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Post-Keynesian macroeconomic policy regime formation: What lessons can be learnt from the EU experience by the EAEU?

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1. Introduction

The Great Recession has exposed the shortcomings of EU institutional deficiency and confined variety of anti-crisis measures. Together with irresolute policies to avert stagnation, it has led to the biggest crisis of European integration so far. At the same time, the EAEU tries to develop its own regional integration learning from the example of the EU. This paper studies what macroeconomic policy arrangements with regard to Post-Keynesianism for a future EAEU should be made to ensure the problems of the EU are not replicated. Moreover, the EAEU countries have had varying problems with unemployment, income inequality and after-crisis growth which could be either exacerbated or cured by further economic transformation to a complete economic union.

Though often dubbed as purely geopolitical, the EAEU project has nevertheless followed the similar logic of development as its European counterpart. The focus of the 'Eurasian' integration has been specified as economic and trade-oriented and overall the stages of the integration were mostly similar to those the EU underwent. The project was in fact first proposed by the President of Kazakhstan N. Nazarbaev in 1994 and still in counterweight to Russia's political ambitions four states (Armenia, Belarus, Kazakhstan, Kyrgyzstan) are interested in keeping the integration in economic dimension only. This also makes the case for studying the Eurasian integration with no regard onto its political controversy.

It is clear that there are big macroeconomic differences between the EU and the EAEU, making them difficult to compare even taking the early stages of the EU development. That is why the study concentrates on the comparison of the designs of the two unions rather than their economic dynamics and performance. Generally, the study seeks to answer the question: "What should improve EAEU MPR formation, so that EU MPR deficiencies are not replicated?"

Methodologically, this paper is developed on the synthesis of two general scientific methods, inductive and systemic, scaling down from such a broader notion as post-Keynesian macroeconomic policy regime (PK MPR) to consider its application to the case of the EAEU. The comparative method and qualitative institutional analysis also facilitate the assessment of EAEU MPR institutional set-up and available macroeconomic policy tools on the background of EU MPR and PK MPR model. The historical method informs the study of the EU MPR.

Apart from the novel systemic analysis of the macroeconomic policies that are shaped by the EAEU integration, this paper tries to offer an adjustment of a MPR concept to the supranational level of an economic union. Methodologically, we also tried not to employ the mainstream/post-Keynesian dichotomy, very much present in the academic discourse on the EU macroeconomic policy-making, referring rather to the early post-Keynesian authors.

The post-Keynesian core of the paper is generally informed by the classical studies of Keynes (1936), Kalecki (1937, 1971), Minsky (1986), Polanyi (1944), however, more insights on the question of economic growth, income distribution, money theory are drawn from Hein (2012, 2014), Lavoie (2014), Wray (2012). Certainly, field-defining studies of Herr/Kazandziska (2011) and Kazandziska (2013) on the PK MPR serves as the basis for Chapter 1. To scale PK MPR model up to supranational level, Thirlwall (1979) and Hein/Detzer (2015) introduce the balance-

of-payments-constrained growth rate approach, while Lerner (1944) and Hein/Truger (2005, 2013) showcase the application of growth and full employment-securing monetary-fiscal policy mix. A comprehensive look into the European integration history is provided by Eichengreen (1998), Gillingham (2003), McCann (2010), and Tsoukalis (1993). The comparison of the Cecchini report (1992), Heine *et al.* (1991) and Dow (2016) have helped to elicit the ontological and epistemological non-fitments of the EU MPR and the PK MPR. Due to the lack of economic studies on the EAEU and virtual absence of post-Keynesian academic discourse, neoclassical and political economic analysis of Kirkham (2016), Libman/Vinokurov (2012), Tarr (2016) were employed in the discussions over the early development of the EAEU, although mostly official documents of Eurasian Commission and the EAEU Treaty were consulted to confront the EAEU MPR with the PK MPR model as well as data on macroeconomic indicators.

The paper consists of four main parts following the introduction. The first part outlines the main features of Post-Keynesian inspired macroeconomic policy regime theory. The second part critically discusses the institutional evolution of the EU prior to the EMU creation and alternatives to neoliberal agenda of that time as well as the macroeconomic policy mix, the set-up of Eurozone and inefficiency of the EU MPR. The third part introduces the EAEU identifying three main differences between the integration projects in its planned and existing features to those of the EU. In the fourth part, the EAEU MPR is formalized on the background of a post-Keynesian alternative to macroeconomic policy and with the reference to the EU MPR features to prevent the reemergence of issues of EU integration in the EAEU. The following parts on the main findings and concluding remarks outline the results of the study and conclude.

2. Macroeconomic policy regime for economic integration

2.1 General characteristics of a macroeconomic policy regime

Macroeconomic Policy Regime (MPR) is a concept to systematically analyse the coherence and functionality of economic development. Heine et al. (2006) have first brought to light "economic regime" as an analytical tool to encompass "the interaction of the particularly important macroeconomic areas: monetary policy, fiscal policy and the wage development", taking into account the external sector embeddedness of an economy. Basing on that, Herr/Kazandziska (2011) have come up with a definition of a MPR introducing the financial system as a part of a regime. According to them, "MPR (is) the interaction between monetary policy, fiscal policy, wage policy and foreign economic policy within a framework of both, macroeconomic institutions which can be actively changed by policy-makers and become part of economic policy, and institutions which are beyond the control of policy-makers...(The) financial system is an important part of a macroeconomic policy regime." We also find reasonable to add industrial policy to the set of key macroeconomic policies as it has been first done in the analysis of an emerging economy of Latvia by Kazandziska (2013). Thus, we argue that a MPR forms through the interplay of monetary, fiscal, wage, foreign economic and industrial policies that are structured by the financial system and ever-changing design of macroeconomic institutions.

Institutions are therefore not a strict structure; they remain in flux. Institutional changes sometimes occur with no interference from policy-makers, although policy-makers are still to

substantially shape for the specific goals of economic development. To underline this, Herr/Kazandziska (2011) distinguish between the "process policies" and policies that change institutions. The latter are brought about to explicitly change the behaviour of (macroeconomic) agents and direct and frame macroeconomic process policies. For instance, the decision to remove controls on international capital flows may aim at spurring outgoing private investment, or the independence from government interventions enables a central bank to concentrate exclusively on price stability. To a considerable extent, these are politically-motivated decisions which vary on ideological stance and beliefs. In turn, they shape the field of action for the traditional macroeconomic process policies that aim at managing such variables as GDP growth, exchange rate, unemployment rate, etc.

Process policies are conducted on the background of a financial system, the design of which may be also altered to achieve certain economic goals. Of particular importance here is monetary policy which indirectly influences inflation and directly GDP growth by manipulations with refinancing rate. Fiscal policy is equally significant. Discretionary fiscal policy can, for example, aim at increasing economic activity during a downturn. Exchange rate and/or wage policy can be used to promote exports by devaluation and/or wage moderation. Industrial policy also supports industries and firms in the manufacturing sector which are able to increase the economic welfare.

In the tradition of MPR literature, MPR is further considered functional if it delivers employment, a more equitable income distribution and sustainable economic growth. These threefold outcome of the regime is very much based on post-Keynesian economics which will further inform the adoption of the MPR concept to economic integration.

The protracted unemployment in the Western industrial economies for several decades leaves much to be desired from the supply-side view of economics. The principle of effective demand has been introduced by the works of Kalecki (1971) and Keynes (1935) and still guides PK understanding that the level of employment is determined by effective demand in the economy. Independently from prior saving, investment launches growth process, taking use of existing capacities and creating new production capacities on the way (Hein 2014). In its economic core, Post-Keynesianism underscores that reproductability, growth and abundance are the intrinsic economic drivers[1] (Lavoie 2014). As the supply of money is endogenous and demand-led, market cannot alone ensure full employment and this becomes a task for macroeconomic policy. Be it interest rate manipulation, or specific sector subsidies, or tax exemptions - government together with central bank shall take over the responsibility to induce job creation.

Following classical authors, post-Keynesians pay particular attention to the distributional effects of growth and point out that more equitable income distribution characterises a 'healthier' capitalist production system. The role attached to government policies together with inflation management by the CB is paramount in ensuring the wage level. Higher real wages are also propitious to higher levels of employment. Post-Keynesian authors argue that an economy is demand-led not only in the short, but also in the long run. Not only output, but also prices, industry structures, demand patterns, etc. are significantly determined by the income and wealth distributions. According to Norman (2008), they are subject to "the interaction of social

[1] As opposed to neoclassical foundations: exchange, allocation and scarcity.

struggles, inheritance and endowments, regulations and differential opportunities available to different sectors of society".

Thus, aggregate demand determines the level of output, but depends on income distribution. The increase in an element of aggregate demand, be it consumption, investment or export, is able to boost growth. Usage of productive capacities created by investment should be supported by growing consumption demand. The mismatch between them closes down with more equal income distribution.[2] As for export demand, it is vital to understand that for a country in an economic union it is unfeasible to run a persistent current account surplus. In Section 2.3.1, we will further explore how the improvements in exports performance could help boost GDP growth and equalise economic disparities between the member states.

Substantial contributions have been made both for industrialised and developing nation-states, though the focus has always rested on a single nation economy (Herr/Kazandziska 2011, Kazandziska 2013). In this paper we will apply the concept of MPR to an economic union rather than to a single economy. The adjustment of the concept is presented in what follows.

We will first analyse the core features of a MPR that constitute the basic government macroeconomic policies, namely monetary policy, fiscal and wage policy and financial system. It is worth mentioning that the unification of the policies is a long-term process and governments do not easily surrender them to supranational authorities at early integration stages. If the policies and institutions are not unified, we can only argue about the similar patterns of policy-making in the countries what will constitute their MPR. Upgrading MPR to a supranational level also requires dealing with open economy issues, divergence prevention, and convergence promotion. Industrial policy with regional focus and foreign economic policy thus play significant role in ensuring that trade and industrial development do not create imbalances. Industrial policy is also important, specifically in the context of under-industrialised countries or transition economies, since it promotes the catching-up with the rest of the world as well as within a union. Supranational redistributional institutions, such as structural funds or common budget, are of help to target lagging-behind regions.

Talking about an economic union, the mainstream authors concentrate their attention on promoting convergence, while Post-Keynesians underline that growth and convergence of member states' prosperity rather depend on appropriate macroeconomic policy institutions than on convergence criteria (Hein/Truger 2005). Convergence will occur, if the necessary institutions that provide the sustainability of growth are in place. Therefore, in a post-Keynesian MPR divergence prevention, i.e. supporting balanced current account, is of more value. There have been a number of propositions on how to hinder divergences, applied especially to the case of the EMU, such as Keynes' notion of generalized banking principle which underpinned his Clearing Union proposal (Pérez-Caldentey/Vernengo 2012) or balance-of payments-constrained growth rate (BPCGR) approach introduced by A. Thirlwall (1979). Since the former requires the establishment of a reserve fund that would accumulate the surpluses of members' current

[2] Practically speaking, however, the increase in wage share can have contradictory effects on different components of aggregate demand, because aggregate demand can be not only wage- but also profit-led (Stockhammer/Onaran 2013).

accounts, the latter is a more suitable approach, implementable without additional supranational institutions what bears political costs. We will now turn to those macroeconomic policies and institutions that provide the basis for a MPR.

