European Integration

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Overview

1. **Introduction**
2. Overcoming Divisions
3. The EU as Institutional Framework for Business
4. The Euro as a Common Currency
5. Debates & Extensions
6. Implications for Practice

Introduction

■ Learning Objectives

After completing this lecture, you should be able to:

- Explain the **origins** & the **evolution** of the **EU**;
- Explain **how** & **why** the **institutional framework** created by the EU is **pivotal** for **business**;
- Discuss the **merits** & **drawbacks** of the **euro** as a common currency; &
- Participate in debates over the **political institutions** of the **EU**.

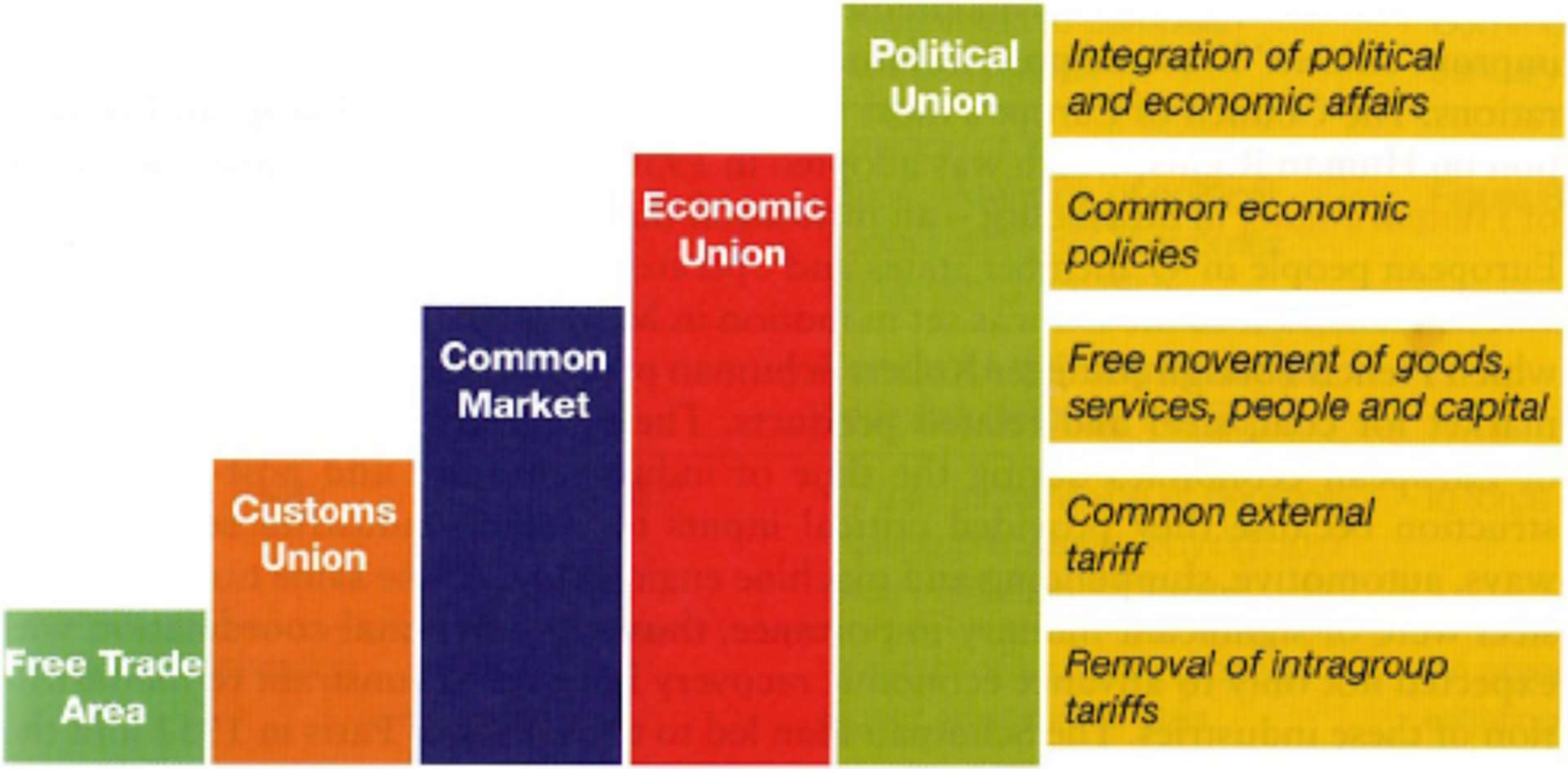
Introduction

■ Key Questions

- ❖ **What** is **"regional integration"**? **How** to **define** it?
- ❖ Are **European & Eastern Asian approaches** to regional integration **similar** or **different**?
- ❖ What is **the major cause of European integration**?
- ❖ Why is **"regional integration"** crucial to **international business**?
- ❖ What is the **impact of Brexit** on European integration?

Introduction

■ Different Types of Regional Integration



Source: Peng & Meyer (2019:211)

