

Economic Integration, structural crisis and Single market

Historical and Political Context

Europe in International Economy
2018



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, 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 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 towards **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 -> **CAP**;
 - 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 **majority voting** - efficiency of decision vs. risk of being overridden (**de Gaulle**);
- **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**;
- **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);

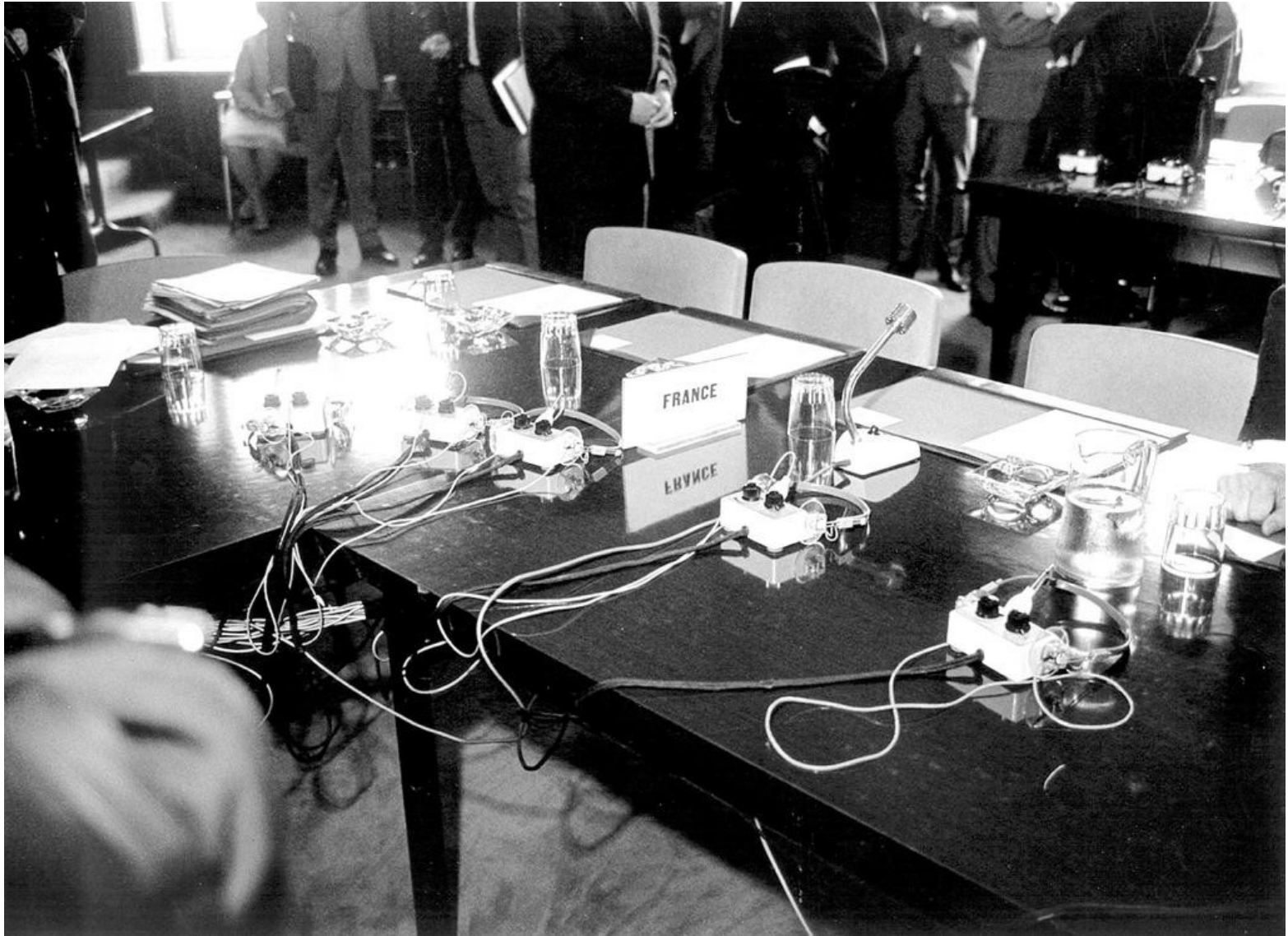




Table 6.2 Primary sources of energy in western Europe, 1955 and 1972 (%)

Use	1955	1972
Coal	75	23
Petroleum	22	60
Natural gas	1	9
Other	2	8
Produced in Europe	78	35
Imported from non-Europe, net	22	65

Source: Prodi and Clo (1976, 92).

