

The Future of the Economic and Monetary Union*

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Péter Halmai (ed.):

A Gazdasági és Monetáris Unió jövője – Európai perspektívák

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The volume is based on the extensive work done in the framework of the Ludovika Key Research Workshop “New Dimensions of the Economic Role of the Modern State” headed by Péter Halmai.¹ It discusses the current state of reforms in the European Union in detail. It also presents the analyses of outstanding experts from Hungary and abroad to cover the entire model of the Economic and Monetary Union (EMU): the possibilities of building EMU 2.0, its sustainability and future prospects and topics related to its expansion and reinforcement. It discusses the structural features and challenges of a fiscal union (FU), the place of independent fiscal institutions in the European system of economic governance and the capital markets union.

In the opening chapter, entitled *Introductory Thoughts. European Reforms: the Future of the Economic and Monetary Union (EMU) – European Perspectives*, Péter Halmai, the editor of the book, provides a comprehensive overview of the most important milestones of the last 70 years of European integration, the creation of the internal market and the introduction of the euro in particular.

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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¹ Important further outputs of this research have been published, for example, in: Péter Halmai: *Európai Gazdasági Integráció (European Economic Integration)*. Budapest, 2020, Dialóg Campus.

Péter Halmai: *Mélyintegráció. A Gazdasági és Monetáris Unió ökonometriája (Deep Integration. The Econometrics of Economic and Monetary Union)*. Budapest, 2020, Akadémiai Kiadó.

Péter Halmai: *Mélyintegráció-paradigma (Deep-integration Paradigm)*. *Közgazdasági Szemle (Economic Review)*, May 2024: 514–558. <https://doi.org/10.18414/KSZ.2024.5.514>

The book analyses the key challenges faced by the Economic and Monetary Union. The global economic and financial crisis of 2008–2009 revealed the most significant shortcomings and prompted the EU Member States to take important steps to strengthen the Economic and Monetary Union through new policy instruments and institutional changes. At the same time, years of low growth, or even no growth, have left a lasting mark on Europe’s social, economic and political fabric. Many countries continue to struggle with the legacy of the crisis – from soaring unemployment to high debt in the public and private sector. While support for the single currency is strong and even growing, the mechanisms of the Economic and Monetary Union and the added value of the euro will be questionable if these mechanisms remain broadly unchanged.

In the first chapter of the volume, *EMU 2.0? Towards a Fully Fledged EMU*, Halmai examines the progress of the Economic and Monetary Union to the next stage and the possible future scenarios of economic integration in a comprehensive approach. He points out that the effects of the global economic crisis can still be felt in the euro area after 10 years, justifying the reason for the completion of the Economic and Monetary Union. However, it is still unclear what EMU 2.0, i.e. “complete” EMU, would actually mean. The divergences between Member States, notably in terms of their level of development, pose further problems in the integration process. The chapter underlines that the precondition for economic integration obviously depends on political decisions made at the top level. Two crucial aspects need to be distinguished in the system of multi-speed integration: “core integration”, which is most prevalent in the most advanced Western core countries of the European Union, and differentiated integration, which provides a framework for integration for Member States outside the euro area. In order to deepen economic integration, the White Paper published by the European Commission outlines five possible scenarios for the future of Europe for 2025, depending on what decisions are taken regarding the key issues of future integration, the main dimensions of which are the single market and trade, Economic and Monetary Union, Schengen, migration and security, foreign policy and defence, the EU budget and the capacity to deliver. The chapter discusses in detail and compares the five different scenarios.

The next chapter, written by *Anna Iara*, is entitled *Deepening the Economic and Monetary Union: Opportunities and Prospects*. *Iara* presents the shortcomings in economic governance, analysing the problems induced by macroeconomic imbalances and unsustainable international capital flows in the context of the failures of the institutional setup established in the Maastricht Treaty. She identifies the risks in the financial sector and the imbalances arising from similar economic structures or a lack of flexibility. This chapter also examines the question of fiscal sustainability, highlighting the lack of a fiscal safety net for illiquid states and banks, as well as the absence of coordinated reforms to improve competitiveness. The

author argues for the legitimacy of the concept of a multi-speed Europe, citing the different degrees of EU Member States' economic development.

In their contribution, *Member State Preferences and/or Common Interest: Reflections on the Possibility of Fiscal Union*, authors István Benczes and Ferenc Kollárik point out an important asymmetry. In the context of deepening economic integration, monetary policy has been escalated to EU level, while fiscal discipline remains the responsibility of Member States. This left the European economy too vulnerable during the global economic crisis. The euro area recovered after 2010, but the crisis in the real economy and high unemployment lasted for years. The need to rethink EMU and put it on a new footing became an agenda item.

In the subchapter *Deepening in the Perspective of Integration Theory*, the authors explain the theory of neofunctionalism, the intergovernmental process of advancing European integration. Following the approach of integration theory, they present the idea of a European Fiscal Union, i.e. the creation of a budgetary union, stating that “Fiscal federalism” would strengthen the economic (in a narrower sense, the fiscal) aspect of EMU and would concurrently bring about a deeper and tighter integration structure.” The authors provide a comprehensive analysis of the literature on the subject. The Member States still have not decided in favour of the immediate introduction of the fiscal union, since the economic development of the member countries does not allow for its establishment, and individual states have different attitudes on the issue. Given the complexity of the issues at stake, the European Union voted in favour of deepening the integration of the EMU.

