

Europe and Economic Integration

Historical and Political Context

Europe in International Economy
2015



The integration of Western Europe

- In **15 years** from a total **war** to the creation of **unprecedented transnational entity**;
- **France: ECSC** – ensure a **reliable supply** of **coal** from the Ruhr – to enhance its own and to limit GER **armaments industry** (*Verdier*);
 - **Euroatom** – achieving **energy security** and **control** of European **A. bomb**;
 - Charles **de Gaulle**: **never** again be France **threatened** by **Germany** + promised foreign **policy independence** from **US**;
- **Germany** – integration for **regaining international respectability**;
 - rebranding Germany as a country of **committed Europeanists**;
- Economic inheritance – **complementary economic structures**;
 - Germany **capital goods**, France **consumer goods**, Benelux provided **food**, finance and transshipment **services**;
 - **1930s Balkanized** European **economies** – **unity** (nationalism, protectionisms, EoS);
- **US** – extraordinary **imbalance** of power – generally **supportive** on both political and economic grounds – united against **Soviet threat** – stability and prosperity;
- Three main actors **FRA, GER, US + GB**;
- **GB ambiguous** – **strong** interests and **ties** to the **Commonwealth** – reluctant to reorient;
 - **Sceptical** about integration – but aspiration to **shape** the integrationist **project**;

- **ECSC**

- **economic** initiative – designed to facilitate the **recovery** and **rationalization** of Europe's **steel industry** by **coordination** national **production** and **investment** plans;
- **political aspect** – *Schuman Plan* for ECSC (French foreign minister) drafted by Jean Monnet – first step in **political integration**;
 - ECSC governed by a **supranational High Authority** checked by a **Special Council of Ministers** a **Common Assembly** (78 advisers) and **High Court** (7 judges);

- **Political Integration:**

- **no consensus** of **elite**, **much less popular support** - conducted in secret;
- in **1954** the **French Assembly rejected** proposal for a **European Defense Community** (EDC) and a **European Political Community**;
- designed to **integrate GER** military force into European army -> since then **collective security** as a group of sovereign states in the **US led NATO**;
- The advocates of deeper integration responded by **focusing on concrete goal** - creating a **custom union**:
 - attempted to capitalize on **concerns** about the **competitiveness** of Europe (small **size** of national **markets** as a handicap);
- **Opposing position: FTA is enough;**

Table 1.1 Schematic presentation of economic integration schemes

Scheme	Free intra-scheme trade	Common commercial policy (CCP)	Free factor mobility	Common monetary and fiscal policy	One government
Free trade area (FTA)	Yes	No	No	No	No
Customs union (CU)	Yes	Yes	No	No	No
Common market (CM)	Yes	Yes	Yes	No	No
Economic union (EcU)	Yes	Yes	Yes	Yes	No
Political union (PU)	Yes	Yes	Yes	Yes	Yes

- **Proposal for re-launching integration** came from **Benelux** 1953 and 1955:
 - **France torpedoed** it – **explored** other **options**: economic **union** with the **UK**;
 - **British refused** – **France** was **left** with **no alternative** to a custom union of the **six** – attempted to extract as many **concessions** as possible (import taxes and subsidies, safeguards commission);
- **Skepticism** of the merits of **political integration**:
 - **Benelux** – threat to **independence**;
 - **French** – accepts only as tool to **enhance power** → **qualified majority** only on issues on which was confident of forming a majority;
 - **UK** – even less enthusiastic – looking for **alternatives** – Europe-wide **free trade area**;
 - **German** industry **highly competitive** – positively disposed towards **British proposal**;
- **FTA** (country with **lowest tariffs** set the pace for liberalization) was **not acceptable for FRA**;
 - **Rules of origin** being hard to enforce – **tariffs** would tend to be forced **down**;
 - France **preferred CU** – to **control** the **common** external **tariff** and liberalize more gradually;
 - Consequently – opening to **six safer** than to whole Europe;
- **GER** – **either way** – inclined toward the **UK proposal**:
 - *Erhard* worried that **small community** tilted toward **France** would **discriminate** against **nonmembers** and protect **inefficient** producers;
 - *Adenauer* – favored an **Europe of the six** that **promised** to be **more than a free trade** area;



