Towards a Single European Economy: Current Problems and Long Term Solutions

Summary

This paper is compiled with the objective of critically analysing whether the European Union can be classified as an integrated economy, focusing on the level of economic convergence. Against this backdrop, the current level of economic integration is assessed taking into account empirical research performed by other scholars and economic indicators shown by member states over the years 2004-2014. Results indicate that the European Union is a heterogeneous block of economic clusters with varying degrees of economic health, trends and capabilities. The heterogeneities hinder implementation of policy, which in turn prevents further integration. A “three-fold” solution for achieving a higher level of economic integration is discussed, which incorporates (i) differential treatment of member states depending on prevailing economic conditions, (ii) the establishment of a European Economic Government, and (iii) the introduction of parallel currency regimes in Eurozone countries with ailing economic health.
Keywords
European Union, economic integration, economic convergence, Single European Market, Europeanisation

W KIERUNKU JEDNOLITEJ GOSPODARKI EUROPEJSKIEJ: AKTUALNE PROBLEMY I ROZWIĄZANIA DŁUGOTERMINOWE

Streszczenie
Artykuł przedstawia próbę krytycznej analizy i odpowiedzi na pytanie, czy Unia Europejska może być klasyfikowana jako jednolita gospodarka zgodnie z teorią integracji gospodarczej. W tym kontekście obecny poziom integracji gospodarczej jest oceniany z uwzględnieniem badań empirycznych przeprowadzonych przez innych naukowców oraz na podstawie przedstawionych przez państwa członkowskie wskaźników ekonomicznych na przestrzeni lat 2004-2013. Wyniki wskazują, że Unia Europejska jest niejednorodnym blokiem „klastrów” gospodarczych obejmujących po kilka podobnych gospodarek narodowych o różnym poziomie „zdrowia” gospodarczego, tendencji rozwojowych i możliwości rozwojowych. Te niejednorodności utrudniają realizację polityki gospodarczej, co z kolei zapobiega dalszej integracji. Artykuł omawia tak zwane „potrójne” rozwiązanie dla osiągnięcia wyższego poziomu integracji gospodarczej, które zawiera (i) zróżnicowane traktowanie państw członkowskich, w zależności od panujących warunków ekonomicznych, (ii) utworzenie europejskiego rządu gospodarczego oraz (iii) wprowadzenie reżimów walutowych w krajach strefy euro.

Słowa kluczowe:
Unia Europejska, integracja gospodarcza, konwergencja gospodarcza, Jednolity Rynek Europejski, europeizacja

Introduction
The European Union (EU) currently comprises 28 member states with further enlargement expected in the coming years; the last two enlargements, however, had far reaching economic effects on new member states [Neżinsky, Fifeková 2014]. Since its inception in the
1950s, mixed sentiments have been expressed regarding whether this union of diverse nations can ever grow into a single economy; nevertheless, the EU is currently one of the major international organisations [Gruenwald 2014]. There has been much reason for scepticism given the recent crisis experienced within the Eurozone, causing great anxiety in Europe and worldwide as governments, investors and ordinary citizens begin to question the sustainability of the EU, and even, the attainability of a single European economy. In this context, any attempt to gain a comprehensive understanding of the economic problems plaguing the EU must begin by examining the basic structural and institutional characteristics required for establishing an economic union. It is essential to first evaluate the theoretical framework of economic integration and then examine the current state of integration within the EU. This approach can form the basis upon which proposed solutions are evaluated to determine the most adequate ones for achieving full economic integration, hence creating a single European Economy. Wach [2014b] notices that the European Union, as well as the processes of Europeanisation, are now at the crossroads [Wach 2014a], while Europeanisation is a concept based on twelve dimensions, including seven non-economic and five economic dimensions [Wach 2014c, p. 20], of which one of these is macroeconomic. According to Wach [2014b, p. 137] there is an urgent need to redefine and reconfigure the strategy “to take anticipatory action to support European businesses and European economies (or even the European economy)” in order to play an important role in the global economy.

