

EUROPEAN ECONOMIC INTEGRATION

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Outline

- **Introduction**
- **EMU: key characteristics and issues**
- **Post EMU: stagnating integration**
 - Discontent with treaty reforms
 - Financial crisis & structural issues
- **Ways forward**
 - Levels and types of integration
- **Empirical evidence: integration versus governance**
- **Summary and discussion**

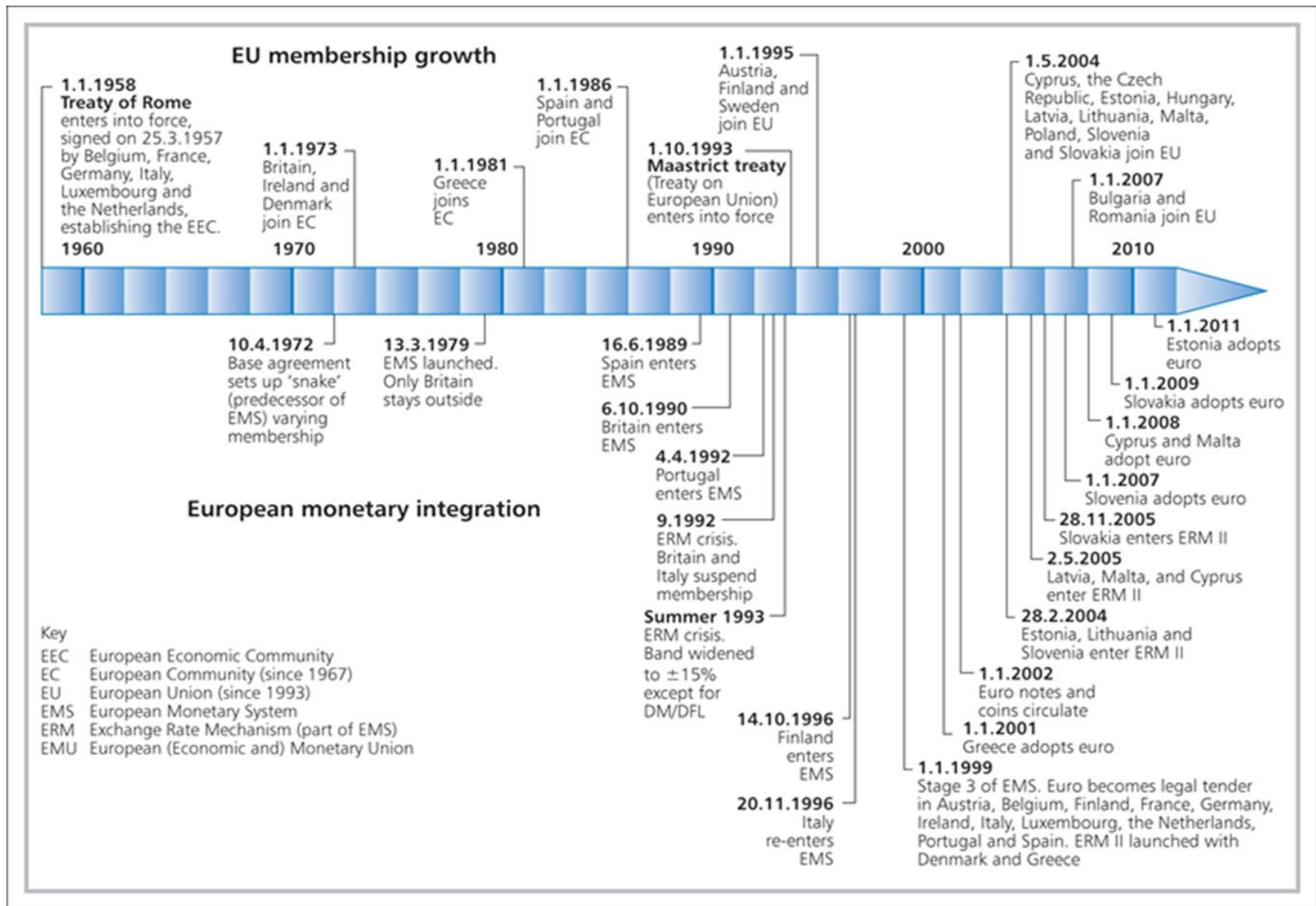
Literature

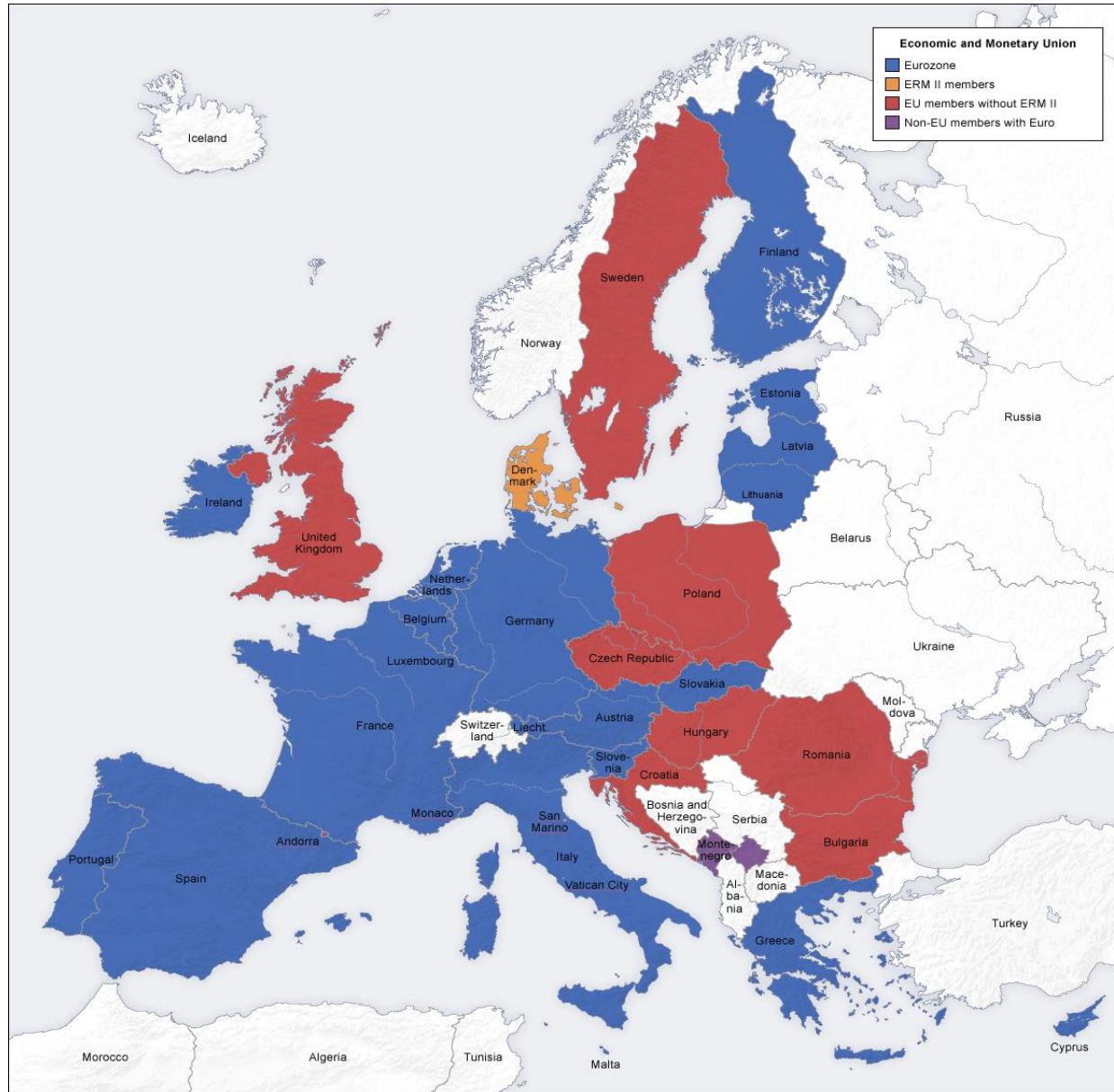
- Dinan, D. (2014) The limits of the European Union. Chapter 9 in: Europe recast. Lynne Rienner Publishers, p. 305-352
- Begg, I., Bongardt, A., Nicolaïis, K. and Torres, F. (2015) EMU and sustainable integration. Journal of European Integration, vol. 37.7, p. 803-816
- Kuhn, T. and Stoeckel, F. (2014) When European integration becomes costly: The euro crisis and public support for European economic governance. Journal of European Public Policy, vol. 21.4, p. 624-641

Introduction

- **Focus on European Union**
- **Huge economic, social, institutional experiment!**
- **Throughout its development, focus on different issues**
 - European peace and stability
 - Economic cooperation
 - From pure trade flows to integrating capital and labour markets
 - Higher levels of integration
 - Social coherence
 - Structural economic change
 - Harmonisation of economic policies
- **Varying levels of support among governments and population**
 - Debates on what to do, goal making, etc.
 - Last decade clear increase in scepticism towards European project

Timeline





Economic and Monetary Union

- **Creation of EMU is impressive achievement!**
- **Up until MU, process of economic integration “natural” process**
- **Free Trade Area → Customs Union → Common Market → Monetary Union**
- **Problem-solving fostered further integration**
- **Debate on tariffs and non-tariff barriers**
- **Relatively not too disruptive for economies**
- **Monetary Union**
 - = Countries abandon independent monetary policy making
 - = Very strong commitment to EU project

EMU key issues: ECB

- **European Central Bank: common monetary policy**
- **Primary objective: maintain price stability**
- **But also:**
- **“Support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union. These include inter alia full employment and balanced economic growth”.**
- As the role of central banks at country level is not undisputed, the role and actions of the ECB are also debated!

EMU key issues: price and fiscal stability

- **One common monetary policy requires degree of homogeneity among member states' economies**
- **Maastricht treaty's criteria for monetary and fiscal convergence**
 - Rules for price and fiscal stability
 - Government debt not >60%
 - Government deficit not > 3%
 - Inflation not larger than the average inflation in 3 EU countries with lowest rates by more than 1.5 % points
 - Interest rates government bonds not higher than average rates in 3 EU countries with lowest inflation by more than 2% points
