Wirtschaftspolitik der EU

The Economics of European Integration

Ludwig von Auer
Universität Trier

Winter Term 08/09
Principal Textbook:
Chapter 1

History
• This chapter summarizes the history of European integration since 1945.
• Section 1.1 covers the early post war years.
• Section 1.2 is concerned with the integration occurring between the early 1950s and the early 1960s (includes the Treaty of Rome).
• The subsequent integration until the mid-1970s is the object of Section 1.3.
• Setbacks during the 1970s and early 1980s are discussed in Section 1.4.
• The revived integration during the second half of the 1980s is covered in Section 1.5.
• Section 1.6 covers the East-West integration that has started during the late 1980s (includes the Maastricht Treaty and the EU Treaty).
1.1 Early Post War Period

1.1.1 A Climate for Radical Change

- In 1945, almost every nation in Europe has been (a) ruled by a brutal fascist dictator, (b) occupied by foreign army or (c) both.
- Germany and France have fought four wars within 130 years.
- In western Europe, the war killed about 8 million people (three quarters were Germans).
- In central and eastern Europe over 9 million people perished (6.3 million of them Poles).
- The Soviet Union lost over 20 million people.
## The Economic Set-Back: Pre-war year when GDP equalled that of 1945

<table>
<thead>
<tr>
<th>Country</th>
<th>Death toll</th>
<th>Year</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>
Rotterdam 1940
Coventry Cathedral 1940
London 1940
East London, 1940
Reichstag, 1945

Frankfurter Allee, 1945
Dresden 1945
Dresden 1945
• Between 1945 and 1947, hunger is widespread (especially in Germany in the harsh winter of 1946).
• Western Europe suffers governmental and constitutional crises.
• General Charles de Gaulle resigns as president of the provisional French government.
• Italy abolishes its monarchy.
1.1.2 The Prime Question in 1945

- How can Europe avoid another war?
- What caused the war? Three answers:
  - Blame the loser
  - Capitalism
  - Destructive nationalism
- These imply three very different post-war solutions:
  - ‘Neuter’ Germany, Morgenthau Plan, 1944
  - Adopt communism
  - Pursue European integration
- Today we know: European integration ultimately prevailed, but this was far from clear in the late 1940s.
• Germany and Austria are divided into US, UK, French and Soviet zones.
• Soviet troops occupy all of central and eastern Europe.
• West European governments are preoccupied and overloaded by the dismal humanitarian situation.
• In eastern Europe the Soviet Union imposes communism on the previously independent nations Estonia, Latvia, and Lithuania.
• By 1948, communist parties are in power in every Soviet-occupied country.
• Communists take power in Albania, Yugoslavia, and gain strength in Greece.
• In 1946, communists gain 19 percent of the vote in Italy, 29 percent in France.
1.1.3 Emergence of a Divided Europe

- Cold War begins.
- In eastern Europe, the Soviet Union aggressively pushes communism.
- This unifies the west in favour of multi-party democracy, social market economy, and European integration.
- The UK, French and US zones merge by 1948.
- Moves towards creation of West German government are answered by the Berlin blockade (June 24, 1948).
• European integration is supported by national interests.
• French leaders see Franco-German integration as a counterweight to UK-US influence on the Continent.
• Reindustrialized Germany is a partner rather than a military adversary.
• The UK and US support European integration as a counterweight to Soviet influence.
• German leaders see the European integration as the surest road to establish Germany as a ‘normal’ nation.
• Italy hopes to keep communism in check and to close the door on Italy’s fascist past.
1.1.4 First Steps of Integration

- In 1948, the Organization for European Economic Cooperation (OEEC) is set up in conjunction with the Marshall Plan (named after the US Secretary of State).
- The Marshall plan offers financial assistance to all European nations ‘west of the Urals’.
- The Soviet Union and all central and eastern European countries decline the offer.
- They establish the Council for Mutual Economic Assistance (CMEA).
- The OEEC coordinates aid distribution.
- More importantly, it promotes trade liberalization within Europe.
- Except for Finland (Soviet pressure) and Spain (Franco), all EU-15 countries are members of the OEEC.
The 17 Founding Members of the Organization of European Economic Cooperation (1948)
• Representatives of the Western Zones of Germany take part in OEEC meetings.
• In 1948, the OEEC establishes the European Payments Union (EPU).
• The EPU facilitates payments and fosters trade liberalization.
• By 1959, 89 percent of quantity restrictions of trade are removed.
• Trade liberalization going hand in hand with strong growth, challenges general wisdom of past decades.
1.1.5 Drive for Deeper European Integration

