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Topic: **EUROPEANIZATION VERSUS GLOBALIZATION**

The EU as Component part of Global Economy or Sovereign Economic Entity
The EU in a labyrinth of transition from territorial into market state

Abstract

The world is changing rapidly. Many distinguished economists were convinced that the international Pareto optimum was quite a realistic achievement only if EU follows the dictate of a strong radical free market reform. “Laissez-faire” was considered as a magic solution for every issue. However, the EU is becoming a perfect case in point to illustrate the labyrinth of transition from a “territorial” (nation) state into a “market” state on the basis of profound globalization process and functional integration of the global economy.

Dialectic of globalization suggests that extant economic theory becomes a virtual and unsuitable to explain and govern sustainable process of globalization. We raise the following questions we are not able to answer by extant theory and policy: whose BDP should be optimized in a global economy? Who is going to be “optimizer“, either global government or someone else? Whose employment level should be addressed, that of territorial or market state? Who is the main economic subject in upcoming market state: corporation or state deprived of economic resources? What is going to look like a new stage in world (capitalist) development? We propose term mega-capitalism for next stage in capitalist development we have partly stepped in which totally differs from Friedman’s (1982) and neoliberal understanding of the economic processes and Fukuyama’s end of history. Should the EU join mega- capitalism as a unique state or as bunch of integrated national states? Should the EU maximize its BDP, or BDP of individual states should be maximized? The same question is pertinent for level of employment, social justice…Does the EU becomes a region of unified global state? These are questions

to be answered in the interest of citizens of the EU ASAP and questions we try to tackle with in the paper.

Key words: deception, globalization, future, dialectic, state-market

The Problem: Quo Vadis Europe

Mr. Sarkozy has raised fundamental question as far as the destiny of the EU is concerned:

„You cannot make a single currency without economic convergence and economic integration. It's impossible. But on the contrary, one cannot plead for federalism and at the same time for the enlargement of Europe. It's impossible. There's a contradiction. We are 27. We will obviously have to open up to the Balkans. We will be 32, 33 or 34. I imagine that nobody thinks that federalism—total integration—is possible at 33, 34, 35 countries.

So what can we do? To begin with, frankly, the single currency is a wonderful idea, but it was strange to create it without asking oneself the question of its governance, and without asking oneself about economic convergence. Honestly, it's nice to have a vision, but there are details that are missing: we made a currency, but we kept fiscal systems and economic systems that not only were not converging, but were diverging. And not only did we make a single currency without convergence, but we tried to undo the rules of the pact. It cannot work.

There will not be a single currency without greater economic integration and convergence. That is certain. And that is where we are going. Must one have the same rules for the 27? No. Absolutely not [...] in the end, clearly, there will be two European gears: one gear towards more integration in the euro zone and a gear that is more co federal in the European Union“

Mr.Sarkozy, the President of France

(The Economist, 2011-11-12)

These Sarkozy's words pointed out to some of the main deception hidden in neoclassical economic paradigm ,and still not recognized by majority of so called distinguished economists: ferry tale about Pareto optimality and the efficiency of „invisible hand“, as well as dream of automatic convergence between developed and less developed countries pending upon free market efficiency allowed to work.

I Deception: Pareto, Say and Prosperity

Microeconomics techs that Pareto optimum within a national economy means that the economy is at the level of full employment, there is neither balance of payments deficit nor surplus. Consequently, when equalization between aggregate supply and aggregate demand is reached there is no room for inflation.

According to Theory of Comparative Advantage, (which we consider as a component part of neoclassical economic model), and Say's law, two countries with common tastes and consumers preferences, and having the same technology may enjoy benefits of open foreign trade, that is they can enlarge „common "GDP by means of international division of labor, and by international specialization in production.

Specialization in production in both countries reaches optimum-equilibrium when marginal rate of transformation between goods (X) and (Y) equalizes with prices of good (X) and good(Y).

At that very moment both countries enjoy full economic equilibrium expressed by equation as follows:

$$Marty= Px/Py=MRSxy\ (A) =MRSxy\ (B)$$

Where (A) means country A and (B) means country B.

The logic of perfect competition , treating two countries as one country, or one country with two regions, and suggesting that both countries or regions are functioning as „connected dishes", may enlarge well-being of both(all) countries importing lower priced foreign goods, and therefore bringing social indifference curve to higher position in comparison with pre-trade levels. Under the condition of „International" Pareto Optimum free foreign trade contributes for both countries (global world) to the following effects:

-Optimal allocation of resources world-wide,

-optimal and enlarged consumers surplus without endangering producers surplus (win-win situation),

-Equalization of prices and wages in both countries and world-wide,

-Convergence of the growth rate of GDP in both (all) countries engaged in foreign trade.

