

“Nous Choisissons L’Europe”: EU’s Economic Development and Current Challenges



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1 Introduction

Undoubtedly, the EU is at a new crossroads. Although reform is inevitable, the way to be chosen is still under scrutiny. The Union’s reform scenarios, advanced by the European Commission in March 2017, indicate the existence of at least five possible directions of evolution by 2015: maintain the current situation (**scenario 1: Carrying on**); returning to a previous integration stage (scenario 2: Nothing but the single market); improve the current situation and deepen the integration process (scenario 5: Doing much more together); or initiate radical changes in the functioning of the EU (scenario 3: Those who want more do more and scenario 4: Doing less more efficiently). Each of these five scenarios emphasizes the need for urgent reform of the EU institutions and policies and the inevitable impact of reforms (and Brexit) on the next EU budget.¹

Whatever EU institution and policy reform solutions are chosen, the urgency to reform the EU as a whole has left the European economy with little room to

Bruno Le Maire, French Minister of Economics, public interview 05.10.2017, <http://www.parismatch.com/Actu/Politique/Bruno-Le-maire-Nous-choisissons-l-Europe-contre-la-Chine-et-les-Etats-Unis-1363628>, last accessed 27.01.2018.

¹European Commission, White Paper on the future of Europe. Reflections and scenarios for the EU27 by 2025, available on https://ec.europa.eu/commission/sites/beta-political/files/white_paper_on_the_future_of_europe_en.pdf, last accessed 31.01.18.

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manoeuvre. Although, according to the Autumn 2017 Economic Forecast, the EU economic recovery, supported by resilient private consumption, stronger global growth and falling unemployment recorded the fastest pace in the last decade (2.3% in the EU and 2.2% in euro area) and predicted trends are also favourable (a trend that is expected to continue in the next years in both the euro area and the EU (2.1% in 2018 and 1.9% in 2019)), internal and external risks could affect the pace of EU economic growth in the short and medium-term. Primarily, internal risks are related to the outcome of the Brexit negotiations, the evolution of public finance and populist movements in different EU member states, while the main external risks are linked to the new geopolitical tensions (from the Middle East to North Korea), the extension of protectionist measures (see, among others, some of Donald Trump's latest declarations) and, last but not least, significant economic adjustments in China.

In fact, on the global market, the EU position appears to be increasingly fragile and exposed to multiple risks. Thus, the EU's share in the global GDP is rapidly shrinking, from 31.4% in 2004 to 23.8% in 2014, while the United States has moved from 28.1% to 22.2%. Meanwhile, the Chinese share of world GDP has risen very rapidly: from 4.5% to 13.4%, moving ahead of Japan (5.9% in 2014).² The same evolutions are evident in terms of international trade, where China's share in global exports has risen from 3.1% in 2000 to 13.6% in 2016.³ Moreover, as Glenn and Sweeney noticed, China's share in global exports is "the highest share any country has enjoyed since the United States in 1968",⁴ a success that contradicts the "widespread predictions that rising costs for Chinese labour and a currency that has increased nearly 20% against the dollar in the last decade would cause China to lose market share to cheaper competitors". *The Economist* (2017), analysing China's position on international competition, notices that though this country is not the first in the process of industrialisation, "none has ever made the leap so rapidly and on such a monumental scale". While a "decade ago Chinese boom towns churned out zips, socks and cigarette lighters (...), today the country is at the global frontier of new technology in everything from mobile payments to driverless cars".⁵

Since China's rapid growth has changed both the global rules of the game and recalibrated the position of developed and developing countries on the international market, and internally the economic crisis has profoundly affected the EU growth engines, the only realistic option for the EU is to rethink its model of development

²Eurostat, The EU in the world: economy and finance, http://ec.europa.eu/eurostat/statistics-explained/index.php/The_EU_in_the_world_-_economy_and_finance, last accessed 31.01.18.

