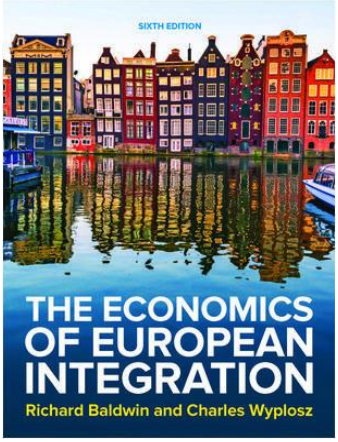


Chapter 7: Growth Effects and Factor Market Integration

Introduction

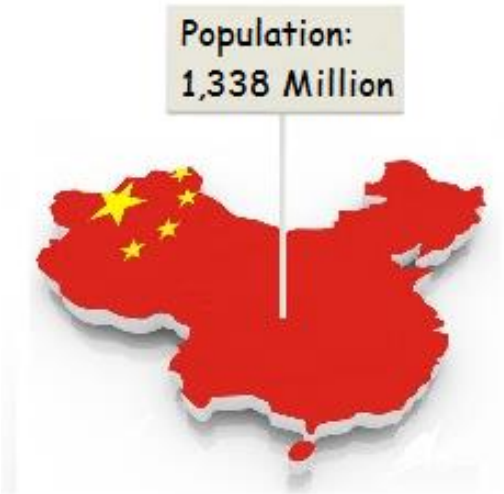
- Why do some countries/regions grow or not grow?
- How EU integration affects growth.

Logic of Growth and the Facts

Definitions

1. Q = (Q/P). P

That is total output is the product of output per head and population. Q in US and China approximately the same, but Q/P around 3.5 times higher in US than in China. Oil consumption per head in chart.



7 BPD per thousand capita

61 BPD per thousand capita

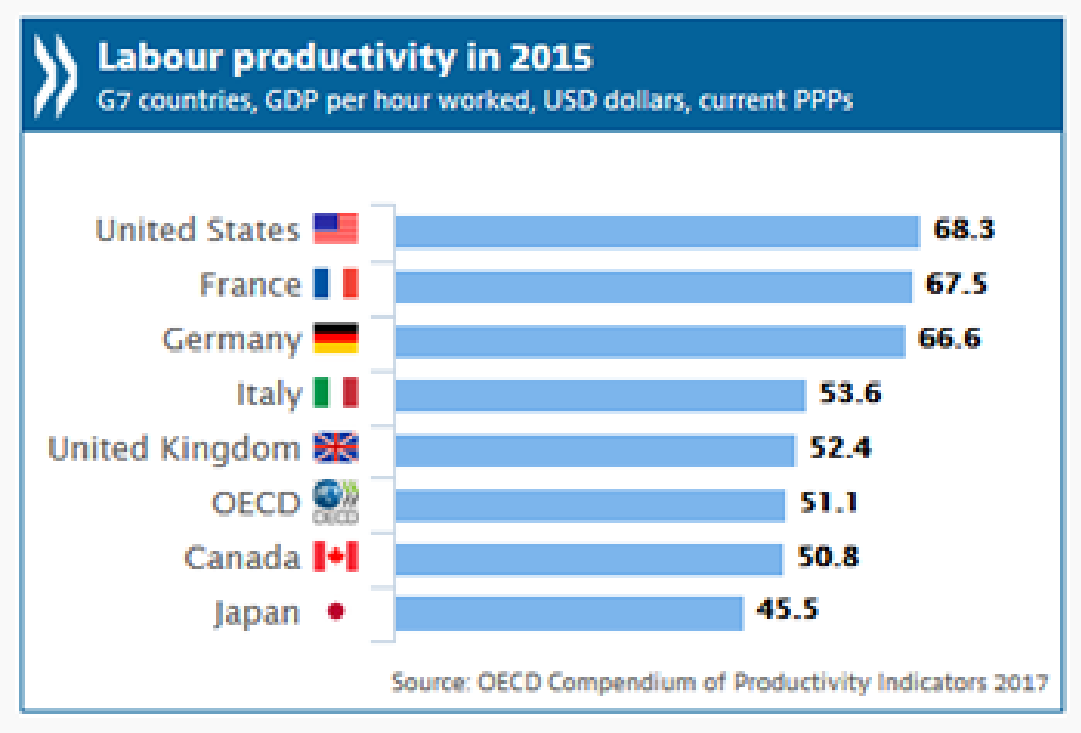
2. (Q/P) = (Q/E). (E/P)

So Q/P is what matters for living standards, and it depends on output per person employed and the proportion of the population employed. So the more dependents (i.e. the lower E/P) the lower

Q/P, even though Q/E might be as high as a country with high E/P.

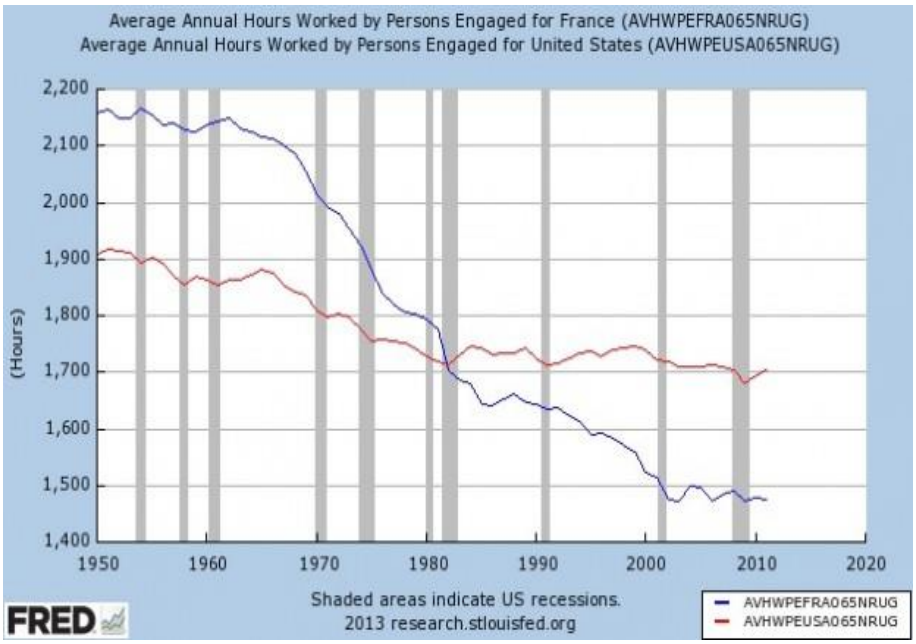
3. (Q/E) = (Q/H). (H/E)

Q/E depends on output per hour worked and average number of hours worked.



Hence, Q/E might be high in one country simply because people work longer hours, e.g. US v Germany or France (see Tables 7.1 and 7.2).

Annual hours worked: France v US



4. Q = (Q/E). (E): explains increases in Q/E, <u>not</u> E

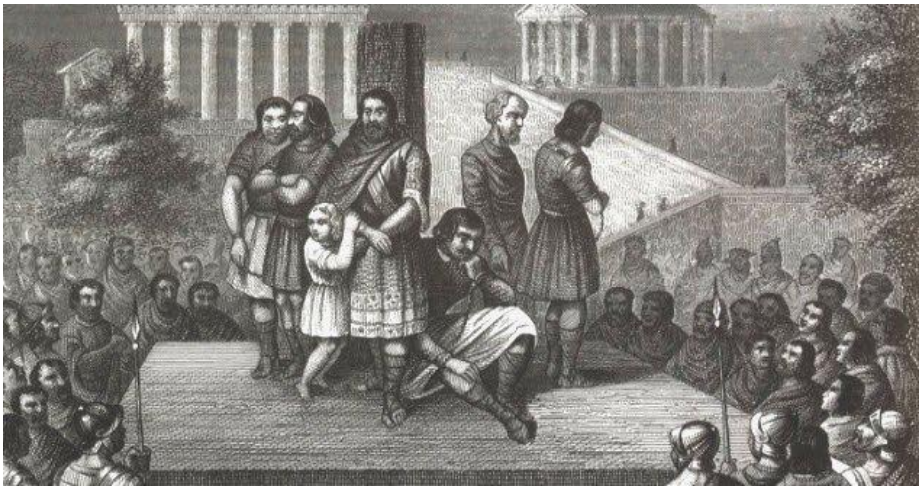
Similar to Equation 1: total output can also be expressed as the product of Q/E and E. So Q could increase steadily if E increasing and with no increase in Q/E.

