To remember from Michelle Turnovsky's lecture

QUESTION: WHY DID THESE COUNTRIES GIVE UP THEIRMONETARY SOVEREIGNTY

- Fixed exchange rates are positive for the economy

WHY? Speculation is minimized; trade is less risky and easier.

- Harmonizing and curbing inflation is essential for fixed exchange rates and the Euro

WHY? Huge disparities in prizes lead to trade imbalances and increase economic rifts.

To remember from Michelle Turnovsky's lecture - 2 -

- EURO member states, by agreeing to curb inflation (via the Maastricht criteria), give up the possibility to increase government spending in recession times or to counteract unemployment.

WHY? Inflation and unemployment are inversely related.

Example: 9/2006 inflation rate EU 1.7% US 3.8%

unemployment EU 8.5% US 4.7%

2010/4: US inflation 0.9%

unemployment 9.5%

Turnovsky-3

- EMS members lose sovereignty in domestic monetary policies
- EMU entails common: ECB, monetary policy, currency, macroeconomic policy
- Right now: 16 EMU members and 22 countries using the EURO
- EURO is good because
- Lower transaction costs and reduced speculation
- Greater market transparency and efficiency
- Used in 15% of world economy, carrying out 20% of world trade

EUROPE TODAY

EURO 301

Maastricht Criteria

word of the week

Maastricht criteria

- Inflation should not be higher than 1.5% above the average of the 3 countries with the lowest rates.
- Interest rates should not be higher than 2% above the 3 countries with the lowest rates.
- Budget deficit should be less than 3% of GDP.

⇒Maastricht as a means to tighten commitment to EMU

⇒Intergovernmentalist vs. neofunctionalist explanations

The Stability and Growth Pact

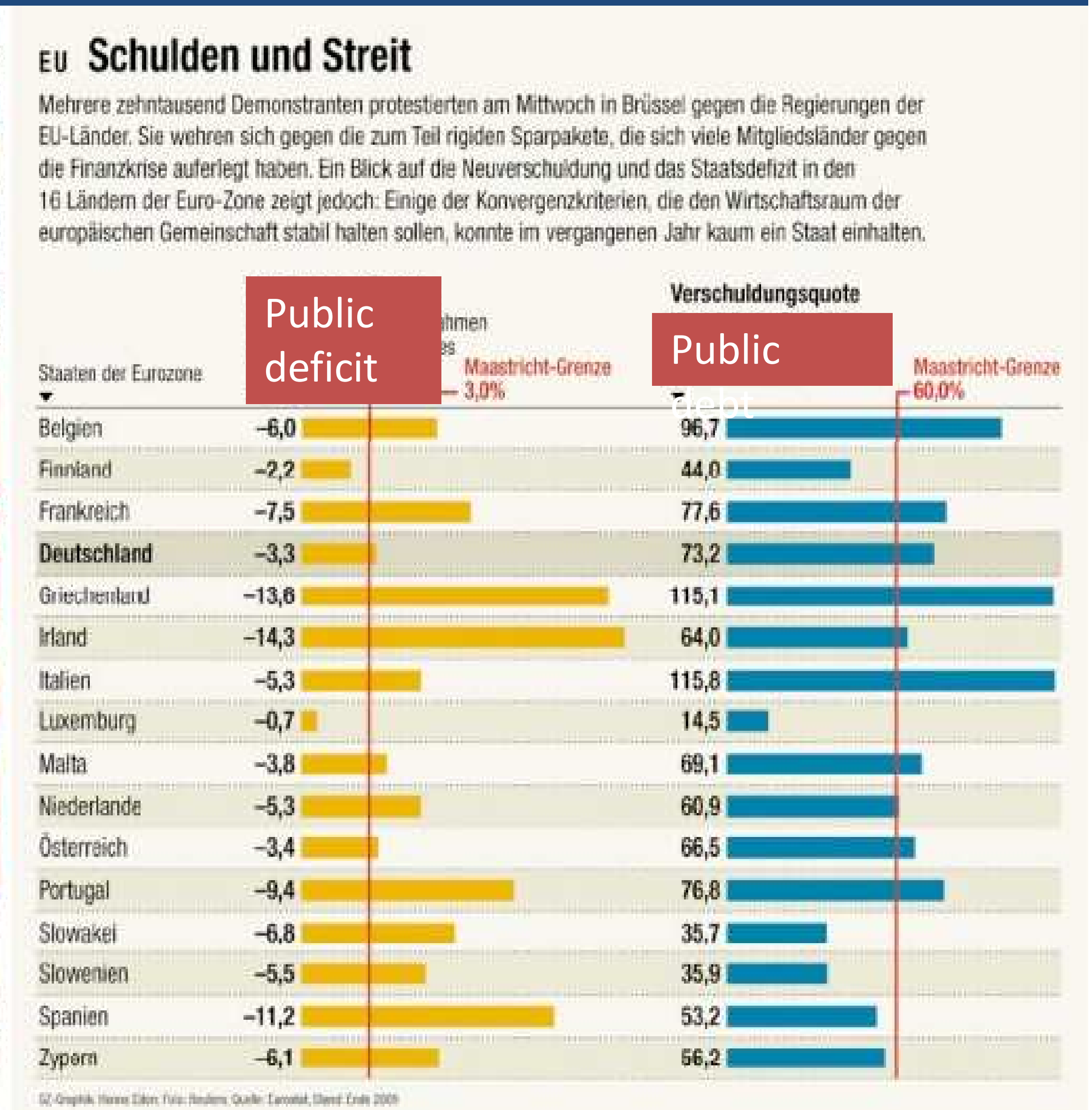
- Signed 1997, demand from Germany
- 2008-10: Gov’t deficit and debt crisis in PIIGGS countries

