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





■ 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**.





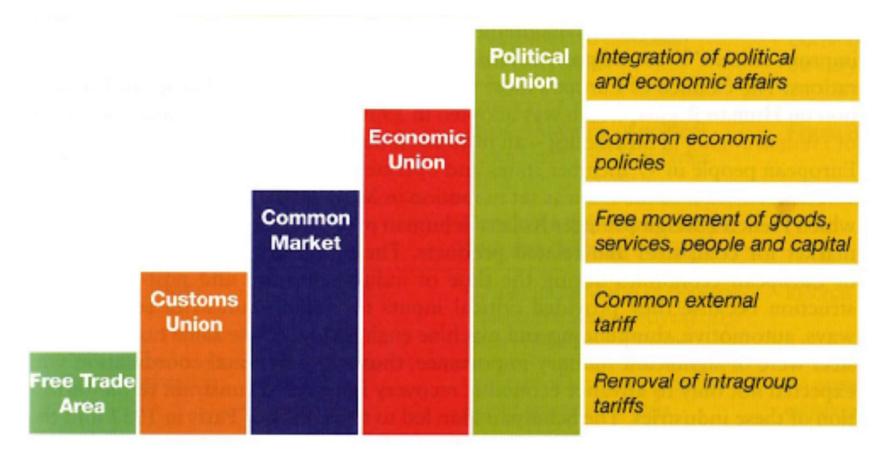
■ Key Questions

- **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?





■ Different Types of Regional Integration



Source: Peng & Meyer (2019:211)



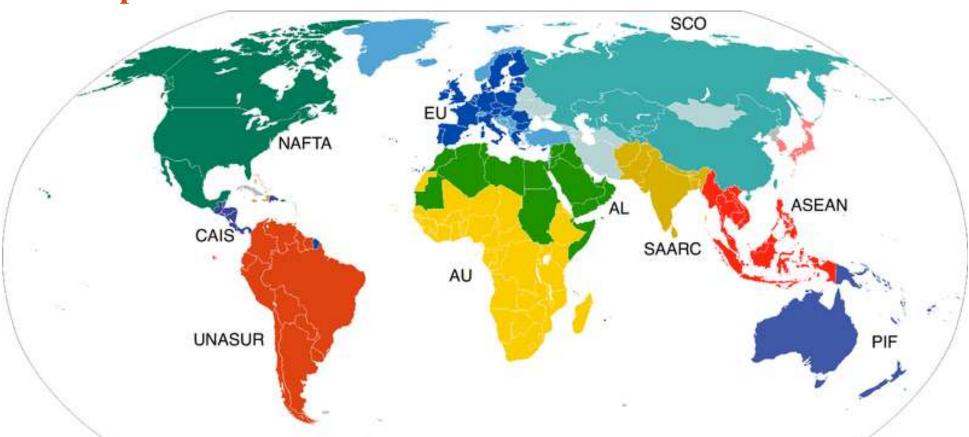


- Major "Stages" of Regional Integration
 - * Free Trade Area (FTA): Traiffs & other trade barriers among members are abolished, but members remain autonomous vis-àvis non-members.
 - If their economic structures are competitive, it is likely there will be no incentive for an FTA.
 - Customs Union (CU): In addition to an FTA there is a common external tariff policy / e.g., EEC
 - 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 <u>labour & capital</u>.
 - Issues: Close cooperation in labor & economic policy as well as law.





■ 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; SAARC: South Asian Association for Regional Cooperation; PIF: Pacific Islands Forum



Theories to Internationalization



■ Trans-Pacific Partnership (TPP)

***** What is TPP?

is a proposed regional free-trade agreement.

... serves as one possible pathway toward realizing the trade area of the Asia-Pacifithe Trans-Pacific Partnership

Who Participates?

As of 2014, 12 (11 in 2017) 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, & UK (since 2024).

