Euro and the three Cs - competition, competitiveness, convergence

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Journal of euro and competitiveness, Paneuropa Foundation Romania

7 August 2014

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Abstract : **The article argues that neither the EU member states, nor the EU candidate states give enough attention to the requirement of maintaining a high economic performance of their economies by convergence and competitiveness strategies, so that they could have "the capacity to cope with competitive pressures and market forces within the Union"1 and ensure the proper functioning of the single currency. Instead, by the synergy of internal market and single currency, coupled with a populist nationalistic policy at the level of most EU member states, ideal conditions were generated so that factors distribution[2] spontaneously acts, as proved consistently and more visible during the latest financial and economic crisis, by the so-called countries' specialization, deindustrialization and a North-South rupture.**

Keywords : competitiveness, competition, convergence, euro, single currency, monetary policy

JEL: E42, E61, F36, F43, G15, O47

In the previous article[3], we advocated that the creation of the internal market[4] for the European Union, as a whole, and the introduction of the single currency, euro, for the majority of EU member states, was a step further in deepening the process of a larger sui generis construction, where the member states agreed to exert jointly a number of attributes belonging to their national sovereignty by means of a common legislative and institutional framework and through a number of policies established by the treaties (the communitary method), as well as to closely cooperate in the development and implementation of other responsibilities (the intergovernmental method). Such a mix of integrated and intergouvernmental approaches could be presumed to ensure that factually all problems EU countries are facing could be tackled with, negotiated and eventually settled by common will.

The advancement of the European Union is not simple and is not fast, and each of its new developments is accompanied by a series of aspects that need further attention and solutions. In fact, the European Union is an *open ongoing project*, where at this stage the economic and monetary union is already functioning and advancing, irrespective of the critics from one side or

[1] That is the economic criterion part of the Copenhagen criteria regarding EU accession criteria, as they were defined at the European Council in Copenhagen in 1993.

[2] See the Heckscher-Ohlin-Samuelson model theory. Further in the article we shall present how we shall see how it was illustrated at EU level

[3] Current article is part 2 of the study "Considerations on the single currency seen from the competitiveness perspective", authors dr. Nicolae Iordan-Constantinescu & Silvia Duşa, published in the Journal of euro and competitiveness, nr. 1/2014 http://www.jeurocomp.net/index.php/elibrary/issue-nr-1-2014/53-considerationsonsinglecurrency

[4] The internal market is one of the pillars of the European Union, completed in 1993. In accordance with the Treaty establishing the European Community (Art.3 of the Maastricht Treaty) the internal market is "characterized by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital" and represents "a system ensuring that competition in the internal market is not distorted".

another, while the political union is still lagging behind, even if elements of such a union are already present and continue to accumulate in a rather federalist direction.

Therefore, despite the requirements formulated by politicians or the arguments brought about by the scientists, the process of European integration cannot and should not be urged. It has its own inner dynamics and Robert Schuman continues to be right in what he declared on 9 May 1950: "Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity".

But what is needed is to come back to the spirit of the European construction and share again the courageous and innovative vision of Europe that made possible to live now in an area of peace, freedom, prosperity and justice.

The recent financial crisis evidenced the serious problems the European Union is facing as a whole and almost each country individually. The study below deals with some of the problems related to competitiveness as part of a more complicated equation uniting competitiveness, convergence, competition and euro.

The competitiveness

We found extremely interesting the study "End the divergence of competitiveness between France and Germany"5, prepared for the Ministry of Economy, Finance and Industry of France and finalized in January 2011, by a team of experts coordinated by Michel Didier and Gilles Koléda, from the "Center of economic observation and research for the expansion of the economy and the development of enterprises"6. It is one of the few comprehensive studies dedicated to the fundamental changes operated by the "competitive pressures and market forces within the Union" on the example of France and Germany.

The study represents a big commitment that employed important sources, resources and logistics, aiming to measure and explain the gap of industrial competitiveness between France and Germany.

Encompassing the period 2000-2010, the study reveals, from the very beginning, a "permanent and structural fall of competitiveness" between France and Germany, manifested into a "rupture of trend with a magnitude without historical precedent", which intervened, "very surprisingly, at the very moment when they were founding the euro zone"7.

