Ευρωπαϊκή Οικονομική Πολιτική

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Τμήμα Οικονομικής Επιστήμης (ΟΠΑ)

Δεκέμβριος 2020

Πλάνο Διάλεξης

- Περιγραφή Μαθήματος.
- Ερωτήσεις.
- Ιστορική Αναδρομή
- Μεθοδολογία

Επικοινωνία

- Διαλέξεις: Τρίτη 6-9 .
- Ώρες γραφείου: Παρασκευή 17.00-18.00, Πτέρυγα Δεριγνύ, 4ος Όροφος
- Ηλεκτρονικό Σύνδεσμος Κράτησης Ωρών Γραφείου:
- https://docs.google.com/document/d/16txhfLhkGAxMHQFdiCcj4BBYY9cROG-1oweZePsP8Ys/edit
- Email: edioik@aueb.gr
- Κωδικός Ομάδας στο Teams: sjwo7zm
- Ερωτήσεις στη διάλεξη

Βιβλιογραφία

- Τα βασικά βιβλία είναι:

- «The Economics of European Integration», Richard Baldwin and Charles Wyplosz, 6th Edition, Mc Graw Hill **(Προτεινόμενο Σύγγραμμα)**.
-«Economics of Monetary Union», Paul De Grauwe, Oxford University Press, Oxford, UK. ISBN 9780198849544 **(Εναλλακτικό Σύγγραμμα)**

- Σημειώσεις Διαλέξεων (Ευάγγελος Διοικητόπουλος)

Βασικά Θέματα - Κύριος Στόχος

- European Union is all about the concept of **Integration**
- Countries with different cultures join together for a common interest

- Two forms of Integration

1. Part I: **Real Integration**: Theory and Applications to Europe
2. Part II: **European Monetary Union (EMU)** and European Monetary Integration

Real Integration

1. **Part I: Real Integration: Theory and Applications to Europe**

- Definition and Mechanisms of Economic Integration
- Integration by differential economic growth
- Integration by capital mobility
- Integration by labor mobility
- Integration by trade
- Globalization, Trade and the Labour Market
- Economic Integration in Europe: Eastern Enlargement

Nominal Integration

2. **Part II: European Monetary Union (EMU) and European Monetary**

- The Macroeconomics of Fixed Exchange Rates: A Review
- The European Monetary System (EMS), 1979-1998: Success or Failure
- One Money? The Theory of Optimal Currency Areas
- Is Europe an Optimal Currency Area?
- EMU and ECB Monetary Policy: Printing money or something more? Stability?
- National Fiscal Policies under the Stability Pact: Is there a Need for a European Fiscal Federalism?
- The Euro-Debt Crisis: Causes and Possible Cures

Definition of Integration

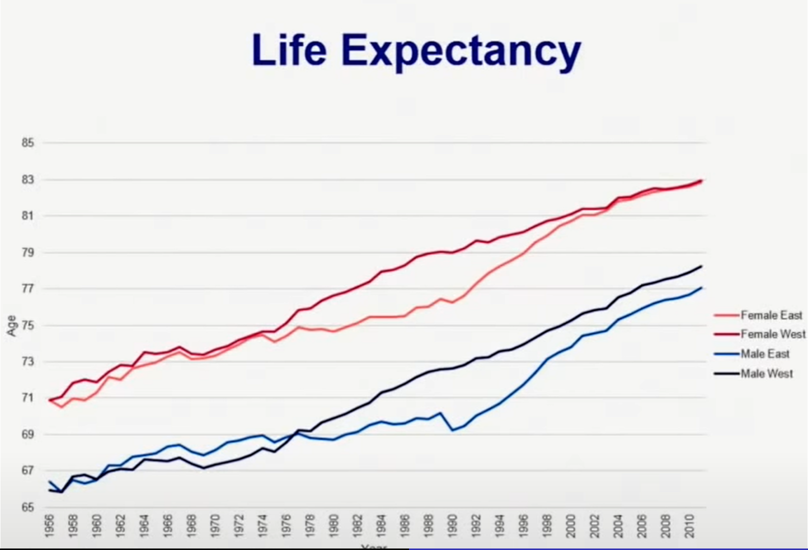
- **Efficiency definition**: Integration occurs when a set of two or more region achieve the efficient production pattern made possible by their union.
- Why intergration in the form of efficiency and not just an increase in income per capita?
- **Efficiency versus Fairness**
- Measures of Convergence (ways to compare a situation before and after)

