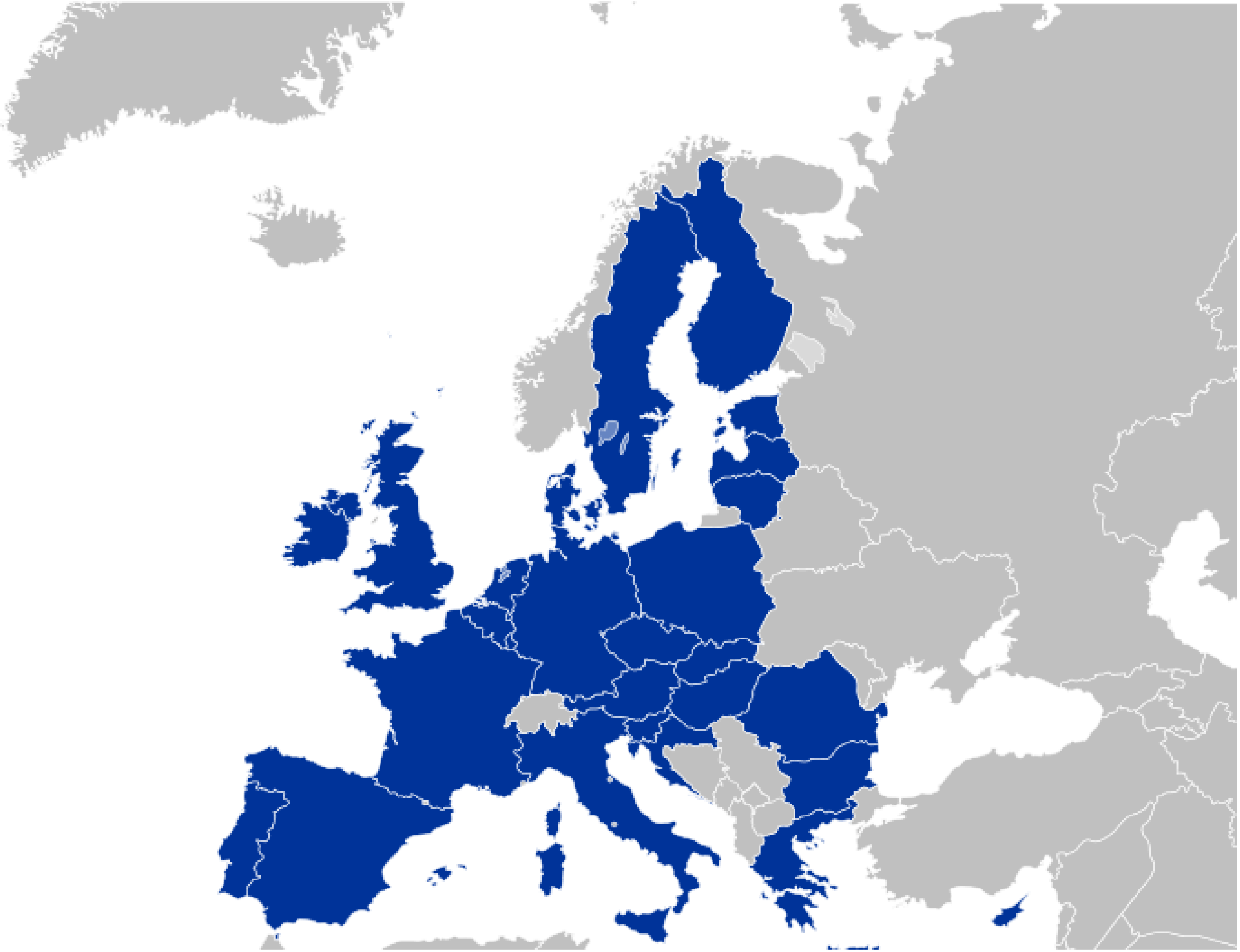
Economic Integration, structural crisis and Single market

Historical and Political Context

Europe in International Economy
2017



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‘s **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, protectionsims, 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 of **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**, **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 specific objective** – to create a **custom union**:
  - capitalize on **concerns** about the **competitiveness** **of Europe** (**small size** of national **markets** as a handicap);
- **Opposing position**: **FTA** **is enough**…