- See Tables 7.1 and 7.2 for data on differences.
- Short, long and medium-run effects.
- Later revisions.

Phases of European Growth (Tables 7.1 and 7.2)

- Living standards of Roman artisans higher than average British worker in 1850, then the richest country in the world. Rome had population of 1m by 100 AD, but just around 50,000 well-off and most were slaves

Slave market in ancient Rome



- Table 7.1: Comparisons back to ancient Greek times: growth a phenomenon only since mid-1800s

- 1913-1950: two World Wars and ‘miracle’ recovery after WWII.
- Golden Age: 1950-73.
- Mid- 1970s to early 1980s: oil crises. 1985 to 1994: recovery but not in E.
- 1995-2019. Slowing productivity growth everywhere (see book)

Determinants of Growth (NOT directly in book)

Q/E = A.F (K/E, H/E, I, R) or q = A.f (k, h, i, r)

- A represents technology and innovation

- k physical capital: infrastructure such as roads, harbours/airports, broadband, water, sewage, etc
- h human capital; education/skill level of population.
- i political and other institutions; for example, rule of law, political stability, education and health, open competition
- r natural resources; land, water, oil, climate, wind
- Also, conquest/imperialism; for example, Roman conquests, colonisation of Ireland in 17th century, colonisation of Africa in 19th century

Source: http://www.boondocksnet.com (adapted)

- Interconnected: increased i could increase h, k and A say.
- Productivity slowdown across the world (p. 162-163)

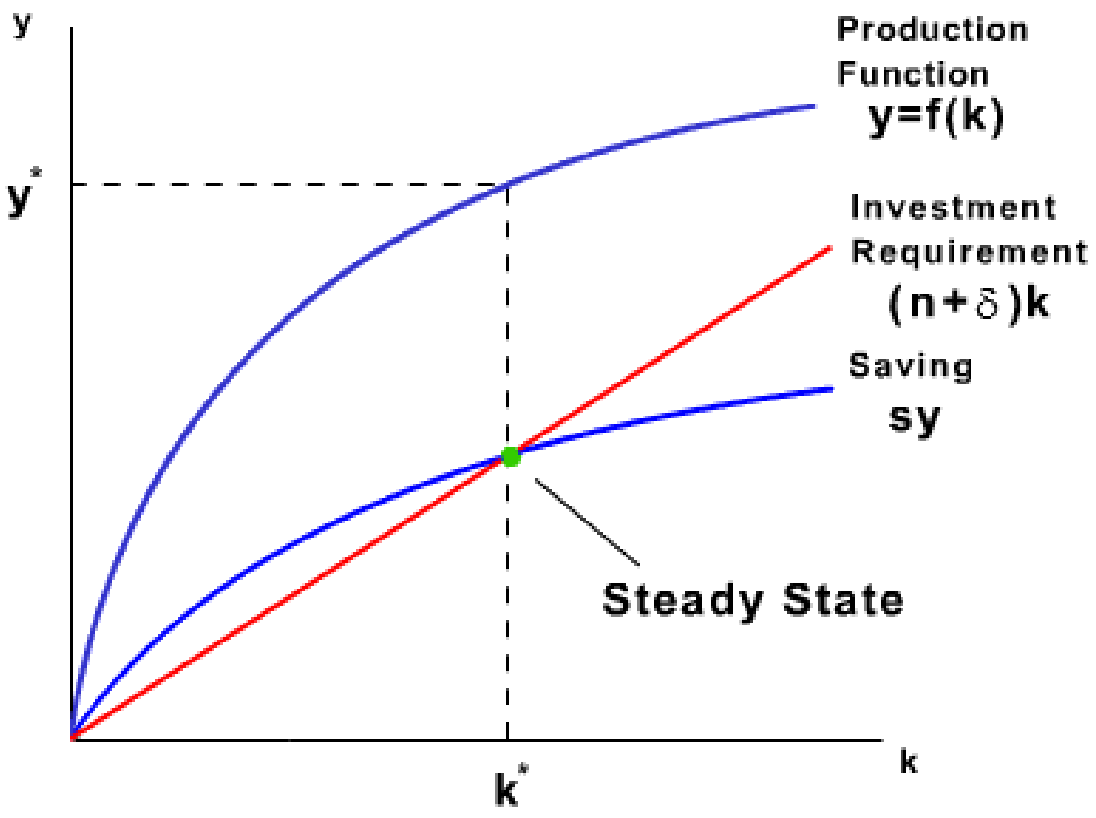
Did EU integration lead to higher growth?

- Counterfactual the real problem.
- Fig 7.2: UK and Spain income gain from European integration. Average per capita incomes 12% higher 20 years after EU membership.

- 7.2.5: evidence from EU accession states
- *How* integration *could* benefit growth easier to demonstrate (see later).

Causes of Growth in Medium Term

Solow Model (not in this edition, except verbally!))



- Q/E or y increases less with increases in K/E or k: i.e. diminishing returns.
- Equilibrium k* depends on inflow (investment)
- And outflow (depreciation) of new capital, n plus
- Assumes *fixed* proportion of y saved (s) and *fixed* proportion of y depreciated (δ)
- Each country gets to equilibrium.
- How does economy grow after this?

EU integration phases: effects on growth in principle (NOT in book)

- Integration could shift out y-curve. How?

Liberalization of trade (Chaps 4 and 5: see summary at end of each chapter)

- Leads to increased competition implies pressure to lower costs and introduce new technology.
- However, winners and losers with tariffs. Diffuse v identifiable groups. For example, huge resistance to EU/Canada trade deal in some areas.
- Marginal political constituency, losing out to globalisation. This state could affect outcome of elections and hence prevent free trade.
- Non-economic reasons: oil, food, water, energy, uranium, etc. Can these vital industries be left to cheapest supplier, no matter where located?
- Need also to take account of environmental costs: e.g. beef production in Brazil

- Technical barriers bigger hindrance to trade. These are: discrepancies between product rules adopted by different countries regarding for example: weight (e.g. litres v pints), size, packaging, ingredients, mandatory labeling, shelf-life conditions, testing and certification procedures etc.
- Free movement of people perhaps the most important factor in exploiting single market
- Competition though leads to overall E increase but falls in some places (see later)

Single market, industrial restructuring and increased competition (Ch. 6)

- Economies of scale the key

- Single market implies mergers and industrial restructuring possible.
- First manufacturing (e.g. Airbus) but now services: insurance, retail, banking (e.g. Aldi, Axa, Allianz, Zara).
- Result a small number of big ‘players’ in intensely competitive market. E.g. Nike v Adidas, Deutsche Bank v Goldman Sachs, Airbus v Boeing

- Pressure to exploit economies of scale and adopt new technology.
- Have to ensure competition though.
- Gainers and losers like with tariffs.
- Also freedom to open a business. For example, Aldi and Lidl transformed food trade in Ireland.

Competition in Clothes Retailing

- Brings technology transfers and assimilation.
- Financial integration also (Module ECU33032). Single currency brings increased competition and transparency and greatly reduces transaction costs of trade and travel.
- No exchange rate risk implies more stability for business and travellers.
- Need for regulation and governance. Role of EU Commission (competition) and ECJ (dispute resolution).

