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The Current Economic Crisis of the EU and the European Economic Government

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Abstract

The article presents the current economic crisis from an historical perspective, analyzing the building of the monetary integration and the common currency. The process is explained pointing out its effects on the European integration and outlining the positive and negative consequences of the introduction of a common currency in the European Union. The investigation continues with a general outlook of the current situation of the countries more affected by the current crisis, Greece, Ireland, Portugal, Spain and Italy. All of them have in common the necessity of extra funding in a context of austerity, plus some national particularities. The author proposes an expansion in the public spending as the only reliable way to stimulate the European economies in crisis. As the Euro meant the end of the monetary independence of the member states it is suggested an innovate solution, the creation of an Economic government in the Union in order to transfer funds from the wealthier states to the countries in troubles. Deeper integration is presented as a necessity for the states in crisis, a necessity for the wealthier states and a must for the European Union.

Keywords: Euro crisis, common currency, austerity, public spending; crisis in Greece, Ireland, Portugal, Spain, Italy; European economic government

The current crisis of some members of the European Union is influencing the Union itself, generating a European crisis. The integration of the European states has not yet been finished and hence creates tensions between the member states and spreads to the whole system. The individual actions to improve the economy in each member state are not effective because the lack of financial instruments of the monetary union, and hence deeper integration is needed in order to solve the current tensions of the system.

Genesis

To understand the difficult times that the EU is going through, we have to go back to the origins of the organization and pioneering ideas in the process of European integration. For centuries there have been thinkers who have proposed different forms of integration in Europe to avoid wars, what was considered the main problem in Europe. Most of them, like the German philosopher Kant and his work Perpetual Peace, identified this problem with nationalism and the confrontation between nations at the European level, given Europe's international influence, worldwide. The armed conflicts in Europe were the result of an exacerbated nationalist propaganda and of the need for internal cohesion in the European states and to establish a strong foreign policy abroad. Building a national image based on the differentiation from the outside (Kant, 2009).

Thus, the process of European integration since its inception is based on the abolition of the political powers of the nation, relegating it to a cultural role. All these thinkers and politicians did not want to end the concept of nation, they just wanted to undress their political forms while retaining their cultural and emotional values. Kant, Aristide Briand, Count Codenhove Kalergi, Altiero Spinelli and Jean Monnet sought to develop a system of peace in Europe based on the integration of the various political entities of the European continent in a merger that would result in a higher political community that came to power in order to manage the common good, encompassing all structures of power in a political institution at a European level that would prevent conflicts between European states. The biggest difference between all these ideas and proposals was, and still is, the different path to reach the desired content of the European state. In this regard there are various theories related to the process of European construction. These theories are important to study what happened in the past, explain what is happening today and what drives the process forward. However, there are three theories that prevail over the rest because of their popularity and influence during the whole process of European integration. They are Federalism, Neofunctionalism and Cooperation (Rosamond, 2002).

Federalism is based on the construction of Europe based on two main premises, the legal and policy framework on the one hand, and citizens and democratic legitimacy on the other. Thus, federalism advocated the creation of a European executive, a strong common parliament and a constitution, with the idea of creating the United States of Europe revolving around a principal axis, the European citizen, which would have the same rights and obligations irrespective of the nationality.

Another important theory is the Neofunctionalism, based on the integration of areas of low political profile, mainly economic, to prevent resistance from various social and political regimes in Europe. The fields of integration should be chosen by their potential for deeper integration, covering more aspects, which would lead to a spiral effect where the integration in a given field generates benefits for society, but in turn creates new problems that can be solved only with more integration, reaching the European state as the final result of the integration process.

Finally, cooperation between states has a great influence on the development of the European Union. It is based on agreements between states and depends on the ability of political, social and economic aspects of each state to understand and reach agreement without resorting to extreme decisions as the use of violence or blocking of the relations between states. Today the ability to reach agreements that determines the jumps of integration caused by other reasons, and has its highest expression in the Council policy requiring unanimity for approval.

The European Union today is the result of an amalgamation of Federalism, Cooperation and Neofunctionalism, and other minor influences. It gives a special character to the process of European construction, being unique in the world (McCormick, 2008). The importance resides on understanding that the current EU is only one stage in the process of European construction whose ultimate goal is the attainment of a European state. As we are not at the end of the process, or in a static situation, in the long term more reforms will be included in the European building process and hence more reforms will surely happen affecting the common currency. Thus, the problems that EU faces today are short term, and are included in another process even bigger, which ultimately will lead to the creation of a European state, whose form and powers are still to be defined.

The word crisis in Latin means change, and in this sense the EU has been in constant crisis since the creation of the first community, the Coal and Steel Community, back in the 50's, until today, constantly changing its shape, policies and powers. And this state of crisis will last until the achievement of the common goal, the European state. In this sense it is important to note that the process never had a regression in the integration, perhaps stoppages in the process but never steps back. The integration model could be explained widely with different stages that are repeated over the time as a cycle, part of the overall process of European construction. It is integration, deepening, stabilization and stagnation, which again after witnessing a new cycle would begin again with integration following the same pattern.