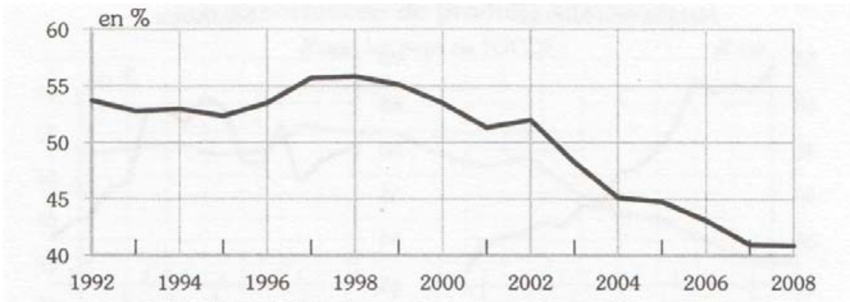
It is not our intention to present the whole study here, but some of its essential findings are necessary to be offered here just to give an image of the "rupture of trend".

In 2000, French exports counted for 55% of the German exports and went down to 40% in 2010. In absolute figures, the balance of 15% in the commercial exchanges between the two countries represented 200 billion euro (10% of the French GDP).

[5] Didier, Michel; Koleda, Gilles - Compétitivité France Allemagne. Le grand écart, Economica & Coe-Rexode, Paris 2011

[6] Centre d'observation économique et de Recherche pour l'Expansion de l'économie et le Développement des Entreprises (http://www.coe-rexecode.fr

[7] Didier, Michel; Koleda, Gilles - Compétitivité France Allemagne. Le grand écart, Economica & Coe-Rexode, Paris 2011, pp.11-12



Graph nr. 1: Evolution of the ratio of French exports to German exports

The trend is similarly reproduced in relationship with other countries or groups of countries or with different products!

Similar situation occured in the French exports to euro zone states, where France lost 4 points, from 16.9% in 1999 to 13.1% in 2010, each point counting for 25 billion euros, 100 billion euros altogether! On the contrary, in the same period Germany increased its share of the European market, the German exports witnessing a significant increase, from 29.3% in 1999 to 32.1% in 2010.

At the same time, the average price of the French exports increased by 8% as against the average price of the German exports and the added value of the French industry decreased from 50% in 2000 to 40% in 2010. French share of the industrial added value in the total added value in the eurozone went down from 17.2% in 2000 to 14.3% at the beginning of 2010, representing almost 36 billion euros (1.8 point of GDP). Instead, Germany maintained its share in the total added value of eurozone (slightly over 35%).

From 2000 to 2007, France lost about 13% of its industrial companies.

The study noted that the losses of market share recorded by the French production concerned "not a slowdown of a certain sector or a decline of implantation on a particular geographical market", but "all products and all regions of destination for the French exports", which means that "the loss of competitiveness is general" and touches "the quasi-totality of products and most of the geographical destinations"8.

Such evolutions took place at a time when the global efforts for research were larger in Germany (1.8% GDP) than in France (1.3% GDP). Also, the rate of employment was higher in Germany than in France.

So, the study fully demonstrates that a "rupture of trend" of competitiveness between France and Germany exists and its main causes would consist, essentially, in the "opposiste policies of managing the labor market" and a "highly ample divergence of costs and margins of enterprises"9.

The loss of competitiveness between France and Germany may be, to a large extent, surprising, as both countries enjoyed a certain reputation of industrial and scientific stature, but the facts are stubborn and the reality of figures makes the situation even worse.

We have now to understand that what happend between France and Germany is not a singular situation. It has deep roots in the way the economy was grounded in each country of the Union and in a way each country prepared its passage to the internal market and the single currency. And here the litmus paper of the financial crisis revealed powerfully the big errors, the faults of construction and policy, the lack of vision and the lack of action.

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[8] ibidem, page 15

[9] ibidem, page 11

Therefore it is not surprising that the situation described for Germany and France can be seen almost everywhere in the European Union, multiplied at the level of all EU countries. And the individual situations has generated a new picture of the overall Union, a Union split between North and South, in the sense that "the industrial production turns down in Spain, France, Greece, Italy and Portugal between 1999 and 2011", while "the agricultural production increases in the same period" in the same countries. "Symmetrically, the industrial production increases in the same period in the Northern countries of the eurozone (Germany, Austria, Belgium, Finland and Netherlands)"10.