Long –Run Growth

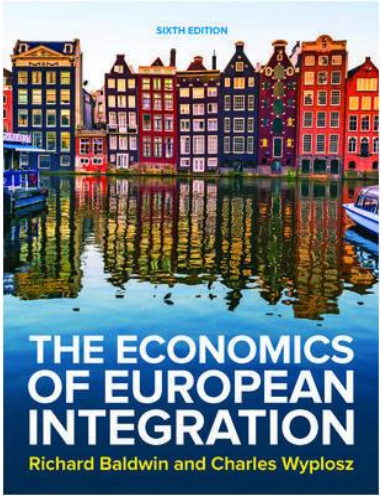
Remember:

Q/E = A.F (K/E, H/E, I, R) or q = A.f (k, h, i, r)

- Continuous invention possible, means A can increase indefinitely

- How to increase h and i also critical. Such as importance of rule of law and competition, and system of education
- Link between i, h and A.
- Integration ensures maximum use of k (i.e. efficiency) *and* the adoption and development of new technology, because of competition.

- EU integration to promote knowledge capital: large research funding, Erasmus exchanges



Chapter 8: Labour Markets and Migration

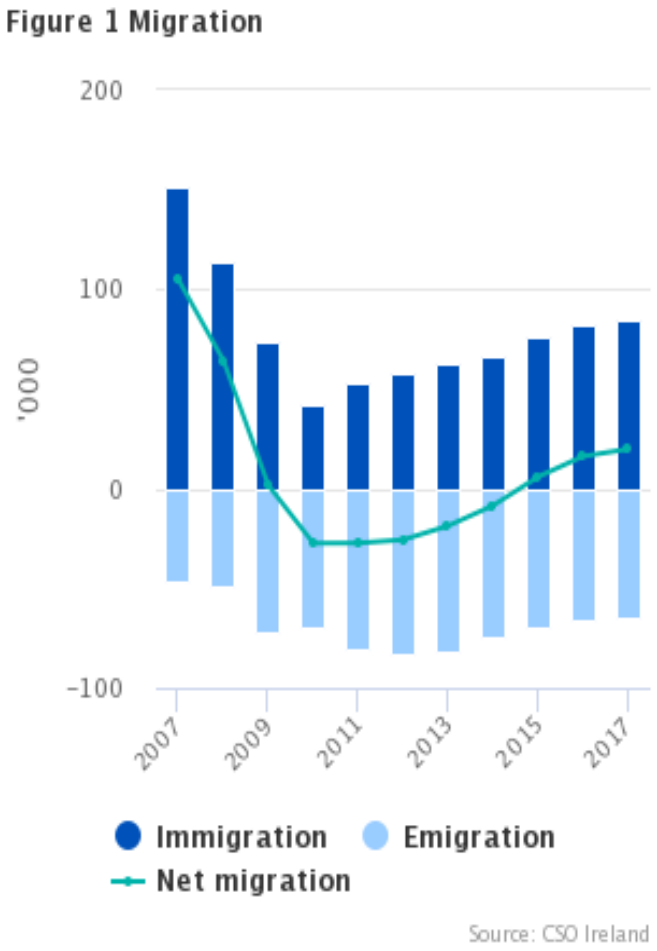
Introduction

- How will EU influence labour market performance? Huge variation by country though and not really integrated. For services for example as we saw earlier.

- And how will institutions in member states, especially of euro zone, impact?

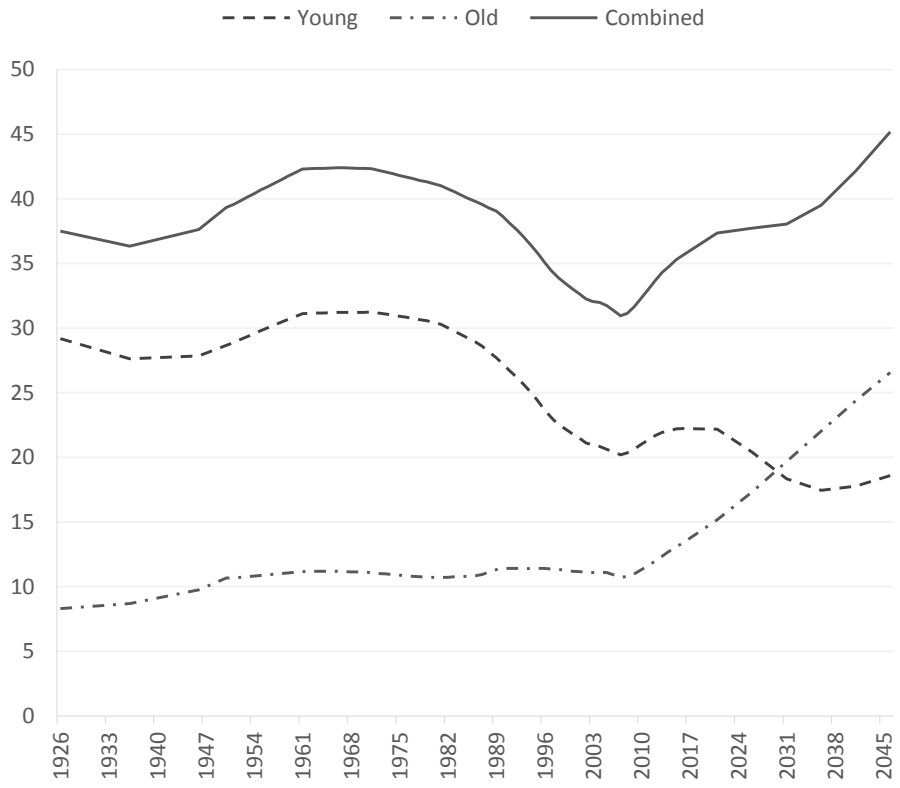
Population (essential background to labour market)

- P (2029) depends on: P (2019), plus natural increase, plus net migration
- Natural increase = births minus deaths. Stable or declining in some EU countries.
- Difference between net and gross migration. For example, Ireland



- Absolute size of population important, but also geographic distribution (see Ch. 10). West v East in Germany and Ireland, North v South of Italy and so on.
- Also age distribution of huge importance, with a marked ageing of

the population in many EU countries, for example Ireland



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8.1 European Labour Markets: Characteristics

Definitions (Box 8.1)

- L = (P). (Pa/P). (L/Pa)

That is, size of labour force (people wanting work) depends on the size of the population, the age distribution of that population, and the share of the working-age group seeking work.

- L = E + UE

Labour force consists of those in employment and those unemployed and seeking employment.

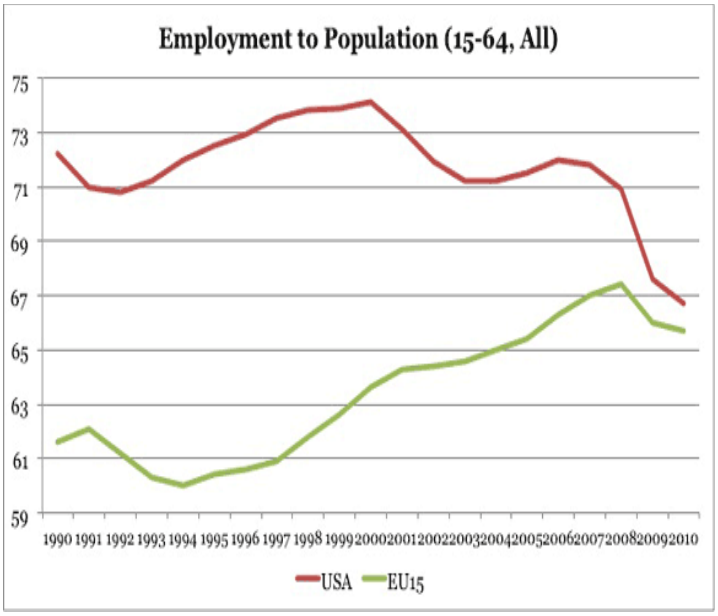
- (E/Pa) = (E/L). (L/Pa)

The proportion of the working-age population in employment depends on the share in employment, and the share