2.2 Basic macroeconomic policies and institutions

2.2.1 Financial system

As put forward by Minsky (1986), the capitalist financial systems exist in inherent instability. In the course of asset price inflation, economic agents and sectors can become over-indebted and insolvent taking advantage of cheap credit availability. This usually results in abrupt crises characterised by asset price deflations and credit squeezes. Speculation and fraud may also be the final cause of financial activities. To provide the ground for sustainable productive investment, regulations both of national and supranational financial systems should be put in place.

Commercial banks take up a special place in post-Keynesian economics. They are regarded as the institutions which create money and credit flows. Banks are also public wealth storage. The stability of them determines the state of the whole economy and, thus, is a public good. Insurance companies and pension funds have to be regulated as well for similar reasons.

To keep speculation at bay, highly speculative institutions such as hedge funds, investment banks, venture funds or private equity funds should be fenced off from commercial bank sector and financed rather from the deposits attracted from the public (Herr/Kazandziska 2011). Future markets can be also re-organised preserving its basic functions of hedging the individual risk, but standardising and organising exchanges. A tax on all transactions in asset markets in the spirit of Tobin tax is also very much discussed already on the international level.

Central bank is the institution that lends to commercial banks and ensures they keep compulsory reserves at the accounts in central bank. By manipulating with capital adequacy requirements/asset-based reserve requirements or interest rates on its advances to banks, it can control the functionality of banking system (not money supply, however). For instance, a number of post-Keynesian authors advocate the need to narrow the links between real estate markets and the rest of financial system (Palley 2004), provided central bank is able to increase equity holding and/or reserve requirements for too active real estate creditors.

2.2.2 Monetary and Fiscal policies

2.2.2.1 Institutional basis

The prerequisite of a well-functioning capitalist economy is the inter-institutional cooperation between the central bank and government's fiscal authority, or Treasury. To cover government expenditure, Treasury directly loans from central bank or sells government bonds and bills to central bank. Proponents of Modern Money theory, a strait of post-Keynesian economics, go on to say that in fact this operation has no effect on the real economy as long as Treasury doesn't use its deposits or central bank spends the proceeds of the sale. These are largely internal activities and, hence, government financial activities and central bank's operations can be consolidated (Wray, 2012). In an economy with a sovereign currency (where state controls

currency issue), the conventional belief that taxes finance spending is thus doubted. Government originally used taxes to establish its authority, accepting tax payments only in specified means of account, hence, currency. Now, tax management is rather a tool to maintain the aggregate demand in different sectors on a desirable level. Fiscal policy institutionally thus serves the purpose of supporting higher aggregate demand (with the objective of full employment), stabilising real economy and equalizing income distribution. Given the stable inflation level of unemployment and balanced current account, fiscal policy should be used to overcome the excess of saving over investment. To maintain the necessary level of consumption and to equalize income distribution pattern, it is necessary to establish a progressive taxation scheme. This evolves into the setting-up of a comprehensive welfare system of unemployment benefit scheme, social aid, public health care system, etc. Automatic stabilizers can also partially absorb the abrupt demand shocks (Hein *et al.* 2012).

Monetary and fiscal policies should not be separated and given to the authorities completely independent from each other: both policies have an impact on output, and their flux is of even more importance during an economic downturn. At the end of the day, it is not really important by which policies exactly the economic growth objectives are achieved.

There are distinguished functions of central bank which institutionally position it at the central place in an economy. Central bank agrees to supply the reserves to the banks which they demand in case of high economic activity. Reserves against the opened deposits are required by the central bank itself, though they can only be in the end borrowed from central bank which supplies them by purchasing government securities in the open market. Since the central bank should "accommodate" all the demand, or face a liquidity crisis, this function is known as accommodative (Fullwiller 2008). When the demand cannot be accommodated, central bank therefore changes its interest rate target. The mechanism at work implies money is understood as endogenous. The other function comes from the central bank's day-to-day operations of neutralizing the in- and outflows from of the banking clearing and settlement system. This function is known as defensive, since the central bank maintains (by open market operations, transfer of government deposits, repos and reverse repos) the amount of outstanding reserves of banks and a short-term interest rate, hence, overnight interest rate (ibid.).

The close interaction of central bank with Treasury and financial system implies its role as a 'lender of last resort' in the period of economic downturn and probable insolvency of economic agents, specifically banks and Treasury. As Davidson (2007) argues for instance, the lender of last resort should be willing to bail out almost all the creditors in the financial system. To escape from these obligations, central bank should be also empowered to control credit allocation, imposing for example higher equity or reserve requirements on the institutions that fuel speculation.

2.2.2.2 Monetary and fiscal policy mix

Monetary policy obtains a handy instrument that is particularly effective in macroeconomic management, regarding how responsive the economy is to it, i.e. interest rate policy. The operating target of central bank is the interest-rate target. Post-Keynesian authors diverge on the

question how to manage interest rate level. Rochon and Setterfield (2007) single out two broad options: 'activist' approach implies that central bank actively pursues to converge actual inflation rate and the inflation target while proponents of 'parking-it' approach argue for a rather stable low level of interest rates, since short-term interest rate variations can negatively feed back on the long-term income distribution pattern what in turn corrupt inflation (Hein/Stockhammer 2011). The former sees the anti-cyclical role for monetary policy, but the latter transfers it to fiscal policy without a side-effect on income distribution, so it suits the purpose of this paper better.

In an economic union of different currencies it is important to set a rule for all the central banks to follow. There have been many rules proposed for the parking-it, or income-distributional, approach. While the MMT view that given the interinstitutional cooperation the overnight interest rate ought to be zero suffers from a number of consequences,[3] it is better to opt for positive interest rates. Hein's proposal (2012: 138) to set the real interest target 'slightly positively but below the long-run of productivity growth' represents a middle way between Smithin's view (1996) of stabilizing after-tax real interest rates at 1-2% and Pasinetti's fair interest rates (1981: 174) as the sum of labour productivity growth and price inflation rate. Regarding income distribution, this prevents the "euthanasia of rentiers", or rentiers' wealth devaluation, the redistribution from the rentiers to the productive sectors will occur supporting real investment, employment and growth (Hein/Truger 2013).

Fiscal policy can be effectively used to provide real stabilisation and a more equitable income distribution. To stabilise demand in the short term, government should utilise anti-cyclical fiscal policy, accepting endogenous automatic stabilisers and adopting discretionary policy in a recession. Higher unemployment benefits and cuts of income, sales and corporate revenue taxes and other forms of budget revenue that automatically work in a downturn should be legislatively adopted in advance. Active fiscal policy, i.e discretionary fiscal expenditures, should use public investment as an instrument with the biggest aggregate demand multiplier effects (Herr/Kazandziska 2011).

Increasing transfers and cutting taxes should nevertheless follow progressive pattern. Keynes (1936) advocated that the rich have lower propensity to consume and higher propensity to save, especially in a recession, while the transfers or tax cuts in favour of the poorer will necessarily boost consumption, and, thus, aggregate demand. A more equitable income distribution can be achíeved by sensible progressive tax management.

Furthermore, in post-Keynesian macroeconomics it has a significant role of inducing higher economic activity level, i.e. aspiring to full employment. The rejection of Say's Law by Post-Keynesians leads to an understanding that private saving and private investment have to be equalised not only by market forces. Following a basic accounting identity, excess of private saving over private investment has to be covered by the excess of exports over imports and/or by the excess of government spending over tax revenues. With the roughly balanced current accounts within an economic union, to assure a high level of employment is to let the

[3] For a survey look at Lavoie (2014: 236).

government deficits absorb the excess of private saving over private investment. This corresponds to the functional finance view of Lerner (1943) and MMT supporters.

Functional finance is however criticised on the grounds that it provokes skyrocketing public debt-to-GDP ratio, important to credit rating, income redistribution in favour of rentiers by means of higher interest rates on government bonds and lower tax rates and current account deficits (for a single country or a union) with the rest of the world (Lavoie 2013, Lavoie 2014: 346). Regarding the first remark, Domar (1944) proved that with budget deficit-to-GDP ratio and long-run GDP growth rate being constant, public debt-to-GDP does not accelerate but rather stabilises on a definite value. Secondly, the cooperation between the central bank and the government play the role. Keeping interest rates low (below the tax revenue growth), central bank should intervene the government bond market to ensure interest rates on public debt continue to be low, thus preventing income redistribution to rentiers (Hein/Truger 2013). Progressive taxation rather than universal tax cuts shall also ensure that smaller proportion of the full-employment output acquired by the rentiers. Thirdly, as we will show in the next section discussing convergence, pursuing the BPCGR approach limits the chance for current account to get disbalanced. Industrial development of export-oriented high-value goods production and foreign economic policy to improve terms of trade with the rest of the world should also be of help to keep current account roughly balanced, as described in the following section. As Hein/Truger (2007, 2013) argue, in an economic union fiscal policies should be coordinated by means of the long-run expenditure paths for non-cyclical government spending that aim at stabilising aggregate demand at a full employment levels. To tune with functional finance, the long-term expenditure paths should be on average over the cycle roughly equalizing the size of government deficit to the difference between (superior) private saving and private investment (with the average net tax rate including net social transfers given) (Hein/Truger 2013). All in all, it means the current account imbalances will be sustained, albeit with high level of employment and demand.

2.2.3 Labour market and wage/income policy

As Polanyi (1944) argued, labour is not a tradable commodity: norms regulating it override the supply and demand market dynamics. Supporting this view, Prasch (2004) emphasizes that there is no true labour market, since labour cannot be stored and detached from its provider. Therefore, institutions ensure that there is a positive wage development which support growth and more equitable income distribution.

Representation of labour force and employers in the wage bargaining process is vital for its stability. Dense and well-functioning trade unions which interact with employers' organisations make the maintenance of two main labour market functions possible: functional development of nominal wage level and control over wage dispersion.

The first is achieved with respect to a steady development of nominal unit labour costs. They are also the most important indicator to determine the target inflation rate of central bank. The stability of nominal wage anchor defines the necessary field of action of central bank.[4] The

[4] An inflation target hereby means not that a central bank specifically targets an inflation rate, but rather that there is a desirable inflation level that should be sustained (by a policy mix).

bargaining system can help hampering ‘inflationary wage-price spirals’ and deflation, which is even more difficult for central bankers to tackle, as the nominal interest rate cannot go below zero. However, monetary policy has only indirect effects on inflation rates and fighting inflation with comes at sufficient costs to economic activity what will be presented in the next section.

Inflation rather depends on claims of the participants of wage bargaining process: workers claims should be consistent with those of firms, rentiers, government and external sector. Provided the other claims are coordinated, nominal wages, or a wage norm, should move along the long-term growth of labour productivity plus the desirable inflation rate. Smaller wage dispersions are as well more often detected in a labour market system with broad bargaining processes. The scarce coverage and density of unions may result in significant dispersal between the workers protected and unprotected by unions. Decentralisation of bargaining and deregulated labour markets are nevertheless not an uncommon pattern. Statutory minimum wages are thus an important institution to equalize income distribution and support high level of consumption demand financed with income and not credit.

During low unemployment, strong federal union organisations control competition between trade unions that may continue to advocate wage increases. Accordingly, strong employers’ associations should hold off the competition between firms which may like to raise pay above collectively negotiated one. These measures build up on the course of establishing a comprehensive welfare system.

Since inflation is understood by Post-Keynesians as a result of unresolved distributional conflict, the main role in achieving price stability is thus to be given to wage/income policy (Blecker 2011 among others). Price stability is especially important in the conditions of an economic union to prevent ‘beggar-thy-neighbour’ scenarios by minimizing price competition. Moreover, it freezes changes in distribution shares, given firms’ mark-up remains constant. Wage flexibility leads either to deflation if nominal wages increases are kept below productivity growth, or inflation if they surpass productivity development. Therefore, nominal unit labour costs level is assumed to better move steadily in accordance with the desirable (or assumed) inflation rate what is consistent with the wage norm. Steady minimum wage development in line with wage norm is also required, especially in deregulated labour markets.

