Historic developments in the EU important lessons for RS

Many international economists find that now it is practically impossible for Greece to stay within the euro zone. Even worse, some other (much bigger) EU countries, it seems, are heading in the same direction. The Republic of Srpska must learn from this development.

Greece's departure from the euro zone is inevitable?

European monetary union is at a crossroads. Possible scenarios for the period to come about which interesting arguments are led in the EU range from the collapse of euro and return of national currencies to successful salvation of Greece and establishing new and stronger fiscal mechanisms between euro zone countries. One is certain: the European Union will never be the same after this crisis. German officials officially support Greece's stay within the euro zone, even though more and more often German representatives issue strong statements and even threats regarding austerity measures that are not being implemented in Greece. It appears that Germany still wants to keep Greece and thereby lowers the risk of the euro zone breakup, because maintaining the euro and one market is in its interest. Greece's departure from the EU would surely cause it to go bankrupt, and then Germany, as its important direct and indirect creditor, would suffer great losses. Public opinion surveys in Greece show that the majority of the population wants to keep the euro.

> *"Like a failed marriage, it is better to have rules for inevitable divorce that make separation less expensive for both sides. Do not make a mistake: controlled departure of Greece from the euro zone does carry a significant economic pain. But watching slow, uncontrolled implosion of Greek economy and society could be worse."* **Nouriel Roubini, economist.**

> *"It is known that big account imbalances emerged when capital started flying towards European soil upon establishing the euro and overcoming these imbalances demands a high realistic devaluation – a devaluation that has barely started."* **Paul Krugman, economist and a Nobel prize winner.**

However, a significant number of international economists finds that Greece's stay within the euro zone is now practically impossible, having in mind the recessional spiral in which Greek economy has fallen, as well as bad results of previous austerity measures. In order to keep Greece in the euro zone, it is necessary to rapidly recover its competitiveness. According to Dr. Nouriel Roubini, one of researchers who predicted the global economic crisis, theoretically, this can be done in three ways: 1) significant weakening of the euro; 2) strong growth of productivity above the growth of wages; and 3) internal lowering of prices and wages. The problem is that first two options are practically impossible, while price of the last option would be several years of Greek economy's depression. It should be noted that, in essence, some other countries from periphery of the EU suffer from the same issue, among which are Spain and Italy. Therefore, what we have here is a systematic problem in the functioning of the EU.

What it means for us?

1. **Same as Greece, B&H is exposed to open price competitiveness from the EU.** Unlike, for example, Serbia, B&H does not have the ability to devaluate its national currency and affect price competitiveness that way. Besides, by implementing the Stabilization and association agreement, trade competitiveness will additionally get stronger. Basic precondition for B&H's economy to survive in such surrounding is that domestic competitiveness remains complied in relation to main trade partners.

2. **In short-term, prices and wages remain the sole instrument of managing domestic competitiveness of B&H** (this applies to Greece also if it stays in the euro zone). Our price competitiveness essentially depends on the relation between the developments in the aspect of salaries and productivity in our and other countries that are our trade partners. Therefore, amounts of our wages depend on our productivity, and also on the relation of wages and productivity in other countries. It is interesting that some analyses of developments in the EU suggest that so far the expected nearing of productivity among some peripheral and developed EU countries has not happened. The fact that wages between those countries had quicker tendency to level than their productivity resulted in unbalanced competitiveness. Negotiating parties in social dialogue in RS and FB&H should remember that open borders policy (with fixed foreign currency course) is consistent only with flexible labor market policy, i.e. labor market that easily lowers (and also increases) wages and that easily lays off (but also employs) workers. If we do not want this kind of labor market, we have to decrease our exposure to foreign competitiveness.

3. **Much bigger fiscal cuts are needed both in RS and FB&H.** Governmental sector expenditure in B&H is still huge and in 2010 it was 49% of GDP (all governmental levels and public funds). Such burden could hardly be carried by even much more powerful economies. High level of expenditure on wages poses an especially big burden, which is a consequence of over-employment in public sector (we wrote thoroughly about this problem in RS and its various negative effects in the previous edition). With 12.9% of GDP spent on wages in governmental sector, B&H surpasses other Western Balkan countries by far in terms of expenditure for this use. On the other hand, this high expenditure on wages and other current costs cut spending on investments, which was 3% of GDP in B&H and being such was the smallest among these countries.

> *"The account for public sector wages (for B&H) as share in GDP is not only one of the biggest in the Western Balkans, but it is also one of the biggest in the entire Europe and Central Asia."* **World Bank, 2012.**

4. **The degree of fiscal sustainability has great influence on political independence.** More precisely, the bigger the fiscal deficit, the bigger is the cost of political independence. Isn't Greece a perfect example of this? After elections they failed to form new government, so another round of parliamentary elections was organized. It seems like Greek society still has not decided whether to stay in the euro zone and to implement rigorous austerity measures or to follow its own path. In the case of RS and FB&H, financing the existing fiscal deficits demands new debts. The ability of going into debt at the domestic market is limited and only since 2011 has RS been able to issue short-term treasury notes. Access to needed greater long-term financing is currently only possible through international financial institutions, whose funds do not come unconditionally. Negotiations about a new IMF arrangement have already been opened. One of the reasons for that is the need to refinance the ever-growing monthly payments of external debt, and the other, equally important, could be the political strengthening of grounds for implementing necessary reforms. Anyway, new debts must not arrive without major budgetary cuts, which are possible and necessary on all levels. Earnings of MPS and delegates in the Parliamentary Assembly of B&H amounting to more than 5000 BAM a month have been decreased by only 4.5%. Isn't there more space or moral necessity for additional cuts?

> *"The Greeks should know what they are voting about. It is not about politics, but the future of Greece in Europe and the euro zone. We hope and expect that all of those with the right to vote are aware of their responsibility."* **Office of the chief of German diplomacy Guido Westerwelle**

5. **For RS it is not irrelevant what happens in FB&H and vice verca.** We have been able to see that for all euro zone countries it was of great importance how the events would unfold in Greece and other countries threatened by debt crisis, because they are all mutually connected by the same currency and market. Also, investors' and consumers' perception of risk level in a country easily expands to others as well. All this applies for RS and FB&H, since, by its constitution, B&H has similarities to the EU.

6. Fiscal cuts must be followed by simultaneous aggressive support measures to economic growth. Debt crisis in the EU showed that implementing austerity measures during recession without the parallel implementation of developmental measures leads to greater economic downfall. Therefore, this is another reason why cuts on current fiscal expenditure must be implemented now: so funds for increasing the financing of public investments and development programs could be released. So far, it was the opposite: budgets have been cut mostly on capital costs, because these costs have been less politically sensitive. Of course, additional new debts for the sake of financing development programs will surely be necessary.