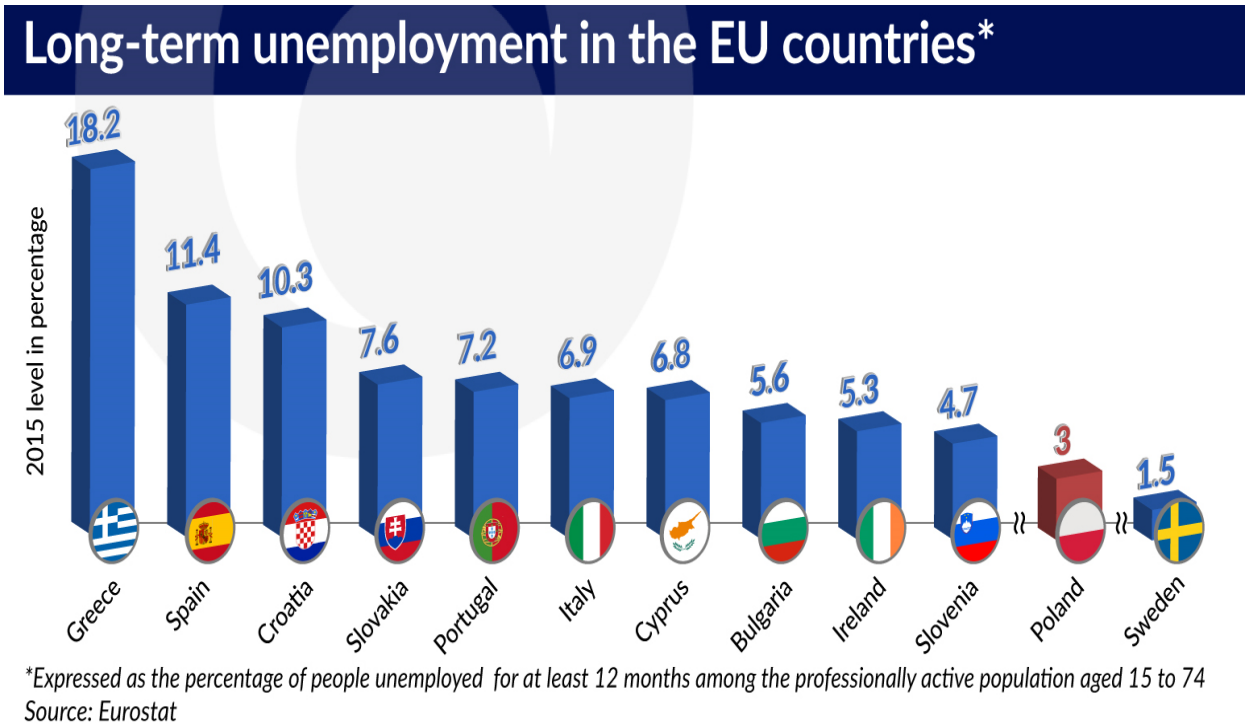
of the active-age group wishing to work. Female participation rates critical to last. E/L is 1 minus UE rate.

E/Pa now used as best indicator of the labour market. Went down for example in US at same time as UE rates went down.

Facts

- US v Europe Comparison of E/Pa and UE/L (Fig. 8.1) and figure below (illustrative only)
- 

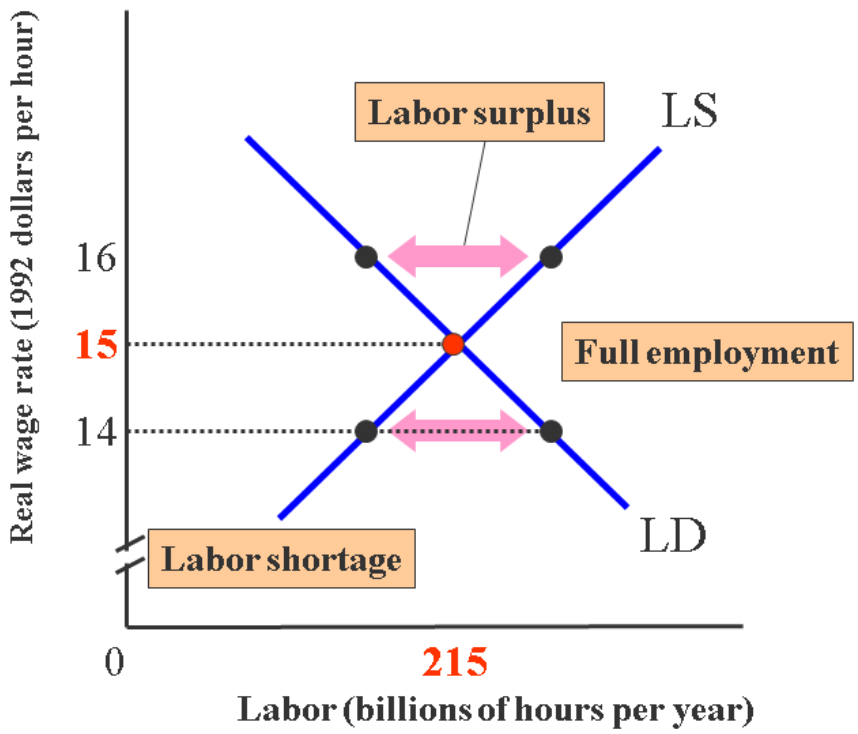
- US better on both counts, but much less so since 2008 in relation to employment rate
- Nature of employment growth: part-time v full-time, temporary to long-term, etc. Is it 'real' in other words?
- *Measurement of unemployment*: valid over time and between countries? (see also Box 8.1)
- Invalidity benefit and early pension payments v unemployment benefit (why E/Pa best measure)
- Standardised rates v social welfare records: e.g. Germany lower than UK using latter but higher using former
- Long-term UE a special case (see also Fig 8.6). Table below for 2015, just illustrative



Two factors influence LTU: flow into it from STU and time in LTU.

- Duration and level of UE benefits critical here. LTU very difficult to solve, as mostly social problem in nature (see later)
- Little in US and *must* accept work or training offer in Nordic countries

8.2 Labour Markets: Principles



- Normal demand and supply analysis does not apply, as in Figs 8.3 and 8.4 or above
- Not just another market.
  - Wages negotiated collectively, minimum wages
  - Limits on dismissals, minimum working conditions enforced, unemployment benefits paid.

- Thus in short to medium term markets may not clear.
- Labour market *special* also in other ways.
    1. excessive market power by employers or unions possible.
    2. price of labour is livelihood for someone: hence a social issue
    3. Human capital: quality of labour changes over time
    4. Trust and loyalty factors in labour market. Min wage 'story'.

- Yet, labour market must work or high UE, to non-one's advantage.

- Policy still mainly national.

Role of Trade Unions

- Historic role still holds, that is defending the interests of their members

- Strong unions in Nordic countries and low UE: strong public sector unions in France and high UE. Conflicting evidence therefore
- Insiders outnumber outsiders and anyway outsiders have no voice.
- Spain's two-tier labour market for example: change underway.
- Irish nurses and teachers during recent recession

- High and persistent UE benefits in turn creates LTU.
- Why no effective EU-wide unions?

Special Case of Long-term Unemployment (because <u>not</u> in labour market)

- Source of persistent UE in Germany, Italy and France in past.
- Hysteresis effects, namely deskilling and demotivation: e.g. surgeon, electrician?

- Outside labour market implies not influencing wage rate either

- Why drift from STU to LTU the key question.
- *Unemployment payments:* Undoubted benefits to recipients.
- May cause UE though as less cost to leisure
- Encourages black economy.
- Enforcement the key.
- Verification checks for fraud
- Availability for work
- *Active labour market policies:* LTU an economic *and* social issue
- LTU have to be 'brought' back to work: cannot depend on market.
- Must have right to withhold benefit (e.g. Nordic countries).
- Co-ordination of EU Social policy to avoid social 'dumping' (8.3.3)

8.3 Effects of Trade Integration

- Integration has led to more intense competition
- It has meant flatter labour demand curves. Which means if wages too high has a major impact on E (see diagram). However, demand curves also move up.