British Dilemma

- **UK insisted** on the maintenance of **imperial preference** and **exclusion** of **agricultural** goods (to continue import foodstuff from **Commonwealth**) – drove **GER** into **FRA** arms;
- **FRA** and **GER** insisted on **equal access for their farmers**, although with **price supports** and **protection** from **extra-European** supplies;
 - de **Gaulle** prime minister **1958** – **announced** that discussions of the **FTA (GB)** were at **end**;
- **New communities** will be **modeled** on the **ECSC** – governed by a **Commission**, a **Parliament** and a **Court** of Justice (uncomfortable **supranational aspect**);
- Two **conflicting visions**:
 - EC as upgraded **FTA vs. step** towards **political integration**;
 - tension between those preferring **open regionalism** and those preferring **exclusive club**;
- **UK** and **six** smaller (AUT, DEN, NOR, POR, SWE, SWI) agreed in **1960** to establish **EFTA**;
 - all but POR **traded more with EC** than with EFTA members;
 - even UK **exports to the Six** grew **faster** than to EFTA – as a rival trade area little sense + no say in EC;
 - **UK applied** for **EEC** in **1961**;
- **FRA (de Gaulle)** feared that **another large member** would complicate the control of the agenda – more difficult for FRA to use EC as a **platform** for **great-power status**;
 - goal of a **tripartite directorate** for the West: **US, UK, French-led EC**;
 - definitive „**non**“ **1963** (UK entered only **1973**);

