<recto><cn>15.<em><ct>Reforms in the EU: the interface of national and community levels[1]

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There are few issues more contested in the literature on European studies than the question pertaining to the architecture of the European Monetary Union (EMU) as it exists today. Opinions revolve around two basic propositions. In one powerful line of thought, gathering momentum in both academe and policy studies, but also in electoral campaigns and discussions in the European Parliament, the whole construction is wrong. First, because it does not take into account the structural disequilibria in the trade and financial positions of the member states, emanating from their different levels of development and also from their different socio-economic models and the lack of political union. Therefore the arrangements are conducive to regular reoccurrence of structural surpluses and structural deficits that cannot be managed via the exchange rate mechanism or monetary policy in general. Thus, as argued, *inter alia* by Nobel laureate Joseph Stiglitz (2016), the single currency, owing to its misconstruction, is the problem rather than the solution.

Second, as explicated by analysts taking a broader analytical perspective and echoing the concerns of the southern member states, the EMU framework fortifies the inherited core–periphery relations, imposing an overly stringent set of policies on the weaker economies without actually providing the usual benefits via fiscal transfers and allowing for delayed and managed structural adjustment, by allowing for lax fiscal and monetary policies (Magone et al. 2016). The latter no longer counts as an extreme or non-professional viewpoint, as we would have had it a decade ago: sustaining negative real rates of interest, sustaining coexistence of lax fiscal and monetary policies, are often presented as inherent features of the 'new normal' (Blanchard et al. 2016, Chapters 2 and 3).

I have always taken a different position, which seems to have been borne out by the facts. The EMU has proven to be a great success if measured in its own terms. The phrase originally introduced by Helmut Kohl, namely that the single currency is to be 'as strong as the German Mark', has proven right. Perhaps even too much so, judging from the policy-makers at the European Central Bank (ECB), who have adopted a set of policies, not originally envisaged by the mandate of the ECB, to provide liquidity and avoid the threat of a depression, especially since President Mario Draghi famously remarked in July 2012 that the 'ECB will do whatever it takes to save the euro'. This included a series of non-conventional measures of monetary easing, without actually pushing up inflation, as measured by the Harmonized Index of Consumer Prices anywhere close to 2 per cent, the inflation target of the ECB since 2003.

This is not to dispute away or belittle the series of challenges faced at both the Community and national levels, be they in the sphere of environment, unemployment and low labour market participation rates, sluggish innovation and secularly low rates of macroeconomic growth in Europe, let alone the series of problems of a purely political nature that have led to grave consequences, from the Brexit vote in June 2016 to the referendum in Catalonia in October 2017. Also, classical EU policies such as those on cohesion and agriculture, environment and global trade relations, face a series of unmet challenges. However, if we take the classical assignment problem of economics and public administration seriously, it is certainly wrong to ascribe all tasks to a single player, in this case the ECB. As labour markets in the European Union (EU) are nationally segmented, and fiscal policies are also managed nationally, with no structural policies at the Community level, growth as a synthetic indicator of economic success can and should not be measured on the performance of any single player, and vice versa. The result is an outcome of interaction of several policies, with monetary management being only one of many tools, even if a quite powerful one. Therefore I continue to agree with those who appreciate the performance of the ECB and joint monetary policy in securing one of the fundamental side conditions for lasting economic growth: price stability, that is, neither an inflation nor a deflation environment (Brunnermeier et al. 2016; Dallago et al. 2016).

One of the fundamental arguments supporting my view is that several members of the euro zone have been performing quite well in terms of international standards, from Luxembourg to Estonia, and from Slovakia to Germany, and more recently Ireland. Therefore it seems to be a fallacy of overgeneralizing the Greek, French and Portuguese experience if claims about the alleged EMU-induced austerity and the ensuing national-level secular stagnation are being theorized. If we take into account the very broad array of new monetary instruments applied by the ECB since July 2012, and if we are aware of the extensive liquidity provision which has ensued ever since – that is, over a period of five years, thus exceeding the time span of the Great Depression of 1929–33 – the claims advanced about the alleged excessively restrictive stance of the ECB following German economic thinking seem unfounded and misplaced.