As Kazandziska (2013) mentions, within fixed exchange rate systems changes in prices and unit labour costs automatically affect competitiveness (via real exchange rate deviation) and, therefore, current account position. Hence, constant wage development will then provide a wage anchor for the real exchange rate.

2.3 Divergence prevention in an economic union

2.3.1 Foreign economic policy

In this model, foreign economic policy together with industrial policy and creation of institutions supportive of catching-up process are given the task to make sure the development of the member states is more convergent than divergent. We will specifically apply BPCGR approach developed by Thirlwall (1979) for the single economy and Hein/Detzer (2015) for a currency area.

Foreign economic policy should be specifically used to improve terms of trade with the rest of the world. In general, for a country with a sovereign currency it is possible to use foreign economic policy to cut current account deficit by four ways: real devaluation, increasing exports, decreasing imports and/or follow unit labour cost development below the one of the trade partners. Real devaluation is implausible in an economic union, since, as proved by Blecker (2011), higher exchange rate accelerate faster wage and price inflation, what negatively affects the wage share (thus, income distribution), fuels price competition and disbalances the current accounts of other member states (Kazandziska 2013). Decreasing imports and dampening trade within the union members also don't correspond to the ideals of economic integration. Keeping nominal wage development under productivity level is conditioned by the wage negotiation between the sectors. Changing export structure by the promotion of high value-added production is therefore the most adequate strategy in the long run.

This argument coincides with the already mentioned view derived from the Thirlwall's Law (Thirlwall 1979): growth rate is constrained by the balance of payments. The persistent deficit of the balance of payments (balance of current account and long-term capital flows) has to be financed by the short-term foreign capital injections what raises external debt-to-GDP ratio (and concerns of international financial observers). Such a policy will increasingly pressure the national currency downwards and trigger a depreciation/inflation spiral (McCombie 2002). An economy should grow according to its balance-of-payments constrained growth rate (BPCGR), adjusting the growth rate (by means of expansionary fiscal policy) or the BPCGR. The BPCGR is determined by foreign GDP growth, inflation differentials and the income elasticities of the demand for exports and imports which represent non-price competitiveness (provided that the sum of the price elasticities of demand for imports and exports is greater than unity, i.e. 'Marshall-Lerner' condition holds). Already on this level it excludes mercantilist 'beggar-thy-neighbour' policies, since the growth rate of a member state of an economic union depends not only on its competitiveness but also on the well-being of the other members. With given foreign GDP growth and foreign inflation, the BPCGR can be improved by lower domestic inflation or by non-price competitiveness. However, recourse to the instrument of inflation or devaluation within economic union is only justifiable during an economic distress. Although improving BPCGR, it does not bring any value to the real economy. Therefore, increasing income elasticity of demand for exports and decreasing income elasticity of demand for imports will raise the BPCGR. It is worth noting that an improvement of BPCGR in a single country damages other members' BPCGR if current account of the union is taken as balanced with the rest of the world.

If an economy is growing faster (slower) than its balance-of-payments constrained growth rate - BPCGR, then it is growing beyond (under) its production capacity and will inflate (deflate). Application of the BPCGR approach has two important implications. First, in a single economy, it precludes the growth strategy that should not only intensify exports but also equalize them by imports growth in the balance of payments, so that there is no mercantilist build-up of current account surplus. Second, on an economic union level, BPCGR approach provides an insight on the nature of imbalances between the members. The imbalances are either actual growth rate differentials, or BPCGR differentials. All the member states should thus adjust their actual growth rates to the respective BPCGR or vice versa. To conclude, current account deficit countries (usually building up deficits because of catching-up process[5]) should aim at improvement of their BPCGR (by means of improving quality competitiveness) up to the higher actual growth rate, while current account surplus countries (typically industrialised countries able to expand

[5] It should be noted that the higher actual growth rates can also be the result of high financial investments in the asset and/or housing market and debt-accumulating consumption boom, what is however should be prevented by the institutional set-up outlined in Part 2.

exports) should stimulate the demand for imports (especially from within the union) and overall aggregate demand (Hein/Detzer 2015) to move the actual growth rate to the BPGPR.

The other task of the foreign economic policy is capital flow management. Imported intermediate goods and capital utilized for further production can be only partly translated into exports. In case import inflows are used for domestic consumption and speculation, it draws heavily on current account without adding much to future development. The most desirable form of capital inflows is then FDI because it doesn't create direct external liability. Intersectoral financial inflows and non-financial corporate investment into innovative technologies are beneficial for economic growth (Herr/Priewe 2005). Central bank interventions into foreign exchange market provide for equalizing of currency mismatch on the accounts of economic agents to ensure financial stability and stabilize exchange rate to limit the effect on interest rate setting. This is especially important in fixed exchange rate regimes, when the country adopts a foreign currency to eliminate the risk of exchange rate collapse. However, this offsets by adding on a default risk while markets may be worried that a country could not maintain the peg. To hold the peg, a country thus needs sufficient dollar/euro reserves (Wray 2012: 147).

2.3.2 Industrial and regional policies

2.3.2.1 Industrial policy

As Kazandziska (2013) highlights, industrial policy receives the objective to improve the terms of trade and non-price competitiveness. In current account deficit countries it is necessary to decrease income elasticities of demand for imports and increase income elasticities of demand for exports. Typically, current account deficit countries are those that undergo catching-up process, since they need to import intermediate goods and innovative technologies. Therefore, facilitation of investment to build up innovative capacity in these countries becomes the other objective. This also applies to the transitional economies that already had considerable industrial capacity in certain sectors, although they need to increase its productivity with newer technologies.

It is worth noting that for the members of an economic union and of the WTO, it would be difficult to implement such policies as infant industries protectionism or import-substitution industrialisation that have been extensively used in the past, but contradict the pinnacle of economic integration - free trade. On the contrary, a more sensible solution is the public spending on R&D channelled to high value-added industries that supports the catching-up process and together with public spending on infrastructure attracts further private investment. For Hausmann/Rodrik (2002) public sector credits and guarantees should complement it. Government development banks have then an important role in supporting infant industries while they generally don't contradict single market principles (UN, 2005). Targeting specific sectors with subsidies, tax exemptions, conditional provision of foreign currency, and simplification of regulation for market entry/exit of businesses and for capacity expansion thus seems to be a reasonable strategy in addition to the public investment in infrastructure and R&D.

2.3.2.2 Regional policy

To ensure member countries are not diverging, some measures should be taken on the supranational level as well. While the adjustment of the actual growth path to the BPCGR of a current account surplus country is at best implemented by corresponding national fiscal policy, current account deficit countries can be the focus of a broader industrial restructuring policy to move their BPCGR up to the actual growth rate. Furthermore, the problems associated with climate change, intraregional infrastructure, creation (or rejuvenation) of cross-border industrial

complexes are more efficiently resolved with pooled funding rather than separate national policies.

Strong regional orientation, as advised by Botta (2014), should accompany the union's industrial restructuring policy, since the focus of economic development of different regions is very specific. Region-based approach will help to concentrate the efforts to increase productivity, connect the production complexes between each other and overcome structural asymmetries.

On the finance side, mutual financing instrument such as supranational (re-)structuring development funds will help to equalize periphery and core economies. This doesn't necessarily involve the creation of a common Union's budget and decreases the political costs of redistribution. To add, Hein/Detzer (2015) reiterate that long-term financing, namely FDI and long-term loans, concentrated on sustainable development projects, catching-up and building-up of innovation and knowledge economy is more appreciated as compared to short-term financial investments. Growth of export capacities should in turn be accompanied by the in-step growth of imports, as demonstrated in the BPCGR approach.

3. Designing Macroeconomic Policy Regime of the EU

3.1. The European liberal ambition

Already the Treaty of Rome (1957) that established the European Economic Community clearly postulated the liberal ambitions of the European integration project. Article 2 introduced 'a common market and progressively approximating economic policies of the member states' as an instrument to achieve 'harmonious development …, increase in stability, accelerating raising standard of living and closer relations [between the Member States - I.B.]'. The creation of a common market signalled the establishment of a common external trade policy and common external tariffs as well as the abolition of internal trade restrictions and 'obstacles to the free movement of goods, persons, services and capital' (Article 3). Free competition was given a leading role - more than a half the treaty's policy design provisions were dedicated to four freedoms or rules to eradicate distortions to competition (Gillingham, 2003).

During the 1960s, both the establishment of a customs union and elimination of internal tariffs and quotas were a success story. Trade creation within the union developed substantially faster than with the rest of world (McCann 2010). However, in practice, non-tariff barriers such as non-acceptance of foreign worker's qualifications, monopolising practices of national firms (for example in mergers), packaging differences, etc. remained present. Capital controls were not eradicated, while the national control over monetary and fiscal domains was rather kept to target full employment in the Keynesian tradition (Tsoulakis 1993). Welfare state remained a steadfast pillar of the national macroeconomic policy making, while the common market was understood to generate additional economic resources and in no way regulatory competition was to be allowed to weaken social standards (Ferrara 2005: 93). The liberal ambitions of the Treaty of Rome were thus limited by the Keynesian domestic macroeconomic policy mix, and by the end of 1970s were 'overwhelmed by the national protectionist impulses and the harsher climate of international economic competition' (McCann 2010: 26).

Already in 1970, the Werner Report of the Council of Ministers spelled out the vector of further integration. In three stages over ten years, the EEC should have become a monetary union. In this sense, the project was very different. The first stage prescribed the extensive symmetrical coordination of economic policies together with the cooperation in monetary affairs. The second stage presumed the 'irrevocable setting of parity rates' or basically a single currency, and the third one finalised the economic and monetary union by the transfer of the economic and some political authority from the national to the supranational level (European Parliament), together with the establishment of the Community system of central banks. As a temporary measure, the exchange rates were agreed to be set against the dollar and in 1972 limited by +/-2.25% of fluctuation (Italy negotiated +/-6%), what became known as "the Snake in the tunnel" system. Although the plan bogged down on the first stage (due to the collapse of the Bretton-Woods system and political resistance), the debates between 'monetarists' and 'economists' in the Werner group which worked on the plan considerably framed future European integration. As Gillingham (2003: 271) tells, all resemblance of the Werner plan to the final EMU design is however superficial. The monetary unification was in fact aimed at monetary confederation (rather than a currency union), that would rest on fiscal federalism (with the size of the EU budget considerably and policy coordination increased). The removal of capital controls would be the end rather than the means of integration - what was effectively the view of the 'economists'. As Dow (2016) shows, the European Monetary System (EMS) and the European Monetary Union (EMU) preferred the view of the 'monetarists' which argued that economic convergence would be brought about by the introduction of the single currency, with increased labour mobility and competition within Europe. The view of the 'economists' in favour of the setup of the single monetary system only after achieving real convergence featured on the plan but didn't make a considerable impact after the collapse of the Werner plan.