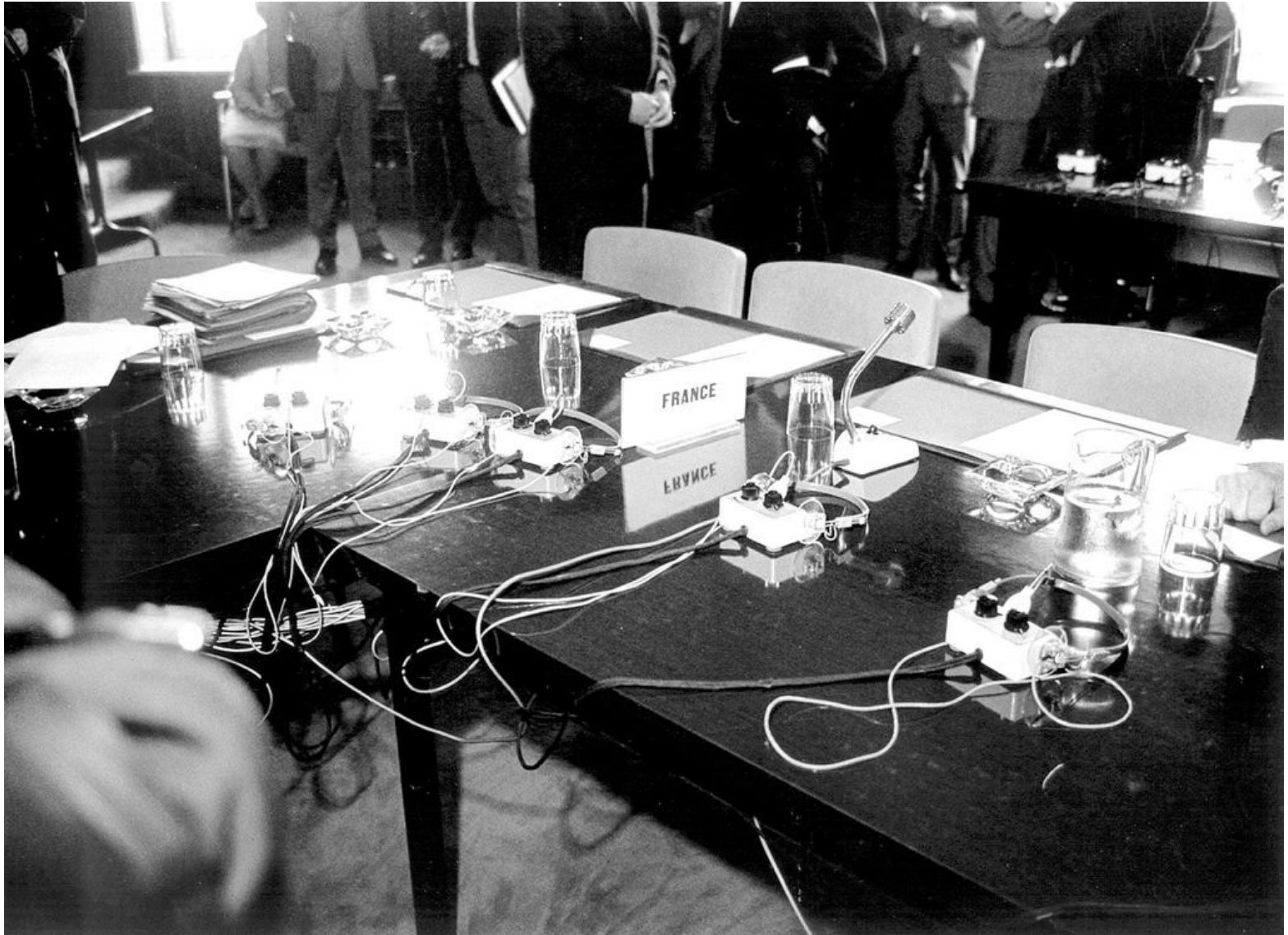


Manufactured exports as a share of GDP (%)

	1913	1929	1950	1973	1992	1998
France	7,8	8,6	7,6	15,2	22,9	28,7
Germany	16,1	12,8	6,2	23,8	32,6	38,9
Netherlands	17,3	17,2	12,2	40,7	55,3	61,2
GB	17,5	13,3	11,3	14,0	21,4	25,0
Spain	8,1	5,0	3,0	5,0	13,4	23,5
SSSR/Russia	2,9	1,6	1,3	3,8	5,1	10,6
Canada	12,2	15,8	13,0	19,9	27,2	-
USA	3,7	3,6	3,0	4,9	8,2	10,1
Argentina	6,8	6,1	2,4	2,1	4,3	7,0
Brazil	9,8	6,9	3,9	2,5	4,7	5,4
Mexico	9,1	12,5	3,0	1,9	6,4	10,7
China	1,7	1,8	2,6	1,5	2,3	4,9
India	4,6	3,7	2,9	2,0	1,7	2,4
Japan	2,4	3,5	2,2	7,7	12,4	13,4
Korea	1,2	4,5	0,7	8,2	17,8	36,3
World	7,9	9,0	5,5	10,5	13,5	17,2

The Luxembourg Compromise

- Battle over majority voting - efficiency of decision vs. risk of override; (de Gaulle)(**unanimity-simple majority**);
- **Independent resources** for **Commission** and the **Parliament say** over EC's **budget** (FRA interest - room to maneuver);
- **1965: Commission proposed** permanent **income** (duties) + greater **power over use**;
 - **France** suggested that a permanent **decision** be **put off** for four years **ensuring** continuing for the **CAP financing** without any concessions;
 - Coolidge received in the Council – **France withdrew from negotiations** – 1965 presiding Council – crisis of “**the empty chair**”;
 - **de Gaulle**: EC was **more important** to **others** -> to force concessions;
 - importance of the EC to his **own constituents** – **opposition: farmers** (jeopardizing **CAP**); **industrialist** (Common Market at risk);
 - **reelected 1965** in second round and by **slim majority**;
- **Compromise** – meeting in **Luxembourg** (instead of Brussels):
 - EC received **permanent** source of **income**; **CAP** ensured; powers of **Commission** and **Parliament not enhanced** to the extent foreseen in original package;
 - The extension of **majority voting** was accepted **in principle** – no vote in matter **unless** all **members** prepared to **abide** (**vital interest** at stake);
 - EC would remain an **intergovernmental** institution;
 - Incentive for **FRA** and **GER** to negotiate **bilaterally** (fait accompli);



	1951– 1960	1961– 1970	1971– 1980	1981– 1990	1992– 2000
USA					
GDP growth	3,4	4,2	3,3	3,2	3,6
Inflation	2,1	2,8	7,9	4,7	2,6
EU-15					
GDP growth	4,8	4,8	3,0	2,4	2,1
Inflation	3,6	3,9	10,8	6,7	2,4

Table 3–8. Experience of Unemployment and Inflation in Advanced Capitalist Countries, 1950–98