In one of the classical debates ever since the classical paper of Martin Feldstein (1997) doubting the viability of EMU on both theoretical and policy grounds, two big questions have been looming – like the proverbial elephant in the room – in the professional debates globally. Number one is: if EMU is infeasible, how did the euro survive, and in good shape, a period of more than 15 years, which is already a respectable time span in economic history terms? Number two, if Feldstein and his countless followers were right, has there been any benefit of non-participation in EMU, and for whom, and why? With the spread of political Euroscepticism and inspired by Brexit, the doubters' voice has become more vocal than, say, it was in the 2000s.

Looking from the economic angle it is hard to find relevant arguments against euro membership for any small open economy. The debate might well have been sidetracked by the fact that English is the lingua franca for the economics and European studies communities. Thus the influence of British positions tends to be magnified by the single language domination in the profession. The United Kingdom (UK) has never been enthusiastic about the single currency, and with good reason. Having been the centre for global capital markets since the late eighteenth century, the City of London easily survives without the complex and also in part politically motivated arrangements of the European Union in general and the ensuing monetary model of integration, and thus also the practical arrangements of the single currency in particular. It is common knowledge that UK capital markets are deep and sophisticated, while Continental capital markets are shallow and segmented; the Capital Market Union is in its planning stage only, with a series of preconditions missing. Banking in the UK is more extensive and sophisticated than on the Continent. The UK financial sector has always been global, transacting more with the rest of the globe than within Europe. The British business cycle has never been synchronized to that of continental Europe (particularly Germany). The UK never traded more with Europe than with the rest of the globe, while continental Europe and the euro zone tend to be a relatively closed economy, on a par with the United States (with trade accounting for 18 to 20 per cent with the non-EU world, measured in terms of the gross domestic product). In short, the UK has never been a serious candidate for monetary union,[2] let alone forming an optimal currency area with the rest of the EU.

Once we abstract away the special situation of the United Kingdom and return to continental Europe, none of the above arguments hold. The euro zone is a relatively closed economy, with synchronized business cycles and a long history of learning-by-doing that culminated in the establishment of a special construct (Issing et al. 2004). The two fundamental arguments have been, first, the need to avoid currency fluctuations, which make retaining a separate currency a luxury good for any small open economy, but even for medium-sized economies; and second, importing the stability originating from the Bundesbank and complementing the single market with a single currency entailed a plethora of obvious and hardly disputable palpable benefits for the vast majority of actors, corporations, banks, households and policy-makers alike. If we exclude currency traders and central bank board members, very few individuals lose out, even in theory, from 'giving up the exchange rate instrument', as long as they joined a stability club with interest rates way below the accustomed historical levels.

Once we consider the experience of crisis management in Europe we find that no country actually benefited from big devaluations or from applying interest rates which would not have shadowed those of the ECB. Therefore neither theory nor policy provides sound arguments for the theoretically conceivable position arguing in favour of a nationally separate, arbitrary or old-fashioned monetary policy and its instruments in any real-world scenario.

The study of various adjustment programmes (most recently, Costa Cabral et al. 2017; Ódor 2017) has underscored the great and fundamental diversity in the member states' coping with the crisis. In other words: there is neither a cookbook to go by that would follow from abstract academic insights, nor do we observe the EMU framework acting as a straightjacket on the options taken by the member states.

This is by no means a trivial observation. On the one hand there is a newly emerging consensus on the features of the 'new normal' set of policies, including the lastingly negative real rates of interest and a relatively lasting application of lax monetary conditions. Furthermore the reliance on fiscal policy tools, including some discretionary elements, is no longer anathema, although as the volumes cited above highlight, the rules-based arrangements still prove superior to ad hoc measures, especially in the medium and longer run.

Meanwhile institutional arrangements have proven to be less crucial than was previously theorized. The availability of complex and highly institutionalized arrangements at the EU level, such as the two-pack, the six-pack, the fiscal compact, and the fines introduced for trespassers, failed to stop the notorious non-compliance of traditional violators of fiscal discipline, such as France and Italy.

