# EU Political Economy Newsletter

Newsletter of the EUSA EU Political Economy Interest Section
http://www.eustudies.org/pesection.html

*The EU Political Economy Interest Section is an official section of the* ***European Union Studies Association***

Section co-chairs: Tal Sadeh and David Howarth
Managing Editor: Mitchell P. Smith
Database Review Editor: Patrick Leblond
Forum Editor: Dermot Hodson

Issue 9 Fall 2007

**Greetings from the co-chairs of the EUSA Political Economy section:**

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Dear Section Members,

The EUSA tenth biennial meeting in Montreal last May was a great success and a chance for many of us to get together. As EUSA's most active, the Political Economy Interest Section was well represented in the program with many participants, and organized panels on issues such as the Stability and Growth Pact, EU trade policy and EU macroeconomic governance.

Approximately 30 people attended the section's business meeting (roughly the same number as in the Austin 2005 meeting). The meeting was chaired by David (Tal was unable to attend) who circulated the agenda to all section members the week prior to the conference. Section members were invited to volunteer to assume section positions including the co-chairs. However, in the tradition established by the previous co-chairs of the section it was preferred that the co-chairs serve for a four year term for the sake of greater continuity in section leadership. The co-chairs were duly reelected in the meeting.

David also relaunched the appeal for possible candidates to fill positions in the section's steering committee (newsletter editorial board, EUSA forum editor, and website editor), but most of the committee's members were reelected. Indeed, the members present expressed their great satisfaction with the operation of the section. The newsletter in particular was seen to be a very useful mechanism for allowing members to share ideas with others and keep their colleagues informed of their publications and related accomplishments. Stefanie Walter (of the Center of Comparative and International Studies at the Swiss Federal Institute of Technology Zurich) later agreed to become our new website editor. Please let us know if anyone of you is also interested in this position. We thank Jim Angresano for his efforts on this issue in the past two years. Members are again encouraged to suggest ways to develop the interest section's website.

Another important item on the meeting's agenda was an overview of the progress achieved on the Section's current publication project on *Economic Interests and European Integration* (see previous issues of the newsletter). Following the workshop in Edinburgh in April 2006 final drafts were submitted for review by up to four referees. Our section sponsored two panels at the Montreal Conference that drew on papers from this project. Six of the contributions have later been accepted for publication after further revisions in a special edition of the *British Journal of Politics and International Relations* (BJPIR) to appear in January 2008. BJPIR is circulated to all members of the *British Political Studies Association* and thus has a potentially large readership. These articles and additional pieces will then be published as a longer edited volume.

At our meeting we also launched a new project on *Completing the Single Market*. The objective of this project is to provide an opportunity for section members to participate in a collective endeavour, network with other members and produce a high quality journal publication on an important theme. Although we have already received numerous high quality proposals, we have decided to extend the deadline for submissions with the aim of attracting additional contributions **in particular from younger section members**. We will provide updates about this project in the next issues of the newsletter. A call for papers is posted on our website.

Another new call for papers is for a conference on *The Political Economy of Monetary Anchors*, next May in Jerusalem. This conference, organized by Tal, has so far attracted some of the world's leading lights on the subject (see list in the call), and a substantial part of it is expected to be devoted to EMU and European monetary integration. Don't miss it!

There are other ongoing projects, organized by the section's members. One of these projects is on *Europe's Expanding Currency: Fiscal Stability and Democratic Legitimacy* (earlier called *The Emerging Political Economy of Europe's Monetary Union*) and is co-organized by Erik Jones, Amy Verdun and Tal Sadeh (see previous issue of the newsletter). Six of this project's papers have been accepted for a special issue in *Review of International Political Economy* (RIPE) to appear in December 2007. Amy Verdun and Henrik Enderlein are also organizing a project on *EMU after 10 years: What have we learned in Political Science?* which will be published as a special edition of the *Journal of European Public Policy*. Having circulated a call for papers last May, they will soon notify selected authors. Please let us know of any other projects on which you are working.

With all this activity going on we feel proud of the section and its members. We want to thank you all for your trust and cooperation, and look forward to another exciting two years as co-chairs. Cheers!