The first stage is the creation of new policies at a European level that include different aspects that are integrated in a common management. Following the integration there is a period of deepening following the paths opened by enhancing integration of the Community status of those policies to absorb the different prerogatives of member states and managed in a European or supranational level. This progress in integration is slowing down to a state where the process of stabilization takes hold and the different problems raised during the previous stages are treated. After that there is a high integration, a result of the process of stagnation, as the fields or integrated policies begin to show problems that can only be resolved by integrating them further, and including other new aspects, but in some way related, with the original policies. As the output of the deadlock there can be only one possibility, more integration. The intention to keep the European Union static, without further movement forward, without further integration, would mean the collapse of the organization because it would not be able to meet the new challenges created by the previous integration. Obviously, this would lead to the demise of the organization, which would have devastating consequences for Europe, so that member states would not take that path lightly and finally would have to accept greater integration albeit as a lesser evil (Naurin & Rasmussen, 2012).

According to this model of integration in Europe, the European organization always take member states' policies and manages the common way, but never returns the same policies to the states, the EU always takes, never returns. The EU absorbs above all policies that have been under the power of the member states to manage them jointly, but it never nationalizes, or reverses the Community policies already in the European sphere to the member states.

Currently the process of European construction is in a delicate stage of stagnation that will be followed by another phase of integration. The EU's current problems will be solved with more integration. Of course, after overcoming the reluctance of national governments of the various current EU member states, which is given by the gravity of the crisis itself that Europe is facing right now (Glencross, 2009).

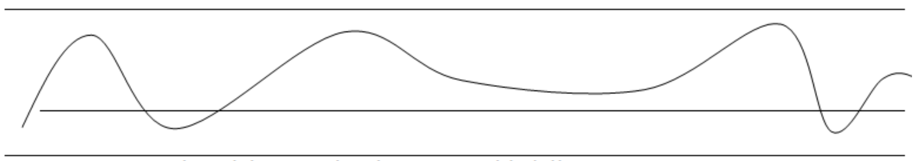
Analysis

Currently there is a serious economic and financial crisis in Europe. It will be a national problem of the member states if they will still have their national currencies, without the common currency, and thus would be resolved at the national level without significantly affecting the rest of the members of the Union, as it happened in the 80's when economies of Spain, Italia or Great Britain responded to their domestic crisis by devaluing their currencies.

Monetary integration has its most remote roots in the decision of U.S. President Richard Nixon to abandon the gold standard, which led to worldwide monetary instability. European states reacted to the Breton Woods conference with the creation of various financial mechanisms to ensure stability, especially the creation of the ECU, a basket of European currencies in which the central banks of each state were responsible for maintaining the value of their currencies within certain limits, 2.5% of the mean. So if a currency was revalued above that limit, it was a consequence of demand of the international financial markets being higher than the supply. That is, most traders had wanted more of this currency than they could acquire. As the demand was higher than the offer the value rose, and the Central Bank of that state had to supply the market with more of its currency, which traded for dollars, the international currency of reference, matching demand and supply. In the case of a devaluation of its currency value, it meant that the offer was greater than the demand: more national currency in the international market than could be absorbed. The way to stabilize the currency was using the national Central Bank for buying national currency in the international market with dollars, and hence equalizing the demand and the offer.

Currency Stability: 2.5% +/-

+ 2, 5% Central Bank sells National currency for dollars O<D



- 2, 5% Central Bank buys National currency with dollars O>D

O=D Full stability, the value do not change

The main problem was when the National Central Bank lacked enough dollars for stabilizing the value of its currency. The system worked properly for a few years, but the financial crisis of 80 and great movements of financial capital markets led to the extreme situation when some Central Banks lacked enough dollars or national currencies to stabilize their currencies, to match the offer and demand. Then it was decided to extend the limit to +/- 15% fluctuation, which in reality meant the end of the system because it allowed the value of the currencies a fluctuation of 30% of their value, a very big gap in terms of stability.

To avoid these fluctuations and maintain a stable financial situation, apart from other political reasons as the predominance of the German Mark in Europe or the process of European integration, it was decided to create a single currency for the European Union, the Euro (De Grauwe & Peeters, 1998).

Positive Aspects of the Common Currency

1. Decrease the costs associated with foreign currency exchange for trade. The development of the Common Market and later the Single Market in Europe meant a significant increase in intra-Community trade so that a common currency meant the stabilization of trade. It reduced costs related to intra-Community trade, and meant less than 1% of EU GDP, since all companies involved in foreign currency exchange had a substantial reduction in their business activity.
2. End of uncertainty. When trading between countries with different currencies and with different periods of payments and delivery, the final price may be altered depending on the fluctuations of the exchange rate. This creates some uncertainty and has a restrictive effect on international trade. The common currency ends the uncertainty and increases trade between Eurozone countries.
3. Euro International Importance. As the world's largest trading bloc, the common currency of the European Union could become a competitor of the U.S. dollar as international currency. This means that many Central Banks of other countries will have financial reserves in Euros, with the consequent benefits for Europe and its economic system.
4. The introduction of the Euro led to a decline in interest rates, which meant a period of expansion in some European economies because they had

a cheaper access to loans. Anyway this positive aspect is relative because some EU members already had low interest rates. It could be also included in the negative effects of the Euro, as it led to an increase in debt of the weaker economies, a worrying problem nowadays.