Interesting Example - Germany

Example German Unification: Ownership of consumption goods

Durable Good	1993 East/West	1998 East/West	2008 East/West	2013 East/West
Automobile	66/74	71/77	73/78	70/79
Landline telephone	49/97	96/98	99/99	100/100
Cell phone	-/-	11/11	86/86	87/93
Personal Computer	16/22	34/40	72/76	83/86
Internet access	-/-	5/9	58/66	77/81
Television	96/95	98/95	95/94	95/95
Cable access	-/-	64/51	55/46	55/45
Satellite dish	-/-	30/29	34/40	37/47
Video recorder	36/49	61/63	-/-	-/-
Refrigerator	95/95	99/99	99/99	100/100
Microwave oven	15/41	41/53	70/70	71/71
Dishwasher	3/38	26/49	55/64	59/70
Washing Machine	91/88	94/91	-/-	96/94
Dryer	2/24	14/33	22/42	22/44

Interesting Example - Germany



Happiness WE Germany

Interesting Example - Germany

- **Economy**: e.g. Cellphones - East (49%) - West (97%)
- Huge Differences in **Life Expectancy**
- **Happiness**

GDP in the Euro Area

Example Euro Area: GDP per capita (in US $)

	2000		2009	
	Absolute	Dev from mean	Absolute	Dev from mea
Austria	23936	1.25	45686	1.16
Belgium	22716	1.19	43794	1.11
Cyprus	13493	0.70	29620	0.75
Finland	23561	1.23	44581	1.13
France	22574	1.18	42413	1.08
Germany	23220	1.21	40832	1.04
Greece	11662	0.61	29635	0.75
Ireland	25607	1.34	49863	1.27
Italy	19293	1.01	35435	0.90
Luxembourg	46360	2.42	105918	2.69
Malta	10104	0.53	19238	0.49
Netherlands	24250	1.27	48209	1.23
Portugal	11511	0.60	21970	0.56
Slovak Republic	3788	0.20	16282	0.41
Slovenia	10045	0.52	24111	0.61
Spain	14464	0.75	32030	0.81
Mean	***19162***	***1.00***	***39351***	***1.00***
Weighted mean	***18863***	***1.05***	***38955***	***1.00***
Unweight. std dev	***9868***	***0.515***	***20733***	***0.527***
Wgt. std dev		***0.061***		***0.033***

Source : World Economic Outlook Database (http://www.imf.org)

Example - The EU

- 1. Increase in the **well-being**
- 2. A lot of disparity and **inequality** accross countries and within countries
- 3. But **convergence**. Standard deviation (differences between countries slows down - red). In other words, poor countries seems to grow on average faster.
- Note: 2000-2009 (take crisis out)

Where this convergence comes from?

- 1. **Economic growth: Capital Accumulation, Adoption of Technologies, Mobilization of Workers**
- 2. Processes that drive households and firms make decisions. Why a woman want to raise students? When do we have stop studying? When to invest?
- We need to study macroeconomics and microeconomics

Macroeconomics and Macroeconomics

- Modern Macroeconomics are with Micro-Foundations.
- Households: Preferences, Behaviour, **Culture.**
- Firms: Maximize Profit, Minimize Cost.
- Governments. Regulations - Policy Instruments.

Why a government?

- Market Failures
- Externalities

Money

- Money matters, mostly in the short-run. Do we need monetary policy? What is quantitative easing?
- Probably not at all in the long-run (Monetary Neutrality).
- Why money? Why a Central Bank to have this authorization?
- Real vs Nominal Economy.

Positive versus Normative Issues

- Positive economics: Descriptive and analytic. How the world works (analysis of outcomes).
- Normative economics: What should we do about it (policy recommendations).
- This classification is important so as to understand the structure of communication between parties.
- We will do mostly positive analysis in this course.

A travel to history

Europe has experienced horrifying wars and was in ruins after WWII:

- Mainly as an effect of governmental failures
- Pictures show London in late 1940 (left) and Dresden in 1945 (right)

Figure 1.1 London Hospital in late 1940 and Dresden 1945

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A travel to history

- During the Second World War, millions of people died.
- The war also caused enormous economic damage.