Negotiating Countries

Invited to Join Negotiations

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** \rightarrow 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

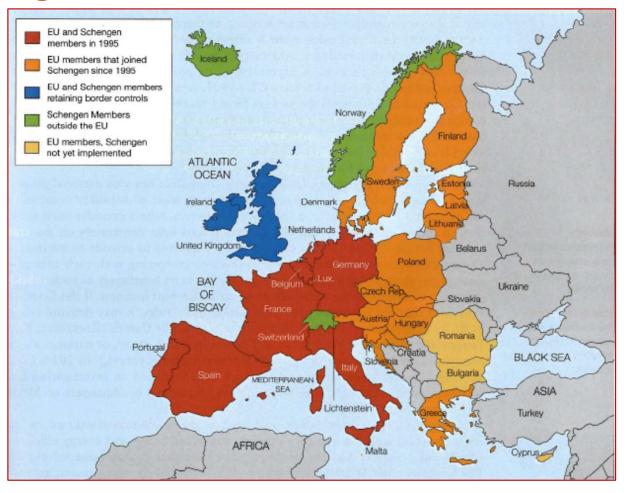
- The right to move freely in the EU to live, work or retire.
- Erasmus + Programme: To encourage student mobility in the EU.



The EU as Institutional Framework for Business



■ The Shengen Area



Source: Peng & Meyer (2019: 223)



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■ 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 <u>3% of GDP</u>;
- Public debt under <u>60% of GDP</u>;
- 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 <u>stability</u>.

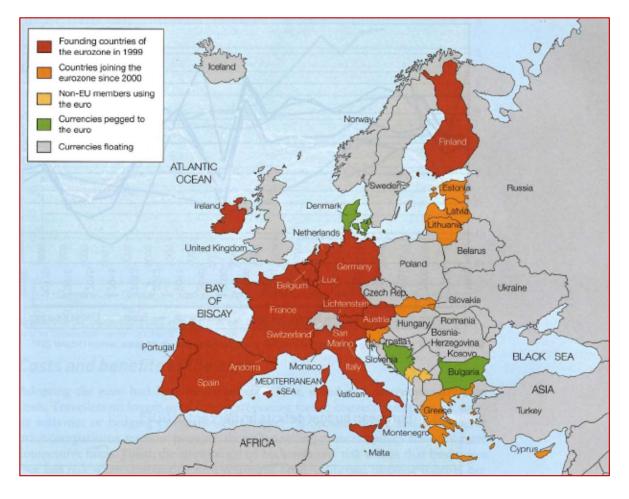
* The European Central Bank

- The central bank of the Eurozone, located in Frankfurt, Germany
- Modelled on the German Bundesbank due to lower inflation rates.





■ The 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.











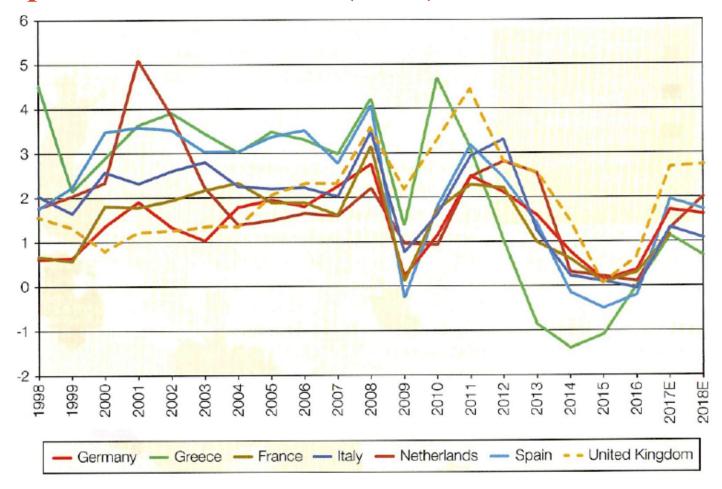
■ Is Participating in the Euro Zone Costly? Answer 'YES'!

- *When a country relinquishes its national currency, it also relinquishes an instrument of economic policy.
- ❖It <u>loses the ability</u> to conduct <u>a national monetary policy</u>.
- 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.





■ European Inflation Rates (in %)

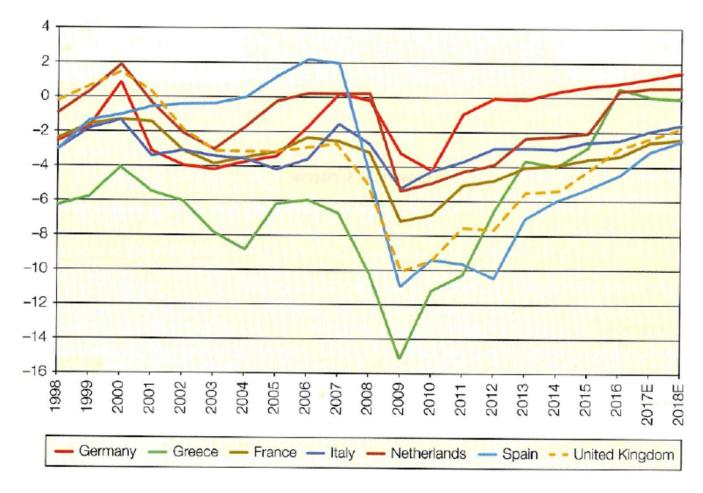


Source: Peng & Meyer (2019: 226)