The objective of this paper is to critically analyse whether the EU can be classified as an integrated economy as set forth by theories of economic integration, focussing on the level of economic convergence within the Union. In doing so, I scrutinise the current level of economic integration taking into account empirical research performed by other scholars and economic indicators shown by the member states over a 10 year period (2004-2013). Moreover, this paper presents the major problems facing the EU and assesses proposed solutions with the goal of determining how adequate they are for fostering a higher level on economic integration.
THEORY OF ECONOMIC INTEGRATION

In a general sense the term “integration” refers to the bringing together and alignment of different components or factors into a unified whole [Merriam-Webster 2015]. In the field of economics, the term takes on a broader scope as the means and extent of integration vastly contribute to an understanding of how the related components are concatenated to derive the whole. B. Balassa [1961] provides a two-fold definition, which explains economic integration as a process and a state of affairs. He asserts from one point of view that economic integration “encompasses measures designed to abolish discrimination between economic units belonging to different national states” [Balassa 1961, p. 174]. In another viewpoint, economic integration according to B. Balassa is “represented by the absence of various forms of discrimination between national economies” [Balassa 1961, p. 174]. Taking these two aspects into consideration, it is logical to say that the desired end of the economic integration process is a state of affairs marked by an absence of all types of discrimination between national economies. F. Muchlup provides another thought provoking definition as he takes a process-centric approach to explaining economic integration. A. Hosny summarised Muchlup’s interpretation of integration as the process of coupling independent economies to form a larger economic region [as cited in Hosny 1997, p. 133].

In the existing literature, the economic integration process is said to comprise several stages, each of which signifies the abolishment of specific discriminatory elements, and hence facilitates a higher level of integration. Separate economies can be integrated in the form of a free-trade area with removal of tariffs between participants, a customs union characterised by the harmonisation of tariffs in trade with non-participants, a common market which eliminates both trade and factor movement restrictions, an economic union with adaptation of common commodity and factor policies, or complete economic integration that implicates unification of monetary, fiscal and social policies [Balassa 1961, p. 174-175]. This analogy of the integration process, with its five-stages, made a substantial contribution upon which other scholars have built their theoretical models. A good example is provided when reflecting on the concept brought forth by L. Andrei who summarised Balassa’s five-stages into two, namely
incipient integration that inculpates the formation of a free trade area and customs union, followed by advanced integration which ends with economic convergence and the formation of an optimum currency area [Andrei 2012, p. 62]. Taken together, the stages of economic integration discussed here all point towards a succession of measures to lead separate economies on the path towards harmonisation of economic policies and performance, and ultimately transforming them into a unified single economy.

Given the aforementioned actions required to achieve integration between national economies, one may wonder what the rationale is behind such efforts. Economic integration can enhance efficiency in production due to increased specialisation derived from comparative advantage, boost productivity levels resulting from economies of scale, foster more desirable terms of trade given a better bargaining position, facilitate factor mobility, allow the coordination of monetary and fiscal policies, and ultimately lead to better income distribution and higher economic growth [El-Agraa 2011, p. 83]. When considering these potential benefits, it is important to note that the level of integration will dictate the extent to which the participating economies reap the rewards of integration. Supplementary to the static efficiencies economic integration can bestow, with direct effects on the income level, there are dynamic implications resulting in the long-term evolution of the converged economy, through positive spill-over effects, a rise in the growth rate, and the reallocation of resources to technology and innovation-driven sectors [Bretschger, Steger 2004, p. 2]. In this sense, integration does not only lead to an increase in the income of people within member countries, but also gives an impetus to participating economies, that offer a wide range of economic benefits in the long-term.

THE PATH TO A EUROPEAN MONETARY UNION

Economic integration in Europe can be traced as far back as the 1950s with the creation of the European Coal and Steel community, and then the European Economic Community (ECC). The latter agreement in 1957 set up a customs union with the objective of ensuring the economic and social welfare of the signatory countries through
the eradication of barriers that divided Europe [Spolaore 2013, p. 126]. As previously discussed in this paper, a customs union entails the adaptation of common tariffs when trading with non-member nations. From an Economics standpoint, the objective of creating the ECC customs union can be interpreted, within the theoretical framework of B. Balasa [Balasa 1961, p. 174], as one of the first initiatives to remove existing forms of discrimination between independent national economies in Europe.

In 1992 further steps toward greater integration were taken through the signing of the Maastricht treaty. The Convergence Criteria of the treaty set forth conditions that EU member states must fulfil in order to adopt the Euro as a currency. The criteria focus on convergence of inflation rates, interest rates, exchange rates and the adherence to fiscal discipline [Drastichove 2013, p. 208]. Although the Maastricht agreement provided a good basis for further integration, it was still vital to ensure continued prudent fiscal and economic policies once countries had entered the Eurozone [Baskaran 2009, p. 332]. Given this, the Stability & Growth Pact was adapted in 1997. Signatories agreed to maintain a balanced budget or budget surplus in the medium term, as the pact aimed at steering EU member states away from fiscal instability and at the same time monitoring those at risk of attaining an excessive budget deficit [Extenberger 2004, p. 3]. In sum, the Stability & Growth Pact and Maastricht Convergence Criteria were put in place to safeguard a European economy that had taken one step further towards full integration. Such measures are necessary since fiscal and/or monetary instability in one or more member countries can have disastrous consequences on the health of the converged European economy and the value of the single European currency, the Euro [Allen 2011, p. 19].