	<i>Level of Unemployment (per cent of labour force)</i>				<i>Changes in consumer price index (annual average compound growth rate)</i>			
	<i>1950–73</i>	<i>1974–83</i>	<i>1984–93</i>	<i>1994–98</i>	<i>1950–73</i>	<i>1973–83</i>	<i>1983–93</i>	<i>1994–98</i>
Belgium	3.0	8.2	8.8	9.7	2.9	8.1	3.1	1.8
Finland	1.7	4.7	6.9	14.2	5.6	10.5	4.6	1.0
France	2.0	5.7	10.0	12.1	5.0	11.2	3.7	1.5
Germany	2.5	4.1	6.2	9.0	2.7	4.9	2.4	1.7
Italy	5.5	7.2	9.3	11.9	3.9	16.7	6.4	3.5
Netherlands	2.2	7.3	7.3	5.9	4.1	6.5	1.8	2.2
Norway	1.9	2.1	4.1	4.6	4.8	9.7	5.1	2.0
Sweden	1.8	2.3	3.4	9.2	4.7	10.2	6.4	1.5
United Kingdom	2.8	7.0	9.7	8.0	4.6	13.5	5.2	3.0
Ireland	n.a.	8.8	15.6	11.2	4.3	15.7	3.8	2.1
Spain	2.9	9.1	19.4	21.8	4.6	16.4	6.9	3.4
Western Europe Average	2.6	6.0	9.2	10.7	4.3	11.2	4.5	2.2
Australia	2.1	5.9	8.5	8.6	4.6	11.3	5.6	2.0
Canada	4.7	8.1	9.7	9.4	2.8	9.4	4.0	1.3
United States	4.6	7.4	6.7	5.3	2.7	8.2	3.8	2.4
Average	3.8	7.1	8.3	7.8	3.4	9.6	4.5	1.9
Japan	1.6	2.1	2.3	3.4	5.2	7.6	1.7	0.6

Source: Unemployment 1950–83 from Maddison (1995a), p. 84, updated from OECD, *Labour Force Statistics*. Consumer Price index 1950–83 from Maddison (1995a), updated from OECD, *Economic Outlook*, December 1999.

Monetarism in Great Britain

- **M. Thatcher:** 1979 announced four-year **declining** path for the growth of **money supply**;
- Fight **against inflation** linked to the goal of **reducing** the **role of the government** in the economy;
- Moved to eliminate **labor involvement** in the design of industrial policies;
 - More **flexible labor markets**: easier hiring and firing, reduced unemployment benefits;
 - Attacked the **union movements** and crushed the strikes;
- **Adjustment slow:**
 - **Inflation** came down only to 11%;
 - Main effect of higher interest rates was a **appreciation** of sterling – **recession** from loss of competitiveness;
 - **GDP** fell by 5% and **unemployment** doubled to 10,4%;
- 1981 move towards a **looser monetary policy** and a **tighter fiscal policy** to continue disinflate;
- Failing **petroleum prices** unhelpful (GBs - North Sea oil);
- **Exchange rate** slid from 2,45 towards 1,04 (USD/GBP) 1985 – **interest rates up** to 14%;
 - British **industry another blow**...
- Thatcher **reduced taxes** and **privatized** Airlines, BP, Telecom, Gas, sold council houses;
- Finally - deregulation delivered significant **raise in productivity**...
- **Non transplantable** to other countries – GB elected „economic radical“ because of three decades of disappointing economic performance...