■ European Budget Deficits (in % of GDP)

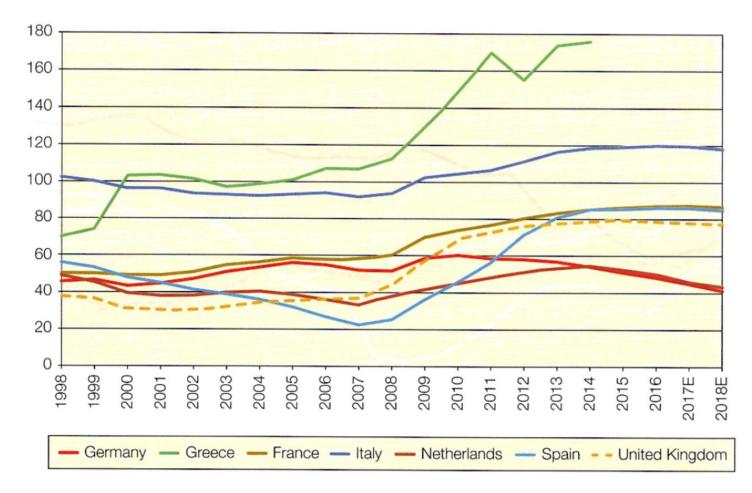


Source: Peng & Meyer (2019: 226)





■ European Government Debt (in % of GDP)



Source: Peng & Meyer (2019: 227)





■ Shifts in Demand (Mundell)

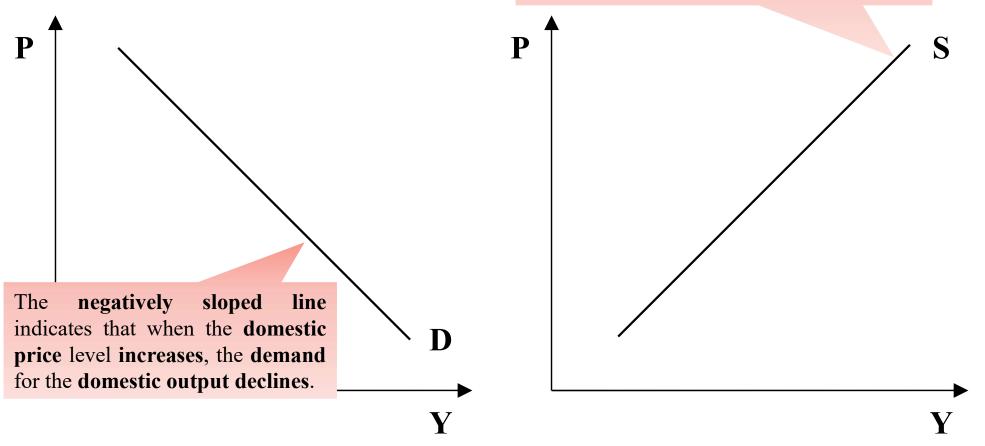
- *Consider the case of a demand shift developed by Mundell (1961) in his celebrated article on optimum currency areas.
 - Let's assume first that 2 countries, France & German, form a monetary union.
 - Hypothetically, they abandoned their national currencies, & use a common currency, the Euro, which is managed by a common central bank, the European Central Bank (ECB).
 - Let us assume further that for some reason <u>consumers shift their</u> <u>preferences away</u> from <u>French-made to German-made products</u>.
 It implies the effects of this <u>asymmetric shock in aggregate</u> <u>demand</u>.