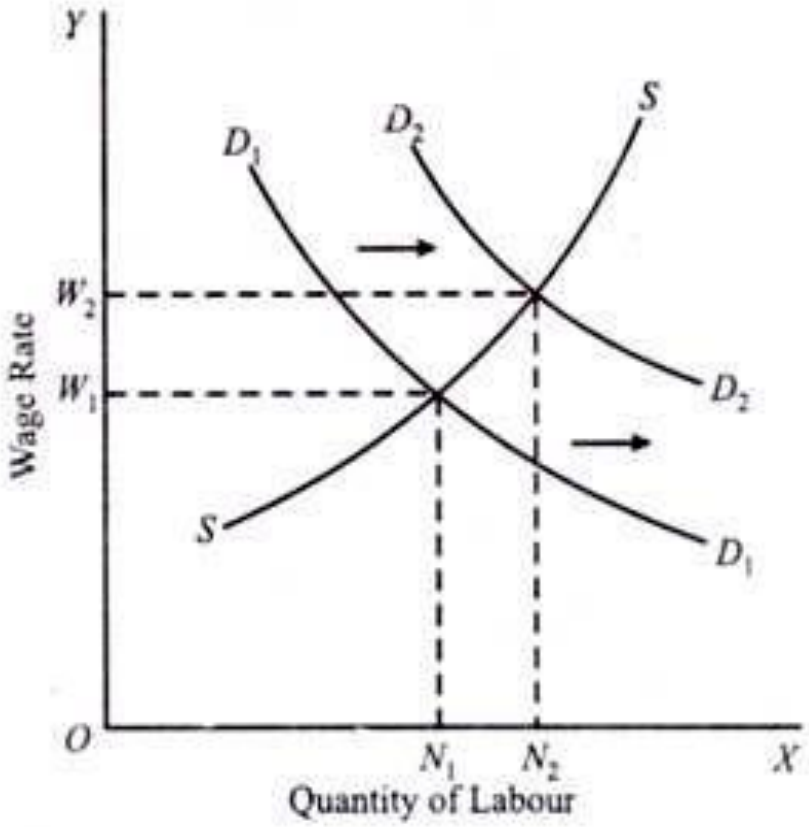
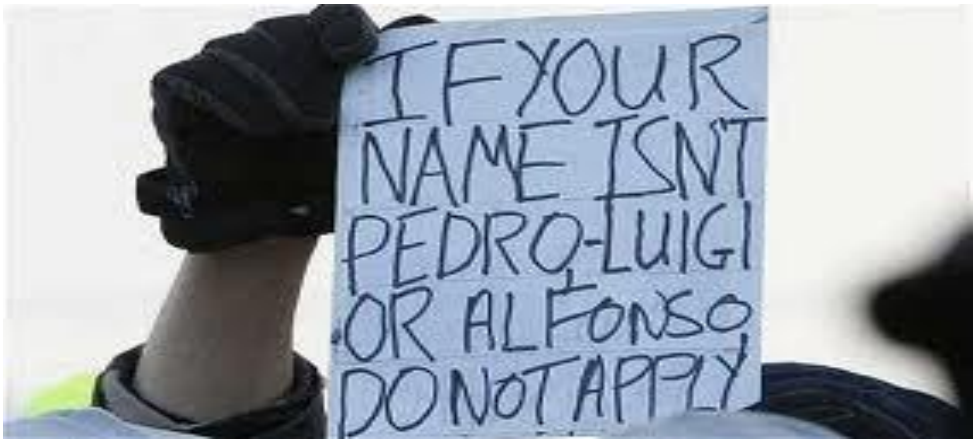


Fig. 33.10. *Effect of Increase in Labour Demand on the Wage Rate*

- Compositional effects: some lose out. Losers, understandably very vocal.
- Monetary union increased competition and trade.
- Major implications also for Unions.
- No exchange rate option. Vital factor as effects immediate and large
- Also affects operation of industrial relations.
- Why no move to EU-level unions?

8.4 Migration (economic <u>and</u> political)



Issues in General

- Free movement of labour in Rome Treaty
- Free movement of labour could lead to great efficiency gains and much higher living standards on average
- In past south-north immigration, plus from outside EU.
- Then from new EU countries (see Table 8.3). In relation to population, immigration is highest for Ireland, mostly from Poland. Austria next highest, but from Hungary, Poland, Romania, Croatia and Slovakia. Fig 8.10 has interesting statistics also.
- Also, for some years south-north again (e.g. Spain to Germany), for skilled works though.
- Migrations flows not linked to EU per se but relative economic

performance. Expansion to EU28 though had huge impact.

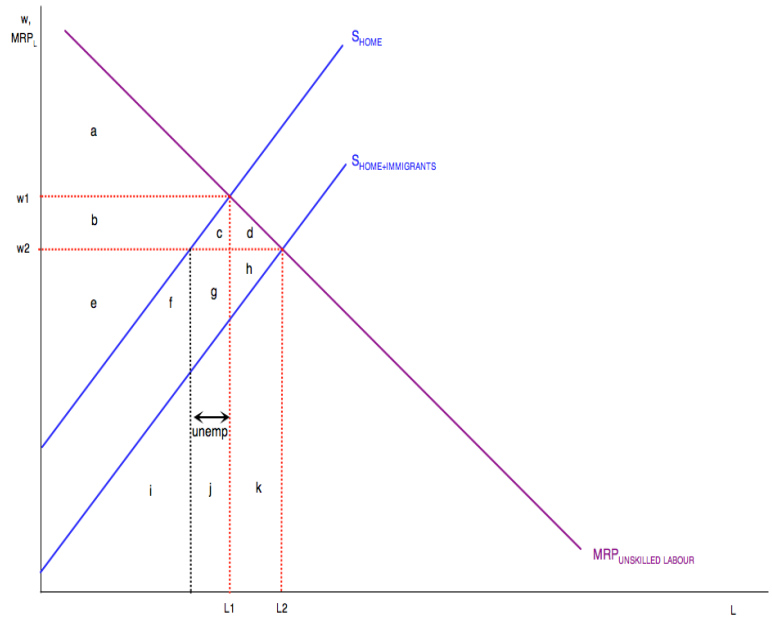
- Why is migration from new and non-EU countries so contentious?

- Again gainers and losers.
- Educated v unskilled migration (but both needed in many countries.
- Complementarity v substitutability (see 8.4.2)
- Irish example: immigration of entrepreneurs/high skills to create other employment.

- Also to adopt and adapt new technologies.
- Little controversy over migration *within* EU 17, e.g. France to UK
- Why? More complementary and also two-way.
- Restrictions apply in most countries in relation to <u>non-EU</u> migration, yet very high in UK.
- Also, many other barriers to mobility (8.4.2): language and lack of desire to migrate
- Migrants usually contribute net payments to budget: education, health and infrastructure expenditure must be correspondingly increased

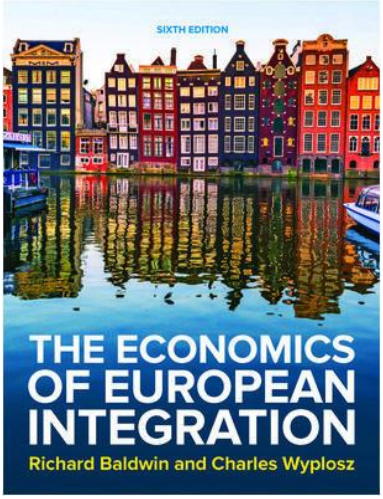
Analytical Framework

- Effects on wages



- Immigrants may be prepared to work for less, which means lower wages.
- And lower prices though for consumers
- Increased E and W for foreign workers. Useful in book to look at impact BOTH on receiving and sending countries (8.4.2)
- Different if immigrants wish to work only for going home rate.