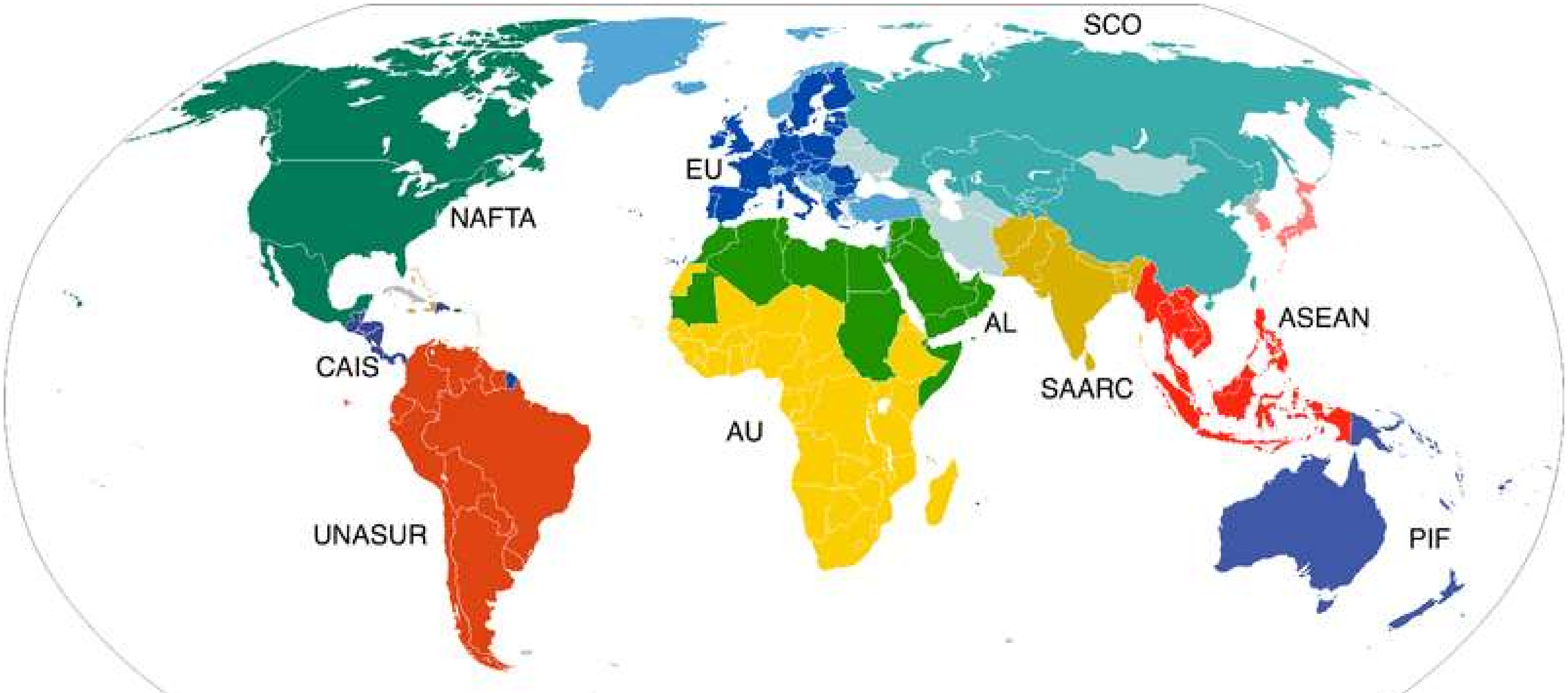
Introduction

■ Major “Stages” of Regional Integration

- **Free Trade Area (FTA)**: Traiffs & other trade barriers among members are abolished, but members remain autonomous vis-à-vis non-members.
  - If their **economic structures** are **competitive**, it is likely there will be **no incentive** for an FTA.
- **Customs Union (CU)**: In addition to an FTA there is **a common external tariff policy**.
  - **Issues:** Decision about **tariff level**, common competition policy, **political & cultural ties** between the member countries.
- **Common Market (CM)**: In addition to CU, all barriers within the integration space are abolished, including those for production factors like labour & capital.
  - **Issues:** **Close cooperation** in labor & economic policy as well as law.

Introduction

■ Map: International Trade Blocs



EU: European Union; **NAFTA:** North American Free Trade Agreement; **CAIS:** Central American Intergration System; **USAN:** Union of South American Nations; **AU:** African Union; AL: Arab League; **ASEAN:** Association of Southeast Asian Nations; **SCO:** Shanghai Cooperation Organisation; **SAARC:** South Asian Association for Regional Cooperation; **PIF:** Pacific Islands Forum

Introduction

■ Trans-Pacific Partnership (TPP)

❖ What is TPP?

- … is a proposed **regional free-trade agreement**.
- … serves as one possible pathway toward realising **the vision of a free trade area of the Asia-Pacific**.

❖ Who Participates?

- As of 2014 **twelve countries** throughout the Asia-Pacific region have participated in negotiations on the TPP: Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, & Vietnam.

❖ Issues?

- The TPP suffers from a serious lack of transparency, threatens to impose **more stringent copyright** without public input, & pressures foreign governments to adopt unbalanced laws.

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Overcoming Divisions

Origin

- **The rise of nationalism** (the Nazi party in Germany in particular) deepened divisions & eventually led to WWII.
- **Treaty of London (1950)**
  - The creation of the Council of Europe to improve citizens' lives & prevent future wars →**The European Convention of Human Rights** & **the European Court of Human Rights**.
- **The 'Schuman Plan' (1950) & Treaty of Paris (1951)**
  - **European Coal & Steel Community** (**ECSC**).
  - Supra-national coordination was expected not only to **advance economic recovery** but also to **constrain re-militarization**.
- **Treaties of Rome (1957)**
  - Creation of the **European Economic Community** (**EEC**) & **Euratom**.

Overcoming Divisions

Origin

- **Schengen Treaty (1985)**
  - **Abolition** of **border controls.**
- **Single European Act (1986)**
  - Policy initiative to promote the rigor of the European integration process along with **economic liberalization** → the **European common market**.
- **Maastricht Treaty (1992)**
  - It set the basis for **(1) common foreign & security policy** & **(2) cooperation in police & judiciary matters**.
- **Copenhagen Criteria (1993)**
  - **Acquis Communautaire:** various requirements for new EU membership (*e.g.*, a stable democracy, a good human rights records).
- **The Treaties of Amsterdam (1997) & Nice (2003)**
  - Streamlining decision-making procedures: (1) The power of **national vetoes (↓)** & (2) the power of **the European Parliament (↑)**

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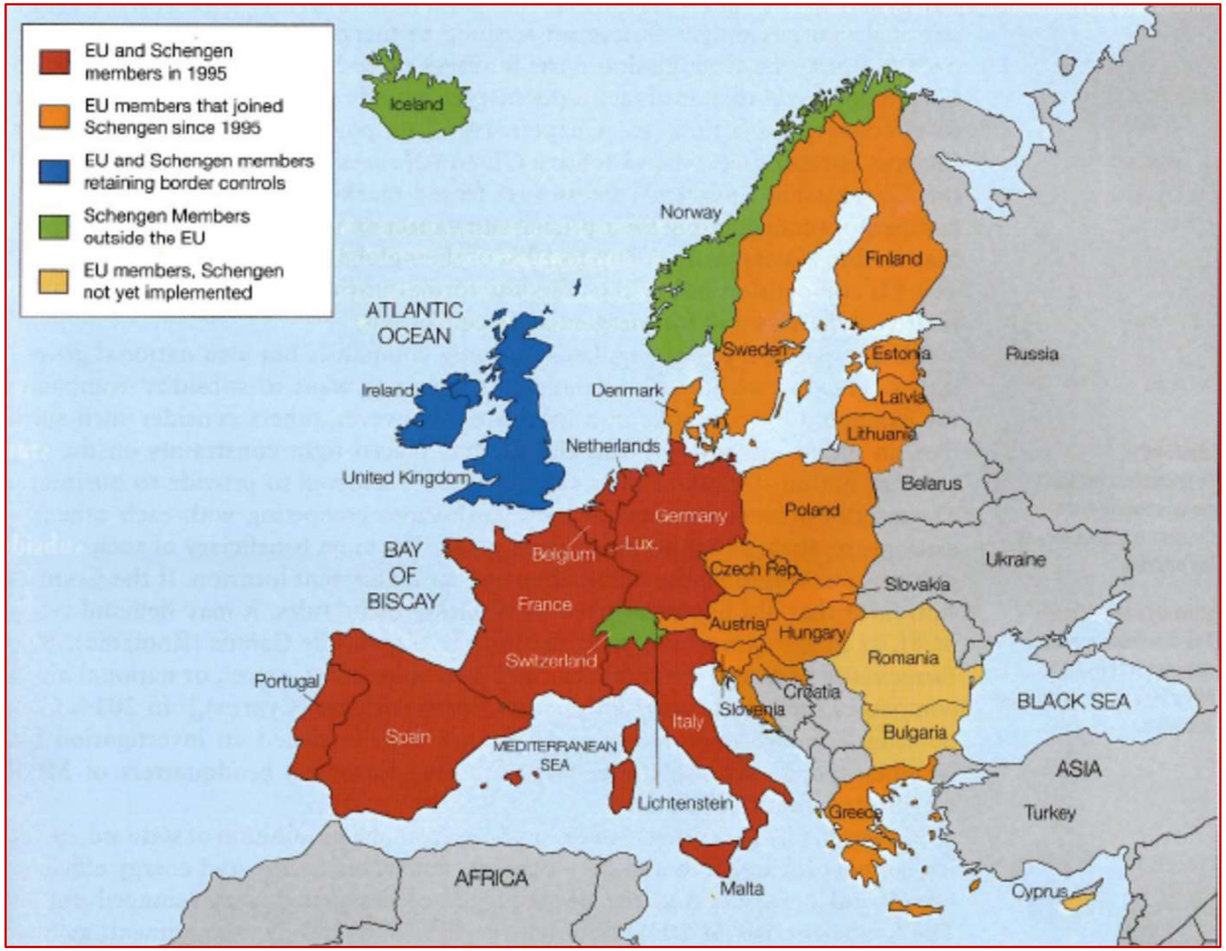
The EU as Institutional Framework for Business

The ‘4’ Freedoms as the Principle of the Common Market

- **Free Movement of Goods**
  - The **SEA** in **1986**
  - **Common European rules override national regulations in sectors** where the EU sees **higher risks for customers** (*e.g.*, food & drug).
- **Free Movement of Services**
  - Difficult to implement: (1) very complex regulatory regimes (*e.g.*, banking & telecommunications) & (2) no clear form of local delivery.
- **Free Movement of Capital**
  - **Coordination of financial market regulations & supervision** (*e.g.*, Can London-based banks serve EU customers after Brexit?!).
- **Free Moving People**
  - The right to **move freely in the EU to live, work or retire**.
  - **Erasmus + Programme:** To encourage student mobility in the EU.