Table 1.1 Death and destruction in the Second World War

	Death toll	The economic setback: pre-war year when GDP equalled that of 1945
Austria	525,000	1886
Belgium	82,750	1924
Denmark	4,250	1936
Finland	79,000	1938
France	505,750	1891
Germany	6,363,000	1908
Italy	355,500	1909
Netherlands	250,000	1912
Norway	10,250	1937
Sweden	0	(a)
Switzerland	0	(a)
UK	325,000	(a)

(a) GDP grew during the Second World War.

Source: GDP data from Crafts and Toniolo (1996), p. 4; death toll from https://en.wikipedia.org/wiki/World_War_II_casualties

A travel to history

- The Prime Question in 1945. "**How can Europe avoid another war?**"
- What cause the war? a) Blame the loser, b) blame capitalism (great depression), c) blame nationalism.
- Answers: a) Eliminate Germany's ability to wage war (destroy military strength), b) Communism (Soviet union as winner was willing to propagate its business model), c) Pursue European Integration.
- European integration ultimately prevailed, but this was far from clear in the late 1940s. e.g. Eastern Europe adopted communism.

Emergence of a divided Europe

- Germany was divided into zones of influence: US, UK, France, Soviet Union.
- The Soviet Union "spread" communism in East Europe
- US and UK rejected the Soviet vision and this lead to the Cold War: a) Merge of US, UK, French zone b) Berlin blockade in 1948, c) Federal Republic of Germany in 1949
- The merger of Frence, US and UK zone was a defining moment in Europe and a precursors of the European integration

First Steps in European Integration

- The USA offered financial assistance if countries agreed on a joint programme of economic recostruction: **The Marshall Plan (1948)**
- Marshall Plan aid amounted to $12 billion, with half of this going to the UK, France and West Germany.
- The Organisation for European Economic Cooperation (OEEC) administered this aid and prompted trade liberalization
- New view: trade liberalization could be pro-growth and pro-industrialization.

First Steps in European Integration

- The problem was that European nations disagreed sharply on how European integration should move beyond the OEEC
- Trade liberalization: Autarky vs Trade. They describe the trade-off between European integration and national sovereignty.

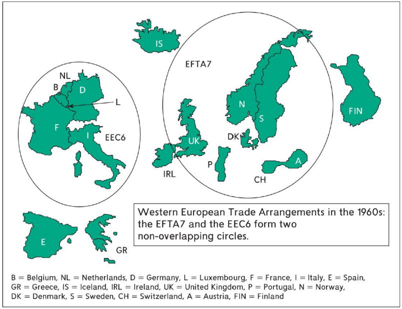
First Steps in European Integration

- ECSC (1951): Belgium, France, Germany, Italy, Netherlands, and Luxembourg (the 'Six') place their coal and steel sectors under the control of a supranational authority (Schuman Plan);
- EEC (1957): Riding on the success of the ECSC, the 'Six' committed to form a customs union, promise free labour mobility, capital market integration, free trade in services, and a range of common policies
- Western European Trade Agreements in the 1960: EFTA7 (European states: Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the United Kingdom) and
- EEC6 (European Economic Community: Common external customs tariffs): Belgium, France, Italy, Luxembourg, the Netherlands and West Germany

EFTA7 and EEC

Situation by the late 1960s: European countries either joined the EEC or the EFTA with economic discrimination between the two groups:

Figure 1.4 A Europe of two non-overlapping circles



Source: Baldwin (1994)

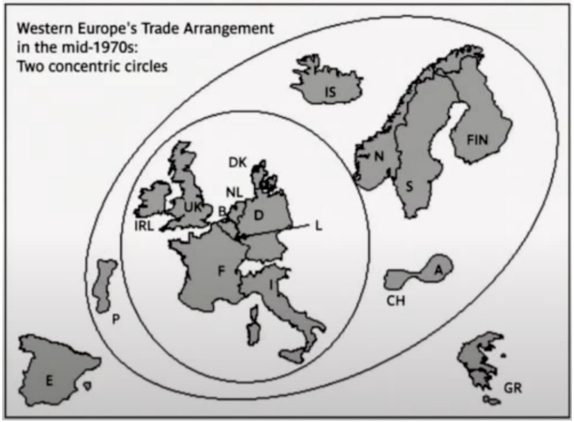
Domino Effect

- Falling trade barriers within the EEC and within EFTA lead to discrimination from other external nations.
- The GDP and market size of the EEC was much larger than the EFTA, and the growth rate was higher.
- The EEC club was far more attractive to exporters and this lead to new political pressurre for EFTA nations to joing the EEC.
- The UK applied for Membership in 1961 and Denmark, Ireland and Norway also followed since they would otherwise face stronger discrimination. This is related to Brexit from the other side.

