At the Gateway to a New Integration Paradigm

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'Deepintegration'.

The Economics of the Economic and Monetary Union

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It is not the first time that *Péter Halmai* fills the economics of integration with fresh and innovative ideas.[1] Now, in his new book '*Deepintegration*', he has rotated the frameworks of interpretation, examination, and content related to economic and monetary integration so as to bring fresh air to the stale theses that have been repeatedly described, or empirically substantiated and refuted by many in the past three-four decades. The Széchenyi Prize-winning academician undertakes not less in the book than to place everything we have known and thought so far about economic and monetary integration in the framework of a new paradigm, based on the latest theories of trade and growth.[2]

The book is based on the general recognition that the crisis in the euro area in the early 2010s shook confidence in the EU (as an international institutional framework for more effective economic policy) as well as in the process of economic integration. As, for example, *Benczes* (2020) concludes, from an analysis of institutions, that in the 2010s the EU's Community-level economic governance turned from being a solution into being part of the problem. Despite all these developments, the book – using new trade and growth theories to explore deeper economic contexts – convincingly demonstrates the existence and a strengthening trend of elementally exogenous and increasingly endogenous interdependences linking the system together. All this may substantiate the need for an ever closer integration as well as the economic and scientific background of this vision. The theoretical system and empirical foundation of 'deepintegration' justify the need for a growing homogeneity in the EMU and the deepening of economic integration. What follows from the above is the strengthening of European economic governance in the core integration and, at the same time, additional transfer of sovereignty. Thus, even if convergence cannot be strengthened in all cases, the asymmetric shock-absorbing capacity (resilience) of the euro area may be improved and the threat of disintegration, becoming a reality now, may be offset.

The function of the book as a whole is to open the door to the new paradigm. Accordingly, it begins with the foundations of integration theory, starting from the deepening process, to integration theories and customs union theories, to a graphical analysis of demand and cost functions, to the interpretation of the process of economic liberalization, and to the need to harmonize economic cycles. The book, already in its first chapter, describes the exciting novel idea of merging intra-sector trade with integration theory (page 72). Chapter 1 essentially brings together all the classical integration theories that are considered later in the book, starting from Chapter 3.

Chapter 2 sheds light on the interpretive framework for 'deepintegration', starting from a new trade theory that interprets regulatory convergence as 'deepintegration'. According to the author, the depth of integration is a crucial dimension in the process of European integration. It indicates not only the state of progress but also the direction of the development process (pages 143-147). Interpreting deep (regional) integration (i.e. 'deepintegration') as a system or a conceptual framework is a significant step forward in the renewal of comprehensive integration theory. The two main dimensions of the interpretive framework for 'deepintegration' are depth and homogeneity. Based on their combinations, the various stages of integration, development phases and configurations can all be analysed within a systematic framework. 'Deepintegration' is a category summarizing the features of a system that, while relying on '*an increasingly close core integration*', can also interpret the integration of the periphery. This framework sets out the main features of the system of 'deepintegration', starting from deep trade integration to a free movement of factors and to supranational structures (pages 148-153).

The concept, briefly summarized, contains a number of novel elements. It broadens the interpretation of integration by adding, inter alia, agreements with third countries, a holistic examination of the benefits of integration, and the effects of growth outside the European Union. It is very important that 'deepintegration', as interpreted in the book, can integrate the model of a multi-speed Europe, as explained in Chapter 9 (pages 365-372). The empirical literature review in this Chapter deals with a wide range of methodologies taken from studies covering methodologies ranging from CGE models[3] to descriptive statistics and to regression models. This also strengthens the professional profile of the author, namely, that it is not enough *to be* a macroeconomist, you should also *look like* one. The author's professional career is exemplary in this sense, too. While presenting results and graphs of macroeconomic functions in abundance in his book '*Deepintegration*', the author had already placed great emphasis on the application of growth accounting and integration macroeconomics in his volume of 2014 (Halmai, 2014), which laid strong technical foundations for '*Deepintegration*', exceeding the book, less mathematical in terms of economic methodology, written by Palánkai et al. (2011).

