, 2003; Overhaus 2008) While not ready to give Moscow a veto over the enlargement, Bonn repeatedly took into account the views of Russian President Boris Yeltsin, going so far as to deliberately slow down the whole process it set in motion when it threatened to weaken the relatively cooperative Yeltsin's domestic position – all this in accordance with Paris and Washington. (Asmus, 2003: 211) Without alienating any of its partners too much, Berlin realized its goals in 1999, 2004 and 2007, when the countries of the CEE region successfully joined the EU and NATO. Germany was now completely surrounded by allies, a satisfied German diplomat told Hungarian Foreign Minister János Martonyi in 1999.[16]

Germany as a Civilian Power after 2004

Having achieved the region's EU and NATO accession by 2004/2007, Germany's civilian power foreign policy towards the CEE had to change inevitably. Germany no longer had the leverage over the countries of the region as before. Once in, the CEE countries had more room to manoeuver and were no longer reliant on German support. This was very much in line with expectations that relations between Germany and the Visegrád countries should continue to loosen after the enlargement. (Baun, 2005: 374) Put it simply, the countries of the region now could afford to oppose German positions. Gone were the days when EU accession conditionality and the need for Germany's support limited the options of the CEE countries. (Not that Germany often threw its weight around: in case of Hungary, we could only identify one instance for a coercion-like behaviour, when in 1995–96 Bonn refused to grant the country a cheap loan and instead pushed the socialist–liberal government to enact austerity measures and apply for a credit line from the IMF.) (Hettyey, 2018) Overall, the cost of non-compliance with German positions lowered significantly once Hungary and the other countries of the region joined the EU and NATO.

Still, one might ask whether there is still a residue of civilian power in Germany's foreign policy towards the Eastern European member states. After all, Germany's overall civilian power approach to international affairs did not change in the period since the CEE countries joined. We argue that, in effect, what happened was that Germany's civilian power approach was multilateralized after 2004/2007. Berlin's civilian power approach now works through the EU, and, to a lesser extent, NATO. This is made all the more easier as many scholars argue that the European Union as a whole has a civilian power role concept of itself. While in no way accepted by the whole scientific community, some authors claim that the EU's approach to foreign policy can be characterized as that of a civilian power. Based on Francois Duchene's ground-breaking study in the 1970s, there has been a certain tendency to describe the EU as an international actor with a principled behaviour in the international sphere. (Duchene, 1972) The civilian power concept is not just the description of an economic giant with little political power, but the representation of an international actor that spreads civilian and democratic standards of governance on the basis of an

[16] *Jelentés a Kormánynak Martonyi János külügyminiszter bonni tárgyalásairól.* [Report for the Government on the negotiations of Martonyi János in Bonn.] KKM Irattár, Külügyminisztérium Admin, 109. csomó, 6173-4, December 7, 1998.

"ethics of responsibility" which is usually associated with home affairs. (Lucarelli, 2006) The EU's goal of strengthening human rights, democracy and the rule of law, as well as the aim of spreading prosperity and achieving convergence between the member states can be seen as quintessentially civilian power goals, very similar to Germany's role concept, we might add. (Jünemann–Schörnig, 2002)

German civilian power foreign policy can be detected in traces in the European Union's behaviour towards rule of law issues, especially in Poland and Hungary. Take the controversial Hungarian media law of 2010. After its adoption by the Hungarian Parliament, the Merkel Government quickly called upon the Commission to investigate whether the law was in compliance with the European norms. Due to the pressure from the Commission, the Hungarian Parliament later modified the bill.[17] Berlin has taken a similar stance in various following rule-of-law-arguments with Hungary. Similarly, in 2017 Germany supported the European Commission in initiating Article 7 procedures against Poland.[18] These episodes show elements of the preferred tactic of the successive Merkel governments. Berlin opted to "multilateralize" criticism and, in a sense, "hide" behind the seemingly un-political façade of the Commission. The troubled German–Polish history was another reason why Berlin dearly wanted to avoid to bilateralize the disagreement over the state of democracy in Poland.[19] In other words, Berlin wanted to make it clear that the argument is not between Germany and Poland but between the European Union as a whole and Poland.

In our view, Germany's, and more specifically Chancellor Angela Merkel's handling of the 2015 refugee crisis can also be partly understood in terms of the civilian power vocation of the country. The "moral leadership" displayed in August 2015 when Merkel repeatedly proclaimed "wir schaffen das" was rooted in the peculiar identity of Germany after 1949: an innate openness toward refugees, the upholding of international law provisions and a sense of indispensability. (Bulmer–Paterson, 2016: 7–9) Obviously, migration is an issue which is viewed very differently in many CEE countries: Germany's role concept and the role concept of Hungary, for example, seem to be diametrically opposed in this regard. The rift in the identities, histories, perceptions and world views of the two societies and of the decision makers seems to be well-nigh unbridgeable. Yet what put German foreign policy on collision course with many CEE countries over this issue were not only competing role concepts but the fact that Germany did not remain true to its civilian power method: instead of a multilateral approach, Berlin, at least initially, acted unilaterally. As Bulmer and Paterson observed, Merkel showed none of the reluctance that has characterized her position in other crises. Nor did she indulge in the exhaustive consultation, which has been such a major feature of German civilian power foreign policy. International consultation was restricted to the then Austrian Chancellor Faymann. (Bulmer–Paterson, 2016: 7) No such privilege was granted to the CEE countries.

17 Bundestag: Antwort der Bundesregierung auf die Kleine Anfrage der Abgeordneten Katrin Werner, Sevim Dagdelen, Annette Groth, weiterer Abgeordneter und der Fraktion DIE LINKE, Drucksache 17/7468, November 11, 2011.

18 Welt.de: Auswärtiges Amt hofft auf endgültiges Aus für umstrittene Justizreform [Online], July 24, 2017.

19 Zeit.de: Das Ende der Geduld [Online], December 20, 2017.

On a more positive note, Germany continued the support of the region's economic modernization after 2004/2007. The change taking place was that Germany more or less ceased its *bilateral* assistance. Instead, the German contributions to the EU's (and NATO's) common budget played this part. Berlin was true to its word. After 2004, Germany was consistently among the biggest contributors to the Multiannual Financial Framework, as the EU budget is called. To take two snapshots: in 2012, Germany was the third biggest net contributor in terms of share of GDP, fourth biggest in contributions per capita and the biggest in absolute numbers (–0.44% of the GDP, –146 euro per capita and –11.95 billion Euros, respectively.)[20] In 2016, the same applied: it was the third biggest net contributor in terms of share of GDP, fourth biggest in contributions per capita and the biggest in absolute numbers (–0.46 per cent of the GDP, –176 euro per capita and –14.3 billion Euros, respectively.)[21] As can be seen, Germany's overall net position decreased significantly in the intervening years along all three measures. Once again, Germany's civilian power foreign policy goal of stabilizing and modernizing the CEE countries through various forms of economic assistance did not disappear: only, its execution changed from bilateral to multilateral avenues.

Conclusions

When summing up whether Germany was faithful to its civilian power role concept in the CEE region, it seems useful to identify two distinct periods: before the Eastern enlargement of the EU in 2004/2007 and after. In the first period, Bonn very much lived up to its role concept, both in terms of various forms of economic assistance and in its support for EU and NATO enlargement, often in the face of significant domestic and international scepticism and/or outright opposition. Even in the field of minority rights Germany was ready to expend political capital, if not to the extent Hungary wished. One caveat must be added: the three (later four) Visegrád countries were heavily favoured in terms of economic assistance, while the Baltics and Romania and Bulgaria were relatively neglected. Yet Germany supported the latter's EU and NATO accession, as well. Compared to other European big powers and measured against its own yardstick, Germany delivered in the CEE region, without unilaterally dominating the region.

After 2004/2007 Germany's civilian power approach towards the CEE region changed considerably. First of all, the classic civilian power approach "moved on" in a geographic sense, as it became much more visible in the Western Balkans region, where the traditional civilian power methods of conflict prevention and bilateral economic assistance were increasingly applied. (Obradovic-Wochnik, 2014: 10) These traditional instruments were no longer applicable or necessary with the already-member CEE states. What changed with regards to the CEE countries was that, in effect, Germany's role concept was multilateralized by the EU: instead of bilateral avenues, German foreign policy increasingly flowed through Brussels, be it rule-of-law criticism or German financial contributions through the common EU budget. This is not to say that bilateralism stopped between Berlin and Budapest (or

20 Bundeszentrale für politische Bildung: Top 5 Nettozahler und Nettoempfänger in der EU, 2012.

21 Bundeszentrale für politische Bildung: Nettozahler und Nettoempfänger in der EU, 2016.

Warsaw, for that matter) – witness the current disagreements between Germany and Poland over the World War 2 reparation issue. Yet, by and large, Germany took advantage of the fact that its role concept is very close (if not identical) with the EU's role concept. This has enabled Germany to sometimes "hide" behind the seemingly objective face of the Commission when it came to criticizing CEE countries. At its optimum, this also gives Berlin an even bigger leverage over the CEE countries: the common weight of the EU apparatus *and* Germany is considerable. What happens if Germany moves unilaterally, was shown in 2015, when the German response to the refugee crisis Germany laid bare the risks of a departure of its traditional way of conducting foreign policy. It seems that the tried and tested civilian power approach still does the best services for Berlin.