Consequently, there are now two different groups of states, "the group of the Northern countries , where the industrial production increases, and the group of the Southern countries, where the industrial production decreases"11. We are now contemplating a process of deindustrialization12, a name which has to some extent a certain negative connotation, or better sait a process of specialization, which the authors Patrick Artus and Isabelle Gravet call specialization of type "interbranch"13.

This type of specialization can be explained by means of Heckscher-Ohlin-Samuelson model, which takes into consideration the different endowment of each country in factors of production. The different endowment of factors of production makes that a country specializes in a domain where it proves to be more efficient. For example, a country disposing of a highly qualified labor force will specialize in the production of sophisticated goods, while a country with a less qualified labor force will specialize in less sophisticated products. But such an interbranch specialization determines not only a specialization of production, but also a migration of factors, in the sense that factors go where they are better employed and paid.

What happens with the countries that had a certain production and they have it no longer now? And what happens with the countries that have to develop new productive capacities for goods they were not producing before? The first group of countries will face a shortage for the products they are no longer producing and will have to import them. The second group of countries will have an additional production of goods they will now export. Consequently, some countries will export more and will record a commercial surplus, other countries will import more and will have a commercial deficit. The commercial surplus will be reflected in a surplus of the balance of payments, while the commercial deficit will need to be covered by adjusting consumption and/or by borrowing money. Ultimately, the North will be financing the deficit of the South and the South will become (more) indebted to the North.

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[10] Artus, Patrick; Graver, Isabelle - "La crise de l'euro. Comprendre les causes. En sortir par de nouvelles institutions", Armand Collin, Paris, 2012, page 33

[11] ibidem, page 34.

[12] See the study "Deindustrialization: Causes and Implications" prepared by Robert Rowthorn and Ramona Ramaswamy, for International Monetary Fund, Research Department, in April 1997, where they wrote "The advanced economies have witnessed a virtually continuous decline in the share of manufacturing employment in the last two decades - a phenomenon referred to as deindustrialization. Employment in manufacturing constitutes only a small fraction of civilian employment in most pf the traditional "industrial" countries". But, "contrary to popular perceptions, deindustrialization is not a negative phenomenon, but it is a natural consequence of the industrial dynamism in an already developed economy ... deindustrialization implies that the growth of living standards in the advanced economies is likely to be increasingly influenced by productivity developments in the service sector".

[13] Artus, Patrick; Graver, Isabelle - "La crise de l'euro. Comprendre les causes. En sortir par de nouvelles institutions", Armand Collin, Paris, 2012,, page 34. The "interbranch specialization" is a specialization between economic branches, what means that the specialization is in the production of different goods, while the "intrabranch specialization" happens within the same economic branch, what means that the manufacturers are producing varieties of the same type. pages 31-32

Some of the consequencies induced by this new type of specialization can be listed as shutting down of productive capacities, increase of unemployment, expansion of foreign debts, austerity measures, diminution of the living standard, social unrest. The fact that the subprime crisis started in USA was continued by a crisis of sovereign debts in the European Union is a direct consequency of the new economic development determined by the competition freed and amplified by the cumulated effects of the internal market and euro introduction.

Naturally, at least one question has to be put at this point: how it happens that a project meant to have positive impact on the overall Europe and contribute to the strengthening of an "area of freedom, security, prosperity and justice" has such perverse consequencies?

In this case, we have to recall the treaties and try to find a first reply there. And afterwards we have to recall the recent history of the European Union and of its member states, the policies they developed and implemented. A possible reply will have to include these three C's ingredients of the European construction: competition, competitiveness and convergence, how they were worded in the treaties and which is now the state of affairs! We saw in this section that as soon as the borders were opened for an unlimited competition, the competitiveness intervened and imposed the rules of play, the winners and the losers. And the downgrading of the situation cand be prevented or cured only if a strong policy of convergence is pursued, in the sense of attaining all a better if not the best performance possible in any given moment.

The competition

The founding fathers of the European Union had a correct insight of the transformations that a deeper integration would bring about when they included among the EU accession criteria that of the "capacity to cope with competitive pressures and market forces within the Union". And they also provided for this countries some of the instruments appropriate to cope with these forces, a resolute policy of convergence and an articulated policy of competitiveness increase.