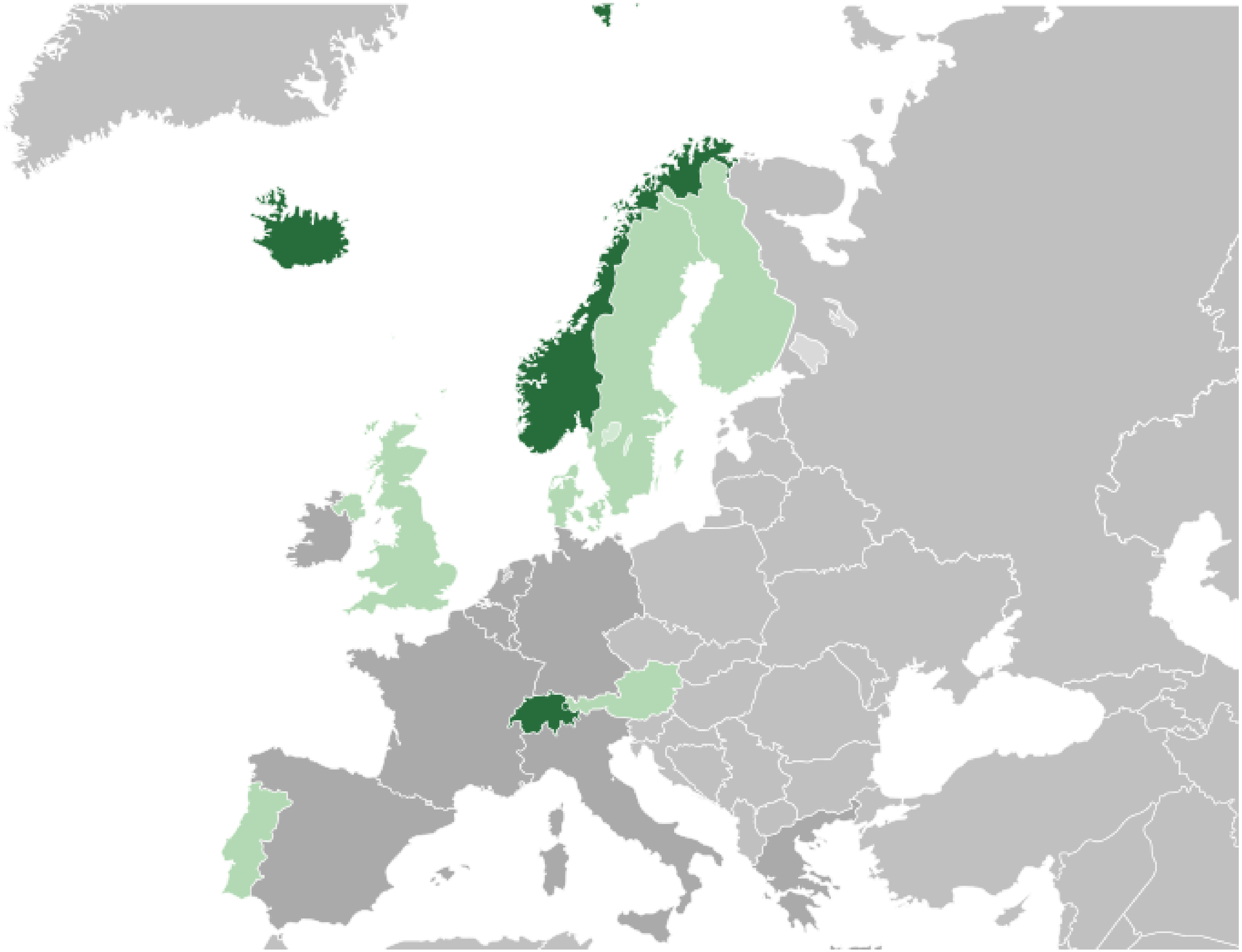
Table 1.1 Schematic presentation of economic integration schemes