 - Membership in ERM no less than 2 years without devaluation

EMU: need for control of fiscal policy

- **EMU: financial markets strongly linked**
- **Common Monetary Policy**
- **Heterogeneity of fiscal policy can generate substantial international spillovers**
- **Say country A increases government expenditure**
 - Economy starts to grow, returns on financial investments increase in comparison to other countries
 - Investors will switch their investments from other countries to country A
 - Country A grows further, other countries negatively affected
- **Needs to be addressed**

EMU key issues: restraining fiscal policy

- **Need for restraining fiscal policy**
- **Stability and Growth Pact**
 - = prevents members from running excessive budget deficits
 - Government deficit up to 3% ok
 - Can be larger than 3%, but only in case of serious economic setback

What is serious setback?

- Decline of real GDP of at least 2%
- Decline of less than 0.75% not setback
- In between: Economic and Financial Affairs Council (ECOFIN)

EMU key issues: restraining fiscal policy

- **If budget deficit is excessive, ECOFIN calls for measures**
- **If not implemented within 4 months, sanctions possible**
 - 0.2 % GDP deposit
 - 0.1 % GDP fine for each % point over 3%
 - (Σ not larger than 0.5%)
 - Deposit becomes fine after two years
- **2005 reforms**
 - Any decline of GDP is considered setback (possibly even low growth)
 - Leeway for other factors
 - 6 months to introduce measures
 - Not only looking at short run effects
- **Counter-intuitive? Fiscal policy should be facilitated when economy is slowing down?**

Stagnating integration (1)

- **Treaty establishing a Constitution for Europe**
- **Signed in October 2004**
 - Replacing existing European Treaties
 - Charter of Fundamental Rights
 - Expansion of Qualified Majority Voting
- **Step too far?**
- **18 countries ratified the treaty, but French and Dutch voters rejected it**
- **Replaced by Treaty of Lisbon, signed in 2009**
- **Clear signs of discontent with integration**
 - Level of integration
 - Coverage of integration

Stagnating integration (2)

- **Financial crisis 2007/2008**
- **Started in US with collapse of housing market**
 - Sub-prime mortgages
 - Securitization, leverage, derivatives
- **Initial EU reaction was that this was an American crisis and would be confined to US economy**
- **EU banks also heavily involved**
 - ING good example
- **Strength of globalisation under-estimated**
- **Loss of trust, sharp drop in investment**

Stagnating integration (3)

- **Following economic crisis, markets started to have less trust in certain countries**
- **Greek Sovereign debt crisis**
- **Growing divergence of bond yields in EU**
- **Relates to the presumed homogeneity of EMU member countries**

- **Initial EU reaction was that it should not get involved**
 - Maastricht Treaty's no bailout clause
 - "The community shall not be liable for or assume the commitments...of any Member state"
 - Why?