³World Trade Organisation (WTO), Annual Report, 2001, p. 20, https://www.wto.org/english/res_e/booksp_e/anrep_e/wto_anrep01_e.pdf, World Trade Organisation (WTO), Annual Report, 2017, https://www.wto.org/english/res_e/booksp_e/anrep_e/anrep17_e.pdf, last accessed 31.01.18.

⁴Elias Glenn, Pete Sweeney, China seizes biggest share of global exports in almost 50 years, Reuters, Business News, April 22, 2016, <https://www.reuters.com/article/us-china-exports/china-seizes-biggest-share-of-global-exports-in-almost-50-years-idUSKCN0XJ097>, last accessed 31.01.18.

⁵*The Economist*, How China is battling ever more intensely in world markets. But does it play fair?, 23 September 2017, <https://www.economist.com/news/leaders/21729430-does-it-play-fair-how-china-battling-ever-more-intensely-world-markets>, last accessed 31.01.18.

and reform its policies and institutions by deepening the interdependencies among member states. The EU 4.0 revolution is not only a possible option but a mandatory choice.

2 Economic Survival Strategies for EUROPE 4.0

2.1 *Crisis Hits: First Aid Kit*

The economic crisis that started at the end of 2007 in the USA and the beginning of 2008 in the EU had by all accounts a different impact on the two regions. This can be easily explained by the different governing structure. The US government was able to take political action swiftly to deal with the aftermath of the financial bubble, while the hybrid political ecosystem of the EU had to deal with numerous tensions between the diverging interests of the member states. While periphery states such as Greece, Italy and Portugal preferred to manage the economic crisis from a social economic model targeting record high unemployment, the wealthy core of the Eurozone (e.g. Germany, the UK) opted for austerity measures as the prescribed solution to curb governmental debt. In contrast, the United States opted for “quantitative easing” measures that essentially meant printing more money, but they also helped the housing market to recover⁶ as well as keeping unemployment at bay. The deficit problems may be solved by the Eurozone’s approach to the crisis but the long-term damage of extremely high youth unemployment (up to 50% in some periphery countries) and growing inequalities⁷ is not being addressed. In this context, the positive effects of economic growth might no longer be distributed to all European citizens.

A European Central Bank assessment after the financial crisis warned that “the global economy continues to be exposed to the risk of a creeping return of trade protectionism”, and as Georgiadis and Gräß found, countries “pursue more trade-restrictive policies when they experience recessions and/or when their competitiveness deteriorates” (2016, p. 1). Knetter and Prusa (2003), Bown (2008) and Bown and Crowley (2013) all point to the negative correlation between losses in competitiveness or economic decline and the likelihood of a country adopting anti-dumping measures.

Most evaluations of losses in competitiveness or economic slowdown take into consideration the real exchange rates. This is a useful methodological approach for large N datasets but we can equally assess the decline of competitiveness at case

⁶Mark Weisbrot, Why has Europe’s economy done worse than the US?, 16 January 2014, <https://www.theguardian.com/commentisfree/2014/jan/16/why-the-european-economy-is-worse>, last accessed 10.02.2018.

⁷European Commission. Competitiveness in low-income and low-growth regions: The lagging regions report. 10 April 2017. http://ec.europa.eu/regional_policy/sources/docgener/studies/pdf/lagging_regions%20report_en.pdf, last accessed 10.02.2018.

study level through various changes in the performance of economic agents. As the global financial crisis swept across the Western world, companies saw their profits diminish while governments resorted to austerity measures. Some authors have strongly critiqued the capacity of the austerity measures to reignite a growth tendency in the economy, amongst whom the strongest has been Mark Blyth (2013). Even in the absence of austerity measure, the European Union has made a clear emphasis on downsizing inward protectionism such as state subsidies and state aid. In this context, we can see how large-scale producers in Europe are facing the double constraint of a declining consumption capacity in the domestic market and less state intervention in their favour.

The European Union was built on what was initially called the European Coal and Steel Community (ECSC), which was established upon the proposition of the French foreign minister Robert Schuman in 1951. Looking back on the industries that lay at the foundation of the EU, the context could not be more different. The Third Report on the State of the Energy Union⁸ stated clearly that the days of the coal industry are numbered as closure aids are granted to member states in the fast-paced transition process towards a clean energy economy. In contrast, the downturn of the steel industry is not yet a foregone conclusion.