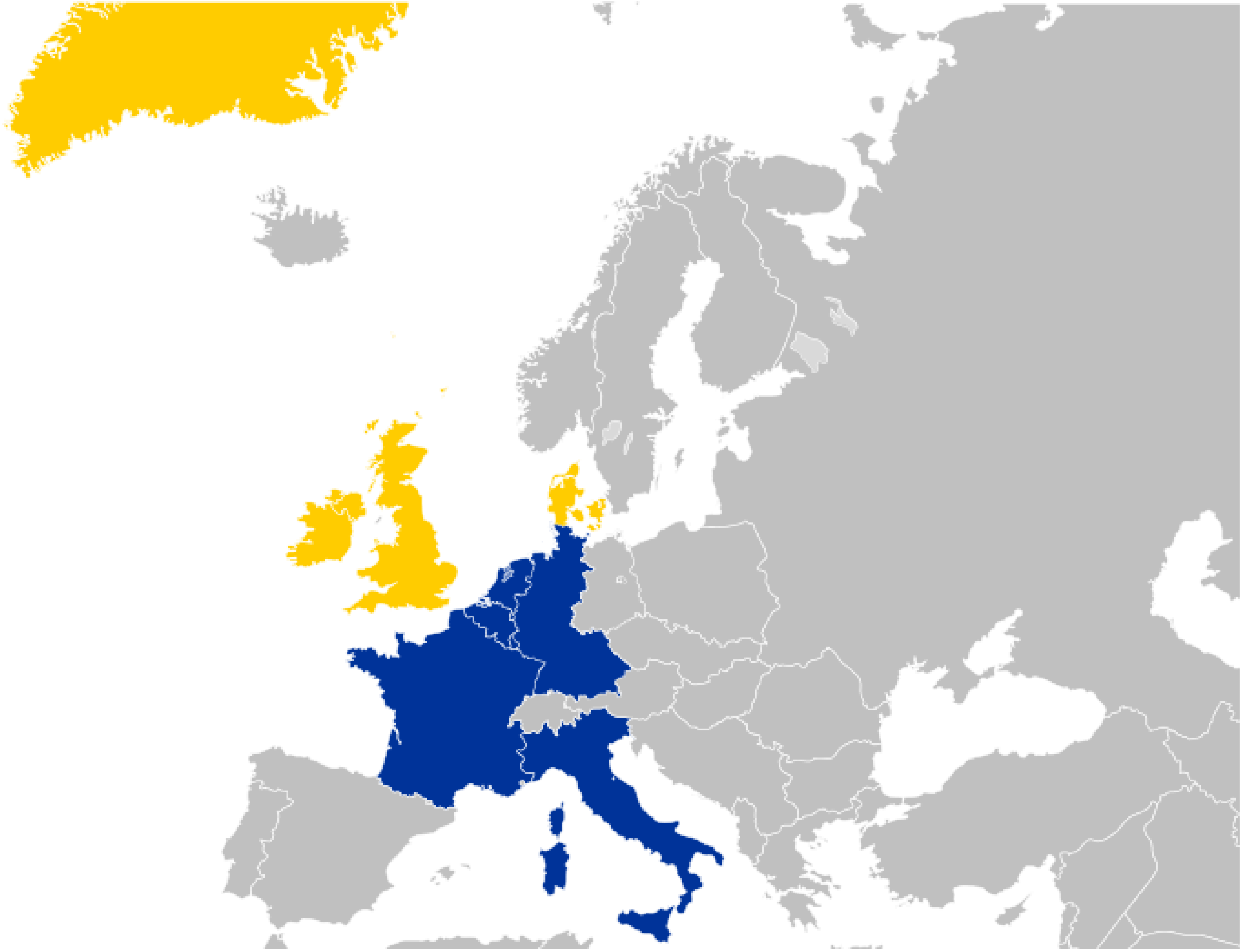
Scheme	Free intra-scheme trade	Common commercial policy (CCP)	Free factor mobility	Common monetary and fiscal policy	One government
Free trade area (FTA)	Yes	No	No	No	No
Customs union (CU)	Yes	Yes	No	No	No
Common market (CM)	Yes	Yes	Yes	No	No
Economic union (EcU)	Yes	Yes	Yes	Yes	No
Political union (PU)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

- **Proposal** for re-launching **integration** came from Benelux 1953 and 1955:
    - France **explored** other **options**: economic **union** with the UK;
    - UK 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);
- Scepticism of the merits of **political integration**:
    - Benelux – threat to **independence**;
    - FRA – 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 **FTA**;
    - 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;
        - 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**) – that drove **GER** into **FRA's** 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 no sooner than **1973**);





Manufactured exports as a share of **GDP** (%)