After a turbulent decade for the European economies and short life of the the Snake, in 1978 the EEC countries came back to the idea of a temporary fixed exchange rate regime on the road to the single currency. The EMS, or European Monetary System, was largely similar to the Snake. The currencies of the member states didn't get a particular anchor, although soon were pegged against Deutsche Mark as the strongest currency in +/- 2.25% corridor (wider band being +/- 6%). Bundesbank followed a sound money, low-inflation policy and in order to keep its exchange rate afloat and stay in the system, other central banks needed to run on their currency reserves (provided Bundesbank was willing to sell DMs), use capital controls or match by similar macroeconomic policies. Basically, the EEC countries had already found it unbearable, after the Snake converged to the DM rate in the first post-Bretton Woods years. Yet due to complex political circumstances and an ideological change, in the 1980s national macroeconomic policy priorities changed - EEC countries (except Great Britain) started to compromise their Keynesian policies (McNamara 1998: 128). The adoption of German anti-inflation regime came at cost of importing deflation and losing growth. However, the exchange rates variability desirably contracted.

In fact, since then the single currency became not only the primary objective of the integration but also the ultimate instrument of eliminating final trade barriers to allow for market mechanisms to equilibrate European markets and economies of scale to develop. A single

currency would also make visible which countries use price differences to gain competitiveness and thus puts them under the pressure to adjust. The European project became twofold: single currency was envisaged as the second major building block to compliment a single market objective.

Having discovered the momentum in supranational macroeconomic policy making, member countries reinvigorated the quest to the core objective of the Treaty of Rome - a genuinely common European market. There were of course other important influences. The ongoing legal consolidation that brought the supremacy of European over national law, the *Cassis de Dijon* case resolved by the European Court of Justice in 1979 that established the 'principle of mutual recognition' of other members' regulatory standards, a political push for integration exemplified by the decision to abandon the unanimity vote in favour of qualified majority voting (QMV) - all of these developments accompanied a growing need for the single market to be finalised (McCann 2010: 31).

The quest set out with the Cockwell's Commission 1985 White Paper "Completing the Internal Market" and solidified with the Single European Act the same year. The White Paper outlined three main remaining obstacles that constituted non-tariff barriers. FIrst, physical barriers, meaning mostly administrative border controls, were still of concern. Second, the market was still fragmented by the technical barriers, i.e. differing technical standards for goods, working permits. Third, the fiscal distortions originating from the different patterns and rates of indirect taxation complicated the investment decision-making and hampered trade.

The Commission sought to remove these obstacles by two ways. The first strategy was to narrow the need for regulatory harmonisation. It had already embarked on the principle of mutual recognition and promoted this further to cover as many items as possible. QMV in the Council of Ministers also helped significantly to bypass remaining disputes.

The second strategy envisaged the enhancement of Commission's own policy-making and supervision. It sought to cut off the roots of these obstacles, i.e. the government-imposed barriers and tax restrictions. Government subsidies, national procurement policies, regulations covering corporate takeovers became subject to supervision by the Commission. Within a decade following the White Paper, "Commission's capacity to police Europe's integrated market was transformed from minimal to formidable" (McCann 2010). Conversely, the capacity of the member states to bypass EC policy requirements and utilize the whole variety of national policies diminished.

The Cecchini Report "The Benefits of a Single Market" (1988) reinforced the view that these are the necessary conditions. The Cecchini group argued the completion of the internal market would bring EU GDP growth of average 4.5%, create 1.3-2.3 million new job places. The prices would be cut by 4.5%-7.7%, but it was explicit: the effective competition policy and a single currency would be needed to assist. Both of them were designed to guard the efficiency of the equilibrating mechanisms in the four markets of goods, services, labour, and capital. Dow (2016: 3) presents a clear example: the preparatory work in the run-up to the creation of the EU is solely based on the application of general equilibrium macroeconomic models.

Thus, the deregulation of markets should have finally been completed by the monetary unification and safeguarded by the supranational institutions' competition policy. Regarding the former, the Cecchini Report triggered the process of finalising the institutional set-up, and the famous Delors Report followed to foretell how European Communities would transform into the European Union by 1992 and the Economic and Monetary Union by 1999. The first step set the deadline to complete the internal market (elimination of final restrictions for the financial integration) by 1994. In the meantime the new fundamental treaty was being developed - signed in Maastricht in 1992 - that precluded the second and third steps of monetary integration, namely the convergence criteria, creation of necessary monetary institutions and transition to euro.

In terms of MPR design, the Maastricht Treaty essentially consolidated what Europe had been preparing for since the Werner Report - complete monetary integration. Monetary domain was placed at the centre of macroeconomic policy-making and all other policies were assumed secondary, since market would have equilibrated existing imbalances and possible future asymmetric shocks. While the foundations of fiscal and monetary policies were sufficiently altered by the Treaty, certain features of the MPR had thus formed before the Treaty on the European Union. We will now proceed to the investigation of each policy component of the EU MPR before the introduction of the single currency.

3.2 The MPR of the EU: before the single currency

3.2.1 Foreign exchange policy

One of the basic theoretical starting points for the European integration is Optimal Currency Area theory developed by Mundell (1961). The theory explains that production factor mobility in an OCA will make sure the effect of asymmetric shocks is extinguished. An OCA is thus an economic area where factors, especially labour and capital as emphasized by McKinnon (1963), are mobile enough to absorb the shocks, so that there is no need to resort to exchange rate adjustments. By establishing a single currency zone, transaction and information costs as well as the risks of exchange rates fluctuations are cut. Allowing for free factor movement makes it possible to get rid of the necessity for government interventions.

Such an approach based on the general equilibrium model heavily resides then on monetary flows (Dow 2016: 5). Monetary policy tools of more importance than any other policy in tackling possible imbalances. If a current account deficit emerges, it is equilibrated by the outflow of capital that will cut the local factor prices (and vice versa for a country with current account surplus). The banks in this multinational system act only as intermediary institutions that do not give out credits if an economy is booming thanks to BoP deficit and people are unwilling to create deposits. In Post-Keynesian economics, as discussed earlier in Section 2.1, the causation is reversed. Money flows endogenously depend on banks' decisions to provide more loans. In case of a decline in productivity, not only current account but also the capital account of a country is in danger of deficit via perceived uncertainty over investment prospects. In turn, banks ration credits due to lack of confidence and capitals are flowing out of the economy to satisfy the liquidity preference (ibid.: 8). Therefore, in a fixed exchange rate systems economies are forced to adjust their BoP through austerity policies and aiming at budget surpluses whilst the BoP deficit must be financed by borrowing on foreign markets.

This is exactly what happened in the EEC in the 1970s-1980s. The cuts of government expenditures for domestic demand-led countries associated with such a system were hard to bear in a macroeconomic policy regime that formed around the Snake and EMS. If in the first case the exchange rate system collapsed, the second one kept existing only due to the increased political will for liberal integration. The decision to facilitate trade by removing the exchange rate uncertainty remained in the focus of the European integration project since its inception, that is why foreign exchange policy serves as a good starting point of the MPR analysis.

Fixing exchange rates in the post Bretton Woods era without a particular anchor, such as gradual wage development, proved to be cumbersome for all the member states except Germany. As the strongest, most appreciated currency, DM emerged as the anchor for others' exchange rates. The EMS members were determined to keep the fixed exchange rate system functioning, perceiving it as more important that to maintain current account balanced. Running into current account problems, they rather accepted growing borrowing costs via the rise in interest rates and eventually compromised their Keynesian policies. Real devaluation was also an option that many states, unable to cut welfare spending, resorted to. The story behind 1992/3 EMS crisis was the result of several previous devaluations: financial markets awaited that rising German interest rates would not be accommodated by its EMS partners (that needed lower rates to limit unemployment growth) and started speculative attacks on their currencies in anticipation of devaluation. As Blanchard/Sheen (2013: 479) testify, Swedish overnight interest rates increased to 500% (expressed at an annual rate)! Still, the interest rates were not increased enough to prevent capital flight and depletion of foreign currency reserves. In the end, some countries like Great Britain and Italy left the EMS, Spain chose to devalue, while France decided to sustain high interest rates. Even after these arrangements, the problem with high German interest rates remained, and Spain, Sweden and Portugal, for instance, needed to devalue again, and in 1993 the wider exchange rate bands (up to 15%) were accepted and held so till the start of EMU operation. The crisis ended just before the convergence period towards the Maastricht criteria began. One criterion precluded that to become a member a country should maintain the normal ERM fluctuations margins without currency devaluations at least for years before. All in all, to keep the peg, the immediate adjustments could be made only via running onto currency reserves, periodic real exchange rate devaluation and/or dampening aggregate demand by austerity policies what represents a total departure from a Post-Keynesian MPR.

3.2.2 Monetary policy.

The pegging to the DM meant German macroeconomic policy in turn became a significant reference point for the other countries as well. German monetary policy lied in the center of the EMS. Monetary policy of the Bundesbank and German government was specifically focused on reducing the price level by means of money stock targeting (Giavizzi/Mocossi/Miller 1989: 360). The DM enjoyed considerable appreciation due to the consistent demand for German exports, and conversely to maintain the peg other countries needed to maintain the same low inflation policy as Germany did. In theory, inflation and money stock targeting distorts economic activity, while interest rate level is unstable and firms face greater uncertainty. Monetary policy should indeed aim at stable low interest rates to help central bank fulfill its defensive function, but not by hindering higher GDP growth levels. Furthermore, the central role of Bundesbank in the EMS didn't certainly imply its readiness to perform 'lender of last resort' function. To prevent insolvency, the member states then needed to use anti-cyclical fiscal policy or austerity policy.

The convergence criteria of the Maastricht treaty laid the new quantitative basis for further macroeconomic integration. All the members (except for Denmark and United Kingdom that negotiated the opt-outs) are obliged to join the EMU. To eliminate the effect of price competition between the integrating members, the inflation target was set to be not more than 1.5% of the average of 3 EMU members with the lowest inflation rate. The benchmark was though lifted by not considering the countries which maintain the inflation rates significantly below the EMU average. The same benchmark applies to calculation of sufficient long-term interest rates (on 10-year government bonds). To join the EMU, they should be maximum 2% higher than the EMU average low. In general, it does make sense to define the price stability in relative terms, if a single monetary policy is to be conducted. But the focus of was placed on nominal variables rather than "real convergence" variables such as GDP growth rates, unemployment rates, national income per capita, business cycles, etc. (Arestis/Sawyer 2001, Hein/Truger 2007)

No particular deadline was set to fulfil the convergence criteria and on when to join the EMU. However, a number of countries strived to join the eurozone already by the start of its operation in 1999. The number of studies demonstrates that the average GDP growth of them was sufficiently below the one of the countries which opted out. The same pattern can be tracked in terms of unemployment rates.

3.2.3 Fiscal policy

Sound finance thus also became a feature of the overall MPR. Taxes were gradually being used to finance expenditures and cover current account deficit rather than ensure the desirable level of economic activity in specific sectors. While the member states were in principle still able to use discretionary fiscal policy, it drove up the interest rates on the attracted borrowing, conditioned by the inability of central banks to finance government expenditures without devaluation looming. In MMT terms, the currencies of the member states (except DM) under the EMS were not sovereign, since they could not "print its way out" of insolvency not losing the peg anymore, therefore facing questions from the financial markets and growing borrowing costs during the times of economic disturbances. A central bank of an economy in trouble also could not intervene into the government debt market to sustain low interest rates on public debt that will grow in case central bank needs to finance government expenditures what favours the income redistribution to rentiers.