Complex national arrangements in Belgium, for instance, failed to impose austerity. By contrast, in some countries the low level of institutionalization has not proven to be a major obstacle to fiscal solidity. As a matter of fact, some of the best performers, such as the Baltics and Slovakia, until very recently, have been operating with a very low level of institutionalizing solid fiscal practices by way of independent fiscal councils or budgetary guidelines anchored in the Constitution. Even in Hungary, abolishing the independent fiscal council with an independent analytical apparatus of its own in 2010 has not led to major derailment. Except for the crisis year of 2011, the government made an effort and managed to keep headline deficits under the Maastricht level; and the reported public debt to GDP ratio, the more relevant indicator for assessing fiscal sustainability in the medium run, has also declined, from 81 per cent in 2010 to 74 per cent by end 2016. While the latter is much less than stipulated in the debt brake framework written in the 2011 new Basic Law – that replaced the 1989 Constitution, negotiated during the round table talks leading to peaceful transition – the improvement is non-trivial and rather exceptional among the EU countries, and EMU countries in particular.

What is the explanation for this paradox? It is less of a novelty to claim that the basically intergovernmental nature of the EU, that is a legal-political setting anchored in the 2009 Lisbon Treaty on the European Union, puts severe limits on any supranational practice that would directly interfere with the economic practices of the member states. At least as important are the precedents, set *inter alia* in 2003–2004 on non-punishment of flagrant fiscal trespassing by Germany and France. This allowed smaller states to replicate, and not only in years of deep recession. The most obvious case has been Greece (Visvizi 2014), but other countries such as Hungary also managed to allow practices that are out of line with the Community financial framework in philosophy and implementation alike.

On the national level the explanation lies in the nature of the polity in each country. In the well-performing countries there is a wide professional and also social consensus over the basic issues, for example about what is the right way to follow. In Ireland, for instance, big political changes have not prevented the successful continuation of the adjustment programme and of financial consolidation of the banking sector. In Slovakia a hectic political scene never translated into a derailment in the fiscal and monetary fields. In short, broad consensus – both professional and political – was able to fill the institutional gaps with success.

By contrast, the only commonality in the varieties of political complexities shared by the trespassing countries is the lack of consensus and the weak implementation capacity of formal institutions. This sounds like a platitude in some cases, such as Greece and Portugal.[3] It is less trivial but equally important in countries such as Spain, where fiscal improvements seem to have been making headway since the early 2000s or so. However, as the 2008–2009 crisis has revealed, local finance revolving around the local savings institutions, the *caixas*, has sustained an intimate and unhealthy relationship with local political structures, thus undermining the efforts of the central government and the central bank alike.

From the above it follows that the euro zone framework cannot and should not be blamed for what has been, in essence, poor national crisis management. The framework, to be discussed in the next point, has not been perfect, but did not constitute a barrier to successful adjustment. True, it has also proven ineffectual in pressing for deep changes and adjustment in the countries in difficulty, most importantly in France, Spain and Greece.

It would be grossly unfair to skip the question of whether and to what degree the euro zone framework has been able to cope with the financial crisis of the past, and to what extent has it been upgraded to forestall similar events in the future. As far as the past is concerned, the answer is rather negative. The crisis has uncovered the improvised and unfinished nature of the EMU framework, lamed by a large degree of national egoism and unwillingness to confer power to the Community-level regulators even in cases where the logic of the internal market would have called for it. What emerged in 2016 as the Single Resolution Mechanism is basically the implementation of the Lámfalussy proposals dating back to 2001 (more on that in Kudrna 2016). The ECB could not play the role of lender of last resort within its original mandate, which has proven to be a problem during crisis management. In a single market with many cross-border transactions, banking supervision is bound to be transnational (that happened only in 2014). Last but not least, the insight over the need to create a standing buffer to avert and pre-empt speculative attacks took a long time to emerge in the form of the European Stability Mechanism.

It is difficult to assess whether those new arrangements – somewhat overambitiously termed as the Fiscal and Banking Union – will prove waterproof in the case of the next crises. This is so not least because of the ever-growing expansion of private finance and globalization. If, back in 1994, a US$50 billion dollar bail-out for Mexico was considered to be a jumbo deal, by now a ‘normal’ Greek rescheduling – which is unlikely to be a singular, one-shot action as was the case with Mexico – involves similar or bigger sums without calling for headlines in the news. Monthly asset purchases in the range of €80 billion – twice nominally the sum mentioned[4] – and targeted discretionary measures, as well as liquidity provision without upper limits, constitute an integral part of the unconventional monetary policy instruments lavishly used by the ECB since 2014 (see Alvarez et al. 2017). Financial innovation implying market actors’ ability to circumvent rules is unlikely to come to a halt. Also, in times of crisis the cohesiveness of the Community is crucial for efficient and swift action; this may or may not be forthcoming.