- If immigrants complement a win-win situation.
- Effects on unemployment (Fig 8.13)
- Impact in all cases unclear.
- Worst case scenario loss to home workers is large drop in wages and E.
- Gain to consumers: gainers and losers again then
- Much misinformed <u>emotional</u> commentary.
- How to overcome this the problem: analysis and facts do not seem to make any difference



Chapter 9: Common Agricultural Policy

Introduction (not in book)

Key Considerations (makes sector very interesting to study)

- Still an important sector, especially if looking at food sector as a whole
- Uses very large portion of land area (around 60%): hence major visual/environmental effects
- Accounts for large share of greenhouse gas emissions

- Huge government intervention in sector; regulation and funding
- Critical to WTO trade talks, plus environment and health and safety of EU citizens; e.g. use of pesticides, steroids in cattle, factory farming destroying hedge rows, and so on

Uniqueness of Sector

- Supply factors: disease, weather, storage costs, health/safety. Causes instability.
- Inelastic demand, plus fluctuating S due to above, implies large swings in price. E.g. strawberries, or wheat.
- Large number of producers
- Immobile factors of production: labour and land
- Small shop analogy (Box 9.1)
- Security and safety of supply essential, like water

- Long-run v short-run cost of production. For example safety, sustainability, environment.
- Cultural role of family farm: e.g. Ireland, France, Poland, Switzerland

9.1 Old Simple Logic of CAP

- French/German 'deal'
- Objectives in Treaty of Rome: increased Q, fair standard of living, stabilize markets, guarantee supply, reasonable prices to consumers
- In past, target and floor prices (Fig 9.2)

- Import tariffs, export subsidies and intervention purchases
- FEOGA: Guarantee (price support) or Pillar 1 and Guidance Funds (structural change) or Pillar 2.

9.2 CAP Problems

- Hypothetical Example (see also Section 9.1.1)

	Large Farmer	Small
Output (litres)	800K	40K
Cost/litre	€1	€3
Total cost	€800K	€120K
Market price	€1	€1
Balance	Breakeven	Loss €80K
Support Price	€3	€3
Balance	*Profit €1.6M*	*Breakeven*

- Inefficient: for both small and large farmers, because prices artificial
- Very inequitable (Table 9.2 and Fig 9.4); a hidden regressive tax

- High budgetary costs and disposal problems (Fig 9.8)
- Damaged world trade (through ‘dumping’)
- Concern for Developing Countries (Box 9.3): entry to market blocked
- Damaged environment (through use of fertilizers etc)
- Animal welfare neglected and incentive to factory farming
- Does world price reflect all costs? Such as environment, exploitation of labour in poor countries?

9.3, 9.4 and 9.5. New Economic Logic, CAP Reform and Today’s Cap

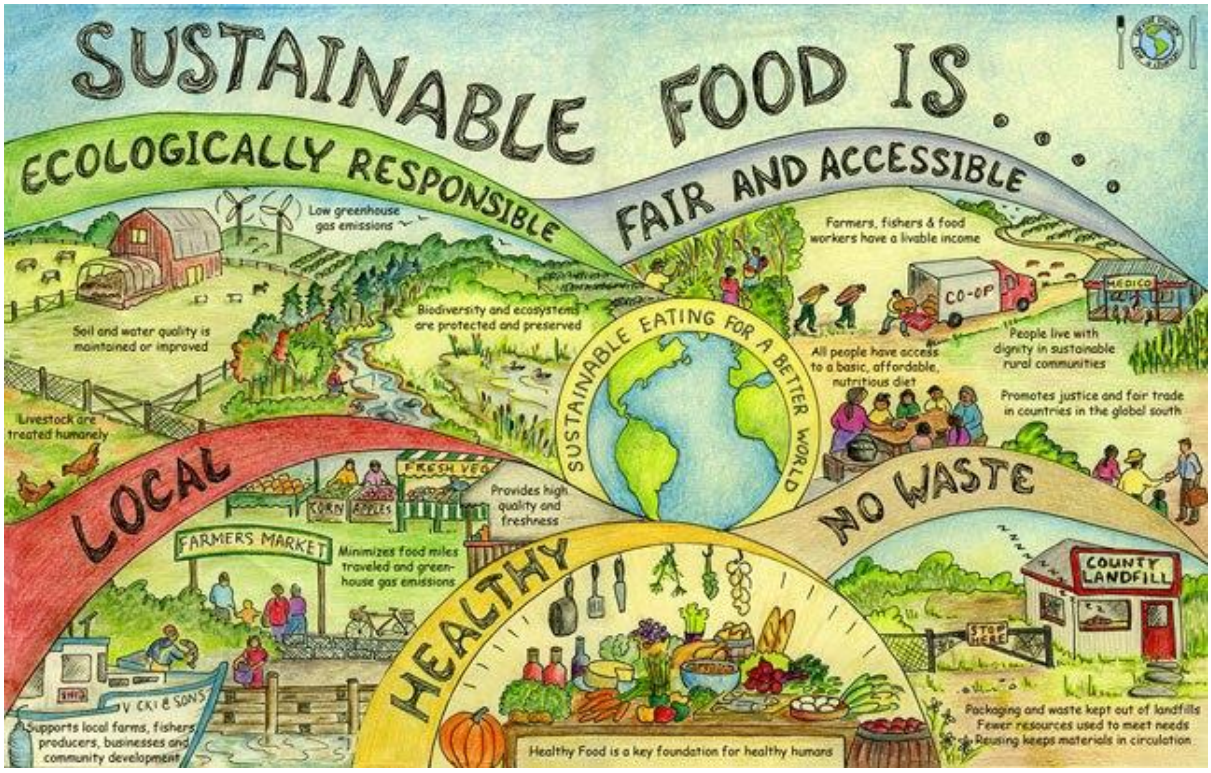
Farm lobby still strong: Beef protests August 2019

Price and Income Supports: Pillar 1

- Mansholt 1968
- Avoid distorting market as above
- Pressure through WTO: change in US stance
- McSharry (Irish Commissioner) 1992: reduced support prices; supply controls (e.g. set aside land).
- Direct payments, coupled to output measures. Not affecting price therefore.

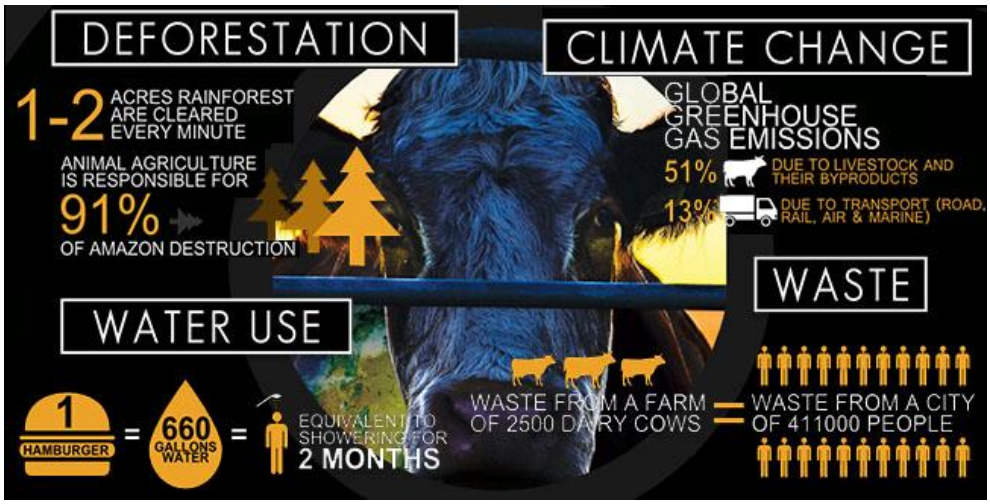
- New environmental, forestry and early retirement emphasis (both in Mansholt)
- Luxembourg Agreement 2003 and Health Check 2009. Three strands.
- Payments not linked to output (de-coupled)
- Now a Single Payment Scheme based on historical factors
- Less so since 2013, but much change still needed
- 'Cross compliance' should apply to receive payments: with environment, food safety and animal welfare
- Importance of rural development
- Direct payments still favour hugely the larger farmers, but to be reduced over time (Table 9.2)
- Benefits landowners: (Boxes 9.4 and 9.5)

Future Reform



- Irreversible change now: emphasis switching to guidance funding.
- Strategic importance and sustainability of food supply understood
- Cannot be dependent on another country or on 3 or 4 huge producers
- Budget 2022-2029 will see major change?