Chapter 3 builds on the theory of optimal currency area (OCA) to establish a set of criteria against which to interpret the success or failure of 'deepintegration' in the euro area. Key elements of these criteria include an endogenous approach to OCA as well as determinants of responsiveness and resilience to asymmetric shocks (such as flexibility of production factor markets; fiscal transfers; diversification of industry; trade openness; homogeneity of economic policy preferences; and the degree of solidarity). This analysis is actually carried out for the euro area. Here, however, some critical remarks can be made. On the one hand, concerning the issue of solidarity versus (economic) nationalism, the statement that '*no one may be a free-rider in the Monetary Union*' (page 189), a requirement for whose fulfilment is otherwise justified, is highly questionable in the light of the fiscal indiscipline of the 2000s. Moreover, if, going beyond macroeconomics, we use an approach from the aspects of politics and economics to study the ways in which the leaders of Greece, taking advantage of the country's geopolitical importance, had, during the decades before the sovereign debt crisis, steadily escaped austerity measures, reforms and agreements on them, then we can see a possibility for someone to be a free-rider, after all. A relevant and exciting statement by the author is that there has been a marked divergence in social indicators in the euro area so far, which is a phenomenon showing not too much solidarity (page 288).

The other critical point is competitiveness expressed in terms of real exchange rates and the balance of payments for countries within the integration. Section 6.3. addresses the problem of external balance, but an even deeper analysis would be needed. It may not be relevant to the new paradigm, but the book – illustrating it by a pair of real effective exchange rates from Italy – considers the problem to be resolved more or less, by saying that '*the long-term equilibrium level of the real exchange rate is relatively constant*' (page 171), while external imbalance is striking and that interest on external debt can place a significant burden on some Member States, which may also cause a shock of economic downturn (page 275). It is worth adding that the challenge doesn't lie in whether a country's real effective exchange rate (REER) fluctuates over a 40-year horizon, but in the fact that, during the monetary integration, the less competitive Italian REER has risen by 8-10 percent, while the more competitive German REER has decreased by 20 percent. This price and wage convergence will persist, while the German economy has undergone significant structural reforms and the Italian economy has not.[4] (See: European Commission, DG-ECFIN, Price and Competitiveness Indicators.). As a result, the German economy will absorb net exports from most of the other Member States as long as the latter ones fail to implement radical reforms in labour market, vocational training, pension regulations, etc. This problem is reinforced by Figure 7.5 of the book (page 283), which clearly shows that there was a divergence between the German economy and some selected Southern-European and the French economies in the 2010s. There is a solution to this problem in the form of a foreign exchange reserve criterion (Kutasi, 2015). This has not been included in the literary canon of the European monetary integration, presumably because of the assumptions about homogenization and convergence derived from internal market trade processes by the endogenous OCA, which is also highlighted in the book.

Chapters 4 and 5 take a close look at the EMU's rules, changes in them, and additions made to them during the debt crisis in 2010. In addition, the two chapters also follow the economic policy actions and the steps of economic governance until the end of crisis management efforts in the 2010s.

A critical analysis of EMU is contained in Chapters 6 and 7, cited above, which provide an overview of the structural flaws and weaknesses of the system. A novel approach is to include a cyclical approach to convergence in the EMU discourse, as a long-term convergence[5] could not be demonstrated in Part 7. At the same time, an assumption seems to be justified, namely that the negative shock of crises fundamentally breaks the process of convergence and homogenisation and, once the asymmetric shocks of the crisis have been absorbed, convergence will continue even in comparison to the pre-crisis starting point. This thesis opens the build-up of a new paradigm structure, starting with Chapter 8 explaining economic resilience, which means shock avoidance and ability to recover. In this Chapter, we can learn about what else can be done to improve the single internal market; and how to interpret vulnerability to shocks and the capacity to absorb shocks. Concepts such as diversity and price elasticity are not entirely new ones, but an approach based on the concept of resilience (and the underlying empirical background) gives new meaning and function to the microeconomic tools of integration. On the subject of shock absorption and recovery, readers can get a practical economic policy guidance on where economic policy makers have room for manoeuvre and how this can manifest itself in European economic governance, inter alia in the financial services market or the labour market.