According to official trade statistics, the top importers of iron and steel worldwide are Germany with \$23 bil., United States of America with \$22 bil., China with \$17 bil., Italy with \$14 bil., and South Korea with \$14 bil. Similarly, the top exporters of iron and steel worldwide are China with \$43 bil., Japan with \$24 mil., Germany with \$21 mil., South Korea with \$19 mil. and Russia with \$14 mil. Together, the EU market represents almost 40% of the worldwide imports or exports of iron and steel.

The steel industry is relevant on many accounts to the European economy. International trade revenues are only part of the story. Equally important is the scale of employment in this sector. Currently there are approximately 300,000 people in direct employment in steel refineries across member states, and one could expect a matching figure for those in dependent or indirect employment. It is true that the number of employees in this sector is significantly lower than a decade or two ago. The decrease of the number of employees however is not only related to a decrease in domestic consumption and delocalisation processes. Technological advances are one of the driving factors in the lowering levels of labour intensity in many industrial sectors, not just steel. Finally, the steel industry is relevant to the European economy not by itself but also because of its contribution to two of the most competitive sectors in the EU: the automotive and construction industries. Very early on, given the increased economic integration driven by WTO negotiations, the European Union placed its global competitiveness aspirations on the back of higher-value products and services, where it could retain an advantage in the face of emerging markets with larger economies of scale than its own.⁹

⁸European Commission (2017) Third Report on the State of the Energy Union, available at: https://ec.europa.eu/commission/publications/third-report-state-energy-union_en, last accessed 22.01.18.

⁹European Commission (2006) Global Europe: Competing in the World, A Contribution to the EU's Growth and Jobs Strategy. http://trade.ec.europa.eu/doclib/docs/2006/october/tradoc_130376.pdf

Protectionist measures nowadays take many forms so as to escape the commonly agreed upon liberalization framework. One form of defensive protectionist measures is the anti-dumping regulation aimed at addressing the unjust imbalances in the world trade. As such, the European Union and the United States have throughout 2017 seen a sustained campaign against the steel imports from China that many believe are sold at dumping prices. It is not hard to imagine that in the regulatory context in which the Chinese economic actors operate, the state-owned enterprises (SOEs) that are active in this sector benefit from state support in the form of subsidies or preferential interest loans. On this ground, the EU has imposed anti-dumping measures in this sector while the US is challenging the market economy status of China at WTO. These actions are consequential not only in terms of protecting a strategic economic sector but also in terms of the larger cooperation in trade liberalisation at the global level.

The multilateral system of cooperation that saw the inclusion of China in 2001 and Russia in 2012 in WTO seems to be counterbalanced by regional and bilateral approaches nowadays. In the aftermath of the financial crisis, the European Union has been much more successful in pushing through bilateral trade and investment partnerships with neighbours (e.g. Eastern Partnership countries—Ukraine, Georgia and the Republic of Moldova) and historical partners (e.g. Canada) than multilateral rounds of negotiations within the WTO format.

2.2 Lagging Behind in Consumption

The decline of the single market’s capacity is not solely based on economic cycles and recessions. Throughout the past decades, the population in the European Union member states has been recording a steady downward trend. For some countries, especially in Southern, Central and Eastern Europe, an important factor in the demographic decline is emigration. Eurostat data (2017) shows the migration patterns within the European Union begin from the crisis-affected countries in the South or the poorer regions in the East and head mainly towards Germany, which has been additionally targeted heavily by outside migrants. Still, across Europe, low birth rates are the primary causal factor of the population decline. Increases in life-expectancy have also increased the median age of the population, leading to what is frequently referred to as the “greying Europe”.