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László Szegedi

The Crisis Management of the "Dieselgate" – Transboundary (and) Crisis Driven Evolution of EU Executive Governance with or without Agencies?[1]

The so-called "Dieselgate" was one of the major scandals of recent years, in which it has been revealed that several car manufacturers (and primarily the Volkswagen Group) manipulated with computers certain diesel-engine models. As a result, the software of the cars could detect when the models concerned were being tested and adjust the car's emissions to minimum requirements under laboratory circumstances. The starting point of the scandal was the notice of the US Environmental Protection Agency issued in September 2015, which obviously leads us to the dilemma, whether the EU would also need such supranational level watchdog instead of the current system of mainly national level-enforcement and supervision. The European Parliament's Inquiry Report and some MEP revealed several shortcomings and the need for an EU Road Transport Agency, though this option has not been followed by the Commission in related amendments. The article focuses on the different ways of EU "agencification" with emphasis on the relevant factors such as major crisis events or transboundary effects (standardisation requirements) which clearly resulted in creating EU agencies. This has been the relevant factors in establishing the three (other) EU transport agencies just like in case of the EU's environmental agency. Therefore, it is the question of the future, whether the reluctance mentioned, combined with the partly reformed enforcement framework with some increased powers given to the Commission (also to the newly created Forum inside the Commission), and the new

László Szegedi, Senior Lecturer, National University of Public Service, Faculty of International and European Studies, Department of European Public and Private Law. E-mail: Szegedi.Laszlo@uni-nke.hu

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requirements towards national authorities could adequately address the concerns revealed by the Dieselgate.

Keywords: Dieselgate, EU agencies, agencification, Meroni doctrine, EU Executive

The Short Story of the 'Dieselgate' and the Responses Given by the European Union

How the scandal escalated

The starting point of the so-called "Dieselgate" was the notice of the United States Environmental Protection Agency (EPA), which was issued in September 2015 to car manufacturer Volkswagen (VW) Group. Several Volkswagen and Audi models had been launched to the US market with "clean" diesel engines without further equipment of selective catalytic reduction such as AdBlue tank or urea to reduce its NOx (nitrogen-oxide and nitrogen-dioxide) emission and to meet the US requirements in this regard. However, it has been cleared, that the software of the cars could detect when the models concerned were being tested and the software could adjust the car's emissions to minimum requirements under laboratory circumstances. (Bovens, 2016: 262)

In the wake of the scandal senior officials of the VW Group were forced to resign, the company must face fines that could reach billions of dollars, class action and other lawsuits that could add billions of dollars more in liability. (Gardner et al., 2015) Regardless of the consequences related to the US market, this article intends to reflect the reactions and responses given by the European Union considering that neither the EU nor its Member States were able to identify the default devices of such models, while the diesel engines have always been much more popular in Europe compared to their popularity on the American continent.[2]

The EU Member States started to take their own measures, while the EU had not given coordinated response in the wake of the scandal, the main event in this regard was the creation of the European Parliament's Inquiry Committee, which has published its conclusions in March 2017 as a basis for further legislative steps due to be taken by the EU legislator. Nevertheless, some factors of the maladministration have already been revealed in the Joint Research Centre's (JRC) 2013 report[3] entitled *A complementary emissions test for light-duty vehicles*.

[2] Based on figures US rate of diesel engines remained marginal over the last decades, there was a clear decrease in Japan, while the share of diesel cars in Europe reached its peak by 50–53% in 2012–15. (Cames–Helmers, 2013: 3)

[3] Joint Research Centre's 2013 report entitled *A complementary emissions test for light-duty vehicles.* (JRC Report)

The Report of the European Parliament's Inquiry Committee

The Report of the European Parliament Committee (Report) dealt with diverse aspects of the root causes, namely the failures in testing procedures, the defeat devices, as well as with the concerns over European type-approval, and finally the concern of enforcement and penalties.

1. As for the main failures in *testing procedures* it has been identified long ago that there were substantial discrepancies between laboratory tests and real world emission measures of the New European Driving Cycle (NEDC), which affected the vast majority of diesel cars and are not limited to the VW vehicles equipped with prohibited defeat devices.[4] Before September 2015 the discrepancies were generally attributed to the inadequacy of the NEDC test with conformity factor, which was not representative of real-world emissions, but not to the use of prohibited defeat devices. The introduction of new techniques with real driving emission (RDE) and the Worldwide Harmonised Light Vehicles Test Procedure (WLTP), due to replace the obsolete NEDC, has only been decided as of 2017.[5]

   Some *Member States* clearly prevented the formation of a qualified majority in the Real Driving Emissions – Light Duty Vehicles (RDE–LDV) working group, resulting in a delay to introduce more ambitious Commission proposals for conformity factors in case of NO_x limits.[6]

   The *Commission* failed to use the means at its disposal, at the level of the RDE–LDV working group, to advance the decision-making process and ensure a timely adaptation of the type-approval tests to reflect real-world conditions. Moreover better coordination between the different Commission services involved (including the JRC) could have been instrumental in accelerating the process of adapting the tests.[7] Additionally there was a clear conflict of interest in representation of RDE–LDV working group consisting mainly of experts from car manufacturers and other automotive industries without ensuring balanced representation of the policy area.[8]
2. Regarding *defeat devices* neither the EU nor the Member State authorities searched for such devices or proved the illegal use of defeat devices before September 2015 – even if the JRC Report mentioned their potential use, while formulating the general policy goal to decrease their use as far as possible.[9] On 26 January 2017, the Commission published a Notice on Guidance on the evaluation of Auxiliary Emission Strategies and the presence of such devices. It suggested a testing protocol for defeat devices to assist Member States in detecting potential

4 European Parliament (2017): *Report on the inquiry into emission measurements in the automotive sector.* (2016/2215[INI]), (EP Report) 4. The JRC Report has identified the problem years before the Dieselgate, which also led to the establishment of RDE–LDV working group. (JRC Report, 1.)

5 EP Report, 5.

6 EP Report 6–7. The JRC Report has proposed the finalization of new test procedure until December 2013. (JRC Report, 2.)

7 EP Report 7.

8 Ibid. 8.

9 JRC Report 31.

defeat devices by testing vehicles under non-predictable variations of the standard testing conditions.[10]

On the side of the *Member States* there was no consistent application of EU law as regards exemptions on defeat devices. Moreover, none of them could find the defeat devices installed in the VW vehicles, in particular those Member States whose authorities type-approved those vehicles.[11]

Even if the *Commission* had the legal obligation to oversee the Member States' enforcement of the ban on defeat devices, it neither undertook any further technical or legal research or investigation, either on its own or by mandating the JRC, nor requested any information or further action from the Member States to verify whether the law may have been infringed. The Commission never made use of the provision, which entitles it to request the Member States' type-approval authorities to provide information on the functioning of emission technology under special circumstances (e.g. at low temperatures).[12]

3. Concerning the *type-approval and in-service conformity* serious systematic concerns have been identified by the Report. 28 national type-approval authorities were functioning with diverse technical expertise and human and financial resources in order to obtain a vehicle type-approval, while there is neither specific EU oversight over national authorities, nor uniform interpretation in this regard. As a result manufacturers potentially addressed the national authority with least stringent interpretation of the rules, as well as the lowest fees.[13] Notification due to be submitted to the Commission by national authorities in case of rejection of approval request was unclear in general, while the car manufacturers could also submit the request. Nevertheless, the life-cycle surveillance competences remained also unclear in practice due to the clear distinction of national competences and in lack of physical tests.[14]

   The *Member States* relied heavily on the tests performed in the car manufacturers' certified laboratories under the supervision of technical services. This also included consultancy services to car manufacturers on obtaining type-approval. There was an obvious conflict of interest due to the existence of an additional financial link, while the national authorities were only kept responsible to validate the procedure at the end.[15]

   The *Commission* should have taken a more prominent coordinating role to ensure the uniform application of the EU legislation on type-approval, while requesting more information from the Member States on how they dealt with those vehicles in the existing fleet that do not comply with the legal emission limits under real driving conditions.[16]

10 EP Report 8–9.
11 Ibid. 9.
12 Ibid. 10.
13 Ibid. 11.
14 Ibid. 12.
15 Ibid. 12.
16 Ibid. 12.

4. *As for the enforcement side and penalties* the EU merely had regulatory power and the responsibility to implement EU law on car emission measurement lied primarily with the Member States, while the enforcement powers of the Commission are limited to initiating infringement procedures against Member States. There is no unified practice in the EU for transparent access by consumers to information on recalls, nor is there a unified EU legal framework to compensate consumers, while only the type-approval authority that granted a type-approval to a given vehicle can effectively withdraw the certificate.[17]