Developments in 2010 have led to the general perception that the EMU's institutional framework is inadequate (Benczes and Kutasi, 2010). Additions to this framework were made a decade ago to increase crisis resilience, as analysed in Chapter 5, but the system has not fundamentally changed. Chapter 9 explains all phases of any possible further deepening and considers the possibility thereof, building on the scenarios of the Commission's 2017 White Paper on a Multi-Speed Europe. Its conclusion concerning the reform is the need to achieve risk-sharing between Member States, which – by forming a kind of financial and economic risk community – can create security, thereby increasing economic efficiency and the convergence of the region and even the region's attractiveness to those outside the euro area. The unsustainable balance of EMU 1.0 requires changes, or a reform of the EMU, as a comprehensive solution. (It should be noted that so far even the Covid crisis has been sufficient for no more than to force Member States to create a one-off debt union in the form of the, so-called, New Generation bond financing.)

Halmai describes the gradual transformation of the EMU as a bold vision and a delayed reform; and the latter one seems to be working, for the time being, taking mainly the forms of aid funds and the banking union on a lasting basis. If we disregard the deeper mechanisms of endogenous interdependence presented in the book, which are also the driving forces of the further deepening of the integration, then the situation can be reinterpreted somewhat by saying that the deeper the integration penetrates into financial and fiscal sovereignty (which provide the basis for national sovereignty), the stronger resistance it will experience and the fewer supporters it can expect from among member states. All this underscores the political economics context and – not surprisingly on the subject of integration – the political context of the issue. At the same time, the multi-speed solution outlined in Chapter 9 and the introduction of the concept of core integration represent important steps for furthering integration. The concepts of core integration, multi-speed, and differentiated integration make it possible to interpret drop-out during the deepening process as something that does not automatically undermine the convergence objective but maintains the possibility of convergence, to a greater or lesser extent, with different groups of Member States participating in the integration at different depths. This maintains the attractiveness of integration as opposed to the exit option.

Using the above as a starting point, Chapter 10 specifies one of the basic dimensions of the interpretive framework by name: differentiated integration. This creates a new language in the scientific, public and political discussion about integration. Thus, not only two options (stay versus exit) can be considered, either scientifically or politically, any longer. Moreover, the option of staying in will become a cornerstone in the discourse from now on, and the question to be decided will remain to be only the level of integration at which a Member State should participate. At the same time, the book does not forget that integration is a political process, fundamentally. Statements to that effect are made in several parts of the book (pages 21 and 456), and Chapter 11 describes Brexit[6] to show how a political decision can lead to economic damage, even if convincing economic arguments have not necessarily convinced the majority of British voters. Brexit is an excellent example of what happens when – according to the themes of a political campaign – there is a choice only between staying in and leaving. The discourse of differentiated integration is a preventive one in this sense.

Chapter 12 undertakes to summarize the conclusions of broader integration theory beyond the narrower field of analysis. As one of the main achievements of the work, a new analytical framework, i.e. the 'deepintegration' paradigm, is outlined through rethinking the integration theory, and, in this context, it summarizes, among other topics, how it is possible to reinterpret the issue of transfer of sovereignty through the concept of differentiated integration, so as to satisfy each Member State according to their individual preferences in the integration process. Citing the closing sentences: '*The key to the new paradigm is a deepening core integration. In the system of 'deepintegration', core integration is the determining factor and the carrier of the dynamics of the system. In 'deepintegration', core integration matters*.' (page 502)

A holistic and unified approach, in terms of both content and methodology, is used to create a truly new paradigm in the discourse on European integration as regards both the EMU as a whole and the domestic debates on integration. ■

Notes

[1] Some works by the same author, which are the direct precursors to this book and deal with comprehensive issues too, were published in 2013, 2014, 2017 and 2020

[2] For precursors of growth theory of the book, see *Elekes, Halmai* (2013a, b), *Halmai* (2011, 2014, 2015, 2018a), *Halmai, Vásáry* (2010, 2011)

[3] For more information on CGE models, see Kutasi et al. (2014)

[4] These issues are discussed in several places in the book (see, for example, pages 219-221, 256-257, and 273-275)

[5] On the issue of convergence, see, for example: Halmai, Vásáry (2012); Halmai (2019a, 2019b)

[6] For more details, see: *Halmai* (2018b, 2020b, c, d)

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