The “demography crisis” with the well-known ageing of the population is not only relevant from the perspective of the burden it applies on social security expenditures and, more specifically, pension funds (Vasile et al. 2012), it also has a profound impact on the relative positioning of the European economy as a whole from the perspective of the downsizing consumer market. In a recent study on this topic, a Romanian economist looks at the car sales data across the world as a proxy for middle-class purchasing capacity (Silva 2017). Based on the International Organization of Motor Vehicle Manufacturers (OICA) reports, the European Union has levelled at a total purchasing of approximately 15 mil. personal cars yearly—this has

been relatively constant across the past decade, with a slight decrease after the financial crisis of 2008. Similarly, the United States recorded approximately 11 mil. personal car sales in the past decade. In contrast, Asia reached approximately 40 mil. personal car sales, out of which approximately 25 mil. are sold only in China—recording a five-fold increase since 2005.

The sharp difference between the Western powers and Asian economies in the volume and historical trends of consumption is a sombre reminder that the economic growth of the European Union member states can only be achieved through innovative development strategies. According to the latest Global Competitiveness Report (2017–2018), EU economies have improved their innovation capacity over the past decade (especially Germany, Netherlands and Sweden), but as a whole still trails behind the United States, Japan and Israel.

For the European Union, consumption is an ambivalent point of reference. On one hand, much like in many developed economies across the world, household consumption represents an important driver of economic growth measured in gross domestic product (GDP) increases. In the EU, household consumption represents roughly 60% of GDP (almost three times higher than governmental consumption). Still, in the context of an cumulative effort of approx. 5 bil. EUR for the current financing period devoted to the transition to a clean and sustainable economy, we see consumption patterns coming under the scrutiny of these new environmental goals.¹⁰

2.3 *Economic Drivers*

A quarter of the European Union's trade with outside partners is realised by Germany alone (see Fig. 1). It has a positive trade balance, meaning that it exports more than it imports. It has seen a slight decrease over the past years, from a total exports annual value of \$1.4 bil. in 2012 to \$1.3 bil. in 2016. This however follows the overall trend of the main trade powers in the European Union: France, Italy, Netherlands, the United Kingdom and Belgium. All top traders in the European Union have been colonial powers, with the exception of Germany, which, incidentally or not, outperforms them by far. The status of former colonial powers is important even within the context of the European Union because the preferential trade relations with the former colonies (e.g. favourable tariffs on imported goods) were granted since the Treaty of Rome under French pressure and Belgium's and the Netherlands' support (Dinan 1999).

One of the main elements of the trade performance of Germany is its own market. As we can see from the two graphs showed above, while lower than its exports

¹⁰European Commission (2011) 571 final, Roadmap to a Resource Efficient Europe http://ec.europa.eu/environment/resource_efficiency/about/roadmap/index_en.htm; A /RES/66/28 (2012) UN General Assembly resolution 66/288, The future we want. http://www.un.org/en/development/desa/population/migration/generalassembly/docs/globalcompact/A_RES_66_288.pdf

EU Exports by country of origin, mil. \$

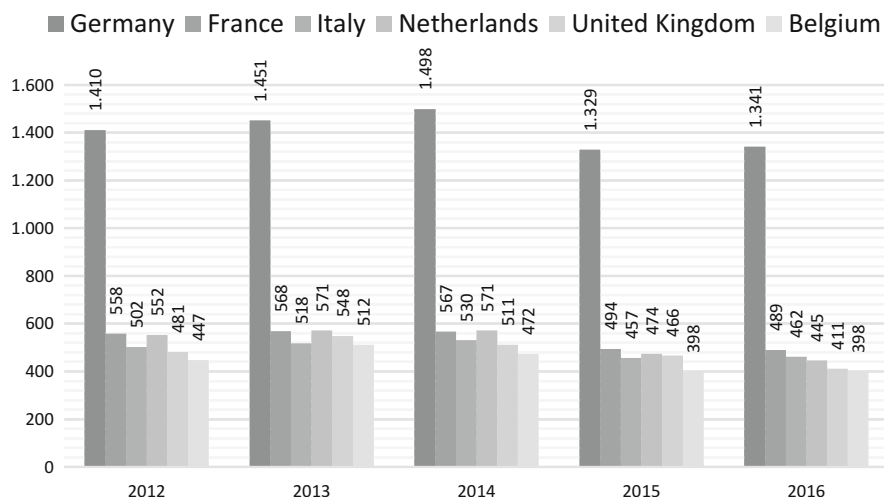


Fig. 1 EU exports by country of origin. *Source:* Adapted by the authors based on data from trademap.org