With further economic integration came new institutions to facilitate centralised decision making and the implementation of policy. One of the most important was the establishment of the European Central Bank in 1998. With this institution, monetary authority was shifted [Baskaran, 2009, p. 336] from individual member states with the Euro as currency to a centralised base, where decisions are made and policies enacted.
THE CURRENT STATE OF EU ECONOMIC INTEGRATION

The EU with its institutions and policies were established to facilitate the integration of independent nations within Europe. From an Economics standpoint, the aim is to create a single economy with shared benefits for all member states and ensure the welfare of citizens both in the short and the long-term. Over the years, there have been countless initiatives to foster greater integration and safeguard the economic health of EU member states. However, the problems still persist. Through an evaluation of the current state of economic integration one can understand the root causes of the problems plaguing the Union, and decipher the complex interplay between the diverse national economies of member countries.

Economic indicators provide a good basis when analysing the state of EU integration, as they reflect the performance of individual national economies. Taking this into account, the level at which economic indicators are in sync can be interpreted as the extent to which economies are integrated. J. König and R. Ohr [2013] performed an analysis using the, so-called, EU index which measures the extent of economic integration for 14 EU countries (old member states excluding Luxembourg). The analysis took into account specific fields of integration including trade integration, monetary integration, capital market integration and labour market integration [König, Ohr 2013, p. 1074]. Against this backdrop, the two researchers pinned down four dimensions of integration namely EU single market integration (considering goods, services, capital and labour), EU homogeneity that measures convergence, EU symmetry of the business cycle, and EU conformity that measures institutional compliance [König, Ohr 2013, p. 1077]. Results indicate that EU member states have different levels of economic integration although the majority of them have been able to increase their integration level during the period from 1999 to 2010. More interesting is the fact that EU nations form a heterogeneous block, instead of the desired homogenous group of national economies, with “richer” nations clustering together with “richer” nations, and the “poorer” problem-prone nations forming a block of their own [König, Ohr 2013, p. 1077]. It is important to note here that when considering Eurozone countries, the clustering of national economies according to
their integration levels reflect the same grouping of nations in view of economic health. This implies that the nations that show the lowest level of economic integration are those that have suffered major hardships in the wake of the economic crisis plaguing the EU. Figure 1 provides an overview of the EU index for 2010 with national ranking according to the overall level of integration.

Figure 1: Results of EU Index 2010 for 14 Old Member States

![EU Index 2010 Graph]

Source: adapted from [König, Ohr 2013, p. 1083]

The approach used by J. König and R. Ohr affords a good starting point for a more comprehensive assessment of EU economic integration. With this in mind, I performed an analysis of the convergence level shown by all EU member states with the exception of Croatia, which gained membership in 2013. This evaluation is based on the premise
that convergence levels of national economies within an economic union can be measured by comparing their GDP in terms of purchasing power parity (PPP) over a given period of time [Drastichova 2103, p. 209]. In this light, national economies that form part of an economic union must show similar GDP per capita figures. The more integrated that national economies are, the lesser the deviation between their GDP per Capita levels. When measured over time, national economies with a lower GDP per capita than others within the economic union must achieve a faster rate of GDP growth in order to close the gap [Drastichova 2013, p. 209] between their GDP per capita levels and those of their counterparts with higher GDP per capita. In the framework of my assessment, the GDP per capita, PPP (current international $) of 27 EU member states for the year 2003 formed the basis for grouping. The countries were allocated into 3 groups, i.e. Group 1 with GDP per capita larger than $29,000, Group 2 with GDP per capita from $29,000-$19,000 and Group 3 with GDP per capita less than $19,000. Subsequently, the average GDP growth rates of the 27 EU member states for the period from 2004-2013 were calculated (excluding Croatia). The illustration in Figure 2 affords an overview of the results generated.