The EU as Institutional Framework for Business

The Shengen Area



Source: Peng & Meyer (2019: 223)

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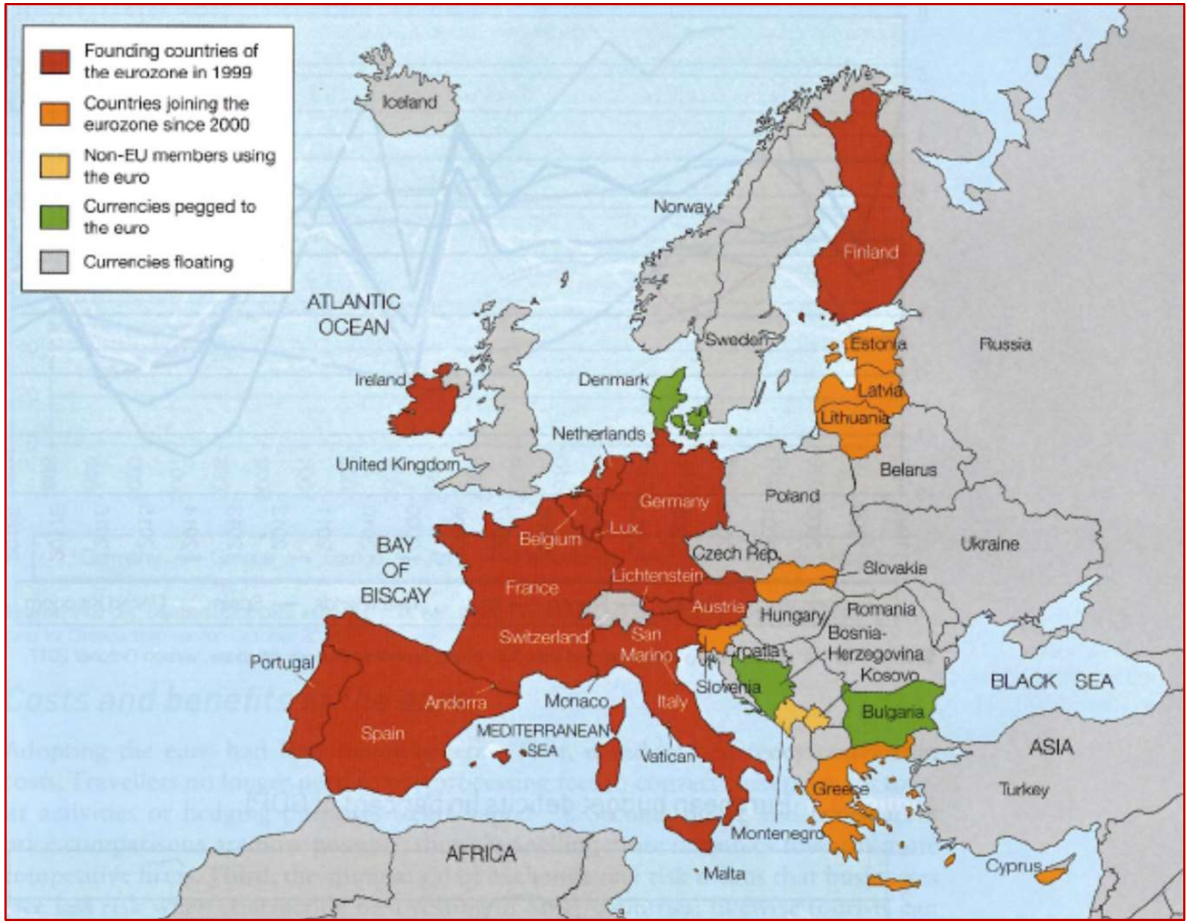
The Euro as a Common Currency

Introduction of the Euro

- **The Eurozone** (The countries adopting the Euro as their currency)
  - In **1999**, the Euro became **'virtual money'** in 11 countries & **exchange rates with national currencies** were **fixed**.
  - In **2002**, the Euro was introduced as **banknotes & coins**.
- **The Maastricht Treaty of 1992 – Convergence Criteria**
  - Annual deficits not exceeding 3% of GDP;
  - Public debt under 60% of GDP;
  - Inflation rates within 1.5% of the three lowest rates in the EU;
  - Long-term interest rates within 2% of the three EU countries with the lowest rates; &
  - Exchange rate stability.
- **The European Central Bank**
  - The central bank of the Eurozone, located in Frankfurt, Germany
  - Modelled on the **German Bundesbank** due **to lower inflation rates**.

The Euro as a Common Currency

The Eurozone



Source: Peng & Meyer (2019: 225)

The Costs of A Common Currency

■ Costs Exceeds Benefits of the Euro?

❖ Benefits

- No currency conversion costs.
- Imposing macroeconomic disciplines.
- Elimination of exchange rate risk.

❖ Costs

- Loss of sovereignty.
- Giving up executing monetary policy.
- Reduced flexibility in fiscal policy.
- Free-rider problems & loss of credibility (*e.g.*, Greece after the global recession of 2008-2009).

❖ An Optimum Currency Area?

- The extent of intra-regional trade?
- How mobile is a region's labor force?
- Similarity of economic structure?
- Fiscal federalism.