- As Cold War gets more war-like, West Germany’s rearmament becomes necessary.
- In 1949, the Federal Republic of Germany is established (recognized as an independent nation only in 1955).
- But a strong and independent Germany is a scary thought to many, including many Germans.
- The aim is to embed an economically and militarily strong West Germany in a European superstructure.
- Problem: The OEEC is possibly too loose to avoid future war among Western European powers.
Konrad Adenauer
1876-1967
1.2 Supranationalism and Intergovernmentalism

• Immediate disagreement arises about the desirable depth of European integration.
• The concept of “Supranationalism” relies on supranational institutions.
• It is supported by nations that have experienced land combat, extensive death and destruction: Belgium, the Netherlands, Luxembourg, France, Austria, Germany, and Italy.
• The concept of “Intergovernmentalism” is based on nations that retain all sovereignty.
• It is supported by nations that avoided foreign occupation and/or extensive death: UK, Denmark, Norway and Iceland and the neutrals Ireland, Sweden, Switzerland.
1.2.1 European Coal and Steel Community

- Intergovernmental initiatives dominate (between 1945 and 1947, the UK has the only effective government).
- Examples of this period are
  - OEEC 1948
  - Council of Europe 1949
  - Court of Human Rights 1950
- A path braking federal initiative is the set up of the European Coal and Steel Community (ECSC) in 1952.
- It comprises “the Six”: Belgium, France, Germany, Italy, Luxembourg, the Netherlands.
The 6 Founding Members of the European Coal and Steal Community (1952)
Robert Schuman
1886-1963

Jean Monnet
1888-1979
<table>
<thead>
<tr>
<th>Country</th>
<th>Back-on-Track Year</th>
<th>Reconstruction Growth (Growth rate during 1945 to back-on-track year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>1951</td>
<td>15.2</td>
</tr>
<tr>
<td>Belgium</td>
<td>1948</td>
<td>6.0</td>
</tr>
<tr>
<td>Denmark</td>
<td>1946</td>
<td>13.5</td>
</tr>
<tr>
<td>France</td>
<td>1949</td>
<td>19.0</td>
</tr>
<tr>
<td>Germany</td>
<td>1951</td>
<td>13.5</td>
</tr>
<tr>
<td>Italy</td>
<td>1950</td>
<td>11.2</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1947</td>
<td>39.8</td>
</tr>
<tr>
<td>Norway</td>
<td>1946</td>
<td>9.7</td>
</tr>
</tbody>
</table>

Source: Crafts and Toniolo (1996), p.4
1.2.2 Supranationalist Track: The Treaty of Rome

- In 1952, plans for the European Defence Community (EDC) are worked out.
- In 1953, a plan for the European Political Community (EPC) is published.
- The EDC is rejected by the French government in 1954. The EPC project is abandoned.
- In 1955, Germany joins the North Atlantic Treaty Organization (NATO).
- The Soviet Union and central and eastern European nations form the Warsaw Pact.
- In 1957, the Six sign in Rome two treaties:
  - European Atomic Energy Community (Euratom)
• The Treaty of Rome commits the Six to
  – forming a customs union (import quotas are to be abolished by 1961; tariffs are zero by 1968, ahead of schedule; external tariffs are a simple average of the Six’s pre EEC-tariffs)
  – free labour mobility
  – capital market integration
  – free trade in services
  – several policies that were to be implemented by the supranational European Commission
    – set up the European Parliamentary Assembly
    – set up the European Court of Justice
• The UK tries to sabotage the supranational initiatives of the Six.
• In 1958 Charles de Gaulle returns to power (absent since 1946).
1.2.3 Intergovernmental Track: From OEEC to EFTA

• The non-EEC members of the OEEC fear to get sidelined.
• In 1960, seven of them form the European Free Trade Association (EFTA).
• EFTA comprises Austria, Denmark, Norway, Portugal, Sweden, Switzerland, and UK.
• EFTA is a free trade area (UK maintains preferential tariffs with Commonwealth).
The 7 Founding Members of the European Free Trade Association (1960)
1.2.4 Two Separate Free Trade Associations

• Between 1958 and the early 1960s, the share of within-EEC trade rises from 30 percent to 50 percent.
• The share of imports from six major other European nations falls from 8 percent to 7 percent.
• EEC-6 and EFTA-7 are two separate free trade associations.
1.3 Evolution to Two Integrated Free Trade Associations

