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THE DISINTEGRATION CHALLENGE OF REFORMING THE EUROZONE

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The main objective of this study is to analyze endogenous destabilizing and disintegration tendencies within the framework of the crisis of the European Monetary Union, which grew into a crisis in the real economy. Research methods include: systematic, procedural and situational approaches to the study of Eurozone countries and participants in the integration project and disintegration influences and an institutional approach to the detection and analysis of dysfunctional institutional configuration within the framework of the European Monetary Union. Of significant importance for the study of the problems of economic integration and disintegration was the use of the principles of universal scientific methodology. The unity of logic and history in the development of a research object confirming the synergistic effect of historical and theoretical lessons. The main result and conclusion of the study is to formulate a clear and important dilemma for the survival of the European economic project.

Keywords: Eurozone, European Monetary Union, integration, disintegration, systemic crisis, theoretical and historical lessons, capital movements, “excessive financial elasticity”.

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Introduction

In February 1992, a document on the establishment of the European Union (EU) was signed in Maastricht (Netherlands), which became effective the following year. Consequently, European countries moved to the implementation of a common financial and economic policy, the ultimate goal of which was the introduction of a single currency. The Maastricht criteria clearly set out the requirements for joining the Eurozone. This including a zero deficit or surplus state budget (with the exception of a deficit of no more than 3% of GDP), public debt of no more than 60% of GDP, exchange rate stability, and annual inflation no more than 2%.

Following the adoption of the new euro on 15 December 1995, the European Commission identified, in May 1998, 11 of the 15 EU members states whose economic performance met the Maastricht criteria. These countries included Austria, Belgium, Germany, Holland, Ireland, Spain, Italy, Luxembourg, Portugal, Finland, and France. Although the United Kingdom, Denmark and Sweden met the criteria, they refused to use the new currency. The above-mentioned 11 states introduced the euro into non-cash payments on January 1, 1999.

It should be noted that from the very beginning the Eurozone was conceived as an important integration project, primarily in economic terms. If at the beginning it was possible to postpone the political aspect, focusing exclusively on the technical and economic, then over time, the awareness that further integration processes require important political decisions would have become relevant. And if we add to this the effect of the movement of capital, in the form of rising interest rates, on government and corporate bonds of peripheral countries, then we would see clear signs of disintegration trends. This an example of the Eurozone itself as an integration project.

Issues of integration and disintegration of the economy were dealt with by such foreign authors as: G. Minsky, R. Triffin, J. Ostry, also Ukrainian scientists A.N. Kolumbet, L. Dudorova, A. A Dovgych, E. Ivaschenko, A. Melnik, I. Nichiporenko, M. Suprunenko and others. The emergence and understanding of disintegration processes within the integration efforts of the Eurozone remains a crucial object of study. In recent years international institutions and economic experts criticized the Eurozone, for its operation, declaring it a systemic failure. Evidence cited was by the formation of a deflationary environment and a dysfunctional institutional configuration of the European Monetary Union itself (Polishchuk et al. 2019).

Given the history of the Eurozone, it is important to understand that in this case, a situation had arisen that is more reminiscent not of conflict but of latent disintegration. Instead of a single outbreak of long conflict. In our opinion, researchers for some reason pay little attention to this aspect of the problem; ignoring the answer to the question: is European integration disintegrating and how did it happen? (Britchenko et al. 2018) The primary purpose of this analysis is to analyze endogenous destabilizing and disintegration trends as a crisis of the European Monetary Union. This developed into a crisis of the real economy, affecting several EU members states at the same time. In considering this issue, a number of theoretical and historical lessons need to be addressed. These lessons point to an important dilemma for the survival of the European project in the future.