levels, German imports are still almost double the value of French imports, the second-ranked importer in the European Union (see Fig. 2). The relatively high purchasing power of private sector and household consumers in Germany is granted by a well-balanced developmental model, labelled as “social-market capitalism” (Gilpin 2001) or *soziale Marktwirtschaft*, that combines the free market principles with economic policies designed to support the general development of the economy (e.g. monetary, trade or fiscal). As a result, we can see that the German economy meets both social indicators that portray the general welfare of the population as well as competitiveness landmarks. It has some of the largest multinational companies in the world while also having a large and dynamic SMEs sector. Sustained economic growth in Germany is also maintained through technological innovation, having substantial public and private funding allocated in this direction, and high value-added products as a result.

The main economic products with which Germany dominates global markets are: vehicles other than railway or tramway rolling stock, and parts and accessories thereof—18% of world exports, largest exporter globally; machinery, mechanical appliances, nuclear reactors, boilers—12%, ranked second-largest exporter globally, pharmaceutical products—16% of world exports, largest exporter of this product globally, and other technological intensive products such as aircraft and electrical machinery.

Despite the current snapshot, the European top exporters are losing ground in sectors that are growing at global level. This is mostly due to the increasing competitiveness of multinational companies in emerging markets. As such, a series

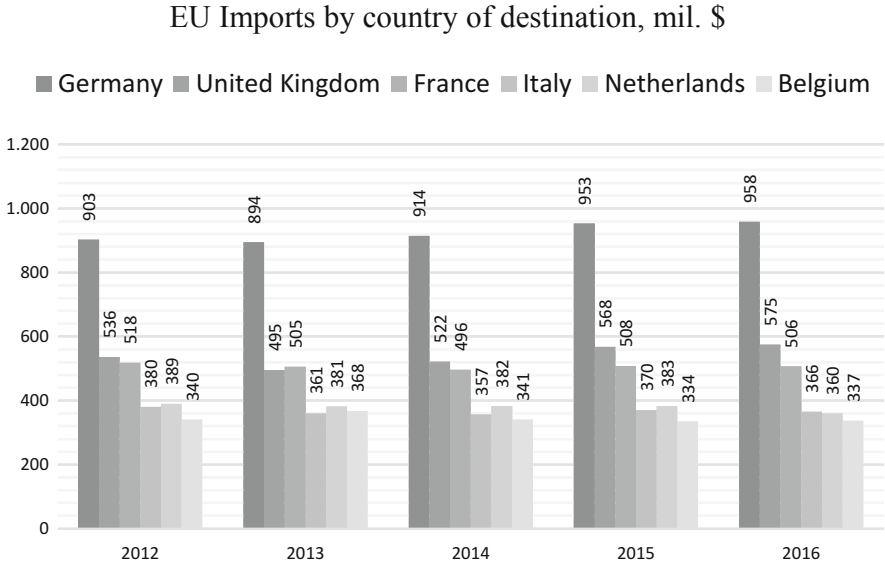


Fig. 2 EU imports by country of destination. *Source:* Adapted by the authors based on data from trademap.org

of reactions have been recorded recently in Western Europe. France, Germany and Italy presented a public letter in 2017 amid concerns over the size of Chinese investments in European state-owned enterprises (SOEs). They claimed that “a growing number of non-EU investors were buying up European technologies for the strategic interest of their home country”.¹¹ The large Chinese investment through its state-owned COSCO company in the Piraeus port of Greece last year is only part of a larger-scale investment plan across the EU and its Balkan periphery. In response, a series of mergers, acquisitions and “alliances” have been launched amongst Western European states to consolidate their European position. Saint-Nazaire has teamed up with the Italian Group Fincantieri and Alstom, the state-controlled producer of TGVs, has teamed up with the German company Siemens and they are reportedly on track to introducing autonomous trains on the market. The stated goal of this latter fusion is to “create a new European champion that is big enough to take over the world leader CRRC of China”.¹² As state participation in French companies is currently valued at over \$100 bil., we might expect future consolidation moves amongst the founding members of the European Union in the near future.