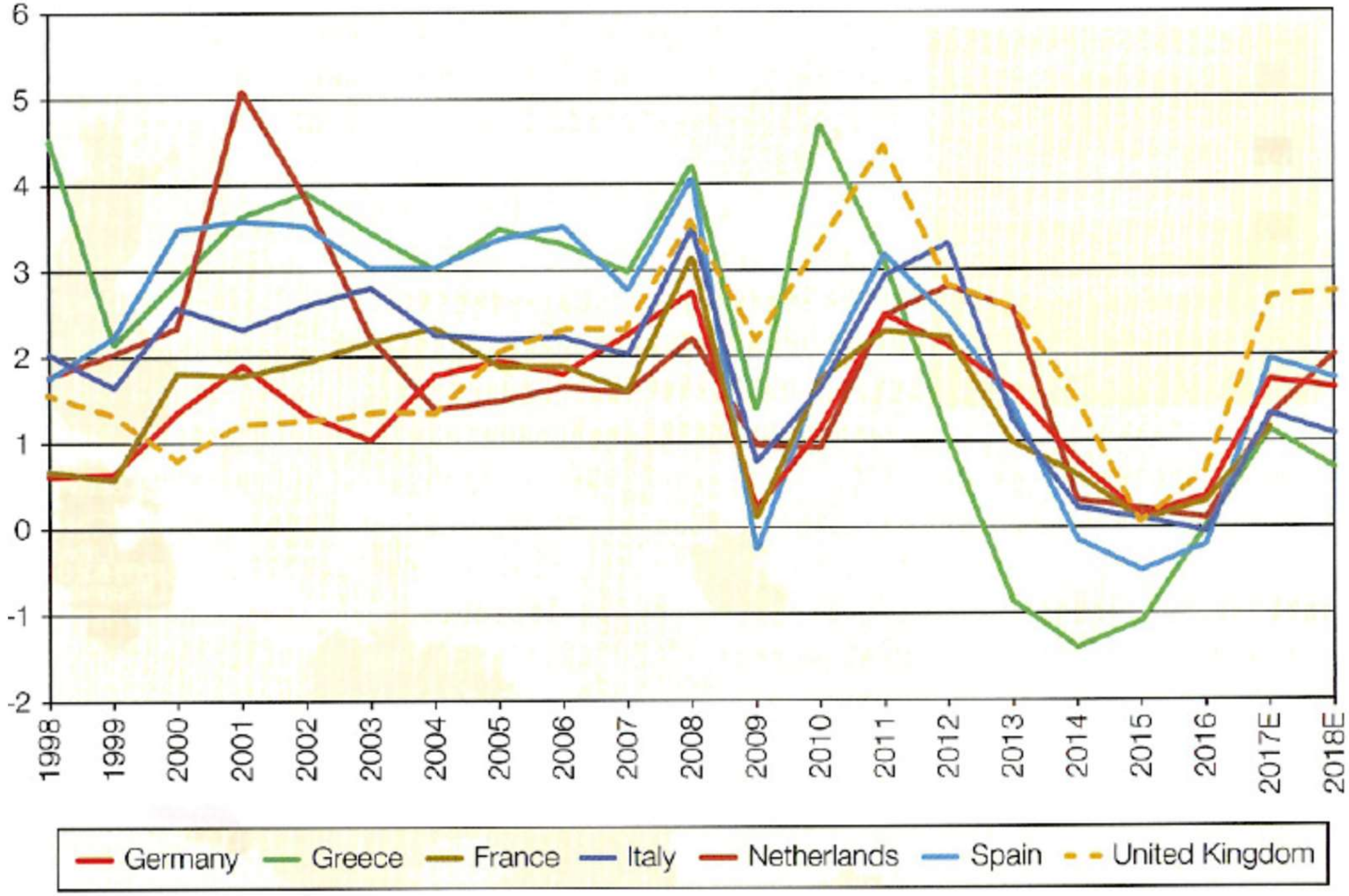
The Euro as a Common Currency

■ Is Participating in the Euro Zone Costly? Answer 'YES' !

- When a country relinquishes its national currency, it also **relinquishes an instrument of economic policy**.
- It **loses the ability** to conduct **a national monetary policy**.
- A nation joining a monetary union will **NO longer be able to:**
  - **Change the price of its currency** (by devaluations & revaluations);
  - **Determine the quantity of the national money** in circulation, &/or
  - **Change the short-term interest rate**.
- The **theory** of **optimum currency areas** (**OCA**).
  - Mundell (1961), McKinnon (1963), & Kenen (1969).
  - The **cost-benefit analysis** of a monetary union.

The Euro as a Common Currency

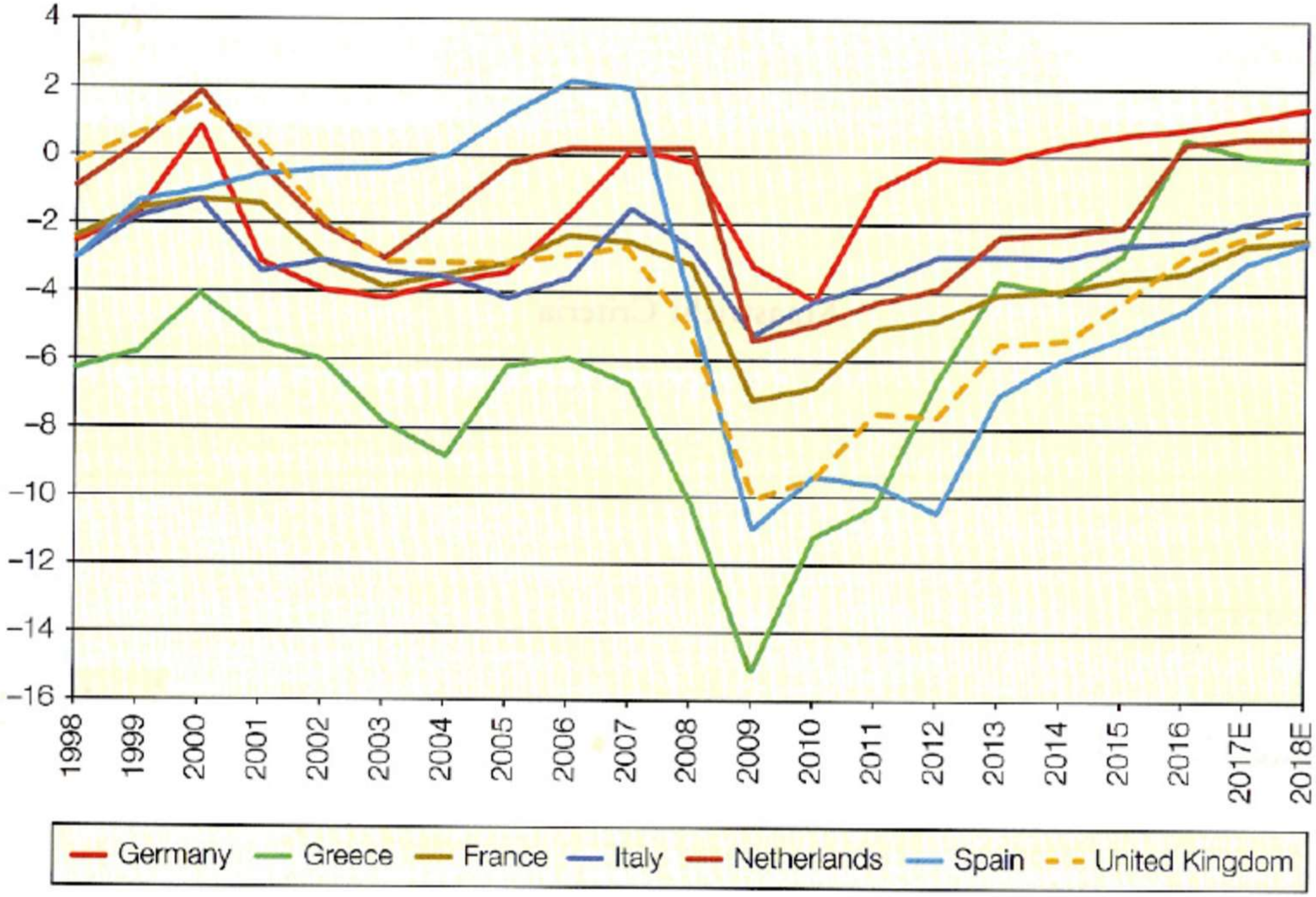
■ European Inflation Rates (in %)



Source: Peng & Meyer (2019: 226)