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)**;

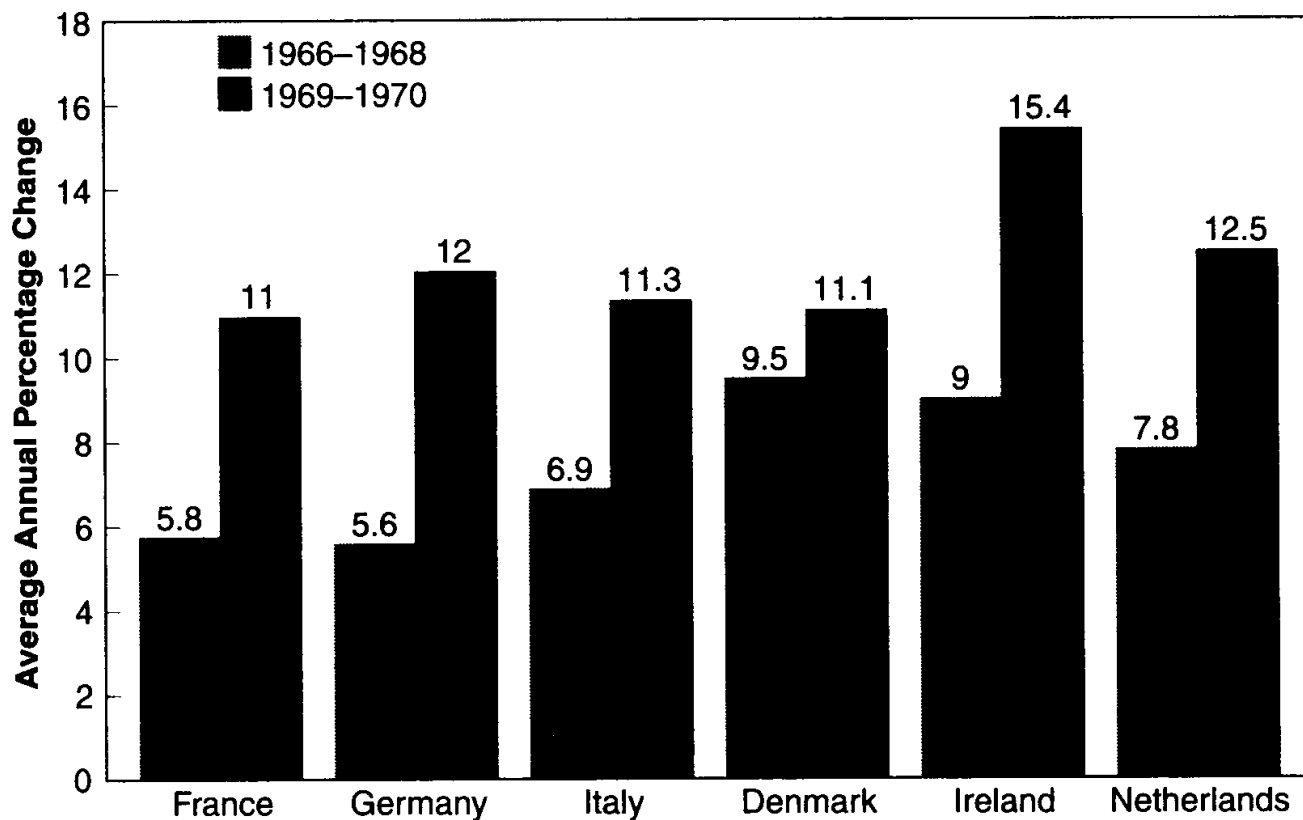


Figure 7.2. Nominal wage changes, 1966-1970. *Source:* Boltho (1982). *Note:* Figure shows average annual percentage changes of wages and salaries per employee. For France, figures are based on statistics for 1965-1967 and 1968-1969.