   The *Member States* started to enforce the EU law on emissions from light-duty vehicles as required only after the Volkswagen emissions case broke out in September 2015 by following diverse approaches and legal consequences. Member States did not monitor and enforce appropriately the application of Regulation (EC) No 715/2007, notably in contravention of Article 5(1) on the obligation for manufacturers to design, construct and assemble cars so as to enable them to comply with the regulation in normal use (non-laboratory conditions).[18] Most Member States did not adopt an effective, proportionate and dissuasive penalty system, notably in relation to the illegal use of defeat devices, several of them did not notify the Commission in time about the penalty regime in place to enforce the ban on defeat devices.[19]

   Despite the 2013 JRC report concerning the possible use of defeat devices, the *Commission* did not undertake further technical research, did not request additional information from the Member States and did not ask the responsible national type-approval authorities to undertake further investigative and corrective actions. There was a lack of coordinated recall programme in case of Dieselgate, while formal infringement proceedings had also not been initiated before to meet related legislative requirements.[20]

As a result of the inquiry report and further discussions, the related EU legislation has been modified, however no new EU agency would be created, even if this had been mentioned by various parties during the investigations and in preparation of legislative steps.[21] Though, the amendments are not finalized yet, the institutional changes can be summarized as follows, based on the first reading provisions:

1. The Forum for Exchange of Information on Enforcement (Forum) shall be created with representatives of national authorities as well as of wider circle of interested parties (economic operators, safety and environmental stakeholders) in order to facilitate the uniform interpretation and implementation of the related

[17] Ibid. 13.
[18] Ibid. 13.
[19] Ibid. 14.
[20] Ibid. 14.
[21] Euractive: MEPs reject EU road agency in vote for new post-Dieselgate car approval rules, 4 April 2017. https://www.euractiv.com/section/transport/news/meps-reject-eu-road-agency-in-vote-for-new-post-dieselgate-car-approval-rules/ (Accessed: 01.04.2018)

Regulation. Within its advisory capacity the Forum may issue (with consensus or simple majority as a second option) soft law opinions and recommendations.[22]
2. The Commission shall conduct compliance verifications with on-road test and laboratory tests, and also perform inspections and assessment of approval authorities.[23]
3. Several requirements have been formulated related to national authorities concerning their administrative capacities, type-approval and market surveillance functions.

The EU Agencies and the Threats of "Agencification"

The "agencification" process

The implementation concerns of EU law have been discussed by the literature since long ago. (Alter, 1996: 458–87; Duina, 1997: 155–79; Mabbett, 2005: 97–120; Börzel, 2006: 128–152) Based on the Report, the EU's composite administration consisting of the Commission, as well as national authorities constituted maladministration in several different ways. The type-approval procedure and the related laboratory testing relied heavily on national authorities, however, neither the Commission nor the national authorities could act effectively in order to ensure the compliance of car industry with related EU obligations. Nevertheless, the obligations and the procedural duties were not sufficiently designed to tackle the potential concerns related to car type-approval, conflicts of interests occurred in laboratory testing. The whole policy area seems of not having a real "owner", which led us to the issue of "agencification" as the EU decided several times in the last decades to address transboundary (and) crisis-related administrative malfunctions of the Single Market by creating EU agencies. These agencies as "inbetweeners" have their potential inside a triangle consisting of EU institutions, national authorities as well as market participants. (Everson et al., 2014: 4)

The so-called mushrooming of EU agencies refers not only to the phenomenon that the number of such bodies expanded tremendously in recent decades, but to the fact, that substantial powers have been conferred upon them by acquiring direct powers over market participants/citizens just like powers over national authorities (responsible for indirect implementation of EU law), as well.

The concerns and threats of the "agencification" process

One of the main concerns of agencification is the shift of *powers* to EU agencies. These agencies are non-Treaty bodies as they still lack today the proper (sector-neutral) primary

[22] European Parliament legislative resolution of 19 April 2018 (P8_TA-PROV[2018]0179) Art. 11.
[23] Ibid. Art. 9–10.

legal basis[24] on their creation and functioning.[25] Therefore, their definition was also laid down by the scholars with the formulation of their main characteristics: relative independence, non-terminated mandate, own legal personality, creation by Union law for specific purposes (competences). Due to their "non-Treaty" status some common rules on their establishment and functioning in form of the soft law Joint Statement and Common Approach of the European Parliament, the Council and the European Commission on decentralised agencies (Common Approach) have been enacted in 2012. However, the Court of Justice of the EU (CJEU) mainly kept the delegation model of powers to the agencies dated back to the 1950s case-law called Meroni doctrine in its recent judgment,[26] primarily based on the restricted delegation due to the "non-Treaty" nature of such bodies. This new model of reshaped Meroni doctrine partly recognizes the recently increased role of agencies, however still treating them as "supporters" of the EU's policy-making, denying the prerogative of making their own policy choices without the involvement of further EU/national counterparties.

Further dilemma in case of EU agencies occurs related to the *internal structure* and to the *decision-making* of their internal bodies. The management boards, consisting primarily of the representatives of Member States are the main decision-making bodies with further involvement of representatives of the Commission, the European Parliament, as well as of the stakeholders.[27] Even if the national representatives have various integrity requirements related to their tasks based on the Treaties, the EU Staff Regulation and the related requirements of sector-specific laws to prioritize EU interest, in practice the national interests might overrule that of the Union's. As a result, the lowest common denominator solutions would be easier agreed, which prevents to effectively represent the EU interest in Union acts. (Vos, 2014: 26) Therefore, some EU agencies already follow modified internal structure and decision-making procedures in this regard.[28] Nevertheless, this factor should not be overestimated. According to some scholars, what matters mostly is the independence and impartiality of the scientific internal bodies, which has already been enacted to the Common Approach.[29] (Vos, 2014: 37)

As for *independence,* the Dieselgate demonstrated the general importance of the relationship with the Commission, as well as with national authorities. The European composite administration is far from having DGs and commissioners as heads of ministerial administration with its classical centralistic organisation as Member States have autonomy in creation of their own administrative systems even if the principle

24 EEA has sector-specific primary legal basis in form of Art. 192 TFEU (EC-Treaty Art. 175). Art. 100(2) TFEU (EC-Treaty Art. 80[2]) applies in case of EMSA and of EASA and Art 91(1) TFEU in case of EUAR.

25 Article 263.1 of the Treaty on the Functioning of the European Union as almost the single reference to agencies guarantees the judicial review against their acts for third parties before the Court of Justice of the European Union.

26 C-270/12, United Kingdom v. Parliament and Council, EU:C:2014:18, paras. 46–50 and 67.

27 Common Approach Point 10.

28 European Food Safety Authority has a smaller management board of 14 members appointed by the Council in consultation with the European Parliament from a list drawn up by the Commission, from whom four members shall have their background in organisations representing consumers and other interests in the food chain. (Regulation 178/2002 Art. 25.)

29 Common Approach Point 20.

of loyalty has a binding force upon them.[30] The EU agencies recently started to refer to certain DGs as "partners" in their reports, (Egeberg et al., 2014: 620–24) while some of them could also acquire inspection powers over national authorities. I would also like to reveal the role of informal relationships between the different actors in EU composite administration as the recent evolution of agencies could serve as a proper example, how the law in books can be overruled by the daily practice in order to keep the institutional status quo or to avoid the repositioning of an EU agency. Nevertheless, the independence in this regard also refers to the opportunity of agencies to be more proactive, act without pre-established procedures, which are crucial elements of transboundary crisis management according to related studies. (Jordana–Trivino-Salazar, 2017: 9–10)

The Different Paths of "Agencification"

The European Environmental Agency

Considering the role of the US EPA in the Dieselgate, it would seem obvious to confer further competences on the European Environmental Agency (EEA) as increased emission levels clearly endanger the environment, as well as human health.

However, the political considerations between EU as well as national level actors clearly influenced that limited powers have been conferred upon EEA. In 1994 each of the tasks mentioned during the EEA establishing negotiations have been guaranteed for the EEA without the required staff and budget to perform adequately. (Schout, 2008: 265) Its creation was not necessarily a reaction to a transboundary and/or crisis situation, however clearly signalized the commitment of the EU to take care of the environment in light of the substantial amount of EU legislation issued in this policy area. (Chatzopoulou, 2018: 7)

The EEA's main *competences* still include today the collection, processing and analysis of data, providing information for further policy-making, processing of questionnaires, support and stimulation of exchange of information as well as further stimulation in this regard. Nevertheless, the focus point of its responsibilities also refers to the coordination of the network consisting of national focal points, topic centres and national information networks (European Environment Information and Observation Network – EIONET).[31] In course of its creation process, however, some even wanted to give inspection powers to the EEA, which remained unfulfilled. (Martens, 210: 884) The EEA competences as a so-called information agency clearly reflects the logic of the Meroni doctrine treating agencies as mere supporters of policy-making without having real influence on policy-decisions, even if the share of competences was not that clear at the beginning of the EEA's history.

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30 Treaty on the Functioning of the European Union Art. 4.2–4.3.

31 Regulation (EC) No 401/2009 of the European Parliament and of the Council of 23 April 2009 on the European Environment Agency and the European Environment Information and Observation Network (EEA Regulation) Art. 4.