Unfortunately, politicians were inclined to take less into consideration the treaties and the policies there formulated, and preferred to address rather what they consider to be the urgent and important issues at home, trying to find immediate solutions. And when problems occurred, they were immediately those ready to blame the European Union, the European single market, the European single currency and anything else that to say something wrong about their own deeds.

The internal market is part of this open project called European Union. It created an area where goods, services, capitals and persons can move without any restrictions, as later the eurozone created a space where participating countries share the same currency and conduct a common monetary policy. What could a businessman better dream at than a free trade area with a single currency?

So, the competition between national economic actors is no longer screened by border policies, like customs regulations, or by monetary instruments, like those related to the rate of exchange. On the contrary, goods, services, persons and capitals can move freely, since January 1, 1993, all over the territory of the European Union and transactions are being made based on the traditional simple mechanism of demand and offer.

But the internal market is not a uniform area. There is a diversified endowment in human, natural and capital resources and there are differently structured economies on this basis in each country, tailored to meet to a larger extent countries' needs, without making recourse to imports, except when there is no other exit out. The internal market has abolished the internal borders and the wide dispersion of levels of development between countries and regions has become completely visible.

And it acted as a litmus paper to determine what capacity has a country "to cope with the competitive pressures and market forces within the Union".

The direct interaction within the internal market of all national actors, who have at their disposal only their skillfulness and behind it a presumed best ratio performance/price sharpen the competition and put extreme pressures on the less prepared participants in the play, who have very few choice: to innovate and make better and cheaper products, or to reduce and even lose their market share.

It is good to remember that both demand and offer are globalized, so anyone can at any moment procure goods or services where it is offered the best performance (the highest) at the best price (the lowest). Practically, the highest performance at the lowest price is just an assumed attempt to optimize both buyer's and seller's own restrictions: the buyer cannot go down a certain quality, the seller cannot go down a certain price and the tradeoff should be achieved within these limits to be mutually affordable.

And so we come back to the concept and the policy of competitiveness.

The competitiveness revisited

To resist such a competition, it is important for a country to have attained a sufficiently high level of competitiveness, translated into a high rate of labor productivity and the best ratio of costs/performances.

That is why competitiveness goals became important and the European Union started to pay an increased attention to it. In order to accomplish the objectives of competitiveness, the European Union formulated its first strategy on competitiveness in 2000, called also "Lisbon Strategy" or "Lisbon Agenda", for the decade 2000-2010, having as "a new strategic goal", "to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion".

Unfortunately, the Lisbon Strategy seemed not to be born under good auspices as the first evaluations in 2002 and 2003 revealed certain weaknesses in its functioning and results. Also, its efficiency was questioned and serious doubts were raised as to whether or not the 2010 objectives and targets as defined were still realistic. As a consequence, a high-level expert group called for a re-launch of the strategy with renewed focus and greater urgency, in order to bring the 2010 objectives into the picture anew. The renewed Strategy had less ambitious objectives and its final outcome was modest.

So, a second strategy was established in March 2010, "The Strategy Europe 2020", for the decade 2010-2020, called also ”a strategy for smart, sustainable and inclusive growth". The new strategy is sometimes referred to as a "strategy on competitiveness", but this word is missing from its official denomination and its objectives are again less ambitious, feeding the sentiments of doubts about its feasibility!

A motivation of why competitiveness does not enjoy so much understanding, appreciation and support on behalf of the politicians, who are formally called upon to formulate national plans for implementing it, is probably its somewhat "esoteric" substance! Esoteric not in the sense of supernatural, transcendental, but in the sense of its comprehensibility or apprehensibility, lack of tangibility or palpability. Competitiveness is an effect, a result of a process, it is not something that can be seen, smelled or taken in hands. The World Economic Forum developed a Global Competitiveness Index that is built on three subindexes, 12 pillars and further 115 indicators to define and measure this so complex reality! The fact that a national product can be sold on a market, national or international, doesn't mean it has competitiveness, it just found a buyer that can afford to pay a prize for the respective product.

To understand competitiveness in its essence, we have to go the definition formulated by professor Michael E. Porter, Institute of Strategy and Competitiveness, Harvard Business School, an outstanding researcher and promoter of competitiveness, who considers competitiveness a function of labor productivity: "competitiveness is defined by the productivity with which a nation utilizes its human, capital and natural resources".