David and Tal

**Also in this issue**

## Data Resources Review

# Economic Freedom

Patrick Leblond
HEC Montreal

In early September, Canada's Fraser Institute (FI) released the 2007 edition of *Economic Freedom of the World*, with data covering the year 2005 (http://www.freetheworld.com/). This annual report, which was originally under the leadership of Milton and Rose Friedman and Michael Walker, is now in its eleventh year. Its goal is to measure individuals' economic freedom in a given country in "an accurate, comprehensive, and objective manner." Similarly, Washington's Heritage Foundation (HF) and the Wall Street Journal (WSJ) published their *2007 Index of Economic Freedom* in early 2007, with the objective of developing a "systematic, empirical measurement of economic freedom in countries throughout the world" (http://www.heritage.org/research/features/index/). The first edition of this annual report was made available in 1995.

These two competing annual reports aim to measure the same thing: economic freedom. The Heritage Foundation defines economic freedom as the "part of freedom that is concerned with the material autonomy of the individual in relation to the state and other organized groups. An individual is economically free who can fully control his or her labor and property" (Beach and Kane 2007, 37). For its part, the Fraser Institute uses the following definition: "Individuals have economic freedom when property they acquire without the use of force, fraud, or theft is protected from physical invasions by others and they are free to use, exchange, or give their property as long as their actions do not violate the identical rights of others" (Gartney *et al.* 1996).

The idea behind measuring economic freedom is that for individuals and countries to prosper economically, they need to be free to "work, produce, consume, and invest in any way they please, and that freedom is both protected by the state and unconstrained by the state" (Beach and Kane 2007, 38). In order to test this belief empirically, an objective and valid measure of economic freedom was necessary. This is why these two indices were created. It is also why both annual reports provide graphs that show the correlation between economic freedom and economic growth as well as prosperity or socioeconomic development (e.g., as measured by GDP per capita). In addition, the Fraser Institute provides a list of articles and papers (dating back to 1994) that use its index of economic freedom for various types of analysis http://www.freetheworld.com/papers.html.

European countries are amongst the most economically free in the world. According to the HF/WSJ index, 12 of the top 20 freest countries hail from Europe, while almost half of the top 50 consists of European countries (24). This index covers a total of 157 countries. Europe's representation in the FI index (which covers 141 countries) is similar, with 11 countries making it into the top 20 and 22 into the top 50. See the table below for the list of European countries making into the top 50 of each index of economic freedom.:

| **HF/WSJ Index** *(Overall rank in brackets)* | **FI Index** *(Overall rank in brackets)* |
|---|---|
| United Kingdom (6) | Switzerland (4) |
| Ireland (7) | United Kingdom (5) |
| Luxembourg (8) | Estonia (8) |
| Switzerland (9) | Ireland (9) |
| Estonia (12) | Finland (11) |
| Denmark (13) | Iceland (11) |
| Netherlands (14) | Denmark (15) |
| Iceland (15) | Netherlands (15) |
| Finland (16) | Germany (18) |
| Belgium (17) | Austria (18) |
| Germany (19) | Cyprus (22) |
| Cyprus (20) | Hungary (22) |
| Sweden (21) | Lithuania (22) |
| Lithuania (22) | Sweden (22) |
| Austria (25) | Latvia (22) |
| Spain (27) | Norway (22) |
| Norway (30) | Malta (32) |
| Czech Republic (31) | Slovak Republic (32) |
| Slovakia (40) | Belgium (38) |
| Latvia (41) | Portugal (38) |
| Malta (42) | Spain (44) |
| Portugal (43) | |
| Hungary (44) | |
| France (45) | |

From the table, we can see that ranking of European countries resemble each other but are not the same. This suggests that the indices are measured differently.