- Preferential liberalisation in the EEC and in the EFTA proceeds and is completed by 1968.
- Relative competitiveness of firms matters.
- Gross domestic product of the EEC countries is more than twice as large as that of the EFTA countries.
- Discriminatory effects emerge, leading to new political pressures for EFTA-countries to join the EEC.
- As the EEC enlarges, the force for further inclusions strengthens (domino effect).
1.3.1 First Enlargement

- The UK decides to apply for EEC membership (1961).
- It would have to re-impose tariffs on imports from other EFTA-countries.
- Denmark and Norway apply.
- Austria, Sweden, and Switzerland do not apply for political reasons (neutrality).
- Portugal does not apply for lack of democracy.
- Finland does not apply for political reasons (instead it becomes an associate member of EFTA in 1961, full membership in 1986).
- Iceland does not apply because it is not heavily dependent on the EEC market (instead it joins EFTA in 1970).
- In 1963, France’s Charles de Gaulle says *non* to UK membership.
Charles de Gaulle
1890-1970
• In 1965, the EEC and Euratom are merged in the ‘European Communities’ (EC).
• The three EFTA-countries reapply in 1967, but again de Gaulle says non.
• Membership is granted in 1973.
• However, Norway’s citizens refuse to join the EC in a referendum.
• Denmark, Ireland, and UK join the Six to form the European Communities (EC-9).
• In 1975, the first European Council – informally called the European summit – takes place (meeting of the heads of state or government and the President of the European Commission).
1.3.2 Second Enlargement: EC-EFTA
Free Trade Agreements

• The remaining EFTA countries are pushed by their industries to sign free trade agreements with the EC (e.g., Sweden).
• These agreements are signed in 1973.
• By the mid-1970s one can distinguish between the core area of free trade (territory covered by the members of the EC-9) and an peripheral area of strongly liberalized trade (territory covered by the members of EFTA)
• The core area concerns trade within the EC.
• Trade within EFTA and trade between EFTA- and EC-countries is governed by the rules applicable to the peripheral area.
The Members of the EC-9 and EFTA in 1973
1.4 Euro-Pessimism

1.4.1 Political Shocks

- In the 1960s, confidence of Europeans in their governments’ ability to govern is widely restored.
- A pro-national sovereignty charge is lead by de Gaulle.
- In the ‘Luxembourg compromise’ of 1966 majority voting is de facto replaced by a unanimity rule (necessary when ‘very important interests’ of a member state are at stake).
- The EC enlargement of 1973 (Denmark, Ireland, UK) leads to decision-making jam.
1.4.2 Failure of Monetary Integration

- Werner Committee designs a step-by-step approach to full monetary union by 1980.
- In 1973, the Yom Kippur War triggers an Arab oil boycott and sharp economic downturn in Europe and elsewhere.
- Because of monetary and fiscal expansion, this first oil shock brings high inflation without growth (stagflation).
- In 1979, the Iranian Revolution triggers the second oil shock.
1.4.3 Failure of Deeper Trade Integration

- Detailed technical regulations and standards (technical barriers to trade) fragment the European market.
- In 1969 a slow process of harmonization starts.
- However, during the 1970s, the number of new national regulations grows much faster than harmonization.
• Trade inhibiting barriers are
  – differing technical standards, industrial regulations
  – capital controls
  – preferential public procurement
  – biased purchasing patterns
  – exclusive production or service rights
  – production subsidies to national champions
  – service providers need local certification
  – administrative and frontier formalities
  – value added tax and excise tax rate differences
  – differing transport regulations
  – …..
1.4.4 Bright Spots

- Greece joins the EC in 1981, Spain and Portugal in 1986, forming the EC-12.
- The European Monetary System, established in 1978, is a success.
- In 1979, the European Parliament is directly elected for the first time.
- High inflation is successfully fought.
- However, this brings recession in 1981-83.
- In 1984, recovery starts and a deepened belief in market economics begins (Ronald Reagan, Margaret Thatcher).
Margaret Thatcher 1925-

Ronald Reagan 1911-2004
1.5 Revived Integration

• In 1985, Jacques Delors becomes President of the European Commission.
• He launches the completion of the internal market (called the Single Market Programme) with the Single European Act.
• The aim is to create "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured".
• Important institutional changes are introduced, especially the move to majority voting on Single Market issues.
• By 1987, all member states have adopted the Single European Act.
Jaques Delors
1925-
1.5.1 The Single Market Programme: EC92