The Maastricht criteria included the clause on "acceptable" government finance, meaning that candidate countries should have converged to less than 3% public deficits and less than 60% of public-debt-to-GDP ratio before joining the EMU. The Stability and Growth Pact (SGP) that was signed in 1997 reinforced this stance by introducing sanctions against profligate behaviour of national governments. Named Excessive Deficit Procedure, it was initiated if the medium-term objectives of maintaining budget in surplus or balance were violated. Cyclical fluctuations in government deficit were limited by 3%. Fiscal policy was thus assumed to be very important for securing price stability and market acceptability of the exchange rate elimination. The sovereign debt of different countries conducting different national fiscal policies was to become denominated in one currency, meaning there should be in fact no difference in real economic conditions between them (Dow 2016: 2). Still, as we pointed out, the convergence criteria were rather nominal, and the real economic differences remained. The strict rules on debt and fiscal deficit were therefore introduced to make sure fiscal policy does not hurdle monetary policy's mission. By doing so, the risk of default on bonds of a member state was assumably eliminated, while the financial support from other monetary union members was excluded. The disinflation, imposed especially on weaker economies, together with the continuing divergence of real economic conditions overall created a deflationary bias of the EU MPR.

3.2.4 Wage/income policy

Institutionally, the establishment of union level collective wage bargaining proved to difficult, though was addressed in the debates prior to the Maastricht Treaty signing. In preparation to the long-discussed European company statute that would facilitate international mergers and cooperation, alternatives of workers' participation were on the table, but as Tsoukalis (1993: 167) put it, negotiations were deadlocked 'in ideological stratosphere'. In 1991 it was agreed that the social partners would be consulted for Commission proposals in the employment and social fields. Still, given the capacities of trade unions for collective action, their general weakening due to the national neoliberal shift and resistance of employers' associations (such as the UNICE) to strong EC role in the social field, the setup of negotiations was implicitly postponed till closer integration when they would be 'more effective' (ibid.: 171). The SGP, preparation to the EMU, and SEA have considerably changed national employment and industrial policy context. State subsidies, budget deficit spending, and other national practices like competitive devaluations or manipulations with domestic interest rates - the traditional job creating policies have become unusable. Since the Maastricht Treaty (1992) (and its Social Protocol), the principle of subsidiarity has become an important pillar of the EU political philosophy. According to the Article 5, decentralised decision-making is preferred to the centralised one. This especially was employed within European social policy and industrial relations. Officially, the aim was to define minimal social standards instead of broad and painstaking harmonisation process (Keller 2003: 45). For instance, the 'hard' issues of distributional conflict were effectively left at national level, with only such 'soft', less conflictual topics as minimum labour standards discussed under the European Social Dialogue auspices (Schulten 2003: 112).

In a MPR characterised by the deflationary bias, a proactive expansionary wage/income policy couldn't correspond to contracting (or stagnating) aggregate demand. Instead, the burden of adjustment was placed on increasing competitive conditions of labour markets. The promoted intra-EC labour mobility also provided an incentive to flexibilize labour markets for a more efficient allocation of resources. The countries with the developed regulated labour markets (except Sweden) assumed that currency devaluation was not an option for maintaining exchange rate level to DM. One valuable case in point is Denmark. Notwithstanding a partial liberalisation during the 1980s, Denmark, for instance, tried to leave traditionally strong central wage bargaining intact. Avoiding deflation, Denmark soon after joining the Snake was experiencing BoP problems, especially with Sweden where currency depreciation was actively used. Continuous wage increases, brought about by the central wage bargaining, soared up Danish inflation rate above that of Germany and pushed the Danish interest rates on foreign credit markets up. Construction sector literally stopped functioning in the end of the 1970s. "Unwilling to break with DM pegging but unable to control wage inflation, the social democratic government simply gave up and resigned" (Gillingham 2003: 185). The next government logically aspired to austerity policies succeeding to eliminate budget deficit and bring the interest rates in line with those of Germany. As Iversen (1998: 69) explains, the formula of income policy that dominated in Europe before liberalisation started to scatter in the 1970s, and Europe entered into the crisis of the welfare state. The formula meant that when trade unions are big enough to regulate the general price level and monetary policy is predictable, a "nonaccomodating monetary policy" (excluding devaluation) dictates the bargainers to aim at

moderate wage increases that avoids inflation while maintaining high level of demand and employment.

3.2.5 Financial system

As Giavazzi/Giovannini (1990) point out, in cases of intra-EMS shocks in the 1980s Germany's interest rates remained unaffected, while France and Italy extensively leaned on capital controls to prevent wild interest rates fluctuations. By promoting a complete liberalisation of capital markets in the run-up to the Maastricht treaty, the countries were in fact stripped of capital flows management. In accordance with the Delors Report, the Stage 2 of the EMU creation was characterised by the increased cooperation of union's central banks facilitated by the European Monetary Institute (EMI), a forerunner of the area's single central bank. Apart from preparing legal framework, changeover scenario to the new currency and common financial market standards, the EMI has also worked out the payment system for the future EMU (Duisenberg 1997). Trans-European Automated Real-time Gross settlement Express Transfer (TARGET) system was believed to be the main instrument to shorten the imbalances that capital movements would effectively equalise. Such a system was itself an example of the excessive belief in the equilibrating capabilities of financial markets.

The legislative activity of the EC in facilitating of the creation of a single financial system was timid before the SEA. However, it accelerated in the 1990s due to the adoption of new kind of financial reform programme. As Grahl (2009: 115) explains, the previous proposals rested significantly on German experience of bank-based financial system, while during the 1990s securities market financial system, following Britain's model, started to get more credit in the EU ranks. By the Lisbon summit in 2000, the EC openly declared its position that the future of internal market lies with less regulatory and barrier-free securities market financial system (ibid.: 117). This is partly explained by the continuing price stability battle that raised the costs of bank credit over those of securities, and corporations increasingly attracted finance via financial markets operations. In the neoliberal understanding, the availability of finance also increased due to the globalisation of financial markets, giving securities markets a 'comparative advantage' over banks (McCann: 95). Banks' interaction with financial products was itself on the rise (Frangakis 2009: 67). No barriers were thus specifically created between the banking system (as well as pension and insurance systems) and financial markets.

3.2.6 Industrial and regional policy

While industrial and regional policies have not featured in the Treaty of Rome, they have taken long to materialise in the objectives of the European Integration. According to the Cecchini Report, the creation of single market would induce industrial development by a more efficient allocation of resources and incentive to foster further specialisation. Financial flows between the member states would unleash the economies of scale in turn bringing promised jobs and GDP growth. As shown by Kaldor (1970), realisation of economies of scale potential in a particular industry make the regional disparities increasingly apparent. The already advanced regions experience higher industrial output growth, and the market share in industry of the underdeveloped regions declines. This "polarisation process" should have been tackled by the

domestic and union-level policies for structural industrial innovation in the latter regions and reinforced by the creation of pooled financing mechanisms.

Tsoukalis (1993: 235) argues that only after the creation of the Structural Funds in 1988 regional policy dimension got significant attention. Neither the European Investment Bank (EIB) that should had been the source of cheap credit for the least developed regions, nor the free labour mobility, nor the Common Agricultural Policy (CAP) that together with the Structural Funds represented the lion's part of the EU budget could assist to the contraction of regional disparities. The broader consideration of redistributive function was recognised in 1988 with the reform of the Structural Funds after the implicit understanding that further market integration would not bring equal benefits to the already vulnerable regions and employees. The three Structural Funds (the ERDF, the ESF, and the EAGGF) received greater funding on their multiannual programmes, demonstrated far better absorption rate of finance and were complemented by the Cohesion Fund and the Committee of regions in the Maastricht Treaty. In total, however, the EU budget has not reached more than 1% of the EU GDP and still has marginal economic significance leaving the fiscal policy at the national level. With such a size, a disproportionate task of preventing real divergences in the EMU in turn seems unattainable.

The decline in the share of manufacturing in favour of services' sector supported the neglect of the industrial dimension of integration. The economics of post-industrialisation implied that the shift of attention onto services sector, as demand for them is much more income elastic leaving manufacturing sector to drag on. Indeed, between 1988 and 1997 the share of manufacturing in total output grew in Ireland what was stigmatised as "the low stage of development" (Johnson 2003: 6). In contrast, Rodrik (2014) demonstrates the other perspective: despite stagnating nominal value added of manufacturing, the real value added rapidly grew in industrialised countries in post-war years. The falling employment levels in an industrialised economy characterised by already skilled labour force and competent public administration made the case for a comprehensive industrial policy where at least the goals of industrial development could be set at the supranational level.

4. The EAEU and its European counterpart

4.1 The EAEU - the macroeconomic setup

The Eurasian Economic Union (EAEU) is an international economic integration project currently developed by Armenia, Belarus, Kazakhstan, Kyrgyz Republic and Russia. The Agreement establishing the EAEU was signed in Minsk, 29 May 2014. The EAEU was created in succession to the number of integration steps consisting of Eurasian Economic Community (EurAsEC), Eurasian Customs Union (EACU) and Single Economic Space (SES). The EAEU provides for the free movement of goods, services, capital and people as well as pursues coordinated, harmonised and/or single policies in specified sectors of macroeconomic regulation. According to the preamble of the Treaty on the EAEU (2014), the major objectives of the integration are to improve competitiveness of the member states' economies, increase cooperation between them and to promote stable development to raise the living standards in each of them.

Following the collapse of the Soviet Union, former Soviet republics searched for the opportunity to recover the industrial and trade links without establishing of a political authority. The idea was effectively first spelled out by the (still incumbent) Kazakh president Nursultan Nazarbaev in the speech in Moscow State University in 1994. The EAEU was not the first and only integration project in the post-Soviet space. The establishment of an economic union was defined as a final goal of the Commonwealth of Independent States (CIS), an intergovernmental organisation which has served as a forum for discussions on the matters of trade, finance, security and lawmaking (consisting of 11 member states out of 16 former Soviet republics). Despite a proclamatory name, the Economic Union Treaty, signed in 1993, was only a framework for future agreements, with the first objective tellingly being the free trade. In the atmosphere of intensified trade liberalisation all over the world, former commanded economies searched for the sources of foreign currency inflows, and external trade became the best-performing sector in all the countries in the first years of transition to market (Idrisov/Taganov 2013).

Covering trade in goods, opening the possibilities of coordinated liberalisation of services market and eliminating repeating quotas, the CIS Agreement on the Creation of Free Trade Area, signed already in 1994, however failed to become an encompassing treaty to regulate the intra-CIS trade for a number of reasons. Firstly, the list of goods to be exempted from the customs-free regime was not agreed upon and therefore was provisioned to regulation by the bilateral treaties. The countries developed a vast range of bilateral FTAs that should have been abolished over time, although they were not seen as permanent, contained differing exemptions and left room for introducing anti-dumping and anti-subsidy duties and quantitative trade limitations (resulting in a number of trade wars in the region), and thus, couldn't provide the basis for the further regional integration (De Micco 2015: 41). Secondly, the Article 21 precluding that the FTA is a transitional stage to the formation of customs union was dropped from the Agreement text by a protocol of 1999 due to the differences in views over the mutual cooperation (what was especially visible in Ukraine-CIS drift). Thirdly, the Russian parliament didn't ratify the Agreement on the grounds that the unilateral protocol listing the exclusions from the FTA, particularly on oil and natural gas, should be established.

On the background of the problems in economic integration progress in the CIS, the concept of 'multi-speed integration' emerged, meaning that the countries could decide when to join the next integration stage depending on their readiness. As the most committed to the project, Belarus, Kazakhstan and Russia (later in the 1990s joined by Kyrgyzstan and Tajikistan) signed a framework Treaty on Customs Union and Single Economic Space to complete the customs-free zone and internal market. In 2000, in resemblance to the EEC, the Eurasian Economic Community was created. The EurAsEC was specifically oriented towards elimination of trade barriers for goods, a provision that a more preferential status could not be awarded to a country that is not a member of the Community (a provisional common trade policy), and introduced the objective to harmonise indirect taxation. Ukraine and Uzbekistan were shortly members of the community, but overall the EurAsEC generally neither achieved its objectives, nor became more attractive to other countries in the region that could disguise the political component of the integration project (Sushko 2004).