**Measuring Economic Freedom**

The indices measure economic freedom is a similar way. Both focus on the same areas that require measurement. They diverge in the specific factors they choose to measure as well as the data sources. For instance, The HF/WSJ index of economic freedom (IEF) is divided into ten freedoms, which themselves are often composites of more detailed components:

- Business freedom
- Trade freedom
- Fiscal freedom
- Freedom from government
- Monetary freedom
- Investment freedom
- Financial freedom
- Property rights
- Freedom from corruption
- Labour freedom

For its part, FI's Economic Freedom of the World (EFW) index is divided into five areas that correspond to the IEF's ten freedoms:

- Size of government: expenditures, taxes and enterprises
  - Fiscal freedom
  - Freedom from government
- Legal structure and security of property rights
  - Property rights
- Access to sound money
  - Monetary freedom
- Freedom to trade internationally
  - Trade freedom
  - Investment freedom
- Regulation of credit, labour and business
  - Financial freedom
  - Labour freedom
  - Business freedom
  - Freedom from corruption

There is no space here to compare each factor or freedom and their many components given that each index uses about 40 variables in total. They do vary enough from one another that any author using economic freedom(s) as an independent or dependent variable may want to use both indices and underlying databases in order to test for robustness. However, it is worth mentioning that both indices have a correlation coefficient of 0.89 for their latest measure (2007 report), which means that they measure economic freedom in a similar way, at least in the aggregate. The indices seek to measure the same thing, only in a different way; as such, one cannot be said to be better than the other.

Both indices rely on data available from the World Bank's *World Development Indicators* and *Doing Business*, the IMF's *International Finance Statistics* and *Government Finance Statistics*. The EFW index makes extensive use of the World Economic Forum's *Global*

*Competitiveness Report*, while the IEF does not. The EFW also relies on data from the *International Country Risk Guide* and the World Bank's *Governance Indicators* for measuring some components while the IEF does not use these databases. Instead, the IEF relies on sources that provide qualitative information about specific countries (e.g., Economist Intelligence Unit's country reports), from which the authors to form their own assessments of the value of certain freedoms for every country; this is done for the following freedoms: investment, financial and property rights. Such author assessments are something that the EFW avoids, preferring to rely on data obtained through surveys (e.g., *Global Competitiveness Report*).

Both the IEF and the EFW give equal weight to the various elements constituting economic freedom. Both reports suggest there is no good rationale for giving one factor greater weight over another. Moreover, factors are linked to each other as well as interactive, though the reports do not specify precisely how. This is why HF/WSJ and FI leave it to scholars to use their indices and its components as they see fit. For this purpose, the raw data are available in Excel format on the above-mentioned websites.

The grading scale for the IEF index is continuous from 0 to 100, where a score of 100 means "an economic environment or set of policies that is most conducive to economic freedom" (Beach and Kane 2007, 39). In previous years, the scale was from 1 to 5, with 1 representing the best score. Old scores have now been converted to the new scale for ease of comparison over time. For EFW, the index is measured from 1 to 10, with 10 corresponding to highest freedom level.

The period of study for the IEF annual report is from June to June of the year preceding the publication of the report. For example, the period considered for the 2007 reports covers 1 July 2005 to 30 June 2006. It would have been more accurate, however, to say that the authors of the study examine the versions of the databases that were made available or updated during that period of time. Thus, for the 2007 report, it most probably means that the data used to compute the index is for the year 2005 since the 2006 versions of the various databases would only offer data up to 2005. In this respect, the EFW index is somewhat more transparent in saying outright that its 2007 annual report covers the year 2005.

Finally, it is worth mentioning that the EWF data goes back to 1970, though the format has changed over the years. Fortunately, FI provides us with what they call a "chain-linked summary index," which makes the aggregated economic freedom index comparable since 1970. This will be useful to those scholars wishing to perform time-series analyses with the data. For its part, the IEF only goes back to 1995. However, it is worth noting that important changes took place in the measurement of the 2007 index.

**Conclusion**

Economic freedom is an important concept associated with socio-economic development. Many studies have also found it to be a useful concept for analyses focused on other outcomes (e.g., regime type and political freedom). Therefore, the detailed and extensive measures of economic freedom provided by the IEF and EFW indices are extremely useful to scholars of European political economy and beyond.