$\Rightarrow$Council threatens fines of 0.2% of GDP.

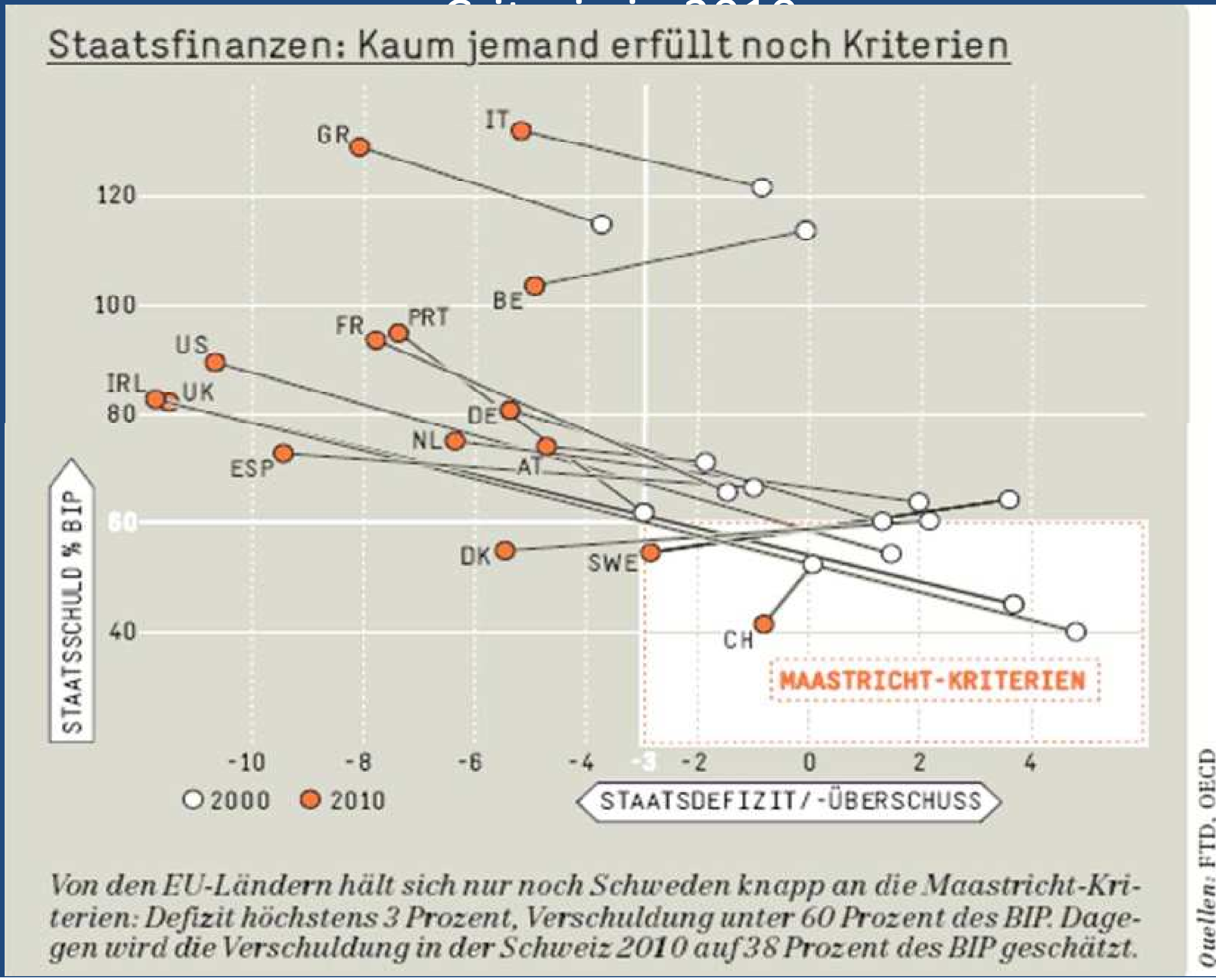
$\Rightarrow$Pact will be revamped to account for special circumstances (recessions etc.)