5. European Identity. The introduction of common currency has led to an increase in the sense of European identity: as EU citizens can use their own currency in other member states, they may feel a sense of belonging to a common area, to a common territory, to Europe.

6. Control of German economic power. The reunification of Germany created a state of panic in Europe because there was a fear about the repetition of the German economic miracle after the WWII in rebuilding the communist East. It could have led to a stronger Germany then the rest of the communitarian partners and the obvious dominance of a united Germany over the other European states. So the best way to prevent it was suppressing the independent monetary policy of Germany, and including it in the community entity, the European Union. For this reason Germany lost monetary sovereignty, but shared it with the rest of its partners.

7. The introduction of the Euro must also be understood within the prism of European integration, whose long-term goal is the creation of the European state. And one of the strongholds of the states is its monetary policy, and one of its major symbols is the common currency, so from that point of view, the Euro is a step nearer the final goal of integration.

Negative Aspects of the Common Currency

The negative aspects of adopting the common currency are primarily related to loss of independence of member states squandering the possibility to use financial instruments independently to revive their economies in times of crisis.

1. Loss of ability using the interest rate. When a state experiences an economic crisis, it can reduce the interest rate, which means that private investors have a lower return on their investments in the public sector. Therefore they prefer to invest in the private sector. This leads to an increase in the economic activity that eventually translates into higher inflation. But the important thing is that it will increase economic activity in a time of economic recession. On the other hand, if a state has overheating problems in its economy, it may raise the interest rates, so that investors allocate their capital

to the public sector because of the highest return, which will reduce investment in the private sector and shrink the economy and consequently reduce the rate of inflation. Currently the interest rate depends on the European Central Bank, so member states of the Eurozone cannot use it to their own devices, and the European agency will only act in case of a global crisis (a European crisis affecting the majority of the market common) not in crisis affecting just some countries of the Eurozone. The reason is obvious; helping some states needs of higher economic activity will mean overheating the economy of the rest of the member states with the negative effect of a high inflation. It means harming the healthy to treat the unhealthy.

↓ I------↑ Private Investment--------↑ Economical expansion------↑ inflation

↑ I------↓ Private Investment--------↓ Inflation

2. Loss of the possibility of devaluating the currency. A state faced with a crisis situation may decide to reduce the value of its currency. The consequence is that the economy of this state produces cheaper goods for the international market, increasing foreign demand for the production of that state, so exports grow, economic activity increases and it also increases the occupation rate. In turn, what is produced abroad becomes more expensive in the domestic market. Thereby there is a reduction of the imports and an increase of the domestic demand for those products produced within the state. It increases the domestic economic activity. Thus, an economy can be reactivated using this financial instrument, but its effects are limited in time and have long-term harmful consequences, since a devaluation means that the price of imports rises. Some of these imported products are replaced by domestic production, but not all can be. So prices rise as a result of more expensive imports and the domestic economic growth, causing real wages to decrease. As the salaries are maintained in a pre-devaluation level and then the products are more expensive, the possibility of employees to purchase goods is reduced. This situation leads to social unrest resulting in increases in wages, which increases the cost of production. It means that the domestic production becomes more expensive and the loss of the initial benefits of the devaluation. Anyway, it can be a useful tool to revitalize the economy in a timely manner at a particular time of a crisis.

Exchange ---------- ↑ Exports---↑Demand-----

i. ----------- ----- ↑ GIP---↑ work situation

Rate ---------- ↓ Imports---↑Demand-----

|

|

|

|---- ↑ P(Imports)---↑ Prices----↓ Real Salaries*---↑ Salaries---↑ Cost---Loose of

i. the benefit

3. Fiscal Policy. According to the Stability Pact countries that joined the common currency have borrowing limits which reduces the possibilities of increasing the deficit. In a crisis situation, a state may resort to international markets to raise capital later used to revive the economy, following the example of Roosevelt's New Deal in the crisis of 29. If the state increases its public investment in a time of recession it becomes the engine of the economy at a time when the private sector lacks the capacity to lead the economic recovery. Obviously, in a time of economic downturn, state revenues are reduced because there is less economic activity and therefore it is less able to fundraise, so the only way is to spend more is by borrowing abroad. Once revived the economy of the state revenues increase again and used the surplus to pay the debt. This is another element that is lost at the national level, although the controls that were established have been insufficient, so that the debt crisis of the states has increased dramatically causing huge tensions in the system and among member countries of the monetary union (Wickham, 2008).

Crisis----↑ Public deficit-------Improvement of the economic situation

All negative aspects of the Euro are related to the loss of independence of national economies in a crisis situation, because these instruments go under control of the community, the European Central Bank, which is only used to benefit the whole community. So the problem lies in cases of asymmetric shocks, crises that affect only part of the community (but not the whole). The more integrated an economy is the less likely is a crisis of this nature, as a crisis that happens in one part of the common market will quickly spread to the rest of the market and the European Central Bank will act accordingly. But now the European market is not as tightly integrated, certain persisting blocks with less integration and less access to the rest of the system, leading to local crises that do not expand to the rest of the system which prevents the European Central Bank to act effectively solving problems without harming healthy economies. Today we have four different cases related to this issue, Greece, Ireland, Portugal, Spain and Italy.