- Fairer distribution of payments; see some extraordinary examples in book of unfairness.
- ‘Green’ emphasis of growing importance: gases from animals, use of pesticides and so on
- Huge issue in Ireland as farming accounts for one-third of all greenhouse gases here
- Worries about farming methods in other countries and dependence in West on meat consumption

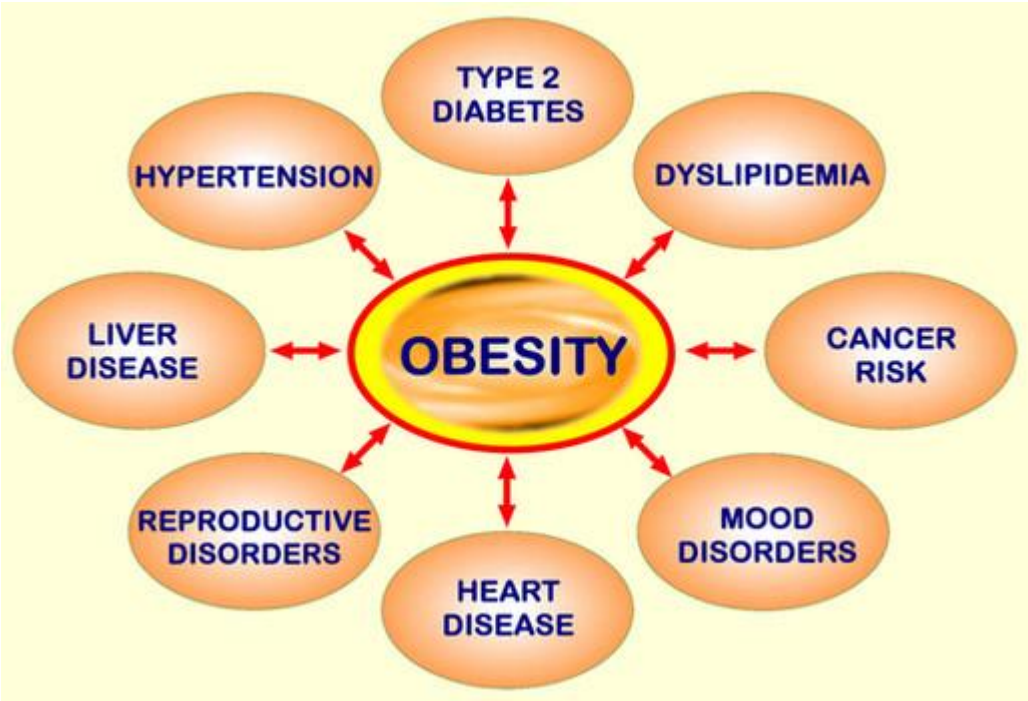


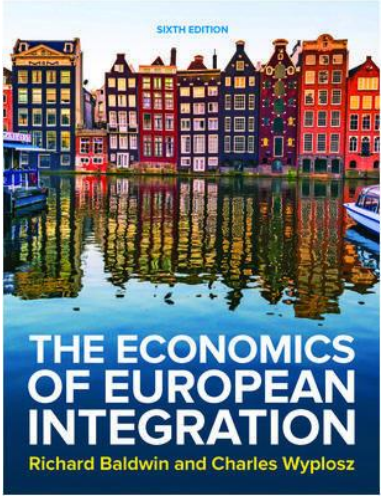
- Shift cost to national governments?

Postscript Food Processing and Food Safety

- Few products sold directly to consumer (e.g. potatoes, eggs, strawberries)
- Food industry value is three times that of primary agriculture
- Growing Concern over Food Safety
- Always a concern: e.g. water in 18th century and around world today
- Huge variety of issues:
  - diseased animals posing threat to human health (BSE and 'bird flu')
  - to other animals ('foot and mouth' and 'bird flu')
  - sanitary conditions in food preparation
  - use of pesticides and hormone residues, GM food, etc
- Can lead to dramatic drops in demand: e.g. listeria in soft cheeses, salmonella in eggs, BSE in cattle, etc

- Also, more awareness now of animal welfare and environmental damage
- Dependence on animal meat for food facing considerable criticism: for environmental and health reasons
- Nutrition always an issue: e.g. huge debate now over obesity problem
- Contrast with food shortages and severe undernourishment in post-War EU. And large parts of world today
- Obesity more serious health problem maybe than smoking in past?





Chapter 10: Location Effects, Economic Geography and Regional Policy

10.1 and 10.2 Facts and Trends

- Core v Intermediate v Peripheral regions (Figs 10.1 and 10.2).
- Last has 40% of pop and 20% of income.

Economist October 14th 2012. Do the seeds of growth spread to the periphery?

- Huge income gaps, especially in EU 28 (Figure 10.3)
- Poor regions in 'new' and 'old' member states
- Distribution *within* countries: variation by factor of 2 to 3.
- Over time?
- *Within* countries (UK, Fig 10.4)
- Enlargement greatly worsened situation (added 10 very poor countries)
- Inequality at individual level much more marked.
- Overall v compositional effects: focus on industry. Former not significant.

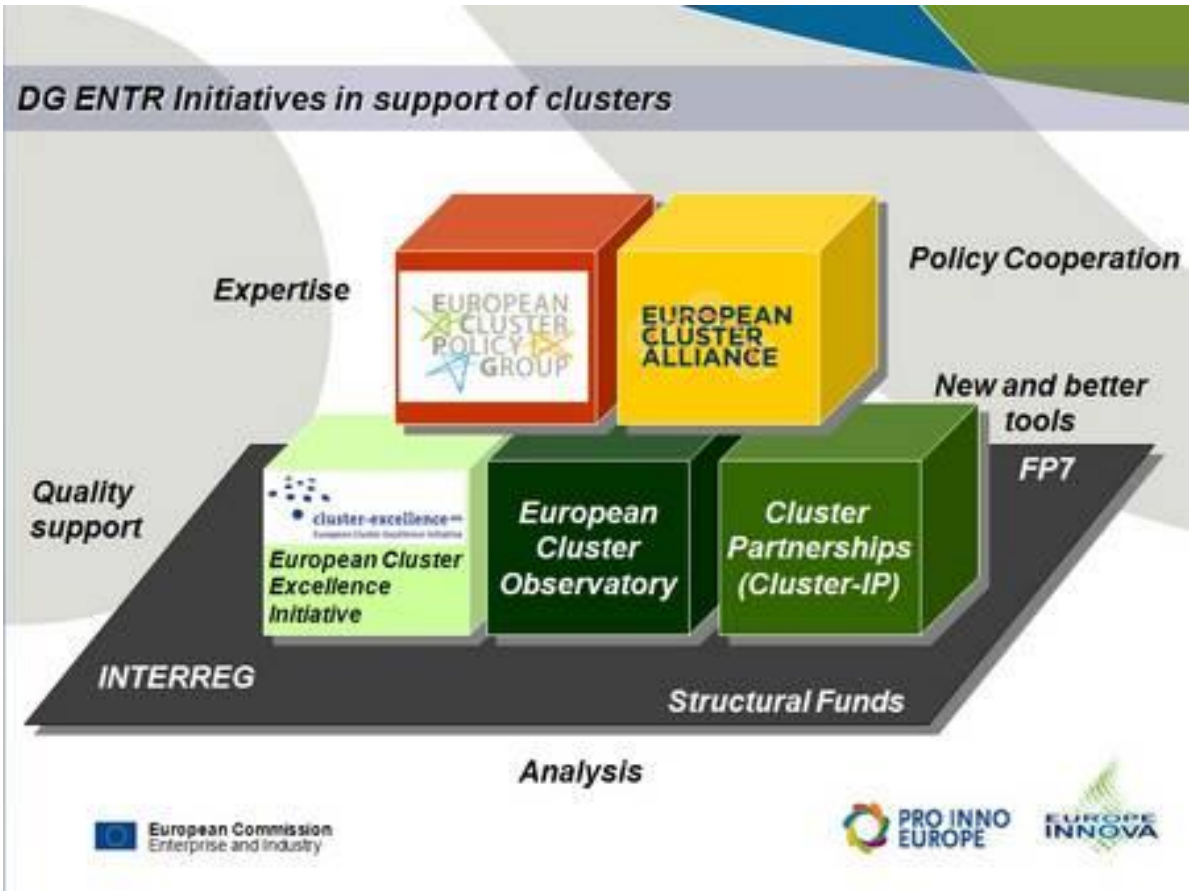
- Specialization (Table 10.1): measure over time