No bailout?

- “When a member is in difficulties.....caused by exceptional occurrence beyond its control, the Council...may...grant...Community financial assistance to the Member State concerned.”
- Greek bailout program was implemented
- Portugal, Ireland, Spain and Cyprus also received support

Policy measures

- **European Financial Stability Facility (2010)**
 - Bonds issued with support of German Debt Management Office
- **European Financial Stabilisation Mechanism (2011)**
 - Emergency funding program
 - Funds raised on financial markets, backed by European Commission
- **European Stability Mechanism (2012)**
 - Permanent rescue funding program
 - Rescue bail-out mechanism spelled out



ECB



Mario Draghi

- March 2015 start of large quantitative easing program
- ECB purchases bonds from banks
- Interest rates fall, loans become cheaper
- Increase borrowing and investments
- Increase economic growth and employment

Reforms to Stability and Growth Pact

- **Tightening of the rules and higher level of macroeconomic surveillance**
- **2011: “six-pack” of regulations concerning debt, expenditure, macro-economic imbalances, etc.**
- **2013 Fiscal Pact**
 - Automatic sanction when budget deficit is larger than 3%
 - Country with deficit ratio $> 60\%$ must reduce this by 5% every year
 - Member countries will adopt into national law a debt brake limiting budget deficits to 0.5% of GDP
 - Will take some time before these come into effect!
- **Fiscal policy more restricted in times when demand / need for such policies is increasing?**

Moving towards fiscal union?

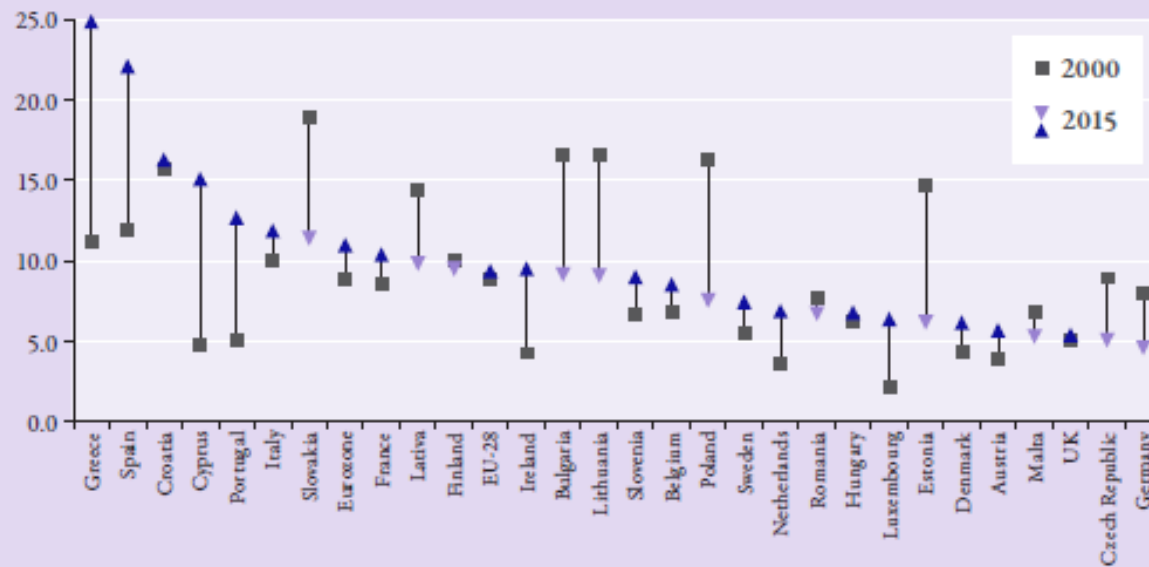
- **Problems that have become visible following crisis**
 - Large country-specific shocks with international spillover effects
 - Government failures
 - Market failures
 - Supply side reforms not implemented?
 - Role of banks
 - Risk assessment errors?
- **Fiscal union the solution?**
 - Fits into notion of ongoing integration
 - Ex-ante framework for enforced fiscal discipline and temporary transfers
 - Promotion of marked discipline and structural reforms
 - Stronger enforcement powers to Brussels required?