As for its *internal structure* and *scientific bodies,* the rules on the EEA's Management Board, even if established long before the Common Approach, are in line with its requirements, while the adaptation of the decisions mainly requires a 2/3 majority. Draft versions of the multiannual and annual work programmes are to be consulted with the Commission, as well as with its scientific committee.[32] The committee is to be designated by the Management Board for a term of four years renewable once as a guarantee of some independence.[33]

In relation to its *independence,* the brief institutional history of EEA should be taken into account, which clearly demonstrates how the daily practice and inter-institutional relations can influence the mandate of EU agencies. The first decade of its history (1994–2003) has been summarized by Martens as the era of *inter-institutional tensions* of the EEA due to the political vision of its first director Mr. Jiménez-Beltrán. He had put much emphasis on producing policy analyses by the EEA rather than gathering facts. (Martens, 2010: 888–89) What refers to inspection power over national authorities, the EEA also made its analysis regarding the institutional performance of DG Environment, as well as of national authorities, which led to the budget freeze proposals from the side of the Commission. The Commission has expressed its position clearly with means related to the staffing and budget so that the EEA should focus on its core tasks of data-gathering, while criticized the EEA for putting too much emphasis on general analyses without providing hard data for further policy-making. (EIPA–IEEP, 2003: 31–39; Martens, 2010: 888)

The next chapter of the relationship between the Commission and the EEA can be considered as a rather *inter-institutional partnership,* (from 2004) as more emphasis has been given to the DG Environment's priorities by the EEA, while the EP clearly positioned itself as an ally for EEA in the budget-proposal process, and the network of EIONET could also acquire substantial position in data gathering. (Martens, 2010: 890–92) Additionally, it seems the EEA tends to keep its less-confrontative attitude as its 2016 report already revealed the shortcomings of the diesel cars' default devices without using the term "exploitation" and described the automakers' behaviour as rather optimising testing procedures. (Skeete, 2017: 379)

The European Transport Agencies

Considering the sector concerned the choice is obvious to further elaborate the EU's transport policy and the ways, which led to establish agencies in this sector. The creation of the European Aviation Safety Authority (EASA), of the European Maritime Safety Agency (EMSA) and of the European Union Agency for Railways (EUAR) relied mainly on transboundary and in certain cases crisis-related factors, which were also given in case of the Dieselgate. The driving force behind the creation of EASA established in 2002 was to give a strong EU solution instead of the pan-European Joint Aviation Authority (JAA), which substantially contributed to the development of the Single Market in the field of aviation and aviation safety by establishing a single authorisation and inspection

[32] EEA Regulation Art. 8.
[33] EEA Regulation Art. 11.2.

body with unified approval, authorisation and safety standardisation requirements. (Schout, 2008: 267) Similar factors were relevant during the establishment of the EUAR – previously known as the European Railway Agency, however this agency acquired substantial powers only in course of the 2016 reform package.[34] (Versluis–Tarr, 2013: 324–25) The establishment of EMSA in 2002 was a reaction to the catastrophe of Erika tanker off the French coast in 1999, which shed light on the need of common ship safety standards and that of the prevention of such crisis situations. (Groenleer et al., 2010: 1219)

As for the *powers,* the three transport agencies acquired substantial inspection competences over national authorities and further direct powers over market participants. Based on the shortcomings revealed during Dieselgate, I would mainly deal with the inspection powers.

The cornerstone of safety standardisation was the work of the International Civil Aviation Organisation from 1944, while the related inspection tasks were organised by the JAA. (Schout, 2008: 267) The EASA took over the coordination of standardisation activities previously carried out by the JAA in Air Operations, Synthetic Training Devices and Flight Crew Licensing in 2007.[35] In the course of the last years, the related Regulation on standardisation inspections has been renewed, while the policy areas covered by standardisation inspections have also been expanded.[36] Similar inspection competences have been given to EMSA concerning safety standardisation (similar to aviation developed on international level by the International Maritime Organisation)[37] as well as to EUAR concerning interoperability and performance of national authorities.[38] The outcome of such inspections involves the issue of a report, however, the formal enforcement power lies at the Commission just like before to initiate infringement proceedings. The inspection cycle cannot be merely considered as objective fact-finding missions as there is some dialogue between the inspector and the inspected party involving the EUAR's right to issue recommendations or at least horizontal findings by the other two agencies. Related to the enforcement of inspection power, the lack of transparency of individual inspections reports towards the general public still creates a clear concern. (Schout, 2008: 284; Scholten, 2014: 106–110)

As for the *internal structure,* the composition of the EU's transport agencies management boards are similar to that of the EEA and to the requirements of the

34 Regulation (EU) 2016/796 of the European Parliament and of the Council of 11 May 2016 on the European Union Agency for Railways and repealing the Regulation (EC) No. 881/2004, (EUAR Regulation) Chapter 7.

35 Regulation (EC) No 216/2008 of the European Parliament and of the Council of 20 February 2008 on common rules in the field of civil aviation and establishing a European Aviation Safety Agency, and repealing Council Directive 91/670/EEC, Regulation (EC) No 1592/2002 and Directive 2004/36/EC (EASA Regulation) Art. 24.1. 54–55.

36 Commission Implementing Regulation (EU) No. 628/2013 of 28 June 2013 on working methods of the European Aviation Safety Agency for conducting standardisation inspections and for monitoring the application of the rules of the Regulation (EC) No. 216/2008 of the European Parliament and of the Council and repealing Commission Regulation (EC) No. 736/2006.

37 Regulation (EC) No 1406/2002 of the European Parliament and of the Council of 27 June 2002 establishing a European Maritime Safety Agency (EMSA Regulation) Art. 3.

38 EUAR Regulation Chapter 7.

Common Approach with the involvement of one national representatives per each Member State, as well as with the further representation of the Commission and the EP. Voting rules require a 2/3 or absolute majority.[39] The boards decide on the annual work programme after receiving the opinion of the Commission on the inspection plans.[40] As a sign of a more sector-specific approach and the potential to better consider the interests of the Single Market, some interested parties are also involved in the work of the boards. This includes the advisory board of the EASA's which issues opinions and the EMSA's and EUAR's expanded board with the representatives of stakeholders and other parties. In terms of decision-making, however, the advisory board may only issue non-binding opinions, while members of the extended boards have no voting rights.[41]

The *independence* of transport agencies relates to the special nature of inspection power and to the fact, that this kind of competence makes agencies more influential against Member States.

The EUAR acquired inspection power over national authorities only in 2016.[42] Interestingly, it has been revealed by scholars that the EUAR's staff was rather unwilling on acquiring new powers. They considered inspection power as a threat to lose their well-established relationship with market participants, as well as with national regulators, while being more exposed to EU-level political implications. (Kaeding–Versluis, 2014: 84–86) Similar problems occurred in case of EMSA, as the Commission first initiated infringement proceeding on the basis of the EMSA's information, while failed to inform EMSA thereof in advance, which put the agency's relation with the concerned Member State at risk. (Groenleer et al., 2010: 1220)

Due to the labour-intensive and time-consuming nature of inspections, in case of being combined with on-site visits, the EASA made attempts to perform its inspection cycles with involvement of less resources. In course of 2014/2015 the so-called Continuous Monitoring Activities (CMA) were introduced, which resulted in a slight decrease of inspection visits. In this system the National Standardisation Coordinators[43] are responsible for data exchange and providing assistance for on-site inspections as part of the system of CMA.[44] As a result of CMA, the 2015 and 2016 EASA Annual reports acknowledged the decreasing trend in numbers of inspections as CMA contributed to reduce the need to perform on-site visits.[45] Even if the risk based approach of on-site inspections could be streamlined related to this new CMA system, there are no further requirements[46] on the independence of the Coordinators, which might lead to "double-hatedness" problems in the future.

39 EASA Regulation Art. 37.; EMSA Regulation Art. 14.; EUAR Regulation Art. 50.
40 EASA Regulation Art. 34.; EMSA Regulation Art. 10–11.; EUAR Regulation Art. 47–49.
41 EUAR Regulation Art. 47.1; EMSA Regulation Art. 11.1.
42 EUAR Regulation Art. 33–35.
43 Commission Implementing Regulation (EU) No. 628/2013, Art. 6.
44 The number of the inspection visits available in the EASA's Annual Reports: 2009 (85), 2010 (111), 2011 (107), 2012 (121), 2013 (103), 2014 (107), 2015 (99), 2016 (99).
45 EASA's Annual Activity Report Year 2015, 25.; EASA's Annual Activity Report Year 2016, 33.
46 Article 6.2 of Commissions Implementing Regulation No. 628/2013 only requires from Competent Authorities to ensure clear lines of communication with the Coordinator without stipulating further requirements on the Coordinator's independent functioning as such.