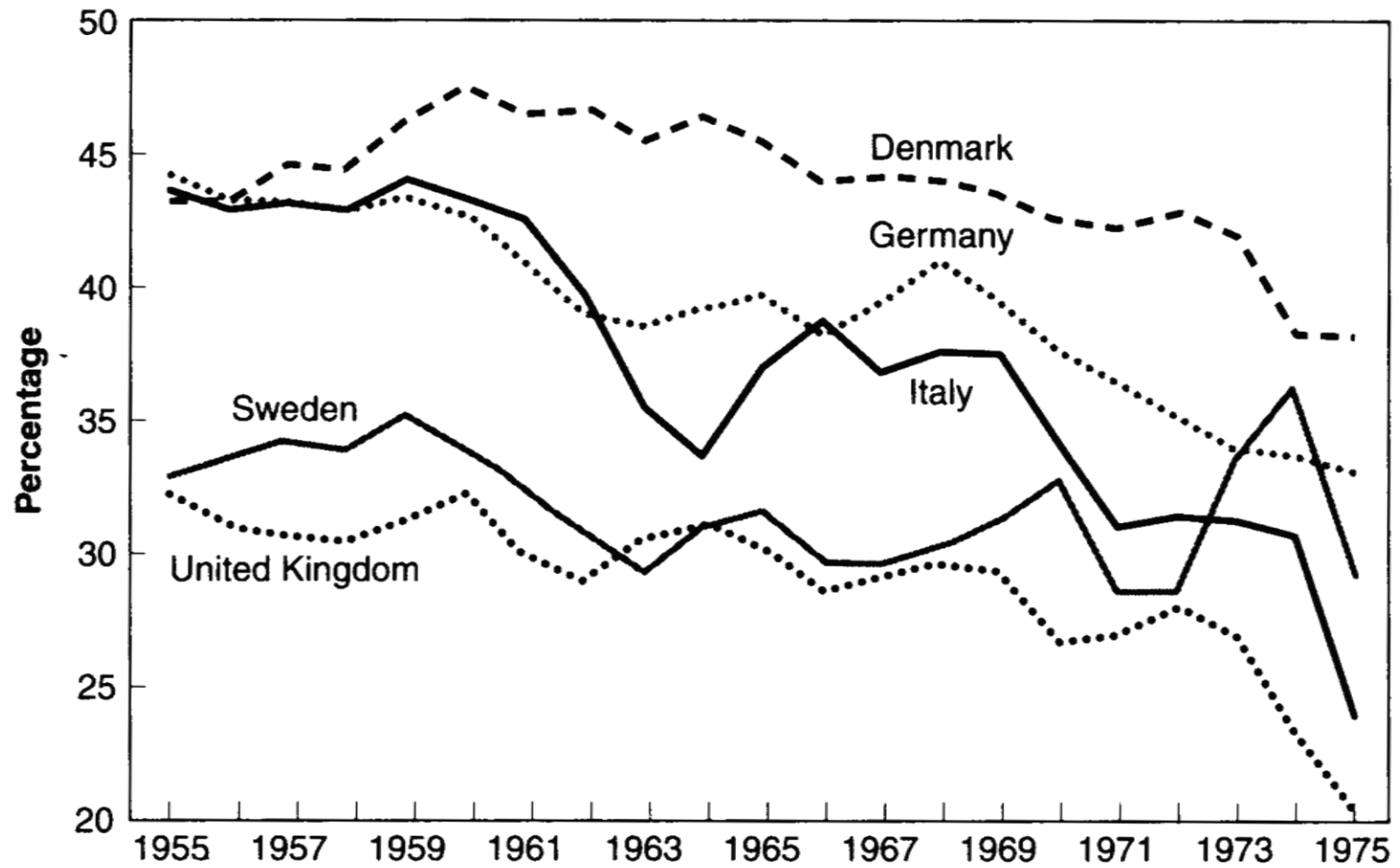


Figure 7.4. Profit shares in selected Western European countries, 1955–1975 (Percentage of national income). *Source:* Hill (1979).