$\Rightarrow$BUT: this past week (10/2010), F and G proposed severe punishments for failing to comply with SGP: loss of voting rights

Who fulfills Maastricht Criteria in 2009?



State finances: Hardly anybody fulfills Maastricht Criteria in 2010



What about major accession states?

Maastrich Criteria table the story december 2009

	2001	2002	2003	2004	2005	2006	2007	2008	2009F	2010F
Czech Republic										
10Y gov yield	6,3	4,9	4,1	4,8	3,5	3,8	4,3	4,6	4,1	n/a
General government deficit/GDP	-5,6	-6,8	-6,6	-3,0	-3,6	-2,6	-0,7	-2,1	-5,7	-5,6
Inflation (HICP)	4,5	1,4	-0,1	2,6	1,6	2,1	3,0	6,3	1,0	1,6
General government gross debt/GDP	24,9	28,2	29,8	30,1	29,7	29,4	29,0	30,0	37,0	n/a
Hungary										
10Y gov yield	8,0	7,1	6,8	8,2	6,6	7,1	6,7	8,2	7,4	n/a
General government deficit/GDP	-4,0	-8,9	-7,2	-6,4	-7,9	-9,3	-5,0	-3,8	-4,0	-3,9
Inflation (HICP)	9,1	5,2	4,7	6,8	3,5	4,0	7,9	6,0	4,2	0,7
General government gross debt/GDP	52,0	55,6	58,4	59,1	61,8	65,5	65,9	72,9	78,4	n/a
Poland										
10Y gov yield	10,7	7,4	5,8	6,9	5,2	5,2	5,5	6,1	6,2	n/a
General government deficit/GDP	-5,1	-5,0	-6,3	-5,7	-4,1	-3,6	-1,9	-3,5	-5,5	-5,8
Inflation (HICP)	5,3	1,9	0,7	3,6	2,2	1,3	2,6	4,2	3,5	2,4
General government gross debt/GDP	37,3	42,2	47,1	45,7	47,1	47,7	45,0	47,2	52,8	n/a
Reference rates										
10Y gov yield	5,9	6,9	6,1	6,3	5,4	6,5	6,4	6,6	5,9	5,2
General government deficit/GDP	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0
Inflation (HICP)	3,1	2,6	2,7	2,2	2,5	2,9	2,8	4,1	3,9	3,3
General government gross debt/GDP	60,0	60,0	60,0	60,0	60,0	60,0	60,0	60,0	60,0	60,0