All of these optimums are reached together with:

-full employment in both countries (world-vide),

-Price stability world-wide,

-equilibrium of balance of payments

Having in mind all of these achievements of free market economy and free foreign trade , neoclassical paradigm firmly suggests to all countries theoretically , and to transition countries even practically, not to disturb automatic mechanism of market forces. The paradigm pleads for abstaining from all of possible sorts of social (state) intervention into the market, and pleads for both entrepreneurial animal and rational spirit. Could anybody invent more efficient and better way for harmonizing economies of the EU member states?

However, extant global economic crisis has raised the questions about the validity of the majority determinates of neoclassical economic doctrine. Invisible hand disappeared and visible hand of clever and frightened state is in the game again. Open issue become: does the world economic crisis mean the crash of neoclassical economic doctrine or we are only on the verge of a new-revitalized and restructured economic view of the world global economy? Or, if we dare to ask that question, was neoclassical paradigm ever anything more than poor deception and ferry-tale invented by dreaming economists?

In this paper we keep in mind that EU is not political union as well as it is not American melting pt.

Besides, members of EU are not equally developed. Moreover, political geography of EU resembles more to that of former Yugoslavia having 27 instead of sixth countries (republics). Consequently, the imperative of convergence in economic development between members is even more important for EU than was the case for former Yugoslavia. We start from a proposition that known and successful cases of economic convergence were possible when a country undertook a dynamic approach towards growth and development supported by wise state intervention and proper instrument of economic policy. (The cases of USA before the First World War, the case of Germany before the First World War, case of Japan and South Korea since the Second World War.) Even the case of Great Brittan before the First World War can be considered as case of development induced and supported by wise government. In that case theory of comparative advantage has been nothing else but clever application of free trade between unequal parties: GB on one side and USA and Germany on the other side, which contributed to GB growth as long as USA and Germany were naive.

II Deception: convergence

Neoclassical and "the old "view of growth assumed that were capital is scarce, it has a high return. There was a natural possibility about this: when you give a machine to a worker who previously did not have one, it has a big productivity effect. Together with the assumption of constant return to scale, and the existence of unalterable factors such as labor supply, the assumption of diminishing returns has a sharp prediction. During the transition to a new steady state, growth in capital –scarce countries will be high because of the high returns to capital. Consequently, poor countries should catch up fairly rapidly to richer countries. Growth is high when capital per worker (k) is low, then declines as (k) rises. Growth stops when the rate of return to capital is just equal to the discount rate. (Easterly, 1998)

Similar view on: growth, development and catching up process are expressed by Madison (2001) «If the world consists only of two groups of countries (developed and developing countries) the pattern of world development could be interpreted as a clear demonstration of the possibilities for conditional convergence suggested by neo-classical growth theory. This supposes that countries with low incomes have «opportunities» of backwardness, and should be able to attain faster growth than more prosperous economies operating much nearer to the technical frontiers. However, Madison points out to the very crucial remark and fact never mentioned, but possibly hidden in neoclassical paradigm, to the existence of an exogenously given technology and capital. Madison reminds that « this potential can be only realized if such countries are successful in mobilizing and allocating resources efficiently, improving their human and physical capital to assimilate and adopt appropriate technology. Resurgent Asia seized these opportunities .The countries (other Asia, Latin America, Eastern Europe and former USSR, Africa) have not. Their relative position has deteriorated sharply since 1973. »

S.Fisher in "Economic Growth and Economic Policy,1987» shares Madison's conclusion pointing to the role of technical progress as one of the main determinates of economic growth of a country, and for a developing country in particular.«The modest long run rates of growth of the industrial economies and lessons learned from that growth are not necessarily relevant to the less developed countries (LDC). The prime reason is that those countries are far from the technological frontiers; technical progress could play a significant role in their future growth without any major technological breakthrough taking place. A quick look at the evidence is not supportive of the hypothesis. Except for Japan, most of the countries currently in the ranks of the industrial market economies have been among the high income countries for at least a century. »

World-wide experience with economic growth of different developing countries suggests that they lag behind developed economies the more they apply neoclassical economic prescription. Such a evidence has led Vanek,J(2004)to conclude on theory of comparative advantage, as an important component part of neoclassical economic paradigm, the following»

1. The point of departure of my paper is that the traditional theory of comparative advantage on which modern globalization is based is incorrect and not applicable to the present day conditions of world trading. Instead I propose a theory of destructive trade which explains much better what happens in world trading today, and whose conclusions are summarized on

2. Destructive trade leads to a world where a minority of the rich dominates a majority of the poor and what is worse, the situation tends to grow ever worse, the rich becoming relatively richer and the poor poorer. Technically, the situation is explosive. »