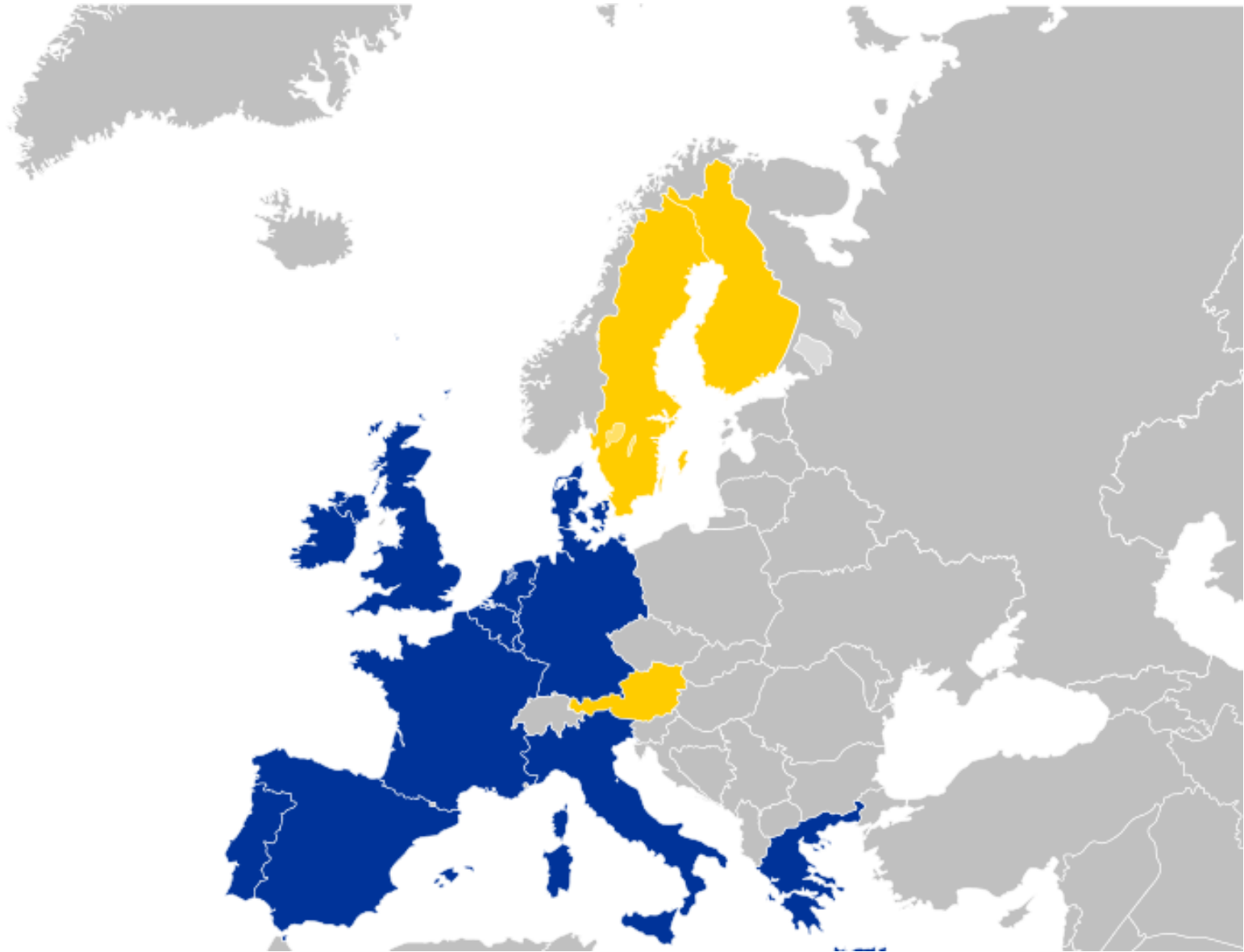
Economic development in Great Britain

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GDP Growth	2,8	-2,0	-1,2	1,7	3,8	1,8	3,8	3,6	4,4	4,7	2,1
Inflation	13,4	18,0	11,9	8,6	4,5	5,0	6,0	3,4	4,2	4,9	7,8
Unemployment	4,0	4,8	7,9	9,5	10,5	10,7	10,9	11,8	10,3	8,3	6,4



Single market

- **1980s** Europe **stagnated**, while **US and Japan surged ahead** (losing market share in cars, electronics) - **deeper integration** seen as a **tonic** for these ills;
- **Governments** such as FRA and UK were **using** the institutions of the **EC** to **advance** their **national agendas** – delegating to the Commission and the Court responsibility for implementing **painful economic reforms**;
- Founding document – *White paper* by team of experts 1985 the **Cockfield Report** (UK civil servant) – summarized **dissatisfaction** with progress (Delors Commission);
 - Reinvigorating **growth** and **accelerating** the **integration** – portrayed as **synonymous**;
 - Goal: **market free** not just of internal tariffs but also of **regulatory barriers** to the movement of goods and services (**Common** -> **Single**);
- Intergovernmental conference **1986** -> **Single European Act** (SEA):
 - commitment to establish a **single market** free of **barriers** to the **movement of goods and factors** of production
 - greater use of **qualified majority** and **cooperative procedure** (first direct elections to Parliament 1979);
 - SEA provided expansion of the **structural Funds** – program for funding of infrastructure investment in its poorer member states – **side payment**;
 - SEA **emphasized** the **need for cooperation** in the conduct of **economic** and **monetary policies** – progressive realization of monetary union;