Fulfilled   Non fulfilled

Source: Eurostat, Consensus Economics, Capital Economics

EUROPE TODAY
EURO 301

- EURO

An economic and cultural success story

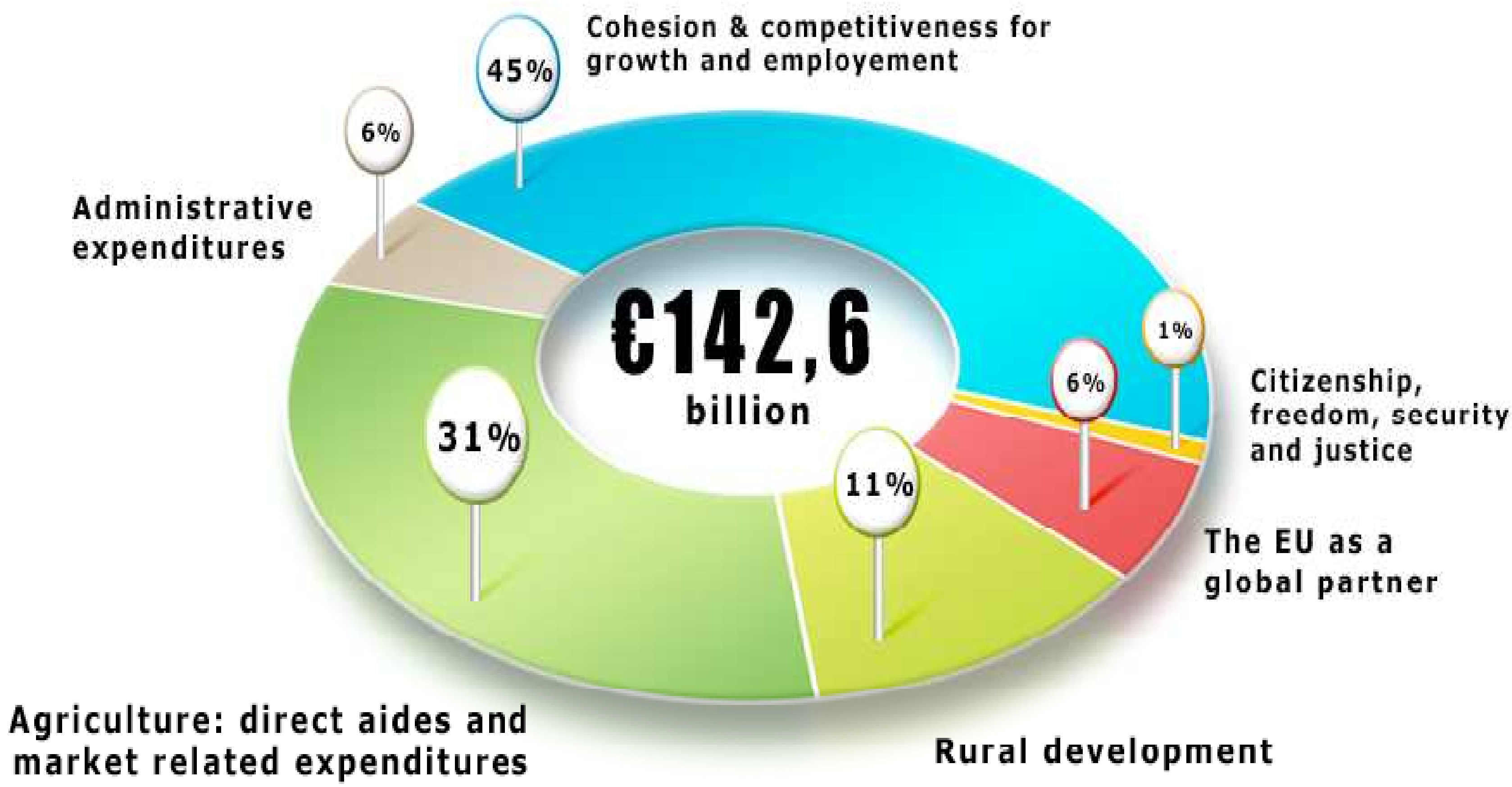
Third largest international trading currency (with $ and Yen)