Materials and Methods

The European Monetary Union is often assimilated to the gold standard in the interwar period, or even to the gold standard before 1914, because its members abandoned monetary policies. When J. Keynes, in his book "A Tract on Monetary Reform" (1923), opposed the restoration of the prewar gold standard, he did so on the basis that a system of exchange rates managed and controlled by central bank intervention would be better than destructive fluctuations in domestic price levels. His argument was still based on the "classical" mechanism of equilibrium in the trade balance. This would be achieved through redistribution in terms of trade of such competing nations. Here are his words: "Under conditions of equilibrium, internal and external purchasing power should be the same, taking into account transport costs and taxes on imports and exports; otherwise, in order to take advantage of the inequality, there will be a movement of trade. The conclusion being that equilibrium has not been established, and that over time forces will come into play to approximate actual exchange rates and purchasing power parities" (Keynes 1923).

In today's widespread interpretation of the Eurozone crisis, excessive and volatile financial flows are seen as the result of "real" trade imbalances. These in turn are the result of differences in relative costs and prices (Lytvyn et al, 2022). While in the age of gold standards, global capital movements and their fluctuations were manifested in speculation about the value of currencies. In the Eurozone, the de facto single currency area, they appeared in the form of rising interest rates on government and corporate bonds of peripheral countries with deficits (Lagodiienko et al. 2019).

Instead of the arguments of the "orthodox" J. Keynes, both the crisis before 1914 and the crisis of the Eurozone can be better explained by abolishing the causal order of events and focusing on the autonomous and predominant role of international financial flows. In fact, as R. Hilferding put it, the long last stage of capitalist development "is financial capital, where large banks are increasingly given the right to dispose of fictitious capital." His innovative approach placed the bank's capital at the heart of the process of capitalist accumulation. This increasingly involved a configuration of close ties, or dependencies, between large industrial monopolies and monopolistic financial capital.

Despite some irrelevant aspects of its interpretation, the great merit of R. Hilferding is that he emphasized the independent and decisive role that banks and other financial institutions play in each individual mode of capital accumulation. This bears a striking resemblance to the cross-border operations of banks and other financial institutions within the so-called "core" of the Eurozone. In pre-crisis times this contributed to unstable economic development in peripheral host countries (Berenda 2019).

In Chapter 22 of the researcher "Financial Capital" you can find detailed explanations of how and for what purposes the export of capital can take place (Hilferding 1910). R. Hilferding was convinced that the consequences of these aggressive, "imperialist" (author's words), cross-border capital flows are very similar to recent events in the Eurozone.

It is striking that the distinction between the "real" development of the current account balance and the autonomous nature of international financial flows, (which is now the central principle of the theoretical analysis proposed by the Bank for International Settlements),

was as important for interpreting the world gold standard before 1914 as it is today. This helps to conceptualize the crisis in the Eurozone is primarily a financial crisis. If we read R. Triffin's critical assessment of the gold standard before 1914, we can see an impressive parallelism with the current debate (Ukraine's sectoral integration into the EU… 2021).

Results

In The Evolution of the International Monetary System: A Historical Revaluation and Prospects for the Future (1964), the researcher reinstated the basic interpretation of adjustment mechanisms between countries in the gold standard era, and their relation to comparative fluctuations of prices and costs as the main factor of imbalance of balance of payments and their correction. Thus, the focus is on the current account positions of the balance of payments and, as a rule, suggests that most violations in this area have arisen and should have been promptly eliminated by restoring the balance between revenues and expenditures on current accounts. However, in fact, international capital traffic has often mitigated—and even stimulated—large and persistent current account deficits, or surpluses, without requiring any correction" (Triffin 1964). R. Triffin himself further explains that even in the distant world the gold standard was characterized by the predominance of international capital flow and the emergence of the main periphery between capital-exporting countries and importing countries. The latter were prone to unstable changes in economic activity, which he called "distorted fluctuations in the availability of capital imports" (Triffin 1964).