¹¹Le Guernigou, Yann; Thomas, Leigh. France, Germany, Italy urge rethink of foreign investment in EU. 14 February 2017, *Reuters*, <https://www.reuters.com/article/uk-eu-trade-france/france-germany-italy-urge-rethink-of-foreign-investment-in-eu-idUKKBN15T1ND?il=0>, last accessed 27.01.2018.

¹²EU signals big asset sales to greenlight Alstom-Siemens tie-up, *Financial Times*, 27 November 2018, <https://www.ft.com/content/a0383fae-f18f-11e8-9623-d7f9881e729f>, last accessed 27.11.18.

As we can see from the comparative figures on export competitiveness and relative growth, Eastern Europe and Central Asia are in a marked downturn compared to world export growth. In contrast, East Asia is performing above global growth trends (see Fig. 3). As the European Union is highly integrated through a common trade policy, the slowdown in parts of it can have widespread repercussions. The poor trade competitiveness of Eastern European markets as well as the Eastern Partnership countries with which it recently established Deep and Comprehensive Free Trade Areas (DCFTAs) (i.e. Moldova, Ukraine, Georgia) can be a significant challenge for sustainable growth. The EU’s engagement in increasingly bilateral trade relations with close historical or neighbouring partners (e.g. CETA—with Canada, TTIP—with the USA, DCFTA—with Eastern Partnership (EaP) countries) can be seen as a clear disengagement from multilateral trade integration efforts. Given the economic figures of export competitiveness compiled by the World

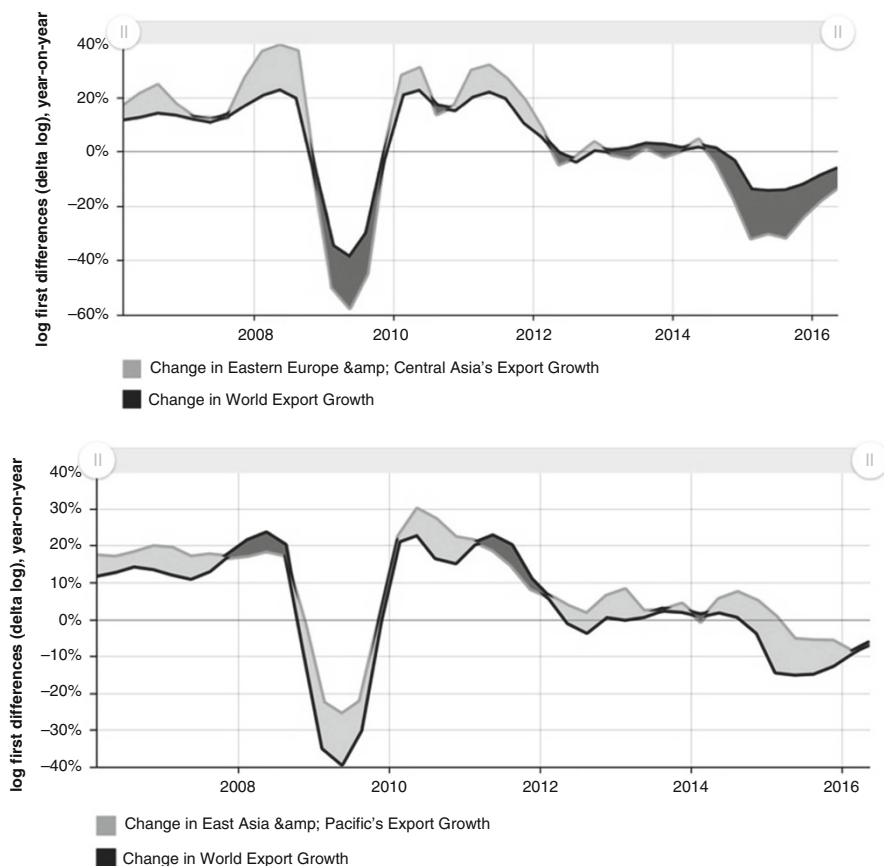


Fig. 3 World exports and change in export market share (region growth minus global growth). Source: World Bank, <https://mec.worldbank.org/export-growth/ECA>

Bank, the EU's detachment from other markets that are experiencing strong growth trends might be a vulnerability for the European economy in the long term.