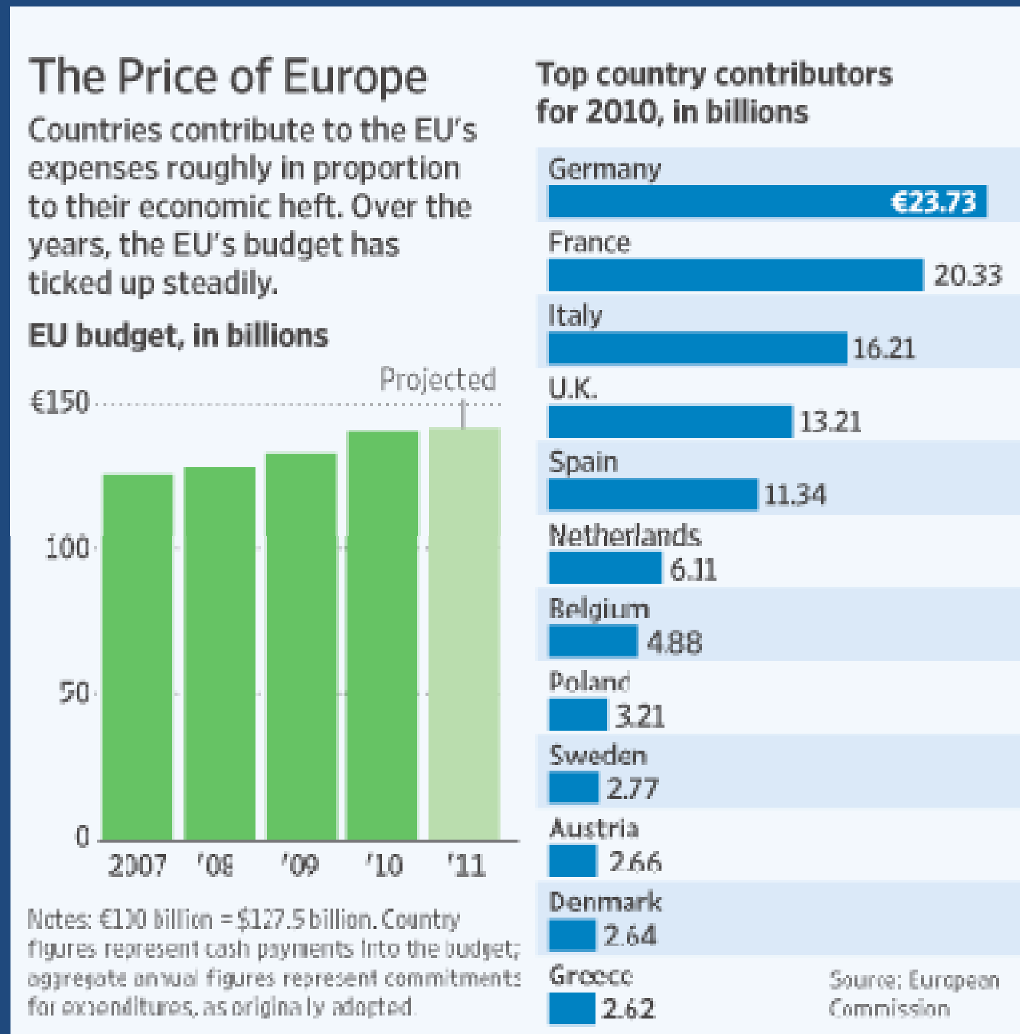
Culturally accepted and valued

European Economic Policies

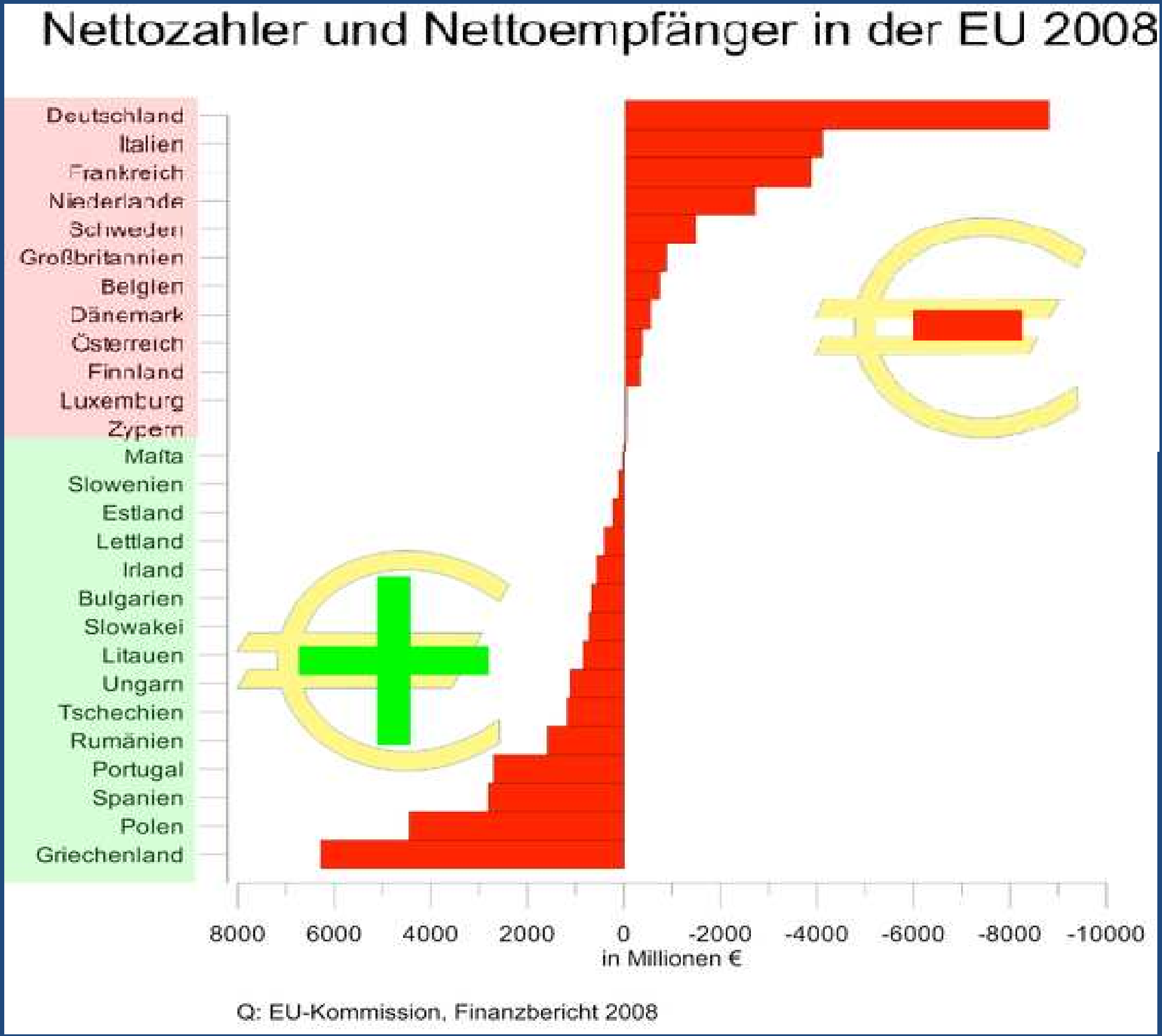
The CAP

WHAT POLICIES?




The Price of Europe
Countries contribute to the EU's expenses roughly in proportion to their economic heft. Over the years, the EU's budget has ticked up steadily.
EU budget, in billions
Projected
€150
100
50
0
2007
'08
'09
'10
'11
Notes: €100 billion = $127.5 billion. Country figures represent cash payments into the budget; aggregate annual figures represent commitments for expenditures, as originally adopted.
Top country contributors for 2010, in billions
Germany
€23.73
France
20.33
Italy
16.21
U.K.
13.21
Spain
11.34
Netherlands
6.11
Belgium
4.88
Poland
3.21
Sweden
2.77
Austria
2.66
Denmark
2.64
Greece
2.62
Source: European Commission

WHO PAYS?


Nettozahler und Nettoempfänger in der EU 2008
Deutschland
Italien
Frankreich
Niederlande
Schweden
Großbritannien
Belgien
Dänemark
Österreich
Finnland
Luxemburg
Zypern
Malta
Slowenien
Estland
Lettland
Irland
Bulgarien
Slowakei
Litauen
Ungarn
Tschechien
Rumänien
Portugal
Spanien
Polen
Griechenland
8000
6000
4000
2000
0
-2000
-4000
-6000
-8000
-10000
in Millionen €
Q: EU-Kommission, Finanzbericht 2008

Common Agriculture Policy (CAP)

it’s all about food…

Introduced in 1962

Aims:

- Ensure European’s food supply
- Ensure fair consumer prizes
- Ensure income stability for farmers
- Origin: WWII
- Protectionist policies required

How does CAP work?