■ Shifts in Demand (Mundell)

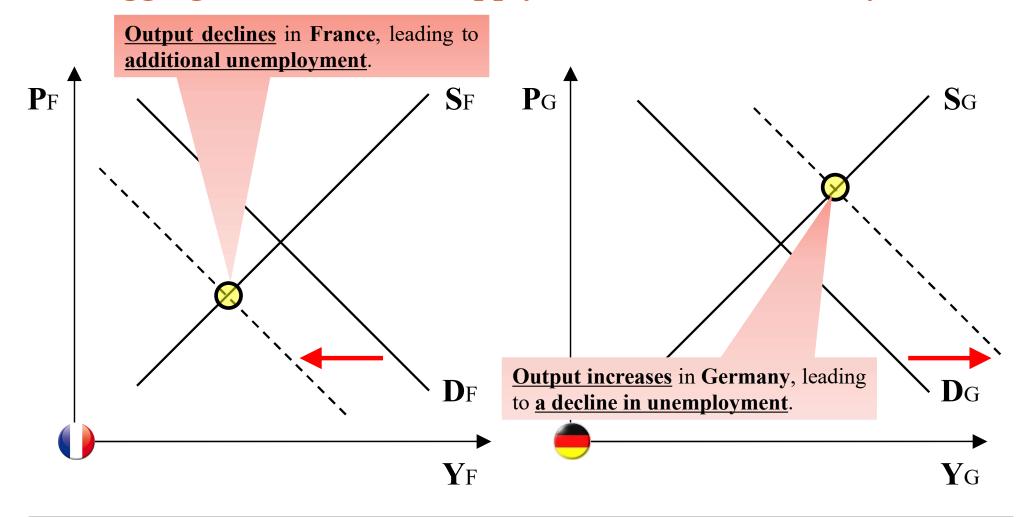
When the price of the domestic output increases, domestic firms in a competitive environment will increase their supply in order to profit from the higher price.







■ Aggregate Demand & Supply in France & Germany







■ Aggregate Demand & Supply in France & Germany

Is there any mechanism that leads to automatic equilibration?

***** Wage flexibility

→ * Labor mobility



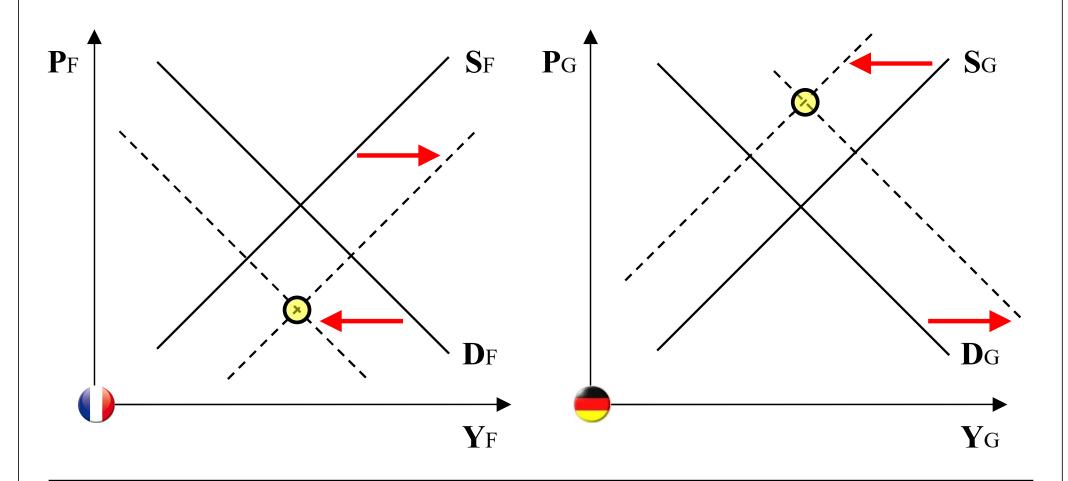


- Aggregate Demand & Supply in France & Germany
 - *****Wage flexibility
 - If wages in France & Germany are flexible the following will happen: French workers who are unemployed will reduce their wage claims (\downarrow) . In Germany, the excess demand for labor will push up the wage rate (\uparrow) .
 - The <u>reduction</u> of this <u>wage rate</u> in <u>France</u> shifts the aggregate <u>supply curve downwards</u>, whereas the <u>wage increases</u> in <u>Germany</u> shift the aggregate <u>supply curve upwards</u>. In <u>France</u>, the <u>price</u> of <u>output declines</u>, making <u>French products</u> <u>more competitive</u>, & <u>stimulating demand</u>. 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 Automatic Adjustment Process: Wage Flexibility







■ Aggregate Demand & Supply in France & Germany

&Labor mobility

- The <u>French unemployed workers move to Germany</u> (where there is excess demand for labor). This <u>movement of labor eliminates</u> the <u>need</u> to let <u>wages decline in France</u> & <u>increase</u> in <u>Germany</u>.
- Thus, the <u>French unemployment problem disappears</u>, whereas the <u>inflationary wage pressures in Germany vanish</u>.
- *What if wage flexibility & labor mobility NOT satisfied?
 - The adjustment problem will not vanish!
 - Suppose that <u>wages in France</u> do <u>NOT decline</u> despite the <u>unemployment</u> situation & those <u>French workers</u> do <u>NOT move to Germany</u>.