Figure 2: Average GDP growth of EU member states over 10 years 2004-2013

![Average GDP growth per Country (2004-2013)](image)

Source: adapted from World Bank Data 2015

Results of the analysis show that with the exception of Hungary, all countries in Group 3 have average GDP growth figures, which
are higher than those in Group 1 and Group 2. This observation can be interpreted as a positive trend in EU convergence, since higher growth rates signify that the “poorer” nations in Group 3 are moving towards achieving GDP per Capita figures similar to those of the “richer” countries in Group 1 and Group 2. The higher average growth rates of national economies from Group 3 point towards the perceived benefits of economic integration as presented in the theory. The positive impact of EU accession on CEE countries was also observed in a convergence analysis and econometric test of economic growth determinants performed by many scholars (e.g. [Rapacki, Prochiniak 2008; Nežinsky, Fifeková 2014]). Results showed that EU enlargement significantly contributed to economic growth, although the actual process of real convergence between CEE economies and the richer EU-15 was projected to take between eight and thirty-three years [Rapacki, Prochiniak 2008, p. 1].

In other words, EU membership has led to higher rates of economic growth [El-Aegraa 2011, p. 83]. Although the growth rates shown in Group 3 are higher than those in Group 1, the differences between the GDP per Capita figures are quite large, and in this regard convergence of the national economies in view of GDP per capita is occurring at a very slow pace. V. Ulusoy and E. Yalcin have also noted the slow pace of convergence within the EU. Taking the manufacturing industry as a point of reference, the two researchers evaluated the speed of convergence of EU countries between 1990 and 2000 [Ulusoy, Yalcin 2011, p. 111]. Empirical results showed low speed of convergence across the EU manufacturing industry, implying that the degree of cross-manufacturing productivity inequality disappear; this, however, occurs in the very long run [Ulusoy, Yalcin 2011, p. 98].

Referring to the illustration in figure 2, the average growth rates shown by most countries in Group 2 paint a contrasting picture from those in Group 3. Particular attention must be paid here to the results for Portugal, Italy, Greece, Spain, and to some extent, Cyprus. These countries had average GDP growth that were less than or close to those of countries in Group 1. This depicts a negative trend in EU economic convergence, since the nations in Group 2 must grow at a faster rate in order to ultimately reach GDP per Capita figures similar to those of the “richer” nations in Group 1. More distressing are the results for Portugal, Italy and Greece, which all had negative
GDP growth on average for the ten year period. This implies a backward move towards the “poorer” countries in Group 3. In order to further examine economic convergence within the EU, I performed another analysis by comparing GDP per Capita in terms of Purchasing Power Parity (PPP) for member states [Dąbrowski 2014, p. 1]. The average GDP figures from 2004 to 2013 were calculated for each of the 3 groups used in the preceding analysis i.e. Group 1, Group 2 and Group 3. The diagram below affords an overview of the results.

Figure 3: Average Annual GDP per Capita, PPP for EU states by national grouping in the years 2004-2013

Source: adapted from World Bank Data 2015

As with the previous analysis, results here indicate a negative trend of economic convergence within the union since GDP levels of poorer countries do not increase on average at a higher rate than that of the richer countries. Although all groups had an increase in GDP when comparing the first year to the last i.e. 2004 to 2013, careful consideration shows that Group 2 actually shows a declining trend overall in GDP levels from 2008 to 20013. GDP levels for Group 3 increased; this, however, occurred at the same or even at a slightly lower pace than that of Group 1.

These findings and the results of the other researchers presented in this section, on the state of EU economic integration, provide clarity regarding the root cause of the economic problems facing the EU.
Simply put: the EU is a heterogeneous block of economic clusters comprising national economies with varying degrees of economic health, trends and capabilities. In spite of these heterogeneities, the shortcomings of individual member states have far reaching implications that (can) affect all countries within the union.

RETHINKING THE CONCEPT
OF A SINGLE EUROPEAN ECONOMY

The economic heterogeneities that exist within the EU may present fundamental difficulties for negotiating further integration as lack of economic homogeneity is often accompanied by heterogeneous economic preferences and interests [König, Ohr 2013, p. 1087]. A more problematic situation is brought forth by the “PIGSC” countries, a group comprising Portugal, Italy, Greece, Spain and Cyprus. These countries face problems of excessive debt and government spending with low tax revenue and poor productivity [Troitino 2013, pp. 14-20]. The situation is dire considering the size of Italy and Spain, whose economic woes can have far-reaching consequences for the entire EU. Compounding the problem is the fact that all these countries use the Euro as their currency. Therefore, spill over effects resulting from a crisis will have implications for both the fiscal and monetary health of respective EU member states.