- Taking produce off the market into storage
- Income support for farmers
- Subsidies - guaranteeing a minimum prize
- Import restrictions (Tariffs and quotas)

- Problems with CAP:

✓ Storage costs and inefficiency (“butter mountains”)

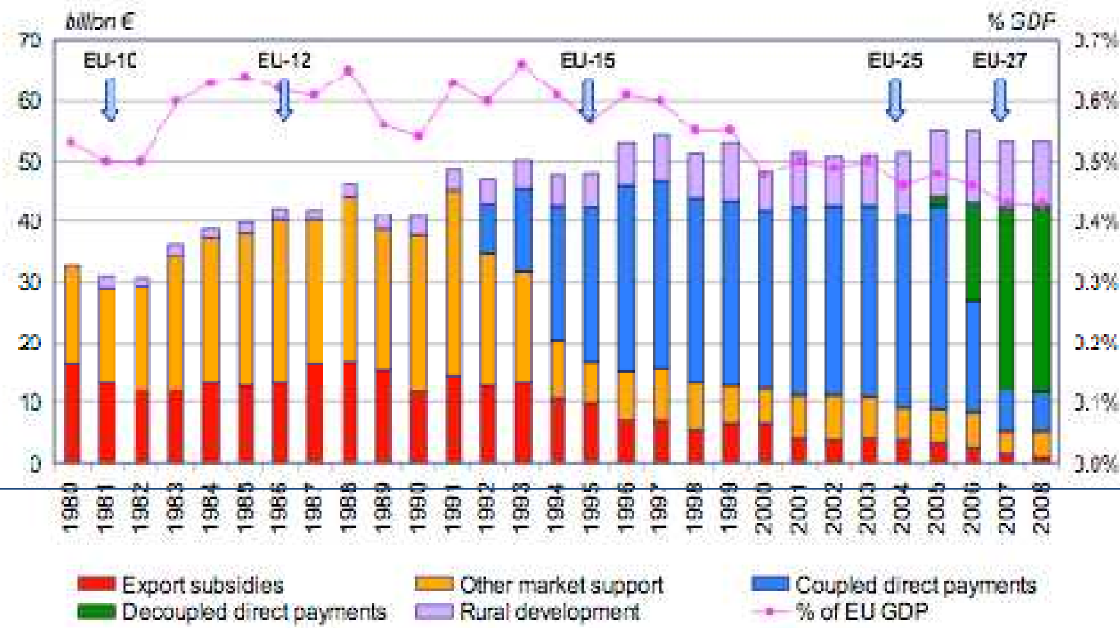
✓ Less incentive for farmers to adapt production

✓ Distortion of world market

CAP Reforms 1992, 1999, 2003

- 1992: From product subsidy to stronger direct income subsidy => direct compensation for prize cuts
- 1999: Supporting environmentally beneficial farming => compensation tied to animal welfare, hygiene standards, protection of rural environment; participation of environmental groups
- 2003: pre-accession ‘multifunctionality’ approach. DECOUPLED PAYMENTS plus RURAL DEVELOPMENT POLICY
- UNRESOLVED CONFLICT: FREE TRADE VS. PROTECTION AND SELF SUFFICIENCY.

CAP expenditure and CAP reform path
(2007 constant prices)



This graph shows **how the CAP has evolved through the evolution of the CAP expenditure**:

- **In the 80s the expenditure was mainly due to price support through market mechanisms** (intervention and export subsidies) which raised by the end of this decade due to the agricultural surpluses.
- **In 1992** there is the first big shift, due to the 1992 reform. **The market mechanisms** (in red and yellow) **were reduced and replaced by direct payments** (in blue). Thus price support is replaced by producer support. Finally, **spending on rural development measures also increased** (in purple).
- **In 2003**, one can see the impacts of the 2003 reform, with **direct payments shifting to decoupled payments** (green). Payments are no longer paid per ha or per animal but paid in function of what the farmer received in a reference period. **Spending in rural development is again reinforced** in this reform.
- **Spending has been stabilized** and despite the successive enlargements, **the overall spending as a share of the GDP has actually decreased**: 0.5% of GDP in the 80s to 0.4% now (graphic line).

Sources: CAP expenditure – European Commission, DG Agriculture and Rural Development (Financial Reports); GDP – Eurostat.