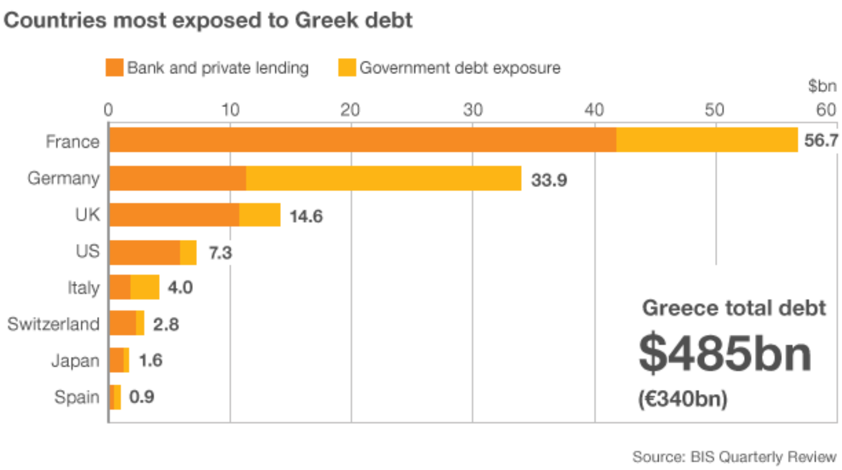
The Case of Greece

The country has spent more than they received, and financed their spending by borrowing with debt. This model can only be maintained in a long term with a future increase of the state revenues to meet the rising payments that have to be performed, basically the common obligations of the Greek State and the payment of the debt and its interest. Normally it is achieved by the growth of economic activity and the consequent increase in government revenue, in other words, the state spends today what it will earn tomorrow. The problem is that you cannot keep this model in a scenario where economic recession lowers the state revenues and spending power is diminished. If expenditures are maintained or even increased, the state has to borrow more money, and it means more debt, increasing future costs (Manolopoulos, 2011). If the crisis persists and future revenues are not increasing the state's ability to repay these loans will decrease, until you reach a situation where lenders doubt of the state's ability to repay loans and fear for their investments. Under these circumstances of mistrust, the international investors will not lend more money to the state, which may not meet its obligations and would lead to the bankruptcy of the state. Part of the problem is that expenditures are constant in the states or even progressive, they are obligations of the state, unless a reform to reduce state spending is done. Thus, the state must reduce its spending and increase its incomes, which in practice means socially painful reforms very unpopular among voters, as increasing the tax burden on its citizens and economic agents, an effective fight against fraud and reducing the salaries. The costs should be reduced in the less productive sectors of the system, especially on those whose influence on the future economic growth is lower, normally the public workers and public institutions. Thus, those most affected by cost containment reforms are salaries of civil servants, social spending, pensions, public enterprises, etc. Revenues increased by raising taxes, combating tax fraud and investing in economic sectors with potential to create growth. These investments are not only monetary, but also may be legal, creating a legal framework that encourages development, which often leads to loss of privileges obtained by different social agents. In the case of Greece there has been a social and institutional fraud, the state deceived the international markets making up their accounts, with greater economic activity than it actually had, thus artificially increasing their ability to generate revenues and meet its obligations, making believe that the international market was a bigger national economic capacity. This institutionalized fraud was discovered by the economic weakness of Greece following the global crisis after the country had problems to pay its debts.

In turn, there is a great fraud of social agents in tax matters. The level of tax evasion in Greece is huge compared with other community partners. Tax evasion between private fortunes and companies is common, even among the middle class Greeks. For example, it was recently discovered that 4000 pensioners were still getting their pensions when they were dead: it was money that was pocketed by their families. All these problems considerably reduce the state tax capacity. Furthermore, the Greek public enterprises have become employment agencies for politicians and their followers, so they are not managed professionally and are economically inefficient, so their losses are substantial. In Greece there is an important social rejection to the reduction of the welfare state, pensions, salaries and other benefits limiting the ability of the Greek state to reduce the public spending (Mitsopoulos & Pelagidis, 2011).

Another Greek problem was the lack of investment in productive sectors with growth of potential that would serve to increase economic activity. The state revenues were spent on ineffective policies from the economic point of view, as artificially high public salaries, or artificially minimum wage in the country.

Thus, as the Greek state spending increases and revenue fell as a result of the economic crisis it cannot meet their payments and responsibilities. As a member of the common currency cannot devaluate its currency, they are not able to lower the interest rate and simply increase its deficit against the provisions of the Stability Pact. By the time the markets decided they did not trust Greece's ability to repay loans, funding became more expensive while the collapse of the Greek economy comes closer. The result is a bailout led by the strongest economies in the EU, as well as some international financial institutions like the International Monetary Fund, and the loss of independence of the Greek government from having to comply with the requirements of the rescue plan reforms to reduce costs and increase revenue. Even if the public debt was reduced by half the Greek state cannot repay the other half unless it gets another loan from the International Monetary Fund and the other members of the Eurozone. The problem is very basic; Greece cannot keep its high standards of living under the current circumstances because it has no money to pay for it. The country was paying its social system with borrowed money and now cannot repay it. The country has the option of reforming the economy, cutting the expenditures, decreasing the incomes of the Greek citizens and the loss of the financial wealth of its citizens or leaving the Euro adopting back the Drachma devaluating its value, not paying its debt with the international investors and isolating itself from the international world, both options seen hard to accept and will have catastrophic consequences for Greece, its European partners and the holders of the Greek public debt. The Greek government has been playing with their European partners because of the consequences for the Euro if the country leaves the common currency, because it could be seen as the first country forced to abandon it, creating a crisis that could lead to similar situations in other member states of the Eurozone, as Ireland, Portugal, Spain, Belgium or Italy, in order to get more money from Europe. At the same time the Greek government did not reform its economy because of the social resistance, so it still depends on external money to keep the country running. Unless the Greek government starts a serious reform program cutting expenditures and increasing incomes the international aid will stop and the country will be bankrupt (Brown, 2012).