Context of Maastrich Treaty

- 1 January 1993 – **single market complete**;
 - The **share** of **intra-EC** imports in consumption **rose** from 22,6% to 25% (1986-1992); **EU attracted 45% US** and 21% **JAP FDI**, intra-EU trade share from 31% to 51%;
- **Bundesbank** set the tone for monetary policy:
 - **inflation** in GER **low**, **DM** had tendency to **appreciate**;
 - **other central** bank were forced to **follow** to prevent excessive depreciation;
- **FRA**:
 - **unfairly bearing** a **disproportionate share** of the **adjustment burden**;
 - **EMS** would create a **collective policy space** + more **expansionary** thrust for macroeconomic policies;
- **GER**:
 - **skepticism** of monetary union but **advocating** elimination of **capital** controls (monetary union as quid pro quo);
 - committed **Europeanists** saw foreign (FRA, ITA) **criticism** of Bundesbank as **destructive** to goal of FRA-GER partnership (H.Kohl);
- **Business** formed Association for Monetary Union in Europe:
 - **voicing support** (exchange-rate risks and transparency);
 - **financial institutions** saw single currency as economy of scale opportunity;

Economic and monetary convergence

- **Delors report** (1989) recommended **empowering** ECOFIN Council and Parliament to impose **binding ceilings** on **fiscal deficits** + proposed that record of **sound fiscal policies** should be a **precondition** for **joining monetary union**;
- It was **compromise** between **GER insistence** on **stability** (central bank independence) and operation of market forces and the more **politicized approach** of the **French**;
- New **ECB** organized **along Bundesbank lines** – politically **independent** and price **stability** as its primary objective;
- Presumption that only a small subset of member states with impeccably strong and stable policies would qualify for participation;
- Set of macroeconomic preconditions – **convergence criteria**:
 - **Inflation** within 1.5 percent of three lowest;
 - Long term **interest rates** within 2 percent of three lowest;
 - National **debt** no more than 60 percent of GDP;
 - Budget **deficit** no more than 3 percent;
 - **Exchange rate** within 2.25 percent bands of the Exchange-Rate Mechanism;
- Stages of **monetary integration**: independence of central banks -> removing remaining capital controls 1990-1993 -> creation of European monetary Institute 1994 -> monetary union itself no later than 1999;

Table 6.4 *Qualified success on convergence criteria*

Targets	Budget deficit/GDP 3%	Debt/WP 60%	Price inflation 2.7%
EMU hopefuls			
Austria	2.5	66.1	1.2
Belgium	2.1	122.2	1.5
Finland	0.9	55.8	1.2
France	3.0	58.0	1.2
Germany	2.7	61.3	1.5
Ireland	-0.9	67.0	1.2
Italy	2.7	61.3	1.5
Luxembourg	-1.7	6.7	1.4
Netherlands	1.7	70.4	1.9
Portugal	2.5	62.0	1.9
Spain	2.6	68.3	1.9
Refuseniks			
Britain	1.9	53.4	1.9
Sweden	0.4	76.6	1.9
Denmark	-0.9	55.8	1.2
Rejected			
Greece	4.0	108.0	5.9

Source: *The European*, 2-8 March 1998.

Key Contemporary Issues

- **Mutual recognition** – acceptance of the **regulations** and **standards** of **other EU countries** (*activities lawful in one member to be pursued throughout the EC*);
 - **Mutual recognition** of **professional credentials**;
- **Government procurement** – to reduce the bias of governments towards **domestic producers**;
- Since 1990 **control of mergers** – restraining the tendency of states to grant legal **monopolies** (telecom, transport, post, gas, electricity);
- **Services** (insurance, financial and business services) - foreign firms establishing **subsidiaries** being required to undergo lengthy (often discriminatory) **authorization**;
 - **2005 Services Directive** – right to provide services in all member states as long as they follow the **laws of their home states** (*opposition by high-income countries*);
 - **financial services**: elimination of **capital controls** 1988 by EC directive:
 - rapid process > **frustrated industrial policy** → removed barriers for **foreign banks** (*for 40 years was governments directing credit towards industry - now financial sector privatized and domestic bank competed with foreign*);
- **Integration** increasingly came to be **identified with liberalization** + **Commission** perceived itself as an **agent** of **deregulation**;
- Increased mobility of **tax base** – **pressure** for **reductions** in rates of **taxation** (to limit the danger that high taxes would cause **capital** to **migrate abroad** – states with large public sectors pushed for **tax harmonization**);