Discussion about convergence between LDC and developed countries touching upon the role of free trade and the role of capital flows hardly can escape Lucas paradox. Lucas paradox suggests that capital does not flow into the poor countries where capital is scarce, against the neoclassical view that the return to capital accumulation should be higher where capital is rare. Lukas concludes that the neoclassical paradigm should be abandoned, while Reinhart and Rogoff conclude that the risk premium due to bad behavior is the main culprit. (Cohen in Serra- Stiglitz, 2008).Cohen points out that the capital/output ration is, in general, the highest among poor countries: This can be coined as anti-Lucas paradox. "The intuition that we offer is that poor countries, lacking other inputs such is infrastructure, use physical capital as a substitute for the scarcity of those missing inputs."

At this moment seems useful to invite the deliberations into the critics of the paradigm of neoclassical economics, and theory of comparative advantage provided by: J.Stiglitz,(2005), Horvat(1995) Rodik(1999,2011), Rodik-MacMilan(2011),Panic(2003),Pitelis,2000),Adelman in Stiglitz-Meier,2001) . It is not by surprise that I. Adelman introduced a term KISS (keep it simply and stupid) in her "Fallacies in Development Theory and their Implications for Policy "(Meier, G.-Stiglitz, J (2001) Frontiers of Development Economics, World Bank). She writes" I shall argue that the discipline of economics has enshrined the "keep it simple, stupid" principle as an overarching tenet, imbedded in graduate school that can be violated only at the violator's peril. This principle demands simple explanation and universally valid propositions. It has led to three major fallacies, whit significant deleterious consequences for both-theory and policy: single-cause theories of under- development; a single figure of merit criterion for development: and the portrayal of development as a log-linear process"

Historical and challenging proof with plenty of examples of development experiences of many countries all over the history in favor of theses of Adelman's, Stiglitz's, Horvat's, Pitelis's, Easterly's Rodik,etc. might be found in seminal work of Madison A (2001) "The World Economy"

We might conclude this part of paper by asking the following question: if these economists are right how poorer members of EU may catch up with richer? And, if they can't, what is a future of EU like? In the meantime the world is becoming more and more globalized, and position of nation (territorial state) becomes rapidly defenseless.

III Real-world complication: Dialectic of globalization

There are many definitions of globalization. All of them are more or less confined to the country's integration into the international division of labor and integration of production factors in international scale. So, Bhagwaty (Bhagwaty, 2004.) defines economic globalization as "the integration of national economies into the international economy through trade, foreign direct investment, short-term capital movements, international mobility of workers and aid workers in general, and international technology flows" . Anne Kruger defines globalization as "a phenomenon thanks to which economic agents in any part of the world much are more influenced by events in the world than before "(Wolf, M., 2004).A lot closer to us is Henderson' definition of globalization. David Henderson, chief economist of OECD defines globalization as "the free movement of goods, services, labor and capital, while creating the single market of inputs and outputs, and full national treatment of foreign investors, as economically speaking, there are no more strangers" (Wolf, M. 2004.)
We hold that, in this and similar definitions of globalization are technical and superficial definitions, which do not reflect the dynamics of the capital. We are most prone to own polite-economic definition that holds that globalization is a process of privatization of the world's economic resources by large capital, often virtual and hybrid, as evidenced by the exponential expansion of financial derivatives, the last twenty years, whose value has reached 457 trillion Euros in 2007 (Deutsche Borse Group, 2008). And, if privatization is a political process with the economic consequences, often accompanied and favored by policies of international financial institutions, we dialectically come to the conclusion that globalization is the process of transforming territorial (national) market into global corporate state as a new stage in the development of capitalism, which would we call mega- capitalism, and which eventually precedes to post capitalist society, as it was seen by Marx (Capital), Keynes (Economic possibilities of our grandchildren) or Hilferding (Financial capital). Practically observed under conditions of contemporary globalization global economic crisis is a process of centralization of capital on a global scale, which this time happens in conditions of imperfect global market structure. The recent takeover of US Airways by United airline is nothing but the newest case in point witnessing that process.

IV Economic convergence between whom: national sates or TNC?