The Case of Ireland

In the case of Ireland there is not a level of fraud as high as in Greece, so the situation is radically different. The Irish economic system was based mainly on tax breaks for big corporations who came to Ireland because there were paying fewer taxes and in turn had access to the entire European Common Market. These world-class companies settled on Irish soil, such as Microsoft, with only one goal - work in the European common market within a location where taxation was lower. The second point of importance in the Irish economy was the construction sector, real estate, which was the main driver of the Irish economy in the years before the global crisis. With the fall of this economic sector there was a great reduction of the state revenues. In turn, the Irish state did not raise taxes in order to keep the international companies in Irish soil. The Irish government did not generate much newer revenue, and even increased its expenses because the Irish financial sector was in deep trouble for the debts owed to the property developers. Its situation was critical, close to insolvency. The Irish State decided to save its banking system by supporting financially the main banks with the State monetary muscle, but as huge amounts of money were spent to save the banks and the Irish state revenues decreased due to lower economic activity, the country was unable to meet its obligations, and a bailout was needed from its community partners. It meant a loss of independence of Ireland by having to accept the reform plan developed by participants in the bailout. Among the reforms were included higher taxes on large corporations by decision of Germany that saw it as an unfair competition.

The case of Ireland is also special, because of its strong links with the United Kingdom. The British do not have the common currency, and hence they keep independence on their financial decisions, but were involved in the crisis of the Euro because of their implications in the Irish economy, which is integrated into the British economy. So, the bankruptcy of the Irish economy would have affected strongly the British economy and the British financial sector. That’s why the British government participated actively in the bailout developed by the Eurozone countries for Ireland. Anyway right now the British government does not want to get involved in the Euro crisis, and it could have important consequences foe Ireland.

The Case of Portugal

This case is simpler because the problems in Portugal are generated by an economy poorly productive that was financed through borrowing. Revenue did not evolve in the same way as expenses. It led to a situation where the Portuguese state has been unable to meet its obligations. The need for reform in the Portuguese economic system was therefore an obligation, but such reforms were not carried out because of electoral reasons. Nobody wanted to assume the political cost of the reform or face the rejection that arose between important social actors, such as the Trade Unions, a very important social actor in the country. It clearly points out the difference between politicians, who rely more on short-term thinking and statesmen who are concerned about the situation in the long term. The lack of agreement among the ruling classes of Portugal has meant the need to request a bailout from its EU partners and the imposition of reforms from the outside with the consequent loss of independence. The Portuguese state is currently cutting expenditures and raising taxes to balance the national accounting, and these actions are presented as a European requirement reducing the electoral cost of these measures and giving them more respectability avoiding the lack of credibility of the national politicians among the Portuguese population (Ferreira-Pereira, 2011).

The Case of Spain

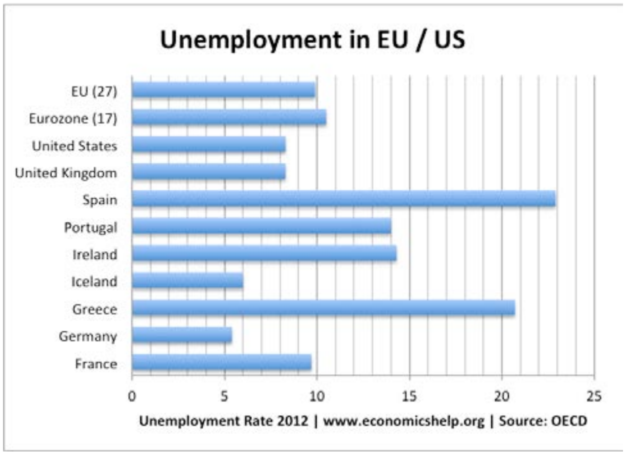
It's a complicated case because of the size of the Spanish economy and its possible knock-on effect to the whole Community as a country too big to fall. Spain had a period of unparalleled economic boom based on real state. During certain periods of time the country built more houses than Germany and France combined, although the Spanish population is 46 million and the Germans and French have more than 140 million people. The crisis in this sector represented a sharp drop in earnings for the State. For example, the sale of flats in the first quarter of the year 2011 was 11,000 million euros, while during the same period four years ago was 38,900 million euros. Despite lower incomes, Spain increased its public expenditures in order to activate its economy. This action was financed by borrowing in the international market through public debt. The money was invested in an artificial way to maintain the welfare state without investing in wealth-generating sectors that would be more productive, as administrative expenses of the State that are duplicated as a result of the regional autonomy status, or social benefits, pensions and public unemployment payments. Other problems of the Spanish economy are corruption, crisis in the public banking sector and its privatization, lack of innovation and lack of external presence of the Spanish companies and a high unemployment rate.