**References**

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Forum Section

# Understanding the EU's Evolving Economic Relations with India

**Dermot Hodson, Forum Editor, and Mujtaba Rahman**

On 12 July 2007, the inaugural EU-India Macroeconomic Dialogue was held in New Delhi, bringing together high-ranking officials from the European Commission, the European Central Bank, the Indian Ministry of Finance and the Reserve Bank of India (India's Central Bank). This dialogue is designed to facilitate an annual exchange of views between the EU and India on macroeconomic developments and challenges in their respective areas and in the world economy. Global imbalances, productivity growth and poverty alleviation were amongst the topics discussed at the first meeting (European Commission, 2007).

The Macroeconomic Dialogue is the latest in a series of initiatives to foster closer bilateral economic ties between the EU and India. Since the mid-1990s, the EU and India have established a plethora of policy fora on issues ranging from financial services regulation, trade and investment to energy, the environment and aviation. This short note looks at how bilateral economic relations between the EU and India have evolved over the last half-century.[1] It then goes on to discuss some of the economic factors that may be driving this change.

## The Evolution of EU-India Economic Realtions

In the year that marks the 60th anniversary of India's independence from Britain and the 50th anniversary of the Treaty of Rome, EU-India relations are in their 45th year. In 1962, India became one of the first countries to establish diplomatic relations with the European Economic Community (EEC). Although diplomatic ties between the EEC and India were quickly forged, bilateral economic relations were slower to materialise. A Commercial Co-operation Agreement was finally signed in 1973, followed by a broader Economic Cooperation Agreement in 1981 (See Sundaram, 1997).

The intensification of EU-India economic relations began with the signature of an ambitious Cooperation Agreement on Partnership and Development in 1994. Under this agreement, the EU and India agreed, *inter alia*, to grant each other most-favoured-nation treatment in accordance with GATT and to develop dispute settlement and antidumping procedures. It was also agreed to extend EU-India economic cooperation to cover a vast swathe of sectors, including energy, telecommunications, electronics, information and satellite technologies, standards, intellectual property, investment, agriculture, fisheries, tourism, science and technology, information and culture.

The Cooperation Agreement on Partnership and Development helped to encourage a close working relationship

[1] The EU's interaction with India in multilateral economic fora, such as the WTO and IMF, is not addressed in this note.

between European and Indian officials, particularly through the Joint EU-India Commission, which monitors policy action in the areas of trade, economic cooperation and development. Contacts between civil servants have, in turn, paved the way for a deeper political dialogue, with the first EU-India Summit in Lisbon taking place in June 2000. This annual event, which is attended by the Presidents of the European Commission, the European Council, the Indian Prime Minister and senior Indian Ministers, has triggered a host of initiatives in the economic field, including the EU-India Civil Aviation Project, designed to facilitate knowledge transfer between EU and Indian civil aviation authorities, the EU-India Maritime Transport Project, designed to boost productivity in the Indian port sector, and the Agreement on Science & Technology Co-operation, which allows Indian scholars to participate in EU research activities and vice versa.

At the EU-India Summit in Hague in November 2004, the EU announced its intention to upgrade its relationship with India to the status of a Strategic Partnership, thus putting it on a par the United States, China, Japan and Canada (European Commission, 2004). The economic pillar of the EU-India's Strategic Partnership has encouraged a broader dialogue between European and Indian officials on monetary and financial issues, industrial policy, regulation, employment and social policy, biotechnology and climate change. The partnership also has led to the creation of High Level Trade Group, tasked with enhancing trade and investment between the EU and India. This group is currently in the process of negotiating a bilateral Free Trade Agreement, which would lead to a significant reduction in tariff and non-tariff barriers between the two areas.

**Economic Drivers of Change**

Over the last two decades, India has emerged as one of the world's fastest growing economies, with real GDP growth superseding other rapidly growing catch-up economies. Growth exceeded expectations in 2006/7, reaching an unprecedented 9.4%, its fastest rate for 18 years. This tops the 9.0% achieved in the fiscal year 2005/6. While economic growth is expected to moderate over the next couple of years, owing to tighter monetary conditions and an appreciation of the Indian Rupee against the US Dollar, India's economic performance up to 2009/10 is likely to continue beating forecasters' expectations.