A historical comparison of the Eurozone crisis with the functioning of the gold standard before 1914 identifies an important feature of the international monetary system: when capital movements across borders are actually allowed with little regulation, the argumentative role of the current account balance is overestimated (Levchenko et al. 2021). It is therefore very important to have a clear idea of the origin and nature of the Eurozone crisis if the desired political implications are to be achieved. In this regard, the theoretical basis proposed by analysts at the Bank for International Settlements is more suitable for understanding the crisis in the Eurozone due to "excessive financial elasticity." (Regulation 2019a)

In fact, these analysts argue that the "financial elasticity" of domestic monetary and financial regimes is significantly influenced by policy and institutional arrangements at the international level (Borio et al. 2014). Monetary regimes, which focus mainly on prices rather than financial stability, tend to increase financial elasticity because they are not forced to adopt restrictive monetary policies as long as inflation remains low and stable. In addition, the transfer of excessive free monetary policy from major economies to the rest of the world is direct and direct when currency areas extend beyond national jurisdictions (in the case of the international role of the US dollar or the euro in the European Union) (Regulation 2019b).

With regard to financial regimes, when the mobility of capital across borders is not limited, external sources of financing contribute to the internal increase in volatile prices for loans and assets. In fact, the history of the international monetary system, from the

Bretton Woods agreements to the 2007 financial crisis, shows a gradual decline in control over capital, even in short-term financial flows, and a shift from financial stability and regulation to financial liberalization and price stability obsession (National security and defense 2020).

In this respect, the European Union is a supreme and radical example of how these policies and institutional mechanisms have been adopted over the last 30 years. For this reason, the analysis of the financial and economic crisis in the Eurozone—given its systemic nature—cannot be carried out without taking into account the role of institutions and rules enshrined in the EU Treaties (Minksy 1986).

The "rigidity" of the monetary union and its tendency to create "undesirable" imbalances were clear long before the introduction of the euro—and even before the European Monetary System was established. N. Kaldor (1971) was one of many who criticized the Werner Report (1970) because he suggested that economic and monetary union may precede political union. In his view, the latter would be necessary to combat external imbalances if there were regional differences within a single country, which need to be addressed through structural budget transfers. In this case, N. Kaldor looked at "real" imbalances, which today are less relevant than external financial imbalances in explaining financial crises (Tariff quota consultation. 2020).

Restrictions on short-term capital movements were a legacy of the 1944 Bretton Woods Conference, which was the starting point for many postwar institutions, including the International Monetary Fund, whose articles of association indicated the possibility for its members to apply controls and restrictions on capital (Article VI (section 3) "Control of capital transfer").

When it comes to the European Economic Community (EU after 1992), the free circulation of capital has always been a central theoretical dogma for adherents of monetary integration in Europe. Since Mandell's theory of "optimal currency space" (1961), in which the mobility of labor and capital plays a central role, the freedom of movement of capital has always been considered a key element for the effective functioning of the single market. Even the Werner Report, despite acknowledging that "speculative capital movements have become enormous" and that they could further complicate the economic development of the Member States, advocated the completion of capital liberalization in the European Community (Kolumbet et al. 2019).

The principle of free movement of capital became part of the European acquis communautaire only after the adoption of the Single European Law in 1986, followed by the agreed Council Directive 88/361/ EEC, which introduced the liberalization of all capital movements between Member States as a necessary step to create a monetary union. (Commission of the European Communities 1990). By July 1, 1990, all other restrictions had been lifted. Then the Maastricht Treaty (1992) solemnly codified the freedom of movement of capital.

The already mentioned R. Hilferding would probably rationalize this historical process, arguing that the development of financial capital increases the importance of the size of the economic territory, so it is not surprising that the introduction of credit controls and restrictions on capital movements, re-introduction of which is impossible (Goodman

and Pauly 1993), is still taboo in the European Monetary Union. Even the International Monetary Fund, following the Washington Consensus, which preached fiscal discipline, privatization, and capital account liberalization, is now rethinking its position on all of these issues, which it is now beginning to consider “oversold” (Ostry et al. 2016).

In fact, some kind of control over the volume, nature and direction of gross financial flow between euro area banks could lead to unsustainable growth in prices for loans and valuable assets in many peripheral countries. This would reduce the outflow of capital that contributed so much to speculation on these countries’ public debt in 2011 and 2012 (Popenko et al. 2020). This in turn justified the reduced budgets that ultimately led many Eurozone members to a double recession in 2012 and 2013. This is the final and final act of liberalization and integration of financial systems of Member States. Instead, if the issue of “excessive financial resilience” is to be addressed seriously, the Eurozone and possibly the EU will require the reintroduction of a certain level of control and restrictions on cross-border financial flows between its Member States.

