Lecture # 1
Economics of European Integration

Spring 2009

Gerald Willmann
The Economics of European Integration

2ND EDITION

THE ECONOMICS OF EUROPEAN INTEGRATION

RICHARD BALDWIN & CHARLES WYPLOSZ

© Baldwin & Wyplosz 2006
Chapter 1

History
# Early Post War Period

- **A Climate for Radical Change:**
  - **Facts:**

<table>
<thead>
<tr>
<th>Country</th>
<th>Death toll</th>
<th>The Economic Set-Back: Pre-war year when GDP equalled that of 1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>525,000</td>
<td>1886</td>
</tr>
<tr>
<td>Belgium</td>
<td>82,750</td>
<td>1924</td>
</tr>
<tr>
<td>Denmark</td>
<td>4,250</td>
<td>1936</td>
</tr>
<tr>
<td>Finland</td>
<td>79,000</td>
<td>1938</td>
</tr>
<tr>
<td>France</td>
<td>505,750</td>
<td>1891</td>
</tr>
<tr>
<td>Germany</td>
<td>6,363,000</td>
<td>1908</td>
</tr>
<tr>
<td>Italy</td>
<td>355,500</td>
<td>1909</td>
</tr>
<tr>
<td>Netherlands</td>
<td>250,000</td>
<td>1912</td>
</tr>
<tr>
<td>Norway</td>
<td>10,250</td>
<td>1937</td>
</tr>
<tr>
<td>Sweden</td>
<td>0</td>
<td>GDP grew during WWII</td>
</tr>
<tr>
<td>Switzerland</td>
<td>0</td>
<td>GDP grew during WWII</td>
</tr>
<tr>
<td>UK</td>
<td>325,000</td>
<td>GDP grew during WWII</td>
</tr>
</tbody>
</table>
• **A Climate for Radical Change:**
  
  – Images

  ![](image1)

  *Reichstag, 1945*

  ![](image2)

  *Frankfurter Allee, 1945*

© Baldwin & Wyplosz 2006
• **A Climate for Radical Change:**
  
  – Images

*Brandenburg Gate*
• **A Climate for Radical Change:**
  
  - Images

Unser der Linden, 1945

Unser der Linden, 1997

© Baldwin & Wyplosz 2006
A Climate for Radical Change:

- Images

Berlin Cathedral, 1945

Berlin Cathedral, 1997
• **A Climate for Radical Change:**
  - Images

Canadian soldiers and tanks advance through the streets of Ortona, Italy in this 1943 photo. Canadian Press
• A Climate for Radical Change:
  – Images

Rotterdam, 1940
• **A Climate for Radical Change:**
  
  – Images

---

Verona 1945
• A Climate for Radical Change:
  - Images

London 1940
• A Climate for Radical Change:
  – Images

London 1940
• A Climate for Radical Change:
  – Images

*East London, 1940*
The prime question in 1945

• “How can Europe avoid another war?”
  – What caused the war? 3 answers
    • Blame the loser
    • Capitalism
    • Destructive nationalism
  – These implied 3 post-war solutions
    • ‘Neuter’ Germany, Morgenthau Plan, 1944
    • Adopt communism
    • Pursue European integration

• European integration ultimately prevailed, but this was far from clear in the late 1940s.
Emergence of a divided Europe

- Cold War begins.
- USSR pushes communism in the East.
- Moves towards creation of West German government.
  - Berlin blockade, 1948.
- “Neuter Germany” solution abandoned for strong West Germany + European integration.

Germany & Berlin divided into 4 zones

Berlin blockade

© Baldwin & Wyplosz 2006
A divided Europe
You are leaving the American sector.

Vous sortez du secteur américain.