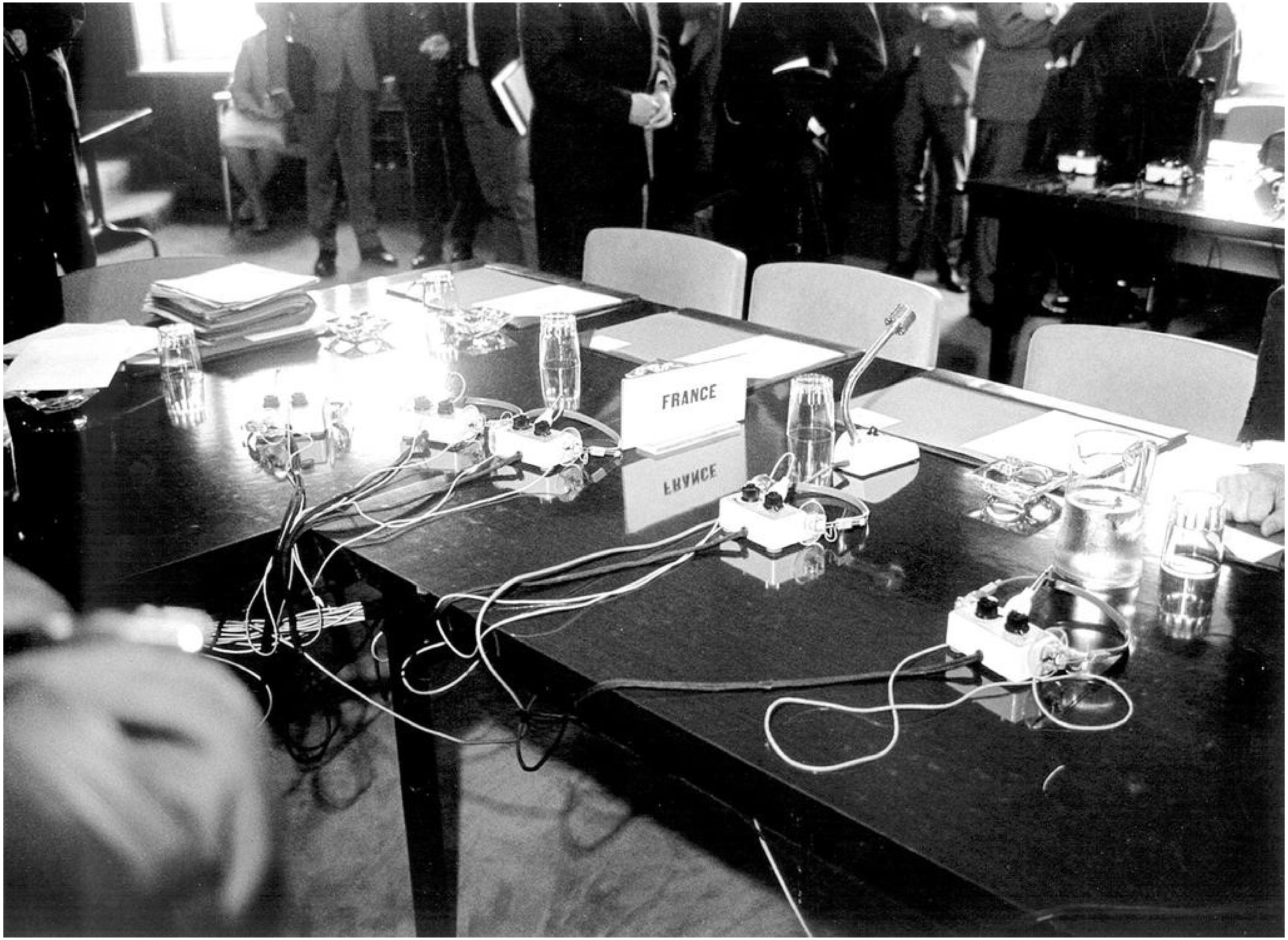
	1913	1929	1950	1973	1992	1998
France	**7,8**	**8,6**	**7,6**	**15,2**	**22,9**	**28,7**
Germany	**16,1**	**12,8**	**6,2**	**23,8**	**32,6**	**38,9**
Netherlands	**17,3**	**17,2**	**12,2**	**40,7**	**55,3**	**61,2**
GB	**17,5**	**13,3**	**11,3**	**14,0**	**21,4**	**25,0**
Spain	**8,1**	**5,0**	**3,0**	**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 <u>**majority voting**</u> - efficiency of decision vs. risk of being overrided (de Gaulle)(unanimity-simple majority);
- **Independent resources** for **Commission** + 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;
  - Coolly 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**;

- <u>**Compromise**</u> – meeting in **Luxembourg** (instead of Brusells):
  - **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);


FRANCE

Problems of European Economy

- Although first **oil shock** seen as a principal **factor** in **terminating** the long **boom** – preceded by number of **worrying developments**:
    - **collapse** of **B-W** and return to **free floating** currencies;
    - **labor market** constraints;
    - **exhaustion** of **catch up effect**;
    - **competitive newly industrialized** countries (JAP, Korea, Taiwan, LATAM);
- *Eichengreen*: Oil shocks cannot explain why **growth failed** to **recover** subsequently:
    - no evidence of **larger falls** in **energy intensive** industries;
    - real **price of energy not** significantly **higher after** 1985 than before 1973;
- **Wages explosion** - major **destabilizing** factor:
    - **rising** income as a norm and **expectation** – labor **markets tightened** as **AGRI** reserves **depleted** -> shorter **hours**, more **holidays**, higher **pay** + requests of **unions** (labor no longer willing to bear the consequences of downturn);
    - **Narrowing technological gap** Europe – US: limited scope for substituting capital for labor –> rise in **real wages** ran **ahead** of **productivity increases** –> **falling profit** levels –> employers responded by **rising prices (inflation);**