The Euro as a Common Currency

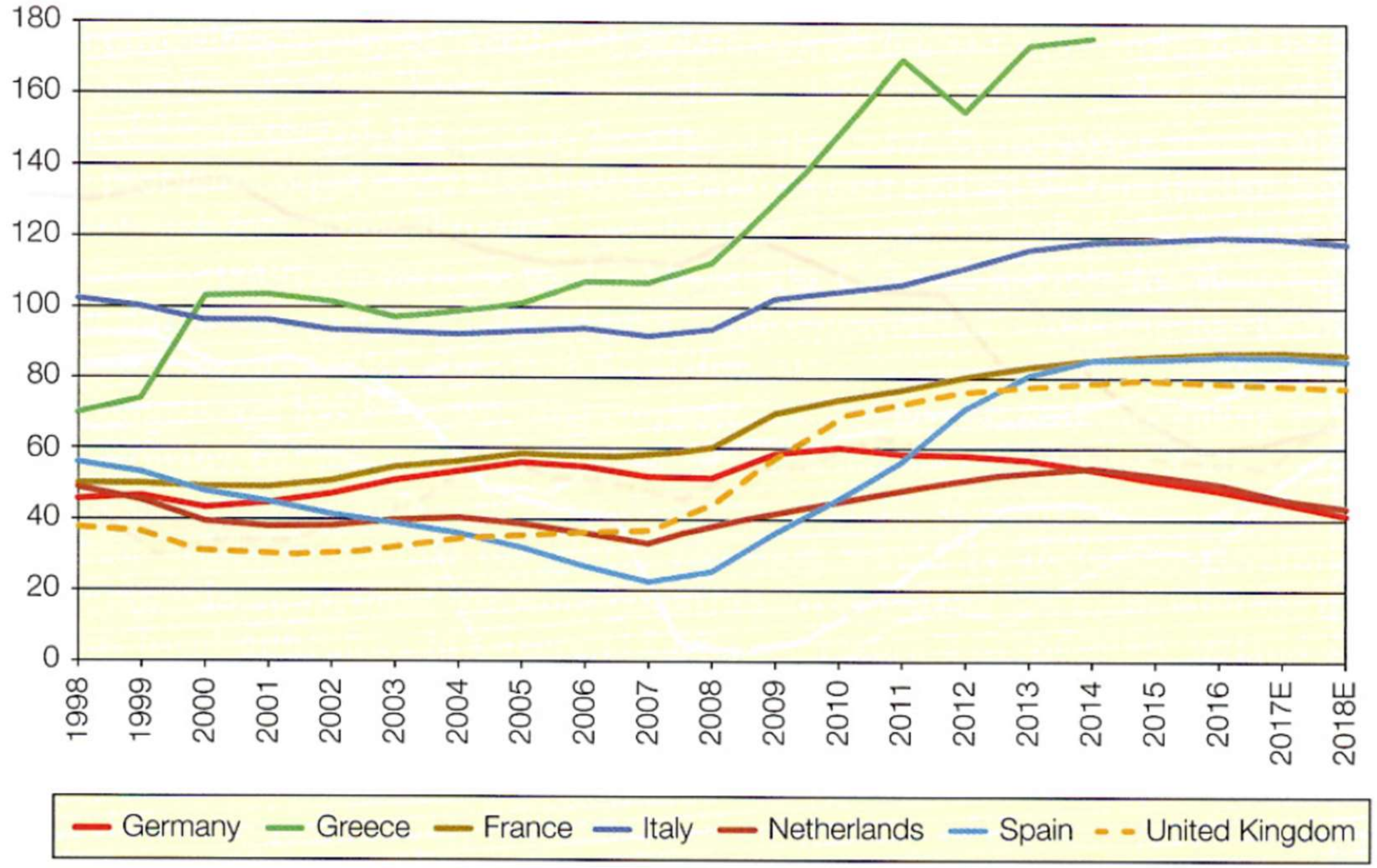
■ European Budget Deficits (in % of GDP)



Source: Peng & Meyer (2019: 226)

The Euro as a Common Currency

■ European Government Debt (in % of GDP)



Source: Peng & Meyer (2019: 227)

The Euro as a Common Currency

■ Shifts in Demand (Mundell)

❖ Consider the case of **a demand shift** developed by **Mundell (1961)** in his celebrated article on optimum currency areas.

– Let's assume first that **2 countries, France & German,** form a **monetary union**.

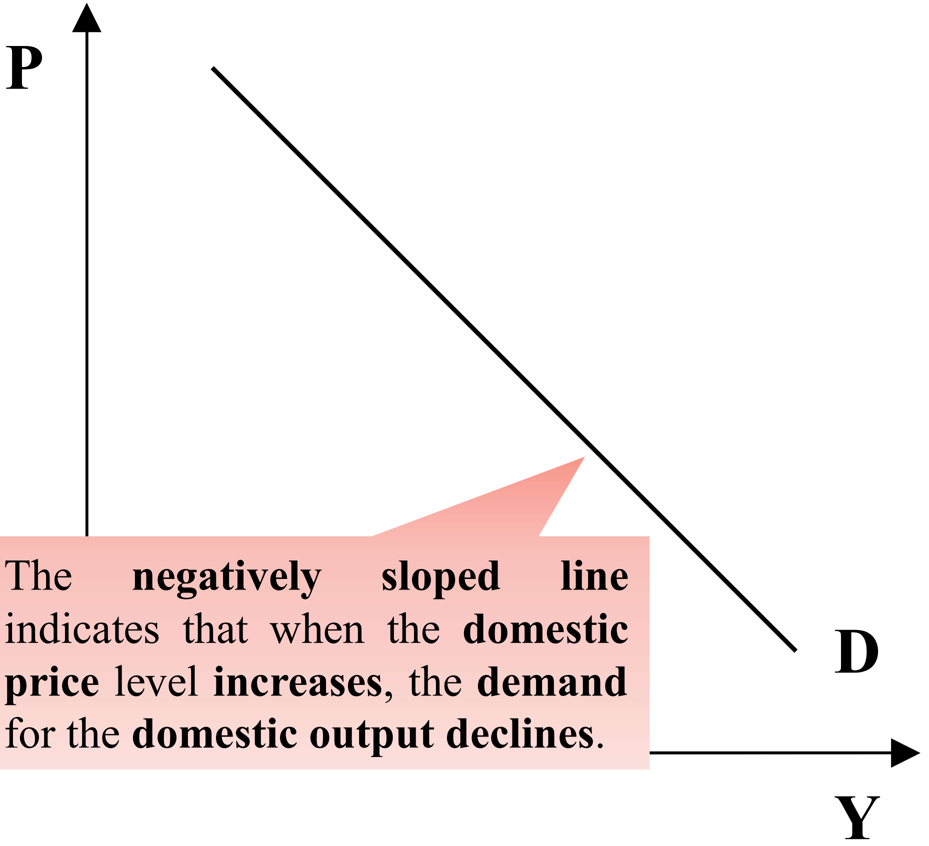
– **Hypothetically**, they **abandoned their national currencies**, & **use a common currency**, the **Euro**, which is managed by a common central bank, the **European Central Bank (ECB)**.

– Let us assume further that for some reason **consumers shift their preferences away** from **French-made to German-made products**. It implies the effects of this **asymmetric shock in aggregate demand**.