Approximately 30 mil. persons are employed throughout the European Union in the manufacturing sector, which makes it responsible for 15% of total employment in the EU, and approximately EUR1700 bil. of value added annually. Nevertheless, in the majority of manufacturing sectors in which Europe is export-competitive the value-added is greater than the employment levels (e.g. manufacture of machinery and equipment, manufacture of motor vehicles, manufacture of electrical equipment, manufacture of chemicals and chemical products). Part of the downturn of Eastern European markets in export competitiveness can be explained by their lowering production in these higher value-added manufacturing sectors. Out of the top 10 - European manufacturing companies, 8 are German—3 are in the automotive industry, 2 in engineering, 1 in chemicals and 1 in aerospace and defense. While employment levels are high in such areas as the manufacture of textiles and furniture, their value added is much lower.

2.4 Trade Relations with Historical Partners: Implications for Brexit

The European Union is increasingly represented as a single unit, from statistical repositories (almost all relevant databases have a EU 28 category) to international trade deals. In recent transatlantic negotiations, such as the CETA and TTIP, the European Union was the counterpart given the exclusive competencies of the trade policy, but national and local interests differed significantly. The unitary approach of the EU in international economic affairs is not an easy feat. The subnational differences reflect the well-known challenges of multi-level governance (Hooghe and Marks 2001), the significant divides across European regions, as well as the political posturing that creates tensions in multi-level game diplomatic efforts (Putnam 1988). Amongst all of these structural challenges, we currently find the additional element of unsteadiness: the potential exit of Britain (i.e. Brexit) from the European Union.

As seen in the previous section of this contribution, the status of colonial powers and the worldwide coverage this implied correlates with modern-day economic trade performances. What is important beyond current economic ties is also the process through which the former metropolises have become detached from their periphery and embedded their power aspirations in the European Union. Some authors point to the sobering effect the Suez crisis had on the relative self-projections of European powers (Hansen 2002) as it was in this context that France really became committed to the European Community negotiations and the Treaty of Rome (Young 1996; Anderson 1997). Nevertheless, no European Empire was more focused on trade and economic relations between the centre and the periphery than the British Empire.

Before and after the Referendum in Britain on the question of its EU membership, the Commonwealth was largely referred to in public discourse as a substitute for the EU market. Called by many analysts the Empire 2.0 strategy, at the end of a dedicated Summit in 2017 on the trade relations between Britain and its former colonies, Patricia Scotland, the Commonwealth Secretary, stated: “Because we share common law, common language, common institutions and common parliamentary structures, that has given us a de facto advantage”.¹³

Over half of the United Kingdom’s imports came from the European Union over the past decade, but less than half of its exports go to the European Union in return. In contrast, less than a tenth of its trade is engaged with the 49 Commonwealth markets that do not belong to the European Union (i.e. Cyprus and Malta). Overall, the value of the trade between the United Kingdom and its former colonies represents only 16% of the value of the trade between the United Kingdom and other member states. One of the reasons the trade potential with the Commonwealth states is so overrated is that there are some very large markets in this set of countries judging by population level. If we look at only the top 8 countries by population in the Commonwealth,¹⁴ we find a total of approximately 2 billion persons. In contrast, the entire European Union has only half a million people. Still, even though we can count Canada and Australia amongst the most developed nations, and some of the most dynamic emerging markets such as India and Singapore, the Commonwealth is largely comprised of small, poor states. The geographical distance between UK and them is an additional impediment for trade (Fig. 4).