Some agencies have acquired much stronger power *directly addressed to the market participants,* which could have been introduced simultaneously in case of creating a road transport agency by the EU. The EASA gained power to issue type-certificates, certificates for parts and appliances, appropriate environmental certificates in the field of airworthiness, EUAR issues authorisations for the placing on the market of vehicles and vehicle types.[47] This kind of direct power necessarily involves the consideration of policy choices related to market regulation and surveillance. In this regard even the reshaped Meroni doctrine of the CJEU seems to be outdated, especially considering the allocation of powers by ensuring exclusive EU competences for certain agencies (also EASA) without any involvement of national authorities.[48]

In terms of structure of the EU Executive, the creation of a road transport agency would also have a potential by closing the gap and ensuring that each subsector of the transport area (aviation, maritime, railroad, road transport) do have its own dedicated EU body. Further on, these transport agencies could be merged into one EU Transport Agency, which option has already been foreseen by the Common Approach.[49] With this future measure, the whole sector could keep its core functionality, even have a stronger voice by the creation of a general EU Transport Agency, while the elimination of duplicated functions would make it easier to meet the presumably upcoming budget restrictions following the current system of capping of their resources.[50]

Lessons to Be Learned

Though the transboundary (and) crisis driven factors were given in case of Dieselgate, it seems that no new agencies will be created or more power will be given to the existing ones. In light of the above analysis, the agencies or more powerful agencies should not be considered as "always-true-solutions" for administrative malfunctions of the Single Market. Theoretically the Commission, the Forum and national authorities can also properly address the concerns identified by the Report, if lessons based on the functioning of the elaborated agencies would be taken into account.

The *legal status* of the Commission and of the national authorities does not need to be analysed. The Forum functioning within the framework of the Commission is similar to that of the comitology committees and regulatory networks without having legal personality. However, the symbolic status of a new road transport agency, even a merged EU Transport Agency could have had a greater impact on the whole transport policy area, just like it could have on the carmakers. On the other hand, the environmental area is among the ones, where regulatory networks are proved to be effective due to their ability to act locally, (Angelov–Cashman, 2015: 350–76) even if the emission related to car

47 EASA Regulation, Art. 20; EUAR Regulation, Art. 20–21.
48 EASA Regulation, Art. 20.
49 Common Approach Point 5.
50 Regulation (EU, Euratom) No 1023/2013 of the European Parliament and of the Council of 22 October 2013 amending the Staff Regulations of Officials of the European Union and the Conditions of Employment of Other Servants of the European Union

industry constitutes a different situation based on the single type-approval and huge amount of sold models compared to that of an "ordinary" single pollution.

Considering *competences,* the reshaped Meroni doctrine created a not necessarily clear situation regarding the constraints of the delegation of competences upon agencies, which makes it obvious why the EU legislator remained reluctant to create a new agency with direct market regulatory/surveillance powers or inspection competences. The Forum being responsible to issue opinions/recommendations could also have substantial effect on the related market considering data gathered from other agencies. (Ferran, 2016: 299) Further on, the general requirement to act effectively in crisis situations, just like their emergence at the EU institutional landscape, make it necessary to guarantee sector-neutral primary legal basis for the EU agencies.

The *internal structure* of agencies, as well as of the Forum might have the same concern as the intergovernmental dynamics of decision-making which is given by the representatives of each Member State in both cases. As for the lessons, transport agencies could be relevant in this regard due to the greater involvement of stakeholders, as well as single majority votes might support to overcome the intergovernmental dynamics concerned. Moreover, the impartiality of scientific bodies is more relevant in light of the inner dynamics of the Commission, whether the output of the JRC's work and the test results will be articulated in the decision-making of the Commission. The NGOs and the relationship with other civil society partners might also be decisive, as the original US test results were uncovered by independent scientists at the University of West Virginia, therefore the reliance on such (outsourced) scientific capacities creates a further option to address criticism on the ever-growing bureaucracy of the EU Executive and of agencies.

As for *independence,* the inter-institutional and intra-institutional relations are of utmost importance not just in the day-to-day functioning of policy actors, but also in crisis situations. In the era of permanent crisis, the proactive attitude, the motivation of creating some kind of self-profile and acting regardless of formalities could be decisive. This kind of expansion might be necessary to handle crisis situations or to avoid such events. Assumingly, the Forum functioning inside its institutional framework of the Commission had less opportunities to act regardless of the political implications of the Commission. However, it does not necessarily mean that the Forum or even other policy actors of the EU composite administration cannot make its expertise "voice" heard, especially if the Commission will show more openness to take into consideration the input given by them.

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Armand de Mestral

Comment on and Issues Raised by the Achmea Ruling of the Court of Justice of the European Union from an Arbitration Perspective

On March 6, 2018 the sword of Damocles which has been hanging over the investor-state arbitration (ISA) came down upon the 196 Bilateral Investment Treaties (BITs) concluded between the Member States of the EU when the Grand Chamber of the CJEU issued its ruling in the *Achmea* case.[1] The operative paragraph of the judgment states: *"Articles 267 and 344 TFEU must be interpreted as precluding a provision in an international agreement concluded between Member States, such as Article 8 of the Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federative Republic, under which an investor from one of those Member States may, in the event of a dispute concerning investments in the other Member State, bring proceedings against the latter Member State before an arbitral tribunal whose jurisdiction that Member State has undertaken to accept."*

On its face, this ruling appears to be a very strong affirmation of the primacy of EU law over treaties concluded by the Member States. It is essentially grounded on the finding by the Court that arbitral tribunals are not capable of making references under TFEU article 267 (in line with its Opinion 2/13[2]) and hence it is impossible for the CJEU to exercise its authority over disputes involving the application of EU law. The arbitration clause in the Netherlands – Slovakia BIT, and presumably other similar intra-EU clauses, is thus declared to be incompatible with the EU law.

This ruling is relatively short, as compared to the complex nature of the issues raised by the case, and very blunt. In consequence, upon examination, perhaps due to its very brevity, this ruling seems to leave open and unclear a number of major issues. In particular, in the respectful opinion of the author of this comment, the CJEU has left uncertain the answers to the following questions:

Armand L.C. de Mestral, C.M., Emeritus Professor, Jean Monnet Professor, Faculty of Law, McGill University. E-mail: armand.de.mestral@mcgill.ca

1 Judgment rendered in case C-284/16 – Achmea [ECLI:EU:C:2018:158] on 6 March 2018.

2 Opinion 2/13 – Accession of the EU to the ECHR [EU:C:2014:2454] of 18 December 2014.

1. What are the incompatible rules of EU law the arbitral tribunal might be called on to apply?
2. Are all arbitral proceedings in the EU at risk?
3. What is the effect of its judgment on the Energy Charter?
4. What is the effect of the *Achmea* judgment on extra-EU BITs?
5. Must the 196 intra-EU BITS now disappear?
6. What is the fate of the Multilateral Investment Court?
7. Does this ruling mean that the current award and pending cases are null and void?
8. What is the fate of survival clauses in intra-EU BITs?
9. What is the impact of this decision on investor-state proceedings outside the EU?
10. What is the impact of this ruling on proceedings under the ICSID Rules?
11. What is the significance of this judgment for the exercise of competence over "foreign direct investment" by the EU?

All these questions cannot be answered today with certainty. This note will simply seek to explain the nature of the concerns raised above.

1. What are the incompatible rules of EU law the arbitral tribunal might be called on to apply?

Nowhere in the judgment does the CJEU explain which rules of the EU law would be shielded from its control. Are all the elements of the typical BIT in conflict with the rules prohibiting discrimination against EU citizens, the freedom of establishment or free movement of services and capital? Arbitrators have held in the *Eureko* case[3] and others that BITs constitute a separate body of law and have denied any inherent conflict. These are major questions which require answers. The Commission and other critics have argued that BITs concluded by individual EU Member States discriminate against the investors of other EU Member States. Unfortunately, the Court does not address this very significant argument.

2. Are all arbitral proceedings in the EU at risk?

The Court suggests that the situation is very different between ordinary commercial arbitration proceedings where EU law is applied by arbitrators in private matters and treaty-based BIT arbitrations where States assume obligations to refer the matter to arbitrations. But, if the capacity to rule on matters of EU law is the central problem, is there not a danger for all arbitration proceedings in the EU which involve EU law? It is by no means clear that private commercial arbitrations are much more subject to domestic courts than investor-state proceedings under the UNCITRAL Rules. Indeed, the general thrust of all modern arbitration legislation is to shield all but exceptional cases from

3 Achmea B.V. v. The Slovak Republic, UNCITRAL, PCA Case No. 2008-13 (formerly Eureko B.V. v. The Slovak Republic).

control by the courts. Does this not infringe the general duty of EU Member States to subject their laws to EU law?

3. What is the effect of its judgment on the Energy Charter?

If investor-state arbitration under BITs violates EU law why is this not also the case for claims brought by EU investors against the government of another EU Member State under the Energy Charter? The object and purpose and procedures are the same as those under BITs. The Court leaves us in the dark with respect to the Treaty that has generated more investor-state claims than any other. Will intra-EU claims under the Energy Charter be prohibited but the right to make extra-EU claims will survive?

4. What is the effect of the Achmea judgment on extra-EU BITs?

Member States have concluded some 1200 BITs with third countries. Indeed, they invented the whole technique. The *Achmea* ruling only relates to intra-EU BITs but what will be the consequence for claims against an EU Member State under a BIT with a third country? The procedure is the same and EU law may be potentially relevant to the decision of the case.