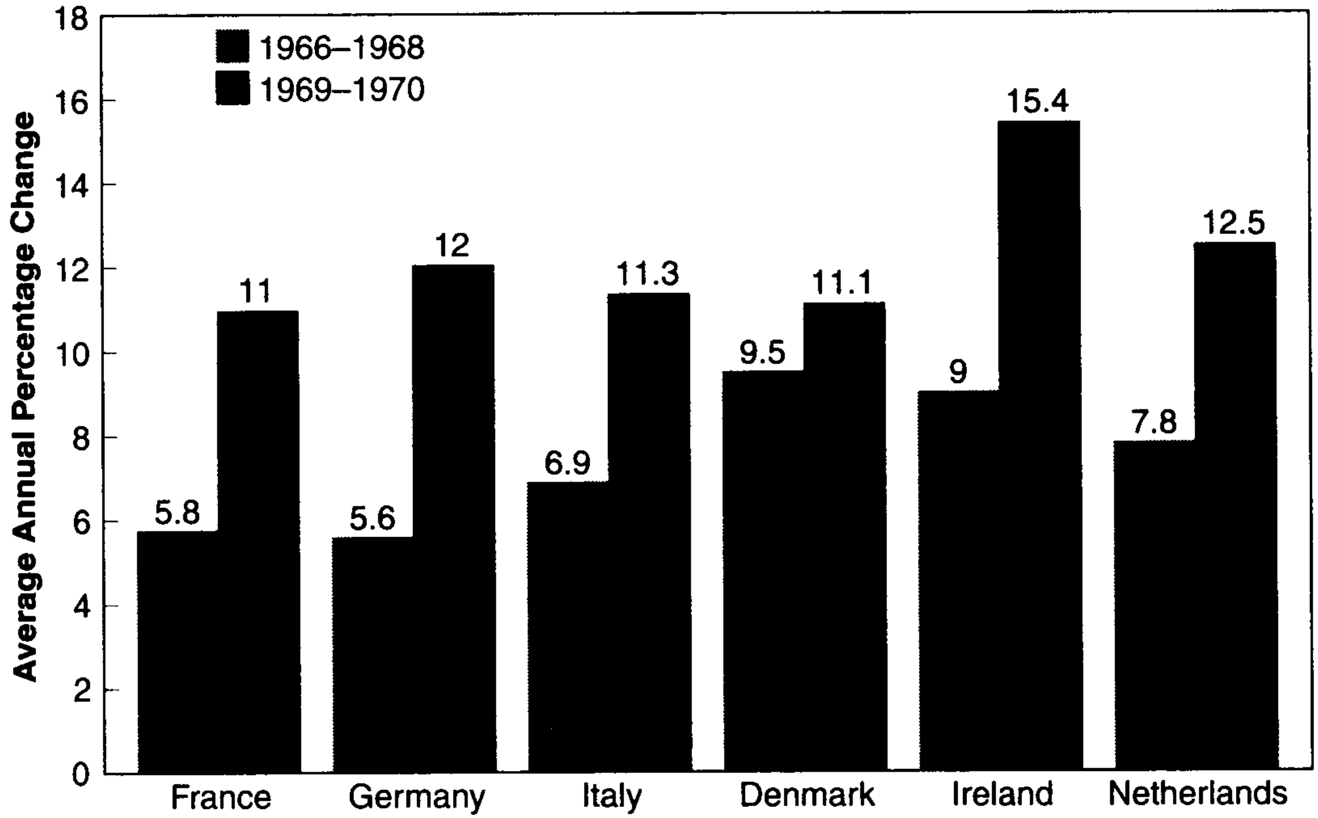


Figure 7.2. Nominal wage changes, 1966–1970. *Source*: Boltho (1982). *Note*: Figure shows average annual percentage changes of wages and salaries per employee. For France, figures are based on statistics for 1965–1967 and 1968–1969.