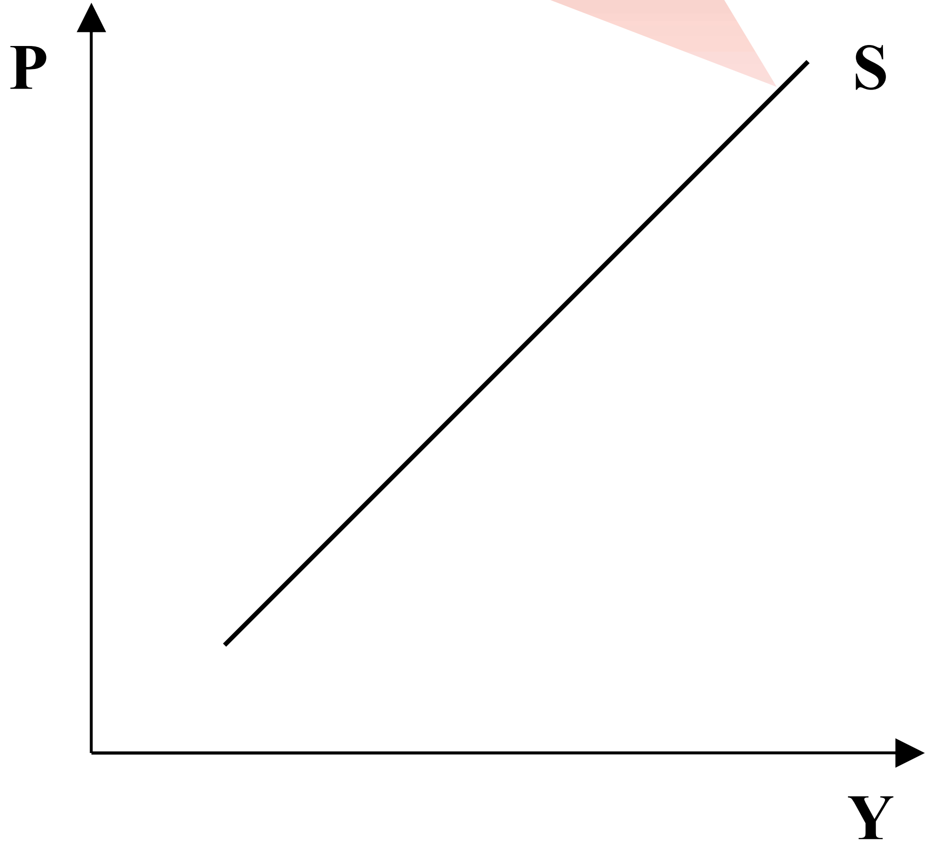
The Euro as a Common Currency

■ Shifts in Demand (Mundell)

When the **price** of the **domestic output increases**, **domestic firms** in a competitive environment will **increase their supply** in order to profit from the higher price.

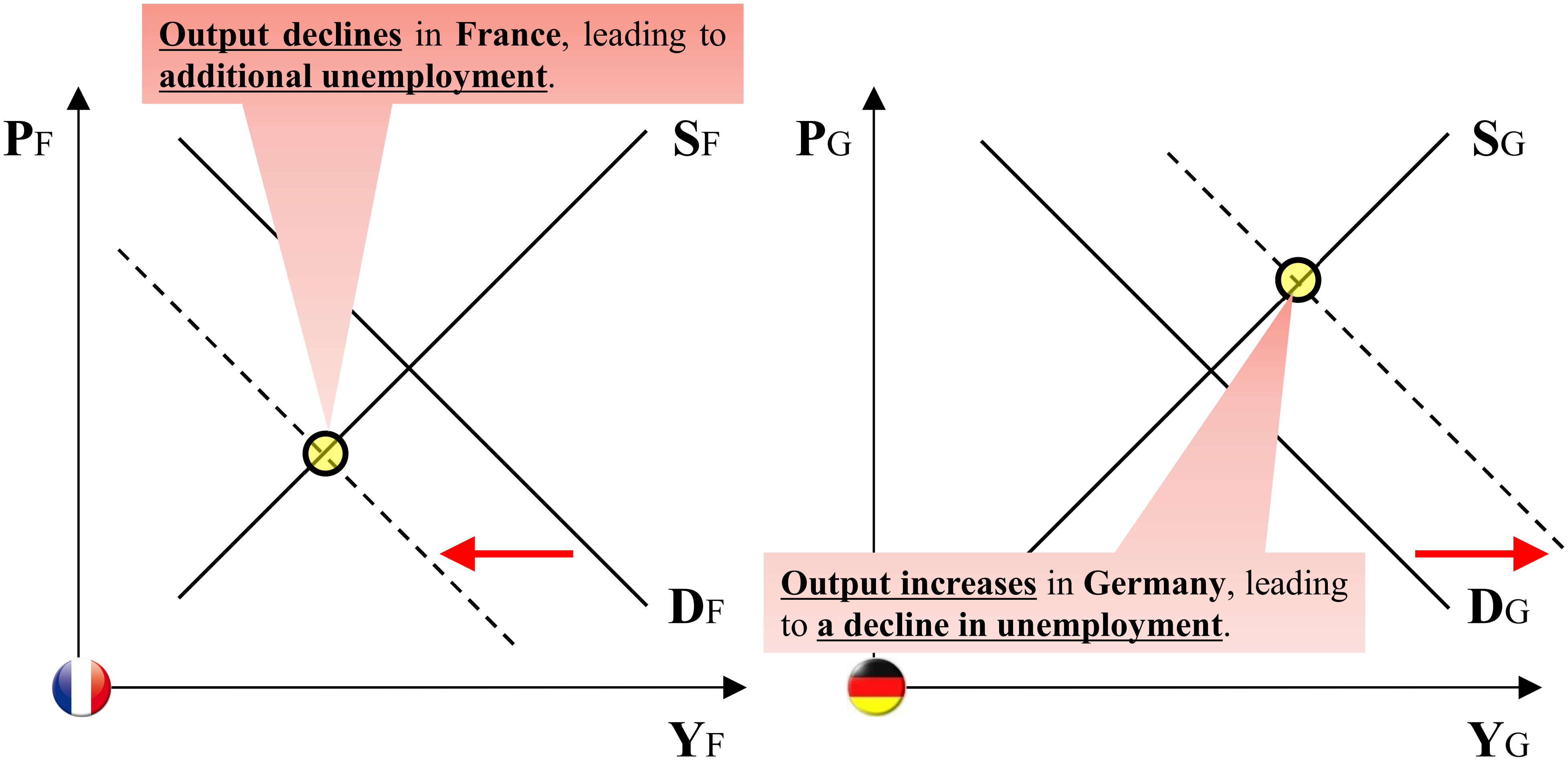


The **negatively sloped line** indicates that when the **domestic price** level **increases**, the **demand** for the **domestic output declines**.



The Euro as a Common Currency

Aggregate Demand & Supply in France & Germany



The Euro as a Common Currency

Aggregate Demand & Supply in France & Germany

Is there any mechanism that leads to automatic equilibration?