Out of the total \$1.3 trillion global market, a fifth of worldwide exports of vehicles other than railway or tramway rolling stock, and parts and accessories thereof is done by Germany, followed by non-European economies such as Japan, the United States of America, Mexico, Canada and South Korea. Germany exported a total value of \$235 bil. worth of vehicles worldwide in 2016, out of which it exports between \$62 and 66 bil. annual value of this product to the United Kingdom alone.

3 Perspectives

European member states can no longer be relevant international actors by themselves. Their strength and developmental perspectives are intrinsically linked to each other. As the political turmoil spreads from one country to another, taking various shapes and arguments, the economic reasoning behind the existence of the European Union is clearer than ever. Evidently, when we analyse trade data we can

¹³Roberts, Dan. Drive to replace UK-EU trade links with closer ties to Commonwealth. 10 March 2017, The Guardian <https://www.theguardian.com/global-development/2017/mar/10/drive-to-replace-eu-trade-links-with-closer-ties-to-commonwealth-economies>, last accessed 27.01. 2018.

¹⁴India, Pakistan, Nigeria, Bangladesh, South Africa, Canada, Ghana and Australia.

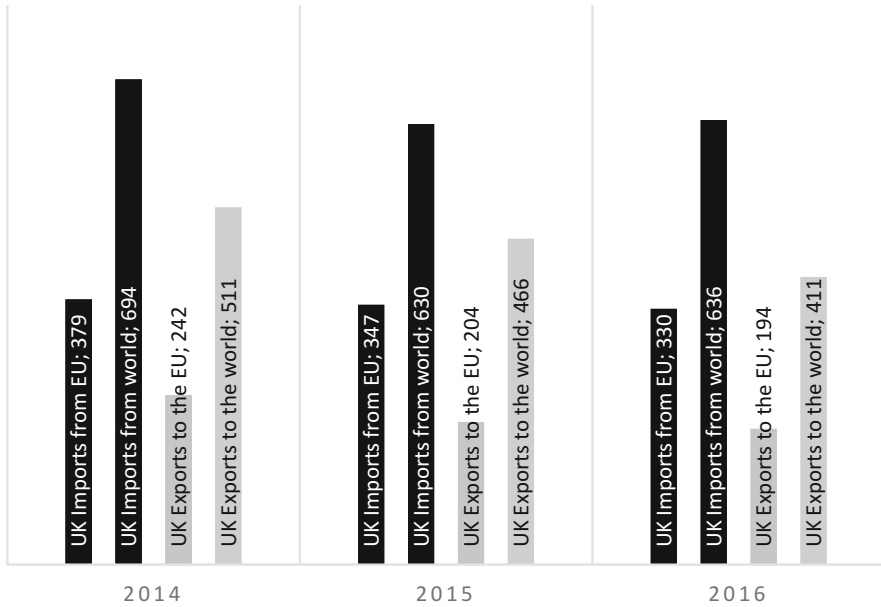


Fig. 4 UK trade balance

clearly see that the sum of the parts is not the same as the single market itself. The existence of a large “internal market” constitutes a significant advantage, even to a large market like Germany. However, it is clear that not even Germany, the “trade champion” of the European Union, can afford to rely solely on the internal market consumption. Asian markets are growing at a much faster pace than European ones, driven primarily by the larger consumption patterns based on population figures. With a sharply declining population in many European member states, the gains of the single market in trade will become smaller and smaller.

As this chapter points out, there are no value-similar alternatives to the European Union for Western powers. At the beginning of the integration process, the historical peripheries of the colonial power still played a somewhat important role in their trade and development, which is why preferential relations were established from the very beginning with these states. However, as the globalization process progressed and the single market developed, the value of intra-EU trade relations and extra-EU trade relations is incomparable. Taking the Brexit context as a test case, we compared the United Kingdom’s trade relations with EU member states and Commonwealth partners. Despite public rhetoric and political discourse, the evidence is clear: the latter is less than a fifth of the first. As such, any decision to cut away or distance itself in any way from the EU core would only involve a significant risk to the economic growth of any European country.

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