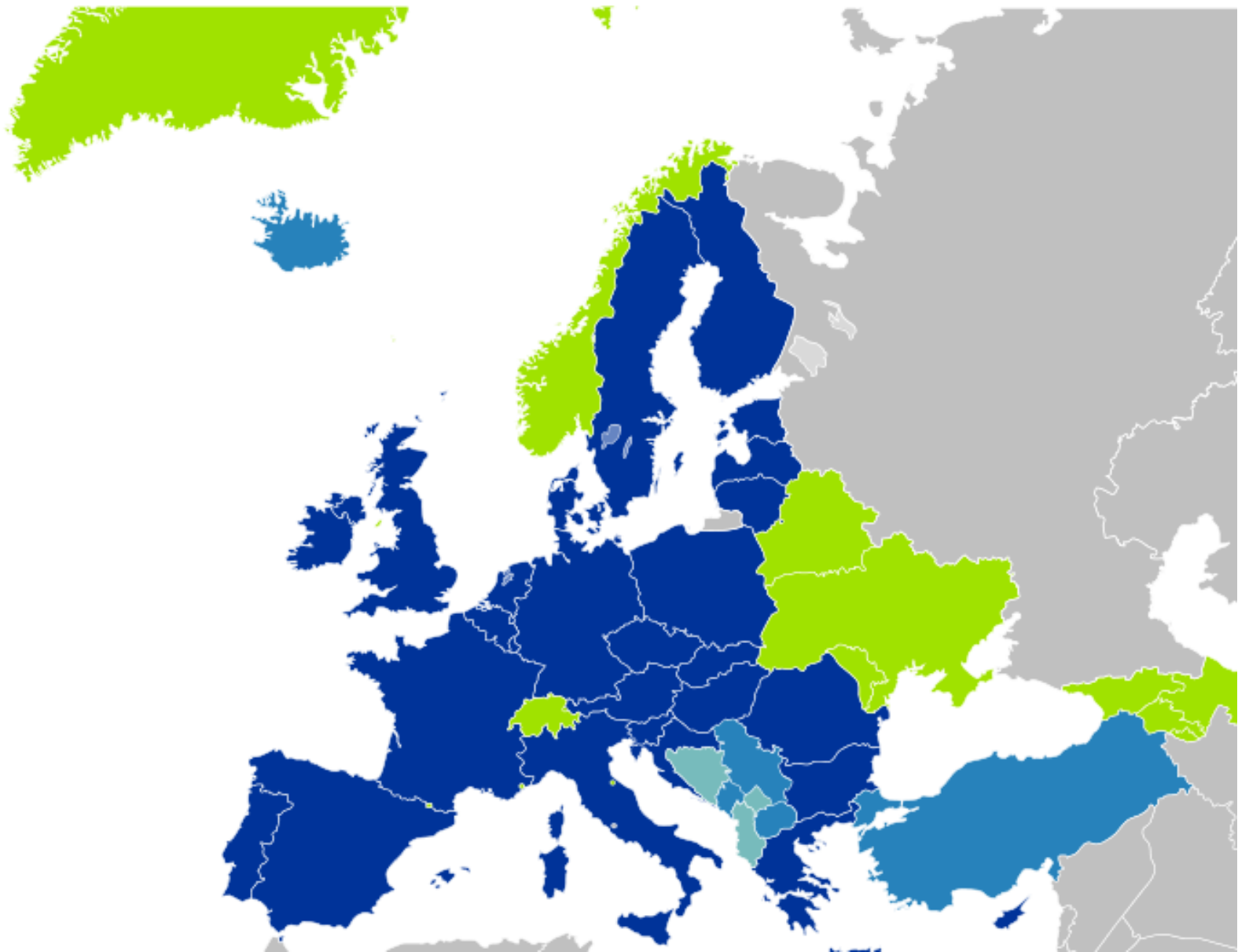


Table 24.5 Import-weighted average applied MFN tariff rates in selected countries, 2004 (2003 for EU25), %