5. Must the 196 intra-EU BITS now disappear?

The Commission has been calling upon Member States to abrogate their intra-EU BITs. Must they now proceed to do this or could they amend the dispute settlement procedure in some way to make it subject to the jurisdiction of domestic courts and the CJEU? This is a key question and one which the Court does not expressly answer even if the Court's ruling has only criticised the arbitration clause in the BITs.

6. What is the fate of the Multilateral Investment Court?

Will the Commission be able to press ahead with its policy of promoting the creation of a Multilateral Investment Court (or even be able to justify the investment tribunals in the CETA, VietNam and Spore agreements) or will they be deemed in conflict with the CJEU under Article 340? The primacy of the CJEU in the enforcement of EU law seems to be a central underlying theme of this decision, and of many others. Does this not suggest that the Court may be hostile to any other court dealing with foreign investment protection?

7. Do the principles of the intertemporal validity of law save the *Achmea* award or does this ruling mean that the current award and pending cases are null and void?

The BIT allowing the Eureko[4] *Achmea* claim was a valid law when the claim was made. Is the ruling only prospective on the basis of principles governing the intertemporal

[4] The undertaking Achmea used to be called Eureko.

validity of law? Is it fair to declare this award retroactively invalid or is the current award actually null and void? Is it simply unenforceable in the EU and can be enforced as an arbitral award under the New York Convention elsewhere in the world? Would the enforcement of the Eureko *Achmea* award in a third country violate local or EU public policy? Arbitrators have already upheld the validity of such proceedings on the ground that they reflect a separate body of law from EU law; how will foreign courts deal with this question?

8. What is the fate of survival clauses in intra-EU BITs?

Many of the intra-EU BITs contain survival clauses by which they remain in force for a considerable period of time after denunciation. Should they not also survive the *Achmea* ruling? Can the court destroy the protections carefully erected by the States which concluded these BITs?

9. What is the impact of this decision on investor-state proceedings outside the EU?

The governing law of most BIT claims against and EU Member State are brought under the law of an EU Member State – in the Eureko (Achmea) case Germany. But the UNCITRAL Rules or the ICSID Convention do not preclude the choice of third countries as providing the governing law. What would be the consequences of organising a claim outside the territory of the EU? This is not impossible. Would the CJEU have to declare the claimant in contempt and the participating state in violation of EU law? It is doubtful that the CJEU could stop proceedings conducted outside its borders.

10. What is the impact of this ruling on proceedings under the ICSID Rules?

The ICSID Convention contains its own rules of procedure and allows for proceedings to be brought against a State party in Washington or elsewhere. Could the CJEU enjoin an investor and an EU Member State from proceeding under a BIT in accordance with the ICSID Convention? This is by no means certain since the Washington Convention does not contain rules of revision and annulment for violation of public order. Would the Member State be violating its obligation of loyal cooperation with the EU by proceeding in this way? What if the complainant proceeds regardless and insists on their right to an arbitration in Washington under the ICSID convention and the relevant BIT?

11. What is the significance of this judgment for the exercise of competence over "foreign direct investment" by the EU?

It is urgent to know whether the EU is competent to adopt a regime of investment protection complete with a dispute settlement system which might replace the network of intra-EU BITs. It is equally urgent to know the consequences of this judgment for the 1200 extra-EU BITs concluded by the Member States and now in force. The *Achmea* ruling of the CJEU is only addressed to intra-EU BITs, but the consequences for arbitration provisions currently in these BITs or for a court system which the Commission wishes to may well be in jeopardy, as well. We can only speculate on these questions also.

The Court seems to have opened a Pandora's box and left the arbitration world with more questions than answers. Perhaps the Commission, having obtained what it wanted, will soon be suffering from a severe case of buyer's remorse.

Györgyi Nyikos

Comments on the Functioning of the European Fund for Strategic Investment

The European Fund for Strategic Investment (EFSI)[1] is to help overcoming the current investment gap in the EU by mobilizing private financing for strategic investments. EFSI as one of the three pillars of the Investment Plan for Europe should unlock additional investment. Legally, EFSI is neither a financial instrument[2] under the Financial Regulation applicable to EU level budgetary operations nor under the definition of the regulation applicable for European Structural and Investment Funds. The common point is however that EFSI should provide financing for economically viable projects using loans, guarantees and equity investments.[3]

EFSI was established in a very short time frame[4] by skipping a number of important steps in the preparatory and planning phases.[5] EFSI was originally a EUR 16 billion guarantee from the EU budget, complemented by a EUR 5 billion allocation of the EIB's own capital which provides additional guarantee permitting higher risk-taking to the EIB project finance. A higher risk profile is possible in the projects finance as compared to standard EIB activities and the pricing policy could also be different due to the support of the EFSI guarantee. Additionally, a dedicated governance structure for EFSI decision process has been established. This has been put in place to ensure that the investments

Györgyi Nyikos, Vice-Rector for International Affairs, National University of Public Service. E-mail: nyikos.gyorgyi@uni-nke.hu

1 Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub, and the European Investment Project Portal and amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013 – the European Fund for Strategic Investments, OJ L169, 01.07.2015. 1 (the "EFSI Regulation") entered into force on 4 July 2015.

2 FIs are defined also in Financial Regulation as measures of *"financial support provided from the budget in order to address one or more specific policy objectives by way of loans, guarantees, equity or quasi-equity investments or participations, or other risk-bearing instruments, possibly combined with grants"*.

3 Nyikos, Györgyi (2016): *Financial Instruments in the 2014–20 Programming Period: First Experiences of Member States*. Brussels, European Parliament, Policy Department B: Structural and Cohesion Policies.

4 From the moment the IPE was announced in November 2014 to the signature of the agreement between the Commission and the EIB in July 2015 it took only eight months.

5 e.g. ex-ante analysis.

made under EFSI remain focused on the specific objective of addressing the market failure in risk-taking which hinders investments in Europe. EFSI has two channels to support projects: an Infrastructure and Innovation Window (IIW) to be deployed through EIB [6] and an SME Window (SMEW) to be deployed through the EIF[7] to support SMEs and mid-caps.[8]

After the initial investment period, the European Commission proposed to double the duration and size of EFSI. On 12 December 2017, Members of the European Parliament voted to adopt the Regulation to extend and enhance EFSI.

However, questions also arise about the impacts and effective functioning of the EFSI.

The first issue is whether EFSI is reacting to the challenge of fostering investments and *addressing market failures* in Europe. According to several studies and analyses there is an investment gap, but it can be understood in two different ways. Looking at the figures and facts,[9] EFSI being an additional guarantee as an immediate stimulus offers nothing of substance. For dealing with long-term investment needs, it makes more sense. However, the geographical bias – so far not towards lower-income countries[10] – would seem undesirable in this context.

This result could come from the fact that on the one hand even though in Eastern Europe the lack of finance is more obvious, still at the same time this has to be related to the market demand (e.g. a lack of projects). Furthermore, the lack of projects is not necessarily the sign of lack of finance, but the lack of proper administrative capacity to develop and implement a project. On the other hand, investments need financing and the conditions for financing are different in the Member States and the availability of different types of financing from ESI-funds (e.g. grants) led subsequently to different results in terms of EFSI implementation. There are huge differences between Western and Eastern Europe and one size fits all is not the best approach.

The measurement of the financial gap and the best way to address it links to another area: the *proper preparation of the instrument*. For the establishment of financial instruments in cohesion policy ex-ante analysis is obligatory to answer this question. In case of EFSI the political decision was put in practice without an ex-ante assessment for the rationale or approach of the fund. The overarching question is the following: is it acceptable that EU-policy decision making is made in a way that the relevance is inadequately justified and that the effectiveness and efficiency are unproven? There was an amount available (as much as could be agreed within political constraints) and a target (the most that could conceivably be hoped for on the basis of past EIB experience), so the

6 European Investment Bank.

7 European Investment Fund.

8 There is no common EU definition of mid-cap companies. While SMEs are defined as having fewer than 250 employees, mid-caps are broadly said to have between 250 and 3000 employees.

9 EFSI is 0.5% of EU GDP in 3 years, launched in 2015, 7 years after the crisis.

10 As at 31 December 2017, 47% of the financing under the IIW is concentrated in three Member States, exceeding thus the IIW geographical concentration limit of 45% in any three Member States as set in EFSI's Strategic Orientation. See projects http://www.eib.org/efsi/efsi-projects/index.htm (Accessed: 30.07.2018)

whole process and the established structure was based only on the existing practice of the EIB.

At that point arises the next question about the *additionality of the instrument*. Even though the definition of additionality is vague[11] and there are different ways to interpret and assess it. When looking at additionality, the starting point should be the "policy of additionality", which would subsequently ensure the additionality of operations. The additionality of the EFSI at both level is hard to judge because decisions are not taken in a transparent way.

At the operative level especially in the *IIW* is a good reason to believe that many projects are typical of past EIB practice. Despite the claims, there is no clear evidence to show that they really are riskier. Transparency is one of the most important issues regarding the additionality of EFSI operations and because the EIB provides very limited information on the EFSI projects. With no information on the riskiness, subordination and maturity, it is very difficult to assess their additionality.