Current situation

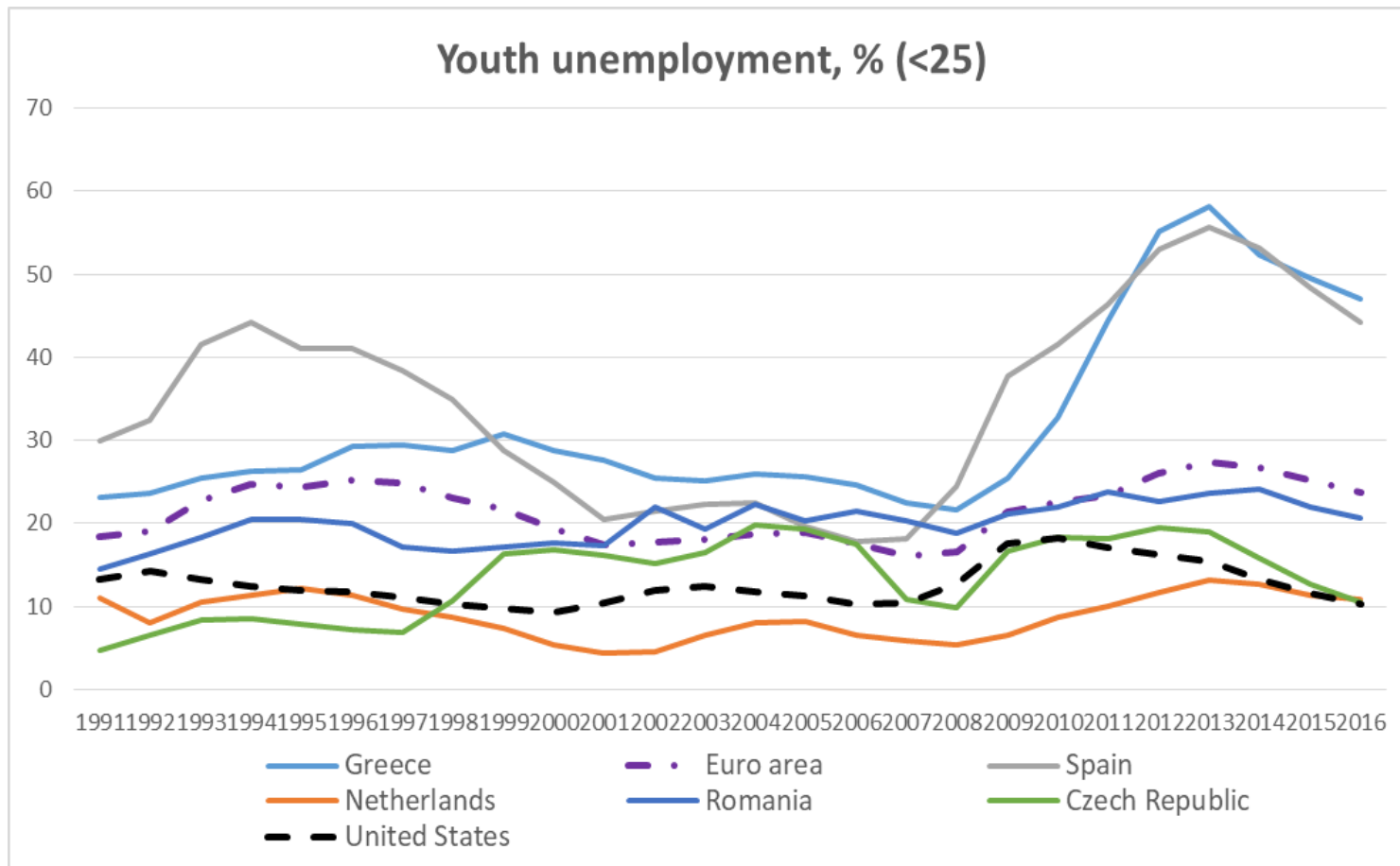
- **EU is still trying to recover from latest crisis**
- **EU commission provides many statements on common goals related to growth, productivity, employment, social coherence, etc.**
 - But also pushing for deeper and wider integration
- **Scope for individual country's policy-making more and more confined and restricted**
- **Quantitative easing by ECB cannot be the only solution**
- **Growing discontent with integration**
- **Further additions to EU postponed / slowed down**

Heterogeneity in EU

Figure 1. Unemployment rates in EU-28 countries, 2000 and 2015 (per cent)



Source: ILO calculations based on Eurostat.



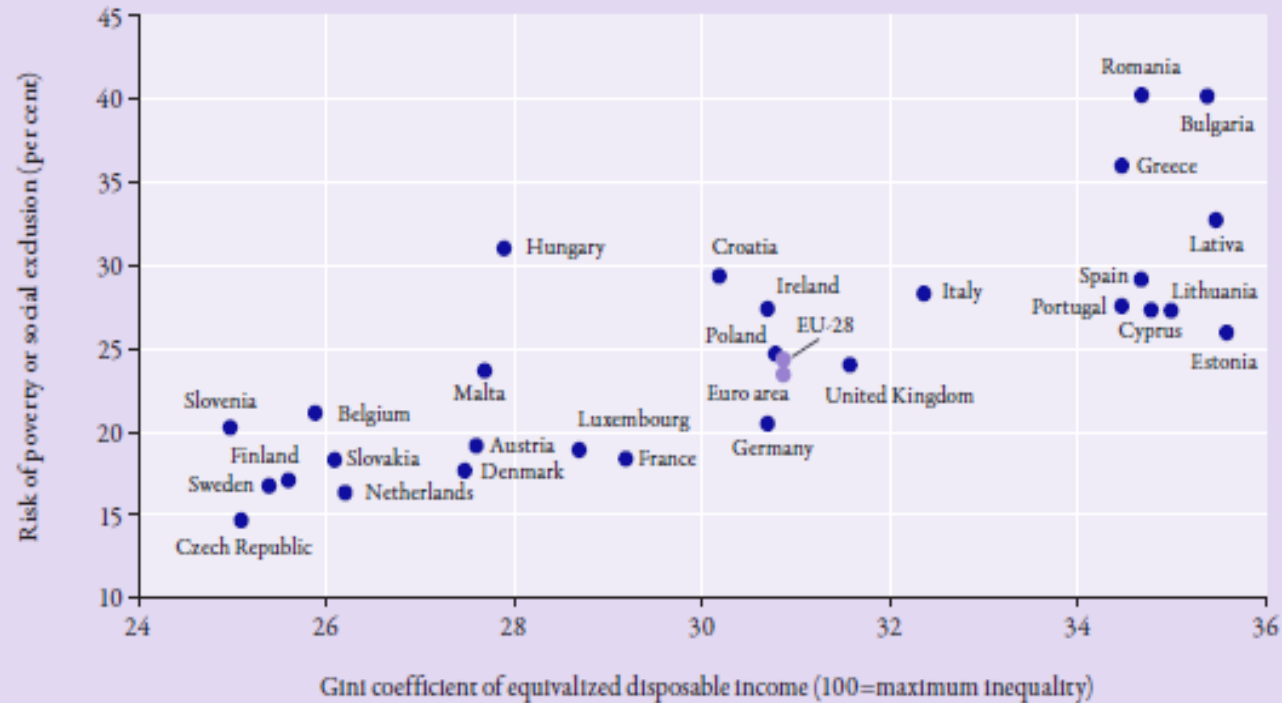
Source: Based on World Bank

Table 1. Selected labour market and social indicators, range of values in EU-28 (latest year available)

	Lowest	EU-28 average	Highest	Ratio (high to low)
Labour market indicators				
Unemployment rate (per cent)	4.6	9.4	24.9	5.4
Youth unemployment rate (per cent, aged 15-24)	7.2	20.3	49.8	6.9
Long-term unemployment rate (percentage of total unemployment)	19.6	48.2	73.1	3.7
Gender gap: unemployment rate (female-male, percentage point difference)	-3.2	0.2	7.1	-
Involuntary part-time employment rate (percentage of total part-time employment)	9.9	29.2	68.9	7.0
Social indicators				
Median income (PPS)	4,090	15,777	28,271	6.9
Income inequality (Gini coefficient)	25.0	30.9	35.6	-
At-risk-of-poverty or social exclusion	14.8	24.4	40.1	2.7