ISIC code	Industry	EU25	US	Japan
1	Agriculture, forestry, fishing	14.2	4.5	2.4
2	Mining and quarrying	0.1	0.0	0.0
3	Manufacturing	7.0	3.1	2.5
31	Food, beverages and tobacco	22.4	8.2	8.3
32	Textiles and apparel	10.2	10.6	9.6
33	Wood and wood products	6.2	1.3	2.9
34	Paper and paper products	6.3	0.1	0.0
35	Chemicals, petroleum products	5.7	3.3	1.7
36	Non-metallic mineral products	7.5	4.4	1.1
37	Basic metal industries	6.7	1.0	0.6
38	Fabricated metal products	7.6	2.6	0.8
39	Other manufacturing	5.6	1.8	0.2
	Total all products	6.7	2.7	2.0

Note: The tariff averages in this table are calculated by weighting tariff rates on individual goods by the relative importance of the value of each good in each country's imports.

ISIC = International Standard Industrial Classification.

Growth of intraregional and total exports, 1950–2002
(Average annual percentage growth rates)

	<i>Intraregional exports</i>		<i>Total exports</i>	
	1950–1973	1974–2002	1950–1973	1974–2002
Austria	14.2	10.8	13.2	10.4
Belgium-Luxembourg	13.5	8.5	12.1	8.8
Denmark	9.3	8.5	10.1	8.3
Finland	12.9	9.2	11.4	9.6
France	15.0	8.5	12.6	8.4
Germany	18.6	8.3	19.8	8.5
Greece	12.5	6.9	12.3	8.0
Ireland	9.6	13.4	10.5	14.1
Italy	15.9	9.1	13.8	9.3
Netherlands	14.5	8.8	13.4	8.8
Portugal	13.2	11.7	11.6	10.5
Spain	14.0	13.2	12.5	12.0
Sweden	11.8	7.2	11.2	7.5
United Kingdom	9.3	9.7	6.9	8.4
EU-15	13.2	9.6	12.2	9.5

Source: International Monetary Fund, *Direction of Trade Statistics* (1948–1980 and 1980–2003 versions).

Table 15.1 EU25 tax structure, 2004

	Personal income tax	Corporation tax	Social contributions	VAT	Excises	Total tax revenue % of GDP
	<i>% of tax revenue</i>					
Belgium	12.8	3.2	14.1	7.0	2.5	45.2
Denmark	24.9	3.1	1.2	9.8	3.8	48.8
Germany	8.7	0.9	16.5	6.2	2.3	38.7
Greece	4.8	3.3	12.1	8.3	2.9	35.1
Spain	6.4	3.5	12.2	6.1	2.5	34.6
France	7.8	2.4	16.3	7.2	2.3	43.4
Ireland	7.4	3.6	4.6	7.4	3.4	30.2
Italy	10.4	2.2	12.3	5.9	2.3	40.6
Luxembourg	7.1	6.1	11.3	7.3	5.2	40.1
Netherlands	6.0	3.3	14.0	7.7	2.6	37.8
Austria	10.0	2.4	14.4	7.8	2.9	42.6
Portugal	5.5	2.9	11.3	8.1	3.3	34.5
Finland	13.5	3.6	11.9	8.7	4.0	44.3
Sweden	15.7	3.0	13.8	9.1	3.1	50.5
UK	10.3	2.8	6.6	7.0	3.4	36.0
EU15 average	10.1	3.1	11.5	7.5	3.1	40.2
Czech Republic	4.8	4.4	15.1	7.4	3.4	36.6
Estonia	6.7	1.8	11.1	8.2	3.7	32.6
Cyprus	3.6	3.8	7.8	9.3	4.5	34.1
Latvia	6.0	1.7	7.8	7.0	3.5	28.6
Lithuania	6.8	1.9	8.7	6.5	3.0	28.4
Hungary	6.7	2.1	13.5	9.0	3.4	39.1
Malta	7.2	4.2	6.9	7.7	3.0	35.1
Poland	4.0	2.0	13.4	7.2	4.2	32.9
Slovenia	5.9	2.0	14.7	8.9	3.5	39.7
Slovakia	3.3	2.8	12.2	8.0	3.1	30.3
NMS10	5.5	2.7	11.2	7.9	3.6	33.7
EU25	8.3	2.9	13.2	7.7	3.3	37.6

Source: CEC (2006k).