In the case of *SMEW* EFSI made it possible to frontload the other instruments which is positive. The question here is whether this SME programs are useful or they are *crowding out* private investors, private banks, and national schemes or even other EU funds (e.g. CEF DI, COSME EFG and Innovfin Large Projects). It could be especially problematic, because EFSI is not coordinated with other EU instruments and works by different rules. Compared to other tools financed by the ESI-funds financial instruments' implementation through the ElF is more flexible (procedural wise), as it does not involve procurement or state aid issues, which areas are the biggest obstacles in the implementation of ESIF FIs. The differences in setup and rules create huge obstacles that make it almost impossible to combine different sources of funding. An integrated approach is useful and necessary. Looking also at the SMEW distribution the question arises again if the funds went to the countries having the strongest need. The Member States using the most of the SMEW money are countries which do not have huge difficulties in accessing finance.[12]

The explanation could be two folded: there is a trade-off between the *focus on volume* (315 billion Euros) and the additionality and risk profile of EFSI operations. In the context of EFSI, so far it appears that the *finance is not necessarily going to the projects in need, but the funding is going to well-developed and low risk projects*. The defined high multiplier (15) can only be achieved in developed countries, and it is not realistic for high risk projects: the higher the multiplier, the lower the risk of the project. In the light of this context it was maybe a conceptual mistake to set the target volume and the leverage effect as the most important indicators for EFSI, as they became criteria against which EFSI is judged at the expense of development and other qualitative objectives. The projects are selected in order to meet this high multiplier. If riskier projects were selected in less developed parts of the EU, then the multiplier of 15x would not be realistic.

It is also important to notice, that the *multiplier effect reflects the outputs, but not the real economic impact*. In order to measure EFSI's performance and to assess additionality

11 In the preamble of the EFSI regulation it is addressed, but there is no practical mechanism to test the additionality of EFSI.

12 Again the same three Member States account for 38% of the financing: France, Italy and Portugal.

beyond the financial aspect, the Cost Benefit Analysis (CBA), or in case of financial instruments, the Economic Rate of Return (ERR), are more relevant indicators.

Thus, the focus on volume impacts the geographical and sectorial distribution of EFSI investments, because of the differences considering aspects such as technical assistance, the way projects are prepared, and the development of financial markets.

If the aim is to achieve more useful investments in countries where investment has fallen the most, then a *more comprehensive policy approach* is needed. The *advisory services* on offer look much too week and small a step to overcome existing weaknesses. A more proactive approach and more *technical assistance* would be advisable. For better integration between the different tools *mapping of all existing FIs* would be also needed.

EFSI should stay if it could be really additional, transparent. Even if EFSI financing is not granted to a riskier type of project, it still could be a good tool to finance useful, innovative but projects with a higher level of risk, particularly in the innovation R&D sectors, but an integrated approach is necessary (EFSI vs. ESIF and other EU tools).

Interview with Margrethe Vestager, European Commissioner for Competition[1]

Krisztián Kecsmár: I was in Copenhagen for the end of the Danish Presidency of the Council of Europe. The Danish economy is impressive. Small country, high GDP, innovative or big companies such as Maersk, Lego, Coloplast, Lundbeck or Bang & Olufsen. What is the secret of the Danish competitiveness?

Margrethe Vestager: I think it is a combination of a number of different things that work well together: people are highly skilled; you can come back and learn more; you have a close relationship with research and development infrastructure; you can work well with the Government; things work fast and with a very lean approach. There is also one sort of fundamental thing: Denmark being a small country, people tend to trust each other quite a lot and take a lot of responsibility in their positions. It applies also to the youngest employees, such as a trainee: if they find that something is not working well, they will tell you. They may even also try to take an initiative to correct things. For us this is very important: for one field of responsibility what you do, you are trusted.

KK: So there is a very fruitful dialogue between the different actors if I understand correctly.

MV: Yes. I think so. We have this very long tradition for our labour market with a very high degree of governance by the social partners. The unions and the employers' organisations, with very little political interference.

KK: As a Danish Commissioner with economic background what is your added value in the competition policy at the European Commission?

MV: That is actually a difficult thing to know whether your nationality is an add-on. Because you are a law enforcer. And the basics were formulated 60 years ago and have been enforced ever since. So, I don't know whether the Danish approach has an added value in that sense. I think, sometimes, maybe, the sort of Northern, direct, hands-on approach to things may be different from how other people would do it, but if you

[1] By Krisztián Kecsmár and Annamária Dobrotka-Mayer on 26 April 2018.

do something wrong on the market place, well, it is the same no matter whether the commissioner is Danish, Italian, Portuguese or Hungarian.

KK: Just to stay a little bit more in the field of competition policy. You just adopted the Bayer/Monsanto decision. Do you think that undertakings resolve everything or more mergers should be prohibited? Should competition policy remain an investor friendly environment?

MV: To tell the truth, the most important thing is that consumers get a fair deal. This is one of the important decisions taken in Europe that the markets should serve consumers. In the market place you shouldn't just serve the interest of your undertaking. It is a very important card of being a citizen that in your role as a consumer you are in charge of. If you do not feel that you get the best offer, good service with one provider you will go to another one. And that is for me the most important element. In that, of course, we have the possibilities to make sure that companies don't exclude other companies from trying to compete against them, that cartels do not make it difficult for consumers or for competitors not being part of the cartel. But when it all boils down, it boils down to the right of the citizens to have a fair deal as a consumer.

KK: Do you feel that you need to revitalise anti-trust investigations including cartels? Or is it imperfectible?

MV: Unfortunately, I do not think that we will ever be done. It seems like this: when we are done with one cartel case there is another coming up. Most probably because some of the underlying reasons are very old human characteristics: that you are greedy or you want to obtain something that you don't really want to work for, that you've been pushed out of the market or that you want to exercise more power. Greed and power if they go alone or in combination, they are very powerful reasons. And, unfortunately, I don't think that we can overcome them; there will always be a minority who will not take by the rules.

KK: As a European Commissioner for Competition what's your opinion on the debate that was surrounding the posting directive review? Lower wages, bundled with some of the four freedoms such as the free movement of persons and provision of services, constitute in your view a competitive advantage or social dumping?

MV: I think there is a number of things to be set in this context such as the right you have to go for a job in another country. I think one of the surprising things for many people was to realise how few Europeans are doing that. I think it is less than 5% of Europeans that work in another country than where they are settled. Because most people want to have a nice job at home, close to their family and their friends. But that being said I think it is very important that we can do that, that you can apply for a job in another country, that in your quality of employer you can hire the people that you want to hire. I think those are important possibilities on an individual basis and for the different societies in Europe. And I think that the changes that were agreed when it comes to posting the workers enabled the balance, but I think these are very important rights for individuals and societies.

KK: At the beginning of his mandate President Juncker made clear that the European Commission will work as a political institution. Do you think it constitutes a positive precedent or this concept should be reviewed?

MV: The first perspective of this question is that, for me, it has not been an everyday issue, because being a law enforcer I enforce the political choices made 60 years ago. Obviously when they wrote the first Treaty, they made the choice that they wanted to have competition law enforcement. They did not want the law of the jungle or monopolies to raise the market place. So, these are fundamental political choices but they were made a long time ago. And no political party can play any role in what we do now in our case work. Because the cases have to rely on the facts of the case, the evidence, as set in the case law. The second perspective of the question is: what do we think when we talk about a political Commission? Because I think it is a good thing to make priorities. In the Commission we do things that have a sort of view at a European scale and advise the Member States what can be done in a national democracy. And if that's being political, I am absolutely fine with that. There is a limit of the politics of a Government. Because you have so many Governments in Europe but you have only one Commission, with a very unique mission. And I think it is very important to maintain that. And part of that, an important cliché: it's of course you treat everyone the same, no matter the geography, no matter the history of membership, no matter the colour of the concerned Government, these are values that are very, very fundamental for the working of the Commission. And they are unique for the Commission and the mission we have.

KK: Emmanuel Macron's election one year ago was warmly welcomed by the European Commission. What do you think about his proposal made during his Sorbonne speech to reduce the number of Commissioners to 15?

MV: I can say that I am very happy to have colleagues from every Member State. Not because we serve a Member State since we serve the values of the Treaties without instructions from Member States. But the knowledge and the insight about the sort of real everyday life of the political culture, how the medias work in the country among other things are very important in the decision making process. Because I don't know in any detail what goes on in your country, in Bulgaria, in Portugal not even in Sweden, a Denmark neighbouring country. And I learn a lot from my colleagues, and I think that together we make better decisions when this knowledge and these insights are represented in the decision making process.

KK: In your view was President Macron right stating that *"the founding fathers built Europe in isolation from the people"*? How should the EU be maintained connected with people, with less or with more Europe?

MV: I don't think that we can talk about that in abstracts: more or less Europe. Because, I think, in some areas like third border control, managing illegal immigration, protecting refugees, handling climate change it is important to work more together. In other areas we may say, actually we don't need European initiatives because Member States could deliver this on their own or in a different way. So maybe actually we can have both: in some areas you want more a classical relation, and in other areas not so much allowing to take another direction. I think any democracy being local, national, regional or European sometimes can see victims in some citizen's point of view and I think one of the important things that Macron also proposed that you actually make a real effort to listen to when people, sort of, engage in discussions about the use of our European democracy. What do we want from the future? Because I think that the only way to come close to one another is of course to talk with one another. It is therefore important to listen when people discuss about the future.