The bank system is still in trouble by its exposure to the real state. As many real state developers could not pay their loans, the banks seized their real state possessions and included them in their balances with the economic value if the times of economic expansion. It means that their value is not real, but if the banks reduce the prices of the real state in order to get rid of their stock, their losses will be great. The Spanish government has supported it for avoiding the collapse of the banking sector, as a minor harm. The current stock of new houses in Spain is around 700,000, plus the second hand houses in the market. The real estate market with the current prices will need many years to absorb this stock without any new building activity. But during the year 2011 more than 250,000 houses have been built in Spain increasing the problems of stock but avoiding the collapse of the real estate sector that currently employs more than 1 million workers. On the other hand, the incomes of the Spanish citizens have been reduced by government cutbacks, the effects of the crisis and the reduction of bank loans for real estate purchases, increasing the problem of the real estate stock.

The other main problem of Spain is the high unemployment rate, 4,998,225 people. It means a huge reduction in the state revenues from the taxes of the people who was working before and now are not, plus an important increase in the expenditures of the state via social policies as unemployment payments and other economic and social aid for those without work, and finally the impossibility of reforming the real estate sector reducing the current rate of construction because it will mean an even higher unemployment.

Thus the hope of the Spanish state is reducing expenses and increase revenues. Some reforms have been done, such as reducing the salaries of public employees, reducing subsidies, in addition to reducing other unnecessary expenses. But reforms are insufficient and will need to be deeper in order to escape the ghost of the bailout that could have tremendous consequences on the whole Union. Discussions are ongoing about the need for a more flexible labor market, reducing the regional institutions expenditures

- totaling more than central government spending - and investments in productive sectors with a potential capacity to generate wealth. In turn, the Spanish state has increased its revenue capacity increasing taxes and combating tax fraud. Also, the Spanish state revenues have been increased by the activity in the current motor of the Spanish economy - tourism.



But this is a temporary solution that must be managed cautiously because the current tourist growth is a consequence of the crisis in Arab countries. Tourists, that are looking for sun and sand, mainly come from Northern European states. Although Spain is comparatively more expensive than countries like Tunisia or Egypt, recent changes of government in these countries and the consequent political instability has caused fear among European tourists who preferred the security offered by Spain as a place to spend their holidays, despite being more expensive. Another importance sector, agriculture, has not been affected by the crisis, as it is one of the few sectors of the Spanish economy orientated to the external market (Rosell & Trigo, 2011).

However, deeper reforms are needed to solve the problem in the medium and long term, a process that the current government is undertaking with an important program of expenditure cuts provoking a reduction in the living standards of the Spanish citizens and with a negative impact in the economic growth.

The Case of Italy

Italy is one of the biggest economies of the European Union and the 7th largest economy of the world. The situation of Italy is in many cases similar to the Spanish one, but more serious because of its bigger size. Corruption is wider than in other European States, the subsidies are numerous but ineffective from an economical point of view, the unemployment rate is high, but the tourism industry is also big in Italy and also has benefited from the recent disturbances in the Arab countries increasing the revenues of the Italian state and benefiting its economy. Also Italy has a problem with the regional governments and the overdeveloped national, regional and local institutions. These regional institutions have more employment agencies for politicians and its supporters than effective or needed public institutions. Its agriculture has been also less affected than other economic sectors because of its orientation to the European market. But there are also differences. Firstly, the real estate, less developed in Italy than in Spain, and secondly, the historical division in two areas of Italy, north and south. The northern part of Italy, more industrialized and strongly linked with the European markets is in a better position to overtake the crisis, but the southern part, continuously being heavily subsided by the Italian State needs to change its patron of growth and public expenditure. The political situation is also different in Italy. The previous government opted to avoid the crisis by hiding it, without any effective action, just with some dramatic reforms that seemed to be effective just on paper but with small implication in the real problems of the Italian economy. Anyway the changes in the Italian government and the strict program of reforms of the technocrat Monti can help to reverse the situation. The Italian state cannot afford financing its expenditures with public debt anymore because it is already huge, much bigger than in the other cases explained here, so it needs to reform the economy in two possible ways: expending more in order to increase the economic activity and its revenues in the future or reducing its expenditures in these cases where the economic benefits for the whole country are small or nonexistent. But as Italian politicians are trusting the size of the economy to avoid a bailout, and hence are trying to win time to have the economic growth back in the close future without doing any important reform; their support to their new technocratic government could evaporate leading to the ruin of the country. This strategy could work because the European Union will obviously collapse if Italy goes into bankruptcy because it won't have the financial muscle to help such a big economy and could mean the end of the Eurozone as we know it today and destroy the future possibilities of the area. But it also depends on a fast world recovery from the crisis, if this world economic recovery will not happen soon, Italy will not be able to last without important and real reforms.