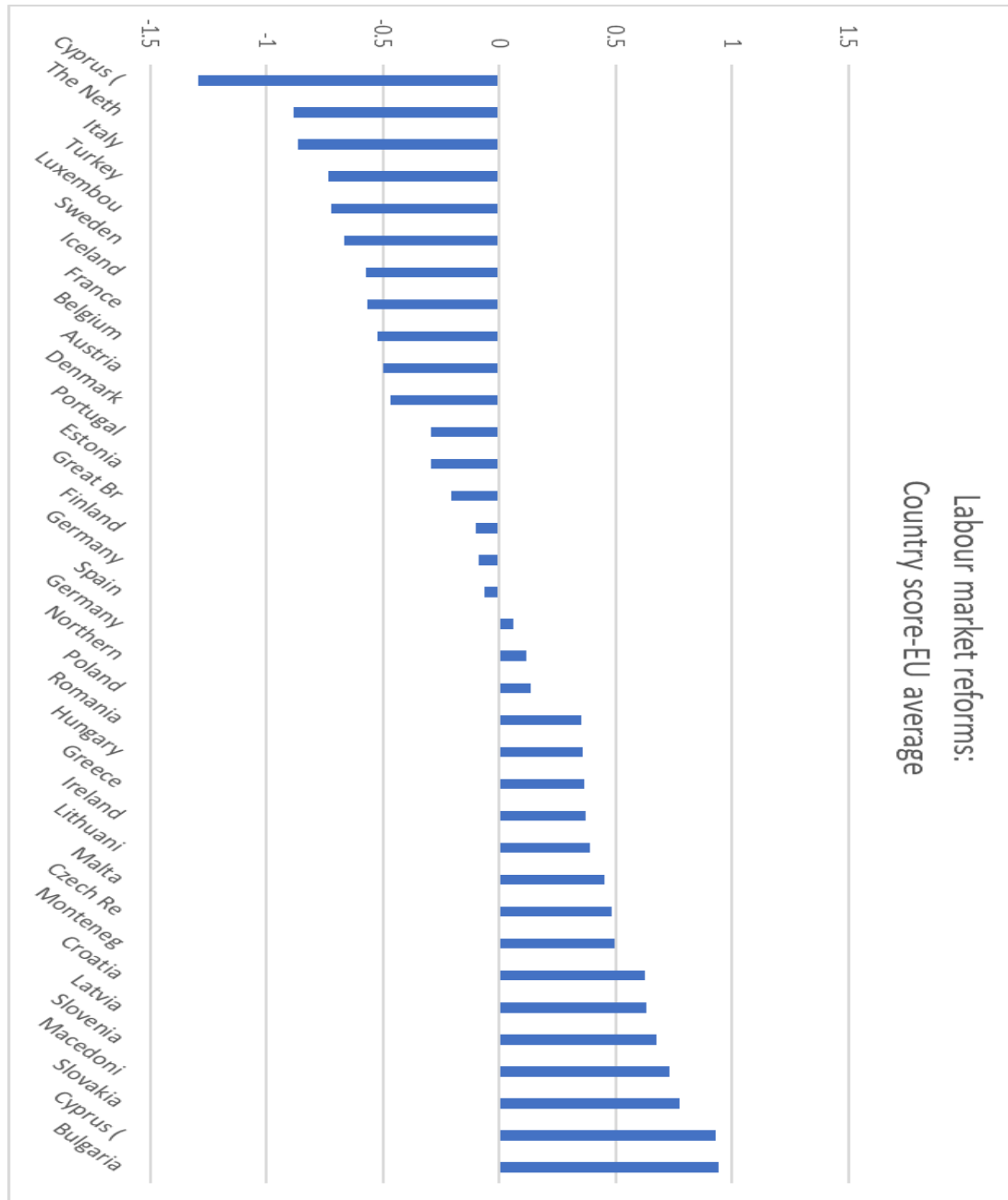
Note: Data for labour market indicators are for 2015 and social indicators for 2014.
Source: ILO calculations based on Eurostat.

