THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
888 16th Street, N.W., Suite 740
Washington, D.C. 20006
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com

European Integration, R.I.P?

By Thomas Mirow

Thoughts on the aftermath of the financial crisis.

This could have been a year of joy for Europe. The twentieth anniversary of the fall of the Berlin Wall was commemorated in November, and it has been five years since the European Union's "Big Bang" enlargement. The Cold War division of Europe is well and truly over.

But, instead of setting off fireworks, the European Union finds itself under fire, as the global economic crisis confronts it with the greatest challenge it has seen since 1989. After years of strong growth and remarkable resilience, the Union's new member states in the east are being hit hard by the economic turmoil that started in the west.

Integration into the global economy, a crucial source of capital, stability, and innovation, has become a threat to many of these countries. This is true both of the region's financial sectors and its real economies.

But the tough question that has to be asked is whether the crisis could lead to the unraveling of European integration. There are four key issues that need to be tackled if we are to ensure that Europe emerges from this crisis strengthened.

The first issue concerns the continuation of enlargement. The European Union is an indisputable success, constituting the largest integrated economic area in the world and accounting for more than 30 percent of world GDP and around 17 percent of world trade.

Even with this year's marked contraction of some central and eastern European countries' economies, their accession to the European Union boosted its overall economic growth, with the European Commission estimating that GDP in the new member states increased by extra 1.75 percentage points in the period 2004–09. For the pre-Big Bang EU-15, enlargement significantly contributed to their growth through investment opportunities and increased foreign demand: 7.5 percent of the older member states' exports went to the newcomers in 2007, up from 4.7 percent in 1999. Indeed, by 2007, central and eastern Europe had become the second most important export destination for eurozone countries.

But EU membership has always been about more than economic integration and trade flows. The prospect of a "return to Europe," as Václav Havel once put it, provided the backing for essential, if sometimes painful, economic, social, and political reforms.

Thomas Mirow is President of the European Bank for Reconstruction and Development.

Today, EU membership is a more powerful incentive than ever for what the European Union calls three "candidate countries" (Croatia, FYR Macedonia, and Turkey) and five "potential candidate countries" (Albania, Bosnia and Herzegovina, Kosovo under UN Security Council Resolution 1244, Montenegro, and Serbia). These countries are increasing their efforts to prepare for EU admission, and the European Union must not shut its doors on them. On the contrary, it should finalize further enlargement: the economic crisis has clearly demonstrated that the European Union cannot afford black holes on the map of Europe.

The second key issue concerns the European Union's internal structure. The Lisbon Treaty offers a fundamental redesign of how the Union works. It was ratified in October 2009 and will enter into force in December 2009. The economic crisis makes it more important than ever to introduce these reforms.

Third, there is the euro. The twelve new member states that joined the European Union in 2004 and 2007 committed themselves to its adoption, but with no set date. Expansion of the eurozone has therefore been slow, especially in central and eastern Europe, where to date only Slovenia (2007) and Slovakia (2009) have become members of the single currency.

But the financial and economic crisis has demonstrated the benefits of euro membership. Ten years after the common currency's introduction, the sixteen-member eurozone has the world's second most important currency, accounting for more than one-quarter of all central banks' foreign-exchange reserves and having overtaken the dollar as the currency of choice for international bond issues.

The euro's increasingly important role brings stability, something that is never more important than in times of upheaval. The European Bank for Reconstruction and Development therefore encourages all new EU member states that have not yet started doing so to draft credible and convincing plans for eurozone admission. But there must be no softening of the criteria for joining the euro.

The European Union drew the right conclusions when it stressed that national bank rescue packages must not be designed in ways that starve subsidiaries.

The financial and economic crisis has demonstrated the benefits of euro membership.

The final issue concerns European solidarity. EU enlargement brought greater prosperity, with living standards improving throughout the Union, particularly in the new member states. But many of the older member states also benefitted, and not only in economically measureable ways. The growing together of people, regions, and countries underpins the foundations on which Europe rests.

The European Union's newcomers have adopted growth models that rely to varying degrees on foreign capital to finance domestic investment, and on banking systems that are largely owned by west European banks. It is a model that has served new and old member states well. Investors from the EU-15 committed €37.2 billion in central and eastern Europe in 2006, roughly double the €19.1 billion spent there in 2004. Over the past five years, foreign direct investment in the new member states topped the €100 billion mark.

This process enabled western European companies and banks to expand into new markets with higher growth rates and thereby satisfy pent-up demand and tap unrealized potential. This has created jobs in central and eastern Europe, while boosting prosperity in the older member states. To turn our backs on these countries would have serious economic ramifications.

The European Union drew the right conclusions when it stressed that national bank rescue packages must not be designed in ways that starve subsidiaries, and also by doubling—to €50 billion—the crisis funds available to EU countries outside the eurozone. The European Union must not stand aside when solidarity is needed.

Today's crisis offers an opportunity to show that the European Union can provide stability, support, and solidarity. By taking the right steps now, the Union is laying the foundations that will enable it to emerge from today's difficulties strengthened and more united. ◆