In the second half of the 2000s, the economic integration gained faster pace and in 2007 the Treaty on the establishment of customs-free zone between Belarus, Kazakhstan and Russia was concluded with the deadline being the year of 2010. It was difficult to incorporate Kyrgyz Republic and Tajikistan, since these countries are major narcotics producers and transit zones (Afontsev 2014: 14). Moreover, the common external tariff for all the members implied the losses in duties' contribution to the budgets of smaller economies and gains for Russia (since the higher level of Russia's external tariff was taken as common). Tarr (2016: 3) cites this as a problem that prevented other countries of the CIS from joining the Customs Union. Indeed, the allocation quotas of import duties were 87.97% to Russia, 7.33% to Kazakhstan and 4.7% to Belarus. However, trade diversion transfers from Russia to cover the costs for the smaller, more open economies and Russia's WTO accession that prompted the reduction of the common external tariff still lured Belarus and Kazakhstan.

After the establishment of the Customs Union in 2010, the necessary procedures were taken to finalise Single Economic Space till 2012 that would allow for the four freedoms between the three members. The internal market became rooted in 17 basic agreements covering different aspects of integration: notably, six the most elaborated agreements, covering competition and regulation of natural monopolies, technical regulations and intellectual property rights, as well as state subsidies in agriculture and industries. The other 11 agreements were less detailed and were devoted to, notably, coordination of macroeconomic policies and principles of monetary policy, free flow of capitals on capital markets, operation and development of oil and oil product markets among others. By 2015, all the agreements were implemented to pave the way for the scheduled EAEU. Kyrgyzstan and Armenia adhered to the EAEU in 2015 by joining the Customs Union and the Single Economic Space the same year. As Tarr continues (2016: 4), the gains of the free labour movement could neutralise the losses in import duties for them.

Institutionally, the EAEU is largely similar to the EU, although with a more distinguished vertical of power. The Board of the Eurasian Commission (which succeeded the Customs Union Commission) consists of 10 members (2 Commissioners per each member state) and is vested with the executive power. Each member is in charge of 2-5 departments and there are 23 departments in total. The council of Eurasian Commission consists of 5 members and resembles Council of the EU in its powers. The higher political authority is the Supreme Eurasian Economic Council which is comprised of the heads of member states and defines the principles, strategy, objectives as well as controls all budgetary questions and approves the composition of the Commission. The Prime Ministers of the member states compose the Eurasian Intergovernmental Council what essentially was a part of the Supreme Council and still has similar tasks. Its competences are limited to the supervision of the compliance with the Treaty and negotiation of the new agreements between the members. The last but not the least is the EAEU Court, the judges of which are appointed and can be dismissed by the states (and by the Commission).

Therefore, the major institutional inconsistency with the EU set-up is the lack of the legislative body, a supranational Parliament, making the overall power structure of the EAEU more pyramidal. The unanimity as a principle of decision-making is also different from the QMV that

the EU started to employ after the SEA. What the macroeconomic differences and starting positions of the two unions are, we will discuss in the next section.

4.2 The comparison of the unions

Speaking about macroeconomic design, it makes no sense to compare the two unions with each other in absolute quantitative terms. Being still composed of the developing economies, it is difficult to draw particularly telling conclusions on the comparisons of the GDP sizes. Behind the bravura of the being the world's number one producer of natural gas, oil (including gas condensate), mineral fertilizers, sunflower and sugar beets, as well as the second- or third-best in total railway mileage, electric output, coal, steel and cast iron production hides the fact the economy of the EAEU member states is built on the exports of natural resources, energy sector, low value-added manufacturing industry and agriculture. Comparing to the EU member states that already from its outset were regarded as the most advanced capitalist economies of the continent and traded with the rest of the world in high value-added products, the EAEU is still lagging behind in modernising its economy. Therefore, we come up with three main qualitative criteria to identify the differences (and starting positions) between the integration projects. The first criterion is a broad notion of economy's structure (including trade structure) what is specifically important for the reasoning to FTA creation and further integration. As the second criterion, we will take the asymmetries within a union and how it conditions macroeconomic policy. Although we presumably tried to analyze the unions taken on the same integration level, the EU still experiences deeper integration in certain areas what should be addressed before proceeding to the EAEU MPR completion in the next chapter. Thus, the third criterion are the objectives of economic integration that define the field of action for integration..

Despite an economic union formation, the proportion of EAEU trade in the overall trade volume of the members was just 6,5%. The main trade partners for the EAEU remain to be the EU countries and China (Eurasian Commission 2014a). For instance, Afontsev (2014: 12) shows for the period 2009 and 2011 that the creation of Customs Union initially skyrocketed the trade volumes between Kazakhstan and Belarus that increased by five times in 2010, but contracted by two thirds next year. The trade surge was dominated by fuel and energy exports from Kazakhstan and fell when the prices for Russian energy exports fell accordingly. The continuing fall in overall trade since 2013 (9% till 2015), after the initial boost of 2010-2012, between the three founding members means that due to the trade structure, dominated by mineral resources (up to 26% of the total EAEU trade turnover) and agricultural products, the trade creation prospects are rather limited (Eurasian Commission 2013). The volume of trade and production levels are very much dependent on the global oil prices.[6] The overall trade in Q1 2016 fell to 84,2% of the Q1 2015 level (ibid.). As for the newcomers, Armenia still experiences twofold growth in trade volumes since last year, with Kyrgyzstan showing more modest trade volumes growth rates but a steady growing pattern for both imports and exports. Turning to the first years of the EU, as Eichengreen demonstrates in Table 1, the intra-regional trade grew steadily at

[6] For instance, the significant portion of Belarus exports occupies the oil imported from Russia and Kazakhstan and refined to be further sold.

substantial pace in the period of 1955-1970. The biggest increase of 14% was achieved in the EEC-6 after the agreement on the customs union was reached. It also follows from the Table 1 that the trade would increase even in the absence of the common market, as the overall trade circulating in Western Europe grew by 11%. Notwithstanding that global and domestic economic circumstances were of course different, the structural similarity partly explains the scepticism surrounding the Eurasian integration project. But Kirkham (2016: 118) sees this structural homogeneity of the EAEU not only as a restraint and the need for economy diversification, but also as a potential strength, "as it sets common technological targets". Since EAEU members used to form a common market before the 1990s, they still share transport, communications, power infrastructures. Similar education and research system could support the technological cooperation.

Table 1.

Intraregional exports as a percentage of total exports, 1955–1970

From	*To*	*1955*	*1960*	*1965*	*1970*
EEC-6	EEC-6	32	35	44	49
	Western Europe	59	60	68	69
Western Europe	EEC-6	28	31	37	41
	Western Europe	55	56	64	66

Source: International Monetary Fund, *Direction of Trade Statistics, Historical Summary, 1948–1980.*

Note: Western Europe includes Austria, Belgium, Denmark, Finland, France, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and West Germany. The EEC-6 are the six founding members of the European Economic Community: Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany.

Source: Eichegreen (1998)

Discussing the economic asymmetries, the striking importance of Russian economy definitely needs some mention. In 2014, Russia accounted for 59% of Belarusian imports and 35% of Belarusian exports; Armenia received 49% of total FDI from Russia, while the remittances of Kyrgyz workers in Russia accounted for 29% of Kyrgyzstan's GDP (Popescu 2014: 14). 69% of EAEU trade volume fall to the share of the biggest country, what is explained by the fact that EAEU members now have access to the 170 million people market, several times bigger than the domestic market. The effects of a slowdown in Russian economy on its trading partners will only get stronger on the course of integrating. By contrast, the importance of EU's biggest economy Germany is relatively smaller in GDP and market size terms. But its power in supranational monetary and fiscal policy-making is very substantial in a fixed exchange rate system, as we have shown in the Section 3.4. As Dyson (1994:149) argues, the capabilities that rested on the "structural power of its economy and currency and its role as the anchor of the ERM" Germany could easily got its way in negotiations on the future EMU. Powerfully positioned, Russia also has the capacity to exert considerable influence on other economies.

A valuable example is non-tariff barriers (NTBs). The EAEU Treaty provides for the removal of NTBs that still remain between the countries. The pledges of both Kazakhstan and Belarus that the obstructions for registrations or sanitary controls, especially in Russia, were made even after the proclaiming of the SES (Schenkkan 2015). NTB costs are the highest for Kazakh-Belarus trade (accounting for 40%![7]), with the NTB costs in the trade between Russia and Belarus being also on the high level of 12,4% (EDB 2015). The study splits the NTBs into two groupings: the first being the protective measures of quantitative limits, bans, quotas, sanitary and phytosanitary controls, while the second one comprises price control measures, subsidies, restrictions in marketing and public procurement, etc. The first group is assumed to be more 'natural' and will be gradually disappearing in the process of internal market integration, but the second one proves to be more resistant to change in practice. In the EU experience the first group of NTBs was indeed tackled by the principle of mutual recognition. The second group is rather difficult to eliminate without a more rigorous competition policy, where the Court of the EAEU would play the main role. The benefits of dismantling the NTBs are measured to be the highest for Belarus, slightly smaller for Kazakhstan and insignificant for Russia (ibid.: 54). Tellingly, the progress in the areas of integration not so beneficial for Russia is rather slower.

Turning to our third criterion, in spite of similar integration stages, the EAEU project has considerable design differences from its EU model. The EAEU doesn't aim at creating a currency union in the near future. However, in theory, a monetary and political union is acknowledged to be the final integration step that should be preceded by the convergence of macroeconomic variables and other policy fields (Dow 2016). The EU (EEC) started its existence in the fixed exchange rate system of Bretton Woods and continued to fix exchange rates after the system collapsed. In 2015, in the circumstances of plunging oil prices and the international sanctions put on Russia, the central banks of the EAEU countries were unable to maintain the peg to a currency basket what has led to the abandonment of fixed exchange rates (and following devaluations). Now, all the EAEU currencies are free floating (though manageable by central banks). Despite the costs trade bears in the form of exchange rate uncertainty, the EAEU MPR is now more flexible to shocks.

An interesting point here is the nexus of monetary and fiscal policies. Even before the preparations to the EMU, the fiscal policy was put under limits to support monetary policy's quest for the price stability. Monetary policy patterns had to be imported from Germany, where the growth objective was of secondary nature, otherwise the ability of governments to serve debt and maintain the peg were questioned by the markets. The fact that, when the EAEU was designed, price stability was also placed in the center of monetary policy-making and the exchange rates were supposed to stay fixed to the currency basket partly explains why the EAEU have inertially copied the fiscal rules of the EU. The Commission of the EAEU openly declared that it used the experience of the EU and taken the Stability and Growth Pact as a reference

[7] Although the volumes of trade between Kazakhstan and Belarus are not big, this represents the fact that there can be structural problems in total phasing-out of tariffs in the future. The study also logically shows that the higher the NTBs - the smaller the exports volume.

document (Eurasian Commission 2014b).[8] There's also no EAEU budget even for the common projects, thus, the fiscal domain is only regulated by rules.