- Wage flexibility
- Labor mobility

The Euro as a Common Currency

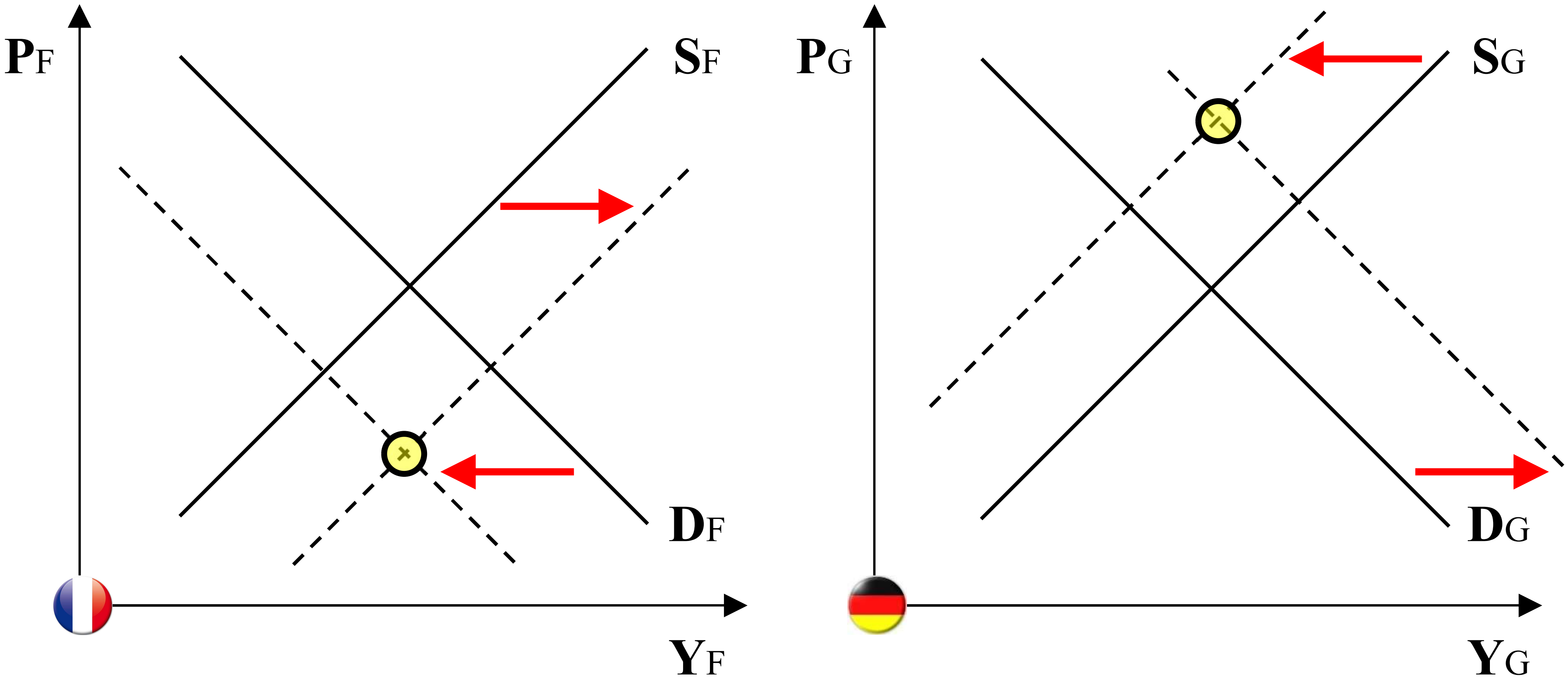
Aggregate Demand & Supply in France & Germany

Wage flexibility

- **If wages in France & Germany** are **flexible** the following will happen: **French workers** who are **unemployed** will **reduce their wage claims** (↓). In **Germany**, **the excess demand for labor** will **push up the wage rate** (↑).
- The **reduction** of this **wage rate** in **France** shifts the aggregate **supply curve downwards**, whereas the **wage increases** in **Germany** shift the aggregate **supply curve upwards**. In **France**, the **price** of **output declines**, making **French products** **more competitive**, & **stimulating demand**. The opposite occurs in Germany.
- The **wage & price increases** in **Germany** make **French products more competitive** = The decline in French costs & prices makes **Germany products** **less competitive** & shifts the **German** aggregate **demand curve downwards**.

The Euro as a Common Currency

■ The Automatic Adjustment Process: Wage Flexibility



The Euro as a Common Currency

Aggregate Demand & Supply in France & Germany

Labor mobility

- The **French unemployed workers move to Germany** (where there is excess demand for labor). This **movement of labor eliminates** the **need** to let **wages decline in France** & **increase** in **Germany**.
- Thus, the **French unemployment problem disappears**, whereas the **inflationary wage pressures in Germany vanish**.

What if wage flexibility & labor mobility NOT satisfied?

- **The adjustment problem** will **not vanish** !
- Suppose that **wages in France** do **NOT decline** despite the **unemployment** situation & those **French workers** do **NOT move to Germany**.

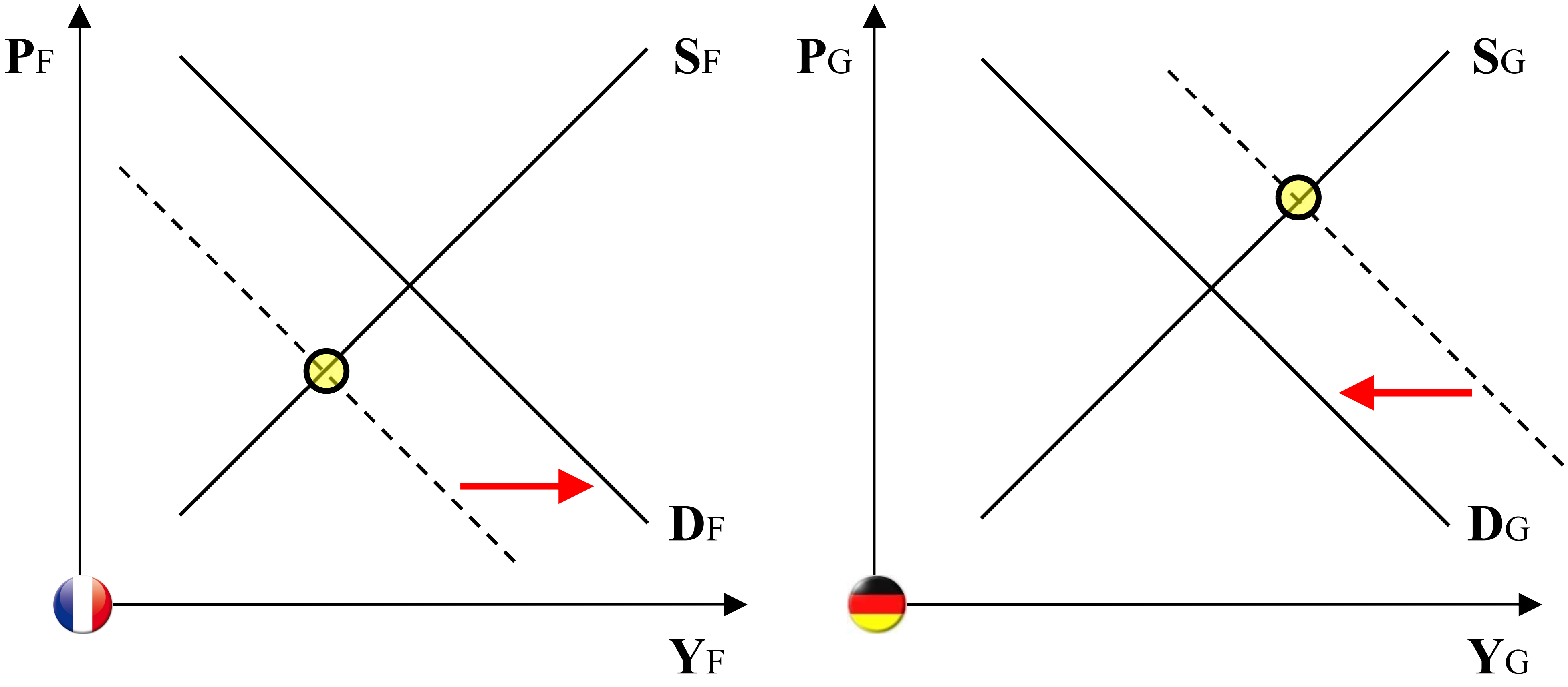
The Euro as a Common Currency

Aggregate Demand & Supply in France & Germany

- **What happens if they are NOT in a monetary union?**
  - Countries maintain their **monetary independence** are **free to use** their **national monetary policy tools** to **adjust to the asymmetric shocks** (**See the next slide**).
  - They can change their monetary policies (**through changes in the domestic interest rate &/or the money supply**).
  - **France could lower its interest rate**, thereby **stimulating aggregate demand**.
    - ✓ The **expansionary monetary policy** in France = a **depreciation** of the French franc.
  - **Germany could raise its interest rate**, thereby **reducing aggregate demand**.
    - ✓ The **restrictive monetary policy** in Germany = an **appreciation** of the German mark.