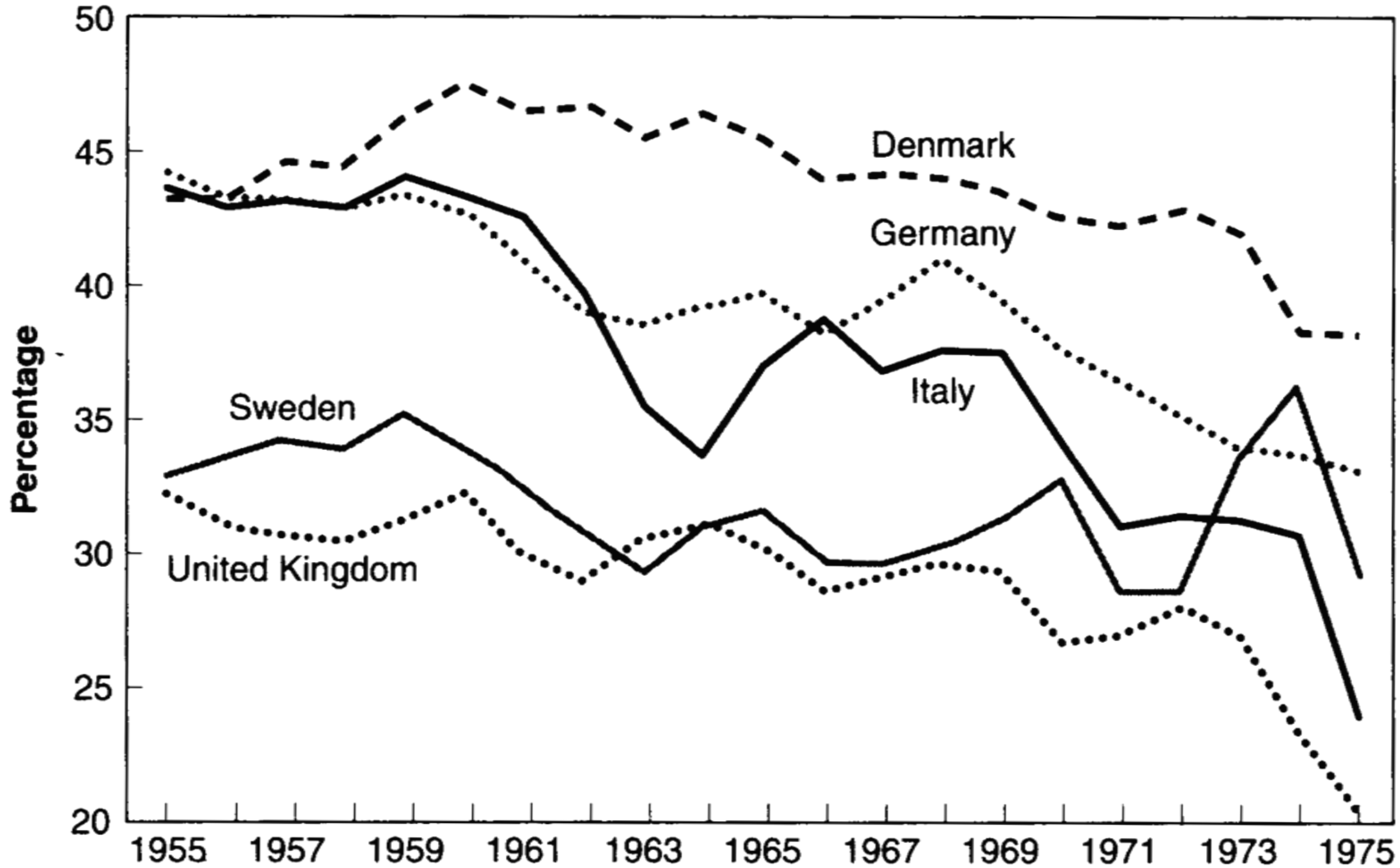


Figure 7.4. Profit shares in selected Western European countries, 1955–1975 (Percentage of national income). *Source*: Hill (1979).

Average annual rate of growth of output per worker and its determinants, 1960–2000, various subperiods (Percent per year)

Country	1960–1975 *y*	*k*	*h*	*tfp*	1975–2000 *y*	*k*	*h*	*tfp*
Austria	4.65	7.03	0.50	1.99	2.00	2.58	0.98	0.49
Belgium	3.88	4.55	0.79	1.85	1.79	1.97	0.72	0.66
Denmark	2.07	3.21	0.36	0.77	1.74	1.39	0.33	1.06
Finland	3.70	5.68	1.11	1.08	2.14	2.21	0.98	0.75
France	3.87	6.09	0.96	1.22	1.67	2.27	0.80	0.39
Germany	3.45	6.19	1.06	0.69	1.21	0.83	0.72	0.45
Greece	6.47	9.33	0.71	2.92	1.06	1.03	1.02	0.03
Ireland	3.68	3.30	0.54	2.23	4.23	3.96	0.86	2.35
Italy	4.40	5.15	0.78	2.18	2.05	2.01	1.02	0.70
Netherlands	2.78	4.54	0.83	0.73	1.11	0.99	0.90	0.19
Norway	2.62	3.00	0.41	1.36	2.21	2.12	0.52	1.16
Portugal	4.64	5.46	0.61	2.43	2.69	3.63	0.79	0.96
Spain	6.47	6.30	0.37	4.14	1.28	1.99	1.17	–0.16
Sweden	2.56	4.43	0.69	0.63	1.15	1.31	0.88	0.13
United Kingdom	1.96	5.14	0.58	–0.13	1.86	2.05	0.73	0.69
Memo item: United States	1.81	1.61	0.80	0.74	1.94	2.62	0.53	0.72

Source: See appendix.

Notes: y = output per worker; k = physical capital per worker; h = human capital per worker; *tfp* = total factor productivity per worker.

