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The European Integration and its International Dimension: An Introduction

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Almost 20 years after the onset of the currency union, the European Integration remains challenging for certain member states. The severe economic crisis in the last nine years has put the fundaments of the European Union (EU) in doubt. Still, it has given answers to many questions that would not have been put without the severity of the ensuing deep recessions and the high burden of unemployment in some EU countries. The warnings of the literature on optimum currency areas were pulled out of the hat but they offered rather an alert than a realistic solution to the issues endangering the further existence of the currency union. While the crisis exposed weaknesses in these regards, it also fostered reforms that improved the optimum currency area conditions of the euro area (Matthes/Iara, 2017). However, the lack of a lender of last resort made the stressed and often highly indebted countries an easy prey for self-fulfilling prophesies. At the height of the financial markets' panic, it was all about psychology and less so about economy. A promise, a speech, a commitment – this is what was needed to save the euro. Only three words by Mario Draghi, "Whatever it takes…", were sufficient to calm the markets and gain time for reforms to take effect (Matthes, 2015). Monetary policy turned into a captive of low inflation and temporarily also fear of deflation. Its effect on real activity of the whole currency union was substantially dampened since the member states' economies reacted very heterogeneously to lower interest rate and unconventional monetary policy measures (Boeckx et al., 2017, Burriel and Galesi, 2018, Georgiadis, 2015). Recent research by Burriel and Galesi (2018) shows that especially countries with more fragile banking systems seem to benefit the least from unconventional monetary policy measures – especially in terms of output gains. The business cycle in the EU still exists and even though this time is different, it will come to an end. It remains to be seen if Mario Draghi will be the ECB president who will go down in history by having killed the interest rate as a monetary policy instrument.

But why is it so difficult to coordinate policies and to assure fiscal discipline – as required by the commitment to be part of the project called European monetary integration in order to assure the stability of the monetary union? And still, it delivers plausible explanations, even in cases when they are not comfortable at all. Because one possible explanation for the difficulties facing the Greek economy since the breakout of the economic crisis is as simple as that: Greece was probably not ready to join the monetary union. Neither in terms of convergence, nor in terms of political commitment. Since there is no feasible way back, the readiness of the Greek economy to introduce the common currency in 2001 is not the issue. Instead, the point has been in recent years how to make the best of the current situation – and to take care that the Greek economy adjusts to the requirements of the currency union. First and foremost, the issue has been to help it to get back on its feet. As Ansgar Belke and Daniel Ross

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stress in this issue, regaining competitiveness is only possible via internal devaluation, i.e. a fall in domestic prices and wages. Their analysis points out that labor markets function very differently across the EU. If the Greek Phillips curve had the same slope as that of Latvia, i.e. if the reaction of wages in Greece to unemployment were as in Latvia, then it would have been sufficient to have one year of unemployment at the present level to achieve the adjustment needed to bring competitiveness back to acceptable levels. However, in Greece wages seemed to be largely insensitive to unemployment before the crisis and this changed only with the crisis and the adjustment program. It remains questionable if this was only due to the program, since it is also very likely that labor market participants behaved differently because of the different environment the country faced. In Portugal, on the contrary, wages and unemployment had been closely linked even before the crisis and the program has hardly changed this relationship. The onset of the euro provided wrong incentives – mainly the steep decline in interest rates in Southern Europe. Moreover, fiscal rules were not always taken seriously after Germany and France had bent them.

A similar pattern can be observed also regarding public indebtedness in the EU cross-country comparison and over time. Especially in the last decade and during the course of the economic crisis, fiscal discipline and the role of expansionary policy have been revised several times. Debt increased in the EU as a whole from 58 % of GDP in 2007 to 89 % of GDP in 2014 – partly because of fiscal stimulus and rescue packages combined with shrinking government revenues during the recession – and among the main contributors are not only the crisis countries but also countries like France and the Netherlands, where gross public debt increased in the same period by nearly 30 percentage points of GDP. Some countries of Central and Eastern Europe let debt increase as well. In Hungary, gross public debt increased from 66 % of GDP in 2007 to 76 % of GDP in 2014, in Slovenia the increase in the same time period was even more dramatic, from 23 % of GDP to 80 % of GDP. Although there are plausible explanations for this development in the course of banking crisis, recession and increasing private indebtedness, the question arises about other reasons for neglecting fiscal discipline. Is the increase in indebtedness the result of urgently needed expansionary impulses or is it again psychology? Have the incentives to join the monetary union decreased in the course of the economic crisis? Or is it even the successfully accomplished EU accession that decreased the incentive to stick to the rules? Indeed, there has been significant change in behavior during the crisis indicating a stronger response to public debt increases since 2008, especially for crisis-affected countries (Baldi and Staehr, 2013). Still, public debt has been on an increasing path for a long period of time. In the new EU-member states (NMS) from Central and Eastern Europe the accession to the EU has induced change in behavior as well, as the result from the research by Bettina Bökemeier in this issue show. The panel analysis of 8 NMS indicates sustainable fiscal behavior since the governments of the countries, on average, reacted by raising primary surpluses (reducing primary deficits) when public debts increased. Especially in the period before EU accession the countries were putting strong effort and emphasis on fiscal sustainability and on fulfilling the criteria for EU membership. After accession, however, the corresponding effect was lower, although still significant. Sustainability remained a political priority – but slipped down on the priority list. Especially as a member of the Union, the NMS are expected to retune their fiscal discipline to former sustainable fiscal paths.

The results by Bökemeier address a further issue, namely the role of fiscal policy within the business cycle. The analysis indicates countercyclical behavior for the group of the NMS. Fincke and Wolski (2016) confirm this result especially for the time period since EU accession. They find a structural break in fiscal policy, implying more counter-cyclical fiscal policy in recent years. Accession to the EU could be a trigger to changes in policy behavior, and still it has pushed convergence in economic terms forward. Of course, a change of this magnitude needs time for adjustment – and it is similar across countries. As Aleksandar Vasilev shows in this issue for the case of Bulgaria, both transition and EU accession experience and even the slump during the financial crisis are comparable in magnitude to what other old and new EU member states experienced. More competition and more flexible labor markets could support the adjustment process. Nevertheless, Bulgaria remains a country where much still has to be done in order to achieve further convergence. Capital utilization is a problem, demographics, aging and migration, education and last but not least corruption and judicial independence have to be addressed to alleviate the doubts about the EU membership of the country.

The recent experience of the EU point towards significant challenges. However, there has also been good will to reform the Union and to put it on a sustainable path that is less fragile and vulnerable when it comes to an economic downturn. The past enlargements show that even enlargement and the associated divergence of opinions and positions within the Union can bolster deepening integration (Keleman et al., 2014). For sure, the impact of widening on deepening depends on the position of the enlargement state relative to the existing members within the preference distribution. Widening can also provide impetus for institutional changes which are needed to facilitate deepening over the long run.

The economic crisis is still not completely over and political actors need to find solutions to new problems like those arising from increasing migration. The history of the European Union remains a reliable source of optimism, since the current crises are not the first to have been faced by the Community (Nugent, 2017). After the "eurosclerosis" in the late 1970s and the early 1980s, the budgetary crisis of the early-to-mid 1980s and the "treaty crises" of the 1990s and 2000s, the EU has some experience in dealing with difficulties in the process of European integration. However, serious though they were, none of these past crises and challenges were on the scale of the past economic crisis or the disintegration expected in 2019 due to the Brexit. It is more than ever obvious that a new approach is needed and the time for a fundamental reform has come.

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