The Euro as a Common Currency

- Effects of Monetary Expansion in France & Monetary Restriction in Germany



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Debates & Extensions

The Structure of Political Institutions

The European Council

- **The assembly of heads of governments** setting overall **policy directions & priorities** of the EU
- … decides on **key legislative initiatives** & **senior appointments**
- **The President of the European Council** who chairs the meetings

The Council of the European Union

- The top decision-making body of the EU, consisting of **ministers from the national governments**
- **Subjects:** Foreign affairs, finance, transport, agriculture etc.
- **Qualified majority voting** (weighted by each country's population)

The European Commission

- … is responsible for **the day-to-day running** of the EU – executive arm
- Most legislation is initially discussed in the Commission.

Debates & Extensions

The Structure of Political Institutions

The European Parliament

- Located in **Strasbourg**
- Members are elected **every fifth year** since 1979 directly by the citizens of member states.
- … has important **monitoring & co-decision rights**, yet it does not hold all the powers of a typical national parliament.
- **No power** of **choosing a head of government**

European Court of Justice

- The EU's own judicial system based in **Luxembourg**
- … deals with **cases taken up by the Commission** & **cases** referred to it **by the courts of member states**.
- **National courts are required to enforce the treaties** that their country has ratified & thus the laws enacted under them.

Debates & Extensions

Democratic Legitimacy?!

Less Attention in the Media

- European elections tend to receive much less attention in the media than national elections.
- The European election is the second-largest election next to India …

Many voters feel disenfranchised

- Because they do **not see how they can influence Brussels' decisions**.
- This **'hostility'** feeling is particularly strong in **the UK**.
- The aversion to EU decision-making processes is derived from **the complexity of process**.
- **The larger a group** trying to reach a common policy, **the more compromises** have to be made.
- **The principle of 'subsidiarity'** feels rather vague & does not seem to work in reality.

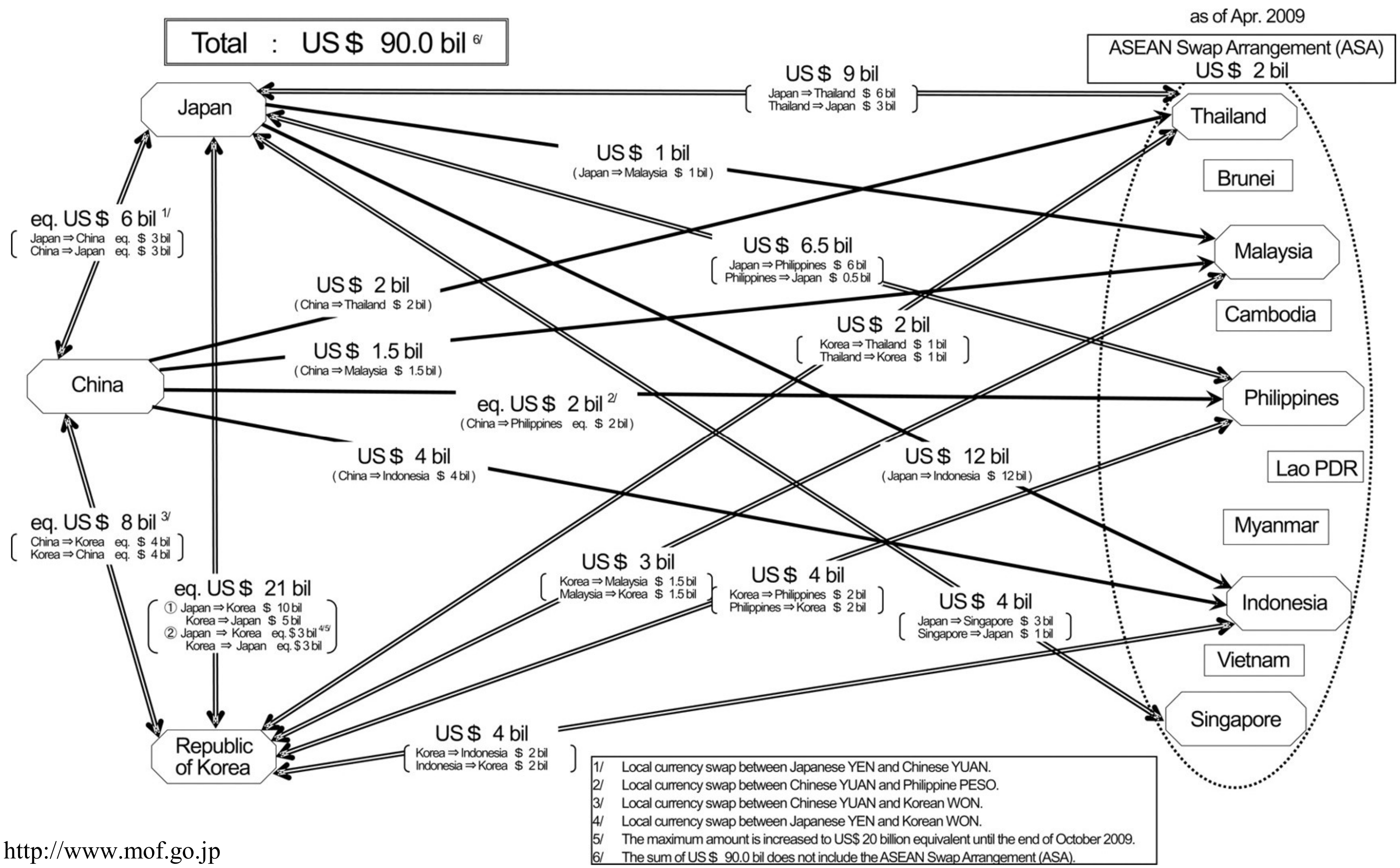
Debates & Extensions

- **Myth or Reality: Economic & Political Integration in Asia**

?

Debates & Extensions

■ The 2000 Chaing-Mai Initiative



Source: http://www.mof.go.jp

Debates & Extensions

Pascha (2004 & 2007): European & Asian Approaches

		East Asia	Europe
1	**Integration type**	Market-dominant	Functional/institutional
2	**Rules**	Flexible, consensus	Binding agreements
3	**Movers**	Multinational enterprises (MNEs)	National politicians, EU bureaucrats
5	**Members**	Extensive (DCs, NICs, LDCs)	Advanced economies
6	**Trade**	World market, intra-trade (↑)	Intra-regional (↑)
7	**Investment**	Prodcution networks growing	Dense links
8	**Monetary integration**	Still weak	Tight (Euro)

"Institution-led" in Europe vs. "Market-led" in Asia

Obstacles to FTAs in East Asia

- In reality, the formation of FTAs would encounter **strong opposition from non-competitive sectors**.
  - It is better to form an FTA among countries which have similar levels of economic development.
- **Different political systems** (China & Myanmar have authoritarian regime) & **security issues** (Many countries have strategic alliances with the US, but China does not).
- The **absence of strong leadership**.
- **Gaps** in the views of China, Japan, & Korea on **historic & other issues**.

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Implications for Practice

What Should Managers Care About?

> **Know the rules that apply to your industry in the EU.**
- The provisions, stipulations & legal requirements attached to the different EU policy areas require careful audit from businesses operating in the EU.
- Analyze how to follow existing rules in your industry

> **Anticpate future changes in the rules in the EU.**
- To be able to anticipate changes in the institutional framework of the EU, you need to monitor the discussion in the EU, particularly the European Parliament.

> **Seek to lobby towards the institutions of the EU.**
- As a lobbyist you may be able to influence preferences at an early stage, influence the positions taken by national governments , – by working together with the media – influence public perceptions of European issues.

The End of Today’s Lecture

ご清聴有難う御座いました。

Thank you so much!

Merci beaucoup!

Vielen Dank für Ihre Aufmerksamkeit!

Grazie mille !

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