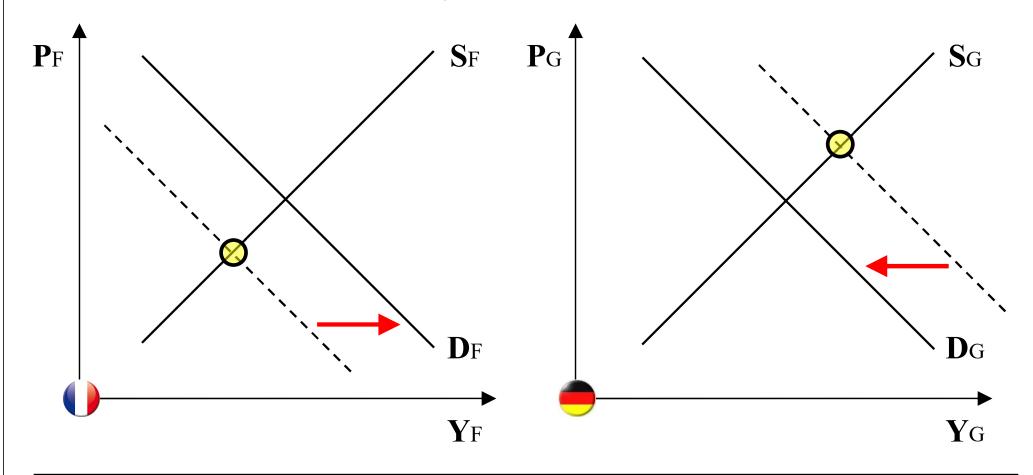


- Aggregate Demand & Supply in France & Germany
 - **❖**What happens if they are **NOT** in a monetary union?
 - Countries maintain their <u>monetary independence</u> are <u>free to use</u> their <u>national monetary policy tools</u> to <u>adjust to the asymmetric shocks</u> (See the next slide).
 - They can change their monetary policies (<u>through changes in the</u> <u>domestic interest rate &/or the money supply</u>).
 - 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.





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





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■ 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.





■ 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.





■ Democratic Legitimacy?!

Less Attention in the Media

- European elections tend to receive <u>much less attention</u> 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.





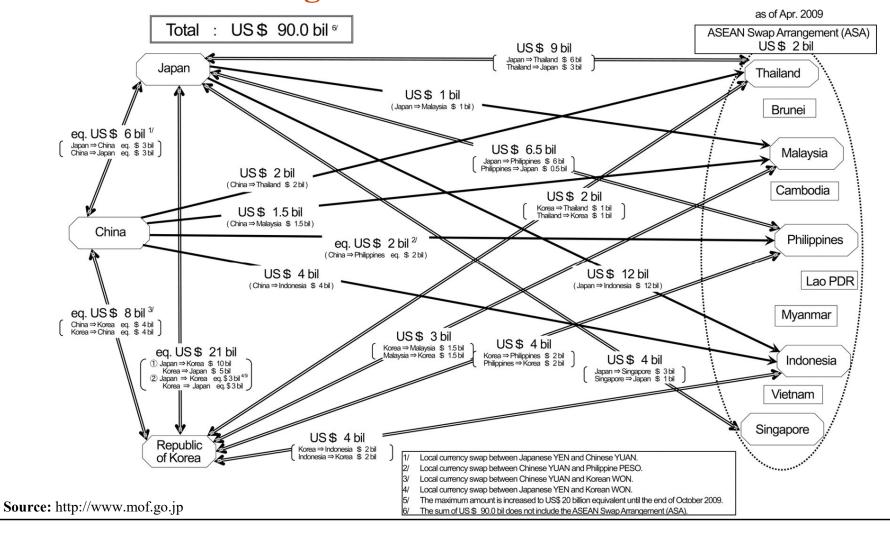
■ Myth or Reality: Economic & Political Integration in Asia







■ The 2000 Chaing-Mai Initiative







■ 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 (MNFs)	National politicians EII bureaucrats
	"Institution-led" in Europe vs. "Market-led" in Asia		
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)





■ 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!

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Grazie mille!

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