5. EAEU and PK-wise economic integration

5.1 Basic macroeconomic policies

5.1.1 Financial system

As Kirkham (2016: 119) notes, the production development plans of the EAEU are inconsistent with the financial system. The plans of technological advancement and re-industrialisation have to be financed by primarily domestic capital. In the face of unfavourable business conditions and sanctions against Russian state capitalism, major Russian banks are unable to receive foreign loans, resulting in the banking system's low capitalisation. The state-organised consolidation of the banking sector in the response to the crisis of 2009-2010 is viewed positively, since it cleared up the weak banks from the banking system (ibid.:120). Yet, the centralisation of the banking system is controversial, since local banks are more active in crediting smaller local businesses. It is a credit wall between financial services, insurance and banking sector what should be institutionalised to strengthen the financial system. Credit wall should be especially established to prevent the bubble in construction and real estate sectors, since in all the countries of the future EAEU construction boom (doubled to up to 10% GDP in Kazakhstan over the 2000s) was largely financed by mortgage lending (EBRD 2009). Vymyatina (2013) also suggests the introduction of specific reserve requirements for the Russian banks' assets to ensure no bubble emerges following the active crediting of state-owned corporations. What exacerbates the lack of finance, as Pirani (2011: 500) shows, Kazakhstan and Russia have experienced massive capital outflow (up to $385 billion, with almost $130 billion in 2008 alone) in the period of 1994-2010. The administrative pressure on businesses to prevent offshoring and tax evasion thus increased, further fostering negative business climate.

Despite the announced free capital movement, a common financial market is still under construction. The Treaty on the EAEU (Section XVI) precludes the harmonisation of the requirements for regulation and supervision of the financial markets as well as mutual recognition of licenses in banking, insurance and financial services sectors are the stepping stones in the process. The market is expected to be finalised in 2025 with the establishment of the supranational body for the regulation of financial market based in Almaty. According to the 'Strategy of the financial markets development till 2025' (Eurasian Commission 2016b: 15) drafted under the auspices of the EAEU, this body will be similar in its functions to Single Supervisory Mechanism in the EMU, yet employed also in the insurance and financial services sectors. The extension of its powers to direct implementation of its recommendations either by the EAEU members or financial institutions is envisaged in the after-2025 future. Although it is still early to predict how detailed the regulatory system will be, generally great attention is given

[8] We will discuss in more detail the position of fiscal policy in the EAEU MPR in the next chapter. However, a big remark here is that the respect for the sovereignty of member states received a special treatment in the EAEU design, and incompliance with the fiscal rules or high inflation rates do not automatically lead to sanctions or mitigation plans' imposition on a member state by the Commission.

to the necessity to regulate the sectors both in the Treaty and the Strategy. The implementation of Basel II and Basel III requirements should be finalised, and the model of mutual recognition of licenses is in development.

5.1.2 Monetary and fiscal policies

The Treaty on the EU (Section on XIII) formalizes that macroeconomic policy in the member states is to be coordinated with 'the aim of achieving balanced macroeconomic development'. To monitor that, the EAEU comes up with a series of indicators. Following the Maastricht convergence criteria, the countries agreed to use fiscal and monetary brakes to ensure 'sustainable development'. A sustainably developing economy shall pursue an annual inflation rate not higher than 5% of the lowest in the EAEU. This is a much looser definition of price stability than the one in the Maastricht Treaty that puts less pressure on growth, even though member states should aim at maintaining the same inflation rate to exclude uneven price competition. Central banks are necessarily obliged to share information on its operations with each other as well as ensure the convergence of approaches and 'increase the confidence in the national currencies' both internally and internationally.

In the fiscal domain the EAEU followed its European counterpart more closely. Although the SGP was developed to support market acceptability of fixed exchange rates, the EAEU took it as a reference. The government budget deficit should not exceed 3% and the government debt-to-GDP ratio should stay below 50%. Thus, fiscal policy is accordingly believed to run on the monetary policy mission of price stability. As it was mentioned, if a member state goes beyond these limits, the initiated recommendations of the Commission are not obligatory to follow, meaning that there is no equivalent of the EDP. However, in this case the other power channel in form of direct negotiations in Intergovernmental or Supreme Council can be utilized. Any system of redistribution within the Union is not envisaged, since its budget is used only for the administrative purposes and is essentially balanced over the year. As a part of competition regulation, the Treaty also underscores that indirect taxation rate on similar products should be the same, but does not correct fiscal policies beyond that. Comparing the two unions, the fiscal-monetary policy regime in the EAEU is more flexible to accommodate growing demand, but the deficit and debt brakes still put the economy in jeopardy of slipping into stagnation if demand is low, just as in the EU design.

The levels of the public debt-to-GDP are not that high in the member states, so that the member countries should be aiming at maintaining budget surpluses. At the same time, the unemployment in Armenia (20% in Q4 2015) and Kyrgyzstan (8% in 2014) is at significantly high levels (Eurasian Commission 2014a, 2015). In Belarus the number of officially unemployed increased since 2013 increased by 3,5 times, whilst Russian hidden unemployment is not an issue only during the current economic downturn (Dokuchaev 2016). In the circumstances of reduced availability of foreign finance and capital outflow, the public sector could take up the role of aggregate demand improvement. With floating exchange rates, it is then possible to pursue policies aimed at unemployment reduction via public finance, i.e. functional finance policies. To prevent capital flight, central banks have recently raised the interest rates in the EAEU, putting pressure on smaller businesses and favoring rentiers. What central banks should aim at is a stable low reference rate level (below the tax revenue) while maintain the interest

rates on government bond market on sustainable levels. Member states should coordinate its fiscal policies (also via Commission's recommendations) by ensuring long-term public expenditure paths are covering the excess of private spending over investment (Hein/Detzer 2013). What follows from the basic accounting identity, such a pattern allows for the current account to be balanced.

5.1.3 Wage/income policies and labour market

Labour market institutions are conditioned by its historical development. In the post-Soviet countries trade unions have never been fully independent, being a part of administrative apparatus and only superficially involved in labour-capital struggle. Atavisms of former practices are still burdensome: thereby, its labour movement skipped the stage of social conflict that eventually transformed European labour-capital relations into social dialogue. The EAEU integration generally continues the story of weak involvement in collective wage struggles (Cazes/Nesporova 2003). The provisions of the EAEU only consider labour migration, as a major instrument in providing for common labour market. Social security provisions and non-discriminatory work acceptance principles, outlined by the Treaty, are therefore not protected. Accordingly, Kyrgyzstan has voiced out the necessity of establishing a union-level trade union for labour migrants (Kyrtag 2016).

Despite the relatively high level of collective bargaining coverage - circa 70% - in Kazakhstan, Belarus and Russia, the wage share was stagnating in the 2000s, with a slight increase in Belarus and Russia and slight decrease in Kazakhstan. The wage share/average share index show similar pattern. Four countries (Russia, Kyrgyzstan, Kazakhstan and Belarus) experienced a slight decline, while Belarus noted a small relative growth in minimal wages.

The EU tried itself in attracting the labour side in the social dialogue on the supranational level, as Delors Commission pushed European Social Model proposal with the participation of the trade unionists. Although the social dialogue provisions were enshrined already in the Treaty of Rome, in the end, the tripartite model of labour-capitalists-Commission worked only on the rare proposals that touched upon social security issues. The EAEU Commission also attracts the labour institutions in the discussion process. A good example of how the EAEU essentially replicates the model of the EU is the current discussions around the EAEU pension system. The issue has got excluded from the Treaty for the further consideration. Right now, this is the only problem (apart from labour migration) social partners are involved at, as the EAEU Commission drafts a Treaty on the provision of pensions for workers of the EAEU Member States (Eurasian Commission 2016a). The General Confederation of the Trade Unions, covering the CIS countries, and the non-commercial partnership International Alliance "Labour Migration" are regarded as weak underrepresented institutions (EDB 2016). The 'hard' issues of the dialogue, i.e. wage bargaining, remain of national or enterprise-level competence. With no sectoral bargaining it is hard to envisage a supranational system.

5.2 Divergence prevention

5.2.1 Foreign economic policy

Generally, the Treaty also lists the indicators to measure integration level, economic development level and dynamics as well as external forecast parameters. The Commission then develops the 'main benchmarks', similar to the Medium-Term Objectives of the EU, that could be used by the member states to follow 'sustainable path of macroeconomic integration'. In principle, the goals of economic development are broadly consistent with the principles of BPCG approach, since it aims at inducing GDP growth rate and GDP measured on PPP, while

maintaining current account balanced and real exchange rate stable. Basically, foreign economic policy with help of other policies should thus aim at re-balancing current account.

BPCG approach informs not to use real devaluations (that have soared on consumer purchasing power in the EAEU recently), import cuts (that are inadvisable in conditions of poor EAEU trade performance) and ULC developments below the ones of the partners (what requires supranational collective wage bargaining system). At the same time, the modernisation goals of the resources-based economies correspond to the ideas of non-price competitiveness improvement of the BPCG model. If the inflation levels are to be sustained and Marshall-Lerner condition holds, then the Member States that observe current account surpluses should induce aggregate demand. This can be done either by public investment and/or increasing imports that would stimulate production (rather than consumption). This relates to Kazakhstan and Russia which in spite of the considerable drop in overall trade turnover in 2015 have still maintained trade surpluses for at least five consecutive years (Eurasian Commission 2015). Belarus observes generally stable current account with a slight surplus. The "catching-up" Kyrgyz and Armenian economies observe current account deficits and thus should improve their BPCG rate by means of improving the elasticities of the demand for their exports and imports. These imply an industrial policy oriented towards attracting investment into high value-added production and more participation in the union's value chains. The growth strategy of using 'competitive advantages of each member state' that is implied in the EAEU Treaty is certainly inferior to the one outlined here, since it doesn't take into account intra-regional macroeconomic imbalances and one-sided economic development within a country that pursuing of comparative advantages can create. The recent studies have already indicated the spillover effects of the Dutch disease noted in all the countries (Vymyatina 2013).

The above-mentioned high levels of capital outflows certainly add up to the concerns of the EAEU countries. Therefore, the Treaty enables the central banks of Member States to impose the controls on the currency flows for up to a year in case 'liberalisation measures', i.e. easing of restrictions on foreign exchange transactions, worsen economic development or international currency reserves are depleting. Such capital controls were already introduced once in Kazakhstan, Russia and Belarus following the fall of the oil prices in 2014. The Treaty obliges central banks of the member states to follow the policy of increasing confidence in the national currency both internally and internationally, what means replenishing international reserves and goes in line with the propositions for developing countries of Herr/Priewe (2005).

5.2.2 Industrial and regional policies

As we outlined in the Section 2.3, public spending on R&D in the high value-added industries and infrastructure helps to attract domestic private investment and FDI. Increasing productivity in the manufacturing sector inherited from the Soviet economy and coming back on the former industrial level do not contradict the present strategy of comparative advantage utilization but also fulfils the objective of increasing non-price competitiveness. As Kazandziska (2013: 14) shows on the example of Latvia, however, it is important to ensure FDI is not more import- than export-inducing and is attracted not only by the financial services sector.

Regional and industrial policies do not feature on the EAEU agenda and remain essentially domestic. As it was mentioned, the part of the EU budget is occupied by the funds channeled towards regional

development and catching-up of the Southern states. That practice proved significant but still insufficient to prevent the real economic imbalances from emergence because of the other features of EU MPR. In case of the EAEU, there are no Structural Funds and intra-regional projects are established via bilateral agreements. Development banking is an option explored. The Eurasian Development Bank (EDB) was created already within the EurAsEC structure and aims at developing regional integration projects and provides advice on the EAEU economic development. But overall redistributive mechanism is not present in the EAEU design.

