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European Integration Reset: Lessons from Brexit, Norway, and Eastern Europe[1]

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Summary

Given the severity and length of the Great Recession, whether or not Europe needs more or less integration is a much less consequential discussion than that Europe needs better and more effective integration. In this policy brief, we argue that taking stock of the integration experience may be the key to support the search for novel and more effective policy initiatives, resume growth and leave the current crisis behind. The brief presents three historical examples that illustrate the power deep integration has had in propelling the European project. The first demonstrates how deep integration contributed significantly to stop the relative economic decline of the United Kingdom (UK) vis-à-vis the EU founding members. We suggest EU membership played a greater role in this respect than Thatcher's reforms. The second example displays how deep integration drove increases in labor productivity in Sweden, Austria and Finland (which gained unrestricted access to the Single Market by joining the European Economic Area, EEA, in 1994 and later the EU in 1995) compared to similar developments in Norway (which joined only the EEA in 1994). The third example draws from the experience of the Central European new member members to illustrate that a crucial (yet less appreciated than trade openness, foreign investment and migration) mechanism to these advancements has been the ability of deep integration to increase State capacity and hence to shore up positive institutional change.

The European Integration project has experienced multiple crises since the onset of the Great Recession. Yet Brexit (the UK vote to leave the European union) stands out[2]. Brexit is a unique crisis because it asks existential questions about the value of being in the Union, the worth of membership, the dynamics and distribution of its benefits and costs, and about the type of integration that can sustain (and hopefully increase) the benefits seen since the project started in the 1950s[3]. Such questions must be addressed if the EU is to be after this crisis.

Our main argument in this brief is that the solution to these crises requires taking stock, rethinking and resetting deep integration. Given the severity and length of the Great Recession, whether or not Europe needs more or less integration is a much less consequential discussion than that Europe needs better and more effective integration. Deep integration involves regulatory, policy and institutional dimensions which are not covered by shallow integration (which is often equated with purely economic integration which mostly involves tariff reductions)[4].

This brief presents three historical examples to support the argument that deep integration should take center stage. They are presented in chronological order and reflect key moments in the European integration process. These are lessons from the 1973, 1995 and 2004 EU enlargements. The first example shows how deep integration significantly contributed to stop the relative economic decline in the United Kingdom (UK) vis-à-vis the EU founding members. The second shows how deep integration engendered substantial increases in productivity in Sweden, Austria and Finland compared to the experience in Norway. The third example draws upon the new Central European EU members and it demonstrates that a crucial mechanism to these advancements has been the capacity of deep integration to increase State capacity and thus to generate beneficial institutional change.

Deep European Integration and the United Kingdom

An extremely prominent area of economic history scholarship is "British relative economic decline."[5] It offers a detailed understanding of key turning points in British economic history since the 1800s. This long-term perspective, however, tends to downplay WWII and European integration (including gains from liberalization and increased competition)[6]. Did EU membership significantly improve UK economic performance? And if so, how?

The unprecedented destruction of WWII resulted in a similarly unprecedented recovery effort. Reconstruction and catch-up with pre-war levels were broadly completed by 1950 so other factors were at play. The following period, until 1973, is often referred to as the Golden Age of European Economic Growth. A Marshall Plan requirement was economic coordination among recipient countries. The French favored a customs union, the British a free trade area. Only the former entails substantial institutional change[7]. Without the UK, the European Coal and Steel Community (ECSC), as proposed by the Schuman Plan in 1950, created a set of institutions to integrate coal and steel production. It included a High Authority to monitor compliance with the terms of the agreement, an Assembly to hold the High Authority accountable, and a Court to adjudicate disputes.

In 1950, per capita GDP in the UK was about 28 percent above EU6 countries average. When the Treaty of Rome was signed by the EU6 in 1957, that figure had reduced to 15 percent. The year De Gaulle resigned, the ratio of per capita GDP in the UK was about 7 percent below EU6 average.

A fundamental yet largely unappreciated feature of the UK-EU relationship is a structural break[8]. The ratio of UK's per capita GDP to the EU founding members' declines steadily from 1945 until 1972 but is stable between 1973 and 2010. For total factor productivity, the ratio decline until around 1970 and increased afterwards. The turning point in productivity is thus clearer than in per capita GDP. Although it occurs later for Ireland[9], the evidence shows that for the UK and Denmark it happened around the time these joined the EEC in 1973.