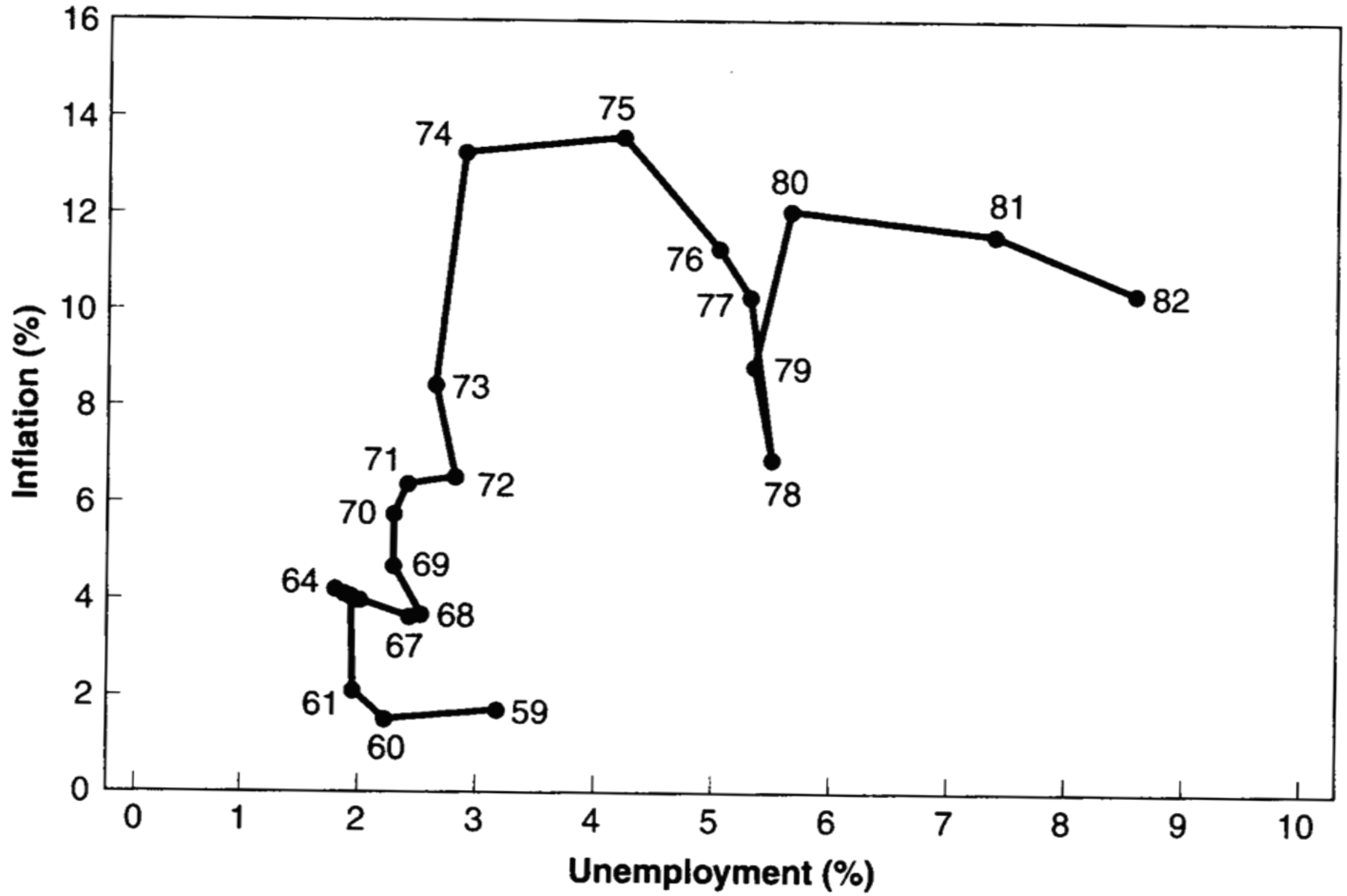


Figure 9.4. Inflation and unemployment in Europe, 1959–1982. *Source*: Eurostat. *Note*: Figure shows aggregate statistics for nine European countries: Belgium, Denmark, West Germany, France, Ireland, Italy, Luxembourg, Netherlands, and the United Kingdom.

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

	Level of Unemployment (per cent of labour force)				*Changes in consumer price index (annual average compound growth rate)*			
	1950–73	***1974–83***	***1984–93***	***1994–98***	***1950–73***	***1973–83***	***1983–93***	***1994–98***
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.

Explanation of Problems of European Economy (*Eichengreen*)

- Just **as** this **inheritance** of economic and **social** **institutions** **contributed** to the extraordinarily **successful** performance of European economy after 1950 – it was equally part of the **explanation** for European **less satisfactory** **performance** in the subsequent 25 years;
- As the early opportunities for **catch-up** and convergence were **exhausted**, the continent had to find **other ways** of sustaining its growth;
- Had to **switch** form growth based on brute force **capital accumulation** and the acquisition of **known technologies** to growth based on increase in **efficiency** and internally generated **innovation**;
- Shift **from** **extensive** to **intensive growth**
  - **Extensive**: based on capital formation and the existing stock of technological knowledge – **raising output** by **putting more** **people to work** at **familiar tasks** and raising labor productivity by **building more factories along** the **lines** of **existing** factories;
  - **Intensive growth** – through **innovation** - more of the increase in output is accounted for by **technical change** and **less by the growth** of **factor** inputs;
- Europe had no choice but to **switch** to intensive growth **from the 70s** on;

- Bank-based **financial systems** had been effective at mobilizing resources for investment by **existing enterprises** using **known technologies** – **less** conductive to growth in a period of **heightened technological uncertainty**;
  - The role of finance was to take **bets** on **competing technologies** something for which **financial markets** were **better** adapted;
- Generous employment protections and welfare – given labor the **security** to accept the installation of **mass-production technologies** – now become an **obstacle** to growth as **new firms** seeking to explore the viability of **unfamiliar technologies**…;
- System of **worker co-determination**: union representative on big firms supervisory boards – ideal for helping labor to verify that **owners** were **investing** the **profits** resulting from wage restraint **-** but **now discouraged** bosses form taking the tough measures needed to **reconstruct** in **preparation** for adoption of radical **new technologies**;
- **State holding** companies that had been engines of **investment** and **technical progress** were **no longer efficient** mechanisms for allocating resources;
  - They were increasingly **captured** by **special interests** and used to bail out loss-making firms and prop up declining industries;
- This explains how the average **annual** rate of **growth** GDP/C in **WE** could have **fallen** by **more than half** between the 1950-1973 and the 1973-2000 period.