KK: Today when one evokes the European Union, it is impossible to pass by the question of the next MFF. Do you agree to include a kind of rule of law mechanism or independence of judiciary aspects in the MFF structure or you would consider that the current provisions of the Treaties are enough to guarantee the conformity with EU law such as Articles 7, 258 or 260? Or more needs to be done in terms of safeguards in the MFF?

MV: Yes. I think it is important. Because what we have seen over the last year, even when the rule of law is present, it is in discussion, but there is very little concrete action taken. Even if you have doubts, if things can be done in a way that actually making sure that you have independence in looking it also the way of dealing with legislation that has been decided in common in the European democracy. And I think that it is part of the premise of being a member of the Union that you as a citizen can be absolutely certain that the judiciary is independent. I think for me as a Dane it is a huge privilege to live in a country where we never ever question that. I think Denmark is one of the countries where citizens have the highest degree of trust in the judiciary and also see it as independent. So for me it is very important as a citizen that you can trust that if your authorities do something wrong you can actually go to the judiciary and they will take an independent view, maybe they will not get your way but they will get the fair way.

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Olivér Kovács

Review of Sarah Wilson Sokhey: *The Political Economy of Pension Policy Reversal in Post-Communist Countries*

Mainstream economics of today still neglects the importance of time and the complex interactions in the socio-economic innovation ecosystem leading to misinterpretation of real processes. The present book, to a certain degree, bridges this gap by exploring one of the most intriguing and embarrassing questions regarding economic governance, namely that why do governments backtrack on major policy reforms? By building on the case of the reversals in pension system reforms, in general and specifically in cases of Russia, Hungary, and Poland, the book offers new insights for economics science and economic policy practitioners alike. The author convincingly demonstrates that, with a wide readership, *extensive reform programmes signalled more commitment and thus were predestined to survive,* while more moderate ones were doomed most of the time.

The *first part* of the book (introduction and theory) sets the scene by emphasising the puzzling reversals of pension privatization reforms. By touching upon numerous issues, ranging from how the privatization of pension reforms spread around the world through how it affected the politicians' vulnerability to the pros and cons regarding the costs and benefits of such grandeur changes, the author argues that pension privatization was supposed to be a complete overhaul in how countries and citizens thought about social security (p. 5). The author juxtaposes a series of reasons why the book's approach is a novel one, among others, it offers a better understanding on why market-oriented reforms are adopted and potentially abandoned later on. Additionally, as the book depicts, the Central and Eastern European post-communist transition countries had very different initial conditions (gargantuan implicit pension debt-to-GDP ratio) that made possible

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Olivér Kovács, Research Fellow, ICEG European Center; Senior Research Fellow, National University of Public Service; Member of the Economics and Law Section of the Hungarian Academy of Sciences, Committee on World Economics and Development Studies. E-mail: Kovacs.Oliver.Istvan@uni-nke.hu
Web: http://oliverkovacs.com

only a more moderate reform pace. The first part of the book, inter alia, emphatically highlights that politicians' short-term fiscal incentives will undermine reform and lead to various types of reversals (temporary reversal, multi-step, and partial) unless domestic interest groups do support the measures.

The *second part* widens the perspective by looking at global trends in pension privatization reversals. This section conveys that our profession does not know too much both about the why and how these reversals happened. The author argues that global trends suggest that the post-communist countries may be special or unique in some way that explains the regional concentration of reversals. As the chapter evolves, it becomes clear that the degree of pension privatization and the duration of reversals were varying and these are interlinked. One of the greatest virtues of the book is the scientific value and modesty of the author when it comes to any conclusions. Thus, correlation is not mixed, as it is often the case, with causality (e.g. "[…] the results are not the last word on the causal effect of any of the variables considered here. […] these results are indicative that the degree of pension privatization does appear to play a causal role in the manner indicated". p. 86).

Although the author provides a thorough revision on the available evidence and makes an empirical analysis to justify this argument, the only casuistry what this reviewer can make is as follows. On the one hand, there is a great difference between replication and reaction (i.e. in case of the former, new but redundant institutional architecture emerges, while in case of the latter new institutional framework is created but with the old incentive regime).[1] On the other hand, there is a less-trumpeted factor influencing the adoption and delays of such reforms: the development of the Economic and Monetary Union in the European Union had a very strong influence[2] on the launch of pension system reforms even in the core countries so that the geographical concentration of puzzling pension reversals might be somewhat different from that the author outlines.

The *third part* is to exemplify that moderate reforms are more likely to be doomed in the sense they tend to ricochet off the political-economic systems. All of the case studies are well-written and able to demonstrate with impeccable clarity the author's narrative. The cases in this part (Russian, Hungarian and the Polish cases) prove that pension system reversal was a strategic political tool, a stratagem to sidestep the more painful fiscal adjustments. Still, we can claim that this act triggers a vicious circle and cannot be regarded as an instructive way toward fiscal sustainability, and ultimately, toward a fiscal ammunition to enable the state to fulfil its development functions in the longer run, either. In case of Russia, the financial crisis of 2008 instigated the need for short-term revenue and explains the timing of Russia's reversal. In case of Hungary, the private pension fund was nationalised to reduce burning indebtedness. This step was undoubtedly a jury-rigged measure in the aftermath of the 2008 global financial and economic crisis and the sovereign debt crisis (which was mainly private debt crisis) in order to avoid Brussels' voice in the domestic economic governance by reaching out a trend towards a more disciplined public finance. The Polish case is still an open issue,

1 This was presented by Guardiancich (2011) in case of Hungary and Poland, as well.

2 See Henessey and Steinwand (2014).

where the legal changes in 2011–2014 accompanied with a more slowly reversal of the capital part of the Polish pension system. In all three cases, the public reaction and the backlash from the private sector remained infinitesimally minimal.[3] The cases give an impression about a balanced and critical thinking of the author, still, there might be even more nuanced insights once psychological and behavioural findings would have been incorporated.[4]

The *fourth part* concludes and underlines the crucial importance of systemic and not so hectic reforms of retirement policies and the pension system (p. 222). We would like to add that hectic movements are not warmly welcomed by the wider public and they can engender bigger fluctuations in the effective and perceived performance whereby the public trust and confidence, necessary for further reform measures, can to a large extent evaporate. Nevertheless, at least three marginal comments are in order here to be mentioned: 1. retirement policy changes per decade might be a real perspective in high trust environments (i.e. countries where the public trust in governance and institutions is higher); 2. in an era of growing corrosive inequalities (intensifying impoverishment) coupled with ageing population (increasing number of elderly poverty), the willingness of people to support cuts in pension benefits and more fundamental adjustments is getting lower and lower; 3. in countries where the tax burden is already conceived as excessively high (i.e. in countries with higher social security contributions), people are becoming less likely to support further increases in these contributions.

Let us underscore that the case of analysing the puzzling reversals of public pension reforms calls for a more systemic approach that considers the socio-economic ecosystem as an open, dynamic and adaptive system interspersed with far-from-equilibrium, non-linearity and feedbacks. In short, governments have to navigate through uncertainty and initiate reforms. Still, researchers and the public must not forget that the time preference differs strongly in the political arena from that of the private sector most of the time and reversals can be a real perspective in case of certain measures. This view has to incorporate, as the author of the book eloquently presented, the interactions among relevant phenomena. The given book is a valuable contribution in this regard since it takes into account not only the fiscal dimensions (fiscal pressures), but also the myopic thinking of politicians and the strength of domestic interest groups. The author's presented work raises many interesting issues for further research of which one of the most important ones presumably is how the ongoing fourth industrial revolution will affect pension systems in an era when inclusive growth is needed but robotisation and automation will make it more and more cumbersome to pursue (i.e. this per se suggests

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3 One would expect that the growing Internet penetration (76% in Russia, 79% in Hungary, 73% in Poland, as World Bank documents) is associated with better informed population (e.g. about painful and substantial reforms of the pension system); but the reality paints a rather different picture. In this regard exploring the nature of a post-factual society, in which manipulation and misguidance play a definitive role should be taken into account.

4 Kahneman (2013) demonstrated that the success or failure of a given governmental program (measure, reform) is judged by the voters on the basis of whether that measure resulted in a perceptibly good or bad outcome. Accordingly, the rationality of the given measure at the time of its design and implementation do not really matter. In this process, public perceptions and attitudes (in the form of positive or negative feedbacks) play a key role in the success of a policy measure as Fernandez and Jaime-Castillo (2013) sensitively illustrated.

that retirement regulation should aim at increasing further the employment rate of older workers, or to envisage further increases in incomplete careers that affect pension entitlements and the risk of poverty etc.).

Overall, the presented book gives a new slant on an old issue (pension system reforms) by looking at its less researched aspect (reversal), it is therefore undisputedly useful not only for academics but also for economic practitioners who are to know much more about the nature of pension reforms.

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