• By 1985, internal trade is inhibited by many non-tariff barriers (as listed before).
• Measures to liberalize the trade in goods are
  • streamlining or elimination of border formalities,
  • harmonisation of VAT rates within wide bands
  • liberalization of government procurement
  • harmonisation and mutual recognition of technical standards in production, packaging and marketing
• Measures to liberalize the trade in factors are
  • removal of all capital controls (a new area of integration), and deeper capital market integration
  • liberalization of cross-border market-entry policies
1.5.2 EEA and the Fourth Enlargement

• For economic reasons, nations outside the EC feel mounting pressure to join (domino effect).
• Austria applies for membership.
• In 1989, the single market is extended to the non-EC countries in the EFTA (apart from agriculture and the common external tariff).
• The complete area is called the European Economic Area (EEA).
• EFTA-members in the EEA have to adopt EC legislation without own formal input into the formation of these laws.
• These countries accept a good deal of supranationality.
• By the end of EEA negotiations, Austria, Finland, Sweden, Norway, and Switzerland have applied for EC membership (EEA only phase of transition).
• The end of the Cold War, was a prerequisite for their applications.
• Iceland is the only EFTA country that does not apply.
• In 1993, Swiss voters reject the EEA arrangement, and in effect the Swiss EC application.
• Today, the EEA consists of the EU-27 plus Norway, Liechtenstein, and Iceland.
1.6 East-West Integration

1.6.1 Communism’s Collapse

- The Berlin Wall, built in 1961, cements the division of Europe into communist and capitalist camps.
Berlin’s Checkpoint Charlie 1961
East German Guard Tower

Overhaul of the inner German Frontier
• By the 1980s, western living standards are considerably higher than in the central and eastern European countries and the Soviet Union.

• The ‘creeping failure’ of communism forces changes inside the Soviet union:
  – pro-market reforms (perestroika)
  – openness (glasnost)
  – less interventionist foreign policy.

• In 1989, Lech Walesa and his Solidarity movement force free parliamentary elections.

Mikhail Gorbachev
1931-
Lech Walesa
1943-
• In 1989, Hungary opens its border with Austria.
• On November 9, 1989, the Berlin Wall is opened.
• Estonia, Latvia, and Lithuania declare their independence from the Soviet Union.
• In 1990 East and West Germany re-unify.
• At the end of 1991, the Soviet Union breaks up.
• Democratic forces are in control in Poland, Hungary, Czechoslovakia, and East Germany.
Berlin, November 9, 1989
Berlin, November 9, 1989
Berlin, November 9, 1989
1.6.2 Maastricht Treaty

• Germany’s unification should occur in conjunction with a big increase in the forces tying EC members together.
• Jacques Delors proposes the formation of a strong union, including a monetary union.
• The union is to be called the European Union (EU).
• He receives support from the French president Francois Mitterrand and the German Chancellor Helmut Kohl.
• The proposal is known as the Maastricht Treaty.
• It is signed in February 1992.
• Monetary union should be reached by 1999 and a single currency by 2002.

• Other parts of the Maastricht Treaty are
  – creation of EU citizenship
  – strengthened EU cooperation in non-economic areas (e.g., security, defence, law enforcement, criminal justice, etc.)
  – principle of ‘subsidiarity’ (the EU may act only where its member states agree that actions by individual countries would be insufficient).
  – strengthening of the European Parliament
  – Social Chapter
• The UK insists on an opt-out from the single currency and the Social Chapter.
• After the Treaty’s rejection by Denmark’s voters, Denmark is granted opt-outs on the single currency and defence matters.
• The referendum in France is very close.
• The Treaty enters into force in November 1993.
• It is the birth of the European Union (EU).
• Austria, Finland, and Sweden join the EU in 1995, creating the EU-15.
• Norway’s voters again reject EU membership.
1.6.3 Europe Agreements

- The strategic goal of the central and eastern European countries is EU and NATO membership.
- The EU is reluctant.
- In 1991, the EU signs Europe Agreements with Poland, Hungary, and Czechoslovakia.
- By 1994, similar agreements are signed with Romania, Bulgaria, Albania, Estonia, Latvia, and Lithuania.
- The Europe Agreements commit the EU to remove tariffs and quantitative restrictions on most industrial products by the end of 1994.
- Protection remains, however, for textiles, some coal and steel products, and almost all agricultural goods.
• The Europe Agreements commit the central and eastern European countries to adopt EU competition policy, harmonized standards, and so on.
• The Europe Agreements do not offer EU membership.
• The central and eastern European economies are poor and agrarian.
• The EU spends 80 per cent of its budget on farms and poor regions.
• Therefore, eastern enlargement of the EU is a threat to special interest groups in the EU-15.
1.6.4 Copenhagen Criteria

• In 1993, at its Copenhagen summit, the European Council defines the Copenhagen Criteria for EU membership of new applicants:
  – stability of institutions guaranteeing democracy
  – rule of law
  – human rights and respect for, and protection of, minorities
  – existence of a functioning market economy
  – capacity to cope with competitive pressure and market forces
  – willingness and ability to adhere to the aims of political, economic, and monetary union.