Next step

- Charles de Gaulle stopped UK member twice. Denmark, Ireland and UK join in 1971 while Norwegians said no in a referendum.
- Firms based in the remaining EFTA states would suffer a disadvantage (trade diversion effects): EFTA industries pushed their governments to address this situation;
- Resulted in a set of bilateral free trade agreements (FTAs) between each remaining EFTA nation and the EEC.

EFTA + EEC


Western Europe's Trade Arrangement
in the mid-1970s:
Two concentric circles
IS
FIN
N
S
DK
NL
UK
B
D
L
IRL
F
I
CH
A
P
E
GR

Euro-pessimism, 1973-1986

- Political shocks: 'Luxembourg Compromise' + enlargement = decision-making jam; unanimity was the typical rule in EEC decision-making procedures: the insistence on consensus radically reduced the EEC's ability to make decisions.
- Economic shocks: Bretton Woods falls apart, 1971-1973; EEC failed to establish monetary union (Werner Plan was put on hold); 1973 and 1979 oil price shocks with stagflation;
- However, also some bright spots: democracy in Spain, Portugal and Greece lead to their accession;

More integration - Single Market Programme

- Jacques Delors launches completion of the internal market. While there were no tarriffs, so far was difficult to move.
- The Single European Act (SEA, 1987) aimed to create 'an area without internal frontiers in which the free movement of goods, persons, services, and capital is ensured' (i.e., the four freedoms already promised by the Treaty of Rome). For US this was something taken for granted.
- It also implemented important institutional changes: majority voting instead on unanimity on issues related to the Single European Market

Further Enlargement

- Deeper integration in EC12 strengthened the ‘force for inclusion’ in remaining EFTA nations.
- New ‘forces for inclusion’ lead to a further domino effect (part II): European Economic Area (EEA) initiative (1989) to extend single market to EFTA nations.
- Membership applications by all EFTA nations except Iceland and Liechtenstein:
- The fourth enlargement (1995) adds Austria, Finland, Sweden, and leads to the EC15.

Communism's spectacular collapse

- Division of Europe was cemented by the Berlin Wall (1961)
- By the 1980s, West's economic system provided a better standards of living and arguably a better wasy of life.
- Up to 1980s, Soviets thwarted reform efforts but inadequacy of Soviet system forced changes in USSR
- timid pro-market reforms (perestroika)
- openness (glasnost)
- Soviet people were able to compare themselves with others - leading to pressure to change the system.

Communism's spectacular collapse

- Moscow's hands=off approact to the Polish election triggered a chain of events
- Hungary opened its border with Austria
- mass protests in GDRl Wall falls 9th November 1989
- Yearend 1989: democracy in Poland, Hungary, Czechoslovakia;
- Yearend 1990: German unification.
- Democracy established in Romania, Bulgaria.

Communism's spectacular collapse

- End of 1990: independence of Estonia, Latvia and Lithuania;
- end of 1991, the USSR itself breaks up.

•The Cold War ends without a shot fired and with it, the military division of Europe ends.

The Maastricht Treaty

- On the success of the Single Market, Jacques Delors proposes a secon, more radical increase in European economic integration (2 year after Germany unification). **The Monetary Union**.
- Maastricht Treaty (1992), committed EU countries to achieve **monetary union** by 1999, and a **single currency** by 2002.
- Difficulties: a) Britain opted out of common currency, b) Danish voter rejected the Treaty