Given the current economic difficulties plaguing the EU, action has been taken to mitigate the effects and reverse the cycle of the failing economic health of member states. Nonetheless, the most prevalent initiatives such as austerity measures and emergency lending by the European Central Bank can only serve as temporary solutions. In order to tackle the problems at their root, more holistic approaches are needed that consider fundamental structural and institutional shortcomings. A good example is the proposal to create a European Economic Government (EEG) which will be given the responsibility of addressing the economic problems of member states, with a mandate to alleviate asymmetric shocks in the EU through common management of expenses and incomes [Troitino 2013, p. 25]. This implies that a governing entity will be put in place to deal with fiscal issues facing member states and have the authority to take action in order to
tackle a crisis in one or more member states. As opposed to the use of financial instruments such as interest rates or currency devaluation that would have negative implications on other member states with healthier economies, the EEG will be empowered to provide funding to a specific member state in order to increase economic activity [Trotino 2013, p. 25]. Taking this solution one step further, the EEG should be given authority to draw up, and together with national governments, implement fiscal policies in member states with ailing economies. The goal of this mandate will be to ensure economic stability and ultimately lead the national economies of “poorer” and “problem-prone” member states in order to converge with the economies of “richer” EU countries.

Another possible solution lies in the concept of a so-called two-speed Europe, which entails differentiation between member states based on a new carefully constructed institutional and policy framework [Meny 2014, p. 1347]. In this case, the economic indicators of EU member nations can form the basis for differentiation, with policies put in place to foster long-term economic growth of the “poorer” and “problem-prone” member countries. In sum, a paradigm shift is needed whereby the EU is no longer regarded and operated as a “single economy”, but instead is viewed as various economic blocks towards which varying economic policies must be directed. It is evident that a two-speed system can no longer serve as the basis for transition to full EU membership [Meny 2014, p. 1348], however it can provide a viable framework upon which further economic integration can be achieved.

With the aforementioned solutions geared at fostering EU economic convergence, it is also important to reflect on remedies to the crisis facing the Eurozone, as they can serve as a means of ensuring fiscal stability within the union. A thought provoking suggestion involves the establishment of a parallel currency regime in the Eurozone countries most affected by the crisis. With this approach, a second currency could be introduced in these member states which would perform the same functions as the Euro. The use of the second currency outside its country of origin will be illegal, and the market will determine its exchange rate with the Euro [Rusek 2012, p. 15]. A parallel currency regime will allow member states to use financial instruments such as devaluation of their second currency to obtain a competitive advantage on the global market. Restored competitiveness should improve the current balance position of the member
state, and over time generate a budget surplus that could be used to service debt [Rusek 2012, p. 16].

CONCLUSIONS

This paper aimed at critically analysing whether the EU can be classified as an integrated economy as set forth by theories of economic integration. In doing so, the current level of economic integration was assessed taking into account empirical research performed by other scholars and the economic indicators shown by EU member states over a 10 year period; that is, in the years 2004-2013. The results provided the foundation upon which proposed solutions to prevailing problems were evaluated. The EU is a heterogeneous block of economic clusters comprising economies with varying degrees of economic health, trends and capabilities. In spite of these heterogeneities the shortcomings of individual member states have far reaching implications that (can) affect all countries within the Union. This is regarded as the root cause for the economic issues that plague the EU today. By the same token, the heterogeneities within the union hinder the implementation of policy, which in turn prevent further economic integration.

Reflecting on the state of economic integration within the EU and the prevailing problems, I suggest a three-fold solution for achieving a higher level of integration. The comprehensive solution incorporates elements of the remedies discussed in the preceding section of this paper on ("rethinking the concept of a single European economy"). A paradigm shift is required, where the EU is no longer treated as a single economy with policies and institutions geared towards all member states. Instead a two-speed, or even, three-speed system should be established, with differential treatment depending on prevailing economic conditions of the member states. Parallel to this, the European Economic Government must be put in place to draw-up and oversee the implementation of policy based on differential treatment. A key aspect of monetary policy drafted by the European Economic Government should involve the concept of a parallel currency regime, as a means for restoring the competitiveness of Eurozone countries with ailing economic health. The parallel currency will allow the use of financial instruments to
guide member states towards economic convergence and ultimately transform the EU from a heterogeneous block of economic clusters to a fully integrated economic union, a single European economy.

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