Solutions

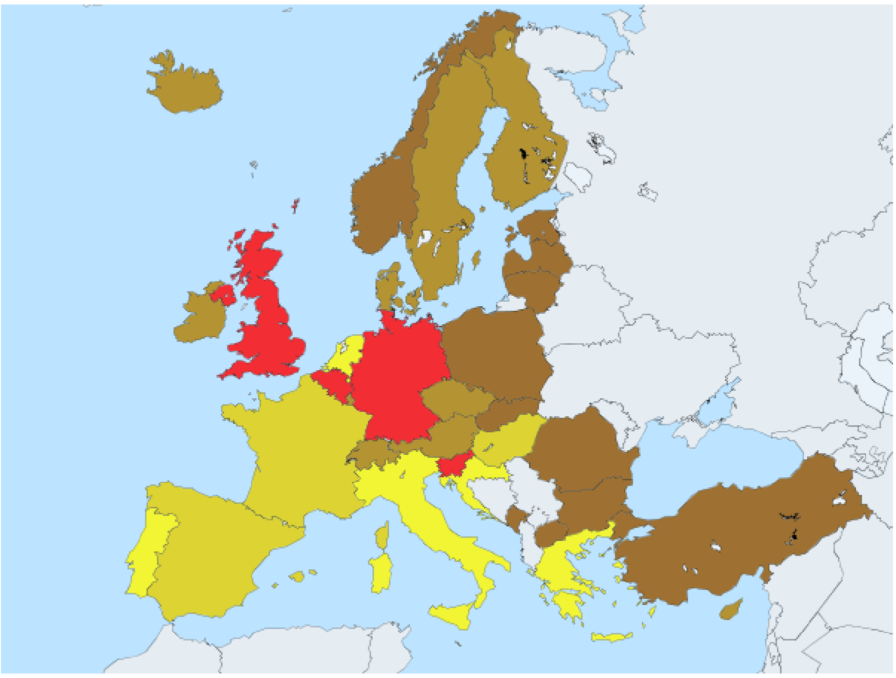
As these five countries are member of the Eurozone, their problems become problems in Europe because their bankruptcy would create tensions that could lead to the end of the common currency and a major European crisis. But the crisis in the economies of these five countries has not spread to the rest of the Community, i.e. the core economies of France and Germany are growing and overcoming the crisis. It makes it impossible for the European Central Bank to use any financial instruments available to help countries in crisis without harming healthy economies in Europe. The solution to current problems at the community level depends largely on the following factors:

1. The historical evolution of European construction process teaches us that the EU will never return policies to the member states, because it always adds and never subtracts. As the dissolution of the common currency, or abandonment of the group of countries with problems, is not feasible within the historical development of the EU, this option could be used just in the case of Greece, as a minor partner of the Union. Anyway it is not likely to happen as Europe is in a process that began in the 50's and is still developing; the member states will try by any mean to avoid this solution.

Real GDP growth rate - volume

Percentage change on previous year - 2013

Based on a comparison with:EU (27 countries)



Legend

0.4667 - 0.8667 | 0.8667 - 0.9999 | 1.0000

1.0001 - 1.8 | 1.8 - 2.7333 | N/A

Minimum value:0.467 Maximum value:2.733 eu25:1.5 eu15:1.4

Source of Data:: Eurostat

Last update: 14.04.2012

Date of extraction: 16 Apr 2012 12:37:04 MEST

Hyperlink to the map: http://epp.eurostat.ec.europa.eu/tgm/mapToolClosed.do?tab=map&init=1&plugin=1&language=en&pcode=tsieb020&toolbox=legend

Short Description: Gross domestic product (GDP) is a measure of the economic activity, defined as the value of all goods and services produced less the value of any goods or services used in their creation. The calculation of the annual growth rate of GDP volume is intended to allow comparisons of the dynamics of economic development both over time and between economies of different sizes. For measuring the growth rate of GDP in terms of volumes, the GDP at current prices are valued in the prices of the previous year and the thus computed volume changes are imposed on the level of a reference year; this is called a chain-linked series. Accordingly, price movements will not inflate the growth rate.

Code: tsieb020

2. Germany is the largest economic power in Europe and its economy is based on exports, so an important part of the debt owed by the countries in crisis has been devoted to buying German products. Two thirds of German companies' exports are destined to other EU countries, so the Teutonic country has enjoyed a big economic growth and higher tax revenues from the economic activity of the German companies. So, there is no sense that Germany's refusal to help these countries is against its own economic interests. Here the problem is the management of the benefits generated by German companies because of their exports to the rest of Europe. They are under the control of the German state and under the European Union. Therefore, it is radically false that the Germans paid with their own money to save the struggling economies of the Eurozone. Germany is the main beneficiary of a common policy, internal market, but there is not a common policy in the European Union to manage periods of crisis as the current one. Germany benefits from the European Union, but its contribution to help the countries with problems can be seen as a national generosity.

3. The current bailout is temporary and unstable, depending on the willingness of the richest states, read Germany and France, although France is showing itself much more flexible. The rules of the rescue are not decided within the EU but by the strongest states. It breaks the principle of Communitarian solidarity and the spirit of coexistence and common management. On the other hand it also lacks any efficient tools to introduce reforms in countries receiving financial aid, because it is based primarily on good faith without coercive legislation. It leads us to a situation of dictatorship of the rich countries to determine unilaterally the conditions of redemption, and to the fraud of the weak countries that do not meet their commitments (Blanchard, Giavazzi, &Amighini, 2010).