The basic economic entities of our time are becoming transnational corporations as the entities which reflect globalization process. The basic microeconomic principle of their behavior is the principle of increasing returns and diminishing costs! Transnationalization and globalization of the world economy forms a global market, but the market, whose one of the main characteristics is imperfect competitions with the prevailing oligopolistic market morphology. In an oligopolistic global market large corporations become "price makers" and "" rule makers "also. The market does not determine the behavior of market participants such as is the case under the conditions of full competition. In fact, the "great" form the market and run it, they share it. Transnational corporations spread their production around the world in order to minimize production costs, and the same time they use "world demand curve „as a source of their marginal revenue. So while the existing microeconomic theory helps understanding the operations of transnational corporations, global economy macroeconomic theory is neither on the horizon. In all this TNCs significantly influence the formation of macroeconomic and development policies of countries all over the world which is becoming addicted to FDI, that is of the capital that TNC have in abundance. If TNC are becoming "optimizers", what would they wish to optimize: its own profit, well-being of their shareholders or well-being of citizens world vide?

Whether any of the assumptions of virtual neoclassicism is valid in such an emerging global world? If not, then neoclassicism in time of the global economy deserves to go into the memory hole. Again, the global economy does not have a theoretical construct as seen from the angle of the global economy as a whole. What we want to optimize from the point of view of the global economy? Is that the GDP? Whose GDP should be optimized: either that of the global economy, or GDP of less and less sovereign individual countries which are by global privatization deprived of their resources? What about the issue of employment? What about the issue of optimal allocation of resources at the macro (global) level or about the issue of general equilibrium? The same question we raise for the EU. Who is EU: integration of nations or integration of big capital (TNC) .Isn't EU in labyrinth of transition from an integration of nations into formation of regional market sate on its way towards full globalization of the world?

V Confused economic Science

Globalization provokes a number of issues related to the process of economic development and its effects on both the host country and the capital exporting country. For example, an American transnational corporation produces a product in China while exporting capital from US. Then, it imports the produced goods from China back to the US. From the point of view of standard balance of payments statistics this transaction is clean and clear. However, from the angle of property rights (especially capital), policy and economic issues seem to be much vaguer on how to treat such a transaction. Does the US import its own goods produced by its own capital and knowledge, or does it import Chinese goods? Foreign direct investment and transnational corporations in the global economy provoke confusion between the "territorial" state and "market" state. The balance of payments issue is only the beginning of opening the Pandora's Box which will have to be opened and studied by the new economists. Once opened, the Pandora's Box of globalization will have a profound impact on relations between the "territorial" and "market" state as well as on the relations between virtual neoclassicism and real corporatization of the world.

Economic science, which until the age of extant globalization generally reflects national economic interests, presumably has to be transformed into economic science, which reflects the interests of new core subjects of globalization of society; such are transnational mega- corporations and transnational mega- banks

VI A Look Forward

The history and experience concerning development of both economic reality and economic theory suggests that the strongest interest groups are the ones that define the economic system, economic policy and economic institutions. If these interest groups today are depicted in a form of corporate power centers, as we believe to be so, then we are free to suggest that we are heading towards “Mega-capitalism”! “Mega-capitalism” seems to be the next stage in the development of capitalism, which will be dominated and led by both mega-corporations and mega-banks. This, in turn, will result with global cybernetic robotization of workers. This process might be supported by neuro-economics, which we would define as cybernetisized neoclassical economics applied under imperfect market conditions. This is because extant economic doctrine is dominated by neoclassical economic theory regardless of the fact that such a theory has definitely become obsolete. Therefore, contemporary economist is lost in the fog of inadequate economic theory. Sure, the process will be followed by the death of the “territorial” state. This process reflects the centralization of capital on a global scale. This process, however, is evolutionary and repetitive since the beginning of the capitalistic way of production

E.U. is economic union, but not completes one. E.U. is not a political union.

In time of fair-weather condition the E.U. may function well both on behalf of its citizens and national state members.

However, in bad-weather conditions (economic crisis) members of the E.U. might need to resort to Keynesian type of economic policy. Keynesian’s sort of economic policy might not be effective without proper management of monetary and fiscal policy. Such effective Keynesian policy seems far from reality on the level of the EU. Applied nationally, such an economic policy might contribute to economic divergence between members and might dilute the efforts necessary for achievement of political union in the future. On top of that the reality of mega-region contributes to economic divergence between richer and poorer part of EU.

The EU looks like as classical example of an entity which finds itself in a labyrinth of transition from territorial into market state.

Taken altogether only one conclusion seems pertinent at this moment, and that is that EU is in the midst of economic policy fog as well as global economy and whole economic science.

Great challenge for EU politicians is how to reconcile a) different interests between nations which need an efficient economic and developmental policy, and b) that of big companies having its own profit making motive and demanding state- less economic space? Is an EU as space of regions instead of a space of sovereign states feasible in near future? What is EU going to look like in near future if it is not feasible as state-less entity? Shall we witness another Balkan syndrome developing itself within EU? Could we resort for a wise advice either to economic history or to extant economic science? We are not sure we can. Simply speaking we have to be creative. New time begs for new solution.

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