Вы выезжаете из американского сектора.
Checkpoint Charlie, 1961
First Steps

• First Steps: the OEEC and EPU
  – OEEC and EPU set up in conjunction with Marshal Plan, 1948.
  – OEEC coordinated aid distribution and prompted trade liberalisation.
  – EPU facilitated payments and fostered trade liberalisation.
Need for deeper European integration

- As Cold War got more war-like, West Germany rearmament became necessary.
  - But strong and independent Germany was a scary thought to many, including many Germans.
  - Wide-spread feeling: best to embed an economically and militarily strong W. Germany in European superstructure.
  - Problem: OEEC was too loose to avoid future war among Western European powers.
Two strands of European integration

• Federalism and intergovernmentalism
  – Immediate disagreement about depth of European integration
    • Federalism – supranational institutions
    • Intergovernmentalism – nations retain all sovereignty

• Intergovernmental initiatives
  • OEEC (1948), Council of Europe (1949), EFTA (1960)

• Federal initiative
  • ECSC (1951), EEC (1958)
1960-1973, two non-overlapping circles

West European Trade Arrangements in: 1960s

The EFTA-7 and the EEC-6 form two non-overlapping circles.
Evolution to Two Concentric Circles

• Preferential liberalisation in EEC and EFTA proceeded
  – (EEC’s customs union and EFTA’s FTAs completed by 1968)
• Discriminatory effects emerge, leading to new political pressures for EFTAs to join EEC
  – Trade diversion creates force for inclusion
  – As EEC enlarges, force for inclusion strengthens
• When UK decides to apply for EEC (1961), 3 other EFTAns also change their minds.
  – De Gaulle’s ‘non’ (twice)
Evolution to Two Concentric Circles

• First enlargement, 1973
  • UK, Denmark, Ireland & Norway admitted
    (Norwegians say no in referendum)

• Enlargement of EEC reinforces ‘force for inclusion’ on remaining EFTAs
  – Remaining EFTAs sign FTA agreements with EEC-9
  – Why weren’t the FTA’s signed before?
    • Domino-like affect of lowering barriers
    • 1st within EEC6 → enlargement → EEC-EFTA FTAs
Two concentric circles

West Europe's Trade Arrangement in mid-1970s
Euro-pessimism, 1975-1986

- Political shocks:
  - ‘Luxembourg Compromise’ (1966) + enlargement leads to decision-making jam.

- Economic shocks:
    - Failed monetary integration schemes (except within DM bloc).
  - 1973 and 1979 oil shocks with stagflation.
  - Failure of Deeper Trade Integration.
  - Growing cost of Common Agricultural Policy creates frictions over budget.
Bright spots

• Democracy in Spain, Portugal and Greece
• Greece joins in 1981
• Spain and Portugal join in 1986 after long and difficult accession talks
• EMS set up in 1979 works well
• Budget Treaties
• 1979 Cassis de Dijon decision built on 1974 Dassonville ruling
  – Challenged validity of national rules that introduce non-tariff barriers to trade.
  – Mutual Recognition Principle introduced.
Deeper circles: single market programme

• Mutual recognition as threat to national regulatory control; race to bottom?
• How to put member gov’t back in charge?
• Delors launches completion of the internal market with Single European Act
  – create "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured".
• Important institutional changes, especially move to majority voting on Single Market issues.
  – Mutual recognition is disciplined by minimum harmonisation
  – More efficient decision making procedures allow agreement on min. standards “New Approach” Directives.
Single Market Programme, EC92

• Basic elements
  – Goods Trade Liberalisation
    • Streamlining or elimination of border formalities,
    • Harmonisation of VAT rates within wide bands
    • Liberalisation of government procurement
    • Harmonisation and mutual recognition of technical standards in production, packaging and marketing
  – Factor Trade Liberalisation
    • Removal of all capital controls (!!!), and deeper capital market integration
    • Liberalisation of cross-border market-entry policies,
Domino effect, part II

• Deeper integration in EC-12 strengthened the ‘force for inclusion’ in remaining EFTAns.
• End of Cold War loosened EFTAns’ resistance to EC membership.
• Result of ‘force for inclusion’
  – EEA – initiative to extend single market to EFTAs.
  – Membership applications by all EFTAns except Iceland.
• Concentric circles, but both deeper.
Fourth enlargement