The Impossibility of Ending the Crisis Cutting the Public Expenditure

The main problem of the economies in recession is finding money to invest in their economies to push the economy towards a higher activity. Following the teaching of Keynes, still updated even when the main economies of Europe are presently preaching state prudence. Keynes already spoke about fiscal austerity during periods of expansion in the economy but during recessions a cut in the public expenditure will lead to a deeper depression of the economy. According to Paul Krugman the European leaders reacted against the crisis focusing on public debt instead of employment, and it has been a great mistake. The Europeans based their reaction to the crisis on the trust of the economic agents on the general accounts of the national governments as the best way to increase consumption in an environment of global recession and activate their economies. The so called expansionary austerity is not working, as the crisis is deepening in the economically weaker European states. The case of Ireland has been used as an example when in 2010 it seemed that the economy of the Irish tiger would recover thanks to the austerity measures, but it was just a mirage, as later it was checked with the national accounts at the end of the year. Anyway, as the member states of the Eurozone do not yet have the possibilities of devaluating the currency, or using the interest rate or increasing the public debt in the short term without paying outstanding types of interest, obviously they cannot find the money to shake their economy and hence accelerate their economies in order to overtake the crisis. Austerity measures are needed in order to avoid national bankruptcy, but it should be focused on nonproductive sectors, eliminating all the superfluous expenditures. But if the austerity depresses the economy even more, as the unemployment rate will grow and the state revenues will decrease and the expenditures will grow. Hence, the main problems are where to find the money to activate the economy via public expenditure and how to design and apply credible economic plans in countries that already showed an obvious incapacity in this task (Krugman, 2008).

Conclusions

The only acceptable solution to the current economic problem is more EU integration, the common management of the problem through the creation of a European Economic Government to manage the costs and revenues on a common ground based on communitarian legislation and new communitarian institutions. This does not mean the end of the economic management of the states, which would continue managing their respective budgets, albeit reduced, to develop national policies and influence the European Economic government via the European Council. It will be the creation of a European entity, funded with European taxes paid by the European citizens and the companies operating in the common market. The European taxes will provide the European Economic government with enough financial muscle to address the economic problems of the European states alleviating the effects of asymmetric shocks in the European Union with a common management of expenses and incomes.

The idea is feasible and could function as in the case of the federal government of the United States and the crisis in California in the 80's, where after the Cold War the U.S. federal government cut its defense spending, with the resulting crisis in the weapons industry. Most companies in this sector were located in California, so there was a crisis focused in this state and it did not spread to the rest of the country. Thus, the Federal Reserve of the United States could not use financial instruments such as interest rate or devaluation to solve the problem of California because it would hurt the economies of other U.S. areas whose economic performance was good. The California state revenues declined, so that reduced its transfers to the federal state, but at the same time, the federal state, despite receiving less money from California, increased funding for the state to alleviate the crisis. It helped to increase the economic activity of California and solved the crisis.

The members of the Eurozone have lost their monetary independence, and currently are in a big need of funds to activate their economies. As the European Union holds nowadays the monetary power via the European Central Bank, it is logical that the European Union will provide these needed funds to these member states. On the other hand, these countries have shown a lack of credible economic governance, and the European Economic government could also solve this situation, being the institution in charge to develop credible plans and oversee its right application. The member states should adopt in their national systems the communitarian rules. There will be resistance for the inclusion of a new tax in Europe, but first of all it should replace existing taxes in order to avoid a tax increases with negative effects on the economy. The tax should be paid according to the economic activity, and hence the areas with more economic activity and hence have benefited more by the European common market will contribute to keep this market in particular, in Europe in general.

Finally, a European Economic Government will avoid the current situation of domination of the strongest economies over the weakest. The rules of the financial help given to countries as Greece, Ireland or Portugal are decided by the main donors, mainly by Germany. In a common Economic government decisions will be taken by all its members by a system of qualified majority where countries with stronger economies will have more votes and it will avoid any single state to veto any decision. It will create a more democratic and equal system where all the members share the benefits and losses of the European integration.

Currently the European Union is working in the direction of reform but still much is needed. The presidential elections of France and the pressure of Monti, prime minister of Italy are focusing the solution of the crisis in measures focused on activating the economy of the member states rather than in cutting the public debt, but the European Commission lacks a clear plan on the European level. It means that the creation of a Common Economic government is even more needed in order to increase the economic activity and solve the current crisis. Germany has become the main supporter of fiscal austerity, and the German Minister of Economy has become a key figure in European politics. But the social consequences of these actions are high in many states of the Union, and the German political cost is becoming very high, with a growing rejection among Europeans of the growing German influence in the national affairs of the other member states of the Union. Again, this problem could be solved with a common management of the crisis by a European Economic Government. All the fiscal measures of the Union will be empty in the middle term if they do not lead to more integration and a common management of their fiscal affairs, but such a concept is strongly rejected by the nationalist forces in the member states of the EU.

This current crisis can only be understood in the context of the European integration process, as a stage of change and which most likely effect will lead to a deepening of the integration. Currently there have been some movements in the right direction, but still they are very weak and mild, just temporal solutions for a long term problem that could be reproduced again and again until a final solution is reached.

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