Such prominent structural break suggests substantial benefits from EU membership to the UK especially considering that, by sponsoring an overpowered integration model, Britain joined too late, at a bad moment in time, and at an avoidably larger cost. A common explanation is that this turning point occurs in the mid-1980s instead and the reason is that this is when Mrs. Thatcher implements her package of far-reaching structural reforms. The finding that Denmark shows structural breaks that are dated similarly to the UK's suggests rather stark limits of explanations of this kind[10].

Deep integration creates its own "constituency." he UK experience is illustrative if one considers that the success of Mrs Thatcher's reforms may have actually required EU integration. Those structural reforms could not have taken place without a large and powerful constituency. In this case, these were British entrepreneurs who would benefit from a much larger, more innovative and demanding market place (contrast the EU and the Commonwealth in this respect). These entrepreneurs also realised that to be competitive they would need to tap in mobile capital and labour and would need a clear set of common standards and regulations so as to guarantee a level playing-field. Without the support of such powerful constituencies, Mrs. Thatcher's reforms would not have been proposed or fully implemented, and clearly would not have been nearly as successful or influential. Moreover, this explanation draws parallels with the French experience in the post-World War 2 period[11]. Between 1945 and 1957, there was conflict of interest between powerful groups of entrepreneurs against and in favour of furthering European economic integration. Those against tended to export mostly to the former French colonies. Yet these groups lost influence in the run-up to the Treaty of Rome and found themselves locked-in the project even after regaining considerable political influence with De Gaulle appointment in 1958. At that point, they could slow down but they could not reverse the process.

The debate about the value of EU membership for the UK case is of broader relevance because if one can show that European integration played an important role in "an awkward partner", it is likely it played a substantial role everywhere else. Moreover, it suggests the benefits from deep integration are wide-ranging (that is, they are not restricted to poorer countries that see their catch-up efforts complemented by deeper integration). Another insight is that these benefits manifest themselves mostly in terms of total factor productivity (as opposed to mostly or exclusively in terms on per capita GDP.)

Deep European Integration and Norway

Disentangling the benefits from "shallow" (economic only) and "deep" (economic plus political) integration is notoriously difficult[12]. Yet the Norwegian experience is unique and provides valuable lessons. The EU-Norway relationship shows it is possible for a country to be economically associated to and, at the same time, politically disassociated from the EU. A question is whether the "economic only" type of membership (Norway enjoys) is superior to an "economic plus political" type of membership (enjoyed by the current 28 EU full-fledged member states).

Norway fulfilled all of EU entry requirements, completed accession negotiations, accepted membership in the European Economic Area (EEA, with unrestricted access to the Single Market), but in 1994 voted against full-fledged EU membership[13]. According to the European Commission, Norway was as ready to join the EU in 1994 as were Sweden, Finland and Austria[14].

In Campos, Coricelli and Moretti (2015) we use differences-in-differences and synthetic control methods with regional annual data from Norway, Austria, Finland and Sweden from 1985 to 2000 to estimate the consequences in productivity terms of a hypothetical EU entry of Norwegian regions, before and after the 1995 EU enlargement[15]. We find the level of productivity in Norwegian regions was between 1.6 and 2 euros (or about 6 to 8 percent) lower because of non-entry.

This new evidence suggests that the net benefits from deep significantly outstrip those from shallow integration. Norway would benefit from full EU membership: if it had joined the EU in 1995, its productivity levels in the first five years would have been on average 6% higher. Since Norway already enjoys purely economic integration benefits (via EEA), this result suggests substantial additional benefits from political (deep) integration through EU membership. The mechanisms that support these gains remain very much an open question but our results suggest a large role for political integration in the form of participation in decision-making at the EU level and the associated bargaining over policy matters, as well as regarding then protection of specific sectors (such as agriculture or energy[16].)