10.2 Comparative Advantage

- Integration leads to
  - *specialisation* across countries (comparative advantage) and
  - *agglomeration* within countries (economies of scale).
- Nature of specialization depends on factors of production, especially labour: low (textiles) v medium v high education (banking) (see Figure 10.5).
- Not just labour though.
- Natural resources such as land, water, mines (e.g. oil) access to sea, etc, matter hugely also.
- Also, physical infrastructure such as roads, cultural life, environment, etc
- Climate matters also. Bananas or citrus fruit, sun and snow holidays.

- Liberalisation implies more specialization in *composition*, not level, of industrial activity. But again losers.
- Movement of labour v movement of industrial activity.

10.3 Agglomeration and the New Economic Geography



- Clustering/agglomeration
- Overall v sectoral clustering.

- Why do Banks in London cluster, or similar retail stores in every city? Likewise Silicon Valley and IT sector in Dublin
- Large economies of scale, in overall or part of production process: e.g. cars. (Box 10.1)
- Also want to be close to largest market.
- This creates a cycle, with other companies and spin-offs following.
- Cost linkages (very complex supply chains now, especially say in car production).
- Firm has bigger pool of labour.
- Region not dependent on one industry.
- UK and France very concentrated, Germany and Spain more dispersed
- Dispersion forces also.
  - Land and labour prices (Dublin v Limerick)
  - less competition (for local services)

- congestion and commuting time
- technology (e.g. call centres) implies no need to be in specific location

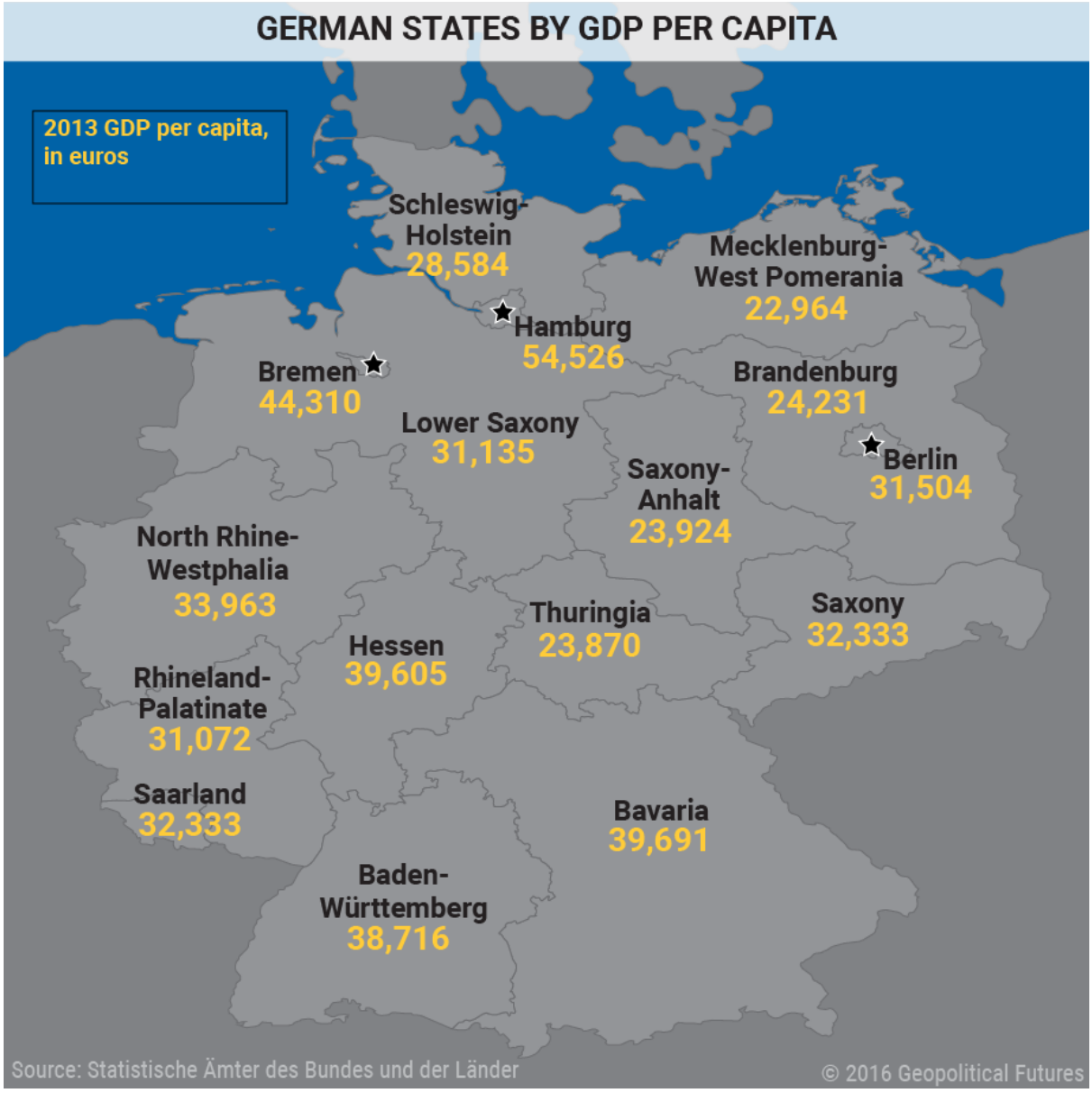
10.5 and 10.6 EU Regional Policy

Expenditure

- Nothing in early days: budget minor
- 1980s: accession of Greece, Spain and Portugal also SEA in 1986
- Monetary union: large increase in 'structural' funds to help periphery.

Instruments, Objectives, Principles

- New schemes for 2022-2029 not known yet
- Thematic objectives: A Europe closer to citizens; a greener Europe; a more innovative Europe; a more connected Europe; mobility; a more socially integrated Europe
- Convergence the key objective
- *Projects chosen at local level and co-financing exists*
- *Also additionality applies, i.e. would not happen otherwise*
- EU enlargement: Insiders v outsiders.
- Empirical Evidence.
- Problems within EU countries also, for example, Eastern and Western Germany


GERMAN STATES BY GDP PER CAPITA
2013 GDP per capita, in euros
Schleswig-Holstein 28,584
Mecklenburg-West Pomerania 22,964
Hamburg 54,526
Bremen 44,310
Brandenburg 24,231
Lower Saxony 31,135
Berlin 31,504
Saxony-Anhalt 23,924
North Rhine-Westphalia 33,963
Thuringia 23,870
Saxony 32,333
Hessen 39,605
Rhineland-Palatinate 31,072
Saarland 32,333
Bavaria 39,691
Baden-Württemberg 38,716
Source: Statistische Ämter des Bundes und der Länder
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