Figure 2. Poverty and inequality in EU-28 countries, 2014

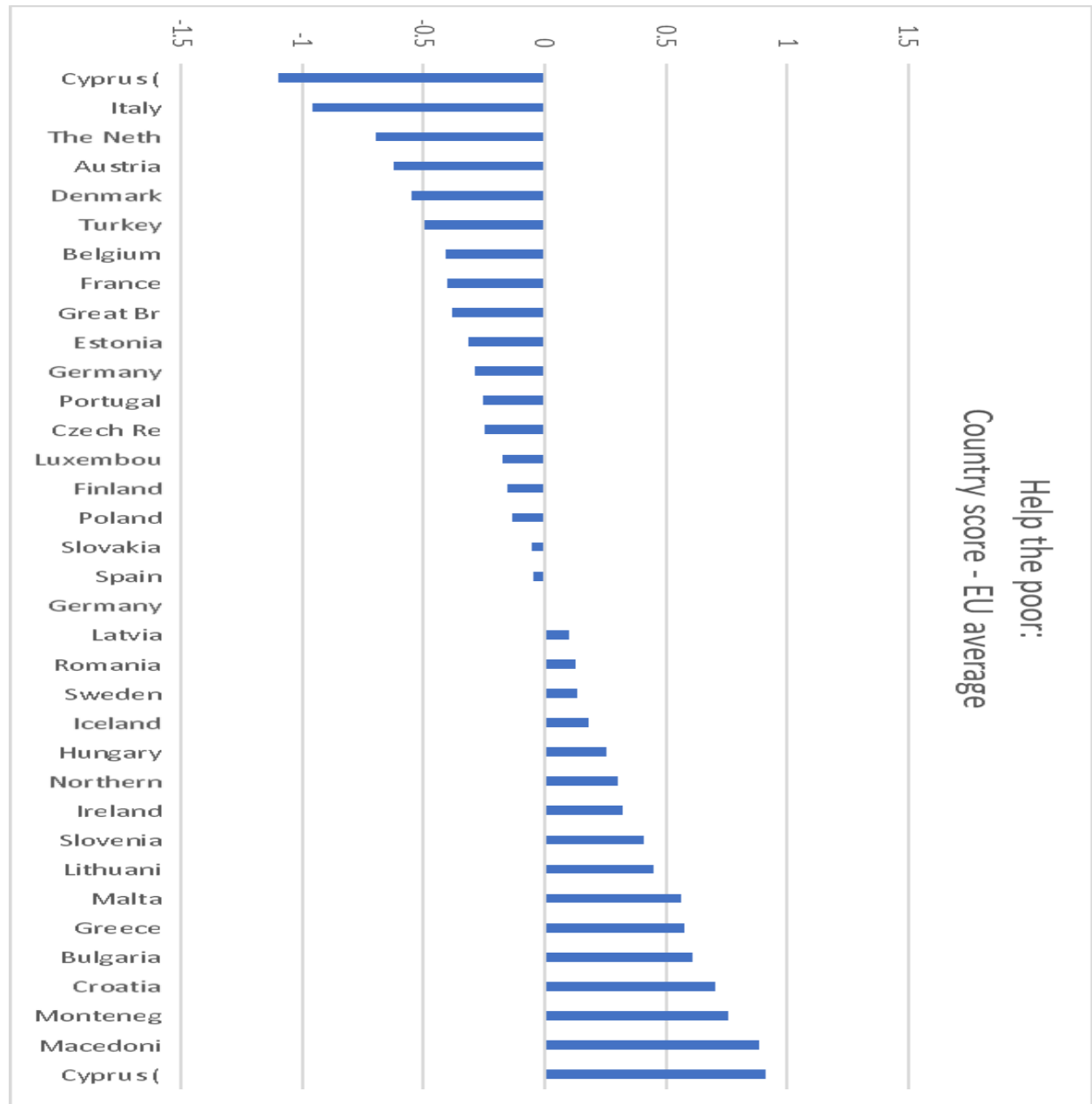


Notes: Euro area refers to the 18-country grouping.
Source: ILO calculations based on Eurostat.

Labour market reforms for restoring growth in EU



Recovery of EU
should include
support for low
income
households



Improving the EMU

- **Begg et al. (2015)**
- **The Presidents' reports on EMU governance**
 - Integrated financial framework to ensure a financially stable system
 - Integrated budgetary framework with dual aim of assuring fiscal discipline and developing new, common fiscal policy instruments
 - Integrated economic policy framework that links growth employment and competitiveness with the sustainability of EMU
 - Enhancement of democratic legitimation and channels of accountability

Sustainable integration (1)

- Begg et al. (2015) argue for **sustainable integration**

Three components

1. Sustainable growth

- Economic, environmental, social
 - This will take considerable time to be created + countries differ in their valuation of different types of growth
- Requires long-term commitments and public investments
 - Who will make the commitment? EU commission and national governments; source of funding? International financing and allocation?
- Institutional robustness to absorb shocks
 - Democratic deficiency is an advantage here!

Sustainable integration (2)

2. Varieties of modernisation

- Member states have followed different paths; socio-economic make-up, state-society relations, social and institutional traditions
 - EU needs to find a way to obtain institutional governance improvement that allows for this variety
- Sovereign debt crisis shows negative spillovers related to economic divergence within EMU
 - This is a tricky issue, given the autonomy of countries in the EU
- Urgency of systematic reform affecting policy domains with divisive political and distributional effects
 - This is approaching areas where national governments and populations are deciding national policies
 - Good example: pension age

Sustainable integration (3)

3. Democratically sustainable reforms

- Political processes in many member countries have hardened
 - National governments find themselves defending EU policies to increasingly dissatisfied voters
 - National politicians do listen to voters; will want to show that they are trying to defend national interests in EU
- Reforms at both the national and EU level need to be accepted by the public, against the context that they are often perceived to lower domestic democracy and autonomy
 - Increasing shares of the EU population understand actions of EU
 - EU needs to find a new way to get the public with the EU project?

One of the underlying debates

- **The aftermath of the financial crisis shows again that we may be approaching the limits of “traditional” integration**
- **Shared monetary policy**
- **Fiscal policy under the control of national governments**
- **They want to act to deal with economic crisis**
- **But EU is limiting the level and scope of their actions**
 - (Which is perfectly in line with MU requirements)
- **How can EU create the necessary level of shared responsibility that will accept this?**

What do the people think? (2014)

Having heard about the priorities of the EU, do you think that the EU is going in the right direction or in the wrong direction to exit the crisis and face new global challenges?

	EB 81.4
	EU28 UE28
TOTAL	28004
In the right direction	45%
In the wrong direction	25%
Neither the one or the other (SPONTANEOUS)	23%
DK	7%

The EU is responsible for austerity in Europe

	EB 81.4
	EU28 UE28
TOTAL	28004
Totally agree	19%
Tend to agree	42%
Tend to disagree	19%
Totally disagree	7%
DK	13%
Total 'Agree'	61%
Total 'Disagree'	26%

The EU will emerge fairer from the crisis

	EB 81.4
	EU28 UE28
TOTAL	28004
Totally agree	5%
Tend to agree	30%
Tend to disagree	28%
Totally disagree	13%
DK	24%
Total 'Agree'	35%
Total 'Disagree'	41%

Do you see yourself as...?

	EB 81.4
	EU28 UE28
	39%
(NATIONALITY) only	
	51%
(NATIONALITY) and European	
	6%
European and (NATIONALITY)	
	2%
European only	
	1%
None (SPONTANEOUS)	
	-
Refusal (SPONTANEOUS)	
	1%
DK	
	8%
Total 'More European than National'	
	90%
Total 'More National than European'	

Integration versus governance

- Kuhn and Stoeckel (2014)
- Ask very interesting and important questions
- To what extent do European citizens support European economic governance in the crisis?
- Are the variables that explain support for integration the same as for governance?
- Use of Eurobarometer survey data (from 2011) to get the public's opinion and also relate it to country level characteristics

Different processes?

1. Integration versus governance

- Up until crisis and aftermath, perception of EU as trade-based organisation
- Now, the EU is talking about the need for deeper integration in the form of regulation and increased oversight on markets and banks

2. Increasing delegation of national sovereignty to the EU level

- Creation of EMU and aftermath already showed growing dissatisfaction with this tendency

Factors influencing support for EU

Integration

Individual characteristics

- National identity (-)
- Socio-economic status (+)
 - Education, skills

National economy

- Direct effect
- Indirect effect

= interacting with national identity

Governance

Individual characteristics

- National identity (-)
- Socio-economic status (-)
 - Unemployed, retired, low-skilled

National economy

- Direct effect
- Indirect effect

= interacting with national identity

Smaller effect when low GDP

Dependent variable

To operationalize support for European economic governance, we use the following battery of items:

A range of measures to tackle the current financial and economic crisis is being discussed in the European institutions. For each, could you tell me whether you think it would be effective or not:

- (1) A more important role for the EU in regulating financial services;
- (2) A closer supervision by the EU of the activities of large financial groups/
most important international financial groups;
- (3) A stronger coordination of economic policy among all the EU member states;
- (4) A closer supervision by the EU when public money is used to rescue banks and financial institutions;
- (5) A stronger coordination of economic and financial policies among the countries of the euro area.