The Figure 1 demonstrates that to a large extent the economic structures of the three founding members are similar (the only exception being the prevalence of manufacturing over mining and quarrying in Belarus). For instance, in Kazakhstan oil extraction has been the main driver of the economy since gaining independence in 1991 and accounted for 60% of all exports in 2014. Despite the overdependence, the attempts to diversify the economy have been timid, as Kazakhstan relied on the utilisation of its comparative advantage. In 2004, the economy was more diversified (in the case of Russia as well) than it was in 2014 (ADB 2014). The integration into the EAEU could intensify the trend to diversify. The common technological goals also manifest themselves in the independently adopted modernisation programmes which have a considerable degree of compatibility and potential merging (Tkachuk 2014). Kazakhstan has already set up joint projects in pharmaceutical, helicopter and railway wagon production with Russia and railway tank-wagon production with Belarus (Eurasian Commission 2013). Following the creation of the Customs Union, the mining of uranium in Kazakhstan to be enriched in Russia grew to 18 thousand tons annually (Eurasian Commission 2014a).[9]

Figure 1. Structure of economy 2013, % to GDP

Sources: National Statistical Agencies of Russia, Kazakhstan and Belarus

Source: Kirkham (2016: 118)

In total, the well-trodden path of common industrial development could help to revive/establish the production of more value added goods, but also shows off the constraint of healthy industrial development - the reliance on comparative advantages. The Annex 14 to the EAEU Treaty on the Agreed Macroeconomic Policy of the EAEU Treaty stresses that 'competitive advantage' of an economy is preserved and the macroeconomic development of other members should not obstacle its utilisation. What

[9] Russia likens to increase the share of nuclear energy by 9% (up to 25%) in energy mix by 2020.

indeed could improve the terms of trade of the EAEU members and maintain the catching-up process is the overall development of the BPCGR of the weaker economies by increased public spending on R&D and technology transfer from the bigger economies (that should use current account surpluses to increase spending on R&D as well). The public investment should be channeled into R&D in industries that could decrease the demand for imports and increase the demand for imports of the high value-added products. A merger of the programmes for modernisation of the members is also advisable, learning on the example of the EU where the supranational industrial policy didn't feature on the agenda of early years.

6. Main Findings.

Analysing the compatibility with PK MPR model and EAEU MPR, it is particularly telling to explore the degree to which macroeconomic policy-making system was inspired by the EU experience and the features which are different from the EU MPR due to the domestic specialties. As we have shown in the Part 2, the EU MPR is dysfunctional in many areas and copying the EU design implies a replication of the mistakes that have put the EU survival into question and bogged the EU economy down into secular stagnation lately. We will now sum up our main findings on the EAEU MPR on the background of our post-Keynesian model and with a reference to the EU MPR.

As a common pattern in developing countries, the underdeveloped and undersized financial system does not let the modernisation and production plans to be fully realised and require foreign investments. But due to the political circumstances and unfavourable business environment, FDI, the most desirable form of foreign investments, are fleeing the big economies of the EAEU. In Russia, the consolidation of the financial system around the state has brought both positive and negative consequences. On the one hand, the crisis-affected financial system gets state backing, but on the other hand it is insufficient to prevent weakening of the system in case of a future crisis as credit walls between the banking and high risk affiliated sectors of financial services and insurance are still absent.

On the supranational level, EAEU design differs from the EU where the single capital market was of preeminent importance to ensure real imbalances diminish. Although the EAEU common financial market is to be established within a decade, the supervision and monitoring of financial market is the most necessary pillar before it fully starts (Eurasian Commission 2014). The decisions of the new supervisory body would be binding for the members and financial institutions.

It is still unclear how responsive the EAEU members would be to the fiscal and monetary brakes established by the Treaty, as the incompliance doesn't necessarily lead to sanctioning. Discretionary fiscal and demand-inducing monetary policies are possible to implement, as the policies are essentially left domestic. However, copying the SGP pattern exemplifies the fact that the macroeconomic policy-making would rather be inspired by the non-Keynesian ideals. Looser inflation limits allow for more flexible accommodation of growing demand, but the brakes on the public deficit and public-debt-to-GDP ratio still put the economy into jeopardy of slipping into stagnation if demand is low, just as in the EU design.

Similarly to the EU, fiscal policy thus remains to be supranationally rule-based and the rules do not aim at supporting higher aggregate demand, stabilising real economy or equalizing income distribution but rather serve the role of budget re-balancing. Redistributive mechanisms that could even the imbalances or help in case of asymmetric shocks are not envisaged. But to a significant difference, no common institution in monetary area is established in the EAEU. Importantly, with no fiscal integration currency management remains sovereign. In difficulty to attract FDI and sanctions on the biggest economy of the EAEU, this leaves the room for public expenditure to be increased not only to equalise BoP but also to overcome the excess of private saving over investment to cut unemployment.

What became a particularly luring factor for the newcomers of the EAEU (Kyrgyzstan and Armenia) is the prospects of free labour movement. Unemployment concerns of them were intended to soften thanks to a complete labour market integration. As in the EU design, market forces should even the real imbalances between the members, although in the EAEU it is labour market which takes up the leading role, as financial markets were assumed longer to integrate. No language barrier and already well-trodden paths of labour migration to Kazakhstan and Russia ease the labour markets integration. The excessive belief in the "egalitarian" power of markets does not fully prevent imbalances from emergence. The emigration countries wouldn't realise its full potential output or improve aggregate demand. In the immigration countries as well, the cheapening of labour force could negatively affect income distribution, as the wage bargaining systems are relatively weak, and consumption demand start to originate more in credit than wages. The supranational institutions do not interfere into domestic income policy and neither the Treaty promotes common non-discriminatory work acceptance rules and social protection provisions, nor wage norms are seen as the anchor for an exchange rate. As in the EU, the EAEU Commission only invites the social partners for consultations on 'soft' issues, such as a not-yet-present common pension system. Domestically, the development of nominal minimum wages remains significantly below the real subsistence wages level and cannot serve the purpose of the supporting stable low inflation.

Since the well-being of the bigger natural resources-rich economies of the EAEU are very much dependent on export prices for oil and natural gas, the exchange rates fluctuate accordingly. The drop of the prices in 2014 even brought an exchange rate crisis about and Kazakhstan and Russia have abandoned their pegs to a currency board. Accompanying currency devaluations have damaged consumer purchasing power with overall drop in demand. However, an important step for market acceptability of the active fiscal policies is the transition to a floating currency regime that is currently observed in all the EAEU countries except Belarus. The possible imposition of capital controls for up to a year allowed by the Treaty and already utilized by the Member States also constitutes one of the few features of a PK MPR.

Just as import cuts or decrease of ULC, devaluations are too burdensome for an economy to bear. The approach of BPCGR outlined in the Section 4.3 provides a strategy of combining technological advancement, balanced current account development, catching-up of the smaller economies of the union and preventing real divergence. Kazakhstan and Russia observe annual current account surpluses from 2010 to now on and could potentially use them to increase aggregate demand by public investment and/or imports that stimulate production. Armenia and

Kyrgyzstan, current account deficit countries, should improve the elasticities of the demand for their imports and exports by means of an industrial policy oriented towards attracting investment into high value-added production and more participation in the union's value chains. Belarus currently observes roughly balanced current account. In contrast to the application of the BPCGR approach to the EU countries, all the transition economies in fact require considerable investment into high value-added production. Thirlwall's approach could be the first step towards improving the investment climate to attract FDI in the future.

In the absence of the pooled funds for intra-regional projects (with the exception of the EDB projects) and common industrial policy agenda, it is hard to envisage a system of mutually beneficial industrial interdependence. There are no fine-tuned mechanisms of technological transfer from the more advanced states to promote catching-up process and no redistribution mechanism to finance it. As we have shown on the example of Kazakhstan, the projects of this nature develop only via bilateral agreements.

The main stepping stone here is the commitment to comparative advantage theory. The integration doesn't touch upon the sources of income of the Member States, meaning natural resources exports. Rather than the adherence to them, the modernisation programmes of the members should be promoted, insofar as they are mutually compatible and have potential for mergers. The common infrastructure inherited from the Soviet times and industrial links could help to revive/establish more value-added production with the help of fiscal transfers, subsidies and stable access to finance.

7. Concluding remarks.

Whether a MPR is able to ensure sustainable growth on the path to full employment and more equitable income distribution defines its functionality. Discussing the arrangements for an economic union, we have added up to divergence prevention to these objectives. Monetary, fiscal, wage/income, foreign economic policies acting in a changeable institutional set-up and financial system have different features that provide for attainability of the four objectives. In this paper we tried to explore the degree to which the EAEU MPR, its institutional set-up and available policy mix, forming on the EU experience corresponds to the fine-tuned PK MPR model. Notwithstanding some positive features in comparison to the EU MPR, EAEU MPR lacks institutional basis and in certain areas is solely based on vague propositions of policy coordination and is dysfunctional, since it doesn't meet the four objectives.

The sustainable economic growth is defined by the EAEU Treaty in the spirit of the SGP. It does not allow an economy to inflate or resort to debt and public deficit, with the fiscal brakes being even harsher than in the EU set-up.[10] The stability of the financial system is so far not guaranteed, but gets some merit, since the common financial market will only start to operate after supranational monitoring and supervision mechanisms are in place. But the financial system remains rather insufficient to finance the growth, not based on the exports of natural resources.

[10] If the EAEU Treaty is respected by the Member States.

In contrast to the EU where the goals of 'the high level of employment and social protection' are enshrined in the Article 2 of the Maastricht Treaty, the EAEU pays little attention to the achievement of full employment. In principle, both fiscal and monetary domains could be used by national governments to promote functional finance, as the Member States recently abandoned fixed exchange rates and there are no particular impediments to its use. However, the problem of unemployment in the weaker economies of Armenia and Kyrgyzstan is rather entrusted to market forces. With increasing labour migration in the internal market, unemployment will fall and remittances will add up to GDP, although the development of the real economy in these countries will stagnate.

Income distribution problems remain essentially domestic in the political discourse of the Member States and would also be tackled by domestic policies. Employment and wage/income policies are led in the decentralised labour markets characterised by weak wage bargaining system. Therefore, if inflation is understood as unresolved distributional conflict, price stability objective of the sustainable macroeconomic development of the EAEU would be difficult to attain. Although this objective is looser than in the EU, austerity policies are likely to be used in case of increasing inflation. By contrast, it is necessary to establish a progressive taxation scheme to maintain the necessary level of consumption and to equalize income distribution pattern.

The convergence promotion or divergence prevention mechanisms are not present in the EAEU set-up. As the comparative advantages continue to be seen as the theoretical basis for the further development and current account imbalances last out, real divergence trends won't be long in coming.

To improve the EAEU, we have proposed a number of departs from the EU design towards a PK MPR basing on the EU experience. A coordinated monetary and fiscal policies in the spirit of functional finance in a regulated financial system on supranational level could ensure the stable availability of finance for firms in a crisis-resistant environment (no or little excess of private saving over investment if a crisis occurs) and thus help to achieve full employment and steady economic growth objectives. Progressive tax system and usage of wages as an anchor for inflation could make income distribution more equitable. Employing BPCGR approach could not only improve its current accounts and prevent real divergence within the union but also promote the technological advancement of Member States' economies and their diversification. Notwithstanding power relations and political factors, the propositions are possible to implement and would considerably improve the EAEU performance in the years to come.

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