• These criteria are still applied today (e.g., Croatia, Turkey, and Serbia).
1.6.5 Treaty of Amsterdam

- Enlargement requires an overhaul of EU institutions and its decision-making process:
  - adjusting voting rules in the Council of Ministers
  - the number of EU Commissioners
  - composition of EU Parliament, and so on.
- In 1997, the EU produces the Treaty of Amsterdam (worked out at an “intergovernmental conference”).
• The Treaty of Amsterdam includes a more substantial role for the EU in social policy (UK Prime Minister Tony Blair cancels the British opt-out).
• The powers of the European Parliament are increased.
• The notion of flexible integration is introduced.
• The key enlargement-related reform issues are not settled.
• The Amsterdam leftovers should be resolved by a new intergovernmental conference to be held in 2000.
1.6.6 Treaty of Nice and Copenhagen Meeting of the European Council

- The Treaty of Nice is signed in 2001.
- The treaty does not fully solve the key issues.
- On the Commission issue, the treaty makes a temporary (until the 27th member has joined) and makeshift (no long term solution) reform.
- The treaty fails to extend majority voting.
- European Council decision-making efficiency is reduced.
• In the 2001 Laeken Declaration of the European Council, EU leaders agree to resolve the Nice leftovers in another intergovernmental conference to be held in 2004.

• In preparation of this conference, a ‘European Convention’ should define various solutions to the problems associated with enlargement.

• The Convention comprises representatives from member states governments, the national parliaments, the European Parliament, the Commission, and the candidate countries.

• Though the Laeken Declaration mentions the vision of a ‘European Constitution’, it does not engage the Convention to work out a draft of such a constitution.

• In December 2002, at its meeting in Copenhagen, the European Council agrees to the accession of ten new members by May 2004.
• The new members are Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic, and Slovenia.
• The Treaty of Nice comes into force in 2003, after a ratification process in the EU-15 countries that is smoother than that of the Maastricht Treaty (with the exception of Ireland).
• In May 2004, the ten new members transform the EU-15 into the EU-25.
• Bulgaria and Romania join in 2007.
The Evolution of the EU-27 (2007)
1.6.7 European Convention

• The European Convention (February 2002 to July 2003) is run by Valéry Giscard d’Estaing.

• He re-defines the purpose of the Convention into a constitution-writing convention.

• He has enormous control about the debate and final control about the actual text.

Valéry Giscard d’Estaing 1926-
• In the June 2003 European Council meeting, the EU leaders accept the draft as a starting point for the upcoming intergovernmental conference.

• Compared with the Treaty of Nice, the voting power of Spain and Poland is significantly reduced in favour of Germany’s voting power.

• The final draft is rejected by the European Council in December 2003 (fiercest opponent: Spanish Prime Minister José María Aznar).

José María Aznar
1953-
• In the Spanish parliamentary election, José María Aznar is replaced by the more flexible José Luis Zapatero.

• In June 2004, the new draft of the Constitution is grudgingly but unanimously accepted.

José Luis Zapatero
1960-
• The British Prime Minister Tony Blair and the French President Jacques Chirac announce that they put the Constitutional Treaty to a popular vote.
• Referendums are introduced also in the Netherlands, Spain and Luxembourg.
• In mid-2005, Dutch and French voters reject the Constitutional Treaty by a wide margin.
• Luxembourg and Spain vote ‘yes’.
• In view of the Dutch and French results, EU leaders decide to suspend the formal ratification deadline of November 2006.
• Shortly after, EU leaders decide to scrap the Constitutional Treaty.
• It is replaced by the Treaty of Lisbon, signed in December 2007.
• It retains most of the elements of the Constitutional Treaty.
• Only Ireland decided to hold a referendum. In June 2008, it rejected the Treaty.
• The future of the Treaty of Lisbon looks uncertain.