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

Country	1960–1975				1975–2000			
	y	k	h	tfp	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.

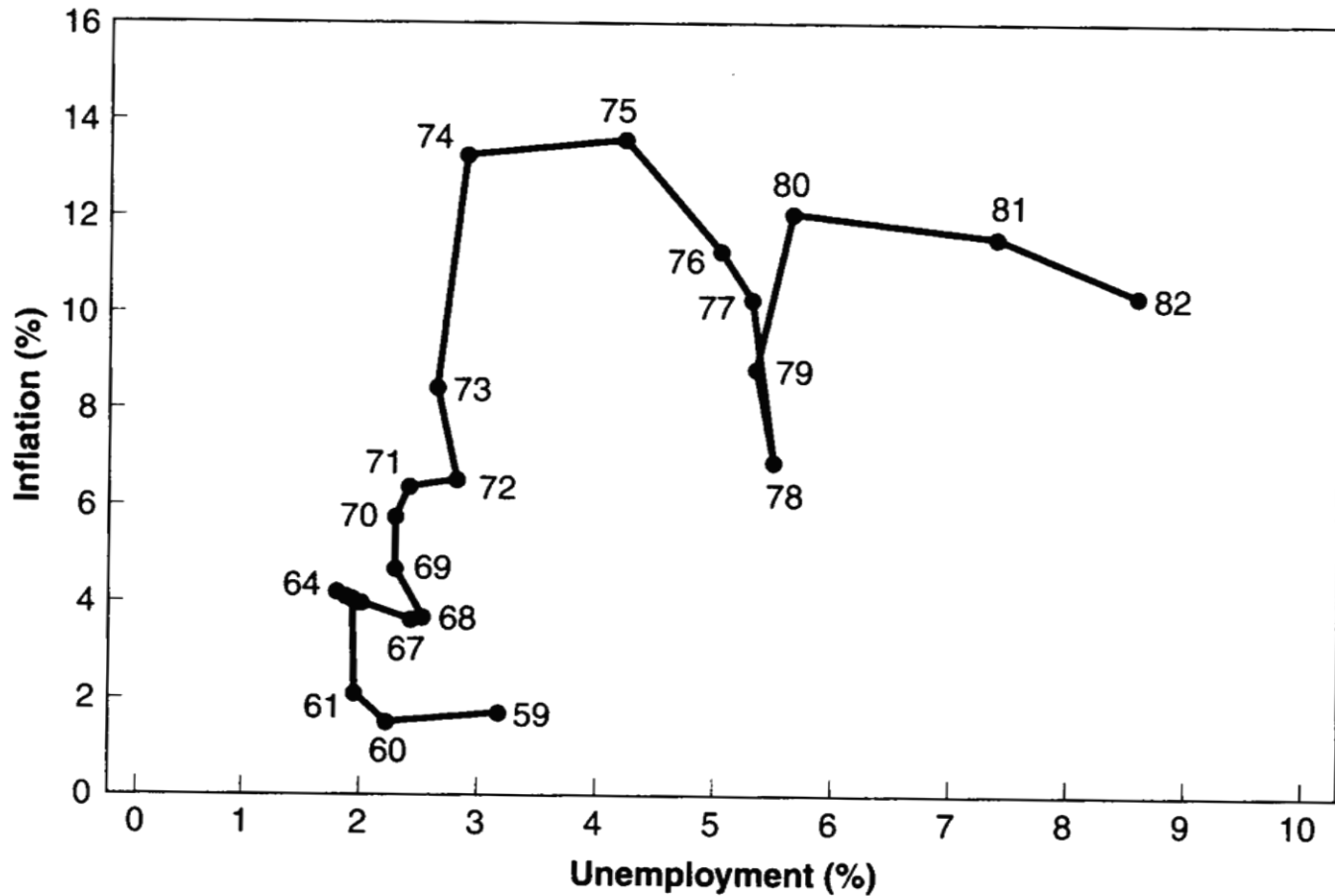


Figure 9.4. Inflation and unemployment in Europe, 1959–1982. *Source:* Eurostat. *Note:* Figure shows aggregate statistics for nine European countries: Belgium, Denmark, West Germany, France, Ireland, Italy, Luxembourg, Netherlands, and the United Kingdom.