So we have to understand that whatever increases "productivity with which a nation utilizes its human, capital and natural resources", increases at the same time the level of competitiveness of the respective nation.

The convergence

To accomplish the objective of establishing the internal market and the single currency, the treaties provided for a policy of convergence, which has to be attained first of all by a close coordination of the broad guidelines of economic and social development and secondly, by concrete actions meant to narrow the gap of economic performances and consequently the possible losses of national substances at trans-border exchanges, providing as well for a series of principles, criteria, rules and mechanisms for the healthy functioning of the single currency.

The convergence refers less at concrete measures to be taken by a certain state but to a set of macroeconomic indicators that are meant to measure the solidity, stability, dynamism, possibilities of expansion etc of an economy. We mean here the Maastricht criteria of convergence that define requirements of sustainable economic discipline that a country should observe in order to be accepted in the eurozone.

The economic convergence becomes particularly important when accessing the eurozone, as this one supposes the achievement of a certain homogeneity, similarity and convergence of the main feature of an economy.

In the literature, there are defined three types separate, but complementary, of convergence, i.e. nominal, legal and real convergence, which have to ensure a certain degree of uniformity of the participating countries uniformity which, in turn, can and must be such as to ensure a sustainable growth of the respective economies.

The criteria of nominal convergence, provided for under the art.109 J of Maastricht Treaty concern the rates of inflation, long term interest rates, government budget deficit, government debt-to-GDP ratio and the exchange rates. All these criteria are in fact variables that express the degree of homogeneity of the participating economies, even if their factual accomplishment doesn't mean that a process of real convergence took place and attained the expected results as regards the rate of unemployment, GDP/capita, the budgetary expenses a.s.o.

The legal convergence regards the harmonization of national legislation and of the rules governing the central banks, so that they become compatible with the statute of the European System of Central Banks (SEBC)14.

The real convergence refers to the equalization of the living standards in the participating countries, what is generally called „economic and social cohesion”. Its variable could be the rate of unemployment, GDP/capita, the budgetary expenses a.s.o.

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[14] Art.109 J par.1 of the Treaty establishing the European Community

No doubt, many of recalled provisions of the treaties were put into operation to a large extent, but in many cases we noted defaults and derogations made or requested by different states. An example is linked to the observance of the Stability and Growth Pact, which was added to the Maastricht Treaty a few years after its entry into force and was destined to monitor and, if necessary, to adopt measures against the states not fulfilling their obligations as to the government budget deficit or the debt-to-GDP ratio. At the request of the bigger states, like Germany, France, Italy, Spain, the policy of excessive deficits was to a large extent relaxed and the countries in default were no longer monitored and especially punished if there was present a clear tendency of evolution towards the benchmark established.

These development allowed the countries to relax their budgetary policies at home, the control was no longer very strict, so that at the moment when the financial crisis burst out, many countries were at non-manageable levels of deficits and indebtedness.

Euro

As concerns euro and the eurozone, we must observe that the eurozone itself acted as a monolith, in the sens that heterogeneity was increasing in the whole area, the rates of exchange between the participating countries were deteriorating fast and significantly, but it had not the ways and means at its disposal to treat the problems and eventually cure them.

If the things where developing in a particularly country, able to manage its own economy and conduct its own monetary policy, the imbalances generated by the irregular development of competitiveness internally could be contained at the level of the country and the possible negative influences generated by a worsening balance of payments could have been treated by a devaluation of the national currency, which would have increased the prices of the imported goods on the internal market and so their pressure diminished, at the same time with making cheaper the prices of the exported goods and so restablishing the equilibrium of the balance of payments.

Unfortunately, the countries belonging to eurozone have no longer such an ability, it has been the competence of the European central Bank to conduct a unitary monetary policy. And this unitary monetary policy was established first to maintain the stability of prices and second to deal with the situations related to the international encironment in which the single currence was meant to function. There is no provisions in the treaties about what happens if the fundamentals of the euro, that means the fixed rates of exchange between euro and each former national currencies participating at the European monetary union were modified by adverse changes in the respective national economies.

Now we see that there many approaches, proposals and even treaties trying to deal efficiently with all these aspects, But the malaise is mainly at the level of the national economies and they have to act focused on increasing competitiveness and convergence and strengthening their "capacity of coping with the competitive pressures and market forces" which are acting within the European Union

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