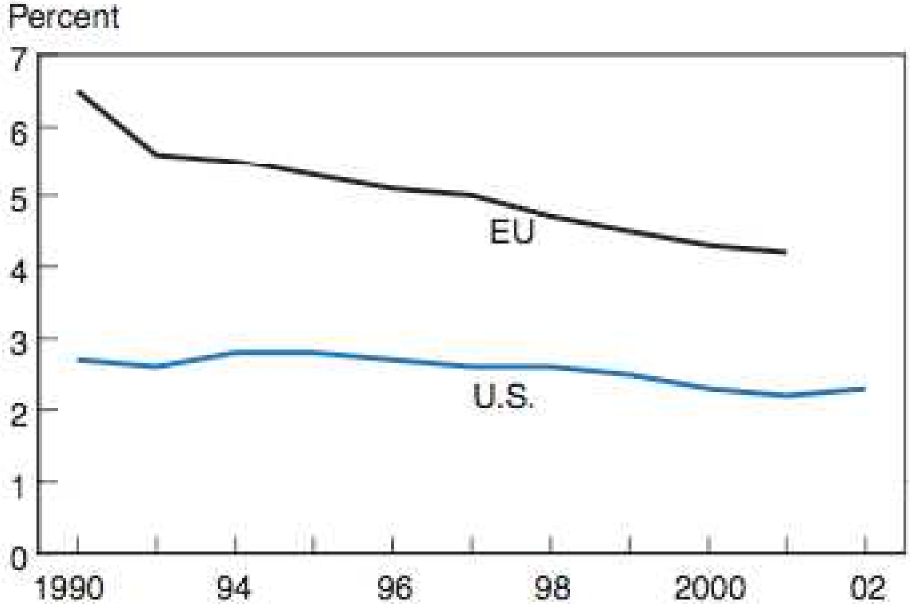
Annual expenditure, in 2007 constant prices.

Updated: 20.1.2010

Comparing farming in US and EU

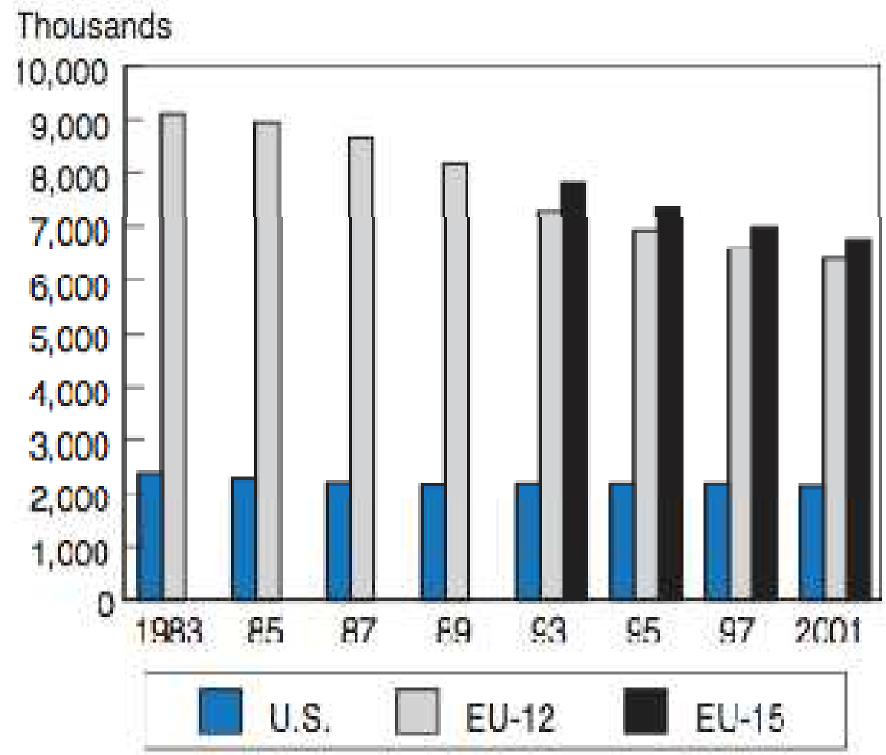
2007: EU 27: 14478 farms in the EU

Agricultural employment as a percentage of civilian labor force



Source: U.S. Department of Labor, Bureau of Labor Statistics; European Commission.

Farm numbers, U.S. and EU



Pros and Cons

- Self sufficiency
- Job protection
- Focus on smaller farms and regional produce
- Positive environmental impact
- Public steering capacity: Examples: Organic produce, genetically modified food.

- Higher domestic prizes
- Consolidated market
- Historically a closed shop for development countries

Who has driven agriculture policies?

- FR and G in the Council of Ministers?
- The European Commission?
- Interest groups/farmer lobbyists?

- => conflicts between supranational and intergovernmental interests