These results also have implications for the broader European project. They show that deeper integration pays off in productivity terms. European integration has always been explicitly a political process and an economic process. Our identification of deep integration payoffs challenges commonly found views that benefits are mostly related to economic integration while the costs are mostly due to the political dimensions of EU integration. The choice of a customs union instead of a free trade area model, enshrined in the Treaty of Rome, underscores the agreed direction of travel as one towards deep integration. "Ever closer union" is often considered as (and often criticized for being) a soft and exclusively political argument. These results suggest that by being at the heart of deep integration, "ever closer union" also plays a very concrete and fundamental role by also generating far-reaching and wide-ranging purely economic benefits.

Deep European Integration and the Central and Eastern European New Member States

While the UK experience discussed above demonstrates that the choice of deep over shallow integration pays off economically, the Norwegian experience allows one to move one step further and generate a robust estimate of these productivity gains. The next issue is how and why are these productivity gains generated? Foreign direct investment, international trade, migration and financial liberalization have been discussed at length before as potentially important channels. Our third and last example suggests a mechanism that has received considerably less attention thus far: the experience of the Central and Eastern European (CEE) countries that became EU members after 2004 shows that these productivity gains can emerge because deep integration increases State Capacity and support inclusive institutions[17]. It remains much under-appreciated that deep economic integration can induce powerful actors to support increasing the capacity of the State to enforce law and order, regulate economic activity, and provide public goods[18]. A pressing issue is whether and under what conditions can deep economic integration yield increases in state capacity.

In order to investigate these issues, we measure the building-up of State capacities in 17 Eastern and Central European countries (EU membership candidates) which were exposed to similar deep integration challenges[19]. Eleven of these countries have already joined the EU; another six are still in the process of meeting the membership requirements. Using the annual monitoring reports produced by expert teams for the European Commission (which cover the chapters of the acquis that need to be successfully negotiated before accession), we quantify changes in State capacity over time and find large variation in their evolution. Our analysis focuses on three fundamental State institutions: the judiciary, bureaucracy, and competition policy. For each, we document the national paths of meeting the institutional requirements of EU membership from the transposition of EU regulations to the creation of EU conform regulatory organizations endowed with the expected powers, resources and personnel.

Not only do we find that deep integration does increase State capacities but we also throw some light on how it does so. It emerges that the effects of deep integration vary with the sequencing of institutional change. There is a small number of key effective implementation sequences. The independence of the bureaucracy seems driven by judiciary capacity, competition policy and administrative capacity. Moreover, our results suggest that the intricate relationship between bureaucratic independence and judiciary capacity plays a key role in driving institutional convergence.

Concluding remarks

Since the Great Recession started in 2007, Europe has experienced a myriad of crises. This sequence of crises has now culminated with Brexit. One of the few benefits of the 'Brexit debate' is that it has promoted a veritable flurry of new research addressing hard and important questions that have not been sufficiently investigated previously. The benefits and the costs from European integration have for too long been taken for granted and were not assessed frequently and rigorously enough. Time is ripe to reverse this state of affairs. Whether the European Union needs more or less integration is at this moment in time a much less consequential discussion than the recognition that it needs better and more effective integration. This brief provided three examples that show the power of deep integration in propelling the European project. We show it contributed to stop the relative economic decline in the UK vis-à-vis the EU founding members, to increase productivity in Sweden, Austria and Finland compared to that in Norway, and to cause positive institutional change in new Central European EU members. On this basis, we argue that taking stock, rethinking and resetting deep integration may be the key to resume growth, to support novel and more effective policy actions, and to leave the current crisis behind. At last.

Notes

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3 Campos, N. and F. Coricelli (2015), "Some Unpleasant Brexit Econometrics," VoxEu, 11 December 2015.
4 The difference between "deep" and "shallow" integration was introduced by Lawrence, R (1996) Regionalism, Multilateralism, and Deeper Integration, Washington DC: Brookings Institution Press. See also Orefice, G and N. Rocha (2014), "Deep Integration and Production Networks," The World Economy, 37(1), 106-136.
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6 A notable exception is Crafts, N. (2012), "British Relative Economic Decline Revisited: The Role of Competition," Explorations in Economic History, 49(1), 17-29.
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16 Further corroborating evidence is that of high correlations across regions between the foregone benefits from deep integration and the employment shares in sectors such as oil and fisheries, on the one hand, and finance and the public sector on the other.
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