- 1994, Austria, Finland, Norway and Sweden admitted (Norwegians again vote no).
Communism’s creeping failure and spectacular collapse

• By the 1980s, Western European system clearly superior due to the creeping failure of planned economies.
• Up to 1980s, Soviets thwarted reform efforts (economic & military pressure).
• Changes in USSR due to inadequacy economic system.
  – timid pro-market reforms (perestroika).
  – openness (glasnost).
Velvet revolutions in CEECs

– June 1989 Polish labour movement ‘Solidarity’ forced free parliamentary elections & communists lost
  • Moscow accepted new Polish government.
– Moscow’s hands-off approach to the Polish election triggered a chain of events.
  • Reformist in Hungarian communist party pressed for democracy & Hungary opened its border with Austria, 1000s East Germans moved to West Germany via Hungary and Austria.
  • Mass protests in East Germany; Wall falls 9th November 1989.
  • End of 1989: democracy in Poland, Hungary, Czechoslovakia and East Germany (unification in 1990).
USSR collapses

• 1990, Estonia, Latvia and Lithuania – declared their independence from the USSR.
• End of 1991, the Soviet Union itself breaks up.
• Cold War ends without a shot.
• Military division of Europe ended.
EU reacts

• The European Union reacted swiftly to this geopolitical earthquake by providing emergency aid and loans to the fledgling democracies.

• Signing of ‘Europe Agreements’ with newly free nations in Central and Eastern Europe
  – These are free trade agreements with promises of deeper integration and some aid
From Copenhagen to Copenhagen

• EU says CEECs can join the EU (June 1993).
  – Set out famous Copenhagen criteria for membership.
    • stability of institutions guaranteeing democracy,
    • the rule of law,
    • human rights and respect for and protection of minorities,
    • the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union.

• Copenhagen summit December 2002 says 10 CEECs can join in 2004.

• 5th enlargement in May 2004
German unification and Maastricht

• Pending 1990 unification of Germany opens door to a ‘grand bargain’ (Mitterrand, Kohl).
  – Germany gives up DM for European Monetary Union & East Germany joins the EU without negotiation.
• Jacques Delors proposes 2nd radical increase in European economic integration.
  – the formation of a monetary union.
  – Idea championed by French President Francois Mitterrand and German Chancellor Helmut Kohl.
• Maastricht Treaty, signed 1992
  – Also, sets up EU’s ‘three pillar’ structure to reduce EU’s ‘competency creep;’
Preparing for Eastern Enlargement

- Impending enlargement required EU to reform its institutions
- Four tries:
  - Amsterdam Treaty, 1997
  - Nice treaty, 2000
  - draft Constitutional Treaty, 2003
    - Reconsidered by IGC 2003
Amsterdam Treaty

• Failed to reform main institutions
• Tidied up of the Maastricht Treaty
  – More social policy, Parliament powers modestly boosted,
  – flexible integration, ‘closer cooperation introduced
• Amsterdam leftovers
  – voting rules in the Council of Ministers,
  – number of Commissioners,
  – Extension of issue covered by majority voting
Nice Treaty

• Reforms of main institutions agreed, but poorly done
  – Council voting rules highly complex and reduce EU’s ability to act with more members
  – No important extension of majority voting
  – Make shift solution for Commissioners
  – No reform of decision making in ECB
• Generally viewed as a failure
• Main changes re-visited in draft Constitutional Treaty, 2003
Constitutional Treaty

• Improved decision-making rules for Council of Ministers and slightly more majority voting.

• Inclusion of Charter of Fundamental Rights.

• Other things where CT not strictly required:
  – Many ‘gestures’ and tidying up.
  – Moves towards more coherent foreign policy decision making.
  – Many de facto points turned into de jure.
Constitutional Treaty’s Problems

• France and Netherlands reject the Constitutional Treaty in referendums in Summer 2005.
• EU leaders suspend the ratification deadline. Next steps uncertain as of early 2006.