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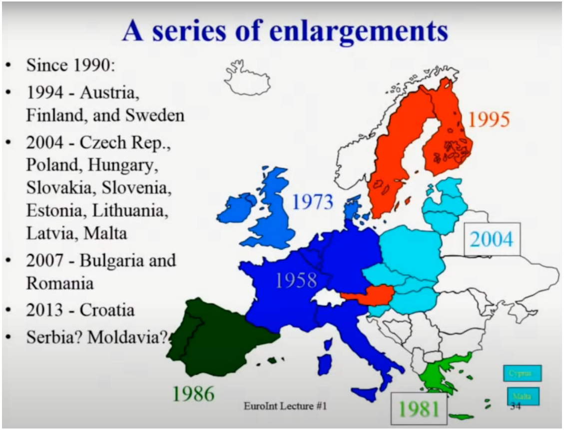
Reuniting east and west Europe

- 1993, the EU sets the **Copenhagen criteria** for accession:
- a) political stability of institutions that guarantee democracy, b) the rull of law, c) human rights, and d) respect for and protection of minorities
- a function market economy capable of dealing with the competitive pressure and market forces withing the Union
- acceptance of the Community 'acquis' (EU law in its entirety - law pillars)
- **Copenhagen summit** (2002) says CEEC nations plus Cyprus and Malta join in 2004 (5th Enlargement).

Preparing for eastern enlargement

- Envisaged enlargement required EU to reform its institutions.
- The EU's institutions, earlier designed for six members and were straining to work with fifteen, had to change if they were to continue to work with a dozen new members.
- Four attempts at reform over a 16-year period: Amsterdam Treaty, 1997; Nice treaty, 2000; Constitutional Treaty, 2004; Lisbon Treaty, 2007.

Reuniting east and west Europe



The Eurozone Crisis

- European Monetary Union seemed to work during the 'Great Moderation': Interest rate convergence caused by EMU formation (sign of confidence).
- But this confidence turned out to be misplaced and sharp divergence was triggered by the crisis.
- The Lehman's bankruptcy in September 2008 witnessed the formation of the biggest and fastest-moving snowball effect that the world has ever seen, turning the world into a deep recession which hit the Euro area hard.

The Eurozone Crisis

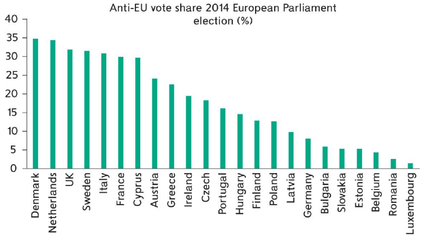
- Emergency loans and packages: Greece (May 2010); Ireland (February 2012); Portugal (May 2011); Spanish banks (July 2012) and Cyprus (May 2013).
- Massive institutional reforms were introduced along with transferring sovereignty to the Eurozone level and new rules, such as Balanced budget rules; Six Pack; European Stability Mechanism; European Banking Union.

The rise of Euroscepticism

- Something like the Euro-pessimism of the 1970s has returned, but with a big difference: **it is about whether it should be stopped or even reversed**.
- Anti-European populistic political parties are winning large vote shares in elections by calling for the break-up of the Eurozone.

The rise of Euroscepticism

Figure 1.7 Anti-EU parties' vote shares in 2014

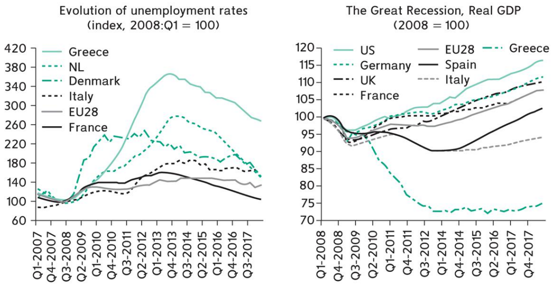


Note: The share was zero for Croatia, Lithuania, Malta, Slovenia and Spain.

Source: Based on data from Figure 1 of Emanuele et al. (2016).

The causes of Euroscepticism

Figure 1.8 Lingering unemployment and slow recovery during the Great Recessions



Source: Author's elaboration of data downloaded from OECD.org; unemployment figures are for unemployment of all people over 15 years old.

Note: Real GDP figures are for the nation, not per person. You can update these figures by visiting www.oecd.org.