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

	<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.

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;

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...



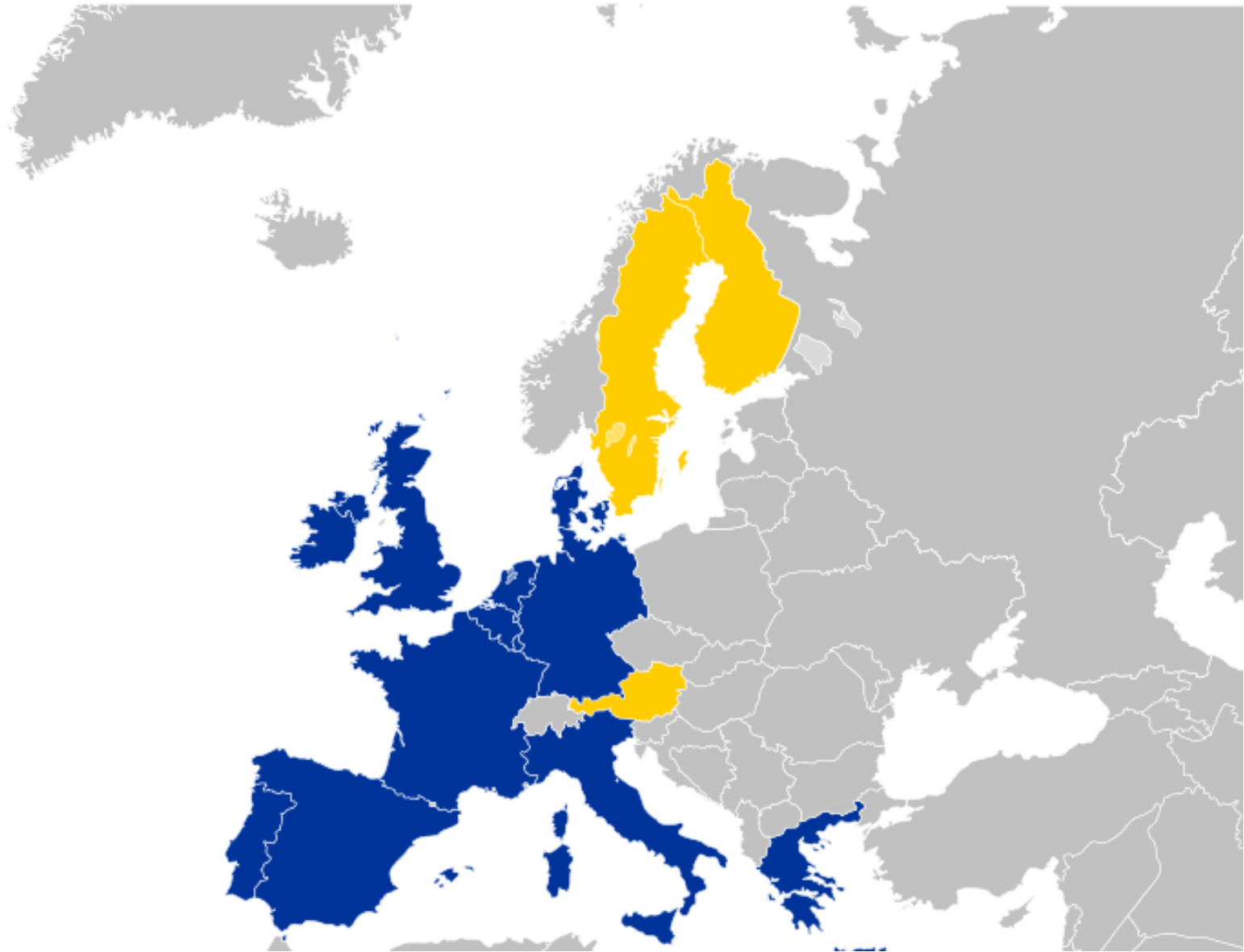
Economic development in Great Britain

	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

	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 (*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 **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**);