This extraordinary economic performance is the result of a paradigm shift in Indian economic policy. Jawaharlal Nehru, who became Prime Minister after India gained independence in 1947, followed an ideology of self sufficiency centred on a state-led approach to economic growth. This involved a closed economy led by the state, and was characterised by the development of heavy industry, import substitution, price controls and redistribution. The strategy led to, what Raj Krishna famously referred to as, the Hindu rate of growth, averaging 3.5% over the period 1950-1980. Accompanied with population growth, the net effect on per-capita income was an average annual increase of 1.3%. It was not until the 1990s, when the current Prime Minister, Manmohan Singh, was Finance Minister, that improving productivity became a key focus of Indian economic policy. This new strategy opened the economy to foreign trade and international competition, liberalised India's Foreign Direct Investment (FDI) regime, and reduced the size and scope of state intervention.

As a result, the Indian economy has become much more dynamic. Tariffs have come down significantly since the early 1990s. While the average Most Favoured Nation (MFN) tariff is slightly above 15%, which is high in comparison with industrialised countries, such as the EU 15 (at around 3%), the US (at around 4%) or other emerging markets, such as China (9%) and Brazil (12%), the highest standard tariff rates for non-agricultural products have been progressively reduced, from 35% in 2001 to 10% in 2007. Furthermore, the government is committed to converge to the Association of South East Asian Nations' (ASEAN) tariff levels of 7-9% over the coming years, as facilitating regional trade integration becomes an ever increasing policy priority. Imports and exports in goods and services as a share of GDP (the standard indicator of the openness of an economy) are close to 45%. This compares to a level of around 13% in the mid 1980's.

Indian's remarkable economic rise over the last two decades has spurred EU-India relations in several important ways. In the first place, India's demand for EU imports has increased exponentially. Between 2002 and 2006 alone, the import of merchandise to India from the EU increased by 60%, with the majority of this increase taking place in the area of textiles and clothing. Over the same period, the import of services to India from the EU increased by just over 50%. As India's economic rise continues and GDP per head grows, the rapidly expanding Indian middle class is likely to consume more and more goods and services originating from the EU. EU firms also stand to gain and increase their own productivity by taking advantage of India's abundant, cheap and increasingly well-educated labour force to off-shore key parts of the production process.

A similar dynamic is at work in economic policy. As noted above, India's current rate of expansion makes it the second fastest growing economy in the world, flanked only by China. It is therefore one of the key pillars supporting current global growth – which reached 5.2% in 2006. As a result, understanding the economic situation, policies, challenges and strategy of the Indian government has now taken on far greater importance than was hitherto the case. Seen in this light, the first EU-India macroeconomic dialogue, held in July this year, has created a forum in which EU and Indian policy makers are able to come together to better understand each others economic situation as well as, importantly, share experiences relating to common policy challenges. For example, the familiarity of EU policy makers with structural reform could well be useful for Indian policy makers, given the current labour and product market rigidities which are preventing India's potential growth rate moving to a sustainably higher trajectory.

Indian's evolving international economic relations are another important factor behind the intensification of its bilateral economic relations with the EU. During the Cold War, the USSR emerged as a key economic ally of India thanks, in part, to the latter's policy of non-alignment on security matters. The dissolution of the USSR in 1991 dealt a significant blow to the Indian economy in terms of both aid and trade flows, prompting the Indian authorities to seek out new economic allies. This was largely achieved through economic openness, and the progressive reduction of India's external tariff and FDI regime, as noted earlier. The EU was quick to seize upon India's greater economic openness, concluding the Cooperation Agreement on Partnership and Development in 1994, less than a year after India and Russia had restored bilateral economic relations.

Of course, India's international economic relations have not stood still since the mid 1990s. Perhaps the most significant development has been its economic rapprochement with the United States, which was started in the final days of the Clinton Administration and intensified in the aftermath of 9/11. India is now recognised as a major economic and political ally of the United States, with the Bush Administration openly declaring its active support for India's rise as a major world power (Office of the Press Secretary, 2006). Faced with these developments, the EU has been keen to deepen its bilateral economic relations in India and to exert influence over the latter's economic development, particularly through initiatives such as the proposed Free Trade Agreement and the EU-India Environment Conference.