Brexit 2016 – 2019

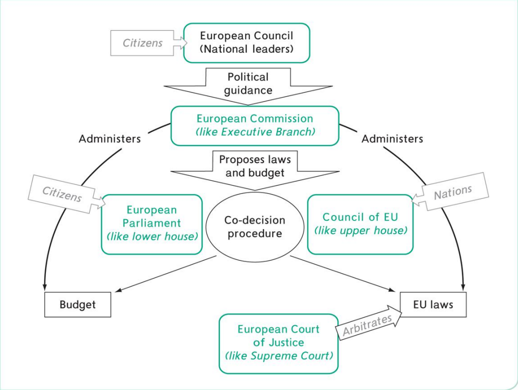
- In June 2016 the UK population voted to leave the EU. About 52 % of voters choose the 'Leave' option, while about 48 % chose the 'Remain' option.
- Article 50 of the Lisbon Treaty (technically known as the Treaty on European Union) states that members can leave the EU.
- UK triggered the process on 29 March 2017 and this set in motion a negotiation for a 'withdrawal agreement'.

Institutions

- The 'Big-5'.
- European Council (heads of state and governments);
- Council of the European Union (member nations' ministers), [still often called by its old name, the Council of Ministers];
- European Commission (appointed eurocrats);
- European Parliament (directly elected);
- EU Court (appointed judges).

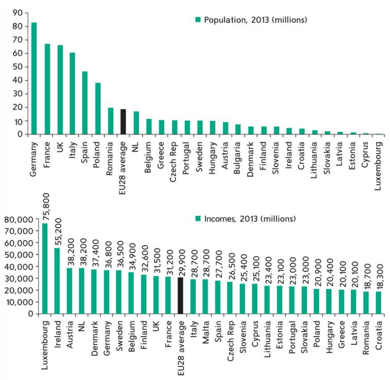
Institutions

Figure 2.3 Basics of EU institutional architecture



Population and Income Per Capita

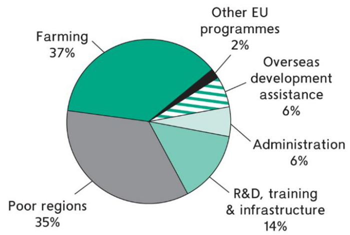
Figure 2.5 Population and income per capita (PPS), 2017



Source: Based on data from Eurostat.eu.

EU Budget - 160 Billions goes to

Figure 2.6 The EU's 2014 budget



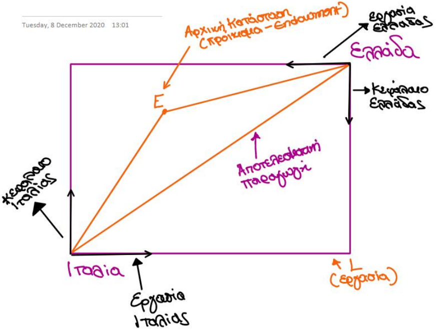
Source: Based on data from ec.europa.eu/budget/

Population and Income Per Capita

- The size distribution of European economies is very uneven, measuring economic size with total GDP.
- Just six nations, the 'Big-5' (Germany, UK, France, Italy, and Spain) and the Netherlands, account for about 75 per cent of the GDP of the whole EU.
- 'Small' economies: account for between 1 and 3 per cent of the EU27's output. This includes Sweden, Poland, Belgium, Austria, Ireland, Denmark, Finland, Portugal, the Czech Republic, Romania and Greece.
- 'Tiny' economies: account for less than 1 per cent of the total. These nations are Hungary, Slovakia, Luxembourg, Bulgaria, Croatia, Slovenia and Lithuania.
- 'Minuscule': ones that accounts for less than two-tenths of 1 per cent. The countries in this category are Latvia, Estonia, Malta, and Cyprus.

Mechanisms of Integration

- "Modified Edgeworth Box" describes location of the endowment of productive factors.
- **Efficiency**: Are there efficiency gains for both regions? Greece unemployment 24%, youth unemployment 50%. Is brain drain optimal?



Mechanisms of Integration

- Potential mechanisms of integrations:
- Internal capital accumulation
- Capital mobility
- Labor mobility
- Goods market integration

Microeconomics of Integration - Trade

- In competitive, decentralized markets the **price of goods** reflects their relative scarcity
- When **prices to consumers** differ, there are possible gains from trade
- Tariffs, taxes represent barriers to achieving those gains
- A customs union or trade integration can allow consumers to realize those gains