Information from these five questions used to obtain common factor = “Economic governance index”

Support for EU and for EU growth

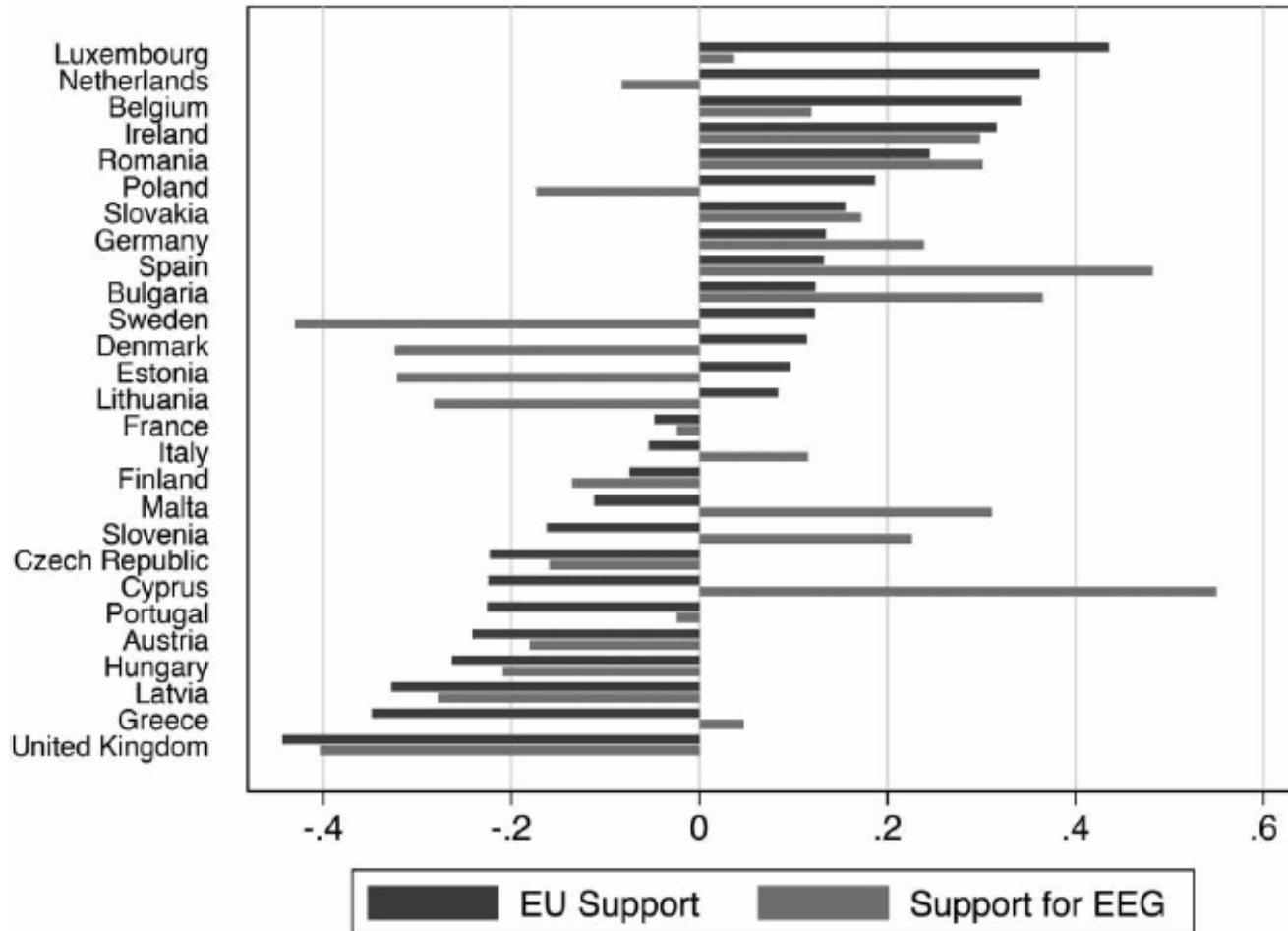


Table 1 Results of multilevel regression models

	Model 1		Model 2	
	Coef.	SE	Coef.	SE
Individual level variables:				
Exclusive national ID	-0.386***	0.030	-0.364***	0.070
Excl. nat. ID*GDP p.c.			-0.337 ⁺	0.270
Education-medium	0.043	0.038	0.038	0.038
Education-high	-0.023	0.044	-0.032	0.043
Occupation:				
Self-employed	0.056	0.055	0.066	0.055
Managers	-0.017	0.051	-0.004	0.051
Other white collar	0.016	0.048	0.029	0.048
House people	0.011	0.062	0.017	0.062
Unemployed	0.124*	0.053	0.122*	0.052
Retired	0.027	0.048	0.036	0.048
Students	0.007	0.070	0.008	0.069
Trust in EU institutions	0.367***	0.016	0.362***	0.016
Personal financial situation	0.037	0.020	0.036	0.020
National financial situation	-0.111***	0.021	-0.112***	0.021
Political orientation:				
Extreme left	-0.076	0.051	-0.076	0.051
Moderate left	-0.040	0.038	-0.049	0.038
Moderate right	-0.136***	0.038	-0.130***	0.038
Extreme right	-0.036	0.054	-0.019	0.054
Refused	0.004	0.051	0.008	0.051
Don't know	0.051	0.050	0.047	0.050
Sex	-0.006	0.026	-0.006	0.026
Age	0.004**	0.001	0.003**	0.001
Country-level variables:				
Growth			-0.086***	0.037
EMU-dummy			0.683***	0.156
Net fiscal transfer			-0.208***	0.060
GDP per capita (log)			-0.774**	0.270
Intercept	7.160***	0.130	6.981***	0.138
Variance components:				
Individual level	3.511***	0.033	3.487***	0.033
Country level	0.311***	0.083	0.106***	0.043
N L1/L2	21892/27		21892/27	
-2*loglikelihood	89737.244		89606.468	