Similarly to the previous chapter, *László Jankovics* explores the fiscal aspects in his chapter on *Independent Fiscal Institutions in the European System of Economic Governance*. He discusses the potential of independent fiscal institutions (FFIs) for economic and monetary integration. These institutions can check the tendency towards deficit and make a “pro-cyclical” fiscal stance less prevalent, in order to make economic integration more efficient. The chapter briefly describes the economics of FFIs, reviews their structural characteristics and summarises actual experiences. The analysis divides FFIs into two groups. On the one hand, the “independent fiscal authorities” can directly set budget balance or debt targets and formally intervene in the structure of the expenditure and revenue side. On the other hand, “fiscal councils” can influence budgetary decisions indirectly through independent analyses and forecasts. Jankovics underlines that – thanks to the European legislative reform process that started after 2010 – there is now at least one such institution in each EU Member State, and concludes by stressing the importance of independent fiscal institutions, recommending the expansion of the legislative framework in Member States for these to operate more efficiently.

Dóra Piroska explores the system of *New European Bank Governance (NEBG)*, which incorporates EU state aid rules and fiscal regulations. According to the author, the global economic crisis of 2007–2008 was also a key factor in prompting the development of the new bank governance system. The chapter highlights what European-level regulations – apart from the banking union – were introduced in the aftermath of the crisis that affect the banking policies of the Member States, limiting their room for manoeuvre and increasing the control of the European Central Bank, DG Competition, the European Commission and the European Council over EU Member States. However, the author concludes that the changes will allow central banks and other regulators integrated into the European system to fend off criticism much more effectively. These processes can weaken confidence in democratic institutions, especially on the European periphery.

In the next chapter, – *How Much Impact Euro Area Membership Has on the Current Account Balance?* –, *Gábor Kutasi* explores the question of whether the participation of individual Member States in the euro area has had any effect on their current account balance. It also underlines the importance of Member States' compliance with the Maastricht criteria, in particular with regard to the degree of budgetary deficit. It looks at other factors, apart from the exchange rate regime, influence the current account balance. The analysis shows that the patterns in the dynamics of the balances of individual Member States were not directly related to euro area membership. The only difference is between nominal and real adjustment rates.

In his paper entitled *European Capital Market Developments in the Light of Brexit*, *István Magas* reviews the most conceivable developments in the European Union's financial and capital markets after Brexit, partly in the light of mature theoretical considerations long known in the capital markets, and partly in the light of financial integration efforts that gained momentum in the wake of Brexit. One of the key questions asked in the study is whether there are any sufficiently sound economic arguments to support the disintegration of capital markets. At the theoretical level, a variety of approaches (such as modern information and network theories) endorse the opposite, i.e. international capital market integration.

The chapter entitled *Some Questions Regarding the Sustainability of an Economic and Monetary Union* takes us back to the main theme of the volume. *Miklós Losonc* reviews the uncertainties about the long-term sustainability of EMU, which have, for longer and shorter times, intensified during peaks of tension in the decade after the crisis. The author believes the key to the sustainability of Economic and Monetary Union is the fulfilment of the Maastricht criteria and analyses their relevance in detail. The main finding of the analysis is that the sustainability of EMU could have been challenged *inter alia* because monetary integration was not accompanied by fiscal integration. While monetary policy has been raised to EU level, fiscal policy – an essential element of national sovereignty – remains a Member State

competence. The sustainability of the euro area depends to a large extent on the structural reforms that the countries of southern Europe will have to implement. The expected deterioration in external conditions, including rising interest rates, makes this even more compelling. Other euro area countries should also support southern European countries in their adaptation efforts.

Péter Mocsáry's analysis, *Deepening and widening the Economic and Monetary Union*, underlines that the development of EMU has now become a central issue. It is urged not only by the EU centre countries, as other Member States around the centre would also like to see closer integration. Two important challenges are discussed in relation to the development of EMU. The first is the exchange rate movements of non-euro area Member States' currencies, and the second is the fact that Member States have different levels of development. In addition to the commitment of Member States, closing the gap in economic development is also crucial for the success of EMU and the enlargement of the euro area. At the height of the crisis, some predicted the disintegration of the euro area and a deterioration in the quality of monetary integration, but experience has shown that the system demonstrated considerable capacity for self-correction.

The volume concludes with a piece by *Péter Halmai* entitled *Some Peculiarities of the System of the Economic and Monetary Union*. The chapter reviews the different aspects of EMU, highlights the importance of the convergence mechanism and ends with a discussion of the possible content and timing of EMU reform, as well as a confrontation between vision and reality. Special focus is placed on the European Union's cohesion policy as the primary tool of tackling regional disparities. The author also points out that Hungary's accession to the euro area will be a recurrent agenda item in the future. He examines in detail the role of the different dimensions of convergence in the operation of the EMU. He provides convincing evidence to prove that persistent disturbances in the operation of the convergence mechanism jeopardise the smooth functioning of integration, in particular its deepening. The study also takes a look at the recovery from the crisis. The divergences in recovery processes are driven by structural differences. The in-depth analysis in this chapter is supported by a number of figures. In the last section, the author sums up what the EMU 2.0 reform could entail in view of the analyses presented so far. (Radical and incremental reforms are equally possible, designated as the "big" or "small" EMU reform package, respectively.)

This book's content and timely analysis can help better understand the opportunities for reform in Europe and the changes that lie ahead. It is, therefore, highly recommended for students of International and European Union studies and for all who wish to become more knowledgeable and familiar with the current processes mentioned above.