**Conclusion**

The character of the international political economy is changing rapidly, no more so than in relation to India. Over the last decade, the world's largest democracy has emerged as a rising economic star and an increasingly important partner for the world's economic superpowers. This economic transformation has prompted the international community to reconfigure its relations with India and *vice versa*. The EU has been at the forefront of this process, strengthening bilateral commercial and economic ties with India since the mid-1990s and, more recently, seeking to develop a more comprehensive strategic partnership.

*Dermot Hodson is Lecturer in Political Economy at Birkbeck College, University of London. Mujtaba Rahman is an economist at the European Commission's Directorate General for Economic and Financial Affairs. The views expressed in this paper are strictly personal and should not be attributed to the European Commission.*

**References**

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Office of the Press Secretary (2006). "President Discusses Strong U.S.-India Partnership in New Delhi, India", Press Release, 03.03.2006. http://www.whitehouse.gov/news/releases/2006/03/20060303-5.html

Sundaram, G. (1997). India and the European Union, (New Delhi: Allied Publishers).

**The Review Forum is open to all members of the EUSA Political Economy Interest Section who wish to share their views on empirical, theoretical and policy questions relating to EU Political Economy. Please send contributions to the next newsletter to Dermot Hodson (d.hodson@bbk.ac.uk) by 22 February 2008.**

## Members' Recent Publications

S. Blavoukos, D. Bourantonis and G. Pagoulatos, "A President for the European Union: A New Actor in Town?" *Journal of Common Market Studies*, Vol. 45, Issue 2 (2007).

S. Blavoukos and G. Pagoulatos, "Negotiating in Stages: National Positions and the reform of the Stability and Growth Pact," *European Journal of Political Research* (forthcoming, 2007).

Sophie Meunier and Kathleen McNamara eds., *Making History: European Integration and Institutional Change at Fifty* (State of the EU Volume 8), Oxford University Press, June 2007, available in both paperback and hardcover: http://www.oup.com/uk/catalogue/?ci=9780199218684

Carolyn Warner, *The Best System Money Can Buy: Corruption in the European Union*. Cornell University Press (2007).

Special issue of *Review of International Political Econimy*, Vol. 14, No. 5 (December 2007):

Introduction by Tal Sadeh, Erik Jones, and Amy Verdun, “Legitimacy and Efficiency: Revitalizing EMU Ahead of Enlargement.”

Benjamin Cohen, “Enlargement and the International Role of the Euro.”

Randall Henning, “Democratic Accountability and the Exchage-Rate Policy of the Euro Area.”

Servaas Deroose, Joost Kuhlmann & Dermot Hodson “The Legitimation of EMU: Lessons after Seven Years of the Euro.”

David Howarth, “Running an Enlarged Euro-zone and Reforming the ECB Governing Council: Efficiency, Representation and National Economic Interest.”

James Savage and Amy Verdun, “Reforming Europe’s Stability and Growth Pact: Lessons from the American Experience in Macrobudgeting.”

James Walsh, “How and Why Britain Might Join the Single Currency."

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## Members’ News

Sophie Meunier is Acting Director of the EU Program at Princeton for 2007-2008.

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**Deadline**

For submissions to the Spring 2008 issue

Friday, 22 February 2008

Please direct all correspondence concerning the Forum and the Data Resources Review to the appropriate editor. All other correspondence to the Managing editor.

Patrick LeBlond (Data Resources Review): **patrick.leblond@hec.ca**

Dermot Hodson (Forum Editor): **d.hodson@bbk.ac.uk**

Mitchell P. Smith (Managing Editor): **mps@ou.edu**

In particular we are looking for:
◊ Members’ recent publications (since this issue)
◊ Members’ news (since this issue)
◊ Calls for papers (due dates prior to 15 September 2008)
◊ Notice of forthcoming events (taking place prior to 15 September 2008)