Liberalization of capital movements in the European Union is only one aspect—financial—of institutional mechanisms that strengthen the “financial elasticity” of this economic zone. With regard to the monetary aspect, many researchers have insisted that the single monetary policy of the European Central Bank requires that all euro area countries be in the same phase of the business cycle. In this regard, despite the slow performance of the German economy in the first years of the monetary union, requiring a policy of low interest rates, for many peripheral countries the opposite happened: the strengthening of the credit boom was associated with low nominal interest rates and high inflation (Grebennik et al. 2019).

The ambiguous institutional structure of the euro area has also proved detrimental in terms of remedial measures that a country with a central bank lender can take to prevent a crisis of confidence in its banking sector or speculation on the value of government bonds. Instead, the architecture of the European Monetary Union does not oppose any of these criticisms, and, as M. Obstfeld rightly points out, it gives absolute priority to maintaining price stability (Article 2 of its Statute) over financial stability in the private and public sectors. Recent events have a bitter irony, suggesting that central banks can do little, if anything, to restore inflation in the deflationary environment in which many Eurozone countries now find themselves.

The combination of gross financial intermediation and the existing free mobility of capital in the wider economic sphere has significantly increased the euro area’s financial resilience to the crisis, as shown by 9BIS data on cross-border transactions, loans to GDP, and asset ratios and prices. Again, the very configuration and institutional structure of the European Monetary Union was not neutral in the process of building imbalances. Here is how G. Minsky put it: “As a result of these constitutional shortcomings, speculative financing and the growth of market institutions, which facilitate the transition to refinancing positions, destabilize development in times of prosperity” (Minsky 1986).

It is important to emphasize that the European Monetary Union has not maintained neutrality in the current crisis. This contributed to the emergence of financial and structural

imbalances between members. Commercial, financial and monetary integration between European countries was confirmed by the rationale for ensuring economic efficiency and stability of the countries involved. Less developed economies, by lifting protectionist trade restrictions, liberalizing their capital accounts and joining the single currency, would reduce the output and per capita income gap with richer Member States. The emergence of current account imbalances and financial flows to peripheral countries in the 10 years before the crisis were seen as positive signs of convergence and efficient functioning of financial markets.

Today, it is pure fantasy to claim that economic, financial and monetary integration has brought convergence between EU member states. Since 2010, a noticeable and dramatic picture has emerged, with peripheral countries showing appalling figures for each variable, other countries such as France and the Netherlands showing better but not extraordinary results, while Germany is recording generally satisfactory figures, especially in issues of corporate insolvency and employment rates.

This is a potentially unviable economic divergence that affects the Eurozone at the present stage. This dramatic situation, which will require substantial and radical reforms in the policy and institutional structures of the Eurozone, is changing the paradigm of economic integration, which seems almost predictable. So far, the socio-economic and political situation remains fairly stable, the current European Union, and especially its core of the Eurozone, is a "promised land of liberalism" and an ideal organizational structure for the socio-economic and national interests that dominate the formation process policy.

Conclusion

Thus, the above theoretical and historical lessons point to a clear and important dilemma for the survival of the European project: either a political alliance will be created with a functioning institutional configuration of federal states, or many necessary political competencies (eg financial control and restrictions, monetary sovereignty, trade policy, etc.) must be re-nationalized. The argument, which covers all aspects of the above analysis, is crucial: the development of the Eurozone over the past 15 years should be seen as a systemic failure, not simply as the fault of a few careless countries or the merits of other virtuous ones.

Instead, the Eurozone crisis was fueled by the dysfunctional institutional configuration of the European Monetary Union itself, together with the integration process and the economic philosophy it was guided by. Today, more and more economists and international institutions are accusing the Eurozone of being a "black hole" in global economic growth, but the time for repentance is running out, and the long-running economic crisis could end in failure for the EU.

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