GDP and national identity

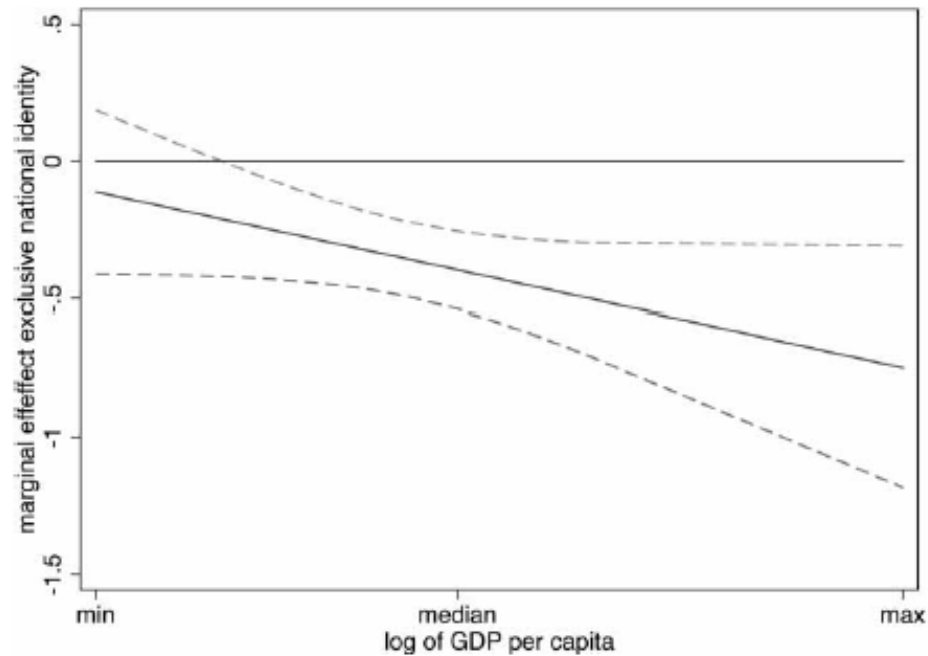


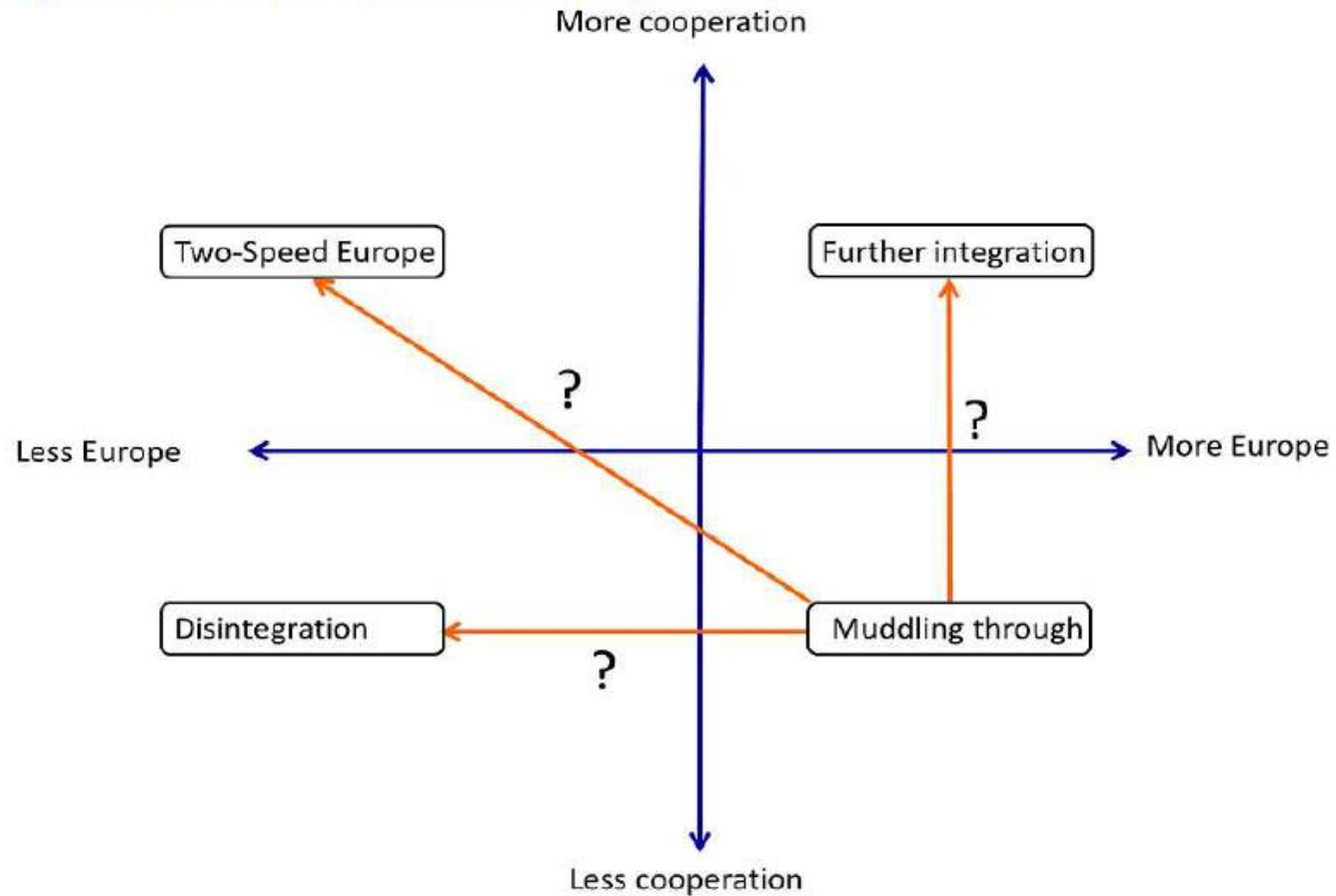
Figure 2 Marginal effect of exclusive national identity on support for European economic governance

Main points

- **EMU big achievement!**
 - End of process of “classical” integration
- **Marking point in integration process**
 - Stagnation of further integration
 - Problems with harmonising economic policies
 - Financial crisis and sovereign debt crisis
- **European Commission’s new policy measures largely in line with traditional thinking**
 - Control of government expenditure
 - Move towards fiscal union
- **Increasing belief that substantial change is required**
 - Heterogeneity of EU
 - Concept of sustainable integration good example
 - Clear that public opinion has changed (and politicians listen to their voters!)
- **Integration versus economic governance**
 - Good example of changing perception of what EU stands for and what EU needs to do

How to proceed?

Figure 1: Four scenario's for the future of Europe



Source: Rabobank