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…


THATCHER PAYS POLICE TO STARVE KIDS
THATCHER PAYS POLICE TO STARVE KIDS
THATCHER SNATCHED OUR MILK NOW SHE'S STEALING OUR BREAD
THATCHER PAYS POLICE TO STARVE KIDS

Economic development in Great Britain

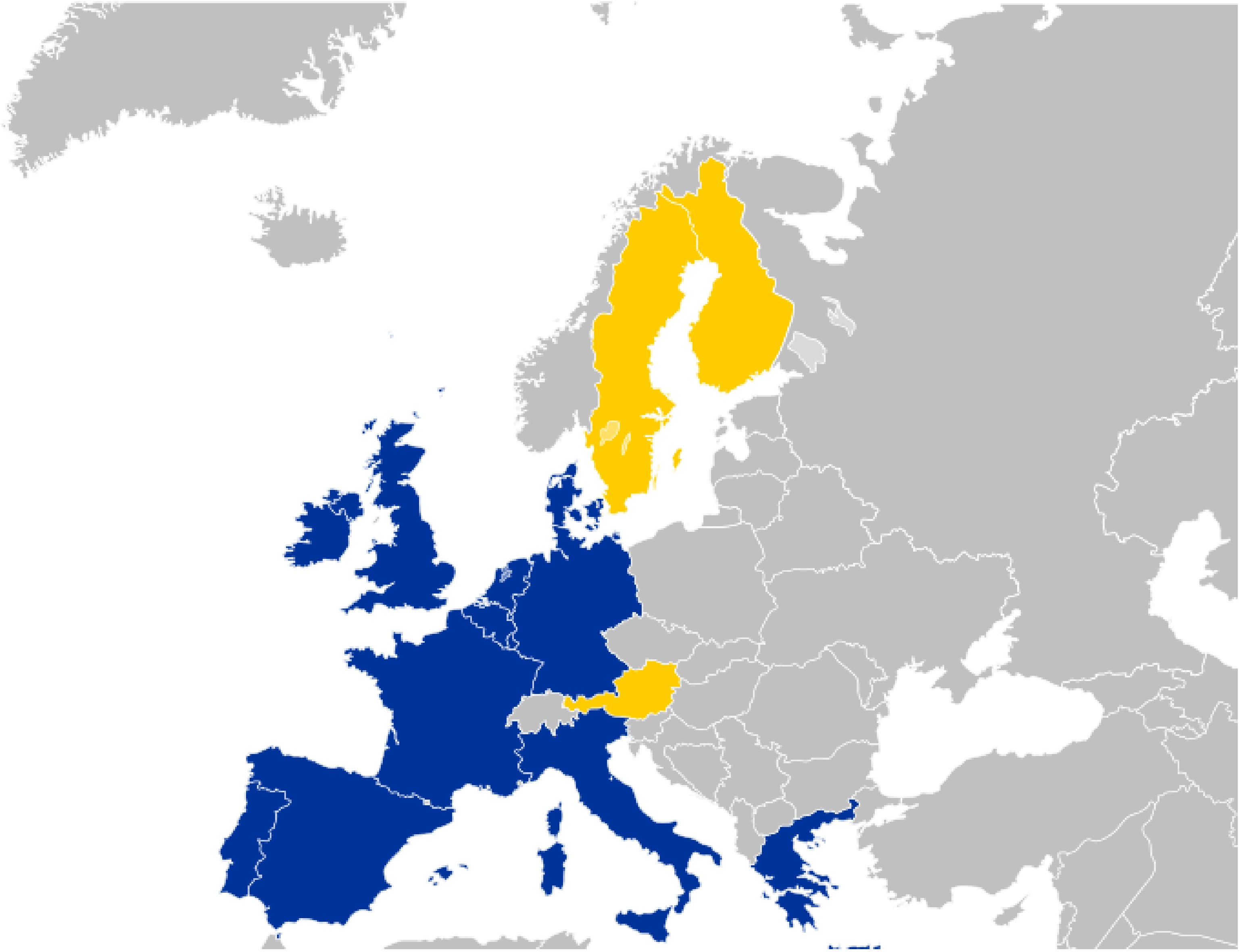
	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GDP Growth	2,8	-2,0	-1,2	1,7	3,8	1,8	3,8	3,6	4,4	4,7	2,1
Inflation	13,4	18,0	11,9	8,6	4,5	5,0	6,0	3,4	4,2	4,9	7,8
Unemployment	4,0	4,8	7,9	9,5	10,5	10,7	10,9	11,8	10,3	8,3	6,4

	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**

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; (Vs. 1995-2005)
- **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 (*Delorse commison*);
  - 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 **FRA**;
- 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 Issues in EU

- **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**);