Q&A

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Time to rethink economic policies

Has Europe fully reaped the potential benefits of the single currency and single financial market over the past 30 years? What are the key challenges the European economy must address going forward?

Europe celebrates the 25th anniversary of the introduction of the single currency in 2024. During this quarter of a century the euro has provided a symbol of unity through incredibly testing times, and motivation to support each other through the darkest of hours. The single currency has shielded the member countries from external shocks. In the shadow of the decades of crisis, the great achievement is the existence of the euro. The euro was born at a good time, but it is not certain that it will experience good times, as economic difficulties and crises affecting the eurozone pose challenges to the common currency. Although the number of countries using the euro has risen from the initial 12 to 20 in the past 25 years, there remains much cause for debate due to the region's results in terms of economic development, competitiveness and cohesion. The facts indicate that the euro area is still lagging behind in the global competition compared to other regions. The weight of the euro area has fallen within the global GDP from 21.8 percent in 1999 with 12 member states to 14.7 percent in 2023 with 20 member states. The 12 founding countries achieved an average annual GDP growth of 1.5 per cent in the last 25 years, less than the over 2 per cent figure achieved by the United States of America.

Boasting an outstanding performance throughout its history, Europe is falling increasingly behind in terms of innovation, with a particularly prominent lag in terms of the growth in intangible investments and productivity. In the two decades since 2004, US productivity growth, as measured by the value of output per hour worked, has been more than double that of the eurozone. Whereas eurozone productivity has flat-lined and even fallen slightly since the outbreak of the COVID-19 pandemic, US non-farm output per hour has risen by more than 6 percent over the same period. Demographic trends in Europe are worsening, compounded by the failure to effectively adapt artificial intelligence technologies. There are significant labor market imbalances, with a notable East-to-West migration of the workforce and increasingly divergent fiscal policies across member states.

Europe still does not fully utilize the benefits of the single market, despite the fact that European consumption is high in international comparison. Therefore, it is important to strengthen connectivity in individual markets, financial markets, consumer markets, and infrastructure. There are key technologies in which progress must be made for Europe to continue developing, such as finance, which is one of the most important innovations of the 21st century. A financial system needs to be developed that can allocate savings quickly, securely, and efficiently.

This alongside with the megatrends emerging in the 21st century, pose significant challenges to government budgets, which means that their role must be fundamentally reconsidered. The green and digital transition is of paramount importance but cannot be implemented without budgetary commitments. Also, the changing geopolitical landscape and the increasing need for security lift the expenditures on security and defence. Finally, ageing societies and higher interest rate environment will automatically increase social and interest expenditures. We should strengthen competitiveness and ensure sustainability at the same time in both advanced and emerging countries. In this regard, a positive change of the new EU fiscal framework is that the national medium-term fiscal structural plans can take country-specific factors into account to a greater extent and more relevant factors are accounted for (national defence spending, increase in interest expenditures, structural reforms).

What are the main economic challenges facing the CEE region, and how are they evolving? What are the key medium- and long-term public policy objectives for promoting growth in the region?

In 1999, the development level of the CEE region, measured by GDP per capita as a percentage of EU average was only 47.8 percent. By 2004, this figure had risen to 56.5 percent, and by 2023 it had increased to 78.3 percent. The pace of economic convergence was different among these countries. Czechia, Slovenia or Lithuania have already approached or exceeded 90 percent of the EU average GDP per capita level, while others have been at the top of middle-income status.

The challenges of the 2020s made it clear, that the European Union must follow the formula of balance and growth. Extensive growth models of the 20th century cannot be continued in the 21st century, a transition to an intensive growth path is required, the competitiveness is the key to the future. Due to the narrower monetary and fiscal room for maneuver, the role of structural policies has increased in value.

- In the light of demographic challenges globally, the importance of quality workforce has increased remarkably. Investments in high-quality education, lifelong learning and digital skills are inevitable to develop human capital and strengthen the quality of workforce.
- We must build our own future. Instead of the quantity of investments, emphasis should be placed on the quality, as smart and green investments are keys to winning the next decades and to increase our competitiveness.
- The future is green. High energy consumption and imports are unsustainable, expensive and cause vulnerability. We must strive for energy sovereignty and a competitive energy mix based on internal renewable energy sources in the EU, and particularly in the CEE region. 9 out of the EU's 10 most energy intensive countries are located in the CEE region. MNB was the first European central bank to obtain a green mandate to encourage and lead the economy and the financial system onto a climate-friendly path.

The CEE region possesses significant growth potential and could serve as the engine of European growth in the future. Kenneth Rogoff, professor at the Harvard University also highlighted the growth potential in the CEE region. According to Rogoff, the CEE region holds significant promise due to its economic reforms, integration into the European Union, and relatively high growth rates compared to Western Europe. Rogoff has pointed out that these factors collectively contribute to the region's potential to drive economic growth within Europe, indicating its emerging role as a key growth engine for the continent.

What is the expected impact of EU initiatives such as NGEU, CMU, and digital and green policies on growth in the CEE region? Are these initiatives well-suited to the specific needs of the CEE region and are additional initiatives required?

The goals of the NGEU are appropriate, yet the speed of execution and the political threads that appear as a condition of use do not support a quick economic recovery.

Hungary supports the deepening of the Capital Markets Union (CMU). Some progress has already been made in the CMU initiative, but further work is needed. In this context it is crucial for Hungary to focus on the development of smaller European capital markets too. For the improvement of retail participation in the capital markets, we believe that reducing regulatory and administrative burden and increasing financial literacy are key drivers. There are significant private savings within the EU, estimated to be around EUR 33 trillion. It is important to effectively channel these savings into productive investment that creates innovation and drive economic growth. Furthermore, it is important that the investments being realized take into account not only the interests of the larger countries but also those of the smaller ones.

Digital and green policies drive the region's transition to a digital and sustainable economy, modernizing industries and promoting renewable energy. This will be key in the current and the next decade, hopefully the CEE region will become a European hub in the GreenTech and the CleanTech industries.

However, to fully realize all the economic opportunities, additional measures are needed, such as targeted regional funds, sector-specific investments, capacity building, skills development, and strengthened institutional frameworks. These tailored initiatives will address the unique challenges and opportunities within the CEE region, ensuring comprehensive and inclusive growth.