What seems to be a fundamental unresolved problem, as I have argued earlier (Csaba 2016), is the fact that all the institutional and policy innovations of the Fiscal and Banking Union, as well as the transformation of the ECB into a fully fledged central bank with the respective function of lender of last resort, have all taken place outside the framework of the Treaty on the Functioning of the European Union. This is problematic in its own right, and even more so in terms of the democratic legitimation of technically necessary measures of improvement. With the United Kingdom leaving the EU in 2019, the major player which opposed any changes to the Treaty has gone. On the other hand, even elementary familiarity with German, French, Italian and Spanish politics indicate that far-reaching changes, as indicated in the White Paper and the Commission paper on the financing options for the next pluri-annual framework, are unlikely to receive the kind of political backing which is needed for such bold initiatives to materialize. Thus further deepening of the Fiscal and Banking Union through issuance of sovereign-backed securities, without this leading to the unconditional mutualization of public debt obligations, looks both technically feasible and economically desirable (Demarry and Matthes 2017). Still, the likelihood of this to happen is sub-minimal, for the very reason mentioned above: the lack of political momentum in the big states in the driving seat. This bleak outlook may change, though, if the political impasse is overcome with the new European Parliament and Commission coming in by mid-2019. Should the domestic political situation come to appeasement, the chance of a Treaty revision, allowed for by the conclusion of Brexit by that time (Fabbrini 2017), could settle this weighty strategic question. Still, the latter seems a highly optimistic reading of events against the sad reality, namely that the weakness of the governance in the large member states is structural rather than ephemeral, ad hoc in nature.

Finally, who should reform, and in what way? (Taking into account that the answer can only be partial, owing to the open-ended nature of the processes analysed.) As far as the Community level is concerned, much of the improvements that are technically necessary as a minimum have been realized. The €705 billion managed by the technocratic team of the European Stability Mechanism (ESM) constitutes a respectable sum to deter playful market actors from speculating against the single currency and the governments of the euro zone. The quasi-unlimited liquidity provision of the ECB and its intervention in favour of ailing economies allows to pre-empt the replication of sudden stops and the drying out of money markets for them. Stress tests conducted by the joint banking supervisions serve as an early warning system to induce capital adequacy improvements and structural upgrading in banks of systemic relevance.

On the other hand, the paradox I discussed in terms of national economies survives at the EU level. As a matter of fact, owing to the de facto two-speed Europe it is likely to intensify. Member states which de facto opted out from the euro zone for reasons of retaining their political room for manoeuvre and freedom to choose any option they deem appropriate – not constrained by the joint framework – are unlikely to get along with the majority, especially not in a quasi-automatic fashion. Consensus-building thus is likely to remain fragmentary and inadequate, with the unreformed system of decision-making in the European Council and the European Parliament causing any decision to come late.

In turn, national reforms supportive of competitiveness cum financial solidity remain key. Possibilities for such measures vary by country. In France, for instance, newly elected President Macron has faced the first strikes against his labour market measures already in the prime time of his taking office. By contrast, the Baltic states continue with their tough line without encountering serious opposition. In much of Central Europe the ambition as well as the ability to change seems to have ebbed. These countries are thus likely to stay out of the euro zone, though the broader and palpable economic benefits of doing so remain unclear to any informed observer. Keeping all policy options open against a rules-based framework is a conceivable stance, but one burdened with high risks for any small open and financially vulnerable economy.

<a>NOTES

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1.<em>This chapter is a significantly revised version of a paper prepared for a conference of the Oesterreichische Nationalbank entitled ‘A Modern Take on Structural Reforms’, Vienna, 20–21 November 2017. Useful comments of conference participants on the preliminary version are appreciated, with the usual caveats.

2.<em>The ‘five economic tests’ promulgated by then Chancellor of the Exchequer, Gordon Brown, in June 2003 was a clear admission of the United Kingdom not being ready for the single currency ‘any time soon’.

3.<em>Compare, extensively, Kotios et al. (2017) and Bongart and Torres (2017).

4.<em>At the time of writing American tapering of these is over, while ECB communication to date shows no sign of replicating the United States practice, despite expectations of many market participants to this end.

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